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How Governments Respond to Business Demands for Tax Cuts: A Study of Corporate and Inheritance Tax Reforms in Austria and Sweden

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How responsive are democratic governments to business demands for tax cuts? We research this question in comparative case studies of cuts in corporate taxes and inheritance taxes in Austria and Sweden. We find that governments, regardless of partisan composition, are responsive to business demands, but that fiscal and electoral goals attenuate responsiveness. In both countries, the limited revenues generated by inheritance taxation and greater alignment of business demands with middle-class voter interests resulted in governments heading business demands for an abolition of this tax. Goal conflict were larger for corporate tax cuts. In both countries, governments tried to minimize these goal conflict by adopting compensatory policy measures, specifically measures to broaden the tax base and simultaneous tax cuts for low-income groups. The findings suggest that the policy output of business-friendly tax cuts reflect a balancing of conflicting goals, rather than outright business dominance.

Introduction

Since the 1980s, organized business has invested immense resources to achieve influence and intensified the pressure on governments to adopt deregulatory policy measures, to cut back the welfare state, reduce public spending and, not the least, to ease the tax burden imposed on business (Blyth 2001; Menz 2005; Mizruchi 2013; Kinderman 2016; Svallfors 2016, 512). Intensified political activity by business does not necessarily translate into government policies that cater to business interests; however, and we do, at current, have few studies that document empirically a causal link between business demands for reforms and policies adopted by governments.

We study in this paper the responsiveness of governments to business demands, as a way to understand the effectiveness of organized business in

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shaping policy output. We study two policy fields where business demands for tax cuts are documented empirically, and government responsiveness therefore can be researched: corporate taxes and inheritance taxes. To what degree do governments cut back on these taxes when organized business demands such cuts, and what shapes government responses? Our analysis builds on comparative case studies of Austria and Sweden, two small, open coordinated market economies (CMEs) that are vulnerable to capital mobility and where governments thus are likely to pay attention to business demands. The choice of two policies and two countries results in four cases in total.

We argue, and show empirically that even though governments headed business demands in all of the four cases, the extent to which organized business got what it wanted is modified by the expected fiscal and electoral costs of the planned tax cuts. Responsiveness is higher where business demands are compatible with the fiscal and electoral goals of governments. Government responsiveness was high on inheritance tax, because conflict with fiscal and electoral goals are weak in this field. Governments were also responsive to business demands for cuts to corporate tax, but conflict with fiscal and electoral goals resulted in the adoption of compensatory measures that were intended to reduce revenue losses and a potential voter backlash. Specifically, corporate tax cuts were combined with tax cuts for low-income groups, measures to broaden the corporate tax base by closing exemptions and limiting tax expenditures such as interest deductions.

Our study contributes to the literature on the relationship between business influence and a declining degree of redistribution by taxes (cf. Hacker & Pierson 2010; Gilens 2012; Gilens & Page 2014). Yet our argument differs from other accounts of business influence in policymaking by showing how business influence, while in general high, varies depending on the intensity of goal conflict that governments confront. We consider our findings to be relevant for CMEs of Europe more generally. Yet, we do not expect our model to apply to liberal market economies (LMEs), in particular the United States, where institutions structure business influence in different ways. Neither does it apply to countries in the global South, where the levels of public spending are lower, nor to authoritarian regimes, where the vulnerability to an electoral backlash is weaker. We present our argument in more detail in the next section of the paper, and then go on to explicate our research design and methods, to present the empirical analyses of reform episodes in the two policy fields, and finally to discuss the bearings, larger relevance and limitations of the study in the final section.

How Governments Respond to Business Demands

A still expanding literature on the politics of inequality focusing especially on the United States suggests dominance by organized business and wealthy economic elites to be a central reason for increasing economic disparities (cf. Hacker & Pierson 2010; Gilens 2012; Gilens & Page 2014; Skocpol & Hertel-Hernandez 2016). The relevance of this 'business dominance' thesis for understanding the role and influence of business in CMEs has, however, recently been questioned (Elkjær & Iversen 2020). Electoral politics in CMEs is structured by proportional electoral systems (PR) which strengthen the power of Centre-Left parties and facilitate alliances between the middle and lower income classes (Iversen & Soskice 2006). CMEs also have high degrees of coordination among economic actors, inclusion of labour unions, and more egalitarian social structures. Traditionally, coordination in corporatist institutions has empowered labour unions and challenged the privileged position of business (cf. Lindblom 1977; Cameron 1984; Western 1991; Paster 2017).

Yet, organized business in CMEs has shifted away from political compromise, and lobbied for far-reaching welfare cuts and tax cuts. They have channelled resources into new strategies such as policy think tanks, media campaigns to prime and frame debates about taxes, lobbying efforts and organizational capacities for ideological advocacy (Blyth 2001; Paster 2015; Kinderman 2016; Svallfors 2016). We assume, for two reasons, that governments respond to business demands for tax cuts. *First*, increased capital mobility incentivizes governments to accommodate business interests in order to appeal to international investors (Swank & Steinmo 2002, 645). *Second*, corporatist institutions that constrain the privileges of business have weakened (Christiansen & Rommetvedt 1999; Klitgaard & Nørgaard 2014) to such an extent that '… unions neither (have) the carrots with which to attract governments (…) nor the sticks with which to compel their inclusion' (Culpepper & Regan 2014, 724). The international economic environment as well as the terrain for organized politics have, in other words, turned more favourable for organized business.

While theoretical reasons thus allow us to expect increased responsiveness by governments to business demands, we argue that this responsiveness is qualified by two types of countervailing pressures. These two types of pressures relate to the fiscal and electoral costs of meeting business demands respectively. These costs vary and thus affect responsiveness. The first qualifier of government responsiveness is the fiscal costs of tax cuts. CMEs feature public policies that involve substantial government spending on social policy and education which is one of its comparative advantages (Estevez-Abe et al. 2001). Governments are bound to these long-term spending commitments, and need to generate the revenues required for being able to meet them (cf. Swank & Steinmo 2002). While organized business prefers tax cuts to be financed by cuts in public spending, we expect that governments in CMEs will finance cuts partly through compensatory measures that offset parts of the expected revenue loss, for example, measures to broaden the tax base.

> H1: Government policy to accommodate business demands for tax cuts are designed to minimize the impact of tax cuts on public revenues.

The second qualifier of government responsiveness is voter preferences. Gilens and Page argue in a study of American democracy that organized business has an advantage in shaping public policy, while the influence of average voters is insignificant (2014). We expect CMEs to differ from this as a consequence of electoral politics there being structured by PR. The multiparty systems produced by PR often produce parties dedicated to promote the interests of organized business (Martin & Swank 2012, 36–7). But multiparty systems also tend to produce coalition governments, and parties can only govern through bargaining and compromise. In this environment, PR incentivizes the middle class to ally with low-income groups which strengthen the parties on the political Left, leading to stronger demands for redistribution, and increase political support behind expanded welfare states (Iversen & Soskice 2006).

Preferential treatment of business in tax policy under PR poses electoral risks if especially middle-class voters perceive tax cuts as biased towards business. Electoral risks associated with business-friendly tax cuts depend on whether tax cuts benefit business only or also other groups. If cuts are benefitting only business and neglect the general voters, electoral risks increase. Thus, we expect governments to avoid policy choices that are likely to create tensions between voters and business. As mentioned earlier, pure versions of the business dominance hypothesis are premised on the expectation that governments disregard middle-class preferences when they deviate from the preferences of organized business and economic elites (Gilens & Page 2014). Different from this view, we expect that governments in CMEs adopt policies that reconcile middle-class preferences with the preferences of organized business interests.

> H2: Government policy to accommodate business demands for tax cuts are designed to minimize conflict between business and middle-class interests.

In sum, governments in CMEs *do* respond to policy demands by organized business, but we expect responses to be modified by fiscal and electoral goals. We focus empirically on taxation but believe our argument to be relevant for a broader class of policies with redistributive implications. Distributive, regulatory and redistributive policies are, following Lowi, characterized by specific actor relations, conflict and processes (Lowi 1964, 688–9). Redistributive policies, including taxes, are the ones that most closely resemble the patterns of class conflict, with business holding interests that often deviate from those held by large segments of the electorate. In this policy field, the need for governments to balance business demands against potential fiscal and electoral costs is highest. Distribution and regulation typically pitch different segments of business against each other and are thus driven more by conflict *within* the business community.

Research Design and Methods

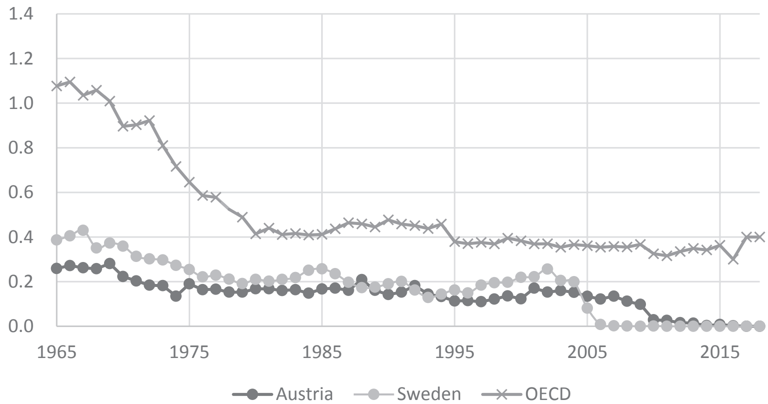
We research the proposed theoretical argument in case studies of tax policymaking in Austria and Sweden. These two CMEs are open to capital mobility and in both countries a strong tradition of corporatist policymaking is weakened significantly (Rothstein 1988; Paster 2014). Advocacy campaigns, media campaigns and lobbying have instead gained importance as mechanisms of business influence (Pühringer & Stelzer-Orthofer 2016; Svallfors 2016). These are developments that increase the pressure on Swedish and Austrian governments to respond to business demands and both countries are likely cases of business influence.

We focus on two types of taxes, namely (i) corporate tax and (ii) inheritance and gift tax. Corporate tax is levied on corporate income (profits) and thus affects post-tax income directly. Inheritance tax is paid by individuals and affects only the owners of corporations. The passing-on of family-owned firms to heirs may be subject to inheritance and gift taxes, depending on how corporate assets are treated in national inheritance tax rules. In some instances, where an heir owns no assets other than the inherited firm, paying the tax may require the heir to sell assets of the firm, thus potentially reducing assets available for investments, or, in extreme cases, necessitating the closure of the firm. Organized business in many countries campaigns for this reason against inheritance taxes with the arguments that they hamper investments, increase the risk of capital flight and destroy small family-owned businesses (Graetz & Shapiro 2005; Emmenegger & Marx 2019).

Our research design, while without variation in the theorized factors between the two countries, establish variation between the two types of taxes. Researching cases from two countries reduce the risk that our results are due to country effects – even if that risk cannot be eliminated completely. The fiscal qualifier is stronger on taxes from which governments retrieve large revenues. For all OECD countries, corporate taxes are more important as a source of revenue than inheritance taxes. For the OECD average, 8.8 percent of total tax revenues come from corporate income taxes; compared to 0.3 percent from inheritance and gift taxes (data for 2018, cf. Figures 1 and 2). Sweden and Austria are in line with this pattern (OECD 2020).

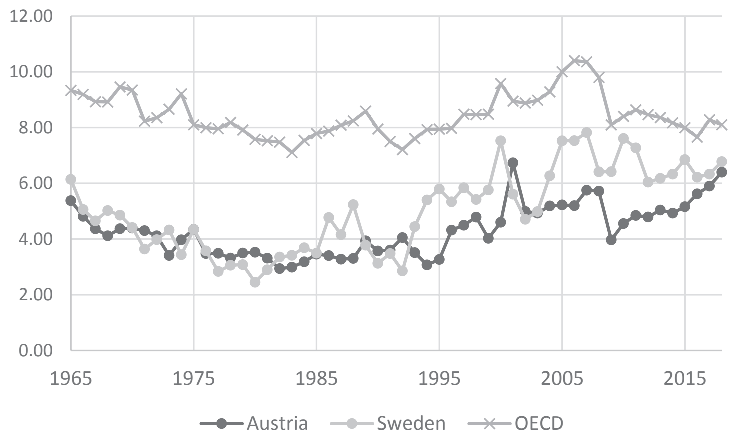
The electoral qualifier is stronger on taxes that are levied on corporate income only compared to taxes that are levied on a larger share of the population, such as inheritance taxes. Corporate tax is paid only by incorporated firms. The self-employed do not pay corporate tax and are taxed instead by personal income tax. Cuts to corporate tax do thus benefit only larger firms. Inheritance tax affects not only persons inheriting firms, but also

Figure 1. Inheritance and Gift Tax Revenues as Percent of Total Taxation, 1965–2018.



Source: OECD 2020.

Figure 2. Revenues from Corporate Income Taxation as Percent of Total Taxation, 1965–2018.



Source: OECD 2020.

middle-class voters who inherit property or financial assets – depending on the design of inheritance tax policy. Most inheritance tax systems include exemptions, and the lower the exemptions, the more the tax affects the middle classes. In the reform year 2004 the exemption rate in Sweden was at 6.700 Euros. In Austria in 2007 the exemption rate was at 2.200 Euros. To compare with, the exemption rate for a married couple in the United States is 11 million USD. Sweden and Austria are thus among the group of countries in which inheritance taxes encompass the middle class and the interests of the middle class for cuts on inheritance tax in theory better aligns with business interests. Notwithstanding the fact that corporate taxes pose a greater burden on firms, the government responsiveness to business demands for cuts is, following the argument we present, weaker on corporate tax than on inheritance tax.

One of the reforms among our cases – the 2013 corporate tax reform in Sweden – was adopted after the financial crisis, and corporate tax cut may theoretically be enacted to stimulate economic growth in a post-crisis era. Policy strategies that were developed in response to the financial crisis were, however, implemented much closer in time to the outbreak of the crisis in 2009–2010. Furthermore, Sweden was not as severely affected by the crisis as other countries (Starke et al. 2014), and the pattern of reform is similar to that in Austria, where the reform occurred before the crisis.

Inheritance tax reform occurred in both countries under Social Democratic-led government coalitions, while corporate tax reforms were enacted by governments of the right. Since we have no instances of Social Democratic-led corporate tax reform and no instances of Conservative-led reform of inheritance taxation, we cannot control systematically for effects of government partisanship which previous research has documented to be strong in tax policy (Klitgaard & Elmelund-Præstekær 2014) 2014. The case selection establishes, however, a set of ramifications that give an edge to party politics as an alternative explanation. Based on our fiscal and electoral qualifiers, we expect a strong response on inheritance taxation (OECD 2010; IMF 2013; Scheve & Stasavage 2016) – a tax that especially a left-wing government should protect against business pressure for cuts. On corporate tax, we expect a more moderate response, even by a right-wing government, while government partisanship would lead us to expect right-wing governments to comply more fully with business demands for cuts. Similarly, to the extent tax reforms are driven forward by international tax competition rather than by domestic business groups, we would again expect a starker, non-modified response on corporate taxes as these are much more important to the flow of offshore capital.

The data we use in the analysis consist of quantitative and qualitative materials. We use quantitative data on rates and revenues from the two different taxes from the OECD and Eurostat. To investigate qualitatively the government response strategies in Sweden and Austria, we consulted primary sources such as the national parliamentary records, legislative proposals, hearing materials and reports produced by the respective national business organizations. We supplemented with materials from media outlets, existing research and literature. In researching the Swedish inheritance tax policy, we had access to interviews with key policymakers that were collected in relation to another project. Requests for interviews with Austrian policymakers were declined, and considering the time span since the reforms were undertaken relying heavily on interview data would in any case be problematic.

How Governments Responded in Sweden and Austria

The result of *inheritance tax reform* in Austria and Sweden is consistent with what we expected. Both countries abolished inheritance and gift taxes, in 2007 and 2004 respectively. As Figure 1 shows, revenues from this tax have in both countries been below the OECD average since at least 1965. In both countries, revenues from inheritance and gift taxes amounted to around 0.2 percent of total taxation prior to the abolition. As in Sweden, revenues in Austria declined to zero after inheritance and gift taxes were abolished in 2007.[1.] The complete repeal of this tax by Social Democratic-led governments is surprising, yet, consistent with our prediction of a strong response where the fiscal implication is low.

Corporate taxes raise significantly more revenues. Corporate tax cuts benefit directly the interests of firms and their owners, and governments risk losing considerably more revenues from a reduction in corporate taxes. Yet, corporate tax is more exposed to tax competition than inheritance tax. Statutory corporate tax rates have been lowered successively in both countries. In Sweden, rates were lowered from 30 to 28 percent in 1993, and reduced further to 26.3 percent in 2009 and 22 percent in 2013 (SOU 2014, 40). Despite these reductions, the revenue-generating capacity of the tax remained strikingly stable throughout the period, and even tended upward. Currently, taxes on corporate income in Sweden generate revenues of around 6.8 percent of total taxation (2018), which is below the OECD average of 8.8 percent. In Austria, the government reduced in 2005 the statutory rate on corporate income (Körperschaftssteuer) from 34 percent to 25 percent. At the same time, some exemptions were reduced or abolished to limit the effect of the rate cut on revenue size. The long-term development of corporate tax revenues in Austria has tended upwards, from an average of about 3.6 percent of total taxation in the late 1960s to 6.4 percent in 2018 (see Figure 2).

A cut in the statutory rate can be revenue neutral for two reasons: First, a simultaneous broadening of the tax base through closing of tax credits and allowances may soften the impact on revenues. Second, a rate cut may attract foreign investments or, alternatively, induce multinational firms to shift profits from higher rate jurisdictions to that country. The European Commission estimates that the effective tax rate on corporate income in the EU went down from 25 percent in 2004 to 21 percent in 2017 (European Commission 2018, Graph 17). At the same time, average revenues from corporate taxation remained stable in the EU and in the OECD, within a range of about 2.5 to 3.5 percent of GDP (see Figure 2 and European Commission 2018, Graph 16). Looking at individual OECD countries, no downward convergence of corporate tax revenues occurred over recent decades (see OECD 2017).

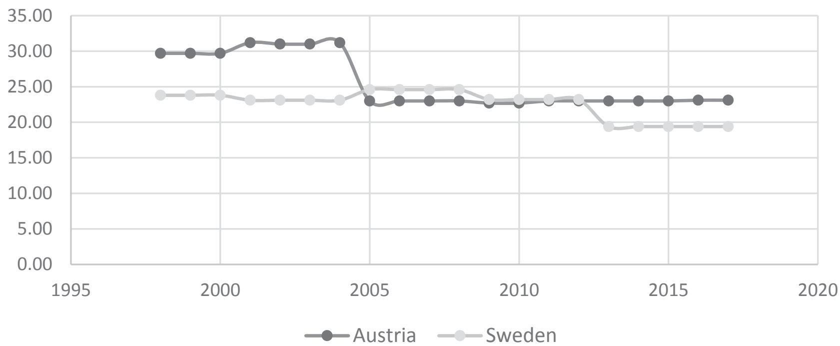
In Sweden and Austria, the rate cuts were associated with some broadening of the tax base, such as closing of allowances and credits. Yet, the net effect was in both countries a substantial reduction of the effective tax rate (see Figure 3). To measure the effective tax rate, we use the Effective Average Tax Rate measure (ZEW 2017). In both countries, the data reflect the effects of these reforms (2004 in Austria, 2013 in Sweden) as Figure 3 shows.

The cumulative effective size of the cuts is at about 5 to 6 percent of corporate income in both countries. The finding of effective cuts combined with a broadened tax base is in line with H1. We now turn to the analysis of policymaking that led to these reforms.

The Politics of Responding to Demands for Inheritance Tax Reform

Swedish inheritance and gift taxes were repealed as part of a reform enacted under the Social Democratic-led government in 2004 (Proposition

Figure 3. Effective Average Tax Rates on Corporate Income.



Source: ZEW 2017, average for all sectors.

2004/5:25). The political dynamic towards repeal commenced in the 1990s and a few years into the new millennium a Social Democratic government presented a repeal proposal in the Swedish parliament (Prop 2004/05:25). Broad support had emerged in the Parliamentary Committee on tax policy affairs, and the proposal was approved by a significant majority on 16 December 2004 (Protokoll 2004/05:52; Sveriges Riksdag 2004b). The pressure for reform came from The Confederation of Swedish Enterprise (CSE). CSE engineered in the 1980s a pro-market movement to challenge political consensus about the Swedish welfare state, taxation policy and the public sector (Blyth 2001; Kinderman 2016). Cuts in wealth and inheritance taxes became a priority in the early 1990s, and in the early 2000s, the CSE decided to launch a final campaign against inheritance taxes (Interview #1).

When the Social Democratic Prime Minister, in 2003, invited labour unions and employer organizations for rounds of 'economic growth talks', the CSE came with a call for the total repeal of inheritance and wealth taxation as a top priority (Ydstedt & Wollstad 2015). At that point, the organization had invested considerable resources to prime the public opinion to support repeal (Interview #1). Several meetings were arranged with business owners to be held at workplaces around the country, and the organization facilitated the writing of hundreds of newspaper articles on the issue in those years (Ydstedt & Wollstad 2015).

The revenue-raising capacity of inheritance and gift taxes, as demonstrated, has historically been low in Sweden. The government, in its proposal for reform, stated that a main reason for repealing the tax was the high administrative expenses relative to the modest public income that the inheritance tax generated (Sveriges Riksdag 2004a). The tax was repealed, as mentioned, in a broad consensus, although a debate emerged in the parliament about why the tax was repealed. While the government emphasized the high administrative costs and low revenues, the Conservative Party emphasized the harmful effects of the tax on business and investments (Sveriges Riksdag 2004a, 29).

This act of signalling business friendliness was also considered from an electoral perspective. Organized business framed the issue as a matter of keeping jobs in Sweden in order to appeal to middle-class interests. Of equal importance was the fact that after a 1992 reform, exemption levels were merely a quarter of the annual income of a blue-collar production worker, and the top marginal tax rate took effect at a level just over the double annual income of that worker. The tax had become disadvantageous to the middle class. The government referred to the way in which the tax had become a burden on the average citizen, for whom inheritance taxes constantly increased as a function of increasing prices on houses and properties. Complicated exemptions and possibilities to register on special lists on the Swedish stock exchange also allowed large fortunes to avoid high effective tax rates (Sveriges Riksdag 2004a, 21). In other words, the government saw the tax, which generated few revenues, as particularly unfair to the middle class, and found itself in a desirable position of making a business-friendly response with modest financial implications that also aligned well with voter interests. A survey of tax policy attitudes showed 70 percent of Swedes either 'supported' or 'strongly supported' lower inheritance taxes. Only 4 percent supported raising the tax (Hammar et al. 2004, 101). These figures were highlighted by the Conservative Party during the parliamentary debate (Sveriges Riksdag 2004a, 29; Protokoll 2004/05:52, 29).

In *Austria,* opponents of the inheritance tax used a decision by the constitutional court in 2007 to push for a repeal of inheritance tax. The court had objected to the treatment of different asset classes for the purpose of inheritance taxation (Verfassungsgerichtshof 2007). For real estate, the assessed value used for tax purposes was lower than the current market value. A person inheriting real estate thus paid less in inheritance tax than a person inheriting financial assets of equivalent market value. The court set a deadline of June 2008 for a revision of the inheritance tax law. Without a revision, the inheritance tax would automatically expire.[2.]

Organized business recognized the opening of a policy window and stepped up in the months preceding the court decision its campaign against the inheritance tax – clearly expecting a favourable decision by the court. In August 2006, the Minister of Finance in the coalition government of the People's Party (ÖVP) and the Freedom Party (FPÖ) had proposed abolishing the inheritance tax (Geyer 2006). At the same time, the Chamber of Commerce also demanded an abolition. Chamber president Christoph Leitl argued that many heirs were unable to pay the tax, a company would have to close down, destroying jobs (Paulick 2006, 2; Wirtschaftskammer Österreich 2006; Goldberg 2007, 84). Similarly, the vice-president of the Chamber of Business Accountants and CEO of the accounting firm BDO called for abolition of the tax (e.g., Kommenda 2007, 6).

The two governing parties, the Social Democrats (SPÖ) and the People's Party (ÖVP), were divided on the issue. The SPÖ wanted to revise the law to bring it in line with the court decision, the ÖVP wanted to repeal it. The latter had the upper hand since, without a reform, the tax would have expired automatically. The Minister of Finance, Wilhelm Molterer, (ÖVP) had ruled out a reform (Wai 2007, 3). The opposition Freedom Party also demanded an abolition. The Greens, also in opposition, demanded a reform. Together, the Social Democrats and Greens held 89 seats in Austria's parliament, just three short of the required 92-seat majority. On 14 March 2007, Chancellor Alfred Gusenbauer (SPÖ) gave in and announced that the government would not revise the law, thus accepting its end (Der Standard 2007, 1).[3.]

In public debate, the opponents of inheritance tax had the upper hand. They focused on two arguments: First, they argued that inheritance tax is a tax on the middle classes, rather than on the upper class (e.g., Grimm 2007, 1). Second, they pointed out that inheritance tax generates very little revenues. Past reforms had created opportunities for wealthy individuals to avoid inheritance tax. The reform of the foundation law in 1993 had allowed individuals to circumvent inheritance tax by setting up a private foundation. Transferring assets to a private foundation is taxed at a one-time rate of 5 percent (*Stiftungseingangssteuer*). Private foundations only pay off for the very wealthy, since the costs for setting one up are high. Approximately 3400 private foundations existed in Austria in 2008, holding assets of about 80 billion euros, about 60 percent of which come from corporate sources (Schmidl & Schratzenstaller 2011, 404–5). The existence of these foundations offered one more argument for opponents to claim that the rich do not pay inheritance tax anyway (Grimm 2007, 1).

Since the system for assessing property value for tax purposes is the same for all types of taxes, a court-compliant reform would have affected property tax as well, in effect raising the tax burden on land- and homeowners (e.g., Bachner 2007, 32; Salzburger Nachrichten 2007). In short, the issues raised by the court decision were of such complexity that the creation of a consistent tax system would have required a comprehensive overhaul of the entire tax system. Opponents of inheritance tax used this complexity to argue that the effort to reform it would be too high to be justified by revenue gains (e.g., Schellhorn 2007).

Media statements suggest that the Austrian Social Democratic leadership concluded that fighting to keep the inheritance tax would not be opportune, due to the impression that the tax burdens the middle classes and is difficult to reform. The labour unions and the party's rank-and-file protested the decision by the party leadership (Presse 2007, 1) and the Chancellor promised to bring the issue back on the agenda at a later point (Der Standard 2007, 1; Moser 2007, 7), which did however not happen. In short, campaigning by organized business combined with low revenues and middle-class interests persuaded the Social Democratic leadership to give in on this issue and accept abolition.

The Politics of Responding to Demands for Corporate Tax Reform

In 2013, *Sweden* cut its statutory corporate tax rate from 26.3 to 22 percent. The Swedish business confederation, CSE, perceived this policy change as the outcome of a persistent focus from the organization on this and other measures with implications for the Swedish business investment climate (Svenskt Näringsliv 2013, 5). The reform was included in the budget proposal of the right-wing coalition government composed of the Conservative Party, the Liberal Party, Centre Party and Christian Democrats for the fiscal year 2013. The government legitimized its corporate tax reform program by invoking OECD studies showing corporate taxes as among the most harmful to economic growth. The tax break for business was accompanied by compensatory measures that would offset some of the revenues lost. An associated proposal to limit interest deductions was emphasized as the main source of financing the proposed tax cut (Sveriges Riksdag 2012d, 39). The tax reform was, however, underfinanced and expected to generate a short-term deficit of approximately one billion Euros which the government counted on would be covered by dynamic economic effects (Sveriges Riksdag 2012c; Prop. 2012/13:1 Utgiftsområde 24, 38). The official proposal stated that *statutory* corporate tax rates are important when business and companies operating in a global economy decide on investment location. And because the pre-reform tax rate was relatively higher compared to other European countries, this difference alone could legitimate a tax reduction. It was expected that with further European integration, business and investments would relocate to low-tax countries (Sveriges Riksdag 2012d, 3).

Sweden's Social Democratic Party, in opposition, submitted an independent budget proposal that cited lower corporate taxes as a structurally appropriate measure. However, the Social Democrats would not support a reform that relied on dynamic effects. Instead they proposed a cost-neutral reduction to 24 percent (Sveriges Riksdag 2012a, 80; Motion 2012/13: Fi302, 80). The Left Party, in the meantime, actually wanted to raise the statutory rate. While recognizing the importance of internationally competitive statutory corporate tax rates, the Left Party referred to the low *effective* corporate tax rates in Sweden and proposed raising the statutory rate to 28 percent (Sveriges Riksdag 2012b; Motion 2012/13: Fi250). The governing coalition, however, had a parliamentary majority, and the debate ended with the statutory corporate tax rate being lowered to 22 percent.

The very limited effect of the rate cut on revenues is partly due to reduced interest deductions as a compensatory measure. We are unable to calculate the precise contribution of this but the government did adopt this and other measures – base broadening, abolished tax credits and closed loopholes (SOU 2014, 70) to soften the reform's impact on revenues. The corporate tax cut in Sweden was thus enacted in a political exercise, where the government balanced challenges associated with international tax competition, investment behaviour of business and the need to maintain a stable generation of public revenues (Sveriges Riksdag 2012c, 38; Prop. 2012/13: 1 Utgiftsområde 24, 38).

Politically, the Swedish parties of the left pitted the interests of the middle class and unemployed against the interests of business during the process. The Social Democratic party claimed that corporate tax reform was an inefficient means of creating jobs as opposed to further social investments (Sveriges Riksdag 2012a, 80). The Social Democrats rejected an underfinanced corporate tax reform, claiming that it would increase financial insecurity for Swedish households. The Social Democratic Party thus sought to establish a divide between middle-class voters and their preference for generous social service provision, on the one hand, and business interests, on the other. The Left Party criticized the government's proposal as preferential for big business and Swedish shareholders, with old-age pensioners, the sick and unemployed paying the price (Sveriges Riksdag 2012b).

The politics of corporate taxes thus generated a more visible electoral dimension, or potential conflict, compared to what we observed in the case of inheritance tax reform. The opposition parties deliberately pitted the interests of business against middle-class interests for social protection in order to expose the right-wing coalition and turn the middle class against it. Even if the right-wing government was willing to deliver what organized business asked for, it was still confronted by the gap between business preferences and the interests of the voting public. The survey that in 2004 had shown a 70 percent majority of Swedes in favour of inheritance tax relief also showed that only 21 percent supported lower corporate taxes (Hammar et al. 2004, 101). To sum up, even a right-wing government, spearheaded by a Conservative Party closely connected to organized business and with a strong preference for business-friendly policies, found itself forced to balance its decision on corporate tax cuts against the implications of such cuts in terms of not only loss of revenues but electoral repercussions as well.

In *Austria*, the major reduction of the statutory rate of corporate taxation from 34 to 25 percent in 2005 was decided by a right-wing coalition government, consisting of the Freedom Party and the center-right People's Party. In January 2004, Finance Minister Karl-Heinz Grasser, from the Freedom Party, announced the plan to cut the tax rate, combined with the elimination of some deductions. Hidden reserves and equity yield rate would now not be deductible anymore. The reform thus broadened the tax base, while at the same time lowering the tax rate (Friedinger 2004, 2). Financial analysts from Bank Austria estimated that the reform would increase after-tax profits of publicly listed firms by about 2 to 5 percent (Himmelbauer 2004, 3). Since a reduction of the statutory tax rate from 34 to 25 percent without changes in the tax base would translate into an increase in post-tax profits of about 15 percent, we may infer that the base broadening compensated for an average of at least two thirds of the rate reduction.

The government presented the reform as a signal to international investors required in response to the eastward enlargement of the European Union in 2004, since many of the new member countries in Central and Eastern Europe had cut their corporate tax rates to levels below 20 percent. In neighbouring Hungary and Slovakia, for instance, the statutory rates were 16 percent and 19 percent respectively. The reduction of the corporate tax rate was preceded by a controversial debate with a number of industrialists that spoke out strongly in favour of a cut. Friedrich Roedler from the accounting firm PriceWaterhouseCoopers said in a newspaper interview that 'tax havens [are] at our doorstep: a tax cut is the right step'. Other executives did also advocate for a cut (Friedinger & Polster 2003, 2). The president of the Chamber of Commerce, Christoph Leitl, praised the rate cut scheme as a 'psychological nudge for more economic growth' (Marschall et al. 2004, 2–3; Matznetter 2004).

As shown above, the reform had only a small effect on revenues and can be interpreted as a measure intended to send a signal to foreign investors of Austria's attractiveness in the wake of the European Union's eastward enlargement. Business protagonists of the reform explicitly acknowledged that the reform would be unlikely to reduce tax revenues. Following the adoption of the cut, Chamber of Commerce president Christoph Leitl stated in 2006 that 'while the Germans are debating tax reforms, we acted. The fact that the revenues from corporate tax are bubbling, despite the rate cut, shows that this was a good deal for the Ministry of Finance and for the public' (Wirtschaftskammer Österreich 2006). Similarly, the CEO of the accounting firm Deloitte, Bernhard Gröhs, told the newspaper *Wirtschaftsblatt* that 'the tax cut was extremely important. The broadening of the tax base has no importance in international competition' (Marschall et al. 2004, 2–3). Since the reform, business continued to campaign for further cuts in the statutory rate (Industriellenvereinigung 2016a; 2016b; 2017).

Speaking during the parliamentary debate on the reform, on 6 May 2004, the deputies of Austria's governing parties, the ÖVP and the FPÖ, justified the corporate tax cut on the grounds that it would be an important signal to international investors and argued, moreover, that the reform was socially fair because of parallel tax cuts for low-wage earners, adopted with the same law. Alfred Finz (ÖVP), undersecretary in the Ministry of Finance, argued that the reform was socially just, since the jobs created by the tax cut would benefit everyone (Parlament der Republik Österreich 2004b; 2004c).

The opposition parties, the SPÖ and the Greens, opposed the cut. SPÖ tax spokesman Christoph Matznetter argued that the cut benefitted mainly large corporations, and that Austria would become a 'tax paradise for multinationals' (Parlament der Republik Österreich 2004a; 2004d). According to an estimate he cited about 70 percent of the tax cuts would go to 839 large firms (Matznetter 2004). From the Greens, tax spokesperson Karl Öllinger doubted that the cut would create new jobs (Parlament der Republik Österreich 2004c). In short, like in Sweden, the SPÖ and the Greens in Austria constructed a divide between middle-class interests and business interests on this issue. This contrasts with inheritance tax, where in public debate middle-class interests were constructed as being in line with business.

Like in Sweden, the Austrian government designed corporate tax reform to attract investors but combined the cuts with compensatory measures to make it revenue neutral. Compared to inheritance tax, goal conflict were more intense, though, because no electoral alliance with middle-class interests could be constructed. Overall, government responsiveness to business demands was significant also on corporate taxation but modified by fiscal and electoral considerations.

Discussion

We have shown in this paper that government responsiveness to business demands for tax cuts is moderated by fiscal needs (H1) and electoral concerns (H2). Overall, our findings show a high degree of government responsiveness to business demands, independent of partisan composition. In none of the cases did governments ignore business demands and complied with demands to abolish inheritance taxation, and lowered the effective tax rate on corporate income, albeit with compensatory measures to reduce the impact on tax revenues and to reduce the risk of an electoral backlash.

Consistent with H1, important differences exist between the two policy fields. In the case of inheritance tax compliance was outright, no compensatory measures were adopted. Both countries abolished the tax, with one consideration for this decision being that the expected revenue losses were small. In the corporate tax cuts, governments expected much larger revenue losses. In response, they combined cuts with measures to broaden the tax base, like closing loopholes and exemptions. In effect, none of the four reforms led to a substantial erosion of tax revenues, despite governments advertising them as lowering the tax burden to businesses.

In line with H2, public support for abolishing inheritance tax was strong in both countries as the tax affected also middle-class voters who have property or financial assets to bequest or to inherit. Business demand for a repeal of inheritance tax did thus not conflict with the interests of broader voter groups. In contrast, an alliance with middle-class interests was difficult to engineer on corporate tax cuts, as surveys showed little middle-class support for corporate tax cuts. Cuts to personal income taxes, adopted at the same time, made the cuts appear socially balanced.

Observed variation across the two policy fields provides evidence for the moderating effect of fiscal and electoral concerns on the strength of business influence in government policymaking. If the tax cuts we studied would have come about as the direct, unmediated effects of business power, we should have observed larger cuts on corporate tax, since this tax generates much larger revenues than inheritance tax, and firms would gain more by cuts on corporate tax than on inheritance tax. We observe the opposite.

Our theory is also supported by the fact that inheritance tax repeal was implemented under Social Democratic incumbency in both countries, whereas corporate tax reforms were enacted by right-wing governments.

This suggests that the need for goal reconciliation shapes government reforms independent of partisan orientation. Yet, our research would need to include more countries and cases to test the scope of validity of our argument, and disentangle the independent effects of the two factors, we theorized to moderate government responsiveness. Conceivably, one of the two factors may be spurious. Bringing in non-reform cases, or cases with policy designs different from the ones we have studied, is an avenue for further research. In another small CME Denmark, for example, the Liberal-Conservative government decided in 2016 to lower inheritance taxes only for family-owned companies – ordinary voters did not benefit from these cuts. In the run up to the 2019 general election, parties on the Left campaigned against the cuts as examples of unfair tax cuts for the rich. After the election the new Social Democratic government agreed with its parliamentary allies to roll back the reforms (Socialdemokratiet, Radikale Venstre, SF og Enhedslisten 2019, 13). The Danish case thus indicate that political conflict can break out over business-related tax policy issues independent of the financial implications of them, which also in Denmark were low.

Case studies are sensitive to contextual conditions. The policy process leading to inheritance tax repeal in Austria, in particular, was affected by a constitutional court ruling creating a window of opportunity for organized business. It is well-documented that strategic behaviour of organized interests is shaped by the institutional environment (cf. Immergut 1992). However, this does not reduce our findings to artefacts of case selection or peculiar contexts, since we observe similar patterns across the two countries and four policy programs that also fit into a larger, more general pattern. Data for the OECD averages (Figures 1 and 2) show that corporate tax revenues as percent of GDP are generally much higher than revenues from inheritance taxes across the OECD world. At the same time, revenues from inheritance taxes have declined on the OECD average, while revenues from corporate taxes have not. Average statutory corporate tax rates in the OECD countries have generally declined, but revenues have nevertheless remained about stable since at least the mid-1960s. These trends indicate that governments in many OECD countries may have targeted inheritance tax for cuts. Public revenues from inheritance taxes are generally negligible, and other countries besides Sweden and Austria have repealed their inheritance taxes or are considering such a move (Graetz & Shapiro 2005; Scheve & Stasavage 2016). At the same time, many countries have counter-balanced rate cuts in corporate taxes with base broadening measures, like the closing of exemptions. In short, our findings are consistent with a general trend in targeting effective cuts on the much smaller inheritance tax, not the larger corporate tax.

There are limits to what we can infer from this study. Even though also larger countries in a globalized economy are pressured to respond to business demands, and certainly do so, our argument is probably better equipped to explain the logic of small states – as the two CME's we have studied – in world markets (Katzenstein 1985). This category of countries is under more severe pressure from external economic forces, as well as from domestic factors such as expanded social security and educational arrangements that requires stability in terms of tax revenues. It is also unclear whether our argument is applicable to countries with weaker economies or weaker government finances, such as in Southern Europe, where the reconciliation of goal conflict is more challenging. Dealing with these two limitations would require further research by including additional countries and additional policy fields to enhance variation. Still, we feel confident to conclude that for the category of countries we have studied, (small) European CMEs, business influence does not equate business dominance and a neglect of the political interests of the middle class.

Interviews

Interview #1: Former employee – Confederation of Swedish Enterprise
Interview #2: Head of section – Confederation of Swedish Enterprise
Interview #3: Former member of Swedish parliament

NOTES

1. Austria continued to collect a very small amount of revenues from inheritance and gift tax even after abolition. This is due in part to pending court cases on the assessment of value, and in part to a small real estate transfer tax that was raised also on property inherited or transferred free of charge until 2015 and which is not reported separately in the OECD data (variable 4300).
2. It is important to note that the court did not declare the inheritance tax unconstitutional, but only a specific feature of the tax, which the court decided to be in need for revision.
3. Gusenbauer had insisted on a revision of the law in a TV interview 3 days earlier. The Federation of Labor Unions (OGB) and the Chamber of Labor (AK), the statutory interest representation of wage earners, protested the government's decision (Moser & Stuiber 2007).

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