

# Common Ground:

Justifications of Neoliberal Tax Cuts in the US and Germany

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## Abstract/ Zusammenfassung

This dissertation explores why two countries with vastly different configurations in tax systems, electoral institutions and production regimes, Germany and the US, implemented highly similar tax reforms since the 1980s. I conducted a historical content analysis of tax debates in the American Congress and the German Bundestag to understand under which conditions the neoliberal paradigm was persuasive to majorities of policy makers in parliamentary bodies. I found that the prime movers, Ronald Reagan and Helmut Kohl, had serious issues implementing their tax plans due to massive protest that sparked among parliamentarians and later in civil society. This protest diminished in time and gave way to tax reforms which considerably shifted the tax burden from higher incomes and corporations to lower incomes and consumption in the early 2000s. I argue on the basis of the theory of *discursive institutionalism* that coherent narratives of normative and cognitive beliefs can become crucial in convincing parliamentarians of tax cuts for higher incomes and creating coalitions for institutional change. This *coordinative discourse* was more successful in the 2000s when George W. Bush and Gerhard Schröder were able to justify the tax reforms under consistent *discrediting* of *social justice* and a strong normative *moralization* of the tax reforms under the concepts of *market justice*. It took twenty years to shift the dominant normative discourse. But eventually a reinterpretation of the credibility of actors to comment on tax policy and a reconceptualization of the concept of tax policy itself as apolitical but moral in the realm of markets made the concept of neoliberal tax policy persuasive and it could transcend the boundaries of different national institutions.

Diese Dissertation untersucht, wie zwei Länder, die sich nicht nur vom Steuersystem stark unterscheiden, sondern auch im Wahlsystem und im Produktionsregime, Deutschland und die USA, seit den 1980er Jahren sehr ähnliche Steuerreformen durchführten. Zur Beantwortung dieser Frage habe ich eine historische Inhaltsanalyse von Steuerdebatten im amerikanischen Kongress und dem deutschen Bundestag durchgeführt. Das Ziel der Analyse war zu erklären, unter welchen Bedingungen neoliberale Steuerreformen eine Mehrheit von Repräsentanten überzeugen. Das Ergebnis ist, dass Prime Movers wie Ronald Reagan und Helmut Kohl zunächst ernstzunehmendem Protest gegenüberstanden, als ihre Steuerreformen im Parlament und der breiten Öffentlichkeit debattiert wurden. Dieser Protest verlor mit der Zeit an Gewicht, wodurch in den frühen 2000er Jahren der Weg für Steuerreformen frei stand, die die Steuerlast von den oberen Einkommen und Unternehmen zu den unteren Einkommen und dem Konsum verschoben. Meine These lehnt an den Ansatz der *Hintergrund Ideen* an, welcher besagt dass ein kohärentes Narrativ von normativen und kognitiven Ideen eine zentrale Rolle dabei spielen können unpopuläre Reformen einzubetten um neue Koalitionen im Parlament zu bilden. Diese Form des *koordinativen Diskurses* war erfolgreicher in den 2000er Jahren als George W. Bush und Gerhard Schröder ihre Steuerreformen durch konsequentes *Diskreditieren* des Konzeptes sozialer Gerechtigkeit, einer *Inkorporation* von

Kompensationen und einer *Moralisierung* von Wachstumstheorien innerhalb des Konzeptes der Marktgerechtigkeit verteidigten. Der neue Diskurs wurde dominant nachdem er festlegte, welche Akteure Autorität im Bereich Steuerpolitik hielten und Steuerpolitik selbst als apolitischen Politikbereich mit moralischer Einbettung im Markt interpretierte. Durch diese neuen Interpretationen von Steuerpolitik konnte die Idee der neoliberalen Steuerreform die Grenzen nationaler Institutionsbarrieren überwinden.

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## Abbreviations

ACCF	American Council for Capital Formation
AEI	American Enterprise Institute
AFDC	Aid to Families with Dependent Children
AFL-CIO	American Federation of Labor and Congress of Industrial Organizations
AMT	Alternative Minimum Tax
BDA	Federation of German Employers' Associations
BDI	Federation of German Industry
CBO	Congressional Budget Office
CBPP	Center on Budget and Policy Priorities
CDU	Christian Democratic Union Germany
CDA	Christian-Democratic Employees Association
CEA	Council of Economic Advisers
CIT	Corporate Income Tax
CME	Coordinated Market Economy
COPE	Committee on Political Education
CSU	Christian Social Union
CTJ	Citizens for Tax Justice
DAG	German Employees Union
DGB	Federation of German Trade Unions
DIHT	Diet of German Industry and Commerce
DIW	German Institute for Economic Research
EGTRRA	Economic Growth and Tax Relief Reconciliation Act
EITC	Earned Income Tax Credit
ERTA	Economic Recovery Tax Act
FDP	Free Democratic Party
FED	Federal Reserve Bank
GBPL	George W. Bush Presidential Library
GOP	Grand Old Party
HWWA	Institute for Economic Research Hamburg
Ifo	Institute for Economic Research
Ifst	Institute for Finance and Taxes
IRS	Internal Revenue Service
IW	Institute of the German Economy
LME	Liberal Market Economies
LWV	League of Women Voters
MMA	Medicare Modernization Act
NAACP	National Association for the Advancement of Colored People
NAM	National Association of Manufacturers
NCLB	No Child is Left Behind

NEC	National Economic Council
NFIB	National Federation of Independent Business Association
OECD	Organization for Economic Co-Operation and Development
OMB	Office of Management and Budget
OPL	Office of Public Liaison
PA	Archive of the German Bundestag
PAC	Political Action Committee
PDS	Party of Democratic Socialism
PIT	Personal Income Tax
RRPL	Ronald Reagan Presidential Library
SBA	Small Business Administration
SEIU	Service Employees International Union
SPD	Social Democratic Party of Germany
SVR	Council of Economic Experts
TEFRA	Tax Equity and Fiscal Responsibility Act
TRA	Tax Reform Act
VAT	Value Added Tax

# 1 Introduction

Justice is based in the equal dignity of all people. It demands same freedom, equality before the law, the same chances of political and social participation and in social security. [...] Justice demands greater equality in the distribution of income, property and power, but also access to education and culture.<sup>1</sup>

When Social Democrats pursue tax policy which increases income and wealth inequality, this can be economically efficient and thereby also socially justified. This is the case when such tax reforms foster economic growth, create employment and promote societal wealth and generate the greatest advantage possible for the least benefitting, as has been stipulated by the American philosopher John Rawls in his “Theory of Justice.”<sup>2</sup>

These statements on values in tax justice originate from two programs of the Social Democratic Party of Germany (SPD). The first statement stems from 1989, when the SPD radically opposed the center-right government’s plan to reduce taxes for the rich and corporations and shift the tax burden to the lower and middle classes. The second statement stems from 1999, when a Social Democratic value commission presented new justice concepts to legitimize the same plan of tax shifting under an SPD-led government. In 1988, the party leaders of the SPD were convinced that tax policy should generate some degree of *income equality* through *redistribution*. In 1999, the Social Democratic party leadership was convinced that tax policy should stimulate economic growth and jobs to provide *market justice* for the least well-off in society. This shift in beliefs among the SPD leaders, from redistribution to market inclusion, is part of a greater societal consensus on market justice that developed during the 1980s and 1990s. Not only did Social Democrats increasingly let go of the concept of income equality, but their closest ideational allies, leftist economists and trade unions, also ceased pressing for politically implemented income justice. The conservative and market-liberal parties were stunned by the new consensus that developed on tax cuts in the German Bundestag.

This evolution of a common ground in tax cuts for higher incomes and corporations was not exceptional to Germany. A similar ideational shift took place in the United States. During the 1980s Democrats and labor unions demanded the recognition of *ability to pay* in the distribution of tax burdens for different incomes, but this stance was softened over time. In both cases, the German and the American, new tax ideals that were closer oriented to market distributions of resources facilitated sweeping tax cuts for the highest incomes. This parallel development in tax cuts is surprising for institu-

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<sup>1</sup> SPD. “Basic Program of the Social Democratic Party of Germany.” December 20, 1989. Berlin, p. 12 [translated from German by the author].

<sup>2</sup> Basic Value Commission of the Executive Board of the SPD. ”Third Ways – New Centre - Social Democratic Markers for Reform Policy in Times of Globalization.” September 1999. Berlin, p. 28.

tionalist theories. Contemporary tax research stressed the differences in German and American institutions and production regimes and expected a resilience of the German tax system. Tax researchers usually position the German and the American tax systems on opposite poles of a market-coordination continuum which they consider to influence policy. While the “American Dream” ideology was considered to prosper within the institutional configurations of the liberal market economy (LME), German political economy and culture seemed exceptionally resilient to market ideals. Most tax research in the tradition of comparative political economy argues that the American tax system collected too much revenue and capital from the wealthy and top incomes and thereby impeded cross-class coalitions for redistribution through welfare transfers. This conflict, institutionalists argued, generated an exceptionally hostile societal environment for expansions of redistribution and resulted in radical tax cuts for capital and higher incomes under increased pressures of efficiency imposed by globalization.

German tax culture, on the other hand, was considered embedded in the institutions of a coordinated market economy (CME) which had always taxed capital income and top incomes at comparatively low rates. The within-class redistribution that resulted from this system was considered efficient and was popular among all political groups including capital owners. As a consequence, institutionalist theorists expected that German policy makers would only make moderate amendments to the system. Institutionalists expected that the already high efficiency in the German tax system impaired cuts for top incomes and capital under increased globalization pressures.

My dissertation explores how the concept of market-oriented tax reforms became so persuasive that it transcended the boundaries of different national tax institutions, production regimes and electoral regimes. How were the deeply culturally embedded societal values in *ability to pay* and *social justice* turned into a dominant discourse of tax cuts for the top incomes? I traced the changing beliefs of German and American policy makers from the early 1980s to the mid-2000s, analyzed debates of administrations with their party base, the opposition and interest groups and interpreted those changing beliefs within changing socio-economic contexts. Drawing on new approaches in *discursive institutionalism* and the central distinction of ideas and interests, I argue that traditional institutionalist thought places too much emphasis on objective-material interests of actors when looking at tax cuts for higher incomes. Even though a material economic crisis is usually the first trigger for tax cuts and the socio-economic context and power-formation guides the evolution of new paradigms within each national socio-economic context, the formation of interests essentially depends on the formation of ideas.

Ideas stand before interests as actors have to learn to interpret their objective-material interest within a new ideational framework. In this vein radical institutional change only becomes feasible when policy makers develop convincing new narratives of the potential interests their parties, the opposition and civil society could form within the new paradigm of economic growth *and* justice. Once this happened, institutional obstacles and relative economic advantages play much less a role for institutional change than the vision of creating sound economic policy and a new system of justice.

This thesis will show that the central act to implement persistent tax cuts for higher incomes was a *coordinative discourse* in parliaments in the United States and Germany which consisted of the formation of cognitive ideas of growth and normative ideas of justice. Institutional change did start with deliberation of cognitive arguments, but in order to turn it into a lasting policy program it had to become embedded in a normative narrative. American debates for instance first circled around supply-side arguments of capital formation and incentives to work and save to solve the productivity crisis, while German policy makers predominantly argued that tax cuts at the top would cut taxes for the *Mittelstand*, i.e. small and medium firms which file their taxes as individuals, which would solve the crisis of unemployment. In a second step however, policy makers had to tap into normative political values to generate an inclusive and coherent narrative of morality within markets. In both countries, I identified a process of discursive strategies which began with the *discrediting* of concepts of social justice, continued with an *incorporation* of compensatory demands and ended with a *moralization* of the market and the shifting of tax burdens to the bottom incomes.

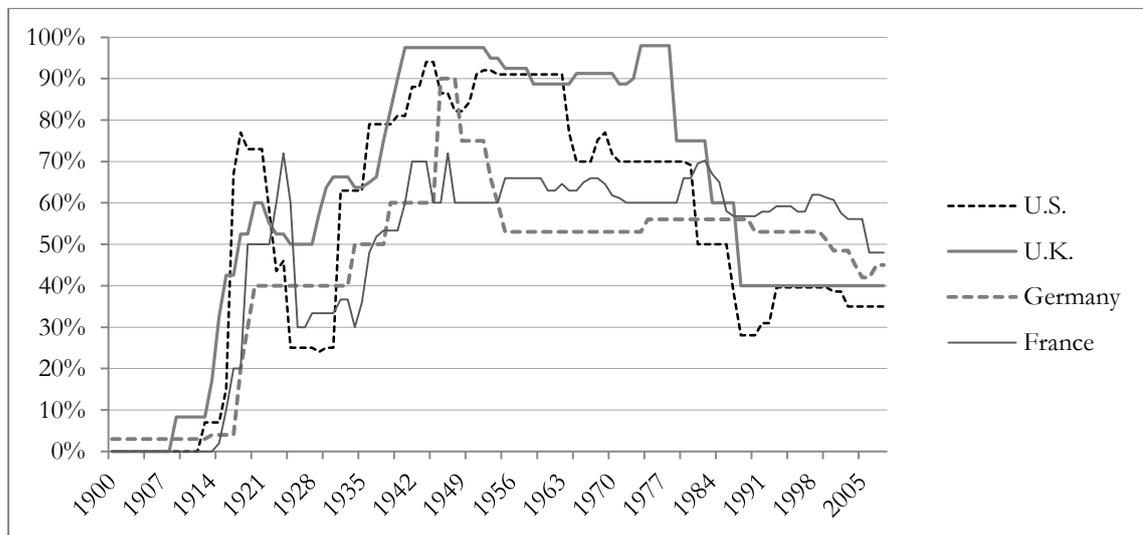
### *Neoliberal Tax Reforms and Inequality*

Since the 1980s almost every country in the world has implemented some form of market-oriented restructuring of the domestic tax system. This trend started with Ronald Reagan's reform of 1981 and Margaret Thatcher's collection of smaller reforms which cumulatively shifted taxes to the bottom incomes over the 1980s. What characterized these reforms as *neoliberal* was a paradigm shift from the post-war Keynesian economic policy to a revival of many features from the liberal order of the 1930s. Neoliberalism was the practical implementation of many of the suggestions from the newly emerging academic paradigm; supply-side economics, monetarism, rational choice theory and public choice. It was characterized by a general shift from macroeconomic steering to market solutions of efficiency. The instruments used to enhance the optimal allocations of resources in markets were a general downsizing of government intervention in markets, a deregulation of capital markets, market enhancing macroeconomic management, deflationary monetary policy and austere fiscal policy (Blyth 2002, 6, 15). Tax cuts played a crucial role in the new neoliberal paradigm because taxes on capital and investment distorted the allocation of funds to the most productive sites in the economy and taxes on high labor income distorted incentives to work (Fullerton 1994, 167). What all these tax reforms had in common was that they combined some reduction in corporate taxes with income tax cuts at the top and a shift of the tax burden onto lower and medium incomes. Legislators reduced tax burdens on capital income through cuts in corporate income taxes, personal income tax, capital gains tax, dividend tax, and estate, property, inheritance and wealth taxes. The shifting of the tax burden to lower and medium incomes was usually achieved with increases in consumer taxes and social security contributions. Consumer levies were raised through higher value added taxes

(VAT), sales taxes, excises and an increase in lower and medium labor income taxes through one-sided increases in employee shares of social security.

This dissertation investigates the shift in beliefs regarding the desired distribution of tax burdens. Because the distributive effects were greatest in the changes made to the income tax system, income taxes will be the focus of my analysis (Bach, Corneo, and Steiner 2014; Piketty and Saez 2007). Income taxes are taxes on labor income - wages and salaries, capital income - interest, dividends, capital gains and income from renting and leasing, and entrepreneurial income – agriculture, forestry, unincorporated enterprise and self-employed income. Figure 1 shows the decline in top statutory income tax rates, i.e. the tax rates that were applied on the highest tax bracket at each point in time. The figure shows that the tax rates increased from the beginning of the twentieth century, reaching levels as high as 90 percent around the end of the Second World War. In all four countries displayed, the top rates were cut in half by 2005. From this comparison of personal income tax rates, researchers have often argued that the German tax system was more efficient than the American tax system, at least since the Adenauer administration had reduced the burden for the top incomes in the 1950s. The American rates, however, had remained at almost confiscatory rates until Reagan cut them in the 1980s (Hays 2003; Prasad and Deng 2009; Wilensky 1975).

Figure 1 - Top Income Tax Rate since 1900



Source: Own calculations from Piketty (2014) <http://piketty.pse.ens.fr/en/capital21c2>.

However, top statutory income tax rates do not inform us about changes in taxes on lower and medium income groups, i.e. the overall progressivity of the income tax system, and only give limited information about the actual effective tax burdens for each income group. The tax burden is the amount of tax an individual pays on their total taxable income. It is not only determined by tax rates, but also by the definition of the

tax base, which is usually diminished for certain groups through tax allowances, tax credits, tax deferrals and tax deductions (Bach, Corneo, and Steiner 2014, 116). Tax expenditures are particularly heavy in the American tax system which reduced tax burdens by about \$438 billion alone in 1995. That is an amount of tax revenue reduction larger than the entire American defense budget and almost a third of all direct expenditures in welfare. Though tax breaks exist for all income groups, the majority of tax breaks go to higher income groups (Howard 1997, 26). Loopholes for higher incomes increased during the 1950s and since then have provided tax breaks on capital gains, investment income on life insurance and pension contributions (Zelizer 2003, 285). As a consequence the quasi-confiscatory top statutory tax rate of 93 percent in the 1960 translates into 30 percent effective tax rate (Piketty and Saez 2007, 12).

In Germany, loopholes and tax breaks affect the size of effective taxation to a lesser extent, but the highest incomes still receive benefits through capital gains exemptions and tax breaks on leasing and renting. These increased further due to reforms in 1992 and 1998. In 2005 top incomes only paid half the tax rate on such incomes when compared to the bottom half of income distribution (Bach, Corneo, and Steiner 2014, 126–27). In both Germany and the United States, top personal income tax burdens are significantly affected by the fact that self-employed individuals and unincorporated small firms, i.e. S Corporations, individual proprietorships and partnerships in the US and *Personenunternehmen* in Germany, file their taxes as individuals. Since these firms receive a significant number of tax breaks this further diminishes the effective tax burden at the top. In 1994, for instance, the German government reduced taxes on earnings for business enterprise to 47 percent for unincorporated companies but left the statutory tax rate for individual income unchanged at 53 percent (Bach, Corneo, and Steiner 2014, 119). Nevertheless, the tax breaks in the German tax system are much smaller than the loopholes in the American tax system. The statutory rates almost represent the effective rates. In 1960, the German top statutory tax rate of 53 percent translated into 48 percent effective taxation (Corneo 2005, 163). Accordingly, the thesis that the German income tax distribution was more efficient than the American income tax distribution might not hold when we look at effective taxation.

Figures 2 and 3 show the development of the average tax burdens for four income groups in the US and Germany. Average tax burdens were measured as the total amount of tax each income group paid in gross labor, capital and entrepreneurial income, as defined above (see Appendix 9.1 for further definitions of tax burden data). The data only contains individual income taxes and thus measures only part of the tax shifting that governments engaged in. The shifting of tax burdens from top to bottom is even greater if the data set includes social security contributions, estate tax and corporate income tax. Social security contributions are capped at the top, which places a heavier burden on lower and middle incomes and increased the tax burden significantly in both countries.<sup>3</sup> Corporate and estate taxes are more commonly carried by the high-

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<sup>3</sup> In the German case social security contributions for health, pensions and unemployment tax employees at a linear rate, i.e. all income groups with the same rate, until incomes reach the

est incomes and have declined since the 1990s (Bach, Corneo, and Steiner 2014; Piketty and Saez 2007).

Between 1980 and 2005, American tax reforms have led to a massive decline in effective tax rates for the very rich, the top 0.01 percent of incomes. Income taxes alone dropped from 22 percent to 17 percent (see Figure 2). The gains of this group were excessive considering they earned on average \$18 million in the mid-2000s and received an additional 10 percentage point reduction in their tax burden through estate tax and corporate tax cuts (Piketty and Saez 2007, 6). The top five percent of incomes earned on average \$117,000 and only paid 10.9 percent in effective income tax in 2005, down from 15 percent in 1980. The middle class, which earned half the income of the top five percent, also paid a smaller rate, which fell from eight to three percent. However, considering that their payroll tax burden increased from three to 11.2 percent in the same time period (Piketty and Saez 2007, 6), they actually paid 3.2 percent more in tax. The same is true for the bottom incomes who, on the one hand, gained from higher tax credits which dropped their rates from zero to minus five percent but, on the other hand, paid 7.6 percent more in payroll taxes. Thus, since the 1980s, American policy makers have significantly shifted the tax burden from the top to the bottom.

Even though Ronald Reagan's reforms are often described as the largest tax cuts in American history, with the most devastating effects on the level of redistribution, the development of the tax burden shows that Reagan's reforms were much less effective in shifting the burden than George W. Bush's tax reforms. Though the Reagan administration had stressed the explicit aim to reduce progressivity in the tax system (see Chapter 4), the shift of the burden in his first reform was cancelled out by a reversal in the second reform. Reagan's 1981 reform reduced top rates by three percentage points but his 1986 reform brought top rates back up by two percentage points. Bill Clinton raised the top rates significantly in the mid-1990s. It was instead George W. Bush who achieved a significant shift to the bottom by reducing the top income tax rate from 23 to 17 percent, i.e. by six full percentage points.

From this development I hypothesized that, if concepts of tax justice are relevant for the policy process, we should see changes in these values and the governments' ability to convince societal groups of their concepts. I expected to see a conflictual relationship of the Reagan administration with demands of parliamentarians in his 1981 reform, the Economic Recovery Tax Act (ERTA), as it was reversed in its distribution to the bottom in the 1986 in the Tax Reform Act (TRA). I chose these two reforms as cases of impaired distribution to the bottom. The case of successful convincing of society of shifting the tax burden is going to be exemplified by George W. Bush's 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA).

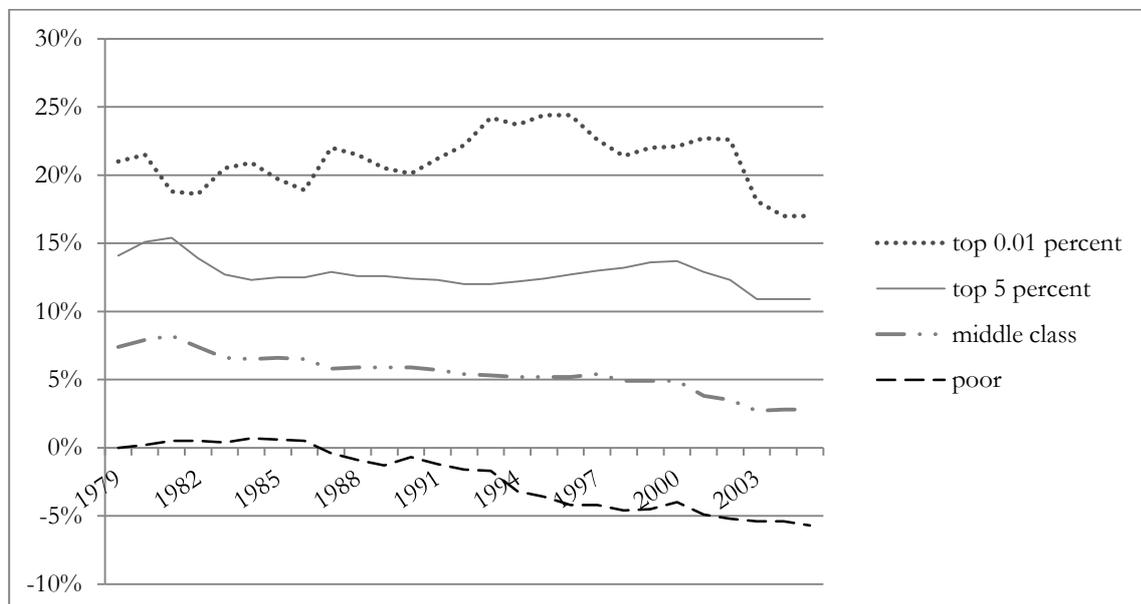
In Germany effective tax rates were generally much higher for all income groups (see Figure 3). The top 0.01 percent of incomes, which on average earned Euro 3 million in 2003, paid an effective tax rate of 55 percent in 1979. This rate was reduced to

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*Beitragsbemessungsgrenze* [contribution ceiling] of Euro 61,200 in West Germany. The lower and medium incomes are thus taxed with the full rate.

42 percent in 2005. The top 10 percent of incomes, which represent the German upper class with average income of Euro 180,000, paid 46 percent in 1985. This rate was reduced by ten percentage points to 36 percent of effective tax rates in 2005. The middle incomes earned, on average, Euro 25,600 and paid 20 percent of income tax in 1979. The rate fell minimally to 18.05 percent. Lower incomes gained more from the income tax cuts, which reduced their effective tax rate by seven percentage points from 15 to eight percent. On top of this, social security contribution rates increased from 32.2 percent to 42 percent between 1979 and 2003 (Streeck and Trampusch 2005, 177). Adding this ten percent increase in contribution rates would increase the tax burden for the lower class by three percent, and the middle class actually paid eight percent more in overall tax burdens when contributions were added.

Figure 2 - Distribution of Effective Tax Burdens in the US



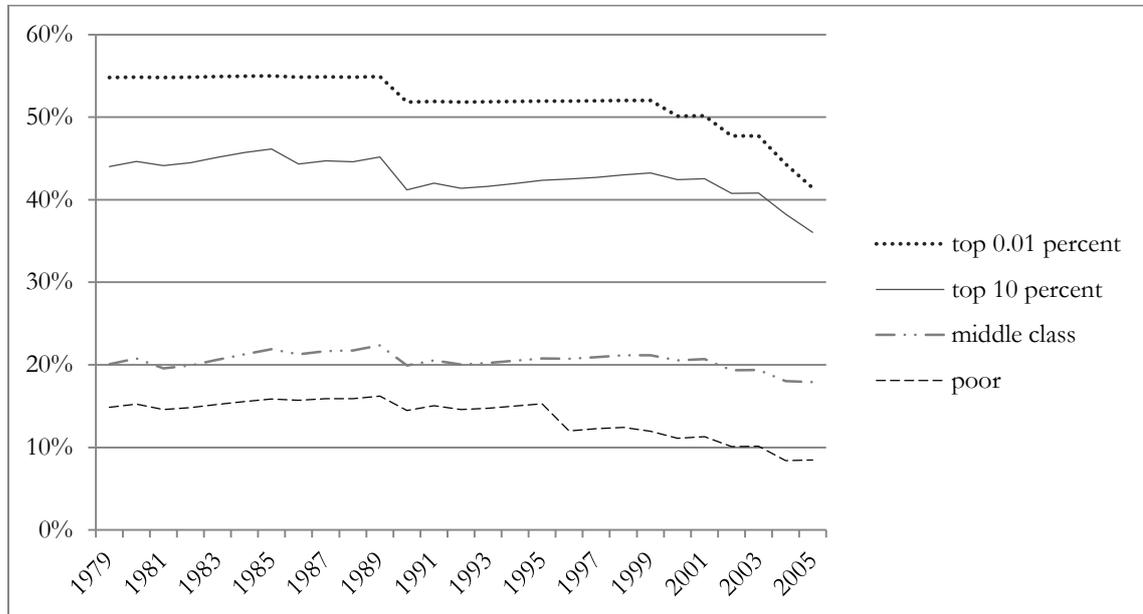
Source: Own calculations from Congressional Budget Office. The data for the upper class, middle class and poor stem from CBO (2014) and the data for the 0.01 percent stem from CBO (Congressional Budget Office 2008).

When comparing the tax burden shifts in Germany with the shifts in the US, the similarities are striking. As in the American case, the reforms of Helmut Kohl in the 1980s and early 1990s did not shift tax burden much to the bottom. The real shift only took place when the center-left government of Gerhard Schröder came to office and reformed the tax system.

I expected to find a conflict of different tax values in the 1980s and early 1990s which might have hampered the tax reforms of Helmut Kohl. I assumed that Helmut Kohl could not convince parliamentarians of a grand shifting of tax burdens when proposing his *Große Steuerreform* [Great Tax Reform] 1986/1988/1990. I contrast the Kohl reform and the limits in distributing taxes to the bottom with Gerahrd Schröder's

*Steuerentlastungsgesetz* [Tax Relief Law] 1999/2000/2002 which achieved a significant restructuring of the tax system.

Figure 3 - Distribution of Effective Tax Burdens in West Germany



Source: Own calculations from data from (2005), kindly made available by Giacomo Corneo.

The reduction in tax system progressivity had devastating effects on income inequality in the US and Germany. From the 1980s, inequality increased in the two countries through greater gaps in pay, which were significantly worsened by the lower degrees of redistribution in the tax systems (Bach, Corneo, and Steiner 2014; Piketty and Saez 2007). The reforms of Kohl, Reagan, Bush and Schröder have contributed to a concentration of incomes at the top. For the US, Piketty and Saez (2007, 19) show that the share of the top 0.01 percent of income before taxes, i.e. of market income, increased from 1.76 to 5.46 percent between 1970 and 2005. In the 1970s, this income concentration was diminished by tax redistribution of 46 percent, resulting in a post-tax market share of only 0.94 percent. In 2005, the market income share of the 0.01 percent amounted to 5.46 percent and was only reduced by 14.1 percent in tax redistribution, which left disposable top income concentration at the very high rate of 4.69 percent. For Germany, Bach et al. (2014, 133) also reported that income concentration was worsened significantly through tax burden shifts between 1992 and 2005. Market income shares of the top 0.01 percent increased from 1.39 percent to 2.09 percent and gross income shares increased from 0.91 percent to 1.59 percent. Accordingly, the 34 percent reduction of inequality through the tax system in 1992 was diminished to 23.9 percent. Though smaller than the reduction in redistribution through the tax system in the US, this is a significant increase in inequality caused by the tax system.

*Two Worlds of Tax Cuts?*

Literature in the traditions of Comparative Political Economy (CPE) and Historical Institutionalism (HI) has made many contributions to the field of tax research in recent years. Researchers in these traditions reject the primacy of tax competition and stress that economic pressures for tax cuts were mitigated by domestic institutions and the state's ability to generate societal coalitions and compensations through these institutions. Scholars argued that economic pressures on capital and top income tax could result in a highly diverse set of tax reforms across national borders. Distributive conflicts of capital and labor and among different income groups were not determined solely by capital mobility but also by electoral and corporatist institutions. Even though liberalization of capital accounts gave capital greater options to move abroad, capital might choose to stay in high tax countries when corporatist institutions diminished other production costs such as wages. Since coordinated market economies offered capital bargaining institutions along with labor the two groups could find consensual efficient solutions to the problem of market pressures. HI argues that consensual electoral systems may hamper the adoption of efficient tax policy because the opposition potentially held a strong veto-player position in the second chamber. The two literature strands conclude that, in coordinated market economies, the power of labor unions and center-left parties did not vanish just because capital was more mobile.

Institutionalists place a strong focus on the differences in tax reforms across national boundaries and institutional continuity and do not offer explanations for similarity. The data for tax reforms in the US and Germany, however, imply that governments in the two countries engaged in strikingly similar tax reforms. One reason, which comparative literature points out, is that the historical configurations of the German electoral system and the distribution of power that became ingrained in it since the early 20<sup>th</sup> century resulted in an efficient tax mix.<sup>4</sup> The German tax system was described as a role model to liberal economies such as the US because overall revenue was mostly collected from consumption taxes and social security contributions and less from capital and the rich. The opposite was true for the American tax system. Table 1 shows that the tax revenue shares in GDP display exactly what HI and CPE predict about the different tax mixes in the US and Germany. In 1990, the German Social Security Contribution (SSC) shares and consumption tax revenue shares were much higher compared to the US. But if the German tax system was already so much more efficient, why did the Kohl and Schröder administrations cut the effective income tax rates for the rich by such large shares?

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<sup>4</sup> For a summary of the approaches see Chapter 2, Sections 2.2 and 2.3. The most important representatives of Historical Institutionalism which argue in this vein are Steinmo – though he compares the Swedish economy with liberal market economies (1993; 2002) – and Prasad (Prasad 2006; Prasad 2012a; 2009).

Table 1 - Federal Revenue Shares in GDP in 1990

	Total revenue	PIT	CIT	SSC and payroll	Property tax	Consumption tax
US	25.93%	9.95 %	1.68 %	6.55 %	1.17 %	4.57 %
Germany	34.80 %	9.59 %	1.95 %	13.04 %	3.02 %	9.30 %

Source: OECD Revenue Statistics (2014)

Despite criticizing the overly functional mechanisms presented by tax competition literature and promoting a better embedding of economic developments into the socio-economic contexts in each national political economy, historical institutionalists and comparative institutionalist eventually equally rely on objective material interests of actors in the political economy. Even though these approaches argue that economic pressures will not take equal forms in all national political economies, these theories still argue that coordination of the objective material interests of capital and labor stands at the heart of political solutions of economic crisis. Take for instance the theory that the German political economy can fence off globalization pressures on its national tax system by offering corporations moderate wages in exchange for high redistribution in the tax system. This mechanism clearly rests on the idea that trade unions are under all circumstances interested in high wages and high levels redistribution and that corporations are under all circumstances interested in low taxation and low wages. My thesis argues that interests are not as objectively identifiable in complex socio-economic configurations and that ideas mitigate the formation of new interests.

This thesis will show that institutions are important in mitigating the pressures of globalization, but there are certain conditions under which policy makers find ways to surpass these national institutional barriers. Though CPE analyzes coalitions and conflicts of organizations, policy makers and voters in their theoretical framework, these coalitions follow logics of objective material interests. For instance, CPE argues that neoliberal tax reforms were more radical in the US than in Germany because the fragmented American electoral system was more permeable to business lobbying. For Germany this literature expects that the power of trade unions and center-left policy makers in the electoral system hampered tax cuts. In neo-corporatist institutions labor unions agreed with business leaders on moderate wage increases in exchange for high redistribution in the welfare system. Also, in parliament, the veto-power of the opposition in the second chamber hampered tax cuts for the top incomes and corporations. Thus CPE assumed that labor fights for redistribution and business fights for lower tax rates. In terms of interests of parliamentarians, many CPE scholars argue that partisanship still plays a decisive role in the outcome of redistributive policies. Center-left parties follow their voters' material interest in increasing redistribution to the bottom. I find that *interests* of political actors are much less organized around material objective logics than envisioned in these theories and that new *ideas* can become part of a formation of new interests and new political coalitions. I will show that actors' interpreta-

tion of their objective material interests changed significantly over time and argue that a new narrative in parliament influenced their ideas of policy demands.

### *Why Care About Concepts of Tax Justice?*

My dissertation investigates the conditions under which policy makers and associated interest groups who had successfully blocked tax cuts for higher incomes in the 1980s became persuaded of the new supply-side or neoliberal tax paradigm and the related shift from justice concepts from *social justice* and *ability to pay* to *universalism* and *horizontal tax justice* associated with it. Accordingly, I look into the communication of traditional opposition to such cuts within the Democratic Party, the SPD and the Green Party in Germany, as well as trade unions and liberal interest groups with groups that supported such cuts since the early 1980s, i.e. the Republican Party, the CDU/CSU and the FDP and all kinds of conservative think tanks and business groups. This kind of discourse analysis fills a research gap for the time period of neoliberal downscaling of progressivity, but it relies on a number of historical accounts which have made similar investigations for the period of the emergence of progressive income tax systems. I use this literature as a vantage point to derive the different facets of the two tax justice concepts that stand at the core of my dissertation: *vertical tax justice* and *horizontal tax justice*. I will also use this literature to argue that in both countries, the US and Germany, vertical tax justice concepts of *ability to pay* and *social justice* were the building blocks for the introduction of the progressive income tax system and modern fiscal citizenship. The fact that these concepts were replaced with the *horizontal tax justice* concept of *universalism* deserves explanation.

The principle of *horizontal tax justice* was originally developed by classical economists in the 19<sup>th</sup> century which became revived in the neoliberal paradigm. *Horizontal tax justice* is tightly linked with the concept of *proportional income tax* which in its extreme version would place an equal rate of tax on each unit of earnings, i.e. *treat* all taxpayers equally irrespective of amount or source of income. In its full consequence, proportional tax justice calls for the implementation of a flat-tax tax system under which every citizen receives the same tax rate (Atkinson 1983, 93; Scheve and Stasavage 2016, 6). The theoretical basis for proportional tax justice stems from the liberal thinkers Adam Smith, David Ricardo, John Stuart Mill and Thomas Hobbes but had already been debated in the 16<sup>th</sup> century works of classical economist William Petty. Liberal theorists argued using Hobbes' theory of the social contract that a citizens' relationship to the state was in essence a market relationship. They paid taxes in exchange for the state's provision of security and peace. Hobbes argued that taxes should be levied on consumption and not on income and property because those who work and save should not get punished (Seligman, Edwin R. A. 1908, 165; Mann 1978, 262). Accordingly, the broader application of the concept of market justice combines proportional tax justice with notions of deservingness, effort and equal opportunities and hence *meritocracy*. In

this vein, liberal theorists consider it unfair to tax individuals who contribute most to the common good. Workers and entrepreneurs who contribute through job creation, creativity and income generation deserve to keep more of their income than others. Liberal thinkers see the market as generating justice by rewarding those who put the most effort into it (Lane 1986, 386). The concept of market justice is often presented alongside arguments of economic growth theories, but these arguments are not equivalent. There is a difference between arguing that tax cuts will enhance incentives for work and saving and arguing that it is unfair that someone who works harder and saves more carries the highest burden in the tax distribution. My dissertation will show that the latter argument was much more persuasive for parliamentarians and interest groups than the former.

Both the American and the German progressive income tax systems were built on societal demands and pressures for *social justice*. The three most important concepts raised were ability to pay, compensation for the poor and equality of outcome. Though the states' need for revenue for war finance drove the general introduction of income taxes, the progressive rate structure of the tax systems resulted from the pressures of social revolutions and social reformers' demand for higher taxes of the rich. Since the French Revolution, the idea of *ability to pay* spread across European countries and to the US (Mehrotra 2014; Scheve and Stasavage 2016; Seligman, Edwin R. A. 1908). Ability to pay defines taxes as fair when citizens pay depending on their capability to generate income. It was the most important concept in the American debate of social justice in the income tax system (Mehrotra 2014, 1800). In the German debate, the concept of *compensation for the poor* was more important. Socialist theory of progressive taxation by Adolf Wagner and Hans von Scheel argued that taxation in the Reich was unfair because it was regressive. The high revenues that were collected from tariffs and consumption taxes placed a higher burden on the poor who paid a larger share of their income in consumption. The social reformers proposed that taxes should be applied beyond fiscal uses for social purposes and that progressivity should limit the concentration of wealth in large fortunes. Lower incomes should get *compensated* for the high tax burden in consumption through the progressive income tax schedule. From this theory, social reformers demanded a progressive income tax to reduce the burdens of the poor and shift them to the wealthier classes (Seligman, Edwin R. A. 1921, 136–37). Both the concept of ability to pay and compensation were intertwined with the concept of the *need* of the poor and the emergence of the welfare state. The concepts were directed at the *political sphere* as opposed to the market sphere (Lane 1986, 387). None of these concepts explicitly call for equality of outcome, i.e. the elimination of income inequalities (Cohen 2000), but they imply that the tax burden should be progressive and should tax individuals depending on their capability of generating income.

Both the American and German progressive income tax systems essentially developed as a response to the destitution caused by industrialization and urbanization, which sparked social upheavals in the mid-19<sup>th</sup> and early 20<sup>th</sup> centuries. In Germany, the Revolutions of 1848 and 1918 pressured the state and social reformers to resolve

the social question through greater *equality of outcome* and *compensation for the poor*. The German tax system was implemented after almost a decade of debate in 1919 and had a highly progressive rate structure (Beckert 2004; Seligman, Edwin R. A. 1921). In the US, the social pressures in the progressive era at the end of the 19<sup>th</sup> century culminated in the implementation of the progressive income tax system in 1913. Though the Supreme Court suppressed social movements for greater justice in American income distribution, intellectuals and progressive lawmakers brought the issue back on the agenda (Mehrotra 2014). The need for greater revenue to finance the Civil War led to the concept of fiscal citizenship which placed a great emphasis on ethical duty for the wealthy vis-à-vis the lower classes who potentially gave their lives as soldiers (Mehrotra 2005; Scheve and Stasavage 2016). The principles of social justice were deeply ingrained in both political cultures and, we will see in Chapters 4 to 7, they did play an important role in political debates in the early 1980s. Since then, their importance has faltered and this faltering facilitated the implementation of radical tax cuts for the rich.

### *My Research and Organization of the Thesis*

This thesis is interested in the fundamental involvement of ideas in reshaping the institutions of income tax progressivity. It demonstrates that existing theories of tax cuts for higher incomes place too strong a focus on objective material interests of actors in tax policy making. The theory that the efficiency of the tax mix determines governments' interest in pursuing such reforms, the theory that the production regime determines capital and labor interests in such reforms and the theory that the electoral system aligns or impairs interests of parties and societal income groups in coalitions are all based on the basic premise that actors pursue and achieve their narrow material interest within the confines of the distribution of power in specific institutional settings. Conversely, I draw on the concept of *discursive institutionalism* to demonstrate that actor interests are formed within and are confined by a dominant discourse which defines which interests are thinkable for each actor, be it administration official, opposition MP, trade union leader, business group representative or civil rights leader (Schmidt 2008). In line with recent theoretical developments in discursive institutionalism I distinguish interests which are predominantly driven by external socio-economic conditions from internally structured ideas. Despite some residual 'remote cause' which remains stable over time for each group, i.e. politicians want to get reelected, trade unions will be interested in an increase of the wellbeing of their members and business will be interested in economic success (Münnich 2010: 95), there is leeway in which these basic interests can become interpreted over time. In my theory ideas are not independent of socio-economic conditions, but socio-economic conditions offer a range of different ideas to participants how to construct a specific interest in one or the other position towards tax cuts.

I find that the formation of a dominant discourse of tax cuts for higher incomes in both the US and Germany followed two decades of naturalization of ideas around the

supply-side paradigm. The naturalization of discourse of tax cuts for higher incomes became supportable or at least hard to refute for almost any participant in the public discussion about taxation after two steps of discursive practices were firmly in place. The process of persuasion of a critical mass of actors in policy making started with a new interpretation of the crisis within the new supply-side paradigm in which the discursive interaction of policy makers and the epistemic community played a central role and mostly cognitive ideas of economic growth were subject to change. In a second step, administrations had to develop a new normative narrative of horizontal tax justice by *discrediting* government involvement in the economy, *incorporating* compensations for lower incomes and *moralizing* supply-side economic growth with new concepts of horizontal tax justice (see Table 2 for a summary). In both cases, Germany and the US, these four acts entirely restructured the way policy makers, experts and interest groups interpreted the policy options to economic growth and the viability of social justice within the new supply-side paradigm until the early 2000s. My thesis shows that the new interpretations crucially helped building a new paradigm that was both cognitively and normatively coherent and persuasive to many groups in society. Despite this similarity of idea formation, ideas were not entirely independent of the conditionality of the specific socio-economic background in the two countries. Each political economy created specific economic problems and specific institutional and cultural solutions which were contextually embedded despite following a similar overarching pattern of change.

In the process of *discrediting*, American policy makers capitalized on the traditional anti-tax and anti-government sentiments in American culture with which the *theory of public choice* resonated nicely. Public choice was very effective in discrediting the center-left's demands for *ability to pay* and claiming that the associated support groups, the trade unions, were particularistic special interests. As a response, the center-left replaced trade unions as witnesses in hearings with analytical research institutes which were seemed more suitable to represent *universal* societal interests. In Germany, the process of *discrediting* was embedded in the German traditions of Christian social thought and concepts of *subsidiarity* which highlight the freedom and responsibility of the family and rejects too much involvement of the state. These concepts became particularly powerful in times of reunification and the West-German values of freedom in the systems competition of liberal democracy and the real socialist GDR regime. Over time, these concepts inspired the SPD to cease inviting small unions and radical civic groups to hearings and replaced them with umbrella organizations which were more conducive to a common goal of economic growth over social justice.

In the second discursive step, conservative governments filled the normative void with new concepts of tax justice. They *incorporated* material compensations demanded by the center-left into their policy plans, including greater concentration of tax cuts on small firms in the US and the *Mittelstand* in Germany and a greater compensation for the poor through tax allowances and tax credits in both countries. After the partial integration of those demands, policy makers from the center-left and labor unions lost their verve for protesting the plan. The third strategy was a *moralization* of supply-side tax

cuts with the normative concepts of *horizontal tax justice* and *market justice*. The German Social Democrats explicitly built on concepts of a just market when raising John Rawls' *fairness concept*. They argued that tax cuts generated fairness by including the least well-off in German society in the market and giving them the opportunity to find employment in corporations. Additionally, German policy makers adopted a theory of post-industrialism from sociologists and the international Third Way movement for modernization of the German economy. In the US case, policy makers also argued on the basis of market justice by raising the *American Dream ideology* within which tax cuts for small firms gave every American citizen greater chances to become a successful entrepreneur in the product market. *Universalism* in tax cuts also played an important role in the moralization of the tax cuts for higher incomes in the US.

The methodology most suitable to grasp complex social processes of idea formation, which on the one hand demonstrates *similarity* in the overarching mechanism of change, but is simultaneously equipped to contextualize the mechanism in the local embeddedness of *different* national cultures, is the case study approach of 'parallel demonstration of theory'. My adaptation of this approach begins with an explicit outline of a theory of *discursive institutionalism* and the relevance of ideas in the formation of interests and coalitions for tax cuts for higher incomes. What follows, is a demonstration of the theory's fruitfulness over and over again in each of the case studies presented. Even though the practices of persuasion used by administrations to convince the opposition and important interest groups of the new paradigm and its normative embeddedness follow similar patterns, the phenomenon of idea formation will take different shapes depending on national cultural and political contexts. My goal is to contribute to a better understanding of the formation of *persuasions* and how these guide and inform the evolution of objective material interests of different policy actors in the new paradigm. In order to demonstrate that existing tax research does not sufficiently explain institutional change, my empirical approach will alternate between laying out the existing theoretical explanations based on material interests, will show in which cases theories cannot sufficiently explain empirical outcomes and will demonstrate how adding a layer of idea formation will fill in the blanks. My case studies will highlight those events in which existing theories of objective interests, institutional configurations and economic efficiency cannot sufficiently explain the beliefs, ideas and interpretations voiced by actors or when ideational change is not matched by objective material change.

In order to investigate which concepts were used in the policy process and whether or not these ideas did have an influence on the outcome of tax reforms, I conducted a content analysis of policy debates for four reforms. These four reforms had similar goals in reducing the taxation for top incomes and corporations and shifting the tax burden to lower incomes, but only two of them succeeded in doing so: the 2001 tax cut by George W. Bush and the 1999/2000/2002 reform by Gerhard Schröder. The Reagan reform of 1981 was partially reversed in its distribution effects and Kohl's reforms were impaired by the pressure of the opposition and factions of his own party. In

all reforms, the respective government lacked the support to pass the reform right away in parliament/Congress, which is why ideational coalitions became such a powerful tool for policy makers. In three of the four cases the government did not hold a majority in parliament. This was the case for Reagan and Bush who depended on Democratic support in Congress and the Senate. The same was true for the Social Democrat Schröder who depended on the support of the center-right's opposition. Only the conservative chancellor Kohl had a majority in both Houses. However, he faced a renegade laboring, and therefore had to strike deals with the Social Democrats.

I begin each case study with an analysis of the specific macroeconomic crisis which respective administration encountered and show that this changing external macroeconomic context cannot alone explain why policy makers opted for a cut in the top personal income tax rates. I present statistical data and interpretations of policy makers and experts to demonstrate that the external economic conditions inspired a variety of ideas and interpretations of interest in this new economic setting. This outline of a variety of solutions to the economic problem is followed by several sections which analyze the formation of tax cuts for higher incomes. The first section looks into the influence of the formation of coalitions in support on the evolution of specific features tax cuts in Congress and the Bundestag. This section will demonstrate that partisan interpretations of their own interests changed over time especially among MPs from the center-left and how this changing interest affected the outlook of the tax reforms. In step three and four, I will show the relevance of epistemic communities in the formation of new policy narratives and how these new narratives were translated into new policy programs. Step five finally shows under which conditions a new policy narrative translated into new ideas in policy debates in the Bundestag and Congress.

This dissertation is structured as follows. The next chapter will introduce the existing academic literature on neoliberal tax cuts. In Chapter 3, I will describe the methodological basis for my dissertation. Chapters 4 to 7 display my empirical analysis of tax justice concepts for each case. I begin with Ronald Reagan who is generally portrayed as the most radical proponent of supply-side tax cuts. I show how Reagan's supply-side arguments caused protest among parliamentarians and interest groups. I continue with George W. Bush's tax cuts in Chapter 5. Bush was highly successful in generating a normative inclusionary approach of morality of markets and brought one of the most radical tax cuts through Congress. In the German case, I begin with Helmut Kohl's reform which was much smaller than Gerhard Schröder's. Though Kohl embedded his proposal in a normative frame of market justice, the dominant discourse of social justice was too strong to allow for large redistribution to the top. Schröder's theory of universal justice and inclusion of the poor into the labor market was more persuasive. Aside from the hermeneutic analysis in each chapter, I provide a quantitative table by the end of the Bush and the Schröder chapters which compares the frequency of arguments over time. The empirical chapters are followed by a conclusion which summarizes the effects of normative arguments in tax cuts at the top and highlights the theoretical implications of my findings.

Table 2 - Process of Formation of Discourses

	<b>Ideas</b>
<b>Cognitive</b>	- Epistemic community offers new growth theories of supply-side to solve an economic crisis through incentives to work and save to enhance capital formation (supply-side) and unemployment (supply-side and ordoliberalism)
<b>Discredit</b>	- Administration uses public choice (Reagan) and Christian principles of subsidiarity (Kohl) discredit particularism as special interests
<b>Incorporate</b>	- Administration offers compensation for lower incomes in the form of loophole closing and larger tax credits - Support small-business economy which promises jobs and market access for everyone
<b>Moralize</b>	- Administration reframes tax cut under the normative terms of universalism; everyone gains a share in the tax cut (US), uses Rawls' principle of difference and post-industrial theories to argue for an inclusion of the poor in labor markets (DE)



## 2 Explaining the Emergence of the Supply-Side Tax Paradigm

Scholarship on supply-side tax cuts thrives in historical studies and the social sciences and provides various explanations of the logic of paradigm shifts in tax policy. This literature largely tries to explain the emergence of neoliberal or supply-side ideas and its effects on Keynesian demand-side policy and the viability of welfare states in Europe and the North America. There are four principal analytical schools of thought which can be distinguished in the tax reform literature. The first three respectively emphasize the impact of the state's dependence on capital, power resources and electoral institutions. While each of these literature traditions gives useful insight into the logic of paradigm shifts, they place too much emphasis on objective material interests of actors. In each of the three research strands political actors are theorized to adopt stances towards tax cuts for higher incomes on the basis of externally defined interests within economic and institutional structures. Policy makers adopt neoliberal policies because they enhance productivity; because powerful business actors need to be served to get legislation through Congress or because electoral institutions structure conflicts and consensus among different societal groups which benefit materially from certain tax cuts. Convincing parliamentarians and interest groups of the program – especially those who traditionally were in opposition to these policies – does not always follow the logic of objective interests. Conversely, I will argue that interests are formed within a structure of normative ideas which become persuasive when policy makers are capable of creating a coherent framework of cognitive and normative ideas.

This chapter is organized as follows: I will first describe the analytical claims and empirical findings of each existing theoretical perspective and outline what my dissertation has to add to their arguments. I will proceed from the analysis of structure to institutions and finally debate discursive approaches which are most interesting to my thesis.

### 2.1 State Dependence on Capital

The origins of tax policy research lie in the field of theories of the dependence of the state on capital which have transformed since the mid-20<sup>th</sup> century into approaches of tax competition. Scholars in this tradition developed rather functionalist theoretical mechanisms which focus on objective material interests of the state and capital. The baseline argument is that the state implemented economic policy which grants high employment rates and high productivity rates in order to serve its intrinsic interest to get voter support and to collect high levels of tax revenue. Such efficiency enhancing policies could be observed especially since industrial economic conditions deteriorated since the 1960s and capital owners demanded lower costs of production through cor-

porate and income tax reductions. Tax competition theories have developed highly valuable insights into the macro-causal correlations of economic crises and tax cuts for higher incomes since the 1980s, however, the overly functional approach to tax reform leaves the black box of policy maker options to tackle economic crises relatively closed. I will argue that the economic crises provided an initial impetus for tax policy change, but am interested in how alternative ideas of economic betterment were rejected in the process of idea formation.

The origins of tax competition literature go back to capital dependence theories which originated in the 1950s and 1960s. Scholars in this tradition argue that the state was structurally dependent on economic development and capital accumulation and depended on tax revenue collected from profits of firms and income of individuals. In order to foster capital accumulation, the state had to implement reforms that raised the return on capital. This included reduced corporate taxes and top personal income tax rates to incentivize capital owners to invest in new production sides, machinery and jobs (Kalecki 1943; Lindblom 1977; O'Connor [1973] 2002, 40–41). Capitalist state theorists argue that during postwar Atlantic Fordism dependence was temporarily offset by political economic regulation that shielded manufacturing economies from international markets. Because Keynesian demand stimulation was built on domestic mass consumption and policy makers were able to politically choose between inflation and unemployment, labor had a strong bargaining position. Marxists argue that this structural configuration gave rise to labor demanding higher wages and higher living standards and enabled the expansion of welfare and redistribution (Jessop 1999; Jessop 2003; Jessop 2012; O'Connor [1973] 2002).

With the waning post-war consensus, capital dependence intensified and new contradictions emerged. When industrial productivity declined after the postwar boom and stagflation diminished capital's returns to profit, the state had to solve incommensurable contradictions in the field of tax policy. The need to reduce taxes created a *Fiscal Crisis of the State* (O'Connor [1973] 2002) due to the contradictory developments in late capitalism of diminished returns to profit and increasingly proletarianized societies. The state needed revenue to engage in complementary societal tasks like public employment and social security funding to protect capitalism from its own destructive forces (Boyer 1990; Jessop 2012; Offe [1972] 2006; Offe 1975; Offe 1982). At the same time, revenues were increasingly under threat through deindustrialization and investment strikes of manufacturers (Streeck 2011).

Capital dependence theories inspired a thriving body of *Globalization literature* during the 1990s which tried to show the negative effects of tax competition on the welfare state. They argued that increasing economic integration curtailed the ability of governments to finance social security and that redistribution could not be maintained at the levels of the golden age of welfare spending. Quantitative studies showed that trade integration and reduced capital account restrictions correlated with tax rate reductions on corporate income (Genschel 1999; Dehejia and Genschel 1999; Mishra 1990; Rodrik 1997; Sinn 1990; Tanzi 2002; Winner 2005). Additionally, qualitative studies suggested

that the reductions in the American corporate tax rates and income tax rates in the early 1980s led to capital flight to the US (Tanzi 2002; Wagschal 1999, 224) and sparked a domino effect of corporate, capital gains, dividend and inheritance tax reductions across the Organization for Economic Co-Operation and Development (OECD). In order to finance the revenue loss, governments shifted the tax burden increasingly to indirect taxation, i.e. consumption taxes, social security contributions and taxes on labor income (Scharpf 2000, 201; Ganghof and Genschel 2008; Genschel 1999). Scharpf (2000, fn. 14) explained that this was particularly the case when consumption taxes like the value added tax were collected in a system of country-of-destination taxation, i.e. when exports remained untaxed but imports were taxed with the local VAT rate. While Scandinavian and continental welfare states defied tax reductions by lowering wages in export sectors, this ability was exhausted in the early 1980s when neo-corporatist institutions fell apart (Scharpf 1991, 147, 249; Streeck 2014, 22). Others analyzed the specific pressures that European integration put on national governments to reduce taxes. The deep market integration in the Single Market and the European Monetary Union eliminated almost any cost for capital exit and pressured governments to reduce taxes on investments (Ganghof and Genschel 2008, 58; Sinn 1990).

Newer empirical studies of globalization's effects on tax systems from the 1990s reported that the pressures on systems of redistribution did not result so much from corporate tax reductions and ensuing revenue losses, but more from shifts in the tax burden from the top to bottom. Many governments had simultaneously cut corporate tax rates and broadened the tax base, i.e. closed loopholes. As a consequence, the rate of taxation of corporations remained relatively stable, as did the share of corporate tax revenues (Genschel 1999). However, states had nevertheless reduced redistribution by increasing their value added taxes (VAT) and social security contributions (SSC) which were mostly carried by low income groups (Genschel 2002; Genschel and Schwarz 2013). Qualitative case studies traced how governments had complemented corporate tax cuts with reductions in the top personal income tax rate to keep the corporate incomes taxes' (CIT) backstop active, i.e. the barrier for individuals to transfer their incomes into the legal realm of firms to save taxes (Auerbach and Slemrod 1997; Genschel 2005; Ganghof and Genschel 2008; Wagschal 1999). Recently a group of economists was able to calculate the quantitative shifts in the tax burdens which resulted from the top personal income tax reduction and the increases in social security and consumption taxes (Bach, Corneo, and Steiner 2014; Corneo 2005, 159; Piketty and Saez 2007, 7). The average top rate of income taxation across twenty OECD peaked in 1950 at 64 percent (Scheve and Stasavage 2016, 197). Since 1982, taxation of the top incomes had steadily declined with the OECD average dropping to 37 percent in 2010 (Scheve and Stasavage 2016, 197).

The largest shifts in tax redistribution have taken place in the US, where a very effective tax rate of 75 percent on the top 0.05 percent of incomes in 1960 was reduced significantly by 2003 when top incomes only paid 35 percent (Piketty and Saez 2007, 3, 12). But a similar trend was reported for many other OECD countries. In the UK the

tax shares of the 0.05 percent highest incomes dropped from 69 percent to 35 percent from 1970 to 2000 (Piketty and Saez 2007, 17). In Germany, the effective average tax rate of the top 1 percent dropped from 34.8 percent to 30.8 percent since 1992 (Bach, Corneo, and Steiner 2014, 130). Even Scandinavian countries cut progressivity significantly. Swedish governments reduced the average tax on the top 0.1 percent from 70 percent to 40 percent since 1978 (Bengtsson, Holmlund, and Waldenström 2012, 15). Lower and medium income earners paid increasing levies on their labor income and consumption. Average American payroll taxes increased from 7.2 percent in 1970 to 11.5 percent in 2004 with similar trends in other countries (Bengtsson, Holmlund, and Waldenström 2012, 26; Piketty and Saez 2007, 18–19).

Today, the correlation between economic integration and tax cuts for corporation and top incomes has been convincingly shown by many studies. However, scholars interested in the formation of ideas and policy paradigms have questioned the Bayesian concept of policy learning that this approach applies. Can policy makers really objectively grasp economic realities and rationally update economic policy according to economic change and is tax cutting really the most efficient way to counter the decline in productivity growth (Blyth 2002; Blyth 2013; Blyth and Schmidt 2010)? With its mostly quantitative approach, tax competition literature interprets the correlation of external economic pressures and tax cuts for corporations and top incomes as causal. However, the ex post analysis does not tell us anything about which kind of alternative ideas have been presented to policy makers as economically viable and under which conditions policy makers increasingly opted for reductions in top personal income tax rates.

My analysis of idea formation in the area of tax cuts for higher incomes will show that those external economic pressures that tax competition literature describes are necessary for institutional change, but not sufficient. External economic pressures on tax systems can always only create a first *impetus*, a trigger, for institutional change but they cannot determine how policy makers interpret the crisis in terms of policy recommendations and how they eventually construct economic reform. We will see in the four case studies that the *same* economic indicators of rising sovereign debt, unemployment and inflation have spiked a plethora of *different* interpretations of which economic policy remedies had to be employed to the crisis among policy makers. The remedies ranged from industrial policy, to subsidies to specific sectors, to stimulation of consumption, to tax cuts for corporations and tax cuts for higher incomes. Tax competition theory cannot explain why under similar economic pressures, policy makers would find different policy solutions attractive. Only when adding the layer of idea formation to these scenarios can we truly understand why policy makers opt for different reforms under similar economic pressures. Equally interesting are moments in which policy makers hold on to a policy solution which has failed to resolve the same crisis in the past. We must doubt policy makers' ability to *policy learning* when we look at incidents at which they stuck to the remedy of neoclassical supply-side tax cuts to *reduce* sovereign debt, despite having learned in the past that tax cuts *raise* the level of sovereign debt.

## 2.2 Power Resources of Societal Groups

*New Institutionalism* has criticized globalization literature for the power it ascribed to economic integration processes on national regulatory systems. Or as Pierson put it, they rejected the “economic determinism” of globalization theory (Pierson 1996, 143). Institutional accounts of tax reform analyses can be differentiated into power resource, state-centered and institutional feedback literature depending on their emphasis of societal groups, state actors and societal values respectively. What all these approaches have in common is that they stress the context in which policy decisions are made and that they question the ability of fully informed rational decision making (Orloff 1993, 42). This focus however had the practical consequence that institutionalists have searched for the *differences* in policymaking across nations. Accordingly, this body of literature emphasized the three worlds of exceptionality and divergence. On the right-hand side of the institutional continuum, *American exceptionalism* portrays residual welfare provisions complemented with dynamic and radical tax cuts. On the left side, *German or Swedish exceptionalism* portrays the unchangeable nature of broad welfare provisions and resilience in tax redistribution.

*The Power Resource* or *social democratic approach* revolves around considerations regarding the power of the working class. The emergence and size of welfare provision and redistribution is determined by the “balance of class forces” of capital and labor (Orloff 1993, 59). Initially, power resource theory explained the emergence of welfare state regimes, but since the 1990s this theory tradition was reversed to explain welfare state retrenchment and, maybe even more importantly, the lack of it. The underlying *logic of collective action* can be summarized as the idea that the least well-off individuals in a society organize in unions and political parties to collect and disseminate information, form a class-related political will and organize material resources through strikes and pressure on government parties (Olson 1971). Only through these resources can labor keep the omnipotent influence of business in check (Boix 2003, 13). Walter Korpi posited that capitalists clearly have greater power in the market, but labor has resources in the polity through rights of voting and organizing. Thus labor or left voter interests that find manifestation in trade unions or left parties have greater influence in centralized corporatist parliamentary systems than individual voter interests in pluralist societies (Korpi 1978; Korpi 1983).

Similarly, *compensation literature* developed in explicit opposition to competition theory, argued that Keynesian demand stimulation and redistribution were still viable policy options. Research in this tradition pointed to the surprising degree of *resilience* in corporatist and Social Democratic welfare institutions. As globalization and deindustrialization worsened the income and employment risks for the left’s main constituency blue-collar workers increased. As a consequence governments spent more in welfare and countercyclical demand stimulation financed by higher capital taxation and deficits. Thus, the combination of left partisanship and globalization pressures led to increases in the levels of capital taxation (Cameron 1978; Garrett 1995; Katzenstein 1985). Leftist

policies were even economically efficient because neo-corporatist institutions could moderate wage increases in exchange for redistribution (Garrett 1995, 670). This way, Social Democrats could use macroeconomic steering and yet keep inflation tendencies and interest rates low (Alvarez, Garrett, and Lange 1991; Bradley et al.). Quantitative studies in this tradition showed that there was no clear evidence for retrenchment (Swank 2003; Swank 2010) and that there was a high correlation of redistribution and left governments in the OECD world from the 1960s through the 1990s (Garrett 1998; Garrett and Mitchell 2001; Huber, Ragin, and Stephens 1998).<sup>1</sup> Comparative studies indicate that Social Democratic or corporatist policy regimes still reduced market inequities without negatively affecting economic growth (Kenworthy and Pontusson 2005; Wilensky 2002). For Scandinavian economies it was shown that the formal institutions of collective bargaining were still in place (Kenworthy 2001; Wallerstein, Golden, and Lange 1997) and tax revenues in OECD countries had prevailed at their post-war peak level (Huber and Stephens 2001).

With the emergence of the Third Way or New Labour policies during the 1990s, most power resource studies shifted their focus from explaining resilience to explaining retrenchment. Left governments headed by Bill Clinton, Tony Blair and Gerhard Schröder implemented free-market policies including flexibilization of labor markets, activation of the unemployed, welfare spending cuts and tax cuts for corporations and top incomes. Recent quantitative studies showed that, since the mid-1990s, left partisanship was no longer correlated with tax and spending increases (Busemeyer 2009; Huber and Stephens 2014). Power resource theorists argued that corporatist or Social Democratic countries *incrementally* adapted to market pressures and that the power structure of capital and labor had changed significantly in all advanced capitalist democracies (Streeck and Thelen 2005b; Streeck and Thelen 2005a; Streeck and Thelen 2005a). Union power had significantly declined, industrial strikes had practically ended in the 1980s and union member rates fell across the OECD (Thelen 2012; Streeck 2009). The power of business vis-à-vis labor had increased accordingly. Though the largest effects of this shift were felt in the US, where the pluralist political system was particularly permeable to business lobbying, shifts in power were seen in many other countries (Gilens 2005; Hacker and Pierson 2010; Hacker and Pierson 2005a).

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<sup>1</sup> The firm-centered *Varieties of Capitalism* literature arrives at a similar theoretical conclusion as compensation literature does but argues that social protection emerged from business' power and not its weakening. Welfare institutions complemented industrial relations and gave a competitive advantage to firms. Thus, greater economic integration led to divergence in different systems of production because businesses benefitted from education and infrastructural expenditure of the state as well as social security of workers which cushions worker's risks. As a consequence redistribution increased in coordinated market economies (CMEs) and is reduced in liberal market economies (LMEs) (Cusack, Iversen, and Rehm 2006; Iversen 2001; Iversen and Soskice 2009; Paster 2013; Soskice and Iversen 2006). The introduction of income taxes in 19<sup>th</sup> century Europe was not a function of electoral enfranchisement but the need for infrastructure, public health and education and was often enacted against reformer interests in parliaments (Mares and Queralt 2013; Mares 2006).

Power resource literature also reported that the decline in union power had negative effects on electoral politics. Electoral turnout rates and other forms of political participation declined with lower union influence and coverage (Schäfer 2010). More specifically, this literature showed that deindustrialization changed the composition of union membership, which led to a *dualization* of political participation. From 1980 to 2010 the share of workers voting left declined by about 50 percent in northern and continental European countries and even more in the UK (Gingrich and Häusermann 2015, 50). A number of quantitative studies found a relationship between the decline of worker representation and the decline in redistribution (Boix 2003; Häusermann and Schwander 2012; Kenworthy and Pontusson 2005; Rueda 2008).

Even though most power resource scholars today agree that redistribution was reduced in many OECD countries under the new power relations of labor and capital, the *New Politics of the Welfare State* qualified this statement by arguing that retrenchment was still much more restrained than envisioned by competition theory. Paul Pierson famously argued that power resource theory could not reverse the logic of the growth of the welfare state into a retrenchment theory because different political logic applied. Welfare state expansion was popular and allowed for *credit claiming*. Retrenchment, on the other hand, was generally unpopular and had to endure the pressures of organized interest groups. Thus, cutting welfare followed the political logic of *blame avoidance* and was significantly restrained (Pierson 1996, 143). Even Reagan and Thatcher had been unable to dismantle British and American welfare the way they wanted.

Scholars in the tradition of power resource theory have been interested in looking into the combined effects of external economic pressures and the mitigating effects of domestic institutions. Despite trying to move beyond efficiency pressures of economic integration on taxation and an attempt to open up the black box of domestic institutional specificities moderating such efficiency pressures, tax changes in this theory are still predominantly driven by objective material interests of capital and labor. Capital interests play a similar conceptual role in power resource theory as in tax competition approaches. Capital is interested in low costs of production which can be achieved by either low taxation or low wages. Tripartite or corporatist institutions, such as the ones which structured the German political economy, are considered to limit efficiency pressures on redistribution by wage moderation.

Even though tax cuts at the top of the income distribution were impaired by a consensus of capital and labor in the German corporatist system of coordination in the 1980s, this consensus was crucially dependent on idea formation of the interest groups invited to hearings at the time and those interpretations of interests by the social partners changed over time and set in motion radical institutional change in the German system of redistribution. In the 1980s, manufacturers and crafts business groups weighted the gain of tax cuts for higher incomes for small businesses which filed their tax as individuals against the collection of subsidies financed by tax revenues of the state and thereby entered a coalition with those sectoral trade unions which believed that subsidies would help job creation within these firms. Those interpretations of in-

terests in taxation changed radically over time and with them the effect of German institutions of collective bargaining. In the 2000s, German industrial business groups and trade unions reinterpreted their interests in tax cuts for higher incomes arguing that economic growth and employment could only be reinvigorated by a reduced rate of revenue collection. I will show that the emergence of beliefs in modernization stemming from the Third Way movement and post-industrial thought shifted the focus of policy makers and interest groups away from state involvement into the German industrial economy towards tax cuts for productive resources.

### 2.3 Constitutional Embeddedness

Approaches of constitutional embeddedness sketch the pathdependent effect of historical power relations from the 19<sup>th</sup> century implementation of constitutions to today's changes in tax systems. Like power resource theorists, scholars in this tradition highlight how different institutional configurations in Germany and the US generate specific policy maker interests in tax cuts. In the conflictual American political economy, policy makers are more likely to implement radical tax cuts because they will be rewarded by increasing vote shares which is not the case in Germany. First, radical tax cuts are less likely in a political system which predominantly governs in coalitions. Second, large welfare states like the German generate protest coalitions against tax cuts for higher incomes. Both theoretical mechanisms provide interesting descriptions of coalition formation for tax cuts in different political systems, however, once we open the black box of idea formation in the area of tax cuts, we find that partisan conflicts on the ideational level were much more fluid across electoral regimes than constitutional embeddedness envisioned. I argue that persuasive beliefs about how to promote economic growth and justice were more important than the institutional embeddedness of political interaction.

*State-centered institutionalism* stands in opposition to functionalist Marxist assumptions that the state is a mirror of the power relations in civil society. In *Bringing the State Back In* Theda Skocpol and her collaborators argue that the state has autonomous power in creating new coalitions of societal actors and thereby maintains its own power (1979). The emergence of welfare states is understood as an element of modern state building which is partially autonomous from the influence of societal groups (Clemens 1993; Clemens and Cook 1999; Hall 1993; Campbell 1998). As opposed to power resources, the state-centered approach predominantly looks at constitutional structures and its path-dependent institutional effects on interest group influence. Tax reforms are guided by three important variables: patterns of governance and rules of electoral competition, patterns of tax systems and voter coalitions across class lines.

One of the institutional approaches is the *veto-player approach* which argues that specific constitutional veto points may inhibit policy change. Immergut (1990) and Tsebelis (1995) argued that direct democratic instruments, federalism, bicameralism, strong party

competition and a constitutional court were particularly powerful veto points. As veto points disperse the power of the state among a number of actors, they inhibit radical reforms in parliamentary systems (Huber, Ragin, and Stephens 1998). During the 1990s scholars used this theory to explain the European resilience in redistribution. They looked at single case studies and concluded that the consensual German system was particularly reform resistant as the bicameral federal system forced the governing party to integrate the interests of the coalition partners and the opposition if it dominated the upper house, the Bundesrat. This was proven in 1997 when the governing party, the CDU, could not pass their neoliberal tax plans, the *Petersberg Plans* (Wagschal 1999, 231). Another obstacle to reform was the constitutional court which enforced horizontally equal tax burdens on all forms of income (Ganghof 2004).

The *Three Worlds of Welfare literature* argued that voter loyalty and cross-class coalitions potentially inhibited welfare cuts. Scandinavian and continental decommodification remained relatively stable because the middle classes benefitted from welfare. Group affinity and racial homogeneity in welfare spending structured the welfare support of citizens. Scholars showed that the encompassing, universal nature of Scandinavian welfare created a coalition of the lower and the middle classes supporting welfare, as both income groups benefitted from basic and earnings-related security. This was also the case with the German social-insurance system, but not for American targeted liberal welfare. Even today, shared class norms manifested themselves in sentiments of social citizenship and demands for redistribution in Scandinavian countries (Esping-Andersen 1990, 167; Korpi and Palme 1998, 674–75).

From the three worlds of welfare scholarship, comparativists developed a theory of *tax mix* which is the most intricate approach when it comes to analyses of changes in taxation across countries. Scholars argued that fiscal policy trajectories in the different electoral and tax systems were “locked-in” since the introduction of income tax systems with franchise extension, war finance and the Great Depression during the 19<sup>th</sup> and early 20<sup>th</sup> century (Lindert 2004). In the post-war period of welfare growth Scandinavian and continental European welfare states flourished on revenue mainly collected from regressive value added taxes. Such a welfare expansion had been blocked by capital interests in the US where welfare was financed with highly visible and progressive taxes on income and property (Prasad and Deng 2009; Wilensky 2002). Whereas the European systems enabled welfare expansion due to the high revenue generation of regressive taxes, the American welfare system remained residual. Taxes on income and capital distorted market activity and aggravated conflicts among the lower and the middle classes (Lindert 2004, 178). It was expected that the efficient regressiveness in Scandinavian and continental tax system inhibited neoliberal reforms in European countries (Hays 2003; Prasad 2006; Prasad and Deng 2009; Prasad 2012a; Swank 2002).

Cross-class voter coalitions also played a central role in *Historical Institutionalism*, which based its basic premises on the power resource and compensation theories of authors like Peter Katzenstein, but tried to embed their theory in an historical institutional context. Historical Institutionalists argued that institutions are not only relevant

in the power distribution of actors but also shape the preferences of parties, interest groups and bureaucrats. Drawing on Arend Lijphart's account of *Patterns of Democracy* ([1999] 2012), scholars argued that certain electoral institutions shape the structure of decision-making processes as they help bring to life coalitions and party consensus (Steinmo 1993, 8). In proportional electoral systems, political power was dispersed through executive power sharing, multiparty systems and corporatist forms of interest intermediation, and created a high degree of consensus in coalition governments. Corporatist cases such as Germany and Sweden provide examples of this, in which a conservative oligarchy implemented a proportional electoral system at the turn of the century in which the majoritarian influence remained low and labor and capital interests were embedded in industrial bargaining institutions. The result was that the tax system remained regressive, with low taxes on capital, and collected the majority of revenue from the working class as a form of within-class redistribution (Steinmo 1993). Universal welfare spending in these countries led to solidarity among the middle and the lower classes and prevented neoliberal reforms in Germany and France (Prasad 2006; Steinmo 1993; Steinmo 2002). The conflict lines in the majoritarian Anglo-American system were more pronounced and the power of the left in the post-war period produced highly progressive taxation (Crepaz 1998; Hays 2003; Lindert 2004; Merkel et al. 2008; Steinmo 1993). The high progressivity and targeted welfare created conflicts among the lower and middle classes which made the system more prone to retrenchment and tax cuts since the 1980s (Hays 2003; Prasad 2006; Prasad and Deng 2009).

Institutional approaches explain different outcomes in tax reforms under globalization pressures with differences in societal coalitions that emerge from tax mixes, electoral institutions and corporatism. Such macro-causal understanding of institutional change rests upon the assumption that political actors formulate policy goals on the basis of their own objectively defined material interests and the material interests of societal groups. It is assumed that the American middle class is more prone to support tax cuts for higher incomes because they do not immediately benefit from welfare spending. It is also expected that American policy makers are aware of this middle-class preference and exploit it accordingly to gain higher vote shares. These objective stances of interest have been questioned by recent theoretical and empirical approaches which grant idea formation a greater autonomy from external socio-economic conditions than expected by these institutional approaches. For instance it has been shown that altruistic sentiments among the middle classes may incite them to support welfare spending for lower income groups even though they do not individually benefit from them (Anderson 2001).

By opening the black box of idea formation among policy makers, we will be able to see that in times of political change, policy makers debate a number of alternative approaches to solve an economic and political problem and to achieve their basic material interests. A crisis of declining vote shares for instance, opened up a variety of program alternatives to policy makers which were genuinely debated among party members and parliaments. The decision to choose the path of modernization, i.e. tax cuts for higher

incomes, over traditionalism, i.e. redistribution, of the left often originated in experts providing convincing *interpretations* about the future developments of the economy and justice and not just economic developments as such. In Germany for instance, the Social Democratic Party was elected to reinstate welfare provisions that had been cut by the previous administration. Only after sociologists and economists repeatedly reminded policy makers that industrial employment and industrial voting could not be revived, did the government and its allies turn their backs on traditional solutions to the political crisis. By discrediting state involvement in the economy, by incorporating compensations for the losers of tax reforms and by moralizing justice solutions within markets did administrations create new coalitions of support. It seems that the embeddedness actor interests within institutional frameworks can be transcended by new interpretations of such interests.

## 2.4 Authority of Experts

*Discursive Institutionalists* argue that there is no such thing as an objective material interest or functional adaptation of interests to material and institutional changes. Researchers in this tradition developed a critique of the existing institutionalist reasoning which to them had an overly rationalist approach to human reasoning. Peter Hall used the concept of *focal points* to explain how ideas influence economic policy choice. Focal points determine an array of potential policy options with pareto-optimal outcome and cooperative effects on societal groups. Policy makers were able to determine which options were viable and to choose one of these equally feasible options (Goldstein and Keohane 1993, 12). Hall also introduced a theory of *Policy Paradigms* based on Thomas Kuhn's ideas of scientific advancement. Here, expert ideas and academic theories become central to policy making. New paradigms enter policy making processes in times of discontinuity or crisis in which a "policy window" opens up. A new policy paradigm gains authority through the failure of the old policy framework, its intellectual coherence and success in experiments (Hall 1993, 279–80; Kingdon 1984, 201–3). One theory will supersede another theory because it provides a better solution (Hall 1989, 8–9).

This approach has been criticized by two research strands which are equally interested in ideas but reject the notion of objective and rational policy options. Both expect ideas to have a greater autonomy in the policy process. The power driven ideational approach has argued that a minority project can get turned into a majority project when capital interests for greater financial revenues is supported by a greater conservative ideology and credible policy actors. A number of studies have dealt with the impact of business investing in institutions which disseminated supply-side economic theories. Business-financed think tanks issued books and articles to influence public sentiment and helped bring to life supply-side ideas and anti-government ideals among policy makers and the public (Blyth 2002; Jabko 2012; Hacker and Pierson 2005b; Hacker and Pierson 2010; Mizruchi 2013, 149, 157; Mudge 2008).

The other research strand that emphasized ideas places a greater weight on culture. These scholars take into account the Weberian notion of *worldviews* or *frames* and ascribe a greater autonomy of ideas from power relations in policy paradigms. Scholars in this tradition have argued that objective rational decision making does not exist because “ideas are prior to interests” (Gofas and Hay 2010, 24). For this reason, power relations and the institutional context do not determine ideas or interests beforehand. At the same time ideas are *embedded* in the structural, cultural and institutional framework. Actors use ideas - subjective ascription of meaning - as instruments to understand objective socio-economic structures (Gofas and Hay 2010, 24; Münnich 2010, 61). As a consequence, the same economic transformation can be perceived differently and the “re-birth of the liberal creed” is structured by the cultural and institutional context. It is “socially constructed through the mediation of national institutions and culture” (Fourcade-Gourinchas and Babb 2002, 536).

## 2.5 Discursive Power of the State

So far tax research that is interested in the effects of ideas on policy making has focused on the authority of economic experts, think tanks and interest group in convincing policy makers to adopt a new paradigm. Even though this literature made crucial contributions in understanding *epistemic discourse* between economists and administrations, we still know relatively little about the *coordinative discourse* among administrations and parliamentarians. My dissertation strives to explain which kind of narratives persuaded parliamentary representatives of tax cuts. I argue that administrations were most successful in passing tax cuts when they developed coherent narratives of economic growth and normative justifications. I argue that a shift in the dominant discourse from one paradigm to another crucially depends on the government’s ability to convince parliamentarians normatively of the new paradigm and these normative ideas often originated from thinkers outside of the economics profession. More important for the normative foundation of tax cuts were sociologists, political scientists and political theorists.

Radical tax cuts were subject to significant resistance in the 1980s when the majority of parliamentarians believed in the moral concepts of social justice which created a coherent synergy with Keynesian policy making. At that point in time, supply-side oriented policy makers which tried to shift the paradigm relied heavily on the supply-side theory which had no strong moral embedding at the time. Cognitive growth arguments did not suffice to convince parliamentarians, trade unions and civic groups of the neoliberal tax program. It took until the early 2000s that policy makers developed a convincing argument for tax cuts which integrated economic growth and justice. Administrations were then able to *discredit* redistribution as political and particularistic with a rival normative concept of universalism in a common good, *incorporate* some of the social values of the opposition and *moralize* markets with theories of market justice. Combining these strategies of discursive interaction can become a significant source of pow-

er for the state when the government generates normative coalitions of actors in the parliament which help pass the law.

In my dissertation, I show that policy makers were able to develop convincing ideational arguments which legitimized tax cuts for the highest income earners. This finding implies that in some cases trade unionists, business representatives and civic groups argued on the basis of two different paradigms in the 1980s and the 2000s. In both periods, they considered each economic paradigm conducive to their material interest. This is only possible if their material situation had changed significantly, which was mostly not the case, or if their ideas about their interests had changed. I follow Vivien Schmidt and other theorists who have argued that ideas determine what actors conceive their objective material interests (see Section 2.4). According to Schmidt, political actors structure their beliefs in systems of background ideas, which are relatively stable and help policy actors engage coherent routines of political decisions. These ideas “frame policies and programs through appeal to a deeper core of organizing ideas, values, and principles of knowledge” (2016, 324). When administrations introduced the new ideas of neoliberal tax cuts to the polity they faced fierce resistance from the opposition, factions of their own party base, trade unions, economic experts and some business groups. The dominant discourse, of Keynesian demand stimulation and social justice in a progressive tax system, was not easily conveyed to these groups even if the cognitive arguments of the government would have qualified as representing their objective interests. Many of these groups supported the broader social justice concepts against their members’ objective interests. In the 2000s, when the neoliberal paradigm was firmly ingrained as the dominant discourse, the same groups argued in line with neoliberal tax reforms and considered them representative of their members’ material interests.

Distinguishing objective interests and ideas is a crucial step in understanding the development of discourses in the polity. I find that contrasting the influence of cognitive and normative ideas is crucial to understanding which ideational instruments are most important in persuading parties, trade unions, businesses and economists to switch from one dominant discourse to another. Only when a coherent normative program embeds the cognitive growth theory are administrations able to convince legislators. Schmidt distinguishes between three modes of communication which generate beliefs, ideas and values which become “unquestioned assumption of a polity” (2016, 320). In the first process the epistemic community comprised of the financial press, economists and central bankers convinces the administration of the new economic theory. This process is driven by communication of knowledge and follows cognitive rules of persuasion, but the second step of persuasion is a coordinative process in which the prime movers persuade policy actors in parliament. In this process, normative values play the central role because parliamentarians want to convince the public of the program in a third step (2016). While economists base their frames in *cognitive arguments* of how tax cuts generate economic growth, parliamentarians have to integrate the expert knowledge and *normative legitimation* in forms of societal values (Hall 1993; Schmidt 2016).

I follow theorists who have argued that in the field of tax policy the intermediate step of convincing parliamentarians and interest groups in parliament can be a significant resource of power for the state. I show that the state can use these values to generate ideational coalitions of party factions, interest groups and economic experts. This way values and normative persuasion become central instruments of democratic legitimation. Recent studies in the history of ideas have stressed the influence of larger cultural developments on policy making. Daniel T. Rodgers, for instance, showed that policy makers' support for monetarism and the supply-side was not confined to the authority of conservative idea brokers and their cognitive arguments. Rather, a complex cultural turn had taken place which shifted ideas and values in the entire American society, and incited policy makers to adopt neoliberal policies. Similar observations of the impact of value shifts were made by Julian Zelizer (2003). The relevance of public sentiments in policy making was also stressed by sociologists like Leslie McCall (2013) and Andrea Campbell (2009) who looked into the impact of traditional American values, of the American Dream and post-war prosperity which policy makers used to convey these reforms to the public. Vivien Schmidt argued that policy makers use existing moral values in society to legitimize paradigm shifts. Governing actors stress those values of civil society which support their policy proposal. For instance, the values of solidarity in the welfare state can be turned into pension-cut arguments by the frame of intergenerational solidarity (Schmidt 2000, 232).

One way in which policy makers enhanced the normative legitimation of tax reforms was through the integration of ideational contributions of sociologists, political theorists and political scientists. These groups contributed to the moralization of markets by providing theories of justice which argued that tax cuts generated a *universal common good for society*. First, public choice argued that modern democracies should not build on particularism of special interest groups but on universal goals for the entire society. This idea has also been adopted by sociologists who called for Third Way policies, liberal political theory and political science. Post-material sociologists argued that instead of focusing on the working class as a political actor parties and trade unions should rather work towards growth increases, which would enhance the economic conditions for the working and middle classes, which policy makers increasingly adopted. Public choice theory helped reverse the particularistic responsibility of organizations, society and the state vis-à-vis individuals to individuals vis-à-vis a *societal economic common good* (Cohen and Rogers 1994). Parties also endorsed John Rawls' principle of difference which argued that economic growth helped the least-well off in society more than redistribution. Policy makers, especially in the Social Democratic tradition, argued that a new justice frame had to be developed under the conditions of lower economic growth and that, under the principle of difference, tax cuts were fair to everyone in society as it generated jobs and thereby included the poorest individuals in society (Mouffe 2005; Zerilli, Linda M. G. 2012).

Investigating the relation of a *cognitive ideational world* and the *popular ideational world* can provide important insight into the shifts in dominant paradigms. It explains the condi-

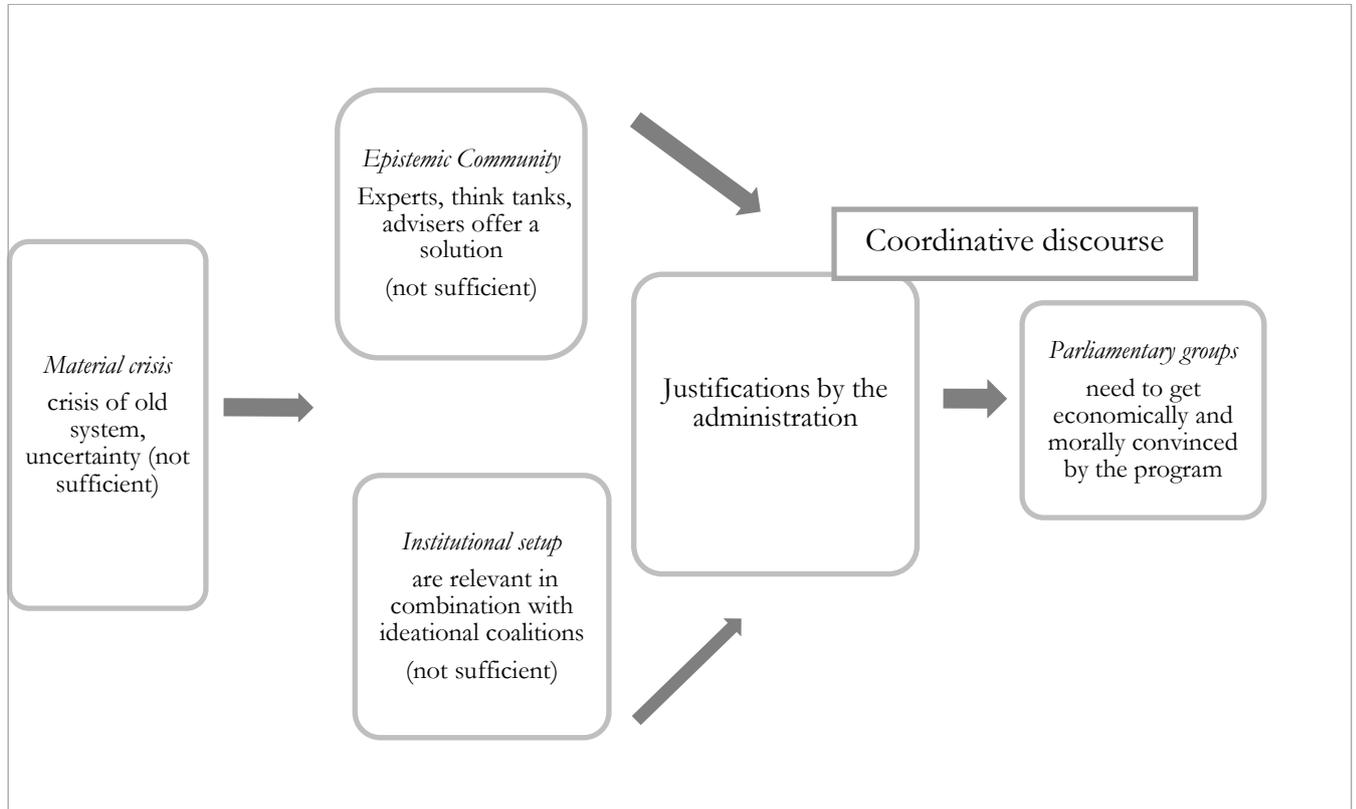
tions under which coalitions evolve which help to bring tax cuts through parliament. I will show that supply-side tax reforms did originate from the interpretation of material structural changes in the economy and the power of business groups in the institutional configuration of the polity. At the same time, societal moral frames had to be taken into account by policy makers. Thus, this dissertation provides a history of ideas that looks beyond expert concepts and economic theory. It gives insight into the process through which policy makers integrate economic ideas into popular concepts and justifications.

My framework is summarized in Figure 1. The starting point for policy change is a material crisis which cannot be tackled with the existing economic paradigm. Under those circumstances, a policy window opens and several different solutions are debated (Blyth 2002, 30; Kingdon 1984; Hecló 1975; Münnich 2010, 62). The crisis is a necessary part of the explanation of tax cuts but not a sufficient one, because governments will begin debating several different policy options while only one will be implemented. Institutions of veto-players can potentially block tax reforms or facilitate them, but eventually veto-players depend on coalitions which believe that the tax cut is the right policy solution or not. Accordingly, institutions can be transcended and amended by policy coalitions in favor of tax cuts. In the 1980s, such a coalition endorsed the concepts of social justice and Keynesian economic policy in both countries and despite institutional differences blocked tax cuts. Institutional differences may influence tax policy making but are not sufficient as an explanation. Only once we add ideas to the equation can we see the interplay of power in institutions and economic environments.

I find that the success of a new paradigm of tax policy depended on the application of three discursive strategies that had surprisingly little to do with economic theories. The first strategy to turn a dominant discourse around was to discredit its moral basis. The early adopters of the neoliberal tax reforms discredited the Keynesian economic frame as particularistic, partisan and political. They argued that redistribution was oriented at special interest groups and hence undemocratic. This argument was very powerful as it called for a *depoliticization* of tax reforms. The second strategy was to *incorporate* parts of the demands of the opposition. Especially in the wake of protests against the injustices that would result from the new program, policy makers had to adopt some of the demands of the opposition to get their support in parliament. In the 1980s this meant that the government had to provide for a compensation of the poor through tax credits and tax cuts at the bottom end of the income distribution. The third step, which only the governments in the 2000s were able to employ, was to *moralize* the program and embed it in a coherent moral framework of market justice. Moralization is usually the combination of market arguments with cultural conservative frames (Brown 2006). We will see that policy makers aligned conservative moral frames with market values and thereby drove social justice frames out of parliament. The new framework of market justice capitalizes on the responsibility of individuals for the economic development of society (Lessenich 2008). This narrative of a common good was based in the theories of sociologists, political scientists and liberal philosophers (Mouffe 2005). This popular parallel world created an idea of a common good that was able to

align the narratives of almost all groups represented in parliament and eliminated redistribution and social justice from the larger societal discourse.

Figure 4 - Creating a Common Ground



### 3 Methodology

My historical case studies compare the narratives through which policy makers attempted to convince parliamentarians of their own parties and of the opposition to vote with their tax cut proposal. The most important feature of this comparison is that I do not contrast the processes in two countries which have highly different institutional, cultural and economic conditions to implement such tax cuts but I also compare over time. By doing this, I can grasp striking similarities in the successes of tax narratives across two political economy regimes which are generally considered opposites in their ability to conduct radical tax cuts. I find that both Reagan and Kohl have been obstructed, albeit to different degrees, by the opposition and specific groups in their own ranks to pursue a shift of the tax burden from the top to the bottom. Whereas Bush and Schröder convinced large parts of those groups that had rebelled before to support the tax cuts. My approach of parallel demonstration of theory allows me to comparing the evolution of tax cuts in different institutional, cultural and economic contexts across countries and over time and allows me to demonstrate that those contexts may enhance the probability for tax cuts, but that in order for radical tax cuts to the government has to develop a coherent and convincing narrative of economic growth and morality. In order to grasp the narratives and their effects on parliamentary groups, I enrich my case studies with hermeneutical content analyses.

#### *Existing Methodologies in Tax Research*

In terms of use of different methodologies, we can split existing tax research into two groups which are neatly separated from each other while investigating the same question of why governments adopted tax cuts for higher incomes. On the one hand, those scholars who were interested in economic variables in an intention to demonstrate tax competition and the race to the bottom have largely employed quantitative large-N analyses such as regression models to show that a global phenomenon of market integration had equal effects on all countries in the world to reduce their tax rates for corporations and for higher incomes. On the other hand, most scholars who were interested in the impact of institutions and power resources used comparative case studies and descriptive statistics to demonstrate how institutions facilitated or hampered the pressures of globalization to reform tax systems in specific national institutional frameworks. Finally, the group of scholars which investigated the authority of experts in tax reforms mostly employed single case studies and a historical method which allowed them to trace the growing power of experts over time.

The theory section introduced three dominating approaches in tax research which all have their merits and have produced strong theoretical tenets in ascribing tax reductions to economic pressures of tax competition, institutional conflict over the distribution of resources or ideational power of academics. However, each approach only sheds

light on one selective fraction of the entire policy problem and none of the approaches can explain how two countries as economically, institutionally and culturally different as Germany and the US would follow similar paths in tax reforms. Each of the three methodologies is likely to find its respective theoretical factor because it determines the level of analysis.

The interest in global flows of trade and capital leads tax competition scholars to conduct large-N studies which either employ regression models or large-N descriptive statistics. These analyses use data from the OECD to show that increasing trade integration among OECD countries and increasing financial and FDI flows from one country to another make it difficult for states to maintain high levels of redistribution because capital has an exit-option to produce in countries where its corporate and individual incomes are taxed less. Studies in the race-to-the bottom of income taxation for the rich are not particularly interested in how this global capital pressure generates different outcomes across countries. Scholars in this tradition want to show how capitalism and the power structures in global markets work identically in any country (see Genschel 2002 for a state of the art summary). The only theoretical distinction of different tax competition effects for different countries which has been introduced is that small countries are expected to have greater incentives to enter this race to the bottom and turn their economies into tax havens because of their dependence on world producer markets. However, only rarely do tax competition scholars integrate this distinction into descriptive statistics (but see Genschel and Schwartz 2013).

The strength of the large-N approach is that it shows the strong similarities in corporate and top income tax cuts across all kinds of different political economy regimes - in which I am equally interested in. The downside of this approach is that the large-N correlation of economic integration and tax cuts does not explain the causal effects and mechanisms between those two variables. Where race to the bottom researchers assume that the correlation indicates a real economic pressure on all economies, this real economic pressure may equally result from a global belief of policy makers that that is the case. My case studies will show that especially the policy debates under chancellor Schröder assumed the necessity of tax cuts for higher incomes to stay competitive. When an OECD expert gave a testimony to the German Bundestag that Germany had attracted the largest share of productive FDI from both fellow EMU countries as well as the United States over two decades and argued that there was no reason to believe that the German economy in any way depended on lower tax rates, especially not for top incomes, German policy makers opted for questioning the credibility of the expert instead of their own assumptions about tax competition.<sup>2</sup> I arrive at the conclusion that looking at change across countries is crucial to understand policy change, but regression

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<sup>2</sup> Bury, Hans Martin. "Public Expert Interview of the Committee of Finance and the Committee for the Economy and Technology. Questions on Corporate Taxation in International Comparison with Representatives of the OECD." April 21, 1999. 14<sup>th</sup> legislative period, PA XIV/154, Vol. A3, p. 12.

models will not be able to give enough depth to understand complicated processes to belief formation.

The second strand of literature which has dealt with tax reforms is institutionalism or compensation theory. Those studies have predominantly employed comparative case studies in order to show how international integration had different effects on different power relations in different policy regimes. Scholars in this tradition object the economic theorems of tax competition research and try to show that policy making is a complex process in which economic change interacts with domestic political cultures, domestic institutional veto-players and domestic power relations of capital and labor. The case studies that are conducted in this field of research arrive at a medium level of abstraction which suits the interest of looking at institutions which represent the medium-level of policy processes and sit between macro-level markets and micro-level beliefs of individual actors.

The strength of comparative case studies like Katzenstein (1987), Prasad (2006, 2012) and Steinmo (1998) is that they can capture the relevance of institutional regimes in preventing tax cuts. We have learned that strong trade unions are likely to prevent tax cuts at the top if they work in a policy regime in which cooperation between capital and labor is institutionalized. We have also learned that consensual electoral institutions, such as the German one have for a long time period generated coalitions between the center-right and center-left which objected tax cuts. However, the focus on institutions which have not changed since the end of World War II and sometimes are theorized to have path-dependent effects which go back to the 19<sup>th</sup> century makes it difficult to explain the radical change that took place especially in the German tax policy with the Schröder government. I arrive at the conclusion that my thesis can benefit from the comparison across cases if it adds a comparison over time and contextualizes changes of ideas in the economic, institutional and ideational realms of policy making.

The third strand of literature which has been influential in explaining tax cuts for higher incomes argues that supply-side ideas were important drivers of change when the authority of economists grew with greater monetary resources and growing networks which disseminated their ideas into realm of policy maker circles. This research strand has focused on single case studies or comparative studies which trace growth of ideas of supply-side thinking in policy circles (e.g. Blyth 2002; Mizruchi 2013; Ptak 2009). The interest in the evolution of ideas has inspired scholars in this tradition to focus on the sources of the supply-side ideas or neoliberalism which originated in academic circles, think tanks and the financial press. Their comparative case study approach usually traces paradigm shifts over time *and* in different countries which seems a highly effective approach to grasp common factors driving change while acknowledging that ideas will be embedded in specific configurations of the institutional and cultural context in which they originate. I arrive at the conclusion that this approach is closest to my own approach of parallel demonstration of theory to ideational change in tax cuts.

The only thing I add to this approach of comparative tracing of ideas is that I look at a different arena of discursive communication. Instead of looking at the epistemic discourse between academics and administration officials or party leaders, I am interested in what happens to those ideas once policy makers accepted the new paradigm. This coordinative discourse between policy makers and parliamentarians will be portrayed through a comparison of policy maker justifications and a content analysis of parliamentary debates. This way, I can demonstrate that in order to successfully cut taxes, policy makers have to learn to embed their cognitive arguments for growth, i.e. supply-side theory, into a broader societally acceptable normative framework.

### *Parallel Demonstration of Theory*

Parallel demonstration of theory is a case study approach which investigates how one underlying theoretical mechanism plays out in different idiosyncratic contexts. It is particularly useful for research which is interested in investigating changing ideas across countries because it only asks for similarity in the overall mechanism but allow for difference in how this change plays out differently in different cases. The analysis of ideas needs such flexibility in the specific domestic configuration because ideas are highly dependent the local embeddedness in traditional beliefs, values and institutions. The fact that I am particularly interested in *normative* communication of policy makers with parliamentarians and voters makes this approach even more useful for my research purposes values sit at the center of analysis. My thesis develops the theoretical argument that German and American policy makers equally depend on an ideational response to normative values which policy makers and voters hold and they have to embed new economic growth arguments into those traditional political values if they want to be successful. However, the values as such differ greatly. In the German case we look at values of the social market economy and social justice, while in the US we look at anti-state, anti-tax and anti-corporation values which play a role. Parallel-demonstration of theory allows me to investigate what is common to those cases without cancelling out the specific local ideational and institutional contexts.

When applying parallel demonstration of theory, the researcher juxtaposes historical events to show that a predefined theory ‘can repeatedly demonstrate its fruitfulness’ in each case (Skocpol and Somers 1980, 176). It is hence to distinguish from two alternative approaches to case study research: macro-causal analyses and contrast of context. Whereas the first approach demands that the researcher generates a controlled research environment of hypothesis testing through case selection and then predominantly sketches the one variable of interest in relatively isolated terms, parallel demonstration of theory allows for greater freedom to show the idiosyncratic context within which the theory plays out. Although the approach of contrast of context also focuses contextual differences but it is interested in the uniqueness of a case and hence less capable to capture a general underlying pattern of change. Parallel demonstration of theory, however,

allows for the analysis of a general theoretical mechanism which plays out differently in both of my cases (Skocpol and Somers 1980).

Parallel demonstration of theory proposes a specific sequence of research activities. The research process begins with laying out the theory which the researcher intends to apply to the empirical material. In a second step, cases are selected in a way that they can best represent the theory outlined and finally the researcher can use his historical material to develop a 'case-oriented approach' which shows how the theory works again and again in different and causally complex contexts (e.g. Trampusch and Spies 2013: 7). My goal is to show that the theory that normative ideas hold an intrinsic power which policy makers used to highlight the normative value of tax cuts was crucial in building coalitions for tax cuts equally holds in two cases which could not differ more in competing key variables. Choosing cases which differ greatly on important alternative variables allows me to highlight throughout my analysis which contextual variables were in place but became overridden, or transcended, by the strength of new convictions of the normative values of tax cuts developed in coordinative discourses in parliaments.

I embed the analysis of discussions in parliament in a portrayal of detailed contexts which differ but are driven by a communal broad theoretical mechanism which underlies change over time. I will show that the three discursive strategies of policy makers which were outlined in the theory chapter, *discredit*, *incorporate* and *moralize*, play out in both case studies alike even though the different political traditions in Germany and the US made policy makers fall back on different normative concepts. Even though the German political tradition of corporatism and collective workers' rights differ a great deal from American individualism, anti-statism and anti-corporation sentiments, these opposing traditions were used equally to legitimate tax cuts for higher incomes. In Germany policy makers justified tax cuts for the top by emphasizing the benefits for corporations and new chances for the workers' collective to get employed, American policy makers argued that tax cuts for the top benefitted individual entrepreneurs and enhanced opportunities for the unemployed to build their own business.

However, despite being of specific value for studies interested in ideas, contextualized comparisons also encounter specific epistemological problems. In those instances where the researcher finds contextual events which run counter the theoretical framework, she or he can either interpret these as events of falsification of the theory *or* interpret them as 'noise' which historically contingent and causally complex cases naturally produce here and there (Münnich 2010: 91).

The main epistemological question that parallel demonstration of theory has to tackle is how the researcher can argue with confidence that the theory outlined at the outset of the study is superior to alternative theoretical explanations. A simple description of the evolution of the theory in each case is not sufficient to argue that the theory entails generalizable explanatory power. However, the researcher can practice a strategy of *alternation* which is a continuous 'back and forth between laying out [a] theoretical argument and illustrating each part's parallel applicability to aspects of case histories se-

lected from the range of empires' (Skocpol and Somers 1980, 177). Following this suggestion, my approach of parallel comparative history will constantly integrate the theoretical mechanism of interest as well as all relevant alternative explanations in each empirical case study to demonstrate the weaknesses of alternative accounts and to highlight the applicability of my own mechanism.

The strengths of my theoretical argument will be demonstrated by the employment of a variety of data sources which give detailed information about the historical context in which policy makers made political decisions. In the case of tax cuts, relevant external events which are expected to structure decisions to cut taxes are for instance low rates of productivity, high levels of unemployment or tax competition and corresponding corporate pressures for tax cuts. In my analysis of the relevance of changes in normative beliefs and tax cuts that means that I integrate historical statistics of macroeconomic indicators and institutional frameworks to see whether or not external factors sufficiently explain tax cuts. While this may be the case in some instances, in which economic change and changes in beliefs move in the same causal direction - e.g. productivity and employment are waning and beliefs in tax cuts as a remedy increase - we cannot make a final statement which of the two factors was decisive for institutional change. However, if the analysis is capable of demonstrating that economic indicators did not move in same expected direction as the outcome - e.g. productivity and employment were high by the time tax cuts were proposed - the explanation that beliefs are relevant for institutional change becomes more probable and may be interpreted as a temporarily sufficient condition.

### *Selection of Cases*

The German and the American tax cuts make two great comparative cases to demonstrate the relevance of ideational change across different political economy regimes. Parallel demonstration of theory is most successful when the same theory is applied to cases which provide a diverse background in institutions and cultural contexts in order to show that despite those differences the theory plays out in any context. The variables which tax cut theory considers most important in producing different conditions for the successes of tax cuts in industrialized political economies are power resources of capital and labor and veto-players in electoral institutions. Often these institutions are theorized to affect domestic sentiments of voters via feedback effects (Pierson 1996). Political scientists and sociologists have looked into voter sentiments towards taxation and report that the cultural background in word views differs a great deal among Germans and Americans.

Economically, we will look at three cases of administrations which faced a severe productivity crisis, with high unemployment and high sovereign deficits as central symptoms of the crisis. Ronald Reagan, Helmut Kohl and Gerhard Schröder faced declining rates of productivity which may speak for tax cuts for corporations and higher

incomes. However, we also have one case, the George W. Bush tax cut, which was pursued right after a spectacular boom of finance in the new economy and Bill Clinton's household surplus which shows that economic pressures are not the only explanation for radical tax cuts and strong societal support for it.

Institutionally, both the American and the German case are often characterized as exceptional. The US seems exceptionally prone to tax cuts, whereas the German case had been considered exceptionally resilient against globalization pressures on the tax system. The most important distinction that historical institutionalists make in terms of parliamentary institutions is that the German system is organized in consensual terms as the Bundesrat, the section chamber, is exceptionally powerful and often ruled by the opposition. The proportional voting system additionally facilitates the access of smaller parties to the political competition and hence depends on coalition governments as opposed to single-party governments of the sort that we see in the United States. Accordingly, historical institutionalists argue, the German system is a system of compromise between societal groups and incremental reform. The US electoral of winner take all first-past-the-post system, on the other hand, organizes politics around conflict and the single-party governments often implement radical reforms to counter the radical reforms of the previous government. Institutionalists argue that that is why radical corporate tax cuts and top personal income tax cuts were implemented in the eras of Reaganism and Thatcherism but there had never been such a thing as Kohlism (Lijphart 2012; Steinmo 1993; Prasad 2006).

The second crucial institutional difference is industrial relations. Again the American system creates conflict among capital and labor. Institutionalists have argued that tax cuts in the US were more radical than in corporatist European countries such as Germany because the liberal production regime lacks centralized organizations and institutions for cooperation of capital and labor while the German corporatist production regime rests upon institutions of *Tarifautonomie*, *Mitbestimmung* and the *Betriebsrat*, which allow for flexible sectoral self-coordination, co-determination of workers on corporate boards and workers' representation through works councils, respectively, which leads to moderate decisions in tax policy serving the interests of both social partners. While, German institutions enforce agreement of capital and labor, US policy making is often influenced by the lobbyism of businesses (Campbell 2014; Prasad 2006; Streeck 2003).<sup>3</sup>

The political environment of conflict in the US, Prasad (2006) argues, has created negative sentiments among the American middle class towards welfare spending and taxation. American voters were particularly supportive of tax cuts in the 1980s because the residual welfare state that resulted from the conflicts of capital and labor in American institutions rarely served them while they still had to pay for it often through highly

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<sup>3</sup> Though there are business associations like the National Association of Manufacturers, the Chamber of Commerce and the (NFIB), there is not umbrella organization which represents all of them, as is the case in the Federation of German Industry (BDI), the Federation of German Employer Associations (BDA) and the Diet of German Industry and Commerce (DIHT).

visible taxes such as property taxes and income taxes. Germans, however, have shown relatively high support rates for redistribution as the welfare state has traditionally included at least vast parts of the active work force (Prasad 2012; Wilensky 2002).

### *Selection of Documents*

I selected two German and two American tax reforms of which one took place in the 1980s and one in the early 2000s. All four reforms constitute the largest tax cuts for higher incomes conducted in the post-war era even though the reforms in the 1980s were much smaller in terms of their distribution to the top than the ones in the 2000s (for the distribution of tax burdens over time see Figures 2 and 3 in the introduction). By this selection of cases I intend to grasp a similar evolution of the German and the American case over time, albeit at different levels of taxation, and trace how the 1980s were different from the 2000s.

I relied on three main sources of documentation in order to test the effects of narratives of governments on parliamentary debates: Speeches of head of government, congressional debates and congressional hearings. In order to obtain a comprehensive collection of all those documents I spent three months in four archives: the *Parlamentsarchiv des Deutschen Bundestages* in Berlin, the *Roland Reagan Presidential Library* in Simi Valley, California, the *George W. Bush Presidential Library* in Dallas, Texas and the *Library of Congress* in Washington D.C. Even though parliamentary debates are available for both my cases online after 2000, the 1980s debates were not publicly available and had to be copied at those institutions. Equally important was to collect and copy the classified confidential congressional hearings in the leading committees of Congress and Senate, i.e. the Ways and Means and the Finance Committee, and the confidential hearings of the German Bundestag and Bundesrat in the Finance Committee. Those committees often also organized meetings in subcommittees which I also looked at because they asked experts and policy makers about the impact of taxation on the policies of education, social policy and the economy. Additionally, all four archives had a comprehensive collection of all letters sent to government by interest groups including business groups, trade unions and civil society groups and all articles in the print media on the topic of taxation.

For the content analysis of parliamentary debates, I coded all content related debates and hearings of tax cuts for higher incomes in both of my cases, that is, all documents in which policy makers from both parties presented arguments for or against one of the two reforms. In the American case, I included debates preceding the roll call votes in the House and Senate and the committee meetings with experts, but excluded the introduction of the bill and signing it into the law which do not contain content related arguments about taxation. In the German case, I also did not code the introduction of the law, but the floor debates in the Bundestag and the Bundesrat. Since the copies of the documents did not allow for digitization, it is difficult to estimate the amount of

text that I coded. However, many of those debates went on for several weeks in several parliamentary bodies, probably went over several thousand pages and portrayed more than 1,000 arguments which I coded in two months of empirical investigation.

In order to show government narrative had the most positive effect on Congress and the Bundestag, I also collected all public speeches that were related to tax cuts by respective head of government: which were two to four in each case. I also used newspaper articles and the letters of interest groups to contextualize the discourse of administration and parliament in societal and economic developments at the time.

### *Discourse Analysis*

My methodological approach to analyze the impact of narratives of policy makers on neoliberal tax justifications is a content analysis with a broad hermeneutical definition. I follow Krippendorff's methodological concepts; he defines a hermeneutical content analysis as "a research technique for making replicable and valid inferences from texts (or other meaningful matter) to the contexts of their use" (Krippendorff 2004, 18). In hermeneutics, researchers try to understand the meaning of a text by reading, contextualizing and interpreting it (Krippendorff 2004, 22–25). My content analysis is based on statements made by representatives, interest groups and economists during debates on each selected tax reform in the plenary sessions of the Bundestag and Bundesrat for the German case and Congress and Senate for the American case. I also analyzed the related committee hearings. The most important hearings were held by the Finance Committee in Germany and the Ways and Means Committee in the US, but subcommittee sessions were also held. My content analysis contains both quantitative and qualitative elements. I coded all justifications used for and against tax cuts in the coding program MaxQDA and measured the frequency of justifications most used in the debates in quantitative tables. Then, from the quantitative analysis, I chose the concepts most frequently used and completed a tick description of the content based on a hermeneutic-interpretative methodology.

The coding unit was defined as one single argument for a tax cut which might be comprised of one or a number of sentences that bring forward one coherent legitimation or rejection of a tax cut. The coding categories were chosen as relevant when they were used in more than ten percent of the justifications in at least one country and year. In total I defined fourteen important categories. In Appendix 9.2, I present coding examples for each category. As suggested by Krippendorff, the dimensions of my categorization do not overlap and are exhaustive in representing the entire breadth of potential arguments (Krippendorff 2004, 130). The thick description that follows in Chapters 4 to 7 is presented by paraphrasing and citing - and in the German case, translating - the arguments made by the politicians and other groups that speak in the arena.

I follow Krippendorff in his argument that a content analysis will never produce fully objective findings, as the content is analyzed and interpreted. However, content

analysis should try to achieve replicability and validity so that readers of the analysis with different knowledge and intuitions find the results comprehensible and coherent. The validity of a coding system is higher when the theory and plan of the research are represented in the coding and when codes grasp a realistic picture of the event (Krippendorff 2004, 313).

## 4 The Reagan Tax Cut in 1981

Tax research characterizes the ERTA, the tax cut implemented by Ronald Reagan in 1981, as a revolution of rapid and radical restructuring of the American economic policy paradigm from Keynesian demand stimulation to supply-side economic policy (Brownlee 2004; Prasad 2006, 2012; Zelizer 2003). Authors argued that the American anti-tax culture and the conflictual nature of institutional configurations in the electoral and welfare system made it particularly easy for policy makers such as Jack Kemp and Ronald Reagan to turn the regime of “commercial Keynesianism” into a supply-side paradigm as soon as productivity declines showed weaknesses of the Keynesian model. The surprise is, however, that Kemp’s and Reagan’s tax policy suggestions were not as radically different from the previous solutions to growth problems. Ronald Reagan’s first tax cut focused predominantly on tax cuts for capital formation which had already been part of Jimmy Carter’s tax agenda and did not yet entail the famous supply-side arguments of relieving individual incomes and reduce progressivity to give incentives to work and invest which Reagan championed in the later years of his presidency.

The ‘Reagan revolution’ significantly depended on a strong influence of economic experts and a growing authority of the epistemic community of supply-side in politics (Blyth 2002; Mizruchi 2013; Prasad 2006). It is true that the epistemic community of central bankers, the financial press, think tanks and selected members of the administration introduced a revolutionary turn of the economic paradigm to policy makers. However, the coordinative and communicative discourse in which the administration tried to convince the party bases, liberal interest groups and voters was less successful. When the Economic Recovery Tax Act (ERTA) was introduced to Congress in 1981, it was highly contested. Progressive unions and the Democrats rejected the plan for its flattening of progressivity. Skepticism was even voiced by large parts of the Republican Party which prioritized the traditional goal of the GOP to balance the budget. Together these Democrats and Republicans demanded a turn away from cutting taxes for big business which was seen as unfair in the eyes of Democrats and inefficient among Republicans. This cross-class coalition was strong enough to transcend the institutional obstacles to coalitions against tax cuts.

I will show that the cross-class and cross-party coalition against corporate tax cuts and tax cuts for the rich came about because the administration had not yet developed a convincing and coherent narrative for tax cuts. While the cognitive growth arguments of supply-side theory did provide solutions to the economic problem of productivity growth which was the basis for all other economic problems in the economy, the overly cognitive argument developed by Reagan and his reliance on a program that supported big-business of which politicians and voters were wary could not convince enough parliamentarians to let go of the former growth model which already provided an embed-

ding in societal norms. The lack of support in parliament and a worsening of the sovereign debt level of the cut economic crisis pushed Reagan into a crisis of voter confidence and he had to repeal the cut. I come to the conclusion that societal cross-class coalitions do not need to be institutionalized to become powerful but can thrive on strong beliefs of groups in the former background idea, i.e. the former paradigm. Because American protest groups never had institutional power in Congress they developed skills to gather powerful coalitions outside of Congress (Clemens 1993; Skocpol 2004) and that is what happened when Reagan presented a tax program which upset American values. Only when George W. Bush presented the same tax cuts by appealing to traditional values could the new paradigm take hold of Congress, civil society and voters.

This chapter is structured as follows: I will first introduce the macroeconomic crisis of the late 1970s and the material crisis of the paradigm of commercial Keynesianism. I analyze the cognitive debate of the prime movers on the newly emerging supply-side paradigm in epistemic communities. Then, I demonstrate in an analysis of the congressional debates that these cognitive arguments were contested by conservatives as well as the left, mostly on the ground of normative arguments. I show that after passing the reform with business-lobby power, public protest arose which led to a passing of a second reform, the TRA, which had to reverse parts of the tax cuts. I conclude with a summary of the ideational shifts and their effects on the conviction of tax reforms in Congress.

## 4.1 Macroeconomic Context

The economic crisis which Ronald Reagan inherited when he was elected in 1980 was predominantly a productivity crisis. Productivity had declined since the 1960s when the very high growth rates of American Fordism and European consumption of American products began to fade. Not only the administration believed that the crisis originated from a growing competition for the American market from Japanese and European production and that the stagflation crisis, i.e. inflation and unemployment, resulted from broader trends in the rise of new economic powers in world markets and the maturing of the American capital base from the immediate postwar period. Economists and interest groups agreed on this reasoning. When Ronald Reagan then proposed to cut taxes for heavy-capital firms and top personal incomes arguing that this would enhance the capital formation in the corporate sector, this was a direct response to this debate and one way to solve the productivity crisis in the American economy. However, the fact that his ideas could potentially solve the economic crisis was not enough to convince parliamentarians and civil society as we will see in the next section.

Post-war American economic policy making had rested on Keynesian ideas since the New Deal policy frames had been implemented during the 1930s. This paradigm of 'commercial Keynesianism' included ideas and ideals of Fordist mass production and

mass consumption and focused in its fiscal and monetary policy on both price stability as well as employment. The application of special product machines to enhance the productivity of single workers made the regime heavily dependent on capital-intensive investments (Martin 1991, 17–18). Industry, manufacturing and high employment levels were central focus points of macroeconomic steering in the regime. The other economic requisite for the regime was a large domestic market providing consumption of products. As opposed to neoclassical theory, Keynesian thinkers argued that the market would not regulate itself and generate equilibrium with price signaling to rational market actors, but needed stimulation in case price rigidities caused overproduction. The American postwar Keynesian regime was a conservative form of Keynesianism which included policy stimulants for capital formation aside from consumption stimulation (Martin 1991, 17–18).

Since the 1960s the American economy increasingly produced negative results among those indicators that had been central to the heavy-capital and full-employment goals of the post-war era. The central problem of Keynesian economic policy making was a decline in productivity rates. Since the 1960s, American manufacturing productivity had declined significantly, leaving growth rates plunging. Whereas between 1948 and 1966 productivity had increased by an average rate of 3.3 percent, the rate increased only by 2.1 percent in the years between 1966 and 1973 and finally fell to 1.2 percent between 1973 and 1978. The loss in the relative competitive position of the American economy in world markets was reflected in the increasing trade deficit which moved into the red for the first time in 1972 and accelerated to \$140 billion by 1984 (Martin 1991, 23–24). American policy makers considered the great productivity increases of the Japanese market, of 6.6 percent from 1960 to 1973, as particularly worrisome and over time demanded a turn away from big industry to knowledge intensive, human-resource focused, high-tech industries (Fantasia and Voss 2004; Martin 1991, 30).

However, this new vision of adapting the American mature capital base to the new imperatives of world markets, did not immediately translate into support in parliament because it was presented in an unpopular narrative. Even though the supply-side paradigm had been officially adopted by the Reagan administration long before the election and reductions in top personal income tax rates were a much more conducive to the goal of supporting small high-tech companies and giving incentives to save and invest, it took a number of years and a government crisis before the Reagan administration *reinterpreted* the supply-side paradigm as a frame that suggested small firm efficiency. Only in the second and third tax cut did the government shift its focus from corporate tax cuts to top personal income tax cuts which were supposed to implement greater saving and work incentives. In the first tax cut, the ERTA, the Reagan administration retained much of the former Keynesian tax predicaments. In the post-war era, Keynesian progressive personal and corporate income tax systems focused on stabilizing the business cycle - through the progressive rate structure and tax credits which stimulated

consumption<sup>1</sup> - and incentivized new equipment through tax incentives for heavy capital. Even though growth had never been a central goal of American Keynesian tax policy, incentives like accelerated depreciation became more important over time (Martin 1991, 20). Reagan's first tax cut is clearly in line with the previous tax cuts implemented by the Carter government in that it equally focused on heavy-capital as opposed to top personal tax rate reductions. Instead of adopting the emerging ideas of shifting to human-resource, high-tech industry, which promised greater growth levels than the mature capital base in manufacturing, Reagan and his team focused on corporate tax cuts. Only in a second step - and under the ideational pressure of the Democrats - did tax cuts for small high-tech firms emerge which is when income tax cuts for higher incomes became a central element to the new policy paradigm.

Aside from this lag of adapting tax policy predicaments to their own visions and understanding of external imperatives of the world markets, which is probably also due to the heavy lobbying that took place in the 1981 ERTA reform (Martin 1991), the most instructive way of demonstrating the relevance of ideational change in tax cuts for higher incomes under Reagan, is to look at the gap between Reagan's focus on the source of the economic problem, namely productivity, and parliamentarian focus on soothing the symptoms of the crisis, namely inflation and debt. Clearly, the new ideas within the supply-side paradigm, *public choice theory* and Reagan's personal anti-government, anti-union and anti-tax sentiments which were reinvigorated after he faced parliamentary and voter resistance did play a significant role in the evolution of a focus the new *normative frame* which focused on excessive government and helped George W. Bush to cut taxes in the 2000s. When Reagan came to office his focus on productivity declines was countered by a continuous focus on the dissipating relationship of the *Phillips curve* by parliamentarians. The Phillips curve was one of the central theorems in Keynesian thinking, which argued that macroeconomic cycles moved between high levels of inflation and high levels of unemployment. Under this relationship expanding monetary supply or fiscal spending balanced out cyclical downturns. After the productivity and oil crises of the 1970s, however, *stagflation* became the normal state of the economy, producing high inflation and unemployment simultaneously. Stagflation left conservative policy makers puzzling about the effectiveness of macroeconomic adjustment tools. However, even though both unemployment and inflation increased, the focus of policy makers was now clearly on price stability and government debt and moved away from employment. Between 1961 and 1964, unemployment reached the level of 5.5 percent and was soaring to 6.5 percent from 1973 to 1979 (Scharpf 1991, 239). At the same time two oil price shocks in 1973 and 1978 drove inflation rates to

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<sup>1</sup> The tax system entailed automatic stabilizers which move individuals into lower income brackets in recessions and higher income brackets in boom periods to regulate business cycles countercyclical. Stabilizers cooled down booms and elevated consumption in bust times (Pechman 1987, 12–14). Nevertheless, the top rate was reduced during the 1960s from 91 percent top rate to 70 percent and the corporate top rate dropped to 60 percent (Martin 1991, 20).

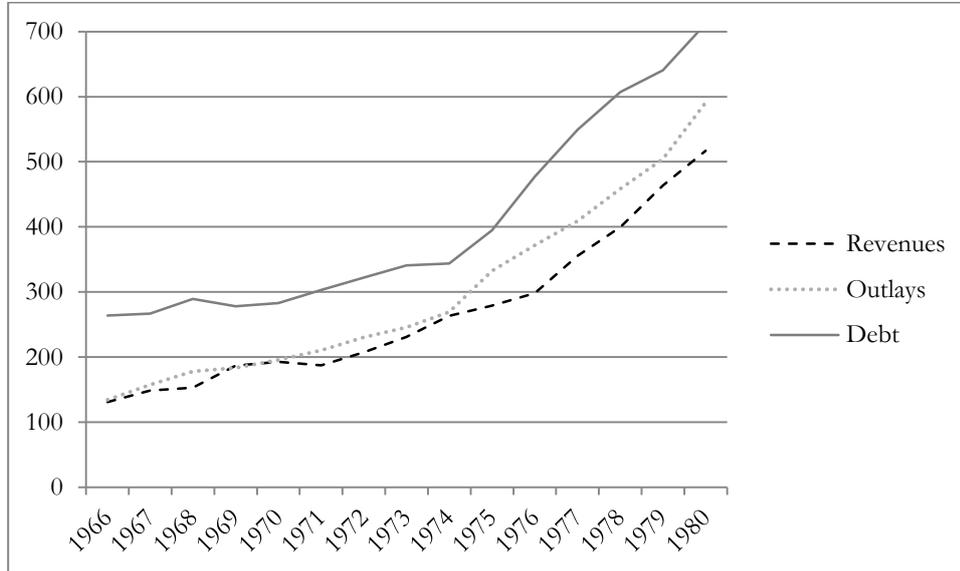
unprecedented levels. In 1964 inflation was below 1 percent, but soared to 11 percent by 1980 (Harvey 2005, 14).

With soaring inflation, *bracket creep* became one of the central topics in parliament. Bracket creep pushed individual taxpayers into higher tax brackets with inflation due to the automatic stabilizers ingrained in the Keynesian tax system. On the basis of American values of ability to pay, both Republican and Democratic policy makers wanted to stop this through a measure of indexing. However, this measure was far from Reagan's plan which meant to tackle the productivity crisis through liberation of corporate and top incomes. Even though inflation was a real problem in the American political economy at the time, reaching levels that impaired the working of the tax system and spurred voter discontentment, the new monetarist focus of monetary policy already took care of the problem of inflation. The policy focus on price stability in Paul Volcker's chairmanship at the Federal Reserve Bank in 1979 countered increases in inflation with immediate rapid contraction of money supply. In 1983, the monetary stability course of the central bank achieved a moderate increase in the inflation rate, but at the expense of excessive increases in interest rates which drove unemployment to even greater heights (Blyth 2002, 84). For long-term government securities, the average interest rate grew from 9 to 14 percent from 1979 to 1981, and unemployment rose to 7.7 percent from 1979 to 1985 (Scharpf 1991, 239, 243). These increases in interest rates caused a deep recession, which closed factories and led to massive unemployment, but also reduced inflation to normal rates. If tax policy just followed external economic pressures of rising stagflation, as tax competition and compensation theory argue, the government did not need to try to further reduce inflation through income tax cuts at the top.

The relevance of ideas and the paradigm in parliamentary debates shows in the overemphasis of sovereign debt problem after Reagan implemented the tax cut. Economically speaking, the productivity crisis was the source of debt and inflation. But Republican and Democratic parliamentarians interpreted the crisis still as a domestic fiscal policy crisis, as the Keynesian paradigm suggested. They pointed to the fact that between 1966 and 1980, sovereign debt increased from \$300 billion to \$712 billion, which was accompanied by a similarly steep increase in revenues and government outlays. In 1970, the government spent \$195.6 billion, which more than doubled to \$503.5 billion in 1979, while the tax revenue had increased from \$192.8 billion to \$463.3 billion (see Figure 5). Behind the focus on sovereign debt and the idea that tax cuts for higher incomes would eventually increase the level of revenues and thereby resolve the deficit crisis, stand mostly an ideational reinterpretation of the relevance of the government in the economy. Even though the Laffer curve reasoning (section 4.3) did provide somewhat an academic reasoning for tax cuts leading to higher revenues, there was no evidence whatsoever for this relationship. That is why the Congressional Budget Office, one of the central statistical offices which provided macroeconomic guidance for the administration, was most worried about the deficit increases, from 0.5 percent of GDP in

1966 to 2.6 percent in 1980, and not about the overall government outlays on which the administration focused (Congressional Budget Office 2016).

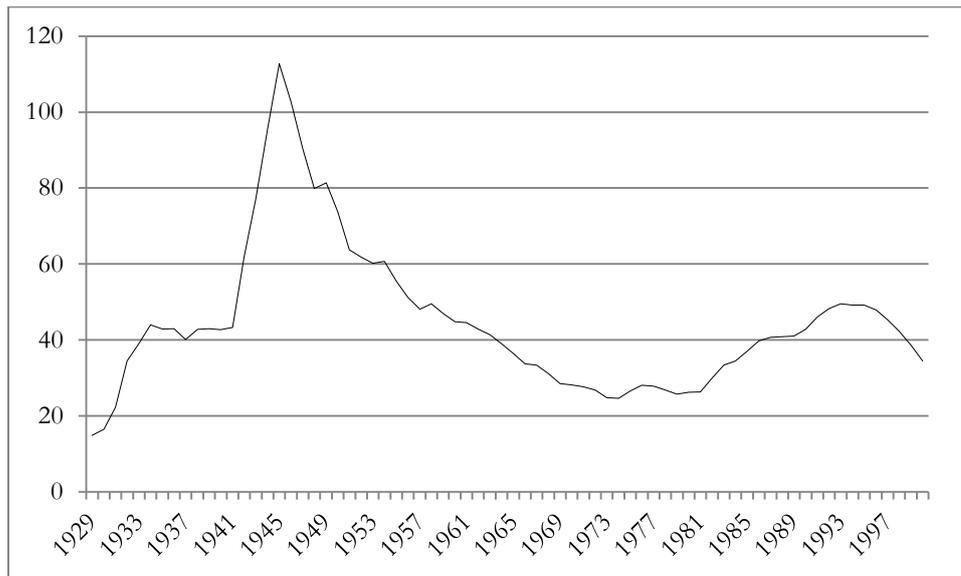
Figure 5 - Total Federal Revenues, Spending and Debt in \$ billions



Source: Congressional Budget Office (2016)

Debt had fallen significantly from a level of debt exceeding GDP during World War II, to 24.8 percent in 1974. Despite the output and inflation crisis of the time, debt levels remained relatively moderate during the 1970s (see Figure 6). More importantly, once Reagan implemented the tax cuts during the 1980s, the level of debt increased significantly, as it did during the 2000s when George W. Bush implemented supply-side tax cuts (see section 5.1). The apparent ignorance of past negative experiences with the effects of tax cuts on deficits, speaks against efficiency driving tax cuts for top incomes. The overall ideational shift of policy makers from economic indicators of unemployment to economic indicators of sovereign debt does not seem very tightly linked with the international competition pressures on productivity levels in the US. It seems that tax competition is not sufficient to explain why the Reagan administration decided that top personal income tax rates would improve the economic outlook of the American economy vis-à-vis world markets.

Figure 6 - Debt as Percentage of GDP



Source: Congressional Budget Office (2010)

## 4.2 Institutional Context

Tax research in the historical institutionalist tradition explains the radical tax cuts implemented under Ronald Reagan through a lack of solidarity in American society. These scholars argue that the constitution with its first-past-the-post system generated a two-party dichotomy and the radically progressive tax system impaired the formation of upper-class solidarity with the lower class since its implementation in the early 20<sup>th</sup> century. The lack of solidarity was aggravated in times of globalization pressures in which capital and the upper and middle classes tried to curtail the effects of a highly visible redistributive taxes system (Prasad 2006; Steinmo 1993; Wilensky 1975; Wilensky 2002). Essentially, what these authors argue is that US institutions facilitated tax cuts because of a conflict of capital and labor ingrained in American institutions.

This section will demonstrate that coalition building and conflicts were at the heart of policy change, but contrary to institutionalist theory's expectation, the conflict in American Congress did not exacerbate but diminished over time. Policy narratives of the Republican Party were capable of discrediting the opposition's demands of government involvement among Congressmen and thereby limited their power to counter the liberation of markets in Congressional debates. This loss of power in discourse did not yet exist in the Reagan years where the administration relied on overly economic arguments, easily countered by opposition and social movements with strong traditional arguments of ability to pay. However, the Reagan and Bush cases demonstrate how interpretations of policy makers and civil society groups about the economic viability and fairness of tax cuts changed significantly and thereby enabled coalitions for tax cuts over time. One of the most important obstacles for the sustainability of Reagan's tax cuts was that the opposition had formed a strong normative coalition on the ideas of

ability to pay. Even though Ronald Reagan additionally faced an institutional obstacle of a House being dominated by the Democrats (Busch 2015, 98), the fact that George W. Bush attracted a much greater share of renegade Democrats voting for his much more radical tax cut in 2001, at least makes us wonder what to attribute the change to.

One crucial ideational aspect which shaped the conflict over the Reagan tax cuts was an economically and normatively convincing alternative provided by the Democratic Party. Traditionally, Democrats and Republicans had worked out tax programs together in the Ways and Means Committee of Congress. But this time, the chairman of the Committee, Dan Rostenkowski of Illinois, proposed an alternative tax plan less skewed to higher incomes and entailing subsidies into high-tech industries which promised future employment. Rostenkowski presented the alternative *Ways and Means proposal* on June 3, 1981 which proposed a 15 percent across-the board income tax cut over two years instead of a 30 percent tax cut over three years. The Democrats intended to increase the tax thresholds for all income groups, raise the earned income tax credit and give the greatest rate reduction to the middle class. Capital was supposed to gain from the reduction in the investment tax rates from 70 to 50 percent and a tax break for savings for retirement and small businesses would gain from faster write-offs for cars and trucks and a corporate tax reduction from 46 to 34 percent.<sup>2</sup> Refundable tax credits for manufacturing were also added, as well as job credits for small firms, research and development credits for high-tech sectors and individual retirement accounts for the financial sector. The income tax cuts were concentrated on incomes between \$20,000 and \$50,000, instead of cutting marginal rates as Reagan proposed, which would benefit higher incomes to a greater degree (Martin 1991, 121–24).

As opposed to the argument of historical institutionalism that business and the middle class were happy to support tax cuts for higher incomes because taxes were too visible and the upper and middle class did not benefit from welfare spending (Prasad 2006), the Republican Party went to great lengths to convince businesses that they actually benefitted from top personal income tax cuts. Businesses worried that tax cuts at the top of the personal income tax schedule would worsen the inflation pressure on the economy and corporate tax cuts benefitted a much bigger and much more powerful group of American businesses. As both parties feared that they could not convince both Houses of each individual tax plan, policy makers kept trying to convince powerful business groups for their tax program. The Republicans feared they would not be able to pass their plan in the House and Democrats feared they could not pass it in the Senate. The government tried to win southern Democrats and small businesses for a coalition by integrating some of the small-firm provisions which the Democrats had introduced in their new compromise bill, *Conable-Hance II*.<sup>3</sup> By adding an estate and gift tax cut for farmers and a \$10 billion tax cut for oil, Southern Democrats joined

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<sup>2</sup> Valis, Wayne H. "Memorandum to Elizabeth Dole, Red Cavaney, Bob Bonitati, Jack Burgess and Barbara Smith." June 17, 1981, Robert Bonitati Files, OA 6847, box 10, file Tax Policy, RRPL.

<sup>3</sup> Dole, Elizabeth. "Memorandum for James A. Baker Tax Coalition Update." July 27, 1981, Edwin Meese Files, OA 2408, box 57, RRPL.

Reagan's coalition (Martin 1991, 124). Small businesses represented by the National Federation of Independent Business Association (NFIB) gained from the top rate, as many small firms and Subchapter S corporations file their taxes as individuals (Fullerton 1994, 185; Martin 1991, 120). Big business groups like the National Association of Manufacturers (NAM) opposed the individual rate cuts, fearing they were inflationary, and had to be persuaded with further tax cuts for big business (Martin 1991, 121). Additional cuts for airlines, automobile producers, steel industries, and mining were included.<sup>4</sup> The government's revised tax plan passed Congress with the support of southern Democrats.

The historical institutionalist argument that tax cuts were driven by the lack of solidarity of the American middle class with the lower class, who did not benefit from the earmarked welfare system, does not seem conclusive if we look at the protests that broke out once the tax cut was implemented. In 1981, a coalition of women's groups, civil rights and lower and middle class workers aligned to protest the Reagan policies and his ideologies of anti-feminism and racism. One central goal was the maintenance of infrastructure and social security spending and *ability-to-pay* fairness in the tax system. The rallies were the largest since the anti-Vietnam marches on Washington D.C. and raised national awareness of the consequences of budget and tax cuts among the voters. The administration called out a number of crisis meeting to tackle popularity slump (see Section 4.5). Government officials decided to implement two follow-up reforms which partially repealed the inequity of the 1981 tax cut. This critique on the left was basically run by middle class groups, including the AFL-CIO which now predominantly consisted of public and service employees, the Consumer Federation of America, the American Agricultural Movement, the National Council on Senior Citizens, the Sierra Club, the League of Women Voters (LWV) and the US Catholic Conference.<sup>5</sup> Clearly, this movement was driven by a commitment of parts of American society to the ideal of *ability to pay* and social justice for lower incomes. Despite the hostile institutional environment for solidarity between the lower and the middle classes, strong *ideals* were capable of aligning those groups.

On the other hand, the Reagan administration had not yet developed a convincing framework to attract enough societal support to their tax cuts. Even though Ronald Reagan had developed a strong conservative narrative in his early political activities in the 1950s in which he aligned ideas of libertarianism, traditionalism, anti-unionism and anti-communism, in his first year as president he switched to a highly technical language of supply-side tax cuts. After getting elected governor of California in 1967, Reagan successfully turned a tax revolt against property taxes in California – which had consisted to equal shares of liberal and conservative groups - (Martin 2008) into a conservative

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<sup>4</sup> Congress of the United States. "Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127." July 29, 1981, University Microfilm International, Ann Arbor, Michigan, p. 18032.

<sup>5</sup> Stewart, Sharon, "Labor, Rights Groups Plan Protest of Budget Cuts," July 1, 1981, *Rocky Mountain News*, Elizabeth Dole Files, Series III Economic Recovery Program, box 68, RRPL.

project of anti-communism and anti-federal government capitalizing on middle-class voters' growing suspicion of the "excessive state", the disgust of powerful unions, and the student and civil rights movement at the University of California and Berkeley. The success of his *Proposition 13* referendum, which implemented a cap on property tax increases in 1978, raised Reagan's popularity nation-wide and made him the perfect candidate for the 1980 federal election (Cannon 2003, 108–9; Clune 2015, 29).

Within the first two months in office, Reagan had already proposed a new budget, which planned to cut social spending and raise outlays for defense and a tax plan sponsored as the *Kemp-Roth proposal*. Despite running on a conservative anti-big government program during his governorship and his presidential campaign, Reagan sold Kemp-Roth to Congress and the voters on the basis of arguments of growth stimuli, work incentives and competition, and used a highly academic technical language adopted from the supply-side theory of his economic advisers. Kemp-Roth intended to cut personal income tax across the board over three years, with the bottom rate reduced from 14 to 10 percent and the top rate from 70 to 50 percent, dubbed the "10-10-10" proposal. It was justified with work and investment incentives. It also planned an accelerated cost recovery system (ACRS) - ten years for long-lived public utility property, five years for machinery and three years for cars and trucks - called "10-5-3".<sup>6</sup> It was justified as giving an investment incentive for renewal of a mature capital stock. The overall cost of the tax cut was scheduled to amount to \$748.9 billion from the budget years of 1981-1986, of which the largest chunk of about 80 percent would go to income tax cuts and only about 20 percent to business cuts (Martin 1991, 12).

However, after the protests, the Reagan administration decided to offer the public two follow-up reforms, the TEFRA and the TRA which were apologetically presented as bringing back equality to the tax system. The government incorporated demands of the protesters by providing compensation to the poor, greater emphasis on support for small businesses and greater tax shares for corporations. The TEFRA was the largest post-war tax increase, which raised corporate taxes by \$120 billion, largely through closing loopholes and the cutting of select incentives for heavy capital (Martin 1991, 159). Though the TRA further reduced the top individual income tax rate from 50 to 28 percent it compensated the poor with increased standard deductions from \$3,670 to \$5,000 and the expansion of the Earned Income Tax Credit (EITC) rate from 11 to 14 percent.<sup>7</sup> The TEFRA and the TRA were developed to the almost unanimous approval of societal groups.<sup>8</sup> The unions and women's groups endorsed the new program enthusiastically. Further cuts in the top rate were mentioned but accepted.

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<sup>6</sup> Reagan, Ronald. "America's New Beginning: A Program for Economic Recovery." February 18, 1981, Federal Reserve, *The American Presidency Project (from here on APP)*, p. 14.

<sup>7</sup> The EITC is a tax credit that was implemented in 1975. Individuals qualify when they earn an income below a certain threshold with the amount paid depending on income and the number of dependent children (Howard 1997, 14).

<sup>8</sup> In my analysis, I will focus on the discursive shift from the ERTA to the TRA instead of the TEFRA because TRA further reduced progressivity in the income tax system, which TEFRA

### 4.3 Context of Expert Authority

In times of economic crisis and repeated failure of former policy solutions, policy makers seek new programs, new advisers and new academic approaches to resolve the problem. In this period of puzzling, ideas which may have been debated in peripheral academic circles for some time but were neglected by mainstream academics and practitioners on the premises of the former paradigm can become very powerful as this window of opportunity opens (Kingdon 1984; Heclo 1975). However, the success of one of the different alternatives debated among policy makers and academics as a new paradigm hinges on three factors coming into existence. This section will show that the theory that ideas gain power predominantly by being repeated over and over again and gaining authority through their monetary and institutional power of a powerful network in the epistemic community, as has been argued by theorists of expert authority (Blyth 2002; Ptak 2009) does not suffice to explain the paradigm shift from Keynesianism to supply-side economics in the US. Reagan did discover a powerful group of think tanks and academics whose ideas had been widely debated in the nationwide media, but this discovery did not lead to a sufficient conviction in American politics that this program would be a better solution to the economic crisis. By developing a program that supported corporate capital, as supply-side theory suggested at the time, he made his administration vulnerable to normative critique based on traditional American values of anti-big business and to the immediate economic success of this program as we will see in Sections 4.4 and 4.5.

Even though the academic authority of supply-side notions had grown during his term and Reagan had convinced large groups of parliamentarians of its suggestions for tax cuts, one could almost argue that this power of the new paradigm was an obstacle to success of his program as it did not help him communicate with parliament. It also worsened economic deficits in the short run, which was the opposite of what conservative Republicans, Democrats and voters wanted. Ronald Reagan's economic program came to be known as "Reaganomics" because it was neatly derived from supply-side theories. Supply-side thinking had gained authority since the 1970s through a growing network of economists contributing to it and teaching it at top economics departments and well-finance conservative think tanks and the financial press disseminating political ideas based on monetarism and supply-side theory in the print media and in political circles. From these circles, Reagan derived a political program that was neatly organized around the suggestions of supply-side theory, monetarism and rational expectations theory. He proposed deregulation, tax cuts, spending cuts and an attack on unions which included the breaking of a strike by the air traffic controllers' union PATCO.

A network of economists and the financial press brought supply-side ideas into the circles of conservative Republicans with the help of conservative think tanks which provided venues for conferences and funded the writing of some of the supply-siders

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did not. Since I am interested in the changes in progressivity TRA is the case with greater relevance to my question.

through stipends. One of the central actors which helped supply-side ideas getting attention by policy makers was the American Enterprise Institute (AEI) which was established in 1943 by a group of businessmen who intended to mobilize against the New Deal policies by giving fellowships to writers who promoted free enterprise ideals. It became one of the largest American think tanks during the 1970s receiving funds from 600 firms (Mizruchi 2013, 148–49). Similarly, decisive for the dissemination of supply-side ideas was the Heritage Foundation, founded in 1973 as a conservative counter power to the Nixon administration, the expansion of the federal bureaucracy and liberal think tanks in Washington. It also grew from a relatively small institution of a value of a little less under \$1 million in 1970 to \$7.1 million in 1981 (Blyth 2002, 156). However, monetary support and practical political application of neoliberal ideas were not as relevant for its transfer to policy circles as its dissemination through finance journalists Jude Wanniski and Paul Craig Roberts, editorial writers at the *Wall Street Journal*, who gave Laffer's supply-side ideas a nationwide public platform (Bartlett 2003, 11).

Wanniski additionally had travelled the country and talked to a number of Republicans in person to convince them of the tax cut ideas which could be derived from supply-side economics. He was also the person who told Jack Kemp, the sponsor of Reagan's tax bill of 1981, about Laffer and Mundell in a meeting in the late 1970s (Blyth 2002, 165; Prasad 2012b, 355). One important landmark in institutional access of supply-side to the administration networks was Martin Feldstein's appointment as president of the National Bureau of Economic Research (NBER) in 1978. Feldstein and his staff published numerous papers based on supply-side ideas and introduced those ideas to congressional hearings. In 1982, Feldstein became appointed chairman of the Council of Economic Advisers (CEA), another central position in the polity. With the appointment of monetarist Paul Volcker as the new chairman of the Federal Reserve Bank (FED) in 1987 demand stimulation was impeded (Bartlett 2003, 9).

#### 4.4 Administration Narrative: Reaganomics

The three most important theoretical explanations for tax cuts since the 1980s highlight economic crises, power shifts among capital and labor or a growing authority of supply-side economic experts in epistemic communities. It is true that the American economy had suffered from productivity declines since the 1960s and supply-siders had developed a program to liberate resources in the corporate sector through corporate and individual income tax cuts. It is also true that the network of supply-siders had grown particularly powerful since the 1980s and that Reagan adopted their program word for word when he presented it to Congress and the public. However, his bill passed only with a marginal majority in Congress, many Republicans and Democrats were not convinced of his program and voters forced him to repeal it protesting against the plan to cut taxes for corporations. This section will look into the narrative developed by Reagan in the early 1980s. Together with section 4.5, which lays out congressional re-

sponses to this narrative, it will demonstrate that the academic and technical narratives of Reaganomics could not win over Democratic parliamentarians and voters because it worsened the economic situation which it promised to resolve and it did not offer a normative alternative to their demands of social justice.

Reagan's electoral campaign and his first speeches after election were clearly inspired by the many supply-side economists who had come to advise the president in the many institutions and commissions that were set up to communicate academic ideas to policy makers. Blyth (2002) shows convincingly how powerful epistemic networks became in this time period. In November 1980, Reagan had put together an economic taskforce that turned supply-side ideas and monetarism into concrete policy suggestions in the governing program *America's New Beginning: A Program for Economic Recovery*. The task force was comprised of a number of economists who had worked in supply-side circles throughout the 1970s. Former chairmen of the CEA Alan Greenspan and Paul McCracken were responsible for the budget and inflation respectively. Economist Murray Weidenbaum was responsible for regulation. Arthur Laffer, Paul Craig Roberts, Alan Ture and Charles Walker were responsible for tax policy. Walker came from the American Council for Capital Formation (ACCF). David Stockman, House Representative from Michigan and later chairman of the Office of Management and Budget (OMB), bundled the ideas of the different economists into one straightforward program (Blyth 2002, 172).

However, this power of economists was not a guarantee for a successful coordinative discourse among policy makers and between policy makers and voters which Schmidt (2008) stresses as particularly important for paradigm shifts. Maybe it was even an obstacle to Reagan's success as it led to presentations of tax policy in highly technical terms in two presidential speeches to the public and Congress. Reagan talked about concepts of capital formation, crowding out, the Laffer curve and incentives for optimal allocation of resources which directed attention to the economic realm of taxation and made the President highly vulnerable to the economic downturn that followed after his cut. The government program devoted an entire section to the topic of crowding out which under the headline: *Government Contributes to the Productivity Slowdown* argued that the American economy had been in a crisis of capital formation to which "government policies have been a major contributor... but they can be an even more important contributor to the cure."<sup>9</sup> Regulation, taxes and inflation had to be reduced to get capital formation flourishing again. To Reagan, as to the supply-side theorists, this crisis of capital formation stemmed from an excessive government that was demanding ever higher taxation, regulation and generated inflation through borrowing:

We invented the assembly line and mass production, but punitive tax policies and excessive and unnecessary regulations plus government borrowing have stifled our ability to update

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<sup>9</sup> Ibid., p. 5.

plant and equipment. When capital investment is made, it's too often for some unproductive alterations demanded by government to meet various of its regulations.<sup>10</sup>

In his government program which was intended to reach out to convince voters as well as parliamentarians of a tax cut of unprecedented size, Reagan mostly talked about benefits of tax cuts for corporations and investors. Even if those were supposed to trickle down to the average voter as well, the economic theorems at the center of the program did not portray the benefits for voters much. It described how corporations were troubled by inflation, taxes and dividends: “many firms are now paying out more than their real income in the form of taxes and dividends”, with the result that “real investment in equipment, maintenance, modernization, and new technology is falling further behind the needs of our economy.”<sup>11</sup> On this basis, the administration planned to direct the greatest share of the tax cut to corporations through new depreciation schedules, the ACRS. The ACRS were openly promoted as helping capital-intensive industries to modernize the mature capital, to enhance “production equipment”, “combat the decline in productivity growth, to hasten the replacement of energy-efficient machines and equipment” and to “provide business and industry with the capital needed to modernize and engage in more research and development.”<sup>12</sup> Considering that American voters have traditionally been highly skeptical of big corporations and were particularly so during the 1980s productivity crisis (Beckert 2004; McCall 2013), the President’s strategy to talk predominantly about capital formation for big business was not a good selling point.

This capital formation crisis, supply-side economics posited, was a crisis of incentives to work and save. Again the president adopted supply-side tenets literally into his program which resulted in the argument that corporations suffered from a lack of access to funds because individuals were not saving enough and not working hard enough. Again, it looks like the power of economists by the time Reagan became inaugurated almost became an obstacle to a popular success of the program. From the theory, Reagan arrived at the argument that individuals did not save enough and had no incentive to work harder as progressive income tax schedules was taking away additional income earned.<sup>13</sup> Even though Reagan also mentioned that voters suffered from bracket creep, i.e. the moving of individuals in higher tax brackets with inflation, which could equally get resolved through tax cuts, the explicit mentioning of cutting progressivity in the tax system in order to shift productive resources to the corporate sector was clearly not popular among American voters who suffered wage cuts, unemployment and welfare retrenchment and were not seeking greater incentives to work, but a relieve from pressures in the market (see section 4.5). But Reagan relied on arguments

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<sup>10</sup> Ibid., p. 15.

<sup>11</sup> Reagan, Ronald. “America’s New Beginning: A Program for Economic Recovery.” February 18, 1981, *APP*, p. 15.

<sup>12</sup> Ibid., p. 2.

<sup>13</sup> The automatic stabilizers in the tax system led to growing revenue collection, i.e. fiscal dividend, and move individuals into higher income brackets, i.e. bracket creep, in economic upturns and under high inflation (Pechman 1987, 12–14) cited in (Martin 1991, fn. 39).

of public finance theorists who argued that transfers impaired work incentives “since the income effect is adverse to leisure” (Musgrave 1959, 246). The political suggestion that followed from this theorem was to introduce a proportional flat tax, or at least to reduce the top rates and broaden the tax base (Feldstein 1994, 13–16). Reagan told Congress that the reduction of productivity would “revive the incentives to work and save.”<sup>14</sup> Through lower tax burdens at the top the government was setting in motion “a positive direction to economic decisions throughout the economy” which would no longer be “overriding motivation.”<sup>15</sup> The fact that Reagan even adopted the terminology of choices between work and free time from the economists: “Economic choices - involving working, saving, and investment - will be based primarily on the prospect for real rewards”<sup>16</sup> indicates that economists may have been a little too powerful at this point in time. It suggests that the reasoning that the authority of economists lead to tax cuts in 1980s must be questioned. This authority in a way has to be considered an obstacle to change.

More successful than the arguments of crowding out and incentives to work and save were public choice theories which were also adopted in Reagan’s speeches. Since the 1970s, these theories which sat between economics and democratic theory had argued that government spending was out of control due to an infinite short-sighted voter demand for government spending which went against their own long-term interest of economic growth. James Buchanan and Richard E. Wagner revived *Wagner’s Law*, which originated in the 19<sup>th</sup> century, arguing that democratic institutions would lead to an excessive government and debts as governments were inclined to expand spending but were impeded from cutting benefits for constituent groups (Buchanan and Wagner 1977; Brennan and Buchanan 1991). The finding of their studies of Keynesian policy making was that “Keynesian politics has turned the politicians loose; it has destroyed the effective constraint on politician’s ordinary appetites” (Buchanan and Wagner 1977, 4). This theory was backed up with historical studies such as the seminal book by Herbert Stein *The Fiscal Revolution in America* (1969) which argued that growth had been highest in times of low sovereign debt and low government spending. Social security spending was particularly inefficient as it reduced incentive to work and save (Office of Income Security Policy 1975; R. A. Musgrave and P. B. Musgrave 1976, 478). From this theory, Reagan and the supply-siders derived the argument that government spending should be impaired through tax cuts.

The narrative of an excessive government resonated with voters’ and policy makers’ real-world observation that sovereign debt kept piling up and American voters’ traditional wariness of government (Zelizer 2004). This story of excessive spending became an important contribution to discredit government intervention of Keynesian economic policy in the run-up to George W. Bush’s tax cut in the 2000s but could not convince policy makers during the Reagan term because the predominant reasoning was one of

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<sup>14</sup> Ibid., p. 1.

<sup>15</sup> Ibid., p. 3.

<sup>16</sup> Ibid., p. 3.

supply-side economics. Even though Reagan argued that the federal budget was “out of control” and faced “runaway deficits,”<sup>17</sup> his solution sounded very technical again. The government program aimed to implement “properly functioning markets, free play of wages and prices, reduced government spending and borrowing.”<sup>18</sup> The tax cuts and the interest in balancing the budget did not contradict each other when the *Laffer curve* was applied to the problem. Some supply-side theorists had suggested that, depending on the size of productivity growth, the tax cuts generated could become “budget neutral” (Roberts 1971, 54). The government argued they could attain both low taxes and a balanced budget: “By fiscal 1984 – under the policy recommendations presented in this document - the Federal budget should be in balance.”<sup>19</sup>

To summarize the concepts used in Reagan’s tax cut narrative, it was highly dependent on supply-side economic thought but it seems this may have been an obstacle to policy change as Reagan and his task force presented the tax program through a highly technical rhetoric adopted from supply-side economics which suggested that voters should get incentivized to work harder in order to have capital accumulate in heavy-capital corporations of which most voters were very wary. More successful could have been the public choice argument of excessive government, which became important in the 2000s, however, Reagan opted for more technical language to portray the highly populist tenets ingrained in this theory.

#### 4.5 Contested Economism in Congress

Existing research on the relevance of ideas in tax cuts has predominantly focused on the epistemic communication of scientists and administration officials (Blyth 2002; Ptak 2009). This section will draw our attention at a different sphere of communication: the coordinative sphere. Policy makers use coordinative discourses to convince fellow policy makers of the cognitive and normative foundations of their program and the normative realm plays a significant role in this process (Schmidt 2016: 320). This section will demonstrate that in the Reagan era, the new paradigm of supply-side economic theory could not convince parliament because it lacked a strong normative foundation which could stand up against the strong social justice concepts that were still debated within the old Keynesian paradigm. The early technical version of the supply-side approach to tax reforms clashed with the traditional reasoning of basically all other groups in Congress. The only area in which the administration was able to transfer their cognitive arguments into congressional debates was incentivizing capital investment to generate growth which was strongly supported by Republicans in Congress. The second important argument, cutting taxes at the top to generate work incentives, was not adopted in Congress. Even the Republicans did not pick this argument up, but instead rephrased

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<sup>17</sup> Ibid.

<sup>18</sup> Ibid., p. 1.

<sup>19</sup> Ibid., p. 2

it as a normative argument for cutting taxes for the strangled lower and middle classes. Unfortunately, this narrative could not credibly justify the much greater cuts at the top. This incoherence in the Republican argument allowed the Democratic Party to attack their program on a normative basis.

Though none of the actors in Congress demanded greater redistribution to the poor, the Democrats and the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) attacked the program for being unbalanced and demanded compensation for the lower and middle classes. They argued, using ability to pay, that only a progressive tax cut was socially just. They also attacked the inequities that emerged with the massive cuts for big business employing an equality of capital and labor argument. They argued that a just tax cut would give greater provisions to the poor and focused on the labor-intensive and growing high-tech small firm sector which employed many more workers than the capital-intensive sectors. Though some small business provisions were added to the program, so were big business provisions. After attacking the program in Congress, the AFL-CIO took to the streets in a union-led protest. When deficits increased and voters grew increasingly frustrated with the program, a new approach had to be envisioned.

### *The GOP*

The Congressional debates in July and August 1981 show that many Republican Congressmen were not convinced of the supply-side reasoning that Reagan had promoted in the tax program even though it was directed at the most urgent issue of the economic crisis. At its source, the crisis was above all a crisis of productivity decline with rates falling from roughly 3 percent in the 1960s to 2 percent in the early 1970s and 1 percent in the late 1970s and triggering all sorts of economic issues in the Keynesian framework (Martin 1991, 23–24). The solution for the supply-siders, Reagan and Jimmy Carter in the previous administration had been to shift resources to the corporate sector through corporate tax cuts, the ACRS, and top personal tax rates to give incentives for individuals to save to revive capital formation. Even though the tax cut was directly responding to the main problem identified by policy makers at the time, Republican policy makers were not convinced of the tax provisions for heavy-capital and instead focused on popular arguments to give tax cuts for the middle class. The arguments that Republicans used were highly morally charged and deeply embedded in the traditional anti-big corporation values of Americans.

On the one hand, many Republicans were critical of tax cuts for oil companies which went against their values of equal treatment of interest groups on Capitol Hill which of course did not rule out the support for corporate tax cuts for heavy-capital but opened a window of opportunity for the Democrats to carry the critique of the program further into a narrative of a big-business reform. Many Republicans furiously rejected tax provisions for oil companies as special interest cuts and rejected the power

of specific sectors in the lobbying process on Capitol Hill. James Jeffords argued angrily: “Do oil companies in this country need a multibillion-dollar tax break? Are they distressed? [...] With a balanced budget already unlikely in fiscal year 1984, it is not sound economic policy to extend these tax breaks to a thriving industry.”<sup>20</sup> Others argued that oil provisions did not add to the “productivity/job raising purposes”,<sup>21</sup> but were the simple result of the political bidding war between the administration and the Ways and Means Committee, which was headed by Democrat Dan Rostenkowski. The oil provisions were not related to the President’s tax proposals or to “his economic goals of more jobs, more saving, and more investment [...]” They were “giveaways to big oil that quite aside from their perceived political necessity are clearly counterproductive to these goals.”<sup>22</sup> The special interests achieved gains from the oil industry “which [was] not exactly starving for capital.”<sup>23</sup> Many called it a “Christmas tree”<sup>24</sup> bill, achieved in “a bidding war”<sup>25</sup> through the influence of special interest, which went against the President’s ideal of implementing a “clean bill.”<sup>26</sup>

Many conservative Republicans mourned that the whole point of cutting taxes had been to curtail the influence of special interests and now, with Conable-Hance, these groups had influenced the tax plan again: “I am distressed that with the bidding war that has gone on between the two major bills it has been necessary to add sweeteners for various special interests with political power in certain key congressional districts.”<sup>27</sup> Other Representatives clearly contradicted the supply-side notions when they argued that it made more sense to use the funds that went into tax cuts for the corporate sector to invest as subsidies in the industrial sector: “These provisions carry a terrific cost that works against the goals of the President’s economic recovery program [...]” and “the savings resulting from their deletion or modification could be put to true supply-

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<sup>20</sup> Jeffords, James. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18042.

<sup>21</sup> *Ibid.*, p. 18033.

<sup>22</sup> *Ibid.*, p. 18033.

<sup>23</sup> Pritchard, Joel. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18033.

<sup>24</sup> Parris, Stanford. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18038; Porter, John, “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18084;

<sup>25</sup> Pritchard, Joel. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18033.

<sup>26</sup> Parris, Stanford. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18038; Lungren, Dan. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18039; Roukema, Marge. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18081.

<sup>27</sup> *Ibid.*, p. 18032.

side use – for example, reducing the deficit or providing additional and much-needed relief to our ailing basic and muture [sic] industrial infrastructuring [sic].”<sup>28</sup>

In the area of income taxes Republican arguments clearly rejected Reagan’s plan to renew the mature capital basis of corporations through income tax cuts. Instead of adopting Reagan’s arguments to lower progressivity in the tax system to incite work and savings, Republicans argued in Congress that income tax cuts were a means to relief American workers from bracket creep and inflation. Again the economic solution to the productivity crisis was not at the center of their argument. Republican parliamentarians almost never mentioned the cut in the top personal income tax rate but focused on tax relief for the middle and the bottom incomes. The majority of the debate was oriented at justifying tax cuts as a means to generate justice for people who suffered an excessive burden of income taxes, inflation and interest rates. Republicans were arguing on the justice concept of universality. Republican Senator Jack Fields argued “Today, we can correct the errors of the past Democratic leadership, a Democratic leadership which over the last 10 years had caused our taxes to rise \$400 billion [sic],”<sup>29</sup> by giving “all working Americans the liberty and freedom from excessive taxation”<sup>30</sup> Some parliamentarians found it unfair that lower and middle-income workers would have to pay higher tax burdens just because their nominal incomes were increasing through inflation. Many explicitly mentioned taxes as a burden: “The taxpayers of this Nation are struggling under the greatest burden of taxes in the history of our Nation.”<sup>31</sup> Stanford Parris, representative from Virginia, compared the excessive rate of taxation that American voters were facing to the rates the American colonies had paid to Great Britain and which had fueled the discontent that led to the American Revolution:

Mr. Speaker, in medieval times the serfs of that nation were taxed 25 percent of their work product. That is what brought about the revolution that created this Nation [sic], and yet today the average American taxpayer pays 44 percent of his or her total income to pay taxes to this Government. The average taxpayer worked this year from January 1 through May 10 simply to pay his or her direct or indirect taxes.<sup>32</sup>

In the congressional debates Republicans rarely mentioned the reduction in top rates and focused on supporting arguments for medium income tax cuts. Potentially this was a strategy to direct attention away from a potentially unpopular facet of the program, however, their enthusiastic endorsement of indexing makes their middle class support highly credible. Indexing tied tax brackets to real income increases and prevented the moving up into higher tax brackets just through inflation. In July 1981, Republicans added indexing to the Conable-Hance bill in a bid to gain support from both Demo-

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<sup>28</sup> Regula, Ralph. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18033.

<sup>29</sup> Field, Jack. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18036.

<sup>30</sup> *Ibid.*, p. 18036.

<sup>31</sup> Parris, Stanford. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18037.

<sup>32</sup> *Ibid.*, p. 18037.

crats and Republicans (Fullerton 1994, 185). Tom Petri argued that he supported the “Conable-Hance alternative, especially for its indexing provisions which will prevent unlegislated tax increases in the future.”<sup>33</sup> Later he repeated his claim when he argued against the many tax breaks for businesses that were added in Conable-Hance: “I support the Conable-Hance alternative, especially for its indexing provision which will prevent unlegislated tax increases in the future.”<sup>34</sup> A related topic was to argue that the middle class had suffered from inflation and that Republicans wanted to reduce inflation and bracket creep for the middle classes by all means. Several statements of Republicans were directed at this relationship: “If my colleagues want to hold inflation down, and inflation is the noose around the necks of all American, if you want to hold it down, vote for the bipartisan Conable-Hance substitute.”<sup>35</sup> Even though parliamentarians sometimes talked about how inflation actually evolved from big government and expansionary monetary policy which crowded out to finance, an important argument which Reagan also used. Most Republicans highlighted how the tax cut and its indexing function would help the middle class survive in times of economic crisis: “The provision for indexing the Tax Code on January 1, 1985, is in my opinion the most compelling reason of all to support Conable-Hance” He argued that under indexing “if the taxpayer gets a raise – he or she gets to keep the money [...]. The Federal Government does not reach deeper into your pockets when you finally get your raise [...]. Indexing is the one protection to the taxpayer that the seemingly unquenchable thirst of the congressional spenders may finally be abated.”<sup>36</sup>

### *The Democrats*

Rather than working for a strictly across-the-board cut in income taxation, I favor reductions which focus on low- and middle-income wage earners. I believe that any tax cut which shortchanges working Americans is unfair.<sup>37</sup>

The Democrats in Congress were least interested in questions about the economic viability of Reagan’s tax program. Much more frequent were attacks on the basis of normative reasoning. The justice concept used by the Democrats was *compensation* of the poor and the middle class for the extensive provisions for businesses and top incomes. Parallel to the Republican argument of overburdened workers through the current tax code, Democratic congressmen argued that the tax plan did not do enough for the

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<sup>33</sup> Petri, Tom. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 17904.

<sup>34</sup> Ibid., p. 18033.

<sup>35</sup> Quillen, Jimmy. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18031.

<sup>36</sup> Burgener, Clair. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18036.

<sup>37</sup> Gejdenson, Sam. “Tax Cut Legislation. Extension of Remarks. Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 28, 1981, p. 17905.

working people, the wage-earners, or the working poor. Dan Rostenkowski introduced an alternative tax plan against the tradition of both bipartisan bargaining on tax proposals. Rostenkowski's plan did not contain top income tax cuts and instead concentrated on income tax cuts for middle incomes of \$20,000 to \$50,000 (Martin 1991, 131).

Edward M. Kennedy referred to the "hard-working average Americans" who were not represented in Reagan's tax plan despite the "myth surrounding this legislation that it provides a real tax cut for everyone."<sup>38</sup> He worried that "average families earning \$20,000 income a year or less" received "no tax relief whatever, after inflation and rising social security taxes are taken into account."<sup>39</sup> Ed Jenkins, a Democrat from Georgia, argued that the Democrats needed to examine all facets of the tax plan "before [they made] the determination as to whether this [income tax] provision [was] fair."<sup>40</sup> To him, the across-the-board income tax cuts were designed in a way that top incomes gained a larger share than medium and small incomes. Jenkins argued that the disproportionality in the income tax cuts, coupled with all the other provisions for capital owners, was simply unbearable for American society. The cuts for interest and dividend incomes "from a maximum rate of 70 percent down to 50 percent. [...]" were "helpful only to the high-income people."<sup>41</sup> Sam Gejdenson was also worried about the administration's tax plan of across-the-board income tax cuts. "A major tax cut proposal must be subject to careful scrutiny for fairness."<sup>42</sup> And he found that the across-the-board cuts were less fair than cuts that focused on small and medium incomes because the absolute income gain was much greater for the rich in the first scenario:

Rather than working for a strictly across-the-board cut in income taxation, I favor reductions which focus on low- and middle-income wage earners. I believe that any tax cut which shortchanges working Americans is unfair.<sup>43</sup>

In later elaborations of this statement he argued that a tax plan was fair if it supported "most Americans" and not a "small percentage of wealthy families."<sup>44</sup> In a Senate session in August 1981, Thomas Francis Eagleton imagined the story of a conversation between an H&R Block banker and a worker. In this story, the banker explains to the worker why his paycheck is still small after the reform: "Well "across the board" was a clever euphemism. "Across the board" means that the wealthy get a whopper of a tax

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<sup>38</sup> Kennedy, Edward Moore. "Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127." July 29, 1981, p. 17965.

<sup>39</sup> Ibid.

<sup>40</sup> Jenkins, E. "Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127." July 29, 1981, p. 18054.

<sup>41</sup> Ibid., p. 18054.

<sup>42</sup> Gejdenson, Sam. "Tax Cut Legislation. Extension of Remarks. Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127." July 28, 1981, p. 17905.

<sup>43</sup> Ibid., p. 17905.

<sup>44</sup> Ibid., p. 17905.

cut and the average guy like you gets little or nothing.”<sup>45</sup> The Democrats condemned increasing inequality over and over in the debate on Conable-Hance: “And so the chasm that exists between the haves and have nots in our society becomes increasingly greater: and we are mandating that increased chasm by law.”<sup>46</sup> Dan Rostenkowski, the Democratic leader of the Ways and Means Committee and the author of the Democratic tax alternative dedicated one of his extensive speeches in Congress to the devastating effects that the bipartisan tax bill would have for the workers in the US and the poor. He argued that the number one goal of a tax plan should be to “provide equitable tax relief” as the Ways and Means proposal did “and second, to reorient the taxation of business and investment to promote economic growth.”<sup>47</sup> Then he used an extensive part of his speech to demand greater compensation for the poor if such large provisions were provided for businesses and the rich: “We have already enacted billions of dollars of spending cuts whose burden will fall on the working poor. Must we also make them pay income tax as well [sic]?”<sup>48</sup> Similarly, Sam Gejdenson protested:

I rise in opposition to this rule, and seldom do I rise in opposition to rules, but this time I feel I must. I believe that this rule is the most anti-Democratic and most elitist rule that this House has ever had.<sup>49</sup>

Thomas Francis Eagleton, Senator from Missouri, delivered one of the most furious statements on equality and the Reagan tax cut in the Senate: “Mr. President, this is an atrocious tax bill. It is atrocious in terms of economic policy and it is atrocious in terms of fundamental equity”<sup>50</sup> He argued that the tax cuts were highly skewed to the top and that the average American would carry away only limited benefits: “On the question of equity, I do not believe that the American people as yet perceive the inherent inequality of the Reagan program.”

After the indexing for income tax brackets had been included in the Conable-Hance bill in July 1981, the Democrats argued that it was a good measure, supporting the working people in America after “inflation [was] pulling taxpayers into higher tax brackets and [caused] their income taxes to rise at a faster rate than inflation.”<sup>51</sup> However, that was not enough. Dan Rostenkowski repeated the minimal standard of justice that the tax reform needed to achieve as compensation for the working people:

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<sup>45</sup> Eagleton, Thomas Francis. “Congressional Record, Senate, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127, August 1 – October 5, 1981,” August 3, 1981, p. 19306.

<sup>46</sup> LaFalce, John. “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18037.

<sup>47</sup> Rostenkowski, Dan, “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18046.

<sup>48</sup> *Ibid.*, p. 18046.

<sup>49</sup> Ertel, Allan E., “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18036.

<sup>50</sup> Eagleton, Thomas Francis, “Congressional Record, Senate, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127, August 1 – October 5, 1981.” August 3, 1981, p. 19305.

<sup>51</sup> Rostenkowski, Dan, “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18046.

The most reasonable standard for a fair tax cut is that it at least compensates taxpayers for these increased tax burdens [of social security increases and bracket creep], so that the proportion of income paid in individual income and employee social security taxes is reduced below its 1980 level for the vast majority of American households.<sup>52</sup>

Even though Conable-Hance adopted the indexing of income tax, many Representatives wanted to achieve even greater compensation for the lower incomes. They argued that the indexing of social security was almost more important to support the lower and middle income groups. For Dan Rostenkowski, the increases in social security contributions in the last year had excessively burdened the workers: “In 1981, the social security tax rate for employees rose from 6.15 to 6.65 percent.”<sup>53</sup> To John LaFalce, Democrat from New York, the idea of preventing any further bracket creep in the income taxes was a concept he wanted to support. However, he was unconvinced that that would suffice to keep inequality low because “about 50 percent of the American people pay about 50 percent of their total tax burden not through the income tax, but through the social security payroll tax” and the “constant increase in the social security payroll tax” gave “tremendous room for inequality unless we reform the social security system before we go to indexing.”<sup>54</sup>

### *Trade Unions*

The strongest opposition to the tax plan in the Congressional hearings arose from the largest American labor union federation, the AFL-CIO. The two most important topics to the federation were a demand for full employment and a demand for redistribution which were tightly linked. The coherence of the Keynesian with traditional values in American society made it difficult for the Reagan administration to convince the unions of the new program which did not yet carry a strong normative underbelly. The normative demand of redistribution which was embedded in a broader concept of *ability to pay* was later adopted by the protests against the tax plan which erupted in late 1981. These protests generated a serious crisis of popularity for the government in 1982, which pressured the government to engage in two follow-up reforms under the banner of raising fairness. The AFL-CIO and the Democrats formed a coalition which refused to support the tax proposal of Reagan and business groups which sparked normative pressure in civil society protests and public opinion.

Lane Kirkland presented his position on the tax program before the Ways and Means Committee on March 24, 1981. The most important statement in his speech was that “The President’s tax package is grossly unfair.”<sup>55</sup> To Kirkland, the tax program

<sup>52</sup> Ibid., p. 18046.

<sup>53</sup> Ibid. p. 18046.

<sup>54</sup> LaFalce, John, “Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127.” July 29, 1981, p. 18037.

<sup>55</sup> Kirkland, Lane. „Testimony of Lane Kirkland, President American Federation of Labor and Congress of Industrial Organizations before the Ways and Means Committee.“ March 24,

entailed an unfair shifting of the tax burden from the rich to the poor and from capital to labor income. He demanded greater orientation towards ability to pay and an anticipation of the needs of the poor. In the first part of his speech he refuted the government's claim that the tax cut was supporting all income groups in American society. He argued that the "even-handedness implied in the 10 percent per year across-the-board cuts" was a "façade."<sup>56</sup> Not everyone would get a tax cut, he argued; 15 million low income workers actually paid more in taxes when the plan was enacted. "Their taxes went up this past January as a result of the Social Security increases; this same group will be among the first to feel the impact of the Administration's cuts in social programs."<sup>57</sup> Also, average incomes of \$12,000 a year would scarcely benefit from the program. They "would receive a first year cut of \$128 if single; but only \$92 if supporting a family of four."<sup>58</sup> However, top incomes, would gain much higher shares: "At \$100,000 the cut is \$1,840 – eight times as much."<sup>59</sup> As a consequence 30 percent of the tax cut would go to incomes above \$50,000, "the top 5 percent of the nation."<sup>60</sup> The chairman of the AFL-CIO argued that the program was "unfair" because it was "tilted toward the upper-income classes."<sup>61</sup>

The AFL-CIO showed its greatest commitment to redistribution when it argued in a committee hearing that "only a progressive cut would be fair."<sup>62</sup> In November, when the bill had already been passed, the AFL-CIO argued that they wanted to fight new government initiatives aimed at shifting the burden further onto workers "masquerading as devices to meet urban problems (Urban Enterprise Zones), improve educational opportunities (Tuition Tax Credits), and [...] value-added tax or other inequitable consumption taxes must be fought."<sup>63</sup> The organization laid out their own "fair" tax proposal which planned to solve "the problems of the poor and disadvantaged"<sup>64</sup> instead of aggravating them. The main facet of their program was a refundable 20 percent tax credit on worker social security payments. They argued that this would increase justice in ability-to-pay terms, as low income workers would receive a cut, just like the middle-incomes which made the greatest gains in this program. "Taxpayers in the \$30,000 and below group would receive 60 percent of the benefits compared to the Administration's

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1981, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive, p. 1.

<sup>56</sup> *Ibid.*, p. 1.

<sup>57</sup> *Ibid.*, p. 1.

<sup>58</sup> *Ibid.*, p. 1.

<sup>59</sup> *Ibid.*, p. 1.

<sup>60</sup> *Ibid.*, p. 2.

<sup>61</sup> Kirkland, Lane. "Summary of Testimony on Administration Tax Proposals before the Committee on Ways and Means." May 28, 1981, Washington: U.S. Government Printing Office, p. 10.

<sup>62</sup> *Ibid.*, p. 10.

<sup>63</sup> AFL-CIO. "Resolution Adopted by the Fourteenth Constitutional Convention of the AFL-CIO." November 16-19, 1981, New York, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive.

<sup>64</sup> *Ibid.*, p. 8.

40%.” Top incomes above \$50,000 would receive 10 percent of the tax cut.<sup>65</sup> This clear refusal to accept a decline in progressivity and fight for tax cuts for the middle incomes stood against any form of business unionism. The AFL-CIO did promote a program that cut taxes for the middle class and was not directed at business interests.

Another topic that seemed highly important to the AFL-CIO was equality of tax burdens among capital and labor. In this area, the organization showed its low commitment to accommodating the administration’s demands to shift resources to the heavy-capital sector although Reagan envisioned that that would also help to generate jobs. Even though the economic crisis showed problems of capital formation which was the source for rising unemployment, this argument could not convince the trade unions which believed that Keynesian demand stimulation, industrial policy plus redistribution were still economically viable and socially just. In the union’s interpretation, inequality had to be reduced by all means. They argued that the Reagan reform proposal would rig “the tax structure against working people and overload it with tax avoidance opportunities for corporations and the wealthy” and that the government should “end the preferential double-standard which taxes workers’ wages and salaries at far higher rates than “unearned income” on savings, investments and estates of the wealthy.”<sup>66</sup> Kirkland argued that by 1986, revenues receipts from corporate income tax would have fallen from 23 percent to 7.6 percent.<sup>67</sup> Instead of seeing corporate income tax as maintenance to the jobs of their members, they considered tax cuts for corporations as highly problematic if these were not dedicated to manufacturing industries. They argued that they wanted to “reinstate the corporate income tax as a source of revenue and equity and eliminate the so-called “incentives” that subsidize mergers, takeovers, plant shut-downs, [and] overseas investments.”<sup>68</sup>

The AFL-CIO did not support the supply-side notion put forward by the government that “such cuts in marginal tax rates will entice more people into the labor force and encourage them to work harder.”<sup>69</sup> To them, this idea ignored the fact that there were eight million unemployed looking for jobs in the American economy and that this situation of job seeking individuals already generated enough incentives to work as it was. In terms of business tax cuts, the AFL-CIO rejected the idea to cut further corporate taxes for capital intensive sectors, as the administration proposed through the

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<sup>65</sup> Ibid., p. 6.

<sup>66</sup> Ibid.

<sup>67</sup> Kirkland, Lane. “Testimony of Lane Kirkland, President American Federation of Labor and Congress of Industrial Organizations before the Ways and Means Committee.” March 24, 1981, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive, p. 3.

<sup>68</sup> AFL-CIO. “Resolution adopted by the Fourteenth Constitutional Convention of the AFL-CIO.” November 16-19, 1981, New York, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive.

<sup>69</sup> Kirkland, Lane. “Testimony of Lane Kirkland, President American Federation of Labor and Congress of Industrial Organizations before the Ways and Means Committee.” March 24, 1981, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive, p. 2.

ACRS. Instead, the AFL-CIO promoted a strategy of reindustrialization through small firms. This small firm strategy was later adopted by George W. Bush in his tax cut and became one of the big selling points in the American anti-big government framework: “Larger, more prosperous, capital intensive firms would reap huge benefits while smaller, labor intensive firms would benefit very little.” Kirkland elaborated that it was economically unsound to give cuts to “healthy, growing corporations” which would have made the investments that are now subsidized anyway.<sup>70</sup> The AFL-CIO argued that instead, the funds should be used to financially support suffering industries and prevent relocations of firms through a “reindustrialization [...], revitalization and rehabilitation of this nation’s basic industries and economically distressed areas,”<sup>71</sup> Lane Kirkland stated in a testimony before the Ways and Means Committee that Reagan’s tax plan “was too costly,”<sup>72</sup> and would result in “shoe-string public budgets” that would cause “economic and social problems.”<sup>73</sup> If the government engaged in budget cutting, which hurt the poor, it could not simultaneously cut taxes for corporations and the rich:

We see no justification, particularly in this time of budget slashing and proclaimed need for austerity and sacrifice, to throw as much as \$60 billion a year in federal tax cuts to the nation’s corporations and their stockholders.<sup>74</sup>

It would make more sense Kirkland argued, in line with the Democrats, to use the funds to “revitalize” the distressed industries and areas through a program of reindustrialization.<sup>75</sup> The loans and tax subsidies should go to “new U.S. industries with a high growth potential” and firms with “difficulty competing because of unfair foreign trade practices” or who had “special capital needs for modernization, expansion and restoration of their competitive position.”<sup>76</sup> For supervision of the distribution of funds for reindustrialization, they proposed to introduce a tripartite board of “business, labor and government.”<sup>77</sup> In line with the Democratic argument, the union federation argued that industries which promised high employment and which needed help should get funds:

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<sup>70</sup> Ibid., p. 4.

<sup>71</sup> Ibid., p. 6.

<sup>72</sup> Kirkland, Lane. “Summary of Testimony on Administration Tax Proposals before the Committee on Ways and Means.” May 28, 1981, Washington: U.S. Government Printing Office, p. 10.

<sup>73</sup> AFL-CIO. “Resolution Adopted by the Fourteenth Constitutional Convention of the AFL-CIO.” November 16-19, 1981, New York, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive.

<sup>74</sup> Kirkland, Lane. „Testimony of Lane Kirkland, President American Federation of Labor and Congress of Industrial Organizations before the Ways and Means Committee.“ March 24, 1981, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive, p. 5.

<sup>75</sup> AFL-CIO. “Resolution Adopted by the Fourteenth Constitutional Convention of the AFL-CIO.” November 16-19, 1981, New York, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive.

<sup>76</sup> Kirkland, Lane. „Testimony of Lane Kirkland, President American Federation of Labor and Congress of Industrial Organizations before the Ways and Means Committee.“ March 24, 1981, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive, p. 7, 8.

<sup>77</sup> Ibid., p. 7.

“Additional capital investment is needed in many, but not all industries and areas” and the planned tripartite institution would direct its resources to specific geographic areas of the country that are most in need.”<sup>78</sup> Though the AFL-CIO did not explicitly define which industries they wanted to support in their congressional testimony, they provided a written statement which proposed that the basic manufacturing sector should receive special emphasis. The organization also added an article by William R. Kenan, economics professor at Northwestern University, who argued that the government plan to implement ACRS provisions was unfair for the automobile industry, where “depreciation is already very rapid, and three-year capital recovery would be less advantageous than what is currently available.”<sup>79</sup> The building sector and industries with long-lived equipment would gain a lot, and least benefitting were “less capital-intensive, generally small businesses crowded out in the tax-saving orgy by large capital intensive firms in older industries.”<sup>80</sup> The professor argued that high-tech firms and research-oriented firms would lose out.<sup>81</sup> This argument was supported by statements from the United Automobile, Aerospace and Agricultural Implement Workers of America International Union (UAW), who also argued that the 10-5-3 was “disadvantageous to the auto industry”<sup>82</sup>

The second pillar of the AFL-CIO’s growth argument was based on a very clear-cut Keynesian demand stimulation as well as full employment. The organization demanded government support for struggling industries and lower incomes with a high propensity to consume. “The dynamic American economy rests on consumer purchasing power and the principles that workers are able to enjoy the goods and services they produce.”<sup>83</sup> Full-employment was “the cornerstone of [their] domestic program” because employment fulfilled the basic needs of individuals like food, health and housing, but it was also important to generate government revenues which could be used to support the economy.<sup>84</sup> Rather than cutting taxes for higher incomes, the AFL-CIO promoted tax cuts for lower and middle incomes, an expansion in social security expenditures and subsidies for reindustrialization. Public budgets should be used for “creating jobs, revitalizing the nation’s cities, industries and distressed areas, meeting the needs of the poor, the old and the moderate and middle-income Americans.”<sup>85</sup> And they argued repeatedly that social programs were morally and economically imperative. They were

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<sup>78</sup> Ibid., p. 8, attachment 4.

<sup>79</sup> Eisner, Robert. „Write Off 10-5-3, The Washington Post.“ March 19, 1981, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive, p. 8, attachment 4.

<sup>80</sup> Ibid., p. 8, attachment 4.

<sup>81</sup> Ibid., p. 8, attachment 4.

<sup>82</sup> Young, Howard. “Summary of Testimony on Administration Tax Proposals before the Committee on Ways and Means.” April 3, 1981, Washington: U.S. Government Printing Office, p. 49.

<sup>83</sup> AFL-CIO. “The AFL-CIO Program – 1980.” COPE, General, box 1, AFL-CIO Archive, p. 1.

<sup>84</sup> Ibid., p. 1.

<sup>85</sup> AFL-CIO. “Resolution Adopted by the Fourteenth Constitutional Convention of the AFL-CIO.” November 16-19, 1981, New York, Legislative Department, Testimony 1953-1994, RG21-002 box 12, AFL-CIO Archive.

“important to the daily lives of millions of Americans and to the achievement of economic and social justice for every American. These programs are the bulwark of a society with a social conscience.”<sup>86</sup> In the union program that was laid out in 1980, the AFL-CIO argued that social security programs needed to get extended “The status quo – the simple continuation of these programs - is not good enough.”<sup>87</sup> They suggested greater funding for education, Medicare, Medicaid and the implementation of “comprehensive national health insurance.”<sup>88</sup>

In sum, the AFL-CIO clearly condemned the increases in inequality that resulted from Reagan’s tax plan and instead demanded a greater orientation towards the existing Keynesian framework which combined economic growth through industrial policy and growth stimulation with a moral dimension of ability to pay and redistribution in the tax system. Even though the crisis indicated that productivity declines were a problem and Reagan’s tax plan proposed to tackle these, the existing Keynesian arguments of justice and economic growth provided a strong bulwark against the new paradigm.

## Protests

Even though American electoral institutions and institutions of industrial relations tend to generate conflicts among the lower and the middle class because of the unequal distribution of the burdens of the welfare system – paid by the middle class - and the benefits of the welfare system – received by the lower class (Prasad 2006), a strong paradigm which combines economic growth and justice arguments can generate strong coalitions which pressure policy makers outside of electoral and industrial institutions. This is what happened in 1981 when a coalition of women, people of color and workers demanded the maintenance of expenditures in infrastructure, social security and ability-to-pay fairness in the tax system. This group received strong ideational support from the Democratic Party and trade unions in parliamentary discussions and made use of the Republican continuous argument along Keynesian economic policy. This protest pushed the government into a popularity crisis and eventually led to the repeal of the unequal shift of the tax burden from businesses to workers.

The protest coalition capitalized on the critique developed in parliament by Democratic and (some Republican parliamentarians) pointing to the frictions in Reagan’s tax plan. The coalition mobilized groups from the civil rights, women’s and environmentalist movements as well as religious groups, consumer interest groups and agricultural organizations. All these groups demanded a repeal of the generous tax cut for heavy capital and progressivity in the tax system. The United Auto Workers, the National Association for the Advancement of Colored People (NAACP), the Consumer Federation of America, the American Agricultural Movement, the National Council on Senior Citi-

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<sup>86</sup> Ibid., p. 3.

<sup>87</sup> Ibid., p. 3-4.

<sup>88</sup> Ibid., p. 3-4.

zens, the Sierra Club, the League of Women Voters (LWV) and the US Catholic Conference were all part of the group.<sup>89</sup> The coalition organized the largest march on Washington since the 1960s on Saturday, September 19, 1981. Solidarity day gathered an estimated number of 260,000 to 500,000 protesters planning to combat the budget and tax cuts by Ronald Reagan. Even under the conservative estimate of 260,000 this protest was larger than the iconic civil-rights march on Washington in 1963 or the anti-Vietnam War march in 1969. It was the largest labor march in the American history (Minchin 2015, 75). For weeks prior to the protest, the administration gathered information on the protesters' critiques and developed alternative arguments.

Aside from the attack on the normative side of the tax plan, from which Reagan suffered because his tax plan was predominantly based on economic ideas, he had made himself highly dependent on an immediate economic success of the tax plan. When this did not show, his government slid into a deep popularity crisis among voters. Surveys conducted and analyzed by the government show that a majority of Americans worried about the development of the overall economy and prioritized a balanced budget over further tax cuts. 77 percent of Democratic voters felt this way, and even 70 percent Republican voters argued that tax cuts should be postponed to later times. 49 percent rejected another tax cut and 40 percent considered a tax increase a potential remedy to the crisis.<sup>90</sup> The fact protests eventually led the government to argue that a conditional tax increase had become an acceptable idea. Especially, as Office of Management and Budget (OMB) director David Stockman remembered, when the deficit was approached the critical psychological mark of \$200 billion in early 1984 (Stockman 1994, 232).

With the program being so unpopular and Democrats holding a majority in Congress, the head of the Office of Public Liaison, Elizabeth Dole, explained that the administration needed the support of all business groups in their lobbying efforts to get ERTA through Congress. Especially in light of the election in 1984, government officials had to do something to improve the popularity of tax cuts and decided to reverse many of the provisions for corporations and top incomes in the TEFRA in 1984 and the TRA in 1986 and shifted their narrative to fairness and small businesses.

## 4.6 Conclusion

Institutionalist literature often explained the exceptionally small American welfare state and the low degree of redistribution by pointing to a lack of solidarity of American societal groups. This lack of solidarity was generated, or at least aggravated, by a tax sys-

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<sup>89</sup> Stewart, Sharon, "Labor, Rights Groups Plan Protest of Budget Cuts," July 1, 1981, *Rocky Mountain News*, Elizabeth Dole Files, Series III Economic Recovery Program, box 68, RRPL.

<sup>90</sup> Meese, Edwin. 1982. "Flash Results of a Telephone Survey of Adult Americans' Attitudes Toward the Proposed Tax Package." Edwin Meese Files, OA 11844, box 66. RRPL.

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tem which placed high tax rates on highly visible tax measures. American voters never developed strong support for welfare because of the earmarked nature of welfare expenditures and the racist stereotypes that arose with it. The white middle class never developed affinity with welfare recipients which were culturally singled out as predominantly African American unemployed (Gilens 1999; Lieberman 1998; Prasad 2006; Wilensky 1975; Wilensky 2002). However, the debates in Congress in 1981 show that Republicans and Democrats in Congress were highly critical of the new program that Reagan had introduced under the banner of work incentives and competition and demanded the maintenance of ability to pay because the new ideas of Reagan were not capable of replacing the coherent Keynesian paradigm of cognitive and normative arguments. Additionally, interest groups including the AFL-CIO raised their normative demands for greater redistribution in the hearings. This ideational coalition of Democrats, trade unions and parts of the Republican Party spurred public protest which the AFL-CIO organized. Reagan's focus on technical reasoning then caused a serious popularity crisis right after the implementation of the tax cut, because the promised economic improvements also did not show.

## 5 The Bush Tax Cut 2001

The tax cuts of the 1980s were accompanied by substantive protest from congressmen, civic groups and labor unions who demanded the maintenance of the Keynesian approaches to tax policy and normative values in American society. When George W. Bush was elected President of the United States, he promised to revive the “Reagan Revolution” and undo the tax increases of the Clinton administration. This chapter will show that Bush’s success to pursue this goal of permanently shifting the tax burden from the top to the bottom rested on his coherent normative embedding of the tax plan in traditional American values. As opposed to Reagan, Bush abstained from proposing unpopular cuts for big business and instead *moralized* his tax cut as a form of small-firm support which was more conducive to the values of individual entrepreneurship among parliamentarians and civil society. The narrative of the administration additionally *discredited* redistribution as part of excessive government which spoke to American voters’ anti-government sentiments and *incorporated* many of the compensation suggestions made by the Democrats who found it difficult to raise the old paradigm under this new highly coherent paradigm for growth and fairness. The resistance of the Democrats faded and a large share of Democrats voted for Bush’s cut.

Though institutionalist literature is more open to cultural and institutional explanations for economic policy change than many other approaches, tax research in the institutionalist tradition emphasized rational decisions made by policy makers, business interests and society. Historical institutionalists expect neoliberal tax cuts in the US to result from a collision of stable pluralist electoral institutions with objective demands of globalization pressures. The distribution of resources and power in the fragmented political system had feedback effects on culture, but culture had no life of its own. In a surprising way, the attempt to embed the research of taxation in a historicized institutional framework remains somewhat focused on functional inevitabilities. Policy makers made rational decisions to adapt their tax system to economic pressures within an institutional landscape which was particularly permeable to business interests. The nearly confiscatory taxation of the rich and corporations in the American tax system inevitably demanded a reduction in tax under demands of efficiency and business power (Prasad and Deng 2009; Prasad 2012a; Steinmo 1993). The non-existence of an intermediary body between interest of labor and capital – corporatist institutions - exposed American democracy to conflicts which the powerful capital interest won. The rational state had to accommodate capital interests due to its dependency on capital investment for employment (Prasad 2006; Hacker and Pierson 2010; Steinmo 1993). Finally, since there was no pecuniary incentive for the middle class to support redistribution as American welfare was earmarked for the poor, the rational middle class supported neoliberal tax

cut programs and distanced itself racially and economically from the outsiders, i.e. the unemployed (Bartels 2005; Gilens 1999; Wilensky 2002).

This chapter will show that a significant shift in discourses on taxation among policy makers since the 1980s enabled the massive neoliberal reforms. The Bush tax cuts cannot be explained economic pressures alone. Bush came to office in the final year of a decade of strong economic growth rates which saw unemployment drop to four percent, a value last achieved in 1968. The Clinton administration had achieved these growth rates despite raising top personal income tax rates from 30 percent to 35 percent and even generated a solid budget surplus from the revenue increases. All these economic developments indicated that the high taxation of top incomes did not harm economic growth and that there was little efficiency legitimation for tax cuts.

Much more important than real economic developments was the ideational framework in which policy makers operated. After the Democratic political ideals of redistribution, progressiveness in the tax system and industrial policy had been discredited as policies of special interests, the Bush administration filled the normative vacuum with a new framework of morality in markets. Instead of talking about growth theories, as Reagan did, the administration used three basic tenets of justice, which were universalism in tax cuts, genuine meritocracy for all Americans and a right to their money. The first tenet argued that the planned tax cut helped all hard-working Americans alike through a proportional rate reduction. The second argued that the tax cut enhanced opportunities for the poor in the labor market and small businesses in the product market by giving particularly strong cuts to these groups. The third tenet argued that Americans had a right to the revenues which they had paid in the form of taxes and which were now piling up as a federal surplus in treasury. Through this framework, Bush solved the conflict between Democrats and Republicans of the 1980s, in which Democrats championed morality through social justice and Republicans championed objective growth imperatives of markets. Bush's concept gave moral value to the market itself.

This concept was highly effective to win over skeptical culturally conservative Republicans who endorsed Bush's universalistic tax cuts and genuine meritocracy. At the same time, Democrats ceased demanding additional redistribution in the tax system after the principle of equality of outcome had been discredited as particularism of special interests. This concession to conservatism was also reflected by the interest groups invited as witnesses to congressional hearings as Democrats increasingly opted for analytical research institutes instead of inviting trade unions. Institutionalists would interpret this shift as the consequence of declining union power, but I argue that we need to add an ideational element if we want to understand the power of unions in the American political economy. Unions had been stripped of all their institutional power since the early 1980s but had been very successful in leading protests against inequality in a coalition with civil rights and women groups. These coalitions of solidarity did not come to live in the 2000s.

This chapter will lay out the shifts in discourse that enabled the neoliberal tax cuts by George W. Bush. It will start by laying out the economic context and the power of conservative think tanks. Then, it will describe the partisan distribution of power in Congress and the character of the tax cuts of George W. Bush in 2001. It will also describe how the administration developed a highly persuasive ideational framework of morality of markets and show how it was perceived in Congress.

## 5.1 Macroeconomic Context

Most tax research places a strong emphasis on external economic efficiency pressures when explaining tax cuts for higher incomes. The tax cuts of George W. Bush in the early 2000s would accordingly be understood as driven predominantly by the trade and capital market integration since the 1980s. For tax competition research, governments reduce top personal income tax rates to support small firms in the hope that these firms stay within respective jurisdiction. Additionally, governments use tax cuts to attract foreign financial investments which pay smaller tax on interest and capital income (Auerbach and Slemrod 1997; Genschel 2005; Ganghof and Genschel 2008; Winner 2005). This section will show that these external efficiency pressures do not sufficiently explain why the George W. Bush administration opted for tax cuts for higher incomes. What speaks against efficiency pressures on the American tax system is that the Clinton administration had demonstrated how much financial investment a government could spur by deregulating finance for lower incomes while simultaneously balancing the budget through high top personal income taxes. Ideas and interpretations of the economic situation must play a mitigating role in the transformation from the Clinton to the Bush era because overall objective efficiency indicators were high in both administrations.

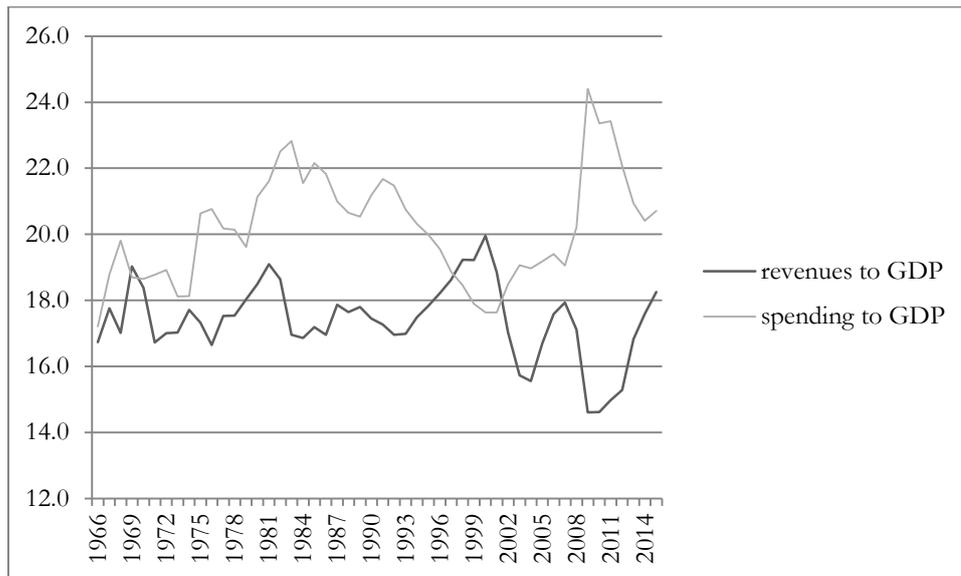
The first reason to believe that ideas and interpretations of economic indicators within specific frameworks of paradigms play a significant role in the tax cuts of Ronald Reagan and George W. Bush is that both governments faced highly different economic conditions but still considered tax cuts a remedy for either of these economic environments. In 2001, the economy had just gone through a boom phase that had lasted for ten years, characterized by low inflation rates, low unemployment rates and a significant surplus in the sovereign budget. Even though productivity kept falling continuously and the economy showed the first signs of a recession in 2001, the experience of Bill Clinton's economic policy, which coupled an expansion of consumer credit and mortgages for lower incomes with high tax rates for the rich and a balanced budget, led many economic advisers – even from the supply-side – argue that balancing the budget was the most important goal to recover economic growth. The fact that both Reagan, who faced a significant budget deficit and Bush, who inherited a budget surplus from his predecessor, considered tax cuts at the top of the income distribution the right economic policy to enhance the efficiency of the American economy indicates that they at

least had different interpretations of efficiency than the economic advisers who kept trying to prevent the accrual of high budget deficit through the tax cuts. Additionally, the variables which tax competition literature mentions, i.e. trade integration and competition for financial and real investments into the American economy, were mentioned by the Bush administration as reasons for tax cuts at the top.

In the two terms from 1993 to 2001, Bush's predecessor Bill Clinton had reinvigorated the progressiveness in the American income tax system. Clinton campaigned on the implementation of universal social benefits and health insurance in 1993, promising every American comprehensive health insurance that covered all the benefits private firms were paying for. However, after the November 1994 election, Congress was controlled by the Republicans after forty years of Democratic dominance. Not only could the health reform not pass Congress, but Clinton turned to eliminating social security provisions for the very poor, including the Aid to Families with Dependent Children (AFDC) (Lieberman 1998, 5–9; Skocpol 1997, 4–5). Under the restrictions of a conservatively dominated Congress and a financial market that increasingly reacted to policy maker decisions with enormous shifts in stock markets, Clinton adopted a Third Way strategy of privatized Keynesianism which coupled financial market deregulation with austerity measures in fiscal policy. In order to dedicate greater funds to poverty alleviation and education the financial market was opened for low income groups to finance their consumption spending and student loans (Streeck 2011, 17–18). In terms of income tax policy, Clinton extended the provisions at the bottom through an increase in the now highly popular Earned Income Tax Credit (EITC) from 14 percent to 34 percent, 40 percent for taxpayers with more than one child, and reduced it to 7.65 for childless taxpayers (Hotz and Scholz 2003, 147). The administration raised the top personal income tax rate from 31 to 39.6 percent while simultaneously reducing the top rate on capital gains from 29 percent to 21.2 percent (Piketty 2014, 499; Seabrooke 2006, 139). Together these resulted in an increase in the average income tax rate for the richest one percent of American taxpayers from 20 percent to 24.5 percent (see Chapter 1 and Congressional Budget Office 2014).

Through the boom years under Clinton, the increases in tax revenues and the declines in government outlays generated a budget surplus from 1998 to 2001 (see Figure 7). This was the first time since the 1960s that the government collected more funds than it spent. Analysts inside and outside government argued that the surplus lowered inflation and interest rates and “crowded in” private investment. Many commentators and supply-side economists applauded the consensus focused on balancing the budget as the right means to generate growth in the economy (Elmendorf, Liebman, and Wilcox 2002). The positive development in the budget area was accompanied by relatively expansionary monetary policy by the FED chairman Alan Greenspan as inflation remained low.

Figure 7 - Revenue and spending as percentage of GDP



Source: Congressional Budget Office (2016)

This policy environment was highly beneficial for financial investments in the US economy which created a boost of economic growth in the new economy of 8 percent in the 1990s.<sup>1</sup> Most economic analysts agreed that tax cuts for higher incomes were not necessary to attract further funds from outside of the US. Quite to the contrary, the financial market was overheated and steered towards a burst of an internet-based financial bubble, the dot.com crisis in 2001. In terms of profit generation, the finance sector – comprising finance, insurance and real estate - increasingly accumulated high returns during the 1990s. In the early 1990s, the share of corporate profits generated in finance had outstripped the manufacturing share. In 1999, 28 percent of the profits generated in the American economy were generated by finance and only 25 percent accruing to manufacturing (Krippner 2005, 179).

The tax competition argument that governments reduce top personal income tax rates to enhance the efficiency and the attractiveness of financial investments in respective economy does not seem to sufficiently explain the shift in tax policy between Clinton and Bush. Clinton's tax policy was very efficient in bringing economic growth to the US economy and the financial sector in particular. However, the growth in financial value took place mostly within the lower and middle income strata of US credit. The Bush administration was aware that a sizable amount of private debt that had accrued during the Clinton years and that it could lead to a bubble bursting. Instead of just intending to raise any kinds of financial investments to the US economy, the administration *interpreted* the tax cut as a way of shifting the distribution of financial investments in the US economy from the lower and middle strata to the top and to institutional inves-

<sup>1</sup> The Economist. "Bush's Big Tax Cut. As President-Elect George Bush Puts His Economic Policy Team Together, He Appears Determined to Press Ahead With His Plan for a Big Tax Cut." December 19, 2000. <http://www.economist.com/node/456946> (accessed February 19, 2017).

tors. It was not intended to attract more resources to the financial market but it was supposed to take the heat out of the market and prevent a financial crisis by giving consumers the funds to repay their private debts.<sup>2</sup> It became one of the declared goals of the Bush tax policy to give lower income individuals more income in order for them to repay the consumer and mortgage debt they had accumulated due to the low interest rates and deregulation of finance for lower incomes. Tax cuts were also intended to keep individuals' consumption alive and give them funds to pay the increasing energy costs.<sup>3</sup> The administration developed a narrative of "ownership society" in which institutional investors should get support through top personal tax cuts, capital gains tax cuts and dividend tax cuts (see Section 5.3 and Davis 2009, 3).

## 5.2 Institutional Context

Historical institutionalism investigates how power relations of the past influence power relations of the present by becoming ingrained in institutional configurations. Most of these scholars argue that tax cuts for higher incomes in the United States were implemented because of the conflictual nature of electoral politics and the lack of solidarity of the middle and upper class with the lower class (Prasad 2006; Steinmo 1993; Wilensky 2002). The chapter on Reagan's tax cuts held against this reasoning that the middle class showed high levels of solidarity with the lower class in a cross-class civil society coalition for social justice which was eventually able to push the government to repeal parts of the inequities of its first tax reform. This solidarity was no longer apparent when the Bush tax cuts were implemented. A second institutionalist or power resource argument for tax cuts, is the decline of trade union power (Hacker and Pierson 2005b; 2010). Even though trade union decline has long term effects on the influence of social movements against declines in redistribution, Reagan's radical breaking of strikes and union rights had pretty much ended the institutional power of unions by 1981, where one final protest against such reforms took place. Aside from this institutional power loss, societal beliefs about the ability to counter austerity must have changed as well. In this section I will argue that the Bush tax cuts were more successful in permanently cutting taxes for higher incomes because the Republicans had convinced large parts of American society that tax cuts were economically necessary and morally integer by integrating traditional conservative values of compassion.

Even though the power relations in Congress were similar to the power relations in the 1980s, liberal Democrats could not achieve a repeal of the tax program as they did in the 1980s because a growing section of the Party agreed with the tax cuts. Accordingly, the historical institutionalist thesis that US electoral institutions produce an overly conflictual institutional environment which is conducive to tax cuts does not seem to

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<sup>2</sup> Stevenson, Richard W. "The Wisdom to Let the Good Times Roll." *The New York Times*, December 25, 2000, p. 1.

<sup>3</sup> Ibid.

hold. It rather looks like a growing consensus among Democrats and Republicans on tax cuts for higher incomes drove much of the change in tax cuts for higher incomes. The Bush administration and the Republicans did not hold a strong mandate after the election in November 2000. George W. Bush's election and the distribution of power in Congress, indicate a rather careful societal endorsement. Bush only won a slight victory over Al Gore which remained controversial for at least another year due to fraud allegations which included uncounted ballots in Florida.<sup>4</sup> The distribution of seats in Congress after the election did not represent a landslide victory for the GOP. On the contrary, the GOP only held a slight majority in the House of Representatives and the Senate was evenly split among Democrats and Republicans. The institutional power of the Republicans deteriorated during the first months of the year of 2001. On June 6 2001, Republican James Jeffords declared his independence from the GOP, joined the Democratic caucus and thereby shifted majority in Senate to the Democrats. Despite the powerful position of the Democrats in the Senate and their ability to veto specific provisions of the tax plan, or the entire tax plan, they did not use this power to change the uneven character of the first tax cut. Though a coalition of moderate Democrats and Republicans pressed the government to reduce the overall size of the cut and limited the provisions for top incomes slightly, its primary features were preserved because many Democrats supported the program (Lewandoski 2008, 2). These shifts in policy maker beliefs must play a significant role in tax cuts for higher incomes.

Power resource theorists argue that the Democratic Party lost in power vis-à-vis the Republicans in Congress with the loss of power of their closest civil society ally: the trade unions. The loss of union power after the 1970s in terms of member size and effectiveness in securing labor rights is certainly one of the reasons why Democrats found it increasingly difficult to gather support of working class voters for projects such as tax cuts. Union coverage had dropped from 35 percent of the total workforce in 1950 to 12 percent in 2003 and forced Democrats to turn to new allies which were supported by large voter groups but lacked the grassroots of trade unions in local communities which is why vote shares kept declining (Skocpol 2004). However, the rate of unionization had already been extremely low in 1980, at 17 percent, and strikes were basically non-existent by the time Reagan broke the PATCO strike in 1981 (Mayer 2004, 11). If union decline had an impact on the power of Democrats it was partially transmitted by a shift in beliefs about justice and economic growth.

The other variable which power resource theorists like to highlight when investigating tax cuts is business power. Business clearly played a role in getting both tax plans - Reagan and the Bush's - through Congress, but Reagan had to repeal this business-oriented approach when civil society rebelled against it, while Bush did not. Accordingly, business power alone cannot explain the difference. The plan for The Economic Growth and Tax Relief Reconciliation Act (EGTRRA), the first tax cut in 2001, had in

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<sup>4</sup> Fessenden, Ford, and John M. Broder. "Examining the Vote: the Overview: Study of Disputed Florida Ballots Finds Justices did not Cast the Deciding Vote." *The New York Times*, November 12, 2001.

parts already been laid out during the Bush campaign. It was concentrated on an across-the-board income tax cut which was supposed to support the economy and simplify the tax system.<sup>5</sup> The tax relief was supposed to cost \$1.6 trillion and bundle the two top brackets and reduce the rates to 33 percent from 39.6 and 36 percent. The tax brackets of the 31 and 28 rates were intended to fall to 25 percent. For lower incomes, the tax reform also planned an increase in the child tax credit from \$500 to \$1,000 and the marriage penalty, i.e. higher taxation for couples with unequal incomes after marriage, was planned to get curtailed through a ten percent deduction for two-earner couples. The plan also entailed the elimination of the estate tax and an extension of charitable deductions for non-itemizers.<sup>6</sup>

Very different from the Reagan tax cut which had given provisions to large businesses to get it passed in Congress, the Bush administration concentrated on small business and finance when it created a Tax Relief Coalition. This reorientation from corporate tax cuts to small business tax cuts enabled the administration to credibly argue that this was a project of equal opportunities for all entrepreneurs in the American market and it prevented protests of the kind that Reagan faced against his heavy capital cuts. Bush received support mostly by small businesses - NFIB and Chamber of Commerce – while big business - the NAM and the National Associations of Wholesaler-Distributors – refused to actively contribute to the Tax Relief Coalition after Bush turned down a request to reduce corporate tax cut in addition to the planned R&D credit and an elimination of the corporate alternative minimum tax.<sup>7</sup> Instead, the Office of Public Liaison concentrated on small businesses and finance by offering them the repeal of the estate tax cut and reduction of the top personal income tax rate to support the program.<sup>8</sup> The finance industry showed the strongest support for the repeal of the estate tax, saving incentives and the reduction in the capital gains tax rate. The Mortgage Bankers Association of America wrote to the President that they supported the tax plan, as the increases in disposable income helped their industry; individuals could use the funds to invest in the real estate market.<sup>9</sup> But finance was also interested in the tax cuts for lower and middle incomes, arguing that these cuts would allow consumers to pay off their debts,<sup>10</sup> which is an interest which only emerged with the piling up of private debt since the 1990s (Mertens and Meyer-Eppler 2014).

Even though business support was important as a source of funding and to gain sufficient support of economically conservative Republican Congressmen for the tax

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<sup>5</sup> Alvarez, Lizette, and Stephen A. Holmes. "Bush Tax Cut Loses Appeal for Republicans in Congress." *The New York Times*, September 14, 2000.

<sup>6</sup> Bush, George W. "Remarks by the President on Tax Cut Proposal." February 8, 2001, *APP*.

<sup>7</sup> NAM "Letter to George W. Bush." February 23, 2001, WHORM Subject File FI0101, box 1, *GBPL*.

<sup>8</sup> Morgan, Dan. "Lobbyists in Final Tax Bill Scramble." May 25, 2001. *The Washington Post*, p. A07.

<sup>9</sup> Woodward, Andrew D. "Mortgage Bankers Association of American. Letter to the President." March 5, 2001. WHORM Subject File FI0101, box 1, *GBPL*.

<sup>10</sup> Various letters to the president; Thies, Clifford F. "Here is What Prominent Economists and Industry Leaders are Saying about the President's Economic Growth Proposal." WHORM Subject File FI0101, box 1, *GBPL*.

cut (Hacker and Pierson 2005a), in order for the tax cut to last, the administration had to create a credible normative narrative of morality in tax cuts. That is why the Office of Public Liaison established close ties religious and culturally conservative interest groups, something that Reagan administration had lacked. The head of the OPL, Lezlee Westine, focused on social, family and women issues (Pika 2009, 560). The Tax Relief Coalition gained much of its persuasive force from the fact that the group was comprised of a mix of business and cultural interest groups. Religious interest groups such as the Christian Coalition, the Family Research Council, the Islamic Institute and Toward Tradition supported the tax plans and thereby gave Bush's coalition greater appeal for conservative American voters. Also supportive were conservative think tanks such as the Center for Security Policy and the Heritage Foundation.<sup>11</sup> A Seniors Coalition formed to support the tax relief from which retirees benefitted, like the retirement savings incentives, and supported the repeal of the death tax.<sup>12</sup> Additionally, Grover Norquist and his Americans for Tax Reform took a leading role in aligning business and conservative ideologies. In a letter to Bush, he endorsed the tax plan, as workers, children, family and the elderly benefitted.<sup>13</sup>

The government's proposed repeal of the marriage penalty, i.e. the increase in taxes for two unequal income earners after marriage, the repeal of the estate tax, and the many proposed tax breaks which helped poor families were generally supported by think tanks and interest groups advocating family issues. Greater provisions for charity were supported by religious groups. The group that the Office of Public Liaison held the closest ties with was the conservative Christian lobby group Family Research Council which was also repeatedly invited to speak before Congress (Pika 2009, 560).

Even though the Democrats were institutionally in an equally powerful position as in the early 1980s, i.e. holding a slight majority in one of the two houses, the alternative tax plan they proposed in the Senate never became as powerful in the 1980s Congressional debates. The alternative tax plan equally focused on tax cuts at the center and the bottom of the income distribution. It planned to introduce a new bottom income tax rate of 12 percent for incomes below \$20,000 and expand the tax credit for the working poor.<sup>14</sup> The Democrats were in a powerful position as only one Democratic Senator was in favor of Bush's plan and two renegade Republicans, James Jeffords and Lincoln D. Chafee, defected from the party line in the Senate.<sup>15</sup> However, they nevertheless agreed to join the Republicans for a bipartisan tax plan which Rostenkowski had re-

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<sup>11</sup> Edsall, Thomas B., "Interest Groups Are Suiting Up for Tax Cut Battle; Fate of Bush Plan Linked to Swing of Government and Legitimacy of President's Election," *The Washington Post*, March 11, 2001.

<sup>12</sup> Martin, Mary. "The Seniors Coalition. Letter to the President." July 3, 2001. WHORM Subject File FI0101, box 2, *GBPL*.

<sup>13</sup> Norquist, Grover. "Americans for Tax Reform. Letter to the President." February 22, 2001. WHORM Subject File FI0101, box 1, *GBPL*.

<sup>14</sup> Kessler, Glenn, and Juliet Eilperin. "House Passes Bush Tax Cut. President Gets First Legislative Victory. 10 Democrats Vote for Bill." *The Washington Post*, March 9, 2001, p. A01.

<sup>15</sup> Mitchell, Alison. "2 Moderate Republicans Oppose Bush Tax Plan as Democrats Offer Their Own." *The New York Times*, February 16, 2001.

fused to do in the 1980s because he *interpreted* the goals of Democratic and Republican Parties as too distant from one another. In the end, the bipartisan plan clearly reflected traditional Republican ideals which the Democrats had basically agreed on but asked to downsize slightly for budget reasons. Instead of cutting taxes by \$1.6 trillion, the EGTRRA only cut taxes by \$1.35 trillion. The Democrats turned the repeal of the estate tax into a significant reduction of estate taxes - the tax free amount was lifted from \$675,000 to \$4 million - and limited the top rate reduction to 36 percent instead of 33 percent. They also added provisions for the poor by the introduction of a new bottom tax rate of 10 percent, by extending the eligibility of child tax credits to individuals without labor income and made the EITC and the additional-child tax credit refundable against the alternative minimum tax (AMT).<sup>16</sup> The doubling of the standard deduction for married couples, however, benefitted mostly double-earner families. The tax plan also gave retirement savings incentives by lifting tax-free contributions to Individual Retirement Accounts (IRAs) (Lewandoski 2008, 4–5; U.S. Government 2001, 53–54). Despite adding some provisions for the lower classes and families, EGTRRA still was highly uneven and top incomes gained the largest tax cuts. Compared to the tax cuts in the 1980s, the most significant factor which had changed was the *narrative* of the Democrats of what good tax policy was. Instead of demanding social justice and ability to pay, coupled with subsidies for high-tech firms, the Democrats now believed that tax cuts were good for growth as long as they did not threaten the budget surplus and the maintenance of existing social security programs.

The second reform, The Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003, was passed in the midst of a deepening recession, increasing economic insecurities after 9/11 and a dominance of the GOP in both Houses after the midterm election. The second reform cut taxes by \$350 billion over five years and largely built on accelerating the already planned 2001 provisions of the individual tax cut, the marriage penalty and child tax credit. Additionally, the reform increased dividend tax allowances for individuals by \$500 plus an allowance of 20 percent income in excess of this amount. Capital gains taxes were also curtailed from 10 and 20 percent to 5 and 15 percent with zero taxation for the year 2008. And small businesses received allowances on expenses to \$75,000 and gained from an extension of the R&D tax credit, an increase in the AMT minimum to \$61,000. The benefits for lower incomes were scaled back by phasing out the bottom rate reduction to 10 percent until 2005. Also, the child tax credit refunds became restricted to families which earn more than \$10,500 (Brownlee 2004, 242; Lewandoski 2008, 26–35; Morgan 2009, 188). This second reform was passed under a new majority of the GOP in both houses (Lewandoski 2008, 34–35).

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<sup>16</sup> Kessler, Glenn. "Senators Unveil Plan to Modify Tax Cut's Tilt." *The Washington Post*, May 12, 2001, p. A01.

### 5.3 Context of Expert Authority

The fact that George W. Bush and Ronald Reagan depended on a very similar epistemic community of academics and think tanks which had already risen to their height of public attention in the 1980s, indicates that Bush's success in pursuing these tax cuts had to rest on an additional to supply-siders' expert authority. One of the factors which crucially helped George W. Bush to sell his tax program and which Ronald Reagan lacked in his program was a traditional culturally conservative underpinning of his economic program which Reagan had dismissed in his quest to sound particularly credible as someone who understood economic growth and would be able to resolve the growth crisis. While Ronald Reagan had predominantly worked with businesses to get support for his tax plan in Congress, Bush had developed very strong ties with civil society, including women groups, African American groups and a number of religious thinkers which helped creating a strong normative narrative for tax cuts for the rich.

The New Right, a movement which had developed since 1970s in the US as a counter-movement to the New Left, had always remained split on cultural and economic topics of libertarianism. The group that developed as an opposition to New Deal and Great Society policies had built their ideational narrative largely on Friedrich Hayek's (1944) *Road to Serfdom* which proposed to diminish the interference of the state with the economy. Though the conservatives who followed Reagan largely agreed on greater self-sufficiency of the individual in the economic sphere, the intellectual movement remained split on areas of cultural and value conservatism. This split sometimes resulted in contradicting sentiments among the intellectual conservative movement which lacked intellectual coherence, for instance, on defense spending and a diminished government budget (Brown 2006).

During the 1980s Ronald Reagan found that proposing a mere elimination of the state and the full liberation of the markets did not resonate with a significantly large constituency base to counter leftist demands of equality of outcome or compensation for the poor or the middle class. In his second term, Reagan had to shift his policy program towards concepts of inclusion and universalism to generate a coalition of market-friendly conservatives with religious groups and other groups which were conservative but did not feel represented by mere market liberalism. George W. Bush's *Compassionate Conservatism* promised to provide this support from the outset. The program proposed an even greater emphasis on moral aspects of policy making and let go of the orthodoxy that some Republicans had placed on the goal to balance the budget. Many supply-side conservatives were angered by Bush's betrayal of the Reagan dogma of not increasing any social security provisions. Bush planned to introduce new provisions for the elderly in Medicare and increase funds for education (Waddan 2010, 174). Bush's greater emphasis on traditional conservative values in the areas of abortion, law and order, the faith-based initiative and support for the needy, women and families was embraced by cultural conservatives in the GOP who had supported him since his campaign (2010, 169).

There was significant continuity in terms of economic ideas and academic advisers relevant in the setup of tax cuts between the Reagan and Bush administrations. The same conservative think tanks supported the Reagan and the Bush tax cuts with very similar arguments. The Heritage Foundation was very active in issuing reports and briefs about the economic advantages of the tax proposal arguing that within the next ten years the tax cuts could eliminate public debt.<sup>17</sup> Similar personal continuities can be observed among economic advisers to the president. Martin Feldstein had been one of the most important advisers in the CEA of the Reagan administration and became one of the most important advisers of the Bush administration. Bush met Feldstein repeatedly personally and appointed his graduate students Lawrence Lindsey and Glenn Hubbard to central positions in his administration.

Even though all three economists followed new approaches in supply-side economics the basic message was still the same: cutting taxes would increase economic activity in the American economy. The only difference was that the new supply-siders added to the former argument of capital formation through savings incentives, that productivity in the labor force and technological innovation could also be stimulated through tax cuts. Some developed new mathematical models and some looked empirically at the economic development after Reagan's tax cuts to find that technological innovation R&D had increased by Reagan's policy program (Barro and Sala-i-Martin 2004; Lindsey 1990; Morgan 2010, 187). Essentially, Bush depended on pretty much the identical group of researchers as Reagan. Both presidents were highly dependent on Martin Feldstein's idea that income tax cuts could generate savings and support the sluggish economy through creative innovation (Morgan 2010, 187–88). Glenn Hubbard was appointed chairman of the CEA and Lindsey advised Bush as the director of the National Economic Council (NEC) until 2002. Lindsey designed the across-the-board tax cuts together Bush which were basically designed on the basis of Ronald Reagan's cuts.

#### 5.4 Administration Narrative: Compassionate Conservatism

It is the American story, a story of flawed and fallible people united across the generations by grand and enduring ideals. The grandest of these ideals is an unfolding American promise that everyone belongs, that everyone deserves a chance, that no insignificant person was ever born.<sup>18</sup>

The political science literature which focuses on the impact of ideas so far argued that tax cuts were driven by a growing authority of economists in networks and epistemic communities with politicians (Blyth 2002; Ptak 2009). Even though the group of economists which advised George W. Bush were part of powerful networks and had a strong influence on policy circles, those economists had already been powerful in the

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<sup>17</sup> Wilson, Mark, and William W. Beach. 2001. *The Economic Impact of President Bush's Tax Relief Plan*. Center for Data Analysis Report, no. 01. Washington: The Heritage Foundation.

<sup>18</sup> Bush, George W. "Inaugural Address." January 20, 2001, *APP*.

1980s. In order to explain the different successes of the Ronald Reagan and the George W. Bush administration in passing tax cuts, we have to focus on what was different between them. Reagan proposed a highly technical program of supply-side economics which went against a number of American values including anti-big businesses sentiments while only marginally drawing on the popular concept of excessive government. This economic approach also made the government highly vulnerable to the economic downturn which followed right after the cut and pushed the government into a popularity crisis. George W. Bush, on the other hand, embedded his project of tax cuts into a popular narrative of excessive government and compassionate conservatism which was capable of embedding the project into a broader normative framework. Compassionate conservatism successfully *discredited* the Keynesian approaches of Democrats as driven by politics and special interests and compassionate conservatism *incorporated* the demands of the opposition for compensations for the working poor, while providing a narrative of universalism which *moralized* tax cuts as democratic and fair. This findings highlights the argument historical institutionalists have made that the communication of policy makers amongst each other and of policy makers and voters critically depend on societally accepted normative frames (Hall 1989; Münnich 2010; Schmidt 2008).

Since his election campaign in 2000, George W. Bush had presented his policy program as inclusive, universal and compassionate. His ideational concept of *compassionate conservatism* explicitly rejected the unpopular Reagan argument of curtailing government spending as a primary goal. Compassion meant that conservative cultural values stood at the heart of the policy program and that the amount of the state expenditure was determined by the funding needs for policies to achieve those cultural values. Accordingly, in Bush's rhetoric, government spending in the area of defense, education and social security was not condemned, but integrated in a larger program of supporting the poor in their struggle to make ends meet. This way, Bush was able to integrate the goals of women and religious groups with business interests. Though the winners of the tax cuts clearly were top incomes, business and finance, with finance benefitting from high incomes having greater funds to invest and lower incomes paying off consumer credit, protest in Congress remained minor. The administration had developed a highly coherent concept of *morality in the market*. This concept of market justice gained part of its support by *incorporating* Democrats' demands of *compensating* the poor and by focusing on tax cuts on *small business* instead of big manufacturing or oil firms. The Bush administration *moralized* their concept of a genuine meritocracy by arguing on the basis of *universalism* that all Americans gained from the tax program by receiving a tax break and improved investment or employment conditions. This coherent normative concept was difficult to object by the opposition.

The thesis that globalization and tax competition drive tax cuts for higher incomes cannot sufficiently explain why George W. Bush implemented a tax cut which came to office after a long period of strong economic growth, low inflation and a government surplus. Equally, trade union power decline cannot be a sufficient explanation for

Bush's success because unions had already lost their power positions in the 1980s. The one thing that clearly distinguishes Bush from Reagan is the way he sold the tax cuts to his voters. The 2000 election had been were overshadowed by scandals of economic fraud including the Enron pension scheme scandal and a number of cases of firms shifting their production to cheaper tax jurisdictions such as Ireland (McCall 2013, 2). These scandals made voters highly sensitive to unequal treatment of corporations and individuals and very unlikely to support a candidate who would cut taxes for corporations and top incomes. The main trait that voters were looking for in a presidential candidate was someone with character and principles, a moderate who could beat the Democrats. Steve Forbes, who also ran for office could not stand a chance with his business background and his open promotion of a flat tax of 17 percent for all individuals and corporations.<sup>19</sup>

Though in the Gallup Poll of 1999, 74 percent of voters favored a tax cut over spending increases when asked for these broad choices. When asked about specific social spending programs like Medicare, 69 percent favored an expansion of Medicare without tax cuts over the reverse scenario which only 28 percent supported. The topics with top priority were: number one raising children in today's culture with 41 percent support for it being the top priority, the cost of health care in the United States with 36 percent support and the availability of good jobs in the United States with 32 percent support. The amount Americans pay in federal taxes was ranked fourth with 26 percent arguing it was the top priority. A vast majority of voters wanted the middle-class families to receive the tax cuts as opposed to top incomes (Gallup 2000, 77, 133, 69; Morgan 2009, 222). This low demand for income tax cuts was probably also due to the fact that the middle class had gained from lower taxation since the tax rate reduction in 1981 and the indexing that had been implemented in 1985. Even those voters who believed that tax cuts would improve the economy had not reason to demand radical tax cuts in the 2000s, as inflation and bracket creep were no longer a significant problem for American middle incomes (Morgan 2009, 222).

This combination of demands for social security and personal character was perfectly appealed to in Bush's narratives of compassionate conservatism. The dominant figure behind this concept was Marvin Olasky, a man who had shown a lot of principles and character in his faith-based program New Start and in numerous books authored on poverty, government and Christianity. His book (1995) *The Tragedy of American Compassion* had been distributed in Congress by speaker Newt Gingrich, which is where Bush got in touch with it.<sup>20</sup> In it he narrated a history of American poverty alleviation through private and church-based initiative and argued that liberals had conquered the concept of compassion for their own agenda of government expansion. In 2000, Olasky published a book on the future of the concept *Compassionate Conservatism* (2000) to which George W. Bush contributed a foreword.

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<sup>19</sup> Wayne, Leslie. "The 2000 Campaign. The End. Forbes Spent Millions, but for Little Gain." *The New York Times*. February 10, 2000.

<sup>20</sup> Grann, David. "Where W. Got Compassion." September 12, 1999. *The New York Times*.

The book was also reminiscent of Robert L. Woodson's ideas of self-help for the poor. Woodson, the head of the Center for Neighborhood Enterprise, had promoted self-help since the 1980s and had justified Reagan's welfare cuts under the imperative of non-paternalism vis-à-vis African American welfare recipients. On this basis, Olasky argued that conservatives had complained about the liberal's inclination to increase welfare spending for the wrong reason. It was not wrong to take care of the needy, but liberals had done it the wrong way. Welfare spending had actually been an easy way of solving a much more complex problem of poverty. The Democrats had left the needy alone by giving them transfers instead of care: "The major flaw of the modern welfare state is not that it is extravagant, but that it is too stingy. It gives the needy bread and tells them to be content with that alone" (2000, 4). What the poor needed was faith-based neighborhood support in the inner cities as Woodson and Olasky had argued in their publications and practiced in their own initiatives (2000, 2). In the foreword Bush argued that compassion needed "personal help and accountability" (2000, xi). Instead of using government spending to alleviate poverty, as liberal governments had done in the past, real compassion demanded both material and spiritual help. Without the latter the poor were left alone and stuck in poverty forever.

This narrative of compassionate conservatism hence appealed to all conservative voters, those who were economically conservative and demanded a small government and those who demanded cultural conservatism and an emphasis of Christian values. Presenting the tax program under the moral umbrella of compassion, George W. Bush's speeches starkly differ from Ronald Reagan's technical and academic speeches in 1981. Instead of talking about the economy, incentives and growth, Bush and his staff built the speeches around the moral concept of *market justice* and *genuine meritocracy*. This allowed them to talk about markets, efficiency, effort and growth, without mentioning economic theorems. Genuine meritocracy implied a universally inclusive market for every individual, an empowerment of individuals, and saw markets as a democratic space, where each individual actor could develop according to her talents and contribute to the common good through self-actualization. In such a society, government was not needed to order, power and distribute resources. Every citizen had access to the market, full potential to develop her talents and earn according to what she deserved. Through inclusion in the market, the poor received the chance to improve their status. The tax reform speeches generated an image of resolving problems through individual initiative, without raising the topics of markets or growth. Individuals did not need incentive to behave rationally in the market, since every individual was born with Christian virtues of initiative, talent and faith. These virtues could not only be found in lower class workers, who wanted to improve their situation in the labor market, but also in family entrepreneurs who wanted to improve their status in the product market. Instead of giving incentives or punish the unproductive, tax cuts could empower individuals, integrate them in the market and reward a group of deserving poor and small firms in their endeavor to work their way out of poverty. The resemblance of the concept of

compassionate conservatism with Helmut Kohl's concept of subsidiarity, which will be introduced in Chapter 6, is astonishing.

Two speeches were central in conveying the new tax proposal to Congress and the public in early 2001. First, Bush gave a speech on the *Tax Cut Proposal* for the general public on February 8 and presented his *Administration Goals* on February 27 before a Joint Session of the Congress. At the center of the speeches stood the narrative that all Americans had been overly burdened by tax increases in the past decade and that an across-the-board income tax cut would bring *universal* tax relief to everyone in society. Bush used the concept of a universal tax cut in almost every section on taxes. In his speeches, Bush argued that he wanted to "lighten the tax load" for everyone by lifting "the tax burden on the American people."<sup>21</sup> The tax cut was helping every American as "everyone who pays income taxes will get relief."<sup>22</sup> The administration carefully avoided leaving an open flank for the opposition to critique equality of the plan. It was important to mention that big businesses did not gain from the tax cut. Instead, Bush argued, that small businesses and all American individuals were the beneficiaries of the tax cuts. They were "directed toward individuals and small businesses. It offers relief for everyone who pays income taxes."<sup>23</sup> Universalism was presented as an inclusive concept which would "welcome everyone" to thrive in the American market. Every American should be able to partake in the growing wealth in the American economy: "This country had prospered mightily over the last 20 years. [...] It's time to open the door and welcome everyone in."<sup>24</sup>

While Reagan presented the tax cuts at the bottom end of the income distribution by a rational and cognitive concept of work and saving incentive, which was closely aligned with supply-side economic theory, George W. Bush rephrased the justification of tax cuts for lower incomes with meritocratic justice and deservingness. He argued that hard-working families, who wanted to improve their lives by entering the labor market, or improve their social status within the labor market, should not get punished with high tax rates. These groups were particularly vulnerable and deserved support in their endeavors. The poor were defined as struggling to survive and struggling to enter the middle class. Bush argued that their efforts were punished by the current tax system which placed a higher marginal tax burden on the lower incomes than wealthier taxpayers. Small parts of the American society had excessively gained from the wealth increases over the past twenty years but vast parts of society had still been "looking from outside."<sup>25</sup> George W. Bush told the story of a waitress with two children, earning \$25,000, and paying a higher tax rate than a successful lawyer, who earned ten times her income. Bush was infuriated about the fact that the tax code told the waitress "stay where you

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<sup>21</sup> Bush, George W. "Remarks by the President on Tax Cut Proposal." February 8, 2001, *APP*.

<sup>22</sup> Bush, George W. "Address Before a Joint Session of the Congress on Administration Goals." February 27, 2001, *APP*.

<sup>23</sup> Bush, George W. "Remarks by the President on Tax Cut Proposal." February 8, 2001, *APP*.

<sup>24</sup> *Ibid.*

<sup>25</sup> *Ibid.*

are, you'll never get ahead."<sup>26</sup> People like the waitress tried "to work their way into the middle class" and were discouraged to do so through the uneven distribution of tax burdens which barred "too many Americans from the middle class."<sup>27</sup> For Bush, this message sent by the tax code collided with the principle of a just reward for hard work. Genuine meritocracy and the American Dream needed a new lower tax rate for the bottom incomes and this lower rate was not presented as an incentives but a "fairer treatment" to those who had earned their money in hard work and overtime.<sup>28</sup> The introduction of the new ten percent tax bracket would encourage individuals "to work, save and pay off their debts."<sup>29</sup> But more importantly, it would reward them for their efforts, gave them what they deserved, and support them in their already chosen "path to the middle class."<sup>30</sup>

Aside from the struggling poor, families were presented as a particularly vulnerable group in American society which needed tax support for their initiative. Bush argued that he wanted to help families through a doubled tax credit for each child. On average families with two children would get \$1,600 and working families, earning between \$35,000 and \$75,000, would keep between \$600 and \$3,000 in tax money each year. "This \$1,600 is good for a family, multiplied by millions of families."<sup>31</sup> From the money, families could pay all their basic living expenses: food, education and gas, which had increased significantly in the past ten years. \$1,600 paid the "gas for two cars for an entire year; it pays tuition for a year at the community college; it pays the average family grocery bill for 3 months."<sup>32</sup> Many families had the dream to improve their living standards or those of their children and taxation restricted them in achieving their dreams by taking away their income: "My attitude is, Government [sic] should never stand in the way of families achieving their dreams."<sup>33</sup>

The third societal group which Bush presented as in need of a tax relief, were small businesses. Equivalent to poor individuals in labor markets, small businesses were the thriving, struggling and deserving entities in product markets. Bush characterized small businesses as deserving because they generated the greatest productivity increases, greatest advancements in innovation and strongest growth in employment. Giving small business a tax cut was giving them "a better chance to grow and hire."<sup>34</sup> Bush worried that the high tax rates of about 40 percent were strangling "thousands of sole proprietors, people with dreams."<sup>35</sup> The reduction in the top personal tax rate was justified

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<sup>26</sup> Ibid.

<sup>27</sup> Bush, George W. "Remarks by the President on Tax Cut Proposal." February 8, 2001, *APP*.

<sup>28</sup> Bush, George W. "Remarks by the President on Tax Cut Proposal." February 8, 2001, *APP*.

<sup>29</sup> Bush, George W. "Congressional Meeting-Taking Points." January 22, 2001, WHORM Subject File FI0101, box 1, *GBPL*.

<sup>30</sup> Bush, George W. "Remarks by the President on Tax Cut Proposal." February 8, 2001, *APP*.

<sup>31</sup> Bush, George W. "Remarks by the President on Tax Cut Proposal." February 8, 2001, *APP*.

<sup>32</sup> Bush, George W. "Address Before a Joint Session of the Congress on Administration Goals." February 27, 2001, *APP*.

<sup>33</sup> Ibid.

<sup>34</sup> Bush, George W. "Remarks by the President on Tax Cut Proposal." February 8, 2001, *APP*.

<sup>35</sup> Ibid.

through the support of small business. The government planned to cut the marginal tax rates for small businesses which would enable them to reinvest profits and grow. These cuts would give small businesses the “fighting chance in a difficult economy”, just as the bottom rate reductions gave the poor a chance to survive in the labor market.<sup>36</sup>

This highly popular project of compassion was coupled with an American Dream narrative of deservingness of hard-working Americans and their right to their money justification, which argued that wage earners were the natural owners of their gross income and the state should diminish it as little as possible by the taxation. Bush defined a threshold to taxation rate of one third of the individuals’ income: “No one should pay more than a third of the money they earn in Federal income taxes.”<sup>37</sup> This way the administration could justify the massive reduction in the top personal income tax rate: “so we lowered the top rate to 33 percent.”<sup>38</sup> A similar argument was applied to justify the planned repeal of the estate tax. Instead of arguing as Reagan did that tax cuts were helping capital formation and improved incentives, Bush stressed conservative family values such as that inheritances belonged to the family and that it was “not fair to tax the same earnings twice-once when you earn them and again when you die.”<sup>39</sup> Bush argued that the budget surplus which had accrued under Bill Clinton was an indicator that too much of taxpayers’ income had been taken away over the past eight years. “We must give over-charged taxpayers some of their own money back.”<sup>40</sup> And “as we debate this issue, always remember, the surplus is not the Government’s money; the surplus is the people’s money.”<sup>41</sup> To Bush, the surplus signified that the state collected more taxes than it needed “to run the federal government.”<sup>42</sup> The state had to “return some of this overpayment to those who sent it. Otherwise, we all know that if we leave it in Washington it will be spent.”<sup>43</sup>

To summarize Bush’s communication strategy with parliamentarians and voters, it avoided arguments on productive investments and capital formation, such as the ones Reagan had used extensively, and rarely talked about economic theory or economic growth. There are probably two reasons for this negligence of economic arguments. On the one hand, the economy had grown at significant rates in the ten years before Bush came to office. On the other hand, Bush knew that technical growth arguments were unpopular and attached his growth arguments to the morally legitimate tax cut for families, lower incomes and small businesses. Taken together with the finding that Reagan had tied his tax program neatly to economic growth arguments and struggled with pro-

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<sup>36</sup> Bush, George W. “Remarks by the President on Tax Cut Proposal.” February 8, 2001, *APP*.

<sup>37</sup> Bush, George W. “Address Before a Joint Session of the Congress on Administration Goals.” February 27, 2001, *APP*.

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.*

<sup>40</sup> Bush, George W. “Remarks by the President on Tax Cut Proposal.” February 8, 2001, *APP*.

<sup>41</sup> Bush, George W. “Congressional Meeting-Taking Points.” January 22, 2001, WHORM Subject File FI0101, box 1, *GBPL*.

<sup>42</sup> *Ibid.*

<sup>43</sup> *Ibid.*

tests after the reform caused a worsening of the economic situation, it seems that the critical difference between Reagan and Bush was the different presentation of the tax cuts vis-à-vis voters and parliamentarians. Globalisation and economic crises cannot explain Bush's tax cuts because economic growth had been very high under Clinton's tax cut. Equally, theories of authority of economists and the decline of union power are not sufficient to explain Bush's cut because economists' authority and faltering unions power had already existed in the Reagan era. It seems that one crucial factor for Bush's successful tax cut was the way he communicated with his voters and other politicians, through a narrative of compassionate conservatism.

## 5.5 Congress and the Accommodation of Morality in Markets

Scholarship which looks at the relevance of ideas in economic policy making has produced a number of highly convincing accounts of how the epistemic community influences policy makers to adopt new ways of thinking about economic policy making (e.g. Hall 1989; 1993; Kingdon 1984). For the Bush era too, scholars showed how those economists who influenced the Reagan program also influenced the tax plans of George W. Bush (Davis 2009; Morgan 2009). What has received less attention is the complex process of coordinative communication in parliament, in which policy makers often transgress greatly from the original program set up by economists and instead look for a normative framework in which to embed the economic policy recommendations (Hall 1993; Münnich 2010; Schmidt 2016).

This section will show how George W. Bush's compassionate conservatism created a narrative of genuine meritocracy, inclusive labor market and inclusive product markets. Tax cuts were presented as helping lower incomes to get access to the labor market and small business to thrive in product markets. Though the tax plan did not entail provisions for big business and did not raise the inequity between big business and small firms, the shifts in the income tax plan significantly raised inequality along the income scale. The rich gained by a much higher degree from the tax cuts than the poor. Critique from the opposition was rather defensive and generate strong societal coalitions outside of Congress to fight the tax cut. I will show that Bush's narrative convinced the opposition, civil society and voters by discrediting their approach to government spending, incorporating their demands for compensations and moralized the tax cuts with the concept of universalism.

*The GOP*

The good news is I think we all agree that we are going to have a tax cut, it's just a question of what kind and how much we are going to give back to the American people.<sup>44</sup>

The popularity crisis of the Reagan administration, in the first three years of government, had in part originated from the fact that even Republicans were not entirely convinced of the new tax program and maintained old arguments from Keynesian and social justice origins. Many representatives questioned the provisions for big business and focused on arguments of universal tax cuts for hard-working Americans instead. Conversely, George W. Bush's presented his tax reform as universally cutting taxes for all American workers and small businesses. He returned to the GOP's traditional belief of deservingness and integrated his arguments into a broader frame of morality in markets. This ideational framework raised the popularity of tax cuts in Congress. Many of the tax provisions that the GOP endorsed originated from Democratic alternative plans from the 1980s, but under George W. Bush's plan became embedded in the moral concepts of market justice and universality. Three issues were central in Republican arguments for tax cuts. Like Bush, they emphasized the universality of the tax cut that went to suffering Americans, they endorsed provisions for the poor which enhanced meritocracy and they agreed with the Democrats that tax cuts should not be too large, so that the budget remained balanced and Social Security spending was maintained.

Economic growth was rarely mentioned as an isolated topic in Congress because the new economy had helped accrue growth rates of up to 8 percent to the American economy during the 1990s. Only few parliamentarians were worried about the decline of the rates in 1999, while most considered this slump a short break from a continuing growth path in finance and high-tech products.<sup>45</sup> This speaks against the theses that tax cuts originate from economic crises and power of the supply-side economists. This is one of the rate quotes by Bill Thomas, chairman of the Ways and Means, who integrates the sluggish economy into his argument: "The health of our nation's economy demands that we act quickly. Pick up the local newspaper and you can see the beginnings of sluggish economy - tens of thousands of layoffs, production cutbacks, and over-stocked warehouses."<sup>46</sup> But instead of explaining how the tax cut would generate growth, he talked about the tax burden in the next sentence. "Working Americans continue to feel the tax bite."<sup>47</sup>

The main justification for tax cuts, raised by GOP representatives, was that a universal income tax cut rewarded all hard-working Americans. This emphasis had not

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<sup>44</sup> Bush, George W. "Congressional Meeting-Taking Points." January 22, 2001, WHORM Subject File FI0101, box 1, *GBPL*.

<sup>45</sup> The Economist. "Bush's Big Tax Cut. As President-Elect George Bush Puts His Economic Policy Team Together, He Appears Determined to Press Ahead With His Plan for a Big Tax Cut." December 19, 2000. <http://www.economist.com/node/456946> (accessed February 19, 2017).

<sup>46</sup> Thomas, Bill. "President's Tax Relief Proposals. Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session" February 13, 2001. Washington: U.S. Government Printing Office, p. 4.

<sup>47</sup> *Ibid.*, p. 4.

changed since the early 1980s, when it collided with Reagan's supply-side program which intended to liberate resources in the corporate sector to bring economic growth back. Bush's tax plan, on the other hand, was highly congruent with the moral ideas of most Republicans. The tax plan to them had a "very positive vision," as David Dreier Representative from California put it, as it called "for a reduction of the tax burden on working families."<sup>48</sup> Many Congressmen argued that despite the tax cuts under Reagan, families still spent more in taxes than they spent in consumption of food, clothing and housing.<sup>49</sup> It seemed outrageous to many congressmen that "hard-working American taxpayers"<sup>50</sup> were not able to pay for their electricity bills, mortgage payments and credit card debt because they had to "sacrifice" so much of their "hard-earned money"<sup>51</sup> to the government. John David Hayworth argued that the planned across-the-board income tax cut rewarded American families for the efforts they made to improve their lives and the common good of American society: "A vote in favor of this legislation will result in tax relief for the American family. That is the basic premise. That is the tool we use to achieve that dream."<sup>52</sup> Scott McInnis (R-CO) attacked the Democrats for their routine to "spend and spend and spend" and called them out to at least acknowledge that the hard-working people deserved a cut for their efforts:

Those liberal Democrats [...] should at least have enough guts to stand up to the people who are working for this money, who are creating jobs in this country, and tell them they want to spend, spend, spend instead of threatening them with their future education for their children or all future needs of this country will not be met if a tax cut goes to the American taxpayer.<sup>53</sup>

Aside from promoting universal tax cuts, the tax credits provided at the bottom end of the income distribution were strongly endorsed by most Republicans. The fact that all provisions for the poor were restricted to married couples and families, made the tax plans attractive to culturally conservative Republicans. To the GOP representatives, the most important provision in the tax plan for poor families was the repeal of the marriage penalty. The proposal to repeal the marriage penalty had originated from a biparti-

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<sup>48</sup> Dreier, David. "Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147." May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2214.

<sup>49</sup> Thomas, Bill. "President's Tax Relief Proposals. Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session" February 13, 2001. Washington: U.S. Government Printing Office, p. 4.

<sup>50</sup> Thomas, Bill. "President's Tax Relief Proposals. Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session" February 13, 2001. Washington: U.S. Government Printing Office, p. 4.

<sup>51</sup> Hayworth, John David. "Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147." May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2210.

<sup>52</sup> *Ibid.*, p. 2210.

<sup>53</sup> McInnis, Scott. "Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147." May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2212.

san tax proposal of the Republicans and Democrats which had passed Congress in 2000 but had been vetoed by President Clinton. The plan was a combination of the doubling of the standard deduction with a doubling of the income threshold in the 15 percent tax bracket.<sup>54</sup> The initiative was an attempt to support poorer and middle-class families and a large share of the provisions went to the unemployed and had the same income effect as social transfers. The working poor benefitted from the expansion of the EITC for the second earner, but the doubling of the standard deduction helped individuals who did not itemize their taxes, which had no labor income. This openness of the Republicans in endorsing family provisions for the non-working later enabled an ideational coalition with the Democrats, who demanded greater cuts through a 10 percent bottom rate. This rate was later added to the bill by support of Republicans. Jerry Weller argued before a Ways and Means hearing that he intended to help the working poor: “In H.R. 6, we help the working poor by addressing the marriage tax penalty under earned income credit.”<sup>55</sup> Just as Bush had done in his speeches, Bill Thomas called the provisions at the bottom a means to enhance the inclusion of the poor into the labor markets. A genuine meritocratic system gave the lower class the opportunity to enter the middle class.

Mr. Speaker, there is a tremendous toll gate in the middle class. We are penalizing success in this country [...] They want to suggest that this is nothing more than a tax cut to Bill Gates’ or Sam Walton’s heirs. That is not what we are doing here. What we are trying to accomplish is this: You are overpaying your taxes. You ought to get some of your money back.<sup>56</sup>

And Senator Hutchison whole-heartedly supported the provisions for the working and non-working poor:

I believe increasing the standard deduction for a married couple [...] and widening the 15 percent bracket so that we can at least alleviate the pain at the lowest level and it will give some relief to every couple that either does not itemize and takes the standard deduction or anyone who is paying taxes would get some relief<sup>57</sup>

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<sup>54</sup> Ways and Means Committee. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 11.

<sup>55</sup> Weller, Jerry. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 10.

<sup>56</sup> Thomas, Bill. “Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147.” May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2212.

<sup>57</sup> Hutchison, Kay Bailey. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 7.

The Senator from Texas added apologetically: “Of course, this approach does not address the marriage penalties found in the upper income brackets.”<sup>58</sup> But she nevertheless supported this approach as it was “reasonable and responsible for a first step.”<sup>59</sup>

Republicans also claimed to establish genuine meritocracy through tax provisions for small businesses. Often small businesses were presented as individual entrepreneurs whose initiative in generating jobs and growth deserved to be rewarded. For instance, Jim McCrery argued that the Democrats’ tax plan did not “provide incentives for small businesses or entrepreneurs to increase investment in their businesses, to create more jobs.”<sup>60</sup> Similar to the argument that the poor needed better opportunities in the labor market, Republicans argued that improved conditions for small businesses would allow more individuals to become independent from government spending as entrepreneurs. Tax cuts for small businesses reduced the “hurdle on what it takes to build a small business, to employ people, to risk-take and become an entrepreneur.”<sup>61</sup> This reduced hurdle improved the conditions for genuine meritocracy. In a statement in a debate in June 2001, Paul Ryan (R-WI) summarized the three reasons why rewarding small entrepreneurs was helping everyone in the American society:

What we are trying to achieve by lowering the tax rates on entrepreneurs, on small businesses, on the American families, down to 33 percent is to simply say that we recognize that what creates this economy, that what grows this economy, that what creates jobs are small businesses and entrepreneurs.<sup>62</sup>

The importance of the concepts of compassion and morality in markets also showed when Republicans moved closer to social commitments presented by George W. Bush, which later allowed ideational coalitions with the Democrats in the area of health care to the elderly. In his budget proposal George W. Bush had planned to leave enough funds of the budget surplus for the maintenance of Social Security and Medicare and planned an extension of Medicare by implementing of prescription coverage of drugs for elderly. In the discussions on the tax cut, Republicans integrated this provision in their concept of deserving Americans, when they argued that they wanted to keep their “commitment to older Americans that have paid into the system their entire lives.”<sup>63</sup> They supported Bush in securing \$2.9 trillion of the surplus for Social Security and

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<sup>58</sup> Hutchison, Kay Bailey. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 9.

<sup>59</sup> *Ibid.*, p. 9.

<sup>60</sup> McCrery, Jim. “Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147.” May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2218.

<sup>61</sup> Ryan, Paul. “Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147.” May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2212.

<sup>62</sup> *Ibid.*, p. 2211.

<sup>63</sup> Thomas, Bill. “President’s Tax Relief Proposals. Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session” February 13, 2001. Washington: U.S. Government Printing Office, p. 4.

Medicare. Bill Thomas argued that the government was capable to put its “house in order” and at the same time make sure that funding needs were secured.<sup>64</sup> In a similar vein, Jim Ramstad argued in a Ways and Means Committee meeting that the budget plan of the President was “responsible”<sup>65</sup> and that the large surplus allowed “to pay down an unprecedented amount of debt,”<sup>66</sup> and still “preserve Social Security and improve Medicare, fund education, medical research and defense priorities, *and* provide meaningful tax relief.”<sup>67</sup>

### *The Democrats*

We have a tax cut before us that it is [sic] generally felt that we have accumulated a surplus to which the American people have contributed and that we have a responsibility to return a part of that to the people [sic].<sup>68</sup>

In Larry Bartels’ (2005) seminal article *Homer Gets a Tax Cut* the author argued that American voters ignore that increases in social security spending, which they supported, depend on increases in taxation, which they opposed. Voters simultaneously supported tax cuts and increases in social security spending which exposed their limited understanding of fiscal policy. This section will show that the Democrats ceased objecting reduced taxes for corporations and higher incomes and at the same time demanded a maintenance or expansion of Social Security. The liberal progressive idea of taxing the rich and capital, which was portrayed in the congressional debates of the 1980s, had vanished from the ideological landscape by the early 2000s. When the debate in Congress drifts towards a consensus in tax cuts and spending increases, how should voters see the mismatch of these two demands?

When George W. Bush presented his tax plan in 2001, the Democrats focused on defensive statements for fiscal responsibility and maintenance of the surplus in order to keep social security spending stable. Instead of arguing that the massive tax cuts for the rich threatened ability to pay, they solely asked for a downsizing of the tax cuts at the top and accepted the compensations that were given to the poor in tax breaks. They also increasingly adopted the universalistic argument of the Republicans, with which they argued that a tax cut for all Americans were just. Since adopting this principle, the moral arguments for a generally just distribution of income taxes burdens according to

<sup>64</sup> Thomas, Bill. “President’s Tax Relief Proposals. Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session” February 13, 2001. Washington: U.S. Government Printing Office, p. 4.

<sup>65</sup> Ramstad, Jim. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 5.

<sup>66</sup> *Ibid.*, p. 5.

<sup>67</sup> *Ibid.*, p. 5.

<sup>68</sup> Rangel, Charles. “President’s Tax Relief Proposals. Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session” February 13, 2001. Washington: U.S. Government Printing Office, p. 5.

the ability-to-pay principle were no longer raised. The Democrats lost their vision of a broader industrial policy strategy from the 1980s, which would have provided the material basis for such relative equality of outcome. Without an economic program or a moral framework that could defy the congruent morality in markets, the Democrats could not provide substantive protest against Bush's tax cut in 2001. As a consequence the tax plan was brought through Senate with slight amendments despite Democratic dominance.

Sixty percent of Democratic critique of the 2001 tax plan, raised concerns about the budget. Democrats worried that the revenues would fall significantly through tax cuts and that the financial resources in Social Security and Medicare were curtailed, at a time when millions of baby-boomers were retiring. In the Senate the Ranking Member Max Baucus of the Democratic Majority laid out a defensive critique of the inequity of the tax cut. Instead of suggesting alternative measures to generate more income equality, he mostly worried that the tax cut may not be consistent with other priorities, "very demanding priorities."<sup>69</sup> Baucus argued that the tax cut was too large considering that the Medicare reform and other outlays in the budget had not fully been determined yet. He questioned "whether we are truly protecting Social Security and Medicare."<sup>70</sup> Baucus argued that after years of painful cuts in Medicare and "threats to Social Security" this was the first moment in which surpluses were large enough that Medicare and Social Security were not endangered. He argued that he wanted these outlays to get extended and to see the financing of an effective prescription drug benefit.<sup>71</sup> Charles Rangel reminded Congress of the experience of how the Reagan tax cuts drove deficits into excessive heights and argued that such a reform was a "riverboat gamble."<sup>72</sup> This worry about the size of the tax cut and its effects on borrowing and the deficit was shared by most Democrats. Representative Levin devoted his entire speaking time to this issue, warning that the cut would generate borrowing costs of \$2 trillion.<sup>73</sup> By demanding maintenance of social security spending, the Democrats in essence raised the principle of equality of outcome in overall fiscal policy. However, they only wanted it to stay stable and did they demand a shift of the tax cuts to the rich which would have reinstated relative income equality. Though Pete Stark (D-CA) mentioned that the tax cut was highly unequal and reduced taxes for the rich, he used this fact solely to place it against the fiscal irresponsibility that arose from this fact. Fiscal irresponsibility already showed through the administration's procedural practice of passing a tax cut before the budget was passed, Stark argued: "I do not intend to vote for any bill until there is a budget and I know [...] what the effects will be on the American people and whether the sen-

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<sup>69</sup> Baucus, Max. "Revenue Proposal and Tax Cuts in the President's Budget. Hearing Before the Committee on Finance United States Senate. 107<sup>th</sup> Congress, First Session." February 28, 2001. Washington: U.S. Government Printing Office, p. 3.

<sup>70</sup> *Ibid.*, p. 3.

<sup>71</sup> *Ibid.*, p. 3.

<sup>72</sup> Kessler, Glenn, and Juliet Eilperin. "House Passes Bush Tax Cut. President Gets First Legislative Victory. 10 Democrats Vote for Bill." *The Washington Post*, March 9, 2001, p. A01.

<sup>73</sup> *Ibid.*

iors will have a drug benefit or not.”<sup>74</sup> John Lewis (D-GA) also argued that he did not understand how the tax plans could already lay out despite the budget being unknown. With consternation, he observed that such “a massive tax cut”<sup>75</sup> was passed without knowing how to “pay down the national debt, save Social Security, take care of Medicare, educate all of our children.”<sup>76</sup> The Democrats did not lay out an economic theory about growth and taxation. Only rarely did statements talk about growth at all and if they did these were linked with the budget. Rosa DeLauro for instance argued that the tax plan was “a recipe for budget deficits, for more debt, and less economic growth.”<sup>77</sup>

The Democrats increasingly adopted the tax principle of universalism from the Republicans. Instead of arguing that they wanted a renunciation from the tax cuts for the rich and capital owners - as they had done in the 1980s – they increasingly agreed that tax cuts for all Americans were just. In 1981 Sam Gejdenson for instance had questioned universality and demanded a shift of the tax cuts from the rich to the poor:

Rather than working for a strictly across-the-board cut in income taxation, I favor reductions which focus on low- and middle-income wage earners. I believe that any tax cut which shortchanges working Americans is unfair.<sup>78</sup>

Arguments that demanded greater income equality in the American society were no longer existent in 2001. Instead, Max Baucus argued that he supported a tax cut in general and even thought a large tax cut would be tenable if the government made sure it really went “to all taxpayers” and was “really fair to all Americans.”<sup>79</sup> Charles Rangel even supported the Republican argument of a right to taxpayers’ money when he argued that “we have accumulated a surplus to which the American people have contributed and that we have a responsibility to return a part of that to the people [sic].”<sup>80</sup> Representative Rosa DeLauro adopted the Republican concept of the deserving lower incomes and families to support the administration’s tax plan. She argued that “middle

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<sup>74</sup> Stark, Pete. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 16.

<sup>75</sup> Lewis, John. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 23.

<sup>76</sup> *Ibid.*, p. 23.

<sup>77</sup> DeLauro, Rosa. “Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147.” May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2206.

<sup>78</sup> Gejdenson, Sam, “Tax Cut Legislation. Extension of Remarks. Congressional Record, Proceedings and Debates of the Congress, 97<sup>th</sup> Congress First Session, Permanent Edition, Volume 127, July 9 –July 31, 1981,” July 28, 1981, p. 17905.

<sup>79</sup> Baucus, Max. “Revenue Proposal and Tax Cuts in the President’s Budget. Hearing Before the Committee on Finance United States Senate. 107<sup>th</sup> Congress, First Session.” February 28, 2001. Washington: U.S. Government Printing Office, p. 3-4.

<sup>80</sup> Rangel, Charles. “President’s Tax Relief Proposals. Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session” February 13, 2001. Washington: U.S. Government Printing Office, p. 5.

and working-class families need and deserve a tax cut this year.”<sup>81</sup> Instead of demanding a shift of the tax burden from bottom to top, she saw value in cutting taxes for all American families: “Democrats believe that we should cut taxes for all families.”<sup>82</sup> DeLauro qualified this statement by arguing that she wanted the tax cut to be fiscally responsible and allow for increases in Medicare and education expenses but all in all “We support a responsible plan that meets the needs of all America’s families.”<sup>83</sup> Though some Democrats criticized the reduced redistribution in the tax code, they did not clearly demand a halt to this process. Congressman Bob Matsui for instance attacked the reductions in top income taxes and argued that there had already been substantial benefits in the legislative acts of the government for the “top 1 percent of the taxpayers” which earned on average “\$1.1 million a year” and now additionally received “46 percent of this tax cut.”<sup>84</sup> He was furious about the “fact [...] that those people that make over a million dollars a year get 46 percent of the benefit.”<sup>85</sup> Matsui argued that when one added the increases in social security contributions in the overall revenue collection of 2001 to the income tax cuts for the rich, one would see redistribution to the top:

This is redistribution. About 60 percent of the \$5.6 trillion is in the form of Social Security payroll taxes. Who gets the burden of that? The average American, because it is capped at \$76,000 a year. So we are going to take the payroll taxes and we are going to redistribute it to those people that file income tax returns of \$1.1 million a year.<sup>86</sup>

This argument however did not lead to a plea for redistribution to the bottom as it did in the 1980s.

On the contrary, many Democrats only demanded compensation for the lower and middle incomes but generally accepted the tax cuts at the top under the condition that lower incomes would receive some provisions too. One of the important compensations which the Democrats endorsed was the bipartisan initiative to repeal the marriage penalty. James A. Barcia, Democratic cosponsor for the bill (D-MI), thanked his Republican counterpart Jerry Weller for his initiative: “I want to thank [Congressman Weller] for giving me the opportunity to do my part to ensure that, one day, the marriage penalty is taken out of the Federal Tax Code.”<sup>87</sup> James A. Barcia argued that the tax plan was a way to provide tax relief to working families who suffered from credit

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<sup>81</sup> DeLauro, Rosa. “Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147.” May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2205.

<sup>82</sup> *Ibid.*, p. 2205.

<sup>83</sup> *Ibid.*, p. 2205.

<sup>84</sup> Matsui, Bob. “Congressional Record, Proceedings and Debates of the Congress, 107<sup>th</sup> Congress First Session, Volume 147.” May 16, 2001. Washington D.C.: U.S. Government Publishing Office, p. 2212.

<sup>85</sup> *Ibid.*, p. 2212.

<sup>86</sup> *Ibid.*, p. 2212.

<sup>87</sup> Barcia, James A. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 12.

card debt, increases in energy costs and the slowing economy: “So a lot of people certainly would appreciate having that additional tax relief to either pay down perhaps some credit card debt, to perhaps address the increased energy costs.”<sup>88</sup> Barcia also followed the Republicans in their justice concept of deservingness when he argued that it was only fair to give a tax cut to working families: “The penalty harms the pocketbooks of working families.”<sup>89</sup> And he justified the repeal of the marriage penalty as “one way to target tax relief to working families, especially those where both spouses work to sustain the family economically.”<sup>90</sup> William Jefferson criticized inequity in the tax plan calling the changes in tax rates “geared more to people who are the upper income”<sup>91</sup> but was thankful for increases in the EITC “which, of course, is going to be helpful to that lower end of the income scale.”<sup>92</sup> Because the Democrats only demanded compensatory measures against the tax cuts at the top, it was easy to *incorporate* their demands in Bush’s tax plan. In the bipartisan tax plan, which passed Congress that year, many Democrats supported the administration on greater provisions at the bottom end of the income and helped pass the bill.

In May 2001, the Democratic and Republican leaders agreed on a bipartisan tax bill which entailed many demands of the Democrats. The overall size of the tax plan was smaller than originally proposed. Instead of cutting taxes by \$1.6 trillion the plan only cut taxes by \$1.3 trillion. The top rate reduction was smaller and so was the estate tax cut. The provisions for the bottom incomes were extended.<sup>93</sup> Thus, even though the Democrats held a majority in the Senate and could have blocked the bill or demand major amendments to the program, their resistance faltered with the bipartisan plan and the integration of some of their tax proposals (Brownlee 2004, 231). New York Times journalists observed and described the final debate as a matter of inevitability. “Democrats did not even suggest to block the bill.”<sup>94</sup> Because consensus on tax cuts was so high, lobbying played a small role in this reform, commenters argued. Only few Republicans and Democrats received a call from the President or the Vice President trying to convince them of the program. On the day of the vote, only few lobbyists waited outside the chamber to talk to Congressmen. Asked about the number of interest groups which tried to influence him on his vote, one representative said that only one group wanted to talk to him, the AFL-CIO, which had been excluded from all other means of

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<sup>88</sup> Barcia, James A. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 22.

<sup>89</sup> *Ibid.*, p. 22.

<sup>90</sup> *Ibid.*, p. 22.

<sup>91</sup> Jefferson, William. “President’s Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session.” March 21, 2001. Washington: U.S. Government Printing Office, p. 28.

<sup>92</sup> *Ibid.*, p. 28.

<sup>93</sup> Kessler, Glenn. “Senators Unveil Plan to Modify Tax Cut’s Tilt.” *The Washington Post*, May 12, 2001, p. A01.

<sup>94</sup> Kessler, Glenn, and Juliet Eilperin. “House Passes Bush Tax Cut. President Gets First Legislative Victory. 10 Democrats Vote for Bill.” *The Washington Post*, March 9, 2001, p. A01.

influence.<sup>95</sup> The plan passed Congress with the support of ten Democratic and one independent Representatives on a 230 to 198 vote.<sup>96</sup>

### *Ineffective Ideational Coalitions*

The protests of the AFL-CIO, NAACP, LWV and other small feminist, civil rights and religious groups which had crucially restricted Reagan's ability to curtail the level of redistribution in the 1980s, could not gather force in the early 2000s. Even though a grand societal coalition of around 500 organizations gathered in opposition to Bush's tax plan in early 2001, the participating groups could no longer draw on strong normative narratives developed by Democrats and trade unions in Congress because both groups increasingly agreed with the tax program proposed by Bush. Protests against the growing inequity and the decline in progressivity never materialized.<sup>97</sup> Institutionalists would argue that this is due to union power decline since the 1980s, however, unionization and strike activity had already been diminished to minimal levels in 1981 and still the AFL-CIO had been able to spark protests with the help civil rights and other protest groups after its organizational power had already ceased. Ideas are important in this shift from resistance to acceptance of tax cuts because Democrats no longer provided a coherent counterargument of growth and justice in Congress and replaced the AFL-CIO as their main witness in Congressional hearings with analytical research institutes which equally lacked ideas to integrate justice arguments into a broader growth strategy.

The Democrats replaced the traditionally associated organizations with a group of recently established analytical research institutes. The two groups which spoke most on behalf of liberal civil society were the Citizens for Tax Justice (CTJ) and the Center on Budget and Policy Priorities (CBPP). The Brookings Institution was also invited to hearings and presented quantitative analyses about the effects of Bush's tax plan on the overall distribution of tax burdens and inequality in American society. The research institutes made tax calculations for the Democrats which the party used to show that Bush's tax plan would raise income and wealth inequality and potentially threatened social security spending. However, the description of increasing inequity in American society was not a persuasive counterargument against the strong moral economic narrative of the Republicans. The statements lacked a moral foundation and were not embedded in a broader vision of economic policy. The critique that was then raised in 2001 was largely defensive demand of downsizing of the tax plan. The analytical research institutes presented two arguments that supported this demand. First, they had

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<sup>95</sup> Kessler, Glenn, and Juliet Eilperin. "House Passes Bush Tax Cut. President Gets First Legislative Victory. 10 Democrats Vote for Bill." *The Washington Post*, March 9, 2001, p. A01.

<sup>96</sup> Ibid.

<sup>97</sup> Edsall, Thomas B., "Interest Groups Are Suiting Up for Tax Cut Battle; Fate of Bush Plan Linked to Swing of Government and Legitimacy of President's Election," *The Washington Post*, March 11, 2001; Eilperin, Juliet. "Forever in Our Hearts, and Tax Code; House Democrats Pass Bill With Addition of Astronaut Benefits." *The Washington Post*. March 24, 2003, p. A11.

calculated that the budget surplus was actually smaller than reported by the government agency CBO and that such a large tax cut would generate large deficits in the future. And second, the institutes calculated the relative tax gain each income group would receive from the tax cut and argued that it was highly unequal. Unfortunately, this defensive approach of demanding a reduced tax cut did not lead to strong protest among Congressmen or the public.

Since George W. Bush's campaign claim that he would implement another major across-the-board income tax cut, the CBPP had published reports which questioned the actual size of the budget surplus and warned that such a large tax cut might generate significant deficits in the future. In the hearings of Congress in 2001, the director of the CBPP Robert Greenstein had been invited as a witness and testified that at first glance the large surpluses looked like the planned tax cut was affordable. He repeated the CBO and weighted the "\$3.1 trillion surplus outside Social Security versus a \$1.6 trillion tax cut."<sup>98</sup> However, the surplus was actually much smaller than displayed because the CBO numbers had originated in two-year old forecasts when growth was still in full swing. Since growth had declined since then, the budget effects of such a big tax cuts could be disastrous for the budget.<sup>99</sup> As a consequence, the director of the CBPP argued, the tax plan would not cost \$1.2 trillion, as Martin Feldstein had estimated, but \$2.1 trillion when debt service was included.<sup>100</sup> After the reform was passed, William G. Gale from the Brookings Institution was invited to Congress to retrospectively evaluate the tax act and debate ways to simplify the tax code. He argued that some economists had proposed a flat tax model which was morally questionable in his view as ability to pay was the basis for most national income tax system and its elimination a potential threat to the social peace: "When England had a tax like that it created riots and it was repealed. Rather, all countries tailor tax burdens to the characteristics of individual taxpayers. Why? Because it is thought to be fairer."<sup>101</sup> However, aside from mentioning this, Gale did not attack the inequality increases in the recent and in the planned tax reforms, but rather demanded that they be "revenue neutral and distributionally neutral."<sup>102</sup>

The other argument the CBPP and CTJ presented before Congress was inequality. However, instead of demanding more redistribution from top to bottom, as the AFL-CIO had done, both institutes only calculated that larger tax cuts went to the top and

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<sup>98</sup> Congress of the United States. "President's Tax Relief Proposals: Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress. First Session." February 13, 2001, Washington: Government Printing Office, p. 50.

<sup>99</sup> *Ibid.*, p. 50.

<sup>100</sup> Congress of the United States. "President's Tax Relief Proposals: Individual Income Tax Rates. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress. First Session." February 13, 2001, Washington: Government Printing Office.

<sup>101</sup> Gale, William G. "Hearing Before the Subcommittee on Oversight and Subcommittee on Select Revenue Measures of the Committee on Ways and Means of the House of Representatives, 107<sup>th</sup> Congress, First Session." July 17, 2001. Washington: U.S. Government Printing Office, p. 77.

<sup>102</sup> *Ibid.*, pp. 77.

argued that the tax plan lacked proportionality. Taken literally, the maximum demand of proportionality meant that the institutes claimed equal rate cuts to all income groups, which would still result in a higher absolute distribution to the top. The director of CTJ, Robert S. McIntyre, issued a report on the progressivity of the income tax which found that 60 percent of Bush's tax cut benefitted the top 10 percent of American income earners and that 43 percent of income gains would concentrate in the top 1 percent. The majority of American tax payers, the bottom 60 percent in the income distribution, would only receive an average of \$227 in tax cuts (Lewandoski 2008, 8). Wendell Primus, the director of Income Security at the CBPP argued that the proposed doubling of the child tax credit was not enough to make the tax plan equal because the child tax credit did not benefit families without incomes. As a consequence "24 million children, 33.5 percent of all children in this country [...], fifty-five percent of African American children and 56 percent of Hispanic children would receive nothing from this expansion."<sup>103</sup> At the same time, very high incomes between \$130,000 and \$300,000 became eligible for a tax credit. However, when asked about the distributive aim of a tax cut by a journalist from the NYT, the director of CTJ argued for a proportional tax cut: "You ought to treat people who are alike pretty much alike. And it ought to be progressive so that those with the most pay the most."<sup>104</sup>

In sum, even though the research institutes had provided data which showed that the tax cut increased inequality in American society, neither the CTJ nor the CBPP demanded ability to pay or greater redistribution. In most statements, the institutes provided a quantitative problem analysis and did not present a normative analysis or a potential solution. Only rarely did they embed the data in a political statement on tax reforms and when they did, tax philosophy was to equally distribute a proportional tax cut.

## 5.6 Conclusion

The Bush administration developed a highly persuasive concept of morality in markets to convey massive tax cuts for the rich to representatives in Congress. By giving 43 percent of the tax cut to the top 1 percent of American taxpayers, the 2001 reform was the greatest legislative tax cut for the very rich in American history. However, the protest against this plan was rather moderate. Bush's moral framework of compassionate conservatism had persuaded many conservative interest groups from religious think tanks to family-oriented interest groups. This broad societal coalition enhanced the administration's legitimacy in tax cuts. At the same time, Democrats were endorsed the com-

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<sup>103</sup> Primus, Wendell. "President's Tax Relief Proposals. Tax Proposals Affecting Individuals. Hearing Before the Committee on Ways and Means House of Representatives, 107<sup>th</sup> Congress, First Session." March 21, 2001. Washington: U.S. Government Printing Office, p. 39.

<sup>104</sup> Rosenbaum, David E. "Public Lives. Little Known Crusader Plays a Big Role in Tax Debate." May 21, 2001, *The New York Times*, p. 12.

compensation for the poor through tax credits and rate reductions at the bottom of the income distribution. Aside from these material provisions, the concept of morality in markets convinced many Republicans and Democrats in Congress. Republicans were supportive of the moral framework of universality in tax cuts, which argued that all deserving Americans and small businesses would get relief. Democrats also endorsed universality and no longer raised the particularistic approach to economic policy, which they had often used in the debates of the 1980s. The party only demanded a downsizing of the tax cut to maintain a balanced budget. After the government accepted this condition, the critique faltered. Through the re-moralization of tax policy with the concept of morality in markets and the incorporation of demands of the Democrats, the government was able to diminish critique from the usual protest groups.

Table 3 summarizes the shifts in tax justifications in the American case studies. It compares the concepts which parliamentarians used in Congress, the Senate and in the hearings on the tax proposals in 1981 and in 2001. One of the most significant shift in concepts of tax justice occurred within the narratives of the Democratic Party. In 1981, the party based the majority of their arguments, 42.61 percent, in social justice which fell to 16.5 percent in 2001. In the early 2000s, the most important tax concept for the Democrats was revenue collection and the maintenance of social security spending. Though social security spending is related to potential income equality, but it makes a difference if a party argues that it is unfair that the poor or the middle class get a smaller tax cut than corporations or the rich, or if it argues that revenues should be maintained and not reduced through tax cuts for corporations and the rich. Also interesting is the high frequency of industry policy justifications of the Democrats in 1981 which was no longer existent in the 2001. Instead, Democratic arguments moved closer to Republican justifications when the Democrats used universalism in 20.59 percent of their statements in 2001. The Republicans used the majority of the tax cut justifications in the area of supply-side tax arguments, 48.3 percent in 1981. This changed considerably in 2001, when market justice became the most important concept used among Republicans. 50.68 percent of the arguments raised by the GOP now fell into this category, which was rarely used in the 1980s. Growth arguments became less important under the strong persuasive concept of morality of markets which George W. Bush had proposed. Taken together, these shifts point to a greater persuasiveness of George W. Bush's moral tax justifications compared to Ronald Reagan's concepts of the supply-side.

Table 3 - Tax Arguments in 1981 and 2001

	1981		2001	
	<i>Republicans</i>	<i>Democrats</i>	<i>Republicans</i>	<i>Democrats</i>
<b>Social Justice</b>				
Compensation/Relief of the poor/middle class	9.66%	<b>26.09%</b>	14.86%	10.68%
Compensation families	6.25%			0.97%
Equality of capital and labor		16.52%		4.85%
<i>Total</i>	15.91%	<b>42.61%</b>	14.86%	16.50%
<b>Market Justice</b>				
Individual motivation, creativity, productivity	4.55%		<b>37.84%</b>	0.97%
Self-sufficiency	4.55%		2.03%	
Small firm access to markets	2.84%		10.81%	
<i>Total</i>	11.93%		<b>50.68%</b>	0.97%
<b>Equal treatment</b>				
Universalism	<b>20.45%</b>		11.49%	20.59%
Horizontal tax equity	7.39%	0.87%	5.41%	
<i>Total</i>	27.84%	0.87%	<b>16.89%</b>	<b>20.59%</b>
<b>Economic Imperatives</b>				
Supply-side theory	<b>39.20%</b>	11.30%	12.16%	
Budget constraints		6.09%	5.41%	<b>60.19%</b>
Stimulate demand	5.11%	2.61%		0.97%
Industrial policy	3.98%	<b>20.87%</b>		
<i>Total</i>	<b>48.30%</b>	<b>40.87%</b>	17.57%	<b>61.16%</b>
<b>Other</b>				
Process in Congress		15.65%		
<i>Total frequency codes, N=</i>	176	115	148	102

Frequencies in justifications of government programs or their respective objections, source: own coding and calculations.

## 6 Kohl's Great Tax Reform 1986/1988/1990

Comparative literature on neoliberal tax reforms has stressed the significant differences in the national implementation of neoliberal reform predicaments. Authors argued that there was no equivalent version to the radical reforms of the neoliberal and neoconservative policies of Thatcher and Reagan in Germany. Helmut Kohl's reforms actually were a prolongation of the post-war social market economy, less radical and less neoliberal (Borchert 1995; Kemmerling 2009; Schmidt 1998, 145; Schmidt 2000). Institutionalists have explained the German resilience in welfare spending and tax redistribution through the consensual nature of parliamentary institutions in the coordinated market economy. The proportional electoral voting system ensured that in many cases the opposition had a powerful position in the second chamber, the Bundesrat, which acted as a veto-player. This way, German parliament often enforced a moderate version of neoliberal reforms. Also, in corporatist institutions labor unions and capital could bargain over measures of redistribution and traditionally labor unions offered business low wage increases to keep the economy competitive and maintain redistribution (Prasad 2006; Prasad and Deng 2009; Wagschal 2005).

This chapter will show that it is true that the government's tax plan to restructure the tax system was significantly curtailed in the process of legislative deliberation. With the Great Tax Reform 1986/1988/1990 the Kohl administration aimed at replacing the prevalent Keynesian paradigm of redistribution with a tax cut that shifted the tax burden to the bottom. However, institutional veto-players were not the main obstacle to the program. The institutional veto-power of the opposition was extremely limited as the governing coalitions held a majority in both chambers. The main obstacle to neoliberal tax reforms at that time was a cross-party and cross-class ideational coalition of representatives and interest groups. More specifically the coalition comprised the factions of the Green Party and the Social Democrats (SPD), the trade unions, a number of economic experts and the labor-wing of the Christian Democrats (CDU). This coalition restricted many of the distributive plans of the tax reform. The planned reduction in the top personal income tax rate had to be diminished as well as a cut in a tax surcharge for Sunday, night and holiday. I argue that consensual institutions and power of unions cannot sufficiently explain the resistance in the Bundestag as the same actors who protested against tax cuts in the 1980s, were highly supportive of it in the 2000s. And even though trade unions did lose their powerful position in German institutions this had already been the case in the 1980s.

Instead, ideas stood at the center of the shift from restricted tax cuts in the 1980s to strong tax cut support in the 2000s. While Helmut Kohl attempted to integrate the FDP's cognitive growth arguments for tax cuts for the rich in the traditional Christian

Democratic arguments of social market economy, the argument remained contradictory because traditionally German voters associated higher welfare spending with the social market economy and not incentives to work through lower redistribution as argued by the FDP.

This chapter is structured as follows: In the first section, I will describe the economic crisis that the Kohl government faced by its election in October 1982. Then, I describe the adoption of supply-side economics by economic advisers of the government and experts in hearings. This is followed by a description of ideational coalitions that transcended institutional barriers and power decline of Social Democrats and trade unions. In section four, I describe inconsistency of Kohl's concept of *change* [die Wende] and the social market economy which is then contrasted with the discussions in parliament. The opposition rejected supply-side notions on the ground of social justice, need of the poor and compensation for family. The governing parties could no longer focus on the topics they actually wanted to talk about which was economic growth and meritocracy. They tried to defend their program in the sphere in which the opposition had attacked it, in social justice. The FDP and CDU defensively argued that the tax plan was fair in distributive terms as the majority of the tax cuts went to the middle classes and families. But the opposition kept bringing new numbers which showed it was not true.

## 6.1 Macroeconomic Context

A large body of tax research is interested in the external economic efficiency pressures of tax competition when they explain reductions in top personal income tax rates. Tax competition literature argues that trade and capital market integration put pressures on governments to reduce the costs of production and financial investment in each jurisdiction in order to attract or retain those productive resources (Auerbach and Slemrod 1997; Genschel 2005; Ganghof and Genschel 2008; Winner 2005). This section will demonstrate that external economic pressures and unemployment had already put serious economic pressures on the German economy and still this crisis was not sufficient to convince policy makers to implement them in the 1980s.

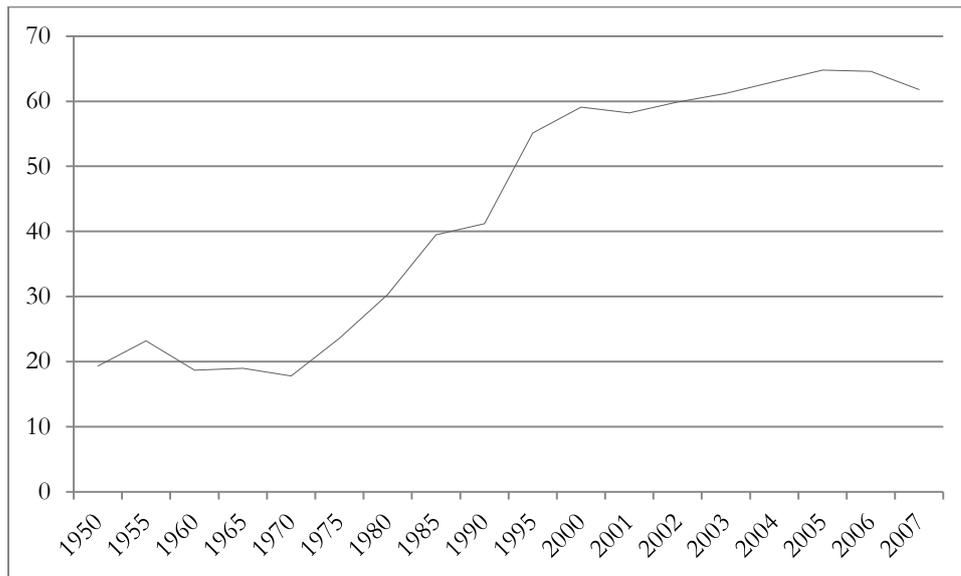
Economic growth had been sluggish in West-Germany since the 1960s and similarly to the American experience, the West German *Wirtschaftswunder* [economic miracle] of the 1950s and the 1960s was slowly replaced with stagnation in productivity. From 1951 to 1960, West German growth rates had reached levels as high as 11.8 percent and averaged 8.3 percent in this decade. Between 1961 and 1970, the rates were reduced but still averaged 4.3 percent. This changed dramatically with the first oil crisis in 1973-74 in which price increases for imports tipped West German growth rates to the negative. In 1975, for the first time in the post-war era, real GDP contracted by 1 percent and unemployment surpassed the critical benchmark of one million (Bökenkamp 2010, 41). At the same time, increasing oil prices drove the trade balance into deficits and ham-

pered consumption and demand in the German economy. By the second oil crisis of 1979, the West German economy had turned into an outgrown recession (Bökenkamp 2010, 40; Ullmann 2005, 196). The crisis led to a nine percent decline in capacity utilization, a large number of bankruptcies and a significant decline in investments (Leaman 2009, 82).

The attempt to resolve this productivity crisis with Keynesian demand stimulation approaches and neo-corporatism had failed and government had to think of new instruments to bring back economic growth. Since 1967, the social-liberal government had tried to counter economic decline and unemployment with macro-economic steering, neo-corporatist alliances and redistribution. In the *Stabilitäts- und Wachstumsgesetz* [Stability and Growth Law] it adopted Keynesian and macro-economic policies of anti-cyclical demand stimulation and global steering with the intention to smooth business cycles, maintain prices stability, increase employment and reach an external trade balance. But these policies were increasingly ineffective under the strict price-stability mandate of the Bundesbank which countered the expansionary efforts by contractionary monetary policy, policy makers (Ullmann 2005, 198, 202; Findling 1995, 100). The Bundesbank unilaterally left the international system of fixed exchange rates and in 1973 for the first time adopted the monetarist approach of targeting price stability through a free floating of the DM against the dollar and the public announcing of targets to make the deutsche mark (DM) one of the strong currencies that investors may use as one of the international reserve currencies (Johnson 1998, 73 f.).

The fact that interest rates were increasing and that sovereign debt was on the rise, led the Bundesbank to cut monetary expansion further. The Christian Democratic opposition party and the Free Democrats who were part of the social-liberal governing coalition were deeply worried about the debt levels. Between 1979 and 1980, the level of new debt increased from DM 24.2 billion to DM 34 billion (Bökenkamp 2010, 200–201; Leaman 2009, 24). However, the Free Democrats and the Christian Democratic Party could not develop a coherent narrative of growth and justice which could counter the strong opposition of Keynesian demand stimulation and redistribution (see Section 6.5). Even though the debt levels increased further until the late 1990s, when the red-green government came to office, debt as a share of GDP had already doubled between 1970 and 1990, from 17.8 to 41 percent, which is when the Kohl government attempted to implement the tax cut (see Figure 8).

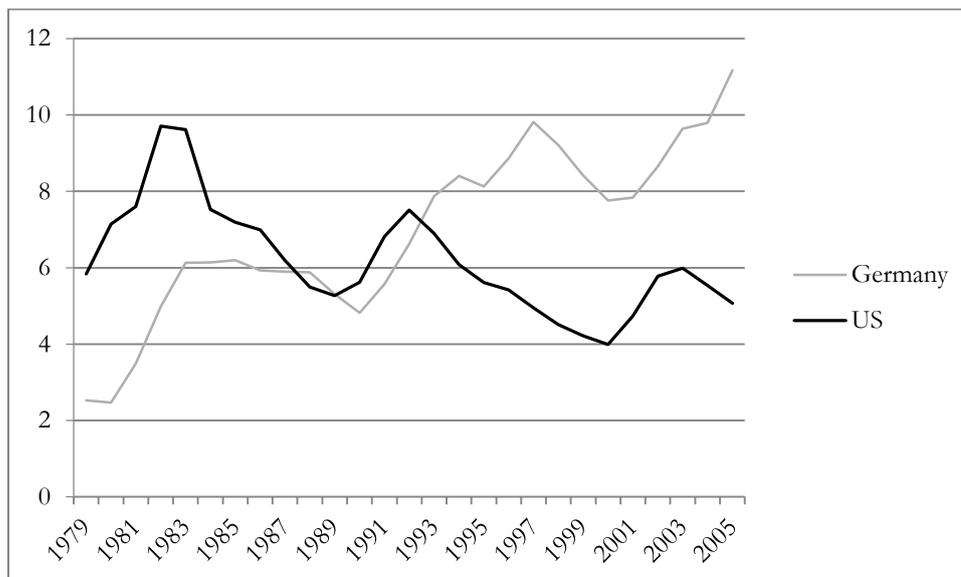
Figure 8 - Percent of Debt to GDP in Germany



Source: Ministry of Finance (2016, 92–93)

Similarly, the general unemployment rate had already been at very alarming levels in the 1980s and 1990s. Between 1979 and 1982, unemployment increased from 2.4 percent to 6.13 percent. Despite these worrying economic developments and the restriction of expansionary fiscal policy through the Bundesbank, the Kohl government was not able to convince the opposition of a new approach to solve unemployment. As Figure 9) shows, unemployment had soared to new heights during the early 1980s.

Figure 9 - Unemployment Rates in Germany and the US



Source: OECD Indicators (2017)

## 6.2 Institutional Context

Scholars in the tax mix and tax compensation literature argue that the German political economy is protected from tax competition pressures because the Supreme Court and the Bundesrat are powerful veto-players in the area of tax cuts. The Supreme Court has a mandate to rule down all unequal tax levels of top personal income taxes and corporate taxation which made the goal to reduce corporate taxes without reducing top rates hard to pursue in the Bundestag. At the same time, it is argued in institutionalist literature, that the German parliament produces highly consensual and moderate policy solutions because the Bundesrat is often dominated by the opposition and has a powerful veto-player position in tax policy changes (Lijphart 2012; Prasad 2006; Steinmo 1993). This section applies these theoretical premises to the Kohl tax cuts and will find that institutions can explain the obstacles to reform partially, but that ideas must have played a role as well.

Before the Great Tax Reform 1986/1988/1990 became legislation, a number of smaller tax reforms were introduced. The *Haushaltsbegleitgesetze* [Budget Reform Acts] of 1983 and 1984 raised the VAT from 13 percent to 14 percent for general products and the reduced rate from 6.5 percent to 7 percent for basic products. Policy makers also raised pension and unemployment contributions which increased the tax burden for lower and medium incomes. At the same time they gave terminated tax allowances for the acquisition of companies threatened by insolvency and the *Steuerentlastungsgesetz* [Tax Relief Law] in 1983 reduced the wealth tax rate from 0.7 percent to 0.6 percent on commercial assets. This reform also provided special depreciation allowance for the *Mittelstand* [small- and medium-sized enterprises] and for research and development investments for all corporations (Leaman 2009, 45; Ullmann 2005, 207). Even though these reforms already shifted the tax burden from capital to labor and consumers, the size of redistribution to the top was minor when compared to the *Great Tax Reform*.

The *Great Tax Reform* 1986/1988/1990 was composed of the *Steuerentlastungsgesetz* [Tax Reduction Law] 1986/1988 and the *Steuerreformgesetz* [Tax Reform Law] 1990. The first step of the tax plan was intended to be implemented in 1986 and was largely directed at small and medium incomes. The small and medium incomes were supposed to benefit from higher personal tax allowances and reduced individual tax rates. The plan intended to flatten the personal income tax progression, raise personal allowances from DM 4212/8424 to 4536/9072 (for singles/ married couples) and lift child tax allowances from DM 432 to 2,484 (Findling 1995, 122; Leaman 2009, 46f; Ullmann 2005, 207). The second stage of the reform was scheduled for 1988, cutting taxes by DM 13.7 billion. From this tax cut small and medium firms were to benefit most. The plan entailed increases in allowances for training, greater depreciation allowances and lowered tax rates and personal allowances. The allowances were to increase to DM 4,752/9,504 DM (Leaman 2009, 46f; Ullmann 2005, 207). The third stage scheduled a reduction of income and corporate taxes by DM 40 billion for 1990. The plan entailed a corporate tax reduction from 56 percent to 46 percent and a flattening out of the *Mittelstandsbauch*

from which small and medium firms and the medium incomes would gain. Lower incomes were planned to benefit from a reduced bottom rate from 22 percent to 19 percent and a lift in basic allowances to DM 5,616/11,232 DM. Also child tax allowances were planned to be lifted for each child from DM 2,484 to DM 3,024.<sup>1</sup>

Institutionalist theorists often refer to the German Supreme Court as one of the institutional obstacles to tax change in the German political economy. And really, the Supreme Court was essential when it ruled down Kohl's corporate income tax cuts in 1990. The German constitution entails a passage where equal taxation of personal income and corporate income is determined. When the Kohl administration presented its tax plans in 1990, legal experts already warned that the Supreme Court had a mandate to rule down a one-sided corporate rate reduction as unconstitutional. Since the government could not convince the opposition in the Bundesrat of an income tax reduction to 46 percent, which considered the plan as socially unfair and detrimental to the sovereign deficit, the government had to diminish the planned corporate rate reduction to the level of the income tax cuts. In the final tax reform the top personal rate fell from 56 percent to 53 percent and the corporate tax rate was reduced to 50 percent (Ganghof 2004, 68; Zohlnhöfer 2001, 94–96). Even though the German Constitution and the Supreme Court played a significant role in regulating a radical tax shift from corporations and top incomes to consumers in the early 1990s, there is reason to doubt that this institution was a stable veto player which would impair tax cuts of this sort in any political-discursive environment because the red-green government did implement a tax cut in the early 2000s which entailed a significant spread of top income tax rates and corporate tax rates – top income tax rates were left at 42 percent and corporate income taxes were cut down to 25 percent. What the Supreme Court ruled down in the 1990s was no longer considered unconstitutional in the 2000s.

The second institution which institutionalists often refer to when describing a resilience of the German tax system against efficiency pressures is the consensual organization of parties in the Bundestag and the veto-power of the Bundesrat (Prasad 2006, 2012). Even though the power of the opposition against Kohl's tax plans was at the heart of the obstruction of the tax plans, the power of the opposition seem to have been predominantly based on the power of ideas as opposed to the power position of actors within a specific institutional framework. Again, the fact the red-green government did find less obstacles to implement tax cuts would speak against this reasoning, but of course that would not be a sufficient argument, as the SPD and the Green Party who had been the traditional opposition to tax cuts had turned into the governing coalition in favor of tax cuts in the 2000s. However, there is another line of reasoning which speaks against the power of institutions in obstructing tax cuts, the Kohl administration held a majority in both chambers in the first nine years of the administration, from

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<sup>1</sup> German Bundestag. "First Report of the Committee of Finance (7<sup>th</sup> committee) on the Legislative Proposal of the CDU/CSU and FDP Factions." Bonn, 21 June 1988, 11<sup>th</sup> legislative period. Bonn. DIP XI/71, Doc. No. 11/2536, p. 3-4.

1982 to 1991, and was generally efficient in getting bills passed through the houses (Schmidt 1998, 145).

Changing ideas about economic justice and economic growth played a significant role in influencing the political positions of policy makers over time. Despite holding majorities in the Bundestag and Bundesrat, the government had to curtail the planned tax rate reduction for corporations significantly and was not able to pass a planned cutting of tax breaks for labor income for night, Sunday and holiday work. The corporate tax rate reduction was restricted, aside from the Supreme Court rule, by representatives of the CDU who opposed the tax plan in the Bundesrat. The Bundesrat also vetoed the cuts in the work surcharges. In both cases, the labor-wing of the CDU built an ideational coalition with the strong normative opposition from unions, business and center-left representatives in the Bundesrat, which led to rewriting of the tax plan in terms of labor surcharges and corporate tax reduction. In both cases discursive deliberation in parliament led to restrictions in neoliberal reform.

A similar ideational coalition of labor, the opposition and the labor-wing in the CDU was formed around the *Verbrauchssteueränderungsgesetz* [Consumption Tax Reform] of 1988 which was not officially part of the Great Tax Reform but made the impression to be engineered to finance the tax cut indirectly. The Consumption Tax Reform planned to increase levies on use of petroleum, tobacco, energy, insurance and vehicle licensees with high emissions and cut special tax surcharge for labor income for Sunday, night and holiday work and an elimination of the advertising cost allowance from which workers benefitted (Leaman 2009, 46f; Ullmann 2005, 207; Zohlnhöfer 2001, 95). Even though the government had split the tax cuts for higher incomes and corporations from the revenue increases through consumption taxes in the fear that trade unions and voters would rebel against this shift of the tax burden from top earners and profits to consumers, both measures raised tremendous resistance in the Bundestag and the Bundesrat. The opposition attacked the governments' tax plan as socially unfair and incoherent in its demand to give more to those individuals who work harder. They argued that individuals who worked at night, on Sundays and on holidays deserved these tax breaks. The opposition was supported by the printing sector and the labor unions who publicly questioned the governments' arguments for tax cuts. This critique was highly successful and shared by many groups in the parliament. Such protest did vanish over the 1990s, and in the 2000s, when the red-green government of Gerhard Schröder implemented a much greater tax cut for higher incomes. Ideas must have been at the center of this shift because the protest coalitions were built on narratives of Keynesian economic policy and social justice which were no longer raised in the 2000s.

### 6.3 Context of Expert Authority

Some theorists who look at the power of ideas in policy change argue that the size of networks of think tanks and academic institutions devoted to the new paradigm deter-

mine the ability of a new paradigm to become dominant over an old one (Blyth 2002; Ptak 2009). Supply-side thought had been exceptionally successful in German academic and policy circles because German academia had never really adopted Keynesian thinking and German institutions had never been adapted to the needs of Keynesian demand stimulation. The network power of ordoliberalism and neoliberalism had hence been exceptionally strong. Despite this power position, the acceptance of new/old paradigm among party leaders of the CDU/CSU and FDP did not guarantee a successful passing of the planned tax cut in the German Bundestag. The Kohl government attempted to build credibility of tax cuts for higher incomes on the authority of the new ordoliberal thinkers who had never really lost their power in central administrative positions in the German political economy. However, this authority did not convince a sufficiently large partisan group of the program. Only after the red-green government created an economically convincing and normatively acceptable framework for tax cuts, could tax cuts for higher incomes convince a large enough group of policy makers.

Even though the social-liberal government had attempted to implement Keynesian steering in the 1960s and some economic think tanks in Germany had adopted Keynesian thinking, Keynesianism had never really become a dominant paradigm in the German economics profession. The networks and monetary power of ordoliberal economics had remained firmly in place since the post-war era and when supply-side thought was adopted in the UK and the US, German thinkers returned to their former models of subsidiarity and free-market thought (Schwarz 2012, 173 f.). The *Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung* (SVR) [Council of Economic Experts], a central institution of economic advice to the government, never fully embraced the Keynesian paradigm and switched back the market-liberal economic policy of the post-war era as soon as the Bundesbank adopted restrictive monetary policy.<sup>2</sup> In a report of 1970, the SVR warned that focusing on full-employment, as suggested by Keynesian demand stimulation, inhibited long-term growth. In line with the emergence of *monetarism* in American economics, it argued that price stability was the most important factor for productivity growth. Government intervention in economic activity hampered efficient market decisions. Later, the SVR argued that inflationary policies and demand stimulation did not create employment because inflation hampered “the inclination to invest; [it] distort[ed] the production structure” and this had negative long-term effects on the development of the economy.<sup>3</sup> A report of 1978 argued that governments had to accept the empirical fact that their debt financing of countercyclical demand stimulation did not work because:

<sup>2</sup> Sievert, Olaf. “From Keynesianism to Supply-Side Politics.” In SVR (ed.) *Forty Years of Sachverständigenrat, 1963-2003*. Berlin: Statistisches Bundesamt, p. 34-35.

<sup>3</sup> SVR. “Yearly Report 1975/1976, German Bundestag.” November 24, 1975. Bonn. 8<sup>th</sup> legislative period. DIP VII, Doc. No 7/4326, p.7.

[The] leeway of such a long-term increase in credit taking for additional government spending or the tax cuts is much smaller than anticipated. Debt carries interest burdens which over time will eat up [the stimulation effects of] credit taking.<sup>4</sup>

The SVR formed a powerful network with other advisory institutions which were spearheaded by ordoliberal economists. Together they criticized the high debt levels that the social-liberal government had accumulated and argued on the basis of the supply-side concept of *crowding out* that sovereign debt inhibited private investments. As a consequence any form of demand stimulation was in the long-run countervailed by a decline in business investments (Leaman 2009, 12–13; Schwarz 2012, 175). At least since 1975, the *Wissenschaftliche Beirat beim Bundesministerium der Finanzen* [Scientific Advisory Board in the Ministry of Finance] supported the SVR in the crowding out argument.<sup>5</sup> As a policy recommendation, the economic advisers proposed deregulation and cuts in social spending and taxes. The economists argued that growth could be revived with reductions in the corporate income tax, income tax, trade tax and wealth tax. They particularly stressed the positive effects of a tax reduction for the middle incomes to eliminate the so-called *Mittelstandsbauch* [middle class belly] – the high progressivity increases in the German individual income tax schedule in the lower progressivity zone.<sup>6</sup>

#### 6.4 Administration Narrative: Social Market Economy

The fact that the Kohl administration had attempted to implement tax cuts since the 1980s but failed to do so has inspired tax researchers to argue that institutional veto-players in electoral and industrial institutions prevented efficiency pressures of international market integration to take hold of German politics. However, this reasoning makes it difficult to explain why the Schröder administration was capable to implement such cuts in the 2000s. Even though the German economy had suffered from a growth and competitiveness crisis in the 2000s, many elements of this crisis – including the debt, social security and unemployment crisis - had already existed in the 1980s and 1990s. At the same time, institutionalists' emphasis on union decline and electoral veto-players is equally insufficient to explain the different ability to cut taxes either. Trade union power was already very low in the 1980s and at least institutionally unions were equally important actors in the red-green as in the conservative-liberal government. Accordingly, the theory that ideas played a role in fencing off tax cuts in the 1980s but no longer in the 2000s seems likely. However, we cannot assume, as Ptak (2009) does,

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<sup>4</sup> SVR. "Yearly Report 1978/1979, German Bundestag." November 23, 1978. Bonn. 8<sup>th</sup> legislative period. DIP VIII, Doc. No 8/2311, p.145.

<sup>5</sup> Scientific Advisory Board in the Ministry of Finance. 1975. "Report of the Scientific Experts at the Ministry of Finance on the State and Development of the State Finances in the Federal Republic of Germany", BMF-Dokumentation 15/75. Bonn, p. 4.

<sup>6</sup> Kohl, Helmut. "Declaration of Government." October 13, 1982, 121<sup>st</sup> session of the Bundestag. *Bulletin of the Press- and Information Office of the Federal Government*, No. 93, p. 853-868.

that the mere dominance of ordoliberal thinking in German economics can explain the shift. Again, the continuity of ordoliberal influence throughout the 20<sup>th</sup> century rules this out as a central factor for change. This section will demonstrate that a coherent narrative of cognitive and normative concepts is essential for paradigm changes (Hall 1989; Münnich 2010; Schmidt 2008).

When we compare the German tax cuts over time, we find that Helmut Kohl's tax narrative lacked something that Gerhard Schröder's narrative had: a credible normative response to the demands of social justice of the left in German politics. Even though Kohl's project *discredited* government intervention and had a much more solid moral foundation than the project of his American counterpart Reagan, it only appealed to culturally conservative voters and lacked to *incorporate* compensations for the poor and lacked a broad *moralization* of tax cuts in a coherent justice framework. Kohl's concepts of *Wende* [change] and *Soziale Marktwirtschaft* [Social Market Economy] promised to tackle the economic recession *and* provide for a *moralisch-geistige Wende* [moral and intellectual change] in German society. Kohl planned to reorganize society under the moral banner of *subsidiarity* and *social market economy* which were popular concepts because Germans associated with them economic growth and social spending increases in the post-war era. When Kohl however argued it would only reinvigorate growth because it would *cut* social spending, the popularity of Kohl's economic program deteriorated significantly.

The early German debates of tax cuts were unpopular because of an equally technical language adopted from Reaganomics and because the emphasis on incentives to work were not a good fit with the dominant German discourse of social market economy. The FDP was the first party to adopt concepts supply-side ideas to German politics, after becoming increasingly dissatisfied with their coalition with the SPD. Despite growing sovereign debts and growing unemployment, the Schmidt administration was unwilling to significantly cut social spending which led the FDP to increasingly distance itself from the coalition partner. In the 1980 election, the FDP gained confidence in its own return to a liberal-market program when they gained vote shares. Though rather citing the German tradition of ordo-liberalism, i.e. the Freiburg School which had argued in the early 20<sup>th</sup> that state-intervention should only be used to enhance competition and efficient market transactions (Müller-Armack 1947), the policy suggestions sounded very similar to supply-side economic theory. They suggested tax cuts for higher incomes and corporations while increasing consumption taxes and spending cuts which should result in a maximum of new sovereign debt of DM 27 billion (Bökenkamp 2010, 200).

This obvious portrayal of policy programs which would increase inequality in the German economy and shift the tax burden significantly from the rich to the lower and middle incomes was clearly not a popular project in a society which had been proud that post-war economic growth had been accompanied by growing welfare spending (Leaman 2009). Additionally, the *Wendebrief* [letter of change], a central strategy paper of Foreign Minister Hans-Dietrich Genscher, openly argued that this reduction in redistri-

bution would enhance self-reliance of workers and give them greater incentives to work which equally went against German values of social market economy:

Change is necessary in the thinking and the acting. It is imperative to break with the mentality of demands which does not result from a less *leistungsbereit* [willing to achieve] generation but from laws which invite to claim, not to say: promotes it. Change is necessary. Now it is imperative to set the course toward greater self-responsibility, to achievement and autonomy, that means more freedom (Genscher 1995, 774).

Equally radical concepts of greater incentives to work were mentioned in the *Lambsdorff Paper* of September 1982, in which Minister Lambsdorff and the later president of the Bundesbank Hans Tietmeyer advocated the “divorce” of the FDP from the social-liberal coalition. The two authors argued that a shift from direct to indirect taxation was imperative to overcome the growth crisis. Only through significant cuts of taxes on individual and corporate income effort could be rewarded. The two policy makers argued that a less progressive tax system would offer entrepreneurs “an effort- and investment friendly structure”<sup>7</sup> and would inhibit *bracket creep*, i.e. the shifting of individual incomes into higher tax brackets with inflation which again had negative effects on the *Leistungsbereitschaft* and tax morality.<sup>8</sup>

Much less technical and much less offending to German workers was the policy program developed in the CDU/CSU which proposed corporate tax cuts and social spending cuts but not greater inequality in taxation through unequal top rate reductions and embedded those proposals in normative argument of liberating individuals from the strains of government authority over individual decisions. Kurt Biedenkopf and Meinhard Miegel, economists trained in both the German ordoliberal as well as the emerging American supply-side traditions, argued in their book *Die vorprogrammierte Krise* [The Preprogrammed Crisis] (1979) that German politics would have to reinvigorate *subsidiarity*. Subsidiarity meant that individuals should liberate themselves from the authority of the state and become independent by taking care of social security through the acquisition of individual wealth. To Miegel and Biedenkopf this independence was the only way prevent an “*Entmündigung* [incapacitation] of citizens and to permanent responsibility of the state, which sooner or later will lead into an authoritarian state” (Biedenkopf and Miegel 1979, 106). The Christian Democratic supply-side thinkers proposed as economic policy monetary stability, tax cuts for corporations and reduced government spending (Biedenkopf and Miegel 1979, 111–12).

Even though the CDU/CSU had not planned to cut taxes at the top and its arguments of social market economy were normatively inconsistent with cutting taxes unequally, they came to agree on this measure with the much smaller FDP faction when they entered coalition talks. This is how the government adopted a highly incoherent normative narrative for tax cuts at the top which could not stand up against the strong worker-wing in the CDU, the trade unions and the SPD and the Green Party. Helmut

<sup>7</sup> Lambsdorff, Otto Graf. “Documentation. A Concept for Policies to Overcome Weak Growth and Combat Unemployment.” September, 9, 1982. *Neue Bonner Depesche* 9/82, p. 1-11.

<sup>8</sup> *Ibid*, p. 7-8.

Kohl adopted the concept of *Wende* and argued it was a revival of the policies of Ludwig Erhard's social market economy. Unfortunately, German voters associated with the social market economy the *German Miracle* of post-war economic recovery accompanied by welfare state growth and tamed capitalism (Ptak 2009, 20).

In four speeches Kohl tried to integrate the ideas of social market economy with incentives to work as promoted by the FDP. Kohl presented his program of change in 1980 at a Party Congress in Berlin, in October 1982 in his first *Declaration of Government*, a *Government Statement on Tax Reforms* in May 1983 and in his second *Declaration of Government* in October 1987. Merit was the concept that Helmut Kohl used most extensively in his speeches. It even became the motto of the 1980 electoral campaign: "*Leistung muss sich wieder lobnen*" [effort must be rewarded again]. Kohl adopted from FDP reasoning the argument that it was unfair that the state took away income and wealth from individuals and firms who had earned it. Tax cuts were not predominantly presented as generating growth but as liberating individuals from a burden and supporting them in their future efforts. Kohl argued that performance-related justice should be the main principle he wanted to abide to: "Personal freedom and rewarding work, wealth for everyone and social security can be promoted through the spirit and power of the Social Market Economy."<sup>9</sup> He argued that ambitious and productive individuals should no longer get punished for their productivity: "We want to support private initiative. Effort may no longer be punished."<sup>10</sup> His tax plans were supposed to increase the "willingness to achieve and stimulate investments and innovation and strengthen the competitiveness of the economy."<sup>11</sup>

Even though Kohl tried to avert the FDP rhetoric of incentives, effort and reward and tried to frame it in terms of adding new spirits to work ethics instead. But the essence of the argument remained the same: all German workers should work harder. Just because Kohl framed it in a slightly more friendly tone, this did not change the central message: "We want a modern society. [...] We want a new understanding of work, which is represented by the European history of thought: Work is not only breadwinning."<sup>12</sup> Within this framework of deservingness Kohl also implied that the higher incomes would also need a reward for the commitments they made to the German economy: "We have to arrive at the top. That is why we acknowledge a responsible elite: Every society is in the long-run only as productive as the humans of which it consists."<sup>13</sup> Kohl's concept of the social market economy entailed a two-sided argument about the maintenance of welfare and redistribution through the tax system. On the one hand, the chancellor did not reject welfare all together but supported a social element in the social market economy. On the other hand, Kohl tried to create the rhetorical image that the individual needed to be independent and individually responsible for

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<sup>9</sup> Kohl, Helmut. "Government Statement." May 4, 1983.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid.

<sup>12</sup> Kohl, Helmut. "Government Statement." May 4, 1983.

<sup>13</sup> Ibid.

social security. Kohl admitted that the market could not solve all the problems in society. Not all societal conditions which “were good for the economy [were] humanitarially desirable.”<sup>14</sup>

Kohl's narrative of subsidiarity entailed a number of arguments that were highly contradictory and at odds with the social market conception that was still prevalent in German society. It was for this reason that it became particularly difficult for the administration to convince the CDU labor wing and the opposition of the tax cut. For instance Kohl repeatedly raised the principle of individual responsibility in social security and breadwinning: “We need to push forward the principle of subsidiarity, because for the self-sufficiency freedom in decisions and responsibility are imperative.”<sup>15</sup> At the same time, and paradoxically, the free market needed social cohesion and social sentiments. Subsidiarity was achieved when the market was fully established *and* individuals looked out after one another to resolve social problems. “Politics have to see their limits,”<sup>16</sup> he argued in his speech from 1983. “The demands towards the welfare state can only be met so far that the productivity of the economy prevails.”<sup>17</sup> But at the same time, the state needed to rely on the “solidarity of the citizens.”<sup>18</sup> Essentially, he argued that citizens had a responsibility towards their community to generate enough income that welfare became obsolete and budget deficits were prevented.

We want to give a strong economy social backing and thereby secure freedom materially. Only when the principles of social market economy are applied decently the economy can grow and social security will prevail. For this purpose *Leistungswille* [willingness to achieve] and creativity have to come together.<sup>19</sup>

Finally, in the concept of the *Mittelstand* [small- and medium-sized firms], the ideals of a free market and a society organized in familial subsidiarity and individual responsibility, generated a highly coherent concept of a market morality. Kohl argued that the planned reductions in the personal income tax rate were intended to give tax cuts to small business people. He argued that these reductions were necessary for reasons of fairness because corporations received cuts through the corporate tax reduction. Small firms were disadvantaged in “competition with large corporations”<sup>20</sup> and that was why the administration wanted “to support them especially in the tax law and the building of equity asset.”<sup>21</sup> When Kohl talked about tax reductions in the corporate tax and top

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<sup>14</sup> Kohl, Helmut. "Protecting the Creation – Winning the Future – Excerpts from the Declaration of Government of Helmut Kohl“, *FAZ*, March 19, 1987, p.7.

<sup>15</sup> Kohl, Helmut. “Declaration of Government.” October 13, 1982, 121<sup>st</sup> session of the Bundestag, *Bulletin of the press- and information office of the federal government*, No. 93, p. 853-868.

<sup>16</sup> Kohl, Helmut. "Government Statement." May 4, 1983.

<sup>17</sup> *Ibid.*

<sup>18</sup> Kohl, Helmut. “Declaration of Government.” October 13, 1982. 121<sup>st</sup> session of the Bundestag. *Bulletin of the Press- and Information Office of the Federal Government*, No. 93, p. 853-868.

<sup>19</sup> Kohl, Helmut. "Protecting the Creation – Winning the Future – Excerpts from the Declaration of Government of Helmut Kohl“, *FAZ*, March 19, 1987, p.7.

<sup>20</sup> *Ibid.*

<sup>21</sup> *Ibid.*

personal income tax, he created an image of a tax cut for the individual entrepreneur. His tax cuts were intended to help “especially small and medium firms, the free professions, craftsmanship.”<sup>22</sup> His tax cut was helping “the workers, the employed, the master craftsmen and the assistants, the self-employed and those in the free occupations, particularly small and medium forms in retail, crafts and industry.”<sup>23</sup>

In Kohl's justifications to cut taxes for the *Mittelstand*, he did not predominantly argue that these tax cuts would generate economic growth or employment which would have made a popular narrative among German workers, but he again relied on the argument that it was fair to give a tax cut to those firms who *deserved* it most. He raised an image of the individual entrepreneurs who deserved the tax cuts most because society benefitted from them and “their creativity, their entrepreneurial courage, their dynamic adjustment indispensable pillars of the German economic progress.”<sup>24</sup> Kohl repeated this argument again in a basic program of the CDU in 1994, where he argued that the German economy depended on the *Mittelstand*: “We need the economic power of a broad *Mittelstand* and the richness and ideas and will for success of entrepreneurs of medium-sized firms with their large innovation and development dynamic.”<sup>25</sup> Small firms also deserved lower taxes because they were more flexible and could “make decisions quicker and are less bureaucratic.”<sup>26</sup> Giving tax cuts to the small and medium firms was not only good for these firms but also for workers who would gain from the growth in jobs. Kohl argued that the *Mittelstand* employed 13 million individuals, “the majority of workers in the Federal Republic.”<sup>27</sup> It was simply right to “relief them from bureaucratic obstacles” and taxes.

In summary, Helmut Kohl was confronted with a normative problem. Large sections of the CDU/CSU and their voters were supportive of the traditional idea of the social market economy which aligned economic growth with expansions in welfare spending. This inclusive concept of economic growth was contradicted by the demands of the FDP to cut welfare spending and top personal income tax rates. Kohl tried to rephrase the FDP's demand for greater incentives to work in a more positive language, but it remained highly contradictory with the values of voters and party bases. Under these conditions, it became easy for the SPD and the Green Party to obstruct the tax cut in the Bundesrat.

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<sup>22</sup> Kohl, Helmut. "Government Statement." May 4, 1983.

<sup>23</sup> Ibid.

<sup>24</sup> Ibid.

<sup>25</sup> CDU. "Freedom in Responsibility. Basic Program of the Christian Democratic Union Germany." February 20-23, 1994, p. 53.

<sup>26</sup> Ibid.

<sup>27</sup> Kohl, Helmut. "Government Statement." May 4, 1983.

## 6.5 Particularism in the Bundestag Debates

Social scientists and historians who look at the relevance of ideas in economic-policy making have convincingly shown the dominance of ordoliberal thought in the German political economy and how it helped to bring about a paradigm shift from the short period of Keynesian steering in the 1960s to supply-side oriented policies within the Kohl government in the 1980s and 1990s (Bökenkamp 2010; Leaman 2009; Ptak 2009). However, even though the government adopted new ideas for economic policy making, it had issues passing the reform programs in the Bundesrat and Bundestag. This section argues that we need to look at the communication among administration and the parliament, and not only economists and administration, to fully understand the relevance of ideas in paradigm shifts. Once we move away from the epistemic communication, i.e. the communication of economists and policy makers, and look into coordinative communication, i.e. the debates of government and parliament, we find that the ability of the government to develop normative frameworks in which to embed their new economic program is essential to get a tax program passed in the German Bundestag and Bundesrat. This section will demonstrate that the lack of a coherent narrative of economic growth and social justice of the Kohl administration could not stand a chance against the powerful social justice frames that were deeply ingrained in arguments of parliamentarians of the SPD, Green Party but also the CDU. In a way, the power of supply-side arguments worked against a coherent normative narrative of as it imposed ideas of incentives to work harder on the Kohl administration which clearly went against the German associations with the social market economy.

The debates of the tax reforms in the 1980s were most of all characterized by conflict. The opposition fiercely attacked the government's plan to reduce the progressivity in the tax system and demanded improvements in social justice. Despite being confronted with a serious economic downturn and unemployment crisis, the arguments of the contentious groups were not so much characterized by different cognitive theories of economic growth, but mostly by normative arguments of social justice versus market justice. Even though the governing parties argued that the tax plan would enhance economic productivity in the German economy, fairness arguments were more frequent. Since the opposition had attacked the Great Tax Reform for its inequity, inequity among individuals and inequity among capital and labor, the factions of the CDU/CSU and FDP had to react to these claims. The governing coalition argued defensively that the tax plan was mainly directed at the middle incomes and families and that meritocracy would generate greater fairness to the hard-working individuals in German society. However, these arguments neither convinced the opposition parties, nor small trade unions, civic groups and the labor-wing of the CDU. A number of economic advisers agreed with the opposition that the tax reform needed to uphold social justice in the tax system. Because of the strength of the dominant normative discourse of social justice in the Bundestag, the government was not capable of passing its plan to significantly shift taxes from the top to the bottom.

*The Center-Right Governing Coalition*

In the debates of the Bundestag and the Bundesrat, the CDU/CSU and the FDP combined two main arguments. The first is an economic argument that was derived from the supply-side which argued that the top rate reductions and corporate tax rate reductions led to higher resources to invest for the Mittelstand and corporations. This idea was predominantly used by the FDP and found little support among the CDU and CSU who instead based their arguments on the traditional values of the social market economy and argued that the tax plan helped the hard-working middle incomes and families. Unfortunately, the latter argument was easily deconstructed by the opposition as the higher incomes were supposed to receive the bulk of the tax cut. The governing parties were not prepared to counter the fierce normative social justice arguments of the opposition against the plan to cut the top personal tax rate and the tax breaks for Sunday, night and holiday labor. The labor-wing of the CDU built an ideational coalition with the opposition and pressured the government to reduce the cuts in the top rate. Despite extended debates and struggles of the FDP and the CDA over the shift of the tax burden to the bottom, the CDA was able to prevent the implementation of a radical tax cut at the top of the income distribution. It also prevented the cutting of tax breaks for Sunday, night and holiday work.<sup>28</sup> The most important asset of the opposition was a normative ideational persuasion of a faction of the governing parties which transcended institutional power distributions.

Many parliamentarians tried to convince the opposition and the CDA of the program to cut taxes for top incomes and corporations used the narrative of the historical role-model of Ludwig Erhard. They argued that Erhard's Social Market Economy had proven that tax cuts generated increases in growth. Hermann Solms from the FDP reminded the Bundestag audience that Erhard's 1955 tax reform gave businesses a significant relief which allowed them to use "the majority of their profits and earnings for investments, the accumulation of capital stock, and to prepare for the future."<sup>29</sup> Coupled with the tax cuts for individuals, this had led to a dramatic increase in productivity because the tax cuts "had given the economy the freedom from which the economic miracle had resulted."<sup>30</sup> A similar narrative was evoked by Max Streibl from the CSU, who argued that tax and spending cuts would bring the German economy back to "the time of reconstruction, when the world was speaking of a German "miracle".<sup>31</sup>

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<sup>28</sup> FAZ. "Hardened Fronts in the Fight over the Top Personal Tax Rate of the Coalition. Blüm and the Social Committees in Conflict with the CSU and the FDP." February, 2, 1987, p. 2; Busse, Carl-Wilhelm. "In Europe Still the Marxist Muff." *FAZ*. February 12, 1988, p. 11.

<sup>29</sup> Solms, Hermann, "Stenographic protocol of the 87<sup>th</sup> session of the Bundestag," Bonn, 23 June, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5866.

<sup>30</sup> *Ibid.*, p. 5866.

<sup>31</sup> Streibl, Max, "Protocol of the 588<sup>th</sup> session of the Bundesrat," 29 April, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 3588, p. 87.

Even though a number of politicians from both the FDP and the CDU/CSU argued that lower taxes for firms would enhance the competitiveness of the German economy, not a single parliamentarian adopted the official FDP argument that a reduced progressivity in income taxation would enhance incentives to work. Some policy makers argued that corporate tax cuts and a reduction in the top individual rate should give businesses greater resources for profit accumulation. The coalition agreed that the Mittelstand would benefit in particular from the reductions in the top rate which would have positive effects on employment as the largest share of German workers and had the highest prospects to generate new jobs. Hans Gattermann from the FDP argued that the tax system needed to be reformed to “become more growth- and employment friendly and at the same time provide solutions for problems in foreign trade and reduce the tax disadvantages of the Standort in international competition.”<sup>32</sup> He found it scandalous that the SPD was still opposing their planned tax cuts because this attitude “ruined the climate for investments, for employment.”<sup>33</sup> High corporate taxes and top personal income tax rates “ruined the optimism that is necessary” for investments.<sup>34</sup> Gattermann wanted the rate reductions to be implemented as quickly as possible, in order to enhance international competitiveness of German producers which were in desperate need of “improved conditions for risk taking and investment opportunities.”<sup>35</sup>

The strong emphasis on competitiveness and unemployment in the Bundestag debates also confirms the thesis that the crisis was interpreted as very severe in the 1980s but that this interpretation was not sufficient to get a tax cut for corporations and top incomes passed in the Bundestag. Max Streibl clearly stated that economic development and reductions in unemployment could only be achieved with “government and society giving a clear yes to profits of corporations and the economy.”<sup>36</sup> The parliamentarian argued that the state could encourage entrepreneurs to “innovate and take on risks in the economic realm.”<sup>37</sup> But the government had to give a “clear yes to the reform of the corporate income taxes and a clear yes to a broad distribution of income and productive capital.”<sup>38</sup> Another FDP parliamentarian, Hermann Solms, argued that “corporations’ ability to invest” could only be improved when the “tax and contribution rate was reduced.”<sup>39</sup> Similar arguments were presented by a number of Christian Democrats, like Hansjürgen Doss, who added, that the general plan to reduce corporate tax rates and income tax rates supported the Mittelstand. The Mittelstand particularly gained through the elimination of the cold progression, i.e. the high individual rates for

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<sup>32</sup> Ibid., p. 5845.

<sup>33</sup> Gattermann, Hans, “Stenographic protocol of the 87<sup>th</sup> session of the Bundestag,” Bonn, 23 June, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5843.

<sup>34</sup> Ibid., p. 5843.

<sup>35</sup> Ibid., p. 5845.

<sup>36</sup> Streibl, Max, “Protocol of the 588<sup>th</sup> session of the Bundesrat,” 29 April, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 3588, p. 87.

<sup>37</sup> Ibid., p. 87.

<sup>38</sup> Ibid., p. 87.

<sup>39</sup> Solms, Hermann, “Stenographic protocol of the 87<sup>th</sup> session of the Bundestag,” Bonn, 23 June, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5866.

medium incomes. "A linear tariff and the lower tax burden on retained profits mean an improvement of profitability, improvement of the accumulation of equity and improvements in the ability to invest."<sup>40</sup> Lower income and corporate taxes were not only good for investments, but also for employment, the representative argued: "A high corporate tax is responsible for the low equity ratio in the Mittelstand" which resulted in "low investment quotas. Without investments no growth in jobs."<sup>41</sup>

However, economic arguments were not the only arguments voiced in the Bundestag. The justification for tax reductions at the top of the income tax schedule predominantly followed a reasoning of supporting the overly burdened sections of society. Rarely do we find statements like this one of FDP parliamentarian Solms which clearly state the FDP's official argument of work incentives: "The *Leistungsbereitschaft* [willingness to effort] of employees and the ability to invest of firms can only be strengthened through lower contributions and taxes."<sup>42</sup> Instead, most parliamentarians argued along the traditional lines of the social market economy. Minister of Finance Gerhard Stoltenberg from the CDU justified his plan to cut income taxes for medium and top incomes with the argument that they had suffered from increasing tax rates, which had resulted from policies of the previous government. He argued his tax plan gave a relief from the "burdening effects in direct taxes on labor and entrepreneurial activity."<sup>43</sup> The Minister argued that the government delivered a tax cut of DM 33.8 billion, which was characterized by an "outstanding relief" which was "given back to the taxpayers."<sup>44</sup> The tax cuts helped the "a large majority of qualified employees, who have been exposed to ever greater and unbearable seizure of their additional income which they had earned through occupational success and wage agreements."<sup>45</sup>

Another issue which many representatives referred to was fairness and the elimination of special tax breaks and loopholes in the tax system. Representative Gatterman argued that the elimination of tax breaks and loopholes would enhance the fairness of the tax system: "The tax system should get fairer. The means to achieve this is the reduction of special rules, group tax breaks etc., in short broadening of the tax base."<sup>46</sup> The tax plan entailed a reduction of many of these rules, which Gatterman considered a great improvement in tax equity "whether the ones who are affected like it or not."<sup>47</sup> The last statement implies that Gattermann already knew the demand of the opposition that the Sunday, night and holiday work surcharges should remain untouched. But not

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<sup>40</sup> Doss, Hansjürgen, "Stenographic protocol of the 87<sup>th</sup> session of the Bundestag," Bonn, 23 June, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5891.

<sup>41</sup> *Ibid.*, p. 5891.

<sup>42</sup> Solms, Hermann. "Stenographic protocol of the 87<sup>th</sup> session of the Bundestag." June 23, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5866.

<sup>43</sup> Stoltenberg, Gerhard. "Stenographic protocol of the 87<sup>th</sup> session of the Bundestag." June 23, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5849.

<sup>44</sup> *Ibid.*, p. 5849.

<sup>45</sup> *Ibid.*, p. 5849.

<sup>46</sup> Gattermann, Hans. "Stenographic protocol of the 87<sup>th</sup> Session of the Bundestag." June 23, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5845.

<sup>47</sup> *Ibid.*, p. 5854.

only the opposition parties were critical of this feature of the tax plan, some representatives from the CDU also opposed this plan, rejecting it on the basis of market arguments. They argued that the structural changes in the German economy needed a greater flexibilization of working hours. To one representative it seemed “that particularly in those cases where production related shift work – night work, Sunday work – is needed, a just compensation between the existing and the future tax break has to be created.”<sup>48</sup> The Sunday, night and work surcharges were cut by a much smaller degree than planned.

In the debates of 1988, the center-left opposition parties, the trade unions and the economists persistently raised social justice when critiquing the tax plan and the governing parties had to counter this critique. What they did in the debates in the Bundestag and Bundesrat was to argue that their tax plan gave the greatest tax breaks to the middle class and families. But this justification was not sufficient to convince the opposition and the powerful labor-wing in the CDU, which pressed for greater compensations for the lower and middle classes. The government could only defensively argue that they refused to think in terms of redistribution. Walter Wallmann observed that the “critique of the tax-reform plans of the government – we see this since weeks and months – is mainly directed at distributive arguments.”<sup>49</sup> Finance Minister Stoltenberg argued that the critique was misguided, as the main objective of the Great Tax Reform was to eliminate the *Mittelstandsbauch* or the *cold progression* which hurt the small and medium incomes most: “The SPD engages in a major twisting of facts when it uses the parole of an apparent redistribution from bottom to the top.”<sup>50</sup> The government wanted to correct the impression that the reform was skewed to top incomes. Many Representatives argued that the total tax volume that went to lower and middle incomes was much larger than the tax amount that went to the top incomes and thereby tried to avoid the tax burden debate that the opposition was raising.<sup>51</sup> Walter Wallmann calculated that “the largest weight of the overall tax cut goes to lower and medium incomes. These groups gain particularly through the diminished bottom tax rate and the three times increases of the personal allowance.”<sup>52</sup> The coalition referred to its written tax program which argued that all families gained from the reform and those with more children got greater support through “the further increases in the personal allowances

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<sup>48</sup> Walz, N.A.. “Protocol of the 570<sup>th</sup> Finance Committee of the Bundesrat in Bonn.” April 14, 1988. 11<sup>th</sup> legislative period. PA XI/71, Vol. A2, Doc No. 18, p. 34.

<sup>49</sup> Wallmann, Walter. “Protocol of the 588<sup>th</sup> session of the Bundesrat,” 29 April, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 588.

<sup>50</sup> Stoltenberg, Gerhard. “The Minister of Finance from the far and distant Bonn is a respected guest in the election campaign,” *FAZ*, 3. Mai 1988, p. 3.

<sup>51</sup> Of course the total amount of tax cut for the lower and middle incomes, i.e. 90 percent of all individuals, is bigger than the tax cut for the rich, i.e. 10 percent, when you sum up the total amounts.

<sup>52</sup> Wallmann, Walter. “Protocol of the 588<sup>th</sup> session of the Bundesrat,” 29 April, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 588.

and the child tax allowance.”<sup>53</sup> This benefitted the small incomes and the families most. Häfele argued in a Finance committee session that it was wrong to consider the tax reform socially unequal as “the largest share of the cut went the bottom and the smallest share to the top.”<sup>54</sup> Families gained through the higher child allowances and lower incomes gained from the increases in the personal allowance “half a million taxpayers were no longer filing taxes at all.”<sup>55</sup> Dregger emphasized that lower incomes gained from the lower bottom rate which “you Ladies and Gentlemen from the SPD raised from 19 to socially unbearable 22%.”<sup>56</sup> Dregger also rejected the argument of the opposition that the tax cut was “meant for the rich.” He argued that the tax cut was even giving greater tax cuts to the bottom than the top when one considered that the share lower and medium incomes paid in the total tax revenue was much smaller than what the top contributed. “While the small and medium incomes get a much larger tax cut and pay a much smaller contribution to overall revenues, the reverse is true for the top incomes.”<sup>57</sup>

### *The Center-Left Opposition*

The German peace movement started mobilizing large protests against the renewal of war language in the Western world but also against the plans to cut welfare. On October 10<sup>th</sup> 1981, about half a million protestors gathered in Bonn under the banner “for disarmament and relaxation in Europe”. And in June 10<sup>th</sup> 1982 around 350.000 protestors called out a “peace-Woodstock at the Rhein” against the NATO double-track decision and Reagan’s “absurd economic policy program”.<sup>58</sup> The protesting groups argued that it had a strong “unsocial taste” when the government of a country that already had very small social spending suggested spending cuts of \$40 million and a tax reduction of 25 percent within three years “of which the richest 6% of Americans would gain a third and the bottom 40% only a tenth.”<sup>59</sup> In 1987 and 1988, when the government put forward their proposals to cut taxes for higher incomes, the German Trade Union Federation, DGB, organized a number of protests under the motto “work for everyone, justice for all, act jointly,”<sup>60</sup> with the chairman of the DGB, Ernst Breit. Together the

<sup>53</sup> German Bundestag, “Legislative proposal of the government,” Bonn, 2 May 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11/2226, p. 1.

<sup>54</sup> Häfele, Hansjörg. “Protocol of the 570<sup>th</sup> Finance Committee of the Bundesrat in Bonn.” April 14, 1988. 11<sup>th</sup> legislative period. PA XI/71, Vol. A2, Doc No. 18, p. 22.

<sup>55</sup> *Ibid.*, p. 22.

<sup>56</sup> Dregger, Alfred. “Stenographic protocol of the 87<sup>th</sup> session of the Bundestag,” Bonn, 23 June, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5834.

<sup>57</sup> *Ibid.*, p. 5836.

<sup>58</sup> Leinemann, Jürgen, “We were floundering in between,” *Der Spiegel*, No. 24, 1982 14 June 1982, p. 19 <http://www.spiegel.de/spiegel/print/d-14341269.html> accessed 19. July 2016

<sup>59</sup> *Der Spiegel*, “Reagan does no longer understand the world,” *Der Spiegel*, No 23, 7 June 1982, p. 24, 26 <http://www.spiegel.de/spiegel/print/d-14339533.html>

<sup>60</sup> Breit, Ernst, “Demonstrations planned in the Ruhr area,” *FAZ*, 3 February, 1988, p. 1.

unions demanded that the government let go of the “outmoded and unjust”<sup>61</sup> tax reforms and suggested to take the constitutional welfare mandate of the state seriously. The *Industriegewerkschaft Druck und Papier* [labor union for print and paper] organized a number of mass rallies against this proposal of the government to cut their Sunday, Night and Holiday surcharge and the advertising cost allowance.<sup>62</sup>

Cognitive arguments were in general not the most important category of frames raised by policy makers in the debates of the Great Tax Reform 1986/1988/1990 (see Table 4 at the end of the Schröder chapter). The Green Party and the SPD argued that cutting taxes for corporations and top incomes did not incite investment and employment. In parliament and in the hearings, they attacked the governing parties and the liberal economists for what they considered a misguided economic policy concept. To the SPD, tax cuts were the last solution to the recession problem because the federal government, the states and the communes had to deal with structural changes. The Social Democrats argued that industrial production was in decline and increasingly under threat from international competition. The solution for the SPD was not to cut taxes, but to collect more revenue to support the suffering firms with industrial policy and subsidies. The argument that the majority of workers were employed in the *Mittelstand*, did play a role for the red-green factions, but in their reasoning they focused on protecting manufacturing jobs. Subsidies were more important than ever because reunification would need regional structural policy.

To the SPD, the Berlin subsidies, the structural support for the Ruhr area and declining sectors like coal were necessary to counter regional industrial downturns. Typically the Social Democrats argued that the government needed revenues to invest in the local industries. They feared that a tax cut would let communal and state budgets slide even deeper into the already soaring deficits. Claus Grobecker from the SPD argued that the tax shortfalls that resulted from the tax plan “could be absorbed by the budgets. That is particularly true for the states and communes and among them particularly these entities which are already highly burdened through economic structural crises and high unemployment.”<sup>63</sup> A state council from Hamburg Hartmuth Wrocklage argued that many states and communes had particular structural problems which needed stronger intervention of the state through subsidies and hence these states needed greater financial resources: “We consider measures necessary which lead to an effective support for states and communes with special structural problems.”<sup>64</sup> The SPD was not persuaded by the Laffer curve arguments of the conservative-liberal coalition and argued that tax cuts would lead to tax increases in the long run. Representative Peter Struck argued in Budget Committee Sessions that the Tax Package 1990 was “economically misguided and not financed solidly. It overcharges public budgets and wreck[ed]

<sup>61</sup> Ibid., p. 1.

<sup>62</sup> FAZ, „Protests against the tax reform planned,“ *FAZ*, 17 December 1987, p.6.

<sup>63</sup> Grobecker, Claus, “Protocol of the 570<sup>th</sup> Finance Committee of the Bundesrat in Bonn,” 14 April, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A2, Doc No. 18, p. 16.

<sup>64</sup> Wrocklage, Hartmuth. “Protocol of the 570<sup>th</sup> Finance Committee of the Bundesrat in Bonn.” April 14, 1988. 11<sup>th</sup> legislative period. PA XI/71, Vol. A2, Doc No. 18, p. 20.

public finances. Massive tax and contribution increases [would] be the consequence.”<sup>65</sup> The increasing government expenditures in the areas of “defense [...], unemployment benefits, coal-, structure and agricultural politics and the expected additional federal funding that was needed for the pension insurance fund were not considered”<sup>66</sup> in the budget plans of the government. In Struck's view, tax cuts simply exceeded the means of the budget, when expenditures were added to the calculation and would therefore result in “deep cuts in the resources to invest of the communes.”<sup>67</sup> At least, argued representative Peter Mitzscherling, the government changed the plan in so far that “4,500 jobs in the Berliner cigarette industry”<sup>68</sup> could be saved. Many parliamentarians worried that the higher burden for the budget that resulted from the tax cut may lead to higher consumption taxes. Representative Christa Vennegerts from the SPD argued that the reform had “created a number of problems for the federal budget. It has not yet been determined which consumption tax increases will follow.”<sup>69</sup>

But the most important topic for the SPD and the Green Party were *social injustices* that resulted from the tax plan. The opposition parties argued that a top rate reduction coupled with higher value added taxes and other consumption taxes would reduce tax justice significantly even if the lower incomes gained from the lower bottom rates. The factions instead suggested to maintain the level of redistribution or to increase it. In a number of highly emotional and pointed statements SPD representative Peter Struck attacked the tax plan as “unjust and family unfriendly, economically misguided [...]”<sup>70</sup> To him the reform was a “tax political miscarry because it mainly hits pensioners and workers [...]. It is economically misguided as it cuts mainly for the rich and less for medium and lower incomes.”<sup>71</sup> He elaborated that top incomes and capital would gain the highest share of the tax cut and that workers would pay increasing shares in taxes. Overall this resulted in a vast “redistribution to the top.”<sup>72</sup> The Representatives of the SPD considered the reductions in taxes for the rich a scandal. Top incomes not only gained from the obvious tax rate reduction at the top of the income tax schedule but additionally benefitted from all those provisions which the government sold as cuts for the lower and medium incomes. Diether Posser argued that the governing factions knowingly misguiding the population when they maintained that they cut taxes for all incomes alike. The government asserted “that the reduction of the top personal tax rate

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<sup>65</sup> Struck, Peter. “Short Protocol of the 29<sup>th</sup> session of the Budget Committee,” June 8, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A3, Doc No. 81, p. 69.

<sup>66</sup> Struck, Peter. “Short Protocol of the 31<sup>th</sup> session of the Budget Committee.” June 22, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A3, Doc No. 81, p. 22.

<sup>67</sup> *Ibid.*, p. 23.

<sup>68</sup> Mitzscherling, Peter. “Short Protocol of the 29<sup>th</sup> session of the Budget Committee.” June 8, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A3, Doc No. 81, p. 24.

<sup>69</sup> Vennegerts, Christa. “Short Protocol of the 31<sup>th</sup> session of the Budget Committee.” June 22, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A3, Doc No. 81, p. 23.

<sup>70</sup> Struck, Peter. “Short Protocol of the 29<sup>th</sup> Session of the Budget Committee,” June 8, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A3, Doc No. 81, p. 69.

<sup>71</sup> *Ibid.*, p. 69.

<sup>72</sup> *Ibid.*, p. 69.

from 56% to 53% lead to a yearly revenue loss of “only” 1 billion DM,<sup>73</sup> however that did not “mean that the taxpayers, who are taxed with the top personal tax rate only get DM 1 billion in tax cuts.”<sup>74</sup> These taxpayers additionally received all “the tax breaks that the lower income brackets get – tax allowances, proportional zone etc.”<sup>75</sup> Posser calculated that summing these tax amounts up would result in a tax cut of 3 billion yearly for the top incomes. In the Bundesrat a group of social-democratically governed states, Bremen, North-Rhine Westphalia, Saarland organized a protest in the Bundesrat against the tax proposal. In one of the Bundesrat debates the Senator of Bremen objected the tax proposal as “socially imbalanced. The earners of high incomes get preferential treatment lacking any sound judgement. The tax cuts for families are totally insufficient.”<sup>76</sup> Grobecker argued that the tax cut would only be socially fair if “the medium and lower incomes [got] a larger tax cut than the top incomes [...]. Families with children need a larger tax cut.”<sup>77</sup> Grobecker did not want to raise social justice “as the only criterion for tax laws, that would be wrong.”<sup>78</sup> But when a government made such comprehensive changes to the wage and income tax “social-justice criterions [had to be taken] into consideration.”<sup>79</sup> Hans Kasper supported Grobecker in arguing that the distribution of the tax reform had to “follow the imperatives of social justice. The medium and small incomes need larger cuts in comparison to the high incomes than envisioned in this plan.”<sup>80</sup>

Both opposition parties laid out alternative tax plans to counter the government's plan to reduce redistribution. The SPD wanted to ensure a “concentration of the tax cuts on small and medium incomes.”<sup>81</sup> For that purpose it planned a greater increase in the basic allowance to 6.750 and 13.500 for singles and married couples “which would give about DM 1.000 more to low income singles and about DM 2.000 more for married couples.”<sup>82</sup> The Green Party went even further in their demands. By proposing a top tax rate *increase* to 60 percent and much greater tax allowances of DM 10.000 and 20.000 for singles and married couples they actually demanded a greater progressivity in the tax system and greater redistribution.<sup>83</sup> This is extremely surprising because the

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<sup>73</sup> Posser, Diether. “Protocol of the 588<sup>th</sup> Session of the Bundesrat,” 29 April, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 588, p. 86.

<sup>74</sup> Ibid., p. 87.

<sup>75</sup> Ibid., p. 87.

<sup>76</sup> Grobecker, Claus. “Protocol of the 570<sup>th</sup> Session of the Finance Committee.” April 14, 1988, Bonn, 11<sup>th</sup> legislative period, PA XI/71, Vol A2, Doc No. 18, p. 16.

<sup>77</sup> Ibid., p. 16

<sup>78</sup> Grobecker, Claus. “Protocol of the 588<sup>th</sup> Session of the Bundesrat.” April 14, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 3588, p. 91.

<sup>79</sup> Ibid., p. 91.

<sup>80</sup> Kasper, Hans. “Protocol of the 570<sup>th</sup> Finance Committee of the Bundesrat in Bonn.” April 14, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A2, Doc No. 18, p. 16.

<sup>81</sup> German Bundestag. “First recommendation of the Committee of Finance.” June 21, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 1102529, p. 7.

<sup>82</sup> Ibid., p. 7.

<sup>83</sup> Ibid., p. 8.

Green Party is the only party in parliament that demands more redistribution and at the same time, the Green Party was also the party that suggested the tremendous top rate reductions in the early 2000s.

Even though the government claimed it planned to finance the tax cuts through cuts in subsidies, the opposition feared that the government would eventually finance the reform through increases in consumption taxes. The SPD and the Green Party worried most about potential hikes in the VAT after the first part of the reform had passed the Bundestag. Grobecker pressed the government to reveal its full plan: "From my point of view it would only be fair to the citizens to let them know, that the government mentions the [...] necessity for a fourth stage in the tax reform."<sup>84</sup> He suspected that "increases in the sales tax and other consumption taxes"<sup>85</sup> would follow. "Only then can we really sum up all the features of the tax reforms and only then will we know that pensioners, unemployed and welfare recipients will carry the burden."<sup>86</sup>

The SPD and the Green Party argued that the proposed increases in child tax allowances contradicted social justice. They demanded increases in child transfers, instead. Child benefits, they argued supported all income groups by the same absolute value which represented a higher relative share of support for the lower income groups. That was considered just because it raised *equality of outcome*. The Social Democrats proposed increases in child benefits to monthly transfers of DM 130 for the first, DM 200 for the second and DM 300 for any other child. They also demanded the child benefit be deducted from the overall income tax due.<sup>87</sup> The red-green factions argued that child allowances should be abolished altogether because they gave greater benefits to richer parents. The overall evaluation of the government's tax plan was that it was hostile to families because it limited redistribution: "Medium-income families get treated worse than singles. Often families with children are disadvantaged over married without kids. Through the unjust child tax allowances top incomes gain three times as much for their children than average incomes."<sup>88</sup> Hans Apel from the SPD stressed that the government could not claim it was supporting families in their tax plan: "The audacity with which you are maintaining a benefit for the families is astonishing. An average family only gets DM 2 more per month and child. Is that supposed to be all that comes out of your family political promises?"<sup>89</sup>

Aside from justice arguments within income groups, tax justice between capital and labor became a highly frequent topic for the Social Democrats in the Bundesrat and the

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<sup>84</sup> Grobecker, Claus. "Protocol of the 588<sup>th</sup> Session of the Bundesrat," April 21, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 3588, p. 91.

<sup>85</sup> Ibid., p. 91.

<sup>86</sup> Ibid., p. 91.

<sup>87</sup> German Bundestag. "First recommendation of the Committee of Finance." June 21, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 1102529, p. 7.

<sup>88</sup> Struck, Peter, "Short Protocol of the 29<sup>th</sup> Session of the Budget Committee," June 8, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A3, Doc No. 81, p. 69.

<sup>89</sup> Apel, Hans, "Stenographic protocol of the 87<sup>th</sup> Session of the Bundestag," June 23, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 11087, p. 5841.

Bundestag. The SPD argued that considering that unemployment was so high it seemed amoral to them to give tax cuts to corporations. This is a highly very interesting finding because it means that the Social Democrats did not even believe that tax cuts for corporations would generate growth. In the debates of the 2000s, the dominant discourse has shifted so radically that all actors in the Bundestag present the effect of corporate tax cuts on growth and employment as the most natural relationship in economics. But in the 1980s, Representative Grobecker argued that under current economic conditions in which 2.5 million individuals were unemployed the government could not additionally cut corporate taxes and show “how tax law works better for the better-off.”<sup>90</sup> He argued that this was “unjust, it works against the principle of social justice.”<sup>91</sup> The unequal treatment of capital and labor was also raised in the field of finance of the tax reform. The opposition argued that the list of tax breaks and loopholes the government intended to close was skewed towards labor. Grobecker argued that the “list of measures to cut tax breaks need[ed] a thorough revision. In particular the disproportionate weight for the workers [had] to be downsized.”<sup>92</sup> Grobecker explained that the reduction in tax breaks was unbalanced among labor and capital because firms only registered their profits earlier under the new source tax for capital income. That had no effect on their overall tax burden. For the workers, however, the elimination of surcharges and the advertising cost allowance the tax break cuts meant a real yearly tax increase.<sup>93</sup> Peter Struck agreed the tax proposal was “hostile to workers”<sup>94</sup> who shouldered the largest share in the financing. This was particularly true for the night, Sunday and holiday surcharge which the government planned to tax. “Workers at newspapers for example, who depend on these working hours would be taxed with additional tax burdens of DM 4-5,000 [sic].”<sup>95</sup> Additionally pensioners would suffer from the elimination of the elderly allowance.

### *Particularism in Trade Unions, Small Civic Groups and Business*

The majority tax literature in the field of comparative political economy suggest that unions favor Keynesian demand stimulation because workers reap the benefits of these, businesses favor neoliberal tax cuts because they keep a greater share of their profits. The shift from Keynesianism to neoliberalism is often theorized as the consequence of

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<sup>90</sup> Grobecker, Claus. “Protocol of the 588<sup>th</sup> Session of the Bundesrat,” April 29, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 3588, p. 91.

<sup>91</sup> *Ibid.*, p. 9<sup>^</sup>1.

<sup>92</sup> Grobecker, Claus. “Protocol of the 570<sup>th</sup> session of the Finance Committee.” April 14, 1988, Bonn, 11<sup>th</sup> legislative period, PA XI/71, Vol A2, Doc No. 18, p. 17.

<sup>93</sup> Grobecker, Claus. “Protocol of the 588<sup>th</sup> Session of the Bundesrat” April 29, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 588, p. 92.

<sup>94</sup> Struck, Peter. “Short Protocol of the 29<sup>th</sup> Session of the Budget Committee.” June 8, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A3, Doc No. 81, p. 69.

<sup>95</sup> *Ibid.*, p. 69.

modifications in the power relations of capital and labor. Power resource argued that the shifts in the relative power of labor unions vis-à-vis business lead to the abandoning of Keynesianism and the adoption of neoliberalism in the field of tax policy (Hacker 2002; Huber and Stephens 2014; Pontusson 2013). This section, and the equivalent section in Chapter 7, show that ideas of the umbrella interest groups changed significantly over time and enabled very different coalitions within the German parliamentary debates. In the 1980s the dominant discourse focused on a combination of Keynesian economic theories in the cognitive realm and social justice in the normative realm. The DGB followed the arguments of small sectoral trade unions and small civic groups which demanded resources for their members but also a general redistribution within society. Federal business associations demanded universal tax cuts for capital and all income groups, but were countered by a number of small sectoral business groups. The small groups fought the reduction in the top personal tax rate, the reduction in the worker surcharge and demanded the maintenance of subsidies. After the exclusion of small civic groups and sectoral unions from the debates in the early 2000s, the discourse shifted towards greater acceptance of market justice and universal arguments in tax cuts.

Among the groups of labor unions that testified in the Bundestag and the Bundesrat there was strong support for Keynesian economic policies. Though the rejection of a personal income tax reduction under the ideal to enhance the willingness to work for their members would have qualified as a narrow material interest, unions even rejected the curtailing of corporate taxes at the time. They could have also interpreted tax cuts for firms in their interest, as a way to maintain or generate jobs, which is what they did in the 2000s. But in the late 1980s and early 1990s, the DGB rejected this argument fiercely. The union federation repeatedly questioned the government's argument that tax competition and efficiency enforced tax cuts for corporations. The idea that tax cuts enhanced competitiveness of the German economy was entirely foreign to the trade unions at that time. In 1991, union leaders from the DGB argued that net tax reductions for corporations through changes in the *Gewerbeertagsteuer* [trade tax], the elimination of the *Gewerbekapitalsteuer* [tax on business capital] and reductions in the *Betriebsvermögensteuer* [wealth tax for firms] were not necessary. They agreed that an income-neutral reform for business taxes, i.e. tax rate reductions with the broadening of the tax base, and a simplification of the tax schedule were feasible instruments to create growth. Also they supported the tax cuts on reinvested profits to create employment and real investment. But cutting overall tax burdens on capital was not necessary for growth and employment. They cited a monthly report of the Bundesbank from the same year which showed that the gross incomes of production firms had increases from 1982 to 1990 yearly on average by 10.5 percent.<sup>96</sup> They argued that this profit growth was three times as high as the growth in gross incomes. The additional support for corporations through tax cuts was worsening the drift of income from labor to capital.

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<sup>96</sup> DGB, "Stenographic protocol of the public hearing of the Finance Committee of the Bundestag in Bonn," 9 October, 1991, 12<sup>th</sup> legislative period, PA XII/66, Vol. A3, Doc No. 82.

Then they presented calculations of tax burdens which showed that the tax burden of incomes from entrepreneurial activity had fallen from 50.9 percent in 1977 to 33.6 percent in 1990.<sup>97</sup> “The net tax reduction for corporations under the imperative of international competition is unnecessary” because the profit taxes have been reduced significantly in the past years where they remained constant in many other countries.<sup>98</sup> In the eyes of the GDB foreign direct investments were rather attracted by structural reforms, investments in infrastructure, demand in the domestic market. The low current FDI levels in Germany were largely due to the very high stock of capital that had flown to Germany in the past. Reducing the trade deficit might help the situation. The DGB also warned that the financing of the tax cuts for corporations should rather work through reduced subsidies and not increases in the VAT because that will further curtail demand in the German market. All in all the GDB questioned the approach of the government and the supply-side economists and based its economic thinking in Keynesian notions that focused on the creation of domestic demand.<sup>99</sup> The employees union DAG supported the DGB and argued that “lower top personal income tax rates did not automatically increase the productivity.” The chairwoman Ursula Konitzer argued that a higher redistribution to the bottom could stimulate “a long-term strengthening of the low demand and subsequently support of the business cycle which is currently one-sidedly driven by the demand for exports.”<sup>100</sup>

This Keynesian growth stimulation argument was tightly linked with the social justice sentiments. The most frequent arguments of labor unions were based in the social justice frame of equality of outcome. The organizations wanted to prevent a shift of the tax burden from top to the bottom because they considered it unfair to the workers. The chairman of the trade, banking and insurance section of the DGB Günther Volmer argued that the DGB planned to inform the public - which was already opposed to the program - about the reduction in progressivity: “As you know the planned tax reform created strong resistance in the public.” The DGB and a number of unions and industry unions now wanted to “inform the public about the negative consequences of the reform, which will again lead to a redistribution of labor income from the bottom to the top.”<sup>101</sup> In a position paper for the Bundesrat, the DGB wrote that reason number one for their rejection of the planned net tax reduction for corporations was that “it was socially unfair, in particular because the workers face the highest tax-increase package in tax the post-war history of the Federal Republic.”<sup>102</sup> The DGB also called the

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<sup>97</sup> DGB, “Stenographic protocol of the public hearing of the Finance Committee of the Bundestag in Bonn,” 9 October, 1991, 12<sup>th</sup> legislative period, PA XII/66, Vol. A3, Doc No. 82.

<sup>98</sup> Ibid.

<sup>99</sup> Ibid.

<sup>100</sup> Konitzer, Ursula. “Stenographic protocol of the Finance Committee, 37<sup>th</sup> Session and the Committee for Youth, Family and Health, 45<sup>th</sup> Session.” April 17, 1985, 11<sup>th</sup> legislative period, DIP X/66, Vol. A4, Doc No. 43, p. 12.

<sup>101</sup> Volkmer, Günther. “Short Protocol of the 29<sup>th</sup> session of the Budget Committee.” 8 June 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A3, Doc No. 71.

<sup>102</sup> DGB. “Stenographic protocol of the public hearing of the Finance Committee of the Bundestag in Bonn.” 9 October, 1991, 12<sup>th</sup> legislative period, PA XII/66, Vol. A3, Doc No. 82, p. 203.

one-sided increases in social security contributions for workers as a form of unequal treatment of capital and labor. Workers had to shoulder “the one-sided finance of the increases in unemployment insurance contributions to consolidate the East-German labor market.”<sup>103</sup> The DGB argued that the diverging trend in corporate profits and labor incomes did not justify tax cuts for corporations. The monthly report of the German Bundesbank showed “that between 1982 and 1990 the gross incomes of production firms had grown with a yearly average of 10.5 percent three times as fast as the gross wages.”<sup>104</sup> When comparing the net incomes of labor and capital the “wage and profit increases diverged even stronger.” They concluded a “net tax reduction [for corporations] is misguided in terms of distribution policy.”<sup>105</sup>

In the position paper the DGB leaders argued that in light of such inequality between capital and labor they would have at least expected that the government would balance it out in the within income tax distribution by “compensating it through a more social tax cut for private households.”<sup>106</sup> But the opposite was the case. The tax plan would result in “households with average and below average incomes are taxed by a much higher tax burden since 1985 and – even more so since 1988.” Households with four times the average income “receive a significant tax cut.”<sup>107</sup> More specifically the DGB objected that “tax households with incomes below two-thirds of the average income (DM 2,475 in 1991) receive a significantly higher rate than households with four times the statistical average income (DM 14,848 in 1991).”

Smaller sectoral unions also raised social justice claims. In a joint meeting of the Finance and the Youth, Family and Health Committee the employees union DAG demanded greater redistribution through increases in the top rate and lower taxes for small and medium incomes. Ursula Konitzer the chairwoman argued that she considered the tax cuts as “socially unbalanced.” She agreed that the cold progression had burdened lower medium incomes with discretionary tax increases in the past which led to a “redistribution from the bottom to the top.”<sup>108</sup> But the tax plan worsened this inequality because of the “greater tax cut in the top area of the progression zone.”<sup>109</sup> Konitzer argued that a reduced progressivity was socially unfair, did “not automatically lead to more productivity”<sup>110</sup> and reduced growth through the lower demand at the bottom. Accordingly, she demanded greater redistribution through an “increase in the top personal rate to 60% from incomes DM 175,350.”<sup>111</sup> The union for workers in the print sector IG-Druck also fiercely protested the tax plan. They wanted to achieve that

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<sup>103</sup> Ibid., p. 203.

<sup>104</sup> Ibid., p. 204.

<sup>105</sup> Ibid., p. 204

<sup>106</sup> Ibid., p. 203.

<sup>107</sup> Ibid., p. 203.

<sup>108</sup> Konitzer, Ursula. “Stenographic protocol of the Finance Committee, 37<sup>th</sup> Session and the Committee for Youth, Family and Health, 45<sup>th</sup> Session.” April 17, 1985, 11<sup>th</sup> legislative period, DIP X/66, Vol. A4, Doc No. 43, p. 11.

<sup>109</sup> Ibid., p. 11.

<sup>110</sup> Ibid., p. 12.

<sup>111</sup> Ibid., p. 12.

the reduction in the tax surcharge for Sunday, night and holiday work was not passed in the Bundesrat.<sup>112</sup>

The social justice debate was fueled by a number of small civic interest groups which were invited to the Finance Committee, Committee for Labor and the Social and the Committee for Youth, Family and Health. The interest groups – the Action Group for Family Questions, the German Family Union, Family Federation of the German Catholics and the Evangelic Action Community for Family Questions – argued that the provisions for families in the tax plan were highly skewed to the top.<sup>113</sup> The Representative from the Family Federation of the German Catholics argued in a hearing that the federation considered it outrageous that lower incomes paid so much in taxes and suggested much higher personal allowances than envisioned in the tax plan. It was unbearable from “a standpoint of ability to pay that individuals who lived at the minimum existence were being taxed.”<sup>114</sup> The German Housewife Union was most aggressive in demanding higher redistribution to families with low incomes. Families were the basis of the German society because they “produced”<sup>115</sup> labor and consumers and that the state and the economy depended on them. At the moment capitalism was destroying its own basis for production by exploiting families in unbearable manner: “If the economy is not meant to destroy the housework through exploitation [...] if the one thing is not supposed to expel the other through the laws of the market” the state had to take care of families by much larger degree of redistribution and not a smaller one.<sup>116</sup>

Even business groups did not coherently adopt the governments' narrative of enhancing work efforts through the cut in top personal income tax rate but rather argued along the lines of supporting highly burdened groups in the German economy. The DIHT argued that the plan to create a linear progressive income tax schedule and thereby reduce the cold progression was fair because all societal groups would universally gain from this: “The elimination of the steep increase in marginal tax rates in the lower and middle progression zone permanently supports all tax payers.”<sup>117</sup> They endorsed the tax cuts for the lower and medium incomes because of the demand stimulation they expected from it which was particularly beneficial to the retail sectors. The tax plan “strengthened in particular the purchasing power of broad societal groups and are therefore welcomed by the consumer-related economy.”<sup>118</sup>

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<sup>112</sup> FAZ. “IG-Druck: Strikes Against the Tax Reform.” *FAZ*, 18 May 1988, p. 4.

<sup>113</sup> German Bundestag. “First report of the Committee of Finance. 7<sup>th</sup> committee on the Legislative Proposal of the CDU/CSU and FDP Factions.” June 21, 1988, 11<sup>th</sup> legislative period, DIP XI/71, Doc. No. 11/2536, p. 19.

<sup>114</sup> Schäffer, N.A. “Stenographic protocol of the Finance Committee, 37<sup>th</sup> Session and the Committee for Youth, Family and Health, 45<sup>th</sup> Session.” April 17, 1985, 11<sup>th</sup> legislative period, DIP X/66, Vol. A4, Doc No. 43, p. 19.

<sup>115</sup> German Bundestag, “Stenographic protocol of the Finance Committee, 37<sup>th</sup> session,” 21 June, 1988, 11<sup>th</sup> legislative period, DIP X/143, Vol. A2, Doc No. 43, p. 20.

<sup>116</sup> *Ibid.*, p. 20.

<sup>117</sup> DIHT et al. “Written statement for the Finance Committee of the Bundesrat in Bonn,” April 18, 1988, 11<sup>th</sup> legislative period, PA XI/71, Vol. A2, Doc No. 78, p. 2.

<sup>118</sup> *Ibid.*, p. 2.

Small sectoral business groups supported unions in their sector in the fight against a tax cuts because they benefitted from subsidies in their sector or worried higher wage demands if workers faced higher tax burdens. The *Zentralverband des Deutschen Handwerks* [German Confederation of Skilled Crafts] worried that the tax plans would reduce subsidies and tax breaks for the crafts sector and preferred special tax breaks for investments for small and medium enterprises, i.e. exactly those policies that the government wanted to diminish. The ZDH also argued that they supported regional subsidies which the government wanted to eliminate in order to “secure comparable living standards in the Federal Republic.”<sup>119</sup> The trade union’s fight against the reductions of the labor surcharges were also supported by one group of sectoral business representatives. The publishing sector argued that they would rather keep the surcharge for Sunday, night and holiday work intact because workers would eventually demand higher wages in the next round of bargaining when such tax breaks would be diminished. The plans for the surcharges gave “the wrong signal to the trade unions to rollover the higher burdens from the employees to the employers.”<sup>120</sup> In sum, even business groups were not unequivocally supportive of the government’s tax plans and Keynesian ideas about growth effects were still alive among many of the representatives.

## 6.6 Conclusion

When analyzing the attempts of the liberal-conservative governments to shift the tax burden from the top to the bottom in the German political economy, institutionalist theories argued that the veto-power of unions and the center-left opposition hampered such reforms. It was argued that electoral veto-players such as the power of the Bundesrat and the power of unions in collective bargaining institutions with business generated consensual political outcomes. Even though the tax cuts for higher incomes in the 1988 reform were significantly reduced during the legislative deliberation in the Bundestag and Bundesrat, I find that this was not due to veto-playing institutions. First, the most important veto-player was not active in 1988 as the Bundesrat was dominated by the governing parties. Labor and the center-left opposition could only influence the reform through raising discursive objection to the program in the Bundesrat, the Bundestag and the hearings. But their protest was highly effective. They used strong justice concepts, which not only convinced their own party base, trade unions and many small protest groups. They even convinced a large group of economists, that the tax policy was not a mere instrument to generate growth, but that it at least equally was an in-

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<sup>119</sup> ZDH. “First Report of the Committee of Finance (7<sup>th</sup> committee) on the Legislative Proposal of the CDU/CSU and FDP Factions.” Bonn, 21 June 1988, 11<sup>th</sup> legislative period. Bonn. DIP XI/71, Doc. No. 11/2536, p. 25.

<sup>120</sup> Publishers. “First Report of the Committee of Finance (7<sup>th</sup> committee) on the Legislative Proposal of the CDU/CSU and FDP Factions.” June 21, 1988, 11<sup>th</sup> legislative period. DIP XI/71, Doc. No. 11/2536, p. 14.

strument to generate social justice. The planned elimination of the night, Sunday and holiday surcharges and advertising cost surcharge were diminished by the government after facing the strong resistance of the opposition, the printing sector and the labor unions. Also, the government had to make concessions in the area of corporate tax reductions. The initial plan to reduce the rate to 46 percent could not be achieved because of the constitutional mandate for equality or near equality of capital and labor taxation. Because some factions in the CDU were not convinced of a significant reduction in the top personal income tax rate, the CIT was only lowered to 50 percent and the top personal rate were only lowered to 53 percent. Nevertheless, the Great Tax Reform did reduce the degree of redistribution in the German tax system. The top personal income tax and the corporate tax rates fell and the increases in social security contributions, the VAT and the taxes on energy raised the cost of living of the lower and middle income groups.

Despite the power of ordoliberal networks in the German political economy which led to a quick transfer from Keynesian policy making to supply-side oriented policy making, the economic arguments developed by the economics profession were not convincing in the German Bundestag. Policy makers of the FDP and CDU/CSU applied a mix of the new economic supply-side theories and traditional social market economy arguments which often contradicted each other. The governing coalitions were confronted with the strong coherent narrative of Keynesian economic growth and social justice arguments which were not only presented by the opposition parties but also small civic groups, small unions and the crafts sector.

## 7 Schröder's Tax Relief Law 1999/2000/2002

Though Helmut Kohl, the Chancellor of the liberal-conservative government, 1981 to 1998, had implemented a number of smaller tax cuts for corporations and higher personal incomes, he had not been able to implement a grand overhaul of the tax system. The previous chapter showed that the discourse in parliament restricted the government in implementing their visions of a large tax cut. The Social Democrats, the Green Party, the labor-wing of the CDU and the trade unions had fiercely rejected the proposed tax cuts for corporations and higher incomes. Objections against the reforms were mostly based in notions of social justice arguing that lower taxes for corporations were unfair to lower and middle incomes. Only when the social democratic chancellor Gerhard Schröder came to office in 1998 and developed together with the modernizing wing of the party, sociologists, political scientists and political theorists a coherent narrative of supply-side tax cuts and fairness, could they convince many of those groups that had rebelled against the cut previously.

Comparative institutionalists emphasize the ability of social democratic governments in the German political economy to maintain a high level of redistribution in corporatist policy regimes and consensual governing coalitions despite growing globalization pressures on the tax system. Collective bargaining institutions are considered especially equipped to produce efficient and socially just economic policies by aligning the interests of capital and labor. This chapter will look into a case of a tax cut by the red-green government which the literature has always considered least likely, a radical tax cut for higher incomes implemented by a social democratic government. It will show that neither economic nor institutional change can be sufficient explanations for those cuts as the productivity crisis and trade union power loss have already existed in the 1980s.

I argue that on top of those crises, important changes must have taken place in the area of narratives and discourses. In the 1980s ideational coalitions of labor and capital and center-left and center-right parties impaired tax cuts in the 1980s beyond institutional support for those coalitions. In the 2000s, another set of cross-party and cross-class coalitions were in favor of tax cuts. At the center of this development stand a narrative developed by the modernizers in the SPD and the Green Party and inspired by Third Way theorists which successfully *incorporated* traditional demands for compensation of the working poor at the bottom end of the income distribution and *moralized* tax cut effects with arguments of growing opportunities for all German citizens in the market when tax cuts brought about economic growth.

This chapter is organized as follows: The next section will lay out the economic crisis that dominated the public discourse in Germany since the early 1990s, which was still exactly the same productivity crisis that the Kohl government had tried to tackle. This section is followed by an analysis of the ideational infrastructure in which the Social

Democratic Party and the Green Party operated, after they came to office. Then, I outline the development of the tax plan in the Bundestag. I describe the ideational tools which the government employed in its new modernizing ambitions since the mid-1990s and then show which of these concepts were adopted by which groups in the Bundestag. I conclude with a summary of the developments, and a table which shows the over-time changes of tax concepts in the Bundestag from the Kohl to the Schröder era.

## 7.1 Macroeconomic Context

Tax competition literature argues that economic integration puts specific strains on the ability of governments to collect revenue from corporations, small firms and top incomes especially when trade integration and capital mobility are high as is the case in the European Union and hence in Germany (Genschel 2005; Ganghof and Genschel 2008; Winner 2005). Even though economic indicators show a reduced level of productivity in the German economy, this negative economic development began long before Germany entered the Single Market and the European Monetary Union. In fact, the crises indicators of low productivity, low employment and sovereign debt that we see in the 1990s and 2000s are also the crisis indicators we discovered for the Kohl era in the 1980s, albeit at higher levels. I argue that the crisis of productivity cannot sufficiently explain the radical shift from tax resilience in the 1980s to radical tax cuts in the 2000s and that ideational change must play a role in the shift. The slight worsening of the crisis seems to have triggered a disproportionately strong shift of interpretations of the crisis. Another aspect which speaks against the tax competition argument is that Germany is a large country which is subject to much less tax competition than the small countries in the EMU (Genschel and Schwartz 2013). Experts of international organizations interpreted the level of competitiveness of the German economy within the European Union as rather positive in its ability to attract foreign direct investment from other European and North American economies.

German reunification was an unprecedented political project of integrating two economies with vast differences in competitiveness and institutional configurations. Even though policy makers had known about the financial resources that would be needed to attune these two systems, the conservative-liberal government and its successor, the red-green government became increasingly impatient with the pace of adaptation of the Eastern economy. After ten years of channeling funds through subsidies and welfare expenditures from the West to the East, the differences in infrastructure and employment will still be great and policy makers increasingly shifted from supporting investments to supporting tax cuts and market-driven adaptation processes. Even though the crisis of the German economy was in part driven by the remaining differences in infrastructure, labor market and industrial adaptation of the Eastern economy - which the Social Democratic Party would have traditionally tackled with greater resources in

industrial policy and demand-stimulation -, modernizers in the SPD increasingly adopted the supply-side notions of the liberal-conservative government.

Reunification had resulted in a higher overall unemployment rate, higher sovereign debt and lower overall productivity in the overall German economy, however, those increases were minor considering the soaring West German rates in the 1980s without carrying the burden of integrating a transition economy. From 1989 to 1991 the costs of unemployment insurance in the East only increased from Euro 2.3 million to Euro 7.3 million (Streeck and Trampusch 2005, 176) which is only a fraction of the total sovereign debt level of Euro 1.13 trillion in 1997 (Ullmann 2005, 217). Considering that Eastern states had experienced significant economic growth in the first three years after reunification, 7.8 percent, 8.9 percent and 9.9 percent between 1992 and 1994, one could argue that the effects of subsidies and transfers of infrastructures and institutions have had strong positive effects on the economy (Leaman 2009, 139).

Aside from reunification being a very unusual burden for an economy, the decline of the competitiveness of the German economy is debatable as the German economy had attracted significant levels of foreign direct investments during the 1990s from both the US as well as other European economies. Even though a handful of big employers like Siemens, Hoechst AG, Daimler-Benz, BMW, BASF and VW began using foreign direct investment activities in Eastern European flat-tax economies to reduce their tax burden (Leaman 2009, 151–54), economic advisers from the OECD argued that in comparison to other countries Germany had attracted the vast majority of all FDI in the industrialized world. During the 1990s, the German economy had attracted about \$13 billion in foreign investments from of American multinationals alone, which comprised about 20 percent of the total FDI flow to the European Union.<sup>1</sup> However, the high levels of unemployment and budget deficits were *interpreted* by the policy makers of the SPD, the Green Party and some of their economic advisers as directly related to the tax-avoidance activities of this handful of big companies. Not only the size of the effects of MNC tax avoidance was questionable, more importantly, the logical link that policy makers drew between multinational tax avoidance and top personal income tax rates was flawed. These corporations had never paid personal income taxes but corporate taxes. Personal income tax reductions predominantly benefitted small and medium firms in the German economy but the red-green government and their economic advisers had no data of tax avoidance of the *Mittelstand* and focused in their arguments of modernization on the big firms (see Section 7.5 for more details on the debates).

The economic crisis sparked an anxious discussion among economists, policy makers and journalists on the German *Standort* [location], a term that referred to high unemployment rates, low growth rates and the high sovereign debts in the German economy (Lieberman 2000). Since the mid-1970s, firms from the chemical and steel sectors

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<sup>1</sup> Geiger, Rainer. "Public Expert Interview of the Committee of Finance and the Committee for the Economy and Technology. Questions on Corporate Taxation in International Comparison with Representatives of the OECD." April 21, 1999. 14<sup>th</sup> legislative period, PA XIV/154, Vol. A3, p. 12.

had repeatedly argued in public debates that their firms had a competition disadvantage because they produced in Germany. The high non-wage labor costs, high wages and high taxation for firms would drive the prices of their products up. Martin Seeleib-Kaiser from the Center for Social Policy in Bremen argued in 1996 in the newspaper *TAZ* that “Germany had slept since the beginning of the present globalization wave which set in approximately in 1973” (cited in Lieberman 2000, 34). Even though the economy clearly suffered from a productivity, unemployment and debt crisis, the radical exacerbation of fears of businesses and policy makers about the German competitiveness in the late 1990s did not behave proportionally to the worsening of the economy since the 1980s. The increases in debt levels had been most severe between the 1970s and the 1980s and since then had only increased gradually. Compared to the 1980s increases in debt to GDP ratios from 17.8 to 41 percent, the increases from 41 to 50 percent in the 1990s do not seem to justify such a radical turnaround from the entire blockage of the tax cuts in the 1980s to radical tax cuts in the 2000s. Ideas must be at the center of a reinterpretation of the crisis.

## 7.2 Institutional Context

Institutionalist researchers consider radical tax cuts for higher incomes highly unlikely in the German consensual institutional setup. We cannot fall back on existing theories from this tradition of why there was a radical shift from resilience to cuts in the early 2000s. The shift can hardly be explained with changes in the German constitution or the Bundestag which are variables that Prasad (2006; 2012) focuses on predominantly. However, we could derive potential theorems of a loss of power of the center-left government in the Bundesrat or a loss of trade union power from existing studies in different political economies (Hacker and Pierson 2005; 2010). The institutions of cooperation and sectoral self-governance which were the central in the resilience in taxation for most of the 20<sup>th</sup> century are based on a significant power position of trade unions (Cameron 1978; Garrett 1998), which have lost in membership since the 1980s. I argue that this loss of trade-union power took place and may explain a general tendency for policy makers to move away from traditional worker interests. However, trade unions had very low member rates in the 1980s and it seems surprising that a minor further decline in unionization after the 1980s allowed for such a radical reorganizing of policy orientations in the 2000s. Institutional power shifts cannot sufficiently explain this radical reorganization of the German political economy. Only when we add shifts in power of ideas, can we fully understand the shift.

One factor which institutionalists would probably highlight when they looked at the shift in institutional power relations in the German political economy is the loss of power of the traditionalist party wings in the SPD and the Green Party since the 1980s. Scholars interested in party power argue that social democratic parties lost support of their traditional working-class voters since the 1980s when industrial jobs declined and

had to turn to middle class voters which were less interested in redistribution (Korpi 1983; Korpi and Palme 1998; Merkel et al. 2008). What speaks against this reasoning of institutional power in a new production regime is that the SPD and the Green Party had run a double strategy in their campaigns which included the traditional and new middle class ideas. Even more importantly, when it comes to tax proposals the SPD categorically objected the idea of income tax cuts and only supported corporate tax cuts until 1999 and only accepted income tax cuts when Keynesian approaches to revive growth had shown no immediate effects and governing advisers convinced the government that there was no bringing back of the German industry.

In the first year of government the tax proposal for the *Steuarentlastungsgesetz* [Tax Relief Law] 1999/2000/2002 comprised two main elements which attempted to strike a balance between social and economic goals of the red-green government. Both parties were very much in favor of corporate tax reduction to a minimal rate of 35 percent to stimulate economic growth and employment. But the coalition was also committed to keep overall corporate tax revenues stable by closing loopholes for corporations and to compensate lower incomes through a rise in basic allowances from DM 13,067/26,135 (single/married couple) to DM 14,000/28,000 and a reduction in the bottom rate from 25.9 percent to 19.9 percent. The tax plan also entailed a relatively minor reduction in the top income tax rate from 53 percent to 48.5 percent.<sup>2</sup> This minor top income tax rate reduction became lowered to 42 percent during the first two years of government after the red-green coalition lost the majority in the Bundesrat. The opposition pressured the government to revise the *Corporate Tax Reform* or *Steuersenkungsgesetz* [Tax Reduction Law] 2000 to accelerate the third step of Tax Relief Law in which the top rate was reduced to 42 percent and the CIT on retained and distributed profits were uniformly reduced to 25 percent (Bach, Corneo, and Steiner 2014, 119; Seidel 2001, 36; Truger 2009, 31).

This radical shift in tax plans from one year to another can hardly be explained by a proportional decline in union power. Unionization had declined since the 1970s. The membership rates in the total German workforce have fallen from a peak of 36 percent in 1976 to 30 percent in 1992. Even though it is true that in the five years between 1992 and 1999, the rate fell further by 2 percentage points (Streeck 2014, 146), significant transitions had already taken place in the years before that. The gradual loss in power of the trade unions had also not translated into an exclusion of the social partners from crucial expert commissions on tax policy planning. The *Brühler Commission* had been implemented by the government in 1999 to debate tax plans with economists, business representatives and trade unions. It was the most important advisory body for the government in terms of tax policy in which the DGB had a central position (Egle and Henkes 2003, 75; Leaman 2009, 158–59; Schöllgen 2015, 407–11). And yet the umbrella organization did not use its central position to object tax cuts for top incomes but

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<sup>2</sup> Ministry of Finance. "Information on the Tax Relief Law 1999/2000/2002 Proposed by the Factions of the SPD and the Green Party." November 6, 1998. 14<sup>th</sup> legislative period, PA XIV/2, Vol. A, 7<sup>th</sup> finance committee, No. 4, p. 60.

showed its support for the proposals made by supply-side economists and political scientists in the body.<sup>3</sup> Ideational shifts in the DGB must have played a significant role in transmitting institutional power changes.

A similar picture emerges in another institution which was crucial for tax cuts, the parliamentary hearings. We can see once again see the importance of ideational shifts in institutional power shifts in the German political economy. The list of invitees to parliamentary hearings changed significantly between the 1980s and the early 2000s. Instead of inviting small sectoral unions, the SPD invited the DGB only alongside the Federation of German Industry (BDI), the Federation of German Employer Associations (BDA) and the Diet of German Industry and Commerce (DIHT). Equally excluded were small civic interest groups, sectoral business representatives and Keynesian economists which had fiercely fought for redistribution and subsidies in the 1990s.<sup>4</sup> Even though this exclusion of small interest and left-leaning interests groups represents an institutional loss of power, its origin is clearly also of an ideational nature. The SPD had changed their perspective on which societal stakeholders would be credible speakers in those hearings

Modernizing ideas had existed in the SPD since the 1980s, but the traditional party base had up until 1999 strongly opposed the plan to cut top personal tax rates and an equal shift in party base opinions had taken place in the Green Party. The Greens had been the strongest advocate of greater redistribution and increases in the top rate to 60 percent in 1988, but had decided in 1998 to adopt a top rate reduction from 53 percent to 45 percent to its party program (Kaltenborn 1999, 36, 54). For the SPD this shift from traditional opinions on taxation to modernizing ideas took place during the second year in office. The SPD had ran a double campaign with the traditionalist Oskar Lafontaine and the modernizer Schröder as candidates without determining which of them would become chancellor until few weeks before the election and had presented a plan to reverse the social justice cuts of Kohl which was very popular among SPD voters and probably brought the SPD into office (Schöllgen 2015, 337). In first year of government, the traditionalists in the SPD had a strong backing by the party base and among those voters who had elected Schröder because he proposed reinstating the welfare provisions that had been cut in the previous administration. It was only in the year of 2000, when economic growth remained at very low levels, that the discourse in the parties and in the media began shifting (Schöllgen 2015, 337). Corporations complained publicly that the loophole-closing had eaten up all the benefits from the reduced corporate tax rate and SMEs mourned that they needed top rate reductions to be internationally competitive (Lieberman 1998). It was only then that the public was disappointed with the performance of the government, the coalition began losing a number of state

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<sup>3</sup> See for all statements of members of the commission: Commission for the Reform of Corporate Taxation. "Brühl Suggestions on a Reform of Corporate Taxation." April 30, 1999, <https://www.bib.uni-mannheim.de/fileadmin/pdf/fachinfo/jura/ubest.pdf>, p. 28.

<sup>4</sup> German Bundestag, various documents, PA XIV/16, Vol. A2, Doc No. 26-42.

elections and its majority in the Bundesrat around mid-2000 and had to revise their approach to economic policy (see Section 7.4).

### 7.3 Context of Expert Authority

Scholars who emphasize the relevance of authority of experts in the paradigm shifts have argued that much power in this process originated from business-financed think tanks which disseminated supply-side ideas. Though authority of economists and think tanks did play a crucial role in putting supply-side and ordoliberal thinkers into powerful position in the German political economy, this power has pretty much existed since the post-war era and was definitely firmly in place in the 1980s (see Section 6.3). Since the tax cuts were impaired in the 1980s but were successfully implemented in the 2000s, the authority of economists cannot sufficiently explain the shift to tax cuts. One important additional factor was that the red-green government added a convincing normative dimension to tax shifting which was able to convince their party bases and voters of the economic and moral necessity of tax cuts.

The normative ideas which the SPD and the Green Party added to the supply-side suggestions were based on notions of post-materialist sociology and Liberal Political Theory. Post-material sociologists had diagnosed a voter problem for the SPD in the declining vote share of industrial workers. In times of information and service economy, white collar workers outstripped blue collar workers and the SPD had to pay greater attention to the middle classes for voter support. Post-material sociology and Liberal Political Theory indicated that conflicts of labor and business did not have to stand at the center of Social Democratic reasoning. On the contrary, governments could achieve the central goal of raising employment by integrating business in the societal deliberation process. All societal groups would gain from this, even the poor when they were ready to get activated in labor markets. Drawing upon John Rawls' concept of procedural justice, the SPD developed the argument that redistributive justice and growth were not contradicting each other when the poorest groups of societies would gain from job creation. On the basis of this argument, the SPD increasingly talked about a universal common good for all societal groups. Cognitive economic justifications were not the most important asset for the new government but a normative concept which could help justify the tax cuts normatively.

The specific power of Third Way and post-material theories lay in its practical policy suggestions for Social Democratic parties and in its broad justice framework that was capable of replacing old justice frameworks. Modernization theory had its roots in sociological debates from the 1950s and 1960s and practical implementation of a Third Way in Social Democratic policy under New Labour in the UK and the New Democrats in the US. Post-material sociologists had argued since the 1950s that Western societies were entering post-industrial times due to an economic shift from manufacturing to information-based industries and services. This economic shift had implications for

societies which moved from traditional to modern forms of societal configurations. These theories reasoned that traditional societies had largely built on collective ties of family, class and partisanship and were organized along hierarchical lines and that that changed in modern societies. The latter became increasingly characterized by individualization and more egalitarian and collegial decision-making processes (Dahrendorf 1979). The old political left-right schema of conflict no longer applied because the increases in general prosperity and welfare spending had solved the basic material questions of income distribution and redistribution. To Daniel Bell this meant *The End of Ideology* (1960). As a consequence the Left had split up into two groups of the traditional left, i.e. blue-collar workers, and the young New Left which stressed social issues and was quiet distant from traditional labor interests. The New Left, they argued emphasized self-actualization and political participation instead of redistribution (Clark and Lipset 1996). These findings culminated in the theory of a post-class political world (Clark and Lipset 1991; Inglehart 1990), in which politics became increasingly pluralistic (Dahl 1961; Dahl 1971).

What distinguishes the power of Third Way and post-material theories from the authority of classical economic theory is that it did not only imply practical policy suggestions under increasing globalization and individualization but it also delivered a broad justice framework that was capable of replacing equality of outcome. After Anthony Giddens had developed practical policy suggestions from his book *The Third Way – The Renewal of Social Democracy* (1999), modernizing ideals found practical implementation in Tony Blair's New Labour and Bill Clinton's New Democrats in the 1990s. These Third Way politicians tried to reconcile traditional Social Democratic ideals with the new economic imperatives of globalization. German sociologists and political scientists increasingly adopted similar theories and carried them to conferences and debates with German policy makers. Ulrich Beck, the director of the Sociological Institute Ludwig Maximilians Universität Munich, became an important figure in this Social Democratic learning process.

Some ideas develop such explanatory and normative thrust that policy makers come to see every policy problem through the lens of this new ideational frame. As we have seen in Section 7.2 the SPD had a strong mandate by voters to reverse the welfare cuts implemented by the Kohl government and bring more social justice to the German political economy and not less. However, when in the first year of government an economic downturn hit the German economy and some Länder elections favored the opposition, the SPD turned away from the welfare spending approach entirely. At the center of this turn stood the idea of *post-industrialism* developed by Ulrich Beck who was an important adviser to Schröder. As outlined in his publications like *Risk Society* (1992) Beck explained to the SPD the technological progress in Western societies had shifted voter interests away from material distributive issues. Societies were moving towards individualization and detraditionalization which made it difficult for traditional worker parties to attract voters. The “struggle for one's ‘daily bread’ had lost its urgency as a cardinal problem overshadowing everything else” (Beck 1992, 87). At the same time,

Beck argued, technological progress created global, social, biographical and cultural risks that parties had to address in new institutions (Beck 1992, 234). The shift from redistribution to tax cuts was crucially based on Beck's ideas which he conveyed to the SPD in several meetings. The state was too rigid, centralized and bureaucratic to support the complex process of technological change and that expert commissions could integrate business and function as a means to generate social peace between capital and labor. And voters were no longer interested in welfare spending in a post-industrial society (Egle and Henkes 2003).

Another strand of non-economic thought that was central in the SPD's success to normatively embed a radical tax cut for higher incomes was Liberal Political Theory from which it derived a justice framework of social liberalism (Frenzel 2003, 90). Most important in this respect was John Rawls' theory of fairness from *A Theory of Justice* ([1971] 1999) to which the Social Democratic Party referred explicitly in their basic program of 1999 (see section below). Two components were useful for the development of modernizing frames of the Social Democrats. First, Rawls argued for shift from particularistic political processes towards an egalitarian mass democracy that was based on a rational consensus of different societal stakeholders. The basic idea of procedural justice in Rawls argued that as long as political influence was not determined by economic dominance and subordination, societies should be able to see the true shared concept of the common good (Mouffe 2005, 10–14; Zerilli, Linda M. G. 2012, 9–12).

The second component that the Social Democrats adopted from Rawls' theory of justice was a shift from social justice frames to an opportunity-enhancing economy. In the new basic program of 1999, the SPD executives acknowledged that in the field of tax policy it was practically impossible to achieve the goals of "fairness, social justice, freedom and opportunity and solidarity and responsibility."<sup>5</sup> However, economic growth could help to achieve manifold goals including a new formulation of social justice. The party derived this new formulation of social justice from John Rawls' difference principle which argued that policies were fair when they led to the greatest advantages for the weakest parts of society. In the field of tax reforms this meant that "increased income and wealth inequality can be economically viable and socially justified" if it raises "growth, creates employment and promotes societal wealth."<sup>6</sup> In the field of labor market policy, the party arrived at the standpoint that a deregulation of the labor market was not unfair if that raised efficiency and the unemployed got *included* in the labor market through increases in employment (Egle and Henkes 2003, 86).

This new justice orientation of social liberalism legitimized a shift from passive welfare spending to an *activating* and participatory social investment state. The framework provided a utilitarian view on competition in markets which could be countervailed by the state through *welfare-to-work intervention*. The party counted among the welfare-to-work interventions social and economic policies which provided enough opportunities

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<sup>5</sup> Basic Value Commission of the Executive Board of the SPD. 1999. "Third Ways – New Centre - Social Democratic Markers for Reform Policy in Times of Globalization." Berlin, p. 28.

<sup>6</sup> *Ibid.*, p. 28.

for citizens to participate in the labor market and refused the imperatives of welfare and redistribution. The program argued that a certain degree of inequality could be socially just if the state provided for an *inclusion* of all societal groups in the labor market. In practice this meant that an expansion in education spending and labor market activation sufficed to create social democratic justice. Fiscal policy was characterized as just, when it supported the labor market through economic efficiency and when it granted inter-generational justice through a balanced budget and declining fiscal burdens for future generations. In a world of ageing societies it was just to make individuals contribute to a greater degree to their own prolonged retirement through private provisions. As a consequence this new program of the SPD placed a great responsibility on the individual and civil society (Frenzel 2003, 90).

One of the key strategists of the modernizers in the SPD Bodo Hombach argued that there was no way around reorganizing the German social security system under the new efficiency imperatives of a globally organized economy. He proposed a *supply-side policy from the Left* which had to be economically viable and socially just (1998, 42). At the same time Gerhard Schröder travelled the world accompanied by the German media to demonstrate voters that other countries in the Western world had already modernized their economies. His trip to the United States in 1997 was the central media event in his campaign. He met with the CEOs Bill Gates and Jack Smith to ask for advice. During his trip he told the German media that the American market was much more innovative and productive than the German one and that globalization needed modern Social Democratic policy making (Schöllgen 2015, 337).

At a party convention in December 1999 the modernizers in the party, among them the chancellor Gerhard Schröder and Wolfgang Clement, finally convinced the party base of a moving away from the traditional values of the SPD (Egle and Henkes 2003, 86). The outcome of this convention was the *Berlin Program* "Third Ways – the New Centre" in which the SPD redefined its traditional values of "freedom and solidarity." The party replaced the goal of *equality of outcome* with the concept of *productivity raising inequality* and *inclusion* in the labor market. As we will see in greater detail in the next section, the SPD argued that increases in inequality could be socially just if an economic dynamic unraveled that supported the weakest societal groups. If jobs were generated for the unemployed through tax cuts, that raised social justice. A deregulation of the labor market was also not unfair if it raised efficiency and an inclusion of the unemployed in the labor market.<sup>7</sup>

Due to the hesitance of the party base to endorse the supply-side from the Left, the SPD presented a campaign which entailed both traditional and modernizing ideals. The program identified unemployment as the central problem of German society and proposed to tackle it through a revived tripartist agreement of labor and capital under the supervision of the SPD, i.e. the *Bündnis für Arbeit* [Alliance for Work]. The second topic that the Social Democrats stressed was the justice gap. The SPD planned to take back

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<sup>7</sup> Basic Value Commission of the Executive Board of the SPD. 1999. "Third Ways – New Centre - Social Democratic Markers for Reform Policy in Times of Globalization." Berlin, p. 28-29.

all the welfare cuts that the conservative-liberal government had implemented, i.e. continued pay in case of sickness, reductions in pensions and dismissal protection (Alemann 1999, 40–41). Oskar Lafontaine argued that social justice could still be achieved and that the pressures of globalization could be tackled by international coordination of domestic policies. In 1998 he published a book with Christa Müller entitled *Keine Angst vor der Globalisierung – Wohlstand und Arbeit für Alle* [No Fear of Globalization – Wealth and Work for Everyone] (1998). The authors criticized the “neoliberal” twist that economic experts from the OECD and business groups like the BDI promoted and explained that the Kohl government was misguided in “downsizing” corporate taxes. To Lafontaine and Müller lower taxes only hampered the investment in infrastructure which was desperately needed to enhance production and create jobs (Lafontaine and Müller 1998, 18).

#### 7.4 Administration Narrative: Third Way

We will finance work instead of unemployment because: A social minimum in income and the reduction of unemployment can get reconciled with each other by using the transfers for unemployment for the subsidizing of wages and income for a transition period.<sup>8</sup>

Tax researchers have for a long time observed a surprisingly resilient German tax system which did not respond to the globalization pressures for higher tax efficiency to which almost all other advanced political economies had adapted (Ganghof 2004). Compensation theorists and institutionalists argued that the institutions of the German political economy had been capable of fencing off such pressures for greater efficiency through strong labor power and a consensual electoral system (Garrett 1998; Prasad 2006). Accordingly, when Gerhard Schröder then implemented his radical tax cut in the early 2000s, the theory of veto-players had to be reversed. Ideas, instead of institutions, seem to play a crucial role in the changes in German tax policy, however, which kind of ideas and how they changed positions about income taxes in the German political economy is still unclear. One approach argues that economists gained authority through the growing monetary and network power of ordoliberal thinkers (Ptak 2009). However, those networks of ordoliberal thinkers have been powerful since the end of World War II and hence can hardly account for radical tax change.

Together with section 7.5, this section will demonstrate along Vivien Schmidt's (2008) argument that a coherent narrative of cognitive growth and normative justice which can convince parliamentarians and voters in coordinative and communicative discourse is essential for a paradigm shift. I will show that this narrative did not depend on economists' ideas about growth and incentives, but on sociologists, political scientists and political theorists who developed a positive vision of gains for all German

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<sup>8</sup> Schröder, Gerhard. 1997. “With Courage and New Strength for Innovation and Growth in Germany.” *FES Publication* No. 3. Bonn: Friedrich Ebert Foundation.

workers in the new post-industrial society. As opposed to the Kohl administration, the red-green government developed a more coherent narrative and a better communication strategy. After several years of unemployment and sovereign the administration successfully won parliamentarians and party bases for their program through a narrative of *social liberalism* which was more honest and trustworthy in arguing that tax and welfare cuts were necessary to get the German economy back on track. This trustworthiness also relied on the SPD as a social democratic party which credibly portrayed their program as the best social program attainable if voters wanted enhanced economic growth (Kitschelt 2001).

Gerhard Schröder built his modernizing program on the concepts of universality and market morality. By arguing that economic development and employment were the basis for all other goals in society, an ideational turn took place within the SPD from traditional Social Democratic goals of social justice. The modernizers in the SPD who dominated the ideational orientation of the red-green government at least since mid-1999 *incorporated* parts of the demands of traditional Social Democracy by giving compensations to the working poor through tax cuts at the bottom end of the income distribution and *moralized* the overall tax plan with the concepts of universalism and inclusion of the poor in the labor market, as Liberal Philosophy had suggested. These steps of normative embedding of the tax reforms were highly persuasive to policy makers in the Bundestag and the Bundesrat and allowed for the strongest shifting of tax burdens from the top to the bottom in the German history.

Two speeches and two papers of the government crucially set this agenda in moralizing tax cuts for higher incomes and corporations. The two speeches were held Schröder before the Bundesrat and the Bundestag right after election. One of the strategy papers is the coalition agreement of the Green Party and the SPD in 1998 and the other paper is the new basic value program which defined the Third Way of the SPD after Oskar Lafontaine stepped back. The primacy of economic growth over social justice in redistribution shows in all of Schröder's speeches and in the coalition contract of the red-green government. To Gerhard Schröder economic growth and employment were the basis of all positive societal developments: "economic performance is the basis of everything."<sup>9</sup> And since economic performance had been low in Germany in the past twenty years, the government planned to "modernize the state and the economy, revive and secure social justice [...] and most of all, we need to push back unemployment."<sup>10</sup> One of the main instruments to revive economic growth was restructuring of the corporate tax system. To Schröder such a reform was "based in economic necessities."<sup>11</sup>

Together with the finding in section 7.5 that economists suggested that the German economy was not subject to tax competition, the negligence of tax competition as a topic in the government narrative points to the fact that economic pressures were not

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<sup>9</sup> Schröder, Gerhard. 1997. "With Courage and New Strength for Innovation and Growth in Germany." *FES Publication* No. 3. Bonn: Friedrich Ebert Foundation.

<sup>10</sup> Ibid, p. 49.

<sup>11</sup> Ibid, p. 49.

the main drivers of the ideational shift. The theme of tax competition and competitiveness was almost nonexistent in the speeches of the government as well as in the Bundestag debates. Of course this rhetorical negligence must not indicate that competition did not exist, but it is interesting that despite its strong focus on economic modernization and economic growth, policy makers focused on the rigidity of *domestic* German institutions such as the social security system and government intervention instead of talking about tax competition. Even more striking is the wording in the basic program of 1999, in which the SPD argued that globalization pressures were not stifling domestic economies, but enabled a modernizing of domestic policies that had become necessary anyway: "The globalization of financial markets, the Europeanization of the trade markets and the related competition of locations is not seen as an inconvenient restriction to Social Democratic policies"<sup>12</sup> but could have a positive effect of a "modernization whip on economy and society."<sup>13</sup> The fact that the red-green government presented itself as the honest modernizers, politicians who implemented the necessary, makes it surprising that tax competition was not equally used for their argumentation.

The focus on domestic unemployment and the maintenance of social security as the main goal of shifting the tax burden from the top to the bottom was much more popular within German society than the former conservative arguments of capital formation and work incentives. Instead of arguing that the unemployed had to be turned into *leistungsbereite* workers, the SPD and the Green Party argued they wanted to alleviate their hardships. The two parties argued that the number of unemployed had amounted to 4.4 million in 1998 and that it had to be reduced by all means. In the same document, the parties proposed to pursue this goal by improving conditions for the market, competition and investors. They planned to use their economic policy to create a "strong, competitive and sustainable economy"<sup>14</sup> which was the basis for "jobs, wealth and social security."<sup>15</sup> The SPD used their credibility as a social democratic party to argue that if there was a way to bring economic growth back while maintaining the level of social spending, the SPD would have followed that path. If the voter wanted higher employment and growth, the consolidation of the budget and tax cuts for capital income were necessary.

Another selling point of the program was that the parties promised that the social dimension of social democracy would remain intact, it would just be situated in a different sphere of society: the market. The fact that the chancellor argued that justice would now be provided by integrating the unemployed in the labor market, helped *moralize* the market project. And another issue which created trust in the project of the

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<sup>12</sup> Basic Value Commission of the Executive Board of the SPD. "Third Ways – New Centre - Social Democratic Markers for Reform Policy in Times of Globalization." September 1999, Berlin, p. 12.

<sup>13</sup> Ibid., p. 12.

<sup>14</sup> SPD and the Green Party. 1998. "Awakening and Renewal. Germany's Way into the 21<sup>st</sup> Century. Coalition among the Social Democratic Party Germany and the Green Party." Bonn, p.2.

<sup>15</sup> Ibid., p. 2.

SPD was that when it introduced the concept of incentives it did not present it as a form of punishment for the lower class which would have to work harder to maintain their living standard while giving benefits to the rich through cuts, but proposed tax cuts for low income earners as a way incite their self-sufficient private social insurance. Even though in part Schröder employed the same notions of depoliticizing fiscal policy which public choice had already promoted when he argued that welfare entitlements were “socially vested rights” which had to be eliminated, the government usually fell back to the argument of necessity and the contemplation of how much of the “welfare support [it could] still afford” (Schöllgen 2015, 318). It also liked to take the responsibility away from welfare recipients who had basically become victim of a system which entailed too many traps of indefinite social security.<sup>16</sup>

Inspiration for this narrative did not stem from economists but from sociologists, political scientists and political theorists. Hence, even if economic networks had gained in authority which many idea-centered theorists argue (e.g. Blyth 2002; Ptak 2009), these did not develop the important arguments which were capable of winning over voters and parliamentarians. Instead of pointing to the failures of the old paradigm and the decline of industry, the SPD actually had a positive vision where future employment could develop: in the growing productive information and service-industry. Instead of describing workers as the problem, the SPD used Ulrich Beck's post-industrial society to stress that they were the solution to the problem. Economic growth would originate in the social climber milieu, i.e. those who were still at the bottom but who wanted to be at the top.

Phrasing the tax cut in a positive vision of the future *knowledge society* in Germany sounded much more inclusive and coherent than the Kohl argument of increasing incentives to get the poor to work. In the basic program the SPD argued: “In these groups performance-orientation [...] is linked with hedonistic motives in the private and a rational and critical responsibility in political key questions.”<sup>17</sup> This strain of thought was legitimized by John Rawls' Theory of Justice which allowed the SPD to frame social justice through the vision of genuine meritocracy which raised opportunities of the poor. In the new basic program of 1999, the SPD executives acknowledged that in the field of tax policy it seemed practically impossible to achieve “fairness, social justice, freedom and opportunity and solidarity and responsibility” all at the same time.<sup>18</sup> However, greater “income and wealth inequality can be economically viable and socially justified” when it raised “growth, created employment and promoted societal wealth.”<sup>19</sup> Accordingly, the SPD argued that relative income shares divergence was just when the poorest strata of society gained in absolute income.

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<sup>16</sup> Ibid., p. 17.

<sup>17</sup> Basic Value Commission of the Executive Board of the SPD. “Third Ways – New Centre - Social Democratic Markers for Reform Policy in Times of Globalization.” September 1999, Berlin, p. 7.

<sup>18</sup> Basic Value Commission of the Executive Board of the SPD. 1999. “Third Ways – New Centre - Social Democratic Markers for Reform Policy in Times of Globalization.” Berlin, p. 28.

<sup>19</sup> Ibid., p. 28.

The last and most persuasive concept which the SPD adopted from the epistemic community of sociologists and Political Theorists was the concept of *universality*. Post-material theory had argued that the declining vote shares of industrial workers posed a serious electoral problem for the SPD and its political project which traditionally centered on interests of workers. The SPD suffered from declining vote shares and had to accept the realities of the new economy and the growing middle class. Gerhard Schröder and his main campaign adviser Bodo Hombach developed the concept of the *Neue Mitte* [New Center] to indicate that the SPD was no longer a mere blue-collar worker party. The modernizers wanted to attract the votes of the growing share of white-collar workers. In order to integrate the demands of the New Left, modernizers called out the “Republic of the New Centre”<sup>20</sup> which did not “exclude anybody” and stood for “solidarity and innovation, for entrepreneurial spirit and bourgeois sentiment. For ecological responsibility and a political leadership which understands itself as a modern management of opportunity.”<sup>21</sup>

## 7.5 Universalism in Bundestag Debates

Research on paradigm shifts has shown that economic thinkers have been important actors in changing economic policy especially in times of economic crisis (Blyth 2002; Kingdon 1984; Hall 1989; 1993). For the German case Leaman (2009) has convincingly demonstrated that the German independent central bank with its mandate for price stability has impaired an implementation of Keynesian economic thinking in the 1960s which led to institutional continuity of the ordoliberal regime since the end of World War II. Ordoliberalism never ceased to dominate German economic policy making and it was only a small step to convince the Kohl administration and the modernizers in the SPD to attempt to reorganize the German tax system in free-market terms once supply-side economic theory became dominant in the American, British and German economics profession. However, party bases and voters were not easily convinced as we have seen in Section 6.5 as the ideals of the social market economy ran counter a reduced progressivity in taxation. This section will show a concept of *opportunity for the poor*, developed by modernizers in the SPD, helped convince voters and parliament of the new program as opposed to Kohl's failure to sell it as a way of *punishing* the unemployed with work incentives.

The power of normative concepts again shows in the coordinative discourse between administrations and parliamentarians (Schmidt 2016). Economists were much less important in this process than ideas developed by post-industrial sociologists and liberal political theorists. The program that the Social Democrats and the Green Party

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<sup>20</sup> Schröder, Gerhard. “Plenary Protocol of the German Bundestag, Stenographic Report of the 3<sup>rd</sup> Session of the 14<sup>th</sup> legislative period.” 10 November 1998, 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 15032, p. 47.

<sup>21</sup> Ibid., p. 47.

proposed in their early speeches and the paper on the new basic values, which we outlined in section 7.4, were very effectively transferred to the debates of the German Bundestag and Bundesrat. Though one of the concepts, the self-sufficiency in social security was almost never raised in debates of taxation, the other concepts that the SPD and the Green Party had raised in the early speeches and the program, were adopted in the debates of the Bundestag.

Table 4, at the end of this chapter, summarizes the frequencies with which the party factions raised the different justifications for tax cuts at the top and for corporations. The governing parties from the SPD and the Green Party used a large share of their arguments in the realm of cognitive growth arguments for growth. They argued along the lines of classical supply-side theory, that greater resources for corporations and the *Mittelstand* would increase investments of German firms. Aside from this cognitive reasoning however, normative arguments played a crucial role in justifying the tax shifts from the top to the bottom. The argument that tax cuts across the entire income distribution and for capital and labor were fair because they were *universal*, was a highly persuasive to the governing factions in the parliamentary debates. Also, the *market justice* argument, that the top rate reductions would generate justice through greater employment opportunities for the lower incomes, was used with a very high frequency by the governing coalitions. The governing parties almost never raised the social justice claims that they had mostly employed in the 1980s. Even though, materially, the lower incomes did receive significant tax cut, as a compensation for the high tax rate reductions at the top of the income distribution. The concept of *moralizing* neoliberal tax cuts as universal and inclusionary for the poor, helped to shift the dominant discourse among left policy makers towards neoliberal tax cuts and so did the *incorporation* of traditional ideals of social democratic policy making of giving compensations for the poor when top incomes gained from the tax cuts.

### *The Center-Left Coalition*

My impression was [...] that after years of discussions about whether the tax burden was a specific cause of the insufficient economic growth in the Federal Republic of Germany and with it the high amount of unemployment, we finally increasingly agree. It became accepted after a record level of tax and spending quotas in the mid-1990s that the tax and spending burden was too high in the Federal Republic of Germany.<sup>22</sup>

In spite of the strong social justice mandate that the SPD and the Green Party had received in the Federal Election of 1998, the representatives in parliament almost never raised social justice as a legitimation for their tax cuts. Instead, they based their narrative of tax cuts on the arguments of *growth*, *universalism* and *market justice*. Only a small group of traditionally thinking social democrats and the Party of Democratic Socialism

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<sup>22</sup> Steinbrück, Peer. "Stenographic Plenary Protocol of the 752<sup>th</sup> Session of the Bundesrat." June 9, 2000. 14<sup>th</sup> legislative period. DIP XIV/154, Doc No. 752, p. 228.

(PDS) still supported equality of outcome arguments in parliament. The ideational coalition of modernizers in the SPD, the Green Party, the CDU and FDP shifted discursive power away from the SPD party base and the voters to an elite discourse of economic growth, universality in tax cuts and morality in markets. Though the cognitive frames of economic growth that were used by the SPD could be interpreted as a functional objective adaptation to real economic pressures, the normative frames played a crucial role in transforming the German parliament into an arena that supported tax cuts as a means to resolve the crisis.

Just as the narrative of the government had proposed, parliamentarians adopted a positive vision of tax cuts supporting all income groups in German society. In this reasoning, the tax cut became a means of generating *universal* benefits to German society. Joachim Poß from the SPD argued that the Tax Relief Law was a "Tax Relief Law for all taxpayers, not only a specific clientele."<sup>23</sup> It was a tax cut that "supported private individuals and the economy."<sup>24</sup> Finance Minister Eichel argued that his tax cut integrated all societal groups: "Private households as corporations, though the focus lies with the small incomes, the average incomes and the families and the small and medium firms. The tax rates will fall for all incomes."<sup>25</sup> Rezzo Schlauch from the Green Party also argued that the cold progression "was a problem that all [income groups] are struggling with"<sup>26</sup> and that the coalitions would now finally resolve:

We raise the tax free minimum existence to DM 15,000 [...]. The bottom tax rate is reduced to 10.9% percentage points and the top income tax rate by 8 percentage points. This way we really support all households and the Mittelstand.<sup>27</sup>

At the center of this positive vision of universalism stood John Rawls theory of fairness which the SPD had adopted to argue that increases in employment would help even poorest sections in society and hence justified the tax cut. Joachim Poß outlined the main goal of the tax cut which could equally speak to traditionalists and modernizers in the SPD: "We will roll back unemployment step by step. The Tax Relief Law will help us with this."<sup>28</sup> Instead of arguing - as the FDP had done in the 1980s - that tax cuts gave incentives to work which sounded rather like a form of punishment, this reasoning allowed for a positive twist of tax cuts as a means to support the unemployed. The SPD and Green Party parliamentarians argued that the top personal income tax reduction was fair because it created jobs in the Mittelstand. Representative Ekin Deligöz from the Green Party argued that greater investments of firms would create

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<sup>23</sup> Poß, Joachim. "Stenographic Plenary Protocol of the 105<sup>th</sup> Session of the Bundestat." May 18, 2000. 14<sup>th</sup> legislative period. DIP XIV/154, Doc No. 14/105, p. 9773.

<sup>24</sup> Ibid., p. 9763.

<sup>25</sup> Eichel, Hans. "Stenographic Plenary Protocol of the 749<sup>th</sup> Session of the Bundesrat." March 17, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 749, p. 76.

<sup>26</sup> Schlauch, Rezzo. "Stenographic plenary protocol of the 105<sup>th</sup> Session of the Bundestag." Berlin, 18 May, 2000, 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 14/105, p. 9771.

<sup>27</sup> Ibid., p. 9773.

<sup>28</sup> Poß, Joachim. "Stenographic Plenary Protocol of the 105<sup>th</sup> Session of the Bundestat." May 18, 2000. 14<sup>th</sup> legislative period. DIP XIV/154, Doc No. 14/105, p. 9763.

greater employment and through investments “more revenues would develop, which helps everyone.”<sup>29</sup> The coalition argued that it was fair to give a tax cut to small and medium enterprises, as they employed the majority of workers and had the highest prospect of integrating the unemployed in the labor market. Finance Minister Eichel argued that income tax cuts would benefit the majority of German firms who were “most decisive in generating jobs.”<sup>30</sup> Tax cuts at the top were justified because the *Mittelstand* “carried the burden of the vocational training and create new jobs.”<sup>31</sup>

The fact that the tax plan entailed significant compensations for lower and medium incomes which the government had *incorporated* from proposals of traditionalists in the SPD helped gaining the support of those sections of the SPD and the Green Party that still supported social justice. Hildegard Wester argued in a debate in the Committee for Families, Pensioners, Women and Youth that “the tax plan is a first step to fulfil the promises of the election campaign of Bündnis 90/Die Grünen and the SPD, to reinstate tax justice”.<sup>32</sup> She argued that families with average incomes gained in the year 1999 round about DM 1,200 and later DM 1,700 which “was urgently needed because families had suffered from high tax and contribution burdens in the past years.”<sup>33</sup> Wolfgang Clement argued in a Bundesrat session that the Tax Relief Law had “supported families with children and small incomes in an unprecedented manner.”<sup>34</sup> Through the planned increases of a tax free minimum existence to DM 15,000 the SPD could maintain its reputation as a social democratic party and argue that all sections of the German society would benefit: “The bottom tax rate is reduced to 10.9% percentage points and the top income tax rate by 8 percentage points. This way we really support all households and the *Mittelstand*.”<sup>35</sup>

The normative narratives of the government generated a social framework within which the SPD had greater freedom to raise supply-side arguments in the Bundestag. At the center of the economic reasoning of the parliamentarians was the competitiveness of the German economy and quest to attract more FDI to the German jurisdiction. The arguments that were raised in this cognitive realm of reasoning had existed since the 1980s but only the SPD could turn them into acceptable frameworks in the German Bundestag by embedding them into the broader framework of traditional social democracy. The Minister of Finance Hans Eichel presented his reform as a “great push in modernization, an important contribution for growth, investment and em-

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<sup>29</sup> Deligöz, Ekin, “Protocol of the Committee of Labor and Social Issues,” 10 May 2000, 14<sup>th</sup> legislative period, PA XIV 154, Vol. A3, Doc. No. 14/45, p. 45.

<sup>30</sup> *Ibid.*, p. 78.

<sup>31</sup> *Ibid.*, p. 79.

<sup>32</sup> Wester, Hildegard. “Short Protocol of the Second Session of the Committee for Families, Pensioners, Women and Youth.” November 18, 1998, PA XIV/16, Vol. A3, Doc No. 57, p. 57.

<sup>33</sup> *Ibid.*, p. 57.

<sup>34</sup> Eichel, Hans. “Stenographic Plenary Protocol of the 749<sup>th</sup> Session of the Bundesrat.” March 17, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 749, p. 84.

<sup>35</sup> Schlauch, Rezzo. “Stenographic plenary protocol of the 105<sup>th</sup> session of the Bundestat.” Berlin, 18 May, 2000, 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 14/105, p. 9773.

ployment.”<sup>36</sup> He argued that the German tax system was not “competitive internationally”<sup>37</sup> because the “corporate tax system [was] characterized – and the same is true for [the] income tax – through high tax rates and a small tax base.”<sup>38</sup> This had “seriously limited the attractiveness of German investment location.”<sup>39</sup> Whereas in the 1980s the SPD had been very careful in adopting arguments to reduce the corporate tax rate, Wolfgang Clement now proudly agreed with the opposition that a reduction in the corporate tax rate to 25 percent will “strengthen the in international comparison necessary improved internal finance of firms and will give incentives for investments and the creation of jobs.”<sup>40</sup> Christine Scheel from the Green Party argued that in times of “globalization and the Euro, corporate taxes play an ever greater role for national governments.”<sup>41</sup> She explained that traditional barriers to trade such as differences in exchange rates and tariffs had fallen. As a consequence, “the importance of corporate tax rates increased” and that the tax plan that the government proposed “will adhere to these international competition aspects of taxation.”<sup>42</sup>

The SPD's social justice position of the 1980s which argued that tax justice should entail a vertical redistribution of resources from corporations to workers was entirely dismissed in the 2000s after the government had *moralized* economic growth as the source for both economic development and justice for workers. In a hearing of the budget committee Jürgen Schmude, a representative from the SPD, criticized the plans to reduce loopholes and tax breaks for businesses as hampering the overarching goal to increase employment in the corporate sector. It did no longer cross the parliamentarian's mind that those revenues could be used for one of the traditional goals of the SPD to invest in subsidies or redistribution to workers: “The plan of the SPD and Bündnis 90/Die Grünen to abolish the depreciations, accruals, partial adjustments in the carrying value and many others diminished the equity of firms”<sup>43</sup> will lead to a loss of “growth and employment.”<sup>44</sup>

Considering the strong and unequivocal support for corporate tax cuts, it is hard to imagine that in the 1980s both the SPD and the Green Party considered tax cuts for corporations as unfair vis-à-vis workers. To highlight the difference in tax arguments

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<sup>36</sup> Eichel, Hans. “Stenographic Plenary Protocol of the 749<sup>th</sup> Session of the Bundesrat.” March 17, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 749, p. 77.

<sup>37</sup> Ibid., p. 77.

<sup>38</sup> Ibid., p. 77.

<sup>39</sup> Ibid., p. 77.

<sup>40</sup> Clement, Wolfgang. “Stenographic Plenary Protocol of the 749<sup>th</sup> Session of the Bundesrat.” March 17, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 749, p. 85.

<sup>41</sup> Scheel, Christine. “Public Expert Interview of the Committee of Finance and the Committee for the Economy and Technology. Questions on Corporate Taxation in International Comparison with Representatives of the OECD.” April 21, 1999. 14<sup>th</sup> legislative period, PA XIV/154, Vol. A3, p. 10.

<sup>42</sup> Ibid, p. 10.

<sup>43</sup> Schmude, Jürgen. “Short protocol of the 4<sup>th</sup> session of the budget committee.” December 2, 1998. 14<sup>th</sup> legislative period, PA XIV/16, Doc No. A2, p. 21.

<sup>44</sup> Ibid., p. 21.

over time, here is Claus Grobecker's statement from 1988 again: "2.5 million unemployed demonstrate how the tax law works better for the better-off. It is unjust, it works against the principle of social justice."<sup>45</sup>

The only objections that the SPD held against reducing the top income tax rate even further than the 45 percent on which the coalition partners had agreed was a defensive argument of revenue loss. The party was hesitant to reduce the rate further, fearing that diminished revenues would strain state budgets and welfare spending. Wolfgang Clement from the SPD argued that he did not generally reject the idea of further reduction of the top personal tax rate, but the revenue loss had to remain sustainable: "I already said a further reduction of the top personal income tax rate – which I do not generally oppose – it only has to be financed sustainably –, is not our main goal."<sup>46</sup> A reduction of the top rate to 35 percent would lead to tax losses of DM 55 billion which would be "unbearable for the public budgets."<sup>47</sup> Of course tax cuts had growth effects, he argued but tax reforms had to be "calculated responsibly."<sup>48</sup> Instead of objecting tax cuts on social grounds, the SPD had fully embraced classical supply-side arguments such as crowding out. The only difference to the 1980s was that the coordinative discourse of the party leaders and the party bases had successfully embedded the economic arguments into an acceptable normative framework.

Only a state that has his spending under control, is a state which they [economy and citizen] can trust that it does not reach into their pockets on the quiet through tax increases. Only a state that reduces its credit in the capital market, is a state that helps to keep interest rates low.<sup>49</sup>

### *The Center-Right Opposition*

The CDU/CSU and the FDP were impressed by the government's proposals to implement those corporate and income tax cuts that the SPD and the Green Party had blocked in the 1980s. At the same time, the opposition used the positive discursive atmosphere that the government had created to push them further along the lines of tax cuts. The FDP which had failed to convince any party in the Bundestag of the argument of incentives to work in the 1980s, now used the framework developed by the SPD to demand a top personal tax rate reduction to 35 percent instead of the 45 percent. Jumping on the bandwagon of SPD's success to justify tax cuts, the FDP now coupled growth arguments with justice. On the one hand, they argued that the *Mittelstand* needed the tax cuts for a better use of its profits for investments. On the

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<sup>45</sup> Grobecker, Claus. "Protocol of the 588<sup>th</sup> Session of the Bundesrat." April 29, 1988. 11<sup>th</sup> legislative period, DIP XI/71, Doc No. 3588, p. 91.

<sup>46</sup> Clement, Wolfgang. "Stenographic Plenary Protocol of the 749<sup>th</sup> Session of the Bundesrat." March 17, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 749, p. 68.

<sup>47</sup> *Ibid.*, p. 68.

<sup>48</sup> *Ibid.*, p. 234.

<sup>49</sup> *Ibid.*, p. 76.

other hand, they argued that corporations and the *Mittelstand* were treated unfairly as big business had received large benefits while the *Mittelstand* was the source of all growth in the German economy. Even though those two arguments at times contradicted each other, the FDP was successful in using the narrative of the government which situated justice in the market and hence pushed the SPD for further cuts. Since the center-left had already adopted similar arguments of universality and market justice in their tax plan, it became increasingly difficult to repudiate such demands and the government had to adopt further income tax reductions when they gained the majority in the Bundesrat. Of course this institutional power shift is at the center of the further tax reductions. However, the Keynesian paradigm of the 1980s transcended party lines by its mere ideational thrust and prevented the demands of the FDP from being implemented.

Considering that the resistance against the reduction of the top personal tax rate among parts of the factions of the CDU and CSU had hampered the tax cut at the top in the 1980s, their strong support for the tax cut is noteworthy. In the 1980s, the labor-wing of the Christian Democrats was one of the strongest opponents of a reduction of the top personal income tax rate and built an ideational alliance with the Social Democrats and the Green Party on this issue. Now, the Christian Democrats were fully supportive of the FDP demand that a stronger tax rate reduction at the top of the income tax schedule were fair to individual entrepreneurs who contributed most to the education of trainees and the growth of jobs. Erwin Teufel from the CDU argued that the government had delivered a tax plan that on the one hand “entailed the urgently needed corporate tax reform and on the other hand – a relatively timid – tariff reform in the income tax.”<sup>50</sup> He worried that the corporate tax reform that the government had developed was a “big firm tax reform” which missed “the small and medium firms, so around 85 percent of the 2.3 million firms in Germany.”<sup>51</sup> The government was giving cuts to “corporations, but not entrepreneurs.”<sup>52</sup>

The Christian Democrats repeatedly expressed their surprise about the market impetus in the government's rhetoric. Peter Rauen was amused about the fact that the SPD and the Green Party wanted to cut taxes on capital gains:

When I heard that capital gains from shares should become entirely exempt from taxation, I couldn't believe it at first [...]. I would have liked to hear the outcry and [sic!] in this house of labor union representatives, if we would have done this.<sup>53</sup>

Ronald Koch observed an international paradigm shift which had now arrived in Germany. Governments increasingly abandoned the idea that tax systems should be used as

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<sup>50</sup> Teufel Erwin. “Stenographic Plenary Protocol of the 749<sup>th</sup> Session of the Bundesrat.” March 17, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 749, p. 81.

<sup>51</sup> Ibid, p. 81.

<sup>52</sup> Ibid, p. 81.

<sup>53</sup> Rauen, Peter. “Stenographic plenary protocol of the 105<sup>th</sup> session of the Bundesrat.” 18 May, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 14/105, p. 9769.

“means to generate *Verteilungsgerechtigkeit* [equality of outcome].”<sup>54</sup> Today the “majority of nation states which compete with us in the industrialized world have moved away from this concept.”<sup>55</sup> Koch mentioned the debates about a flat tax model which some politicians had raised in the American debate and contended that this debate showed “how radically one could talk about [the reduction in progressivity].”<sup>56</sup>

The Christian Democrats and the Free Democrats began developing critiques of the government program that went to the core of their successful narrative. They argued that the fact that the *Mittelstand* stood at the heart of the German Model and only received a minor rate cut worsened economic prospects as well as the normative goal that the SPD had tied to this prospect, i.e. to create jobs for everyone in Germany. On the one hand, a top personal income tax rate of 35 percent was “not suitable to make the German *Standort* more attractive for domestic and foreign investors and to create new jobs”<sup>57</sup> - a direct hit against the central goal of the governing parties. The reasons were that the rates were still so high that they “punished effort, hampered motivation.”<sup>58</sup> The CDU wanted a tax reform that supported the “efforts of young entrepreneurs, retailers and craftsmen. We know that they are the ones who create jobs and training opportunities.”<sup>59</sup> Kurt Faltlhauser, from the CSU, argued that the center-left’s plan to reduce the top personal income tax rate only to 45 percent was problematic because this high rate did not only hit the rich but also the young graduates in business who earn between DM 65,000 and DM 75,000 in the first years of employment.<sup>60</sup> These young and “eager”<sup>61</sup> individuals who are “particularly dedicated, who are the ones who make our economy thrive”<sup>62</sup> would have low incentives to continue their efforts. Both parties concluded from this analysis, that if the SPD was serious about greater competitiveness, it would have to reduce taxes along the entire tariff “but particularly at the top.”<sup>63</sup>

The argument that the SPD had the right intentions but was misinformed or misguided how to achieve economic prosperity must have been a great hit against the economic credibility of the governing parties. The FDP kept calculating in the Bundestag how large the *Mittelstand* contributions to the German economy were and how ridiculous it was of the SPD to think that they would reinvigorate growth by cutting corporate taxes. Additionally, the governments’ new narrative of *universal* benefits in the market opened a second argumentative avenue for the FDP in the area of justice. The CDU and FDP argued that it the unequal corporate tax cut did not represent the gov-

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<sup>54</sup> Koch, Roland. “Stenographic Plenary Protocol of the 749<sup>th</sup> Session of the Bundesrat.” March 17, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 749, p. 87.

<sup>55</sup> Ibid., p. 87.

<sup>56</sup> Ibid., p. 87.

<sup>57</sup> Ibid., p. 16.

<sup>58</sup> Ibid., p. 216.

<sup>59</sup> Ibid., p. 216.

<sup>60</sup> Vogel, Bernhard. “Stenographic Plenary Protocol of the 752<sup>th</sup> Session of the Bundesrat.” June 9, 2000. 14<sup>th</sup> legislative period. DIP XIV/154, Doc No. 752, p. 225.

<sup>61</sup> Ibid., p. 225.

<sup>62</sup> Ibid., p. 225.

<sup>63</sup> Ibid., p. 16.

ernments' claim to improve the situation for all Germans in the market. Dirk Niebel argued that the tax rate for the Mittelstand remained high in the tax plan of the government because of a "traditional mistrust of the Social Democrats towards the self-employed."<sup>64</sup> The CDU equally pressed the governing parties on their commitment of horizontal tax justice employed in their tax plan arguing that "a real reform" was needed which was able to create a "balanced taxation of all forms of income irrespective of their source and use."<sup>65</sup> While Roland Koch praised the plan to reduce the corporate tax rate to 25 percent as "undeniably a step in the right direction," he worried about the effectively higher taxation for small firms and the plan to incentivize retained profits in corporations. Drawing a tax cut line between corporations and personal enterprises and facilitating the entrapment of profits in firms as opposed to supporting the distribution would lead to "serious conflicts in the coming debates."<sup>66</sup>

The SPD kept highlighting that they of course knew that two-thirds of the German economy and two-thirds of German employment took place in the Mittelstand segment of the market and that they of course wanted to reduce taxation for those firms as well. They referred to the fact that the tax plan entailed an option for small and medium firms to be taxed as corporations and thus to receive the same lowered rate as corporate incomes. By admitting to the opposition that they shared the same goals, the government lost all leverage to recuperate the social justice argument against tax cuts at the top. When, the opposition rejected this option as unfair as it created an unbearable bureaucratic hurdle for small entrepreneurs, the SPD and Green Party had to give in and adopt the greater tax cut for higher incomes. The opposition argued that the corporate tax reform led to a "massive tax cut for big businesses"<sup>67</sup> and created serious "problems for small and medium firms."<sup>68</sup> Small firm entrepreneurs only received some "crooks"<sup>69</sup> such as the option model, which were used by the government to create an image of equity. "In reality, the reduction of the top personal income tax rate falls way behind what we consider necessary."<sup>70</sup> And the governing parties had to revise their tax plan according to the standards of the FDP.

### *Umbrella Associations as Single Representatives of Civil Society*

The witnesses the red-green coalition invited to the Committee Sessions in the late 1990s had a completely different composition from the groups that testified in the

<sup>64</sup> Niebel, Dirk. "Protocol of the Committee of Labor and Social Issues." May 10, 2000. 14<sup>th</sup> legislative period. PA XIV 154, Vol. A3, Doc. No. 14/45, p. 7.

<sup>65</sup> Ibid, p. 83.

<sup>66</sup> Ibid., p. 87.

<sup>67</sup> Storm, Andreas. "Protocol of the Committee of Labor and Social Issues." May 10, 2000. 14<sup>th</sup> legislative period. PA XIV 154, Vol. A3, Doc. No. 14/45, p. 7.

<sup>68</sup> Ibid., p. 7.

<sup>69</sup> Hasselfeldt, Gerda. "Word Protocol of the Public Hearing of the Committee of Finance." March 23, 24, 25, 2000. 14<sup>th</sup> legislative period, PA XIV/154, Vol A4, Doc No. 88, p. 50.

<sup>70</sup> Ibid., p. 50.

1980s. The small civic interest groups who made the most radical claims in terms of social justice were no longer invited to testify, which significantly altered the concepts and the rhetoric used in the hearings. Also, the many testimonies of small sectoral unions and small sectoral business groups, which characterized the hearings of the 1980s and enabled occasional alignment of cross-class coalitions, were no longer apparent in the hearings of the early 2000s. Whereas in the 1980s, the business representatives of the printing sector were able to object tax increases for their workers, this was no longer possible in the 2000s, when hearings concentrated on testimonies from economic experts and the umbrella organizations from the unions and business.

The strong demands for equality of outcome raised by women groups were no longer present in the hearings. The chairwomen of the umbrella organization for women groups, the German Women Council, wrote a furious letter to the government in November 1998. "Dear Mrs. Scheel [...] unfortunately you have not followed the usual practice of inviting the Women Council to the hearings on the tax plans."<sup>71</sup> Helga Schulz demanded an invitation to the hearing and laid out her claims for amendments in the tax law. She stressed a return to the goals of coalition agreement of the red-green government in early 1998. The Women Council demanded a concentration of the tax cut on the lowest incomes through a reduction in the lowest tax rate, increases in child tax benefits and an elimination of the marriage splitting. She argued that the new tax plan focused on top incomes and "women with low incomes of starting at DM 17,064 were hurt most."<sup>72</sup> Marriage splitting had to be eliminated because top incomes earned excessive tax breaks through this provision and poor families needed greater transfers to get by. The tax law needed "a socially more just and constitutional child support."<sup>73</sup>

The institutional shifts that took place in the German political economy, including the decline of union power and the increasing ignorance of unions as advisors of governments probably contributed to the ability of the red-green government to implement a radical tax cut. However, the DGB was still invited as one of the key interest groups in the *Brühler Commission*, the most important expert commission for tax cuts. Since the DGB had already adopted the narrative of the government which argued that any instrument which would bring about economic growth had to be supported, it agreed with businesses that tax cuts would help the workers as well. The commission supported the planned preferential treatment of reinvested corporate profits over distributed profits through a reduction in taxation to 25 percent including local trade tax. This way, real investments in machines and endowments and employment should get supported, the DIHT argued. Distributed profits were supposed to get taxed by a top personal tax rate of 45 percent. In order to make up for this divergence in the corporate tax rate and the top tax rate, which applied for small and medium firms, the commission suggested the implementation of an option for smaller firms and self-employed to get treated like

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<sup>71</sup> Schulz, Helga. "Letter to Christine Scheel on the Tax Proposal for a Tax Relief Law 1999/2000/2002." November 18, 1998. PA XIV/16, Vol. B2, Doc No. 87.

<sup>72</sup> Ibid.

<sup>73</sup> Ibid.

corporations.<sup>74</sup> However, economist Pollak objected that greater reductions in the top personal tax rates were necessary to achieve growth effects. She argued that a divergence of the top personal income and the corporate tax rates would lead to distorted allocations of resource:

The most consequent path toward a low, simple and allocation neutral taxation of corporations and individuals can be achieved through a flat rate tax, which has been discussed for quite some time internationally as a reform of the income and corporate tax and which is combined with a low uniform marginal tax rate with relatively high personal allowances and family allowances, which however otherwise is applied on a comprehensive tax base.<sup>75</sup>

After this intervention, the DGB which fiercely fought any form of tax cuts for higher incomes and corporations in the 1980s, agreed with the new discourse that corporate tax cuts and income tax cuts were mandatory to make the German tax system competitive. The DGB argued in a written statement to the Bundestag that it had always “considered low corporate tax rates a value in itself.”<sup>76</sup> Even though in a number of statements in the hearings of the Bundestag, the DGB raised the traditional Keynesian demand stimulation arguments, it also supported the supply-side ideal of tax cuts for investments. Social justice among capital and labor was no longer raised as a specific goal of the DGB for tax reform plans. It seemed obvious to the DGB that foreign investors were attracted by low tax rates and that therefore the government could cut rates and increase the tax base: “Foreign investors in particular focus on tax rates and not so much on the often complex valuation schemes.”<sup>77</sup>

The representation of business in the testimonies in 1998 also focused on umbrella organizations which gathered their demands for the tax cut in a common statement. They demanded a low corporate tax rate and a low top personal tax rate. In a common statement the DIHT, the BDI, BDA, the Federal Association of Banks, the General Association of the Insurance Industry and the Association of German Retail wrote that the many provisions that the government had proposed as loophole closing, in the early tax plan, were economically questionable. Loophole closing would make the tax law even more complicated and limited the “competitiveness of those firms that were supposed to create jobs.”<sup>78</sup> Business groups also rejected notions of Keynesian demand stimulation in the rhetoric of the administration. The organizations argued that higher

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<sup>74</sup> German Bundestag. “Stenographic Plenary Protocol of the 57<sup>th</sup> Session of the Finance Committee.” March 22, 23 and 24, 2000. 14<sup>th</sup> legislative period, DIP XIV/154, Doc No. 88, p. 50.

<sup>75</sup> Commission for the Reform of Corporate Taxation. “Brühl Suggestions on a Reform of Corporate Taxation.” April 30, 1999.

<sup>76</sup> DGB. “Protocol of the Public Hearing of the Finance Committee. Written Statement by the DGB.” March 22, 23, 24, 2000. 14<sup>th</sup> legislative period, PA XIV/154, Vol. A4, Doc No. 88, p. 657.

<sup>77</sup> DGB. “Protocol of the Public Hearing of the Finance Committee. Written Statement by the DGB.” March 22, 23, 24, 2000. 14<sup>th</sup> legislative period, PA XIV/154, Vol. A4, Doc No. 88, p. 657.

<sup>78</sup> DIHT. “Letter of the DIHT to the Finance Committee on the Proposal of a Tax Relief Law 1999/2000/2002.” November 25, 1998, PA XIV/2, Vol. A, Doc No. 32.

disposable income of the poor did not generate greater production in Germany anymore because the products which the lower class consumed were by large shares not produced in Germany: “round about half of the sales of German retail are imported products.”<sup>79</sup> What really helped to promote employment, they argued, was to “reduce taxes for businesses.”<sup>80</sup> In the hearings, business associations were generally supportive of the lower corporate tax rate but demanded greater reductions of the top personal income tax rate for the *Mittelstand*. For instance in one of the Finance Committee a representative of the National Association of Medium and Large Enterprises of the Retail Sector argued that the tax plan was considered positive for enterprises especially medium-sized firms that were incorporated as they gained from the lower corporate income tax of 25 percent. The unincorporated firms gained from the reduced income tax rate at the bottom of the income tax schedule. However, a top rate reduction “in the direction of 40 percent”<sup>81</sup> would help the unincorporated *Mittelstand* and limit the “gap in the tax burden among corporations and unincorporated firms.”<sup>82</sup>

Under these discursive conditions in the Bundestag hearings it became almost impossible for parliamentarians or interest groups to object the general mantra that tax cuts would raise economic growth and enhance the situation for all sectors in the German economy. Ideas of social justice became literally unthinkable for representatives and experts in the Bundestag. Even though the DGB still had an important advisory position in the government, the fact that it became integrated in the broader discourse of a moralized market which brought economic and moral advancements made it impossible to become a strong counterforce to the dominant tax cut argument.

## 7.6 Conclusion

The Tax Relief Law of 1999/2000/2002 was the largest tax reform in German history. It reduced the volume of tax revenues by Euro 43 billion in the year 2000 and by additional Euro 60 billion in each of the following years. In total the cuts accumulated to a budget reduction of 2.3 percent of the GDP (Truger 2009, 30; Wagschal 2005, 214). The distributive effects of the tax reform were tremendous. The top incomes made the greatest gains. The effective tax rate of the *superrich*, the top 0.00001 percent, fell from 48.2 percent to 28.7 percent which is a tax burden reduction of 40.45 percent between 1998 and 2005. The tax share of the top 1 percent fell from 32.1 percent to 26.5 percent in the same time period. Incomes below the median gained on average 26 percent in income taxes as their income tax burden dropped from 2.3 to 1.7 percent. These gains were however eaten up by increases in social security contributions and consump-

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<sup>79</sup> Ibid.

<sup>80</sup> Ibid.

<sup>81</sup> Rometsch, Wilfried. “Protocol of the Public Hearing of the Finance Committee.” March 22, 23, 24, 2000. 14<sup>th</sup> legislative period, PA XIV/154, Vol. A4, Doc No. 88, p. 66.

<sup>82</sup> Ibid., p. 66.

tion taxes (Corneo 2005). Thus, the reforms have significantly contributed to the concentration of incomes at the top.

Many of the expectations about objective material interests of organized groups in comparative political research did not hold for this German case. Comparative political economy expected that corporatist institutions would give trade unions the bargaining power to exchange moderate wage increases against high degrees of redistribution. In spite of having a central position in one of the expert commissions in the government, unions could not achieve the maintenance of redistribution in the German welfare system. The analysis of the debates in parliament showed that this was due to two developments in which ideational change brought about institutional change or a reinterpretation of the utilization of institutions. First, the discrediting of particularistic policy making since the Kohl era had influenced the conceptualization of tax policy among policy makers of all political parties. The new concept understood tax policy as an instrument for economic growth and universal tax cuts for all income groups. The consequence of this reconceptualization was that the Social Democrats and the Green Party no longer invited small sectoral business groups, small trade unions and civic groups which were considered as merely fighting for very particular interests of a very particular constituency. Since the witness composition in the hearings then shifted towards umbrella organizations which could credibly claim to have the interest of the entire German society in mind, coalitions for the suffering industries, sectors or income groups no longer developed.

The other channel through which ideas changed institutions was more tacit. Though the DGB was invited as a crucial actor in the expert commission for tax cuts, it had adopted the arguments of the administration that increasing economic growth would be good for all actors in the German economy. Trade unions no longer protested against the concepts that the modernizers in the SPD and in the Green Party increasingly used to create an ideational coalition with the FDP and the CDU/CSU in the Bundestag.

Table 4 summarizes the quantitative analysis of frequencies of different tax concepts used in the debates in the German Bundestag, Bundesrat and in the hearings. The table shows that tax reforms were not mainly justified through cognitive arguments but that normative arguments played at least an equally important role. The general overtime development that this table depicts is that in the 1980s the Social Democrats and the Green Party used most of their frames in the area of social justice and that this was no longer the case in the late 1990s and early 2000s. The majority of the arguments from the left in the 1980s demanded a compensation for the lower incomes and the middle classes when the center-right government planned tax cuts for top incomes and corporations. A smaller but not negligible part of the normative arguments argued that tax equality between labor and capital needed to be achieved. The left also demanded measures of industrial policy for which tax revenues were necessary and thus opposed large tax cuts at the top and for corporations. In the 2000s, the SPD and the Green Party had almost entirely aligned their tax arguments with supply-side predicaments of the center-right. 38.18 percent of their arguments fell into this category. But again nor-

mative arguments were more frequent than cognitive growth legitimations. 27.88 percent of argument of the center-left fell into the category of equal treatment. Universality was the most frequently used normative tax frame. Horizontal tax equity was also used by the center-right which demanded greater equity among corporations and the Mittelstand. Due to the high agreement that had developed in the new dominant discourse, it was easy for the opposition to push the government into even further reductions in tax rates.

Table 4 – Tax Arguments between 1980 and 2002

	1980-1989		1998-2002		
	<i>Conservative-liberal</i> (CDU, CSU, FDP)	<i>Social Democratic</i> (SPD, Green)	<i>Conservative-liberal</i> (CDU, CSU, FDP)	<i>Social Democratic</i> (SPD, Green)	<i>Left (PDS)</i>
<b>Social Justice</b>					
Compensation of the poor/middle class	17.11%	27.33%	3.16%	4.24%	42.86%
Compensation families	1.97%	5.59%			
Equality of capital and labor		11.18%			
<i>Total</i>	<b>19.08%</b>	<b>44.10%</b>	3.16%	4.24%	<b>42.86%</b>
<b>Market Justice</b>					
Individual motivation, creativity, productivity	15.79%		7.37%	3.64%	
Subsidiarity	13.16%				
Mittelstand employs			1.05%	6.06%	
<i>Total</i>	<b>28.73%</b>		8.42%	9.7%	
<b>Equal treatment</b>					
Universalism	10.53%	21.12%		20.61%	
Horizontal tax equity	5.26%	0.62%	51.58%	7.27%	23.81%
<i>Total</i>	15.79%	21.74%	<b>51.58%</b>	<b>27.88%</b>	<b>23.81%</b>
<b>Economic Imperatives</b>					
Supply-side theory	29.61%		35.79%	<b>38.18%</b>	9.52%
Budget restrictions				5.45%	23.81%
Stimulate demand	2.63%	5.59%		4.85%	
Industrial policy		25.47%			
<i>Total</i>	<b>32.24%</b>	<b>31.06%</b>	<b>35.79%</b>	<b>48.49%</b>	33.33%
<b>Other</b>					
Constitutional court equal treatment capital and labor		0.62%	1.05%	3.03%	
European integration	3.95%			3.03%	
Environmental protection		2.48%		3.64%	
<i>Total frequency codes, N=</i>	152	161	95	165	21

Frequencies in justifications of government programs or their respective objections, source: own coding and calculations.

Aside from the PDS, there was no actor left in the Bundestag, Bundesrat and in the hearings who demanded social justice or the distribution of resources to a specific group in society. Since the Kohl era, the concept of social justice in tax policy had been discredited as ideologically driven and particularistic. As a consequence the SPD and the Green Party ceased inviting the small civic interest groups, which had traditionally pushed the discourse in hearings towards debating social justice for the poor and families. The lack of the voice of women groups altered the debate significantly. The red-green factions in the Bundestag had been persuaded that universalism in tax reforms, i.e. cutting taxes for both individuals and corporations and for all income groups, aligned the economic imperative to give tax cuts to the corporate sector with the moral standard of generating employment and growth for all groups in society. The SPD and the Green Party Representatives increasingly let go of the ideas to give tax breaks and transfer support to suffering manufacturing sectors and poor individuals. Despite being confronted with a structural employment crisis and serious asymmetries of infrastructural investments in the Eastern German economy, the administrations and the Representatives in parliament were increasingly convinced that cutting government resources and tax revenues would enhance growth. Even though Kohl's first attempts to raise productivity with tax cuts had not shown positive effects on employment or sovereign debt, the parties in the Bundestag were more and more convinced that these reforms would help investment opportunities. The belief in tax cutting went so far that the testimony of an OECD expert on tax reforms and investments was questioned by all parties in the Bundestag, when the expert argued that taxation was not the most important factor in foreign direct investment decisions. This expert had explained the relatively low foreign direct investment flows to the German economy in the recent years with the high capital stock that had already moved to Germany during the 1970s and 1980s. This argument did not seem acceptable to the parties in the Bundestag.

## 8 Conclusion

This dissertation set out to explain the puzzle why two countries with highly different configurations of their tax systems, different electoral institutions and different production regimes, Germany and the US, implemented highly similar tax reforms since the 1980s. In both countries, early attempts to cut taxes for higher incomes and corporations and to shift the tax burden on lower incomes and consumption showed only moderate successes. The real shifts in tax burdens could only be implemented in the early 2000s. Because external conditions for such reforms differed greatly, I suspected that similarity may lie in the development of narratives that developed in parliamentary bodies. I conducted a historical content analysis of tax debates in the American Congress and the German Bundestag to understand under which conditions the academic supply-side paradigm was able to persuade majorities of policy makers in parliamentary bodies. I found that the prime movers in neoliberal tax policy, Ronald Reagan and Helmut Kohl had serious issues implementing their tax plans due to the massive protest that arose among parliamentarians and later in civil society. This protest diminished over time and gave way to tax reforms which considerably shifted the tax burden from higher incomes and corporations to lower incomes and consumption in the early 2000s. I argue on the basis of the theory of *discursive institutionalism* that the economic policy paradigm shift is not only a function of the ability of academics persuading policy makers of a cognitive theory of growth but that much power lies in the state's ability to frame such reforms in normative terms which persuade parliamentarians. This coordinative discourse was more successful in the 2000s when George W. Bush and Gerhard Schröder were able to justify the tax reforms under the consistent *discrediting* of *social justice* concepts and the strong normative *moralization* of the tax reforms under the concepts of *market justice*. It took twenty years to shift the dominant normative discourse. But eventually, a reinterpretation of the credibility of institutions and actors to make decisions in the realm of tax policy as well as reconceptualization of the notion of taxes itself made the concept of neoliberal tax policy so persuasive that it could transcend the boundaries of different national institutions. I show how administrations learned to convince parliamentarians from the center-left and the center-right of new concepts and how the new dominant discourse allowed for tax cuts for higher incomes.

### 8.1 The Puzzle and the Argument

When globalization pressures were first debated in the 1980s, comparative political economy literature had predicted that the institutional configurations of coordinated market economies impeded neoliberal tax reforms through the generation of specific

societal coalitions and a consensual political culture. Neoliberal tax reforms were understood to be confined to liberal market economies such as the US and the UK. Neoliberal reforms as conducted by Margaret Thatcher and Ronald Reagan were not expected to become implemented in continental European and Scandinavian coordinated market economies.

One main reason for the thesis of resilience was that the German tax system was considered particularly efficient and hence unaffected by globalization pressures. Prasad and Deng summarize in their findings of a quantitative analysis that the German tax system is highly regressive. Though it had a progressive income tax, it collected “so much consumption tax, the progressivity of income tax is overwhelmed by the regressivity of sales tax, leading to an overall tax structure that is regressive” (Prasad and Deng 2009, 436). Institutionalists considered the German system as a form of within-class redistribution which through a “highly regressive” social security system limited conflict among capital and labor (Scharpf 2000, 222). It was conducive to the interests of classes and thereby highly resilient to globalization pressures (Hays 2003; Prasad 2006; Steinmo 1993; Wilensky 2002). The data I provided in Chapter 1 confirm the thesis of overall regressivity in the German tax system. In the 1990s the German tax system collected a much greater revenue share from consumption taxes and the regressive social security system and could be considered more efficient than the American tax system which collected a greater share of overall revenue from income taxes. From efficiency considerations then, policy makers in the American tax system should have become under much greater pressure to adapt the progressivity in taxes than their German counterparts. But my data on overtime development showed that German shifts in progressivity looked very similar to the American path to regressivity. In both cases progressivity in the tax system remained more or less stable in the 1980s despite the attempts of Ronald Reagan and Helmut Kohl to reform. The real revolution in progressivity decline was implemented in both countries in the early 2000s under George W. Bush and Gerhard Schröder. The thesis that partisanship would still play a role in coordinated market economies because Social Democratic governments could exchange low wages for high redistribution in neo-corporatist institutions must be qualified accordingly. If the left was still capable of engaging in this bargain, it did not do so in the German case in the early 2000s.

The great differences in electoral institutions, political cultures and economic production regimes make the US and Germany cases of two opposite poles in political coordination. Contrasting these two cases seemed highly fruitful in terms of shedding light on the similarities of such different cases. Drawing on newer accounts in *discursive institutionalism*, I suspected a potential explanation in the realm of ideas. There are three reasons why ideas could intervene in the relationship of external economic and institutional configurations and the eventual decisions of policy makers in the field of tax policy. First, discursive institutionalism argues that policy makers do not follow objective material or rational interests but need to make sense of the external material world through *ideas* they have about the world that surrounds them. In that sense, the poten-

tial efficiency of the tax system may lead to several different policy reactions depending on the interpretation of economic indicators and their effects for the domestic economy. Second, the coalitions that comparative political economy finds to influence the power of organized interests also essentially rest in the assumption that these organized groups follow predetermined material interests. Discursive institutionalists doubt that we can determine what trade unions, business organizations and civic interest groups want from the outset.

The first finding of my historical discourse analysis of debates in the plenary and hearings of the German Bundestag and the American Congress is that *cognitive growth arguments* did not stand at the center of the debates in Congress and in the Bundestag. Much more important to parliamentarians were *normative arguments* which legitimized or delegitimized tax reforms in terms of *tax justice*. The second finding is that despite the different political cultural traditions and institutions, the development of discourses followed similar patterns in the US and Germany over time. In both cases *social justice* was the main concept raised by the center-left in the 1980s and in both cases the pressure to arrive at some degree of *equality of outcome* (Germany) or *ability to pay* (US) impaired the implementation of a reduced progressivity in the tax system as planned under Ronald Reagan and Helmut Kohl. Considering that American organized labor, i.e. the AFL-CIO, had much smaller power in the political system than the German DGB. This is a highly noteworthy finding. I argue that both trade union federations built very effective ideational coalitions with small civic protest groups – women, civil rights organizations, religious groups and small sectoral trade unions - to raise public protest against the declines in redistribution. I find that both conservative governments reacted to this backlash and changed their discursive strategy. Both the Kohl and the Reagan administration started a process of shifting the discourse of taxation from social justice to market justice which was fully implemented under the administrations of George W. Bush and Gerhard Schröder. Policy makers *incorporated* parts of the demands of the opposition, *discredited* social justice as ideologically driven particularism and *moralized* tax cuts for top incomes and corporations as a universally fair program within the broader aim of establishing *justice within markets*.

## 8.2 Universalism and Market Justice in the US and Germany

The most important finding of this dissertation is that the ideational changes in the area of cognitive growth theories and academic theories of the epistemic community were not the main drivers of the paradigm shift from Keynesianism to neoliberal tax reforms. Tax research often portrays Ronald Reagan's tax reforms as a revolution of the academic theory of the supply-side. However, the academic rationality in the supply-side rhetoric that Reagan used to justify the tax shifting to the bottom was rather an obstacle than a facilitator of the tax reforms. After Reagan had presented his first tax cut using the economic theory of the supply-side, public protests broke out in the early

1980s and he had to repeal some of his tax shifting thereafter. After this experience of a clash of supply-side theory with the demands for social justice in civil society, rational reasoning for growth stepped back in the frames of administrations and normative arguments of tax justice moved to the fore. When George W. Bush presented his much larger tax cut for higher incomes, he successfully justified it with concepts of morality in markets which raised much less conflict in parliament and civil society. In the German debate academic theories of economic growth never dominated the discourse in the German Bundestag. Tax reforms were always mostly debated with the contentious concepts of social justice and market justice. Table 5 summarizes the frequencies of tax justifications separated along the lines of cognitive and normative reasoning. The number of normative tax justifications was larger than cognitive tax justifications in both country cases and in each point in time.

Table 5 - Frequencies of Growth and Justice

Total N= 1136		<i>US</i>	<i>Germany</i>
<i>1980</i>	Growth	125	99
	Justice	148	203
<i>2000</i>	Growth	19	107
	Justice	161	143

Source: own coding and calculations.

I found that the concepts that were used in tax debates can be systematized in four basic categories. The concepts that were used most frequently in both countries were *social justice* and *market justice*, followed by *equal treatment* and *economic growth*. Table 6 shows the shifts in tax concepts over time. In the 1980s *social justice* concepts were most important for the parties of the center-left in both countries. In the debates, these concepts were usually comprised of demands for tax cuts for lower incomes or the middle classes and families which compensated these groups for tax cuts at the top or even raised equality of outcome by only cutting taxes for groups in need. Also the left often raised demands for social justice in the relative taxation of capital and labor. *Market justice* was usually raised by conservative and market-liberal parties arguing that it was unfair to tax those individuals who contribute most to the common good in society with higher rates. Individuals with high motivation, creativity and productivity should not get punished for these positive traits. Market justice concepts were frequently invoked when policy makers gave tax cuts to small firms which enhanced opportunities for every individual to self-sufficiently generate income as an entrepreneur. Perfect tax justice in this conceptual category would be achieved with a flat-tax system in which every individual pays the same proportional share of her income in taxes. Within the

category of equal treatment, conservative parties argued throughout the period of investigation that incomes of the same source and amount should be taxed equally. The most important concept of change was *universality*, because it was initially invoked by the conservative parties in the 1980s and increasingly adapted by the left. Universality helped align the tax justice ideals from the center-left and the center-right. The center-right used universalism to argue that tax *progressivity should not increase* and that every income group should get an equal proportional tax cut. The center-left argued that the level of *progressivity should be maintained* through the proportional tax cut for all income groups. Accordingly, when in the 2000s both the left and the right used the concept of universalism, it resulted in much more defensive demands from the left compared to the demand for social justice they had raised in the 1980s.

The category of *economic growth* was utilized much less frequent but became an important point of reference for the Red-green government in Germany in the early 2000s. Growth arguments consisted of either supply-side or Keynesian reasoning. I differentiated arguments of industrial policy and consumption stimulation within the latter category because significant shifts took place within these two. The American Democrats and the German Social Democrats made extensive use of demands of industrial policy in the 1980s. In the debates, parliamentarians demanded that the state kept high tax burdens on capital income and higher individual incomes to finance subsidies and special tax breaks for suffering or growing labor-intensive industries. This demand did no longer exist in the debates of the early 2000s. In the 2000s, the center-left sometimes argued on the basis of Keynesian demand stimulation that lower incomes should receive a tax cut which could positively influence domestic consumption. But in general, Keynesian growth theories became rare in debates of both countries. Supply-side arguments clearly superseded consumption oriented growth theories. Supply-side growth arguments state that tax cuts for corporations give enterprises greater resources to reinvest their profits and thereby raise the capital stock and employment. Supply-siders also argue that a reduced progressivity in the tax system gives incentives for individuals to work harder, consume less and save more of their income in capital markets. It is called supply-side because growth originates from the producer as opposed to the consumer, as is the case in Keynesian growth theory.

Table 6) summarizes the shifts of tax concepts for both the cognitive and the normative realms and each party/coalition over time. Three surprising ideational shifts lead me to believe that external globalization pressures were not the only reason why the left adapted parts of their concepts to those of the center-right. Reason number one is that in both countries the parties from the center-left shifted their normative tax concepts from compensation to universalism alongside of letting go of their Keynesian growth concept of industrial policy. In the 2000s, both the Democrats and the Red-green coalition based their arguments for tax reforms on the concept of universalism even though the American Democrats were in opposition and the German Red-green coalition was in power. Whereas in the case of the Red-green government one could argue that they had to find a normative tax concept that coherently went along their new cognitive

growth concept of the supply-side, this cannot be argued for the Democrats. It is surprising that the Democrats ceased objecting the plans of the George W. Bush administration to shift the tax burden to lower incomes with the concept of universalism instead of arguing in the realm of social justice, as they had done in the 1980s. Instead of arguing that such tax cuts would hurt the most vulnerable groups in society, the Democrat increasingly argued that all income groups should receive the same proportional tax cut. Instead of arguing that progressivity should increase, they defensively argued that it should remain. That also showed in the cognitive ideational realm in which the Democrats raised budget constraints and the goal to arrive at a balanced budget as the main obstacle to tax cuts instead of demanding greater state investments through Keynesian demands stimulation and industrial policy. Though in the case of the Red-green government in Germany the adoption of universalism as their main normative concept in tax distribution makes more sense than in the American case, it is still a surprising result. The SPD and the Green Party could have argued that globalization pressures forced the government to implement tax cuts and that they did everything to maintain the level of social justice as high as any possible. Instead they argued that they aimed at proportionality in the tax cuts.

Table 6 - Comparing Tax Concepts

		US		Germany	
		Republicans	Democrats	Center-Right	Center-Left
1980	Growth	Supply-side	Industrial policy	Supply-side	Industrial policy
	Justice	Universalism	Compensation	Market justice	Compensation
2000	Growth	Supply-side	Balanced budget	Supply-side	Supply-side
	Justice	Market justice	Universalism	Equal treatment	Universalism

Source: Summary of my content analysis.

The second surprise is that the left abandoned their concept of industrial policy which demanded tax breaks for the *Mittelstand* or small and medium firms with high growth prospects in the 1980s. In the American case, the abandoning of the concept of sectoral subsidies and tax breaks among the Democrats is surprising because these concepts were highly successful in the debates of the 1980s. After Reagan ran into strong opposition in 1981 from his own party base against the many big business provisions in

his tax plan, he adopted many facets of the Democratic plan to cut taxes for small business with high growth and employment. In the German case abandoning industry policy is surprising because when the Red-green government came to office, the German economies of the West and the East were reunified for less than ten years. Many of the structural unemployment and investment problems could still be interpreted as resulting from the still existent infrastructural and institutional differences of the West and the East and could have been interpreted as needing more regional and sectoral subsidies and special tax breaks and not less.

And the third and most important reason why I suspect that the center-left was persuaded by the normative arguments of tax shifting of the center-right is that many of the distributive facets of the tax reforms were in line with the social justice concepts of the left but were no longer portrayed that way. Both the administration of George W. Bush and Gerhard Schröder had incorporated the leftist demand of cutting taxes at the bottom of the income distribution. In both cases significant increases in personal tax allowances and reductions in the lowest rate of the income tax schedule were included in the tax plans of the early 2000s. They gave - at least within the income tax schedules - greater tax cuts to the lower classes than to the middle classes. The governing coalition of the SPD and the Green Party in Germany did not use this fact to argue - as they traditionally had - that this tax cut at the bottom was a measure of social justice which compensated the poor for the great tax cuts at the top of the income distribution. Instead they argued that these provisions were *just* in terms of universality and that all income groups gained equally.

### 8.3 Theoretical Contribution

The theoretical contribution of my dissertation is to bring together institutionalist literature which tries to explain the national adoption of neoliberal tax reforms and recent discursive institutionalist approaches. Discursive institutionalists argue that political and economic actors do not follow objective material or rational interests but need to make sense of the external material world through *ideas* which are prior to *interests*. Max Weber's concept of *worldviews* is emphasized in this literature to describe the greater openness to non-rational sense-making of actors (Gofas and Hay 2010, 24; Münnich 2010, 61). In this vein, Vivien Schmidt has developed the concept of *background ideas* which argues that paradigms and narratives of economic policy remain stable for most of the time and may change only in moments of crises. That means that paradigms endure for long time periods even when they are repeatedly confronted with external conditions or internally raised arguments which speak against the set of arguments laid out in the narrative (Schmidt 2016, 324). For such a stable paradigm to arise, Schmidt argues, persuasion of the administration through the epistemic community is important. Even more important is, however, the coordinative process among the administration and the parliamentarians. This is also where institutions come into play, because electoral systems

might facilitate different ideational coalitions to develop. I argue on the basis of this theory that ideas and institutions do interact in the establishing of a new paradigm. I add to Schmidt's concept of the importance of coordinative discourses for the embedding of background ideas that normative arguments were more important than rational arguments which were based in economic theory. I find that administrations had to learn in time and through a strong engagement with the demands of the opposition how they could establish new ideational coalitions that were strong enough to replace the old power structures.

I agree with the theories of discursive institutionalism that institutions generally embed the development of ideas and that institutions have feedback effects on the societal values that may or may not develop (Blyth and Schmidt 2010; Prasad 2006; Schmidt 2002; Schmidt 2008). However, during the shift of paradigms I find that ideas transcend the institutional configurations and that the influence may reverse, i.e. ideas influence the institutional setup and not vice-versa. Ideas can become dominant over institutions when actors develop ideas that are so persuasive that the majority of societal groups begin to use institutions differently. This is not an active decision but rather a slow percolating of new understandings of old external and internal imperatives to the policy field. The establishment of a new utilization of institutions can occur in three ways.

First, the concept of the policy field itself can be interpreted in different ways and this can significantly influence the way policy makers go about new legislature. In the case of the tax policy, the policy field can be interpreted as an instrument that is intended to generate positive outcomes in the sphere of the economy or in the sphere of politics or both. If policy makers interpret tax policy as an instrument that generates a common good in the economic realm, the outcome will be completely different from the scenario in which it is organized around a common political goal. In both the German and the American case, the neoliberal paradigm became so persuasive over time, that policy makers shifted their conceptualization of tax policy from economic plus political goals to economic goals only.

And the second institutional configuration is the institutionalization of the state's relations with interest groups. It is considered crucial in determining societal power relations as well as for the outcome of tax reforms in institutionalist literature. Not only Historical Institutionalists, but also many scholarly articles in the field of Power Resource and Comparative Political Economy have argued that the coordinative market economies and their neo-corporatist institutions enable the resilience of redistribution in Germany. They argue that trade unions are able to bargain with business over tax policy and wages and that the outcome of globalization pressures would rather result in wage moderation than in declines in redistribution. In the American fragmented relationship of capital, state and labor, on the other hand, capital has greater power in influencing politics through channels of lobbyism (Cameron 1978; Garrett 1998; Schmidt 1996). However, again persuasive ideas can transcend these institutional differences. First, instead of assuming that actors have objective material interests which they pur-

sue in tax reforms, one could think of occasions in which they redefine their ideas and values in tax policy. And second, policy makers can redefine which groups can credibly speak on the issue of tax reforms. In both the German and the American case, administrations considered a vast group of small societal stakeholders as credible speakers on tax reforms in hearings and consultation bodies in the 1980s. This was no longer the case in the 2000s where umbrella organizations were the main speakers in bargaining institutions.

And third, the societal coalitions that Institutionalism in general and Historical Institutionalism in particular consider stable and conclusive over time are much less theorized. Prasad (2006) and Steinmo (2002) argue that proportional electoral systems have the tendency to generate consensus in parliament through coalition governments. Majoritarian electoral systems and the resulting two-party system, on the other hand, generate conflict. The German system of redistribution is considered resilient to globalization pressures because of the consensual nature of parliamentary coalitions and the comprehensive welfare system which persuades the majority of the middle class that they benefit from taxation, whereas the American middle class is unwilling to pay high taxes for welfare which is largely earmarked to the lower income strata. Though I agree that in terms of official institutions the German Bundestag seems more prone to establish coalitions, I find that party lines were ideationally just as elusive in the US, as they were in Germany. In both countries, policy making in the 1980s was characterized by coalitions of factions from the center-right and the center-left. In the US, the Southern Democrats joined an ideational coalition with the Republicans and voted with them against and for laws. At the same time, there were a number of renegade Republicans which were unwilling to support radical new ideas of fiscal policy which joined the Democrats in their voting behavior. In the 2000s, all factions of all parties increasingly agreed on the same concept of tax justice, *universalism*. This shift in ideas led to shifts in coalitions and voting behavior in both countries. Also, relevant societal coalitions must not necessarily be reflected in parliament, but might configure outside of state institutions. This is what happened in the American case, where large parts of the protest took place outside and was just as effective in influencing the outcome of the reform by raising popular resentment against the reform.

#### 8.4 The Process of Persuasion

If the theory of ideas potentially transcending institutions under the condition of persuasiveness is correct, then the most important question is: When does an idea or a narrative become persuasive? In my historical content analysis I found that three discursive strategies had to be employed by the government to achieve enough persuasion for the implementation of a new paradigm of tax justice. First, policy makers had to *discredit* the old paradigm in its core normative value. Second, administrations had to

incorporate a significant normative demand of the old paradigm into their own tax program. In a third step, the new tax paradigm had to be valorized or *moralized* through an alternative normative concept that conclusively integrated steps one and two (see Table 7 for a summary of the process). Since this process unfolded in both the US and Germany from the 1980s to the early 2000s and only in the 2000s were policy makers able to shift the tax burden from the top to the bottom, I expect that these discursive strategies were part of the process to adopt neoliberal tax reforms across highly different institutional configurations.

Table 7 - Process of Persuasion

	Persuasion
<b>Starting point Particularism 1980s</b>	- Opposition, association interest groups and parts of conservative party demand ability to pay and compensation for the poor
<b>Move 1) Discrediting</b>	- Use public choice to discredit particularism as special interests and demand rationality
<b>Move 2) Incorporation</b>	- Offer compensation for the least-well off in society - Offer an inclusion of the poor into the labor market - Support small-business economy which promises jobs and market access for everyone
<b>Move 3) Moralization</b>	- Morality in markets - Use political liberalism and Rawls' principle of difference to argue for an inclusion of the poor in labor markets and give small businesses access to product markets

The first step of discrediting traditional tax policy of Keynesianism was the basis for all the steps that followed in the later moralization of the neoliberal paradigm. In this step, supply-side economic theory did not stand at the center of tax legitimation. More important was the broader philosophical embedding of supply-side theory in public choice theory. Public choice theorists like James Buchanan argued on the basis of *Wagner's Law* that government spending was out of control because of an infinite demand of voters for spending and the inclination of policy makers to give out more and more funds (Brennan and Buchanan 1991). Redistribution through taxes was considered particularistic, politically motivated and ideologically driven and thus directed at a specific group in society, i.e. the needy, the poor or the workers. Ronald Reagan introduced the

concept of excessive government to parliament when he proposed his first reform. An equivalent concept was laid out by Helmut Kohl who argued that he planned to achieve greater freedom from state intervention through *subsidiarity*. In both cases, the claim that the center-left was giving tax breaks to special interests was highly effective in influencing the long-term development of tax reforms. Though Kohl and Reagan had to scale down their tax plans due to protests in- and outside parliament, the discrediting of politics in tax reforms stuck to the ideas of parliamentarians and led to a depoliticization of tax reforms in the long-run. By the 2000s, the discrediting of particularism had led to a re-conceptualization of tax policy from an instrument to achieve political goals of tax justice and revenue generation to an economic goal of achieving growth and justice in markets.

Through this re-conceptualization of tax policy, policy makers also changed their ideas of which societal groups could credibly speak in parliamentary institutions on tax reforms. The center-left ceased inviting small specific interest groups from civil society such as women groups, religious groups, small sectoral unions and small sectoral business groups as witnesses in hearings. These groups built coalitions to prevent tax increases for specific groups. For instance in the German case, the business groups from the printing sector fought against tax increases for their workers; fearing they would get pushed to pay higher wages in the next collective bargaining round. In both the US and Germany, women groups were very effective in raising family support in parliament and built coalitions with parliamentarians of the center-left and the center-right. And trade union federations incorporated the particularistic demands of those small unions that spoke in parliamentary hearings. By the 2000s, only groups which had no particularistic aims were invited for testimony. In the US, Democrats replaced small protest groups and *all labor unions* with analytical research institutes which could credibly speak on behalf of the entire American population as opposed to special interests. In Germany, the SPD invited the DGB to hearings and tripartite advisory bodies alongside a majority of economists and business groups. Being in the clear minority, the trade union federation could not raise claims for social justice in the bodies.

In the second step of the justification process, the administrations incorporated one central demand of the center-left into the tax plans which in both cases was the compensation of families and lower incomes through lower taxation at the bottom end of the income distribution. Both Ronald Reagan and Helmut Kohl had already integrated some tax breaks for the lower incomes in their tax plans - though Reagan only did after his first reform was opposed by strong public protest - but the full ideational integration of lower income tax cuts was only fulfilled under the governments George W. Bush and Gerhard Schröder. These two administrations argued that they gave compensation for the poor and families not for reasons of social justice, as the left had demanded in their protest in the 1980s. The administrations in the 2000s embedded the idea of tax cuts at the bottom end of the income distribution within their broader concepts of enhanced market opportunities for lower incomes in employment and self-employment as small entrepreneurs. George W. Bush argued that lower taxes at the

bottom would make it easier for the poor to earn enough money to move out of poverty and would simultaneously reduce taxes for small firms which file their taxes as individuals. Gerhard Schröder also argued that the bottom rate reductions would help the *Mittelstand*, i.e. small and medium firms in Germany, and would get the poor out of unemployment through the increases in jobs in the *Mittelstand*.

But only Schröder and Bush combined the first two steps with the third discursive strategy in their process of persuasion. And only through this final strategy had they been able to persuade a grand coalition of societal stakeholders and parliamentarians to pass the grand overhaul of the tax systems and the shifting of the tax burden from higher incomes and corporations to lower incomes and consumption. Both administrations used the depoliticized concept of tax policy and turned it into a positive normative concept of universalism in tax justice. For this purpose, Gerhard Schröder argued on the basis of John Rawls' *principle of difference* that justice in his tax cut would originate from the markets and that the SPD no longer needed their focus on blue-collar worker as the new morality in markets would generate justice for all societal groups in the German economy. Corporations would receive tax cuts, just as the *Mittelstand* did, and top income receivers would get a tax cut as well as those with lower incomes. Low income workers would gain from a greater supply in jobs which normatively justified greater income inequality through the reduced progressivity in the tax system. The new basic program of the SPD argued that increases in income and wealth inequality could "be economically efficient and thereby also socially justified [...] when such tax reforms foster economic growth, create employment and promote societal wealth and generate the greatest advantage possible for the least benefitting."<sup>1</sup> Through this concept an entirely new coalition of the center-right and center-left developed in the German Bundestag which did not agree on strong social justice concepts as CPE often assumes, but in strong market justice. Keynesian economists also followed this increasingly consensual dominant discourse in the Bundestag. Even though George W. Bush was not able to build a coalition with the Democratic opposition, he was able reunite two contentious wings within the GOP with his program of universal morality in markets. Vast parts of the Republican Party had been critical of Reagan's tax program, considering it economic and not conservative enough on the cultural dimension. Moral embeddedness lacked in the program. This changed with George W. Bush's concept of compassionate conservatism which aligned culturally conservative topics and compassion for the poor and weak in American society with concepts of market justice. His project argued that the tax cuts universally benefitted all groups in American society, which is what many Republicans liked, and that the tax cuts at the bottom rewarded and helped the poor to get access to the labor market. The poor were no longer condemned as it was the case under Reagan, but praised as hard-working Americans. Bush's program of helping all Americans was also close enough to the ideals of the

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<sup>1</sup> Basic Value Commission of the Executive Board of the SPD. "Third Ways – New Centre - Social Democratic Markers for Reform Policy in Times of Globalization." September 1999. Berlin, p. 28.

Democrats – at that time - that it was criticized by a much less offensive concept of social justice. Since the discrediting of the normative concept of social justice and ability to pay in the tax system, the Democrats only defensively demanded that the tax cut should be smaller and more responsible in terms of maintaining the revenues and social security expenditure. Though holding a majority in the Senate, the Democrats agreed on a bipartisan tax cut with the Republicans when the GOP made minor concessions in the size of the cut. The overall tax plan significantly cut taxes for the rich and capital income and shifted the tax burden on the lower incomes.

## 9 Appendix

### 9.1 Tax Burden Data

Recent debates of income tax data have shown that only Income Tax Return data sufficiently represent top incomes (Bach, Corneo, and Steiner 2009; Bach, Corneo, and Steiner 2014; Dell 2007; Dell 2005; Piketty and Saez 2006). That is why I chose databases for my measures over survey data. Income Tax Return data is not freely accessible in micro-data form for the German case which is why I rely on data that was already aggregated in income groups by statistical offices. I want to thank Giacomo Corneo for making available his data collection for his (2005) paper. One caveat of this approach is that the German and the American income group definitions in Figures 2) and 3) are not exactly equivalent. The American tax data base of the Congressional Budget Office (CBO) is based in quantile measures and matched survey data at the bottom to enhance the capturing of poor incomes. Accordingly, in the American case the tax groups are defined as the lowest quintile, i.e. 0 to 20 percentiles and the middle class was defined as the middle quintile, i.e. 40 to 60 percentiles. In the German case the middle incomes were defined as mean incomes and the lower incomes as half the mean incomes. The different income group definitions would pose a comparability problem if we wanted to measure a single inequality coefficient such as a progressivity but since we compare the absolute amounts of income of the different groups the different definitions do not restrict the comparability. As soon as we know the exact amounts of incomes for tax burdens we can easily compare these across countries knowing that we look at slightly different income groups.

In my data the rich were defined as the top 0.01 percent of all incomes in the total distribution of income. In absolute incomes, this group earned much higher incomes in the US especially at the end of the observed time period due to excessive income increases at the top. In 2003, the German top 0.01 percent of incomes earned on average roughly Euro 3 million (Bach, Corneo, and Steiner 2009, 217), whereas American equivalent incomes earned around \$18 million (Piketty and Saez 2007, 6). The upper class was defined as the top 10 percent of incomes in the German case which is a group comprised of individuals with average incomes of Euro 128,000 in 2003. For the American upper class the top 5 percent income group was chosen which had average incomes of \$177,100 (Congressional Budget Office 2014). The German middle class was defined as incomes of Euro 25,600 whereas the American middle income group earned on average \$66,100 in 2004. The German group of the poor earned Euro 12,800,

whereas for the American earned on average \$21,800 (Congressional Budget Office 2013, 2; Corneo 2005, 161).

## 9.2 Examples of Coding Categories (German/US)

### 1) Social Justice

- Compensation for the poor: “For these reasons, we demand that the government presents a tax plan, in which net tax cuts are bearable for the budget [...]. The distribution must respect social justice. The medium and lower incomes need higher tax cuts compared to the higher incomes.”
- Compensation for families: “You are making the unfair child tax allowances even more unfair. Our demands for a uniform and comprehensive increase in child tax transfers are ignored.”
- Justice capital and labor: “Parts of the tax plan [...] cut the employee deductible and the Christmas deductible [...]. They allow tax avoiding individuals in the future to trespass the revenue service without risk.”

### 2) Market Justice

- Individual motivation, creativity, productivity: “That we lower the progressivity between the lowest tax rate and the top rate, that we eliminate the not unjustifiable disproportionate taxation of medium incomes, that is good, social and rewards effort.”
- Subsidiarity/self-sufficiency: “Now, so there will be no misunderstanding, it's not my intention to do away with government. It is rather to make it work--work with us, not over us; to stand by our side, not ride on our back. Government can and must provide opportunity, not smother it; foster productivity, not stifle it.”
- Mittelstand employs/Small firm access to markets: “Two thirds of the corporations in Germany earn less than DM 48,000 [...] Thus they earn income below the tax free threshold and cannot gain from the trade tax deduction. But these firms are an important force in the economy and they considerably contribute to employment.”

### 3) Equal treatment

- Universalism: “We are reducing your Federal taxes. We will keep them down. There will be no hidden tax increases. Every American taxpayer will be better off under the President's proposal.”
- Horizontal tax equity: “You ought to treat people who are alike pretty much alike. And it ought to be progressive so that those with the most pay the most.”

### 4) Economic Imperatives

- Supply-side theory: “the majority of their profits and earnings for investments, the accumulation of capital stock, and to prepare for the future.”

- Stimulate demand: “With our tax reform, we are contributing to a considerable strengthening of domestic demand.”
- Industrial policy: “The investments of cities and communes have fallen to the level of the early 1960s. [...] With this, it is urgent for our future that modernization of infrastructure is achieved. That is the result of your policies.”
- Budget restrictions/Revenues and spending: “I had occasion to say when we were discussion the budget that it was a “drop dead America” budget. This tax bill drives the nail into the coffin of America because when we have the kind of rate of increase on defense expenditures, [...] and instead of increasing taxes to take care of that kind of expenditure, we cut taxes, we are asking for chaos in the American economy.”

### 9.3 Process in Congressimary Sources Analyzed

#### 1) US

- Parliamentary debates in Congress and Senate from Congressional Records: url: <https://www.congress.gov/congressional-record>.
- Speeches by American Presidents: American Presidency Project. url: <http://www.presidency.ucsb.edu/>.
- Documents, written statements of interest groups to the Ronald Reagan Administration: Ronald Reagan Presidential Library, highlighted in the text by abbreviation RRPL.
- Documents, written statements of interest groups to from the George W. Bush Administration: George W. Bush Presidential Library, highlighted in the text by abbreviation GBPL.

#### 2) Germany

- Parliamentary debates in the German Bundestag and Bundesrat from Dokumentations- und Informationssystem für Parlamentarische Vorgänge, highlighted in the text by abbreviation DIP: url: <http://dip21.bundestag.de/dip21.web/br>.
- Basic Programs of the SPD: url: <https://www.spd.de/partei/organisation/das-grundsatzprogramm/>.
- Basic Programs of the Green Party: url: <https://www.boell.de/de/2013/12/04/online-kataloge>.
- Hearings and written statements from interest groups from the Parlamentsarchiv, highlighted in the text by abbreviation PA.

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## 11 Eidesstattliche Erklärung

### Erklärung an Eides statt über die Eigenständigkeit der erbrachten wissenschaftlichen Leistung<sup>1</sup>

Ich erkläre hiermit an Eides statt, dass ich die vorliegende Arbeit ohne unzulässige Hilfe Dritter und ohne Benutzung anderer als der angegebenen Hilfsmittel angefertigt habe. Die aus anderen Quellen direkt oder indirekt übernommenen Daten und Konzepte sind unter Angabe der Quelle gekennzeichnet.

Bei der Auswahl und Auswertung folgenden Materials haben mir die nachstehend aufgeführten Personen oder Organisationen in der jeweils beschriebenen Weise entgeltlich/unentgeltlich geholfen.

1. .../.....

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2. .../.....

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3. .../.....

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Weitere Personen oder Organisationen waren an der inhaltlichen materiellen Erstellung der vorliegenden Arbeit nicht beteiligt. Insbesondere habe ich hierfür nicht die entgeltliche Hilfe von Vermittlungs- bzw. Beratungsdiensten, Promotionsberaterinnen oder Promotionsberatern oder anderen Personen in Anspruch genommen.

Die Arbeit wurde bisher weder im In- noch im Ausland in gleicher oder ähnlicher Form einer anderen Prüfungsbehörde vorgelegt.

..... (Ort, Datum)  
(Unterschrift).

<sup>1</sup> Nach § 9 Absatz 3 Satz 3, § 7 Absatz 4 Satz 2 NHG darf die Universität von den Doktorandinnen und Doktoranden eine Versicherung an Eides statt verlangen und abnehmen, wonach die Promotionsleistung von ihnen selbständig und ohne unzulässige fremde Hilfe erbracht worden ist.

Die Abgabe einer falschen eidesstattlichen Versicherung ist strafbar. Bei vorsätzlicher, also wissentlicher, Abgabe einer falschen Erklärung droht eine Freiheitsstrafe bis zu 3 Jahren oder eine Geldstrafe. Eine fahrlässige Abgabe (obwohl hätte erkannt werden müssen, dass die Erklärung nicht den Tatsachen entspricht) kann eine Freiheitsstrafe bis zu einem Jahr oder eine Geldstrafe nach sich ziehen.

§ 156 StGB: Falsche Versicherung an Eides Statt

Wer vor einer zur Abnahme einer Versicherung an Eides Statt zuständigen Behörde eine solche Versicherung falsch abgibt oder unter Berufung auf eine solche Versicherung falsch aussagt, wird mit Freiheitsstrafe bis zu drei Jahren oder mit Geldstrafe bestraft.

§ 161 StGB: Fahrlässiger Falscheid, fahrlässige falsche Versicherung an Eides Statt:

(1) Wenn eine der in den §§ 154 bis 156 bezeichneten Handlungen aus Fahrlässigkeit begangen worden ist, so tritt Freiheitsstrafe bis zu einem Jahr oder Geldstrafe ein.

(2) Straflosigkeit tritt ein, wenn der Täter die falsche Angabe rechtzeitig berichtigt. Die Vorschriften des § 158 Abs. 2 und 3 gelten entsprechend.