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HOW GOVERNMENTS RESPOND TO BUSINESS DEMANDS
FOR TAX CUTS: AN ANALYSIS OF CORPORATE AND
INHERITANCE TAX REFORMS IN AUSTRIA AND SWEDEN

by:

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Abstract

This paper analyses government responsiveness to business demands for tax cuts, using case studies of reforms of corporate taxes and inheritance taxes in Austria and Sweden. We find a high level of government responsiveness in both policy fields, but much higher responsiveness on inheritance tax. We argue that this difference between the two policy fields is the result of an effort by governments to balance three conflicting goals: (i) attracting investments, (ii) maintaining a high level of tax revenues, (iii) and maintaining electoral popularity. The intensity of these goal conflicts varied between the two policy fields. It was higher on corporate taxation, which led governments to combine cuts to corporate tax with compensatory measures, the abolition of inheritance tax in both countries was not combined with compensatory measures, because goal conflicts were low. We show that differences in the expected electoral and fiscal impacts of reforms explain the different levels of government responsiveness. Government efforts to reconcile the three policy goals under conditions of heightened business power entailed sacrificing redistributive goals that have characterized tax policies in earlier periods. (179 words).

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

How Governments Respond to Business Demands for Tax Cuts: An analysis of Corporate and Inheritance Tax Reforms in Austria and Sweden*

Introduction

The political power of business interest groups, organizations that represent the interests of the owners and senior executives of private firms, 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 structural changes in the global economy that facilitated capital flight, as well as to changes in the political strategies of business, including more public campaigning and efforts to promote business-friendly policy ideas (Lindblom 1977; Svallfors 2016; Hacker and Pierson 2010b; Paster 2015; Paster 2017; Vogel 1989; Culpepper 2011). At the same time, some 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 (Kinderman 2016; Menz 2005), Sweden (Svallfors 2016: 512; Blyth 2001: 14) and the United States (Mizruchi 2013; Hacker and Pierson 2010a; Waterhouse 2013: 201-288).

Our understanding of how the interests of powerful business groups are reflected in public policies is however limited by a lack of systematic knowledge of how governments respond to business demands. This is the question we seek to answer in this paper. We present a theoretical model of government responsiveness to business demands that suggests that governments develop policies that reconcile three conflicting goals: (a) attracting investments and maintaining business confidence; (b) maintaining an adequate level of tax revenues; and; (c) aligning policy choices with voter preferences. The intensity with which these goals conflict varies across policy issues, and we argue that governments will accept those business-friendly policy measures which minimize conflicts between a and b and c.

We explore the explanatory capability of this model with case-studies of government responsiveness to business demands focusing on two policy fields, corporate tax and inheritance tax, in two countries, Austria and Sweden, resulting in four cases. Business

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interest groups in both countries have pushed for cuts to, or even repeal, of both taxes, but the governments' responses have varied considerably. While governments in both countries accepted business demands for tax cuts, they deliberately did so in ways that protected tax revenues and electoral support. Governments engineered reform designs that reconciled the three goals of business confidence, tax revenues, and voter preferences; rather than sacrificing voter support and tax revenues at the altar of business confidence. In other words, governments selectively heeded business demands where neither a fiscal drain nor an electoral backlash was likely.

In the following section we elaborate theoretically how and why fiscal and electoral goals may mitigate government responsiveness to business demands. Then we move on to explain the research design, case-selection, and methods of data collection, followed by the empirical section, conclusion and discussion.

How governments respond to business demands: The role of electoral and fiscal goals

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” (Lindblom 1977: 177). State and society depend on investments by private firms, and this gives business 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 (Swank and Steinmo 2002: 645). Second, political and institutional constraints on the power of business also weakened. Katzenstein has explained in detail how the political logic of corporatism reduced structural inequities between business and labor (Katzenstein 1985) by granting organized labor access to policymaking arenas and balance or inhibit business influence (cf. Cameron 1984; Western 1991).

The erosion of coordinated policymaking weakened organized labor (Klitgaard and Nørgaard 2014; Häusermann 2010) 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.” (2014: 724). 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.

Maintaining business confidence is, however, only one of the goals pressuring governments in open capitalist economies. Two other goals are equally important for governments. Governments want to protect the overall level of tax revenues, and seek to avoid becoming the victim in a race to the bottom that hollows out the revenue-raising capacity of the state (cf. Swank and Steinmo 2002). “Governments need money. Modern governments need lots of money”, as Steinmo puts it (Steinmo 1993: 1). The goal of protecting revenues obtains particular relevance during periods of austerity, when governments are suffering from budget deficits and public debt and need an inflow of economic resources. Also, public revenues are critical for governments when they embark on realizing electoral pledges, which brings us to a third goal that democratic governments factor in when they decide on how to respond to demands raised by the business community; electoral consequences. If the general electorate perceives a tax cut to business to be unfair and a financial undermining of the ability of the state to provide social protection and public services, governments may instead seek out alternative routes to accommodate business that are less likely to generate an electoral backlash.

These three goals – business confidence, stable public revenues, and electoral preferences – are potentially in conflict. Cutting taxes on business in an effort to attract or stimulate investments may undermine the state’s revenue-generating capacity, and force governments to either raise taxes again to reduce public debt caused by tax cuts or to cut expenditures (Romer and Romer 2007). Offering business attractive tax reductions may also appear as preferential political treatment of organized business and be difficult to justify electorally. 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, loss of economic viability and financial capacity to provide social security and popular public service.

We argue that the intensity with which these three goals conflict varies across policy measures, and that governments seek policy solutions that minimize these goal conflicts. On this background, we expect, as mentioned, governments to respond to business in dependence of the intensity with which these three goals are in conflict. If the business community

pressure for a type of tax cuts that are expensive in terms of lost revenues and/or difficult to align with general electoral preferences, the policy response of governments is expected to be moderate in terms of size and scale. If, on the other hand, business demand a type of tax cuts that have less significant financial implications and, also sits well with general electoral preferences, governments are freer to adopt a policy choice close to the ideal preference of business.

Research Design and Methods

We research these theoretical propositions with comparative case studies of corporate tax and inheritance tax policy reforms enacted in Sweden and Austria between the years 2004 and 2013. Austria and Sweden are small coordinated 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 (Paster 2014). However, these corporatist institutions have eroded, whereas advocacy campaigns, media campaigns, and lobbying have gained importance as mechanisms of business influence (Svallfors 2016; Pühringer and Stelzer-Orthofer 2016). 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. Our case selection creates variation on the fiscal and electoral factors we expect to moderate government decisions on tax cuts for business. For all the OECD countries, revenues from corporate taxes far exceed revenues from inheritance taxes (figures 1 and 2), with 2.7 percent of GDP coming from corporate taxes versus just 0.1 percent of GDP from inheritance taxes. Sweden and Austria are in line with this pattern (OECD 2017). 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 by personal income tax. Corporate taxes are thus skewed toward big business, and provide organized business – but not average voters – economic incentives to advocate reductions. Inheritance tax, on the other hand, affects not only persons inheriting firms, but also middle-class voters who inherit property or financial assets. 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 strongly to business demands for cuts on inheritance taxes. Notwithstanding the fact that corporate taxes pose a greater cost burden on firms, the government response on this tax is expected to be moderated by fiscal and electoral considerations of the government. We summarize our expectations in table 1 below.

Table 1: *Expected government responses to business demands for tax cuts*

	Maintaining business confidence in conflict with		
	<i>Electoral goal</i>	<i>Revenue goal</i>	<i>Expected government response</i>
<i>Inheritance and gift tax</i>	No	No	Strong
<i>Corporate tax</i>	Yes	Yes	Moderate

It should be stressed that our design and case-selection allow us to explore the plausibility of our theoretical argument rather than to test it rigorously. Specifically, the co-variation on electoral and revenue goals generates an over-determined outcome. To disentangle the relative importance of these two goals in mitigating government responsiveness to business would require additional cases to enhance variation. At this stage, we can research the combined impact of electoral and revenue effects on government responsiveness to business, and allow for the development of hypotheses to be tested systematically in subsequent research on new cases.

The empirical study comprise investigations of 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 Social Democratic-led government coalitions, while corporate tax reform were enacted by governments of the Right. This means that we cannot control systematically for effects of

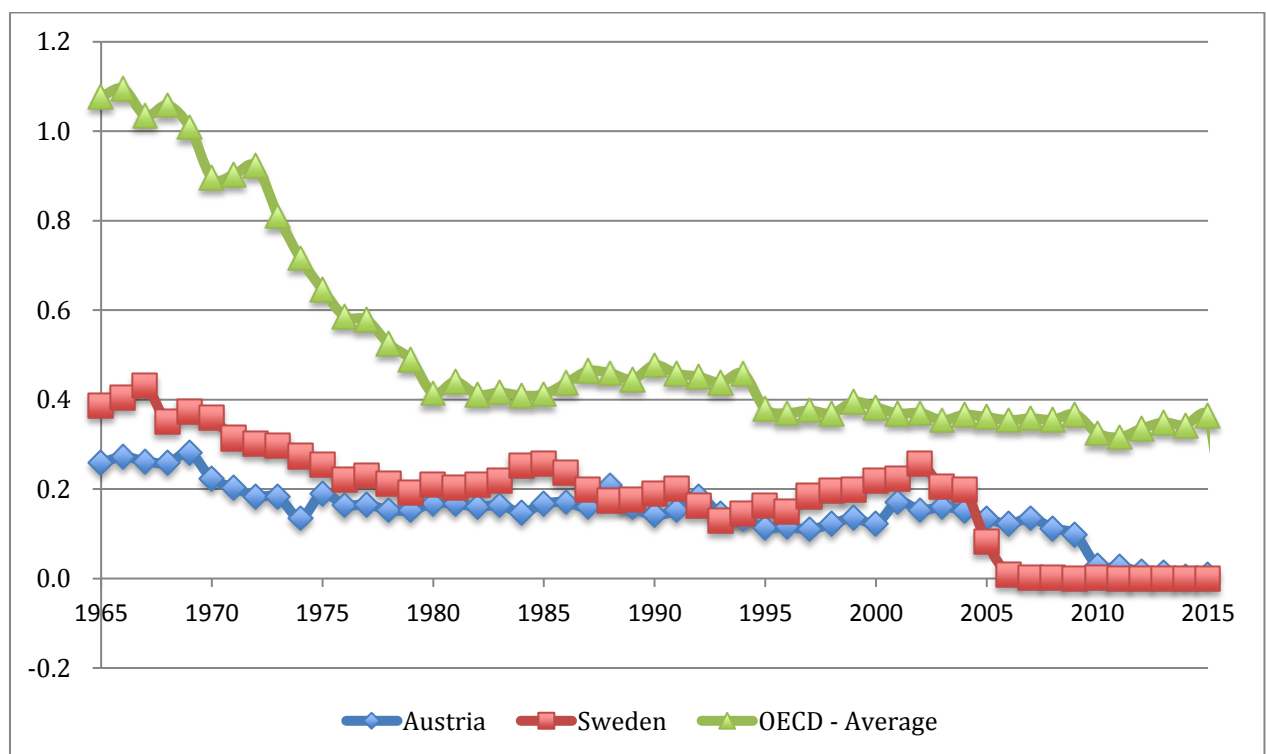
party politics since we have no instances of Social Democratic led corporate tax reform and no instances of Conservative-led reform of inheritance tax. The case-selection establishes however a set of ramifications that theoretically gives an edge to party politics as an alternative explanation. We expect a strong response in inheritance tax -- traditionally among the most redistributive type of taxes (OECD 2010; IMF 2013; Piketty 2014; Scheve & Stasavage 2016) that theoretically is well-protected against business pressure under Left wing incumbency. In corporate tax policy, where we expect a moderate response by governments of the Right, partisan theory would expect a strong and non-moderated response. We return to the possible effects of partisan politics for the empirically observed developments in the conclusion. Another alternative to what we propose is that the organizational strength behind the pressure on governments to produce tax cuts varied across the two taxes. The chosen design and the case-selection allow us to disregard organizational differences as a relevant explanation. In both countries, the interests of organized business are coordinated by peak organizations. The Confederation of Swedish Business and the Austrian Chamber of Commerce called and lobbied for cuts on corporate as well as inheritance taxes.

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 conducted three interviews with key informants participating in the policymaking process.

The Political Economy of Inheritance Taxation

The outcomes of inheritance tax reform in Austria and Sweden is consistent with what we expected; both countries 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 percent 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 percent 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 percent 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 (Du Rietz et al. 2012:

37). 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 (Motion 1991/92: Sk21) (Sveriges Riksdag 1992). 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 16, 2004. (Protokoll 2004/05:52) (Sveriges Riksdag 2004b).

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 (Blyth 2001; Kinderman 2016). 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 (Interview 1#). Interest group representatives and politicians explain uniformly that political pressure for reform was coordinated by the CSE (Interview #1, #2, #3). 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 (Ydstedt and Wollstad 2015). 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 (Ydstedt and Wollstad 2015). 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.” (Interview #1, #2) 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 (Interview #1).

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 (Sveriges Riksdag 2004a). 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 (Sveriges Riksdag 2004a: 29).

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 (Sveriges Riksdag 2004a: 21). 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 percent of Swedes either “supported” or “strongly support” lower inheritance taxes. Only 4 percent supported raising the tax (Hammar et al. 2004: 101). These figures were highlighted by the Conservative Party during the parliamentary debate (Sveriges Riksdag 2004a: 29) (Protokoll 2004/05: 52, 29) 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.” (Interview #1)¹

The Political Economy of Inheritance Taxation in Austria

In 2007, opponents of the inheritance tax used a decision by the constitutional court to push for inheritance tax repeal in Austria. The incident that triggered the repeal effort was a Constitutional Court decision in March 2007 (Verfassungsgerichtshof 2007). 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.² Opponents of inheritance tax used this court decision to call for a repeal of the tax, even though the court did not call for that.

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 (Geyer 2006). 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 (Wirtschaftskammer Österreich 2006; Paulick 2006: 2; Goldberg 2007: 84). 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 (e.g. Kommenda 2007: 6).

The Government coalition between the Social Democrats (SPO) and the People’s Party (OVP) were divided on the issue. The Social Democrats wanted to revise the law, the People’s Party wanted to repeal it. The latter had the upper hand since, without a reform, the

¹ The Confederation of Swedish Labor Unions had not been active on this issue, but they nevertheless expressed opposition with an appeal to principles of societal fairness (LO 2004). In 2014, the organization called for reinstatement of the tax (LO 2014: 11).

² It is important to note that the court did not declare the inheritance tax unconstitutional, but only a specific feature of the tax, which the court decided to be in need for revision/

tax would expire automatically. The Minister of Finance, Wilhelm Molterer, from the ÖVP, had declared on March 8th, 2007, the day the court decision was announced, that he ruled out any revision (wai 2007: 3). 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 14, 2007, Chancellor Alfred Gusenbauer (SPÖ) announced that the government would not revise the law, thus ending inheritance tax (Der Standard 2007: 1).³

Why did the Social Democrats give in so quickly? A continuation of inheritance tax could for example have been traded off against cuts in corporate taxes (Moser 2007: 7). 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 (e.g. Grimm 2007). Second, they pointed out that inheritance tax generates very little revenues: They called it a "trifle tax", 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. In short, the revenues collected would not justify the reform effort.

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 percent (*Stiftungseingangssteuer*). The costs of setting up a private foundation are considerable, however, so it pays off only for the very wealthy. Approximately 3400 private foundations existed in Austria in 2008, and they held assets of about 80 billion euros. About 60 percent of their assets at that time came from corporate sources, 20 percent from private sources, and 20 percent from real estate (Schmidl and Schratzenstaller 2011: 404-5).

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 the rules for private foundations. Another complication concerned the property tax, which is levied by the

³ Gusenbauer had insisted on a revision 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 (Moser, K. & Stüiber, P. 2007. "Kanzler Gibt Bei Erbschaftssteuer Nach". *Der Standard*, 15 March: 8..

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 to maintain consistency, in effect raising the tax burden on land- and homeowners (e.g. Salzburger Nachrichten 2007; Bachner 2007: 32). 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 entire tax system (M.K. 2007: 25). Opponents of inheritance tax used this complexity argument to argue that a reform would not be worth the effort (e.g. Schellhorn 2007).

The opponents of inheritance tax emphasized altogether 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 did not justify the reform effort. Media statements suggest that the Austrian Social Democratic leadership concluded that fighting to keep the inheritance tax was not worth the effort, given these considerations. The labor unions and the party's rank-and-file protested the decision by the party leadership (Presse 2007: 1) and the Chancellor promised to bring the issue back on the government's agenda at a later point. (Der Standard 2007: 1). While the Social Democrats did not support the abolition of inheritance tax, they found it difficult to counter the arguments of opponents. Business interests prevailed in this case because of (a) their ability to construct an alliance with middle class voters; and (b) the limited revenue relevance of the tax. 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, thereby clearing the way to abolition.

The Political Economy of Corporate Tax Cuts

Corporate taxes raise significantly more revenues than inheritance taxes. Corporate tax cuts are also a direct benefit to the interest of firms and their owners, and not a tax cut that directly benefit voters. We thus expect the goal conflicts of taxing business to be more intense in the area of corporate tax compared to inheritance tax. Governments risk losing considerably more revenues from a reduction in corporate tax contributions, while at the same get in tension with the voters. For 2015, revenues from corporate taxes were about 2.97 percent in Sweden, and 2.25 percent in Austria, both roughly at the level of the OECD average (see figure 2).

Yet, a rate cut might turn out as revenue-neutral for two reasons: First, a broadening of the tax base through closing of tax credits and allowances may soften the impact on revenues.

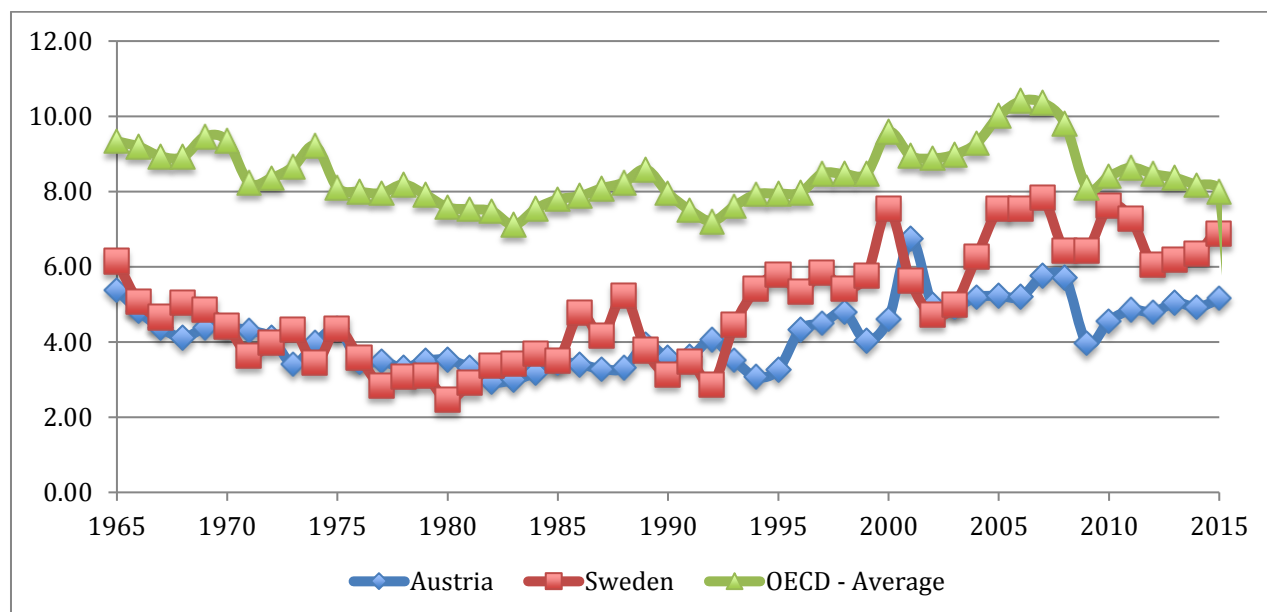
Second, a rate cut may attract foreign investments or, alternatively, induce multi-national firms to shift profits from higher-rate jurisdictions to that country. Governments can, thus, design cuts to corporate taxes in such a way that they see reason to expect them to be revenue-neutral, even though they can not guarantee such an outcome. Empirically, looking at the EU averages, we can observe that effective tax rates on corporate income have declined since the mid-1990s. Valenduc estimates that the effective tax burden on corporate income in the EU28 declined from 28 percent in 1995 to 16 percent in 2011 (2018: Figure 5). The European Commission, using a different econometric model, estimates that the effective tax rate on corporate income went down from 25 percent in 2004 to 21 percent in 2017 (European Commission 2018: Graph 17). At the same time, revenues from corporate taxation remained stable at the EU and OECD averages and within a range of about 2.5 to 3.5 percent of GDP (see figure 2 and European Commission 2018, Graph 16). Looking at individual OECD countries, no downward convergence of corporate tax revenues occurred over recent decades (see OECD 2017). In sum, the general picture for the OECD world is one of a downward trend in the effective tax rates on corporate income, combined with stability in revenues, which results primarily from a disproportionate growth of corporate income relative to GDP growth.

Austria and Sweden fit into this broader trend of lower tax rates and revenue stability. 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 (SOU 2014: 40). 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 percent 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 percent of GDP, while revenues from corporate taxation were at 2.4 percent of GDP (OECD 2017). In 2005, the government reduced the statutory rate on corporate income (Körperschaftssteuer) from 34 percent to 25 percent. At the same time, some exemptions were reduced or abolished to limit the effect of the rate cut on revenue size. The long-term development of corporate tax revenues in Austria has tended upwards, from an average of about 1.5 percent of GDP in the late 1960s to 2.4 percent in 2016. The 2005 cut in the statutory rate had no overall negative effect on revenues, as shown in figure 2 below.

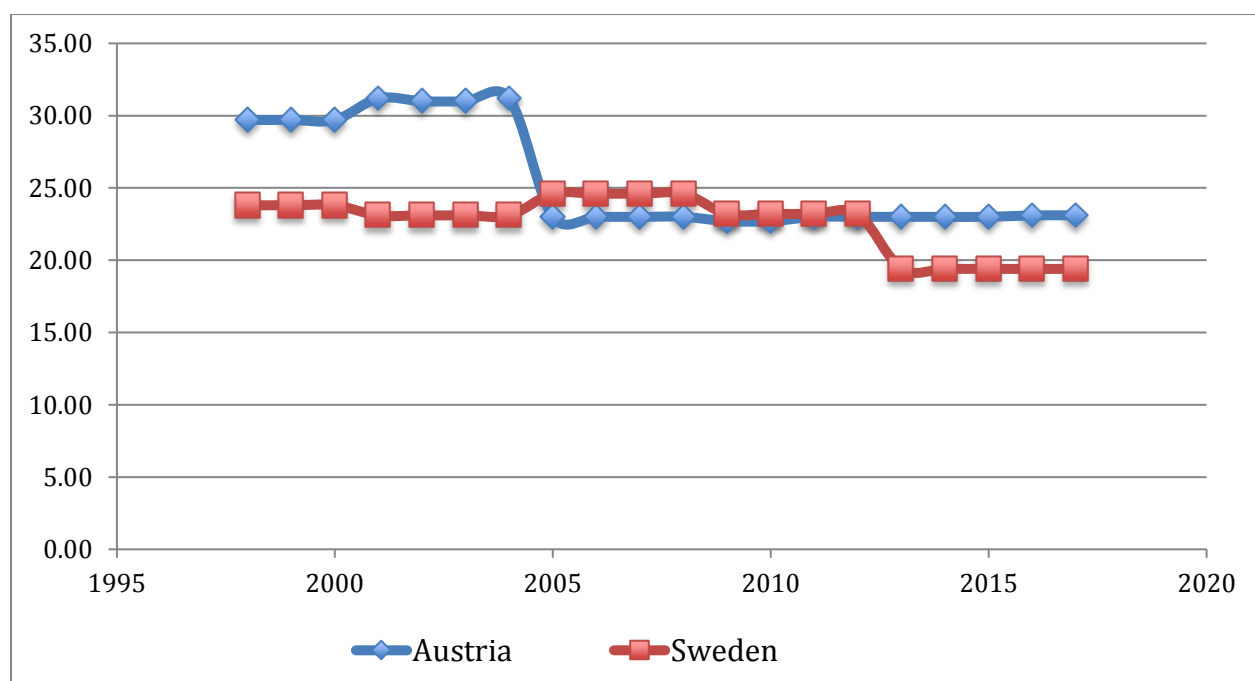
In both countries, the rate cuts came with some broadening of the tax base, such as closing of allowances and credits. Yet, the net effect was in both countries a reduction of the effective tax burden on corporate income (see figure 3). To measure the effective tax rate we use the Effective Average Tax Rate (EATR), an indicator developed the Center for European Economic Research in Mannheim on behalf of the European Commission. This indicator builds on a micro-economic simulation model of the tax burden on an average firm taking into account the relevant rates and tax allowances, an approach known among economists as the Devereux/Griffith methodology. (ZEW 2017) In both countries, the data on the effective average tax rate on corporate income reflect the effects of these reforms (2004 in Austria, 2013 in Sweden) as figure 3 shows. The cumulative effective size of the cuts is at about 5 to 6 percent of corporate income in both countries.

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



Source: OECD 2017

Figure 3 Effective Average Tax Rates on Corporate Income



Source: ZEW 2017, average for all sectors

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 (Svenskt Näringsliv 2013: 5). The reform was included in the budget proposal of the right-wing coalition government composed of the Conservative Party, the Liberal Party, Center 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 some of the revenues lost. 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 (Sveriges Riksdag 2012c) Prop. 2012/13: 1 Utgiftsområde 24, 38). 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 (Sveriges Riksdag 2012d: 3).

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 (Sveriges Riksdag 2012a: 80) Motion 2012/13: Fi302, 80). 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 (Sveriges Riksdag 2012b) Motion 2012/13: Fi250). The governing coalition, however, had a parliamentary majority, and the debate ended with the statutory corporate tax rate being lowered to 22 percent.

The very limited effect of the rate cut on revenues is partly due to compensatory measures. We are unable to calculate the precise contribution of the base broadening to revenue stability, but the government did adopt a number of measures clearly intended to

soften the reform's impact on revenues. The tax base was broadened, deductions and tax credits were abolished, and loopholes were closed (SOU 2014: 70). 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 (Sveriges Riksdag 2012d: 39) 2012/13: FiU1: 39). 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 (Sveriges Riksdag 2012c: 38) (Prop. 2012/13: 1 Utgiftsområde 24, 38).

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 (Sveriges Riksdag 2012a: 80). 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 criticized the government's proposal as preferential for big business and Swedish shareholders, with old-age pensioners, the sick and unemployed paying the price (Sveriges Riksdag 2012b).

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 percent majority of Swedes in favor of inheritance tax relief also showed that only 21 percent supported lower corporate taxes (Hammar et al. 2004: 101).

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 percent 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 Grassler, 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 would now not be deductible anymore. The reform thus broadened the tax base, while at the same time lowering the tax rate (Friedinger 2004: 2). Financial analysts from Bank Austria estimated that the reform would increase after-tax profits of publicly listed firms by about 2 to 5 percent, depending on the firm (Himmelbauer 2004: 3). Since a reduction of the statutory tax rate from 34 to 25 percent without changes in the tax base would translate into an increase in post-tax profits of about 15 percent, we may infer tentatively that the base broadening compensated 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 cut their corporate tax rates to levels below 20 percent. In Austria's neighboring countries of Hungary and Slovakia, for instance, the statutory rates were 16 percent and 19 percent, respectively.

The reduction of the corporate tax rate was preceded by a controversial debate among tax experts. The tax lawyer Werner Doralt from the University of Vienna 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) (Friedinger and Polster

2003: 2). The president of the Chamber of Commerce, Christoph Leitl, praised the rate cut scheme as a “psychological nudge for more economic growth” (Marschall et al. 2004: 2-3; Matznetter 2004).

The reform adopted consisted of a lowering of the statutory rate and a broadening of the tax base, similar to Sweden. The reform had no negative effect on revenues; measured in percent of GDP. Revenues declined during the Great Recession of 2009/2010, but they have since recovered to the pre-crisis level of about of 2.4 percent (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 to be revenue-neutral, partly because of the off-setting measure, and partly because of an expected increase in investments.

Business protagonists of the reform explicitly acknowledged that the reform would be unlikely to 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” (Wirtschaftskammer Österreich 2006). 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” (Marschall et al. 2004: 2-3). These statements show that business representatives attached greater importance to the rate cut than to the base broadening, possibly because they realized the base broadening as a necessary concession to the government.

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 percent, arguing that a rate cut would create jobs and growth (Industriellenvereinigung 2016b). Speaking about reform priorities in industry, Neumayer advocated a reduction of public spending, a reduction of non-wage labor costs, and a lowering of corporate tax on re-invested profits (Industriellenvereinigung 2016a; Industriellenvereinigung 2017). These statements indicate that cost reductions are the main priority for industry, with non-wage labor costs being the largest component.

Speaking during the parliamentary debate on the reform, on May 6, 2004, the deputies of Austria’s governing parties, the ÖVP and the FPÖ, justified the corporate tax cut on the

grounds that it would be an important signal to international investors and that it would 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 to 20 percent. Grasser also claimed that the Austrian Business Agency, a government agency, had seen an increase of 77 percent 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 (Parlament der Republik Österreich 2004b; Parlament der Republik Österreich 2004c).

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” (Parlament der Republik Österreich 2004a; Parlament der Republik Österreich 2004d). From the Greens, tax spokesperson Karl Öllinger doubted that the cut would create new jobs (Parlament der Republik Österreich 2004c). 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. To sum up, like in Sweden, the Austrian government designed corporate tax reform to attract investors but at the same time to be revenue-neutral. Compared to inheritance tax, goal conflicts were more intense, though, because no electoral alliance with middle class interests was possible. Overall, however, government responsiveness to business demands was high also on corporate taxation, but softened somewhat by the compensatory measures designed to protect revenues.

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, show a high degree of government responsiveness to business demands, and this holds for both Social Democratic-led and Conservative-led governments. In none of the cases did governments resist business demands for tax cuts. However, important differences exist between the two policy fields that, as we have shown, resulted from the different intensity of conflicts with electoral and fiscal goals. Governments designed their responses to business demands in such ways that the risk of negative repercussions in terms of voter behavior and tax revenues were minimized. They did not sacrifice electoral and fiscal goals to maintain business confidence,

they aimed to reconcile these goals. They did so by focusing business-friendly reforms on measures that did not undermine revenues and that did not upset voters.

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. Unlike with inheritance tax, an alliance with middle class interests was difficult to engineer, surveys showed little middle class support for corporate tax cuts. At the same time, tax cuts imposed a constraint on governments in this field. Statutory corporate tax rates were lowered, but the cuts were accompanied by base broadening measures that partly off-set the impact on revenues.

In contrast, revenues generated by inheritance and gift taxes have historically been relatively insignificant, and these taxes are at the same time unpopular among average citizens. 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.

Consequently, our finding cannot support the idea that governments respond to the rising structural power of business without much leverage. 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 demonstrated explanatory value 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.

Our theory is also supported by the fact that inheritance tax repeal was implemented under Social Democratic incumbency in both countries, whereas corporate tax reforms were enacted by right-wing governments. It may seem surprising 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, inheritance tax is frequently advocated as an important instrument to prevent rising inequality and a means of increasing redistribution (OECD 2010; IMF 2013; Piketty 2014; Scheve and Stasavage 2016). The Social Democratic-led abolition of inheritance tax can be explained however as a product of efforts to reconcile business demands with voter preferences and revenue needs. While we do not have variation on

partisan orientation within each of the two policy fields, the fact that the abolition of inheritance tax happened in both countries under Social Democratic-led governments, suggests that the need for goal reconciliation shapes government reforms independent of partisan orientation.

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 (Graetz and Shapiro 2005; Emmenegger and Marx 2019). 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 and 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 (Graetz and Shapiro 2005; Scheve and Stasavage 2016). But there are also limits to what we can infer from this study. First, we cannot disentangle the independent effects of each of the two factors we theorized as moderating the response strategies of governments. Second; even though also larger countries in a globalized economy are pressured to respond to business demands, our argument is probably better equipped to explain the logic of small states in world markets (Katzenstein 1985). This category of countries is under severe pressure from external economic forces, as well as from domestic factors such as expanded social security arrangements that requires stability in terms of tax revenues. The consensus

oriented style of policymaking that Katzenstein proposed as the mechanism that constantly generated policy adjustments to shifting conditions of the day, may indeed be an institution of the past.

But the political as well as economic pressure on these economies persist, governments are still forced to develop response strategies, and we provide an explanation for why and how such responses are likely to vary across policy issues. 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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