How Governments Respond to the Rising Power of Business:

Corporate and Inheritance Tax Reforms in Austria and Sweden

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Abstract

Capital mobility and new political strategies by organized business have increased both the structural and instrumental power business interest groups. This paper analyses how governments respond to demands from business for tax cuts in the context of rising business power, using reforms of corporate taxes and inheritance taxes in Austria and Sweden as case studies. Government responses varied between the two policy fields. Governments gave more far-reaching concessions to business demands on inheritance taxes than on corporate taxes. We argue that this difference is the result of an effort by governments to balance three potentially conflicting goals: attracting investments through business-friendly policies, maintaining a high level of tax revenues, and maintaining electoral popularity. The intensity of these goal conflicts varies across policy measures and we expect governments to pursue reform strategies that mitigate them. We show empirically that varying responses to business demands by governments can be explained by differences in the expected electoral and fiscal impacts of reforms -- business-friendly tax cuts are not merely a response to the structural and instrumental power of business. However, government efforts to reconcile the three policy goals under conditions of heightened business power entail sacrificing redistributive goals that have characterized tax policies in the post-war period. (204 words).

Keywords: tax policy, corporate tax, inheritance tax, Austria, Sweden, business power, business-politics relations

Introduction

The political power of business interest groups has increased significantly since the 1970s, resulting in intensified pressure on governments in rich democracies to respond to business demands. This development is frequently attributed to changes in the structural and instrumental power resources of business, such as increased capital mobility and intensified campaigning and lobbying by business interests, as well as for a struggle over ideational dominance in political debates[i]. At the same time, other studies document an intensified assertiveness of business interest groups in their calls for tax cuts, reduced public spending, and general contraction of the public economy in many countries, including Germany[ii], Sweden[iii] and the United States[iv].

Thanks to this new strand of research on business and politics, we now have a more sophisticated understanding of the sources and mechanisms of business power. Nevertheless, scholars have paid little attention to how governments respond to political demands from business. Building on the assumption that government failure to acquiesce to business demands will ultimately lead to capital flight, disinvestment and economic disaster; observers have at times assumed that governments will simply concede to business demands. The interests of business in tax cuts are frequently in conflict with fiscal needs of governments as well as with the preferences of crucial electoral constituencies. Hence, we cannot automatically assume that governments, when confronted with such dilemmas, will always concede to the will of business interests. We seek here to refine the question, investigating how governments react to the political demands from the business community, and how they reconcile the requirements of maintaining business confidence with other, potentially conflicting goals. It is this question that we will pursue in this paper.

We argue that tax policies imposed on business in economically open democracies are shaped by the need to balance three goals against each other: (a) attracting investments and maintaining

business confidence by pursuing policies investors favor; (b) maintaining an adequate level of tax revenues to provide services to citizens; and; (c) aligning policy choices with voter preferences so that governments remain in power. These three goals can potentially conflict. The intensity of these goal conflicts, however, varies depending on the policy under consideration, and we argue here that governments will accept those business-friendly measures which involve the least severe conflicts between a and b and c.

We evaluate this argument by undertaking a comparative study of corporate and inheritance taxation in Austria and Sweden since the early 2000s. While the governments in both countries accepted business demands for tax cuts, they did so in ways that retained sufficient tax revenues and voter support. The literature on the tax policy effects of increased internationalization and capital mobility has shown that even though internationalization prompts tax responses to business and capital, these responses might be moderated by domestic budgetary considerations[v]. Tax competition is held to be especially strong in the area of corporate taxation, and policy responses in this field are shaped by a variety of institutional factors[vi]. Here we will demonstrate how electoral considerations, more specifically, the expected popularity of specific tax cuts among voters, remain an additional important factor in amplifying the influence of business interests.

Our findings have implications for understanding how organized business exerts influence on policy decisions in advanced political economies. Governments are incentivized to respond to the need to maintain business confidence, but they still have options with regard to how this should be done. The analysis presented here does, however, not suggest that those capacities are so effective as to retard the further escalation of economic inequality in advanced political economies. While governments have room to maneuver, our research shows that even those governments that included parties of the Left chose to give substantial concessions to organized

business in the field of inheritance taxation. Inheritance taxes have traditionally been one of the most redistributive measures in the entire tax code. Inheritance taxes have few distortionary effects on labor market behavior and function as one of the strongest symbols of redistribution, in so far as the wealthy pay higher taxes[vii]. In short, the intention to reconcile business demands, voter preferences, and fiscal needs meant the sacrifice of egalitarian goals in this area of tax policy.

Goal Conflicts in Taxing Business

Over forty years ago, Charles Lindblom stated that "when a government official asks himself whether business needs a tax reduction, he knows he is asking a question about the welfare of the whole society"[viii]. State and society depend on investment decisions by private firms, and this enables business to have a structurally privileged position in politics. The unavoidable need of market economies to maintain business confidence is a constraining factor on the policy choices available to governments.

For several reasons, the structural power of business has increased since the 1970s. First, deregulation of capital mobility intensified competition for capital and investments, thus pressuring governments to lower taxes on business in order to appeal to international investors and mobile enterprises[ix]. Second, political and institutional constraints on the power of business in the first decades of the postwar era also weakened. Corporatism and arrangements for collective decision-making granted organized labor access to policymaking arenas and balanced or inhibited business influence[x]. Katzenstein has explained in detail how the political logic of corporatism reduced structural inequities between business and labor[xi].

The erosion of coordinated policymaking weakened organized labor[xii], such that governments are now less dependent on unions for securing support for unpopular reforms. As Culpepper and Regan argue, "unions have neither the carrots with which to attract governments (…) nor the sticks with which to compel their inclusion"[xiii]. A less coordinated setting for policymaking is advantageous for organized business, in that they can now utilize the structural dependence of governments. In addition, organized business has also channeled resources into alternative strategies for influence, such as media campaigns, lobbying efforts, and organizational re-arrangements.

Nevertheless, the strengthened role of business has not eliminated the ability of governments to undertake political choices. Even in an era of increased capital mobility governments confronted by business demands for tax cuts still have options[xiv]. The structural power of business may require governments to signal a business-friendly attitude, but they have a variety of ways of doing so. Confronted with a demand to reduce taxes governments can decide, for example, which taxes to cut: corporate taxes, payroll taxes, capital gains taxes, or inheritance taxes, to name some. They can also choose between lowering statutory rates or expanding exemptions, for instance.

The need to maintain business confidence and to attract investment is only one of the goals pressuring governments in open capitalist economies. Two other, equally important goals are those of electoral support and public revenues. As we indicated earlier, these goals can be in conflict. First, as already discussed, governments are acutely aware that high levels of taxes on business may deter investments or induce business to shift assets to other jurisdictions. Second, governments are constantly seeking to protect the overall level of tax revenues and to avoid becoming the victim in a race to the bottom that hollows out the revenue-raising capacity of the state[xv]. "Governments need money. Modern governments need lots of money", as Steinmo puts

it[xvi]. The goal of protecting revenues obtains particular relevance during periods of austerity, when governments are suffering from budget deficits and public debt and desperately need an inflow of economic resources. The third factor behind the goal conflict is that governments need to consider the electoral consequences of a business-friendly tax cuts. If voters perceive a specific tax cut to business to be unfair in terms of their preferences for social protection and provision of public services, governments may instead seek out alternative routes to accommodate business that will not cause such a negative reaction among voters.

Clearly, these three goals are potentially in conflict: Cutting taxes on business in an effort to attract or stimulate investments may undermine the state's revenue-generating capacity, forcing government to either raise taxes again to reduce public debt caused by tax cuts or to cut expenditures[xvii]. Offering business attractive tax reductions may appear as favoritism, and thus be difficult to justify electorally, a situation that can turn out politically disadvantageous for governments. If tax cuts for business are interpreted as tax cuts for the wealthy at the expense of social security for the middle class, governments may face a backlash at the ballot box. Alternatively, if governments instead opt for maintaining high taxes in areas of business interest, governments run the risk of lost business confidence, capital flight, and loss of economic viability.

We argue that the intensity of the goal conflicts involved in taxing business is not constant but depends on the policy. Some types of business-oriented tax cuts are in more direct conflict with fiscal considerations and voter preferences than others. For example, major cuts to marginal income taxes is an expressed preference of business to increase the supply of highly qualified labor. These kind of income tax cuts may not have dramatic consequences for public revenues, since few people are affected. However, a tax cut for "economic elites" is likely to cause a feeling among the middle class of being passed over, and to generate an electoral backlash. If

governments would instead focus on those groups in the middle class who can strengthen the supply of labor and incentives for labor market entrance, the interests of business would be better aligned with middle class interests and electoral risks are reduced. However, this policy choice comes at the expense of lost tax revenues that in the long run may force governments to subsequently raise taxes or cut back on social protection. On this background, we expect that governments will formulate policies that reduce the intensity of the goal conflicts; they will attempt to constrain any business-friendly tax cuts, to those that do not conflict strongly with fiscal and electoral goals.

Business Friendliness, Maintenance of Public Revenues, and Electoral Politics

When governments attempt to reconcile the need for business confidence with the need for tax revenues, it is often in the context of lobbying pressure from organized business groups. For example, if governments decide to reduce taxation of capital and assets in order to please business interest groups, such decisions will always be weighed against and eventually tempered by budgetary concerns. Confronted with a choice between different ways to show their business-friendliness, governments will thus opt for that policy that can still maintain tax revenues, cutting those taxes that have the least effect on revenues. Alternatively, governments can off-set the budgetary effects of tax cuts with compensatory measures, making the net effects of tax cuts smaller than what they may have been if they had simply reduced statutory tax rates. In order to reconcile the requirements of maintaining business confidence and ensuring adequate revenue, governments will adopt those tax cuts that signal a business-friendly stance to investors but which have relatively minor effects on the revenue-generating capacity of the state.

Apart from avoiding large budgetary deficits as a consequence of tax cuts, we expect governments to balance their policy choices so that they accommodate to business interests in a manner that avoids potential electoral backlash. Such electoral risks arise if and when business

interests are pitted against the preferences of large segments of the electorate, compelling governments to make a choice between meeting business demands or dealing with the discontent of the average voter. Even if tax cuts for business are presented as part of a stimulus package to improve the economy generally and thus benefit middle-class voters, such measures may become electorally risky if the business tax cuts are seen by voters as unjustified perks for the wealthy to be paid for by social policy cuts and austerity. In a choice between maintaining or improving levels of social security and cutting back on taxes, theoretical and empirical knowledge inform us that losses loom larger than gains, thus leading us to expect a status quo. The assumed immediate popularity of tax cuts[xviii] can be electorally damaging if the cuts benefit primarily business interests and are viewed as being detrimental to the interests of average voters. In an effort to reconcile requirements of business confidence and voter preferences, we therefore expect governments to enact those kinds of tax cuts that can align business and the middle class preferences, as opposed to tax cuts that benefit only business.

Research Design and Methods

We research these theoretical propositions with comparative case studies of corporate tax and inheritance tax policy reforms in Sweden and Austria between the years 2004 and 2013. Austria and Sweden are small, open capitalist economies, dependent on private investments and, in theory, especially vulnerable to capital flight. A strong tradition of corporatist policy-making has in the past tamed the structural power of business by directing its influence into institutional forms such as tripartite committees in both countries[xix]. However, these corporatist institutions have eroded, whereas advocacy campaigns, media campaigns, and lobbying have gained importance as mechanisms of business influence[xx]. In the case of Austria, the privatization of state-owned companies in the 1980s and 1990s has eliminated the remaining tools for state control over investments[xxi]. Moreover, further integration of Central and Eastern European

countries, with their lower tax rates, have raised the awareness in both countries of risks associated with tax competition. The combination of increased internationalization and a decreased institutional check on business has thus made these two small states intensely vulnerable to the threat of business exit, pressuring them to respond to business demands.

Organized business called for cuts on corporate and inheritance taxes in both Sweden and Austria. With this 4-case matrix, we have established variation on the fiscal and electoral factors that could moderate government decisions on tax cuts for business. In terms of fiscal importance, corporate and inheritance taxes differ considerably. For all the OECD countries, revenues from corporate taxes far exceed revenues from inheritance taxes (figures 1 and 2), with 2.7 per cent of GDP coming from corporate taxes versus just 0.1 per cent of GDP from inheritance taxes. Sweden and Austria are in line with this pattern[xxii]. Corporate taxes are levied on corporate income and therefore affect only incorporated firms. The self-employed are not subject to corporate tax, and are taxed instead according to personal income tax laws. Inheritance tax, on the other hand, affects not only persons inheriting firms, but also middle-class voters who inherit housing, land or financial assets. Corporate taxes are thus skewed toward big business, and provide organized business – but not average voters -- economic incentives to advocate reductions. Regarding inheritance tax, the interests of the middle class are more aligned with those of business, and because of this, the intensity of the goal conflicts is weaker on inheritance taxes compared to corporate taxes. We therefore expect that governments will respond more positively to business demands for cuts on inheritance taxes, compared to corporate taxes, notwithstanding the fact that corporate taxes pose a greater cost burden on firms. We summarize our expectations in table 1 below.

Table 1: *Expected government responses to business demands for tax cuts, dependent on electoral and fiscal effects.*

	Expected opinion of	Impact of cuts on	Expected outcome

	voters to cuts	public revenues	
Inheritance and gift tax	Positive	Not significant	Governments will accept business demands without balancing measures
Corporate tax	No reaction or negative	Significant	Governments will attempt to balance business demands for tax cuts with electoral interests and needs for public revenues

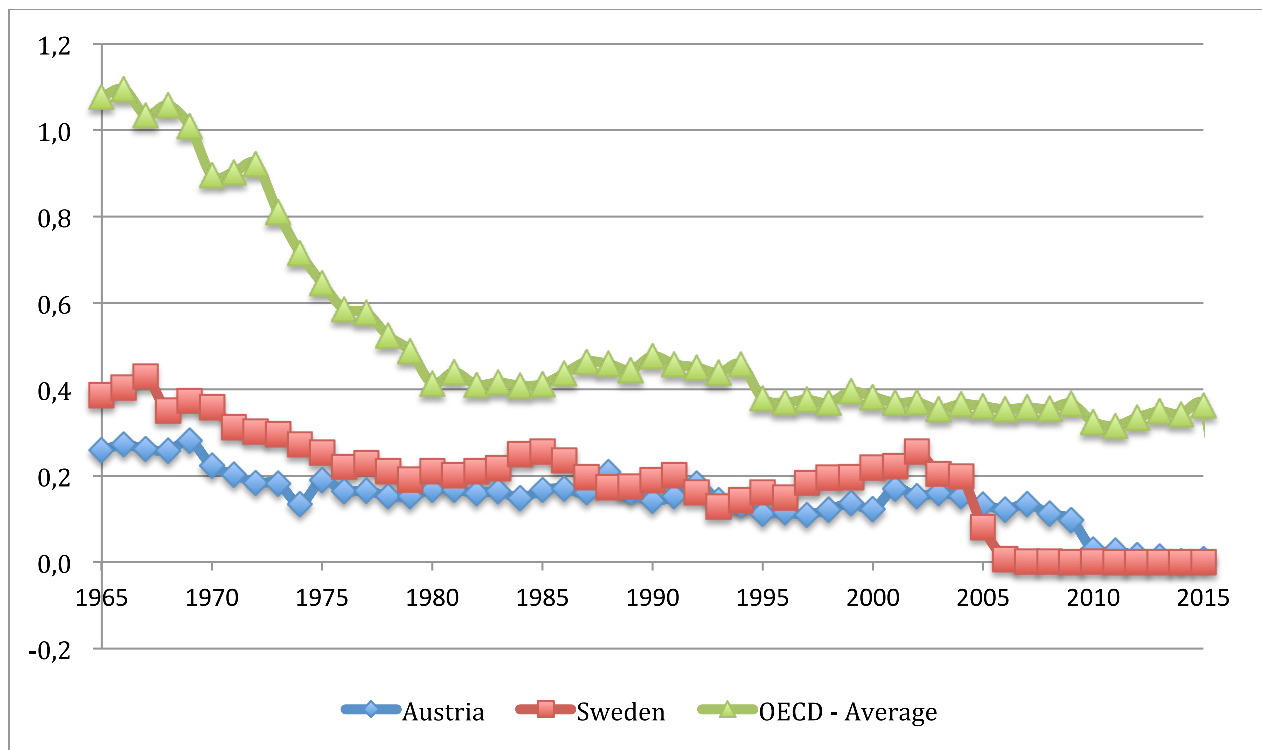
In our empirical study of two political economies that have undergone similar changes in the terrain of organized interest groups, we do not expect cross-national differences. Rather, we expect to see a systematic pattern of differences and similarities across the two policy fields. We therefore investigate the policymaking processes of inheritance tax reform in Sweden (2004) and in Austria (2007), and corporate tax reform in Sweden (2013) and Austria (2005). Inheritance tax reform occurred in both countries under center-left government coalitions, while corporate tax reform took place in both countries while under right-wing governments. Inheritance taxes are traditionally among the most redistributive type of taxes, and have recently been highlighted as an important instrument for preventing rising inequality and increasing redistribution[xxiii]. Acceptance of business demands to reduce inheritance taxes by a center-left government is therefore an unexpected outcome from the point of view of partisan orientation. Right-wing governments, on the other hand, can be expected to be more willing to respond positively to business calls for reduction in inheritance and corporate taxes. Thus, the partisan ramifications of the reforms we selected for the empirical study makes it difficult for our theory to pass the test.

Comparative case-studies provide an opportunity to research government responses to business demands through within-case evidence. To research that proposed link, we investigate how governments responded to campaigns by business interests and specifically, how governments justified and explained their decisions, both economically and politically. Data for this paper was gathered from OECD databases on tax revenues, Swedish and Austrian parliamentary records, papers, reports and publications produced by their respective national business organizations, media outlets, and existing research and literature. In researching Swedish inheritance tax policy, we also had access to a number of interviews with key informants participating in the policymaking process. We begin with the issue of inheritance taxes.

The Political Economy of Inheritance Taxation

Austria and Sweden both abolished inheritance and gift taxes, in 2007 and 2004, respectively. In this section, we analyze these decisions, beginning with a brief overview of revenues from inheritance and gift taxes in the two countries. As Figure 1 shows, revenues in both countries have been below the OECD average since 1965. In Sweden, revenues from these taxes have been consistently lower than the OECD average and varied between 0.10 and 0.13 per cent of GDP over the last five decades, dropping to zero when inheritance and gift taxes were repealed in 2004. In Austria, revenues from inheritance and gift taxes were even lower, and varied between 0.09 to 0.05 per cent of GDP prior to the abolition of inheritance and gift taxes in 2007. As in Sweden, Austria's revenues declined to zero after inheritance and gift taxes were abolished in 2007.

Figure 1: **Inheritance and gift tax revenues as per cent of total taxation, 1965-2015.**



The Political Economy of Inheritance taxation in Sweden

Swedish inheritance and gift taxes were repealed as part of a reform enacted under the Social Democratic led government in 2004 (Proposition 2004/5: 25). The political dynamic toward repeal developed in 1991, when the Conservative party took office and launched a "Tax Policy for Growth" proposal. The reform caused a drop in effective tax rates on personal wealth from super-large estates from nearly 44 to 22 percent, while the effective tax rate imposed on wealth from small estates increased from 3.5 to 5.5 percent[xxiv]. The political Left opposed the tax reform, arguing that huge tax relief for the wealthiest groups violated long-standing principles of societal fairness and economic equality[xxv] . Nevertheless, a few years into the new millennium, it was a Social Democratic government that presented a repeal proposal in the Swedish parliament (Prop 2004/05:25). Broad support had emerged in the Parliamentary Committee on tax policy affairs, and the proposal was approved by a significant majority on December 16th 2004.[xxvi]

This policy of business friendliness was the result of a campaign designed and orchestrated by organized business. From the early 1980s, the Confederation of Swedish Enterprise (CSE)

engineered a pro-market movement to challenge political consensus about the Swedish welfare state, taxation policy and the public sector. The CSE provided new libertarian think tanks with financial support in a strategy to transform the ideological climate in a pro-market direction.[xxvii] Cuts in wealth and inheritance taxes became a priority in the early 1990s, and the Conservative party was strongly influenced by the CSE.

In the early 2000s, the CSE decided to launch a final campaign against inheritance taxes[xxviii]. Interest group representatives and politicians explain uniformly that political pressure for reform was coordinated by the CSE[xxix]. When the Social Democratic Prime Minister, in 2003, invited labor unions and employer organizations for rounds of "economic growth talks", the CSE came with a call for the total repeal of inheritance and wealth taxation as a top-priority[xxx]. At that point, the organization had invested considerable resources to prime the public opinion to support repeal (Interview #1). Several meetings were arranged with business owners to be held at workplaces around the country, and the organization facilitated the writing of hundreds of newspaper articles on the issue in those years[xxxi] . This was an effort to carefully frame inheritance taxes as a threat to family-owned businesses, and a matter of keeping jobs in Sweden. There were two reasons for framing the campaign in terms of family business and job loss. First; "few people understand the tax issue, whereas everyone can relate to losing one's job". Second; "had it been framed as a regular tax cut, it would be associated with an attack on the financial viability of the welfare state. We would have lost that battle immediately"[xxxii]. The CSE also demanded data from *Statistics Sweden* to illustrate that many family-owned firms would be subjects to ownership change in the near future, and that many jobs were at risk. The risks cited were that these firms would be forced to declare bankruptcy as a result of inheritance tax liabilities, or they would decide to relocate to more business-friendly environments[xxxiii].

The revenue-raising capacity of inheritance and gift taxes, as demonstrated, has historically been low in Sweden, and the fiscal consequences of a business friendly attitude for this policy therefore modest. The government, in its proposal for reform, stated that a main reason for repealing the tax was the high administrative expenses relative to the modest public income that the inheritance tax generated[xxxiv]. The tax was repealed, as mentioned, in a broad consensus, although a debate emerged in the parliament about *why* the tax was repealed. While the government emphasized the high administrative costs and low revenues, the Conservative Party also wanted the Social Democratic government to acknowledge the harmful effects of the tax on business and investments[xxxv].

This act of signaling business friendliness was also considered from an electoral perspective. Organized business framed the issue as a matter of keeping jobs in Sweden in order to appeal to middle-class interests. However, of equal importance was the fact that *after* the 1992 reform briefly discussed above, exemption levels were merely a quarter of the annual income of a blue-collar production worker, and the top marginal tax rate took effect at a level just over the double annual income of that worker. The tax had become disadvantageous to the middle class. The government referred to the way in which the tax had become a burden on the average citizen, for whom inheritance taxes constantly increased as a function of increasing prices on houses and properties. Complicated exemptions and possibilities to register on special lists on the Swedish stock exchange also allowed large fortunes to avoid high effective tax rates[xxxvi]. In other words, the government saw the tax, which generated few revenues, as particularly unfair to the middle class, and found itself in a desirable position of making a business-friendly response with modest financial implications that also aligned well with voter interests. A survey of tax policy attitudes conducted during the year in which the tax was repealed (2004) showed 70 per cent of Swedes either "supported" or "strongly support" lower inheritance taxes. Only 4 percent supported raising the tax[xxxvii]. These figures were highlighted by the Conservative Party during the

parliamentary debate[xxxviii] and as a CSE informant explained: to the extent that the politicians "considered electoral consequences of repeal, we had made sure that they would discover an electoral advantage in such a move" [xxxix].[xl]

The Political Economy of Inheritance Taxation in Austria

In Austria, a Social Democratic-led Grand Coalition decided to repeal inheritance and gift taxes in 2007. This decision was the final step in a long-running process of policy changes that had gradually hollowed out the revenue base of inheritance tax, which made the abolition appear as an insignificant step in terms of revenue losses.

In 2007, opponents of the inheritance tax used a decision by the constitutional court to push for an outright abolition. In the months preceding the court decision, business representatives had stepped up their campaign against the inheritance tax, in expectation of a favorable decision by the court. In August 2006, the Minister of Finance in the coalition government of the People's Party (OVP) and the Freedom Party (FPO), Karl-Heinz Grasser (husband to the heir of the Swarovski jewelry firm), had proposed abolishing the inheritance tax in a newspaper interview[xli]. At the same time, the Chamber of Commerce (Wirtschaftskammer Österreich, WKO), the statutory representation of all firms in Austria, demanded the abolition of the inheritance tax. Chamber president Christoph Leitl argued that if heirs were unable to pay the tax, a company would have to close down, destroying jobs. According to Leitl, about fifty percent of all family company handovers fail[xlii]. Similarly, Karl Bruckner, vice-president of the Chamber of Business Accountants and CEO of the accounting firm BDO, presented in the media as a "tax expert", called for abolition of the tax[xliii].

The immediate incident that triggered the repeal effort was a Constitutional Court decision in March 2007[xliv]. In most cases, the assessed value used for tax purposes was lower than the actual

market value of real estate. A person inheriting real estate would thus pay less inheritance tax than a person inheriting the cash equivalent of the current market value of that property. The court had decided that such unequal treatment of different types of assets for tax purposes was unconstitutional. The court set a deadline of June 2008 for a revision of the inheritance tax law. Without this revision, the inheritance tax would automatically expire.[xlv]

The Government coalition between the Social Democrats (SPO) and the People's Party (OVP), however, used the court decision as an opportunity to abolish the inheritance tax entirely, together with the gift tax, although the two parties were divided on the issue. The Social Democrats wanted to revise the law, the People's Party wanted to repeal it, and they had the upper hand since, without a reform, the tax would expire automatically. The Minister of Finance, Wilhelm Molterer, from the OVP, had declared on March 8th, 2007, the day the court decision was announced, that he ruled out any revision[xlvi]. The opposition Freedom Party also demanded abolition of the inheritance tax. The Greens, also in opposition, demanded a reform. Together, the Social Democrats and Greens held 89 seats in Austria's parliament, just three short of the required 92-seat majority. On March 14th, 2007, Chancellor Alfred Gusenbauer (SPÖ) announced that the government would not make use of the revision option[xlvii].[xlviii]

Why did the Social Democrats give in so quickly? The SPÖ could have pushed for a package deal that made reductions in other taxes demanded by business, specifically the corporate tax, conditional on a continuation of the inheritance tax. Specifically, the government had planned a major overhaul of the tax system for 2010. Chancellor Gusenbauer suggested to tackle the revision of inheritance tax as part of this larger overhaul of the tax system[xlix]. As part of that revision, a continuation of inheritance tax could thus possibly have been traded off against cuts in corporate taxes[l]. However, in the end, Gusenbauer abandoned that plan. As we have shown earlier, revenues derived from corporate taxation are much higher than those from inheritance

taxation, which makes cuts to corporate tax more relevant to government, but also to firms, whose after-tax profits are more affected by the recurrent corporate tax, than by inheritance tax.

Opponents of inheritance tax focused on two arguments: First, they argued that inheritance tax is a tax on the middle classes, rather than on the upper class[li]. Second, they pointed out that inheritance tax generates very little revenues: it was called a "trifle tax", and thus not worth the efforts of engineering a reform. They also pointed out the complexity of overhauling the tax system in such a way that the requirements of the constitutional court for equal tax treatment of the different types of assets would be met.

Since both arguments have some validity, it was difficult for the supporters of inheritance tax to counter them. Past reforms had created opportunities for wealthy individuals to avoid inheritance tax. The reform of the foundation law in 1993 had allowed individuals to circumvent inheritance tax by setting up a private foundation. Transferring assets to a private foundation is taxed at one-time rate of five per cent (*Stiftungseingangssteuer*). Private foundations enjoy a number of tax advantages, and in particular, are exempt from inheritance and gift taxes. The costs of setting up a private foundation are considerable, however, so it pays off only for those with high levels of wealth. Approximately 3400 private foundations existed in Austria in 2008, and they possessed assets of about 80 billion euros. About 60 per cent of their assets at that time came from corporate sources, 20 per cent from private sources, and 20 per cent from real estate[lii].

The tax privileges of private foundations created complications in enacting a consistent reform in line with the court decision. The court's demand that all types of assets be treated equally would have required a reform not only of the inheritance tax, but also of foundation law. Another complication concerned the property tax, which is levied by the municipalities. Since the system for assessing property value is the same for all types of taxes -- i.e., property tax, gift tax and

inheritance tax -- compliance with the court decision would thus have required a reform of the property tax regulation as well, in effect raising the tax burden on land- and homeowners[liii]. In short, the issues raised by the court decision were of such complexity that the creation of a consistent and court-compliant tax system would have required a comprehensive overhaul of the tax system[liv]. Opponents of inheritance tax used this complexity argument together with the limited revenues argument in arguing that a reform would not be worth the effort[lv].

The Chamber of Commerce openly acknowledged that abolishing the inheritance tax did not substantially reduce the firms' costs. According to the Chamber's president, Christoph Leitl: "Austria faces international competition [for investments], and has the chance to enhance its attractiveness by abolishing a tax that generates little revenue but has a high psychological impact on investors"[lvi]. Leitl thus clearly understood abolition of the inheritance tax as a symbolic measure that could attract foreign investors.

To sum up the Austrian case: the opponents of inheritance tax emphasized three arguments: inheritance tax imposes a disproportionate burden on the middle class; that revising the law would be a complex affair, and that the limited revenues from inheritance taxes do not justify the revision effort. Media statements suggest that the Austrian Social Democratic leadership concluded that fighting to keep the inheritance tax was not worth the effort, given the strong opposition to the tax. The labor unions and the party's rank-and-file protested the decision by the party leadership[lvii] and Chancellor Gusenbauer promised to bring the issue back on the government's agenda at a later point.[lviii]. In short, the available evidence suggests that campaigning by business interests combined with considerations about the small revenue size and attention to middle class interests persuaded the Austrian Social Democrats to give in on this issue.

The Political Economy of Corporate Taxes

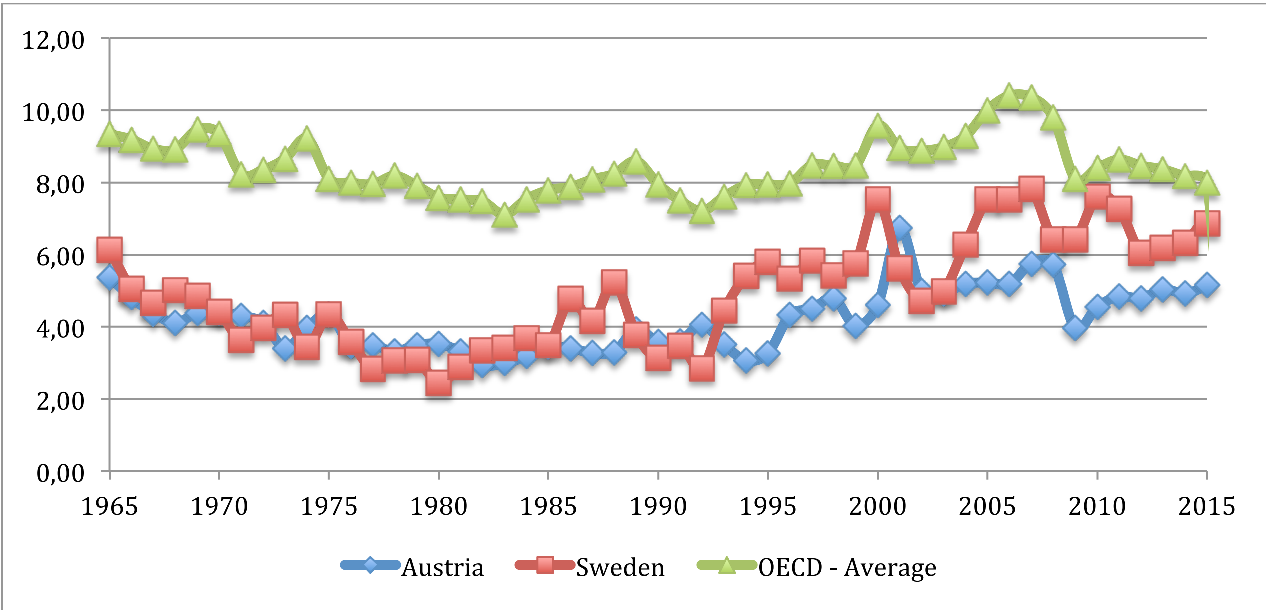
Corporate taxes raise significantly more revenues than inheritance taxes, and corporate tax cuts are a direct benefit to the interest of firms and their owners. We leave aside, for the purpose of this paper, the possibility that corporate tax cuts might benefit the public indirectly through more investment and jobs. We thus expect the goal conflicts of taxing business to be more intense in the area of corporate tax compared to inheritance tax, because governments risk losing considerably more revenues from a reduction in corporate tax contributions. For 2015, revenues from corporate taxes were about 2.97 per cent in Sweden, and 2.25 per cent in Austria, both roughly at the level of the OECD average (see figure 2).

In this section, we discuss the policy decisions in both countries that led to a reduction in statutory corporate taxation rates. Despite being intended as signals to international investors, these cuts have not resulted in an overall reduction in revenues, an outcome that we argue is due to off-setting policy measures. Statutory corporate tax rates have been debated recurrently in Sweden and successively lowered since the early 1990s. Beginning in 1993, rates were lowered from 30 to 28 percent, in 2009 further reduced to 26.3 percent, and in 2013 to 22 percent[lix]. Despite these reductions, the revenue-generating capacity of the tax remained strikingly stable throughout the period, and even tended upward. Currently, Swedish corporate taxes generate revenues of around three per cent of GDP, which is close to the average of other European Union member countries.

In Austria as well, the corporate tax has always been a more important source of public revenues than inheritance tax. In 2008, the last year Austria levied inheritance tax, revenues from inheritance tax were at 0.05 per cent of GDP, while revenues from corporate taxation were at 2.4 per cent of GDP . Similar to Sweden, Austria reduced its statutory rate of corporate tax (*Körperschaftssteuer*). In 2005, the government reduced Austria's statutory rate from 34 per cent to

25 per cent. At the same time, some exemptions were reduced or abolished so that the reform had a net neutral effect on revenues. The long-term development of corporate tax revenues in Austria has tended upwards, from an average of about 1.5 per cent of GDP in the late 1960s to 2.4 per cent in 2016. The 2005 cut in the statutory rate had no overall negative effect on revenues, as shown in figure 2 below.

Figure 2: Revenues from corporate taxation in Austria and Sweden, as per cent of total taxation.



As is well known, calculating the effective corporate tax burden is a highly complex matter, since the tax burden is affected not only by the statutory rate, but by a range of other parameters, such as the definition of the tax base (that is, the taxed income), tax exemptions and deductions. These parameters vary from country to country. Moreover, tax revenues are affected by opportunities for tax avoidance and by the tax attractiveness of a country when companies consider shifting profits or investments to another country for tax purposes . A country with a low statutory rate of corporate tax may thus be successful in attracting investors and, as a result, raise a

disproportionate amount of corporate tax revenues. Nevertheless, we can use time series data on tax revenues as per cent of GDP within a single country as an approximate indicator of whether a general reduction of the tax burden took place over time.

The Political Economy of Corporate Taxes in Sweden

In 2013, Sweden cut its statutory corporate tax rate from 26.3 to 22 percent. The Swedish business confederation, CSE, perceived this policy change as the outcome of a persistent focus from the organization on this as well as other measures, with implications for the Swedish business investment climate[lx]. The reform was included in the budget proposal of the right-wing coalition government composed of the Conservative Party, the Liberal Party, Centre Party and Christian Democrats for the fiscal year 2013. The government legitimized its corporate tax reform program by invoking OECD studies showing corporate taxes as among the most harmful to economic growth. The tax break for business, as mentioned, was accompanied by compensatory measures that would offset lost revenues. However, the government also counted on dynamic economic effects. The tax reform was altogether underfinanced and expected to generate a short-term deficit of approximately one billion euros[lxi]. The government was clearly aware of the symbolic value of low statutory tax rates. The official proposal stated that *statutory* corporate tax rates are important when business and companies operating in a global economy decide on investment location. And because the pre-reform tax rate was relatively higher compared to other European countries, this difference alone could legitimate a tax reduction. It was expected that with further European integration, business and investments would relocate to low-tax countries[lxii].

Sweden's Social Democratic Party, in opposition, submitted an independent budget proposal that cited lower corporate taxes as a structurally appropriate measure. However, the Social Democrats would not support a reform that relied on dynamic effects. Instead they proposed a cost-neutral

reduction to 24 percent[lxiii]. The Left Party, in the meantime, actually wanted to raise the statutory rate. While recognizing the importance of internationally competitive statutory corporate tax rates, the Left Party referred to the low *effective* corporate tax rates in Sweden and proposed raising the statutory rate to 28 percent. The Left Party also proposed imposing a one-time five percent tax on the four largest Swedish banks[lxiv]. The governing coalition, however, had a parliamentary majority, and the debate ended with the statutory corporate tax rate being lowered to 22 per cent.

The very limited effect of the rate cut on revenues is due to compensatory measures. The tax base was broadened, deductions and tax credits were abolished, and loopholes were closed[lxv]. As a matter of fact, after the major statutory tax cut in 2013, revenues from corporate taxes actually increased by 0.4 percent of GDP between 2012 and 2015. The increasing revenues were mainly an effect of a compensatory measure that reduced the value of the deduction for investment interest expenses and dividends[lxvi]. The corporate tax cut in Sweden were thus enacted in a political exercise, where the government balanced challenges associated with international tax competition, investment behavior of business, and the need to maintain a stable generation of public revenues[lxvii]. This is not only consistent with what we argue theoretically, it is also consistent with data from the field: reducing corporate taxes has not led to a reduction in corporate tax revenues[lxviii].

Politically, the Swedish parties of the left highlighted the interests of the middle class and unemployed against the interests of business. The Social Democratic party claimed that corporate tax reform was an inefficient means of creating jobs as opposed to further social investments in the form of increased family allowances, lower taxes on pensions, lower individual contributions to unemployment insurance schemes, and generally more generous social insurance programs[lxix].The Social Democrats rejected an underfinanced corporate tax reform that relied on

expected dynamic effects, claiming that it would increase financial insecurity for Swedish households. The Social Democratic Party thus sought to establish a divide between middle class voters and their preference for generous social service provision, on the one hand, and business interests, on the other. The Left Party went directly to class warfare, criticizing the government's proposal as preferential for big business and Swedish shareholders, with old-age pensioners, the sick and unemployed paying the price[lxx]

The politics of corporate taxes thus generated a more visible electoral dimension, or potential conflict, compared to what we observed in the case of inheritance tax reform. The opposition parties deliberately pitted the interests of business against middle class interests for social protection in order to expose the right-wing coalition and turn the middle class against it. Even if the right-wing government were willing to deliver what organized business asked for, it was still confronted by the gap between business preferences and the interests of voting public. The survey that in 2004 had shown a 70% majority of Swedes in favor of inheritance tax relief also showed that only 21 percent supported lower corporate taxes[lxxi].

To sum up, even a right-wing government, spearheaded by a Conservative Party closely connected to organized business and with a strong preference for business-friendly policies, found itself forced to balance its decision on corporate tax cuts against the fiscal and electoral implications of such cuts in terms of loss of revenues at potential electoral repercussions. Middle class support for corporate tax cut was relatively weak, and political parties on the Left sought actively to establish a political divide between the business friendliness of the government and the social security interests of average citizens. In the field of corporate tax policy, governments are clearly maneuvering between conflicting goals .

The Political Economy of Corporate Taxes in Austria

In Austria, the major reduction of the statutory rate of corporate taxation from 34 to 25 per cent in 2005 was decided by a right-wing coalition government, consisting of the Freedom Party and the center-right People's Party. In January 2004, Finance Minister Karl-Heinz Grasser, from the Freedom Party, announced the plan to cut the tax rate, combined with the elimination of some deductions. Hidden reserves and equity yield rate deductions would now be prohibited against corporate tax. The reform thus broadened the tax base, while at the same time lowering the tax rate[lxxii]. Financial analysts from Bank Austria estimated that the reform would increase after-tax profits of publicly listed firms by about 2 to 5 per cent, depending on the firm[lxxiii]. Since a reduction of the statutory tax rate from 34 to 25 per cent without changes in the tax base would translate into an increase in post-tax profits of about 15 per cent, we can infer that the base broadening was expected to compensate for an average of at least two-thirds of the rate reduction.

The government presented the reform as a signal to international investors required in response to the eastward enlargement of the European Union in 2004, since many of the new member countries in Central and Eastern Europe had corporate tax rates below 20 per cent. In Austria's neighboring countries of Hungary and Slovakia, for instance, the statutory rates were 16 per cent and 19 per cent, respectively.

The reduction of the corporate tax rate was preceded by a controversial debate among tax experts. The tax lawyer and university professor Werner Doralt questioned whether the planned cut would be an effective instrument to stimulate investments. On the other side, a number of industrialists spoke out strongly in favor of a cut. Friedrich Roedler from the accounting firm PriceWaterhouseCoopers, for instance, said in a newspaper interview that "tax havens [are] at our doorstep: a tax cut is the right step". Other executives who advocated for a cut in the media were Franz Ottawa (CEO of Hella, a car parts producer), Claus Raidl (CEO of Boehler-Uddeholm, a

steel producer) and Hans-Jörg Schelling (CEO of Lutz, a furniture retailer, and vice-president of the Chamber of Commerce).[lxxiv] The president of the Chamber of Commerce, Christoph Leitl, praised the rate cut scheme as a "psychological nudge for more economic growth"[lxxv].

The main response of the Austrian government to these demands was a lowering of the statutory rate, combined with a broadening of the tax base carried out by closing down existing exemptions and deductions. The reform had no negative effect on revenues; no drop in revenues as per cent of GDP occurred. Revenues declined during the Great Recession of 2009/2010, but they have since recovered to the pre-crisis level of about of 2.4 per cent (2016). The Austrian corporate tax reform can be interpreted as a symbolic measure: it was intended to send a signal to foreign investors of Austria's attractiveness in the wake of the European Union's eastward enlargement. As such, the government intended the reform as a signal to business that Austria was a player in the field of tax competition with the East European neighbor countries. At the same time, however, the reform was designed in such a way so as to maintain the level of tax revenues. The reform included several measures that offset the cut in the statutory rate, such that net revenues did not decline.

Business protagonists of the reform explicitly acknowledged that the reform would not reduce tax revenues. Following the adoption of the cut, Chamber of Commerce president Christoph Leitl stated in 2006 that "While the Germans are debating tax reforms, we acted. The fact that the revenues from corporate tax are bubbling, despite the rate cut, shows that this was a good deal for the Ministry of Finance and for the public"[lxxvi]. Similarly, the CEO of the accounting firm Deloitte, Bernhard Gröhs, told the newspaper *Wirtschaftsblatt* that 'The tax cut was extremely important. The broadening of the tax base has no importance in international competition' These statements indicate that business-affiliated protagonists of the rate cut fully understood that the reform would be a symbolic gesture, not significantly reducing the effective tax wedge on

firms. They advocated the reform explicitly as a signal to international investors that Austria remained an attractive location for investment.

Since the reform, business continued to campaign for further cuts in the tax rate. In October 2016, the president of the Federation of Austrian Industrialists, Christoph Neumayer, demanded a rate cut from 25 to 20 per cent, arguing that a rate cut would create jobs and growth[lxxvii]. Speaking about reform priorities in industry, Neumayer sought a reduction of public spending, a reduction of non-wage labor costs, and a lowering of corporate tax on re-invested profits[lxxviii]. These statements indicate that cost reductions are the main priority for industry, with non-wage labor costs being the largest component. However, as we have seen, government responses to business demands were not readily focused on substantial, effective reductions of costs to firms. Rather, the government focused either on very small taxes (inheritance tax), or on tax reductions accompanied by off-setting measures (corporate tax).

Speaking during the parliamentary debate on the reform, on the 6th of May 2004, the deputies of Austria's governing parties, the OVP and the FPO, justified the corporate tax cut on the grounds that it would be an important signal to international investors and that it would also create jobs. Moreover, they argued that the reform was socially fair because of parallel tax cuts for low-wage earners. Minister of Finance Karl-Heinz Grasser pointed out that many of the Eastern European neighbor countries, which had just entered the European Union, had rates of around 19 or 20 per cent. Grasser also claimed that the Austrian Business Agency, a government agency, had seen an increase of 77 per cent in inquiries by foreign investors in response to the announcement of the tax cut. Alfred Finz (OVP), undersecretary in the Ministry of Finance, argued that the reform was socially just, since the jobs created by the tax cut would benefit everyone[lxxix].

The opposition parties, the Social Democrats (SPÖ) and the Greens, opposed the cut. SPÖ tax spokesman Christoph Matznetter argued that the cut benefitted mainly large corporations, and that Austria would become a "tax paradise for multinationals"[lxxx]. From the Greens, tax spokesperson Karl Öllinger doubted that the cut would create new jobs[lxxxi]. To sum up, the governing parties tried to present the rate cut as benefiting everyone, while this view was strongly contested by the opposition parties.

Discussion

Our findings from a comparative study of four reforms of business-friendly tax-cuts, produced over the span of a decade by four different governments in two countries, accords well with our argument. Governments respond to organized business by balancing three potentially conflicting goals: enactment of business-friendly policies, generating public revenues, and alignment of policies with middle class preferences. The importance of signaling business-friendliness in an environment of high capital mobility was recognized by governments , as well as by the opposition parties, especially in relation to decisions on statutory corporate tax rates. However, we found that the decisions as to *how* to signal business friendliness were modified by the governments' need for a stable inflow of public revenues, and the extent to which the governments' policy choices aligned with middle class interests.

Corporate taxes are fiscally significant, and corporate tax cuts are easily interpreted as undue benefits given to the wealthy at the expense of middle class interests for social security. The business pressure for tax cuts imposed a constraint on governments in this field. Statutory corporate tax rates were lowered, but these were accompanied by compensatory measures to limit potential loss of revenues. In addition, governments were forced to legitimize their policy choices against claims that they undermined the welfare state, and a survey showed weak middle-

class support for corporate tax reform. Revenues generated by inheritance and gift taxes have historically been relatively insignificant, and these taxes are at the same time unpopular among average citizens. The conflicting goals can be reconciled in this policy field, and governments can send a strong signal of business friendliness on this tax without significant goal conflicts. Hence, in Sweden and Austria, the inheritance tax was simply repealed. The fact that the different goals can be more easily reconciled under a measure to repeal this tax is reflected by the broad parliamentary consensus that emerged on inheritance tax repeal in Sweden. Neither one of the political parties articulated a policy position from which it could benefit from exacerbating the conflict. The political parties were limited to debating *why* their grounds for support of this legislation was more justified than the grounds proclaimed by other parties.

Consequently, the idea that governments respond to the rising structural power of business without much leverage can be rejected. A government capitulation to business preferences unconstrained by the fiscal and electoral moderator would most likely lead to the reverse output, i.e., a strong response in the area of corporate taxes, where organized business has the greater stake in. Furthermore, our theory has passed a relatively strong test by demonstrating explanatory power in a study of two small and open economies. These two economies are not only exposed to external economic conditions, but also characterized by declining institutional capabilities to contain the structural power of business.

The strength of our theory is also supported by the partisan composition of the four reform governments. Inheritance tax repeal was implemented under Social Democratic incumbency in both countries, whereas corporate tax reforms were enacted by right-wing governments. It is a remarkable observation that Social Democratic governments, in the era of escalating economic inequality in Western democracies, are phasing out what has been considered as one of the most redistributive taxes in the entire tax code. Furthermore, policy experts and economists frequently

propose inheritance tax as an important instrument to prevent rising inequality and a means of increasing redistribution[lxxxii]. The observed policy choices of Social Democratic governments in Sweden and Austria show that governments are indeed under pressure to demonstrate their business friendliness.

We would also expect governments composed of right-wing parties to be more unwilling to allow their policy choices to be moderated by fiscal and electoral considerations. When, however, the economic interests of business and capital are framed as being in opposition to the social welfare of average citizens, not even right-wing governments can afford to ignore the fiscal and electoral consequences of policy choices.

What we did not account for theoretically is the possibility that the articulation of middle class interests -- and, thus electoral prospects associated with reform -- is a function of interest group activity. Organized business in Sweden worked strategically to frame inheritance tax reform as a matter of keeping jobs and as a means of mobilizing public opinion to support inheritance tax repeal. Related studies also find that on the issue of inheritance tax reform, organized business deploys strategies to prime the public opinion[lxxxiii]. Electoral opinion on inheritance tax is thus likely not entirely external to the policymaking process. But neither is it entirely internal. A successful public strategy by organized business to influence public opinion is conditional on a policy design that incentivizes citizens to support lower inheritance taxes. If the difference in public preferences on the two taxes were internally created in the process, we would have observed an even stronger effort to prime the public to support corporate tax cuts, where business interests are most intense.

Case studies are sensitive to contextual conditions, such as the role of a constitutional court decision for inheritance tax reform in Austria. However, our findings are not artifacts of case

selection and peculiar contexts. They reveal a larger, more general pattern. Corporate tax revenues are generally higher than revenues from inheritance taxes in the OECD-area. Average statutory corporate tax rates in the OECD countries have generally declined, but revenues have nevertheless remained stable since the mid-1960s. Budgetary pressures normally require compensatory strategies when statutory rates are lowered (cf. Swank & Steinmo 2002). Public revenues from inheritance taxes are generally negligible, and other countries besides Sweden and Austria have repealed their inheritance taxes or are considering such a move[lxxxiv].

Governments have some, but not unlimited, discretion in how to respond to business interests. They will tend to be most accommodating in situations where the fiscal and electoral price of accommodating business demands is low. Yet, the price they pay for reconciling business demands with electoral and fiscal goals is the sacrifice of redistributive policies that either lack middle class support or that generate little revenue.

Interviews

Interview #1: Former employee – Confederation of Swedish Enterprise

Interview #2: Head of section – Confederation of Swedish Enterprise

Interview #3: Former member of Swedish parliament

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[xxviii] Interview #1

[xxix] Interview #1, #2, #3

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[xxxv] Ibid., 29.

[xxxvi] Ibid., 21.

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[xliv] Verfassungsgerichtshof, "Erbschaftssteuer in Derzeitiger Gestaltung Verfassungswidrig," in *GH 54&06 ua*, ed. VfGH (Vienna: VfGH, 2007).

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[xlviii] Gusenbauer had insisted on a repair of the law in a TV interview three days earlier. The Federation of Labor Unions (OGB) and the Chamber of Labor (AK), the statutory interest representation of wage-earners, protested the government's decision (Karin Moser and Petra Stuiber, "Kanzler Gibt Bei Erbschaftssteuer Nach," *Der Standard*,, 15 March 2007, 8..

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[lxiv] Sveriges Riksdag, "För Framtidens Jobb," (Stockholm: Swedish Parliament, 2012).

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[lxviii] cf.Swank and Steinmo, "The New Political Economy of Taxation in Advanced Capitalist Democracies."

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