GROWTH STRATEGIES AND CORPORATE TAXATION:

POLITICS AS CAUSE AND EFFECT

Cathie Jo Martin

INTRODUCTION

Confronted with the corporate changes in the Tax Reform Act of 1986, a well-educated Martian might conclude that American business had slipped from its privileged position. The reform act was expected to shift about $120 billion from individual to corporate taxpayers. Although the act reduced the corporate rate from 46% to 34%, it eliminated or greatly scaled back most of the selective incentives developed over the years to promote economic growth. The explicit rationale for these changes was to instill horizontal equity into the system and to get government out of the business of directing investment decision.[1]

Our intergalactic observer would also be surprised by the nature of the policy process which delivered the reform act. The politics of reform was very "state-centered," in that, politicians initiated the policy and legislators sought to restrict business involvement during the legislative process. Although a segment of the business community supported changes in the distribution of the tax

Research in Corporate Social Performance and Policy, Volume 14, pages 57-76.
Copyright © 1993 by JAI Press Inc.
All rights of reproduction in any form reserved.
ISBN: 1-55938-732-7

GROWTH STRATEGIES AND CORPORATE TAXATION:

POLITICS AS CAUSE AND EFFECT

Cathie Jo Martin

INTRODUCTION

Confronted with the corporate changes in the Tax Reform Act of 1986, a well-educated Martian might conclude that American business had slipped from its privileged position. The reform act was expected to shift about $120 billion from individual to corporate taxpayers. Although the act reduced the corporate rate from 46% to 34%, it eliminated or greatly scaled back most of the selective incentives developed over the years to promote economic growth. The explicit rationale for these changes was to instill horizontal equity into the system and to get government out of the business of directing investment decision.[1]

Our intergalactic observer would also be surprised by the nature of the policy process which delivered the reform act. The politics of reform was very "state-centered," in that, politicians initiated the policy and legislators sought to restrict business involvement during the legislative process. Although a segment of the business community supported changes in the distribution of the tax

Research in Corporate Social Performance and Policy, Volume 14, pages 57-76.
Copyright © 1993 by JAI Press Inc.
All rights of reproduction in any form reserved.
ISBN: 1-55938-732-7

burden, policy entrepreneurs clearly led the initiative and limited concessions to special interests with a zero-sum rule demanding that all changes be revenue neutral (Birnbaum & Murray, 1987, pp. 17-22; Conlan, Wrightson, & Beam, 1990). Special interests were also excluded through a high degree of bipartisanship. Although this cooperation ebbed and flowed, interparty agreement kept reform moving forward at critical junctures.

How can we explain this fairly profound shifting of the tax burden back onto business, and the relatively limited role of corporate interests in legislating this policy? In this paper, I argue that the unusual features of the Tax Reform Act of 1986 reflected a pronounced change in the way that government leaders viewed economic growth, and a new politics to achieve that growth. Tax reform attempted to fundamentally reconstruct corporate taxation around very different assumptions about accumulation, what we might call "postindustrial" growth. This view suggested that the tax incentives for investment in capital-intensive manufacturing industries no longer served their purpose. Investment in human resources and in information-intensive activities was as important as the expansion of plant and equipment, and should not be discriminated against by the tax code.

The reduced role for business must also be understood as a byproduct of the new approach to economic growth. The new growth strategy compelled a very different role for the state in the economy and a different kind of politics from the old order. The tax investment incentives were created in the 1960s, at a time when Keynesian economists prescribed government intervention for economic and social ills. Executive branch entrepreneurs sought support from allies in the business community to carry out these Keynesian mandates. Thus, increased business participation in policy making was an outgrowth of increased state intervention in the economy.

The growth prescriptions underlying tax reform in 1986 favored tax neutrality, less government direction of private investment decisions, and generally less intervention into the economy. This scaled-back role of the state suggested a scaled-back role for special interests as well. In a policy would of reduced state intervention, political entrepreneurs had less reason to mobilize their private sector allies. Thus, the new growth strategy affected both the policy *process* and *content* of tax reform.

The tax reform case illustrates an essential truth about corporate political behavior—that the levels and forms of business participation are greatly influenced by the economic goals and assumptions of government actors. How policy makers think about economic growth shapes their view of the appropriate corporate role in the political process. Thus, there is a relationship be tween the overarching growth strategies guiding state intervention in the economy and the level of business activism.

Corporate activism is tied to economic gr wth strategies in the following way. First, business political activity reflects not only corporate America's own

decision to mobilize, but also political leaders' actions to stimulate private sector participation. Thus corporate political activity can stem from either bottom-up activism or from top-down mobilization by government agents who view business as an important source of support (Martin, 1989). Second, different goals for economic growth elicit different levels and types of state intervention. Consequently, political leaders' efforts to cultivate corporate allies will be shaped by what the former want to achieve. Third, when the ruling political coalition becomes committed to an economic path, a repertoire of political interventions becomes more desirable. Thus, economic development has an internal logic that lends favor to certain forms of political arrangements over others. Overarching economic strategy suggests certain political forms. Thus in thinking about the sources of business activism, one must not overlook the larger economic ends to which such activism is directed and state efforts to guide business toward those ends.

THE PRIVILEGED POSITION OF BUSINESS AND GROWTH STRATEGIES

The relationship between economics and politics has been a question of perennial interest for political scientists. A wide range of theorists from structural Marxists to modernization theorists recognized a primacy of economic systems in political life. Marxists argue that economic systems have a functional need for certain kinds of political arrangements to maintain their reproduction. Political superstructures serve functions for economic development such as assuring accumulation and maintaining the hegemony of the dominant class. Poulantzas, for example, argued that the historic shift from feudalism to capitalism created the need for a different kind of states. No longer was a directly-coercive political apparatus necessary to maintain the relations between classes. The seeming free exchange of labor for money under capitalism allowed class relations to be negotiated outside the state sphere (Poulantzas, 1978). In advanced capitalist countries, states will not make policy that goes against the interests of the dominant class, because the government depends on that class for its own financial continuance. Thus, Lindblom (1977) argues that business enjoys a "privileged position" vis-à-vis government by virtue of its control over investment decisions.

Modernization theorists share a bias for the primacy of the economic. They believe that convergence will take place between governments in all like societies. Skowronek argues that the traditional modernization view of state-building saw political development as "the natural and adaptive reaction of governments to changing conditions" (Skowronek, 1982, p. viii.) Huntington argues that economic systems at certain stages of development have structural-functionalist requirements for political institutions.[2]

The idea that political processes are guided by economic structures is also found in the literature on corporate strategy. Stigler (1971) and Posner (1971) develop an economic theory to explain when companies will organize collectively to seek the benefits of regulation. Porter (1980) expands this analysis of the industrial sector characteristics which influence the rules of and strategies for competition. Ferguson (1984) uses an industrial sector analysis to understand firm involvement with public policy.

The argument that political behaviors are, in a sense, determined by the economic system has been criticized on four general grounds. First, the microfoundations of this abstract relationship are ignored. If one accepts that certain kinds of political behaviors are functional for economic systems, one must, none the less, identify the source of this judgment call. As soon as one introduces an element of human discretion into this relationship, perception becomes important. This may help to explain the anomaly identified by Block: state policies are not always functional, even though they are supposed to fulfill functional ends. (Block, 1977, pp. 6-28).

Second, this systematic influence of economic systems on political development neglects the separate and somewhat independent workings of the state. Government institutions have a logic and a politics of their own that shape the course of political development (Evans, Rueschemeyer, & Skocpol, 1985). Historically dependent events can redirect political evolution onto new paths. Some policies pose a greater threat to disinvestment than others; therefore, some will be more subject to economic constraints than others (Pierson, 1991).

Third, economic growth affects the various parts of the business community differently. Varied economic policies create different winners and losers (Kurth, 1979, Gourevitch, 1977). Therefore, unified opposition to investment-threatening state activity rarely occurs.

Finally, growth itself is not a unified concept; rather, there are a number of ways to combine resources to produce economic growth. Stages of economic development are more indeterminate than is often acknowledged. Aglietta (1987) and Lipietz (1987) argue that these various avenues to growth require very different political institutions to perpetuate growth and reproduce the system.[3] Choice of growth strategy becomes a point of contention; new approaches are arrived at through political struggle.

These criticisms suggest a primary of the political—the resolution of political conflict, both within the state and within business, determines the choice of economic growth strategies. Rather than economic systems creating a functional demand for a certain kind of politics, political developments deliver strategies for economic growth. Much of the recent work on corporate political strategies emphasizes the political institutional origins of business preference and mobilization. Thompson (1982) points out that the firm has multiple objectives and should be viewed as a "nonunitary actor" with

conflicting and ambiguous interests. Fligstein (1990) suggests that the organizational field in which a firm is located helps the company to interpret its interests and to arrive at its objectives. Best (1990) argues that firms are guided in their choices of competitive strategies by national modes of regulation. Jorde and Teece (1989) and Littlejohn (1987) suggest that the main thrust of corporate competitive strategy in the United States is changing as managers rethink the right balance between competition and cooperation. Preston and Post (1981) urge political action for corporate social responsibility. Yoffie (1984) applies the concept of strategy to the political realm in a discussion of why some companies emerge as political entrepreneurs. Vogel (1989) and Harris (1989) tie the political mobilization of business in the 1970s to the changes in the regulatory climate.

While I am in enormous sympathy with this perspective, I am hesitant to rule out the obverse relationship: overarching economic strategies can also delineate political ones. Rather there also seems to be a reciprocal systematic influence of economic growth strategies on political processes. Once commitment is made to a course of growth, economic ambitions predispose a certain kind of politics. Since political institutions are essential to implement the tasks necessary for economic growth, the choice of growth strategy must, in turn, delimit the choice of political institutions.

During periods of crisis the political institutions responsible for coordinating economic growth become objects of contention. The resolution of the crisis entails the creation of new institutions or the transformation of old ones. At this point the fluidity of the crisis period is replaced with a more stable order, and institutional rigidity sets in. One in place, the institutions of the new order have a systematic effect on politics (Hall, 1986). Politics then can be said to constitute both cause and effect. Overarching growth strategies are politically constituted as outcomes of historically contingent political struggle. But, once in place, these growth strategies create a need for certain forms of political action in both the public and private spheres.

This insight has been used to explain changes in national political systems. The perception of a failed economic regime contributes to the rejection of the system of politics surrounding it. Schmitter speculates that "qualitative changes in the production process" may signal an end to corporatism. The new productive processes will no longer necessitate national macroeconomic standards; rather, policies to improve productivity and competitiveness will be in order (Schmitter, 1989, pp. 69-70). Goldthorpe writes that convergence theorists assumed that modern capitalist polities would converge in a political order called "pluralistic industrialism." Yet, convergence theory was a product of its time during the Keynesian boom; in an era of economic decline, there is no place for this theory (Goldthorpe, 1984, pp. 317, 322). My argument here is that overarching growth strategies also have a systematic influence on private-sector political organization as well.

In the following pages I show how changes in these general growth strategies explain the radical shifts in direction of corporate taxation. First, I review the commercial Keynesian system in place in the 1960s and the politics supporting that system. Second, I discuss the decline of Keynesianism and the search for a new order. In the late 1970s, policy makers experimented with hyperaccumulation, which rejected Keynesian demand management and focused exclusively on capital investment. Third, I examine the Tax Reform Act of 1986 and suggest that this legislation represented an entirely new set of assumptions about growth. I illustrate how the emerging strategy evolved through political struggle. Finally, I discuss how the new assumptions about growth explain the change in politics surrounding tax reform.

THE COMMERCIAL KEYNESIAN GROWTH STRATEGY

The postwar American economy was organized around a commercial Keynesian growth strategy (Calleo, 1982; Collins, 1981; Greenberg, 1985; Stein, 1984). This growth strategy had several main components:

- capital-intensive mass production with exceptionally high productivity growth rates;
- high levels of mass consumption to provide a market outlet for the tremendous output delivered by this mode of production; and
- considerable government regulation of the macroeconomy to coordinate production and consumption, maintain adequate levels of each, and provide a state climate for economic growth.

The federal tax system was one of the institutional props included in this growth strategy. The individual income tax was made progressive to stimulate demand. A progressive rate shifts the tax burden off of those lower-income individuals who are most likely to use additional resources for consumption. Corporate taxation was used to stimulate investment and savings and attend to the supply-side requisites of growth. Adequate investment was seen as essential to the capital-intensive mass-production strategy (Canterbury, 1968). The tax burden was manipulated for macroeconomic stabilization purposes: raising taxes in a boom, lowering them in a recession.

Over time, this emphasis on investment had a significant impact on the pattern of corporate taxation. Between 1954 and 1982, the effective tax rates of many sectors decreased dramatically through the creation of selective tax incentives to stimulate growth. The largest of these incentives were the investment tax credit and accelerated depreciation. The investment tax credit allowed firms to subtract $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. And after the passage of the Economic Recovery Tax Act of 1981 (ERTA) the depreciation allowance was expected to be worth $30 billion a year (Lugar, 1984, pp. 204-205).

The emphasis on investment contributed to the decline of the corporate tax share. In 1955, corporate taxes were 27.3% of total federal budget receipts; by 1983, they were down to 6.2% (Pechman, 1983, p. 353.) Also, the capital-intensive investment orientation precipitated a fairly profound redistribution of the tax burden among industrial sectors. Businesses benefited differently from the selective growth incentives. Feld (1982) found the selective incentives to disproportionately benefit large corporations. Lugar suggested that tax incentives were disproportionately available to firms with capital-intensive production processes, growing markets, large-scale operations, and high profits. Using 1975 data, he found that the "receipt of new tax credits per dollar of net income" to be as low as $.0004 in the food and food-processing industry and as high as $0.71 in the lumber and wood products industry (pp. 36-37).

Since a firm's tax burden was affected by its ability to use the selective tax incentives, there was 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. *Tax Notes* surveyed the 1980 tax burden of major corporations in different industrial sectors and found the following: Metal manufacturing had an effective tax rate of 11.8%; paper and wood products, 11.1%; transportation, 11.9%; utilities, 8.5%; and chemical firms, 8.3%. By comparison, labor-intensive sectors were much higher: publishing and printing was 38.2%; food processing, 36.3%; food retailers, 31.5%; and nonfood retail 27.2%. High-technology firms, also labor-intensive, paid high effective tax rates as well: electronic and appliance firms paid 33.5%; instrument companies, 39.7%; and office equipment, 23.0% (Tax Analysts, 1981).

The commercial Keynesian growth strategy required a high degree of state intervention in the economy. This expanded government economic agenda led to a mobilization of business interest for several reasons. First, mobilization of societal interests (especially in the form of corporatism) was used as a mechanism for order. The Keynesian state greatly expanded benefits. Interests mobilized to take advantage of these benefits, and the state set out to organize these interests in order to reduce demands and prevent overload. The corporatist system was thus a way to rationalize decision making, which was made necessary by the expansion of public policy (Schmitter, 1979, p. 74). Corporatism also regulated class conflict, especially in the areas of distribution of national income, structure of industrial relations, and economic policy (Schmitter & Lehmbruch, 1979, pp. 151, 170).

Second, the government sought interest-group participation in the implementation of public policy. Interest involvement was essential to state

planning in order to bring major interest groups together and negotiate agreements (Schonfield, 1965, p. 231). Those who carry out the plans must be involved in decision making. For Streech and Schmitter, private-interest government had functional advantages for implementation, making policy more practical, realistic, and legitimate (Streek & Schmitter, 1985, p. 22).

Third, as macroeconomic management problems increased in the postwar period, governments looked for "Institutional and ultimately political substitutes for the declining efficiency of market mechanisms" (Goldthorpe, 1984, p. 325). Thus, countries with very different patterns of business-government relations have demonstrated a similar impulse toward greater state reliance on private interests. In the United States, reliance on private interests partially compensated for the limited capacity of the American state. Keynesian macroeconomic intervention demanded much more governmental intervention than before. Responsibility for managing the macroeconomy fell to the President, yet the executive branch received no additional power to accomplish its new task (Weatherford, 1985). Share jurisdiction with Congress hindered Presidents from pursuing the new course of macroeconomic management, especially since increased government intervention was resisted by conservatives from both parties.

The Democratic presidents of the 1960s, Kennedy and Johnson, responded to their dilemma of responsibility without power with a political innovation, the coalition strategy. These growth-oriented presidents began to cultivate business allies to mobilize support for their economic agenda, and to fight their opponents in other branches and parties. Although business people have always pressured political figures, and presidents have always consulted with leaders of industry, the coalition strategy represented a new innovation. The mobilization of business was much more systematic: trade associations representing entire industrial sectors were organized by presidential staff. Business-liaison advisors in the executive branch urged business groups to cultivate a political expertise, hitherto underdeveloped in these organizations. Thus, the rise of trade associations on the American political scene was neither a spontaneous response to the reformist policies of the late 1960s and early 1970s, nor to the structural reforms emasculating party and Congress.[4] Rather, the executive branch encouraged the expansion of interest groups as political organizations even before structural changes in Congress and reformist policy initiatives (Martin, 1991).

THE HYPERACCUMULATION RESPONSE

The economic decline of the 1970s called into question the Keynesian growth strategy. The most visible aspect of the economic decline was a startling drop of the productivity growth rate. From 1948 to 1966, United States productivity

grew at an annual rate of 3.3%; from 1966 to 1973, 2.1%; and from 1973 to 1978, 1.2% (Wolff, 1985, p. 32). Although the productivity growth rate declined elsewhere, the problem was especially severe in the United States. Parallel to the productivity problem was the 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 (President's Commission on Industrial Competitiveness, 1985, p. 13).

Problems with sustaining growth led to suffering among business and labor. The average net after-tax rate of profit of domestic nonfinancial corporations dropped from nearly 10% in 1965 to less than 6% by the second half of the 1970s (Harrison and Bluestone, 1988, pp. 115-117). Total real wages for the manufacture of durable goods dropped by 17.5% between 1973 and 1986; for nondurable goods, by 9.7%.

The slowing of the economy cast doubts on commercial Keynesian growth, bringing regulatory policy, social welfare spending,and the tax system all under scrutiny. Initially, Keynesian demand management came under attack and the balance between supply and demand shifted decisively in favor of supply-side incentives. Later, as we shall see, the supply-side measures would also be challenged.

A new breed of neoclassical economists captured the public imagination, charging that the sharp drop in productivity was connected to lagging investment and insufficient available capital. A capital shortage constrained the expansion of production, left industry with outdated plants and equipment, and inhibited the kind of technological innovation that leads to productivity growth. Two aspects of Keynesian fiscal policy were criticized. First, critics blamed the Keynesian emphasis on demand stimulation and the progressive tax rates to achieve it. Second, although investment already enjoyed favorable corporate tax treatment, neoclassical critics felt that the Keynesian measures limited investment capital. Economists from a wide range of backgrounds recommended expanding selective tax incentives to save the invest (Feldstein, 1983, pp. 23-24; Ture & Sanden, 1977).

In 1978 and 1981, tax acts greatly reduced the taxation of capital in an effort to increase investment and resuscitate the economy. The Economic Recovery Tax Act of 1981 expanded the investment tax credit and greatly enlarged depreciation benefits with the Accelerated Cost Recovery system. Kopits calculated the United States "tax subsidy rate" on manufacturing investment to be 1.3% of the asset price in 1973; by comparison the Japanese tax subsidy rate was −3.4%. Japan taxes rather than subsidizes capital. After ERTA in 1981, the U.S. rate jumped to 12.8%; Japan's rate was still −3.4%.[5] This exacerbated the differences in effective tax rates across industrial sectors.

Despite these remarkable tax transfers to the business community, the "hyperaccumulation" solution did not restore economic prosperity. First, the investment incentives failed to trigger the promised supply-side recovery and

the economy sank deeper into recession. Investment in plant and equipment for all industry sunk from $155.21 billion (1972 dollars) for the first quarter 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 (1972 dollars) did investment surpass the 1981 level (Seskin & Sullivan, 1985, p. 33; Seskin 1985, p. 21.). ERTA proponents retort that the investment inducements were constricted by tight monetary policy, enacted at the same time and designed to reign in stampeding inflation. By driving up interest rates, monetary austerity deterred industry from investing and largely canceled out the expansionary impetus of the tax act. Also, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) took away many of the benefits of the 1981 bill. Charles Hulton, Urban Institute, calculated that ERTA would cut the average tax rate on investment in new plant and equipment from 33% to 5%. TEFRA would increase it again to 16% (1984, pp. 53-4).

Second, when the economy finally recovered, increased consumer spending resulting from the huge individual rate was responsible. Ironically, despite ERTA's avowedly anti-Keynesian language, the demand-oriented individual tax cuts greatly outshone the investment measures as economic stimulants. Third, although the 1981 act failed to revive the economy, it managed to create huge budget deficits.

Simultaneous to the eroding belief in the supply-side ideology, significant sectoral change compromised the standing of capital-intensive manufucturers. Imports as a percentage of the GNP originating in the United States manufacturing sector increased from 13.9% in 1969 to 37.8% in 1979, and to 44.7% in 1986 (Harrison & Bluestone,1988, p. 9). Between 1979 and 1984, steel companies laid off 45% of their workforce. Exports of construction equipment dropped 63% from 1981 to 1983; machine tools dropped 60% in this period (Alexander, 1984, p. 63). Shifts in the composition of the economy were projected to generate new jobs in rapidly-growing, sunrise industries (Silvestri & Likasiewicz, 1987, pp. 49-50). The special incentives for manufacturing were increasingly hard to justify.

TOWARD A POST-INDUSTRIAL ORDER

In the 1970s, Keynesian demand stimulants came under attack; in the 1980s, the supply side of the formula was questioned as well. Economists feared that the capital incentives changed the composition of investment rather than increased the total amount of capital (Eisner & Nadiri, pp. 369-83; Lugar, 1982, pp. 33-47.). Critics worried that the investment incentives created a tendency toward overinvestment (inappropriately replacing individuals with capital) and overinnovation (the excessively rapid introduction of new technology) (Bowles, Gordon, & Weisskopf, 1983; Brenner, 1990, pp. 2-3; Roach, 1987, pp. 1-2;

Schneider, 1987, 2-3.). Even the *Harvard Business Review* began to worry about the human climate in which equipment is introduced (Hayes & Abernathy, 1980, pp. 76-77; Skinner, 1974; pp. 113-114; Wheelwright & Hayes, 1985, pp. 99-109).

Dissatisfaction with the old accumulation strategy led to talk of a new postindustrial approach to growth. The postindustrial system would have the following components: Services and knowledge-intensive sectors would be much larger parts of the economy. Production processes would sift from Fordist mass production to "flexible specialization" producing small-batch specialty products. Investment strategies would, therefore, also change from an emphasis on capital-intensive investment to 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 (Sable & Piore, 1984).

The Tax Reform Act of 1986 was geared to equalize these inequities by eliminating such cornerstones of the tax code as the investment tax credit, accelerated depreciation allowances, passive loss deductions, and the differential treatment of capital gains. All this was done in the name of tax neutrality. Granted, the act greatly benefited upper-income taxpayers by reducing the top rate of 28%. But although wealthy individuals might benefit as "heads of household," they would certainly suffer as "leaders of industry."

Tax reform was explicitly motivated by a different view of growth from the older emphasis on capital investment. First, tax reform sought to achieve neutrality or a "level playing field" with respect to investment capital. Richard Darman wrote:

> A depreciation system that is nearly neutral across classes of investment will lead to a more efficient allocation of capital (*"What Tax Reform,"* 1985, p. 129).

Second, reform was expected to revive investment in human resources. To this end, the President's Commission on Industrial Competitiveness recommended restructuring the tax code to equalize investment in physical and human capital (President's Commission on Industrial Competitiveness, 1985, pp. 28, 25).

Third, tax reform was expected to improve competitiveness by improving the utilization of resources. In this vein Andrew Lyon (1987) wrote:

> The traditional approach to economic growth has called for increasing output per capita by increasing the capital stock of the economy. However, economic growth can also be achieved by utilizing the capital stock more efficiently. Economic efficiency offers the true productivity miracle—increasing output without requiring greater inputs. Just as a factory floor can be made more efficient by a rearrangement of machinery that reduces the steps a worker must take to perform an activity, the national economy can be made more productive by achieving a better allocation of its resources... The Tax Reform act recognized that tax incentives can cause less productive investments to be chosen over more productive investments. (p. 360)

Finally, the major remaining selective tax incentive, the research and development credit, was expected to shift investment into new sectors. Darman wrote, "With the elimination of most other credits, the research and development tax credit will be more attractive, and increased R&D will improve productivity" (*"What Tax Reform,"* 1985, p. 129). Finally, the tax act, at least symbolically, signified a relative deemphasis of the role of the federal government in directing economic growth.

Despite the aggregate increase in the corporate tax burden, especially on heavy industry, many sectors actually benefited from the tax act. The rate cuts mainly helped high technology, small business, and service sectors, at the expense of heavy industry. One journalist called the Way and Means bill "a bill that is pro-consumption and anti-capital investment, one destined to accelerate the nation's already powerful shift from a manufacturing to a service economy" (Reilly, 1985, p. 106). A study of the effect of tax reform on small business found that 60% of the sample thought that tax reform would *not* lead to higher taxes. Of small manufacturing and construction firms, 44% feared a tax increase, but only 25% in service companies worried about this (Liebtag, 1987, p. 91). Hardwich Simmons, vice-chair of Shearson Lehman Brothers, said of the Senate Finance bill: "If the bill becomes law as it is, we're in fat city" (Cifelli, 1986, p. 18).

POLITICAL STRUGGLE AND THE DAWNING OF THE NEW REGIME

The closing of the investment incentives and the radical redistribution of the corporate tax burden back onto capital-intensive sectors only makes sense with the acceptance of a radically different approach to growth. Changing assumptions about growth pushed government policy makers in the direction of tax reform, a concept increasingly viewed as necessary for a sound economic future. One Ways and Means participant in the early retreats on tax reform recalled much discussion about "promoting economic growth and cleaning up the tax system.... I walked out of there and thought: 'Jesus, public policy really becomes important'" Another reported: "A lot of the discussion was about what was good for the economy, good for growth" (Strahan, 1989, p. 378).

Good politics reinforced good policy. With the failure of the early Reagan interventions to resuscitate the economy, the Democrats began a campaign to seize control of the economic agenda. In their 1984 bid for election, the Democrats put forth an idea that had gained currency with economic academics associated with their party:—economic restructuring through industrial policy (Rohatyn, 1983, pp. 129-133). Advocates of industrial policy also recommended tax reform, however, this was a sideshow to the main program.

The Republicans, listening to their own constituents in the high technology and service sectors, realized that they, too, needed to develop policy to enable the transformation of the American economy. The relationship between tax reform and industrial policy is made clear by Stokes (1985):

> In recent years, many liberals have advocated an industrial policy to revitalize failing industries.... In contrast, the conservatives' approach would improve productivity by restructuring the tax code, liberalizing antitrust laws and beefing up federal support for R&D, all spurring export-oriented economic growth. (pp. 2298-2301)

The Republicans wanted to avoid additional government intervention, worried about market distortions, and generally viewed industrial policy as an inappropriate vehicle for economic restructuring (McLennan, 1986, pp. 52-54). Instead, they chose tax reform as a solution. This solution was one which had been frequently used by the government in the past to further economic goals. Tax reform offered a mechanism for negating the skews in investment incentives and redistributing resources toward rapidly growing sectors while minimizing state intervention. In this vein, the Committee for Economic Development's Kenneth McLennan argued that tax policy avoided some of the targeting problems of industrial policy but accomplished many of the same goals:

> 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. (p. 46-47)

Business sectors also joined the struggle over reform, bringing to the conflict vastly different conceptions of economic growth. The *National Journal* reports:

> The split has created a kind of class warfare, with capital-intensive companies contending that the President's plan is unfair to them and service-oriented industries arguing that it gives them more tax equality. The divisions are just as deep on larger questions, such as

what the plan will do for the country's over-all economic growth and competitiveness in international markets. (Cooper, 1985, p. 1675)

Capital-intensive manufacturing and real estate sectors had the most to lose from the new approach to growth, since they had been the biggest beneficiaries under the old regime. Lobbyists for capital-intensive industries attacked the new assumptions about growth underlying tax reform, and warned that competitiveness would suffer.

Groups like the Basic Industry Association, the American Council for Capital Formation, and the Coalition for Jobs, Growth, and International Competitiveness worked to build support for policies to foster capital-intensive investment. The National Realty Committee organized 300 large developers and syndicators to fight reform.

Tax reform was supported by those parts of the business community who were most discriminated against by the earlier system. The Tax Reform Action Coalition (TRAC) was composed of firms and associations from high technology, wholesale, retail, food processing, and other small business sectors. TRAC first met June 11, 1985 and eventually had 700 groups from business and consumer causes. The goal of the group was to keep the legislative eye focused on the prize of the corporate rate cuts and not give in to more sectarian demands which could eventually push tax rates up again. Jack Albertine (American Business Conference) explained:

> The purpose of TRAC is to try to move the legislative process forward, to try to build a countervailing constituency on the other side for tax reform, because obviously there are a lot of people who don't want to see [a bill] move forward. (Cooper, 1985, pp. 1675-1677)

Business groups supporting tax reform joined the logic of equity to the logic of growth, pointing to the great variation between industrial sectors. The increasing untenability of the old investment strategy added to the demand for greater equity, since people are less willing to tolerate deviations that appear to have no useful purpose.

NEW POLITICS FOR A NEW ORDER?

Despite the support of a segment of business, societal interests were less important in setting the agenda for tax reform in 1986 than they had been in 1981. Until the final days of the legislative battle, the power balance in the business community was heavily weighted toward the opponents of reform. Yet, the reform legislation miraculously passed. State actors were responsible for initiating the reform effort and constructed the societal coalition around the act. Although tax reform enjoyed business support, policy makers and

business allies alike sought to prevent the emergence of pork-barrel politics which has characterized other tax acts. Toward the end of the legislative effort, groups were required to support the bill in its entirety: private bargaining for tax concessions became grounds for expulsion from the group. All involved feared that particularistic demands would detract from the larger goal of lower rates.

This special zero-sum nature of the reform process was related to the assumptions of the emerging growth strategy. Under Keynesianism, a high degree of state intervention created possibilities for interest-group participation. But, a postindustrial system of growth, entailing less macoreconomic intervention by the state, could also serve to restrict interest-group involvement in policy making.

The relationship between changed economic conditions and political practices has been noted in other settings. Recent years have demonstrated a trend toward automatic government. Automatic formulas, such as the Gramm-Rudman-Hollings Act, alleviate decision-making overload, limit discretion, and help politicians avoid the pressure of taking repugnant policy decisions. Weaver explains this emergence of "automatic government" as a product of the changing fiscal climate brought on by economic decline and the budget deficit. The climate of fiscal austerity has changed the incentives of government actors. During periods of fiscal stress, politicians are less able to satisfy the many claims society-based groups make on government. Policy decisions are likely to be unpopular; therefore, politicians look for ways to avoid blame. A "circle-the-wagons" strategy allows politicians to avoid blame by seeking agreement among themselves and presenting a united front to the public (Weaver, 1988, pp. 24-26).

CONCLUSION

In this paper, I argue that the peculiarities of the tax reform act reflect a fundamental change in our way of organizing growth. The corporate tax burden was redistributed according to entirely different assumptions about the best way to invest in our economic future.

The changing assumptions about accumulation also had an impact on the corporate political behavior exhibited in the process of legislating taxes. The new growth model mandated very different roles for both the state and society in economic management. The postindustrial economic strategy nicely complemented the general ambition of the Reagan administration to get the government out of the economy. From one perspective, the tax investment incentives could have been viewed as pro-business, growth subsidies, likely to elicit support from the Reagan administration. But from another point of view, the tax incentives could be portrayed as devices for government

micromanagement of the economy, thus contradicting the Reagan ambition to roll back the state.

This new policy approach was successfully legislated with the help of some business groups who felt discriminated against by the previous distribution of the tax burden. Therefore, business did not entirely lose its privileged position; rather, "tax reform represented a realignment in the business community" (Interview by author, 1988). But, although a segment of business played a role in the process the general contribution of societal interests was greatly diminished.

What implications to these observations have for the future course of corporate involvement with economic policy? To some extent the long-term impact of the tax reform episode on corporate behavior has been limited for two reasons. First, the assumptions of tax reform did not become the undisputed new growth strategy. The Clinton administration's leanings toward reindustrialization are likely to produce a very different system of corporate taxation, as seen in the recent proposal for an investment tax credit. Again, selective tax incentives are being discussed as mechanisms for stimulating growth; concerns about level playing fields and tax neutrality are fading into the background. This new approach to growth will undoubtedly require a different role for business as well. The Tax Reform Act of 1986 represented a significant break with the old Fordist/Keynesian growth strategy and we are currently in transition, but the new order remains to be seen.

Second, economic-system requirements for a new politics do not automatically produce radical changes in the governance structures, since other institutional legacies perpetuate behavior. Government encouraged business to mobilize in the 1960s to meet the requirements of Keynesian growth; but this does not mean that government actors have the power to demobilize significantly groups in the 1980s. But just because the state took an active role in the political expansion of business, doesn't mean that it will have the power to "put the genie back into the bottle."

Yet, the case of tax reform suggests to those with an interest in the origins of corporate political behavior that greater attention should be paid to state economic goals and to the attempts of government actors to muster private support for those goals. All too often, we assume that the political participation of business is exclusively shaped by dynamics within firms, industrial sectors, or umbrella trade associations. The macroeconomic context is too frequently neglected in this discussion.

The observation that business politicking varies across economic contexts suggests a wider range of possible corporate-political interventions than is often assumed. If the thinking and political actions of business people, like that of other Americans, is swayed by the currently popular strategies for economic growth, then business is likely to demonstrate a range of potential behaviors in the public sphere.

Finally, tax reform suggests an interaction between economic systems and political institutional development at the level of private-sector politics. This relationship is a two-stage process. The choice of a new growth strategy and the institutions within which it is embedded is the outcome of political struggle; therefore, this choice is not economically determined. Yet, the institutions generating the success and reproduction of this system will structure political processes in a new way. Politics is both a cause and effect of economic transformation.

NOTES

1. Certainly, one should not forget that vertical equity (or having those with the ability to pay contribute more) was sacrificed even while horizontal equity (having all in one income level pay the same) was pursued.
2. Certain dynamics tied to modernization, such as, increasing class conflict associated with growth of the capitalist economy, increases in social complexity, and the expansion of markets, make the different parts of countries more interconnected, and brings countries closer together. These dynamics create an imperative for a modern state—an administrative structure that can coordinate the increasing social complexity, manage class conflict, and provide infrastructure for the expanding markets. Thus, the modernization of political institutions in advanced societies has three elements: the rationalization of authority throughout the country, the differentiation of political functions and the evolution of specialized political institutions to address these functions, and an expansion in political participation. So the growth of modern state institutions is a natural outgrowth of the forces associated with capitalist development and national integration. Societies may experiment with various political forms to fulfill these functional requirements, but the forms which are most compatible and stable ultimately are implemented (Huntington, 1968).
3. The regime of accumulation consists of the general model for growth and the institutional arrangements which coordinate production and consumption to this end. The concept specifies the conditions regulating the use of labor, the wage relation, investment, the monetary system, and other arrangements necessary for growth to transpire in an economy. For more on this, see Aglietta (1987), Lipietz (1987, p. 14), Jessop (1988), Quadagno (1988, p. 6)
4. For the contrary view, see Wilson (1986).
5. George Kopits at the International Monetary Fund, cited by Michael Barker and Michael Kieschnick, "Taxes and Growth", *Tax Notes*, Special Report (May 7, 1984), p. 635.

REFERENCES

Aglietta, M. (1987). *A theory of capitalist regulation*. New York: Verso.
Barker, M., and Kierschnick M. (1984). Taxes and growth. *Tax Notes* [Special Report], *23*(6), 629-636.
Baumol, W., and McLennan, M. (Eds.) (1985). *Productivity, growth and U.S. competitiveness*, Oxford: Oxford University press.
Best, M. (1990). *The new competition*. Cambridge, MA: Harvard University Press.
Birnbaum, J., and Murray, A. (1987), *Showdown at Gucci Gulch*. New York: Random House.
Block, F. (1977). The ruling class does not rule: Notes on the Marxist theory of the state. *Socialist Revolutions*, *7*(3), 2-28.

Bowles, S., Gordon, D., and Weisskopf, T. (1983). *Beyond the wasteland.* Garden City, NY: Archer Press.

Brenner, R. (1990, October 2). *The international crisis and U.S. decline.* Paper presented at the Seminar on State and Capitalism Since 1800, Cambridge, MA.

Calleo, D. (1982). *The imperious economy.* Cambridge, MA: Harvard University press.

Canterbury, E. R. (1986). *Economics on a new frontier.* Belmont, CA: Wadsworth.

Cifelli, I.A. (1986) The Tax Upheaval: What it means for business. *Fortune, 113*(12), 18-21.

Cigler, A., and Loomis, B. (Eds.). 91986). *Interest group politics.* Washington, DC: Congressional Quarterly Press.

Collins, R. (1981). *The business response to Keynes.* New York: Columbia University Press.

Conlan, T., Wrightson, M. and Bean, D. (1990). *Taxing choices.* Washington, DC: Congressional Quarterly Press.

Cooper, A. (1985). New business coalition wants to keep the ball rolling on Reagan's tax reform plan. *National Journal,* 29(17), 1675-1679.

Edwards, G.C., Shull, S.A. and Thomas, N.C. (Eds.). (1985). *The presidency and public policy making.* Pittsburgh: University of Pittsburgh Press.

Eisner, R., and Nadiri, M.I. (1968). Investment behavior and neo-classical theory. *The Review of Economics and Statistics, 50*(3), 369-382.

Evans, P.B., Ruschemeyer, D. and Skocpol, T. (1985). *Bringing the state back in.* Cambridge, MA: Cambridge University Press.

Feld, A. (1982). *Tax policy and corporate concentration.* Lexington, MA: Lexington.

Feldstein, M. (1983). Fiscal policy for the 1980s. In Charls Walker and Marck Bloomfield (Eds.) *New Directions in Federal Tax Policy for the 1980s.* Cambridge, MA: Ballinger Press.

Ferguson, T. (1984). From normalcy to New Deal: Industrial structure, party competition, and American public policy in the Great Depression. *International Organization 38*(1) (Winter), 41-94.

Fligstein, N. (1990). *The transformation of corporate control.* Cambridge, MA Harvard University Press.

Foster, J.B. (1988). The fetish of Fordism. *Monthly Review, 39*(10), 14-33.

Goldthorpe, J. (ed.). (1984) *Order and conflict in contemporary capitalism.* Oxford: Clarendon Univeristy Press.

Gourevitch, P. (1977). International Trade, Domestic Coalitions and Liberty. *Journal of Interdisciplinary History.* (Autumn).

Greenberg, Ed. (1985). *Capitalism and the American political ideal.* Armonk, NY: M.E. Sharpe.

Hall, P. (1986). *Governing the economy.* New York: Oxford University Press.

Harris, R. (1989). Politicized management: The changing face of business in American politics. In R. Harris, and S. Milkis (Eds.), *Remaking american politics* (pp. 261-286). Boulder, CO: Westview Press.

Harrison, B., and Bluestone B. (1988). *The great U-turn.* New York: Basic.

Hayes, R. and Abernathy, W. (1980). Managing our way to economic decline. *Harvard Business Review, 58*(4), 67-77.

Huntington, S. (1986). *Political order in changing societies.* New Have, CT Yale University Press.

Jacobi, O., Jessop, B., Kastendick, H., and Regini, M. (Eds.). (1986). *Economic crisis, trade unions and the state.* London: Croom Helm.

Jessop, B. (Ed.). (1988). *Accumulation, regulation, and the state.* London: Century-Hutchinson.

Jorde, T., and Teece, D. (1989, Spring). Competition and cooperation: Striking the right balance. *California Management Review, 31.*

Kurth, J, (1979). The political consequences of the product cycle: Industrial history and political outcomes. *International Organization, 33*(1).

Liebtag, B. (1987) Capital formation by small business, *Journal of Accountancy, 163*(6), 82-92.

Lindblom, C. (1977) *Politics and markets.* New York: Basic.

Lipietz, A. (1987) *Mirages and miracles.* New York: Verson.

Littlejohn, S.E. (1987). Competition and cooperation: New trends in issue identification and management at Monsanto and Gulf. In A. Marcus, A. Kaufman, and D. Beam (Eds.), *Business strategy and public policy* (pp. 19-30).

Lugar, M. (1982, Spring) Tax incentives and tax inequities. *Journal of Contemporary Studies,* pp. 36-37.

Lyon, A.B., (1987, Autumn). Tax reform and economic Productivity: An overview of the goals and results of the Tax Reform Act of 1986. *National Productivity Review,* p. 360.

Martin, C. Jo. (1989). Business influence and state power:The case of U.S. corporate tax policy. *Politics & Society, 17*(2), 189-223.

_______. (1991). *Shifting the burden: The struggle over growth and corporate taxation.* Chicago: The University of Chicago Press.

McComas, M. (1984). Did supply-side incentives work?. *Fortune, 110*(11), 55-54.

McLennan, K. (1986). The case for a non-targeted approach to industrial strategy. In F. Stevens Redburn, Terry Buss, and Larry Ledebar (Eds.), *Revitalizing the U.S. economy* (pp. 46-47). New York: Praeger.

Pechman, J. (1983). *Federal tax policy.* Washington, DC: The Brookings Institution.

Pfiffner, J. (Ed.). (1986). *The president and economic policy.* Philadelphia: Institute for the Study of Human Issues.

Pierson, P. (1991, November). *Politics, markets and the formation of the American welfare state.* Paper presented at the workshop on Emergent Supranational Social Policy, Harvard University.

David P. (1988, September). The political mobilization of business, 1974-1980. Paper presented at the APSA, Washington, DC.

Porter, M. (1980). *Competitive strategy: Techniques for analyzing industries and competitors.* Free Press.

Posner, R. (1971). Taxation by regulation. *Bell Journal of Economics and Management Science, 2*(1), 22-50.

Poulantzas, N. (1978). *Political power and social classes* (T. O'Hagan, Trans. London: Verso.

President's Commission on Industrial Competitiveness. (1985). *Global competition: The new reality.* Washington, DC: U.S. Government Printing Office.

Preston, L.E. and Post, J.E. (1981, Spring). Private management and public policy. *California Management Review,* XXIII(3), 65-57.

Quadagno, J. (1988). *The transformation of old age security.* Chicago: University of Chicago Press.

Redburn, F.S., Buss, T., and Ledebur, L. (Eds.). (1986). *Revitalizing the U.S. economy.* New York: Praeger.

Reilly, A. (1985). A tax bill that hits investment. *Fortune, 112*(14), 106.

Roach, S. (1987, April 22). America's technology dilemma: A profile of the information economy. *Morgan Stanley Special Economic Study.*

Rohatyn, F. (1983). *The twenty-year century.* New York: Random House.

Sabel, C., & Piore, M. (1984). *The second industrial divide.* New York: Basic.

Schmitter, P., and Lehmbruch, G. (Eds.). (1979). *Trends toward corporatist intermediation.* Beverly Hills, CA: Sage.

Schmitter, P. (1989). Corporatism is dead! Long live corporatism. *Government and Opposition, 29* (Winter).

Schneider, Keith. (1987, June 29). Services hurt by technology. *The New York Times,* pp. D1, 6.

Seskin, E., and Sullivan, D. (1985). Revised estimates of new plant and equipment expenditures in the United States, 1947-1983. *Survey of Current Business, 65*(2), 16-45.

Seskin, E. (1985). Plant and equipment expenditures, first and second quarters and second half of 1985. *Survey of Current Business, 65*(4), 21-25.

Shonfield, A. (1965). *Modern capitalism*. New York: Oxford University Press.
Silvestri, G., and Likasiewicz, J. (1987, September). A Look at occupational employment trends to the year 2000. *Monthly Labor Review*, Washington, DC: U.S. Department of Labor Statistics.
Skinner, W. (1974). The focused factory. *Harvard Business Review*, *52*(3), 113-114.
Skowronek, S. (1982). *Building a new American state*. Cambridge, MA: Cambridge University Press.
Stigler, G. (1971). The theory of economic regulation. *Bell Journal of Economics and Management Science*, *2*(1), 3-21.
Stokes, B. (1985, December). Conservatives eying tax reform as step to pre-business federal economic role. *National Review*, pp. 2298-2301.
Strahan, R. (1989). Members' goals and coalition-building strategies in the U.S. House: The case of tax reform. *Journal of Politics*, *51*(2), 373-84.
Streeck, W., and Schmitter, P. (Eds.). (1985). *Private Interest Government*. Beverly Hills, CA: Save.
Stein, H. (1984). *Presidential economics*. New York: Simon & Schuster.
Tabb, W., and Sawers, L. (Eds.). (1984). *Sunbelt-frostbelt: Urban development and regional restructuring*. New York: Oxford University Press.
Tax analysts. (1981). Effective Corporate Tax Rates in 1980 [Special supplement]. *Tax Notes*. Arlington VA: Tax Analysts.
Thompson, G. (1982, August). The firm as a 'dispersed' social agency. *Economy and Society*, *11*(3), p. 233.
Ture, N. and Sanden B.K. (1977). *The effects of tax policy on capital formation*. Financial Executives Research Foundation.
Vogel, D. (1989). *Fluctuating fortunes*. New York: Basic.
Walker, C., and Bloomfield, M. (Eds.). (1983). *New directions in federal tax policy for the 1980s*. Cambridge, MA: Ballinger.
Weatherford, S. (1985). Macroeconomic Policy Making Beyond the Electoral Constraint. In C. Edwards III (Ed.), *The Presidency and Public Policy Making*. Pittsburgh: University of Pittsburgh Press.
Weaver, K. (1988). *Automatic government*. Washington, DC: Brookings Institution.
What tax reform really means. (1985). *Business Week*, 2899: 128-130.
Wheelwright, S., and Hayes, R. (1985) Competing through manufacturing. *Harvard Business Review*, *63*(1), 99-109.
Williams, K., Cutler, T., and Haslam, C. (1987). The end of mass production? *Economy and Society*, *16*((3), 404-439.
Wilson, G. (1989). American business and politics. In A. Cigler & B. Loomis (Eds.) Interest group politics (pp. 221-235). Washington, DC: Congressional Quarterly Press.
Wolff, E. (1985). The magnitude and causes of the recent productivity slow-down in the United States: A survey of recent studies. In W. Baumol and K. McLennan (Eds.), *Productivity Growth and U.S. Competitiveness*. Oxford: Oxford University Press.
Yoffie, D. (1984). Corporate strategies for political action: A rational model. In A. Marcus et. al. (Eds), *Business strategy and public policy*. (pp. 43-60). New York: Quorum Books.

PART II

CORPORATE PUBLIC AFFAIRS MANAGEMENT