SHIFTING THE BURDEN

The Struggle over Growth and Corporate Taxation

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Just as this book was a joint venture with colleagues, it was also a family project. My mother, Mary MacKenzie, enthusiastically doubled as a research assistant and editor. Bob and Patty Martin publicized the forthcoming piece throughout the Midwest. Mary and Jim Kozlowski donated airline passes to do research. Robin and John Hanley provided a weekend retreat during the Chicago years. Jimmy and Julie Martin promised to coerce their friends into buying copies. Polly Taylor marveled at the project. Katy, Michael, Patty, Joey, Jay, and Christina wished that Aunt Coco would work less and play more. Bob and Ruth Milkey, Joanne and Michael Ertel, John Milkey, and Lindley Boegehold enthusiastically welcomed an academic to the family. Kari Moe's adventures in real politics have provided fodder for the intellectual gristmill over many years. Nora Dudwick's studies of political anthropology have opened my mind to new directions. Gary Humes provided bed and breakfast during many trips to Washington. The Brewer family, Janice Mallman, Janice Kettler, Florence Cohen, and Jennifer Phillips reminded me that there was more to my life than political science. Kuniko Shiotani, Marianne and Jørgen Ole Børch, Jens and Lisa Koch, Maryse Igout Pedersen, Ib Høegly, and Elisabeth Møller have sought to broaden my distinctly American world view.

In a class by himself (in many ways) I come to my husband, James R. Milkey. His love has given me the strength and peace of mind to write this book. With all of this help, I have no one but myself to blame for its shortcomings.

Introduction: Corporate Taxation in Pursuit of Growth

Her eyes were open, but she still beheld,
Now wide awake, the vision of her sleep:
There was a painful change, that nigh expell'd
The blisses of her dream so pure and deep.
John Keats, "The Eve of St. Agnes"

Paradigm shifts are intriguing: those Saint Agnes Eve moments when Porphyro suddenly appears to one in the flesh, stripped of dream-state interpretations and disappointing in comparison. The "What did I ever see in this guy?" syndrome boggles the mind. How can one enthusiastically embrace a choice, belief, or style, only to equally resolutely abandon one's preference or understanding later? If transitions in the personal realm are baffling, shifts in national policy are even more so. The mass exodus of elite and public opinion from one worldview to another both challenges one's sense of the rational and disrupts policy and politics as usual.

U.S. corporate income taxation is a compelling example of policy-making at its least consistent. Since the Second World War the progressive and universal tax structure has been eroded by selective incentives to achieve economic goals, contributing over time to a much smaller corporate share of the total tax burden. Yet this trend toward long-term decline has been marked by many reversals. Swings between the opposite poles of taxation sometimes wax violent: the largest corporate tax decrease in U.S. history was legislated in 1981. Immediately thereafter, in 1982, many of the 1981 provisions were rescinded with the enactment of the largest peacetime tax increase ever. The Tax Reform Act of 1986 increased corporate taxes even more.

In fact, corporate tax policy has experienced three paradigm shifts in the past quarter-century. A "commercial Keynesian" growth strategy organized economic policy in the 1960s, encouraging capital-intensive mass production with correspondingly high levels of consumption: in modern language, there was a dual focus on supply and demand. A progressive individual income tax was instituted to stimulate demand by shifting the burden off lower-income individuals, the ones most likely to consume marginal income. The supply side was addressed with selective growth incentives, largely in the corporate tax code, to encourage savings and investment. Figure 1 pokes fun at the Keynesian enthusiasm for spending one's way to economic growth.
Twenty years later, the notion that consumption would enhance growth was definitely passé, as shown in figure 2. Keynesian stability had been disrupted by economic crisis in the 1970s: productivity growth rates dropped, and inflation and unemployment persisted simultaneously. At this point the policy-making community began to promulgate a new approach to growth. Critics of Keynes attributed the sharp drop in productivity to lagging investment and insufficient available capital. The new economic philosophy argued that growth could be achieved through an increased emphasis on savings and investment, particularly in steel mills and other capital-intensive sectors of the economy. The new approach, what I call the “hyper-accumulation” strategy, differed from the older one in that it upset the balance between consumption and accumulation which Keynesians had hoped to achieve. The hyper-accumulation strategy peaked in 1981 with the Economic Recovery Tax Act, which created new incentives or expanded old ones to stimulate accumulation.

But expansion of investment incentives in 1978 and 1981 failed to engineer the promised supply-side recovery, and concerns about economic viability continued. America’s declining position in the world market suggested a new worry: that many industrial sectors had lost their competitive edge. This made the preferential treatment of capital-intensive sectors seem less fair. At the same time rapid growth in the small business, service, and high-technology sectors of the economy further weakened the bias toward capital-intensive manufacturing.
By 1986 special incentives for savings and investment came to be frowned upon in much the same way that consumption-oriented progressive taxation had been renounced in the earlier period. Figure 3 depicts a member of the business community presenting Ways and Means Committee chair Dan Rostenkowski with a sledgehammer to help him pound tax reform through the House of Representatives. The 1986 Tax Reform Act eliminated most selective growth incentives in an effort to make the tax code neutral toward investment and drew inspiration from an entirely different set of economic beliefs.

This book investigates how sea-changes in U.S. corporate tax policy have occurred. I argue that these shifts have been brought about through the efforts of investment subsystems, coalitions of state and society actors organized around strategies for economic growth. The investment subsystem construct has two key features. First, tax policy is developed according to a general growth strategy. Different strategies of growth are possible; periodically a given approach will capture the public agenda and organize economic policy. Radical shifts which alter the tax distribution reflect changing conceptions about the best way for growth to occur. Thus, ideas and beliefs are part of the motivational structure for policy. By strategy I do not mean a consistent goal or ideology, unambiguously adhered to by its proponents. Rather, the growth strategy acts as a sort of rallying cry which unifies individuals for a variety of ideological and self-interested reasons.

The second feature of the investment subsystem has to do with the mechanisms by which a given growth strategy becomes hegemonic. State actors, pursuing their policy programs, mobilize potential allies in the business community to coalesce around these successive growth strategies. The logic of this coalition strategy rests on several observations.

First, both the state and society in America are extremely fragmented. Deep splits in the business community have prevented a clear class mandate from developing in the tax area. Three groups of sectors (finance and housing, capital-intensive manufacturing, and small business and service) hold vastly different tax preferences as well as distinct visions of how growth should occur. Each new direction in corporate taxation creates a new set of winners and losers. Fragmentation in the private sector is matched by fragmentation in government. An exaggerated separation of powers, federalism, overlapping jurisdictions, and the lack of clear authority hierarchies all contribute to a fragmented system with many competing points of power.

Second, this fragmentation has greatly constrained the presidential power necessary to modern economic policy-making. The Keynesian growth strategy demanded considerable governmental economic activism. Since the earliest years of the republic, such intervention was found only briefly during the New Deal. Responsibility for this new management of the macroeconomy was vested in the presidency. The Democratic presidents of the 1960s, Kennedy and Johnson, tied their political fortunes to the new activist agenda. Yet presidents received increased responsibility without the power to accomplish the task. Their legislative partners consistently thwarted their ambitious programs. Key congressional committee chairmen, largely southern Democrats, were hostile to the interventionist state and resisted many presidential fiscal initiatives.

Presidents Kennedy and Johnson responded to their dilemma of responsibility without power with a political innovation: state-led public-private coalitions. These growth-oriented presidents and their political entrepreneurs began to cultivate business allies to mobilize support for their economic agenda and to fight their opponents in other branches and parties. Although businessmen have always pressured political figures and presidents have always consulted key leaders of industry, the coalition strategy represented an innovation. The mobilization of business was much more systematic: trade associations representing entire industrial sectors were organized by presidential staff. White House advisers urged business groups to cultivate a political expertise hitherto underdeveloped in these organizations.

The coalition strategy has implications for the relative autonomy of the state. State actors are often portrayed in one of two ways: as autonomous, because they are insulated from private interests, or as captured by these interests. The view presented here differs: state entrepreneurs are seen as increasing their power vis-à-vis political enemies by cultivating and mobilizing private sector allies. Thus, the insulation-capture dichotomy misses the complex, symbiotic relationship often found between factions in state and society. How do investment subsystems change over time? Economic transformation creates new technical problems to which the state must respond, problems which cannot be accounted for or resolved by the existing paradigm of growth. Alternative growth strategies are introduced into the unstable system as possible new organizing principles. A new strategy is appealing to different groups for different reasons. Economic change disrupts our theoretical under-
standing of reality. Professional economists are attracted to a new theory if it clarifies those issues which confound the explanatory power of the old. To politicians the threatening economic problems motivate a search for new ideas salable to the public as solutions. Politicians might lack a sophisticated grasp of the idea; but latching onto it, they make it a crying cry.

Economic transformation assaults interests as well as ideas when it makes the existing set of political institutions and regulations inadequate to the task of promoting economic growth. Business leaders, especially in emerging sectors, may find that governmental policies hinder production or expansion. The changing climate of growth requires a different government infrastructure. Economic transformation alters the distribution of resources within the business community, upsetting the economic balance of power. The perceived political power of declining sectors may also suffer. Business groups which have benefited least from the prior system are the first to endorse an alternative growth strategy.

My explanation for the changes in corporate taxation both shares much with and differs from other models of policy-making. One set of authors have identified paradigm shifts as the cause for tax transitions. Stein argues that fiscal revolutions occur when professional economists radically revise their beliefs about economic functioning. Weatherford agrees that ideology greatly shapes the course of economic policy. My concept of changing growth strategies rests on paradigm shifts. Yet I do not believe that the power of a new idea alone is enough to engineer a transformation. Indeed, when neoclassical thinking regained center stage in corporate taxation in the late 1970s, a new idea did not triumph. Rather, a very old idea again became popular. This resurgence clearly had to do with the preceding paradigm's failure to explain current crisis conditions. But also important was the political attractiveness of the alternative worldview. My approach, then, searches out the political conditions necessary to incubate an alternative paradigm. This enables me to better explain why a set of ideas, such as tax reform, that circulated the Washington community for years suddenly gained in popularity.

A second set of authors have explained tax policy with capitalist state theory. The state is dependent on the economy for revenue; therefore, it is structurally constrained to take action which is in the best interests of the capitalist system and class. Fostering accumulation is at the heart of this task. At the same time the state is relatively autonomous, allowing it to act as a general manager of economic contradictions and the capitalist class. When the state intervenes to manage economic crisis tendencies, it risks becoming the location for capitalist contradictions. Therefore, the state must also work to maintain the legitimacy of the system. O'Connor blames the "fiscal crisis of the state" on the dual needs of accumulation and legitimation. King has analyzed John F. Kennedy's tax policy as a function of state efforts to stimulate both accumulation and consumption.
where one might expect the greatest degree of “capture,” indicates that the state must intervene in other areas as well. Finally, since accumulation is at the heart of government, decisions made in the tax realm can create structural constraints for other policy problems.

I have avoided normative judgments about alternative investment strategies. This is not a book about what kind of tax system we should have, but rather about what processes shape the tax system we do have. Yet a practical motivation for this effort is to explore the political openings for effective economic restructuring. With the economic stagnation of the 1970s and the decline of America’s competitive position in the world economy, economic renewal has recently been at the center of public attention. Various prescriptions, from targeted industrial policy to the restoration of free-market capitalism, have been suggested as means of restoring competitiveness and rejuvenating the American economy. In light of this current preoccupation, it makes sense to evaluate the institutional context of government attempts to promote economic growth. Unlike some other advanced industrial economies (e.g., Japan and France), the United States federal government has never had a direct industrial policy to promote growth. Rather, the tax code has been used indirectly to further the economic agenda. Therefore, this book seeks to contribute to future policy efforts by exploring what has motivated past policy experiments.

The following pages tell a story of a series of case studies of corporate tax acts legislated since the early 1960s: the Revenue Acts of 1962 and 1964 (to be considered as single cases), the investment tax credit suspension of 1966 and the Tax Surcharge Act of 1968 (to be considered as a single case), the Economic Recovery Tax Act of 1981, the Tax Equity and Fiscal Responsibility Act of 1982, and the Tax Reform Act of 1986. The tax acts in 1964, 1981, and 1986 radically revised the tax code. Those in 1968 and 1982 were less revolutionary, but interesting in that they revised the fiscal revolution preceding them. The major growth incentives—the investment credit and accelerated depreciation—were at the center of all these discussions.

Data for the cases were drawn from the presidential archives, congressional hearings, trade association documents, and interviews with hundreds of private and public sector participants. To understand the underlying growth strategies, I identify the technical considerations of executive branch policymakers and examine how these assumptions changed over time. To explore business pressure, I reconstruct the pattern of business preferences in each tax case and the efforts of trade association representatives to influence the political process. The stories of how presidents use these coalitions to get their policy agendas passed and the resulting impact on policy make up the bulk of the empirical chapters.

Introduction

1

Strategies of Growth and Corporate Taxation

This chapter argues that shifts in corporate tax policy reflect an experimentation with alternative growth strategies. The postwar tax structure was developed in accordance with a “commercial Keynesian” growth strategy: capital-intensive mass production coupled with mass consumption. This growth strategy and its institutional supports served the economy well, producing high growth rates in real income and productivity. Despite questions about the proper balance between investment and consumption and between unemployment and inflation, this approach to growth seemed fairly successful.

The inflationary pressures of the Vietnam War coupled with a productivity crisis in the 1970s signaled an end to the economic bliss of the post–World War II period. OPEC machinations threw the economy into a recession from which it has never quite recovered. The productivity growth rate dropped abruptly, profits plummeted, and economic truisms such as the Phillips curve no longer seemed to hold true. Consequently, Keynesian-inspired economic institutions came under intense scrutiny, attacked as inadequate to guarantee the continuing health of the economy.

Critics promoted a new growth strategy, what I call “hyper-accumulation,” which was firmly grounded in neoclassical economics. They argued that Keynesian policy gave insufficient attention to the investment side of the growth calculus. Inadequate investment in capital goods had constrained the expansion and modernization of industry, thereby precipitating the drop in real income, profits, and productivity growth rates. Prominent business groups, among the major proponents of the laissez-faire vision, demanded tax incentives to restore investment and rejuvenate the economy from the supply side. Tax policy, forged in accordance with these demands, significantly reduced the taxation of capital in the late 1970s and early 1980s.

Yet hyper-accumulation did not achieve enduring predominance. First, the package of investment-oriented tax incentives and other policy innovations failed to solve short-term economic problems. In part negated by a deflationary monetary policy, the supply-side innovations of the 1981 tax act were
unable to increase investment. The recovery was ultimately led by increased consumer and government demand rather than by supply-side stimulants.

Second, evidence of structural change in the economy suggested that the old logic of accumulation was no longer satisfactory. Capital-intensive industrial sectors had enjoyed preferential treatment by the tax code for twenty-five years. Yet, the new international division of labor was eroding their competitive positions in the world economy. In addition, the economy seemed to be growing in new directions: small business firms as well as service, high technology, and knowledge-based industries provided new jobs and investment opportunities. Unable to share in many of the benefits provided by the existing tax code, emerging sectors called for a radical overhaul of the system. If emerging sectors were the source of future economic health, growth as well as equity concerns required that the tax code be made investment-neutral. Taxation in 1982 and 1986 reflected the shifting economic balance and changing investment strategy.

**Trends in Corporate Taxation**

Before exploring the growth strategies guiding corporate taxation, let us look more closely at broad tax trends during the postwar years. First, an immediately apparent phenomenon is that corporate taxation as a proportion of total tax revenues has greatly declined. About 30 percent of total tax revenues in the early 1950s, the corporate tax share dropped to 22 percent by the mid-1960s with the creation of the investment tax credit and accelerated depreciation. This trend accelerated in the 1970s, and by 1983 corporate tax’s percent of total revenues was down to 6 percent.\(^1\) The decline in corporate taxes has been made up for by an increase in payroll taxes (including items such as social security and unemployment insurance). Payroll taxes were only 4 percent of total tax revenue in 1945 but increased to 32.6 percent in 1982.\(^2\) Parallel to the redistribution of corporate taxes and payroll taxes, the top individual marginal rate has fallen over time (see table 1.1).

This shift in the tax burden is a problem if one supports a progressive tax system: a structure in which higher-income individuals pay greater percentages of their income in taxes. The progressive individual income tax and the corporate tax tend to be disproportionately borne by upper-income individuals. But payroll taxes, calculated as a fixed percentage of income and not applicable above a certain income level, extract a larger relative share from lower-income people. The income tax system becomes even more regressive when effective rather than nominal rates are considered. Effective rates calculate in the many deductions and credits selectively available to high-income taxpayers.\(^3\) The addition of state and local taxes, which tend to be very regressive, further erodes progressivity.\(^4\)

A Western European comparison puts the decline of the corporate tax burden in somewhat different light. Total tax revenue as a percentage of gross domestic product is lower in the United States than it is in many other advanced industrialized countries (see table 1.2).\(^5\) But corporate taxation in the United States makes up a larger percentage of the total policy package. Thus, in the United States in 1980 the corporate income tax was 11.1 percent; in Great Britain, 7.6 percent; in West Germany, 6 percent; in France, 4.7 percent; and in Sweden, 3.1 percent. Yet the corporate burden is actually larger in these countries than the figures would indicate: all rely heavily on indirect consumption taxes, part of which are borne by corporations.\(^6\)

A key way in which the U.S. corporate tax system deviates from its counterparts elsewhere is that the erosion of the corporate tax burden has largely taken place with the development of selective tax deductions and credits rather than with across-the-board rate cuts. (A taxpayer subtracts credits from his/her income tax liability, and deductions from the taxable income base.) Although the actual top corporate rate declined only 4 percentage points between 1954 and 1985, the effective tax rates of many sectors decreased dramatically during this period. Steinmo notes many more tax expenditures in the United States than in the other countries in his study.\(^7\)

Most of the corporate deductions and credits were developed as growth incentives to stimulate savings and investment behavior. The largest growth incentives are the investment tax credit and the accelerated depreciation
allowance. With the investment tax credit, a corporation could take a tax credit of 10 percent of the cost of a capital investment. The investment tax credit allowed firms to subtract approximately $90 billion from their tax bills between 1962 and 1981. Between 1954 and 1980, the accelerated depreciation allowance added up to almost $30 billion in tax expenditures. Under the 1981 tax act the depreciation allowance was expected to be worth $30 billion a year.8

This array of tax expenditures has contributed to the second major trend in corporate taxation: the change in the distribution of the revenue burden. Businesses benefit differentially from the selective growth incentives. Feld found the selective incentives to benefit large corporations disproportionately.9 Lugar suggested that tax incentives are disproportionately available to firms with capital-intensive production processes, growing markets, large-scale operations, and high profits. Using 1975 data, he found the “receipt of new tax credits per dollar of net income” to be as low as $0.004 in the food and food-processing industry and as high as $0.071 in the lumber and wood products industry.10

Because a firm’s ability to use these selective tax incentives affects its tax burden, there has been a significant change in the distribution of the corporate income tax. By 1980 capital-intensive manufacturers were paying much lower effective tax rates than labor-intensive manufacturing and service sectors. The Economic Recovery Tax Act of 1981 exacerbated these differences, largely through the accelerated depreciation and safe harbor leasing provisions. Tax Notes calculated the tax burdens of major corporations in different industrial sectors and found the rates shown in table 1.3.11

<table>
<thead>
<tr>
<th>Industry</th>
<th>1980</th>
<th>1981</th>
</tr>
</thead>
<tbody>
<tr>
<td>All sectors</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital-intensive:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mining</td>
<td>14.4</td>
<td>9.4</td>
</tr>
<tr>
<td>Paper and wood products</td>
<td>11.1</td>
<td>4</td>
</tr>
<tr>
<td>Transportation</td>
<td>11.9</td>
<td>-4.8</td>
</tr>
<tr>
<td>Utilities</td>
<td>8.5</td>
<td>11.5</td>
</tr>
<tr>
<td>Aerospace</td>
<td>27.4</td>
<td>13.5</td>
</tr>
<tr>
<td>Chemicals</td>
<td>18.8</td>
<td>13.6</td>
</tr>
<tr>
<td>Labor-intensive:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Publishing and printing</td>
<td>38.2</td>
<td>36.3</td>
</tr>
<tr>
<td>Tobacco</td>
<td>34.2</td>
<td>31.4</td>
</tr>
<tr>
<td>Food retailers</td>
<td>31.5</td>
<td>30.8</td>
</tr>
<tr>
<td>Nonfood retail</td>
<td>27.2</td>
<td>22</td>
</tr>
<tr>
<td>High technology</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electronic and appliance</td>
<td>33.5</td>
<td>29.3</td>
</tr>
<tr>
<td>Office equipment</td>
<td>23.0</td>
<td>26.7</td>
</tr>
<tr>
<td>Financial:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commercial banks</td>
<td>-12.6</td>
<td></td>
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</table>

Tax Equity and Fiscal Responsibility Act (TEFRA) the following year, taxes were scheduled to increase by $205.3 billion during FY1983–87. About one-half of this increase, or $103.4 billion, was in corporate taxation. Among other changes, TEFRA rescinded about one-third of the Accelerated Cost Recovery System (ACRS) benefits which had been legislated the previous year.12 One corporate lobbyist concluded, “The Lord giveth, the Lord taketh away.”13

The most recent attack on this long-term trend was the Tax Reform Act of 1986, which returned corporate taxes to 1970s levels.14 Even more significant than the aggregate figures was the reform effort’s treatment of the growth incentives. Accelerated depreciation was scaled back, the investment tax credit was revoked, and a myriad of other savings and investment incentives were repealed.15

Convention wisdom suggests that the frequent policy reversals represent a tension between goals of equity and growth. Indeed, it would appear that two very different schools of thought influence the course of tax policy: the progressivity school suggests that a tax system is legitimate only if applied equitably. The economic incentive approach holds that tax policy should promote economic growth, thereby maximizing benefits for all by creating a bigger economic pie. Concerns about the allocation of that economic pie should take second place to the efforts to enlarge it.
Specific provisions and concepts of taxation are associated with each approach. The economic incentive or growth school has produced a number of special incentives designed to minimize the tax system's interference with work, savings, investment, and risk taking. The following provisions should be included:

- low marginal rates for the individual income tax, to encourage additional work
- low rates on capital gains, to encourage investment in risky undertakings
- investment tax credit, to encourage investment in capital goods by lowering the cost of this investment
- accelerated depreciation allowances for capital outlays, to generate new funds for corporations and stimulate further investment
- lower corporate rates, to increase the internal funds available to corporations for reinvestment
- savings incentives such as the individual retirement accounts which delay taxing interest on earnings saved for retirement
- depletion allowance, to motivate extractive industries to conduct exploratory drilling
- bad debt deduction, to protect banks against bad loans so they will be willing to finance risky ventures

Provisions associated with the progressivity or equity school tend to emphasize horizontal equity or universality, and vertical equity or progressivity in the tax code. Horizontal equity means that individuals or corporations with equal incomes should pay equal taxes. The tax code should be as universal as possible in its application. Here economic incentives are seen as "loopholes" which distort the equity of the code. Vertical equity or progressivity tailors the tax burden to one's ability to pay. Provisions which reflect the equity school include:

- progressive individual rates
- capital gains taxed as ordinary income
- no special investment incentives
- depreciation allowances based on actual asset lives
- corporate rates commensurate with upper-income individual rates
- no special savings incentives: unearned income should be taxed at least as much if not more than earned income

Tax acts since 1960 have fluctuated between these two approaches. At times acts seem to represent a blend of philosophies. Some of the major reform acts, for example, have reduced tax incentives to achieve horizontal equity. The top rates have been lowered at the same time, in keeping with the economic incentive school (see table 1.4).

One could surmise that the fluctuations in corporate taxation reflect cycles of reform. Yet several problems militate against this simple conclusion. First, such an explanation demands a theory of the conditions (economic and otherwise) under which equity concerns become important. Second, the mantle of reform is routinely claimed by both sides in tax battles; it is a concept which means many things to many people. Third, ideas have a political and economic context which cannot be ignored.

A Growth-oriented Explanation of Corporate Taxation

Tax analysts have explained the general decline in corporate taxes as an effort to stimulate economic growth. The primary function of taxation is to raise revenue. Yet a capitalist-state analysis suggests that this should be done in a way that promotes economic growth (since the state is dependent on the private economy for revenue) and simultaneously achieves equity (to maintain...
the legitimacy of the democratic state.)

King argues that growth replaced equity as the central aim of policymakers when government analysts reformulated taxation in non-zero-sum terms. Determined to augment the total economic pie and maintain U.S. hegemony in the international political economy, policymakers recognized that the public good was tied to the interests of capitalists and taxed accordingly. O’Connor posits a tension between accumulation and legitimation: attempts to address both have produced the fiscal crisis of the state.

This causal reasoning has an intuitive appeal. Many of the selective tax incentives which have eroded aggregate corporate tax levels were advanced in the name of growth. Yet the growth mandate has a deterministic flavor: an enlightened awakening to the logic of capitalist development inevitably sets the agenda for corporate taxation. Nor can the concept of a fixed growth mandate easily accommodate the inconsistencies and reversals in corporate taxation.

A theoretical construct which emphasizes the centrality of growth to public policy but rejects the deterministic aspects of this process is the “regime of accumulation,” developed by the French regulation school. A regime of accumulation describes a general strategy to achieve growth and the institutional arrangements which coordinate production and consumption to this end. The regime of accumulation specifies the conditions regulating the use of labor, wage relations, investment, and the monetary system.

The concept of a regime of accumulation is based on three premises. First, there are a number of ways to combine resources to produce economic growth, as illustrated by the switch from craft to mass production. Second, the forces of production are constantly being developed; an economic system is dynamic rather than static. This means that the constantly changing system cannot automatically replicate itself through the market law of supply and demand. Rather, a set of institutional arrangements are necessary to channel behavior in ways that perpetuate growth and reproduce the system. Third, different strategies for economic growth favor very different sectors of capital, creating winners and losers. Therefore, choice of strategy becomes a point of contention; regimes are developed through political struggle.

A major crisis occurs in a regime of accumulation when the institutions cannot continue to assure the conditions necessary for growth. This may be because the regime of accumulation itself has exhausted its potential or because the existing modes of regulation hold back the emergence of a new regime.

The “regime of accumulation” construct has been criticized in a number of ways. One problem has to do with the establishment of the temporal boundaries of the regime: what has been called the Fordist regime could conceivably be dated from several different points. Disagreements also exist over the extent to which the Fordist institutional arrangements, such as the labor-management accord, really represent a strategy. Indeed, Henry Ford himself never endorsed many of the assumptions about growth associated with the strategy which bears his name. Distinguishing between regimes is difficult. Competing modes of production seem to exist in every period, and mass production itself is not a unitary phenomenon. Conflicting reasons have been given for the decline of the Fordist period. These criticisms should not be dismissed lightly. Fordism is probably a misnomer: many of the institutional supports were not established until the New Deal and continued to evolve for years thereafter. Boundaries between periods are not easily identified. Policies of each period have often been inconsistent and dysfunctional. Regimes of accumulation should, therefore, be considered ideal types rather than empirical absolutes.

Despite these drawbacks, the tax case demonstrates that general strategies of growth do seem to dominate historical periods. Therefore, I use the concept of “growth strategy” to describe an economy loosely organized around a dominant model of growth and the role played by institutions in channeling economic activity.

The Postwar Fordist/Keynesian Growth Strategy

Components of a Fordist/Keynesian growth strategy began to evolve during the New Deal to organize economic development in the United States. A Fordist regime has two primary identifying features: mass production and the large-scale organization of consumption, with considerable coordination between the two spheres. Fordist mass production breaks down the labor process into narrow tasks, and scientifically organizes and coordinates semiskilled workers into assembly lines to perform these tasks. Special purpose (product-specific or dedicated) machines are introduced into the process to augment worker efforts. Thus, the process is more capital-intensive than other forms of production. This production system leads to much higher levels of output.

Proper functioning of the system depends on a large and stable market, and consistent, high rates of capital investment. First, the rigidity of resources in mass production demands a stable market. Capital-intensive manufacturing entails high fixed costs; dedicated equipment and narrowly trained workers cannot be easily reapplied to other types of products. If the market for a product dries up and makes resources obsolete, economic dislocation results. Mass production also greatly expands output, making a large market necessary. Second, mass production processes require high levels of investment because they are capital-intensive. These costs can be partially offset by productivity increases which expand output for each unit of input. But productivity growth requires a high degree of technological innovation, in itself a costly venture.

The reproduction of the Fordist system depends on the dual tasks of maintaining adequate levels of investment and consumption. The system has been reproduced with a set of institutional arrangements including cooperative la-
bor relations, a stable monetary and credit system, the social welfare state, and macroeconomic policy. The last is central to our concern.

Beginning with the Employment Act of 1946, the federal government undertook to oversee the economy and maintain a stable business climate through macroeconomic stabilization policies that involved the income tax structure among other tools. The paradigmatic basis for these policies was predominantly Keynesian, although neoclassical arguments were also woven into the rationale. Deviating from neoclassical economics, Keynesian theory posited that the self-regulating market suffered from crisis tendencies toward inadequate investment and underconsumption. These tendencies could be offset by government interventions to subsidize investment and stimulate demand. Keynesian policy was thereby tailored to reinforce the pillars of the Fordist order: mass production and mass consumption.

Neoclassical economics portrayed an economy characterized by continuously clearing competitive markets, flexible prices, and an efficient decentralized price system. Since flexible prices continually adjusted to match demand and supply, involuntary unemployment and inadequate demand were not problems and government intervention was unnecessary. To neoclassical economists growth in supply was the avenue to economic prosperity. Supply would grow through saving, investment, and technological innovation.31

Keynesian economics deviated sharply from the classical vision of the economy. Inspired by the Great Crash of 1929, Keynes and his followers believed that market regulation alone is insufficient for a healthy economy. Prices are not completely flexible; therefore, the market will not always clear to bring supply and demand into balance. This puts both investment and consumption at risk.

First, capitalist production is plagued by inadequate consumption because output cannot easily be scaled back in response to reduced demand. Output is partially fixed by the production capacity of the machinery, and prices for products are constrained by the wage rigidity of labor. This creates a tendency toward overproduction.34

Second, investment is a problem in the Keynesian universe. An external shock could lower interest rates so much that individuals would no longer be willing to hold securities or private debt, reducing the funds necessary for private investment to achieve full employment. Wage rigidity would keep the price of labor from falling as low as its market equilibrium clearing point, thus creating unemployment. The shock could so shake business confidence that even a very large decline in interest rates would not restore confidence, creating an investment gap and high unemployment. The structural characteristics of capitalism also threaten adequate investment. As production becomes more capital-intensive, the productivity growth rate will decline and the rates of return on investment will fall, thus reducing the profitability of investment just when increased resources are needed to sustain full employment.35

Although common wisdom characterizes Keynesian intervention as demand-oriented, the postwar regime never entirely abandoned concerns about supply. This was reinforced by the fact that the peculiar brand of Keynesianism which developed in the United States was inherently conservative: what Collins called "commercial Keynesianism." Bosworth writes:

Yet it is wrong to believe that economic research or economic policy ignored the issue of supply in the postwar period. The reference of Alfred Marshall to supply and demand acting as "two blades of the scissors" became a cliché; economic growth and the determinants of capital formation were among the more active subjects of economic research; and the postwar history of economic policy in the industrial countries is replete with efforts to encourage faster growth of aggregate supply... the analytical and prescriptive framework remained highly classical in its view of the determinants of growth of potential output, while adopting a Keynesian perspective on demand.37

Tax Policy and the Commercial Keynesian Order

Keynesian economists called for an activist government to address the dual problems of investment and consumption and to generally stabilize the macroeconomy. The federal income tax structure was an important tool to this end. Adequate consumption was achieved primarily by making the personal tax rates nominally progressive. Progressivity stimulated higher demand, transferring a larger proportion of income to lower-income individuals with the greatest marginal propensity to consume. Over time this progressivity was compromised: the marginal top rate on individual income, originally at 91 percent, was lowered to 70 percent in 1964, 50 percent in 1981, and 28 percent in 1986. The top corporate rate dropped to 70 percent in 1964, 46 percent in 1981, and 36 percent in 1986.

The tax code also encouraged demand with a variety of tax subsidies for credit. For example, consumer spending was subsidized with tax deductions for interest on consumer loans. The government encouraged consumer loans with a partial guarantee to banks in the form of the bad debt reserve deduction, which allowed financial institutions to shelter part of their earnings from taxes to protect against bad debts.

The tax system subsidized investment through selective tax incentives which encouraged savings behavior and the rapid replacement of capital plant and equipment. The most important of these incentives were the accelerated depreciation deduction and the investment tax credit. Capital assets (plant and equipment) become obsolete or worn out over time. The tax code recognizes this depreciation as a normal cost of doing business and allows firms to deduct the cost of the asset over its useful life. Accelerated depreciation allows assets to be written off in a shorter period of time, in order to encourage more rapid replacement of capital and the modernization and expansion of production.

Investment incentives were created with the Revenue Code of 1954, the
first year in which accelerated depreciation was formally recognized as a device to inspire economic growth. The 1954 tax act allowed an asset to be depreciated in one-half of its useful life. But the Eisenhower years were judicious in the targeted use of the tax code for economic and social ends. Growth incentives were only widely used after the Democrats came into power in the 1960s. A landmark in the use of selective growth incentives was the 1962 development of the investment tax credit, which allowed 7 percent of the cost of a capital asset to be subtracted from taxes in the year of purchase. As with the accelerated depreciation deduction, the function of the investment tax credit was to encourage the rapid replacement of capital assets.

Finally, the tax code was used for macroeconomic stabilization purposes to counteract the highs and lows of the business cycle. The government injected resources into the economy to stimulate private economic activity during periods of slow growth and to pull resources from the economy during booms. This intervention was said to have a multiplier effect: one unit of government intervention sets off successive waves of entrepreneurial activity in the private economy, increasing GNP by a multiple of the initial intervention. The tax system functions to stabilize the economy both in its discretionary application and in its automatic impact.

Despite the ascendancy of the Keynesian paradigm (or its hybrid, commercial Keynesianism), conflict over tax options continued to exist. This primarily concerned the trade-offs between the goals of equity and growth and tensions within each goal. First were conflicts about equity itself: to what extent were the progressive tax system and the selective growth incentives equitable? Some analysts supported progressive rates as necessary to achieve vertical equity. Progressivity is premised on the declining marginal utility of additional income. As income increases and families can devote more resources to luxury items, each dollar means less. So a truly equitable tax system should place higher tax rates on marginal income. According to an "ability to pay" criterion, one is able to pay proportionately more taxes as income increases. Sacrifice theory seeks to ensure that all should make the same sacrifice. Benefits theory suggests that those who get the most benefits from society should pay accordingly. Measuring the rate of the declining utility of money and the value of satisfaction or sacrifice poses problems for the progressivity argument. Critics charge that progressivity distorts fairness, compromises universality, and interferes with the a priori legitimacy of property rights.

Equity disputes about corporate taxation focus on the double taxation of distributed corporate income (as corporate profit and as stockholder dividends). The creation of selective tax incentives also has raised equity questions. Although the myriad of tax incentives were created to promote social and economic goals, the cumulative effect was to distort the horizontal equity of the code and threaten the legitimacy of the tax system. The issue was complicated by a dispute about who actually pays corporate taxes. Undoubt-edly some of the corporate tax burden is shifted backward onto labor and forward to the consumer, yet the amount shifted is widely disputed.

A second troubling issue during Lord Keynes's American rule was the right mix between accumulation and consumption, although policymakers believed this to be a matter of fine tuning. A final set of conflicts were technical matters concerning the right mixture of policies to achieve growth. A healthy economy is characterized by both a stable noninflated currency and steady growth. Stagnation or the absence of growth increases unemployment, constrains business profits, and prevents increases in the standard of living. Inflation erodes the income of persons on fixed income, makes it harder for businesses to replace outdated equipment, and devalues assets held in money.

These requisites for growth are not always compatible. Keynesian economists determined that there is a reciprocal relationship between the problems of unemployment and inflation. The Phillips curve was a theoretical construct developed to demonstrate this fact. Gerald Epstein observes: "Both inflation and stagnation create problems. But inflation has become the only way to fight stagnation; and stagnation has become the only way to fight inflation." LeLoup has identified the conflict between inflation and unemployment as a main source of inconsistency in congressional economic policy-making. Related technical issue concerned the blend of fiscal policy and monetary policy.

The domestic trade-offs between unemployment and inflation are complicated by an international component. Domestic inflation has a negative effect on the value of a nation's currency in international monetary markets. As more currency is pumped into the domestic economy and as this inflated money can buy fewer goods, foreign central bankers are more reluctant to hold the overvalued species.

Concern over the dollar's role as reserve currency was exacerbated in the 1960s by increasing balance-of-payment deficits. Balance-of-payment deficits became more politically salient when European bankers began to cash dollars for gold in the mid-1950s. By 1962 the U.S. possession of the "Free World's" monetary stock had decreased from 43 percent to 26 percent. As more dollars were held abroad, there was increasing speculation that the dollar would at some point be devalued; its exchange rate would be lowered to reflect its real value. Should this happen, all the governments and individuals who held assets in dollars would lose money. Central bankers urged the United States to restrict liquidity, maintain low levels of inflation, and use fiscal policy over monetary policy for necessary domestic stimulation.

The attempt to balance these somewhat competing goals of investment and consumption can be seen in the tax innovations of the early 1960s. Kennedy began his foray into the tax field with a supply-side creation: the investment tax credit. The investment tax credit was inspired by the twin economic problems facing the Kennedy administration: stagnation of domestic growth and balance-of-payment deficits. Kennedy advisers argued that an investment-led
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recovery would be less inflationary than a demand-led one. The investment credit was their supply-side solution.

Despite the stimulus of the investment tax credit, the macroeconomy continued to be sluggish in the early Kennedy years, barely recovering from the 1960-61 recession. Capital investment in 1962 increased only 8 percent instead of the hoped-for 15 percent; unemployment would not budge below 5.5 percent. Advisers worried that another recession was likely, just in time for the 1964 election.50

Policymakers now focused on the demand-side of the Keynesian balance, deciding to cut taxes to stimulate consumption. The Council of Economic Advisers wanted the tax reduction to be in the form of lower-income cuts, presented as a macroeconomic stabilization device and free from cuts in spending. The more conservative Treasury and most of the business community wanted the tax cut to be concentrated in upper-income levels, tied to reforms and spending reductions to compensate for the revenue loss, and presented in the neoclassical language of investment. The more conservative version was ultimately chosen, culminating in the 1964 tax cut.

In the late 1960s the issue became balancing monetary considerations with adequate domestic growth. Beginning in 1966 inflation began to build. Investment in 1966 exceeded 1965 levels by 17 percent, unemployment dropped to 1.9 percent in the machinery industry, and the stock market suffered, because of the incredibly high interest rates on bonds. Quarterly demand was increasing by $14 to $16 billion, and capacity was created which could set the economy up for a "post-Vietnam investment slump."51

Inadequate funding for the ever-expanding conflict in Vietnam and Johnson's expansive social vision doubtless contributed to inflation. The obvious solution to this dual drain on government coffers was a tax increase; Keynesian stabilization logic also pointed to this solution. The Council of Economic Advisers (CEA) feared that by delaying the tax hike "we could slow the inflation only by throwing the economy into reverse."52 Advisers were concerned about the international implications of an inflated currency. They also realized that irresponsible fiscal policy could lead to a tightening of monetary policy which would constrain the economy. Gardner Ackley (CEA) wrote that without a tax increase

the Fed will inevitably be forced to tighten money a great deal more putting further pressure on home building; threatening the solvency of many savings and loan associations; penalizing small businessmen, farmers, and moderate-income home buyers. To alleviate the high interest rates and take pressure off monetary policy a tax increase should be instituted.53

Yet increasing taxes seemed easier said than done. For one thing, a strange mix of liberals and conservatives opposed the measure. Liberals thought it

would be used to pay for the war in Vietnam; conservatives, for the Great Society. Business support outside the financial community was also limited. But more to our point here, domestic policymakers were reluctant to suffer the consequences of slower growth for the sake of fighting inflation.

The major tax legislation of the period, the tax surcharge, was not enacted until 1968. This legislation applied an 8 percent surtax to individuals and corporations. Accompanying the tax was a $6 billion spending cut package.54 In 1966, two years before the passage of the surtax, the investment tax credit was suspended as an interim measure. Yet the suspension of the investment credit was short-lived. In March of 1967, nine months before it was due to expire, President Johnson asked Congress to reinstate it.

The main reason why the credit was reinstated prematurely was that it had done its job almost too well. Machinery order backlogs dropped by 7 percent, interest rates on three-month Treasury bills plummeted, and planned investment increases for 1967 went up by only 4 percent. In short, the economy seemed destined for a recession. The investment tax credit was reinstated, and Johnson proposed his surtax five months later.

Thus the commercial Keynesian tax system sought to achieve simultaneously a variety of sometimes conflicting goals, resulting in somewhat contradictory directions in corporate taxation. Taxes would be raised one year to fight inflation or curb the boom in accordance with macroeconomic stabilization. The next year a weakening in the economy would elevate unemployment to the top of the public agenda. Expansion of the growth incentives over time produced a gradual erosion of the corporate tax burden. Yet in the golden age of the 1950s and 1960s the fundamental premises of the tax code seemed to be accepted. With fine tuning of the economy, policy analysts believed that compromise between contradictory goals was possible.

The Economic Crisis and Accompanying Assault on Keynes

An economic crisis upset this policy equilibrium. Although the 1973 oil crisis is often given as the starting point of the crisis, signs of economic weakening in the economy were apparent in the late 1960s.55 The economic crisis was to call into question many tenets of the commercial Keynesian strategy.

Evidence of the poor performance of the economy took many forms. Most startling was the decline of the productivity growth rate. From 1948 to 1966, U.S. productivity grew at an annual rate of 3.3 percent; from 1966 to 1973, 2.1 percent; and from 1973 to 1978, 1.2 percent.56 Although the productivity growth rate has declined in other countries as well, many nations have managed to narrow the gap between their levels of productivity and our own. For example, from 1960 to 1983 productivity (or real gross domestic product per employed person) grew only 1.2 percent in the United States. Comparable figures for other countries are 5.3 percent for Korea, 3.7 percent for France.
3.4 percent for Germany, 5.9 percent for Japan, and 2.3 percent for the United Kingdom.\textsuperscript{37}

Total factor productivity, a measure of productivity keeping capital constant, also grew more slowly in the United States at only 1.9 percent per year from 1960 to 1973. During the same period, the Japanese rate grew at 6.6 percent; the Italian, at 5.8 percent; the French, at 3.9 percent; and the West German, at 3.2 percent.\textsuperscript{38}

Mirroring the productivity problem was a decline of the U.S. competitive position in the world economy. The merchandise trade balance first went into deficit in 1972; by 1984 it was in the red by $140 billion. Even the competitive position of our “sunrise” industries was eroded. The President’s Commission on Industrial Competitiveness reported that the United States had lost world market share in seven out of ten of the high-technology sectors.\textsuperscript{39}

Also of concern were the high rates of both inflation and unemployment which plagued the economy during the troubled decade, threatening the validity of the Phillips curve relationship. Finally in the late 1970s the new Federal Reserve chair, Paul Volcker, attacked double digit inflation with an extremely stringent course of tight money. But this precipitated a deep recession, so that when Ronald Reagan was elected in 1980 real growth neared zero while inflation remained high.

The worsening economic conditions severely compromised individual prosperity. Businessmen suffered: the average net after-tax rate of profit of domestic nonfinancial corporations dropped from nearly 10 percent in 1965 to less than 6 percent by the second half of the 1970s.\textsuperscript{40} The real pretax rate of return on capital (return on total assets in manufacturing) was also affected by the economic crisis: about 12 percent in 1965, it hovered between 4 and 6 percent during the 1970s, and dropped to under 2 percent in 1981.\textsuperscript{41}

Workers suffered as well. Inflation-adjusted compensation increased dramatically from the early 1960s to the mid-1970s and then leveled off. Total real wages for the manufacture of durable goods dropped by 17.5 percent between 1973 and 1986; nondurable goods, by 9.7 percent.\textsuperscript{42}

The Necdautical Attack and the Hyper-accumulation Response

The economic crisis prompted a new generation of neoclassical economists to attack Keynesian policies and institutions.\textsuperscript{43} As will be discussed later, business groups played a major role in this effort.\textsuperscript{44} At the heart of the neoclassical critique of fiscal policy was the assertion that a capital shortage was responsible for the economic decline. Inadequate capital for investment had prevented American companies from expanding and modernizing. This served to curb productivity growth and provide an opening for foreign firms to gain market share. Capital investment contributes to productivity growth by expanding capacity, increasing capital intensity, and updating existing capital goods. Expanded production enables greater economies of scale and better production techniques. Updated capital goods are usually more technologically advanced; innovations enable more output per labor hour.\textsuperscript{45}

Critics blamed the shortage of capital on Keynesian macroeconomic policy in general and taxation in particular. Tax policies constrained capital formation by increasing the costs of capital through an adverse treatment of savings and investment. Adversarial taxation, combined with inflation, therefore prevented growth in capital stock and contributed to the decline in productivity growth rates.\textsuperscript{46}

Keynesians disagreed with this analysis of the problem, arguing that the productivity slowdown in the 1970s was due to the instability of demand and underutilization of existing capacity. Disruptions in the international commodity markets made demand unstable; this was exacerbated by vacillations in government policy. Lower demand depressed rates of return and profit margins. As Eisner wrote:

The prime determinant of business investment is demand. Investment in plant and equipment falls off when the economy is sluggish and excess capacity makes additional plant and equipment unnecessary. In such a situation, moderate annual tax benefits to business would appear to have little effect, particularly in the short run. Well-run firms will not be led to invest by tax reductions which increase after-tax earnings but do not make additional equipment profitable in the face of existing idle capacity. Where demand is brisk, firms will invest without special subsidy.\textsuperscript{67}

Thus, Keynesians and neoclassical critics had very different explanations for the slowdown. Let us now examine the arguments concerning savings, investment, and capital formation, since they are central to debates about corporate taxation.

Neoclassical economists argue that the tax system has constrained private savings: taxes on capital income consistently reduce the rate of return below the socially desirable amount. The optimal amount of savings is the before-tax or gross return to society from investment. Yet the actual amount is the after-tax or net return to individuals on savings. Historically the inflation-adjusted net return has been about 2 percent.\textsuperscript{44} Corporate saving has also been constrained by a depreciation system based on purchase price rather than replacement value. During periods of high inflation, corporations are allowed inadequate deductions to replace assets.

Keynesians retort that the linkage between savings and after-tax rate of return is far from settled. Despite the many changes in the tax code, the private savings rate has remained almost constant, fluctuating around 16–18 percent since 1948.\textsuperscript{46} Consistently high rates of gross corporate saving (7.3 percent of the GNP in 1929 and 8.4 percent in 1982) have been stimulated by high individual tax rates, preferential rate on capital gains, and depreciation allowances.\textsuperscript{70}

Economists of all stripes are in agreement in worrying about the decline of
public savings in the form of budget deficits. Averaging 2 percent of the GNP in the early 1970s, the deficit topped 5 percent in the 1980s. Deficits mean that public financing competes with private investment for a limited money supply, pushing up interest rates and further dampening investment. Former chairman of the Council of Economic Advisers Martin Feldstein argues that on the present track, budget deficits of 5 or 6 percent of the GNP could absorb all net private saving. Paul Volcker puts it succinctly:

[The] situation poses a strong potential for a clash between the need to finance the deficit and the rising financial requirements for housing and the business investment that is crucial to healthy and sustained recovery. In the end, all those needs have to be met out of saving, and all our experience suggests there isn't likely to be enough to go around.

The relationship between taxes and investment is another point of contention between Keynesians and neoclassical critics. Neoclassical economists charge that taxes have constrained the after-tax rate of return on investment. This contributed to the declining growth of the capital/labor ratio. The capital/labor ratio in the United States increased at an annual 1.6 percent between 1970 and 1980 in the private domestic business economy. Japanese increases for the same period were 8.3 percent per year.

Keynesians disagree, arguing that the growth rate of U.S. investment in capital goods remained at normal levels during the period of decline. Capital investment in the nonfarm business economy increased 3.36 percent per year from 1957 to 1968, 4.17 percent from 1968 to 1973, and 3.25 percent from 1973 to 1979. The decline of the capital/labor ratio was due to the extraordinary number of new workers in the workforce in the 1970s. The total hours of labor input annually increased 0.38 percent in 1948–65, 1.44 percent in 1965–73, and 1.42 percent in 1973–78.

Neoclassical economists charge that tax disincentives to savings and investment reduced capital formation. Constraints on individual saving and investing behavior added up to an aggregate shortage of plant and equipment. In addition, the pool of funds available for investment were diverted to government social goals. Inflation made the replacement of existing capital goods even more expensive. Auerbach and Jorgensen suggest that a "wider gap between economic depreciation and capital consumption allowances for tax purposes" has made it even more difficult for businesses to recover their investments in capital goods. Michael Boskin charged that by 1977 inflation had cost corporations $32.3 billion in an extra tax burden from distortions in inventory and capital cost accounting.

Keynesians denied the existence of a capital shortage. First, if capital shortage were a problem, one should expect to find high rates of utilization of existing plant and equipment. Yet Kendrick found significantly lower patterns of capital utilization after 1973 in most of the nine OECD countries studied.

Second, if the total capital stock is falling, one would think that a shortage of capital stock would drive up the price of capital (or the rate of return on capital). Yet the before-tax rate of return on capital has declined sharply since the mid-1960s: the total business sector rate was 11.2 percent in 1967 but down to 8.2 percent in 1980. Third, Denison found little support for a linkage between inadequate capital and the slowdown of the productivity growth rate.

The capital shortage dispute stems partly from measurement problems. For example, analysts disagree about the extent to which capital declines in efficiency with age. Composition of capital stock also matters: a larger proportion of less durable capital stock makes the total capital stock figures decline. Another disagreement arises from whether to count capital investment in pollution control outlays. High rates of inflation further complicate the calculation of capital stock. Accelerated depreciation permits faster replacement of capital assets but skews the calculation of the value of existing capital goods. These systems of accelerated depreciation tend to be arbitrary and skew investment opportunities.

The Hyper-accumulation Response

The conservative attack on Keynesian economic policy precipitated action in the corporate tax sphere: a cut in the taxes on capital. The new hyper-accumulation strategy was designed to stimulate growth from the supply side: if accumulation potential was assured, consumption would take care of itself. Charles Walker said, "Attention has shifted from the question of how income should be distributed to how it best can be produced."

Tax legislation to expand investment incentives and stimulate the economy from the supply side was enacted on a small scale in 1978 and on a large scale in 1981. The 1978 legislation was initially sponsored by President Carter as a reform initiative. Yet a group of industry representatives, especially from the timber and high-technology sectors, struggled to gain control of the public agenda. They convinced congressional allies to make the lowering of taxation on capital gains the centerpiece of the legislation instead.

The Economic Recovery Tax Act of 1981 (ERTA) cut individual rates across the board by 23 percent, giving the greatest savings to upper brackets in order to encourage saving and investment. Corporate taxes were also greatly reduced through the expansion of investment incentives. A new system of depreciation, the Accelerated Cost Recovery System, abandoned the idea of useful lives altogether. ACRS lumped all assets into only four categories: most vehicles in three years, equipment in five years, and structures in fifteen years (with a few in ten years such as public utilities). The investment tax credit was expanded, and a host of other incentives enlarged or created.

George Kopits of the International Monetary Fund calculated the average "tax subsidy rate" on manufacturing investment for several advanced indus-
trial countries. In 1973 the United States had a tax subsidy rate of 1.3 percent of asset price. Japan and West Germany taxed rather than subsidized capital: their rates were -3.4 percent and -6.7 percent, respectively. France and the United Kingdom had rates of 1.2 percent and 9.8 percent, respectively. After ERITA in 1981, the U.S. rate jumped dramatically to 12.8 percent; Japan had a rate of -3.4 percent; France, of 4.4 percent; Germany, of -5.5 percent; and the United Kingdom, of 13.1 percent.85

Post-Fordist Attack on Investment Incentives

The hyper-accumulation strategy’s inability to remedy the escalating economic ills precipitated doubts about the efficacy of the selective tax incentives. The expected stimulus from the expanded investment incentives failed to immediately materialize and the economy sank deeper into recession. Investment in plant and equipment for all industry sank from $155.21 billion (1972 dollars) for the first quarter of 1981 to a low point of $138.89 for the first quarter of 1983. Not until the first quarter of 1984, when spending was back up to $161.75 billion (1972 dollars) did investment surpass the 1981 level.86 When the economic recovery finally came, it was set off by the increased consumer spending that resulted from the huge cuts in individual rates. Therefore, the recovery was led by demand rather than by supply, in keeping with Keynesian analysis. An irony of the act was that, despite its language of accumulation and avowedly anti-Keynesian flavor, the individual tax cuts greatly outshine the investment measures as economic stimulants.

True believers in laissez-faire explained away the outcome. First, the investment incentives were never implemented in their pure form. The fiscal expansion was combined with a tight monetary policy designed to reign-in stampeding inflation. Monetary austerity, by driving up interest rates, deterred industry from investing and largely canceled out the expansionary impetus of the tax act. Second, the Tax Equity and Fiscal Responsibility Act (TEFRA) in 1982 took away many of the benefits of the 1981 bill; otherwise, investment would have been higher. Charles Hulton of the Urban Institute calculated that ERITA would cut the average tax rate on investments in new plant and equipment from 33 percent to 5 percent. TEFRA would increase it again to 16 percent.87

Laissez-faire proponents also maintained that the recovery was investment-led. Real GNP grew at an annual rate of 6.4 percent in the first seven quarters of the recovery, as opposed to an average rate of 5.5 percent in the five previous recoveries. Bosworth points out, however, that, although gross investment grew faster, net investment (adjusting for depletion of capital stock) grew at the same rate as it did after previous recoveries.88

Another major consequence of the 1981 tax act was the creation of huge budget deficits. The vast cuts in the personal tax rates ballooned an already growing budget deficit. Although the investment incentives cost less, they were implicated by association.

The perceived failure of the investment incentives drew attention to concerns about their distributive consequences and challenged the legitimacy of the measures. Some economists had long been worried about the effect of the investment tax credit and accelerated depreciation on the composition of capital assets in the economy. They feared that the tax incentives favored some kinds of investment over others. Thus the incentives might change the composition of investment rather than increase the total amount of capital.89 The corporate tax system skewed investment from structures to equipment: income generated by structures is taxed at roughly 30 percent; that of equipment, at approximately 20 percent.90 Corporate taxation also encouraged the replacement of labor for capital. As was mentioned earlier, these systematic biases produced very different effective tax rates across industrial sectors.

The distortions in the effective burden of corporate taxes paralleled similar distortions in the individual taxes. By the early 1980s the public was increasingly dissatisfied with the uneven application of the income tax. The Advisory Commission on Intergovernmental Relations routinely surveys public opinion on the fairness of the federal income, state income, state sales, and local property taxes. In 1972, 45 percent of those polled considered the local property tax to be least fair; only 19 percent found the federal income tax most offensive. By 1979, 37 percent considered the federal income tax least fair, as opposed to 27 percent who still hated the property tax even more.91

Skepticism over the selective tax incentives was reinforced by their failure to reverse the parade of imports into the domestic economy and the erosion of U.S. exporting capacity. Harrison and Bluestone point to the rise of imports as a percentage of the GNP originating in the U.S. manufacturing sector: 13.9 percent in 1969, 37.8 percent in 1979, 44.7 percent in 1986.92 The investment inducements had disproportionately benefited capital-intensive manufacturing sectors, which were the pride of the American economy during the Keynesian golden age. Selective tax incentives for investment were therefore discredited when these manufacturing sectors continued to lose market share.

Disatisfaction with the selective incentives was heightened by structural changes in the economy, and by the growing economic and political power of business sectors discriminated against by the old order. In the mid-1960s the profit shares of productive capital and “of circulating capital (financial, trade, ground-rent, petroleum and coal, transport, communications and services)” were about the same. In 1982 productive capital’s profit share was 25 percent of the earlier level; circulating capital’s share had increased by 60 percent.93 Between 1979 and 1984 steel companies laid off 45 percent of their workforce. Exports of construction equipment dropped 63 percent from 1981 to 1983; machine tools dropped 60 percent in this period.94
Empirical evidence about sectoral change in the economy predicted significant economic restructuring in the coming years. Shifts in the composition of the economy are likely to generate new jobs in rapidly growing, "sunrise" industries; manufacturing sectors will lose jobs. Silvestri and Lukasiewicz project that the wholesale and retail trade and service sector will account for 80 percent of the total rise in employment between 1986 and 2000. Increasing internationalization also works against a prominent role for government regulation of the economy, since national boundaries are becoming increasingly meaningless in the new world order.

A New Investment Strategy: The Human Climate for Growth

The perceived failure of the ERTA stimulants shook faith in the dominant growth strategy. Although capital-intensive investment continued to be important, a growing number of analysts recognized the limits to this use of resources. It was argued that overinvestment can be as disastrous as underinvestment, especially at the cost of inappropriately replacing individuals with capital. Overinnovation or the excessively rapid introduction of new technology also causes problems. Since productivity depends on the human climate in which equipment is introduced, existing technology may not be used to its maximum. Fascination with Japanese manufacturing processes reinforced the emphasis on strategies over pure capital investment. Some analysts came to question the Fordist mass production organization of manufacturing. These insights suggested that investment strategies should be partially redirected into human resources and knowledge-intensive industries and into cutting-edge technologies. These were also areas which offered comparative advantage to the United States in the international division of labor.

Dissatisfaction with the old accumulation strategy thus led to talk of a new post-industrial approach to growth. The post-industrial system would have the following components: Services and knowledge-intensive sectors would be much larger parts of the economy. Production processes would shift from Fordist mass production to "flexible specialization," which produces small-batch specialty products. Investment strategies would therefore also change from an emphasis on capital-intensive investment to an investment in human resources and knowledge-intensive industries. With a larger component of economic activity concentrated in services and more flexibility in manufacturing, it would no longer be necessary to maintain high levels of mass consumption for standardized products. Rather, firms would be more sensitive to fluctuations in consumption patterns. The necessity of government intervention would drop off with the decline in the need to coordinate large-scale mass production and mass consumption. Increasing internationalization would also work against a prominent role for government regulation of the economy, since national boundaries have become increasingly meaningless in the new world order.

Dissatisfaction with the old approach to growth was tentatively demonstrated in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). In spirit and practice TEFRA was a partial repudiation of ERTA. Although the individual tax cuts, the centerpiece of ERTA, were left untouched, the corporate provisions were scaled back considerably. The Accelerated Cost Recovery System deductions were scaled back, the investment tax credit lowered, and some of the other incentives repealed.

TEFRA may be thought of as an effort to address the abuses of ERTA. The 1981 tax act reflected pork barrel politics at its worst, and many provisions found their way into the bill during a bidding war between Democrats and Republicans. Yet, in another sense, 1982 was a precursor of things to come: an assault on the investment incentives which had been the cornerstone of the government's growth strategy.

The Tax Reform Act of 1986 was a more direct attack on the old order. The reform act made profound cuts in the individual rates, continuing a trend of twenty-five years: the top rate was lowered from 50 percent to 28 percent. The act also cut the corporate rate, from 46 percent to 34 percent, but eliminated many of the selective growth incentives which had skewed the capital gains and cut back accelerated depreciation allowances. The bill transferred a $120 billion tax burden from individuals to corporations.

The tax act was explicitly motivated by a view of growth which differed from the older emphasis on capital investment. First, tax reform sought to achieve neutrality, or a "level playing field," with respect to investment capital. The administration explained that this would allocate investment funds in the most efficient and effective manner. Second, the tax changes aimed to revive investment in human resources. Third, tax reform was expected to improve competitiveness by improving the utilization of resources. Finally, the major remaining selective tax incentive, the research and development credit, was expected to shift investment into new sectors.

The tax reform measure was also inspired by a Republican need to come up with an alternative to the Democratic industrial policy proposals. Industrial policy was designed to redistribute resources toward rapidly growing sectors. Republicans had similar goals but wanted to minimize state intervention. Tax reform offered a mechanism for negating the skews in investment incentives and redistributing resources, while limiting the direct involvement of government. Kenneth McLennan (of the Committee for Economic Development) explained:

The Democratic Party’s need to develop an alternative policy agenda to the Reagan Administration’s approach has led to the advocacy of an industrial strategy based on policies which favor the development of specific economic sectors . . . In contrast, the Reagan Administration favors permitting the market system to identify and support
the expansion of promising economic sectors and to permit the automatic and gradual decline of sectors of the economy which have lost their comparative advantage... The issue is which of these extremes should play the dominant role in determining the nation's economic strategy for the next decade.  

Conclusion

This chapter has explored how the course of corporate taxation followed the waxing and waning of the commercial Keynesian growth strategy. The Kennedy administration revenue acts in 1962 and 1964 sought to stimulate capital-intensive investment and mass consumption, the twin requisites of the Fordist/Keynesian order. But the vitality of this approach was challenged by economic disintegration in the 1970s. When achievement of the Keynesian macroeconomic ambitions faltered, policymakers experimented with alternative growth strategies and taxed to these alternative ends. Neoclassical critics alleged that the Keynesian emphasis on demand actually harmed the economy by deterring saving and investment behavior and creating a capital shortage. The Economic Recovery Tax Act of 1981 sought to correct for inadequate accumulation by expanding tax incentives for investment and saving.

The expanded investment inducements failed to stimulate a supply-side recovery and served to distort economic decisions by making some investments more attractive than others. By the mid-1980s America seemed ready for yet another approach to growth. The Tax Reform Act of 1986 signified a new direction in tax policy.

The experimental, somewhat desultory nature of these probes indicates a certain indeterminacy in the creation of new growth strategies. The logic of capitalist development does not point unwaveringly toward a new paradigm. A strategy of growth differentially benefits groups in state and society, suggesting that political struggle may play a part in its genesis. In the next chapter we develop analytic tools for examining the political struggles which surround corporate taxation in pursuit of growth.

Appendix 1.1

Selected Prominent Growth Incentives

Until 1986 the top marginal rate on corporate income was 46 percent on income over $100,000. Since 1982 a minimum tax of 15 percent has been applied to preference income (that sheltered from taxes by the various deductions) above $10,000.

Very generous depreciation allowance. In the United States we have used accelerated depreciation or declining-balance as opposed to straight-line de-
2

Business Influence and State Power

Introduction

This chapter explores the political mechanisms which have delivered new directions in corporate taxation. Political analyses coalesce around two theoretical poles: state-centered explanations and society-centered ones. Society-centered analysts argue that policy largely reflects the interests of private sector powers, because the state is captured by societal interests. State-centered theorists claim policy to be a product of relatively autonomous politicians and bureaucrats, because policymakers are insulated from private pressures.

Neither extreme position in the state autonomy debate seems confirmed by the corporate tax experience. At times the policy process seems the quintessence of pork barrel politics; at other times business interests have much less input. The Economic Recovery Tax Act of 1981 was widely perceived as a business orgy in which private interests feasted on the revenue base of the state. By comparison, the Tax Reform Act of 1986, while certainly beneficial to the upper-income contingent, was initiated by state actors and limited handouts to private concerns.

Policy outcomes also indicate a varying degree of corporate power. The absolute decline in corporate tax levels during the postwar period has been periodically reversed with reform campaigns. During these periods, loopholes have been closed under the banner of equity. Most spectacular was the 1986 legislation which eliminated many of the selective growth incentives.

This chapter presents an alternative view of state-society relations which accounts for the vacillations in private power. Presidents have organized public/private coalitions to seek enactment of their growth strategies. The inconsistent erosion of the corporate burden can be traced to this institutional development.

State Autonomy and the Structure of Business

The centrality of political struggle to the choice of growth strategies makes a theory of politics necessary. Yet analysts are divided over the relative balance of power between state and society: the issue of state autonomy. Society-centered explanations hold that public policy can be explained as a function of private interests. Organized interests translate into public policy through the self-interests of politicians and bureaucrats. A politician is motivated to satisfy constituent demands in order to realize his own interest in reelection. Iron triangles based on self-interests may develop between players in interest groups, Congress, and the bureaucracy. Within these structures, influence flows from the private to the public sector. Many also argue that this influence has a class bias, since the state is dependent on uninterrupted business investment for its continued health.

Society-based explanations have been used to explain the distribution of the tax burden. Schumpeter suggests that tax patterns provide a sociogram of the power distribution among groups and calls for a new field, fiscal sociology, to study the evolution of the political economy. Bartlett asserts that high nominal progressivity satisfies the demands of middle-class consumers and that targeted loopholes appeal to powerful producer interests. Salamon and Siegfried find lower tax rates among larger corporations; and Jacobs finds that when aggregate concentration among the largest firms went up, taxes on all manufacturing firms were reduced. The increase in Political Action Campaign (PAC) funding has also certainly enhanced the role of special interests in policy-making. (See appendix 2.1 for a discussion of PAC contributions to the House Ways and Means and Senate Finance committees in 1981.)

The most notable characteristic of the business community in the United States is its high degree of fragmentation. Business demands may generally establish the acceptable range of corporate tax alternatives; however, specific industry demands are often at odds with one another. Fragmentation in the business community means that no unambiguous class mandate for corporate taxation is expressed. This lack of a unified class position is related to the multiplicity of avenues to growth discussed in chapter 1. In the absence of a class consensus or sectoral dominance, state actors have greater autonomy in the decision-making process to determine directions in policy.

Variations in policy preferences among industrial sectors will be found to some extent in any society. However, the points of disagreement between sectoral preferences are exacerbated in the U.S. system for three reasons. First, the connection between finance and manufacturing is very weak. Unlike in other Western countries, banks do not act as owner-managers of industrial firms in the United States. Banks are restricted to lending for short-term purposes; therefore, industrial investment must be funded through equity sales (stock and bond markets) rather than through long-term loans. In West Germany, by comparison, banks have a significant financial interest in firms and are intimately involved with the management and fiscal well-being of their industrial clients. Financial interdependence leads to a convergence between the interests of financial and manufacturing firms. In the United States commercial banks hold only 8 percent of nonfinancial corporate liabilities; in West Germany this figure is 58 percent. Sabel and Piore attribute the separation of
banking and manufacturing to the early development of corporations and the late development of banks; the latter had little role in bringing about the former.9

These different types of financing systems produce very different types of public policy. A U.S. capital market system which leaves investment and production completely in the hands of management will have only limited capacity for direct state intervention. By comparison a French or Japanese credit-based system with government-administered prices allows the government to guide many industrial decisions.10

The role of the dollar as the international currency has heightened the split between banking and manufacturing interests in the postwar period. As large multinational banks increasingly became bankers for the world, they became committed to maintaining a stable currency in order to protect the integrity of the system (and their own profit margins). Bankers exhibited a rabid fear of devaluation and economic problems (such as inflation and budget deficits) which could threaten the currency. In contrast, when faced with a choice between inflation and recession, industrial capital often favored domestic expansion.

The second reason why American business is fragmented is related to the way in which business associations are organized. Since the 1960s, business interests in the United States have been increasingly organized into single-sector trade associations rather than into the umbrella organizations found in many Western European countries. This process of articulation leads to a more narrow definition of policy preference, exacerbating intersectoral conflict.11 Third, the relative weakness of the labor movement in the United States diminishes class conflict, thus heightening the importance of intraclass divisions.12

An industrial sector analysis of business demands illustrates these corporate divisions.13 This theory assumes that business policy preferences are rooted in industrial structure and policy changes represent the hegemonic ascendancy of one sector of the business community over others.14

One of the two primary issues dividing the business community in the tax sphere has to do with a sector’s preferences for competing macroeconomic goals: monetary stability or fiscal prosperity. Sectors directly affected by monetary policy worry about the former. The industry’s profits or asset holdings may be directly affected by inflation, high interest rates, or balance-of-payment deficits. Housing sales are directly correlated with the level of interest rates; commercial banks, holding assets in long-term government securities, fear inflation. By comparison small business firms, whose profit margins and other resources are meager, fear recessionary dips which they may not survive.

The second issue dividing the business community has to do with the degree of capital intensity of the sector’s production process. In capital-intensive sectors, machines rather than workers are used to create much of the value added during production. Most of the selective growth incentives created in the postwar period have aimed at increasing capital investment in fixed plant and equipment. Therefore, capital-intensive sectors have provided the primary political support for these devices (see table 2.1 for a comparison of capital-labor ratios).15

Three groups of industrial sectors emerge as major actors in the tax policy debates. A finance/housing group is labor-intensive and worries more about monetary stability than fiscal prosperity. These sectors will be the first to call for a tax increase to curb inflation or balance the budget. A small business/ service group, also labor-intensive, worries more about fiscal prosperity. Since these firms cannot use the selective tax incentives, they tend to pay high effective tax rates and have become increasingly critical of the postwar, capital investment-oriented avenue to growth. The final group of manufacturing concerns, capital-intensive, is most concerned about fiscal prosperity.

Industrial structure makes groups more or less responsive to varying approaches to investment. Not all tax proposals are equally supported by all sectors within a group, since many parochial proposals are designed to meet the interests of one or two sectors. This is also not to say that the preferences of these groups are carved in stone. Here I point out only that groups tend to be divided, in fairly consistent ways, on tax policy alternatives. The reader will note that very little attention is given to either the demands of labor or public opinion. These sources of societal pressure have very little impact in the area of corporate tax policy.

The fragmented structure of the American business community has clear implications for corporate tax outcomes. Deep divisions have discouraged a clear class mandate; conflicting preferences generate contradictory pulls.

| Table 2.1. Capital-Labor Ratios (gross book value per man-year, 1957) |
|----------------------|-----------------|--------------|-----------------|
|                     | New England     | South        | Rest of U.S.    |
| Capital-intensive   |                 |              |                 |
| Pulp and Paper      | $11,225         | 18,046       | 11,225          |
| Chemicals           | 12,226          | 24,481       | 13,899          |
| Petroleum           | 29,835          | 42,251       | 43,243          |
| Primary metals      | 7,447           | 18,056       | 13,210          |
| Labor-intensive     |                 |              |                 |
| Food and beverages  | 5,971           | 6,069        | 7,293           |
| Tobacco             | n.a.            | 5,656        | 2,305           |
| Textiles            | 4,983           | 5,488        | 4,156           |
| Apparel             | 770             | 826          | 790             |
| Printing            | 4,194           | 4,247        | 4,269           |
| High technology     |                 |              |                 |
| Instruments         | 3,537           | 3,642        | 4,164           |
making it difficult for the state to build a lasting consensus. The stop-go quality of corporate taxation reflects these pulls. In the early 1960s manufacturing interests demanded an expansionary fiscal policy, but a few years later inflation and balance-of-payment deficits drove bankers to demand a tax hike. In the late 1970s, however, the declining competitiveness of industrial capital led to increased demands by aging manufacturing sectors for state subsidization in the form of investment incentives. The questioning of the old order in 1986 reflected the increased power of the high-technology, small business, and service sectors—parts of the economy unable to enjoy the benefits of the investment incentives.

Yet no one sector has been dominant in the postwar United States in the way that textiles, autos, and steel historically controlled the economies of Western Europe. These divisions among business have accordingly accentuated the power of the state. To state actors and structure we now turn.

The Structure of Government

A state-centered view contests the presentation of policy as merely a function of private sector demands and suggests that the origins of policy may be located in other motivations and interests of state actors. In addition to constituent interests, state actors are motivated by technical goals and institutional interests. This approach does not negate the existence of societal pressures but points to the causal primacy of other considerations, especially among nonelected bureaucrats. Levi characterizes rulers as predatory, since they attempt to maximize revenue collection from subjects.

The separate institutional interests of government players are shaped by state structure. The institutional structure of the state divides the government apparatus into a multitude of factions—branches, levels, bureaucratic departments, and partisan groupings. Factions divide along these fault lines, the opposition drawn differently across political conflicts. Politicians and bureaucrats develop interests according to their institutional affiliation. Institutional interests may be related to the survival or success of the faction, as in competition between branches or parties, or may concern an individual’s goals for advancement within the organization. That government officials can act on the basis of their separate political interests presupposes relative autonomy. Because state actors, especially bureaucrats, are relatively insulated from interest group pressures, they have relative freedom to formulate policy in accordance with their separate goals and interests. Policy patterns are set by these general system characteristics.

An institutional analysis has been applied to tax policy in two ways. First, attention has been given to the ways in which institutional interests supersede constituent demands, implying greater state autonomy. Manley’s study of the Ways and Means Committee under Wilbur Mills points out institutional mech-

anisms to restrict leakage to special interests and enhance members’ freedom to develop good policy.

Second, cross-national comparisons of political institutions have been used to explain variance in policy approaches. Comparing Sweden, Britain, and the United States, Steinmo suggests that the decision-making structures in each country produce very different policy outcomes. The American fragmented political authority has produced a complex and inefficient tax code; Sweden’s fairly simple, efficient system is explained by its stable corporatist system of representation. In like manner, Witte suggests that continuous pressure from economic interests on an incremental decision-making process leads to a gradual erosion of the system. Hall searches out the role played by institutions in both state and society in the articulation of interests, dissemination of ideas, construction of market behavior, and determination of economic policy in Germany and France.

The most salient feature of the American state is its fragmented nature. The doctrine of the separation of powers, federalism, overlapping jurisdictions, and the lack of clear authority hierarchies all contribute to a fragmented system with many competing points of power.

At the heart of the problem of political fragmentation is the separation-of-powers doctrine, which divides tasks between the various branches to keep any one of them from usurping power. Authority to legislate rests with Congress; however, the president has the power to recommend measures for legislative consideration. A separation of powers between Congress and the president has institutionalized organizational irrationality in the corporate tax area. Congress has a clearly specified constitutional responsibility to raise revenue, which it carries out through the legislation of tax acts. Responsibility for developing proposals, however, is not spelled out in the Constitution.

The problem of the fragmentation of the American state has been exacerbated with the new economic activism. The federal government was relatively inactive in the nineteenth century, restricting its activities to expressly delegated functions and leaving all else to the states. The complexity of the twentieth century expanded the role of the national government: changes in economic beliefs made the government into economic manager. The Budget and Accounting Act of 1921 made the president into a general manager; the Employment Act of 1946 expanded this role. The balance of power between branches also shifted. Although Congress retained legislative powers, policy formulation and implementation increasingly became a prerogative of the executive branch. This was due partially to the president’s expanded capability for gathering information. The Council of Economic Advisers, a body composed of professional economists responsible for forecasting the macroeconomy, was placed within the executive branch. In the twentieth century revenue raising has evolved into a two-stage process with participation from both branches: “The president proposes; Congress disposes.”
But increased responsibility for economic policy was given to the executive branch without adequate power to enact the mandate. For example, it was expected that the president would manipulate money aggregates in the macroeconomy in order to curb booms and offset recessions. Although presidents repeatedly requested standby authority to circumvent the legislative process and raise and lower taxes as needed, Congress refused to grant this request. Tax acts typically take at least a year to legislate; therefore, it is nearly impossible for presidents to formulate "optimal" policy. Thus, additional presidential authority without a decrease in Congressional control has greatly limited the success of macroeconomic stabilization. 28

The pattern of fragmentation and overlapping jurisdictions which characterizes relations among branches is reproduced within the executive branch. Three departments in the executive branch plus the Federal Reserve Board constitute an "economic sub-presidency." Each department specializes in a part of the whole: The Bureau of the Budget (now the Office of Management and Budget) has primary responsibility for spending. The Council of Economic Advisers forecasts macroeconomic trends, analyzes general economic issues, and develops the president's annual economic report. The Treasury manages tax collection and currency control. Jurisdictional lines are not firmly drawn, however, so that both the Council of Economic Advisers and the Treasury are very involved in developing tax policy. All three project general economic trends and calculate the fiscal effects of various policy options. 29

The institutional responsibilities and external constituents of these units are quite different, leading to systematic differences on policy stands. The Council of Economic Advisers has traditionally been more insulated from clientele pressures; its composition of professional economists increases its technocratic flavor. The Treasury, by comparison, has been more explicitly political. Constituent groups who would influence corporate tax policy usually direct their efforts toward the Treasury; heads of this department are often drawn from the business community. The institutional responsibility of the Treasury Department reinforces the need to maintain business confidence.

Treasury has traditionally taken more fiscally conservative stands. 30 In the 1960s the CEA was typically more willing to endure small amounts of inflation for domestic expansion; the Treasury was much less willing to sacrifice stable currency for growth. The Federal Reserve Board has traditionally joined the Treasury in the chorus against inflation and sensitivity to the effect of fiscal policy on balance-of-payment deficits. A proliferation of units for making economic policy has further complicated matters. Porter identifies 132 bodies now responsible for developing taxing and spending proposals, thus eroding the knowledge monopoly once enjoyed by the Council of Economic Advisers. 31

Presidents have attempted to coordinate disparate groups involved in economic issues through special policy forums. John F. Kennedy initiated the "Troika" consisting of the Council of Economic Advisers, the Bureau of the Budget, and the Treasury. Lyndon Johnson expanded this to the "Quadriad" with the addition of the Federal Reserve Board. Richard Nixon contributed the Cabinet Committee on Economic Policy and the subsequent Economic Policy Board; Jimmy Carter, the Economic Policy Group. Yet none of these efforts achieved the coordinating importance that the National Security Council did in defense policy. 32

After the president has developed his tax initiative, he must convince Congress to legislate it. First, the bill is considered by the Ways and Means Committee. The committee holds hearings on the measure; at this point the interested public is officially brought into the process. Then the committee "marks up" the bill, debating each measure's inclusion and drafting the legislation. The bill is then debated under "modified closed rule" on the House floor, which limits amendments. If the bill is passed, it is sent to the Senate, where the Senate Finance Committee carries out a similar process. Ultimately, the two versions of the bill are made consistent in the conference committee.

There is evidence that Congress, like the executive branch, has suffered from a gradual fragmentation of authority. In the early years of the postwar period committee chairmen enjoyed enormous power in their substantive areas. The negative side to this was that a hostile chair could simply refuse to report a piece of legislation out of committee. Since the committee chair was disproportionately conservative southern Democrats, liberal legislators bemoaned their considerable power. The positive side to this arrangement, however, was that a chairman could discipline committee members and limit their vulnerability to outside pressures.

The problem of fragmentation has been worsened by the decline of the political party. Parties in the nineteenth century functioned to elect candidates and construct policy, helping to overcome the institutional fragmentation of the American state. The twentieth century has witnessed a decline in parties at precisely the point when integration is most needed. 33

Reforms to democratize Congress and the party structure have increased the fragmentation and permeability of the system and decreased state capacity. 34 These institutional reforms have altered the individual politician's incentive structure and made it harder for him to act on the basis of things other than constituent demands. Thus, institutional changes have restricted Congress's capacity for rational decision making. 35 Open hearings have downgraded the influence of the Treasury and the Joint Committee on Taxation staffs. 36 Since these reforms, the making of tax policy has been more susceptible to private pressure. Strahan points out, however, that tax legislation since 1984 has been marked by somewhat greater stability due to a different policy context and increased leadership in Congress. 37
The Public/Private Coalition

Which type of explanation has greater relevance for corporate taxation? The extreme version of neither the state-centered nor the society-centered model can adequately account for the vacillations in policy outcomes and the differential influence of business interests. There are two reasons for this. First, the high degree of fragmentation in both state and society partially negates the dominance and autonomy of both spheres.

Second, neither explanation allows for the mutuality of interests which develops between actors in the public and private spheres. Society-based views recognize a congruence of interests between state actors and society; however, this congruence is narrowly defined. Politicians and bureaucrats have limited concerns beyond their own economic self-interests. Because these limited interests are satisfied by meeting constituent demands, state actors are captured by society-based groups.

State-centered views correctly point out that politicians’ interests transcend an economic reading. Bureaucrats and politicians have institutional interests that are unrelated to the interests of their society-based constituents. However, these views generally assume that, in order to maximize the other policy concerns, state actors must insulate themselves from private pressures. In fact, public and private sector actors can join forces on the basis of shared interests. Also, key decision makers within the state have worldviews which have been shaped by their societal origins. Politicians with backgrounds in industry have difficulty escaping this perspective, even when they are not directly “captured.”

An understanding of politics which emphasizes the linkage between state and society seems appropriate. There are three central points to the public/private coalition model. The first derives from an institutional analysis of the American state. U.S. institutions are characterized by fragmentation. The existence of this fragmentation means that factions exist within the state apparatus. These factions or small groups vie with one another for political power and for control of the public agenda. This fragmentation is a dynamic variable, manifested to greater or lesser degrees at various points in time. For example, fragmentation may be lessened by partisan unity, when the same party controls both branches of government. Electoral competition generally tends to exacerbate fragmentation. The fluidity of this fragmentation opens possibilities for various combinations or coalitions among players in both the public and private spheres.

Second, the interests of factions within the state may converge with those of groups in society. Public and private factions share a mutual interest in the success of a particular investment strategy or policy solution. Interests converge in the technical issues which preoccupy policy networks of individuals in both the public and private sectors. The organizational intersection of political and economic systems ties the interests of capitalists to the institutional responsibilities of state actors. Political necessity also ties state actors to business allies: politicians develop a policy agenda and approach like-minded business groups to help achieve that agenda.

The final point, then, is that the balance of power in this intrastate political infighting may be altered by coalitions with private sector groups. This convergence of interests motivates groups to form alliances in order to maximize their interests and power vis-à-vis their political and economic opponents. Political entrepreneurs take the initiative in pulling together these coalitions and draw upon factions within both the state and society. Political actors’ successes in manipulating and mobilizing private pressures are the source of their strength.

The joint participation of private and public sector factions is reflected in policy outcomes. State actors define the broad outlines of the initiatives in accordance with the economic strategy endorsed and take the lead putting together the coalitions. Politicians’ choices of agenda, thus, greatly influence policy directions as well as the chances for success of individual business groups. Yet business allies’ demands comprise the details. Business groups use their “privileged position” to set the range of acceptable alternatives. Thus, there are a whole range of tax options relegated to the nondecision sphere, or options which are never really considered.

The coalition approach presents a distinct view of state-society relations. Since state actors turn to private sector groups for assistance in achieving their policy agenda, political players are neither passively captured by special interests nor autonomous from them. For example, the model differs from an iron triangle view of state-society interactions in that (1) state actors initiate the political alliance and (2) the coalition represents a strategy rather than an enduring arrangement.

This approach suggests that the interests of actors in each realm converge; therefore, the boundaries between state and society are not rigidly defined. In this view Katzenstein writes, “The distinction between state and society connotes a gap between the public and the private sector which exists in no advanced industrial state.” Rather, governing coalitions “find their institutional expression in the distinct policy networks which link the public and the private sector in the implementation of foreign economic policy.”

Recognition of this link between private and public has emerged in the American literature in the work on presidential strategies. Before congressional reforms, presidents relied on party and congressional leadership to tie them to voters and legislators. However, the reforms of the 1960s and 1970s compromised traditional channels of authority and consequently the presidential capacity to lead. With the decline in authority of go-between leaders, the president has turned increasingly to interest groups as a means of building policy coalitions. By involving supportive business groups in legislative lob-
bying, presidents enlarged or found alternatives to the electoral coalitions that had sent them to office. Heclo asserts that “each president during the last twenty years has felt increasingly compelled to mobilize the White House to build the equivalent of a presidential party for governing.” McQuaid links presidential mobilization of business power to the emergence of the activist state.

Public/Private Coalitions in Corporate Taxation

The corporate tax cases discussed in the following chapters reveal considerable use of the public/private coalition. To secure political advantage and manage economic policy-making, executives organized public/private coalitions around a growth strategy. These coalitions were of enormous import in bringing about passage of the acts. In the process the interests of both state actors and business allies influenced policy outcomes. Although the direction of policy initiatives was often set by state actors’ political interests, policy outcomes were limited to the range of alternatives acceptable to their business allies.

In the early 1960s President Kennedy was attracted to the “commercial Keynesian” growth strategy as a way to differentiate himself from years of Eisenhower nonintervention. Kennedy had campaigned on a promise to “get the country moving again” — his vision of America as empire mandated a strong economic base. This made economics a key issue for the administration and one on which it was willing to make considerable concessions. In 1962 the administration concentrated on the supply side with the development of the investment tax credit. The 1964 tax cut focused on the demand side.

Although the president’s resulting fiscal policy was far from revolutionary, economic intervention by the government was rejected by Republicans and southern Democrats alike. Even the 1962 investment tax credit, clearly a pro-capitalist measure, was opposed on the grounds that it would give the government excessive influence over private investment decisions. Unfortunately for the president, southern Democrats controlled many key committee chairs in the legislative bodies.

Large parts of the business community responded more favorably to the new economic activism compared with the Republican legislators who generally represented them. Export-oriented manufacturing interests had generally felt frustrated with the slow growth rates of the Eisenhower years, resulting from macroeconomic timidity. The Chamber of Commerce publicly accepted the expansionary deficits; only the banking community seemed adamant that an expansionary tax cut be accompanied by revenue-raising reforms.

To augment its power against fiscal conservatives in Congress, the administration pulled together a core group of private sector supporters in a business-based lobbying group. The “Business Committee for Tax Reduction in 1963” differed from the usual business groups which lobby for legislative concessions. Unlike other lobbying groups, it was organized by the administration, made up of many business sectors, and oriented toward a larger policy vision.

The Business Committee for Tax Reduction helped the administration by expressing widespread support for the tax bill and convincing hesitant Congressmen to vote for it. Business Committee members sent out mass mailings asking their members to support the measure and educated other business groups to the president’s way of thinking. Treasury Undersecretary Henry Fowler wrote that the Business Committee “has been of immeasurable assistance in marshaling support among the various established trade organizations and avoiding the ‘knee jerk’ type of opposition that normally characterizes response to any initiative from a Democratic President.”

As the public/private coalition model predicts, state actors took the lead in the direction and content of the legislation, so that the institutional interests of executive branch actors greatly influenced decisions made about the timing, content, and ideological orientation of the bill. For example, Kennedy was originally persuaded to package the 1964 tax cuts as a long-term growth stimulus rather than a short-term macroeconomic stimulus. Then a dip in the economy in the spring of 1963 quickly generated criticism of the administration from without and panic within. Kennedy backed away from the neo-classical position and bailed the measure in recession-fighting terms. With an upturn in the economy, the president returned to the long-term growth perspective. The timing of the intervention was also influenced by state-centered concerns. Henry Fowler persuasively argued: “Your Administration should be inextricably associated with ‘good times’ in the minds of the people . . . Can that rare political asset—Kennedy prosperity—be preserved until November 1964?”

But as allies to the administration, business groups enjoyed considerable influence. The administration routinely polled business to evaluate political support for competing measures and tried to stay within the range of alternatives acceptable to the business community. Items in which finance and manufacturing were in agreement were usually passed; measures which split the business community were frequently dropped. Fowler argued that the Business Committee for Tax Reduction should not be “divided or paralyzed in their movement by the lack of a definite target.”

Again working within a Keynesian paradigm, Johnson used a public/private coalition to muster support for a 1968 surtax, in order to curb inflationary trends in the economy. Although initially Johnson seemed indifferent to the inflation, a revenue hike increasingly seemed necessary to pay for domestic peace and foreign war—the Great Society and Vietnam. Ultimately passage of the surtax became a symbol of the administration’s efficacy. Joseph Cali-
fano advised the president, "I have a strong instinct that what happens in the current tax fight may be a critical turning point in your presidency, not only vis-à-vis the Congress, but perhaps on a much larger scale." 48

Passage of the surtax was resisted energetically by both conservatives and liberals in Congress. Liberals saw it as a war tax; conservatives, as a way to pay for the detested Great Society. Emerging as the leader of the opposition, Wilbur Mills fought a fundamental battle to keep revenues low and government restrained.

The administration turned to business groups to circumvent the bill's enemies. The multisector tax group forged in 1968 was reminiscent of the 1963 Business Committee for Tax Reduction. At the core of the coalition were the housing and real estate groups that were most concerned about inflation. 49 Again, the timing of the major decisions reflected the president's own institutional interests and auxiliary policy agendas. Yet business groups also were instrumental in shaping the bill. David Rockefeller, one of its strongest supporters, first called for a tax hike in 1966 as part of a broad policy agenda to curb inflation. The administration polled prominent businessmen at regular intervals during the decision-making process to try to gauge support for the measure. During legislation, concessions were made to attract business: manufacturers were allowed to deduct their investment tax credits before calculating the 8 percent measure, and the surtax was tied to spending cuts.

In the late 1970s Ronald Reagan campaigned to rid the nation of Keynesian activist economic policy and return it to a laissez-faire state. The "hyper-accumulation" strategy endorsed lower, less progressive rates and expanded incentives to save and invest. In 1981 Reagan saw his dream come true with the largest tax decrease in the history of the United States: individual rates were cut by 23 percent and investment incentives were greatly expanded. The 1981 act thus fulfilled a major campaign promise and represented a key element in the president's supply-side ideology.

Reagan encountered considerable resistance to his legislative agenda from Democrats for both ideological and political reasons. The supply-side personal cuts were rejected as unfair and unsound; Democrats were reluctant to relinquish demand-oriented progressivity. The losing party also had felt repudiated by Reagan's recent budget battle and were determined to use taxes to recover their status and partisan pride. Jimmy Carter reportedly called Rostenkowski and said, "Do what you have to do, but win!" 50

The corporate provisions were not greatly disputed. The Democrats calculated that the best chance for victory would be to fight the Republicans on the personal cuts and make concessions on the corporate tax structure. In this vein Rostenkowski put forward to business groups a roster of policies left out of the Republican alternative. The president responded by launching a highly sophisticated business lobbying effort. A core of corporate supporters was put together, in part from the three hundred business groups that had participated in the administration's budget battle. This core group, called the "Bomber Squad," helped to engineer the final passage of the act. When the president appeared on television to request support for the tax cut, business supporters tied up the telephone lines of key congressional offices for the next forty-eight hours.

Corporate tax benefits thus became the medium of exchange for buying legislative support. Because of the symbolic significance of the act, the near desperation of the political players, and the choice of corporate taxation as the unit of bargaining, special interests played an extremely prominent role and more concessions were made than usual.

Ronald Reagan's ideological program and political interests in securing its enactment were the guiding force behind the tax act. Yet, as a result of their key role in the political fight, business groups had considerable input into the bill. Many of the corporate provisions were hammered out by the business community ahead of time. Although cutting corporate rates, speeding up depreciation, and lowering capital gains were all on the corporate wish list, private sector groups had negotiated a compromise. The Reagan team chose accelerated cost recovery as its core corporate proposal because it calculated that the adoption of ACRS would bring in 80 percent of the business community. 51 Charls Walker, a powerful Washington corporate lobbyist and architect of the provision, was the chairman of President Reagan's tax transition team.

Almost immediately after the 1981 tax act was signed into law, pressure began mounting to reverse the monumental tax cut. The pressure for a tax increase that began in August of 1981 ultimately resulted in the Tax Equity and Fiscal Responsibility Act of 1982, the largest peacetime tax increase in the postwar period. 52 In spirit and practice TEFRA was a partial repudiation of the Economic Recovery Tax Act legislated only eleven months before. Although the individual tax cuts, the centerpiece of ERTA, were left untouched, the corporate provisions were scaled back considerably.

Why did the president abruptly reverse his commitment to the investment incentives? Conflicting economic problems—slow growth and the budget deficit—were ultimately resolved in favor of political damage control. Only a month after ERTA was legislated the stock market fell dramatically, accompanied by a drop of the dollar on the international currency exchange. This development riveted public attention on the budget deficit and greatly alarmed the administration. For months the president deliberated over an appropriate course of action. He finally decided that the budget deficit presented a more damaging political problem than breaking his promise not to raise taxes and pushed ahead with the TEFRA alternative.

In 1982 the coalition strategy was extended to members of the other party: Reagan turned to the House Democrats as a source of support. The puzzle is why the Democrats went along. The Democrats had suffered a major humilia-
tion in 1981, and most on Ways and Means refused to mark up a tax bill in 1982. Breaking with tradition, the 1982 legislation was initiated in the Senate. But the Republicans offered the Democrats a chance for input on the act in a secret forum called the “Gang of Seventeen,” a bipartisan group of legislators and executive branch officials. The broad outlines of TEFRA were hammered out in secret before the public policy process began. Since both parties felt that it was to their mutual advantage to remain united, they cooperated to an amazing extent with very little interparty competition. Legislation in 1982 thus set the stage for partisan cooperation on taxation.

In 1982 political unity made extensive concessions to business unnecessary; however, the executive branch still tried to mobilize private support to pressure opposing legislators and recalcitrant trade associations. A sophisticated lobbying project called the “Boiler Room Operation” kept files on all congressmen and senators, tallied votes, and lobbied legislators.

Although direct concessions to business were limited in 1982, business groups intervened at key points to influence policy formulation. In December of 1981 President Reagan was on the verge of proposing a massive excise tax increase but the Chamber of Commerce persuaded him to abandon this plan. Shortly thereafter the Business Roundtable and financial sectors convinced the president to move away from his original commitment not to raise taxes.

In 1986 a public/private coalition constructed around a very different approach to growth was successful in gaining passage of the Tax Reform Act. The “reform” claims have been questioned: the act abandoned progressivity and ignored the budget deficit. But the act was revolutionary in greatly increasing the corporate share of total tax revenue and eliminating many of the special growth incentives which had been a prominent part of the tax code for many years.

Partisan leadership on both sides endorsed tax reform and investment neutrality as an antidote to economic decline. Tax reform was also fueled by the institutional interests of its major proponents. The Republicans saw tax reform as an alternative to the Democratic proposals for industrial policy to shift resources to emerging high-technology sectors. They also feared that the Democrats would make it a major campaign issue and wanted to claim “fairness” for the Republican party. Reagan had long wanted to lower the individual rates.

The Democrats thought that tax reform was going to be a big issue in the 1984 election and wanted to be included. In the past, cooperation with the president on fiscal issues had produced better results than competition. As the New York Times put it, the bill was a “political standoff.” Guy Vander Jagt (R–MI) explained, “There’s enough glory and gain to go around for Republicans and Democrats.” Reagan and Rostenkowski went on television together making a bipartisan plea for tax reform. The two men agreed to a contract of silence; Reagan would not criticize the House effort until the markup was completed. Although the administration’s support wavered at points, the commitment held.

Enormous impetus for the corporate side of reform came from the business community: from high-technology, small business, and service groups, who had benefited least from the previous capital-intensive investment approach to growth. The increasing disparity between effective tax rates in the corporate community made “equity” an issue in corporate taxation. As early as 1982 several tax groups had formed to protest high effective corporate tax rates. At the core of this industry group—what eventually became the 15/27/33 Coalition—were the companies left out of the 1981 tax cuts oriented toward capital-intensive manufacturers. The greatest opponents of reform were predictably the capital-intensive manufacturers.

The business supporters were organized into a cross-sector group called the Tax Reform Action Coalition (TRAC). TRAC performed the usual tasks of lobbying and vote counting, and also staged a variety of media events to draw public attention to tax reform. When the rates were dramatically lowered in the Senate bill, many more business groups were lured to join the reform effort.

President Reagan and Chairman Rostenkowski staked their reputations on tax reform; its success was due largely to this bipartisan endorsement. Yet business allies were highly influential in building support for reform during the prelegislative period and in carrying out day-to-day lobbying. Many details of the president’s reform measure (called Treasury II) were constructed to include the core supporters.

Conclusion

This chapter has critiqued the extreme poles of the state autonomy debate. First, neither the state- nor the society-centered model explicitly accounts for the considerable fragmentation within the business community and within the American state. Yet this fragmentation creates factions on both sides of the state-society boundary, which vie for political power and economic benefits. Second, neither explanation allows for the mutuality of interests which can develop between factions in the public and private spheres. Third, neither model recognizes that state actors can gain advantage over political enemies by forming alliances with private sector groups. Thus, success in manipulating and mobilizing private pressures may be the source of political strength.

Presented instead has been the coalition strategy, a technique in which presidents actively mobilize private sector interests for political support. This strategy lies outside the capture-insulation trade-off and suggests a more interactive view of state-society relations. The following chapters describe a series of cases in which desperate presidents turned to the public/private coalition to enhance their influence over policy.
# Appendix 2.1

## Senate Finance Committee

<table>
<thead>
<tr>
<th>Member</th>
<th>Total Contributions 1979–80</th>
<th>PAC % of Total</th>
<th>Business % of PAC</th>
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<td>William Armstrong (R–CO)</td>
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## Business Influence and State Power

### House Ways and Means Committee

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<th>Total Contributions 1979–80</th>
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<th>Business % of PAC</th>
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