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Source: *World Politics*, Vol. 41, No. 4 (Jul., 1989), pp. 500-535

Published by: [Cambridge University Press](#)

Stable URL: <http://www.jstor.org/stable/2010528>

Accessed: 28/12/2010 20:19

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POLITICAL INSTITUTIONS AND TAX POLICY IN THE UNITED STATES, SWEDEN, AND BRITAIN

By SVEN STEINMO*

THIS essay addresses one of the broadest and most complex issues faced by students of comparative politics: Why do different democracies pursue different public policies? I address this issue through a comparative examination of the politics and structure of taxation systems in three prominent Western democracies. Despite the paucity of literature that examines taxation from a comparative perspective, taxes provide a peculiarly appropriate arena in which to examine broad comparative questions. Taxation is at the center of ideological debate between left and right in every modern welfare state. Taxation is a critical arena in the politics of who gets what in society and who pays for it in all polities. And, finally, taxes are fundamental to the very size and functioning of government.

Those few analysts who have attempted to explain why public policies vary between advanced democracies have posited three distinct explanations—"interests," "values," and "the state." The first explanation argues that policy outcomes vary because the distribution of power among political interests differs in democratic polities. Groups use their power to further their short-term interests. Thus, since the relative distribution of power between groups differs in these societies, policy outcomes will also differ.¹

* The author would like to express his thanks to the several colleagues, as well as the reviewers at *World Politics*, who have read and commented on earlier drafts of this paper. The comments made by John Freeman, Peter Hall, Arnold Heidenheimer, Anthony King, Jonas Pontusson, Kent Weaver, and John Witte have been especially useful.

¹ Pluralists, of course, suggested this explanation several decades ago, but it is continually being reviewed in new versions. Corporatists, for example, generally accept the principle that groups will fight for their short-term self-interest, but argue that the pluralist characterization of the bargaining process is inaccurate. See Frank Wilson, "Interest Groups and Politics in Western Europe: The Neo-Corporatist Approach," *Comparative Politics* 16, No. 1 (1983). Power Resource theorists use the same basic characterization of politics as the pursuit of economic self-interest and argue that various democracies pursue different public policies because different groups (now parties) possess different "power resources" with which to fight for their constituency's self-interest. See Francis Castles, "The Impact of Parties on Public Expenditure," in Castles, ed., *The Impact of Parties: Politics and Policies in Democratic Capitalist States* (Beverly Hills: Sage, 1982). See also Walter Korpi, *The Democratic Class Struggle* (London: Routledge, Kegan Paul, 1980).

Proponents of the value, or cultural, explanation suggest that policies vary because people in different democracies want different things. The most famous of these arguments is, of course, Louis Hartz's explanation of American exceptionalism. Here, citizens have different expectations about the proper role of government in society, and this general value frames political debate within a polity. Ultimately, different value premises set nations on different policy paths.²

The third line of argument emphasizes the role of state institutions and actors in explaining why policies vary in modern democracies.³ The analysis presented in this paper falls broadly into this category in its attempt to explain variations in tax policies between the United States, Sweden, and Britain.

Institutionalist analysis is not new.⁴ Indeed it pulls our attention back to analytic categories that have long been of central interest to political scientists.⁵ But it also builds on a critique of the more recently dominant "society-centered" explanations. Institutionalists argue that both the value and interest explanations suffer from at least two basic flaws. First, neither leaves adequate room for the role of the state, either as an independent policy force or as an organizational channel through which political actions must pass. Second, both lack an understanding of how policy preferences and interests are, on the one hand, shaped and, on the other hand, translated into specific policy choices.

Certainly some "state-centered" explanations can also be criticized for being too narrow. In the early attempts to draw attention to the role of the state and state actors, the significance of social forces and nonstate actors in the formulation of public policy was often left undervalued. Few today, however, would argue with the proposition that a more subtle analysis must integrate state/society perspectives in order better to understand how and why democratic governments act the way they act. Such an approach is offered here. My analysis pays attention to the role state actors and their preferences play in public policy making, but at the same time it notes that state actors are rarely particularly autonomous. Instead,

² For perhaps the best recent articulation of the value (or in his words "idea") thesis, see Anthony King's three-part article, "Ideas, Institutions and Policies of Governments: A Comparative Analysis," Parts I, II, and III, *British Journal of Political Science* 3, Nos. 3 and 4 (1973).

³ See, for example, Eric Nordlinger, *On the Autonomy of the Democratic State* (Cambridge: Harvard University Press, 1981); Peter Katzenstein, *Between Power and Plenty* (Madison: University of Wisconsin Press, 1978); Peter Evans, Dietrich Rueschemeyer, and Theda Skocpol, *Bringing the State Back In* (Cambridge: Cambridge University Press, 1985); Peter Hall, *Governing the Economy: The Politics of State Intervention in Britain and France* (Cambridge: Polity Press, 1986).

⁴ James March and Johan P. Olsen, "The New Institutionalism: Organizational Factors in Political Life," *American Political Science Review* 78 (September 1984), 734-49.

⁵ See especially E. E. Schattschneider, *The Semi-Sovereign People* (New York: Holt, Reinhart, 1960).

they, like the societal actors with which they interact, operate within a particular institutional framework. This institutional framework provides the context in which groups and individuals interpret their self-interest and thereby define their policy preferences. Ideas and/or interests are important for understanding variation in public policy among modern democracies. But the central argument of this paper is that one must ground these variables in the context in which they are defined and interpreted. Neither interests nor values have substantive meaning if abstracted from the institutional context in which humans define them.

Specifically, this paper will demonstrate that the different tax systems found in Sweden, Britain, and the United States can best be explained through an examination of the institutional structures through which these tax systems have been created. We will see, for example, that the Swedish tax system is not particularly progressive, and that Swedish capital is relatively lightly taxed, whereas the United States has a somewhat progressive tax system that taxes capital income more heavily than earned income. Neither interest-group nor value-based explanations can account for these outcomes. But through an examination of how the Swedish corporatist and American pluralist institutions shape the policy preferences of the actors involved in tax policy making we can make sense of these apparently counterintuitive results.

This analysis explicitly rejects an economistic or substantive notion of self-interest. Instead, it takes the individual or group's definition of self-interest as problematical. At the same time, this analysis proposes that neither specific policy preferences nor general political values appear out of thin air. Values and preferences are derived within particular contexts. For those who begin with the understanding of human rationality as fundamentally bounded, this argument will be uncontroversial. It marks a beginning toward a better understanding of the linkage between individual preference formation and broader issues of political behavior and policy outcomes.

Much of the "new institutionalist" literature has either emphasized the autonomy of state actors without clearly specifying what accounts for their varying degrees of autonomy, and/or left open the meaning of institutions. Peter Hall, for example, identifies institutions in the following way:

The concept of institutions . . . refer[s] to the formal rules, compliance procedures, and standard operating practices that structure the relationship between individuals in various units of the polity and economy. As such, they have a more formal status than cultural norms, but one that does not necessarily derive from legal, as opposed to conventional, standing.⁶

⁶ Hall (fn. 3), 23.

The following analysis, in contrast, emphasizes more conventional variables. Understanding that institutions are part of an interactive relationship with the public policies that emanate from them, and appreciating that the specific loci of decision-making authority for any particular policy arena can vary across polities, this analysis intends to refocus our attention on variables as obvious as constitutional and electoral structures.

I argue that the decision-making models found in the three countries I examine (pluralism, corporatism, and party government) are rooted in different constitutional and electoral structures. American pluralist policy making can only be understood if we first appreciate the constitutional federal structure, the separation of powers, and the consequent diffusion of political authority in the absence of programmatic political parties. Similarly, Swedish corporatism occurs within a constitutional electoral structure in which national political authority is unified in a parliamentary structure, but the power to dominate that system is muted due to proportional representation, which dooms the dominant political party to virtually perpetual minority or coalition governments. Britain's parliamentary system does not force governments into coalition, or indeed into parliamentary compromise. Under the British electoral system, a political party can win substantially less than 50 percent of national popular votes but can still win substantially more than 50 percent of parliamentary seats. Party government emanates from this constitutional system.

Having emphasized the importance of constitutional structures, I do not intend here to present an ahistorical or unidimensional analysis. These foundations are necessary but in themselves they are insufficient. We must, in addition, consider the structure of the domestic economy. Most specifically, we are interested in the concentration of power within both labor and the business community. These variables are also somewhat historically determined (e.g., early developers have less centralized economies)⁷ but there may also be an interdependence between regime type and public policies that promote and/or inhibit economic concentration. I do not dwell on this variable, however, in large part because it has been the subject of much theoretical and empirical investigation. The correlation between economic structure and regime type is largely uncontroversial.

My argument does not attempt to draw a direct unidimensional link between the electoral structures found in a country and specific tax policy outcomes. It does argue, however, that these structures set the stage for the development of particular decision-making institutions, which must themselves be the subject of empirical investigation. These institutions

⁷ See Alexander Gershenkron, *Economic Backwardness in Historical Perspective* (Cambridge: Harvard University Press, 1962), for the basic line of argument here.

provide the context in which interest groups, politicians, and bureaucrats define their policy preferences. As Peter Hall writes, "Organization does more than transmit preferences of particular groups, it combines and ultimately alters them."⁸ Political institutions, then, are the critical variables for understanding how and why different democratic governments tend to choose different public policies.

COMPARATIVE TAXATION POLICY

As mentioned above, the actual tax systems found in the three countries examined here do not correspond neatly to most people's expectations. Sweden, for example, although famous as the most progressive social welfare state, relies comparatively little on redistributive wealth and property taxes which amount to less than 2 percent of total tax receipts (TTR), little on national progressive income taxes (approximately 14 percent of TTR), and very little on corporate profits taxes (2.4 percent of TTR). Instead, Sweden relies very heavily on regressive value-added taxes (VAT), flat rate local income taxes, and flat rate social security taxes (approximately 20 percent, 28 percent, and 30 percent of TTR respectively). On the other hand, the United States, which is often regarded as a "laggard" welfare state, relies principally on more redistributive taxes, such as progressive income taxes (approximately 35 percent of TTR), corporate profits taxes (10 percent of TTR), and property taxes (10 percent of TTR). Nevertheless, regressive social security and consumption taxes contribute 26 percent and 15 percent of U.S. receipts respectively. Moreover, state and local sales taxes in the United States, like the national VAT in Britain, generally exempt "basic necessities," such as food, in the interests of minimizing their regressive impact. The Swedish VAT, in contrast, is applied at a flat rate on all goods except those designed for investment or export. When all taxes are considered (including state and local taxes), the United States relies substantially more heavily on "redistributive" individual and corporate income taxes and property inheritance and wealth taxes than either Britain or Sweden (see Table 1).⁹

THREE TAX SYSTEMS?

Precisely because tax policies are so central to the operation of a modern mixed economy, they are profoundly complex. At first this complex-

⁸ Hall, "Patterns of Economic Policy: An Organizational Approach," in David Held, ed., *States and Societies* (Oxford: Martin Robertson, 1983), 370.

⁹ All data represent 1980 figures. See Organization for Economic Cooperation and Development (OECD) *Long Term Trends in Tax Revenues of OECD Member Countries: 1955-1980* (Paris: OECD, 1981). Sweden has no general property tax. The national wealth tax has been included in the above figures. The U.S. and U.K. had no general wealth taxes in 1980.

TABLE I
REDISTRIBUTIVE TAXES
(INCOME, CORPORATE PROFIT, PROPERTY, INHERITANCE, AND WEALTH)
AS A PERCENTAGE OF TOTAL TAX REVENUE, 1980

Sweden	44.3%
Britain	49.1
U.S.A.	57.1

Source: OECD (fn. 9).

ity appears to be a dense thicket into which no researcher could hope to penetrate. But after we examine tax structures for some time, we come to appreciate that not all thickets are alike. Indeed clear patterns emerge that allow us to distinguish one tax system from another. Tax structures are not random collections of various revenue sources in which each tax differs fundamentally from the others. Instead each nation's tax system can be distinguished by its broad patterns. Focusing on these broader patterns enables us to examine and compare the tax systems.

The U.S. tax system is often criticized for being "a perverse welfare system that hands out . . . billion[s] a year, primarily to the rich."¹⁰ And it is commonly assumed that effective U.S. tax rates are regressive. But as Figure 1 indicates, neither assumption is particularly accurate. In our common understanding of "progressive," the effective distribution of taxes appears to be at least as progressive in the United States as in either Sweden or Britain. The U.S. tax system does indeed "hand out billions," and many of these billions go to upper-income groups. But, as John Witte has demonstrated, the poor and middle classes are also massive recipients of tax welfare.¹¹ Indeed, one of the major distinguishing characteristics of the American tax system is the huge number and amount of tax expenditures that complicate the tax code.¹² No other tax system is as particularistic, nor as complex, as the American. In addition to its complexity and particularism, the American tax system is distinguished by its low revenue yield, its comparatively heavy reliance on progressive sources of revenue, and the significant tax burden borne by the corporate sector.¹³

¹⁰ Michael Harrington, "Do Our Tax Laws Need a Shake-up?" *Saturday Review*, October 21, 1972. Close to two-thirds of taxpayers in the U.S. feel that the current tax system is "unfair"; H and R Block, *The American Public and the Federal Income Tax System* (Kansas City: H and R Block, 1986), 9.

¹¹ Witte, "The Distribution of Federal Tax Expenditures," *Policy Studies Journal* 12 (September 1983).

¹² The term "tax expenditures" refers to exemptions, deductions, tax limitation, reduced rates, credits, or other special measures in the tax code that effectively reduce the tax burden for some individuals, groups, or companies. Tax expenditures are often called "loopholes" in common parlance. The term "expenditure" has been used to remind us that each of these measures produces a loss of revenue to the treasury and as such constitutes expenditures by the government.

¹³ King and Fullerton designed a general equilibrium model with which to estimate the

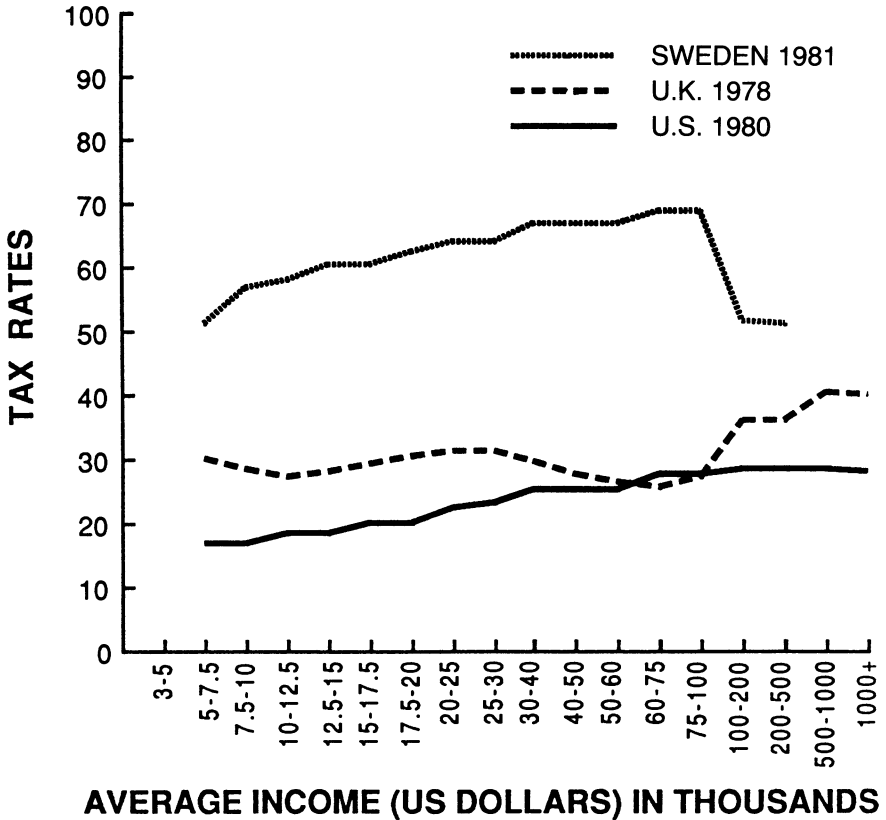


FIGURE I
TOTAL EFFECTIVE TAX BURDEN AS PERCENTAGE OF INCOME

Sources: Joseph Pechman, "Taxation," in R. Caves and L. Krause, eds., *Britain's Economic Performance* (Washington, DC: The Brookings Institution, 1980), Table 12. For the U.S., data courtesy of Joseph Pechman, The Brookings Institution; for Sweden, Riksräkningen, *Statistiska Meddelanden*, SOU:1983:7.1, Tables 4.8, 5.1, 10.7, and OECD, *The Impact of Consumption Taxes at Different Income Levels* (Paris: OECD, 1981). (It is assumed here that the distribution of consumption taxes is the same in Sweden as in Norway.) For a more detailed discussion of the effective distributions of taxes in these countries and the assumptions underlying the incidence distributions, see Sven Steinmo, "Taxes, Institutions and the Mobilization of Bias" (Ph.D. diss., University of California, Berkeley, 1987).

effective marginal tax rate on capital income. According to their estimates, the U.S. had the highest tax rate of the three countries I examine here. Though rates varied according to assumptions used, the overall marginal tax rates in 1980 were estimated to be: U.S., 37.2%; Sweden, 35.6%; and Britain, 3.7%. Don Fullerton and Mervyn A. King, *The Taxation of Income From Capital* (Washington, DC: National Bureau of Economic Research, 1983).

Since these estimates were made, significant changes to these tax systems have taken place (see below). Moreover, though the Fullerton and King findings largely support the arguments made here, we need to be somewhat careful with this type of econometric analysis. For a good overview of general equilibrium analysis and some of its limitations see John Walley, "Lessons from General Equilibrium Models," in Henry Aaron, Harvey Galper, and Joseph Pechman, eds., *Uneasy Compromise* (Washington, DC: The Brookings Institution, 1988), 15-58.

The Swedish tax system, in contrast, is distinguished by its heavy reliance on relatively regressive forms of taxation and relatively light taxation of capital and corporate income. Instead of using taxation as a direct instrument of redistributive policy, Swedish authorities have constructed a tax system that generates huge revenues while at the same time attempting to encourage the concentration of domestic productive investment. In practical terms this has meant that the Swedish tax system taxes average workers exceedingly heavily, yet taxes capital and corporate income remarkably lightly. Of all OECD countries, Sweden's corporate income tax contributes the lowest tax yield, both as a percentage of GDP and as a percentage of total taxation (see Figure 2). Moreover, as several recent studies in Sweden have shown, there are currently so many generous tax expenditures for capital income in Sweden today that, taken together, there is a net revenue loss from capital income taxation.¹⁴

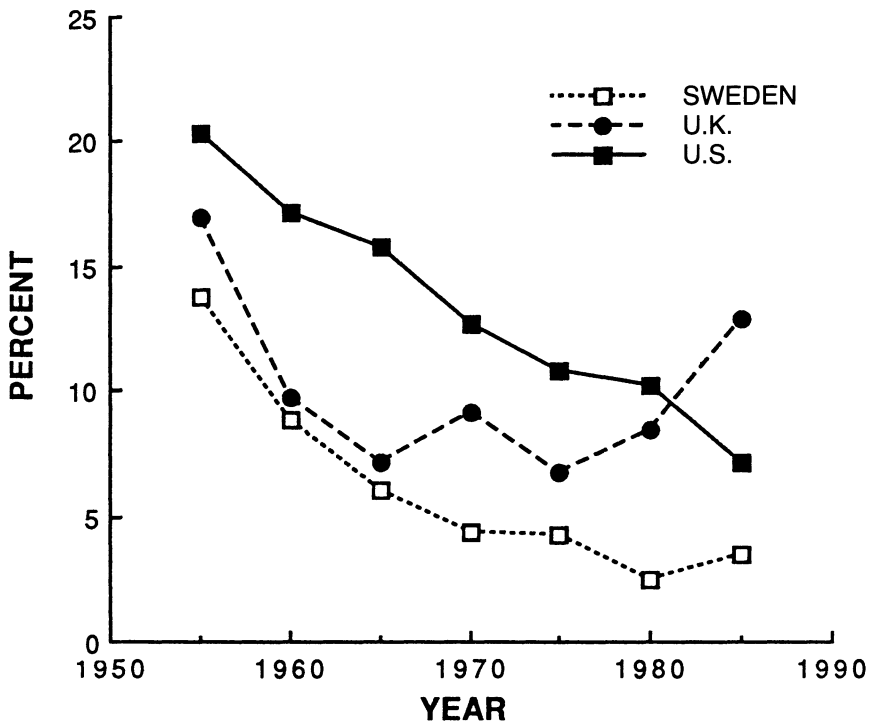


FIGURE 2
TAXES ON CORPORATE INCOME AS PERCENTAGE OF TOTAL TAXATION

Sources: OECD (fn. 9), and OECD, *Revenue Statistics of OECD Member Countries: 1965-1986* (Paris: OECD, 1987).

¹⁴ See Gustav Lindencrona, Nils Mattsson, Ingemar Stahl, and Jan Broms, *Enhetlig Inkomst Skatt* [Integrated income tax] (Stockholm: SACO/SR, 1986); or SOU:1986:40, *Utgiftsskatt* [Expenditure tax] (Stockholm: SOU, 1986).

The British tax system is more difficult to characterize than either the Swedish or the American. In many respects, it appears to stand in the middle between them. In revenue terms British taxes are neither as onerous as the Swedish, nor as light as the American (see Table 2). The same can be said with respect to Britain's reliance on progressive rather than regressive taxes (see Table 1). But this does not imply that British taxation is unremarkable. Instead, the British tax system is distinguished by instability and lack of fiscal coherence in its structure. Since World War II at least, British taxes have seesawed: particular taxes have gone up, down, and up again (both in terms of marginal and effective tax rates); new taxes have been introduced, reformed, and repealed; and old taxes have been manipulated in major ways. Seldom, however, do British policy makers pay significant attention to how changes in one tax affect other taxes. Indeed, the ad hoc character of the British tax structure makes it difficult to describe it as a system at all.

TAXING VS. SPENDING?

Before we continue this analysis we must explicitly address an obvious question. Does it make sense to look at taxation policy separately from spending policy? Though it is clear that most students of comparative policy rarely address the flip side of this question—does it make sense to talk about public expenditure policy without explicitly incorporating discussion of the distribution and incidence of tax policies?—this, in itself, does not constitute a sufficient justification for treating taxing and spending in isolation from each other here.

It makes sense to study taxing and spending as discrete realms of activity because in most cases they *are* discrete realms of *political* activity. The fiscal policy literature is dense with exhortations that public policy goals currently pursued in the tax system could more efficiently be pursued via direct spending. But in most cases the political process simply does not work this way. The incidence, effect, and distribution of taxes in a society rarely affect, or are affected by, discussions of the distributional effects of public spending programs.

TABLE 2
TOTAL TAX BURDEN AS A PERCENTAGE OF GDP, 1985

Sweden	50.5%
Britain	38.1
U.S.A.	28.7

SOURCE: OECD, *Personal Income Tax Systems: Under Changing Economic Conditions* (Paris: OECD, 1986).

I say rarely and in most cases deliberately. As we shall see, in one case examined here (Sweden), tax and spending choices are explicitly considered together. It is integral to the very argument presented here that the specific decision-making institutions extant in corporatist Sweden encourage the joint consideration of tax and spending decisions. Because these policy arenas are considered together in Sweden, the policy preferences of participants almost inevitably differ from the preferences of policy activists in the United States, the country in which tax and spending decisions are virtually always totally divorced.

TAXATION IN THE UNITED STATES

It will perhaps be surprising to many to discover that the United States has had a relatively progressive tax structure for most of the past seventy years. Few realize that the U.S. federal income tax has had higher maximum tax rates and lower minimum rates for most of the twentieth century than, for example, Social Democratic Sweden. Moreover, due to the absence of a national consumption tax and the low rates of most state and local sales taxes, the U.S. tax system bears very lightly on those with the smallest ability to pay taxes. On the other hand, inheritance and property taxes have been exceptionally steep in the United States for most of this century.¹⁵ Moreover, the nation has consistently forced corporations to bear one of the heaviest shares of the total tax of any industrial democracy.¹⁶ Finally, the United States, currently at least, taxes capital gains more heavily than any of its democratic counterparts.¹⁷

But what may be more important than formal tax rates, or even percentage of total tax revenues, for understanding the U.S. tax system (and its problems) are the thousands of exemptions, deductions, credits, minimum taxes, and special rules that litter the tax code. Indeed, these tax expenditures are so significant to the system that they profoundly shape its

¹⁵ The U.S. topped the OECD list in revenue collections (as a percentage of GNP in 1980) in property taxes (except for Britain); inheritance and gift taxes (except for Belgium); and finally, in corporate profits taxes (except for Norway, Canada, Australia, and Japan).

¹⁶ There is much controversy in the fiscal economics literature over where the actual burden of corporate taxation lies. It is a matter of considerable importance for designing reforms of the tax code whether one believes that consumers, workers, or capitalists bear the burden of this tax. But for a political scientist, who is principally interested in understanding why certain taxes have been chosen, the real incidence is of less significance than the perceived incidence on the part of legislators and voters. On this score there can be little doubt that both politicians and mass voters generally believe that corporate taxes are in the end paid by "the rich" who largely own the corporations.

¹⁷ See Arthur Anderson and Co., "Comparison of Individual Taxation of Long-Term and Short-Term Capital Gains on Portfolio Stock Investments in Seventeen Countries" (Paper prepared for the Securities Industry Association, Washington, DC, April 1987).

very structure. First, the United States loses more revenue via tax expenditures than either of the other two systems I examine. In 1986 the revenue lost via tax expenditures equaled 55.3 percent of total federal outlays (excluding tax expenditures) and 100.3 percent of income tax receipts. Second, due to the huge number and highly specific nature of U.S. tax expenditures, no other tax system comes close to being as particularistic and as complex. There are literally thousands of tax expenditures (perhaps more appropriately called loopholes in this context) that are designed to give tax relief to a specific group, interest, or individual. The resulting complexity helps explain why the U.S. income tax has been called the “Lawyers’ and Accountants’ Relief Act” (Cedric Sandford); “a house of horrors” (Wilbur Mills); and “a disgrace” (Jimmy Carter).

Tax expenditures exist in all Western democracies, but not all countries have loopholes like the United States. Indeed, tax expenditures are substantially different in each country studied here. In both Britain and Sweden it is quite rare for the tax code to specify particular groups, interests, companies, or individuals; this is quite a common U.S. practice. Moreover, while tax expenditures are found in Britain and Sweden, they tend to be focused on those at the upper end of the income scale, whereas U.S. lower- and middle-income taxpayers also benefit mightily from the revenue committees’ willingness to provide exceptions to the tax code. Indeed, in both Sweden and Britain today the vast majority of average income tax payers have so few tax loopholes of which to avail themselves that they do not even fill out tax returns at the end of the year.¹⁸

The specific distribution of effective tax burdens observed in the United States, then, results in large part from the porosity of the major revenue source—the income tax—and the unwillingness of Congress to impose other taxes that, though regressive, would generate more revenue. This in no way implies that the U.S. system of taxing and spending—when taken as a whole—is particularly progressive. But, in this country at least, taxing and spending are definitely not considered together.

PLURALIST TAX POLICY MAKING

When the founding fathers constructed the basic form for the U.S. constitution, they clearly intended to fragment political authority in order

¹⁸ Britain has long had a Pay as You Earn (PAYE) system, in which the employer computes the taxes due for the employee with each pay check. Only in very unusual circumstances will an individual even fill out a tax return at year’s end. Sweden has recently converted to a “no return” system, in which the average taxpayer simply signs a statement testifying that he or she has earned no income other than that reported by his or her employer(s). The individual’s tax payment is then computed by the tax authorities at the end of the tax year.

to make it difficult for one faction to impose its will on others. Taxation was a particular worry for them. In perhaps the most critical document in American political history, *Federalist* 10, James Madison wrote:

The apportionment of taxes on the various descriptions of property is an act which seems to require the most exact impartiality; yet there is, perhaps, no legislative act, in which greater opportunity and temptation are given to a predominant party to trample on the rules of justice. Every shilling, with which they overburden the inferior number, is a shilling saved in their pocket.¹⁹

It would be too simplistic to argue that U.S. tax policy today is a direct reflection of the institutional structures created over two hundred years ago. Such an ahistorical analysis would do great injustice to the dynamics of the political process and to the potential for political change. A more complete explanation would require a more fully elaborated analysis of the development of American political institutions over time²⁰ and the dynamic interaction of these institutions and the large, fragmented, and expanding economy.²¹ Unfortunately, space does not allow us to delve into this discussion here. Few readers will object, however, to the characterization of the U.S. political process as one in which power is fragmented and authority dispersed. There can be little argument that the United States possesses a “distinctive complex of weak national administration, divided and fragmentary public authority and non-programmatic political parties.”²²

It is these institutional facts that best help us understand the particular tax policy outcomes described above. First let us take the case of the heavy use of particularistic tax expenditures in the United States. The U.S. tax system is not littered with these special amendments because tax policy makers feel that this is a good way to write tax law. Instead, these outcomes are a direct consequence of the fragmentation of U.S. political authority. Whereas tax policy-making powers rest with central government authorities in parliamentary regimes, in the United States it is Congress

¹⁹ See also *Federalist* Nos. 31, 32, and 33.

²⁰ See for example Steven Skowronek, *Building the New American State* (Cambridge: Cambridge University Press, 1982).

²¹ See Walter Korpi and Michael Shalev, “Strikes, Industrial Relations and Class Conflict in Capitalist Societies,” *British Journal of Sociology* 30 (June 1979), 164-87. Theodore J. Lowi also presents a particularly relevant discussion of these variables in “Why Is There No Socialism in the United States? A Federal Analysis,” in Robert Golembrewski and Aaron Wildavsky, eds., *The Costs of Federalism* (New Brunswick, NJ: Transaction Books, 1984), 37-54, where he offers a compelling argument linking the absence of programmatic parties in the U.S. to federalism.

²² Margaret Weir and Theda Skocpol, “State Structure and the Possibilities for Keynesian Response to the Great Depression in Sweden, Britain and the United States,” in Evans et al. (fn. 3), 136.

that writes tax law. Congress, moreover, is itself a highly fragmented decision-making institution. Absent programmatic political parties that can decisively influence representatives' electoral fortunes, members of Congress are tied to their local constituencies in a way that makes them uniquely vulnerable to locally defined demands and special interest group pressures. Lacking strong institutional support and linkages to a national party, individual members of Congress become independent political entrepreneurs. This implies that they must seek support for election from groups that are often particularly interested in specific legislative outcomes. Tax amendments are often high on the agenda of these interest groups.

Each year members of the revenue committees are besieged by requests from particular interest groups, or from other members of Congress on behalf of specific interests, for special amendments to the tax code. Because members are dependent upon the support of these same interests for financial and logistic support in their reelection bids, they have a strong incentive to accede to such pressures.²³ For example, Witte reports that of 402 tax expenditures introduced or modified between 1970 and 1981, barely more than 26 percent originated in the administration or with the Internal Revenue Service. The rest were put in the tax code by members of Congress, usually on behalf of some particularly important constituency. Indeed, fully 37 percent of these changes originated on the floor of the House and Senate. "Just as tax politics in general centers on Congress," Witte tells us, "so does the tax expenditure 'problem.'"²⁴

Congressional control over tax policy making affects not only the quantity of tax expenditures found in the U.S. tax code, but also their character. This system provides strong incentives for policy makers and interest groups to write very narrow tax legislation. Because political authority is fragmented, it becomes exceptionally difficult to change the basic rules of the tax system, but introducing or amending specific measures to adjust the system on behalf of specific groups can be done relatively easy. Politicians wish to distribute tax benefits for which they can take credit, yet are aware that they cannot give away the bank. Similarly, the incentive structure of this system forces interest groups to fight for particularistic tax measures even when their general ideological positions would tend to favor a more neutral tax system.

Where political authority is more centralized, as in Britain and Swe-

²³ The literature documenting this process is voluminous. See, e.g., John Manley, *The Politics of Finance* (Boston: Little, Brown, 1970) and John Witte, *The Politics and Development of the Federal Income Tax* (Madison: University of Wisconsin Press, 1985).

²⁴ Witte (fn. 23), 322-24.

den, highly specialized interest groups generally have less leverage than they do in the United States. Thus to achieve their tax policy ends they are forced to organize into broader coalitions. The tax policy changes they will demand, then, will necessarily be broader and less particularistic. This is not because football teams, chicken farmers, tuxedo rental companies, or individual taxpayers would not like to have special tax measures benefiting their specific interests (as in the United States), but because interests this narrowly drawn are unlikely to have any significant impact on policy makers in a more centralized political setting.

The fragmentation of tax decision-making authority can thus help to explain another of the distinguishing features of the U.S. tax system: the comparatively heavy taxation of the corporate sector. We tend to find this outcome surprising precisely because we know that the pluralist decision-making process yields power to the well organized and well financed. Why have corporations not benefited mightily from this institutional structure? The answer, of course, is that some companies have. The critical difference is that though the U.S. tax system contains literally hundreds of tax instruments designed to benefit quite specific corporate interests and even specific companies, very broad tax write-offs designed to promote corporate savings and investment have generally been much less common than in Europe. Taken together, these specific tax loopholes cost the Treasury less revenue than broadly based tax expenditures designed to benefit corporations or investment more generally. In Sweden and Britain, in contrast, broad-based tax expenditures that benefit the corporate sector are generally quite common. America's relatively limited experience with accelerated depreciation schedules and investment tax credits pales in comparison to Sweden's historic 100 percent first-year write-offs and the Investment Reserve System,²⁵ or Britain's Investment and Initial Allowance systems.²⁶ Thus, in the United States there can be remarkable disparities in effective tax rates borne by particular companies even while the corporate sector as a whole bears a relatively heavy burden.²⁷

Another major feature of the U.S. tax system is the absence of a national consumption tax.²⁸ The lack of such a tax contributes mightily to

²⁵ See Sven Steinmo, "So What's Wrong With Tax Expenditures? A Re-evaluation Based on Swedish Experience," *Journal of Public Budgeting and Finance* 6 (Summer 1986).

²⁶ See Mervyn A. King, *Public Policy and the Corporation* (London: Chapman Hall, 1977).

²⁷ For a discussion of efficiency losses in the U.S. tax structure and a specific examination of effective rates by asset type, see Jane Gravelle, *Tax Reform Act of 1986: Effective Corporate Rates* (Washington, DC: Congressional Research Service, 1987). Gravelle finds that before the 1986 act effective tax rates by asset type ranged from 1% to 45%. After the reform they ranged from 12% to 40%.

²⁸ State, local, and federal governments combined in the U.S. collect less revenue in con-

both the apparent progressivity of effective U.S. tax burdens and to a comparatively low overall tax burden. But what accounts for the absence of this tax? Again, the answer is rooted in the nation's peculiar political institutions. Several presidents have attempted to persuade Congress of the need for such a tax,²⁹ as has at least one chairman of the Ways and Means Committee. But each time a tax is proposed it is defeated—even when the president's party has had a strong majority in both houses. This could not happen in a parliamentary system.

And why are calls for a revenue-rich consumption tax routinely defeated in the United States? The answer cannot simply be that Americans traditionally oppose this tax, because Swedes and Britons traditionally oppose this type of taxation as well.³⁰ In both Britain and Sweden central government authorities have enacted consumption tax legislation *over clear public opposition* because the government felt that this tax was necessary for future revenue commitments. This was clearly the logic that motivated several U.S. presidents and high-level revenue officials to propose similar taxes. In the United States, however, opposition interests have unique opportunities to use the cumbersome institutional process created by Madison and his colleagues to veto revenue proposals even when they come from very popular presidents and their parties. Though these vetoes are usually blamed on the wealthy, the corporations, or other special interests (i.e., their vetoes prevent the closing of their loopholes), it is also true that liberal interests and Democratic Party politicians have veto powers. This power has repeatedly been used to prevent the introduction of a national sales tax and the broadening of the tax base.

While one could argue that in the long run revenues raised from a consumption tax or broader tax base would be good for the constituents of the Democratic Left, the fragmentation of authority in the United States leads politicians and interest groups to look at the short rather than the long run. An example will help illustrate this point. In 1985 and 1986, nearly thirty liberal tax policy activists were interviewed on their opinions as to whether the United States should follow Sweden's lead and introduce a value added tax. The answer was nearly always the same. To quote one aide to a prominent liberal senator: "It doesn't matter what they do in Sweden. That's a different political world. This is America,

sumption taxes than in any OECD nation (5.2% of GNP in 1985). The OECD average is 11.2%. General sales taxes contribute only 2% of GNP in the U.S., whereas the European Economic Community average is more than 6%.

²⁹ Witte (fn. 23).

³⁰ See, e.g., Axel Hadenius, *A Crisis of the Welfare State? Opinions about Taxes and Public Expenditure in Sweden* (Stockholm: Almqvist and Wicksell, 1986).

and no one can guarantee me that the money taxed out of the grocery bills of American workers will ever be used to benefit those same workers. How am I to know whether that tax money will be used for social spending or for more waste at the Pentagon?" A congressional aide reported: "We don't have a deficit problem because our tax system is too easy on workers. Our problem is that we spend too much on the military and that the rich don't pay their fair share."³¹

No matter how persuasive the arguments of academics, economists, Treasury officials, and even presidents that the revenue generated via broader-based taxes could or would be used for such redistributive programs as welfare or health, congressmen respond "not on my constituents you won't." This response is conditioned by the basic fact that they can be held personally responsible for voting for tax increases while they may find it difficult to take credit for popular spending programs.³² Moreover, the fragmentation of political responsibility in Congress allows politicians simultaneously to support popular spending and oppose unpopular tax increases even while in office.

In sum, Madison's fragmented political institutions provide a profoundly important variable for explaining the complexity, low revenue yield, and ultimately the distribution of effective tax in the United States. The diffusion of political authority and responsibility, and consequent openness to particularistic demands, has encouraged policy activists to pursue their objectives via narrow interest group organizations and to define their objectives as narrowly as possible. Lacking central authority to which to defer, politicians are uniquely vulnerable to these particularistic demands. Since no one is in control, accountability is missing, and it becomes nearly impossible for politicians, interest groups, and bureaucrats to pursue long-range objectives. I have found no evidence to suggest that politicians and/or interest group activists prefer a complex, loophole-ridden tax system. But in the context of the American political structure they continue to circumscribe their policy objectives in ways that have some hope of legislative success.

Barber Conable, when a congressman, explained how the American tax code had developed:

Nobody started out with the idea to make a complex tax system. In the early 1920s, the system was simple and comprehensive. Maybe a lot of things were not taxed, but at least everybody was taxed about the same way. Then we found that we had a complicated economy, and that the tax code

³¹ Interviews with author, May 1987.

³² See Anthony Downs, "Why the Government Budget Is Too Small in a Democracy," *World Politics* 12 (July 1960), 541-63.

was unfair to some people, so we made exceptions, and then we made exceptions and exceptions.³³

The 1986 tax reform, despite its image as a major simplification of the tax code, well illustrates the arguments made above. Indeed, the extent to which the new tax system is distinguished by the same characteristics as the old, despite the radical and comprehensive character of the reform, is nothing short of remarkable.

We have no space here for an elaborate discussion of the 1986 reform, but it yields several useful observations. First, the major policy consequences of the act were to make the tax system *more* progressive than the one it replaced, though clearly not as progressive as many would have liked (see Table 3).

Second, we saw that the United States was distinctive for the heavy tax burden borne by the corporate sector. The reform increased this burden by \$120 billion.³⁴ It is significant that the single largest revenue enhancement on the corporate side was the elimination of the investment tax credit—a general tax expenditure available to a wide variety of corporate interests. Third, the new tax system is even more complex than the one it replaced. Fourth, though a large number of tax loopholes were removed, the U.S. tax system remained radically more particularistic and complex than the others I examine.³⁵ Lastly, even though the U.S. national government faced a \$2 trillion debt and an annual public deficit of nearly \$200 billion, the new tax law raised no new revenue.

TAXATION IN SWEDEN

Contrary to expectation, the Swedish tax system is not distinguished by steep progressivity up the entire income scale, nor by heavy-handed treatment of capitalist or capital income. Instead, the hallmarks of the Swed-

³³ Quoted in Charles Daley, *Tax Cuts and Tax Reform: The Quest for Equity* (Washington, DC: American Enterprise Institute, 1978), 20.

³⁴ Corporate taxes are expected to rise from 8.2% of total federal revenue in 1986 to 11% by 1988. Thus the corporate tax share of total taxation will be close to the pre-Reagan levels (in 1980 the share was 12.5%). See Congressional Budget Office, *Economic and Budget Outlook: Fiscal Years 1989-93* (Washington, DC: CBO, February 1988). According to Fullerton and Karayannis' model, the marginal effective tax rate on capital income increased from 23.5% in 1981 (which was down from the rate before the Economic Recovery Tax Act of 37.3%) to 42.1% in 1986. See Don Fullerton and Marios Karayannis, "The Taxation of Income from Capital in the United States, 1980-1986" (Paper presented to the International Conference on the Cost of Capital, Cambridge, MA, 19-21 November 1987), Tables IV.1, IV.2, and IV.6.

³⁵ An incredible array of particular interests (from sports teams to certain Indian tribes to the Gallo wine-making family) received special tax favors in 1985 and 1986. For a general analysis of the effects of the 1986 tax reform on tax expenditures see Congressional Budget Office, *Effects of Tax Reform on Tax Expenditures* (Washington, DC: CBO, March 1988).

TABLE 3
ESTIMATED CHANGE IN U.S. TAX
BURDENS IN 1988 BY INCOME BRACKETS

<i>Income Class</i>	<i>Change in Personal Income and Corporate Income Tax Burdens</i>	<i>Change in Total Federal Tax Burdens</i>
Under \$10,000	- 32.0%	- 12.5%
\$10,000-20,000	- 8.1	- 3.1
\$20,000-30,000	- 4.1	- 1.8
\$30,000-40,000	- 4.1	- 2.0
\$40,000-50,000	- 6.1	- 3.1
\$50,000-70,000	+ 0.7	+ 0.4
\$70,000-100,000	+ 5.3	+ 3.9
\$100,000-200,000	+ 6.0	+ 5.0
\$200,000 and above	+ 9.2	+ 8.2

Source: Henry Aaron, "The Impossible Dream Comes True: The New Tax Reform Act," *Brookings Review* 5 (Winter 1987), Table 4.

ish tax system are its broad base, its high revenue yield, its comparatively generous treatment of corporate and capital income, and its heavy taxation of ordinary workers.

The Swedish tax system reaches very deeply into everyone's pockets, but tries to avoid taxing the investment potential out of the society's capitalists. As a consequence, Swedish authorities have built a broad-based tax system that finances economic redistribution while eschewing the use of symbolic punitive tax rates. "Ironically," Rose and Peters note, "taxes are least progressive in Sweden [of all OECD democracies examined] because of the high level of tax paid by ordinary workers."³⁶ A few examples are illustrative. Sweden bears the dubious distinction of having the heaviest and most regressive consumption tax in the world. The Swedish VAT taxes virtually all goods and services at a flat rate of 23.46 percent, exempts virtually nothing (not even food or clothing), has no reduced rates, and has no specially high rates for luxury goods.³⁷ The Swedish income tax, similarly, has a much broader base and fewer exemptions or deductions for the average worker than do either the British or U.S. income tax

³⁶ Richard Rose and Guy Peters, *Can Governments Go Bankrupt?* (New York: Basic Books, 1978), 99.

³⁷ See Enrique Rodriguez and Sven Steinmo, "The Development of the American and the Swedish Tax Systems: A Comparison," *Intertax*, 1986/3. Of all OECD countries, only Denmark, Norway, and Sweden have no reduced rates for basic necessities. Denmark, Germany, Ireland, Luxembourg, Norway, Sweden, and (currently) Britain have no special high VAT rates on luxury goods.

systems.³⁸ Additionally, the social security tax (which is paid for workers by employers) is almost three times heavier for Swedish workers than it is for either British or U.S. workers.³⁹

The paucity of tax expenditures available to workers with average and lower wages has broadened the base of the Swedish tax system and thus has substantially increased tax revenues. However, these same measures have pulled the tax system away from the traditionally important goal of ability to pay, or what Americans would simply call fairness.⁴⁰

At the other end of the scale, however, the Swedish tax system appears less onerous. A 1974 study of the income tax system in Sweden found that "the concept of global progressivity has to be qualified by the fact that the distribution takes place mainly between taxpayers in the middle and low income brackets. That is, tax redistribution has affected basically income concentration beneath a certain level. The redistribution process has 'spared' the highest incomes."⁴¹

The taxation of the very wealthy in Sweden differs from the taxation of average income earners because capital income receives much more favorable tax treatment than does earned income. This does not necessarily imply that the rich as a group do not pay taxes in Sweden. On the contrary, as a group the rich bear a heavier tax burden than do either their British or U.S. counterparts. Swedish taxes are often blamed when entertainers, movie directors, and tennis players emigrate. Owners of large manufacturing interests, in contrast, are much less inclined to leave Sweden because of heavy taxes.

The key here is that the Swedish tax system has been used to encourage the use of capital (because this contributes to growth and jobs) while taxing stagnant wealth very heavily.⁴² The wealthy are able to shield their wealth and income from tax authorities in Sweden by refraining from consuming that wealth and instead placing it in the economy's active working capital stock. In Britain in particular, and the United States to a

³⁸ Aguilar and Gustafsson also find that, as measured by the Kakwanis index, Sweden has the least progressive income tax system of the eight they study. On the other hand, Sweden has the most progressive income distribution. See Renato Aguilar and Björn Gustafsson, "The Role of Public Sector Transfers and Income Taxes: An International Comparison" (Working Paper, Luxembourg Income Study, April 1987).

³⁹ The Swedish social security tax is less regressive than the British and U.S. equivalents, however. While both the British and U.S. versions have a ceiling, the Swedes tax all earned income at the same rate, but capital income is exempt.

⁴⁰ Gustav Lindencrona, "Skatteformagapprincip och individuel beskattning" [The principle of ability to pay and individual taxation], in Lindencrona, ed., *Festskrift til Jan Heller* [Festschrift for Jan Heller] (Stockholm: Norstedt, 1984).

⁴¹ Eduardo fayos Sola, "The Individual Income Tax and the Distribution of Its Burden: The Swedish Case" (Thesis, University of Stockholm International Graduate School, 1975), 152.

⁴² Stagnant wealth refers to wealth that is consumed or saved in nonproductive holdings such as jewelry, large estates, etc. See Steinmo (fn. 25).

somewhat lesser extent, the tax system encourages conspicuous consumption on the part of the rich.⁴³

Swedish corporations are well treated by any standard, though Swedish formal tax rates on corporate profits do not traditionally differ much from those found in the United States and Britain. Effective tax rates for large, successful Swedish corporations, on the other hand, are very low by international standards. According to the Swedish Department of Industry, the average tax burden borne by Swedish industrial firms in 1981 was between 3 and 13 percent of profits. Jan Södersten has recently recalculated the effective marginal tax rate on capital using King and Fullerton's model and concluded that considering corporate taxes alone, the overall marginal tax rate in 1985 was between 0.2 percent and minus 2.6 percent depending on the rate of inflation.⁴⁴ "One of the secrets of the Swedish economy is that governments have looked to major corporations to create wealth," Pehr Gyllenhammer, chairman of Volvo and one of Sweden's most powerful industrialists, reported in a recent interview. "There is greater freedom for large corporations in Sweden," he added, "than in the U.S."⁴⁵

Taken together, the numerous mechanisms available to corporate investors in Sweden create a bias in favor of expanding profitable firms with large inventories and/or depreciable assets. It has long been the aim of the government to promote successful corporations and to encourage them to stabilize their investment patterns. Normann and Södersten have shown, for example, that for fifty-one industrial companies examined between 1963 and 1968 effective tax rates and inventory size were negatively correlated. Moreover, expansion rates were positively correlated to both profitability and inventory size, and inversely correlated to the effective tax rate. Finally, and perhaps most surprisingly, profit rates and effective tax rates were inversely related.⁴⁶

⁴³ See John Kay and Mervyn A. King, *The British Tax System*, 3d ed. (Oxford: Oxford University Press, 1983).

⁴⁴ Södersten, "The Taxation of Income from Capital in Sweden" (Paper prepared for the International Conference on the Cost of Capital, Cambridge, MA, 19-21 November 1987). One must remember, however, that the general equilibrium model calculates rates *at equilibrium* and therefore does not necessarily represent an accurate picture of rates paid currently by real corporations. See also Michael McKee, and Jacob Visser, "Marginal Tax Rates on Capital Formation in the OECD" (Paper presented at the same conference). McKee and Visser also conclude that marginal tax rates on capital income are substantially higher in the U.S. than in Sweden, but rates range very widely according to asset type and distributions. According to these authors, effective tax rates can range from 87.5% to minus 169.2% at average inflation in Sweden depending on the source of capital, distribution, and type of investment. In the U.S. the rates could range from 94.8% to minus 131.2% at average inflation.

⁴⁵ Quoted in Steve Lohr, "Sweden: Home of Tax Reform, Arms Scandals and a Strong Defense," *New York Times*, September 6, 1987.

⁴⁶ See Göran Normann and Jan Södersten, *Skattepolitik resursstyrning och inkomstutjämning* (Tax policy, resource allocation and income leveling) (Stockholm: I.U.I., 1978), 184.

In sum, the Swedish tax system encourages the concentration of economic power while it discourages the conspicuous display of wealth. Sweden, in effect, redistributes consumption, not production.

The particular distribution of effective tax burdens for Sweden, then (see Figure 1) is the consequence of a political-economic logic designed to promote stability, economic efficiency, high investment, and growth while concomitantly financing the world's most generous welfare state.

CORPORATISM AND TAX POLICY MAKING

The somewhat counterintuitive structure of the Swedish tax system cannot be explained by a strangely inegalitarian political culture, nor by the presence of popular attitudes favoring capitalists and corporations. Nor does it make sense to describe the Swedish political system as one in which capitalist interests have been politically strong while working-class interests have been weak. Instead, Sweden has developed a remarkably coherent policy-making system in which representatives of labor, business, and the state come together and bargain on a broad array of political-economic policies. The "corporatist" structure provides the context in which these groups define their tax policy goals and has encouraged them to select tax policy objectives that would be quite impossible in a less stable, or less centralized, institutional setting.

The decision-making models observed in Britain and the United States are linked to the structure of electoral representation in these countries. Similarly, in Sweden the development of corporatist institutions depended upon a particular constitutional format, namely, proportional representation.⁴⁷ By the time universal suffrage was finally introduced in Sweden (1918), it was clear to the ruling conservative bureaucratic elite that a single-member-district, first-past-the-post, winner-take-all electoral system would doom them to electoral insignificance. Proportional representation, then, was seen as a way for this numerically small group to retain some degree of power in the face of obviously hostile and increasingly organized middle- and working-class interests.

Proportional representation frames the structure of political conflict in Sweden in two ways. First, it is largely responsible for the remarkable stability of Swedish national governments. Second, it has forced the dominant political party, the Social Democrats, to rule either as a minority or in a coalition government, even though in the thirteen national elections

⁴⁷ Proportional representation is a necessary but not sufficient prerequisite for the development of societal corporatism. A high degree of economic concentration seems also to be a prerequisite.

between 1932 and 1973 they received between 41.7 percent to 50.3 percent of the popular vote. They achieved majority status in the Riksdag (Parliament) on only two occasions in this period. These popular vote figures do not substantially differ from those of the British Labour Party during the same period. The Labour Party, however, has been completely shut out of government for more than half the years since World War II.

These basic structural facts fundamentally shape Swedish tax policy decision making because they are the institutional context in which labor, business, and state officials have defined their policy preferences and strategic objectives. As far back as the 1930s, the Social Democrats realized that the electoral structure would prevent them from gaining the sustained majority in the Riksdag necessary to implement most of the redistributive tax policies suggested in their campaign rhetoric and party platforms. It would therefore be necessary for them to find new mechanisms for achieving their general objectives of getting reelected and improving the standard of living of their constituents.

Ernst Wigforss, party theoretician and finance minister from 1932 to 1949, put the party's position in the following way:

Expressed without euphemisms this means, on the one hand, that those who have power over larger or smaller sectors of the private economy do not base their actions on the assumption that the current tendencies in government are a transitory phenomenon, that a political change will take place within a future near enough that a discussion based on the possibility of concessions, accommodations and compromises becomes unnecessary. On the other hand, it also means that the representatives of political power admit the necessity of maintaining favorable conditions for private enterprise in all those areas where they are not prepared without further ado to replace private enterprise with some form of public operations.⁴⁸

Because authority in Sweden is not fragmented, as in the United States, decision-making power is not diffused, and the government has the power to include or exclude groups and interests from the policy process. But because the government has no majority in the Riksdag, it is forced to seek out compromises and design policies that interests outside the elite of the Social Democratic Party can live with. Thus, the government can dominate, but not predominate in, the policy-making process.

Due to the highly concentrated and centralized structure of Swedish business and labor, which are consequences of Sweden's late development and of specific party policies, Social Democratic governments have had the luxury of being able to consult with a very small group of interest group officials in their attempts to attain their general policy objectives.

⁴⁸ Quoted in Korpi (fn. 1), 48.

Elites of these large, hierarchically structured, noncompetitive interest groups could then be incorporated into and given exclusive access to state policy making. As a result, Swedish tax policy makers are neither as distanced from technical expertise outside the government as are the British, nor as swamped by the multitude of different interests that plague the U.S. legislator.

This process provides a forum in which all sides are able to compromise on specific issues because a wide set of issues of concern to them are integrated. The technical experts attempt to find technical solutions to particular problems—solutions that will not impinge negatively on the interests of the other members of the tripartite coalition. This deliberative decision-making structure facilitates long-range planning and encourages technical experts to become policy initiators. I will cite but two examples. In the late 1930s big industry, represented by the Swedish Employers Federation (SAF), asked the government to implement a series of tax breaks that would discriminate in favor of large and successful companies (and thereby discriminate against small, new, or less profitable companies).⁴⁹ The Social Democratic government granted the request (in the form of Investment Reserves, Inventory Reserves, and 100 percent first-year depreciation write-offs) in exchange for a survey of private business investment plans and tacit approval of a major expansion of the unemployment insurance program, which was to be administered by the central labor union confederation (LO). Additionally, both sides agreed to a new format for the resolution of labor disputes, thus reducing the occurrence of strikes and lockouts.

In the late 1950s, similarly, the Minister of Finance Gunnar Sträng was convinced by two economists from the LO research department that if Sweden was to continue the expansion of the welfare state, new sources of revenue would be needed given increased opposition to heavier income taxes from both industry and the voters.⁵⁰ They advocated the implementation of a national sales tax. Such a tax, however, was vehemently opposed by the labor unions and a majority of Social Democratic voters. But after a year of negotiations with labor union leaders, however, Sträng gained their approval for the new tax by promising that he would quickly expand social spending and in particular initiate a massive program of public housing construction. Labor union members and Social Demo-

⁴⁹ These policy ideas were originally suggested by economist Erik Lindhal, who advocated them in a Swedish government research report in the late 1920s. SOU: 1927:33, *Promemorior rörande vissa beskättnings frågor av 1927 års skatteberedning* [Memorandum concerning certain tax questions of the 1927 tax commission] (Stockholm: SOU, 1927).

⁵⁰ The information in this section was provided by Gunnar Sträng (minister of finance from 1956 to 1976) in an interview with the author, May 1983.

cratic voters still largely oppose the sales tax, but they do not have the multiplicity of access points necessary to translate this opposition into a veto.

Each of the examples above aptly illustrates some of the main dynamics of Swedish tax policy development. In the context of the highly stable electoral outcomes in Sweden, all groups must calculate their objectives as if the Social Democrats will be in power for a considerable time. Thus both business and labor interests are willing to cooperate in ways that would be anathema in either the United States or Britain. At the same time, the Social Democrats know that they too must compromise given their near-perpetual minority government status. The result is a broadly based, financially lucrative tax system that carefully generates maximum revenues while impinging on Sweden's capacity for economic growth and profit generation as little as possible. Efficiency and revenue-yield considerations permeate the system as a whole.

In sum, the distribution of tax burdens described above is not a contradiction in the Swedish context. The specific tax policy preferences of business, labor, and Social Democratic elites appear perfectly rational when we consider the institutional context in which these preferences are derived. Again, the Swedish case yields yet another example in which policy choices are not simply constrained in different ways by different institutional contexts; instead, *policy preferences differ in different institutional settings*. Political institutions provide the boundaries within which rational actors form their preferences, thus they are integral to the very preferences themselves.

TAXATION IN BRITAIN

The instability of British taxes and the lack of coherence between various parts of the revenue structure are the major hallmarks of the British tax system. Not only are various revenue sources changed with dizzying frequency, but changes in one tax are generally wholly unrelated to the structure of problems of other parts of the tax system. Indeed, the fiscal incoherence of the British tax system and the speed with which it changes make it very difficult to describe. As James and Nobes have observed, "one of the most noticeable characteristics of the British tax system is that it is under continual change. Writing about it is very much like trying to hit a moving target."⁵¹

But instability and incoherence are very difficult characteristics to ver-

⁵¹ S. James and C. Nobes, *The Economics of Taxation* (London: Philip Allen, 1981), 135.

ify empirically without a detailed examination of the entire tax structure. Clearly there is no space for such an examination here. While there are certainly dozens of British tax experts and fiscal economists who have decried the instability of the British tax system, this does not definitively prove that their tax system is worse off in this respect than the American, for example. After all, Congress is forever manipulating existing taxes and adjusting the tax code for the benefit of particular constituencies. The difference is that in Britain major changes in specific taxes are quite common and can have fairly profound effects on both the distribution of the tax burden by income class⁵² and upon gross revenue totals. In their detailed statistical analysis of the dynamics of the British revenue system, Rose and Karran find that “there is no similarity between aggregate patterns and specific taxes, no collective homogeneity, nor is there absolute or relative stability. . . . When taxes are compared with each other, virtually every test shows that the collective pattern is heterogeneous, not homogeneous. The most striking feature of taxes in Britain is the extent to which they differ.”⁵³

Without going into great detail, some specific examples of the nature and frequency of the many tax changes made in particular revenue sources in Britain can be instructive. Capital gains taxation, for example, was not introduced until 1965 but was then “reformed” in 1972 and again in 1977 and 1982. The corporate profits tax was first introduced in 1965, and major revisions were introduced in 1972, 1976, and 1983. The VAT was introduced in 1973 (replacing the purchase tax in the same year) and has been “reformed” four times since then. The Selective Employment Tax was created in 1966 and removed in 1973. And the Capital Transfer Tax was introduced in 1976 and reformed to the point of irrelevance in 1980.

The treatment of the corporate sector since World War II provides a particularly good example of the turbulence of British taxation policy. Until 1965 corporate income was taxed under the individual income tax code at the standard, or basic, rate. (This rate was changed five times between 1945 and 1964.) But in addition to this tax, companies were required to pay additional profits taxes on distributed and retained profits. Retained profit tax rates were changed eight times between 1947 and 1964. Distributed profits tax rates were also changed eight times in these

⁵² See Oliver Morrissey and Sven Steinmo, “The Influence of Party Competition on Post-War UK Tax Rates,” *Politics and Policy* 15, No. 4 (1987).

⁵³ Richard Rose and Terrence Karran, *Increasing Taxes? Stable Taxes or Both? The Dynamics of United Kingdom Tax Revenues Since 1948*, Center For the Study of Public Policy Monograph No. 116 (Glasgow: CSPP, 1983), 37.

seventeen years (but not necessarily in the same eight years). Finally, until 1951, profits taxes were allowable as a deduction against income taxes.⁵⁴

But in addition to the changes in nominal tax rates, British companies were also subjected to numerous tax policy alterations that directly affected the tax treatment of capital investment between 1945 and 1964. Various governments introduced, repealed, increased, and decreased a wide variety of investment allowances, initial allowances, and direct grants for investment. According to the Hansard Society, thirty-eight different changes were made in these various forms of investment subsidies between 1945 and 1972.⁵⁵

In 1965 a separate corporate income tax (somewhat similar to the systems in effect in Sweden and the United States) was introduced by the Labour government. Mervyn King described the history of corporate taxation in the following way:

The UK experience in the use of taxation to influence corporation behavior is unique. Four major reforms [now six] of the corporate tax system have taken place since the war, the most recent being 1973 [subsequently 1976 and 1984] and tax rates have been altered at frequent intervals. A good illustration of this is afforded by the excitement generated amongst American economists in the 1960's by the investment tax credit and the attempts to assess its effects. A British economist would have shrugged this off as a mere trifle, compared to the changes he had witnessed over the years.⁵⁶

Finally, in 1984, the Conservative government introduced another major overhaul of the taxes on corporations that substantially reduced many of the investment write-offs available to British companies. Thus, surprisingly, the Conservatives substantially increased effective tax rates for British companies and, moreover, substantially increased the tax yield of this revenue source (see Figure 2).

The taxes mentioned above are not unique in Britain. The characterization of the British tax system as unstable, inefficient, and lacking fiscal coherence could go on. Dilnot and his coauthors, for example, bluntly introduced their examination of the British social security system as “another British failure” due to the complex interaction of payments and

⁵⁴ See King (fn. 26), 258-59.

⁵⁵ The student of U.S. tax policy history may be unimpressed. In the U.S. there may be even more specific changes in tax provisions affecting various types of investments in particular industries, particular products, or particular companies in a single year. The difference, however, is that these changes in the British system were quite general and affected all industry—not just particular firms or types of industries as is common in the U.S. Specific changes were also made during these years in favor of particular industries in the U.K. But these were in fact fewer in number than the general changes listed above.

⁵⁶ King (fn. 26), 5-6.

benefits, their incoherence, and their inefficiency.⁵⁷ They show, for example, that due to the complex and ill-planned interaction of social security and income tax in Britain many low-paid workers pay marginal tax rates *in excess* of 100 percent. This means that as their nominal wage increases their standard of living must decrease. Similarly, the histories of consumption taxation, death taxes, and capital gains taxation have also shown these revenue sources to be tumultuous and instable.⁵⁸

Virtually every government since World War II has changed tax rates affecting income from savings, investment, social security, and death. Additionally, special provisions have been introduced, expanded, contracted, or repealed for broad constituencies by means of surtaxes, investment surcharges, reduced rates, housekeepers' deductions, Child Relief, Earned Income Credit, Personal Relief, and Old Age Relief, to name but a few.

Table 4 shows how income tax policies made between 1946 and 1975 have affected the personal disposable income (PDI) of several income groups during this period.⁵⁹ We see, for example, that tax changes made by both parties reduced the PDI of those in the £100,000 income class by 28.9 percent. Each time the Labour Party entered office, however, it substantially raised income taxes for this group (thus decreasing PDI). But Labour's actions were largely counteracted by Tory tax policies that substantially reduced income taxes for this and all income groups.

Looking back to Figure 1 we see a picture in which no clear pattern emerges.⁶⁰ By some measures the system could be considered regressive, by others it could be seen as somewhat proportional. What is most noticeable is that tax rates can go up *or down* as income rises, depending upon the income level. This pattern is not the choice of any particular government. Rather it reflects the layering of different policy preferences by different governments as they each take office in turn. The result is summarized by Kay and King: "The present state of the British tax system is the product of a series of unsystematic and ad hoc measures, many

⁵⁷ Andrew Dilnot, John Kay, and Nick Morris, *The Reform of Social Security* (Oxford: Clarendon Press, 1984), 1.

⁵⁸ See Morrissey and Steinmo (fn. 52). See also Anne Robinson and Cedric Sandford, *Tax Policy Making in the United Kingdom* (London: Heineman, 1983).

⁵⁹ I use PDI statistics because they encompass a whole range of changes in the income tax, including tax rates, exemption levels, and personal deductions.

⁶⁰ It should be noted here that the British figures must be viewed with some caution. Due to the profound secrecy with which British governments view tax information, no direct examinations of tax returns are possible as in the U.S. and Swedish cases. Joseph Pechman's data were derived by applying British taxes to the distribution of incomes found in the Brookings merge file (see Joseph Pechman and Benjamin Okner, *Who Bears the Tax Burden?* [Washington, DC: The Brookings Institution, 1974]). This is not an ideal approach, but it is the only study of total effective tax burdens in the U.K. available.

TABLE 4
CHANGE IN PDI BY PARTY IN POWER, SINGLE PERSON, U.K., 1946-1975

	INCOME				
	Earned			Investment	
	£2,000	£5,000	£10,000	£20,000	£100,000
Labour	3.0%	-12.0%	-25.9%	-55.0%	-139.5%
Conservative	20.7	56.2	88.5	83.0	110.6
Total	23.7	44.2	62.6	28.0	-28.9

Source: Morrissey and Steinmo (fn. 52).

Note: Table gives cumulative change in disposable income from 1946 base level, i.e., total change in disposable income relative to the base year taking all the years in office of each party into consideration.

undertaken for excellent reasons—for administrative convenience or to encourage deserving groups and worthy activities—but whose overall effect has been to deprive the system of any consistent rationale or coherent structure.”⁶¹

PARTY GOVERNMENT AND TAX POLICY

It is the British constitutional structure that provides the framework for understanding the country's particular tax policy outcomes. With her winner-take-all, single-member district elections, in the context of a highly centralized political structure, Britain has developed a political process often characterized by the term “party government.” Finer has aptly described party government in the following way: “Our system is one of alternating single party governments.”⁶²

Power is more centralized in party government than it is in either pluralism or corporatism because the electoral structure on which party government is based generally insures that one party will have exclusive control over the government. The electoral system produces a majority for one party in Parliament even when that party has received substantially less than a majority of votes from the electorate. It also makes it exceptionally difficult for third parties to compete successfully. Finally, the institution of strong party discipline under party government further centralizes power in the hands of central government elites in general and the prime minister specifically. All parliamentary systems rely on party discipline, and in all cases this yields great power to those at the top of the

⁶¹ Kay and King (fn. 43), 18.

⁶² Sam Finer, “Adversary Politics and Electoral Reform,” in Finer, ed., *Adversary Politics and Electoral Reform* (London: Anthony Wigram, 1975), 6.

hierarchy. It is perhaps an exaggeration to call the British Parliament a rubber stamp, but in comparison to the United States, at least, this characterization does not seem too widely off the mark.

These basic structural features of British party government fundamentally frame the policy preferences and strategic choices of all participants in the policy-making process. Whereas the fragmentation of political authority in the United States facilitates particularistic interest group politics, and the potential stalemate of Sweden's electoral structure encourages compromise, the centralization of national political authority in Britain allows governments to act on their electoral platforms no matter how ill-conceived or antagonistic to the opposition's interests.

First, governments, once elected, have *exclusive* decision-making authority. Though governments can, and sometimes do, consult with interests outside the party when formulating policies they are in no way required to do this, for they are virtually guaranteed passage of the final legislation no matter which groups approve or disapprove.⁶³ Because the government does not have to consult extensively, it seldom does. Indeed, it is often argued that the government rarely consults with its own party members before initiating major policy initiatives.⁶⁴

Second, because the opposition is fundamentally excluded from the policy-making process it is rarely in touch with the details of current tax policy and is rarely aware of the complications and problems that will result from further changes. Instead, having spent the last several years arguing that everything the current government has done is either incompetent or pernicious, the opposition promises its constituents that it will reverse these evils as soon as it wins the next election. "The hot competition of party politics has fostered the desire to introduce party differences and has afforded little incentive to analyze basic objectives, to assess possibilities and costs in the form of sacrificed alternatives."⁶⁵

When a new government takes office, then, it is under pressure to

⁶³ In fact only the topmost elite within the party and the Treasury have any say in tax policy formation. "Revenue changes are solely a tool of macro-economic management considered separately by the Treasury, and announced to the cabinet by the Chancellor in practice for information, not approval—just before the Budget is publicly presented in March or April"; Hugh Heclo and Aaron Wildavsky, *The Private Government of Public Money*, 2d ed. (London: Macmillan, 1981), 179-80.

⁶⁴ An example of this can be found as recently as 1984 when the Thatcher government announced on budget day that they would substantially restructure the corporate income tax system. Until that day in March no one outside a very small group of Treasury officials and the prime minister even knew that a reform of the corporate tax system was under consideration. Even the head of the Conservative Party's research department, Peter Cropper, did not know that a corporate tax reform was in the offing until he heard the budget speech on the radio that day.

⁶⁵ T. Wilson, "The Economic Costs of the Adversary System," in Finer, ed. (fn. 62), 112.

demonstrate that it is different from, and better than, the government that it replaced. Labour must demonstrate its redistributive commitment (that they will indeed “squeeze the rich until their pips squeak”) and the Tories must show how they will unleash market forces and undo the harm to capital inflicted by the last Labour government. But tax systems are complicated affairs, and serious reform takes substantial analysis. Such analysis takes time. Time, unfortunately, is in short supply for governments that have made strong policy promises while campaigning for election.

When the opposition becomes the government it has the legislative power to act out its mandate. The government is pressed to fulfill the promises they made in the heat of the campaign even when better judgment would have them move in other directions. In both U.S. pluralism and Swedish corporatism governments *must* compromise their ideology and policy platforms simply because they need the votes to achieve legislative success. In the British party model, the government always controls a majority of the votes in Parliament. If the government does compromise, it is quickly attacked both by those within the party and also by the opposition for having taken a “U-turn.” In short, the British electoral system presents British governments with strong incentives to act on their campaign promises even when these commitments were made with little analysis and though scarcely any attention was paid to their effects on the tax system as a whole.

The very logic of my argument here evokes an interesting puzzle. If British governments are less constrained by opposition political forces than Swedish or U.S. governments, what explains the lack of coherence in the British tax system as a whole? Presumably, British governments could simply rewrite the entire tax code and thereby make it even more coherent than the Swedish or U.S. systems. The answer to this puzzle is in part answered in Rose and Karran’s recent book, *Taxation By Political Inertia*.⁶⁶ In this interesting analysis of the political and economic dynamics of British fiscal policy these authors remind us that while British governments may be less constrained by Parliament than their Swedish and U.S. counterparts, this does not suggest that British governments are wholly unconstrained in their policy choices. There are very strong incentives in any polity to continue to use the revenue system inherited from past governments. Moreover, large-scale restructuring of the tax system involves huge investments of resources (political, intellectual, and financial), whereas the political benefits of such restructuring may be

⁶⁶ Richard Rose and Terrence Karran, *Taxation By Political Inertia: Financing the Growth of Government in Britain* (London: Allen and Unwin, 1987).

quite marginal if not negative. Most governments, most of the time, are faced with far more immediate problems than that of an incoherent tax structure. Their reluctance to tackle the monumental task of rationalizing the tax system is perhaps further exacerbated by the fact that some of the government's own tax policies may prove to be somewhat less than rational. In sum, from the politicians' point of view the costs outweigh the benefits of truly restructuring the entire tax system. Better, it could be argued, to "fringe tune,"⁶⁷ to use taxation as a symbolic issue in which major changes are made in specific taxes, and, finally, leave the technical issues to the bureaucrats.

But, of course, the policy perspectives of bureaucrats are also shaped by the institutional environment in which they live. Whereas in both the United States and Sweden, Treasury or Ministry of Finance officials have taken quite activist positions with respect to reforming and rationalizing their respective tax structures, British officials have developed a culture of agnosticism. This reticence actively to pursue a reform program is not a product of ignorance or even apathy on the part of British officials.⁶⁸ Instead, they live in a quite unique institutional environment that discourages policy activism and encourages policy neutrality. In Sweden, in particular, decades of political stability and single-party dominance have engendered the development of a very active administrative class.⁶⁹ This activist position has been fostered, in part, by the perpetual minority status of Social Democratic governments. In this context, ambitious bureaucrats with workable ideas have been strongly encouraged by their political masters.⁷⁰ Similarly, in the deadlock of U.S. government by committee, talented fiscal policy experts have often been brought into the Treasury or the Joint Tax Committee to help politicians find technical solutions for profoundly complex tax policy issues. Again, in this context the system rewards innovative and talented officials and their ideas.

In Britain the situation is quite different. Under party government a new election can bring in new political masters who have radically different policy views from those currently in government. The ambitious British official who pursues reform initiatives could well find his ideas are perceived to be on the wrong side of the political fence come the next elec-

⁶⁷ Ibid., 148.

⁶⁸ See, for example, *The Eleventh Report of the Expenditure Committee Session 1976-77*, House of Commons Papers 535-I (London: HMSO, 1977).

⁶⁹ Cf. Thomas Anton, Claes Linde, and Anders Mellbourn, "Bureaucrats in Politics: A Profile of the Swedish Administrative Elite," *Canadian Public Administration* 16, No. 4 (1973), 638-39.

⁷⁰ In fact it is quite common for talented young officials to be promoted from the supposedly apolitical civil service directly into political positions within the Ministry of Finance.

tion. In this context, the rational behavior for officials as a group has been to keep a low profile. This system tends to reward those officials who follow the dictates of their political masters, not those who have ambitious reform ideas of their own.⁷¹

Finally, because the hands that hold the reins of government can change so dramatically from one year to the next, it is rare for ministers to get to know and trust their official advisers in such a way as to develop the close relationships common in Sweden and (but to a somewhat lesser extent) the United States as well.⁷² Dick Taverne describes this as one of the major problems he faced when in the Treasury for the Labour government that took office in 1964. "Indeed, the [Inland] Revenue proved itself expert at showing that all solutions other than their own were utterly unworkable and totally misconceived."⁷³ This does not mean that the new government's proposals will not be passed, just that they do not necessarily get the whole-hearted support of the technical experts who must translate the general policy aims into specific language.⁷⁴ On the other hand, this mutual skepticism means that otherwise politically neutral administrative or technical reforms often may not achieve the political support necessary to translate them into legislation.

TAX POLICY MAKING UNDER THATCHER

Few will be surprised by the fact that the British tax system has become substantially more regressive in the nearly ten years since Margaret Thatcher's government came into office.⁷⁵ Since 1979 the Conservatives have substantially increased consumption taxes, radically decreased marginal and effective income tax rates (especially for those with very large incomes), substantially neutered death and gift taxes⁷⁶ and, surprisingly to many, reformed the corporate tax system so that it actually places a heavier tax burden on some types of corporations and generally produces

⁷¹ See Hecló and Wildavsky (fn. 63) for a more detailed view of the administrative practices and culture of the British administrative class.

⁷² Since World War II, for example, there have been 17 chancellors of the exchequer. In Sweden there were only 3 ministers of finance in this same period.

⁷³ Taverne, "Looking Back," *Fiscal Studies* 4, No. 3 (1983), 5.

⁷⁴ Chancellor Hugh Dalton encountered such opposition to his plan to increase marginal tax rates on the wealthy in 1947 that he was forced to write the proposal himself.

⁷⁵ A plethora of evidence has been presented by fiscal economists to demonstrate that effective tax burdens in the U.K. have been dramatically altered in the past decade. See the annual post-budget analysis of the government's tax reforms, published by the Institute for Fiscal Studies in their *Fiscal Studies*. The budget analysis articles are generally included in the second issue of each annual volume and are usually written by Andrew Dilnot et al. Unfortunately, however, no studies have summarized the effects of all revenue changes since 1978.

⁷⁶ See Cedric Sandford, "Capital Taxes—Past, Present and Future," *Lloyds Bank Review*, October 1983.

more revenue than the system it replaced.⁷⁷ In the tax reform proposed in the 1988 budget, Chancellor Nigel Lawson further radically reduced personal income tax rates for the very wealthy, arguing that this move was made necessary by the reduction of the U.S. tax rate. But, interestingly, whereas the marginal rate cuts for the rich were compensated for in the U.S. case by the elimination of many important tax expenditures favoring the wealthy, in Britain the reduction of tax rates for high-income earners was not complemented by any such reduction. The *Financial Times*, one of Britain's leading conservative newspapers, headlined this version of tax reform in two articles, "Dramatic Gains For the Rich," and "An End To Old Fashioned Egalitarianism."⁷⁸

Thus, the decade of Thatcherism has had important effects on the British tax system. Most would agree that tax policy is more coherent today than it was ten years ago—even if they dislike the direction of change. But it would be incorrect to suggest that the British tax system has become a model of rationality, even if regressive. It is indeed interesting to note that the Conservative government has not been able to reform the system thoroughly even in its own image. The reasons for this are complex, but are consistent with the analysis of how party government affects the actions and perspectives of bureaucratic actors. To undergo major restructuring of a national tax system requires competent technical analysis and long-range planning. The incentive structure facing the British Inland Revenue does not encourage the development of either. One must remember that though we now know that Thatcher won two elections after her initial 1979 victory, no one could reasonably predict this outcome ten or even five years ago. Thus, as discussed above, Inland Revenue civil servants have had every reason to keep their heads low. The many significant tax reforms that have occurred in the past ten years have mostly not been the product of an activist administrative class eager to rationalize its tax system. Instead, these reforms have been pushed by an aggressive political party eager to impose its ideological stamp on the system.

One cannot close this section without mention of the most recent tax reform to be pushed by the Thatcher government—the Poll Tax.⁷⁹ This

⁷⁷ A complete discussion of this apparently unorthodox Conservative tax reform lies outside the scope of this essay. Two important features are worth noting, however. First, the types of companies whose effective tax rates increased the most were large, capital-intensive, manufacturing concerns—these corporations are also heavily unionized. Second, though retained profits taxes were increased, the taxation of distributed profits has been made less severe.

⁷⁸ *Financial Times*, March 16, 1988.

⁷⁹ Specifically, the government has proposed to abolish the existing property tax system (known as rates) and replace it by a head tax. No longer will local taxation be based on property wealth, but instead will be based on size of the household.

move was so radical, blatantly class-based, and obviously regressive that it nearly evoked a constitutional crisis, with the House of Lords at first refusing to yield its rubber stamp. The government prevailed, however, and is now working out the details of a modern version of a tax that was abolished even before the working class achieved the right to vote.

It perhaps goes without saying that the Labour Party has promised to repeal this tax (as well as reverse the vast majority of Thatcher government tax policies) if and when it regains power. This analysis suggests not only that they will indeed act on these promises, but also that these changes will pull the British tax system further into a maze of incoherence.

TAX POLICY MAKING AND ITS INSTITUTIONAL CONTEXT

I have tried to show how and why the structure of decision making in these three democratic governments has shaped the specific outcomes in one of the most important and controversial arenas of public policy—taxation. My argument has emphasized the constitutional/electoral foundations of these modern decision-making institutions and demonstrated that these institutions shape how groups come to define their policy preferences and strategic objectives. Political institutions are the context in which groups, politicians, and bureaucrats come to define their policy preferences.

In the United States, since no one can control the process because of the constitutional fragmentation of public authority, groups whose influence would be nonexistent in a party government or corporatist regime can exact highly particularistic benefits from tax legislators. Diffusing political power is not the same thing as eliminating it. Congressman Dave Durenberger, a Republican from Minnesota, put the problem for writers on U.S. tax policy succinctly. Arguing that he very much liked the Reagan tax reform plan, he said, “If I thought we had a real chance at tax reform that would reduce the deficit, reduce payroll taxes and reform the income tax, then I would vote against my regional and special interest groups.” But because he felt that the plan would not overcome the obstacles put in its way by vested interest groups he added, “I’ll vote my constituency. I see most of my colleagues voting the same way.”⁸⁰

The structure of the political process in British party government establishes a quite different environment for policy makers. While they are less vulnerable to the particularistic demands of specific interest groups, they are more responsible for acting out their campaign promises. More-

⁸⁰ Quoted in the *San Francisco Examiner*, September 1, 1985, p. A-12.

over, because they have exclusive decision-making authority, they are not forced into compromising their policy ambitions as U.S. and Swedish policy makers routinely are. American and Swedish policy makers do not compromise because they like to, or because they are culturally predisposed to consensus building; they compromise over public policy because political realities give them no choice. In party government, policy makers have a choice of whether or not to compromise, and they exercise it only when it suits them. Because the opposition is so totally excluded from the information and expertise of the policy-making process, they can often declare themselves in favor of policies that have substantial practical problems. But once elected they are committed. Thus:

Both Labour and Conservative parties, while in opposition, have succumbed to the temptation to condemn a large proportion of the government's policies and have promised to reverse many of these policies when they themselves took office. *The result has been a fatal lack of continuity.* (Emphasis added.)⁸¹

Continuity is a key word for understanding tax policy making in corporatist Sweden. The system of proportional representation has virtually assured stable minority or coalition governments. Lacking governing majorities, successive Social Democratic governments have been forced to reach out to non-socialists and forge compromises and build coalitions. Likewise non-socialists have been forced to accept the inevitability of Social Democratic political dominance and have thus adopted comparatively conciliatory positions. Over time, business, labor, and government elites have come to understand each other's needs—the government and the unions want revenue for social spending, business wants a decent rate of return on capital—and have been able to construct tax policies that broadly accommodate all three major interests.

Few policy-making elites in either the United States or Britain would deny that capitalists require a profit incentive to make them invest, or that investment is necessary for jobs and growth. But in the heat of political battle, ideologically charged rhetoric can often steer policy makers in less considerate directions.

CONCLUSION

The argument that political institutions are important in shaping politics (and by implication policy outcomes) is, of course, not new. Aristotle,

⁸¹ Michael Stewart, *The Jekyll and Hyde Years: Politics and Economic Policy since 1964* (London: J. M. Dent and Sons, 1977), 241.

James Madison, de Tocqueville and E. E. Schattschneider are but a few of those who have long since argued the importance of institutional structure. This essay has attempted to contribute to this body of literature by demonstrating exactly how institutions help shape policy outcomes in a particularly important arena of political life. I have tried to do more than show that different institutional structures bias politics toward some types of interests and away from others. By arguing that institutions provide the context in which political actors make their political choices and define their policy preferences, this analysis takes a step toward a better understanding of the linkage between macrocomparative politics and public policy on the one hand and our increasing understanding of individual human behavior on the other.

I have not argued here that group interests and political values (or ideas) are irrelevant to public policy making. On the contrary, my analysis is centrally concerned with both. But as I argued in the opening sections of this paper, we cannot simply assume certain interests or policy preferences without examining the context in which people make these choices. Similarly, without understanding the institutional context in which general political values are translated into specific policies no one can hope to predict what these policies may be.

This essay, then, has very broad implications for the analysis of individual decision making as well as for the study of the modern welfare state. First, although my argument might suggest that institutional structures are intervening variables that filter political demands and thereby help shape policy outcomes, I maintain that the analysis can be pushed further. To do this we must link what we have observed in this study to what we know about human rationality. Simon has shown in his discussions of bounded rationality that the boundaries on rational decision making (intellectual ability, time, information, environment, etc.) are not just constraints on optimal decision making. Instead, these boundaries are integral to the very decision-making process itself. We do not have fixed, economically derived preferences that are somehow constrained; instead, what we want is a part of the environment in which we make these decisions.⁸² Political institutions, then, are part of our preference structure because they are a critical referent in making political choices. To abstract political choices (in the short run) and general political values (in the longer run) from their institutional context is to ignore an absolutely essential variable in our understanding of the source of these preferences.

⁸² See, for example, Herbert A. Simon, "Human Nature and Politics: The Dialogue of Psychology with Political Science," *American Political Science Review* 79 (June 1985), 293-304.