Bureaucracies, economic knowledge and neo-liberal reform:

Explaining diverging tax policy trajectories in New Zealand and Ireland

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Abstract

Why did New Zealand adopt one of the most neo-liberal tax systems in the world, while Ireland pursued a heterodox tax policy of low rates, deep deductions and distortionary tax incentives? The diverging tax policy trajectories of these two small liberal market economies since 1980 are not well accounted for by conventional ideational, partisan or political-institutional explanations. The paper argues that the varying degree of neo-liberal reform is better understood as the result of differences in the institutionalization of economic knowledge within the state. Distinct administrative institutions in New Zealand and Ireland gave rise to profound differences in the identities, expertise, economic ideas and policy advice approach of tax policy bureaucrats, which had a major impact on tax policy-making in the two countries.

Key words: tax policy, neo-liberal, bureaucracy, economists, economic ideas
Introduction

Over the last thirty years, the two small liberal market economies New Zealand and Ireland moved in completely different directions in tax policy. New Zealand was a trailblazer in neo-liberal tax reform. It arguably went further than any other advanced economy in lowering rates, broadening bases and introducing neutral\(^1\) taxation in the 1980s and consolidated this system over the following decades (White 2009; Gemmell 2010).

By contrast, Ireland did not introduce neo-liberal tax reform either in the 1980s or later. Instead, Irish governments from the mid-1990s onwards pursued a heterodox tax policy of lower personal income tax rates combined with a narrowing of the tax base and an expansion of tax incentives for specific economic activities (see Commission on Taxation 2009). This policy played a major role both in the Irish economic boom from 1994 to 2007 and in the subsequent bust (see Honohan 2009).

A glance at the two most important types of taxation – personal income tax and value-added tax (VAT) – can illustrate the policy differences between New Zealand and Ireland. By 2006, both countries had a personal income tax with a relatively low top rate – 39 % in New Zealand, 41 % in Ireland. But while there were no major deductions from the personal income tax in New Zealand, Ireland had large standard allowances and generous tax deductions for pension savings, private health care and investments in specific economic activities such as construction. In the taxation of consumption, New Zealand had a VAT with a uniform low rate of 12.5 % and by far the broadest base among the OECD
countries, while the Irish VAT had a standard rate of 21% but a significantly narrower base (IRD 2008, p.25).

This tax policy divergence is puzzling given the important commonalities between the two countries. New Zealand and Ireland are both small, open economies of the liberal market variety with Anglo-Saxon traditions and networks. Moreover, they faced similar contexts for tax policy choice in the early 1980s: There was strong dissatisfaction with the existing tax system of high rates and deep deductions; the government was facing a major economic crisis; and there were concrete proposals for neo-liberal reform on the table.

The dominant narrative in the tax policy literature is that since 1980 tax policies across the advanced industrial economies have shifted in a neo-liberal direction, moving towards lower rates and broader bases (Swank & S. Steinmo 2002; Swank 2006). Yet, the cases of New Zealand and Ireland draw our attention to the major cross-national tax policy differences that remain (Ganghof 2006, pp.31–33) – not only between political-economic regimes such as liberal and coordinated market economies, but also within regimes.

How can we explain that some countries have gone much further in neo-liberal tax reform than others? The paper attempts to address this question through a focused comparison of tax policy-making in Ireland and New Zealand over the last three decades2. This is a ‘most similar systems design’, as the paper seeks to account for the different tax policy outcomes in two countries that are similar in important respects. To explain the policy divergence the paper draws on 45 qualitative interviews with policy-making elites in Ireland and New Zealand3, as well as official documents and secondary literature.
Obviously, the restricted space does not permit a description of the details of tax policy changes. Rather, I compare the broader changes to these two tax systems. I do however leave out the area of corporate taxation, where Ireland has a very particular history4.

The first issue that needs clarification is what we mean by neo-liberal tax reform. In an influential study of free market reforms, Monica Prasad identifies neo-liberalism with “taxation structures that favor capital accumulation over income redistribution” (Prasad 2006, p.4). However, this broad notion obscures the important distinction between tax reforms that combined reduced rates with broader bases and greater neutrality – such as the 1986 U.S. Tax Reform Act – and reforms that cut rates at the same time as expanding deductions and reducing neutrality – such as the 1981 U.S. Economic Recovery Tax Act (see Slemrod & Bakija 2004, pp.24–25). While the former type of reforms conformed to neo-classical economic thinking about taxation (i.e. UK Institute for Fiscal Studies 1978), the latter type was at odds with these economic ideas. I therefore propose to reserve the neo-liberal label for the former type of policies, i.e. low-rate, broad-base, neutrality-enhancing tax reforms. This definition is consistent with how important contributors in the field understand the last wave of tax reforms (Sandford 1993; S. Steinmo 2003; Swank 2006).

In the existing literature, the standard interpretation of neo-liberal tax reforms is that they represented a “shift in policy paradigm” (Swank & S. Steinmo 2002, p.643), that is, a fundamental change in the ideas of policy-makers about the goals and instruments of tax policy (cf. Hall 1993, p.279). The belief that tax policy could be used to influence micro-economic behavior in order to achieve industrial and redistributive policy goals was abandoned in favor of the
idea that the tax system should be neutral with respect to economic choices in order to generate an efficient allocation of resources (S. Steinmo 2003, pp.213–26). The policy prescriptions were lower tax rates, broader bases and uniform taxation of different types of income.

The ideational argument is that the neo-liberal tax reforms around the world were a result of policy learning and the diffusion of new economic ideas about tax policy from the U.S. (S. Steinmo 2003, p.209). Ideational accounts are valuable for explaining the common trend towards neo-liberal tax policy, yet they offer little help in understanding the differences in reform. For instance, an argument about the differential diffusion of ideas according to geographic or cultural factors is at variance with the empirical cases, as neo-liberal tax policy ideas were important in New Zealand but not in Ireland.

A second explanation of the extent of neo-liberal tax reform is partisanship. Swank (2006) argues that the adoption of neo-liberal reform depends on policy-makers’ assessment of the economic and political costs and benefits of reform. This assessment is contingent upon which political party is in power. While right parties will see greater net economic and electoral benefits from market-conforming tax reform, left parties will prefer more interventionist policies and therefore oppose neo-liberal reform (see also Boix 1998).

However, the partisan explanation rests on a simplistic conception of policy-making, according to which politicians make tax policy decisions in a vacuum, solely based on their preferences and rational calculations. In real-world policy-making politicians interact closely with bureaucrats and others, who bring their own expertise and policy ideas to the table. Moreover, the two empirical cases do not conform to the expectations from the partisan
explanation. In New Zealand a Labour government made the major neo-liberal
tax reforms of the 1980s, and in Ireland centre-right and centre-left governments
were equally eager to introduce specific tax incentives that increased market
distortions.

Third, the degree of neo-liberal tax reform has been attributed to political
institutions. The thin version of this argument is that political institutions with
fewer veto points permit a greater extent of reform (e.g. Ganghof 2006). The
radical neo-liberal economic reforms in New Zealand have often been linked to
the absence of effective veto points in its political institutions (Nagel 1998;
Quiggin 1998). Until 1993 New Zealand had a first-past-the-post electoral
system and a unicameral parliament, which tended to concentrate power in the
hands of one-party majority governments. The Irish system has had more
effective veto points as a result of a bicameral parliament and a proportional
representation (PR) electoral system that has produced coalition governments.

An important limit to this argument is that the lack of veto points only is a
permissive condition for policy change (Nagel 1998, p.241). It is difficult to see
how the number of veto points in political institutions can account either for the
initial ambitions for tax policy change or for the neo-liberal content of reform.

Another version of the argument is more useful for our purposes. Relying
on a richer notion of political institutions, Steinmo argues that “different
decision-making systems have profoundly shaped the formulation of tax policy”
by influencing “who dominates the tax policy-making process, the strategic
choices and ultimately the policy preferences of these same actors” (S. Steinmo
1993, p.10). The paper subscribes to this institutionalist approach. Yet, the
problem with Steinmo’s explanation is that it does not specify which institutions
matter and exactly how they shape preferences, strategies and roles in policy-making.

This paper advances an alternative explanation for the diverging tax policy trajectories of New Zealand and Ireland. The main contention is that the policy divergence can be attributed to differences in the “institutionalization of economic knowledge into the state apparatus” (Fourcade 2009, p.247).

Drawing on the state-centered comparative-historical literature (Skocpol 1985; Nordlinger 1988; Weir & Skocpol 1985) and Marion Fourcade’s macrosociology of economic knowledge (Fourcade 2009), I argue that distinct administrative institutions in New Zealand and Ireland gave rise to profound differences in the identities, expertise, economic ideas, and policy-making role of tax policy bureaucrats. These differences shaped tax policy-making in the two countries, leading policy change in different directions.

In New Zealand, strong economic specialization and open recruitment policies within the civil service produced tax policy bureaucrats that identified as economists, had a high level of economic expertise, were very receptive to the neo-liberal ideas from the economics discipline, and took an activist approach to policy advice. Through the formulation and advocacy of reform ideas, officials influenced the policy preferences of politicians and led tax policy change in a neo-liberal direction.

In Ireland, the persistence of a generalist civil service with closed recruitment policies created a tax policy bureaucracy that identified as civil servants, had little economic expertise, was oblivious to micro-economic ideas about taxation, and took a passive approach to policy advice. These features allowed tax policy-making to be completely dominated by the ideas and concerns
of politicians, giving rise to a tax policy of low rates, narrow bases and specific tax incentives.

The paper is structured as follows: The next section presents the theoretical framework. The subsequent section applies this framework to the cases of New Zealand and Ireland, comparing tax-policy making in two phases: the 1980s and the 1990s-2000s. The last section discusses the main findings and concludes.

**Theoretical framework**

The theoretical framework builds on the state-centered comparative-historical literature (Skocpol 1985; Nordlinger 1988; Weir & Skocpol 1985) as well as a recent contribution to the macro-sociology of economic knowledge by Marion Fourcade (2009). In this theoretical section, I first discuss the variation in the policy role and ideas of bureaucracies, and then how the institutionalization of economic knowledge within the state can account for this variation.

**Variations in the policy role and ideas of state bureaucracies**

The state-centered literature of the 1980s argued that states can be potent and autonomous actors in economic and social policy-making. The state is not simply an arena for struggles between interests in society; it has the ability to set goals independent of politicians and interest groups (Skocpol 1985, p.9). The principal source of such autonomous action is *bureaucratic organizations*, or what Theda Skocpol characterizes as “organizationally coherent collectivities of state officials” (Skocpol 1985, p.9).
The theories of the state do not assert that bureaucratic organizations are powerful actors in all places at all times. Instead, they stress that there is great variation in the extent of autonomous state action across countries, policy areas and periods (Skocpol 1985, pp.14, 17). Differences in the extent of autonomous state action can be expected to have a significant impact on policy output.

I propose to assess the variation in the policy-making role of bureaucratic organizations along three dimensions. First of all, autonomous state action can be identified with the independent formulation of goals and ideas for reform. This implies that a bureaucratic organization develops its own transformative agenda, that is, an agenda which does not simply reflect the interests of other actors and which does not merely consist in defending the status quo (cf. Skocpol 1985).

Autonomous state action not only implies that bureaucrats formulate their own goals, but also that they actively pursue these goals (Skocpol 1985, p.9). In the policy-making process, we can identify this with an activist approach to policy advice. That is, bureaucrats push their own policy agenda vis-à-vis politicians, even if politicians have other preferences (Nordlinger 1988, p.881). In addition to exploiting existing mechanisms of bureaucratic influence, this may entail searching for new ways to promote their policy agenda.

Finally, autonomous state action implies that the policy advocacy of the bureaucracy has a significant influence on the policy preferences of politicians (cf. Nordlinger 1988). We would expect to see that the policy preferences of politicians shift towards the views of officials as a result of bureaucratic policy activism. In practical terms, this would imply that the original ideas of politicians are discarded or modified, or that politicians are persuaded to make reforms they had not initially planned.
The state theorists did not only bring attention to the differences in the extent of autonomous state action, but also to the variation in the substantive policy preferences of the bureaucracy (e.g. Nordlinger 1988, p.882). The argument is that the preferences of bureaucrats are not functionally determined. Rather, different bureaucratic organizations are dominated by different ideas about policy. In some ministries of finance a doctrine of fiscal conservatism will prevail, others will adhere to Keynesian macro-economic thinking or neo-classical micro-economic ideas. To the extent that officials have influence in policy-making, the substantive ideas of the bureaucracy will shape the content of policy.

The institutionalization of economic knowledge within the state

What explains the differences in the economic ideas and the policy-making role of bureaucrats? An often-stated criticism of the state-centered literature was that it did a poor job of accounting for this variation, especially the differences in the preferences of the state (Hall 1993, p.275; S. Steinmo 1993, p.6). However, this criticism appears somewhat exaggerated, as Margaret Weir and Theda Skocpol deal explicitly with these questions in their study of the influence of Keynesian economic ideas on responses to the Great Depression in the U.S., the U.K. and Sweden (Weir & Skocpol 1985).

Weir and Skocpol’s main argument is that the policy-making access of economic experts and the substantive content of their ideas are shaped by state structures. They argue that various specific structures of states affect “processes of intellectual innovation” and “pattern the ways in which experts and their ideas enter into public policy making”, thereby affecting “the possibilities for new
economic ideas to be formulated and applied to innovative government policies” (Weir & Skocpol 1985, pp.109, 119). The authors argue that the crucial features of state structures in this regard are “the institutional mechanisms provided for allowing economic experts to participate in public policy making” (p. 120), which leave key state agencies “open or closed to the development or use of innovative perspectives” (p. 126).

The sociologist Marion Fourcade takes this discussion one step further in her recent book about the differences in economic knowledge and the practice of economists in the U.S., the U.K. and France (Fourcade 2009). Fourcade agrees with Weir and Skocpol on the importance of state structures for explaining the content and influence of economic knowledge. However, she argues that the historical-institutional approach to the state is too narrow and needs to be complemented by a more cultural understanding. “[Administrative] institutions are cultural objects that produce meaning – not simply organizational arrangements that filter access,” she asserts (Fourcade 2009, p.25).

Fourcade puts forward an argument about how economic knowledge and the policy-making role of economists are shaped by the “administrative order”, which she defines as “the modes of construction and incorporation of economic knowledge through policy making and policy advice” (Fourcade 2009, p.21). The administrative orders of different countries vary both along structural lines – i.e. objective differences in the economic training of bureaucrats or in the division of responsibilities between ministries – and along cultural ones – i.e. subjective differences in the identities of economists and bureaucrats. Fourcade incorporates both elements, analyzing “how institutional differences in the very
structure of these fields have shaped the social and intellectual trajectories of the
groups of actors that populate them” (Fourcade 2009, pp.239–40).

Drawing on Fourcade, I single out two structural aspects of
administrative institutions that I argue will shape the ideas and policy-making
role of bureaucrats.

First of all, the training of bureaucrats is of fundamental importance (on
this point see also Peters 2010, pp.89–90). In countries with a specialized civil
service – such as the U.S. – bureaucrats possess specific qualifications relevant to
their position. This implies that most officials in economic ministries will be
trained in economics. By contrast, in countries with a generalist civil service –
most famously the U.K. – bureaucrats do not have specific qualifications relevant
to their position. They have a general education – traditionally in the classics or
humanities – and get any specific training on the job (although in-house training
is often limited) (Wilson & Barker 2003, pp.349–50). In generalist systems there
will thus be few economists in economic ministries.

My theoretical argument is that training will shape the policy role of
bureaucrats through three channels: expertise, ideas and identity. First,-specialized bureaucracies have greater technical skills than generalist ones,
which can be expected to give officials a stronger role vis-à-vis politicians (cf.
technical expertise can augment the policy influence of officials by increasing
their ability to set the policy agenda (active role), to evaluate and counter the
policy proposals of politicians (reactive role), and to warn politicians about
deficiencies of existing policies (proactive role).
Second, economic ministries dominated by economic specialists will be more receptive to theoretical developments within the field of economics than generalist bureaucracies. The greater penetration of new ideas from the economics discipline will on the one hand define the substantive policy ideas of officials. On the other hand, it may expand the policy role of officials by “encourag[ing] leading state officials to pursue transformative strategies” (Skocpol 1985, p.9).

The argument that strong ideas can increase policy leverage is put forward by B. Guy Peters, who sees “policy-specific ideologies” - i.e. “well-developed ideas about what government should do [in] the narrow area of expertise of the agency” – as a weapon of the bureaucracy in the struggle against politicians over policy-making power (Peters 2010, p.198).

“[T]he existence of such an ideology is important for the success of the agency in dealing with political institutions. Political actors rarely have a ready reply to such policy-specific ideologies. They labor under a number of disadvantages in competing with the bureaucrats, not the least of which is a frequent lack of any specific policy ideas” (Peters 2010: 213)

The intuition is that the presence of clear policy ideas gives officials the upper hand in the policy-making process by increasing their agenda-setting power. In organizations with strong analytical expertise and a strong ideology, officials not only have the ability derived from expertise to set the agenda, they also have the substantive ideas and the ideological motivation to do so.
Third, in generalist systems officials will identify first and foremost as civil servants, while there will be stronger identification along professional lines in specialized bureaucracies (Fourcade 2009, p.163). My argument is that the subjective identity of bureaucrats will have consequences for their approach to policy advice by influencing what is perceived as appropriate behavior (cf. March & Olsen 1989). Officials that identify exclusively as public servants will be more sensitive to norms that define clear boundaries between the roles of bureaucrats and ministers, leading them to take a restrained approach to policy advice. Officials with a strong professional identification will be less attentive to such norms and more concerned about ‘doing what is right’ according to their professional views, inducing them to take a more activist approach to policy advice. Stronger professional identification can thus be connected to a more prominent policy role for officials, as it increases the willingness to set the policy agenda, counter the policy proposals of politicians, and warn politicians about the flaws of existing policy.

A second important aspect of administrative institutions is their openness in terms of recruitment. In closed administrative systems most bureaucrats are recruited from inside the civil service class. These institutions thus tend to be populated by lifetime bureaucrats (see Fourcade 2009, p.42). In open administrative systems there is greater recruitment of outsiders such as academics, new university graduates, people from the private sector, or even foreign experts. Public servants in open systems thus tend to have experience from other spheres and remain in the bureaucracy for shorter periods of time.

My argument is that the openness of bureaucratic institutions in terms of recruitment will shape the policy-making role of officials through the same three
channels of expertise, ideas and identity. First, open recruitment policies allow bureaucratic agencies to draw on expertise from the outside – from the academic world, the private sector or other countries – and to pick up ‘the best and the brightest’ right out of university, thereby boosting the expertise in the organization.

Second, open systems allow for a greater influx of new economic ideas because the admission of academics, foreign experts and graduates just out of economics programs creates channels for the diffusion of ideas from the economic discipline to the bureaucracy. In closed system, these channels will be cut off.

Third, systems with closed recruitment tend to generate a strong common identity as civil servants. Open recruitment will weaken this shared identification since bureaucrats recruited from the outside carry with them other identities from their educational or professional background (see Peters 2010, p.82).

I thus expect officials in institutions that are open in terms of recruitment to have a higher level of economic expertise, to be more inspired to new economic ideas, and to have a weaker identity as civil servants. As specified above, I expect these features to strengthen the role of officials in policy-making.

**Analysis**

In this section I apply the theoretical framework to the cases of New Zealand and Ireland, comparing tax-policy making in two phases: the 1980s and the 1990s-2000s.
**New Zealand in the 1980s: Neo-liberal tax reform**

In the early 1980s, New Zealand’s tax system was characterized by high rates, narrow tax bases and a plethora of specific tax incentives. The conservative National government used tax policy actively to direct economic choices through differentiated rates and tax incentives for particular sectors and activities.

The Labour government that came to power in 1984 embarked on neo-liberal tax reform as part of a radical program of micro-economic restructuring of the New Zealand economy. Described as “the most radical tax reform programme ever implemented by a Western government” (Kay & King 1990, p.219), the reforms in the period 1984-90 went very far in terms of lower rates, broader bases and neutrality. The most important changes were the reduction of the top personal income tax rate from 64 to 33 %, the introduction of a broad-based value-added tax (the GST) at a rate of 12.5 %, and the elimination of virtually all tax deductions including the large tax concessions for retirement savings.

How we can explain that New Zealand went so far in neo-liberal tax reform in the 1980s? Two factors that are often evoked are political leadership and political institutions. Roger Douglas, Labour’s Minister of Finance, was the political champion of economic restructuring and took a particular interest in tax policy. Douglas used his powerful position within the Cabinet to drive through several rounds of tax reform (Sandford 1993, pp.53–77). Moreover, the strong concentration of power in New Zealand’s political institutions permitted radical reform (e.g. Nagel 1998; Quiggin 1998). With a first-past-the-post electoral
system and a unicameral parliament, there were few if any institutional checks on the majority Labour government. However, these factors are more helpful for explaining why major economic reform was possible than why reform took a neo-liberal shape.

To understand the neo-liberal content of tax reform in New Zealand, we have to turn to the bureaucracy. The New Zealand Treasury played a crucial role in this regard, as it picked up neo-liberal economic ideas about tax policy from abroad, developed them within the organization, and advocated them actively vis-à-vis ministers. The policy role and ideas of the Treasury were the product of a historical process of economic specialization within the organization.

A first step in this process was the internally driven ‘re-invention’ of the Treasury in the 1960s and 70s (see McKinnon 2003, pp.227, 272). The ambition of the administrative head of the ministry was to create a greater role for the Treasury in economic policy-making based on economic expertise. A key element of this re-invention was the strategy of recruiting high-achieving university graduates to serve as policy advisers, mostly (but not exclusively) from economics (Boston 1992, p.197). The Treasury thus practiced an open recruitment policy, as it sought to attract people from the outside with specific skills rather than hire from inside the civil service class. The result was a strengthening of the qualifications of the staff and a growing dominance of economists within the Treasury.

The establishment of an internal ‘think-tank’ in the Treasury in 1977 under the name of ‘Economics II’ was a further step in this direction. Economics II was set up to improve strategic thinking around the problems of existing economic policy and possible new policies for growth (McKinnon 2003, p.285).
The staff of Economics II had a “strong professional identification as economists” (McKinnon 2003, p.298), counted several PhDs, and espoused more theoretical and ideological economic thinking than the regular divisions of the Treasury.

The increasing dominance of economists within the Treasury made it very receptive to the new ideas that emerged within the economics discipline in the 1970s and 80s. The paradigmatic shift from Keynesianism to neo-classical perspectives had a massive impact on the thinking in the Treasury. The main channel of influence was Economics II, which promoted ideas from the multiple streams of neo-classical economic thought and within a few years made this the dominant perspective in the organization (Goldfinch 2000, p.12; McKinnon 2003, chap.7). The neo-classical thinking gave rise to a strong ‘policy-specific ideology’ in the field of taxation, which emphasized low rates, broad bases and neutrality.

The ideas about tax reform along neo-liberal lines were concretized within the Treasury and first articulated in the 1982 McCaw review of the tax system (McCaw 1982). They then became an integral element of ‘Economic Management’ – the Treasury’s radical program for supply-side reform that was presented to the incoming Minister of Finance in 1984 (Treasury 1984).

Treasury bureaucrats took an activist approach to tax policy advice, eagerly advocating their reform ideas to Roger Douglas both before and after he became Minister of Finance (Oliver 1989, pp.11–12; Marriott 2010, pp.244–7). As one central tax policy official observed: “There is no denying that the traditional boundaries observed by public servants in the policy arena were crossed from time to time in the interest of gaining a particular desired state of affairs” (Dickson 2007, p.51). The Treasury’s policy activism was very much an expression of a new style of policy advice promoted by their internal think-tank.
Economics II insisted that the Treasury should offer ‘free and frank’ policy advice regardless of what politicians wanted to hear (McKinnon 2003, p.300). The strengthening of economic expertise within the Treasury thus went hand in hand with a greater willingness to use this expertise vis-à-vis ministers.

Finally, we see that the tax policy advocacy of the Treasury had a significant influence on the policy preferences of the Minister of Finance. Douglas worked closely with a small group of Treasury officials, relying on them to find tax policy solutions that would allow him to achieve his goal of “dramatically lowering top personal income tax rates”. Officials convinced Douglas of the benefits of base-broadening and greater neutrality, since removing tax deductions raised revenue that would permit tax rate cuts. Douglas came to support the principle of neutrality largely because “neutrality was fundamental for being able to lower tax rates – you couldn’t do one without the other”. In other words, Treasury officials managed to fit their theoretical ideas into Douglas’s more practical agenda.

In consumption taxation, the advice and extensive documentation presented by the Treasury convinced Douglas to introduce a value-added tax (GST) instead of the retail sales tax he had originally wanted (Douglas 2007, p.4; Dickson 2007, p.49). In personal income taxation, the Treasury succeeded in pitching the idea of abolishing all tax concessions for retirement and life insurance savings to Douglas as a way to fund the introduction of a flat tax (Marriott 2010, p.204). The fact that the New Zealand tax reforms not only lowered rates but also went very far in terms of broader bases and neutrality can thus largely be attributed to the role of the Treasury.
Ireland in the 1980s: Absence of neo-liberal tax reform

The Irish tax regime at the beginning of the 1980s shared the main features of the tax system in New Zealand: high rates, deep deductions and specific incentives. In addition, the Irish tax system strongly favored farmers and the self-employed over salaried employees (Hardiman 2000, pp.821–7). The dissatisfaction with this imbalance gave rise to massive street protest against the tax system in 1979 and 1980. As a response, the government set up an independent Commission on Taxation made up of experts and interest group representatives. The commission published five reports which taken together “constitute a more comprehensive blueprint for tax reform than any of the other tax reform documents of the 1980s” (Sandford 1993, p.170). Strongly inspired by neo-liberal ideas, the commission proposed a tax system with a single tax rate on all types of incomes, a wide income tax base with a minimum of deductions, a broad-based VAT and a direct expenditure tax on high incomes.

Yet, whereas the Labour government in New Zealand adopted the Treasury’s proposals for reform, the Irish centre-left government of the mid-80s failed to act on the recommendations of the Commission on Taxation. In fact, there was no political response at all to the reports: no official acceptance or repudiation, no white paper and no consultation process (Sandford 1993, p.185). Throughout the 1980s, tax rates remained fairly high and the progress on widening the tax base was limited and uneven, with the abolition of tax expenditures in one area outweighed by new deductions and incentives in others (Sandford 1993, pp.194–5; NESC 1986; 1990).

How can we explain the absence of neo-liberal tax reform in Ireland in the 1980s? First of all, there was very little political interest in tax reform. The
centre-left coalition of Fine Gael and Labour in power 1982-1987 grappled with a major fiscal crisis, as Ireland had been running governments deficits of more than 8 % of GDP every year since the mid-1970s (Sandford 1993, p.179). “Under these circumstances, major tax reform was difficult to contemplate,” observed Alan Dukes, Minister for Finance at the time. The government was looking for “instant solutions, not long-term solutions” such as structural tax reform. Yet, it is difficult to argue that fiscal problems as such made reform impossible, as New Zealand policy-makers saw fiscal crisis as a motivation for tax reform (Treasury 1984).

Rather, the crucial difference seems to be that the idea of tax reform along neo-liberal lines was not entrenched among Irish policy-makers. The main reason for this was the absence of institutional carriers for these ideas within the bureaucracy. In stark contrast to the New Zealand Treasury, the Irish Department of Finance was alien to the new micro-economic ideas about taxation. As shown in the following paragraphs, this can be linked to the persistence of a generalist civil service in Ireland.

The Irish administrative system is built on the British civil service model (see Chubb 1992, p.231). Irish bureaucrats have traditionally been ‘amateurs’, with a generalist education in the humanities coupled with specific on-the-job training. Like in Britain, the tradition of specialized administrative expertise in Ireland has been weak. Yet whereas in Britain the creation of the Government Economic Service in 1964 contributed to a gradual strengthening of the position of economists within the civil service (Fourcade 2009, pp.169-72), no such economic specialization occurred in Ireland. One economist observed:
“While the U.K. Government Economic Service has trained economists and placed them all over the public service, we have had nothing like that in Ireland. It has remained a purely generalist system. There have been very few economists in the civil service, particularly at the senior level. That applies to the Department of Finance, the Revenue Commissioners and several other departments.”

Economists thus remained a marginal group within a Department of Finance dominated by generalists with a strong identity as civil servants.

The absence of economists made the Department of Finance insensitive to the neo-classical ideas about tax policy that emerged within the economics discipline in the 1970s and 80s. In New Zealand, the Treasury had embraced the doctrine of low rates, broad bases and neutrality. But in Ireland the development of such ideas exclusively took place outside the bureaucracy, in the independent Commission on Taxation. As the commission had no members from or links to the departments of finance or revenue (Sandford 1993, p.185), its neo-liberal way of thinking about tax policy did not become entrenched in the Irish bureaucracy. “The commission was set up at arm’s length and asked to go do their thing. As a result tax policy preferences changed among the people on the commission, but there was no such shift in thinking in the political or bureaucratic environment,” a key member of the commission observed. The Irish Department of Finance retained a pragmatic view of economic policy.

The department was thus skeptical if not hostile to the commission’s tax reform blueprint, denouncing it as “crazy”, “theoretical” and “too academic.” In part this criticism reflected the radical nature of the proposals, as the
commission had been more concerned with what would be the ideal tax system than with what was politically feasible (Sandford 1993, p.187). Yet, the department made few efforts to translate the proposals into more workable policy changes, suggesting a lack of enthusiasm for the economic arguments for reform.

More generally, and in stark contrast to the active tax policy advocacy of the New Zealand Treasury, Irish bureaucrats did not exert any noticeable pressure on ministers to move in the direction of lower tax rates, broader bases and greater neutrality. With neither politicians nor civil servants advocating reform, very little happened to the Irish tax system during the 1980s.

New Zealand 1990-2010: Limited erosion then new neo-liberal reform

In New Zealand, the tax reforms of the late 1980s were followed by two decades without major changes to tax policy. The National government in power from 1990 to 1999 was committed to the low-rate, broad-base approach and only made adjustments around the edges of the system. Under the Labour-led governments from 1999 to 2008 the broad lines of the neo-liberal tax regime remained intact, although the system was subject to some erosion. Labour increased the top personal income tax rate from 33 to 39 %, introduced tax credits for families and a minor tax incentive for pension savings, and permitted considerable bracket creep\(^{13}\).

National came back to power in 2008 and introduced a reform in 2010 that moved the New Zealand tax system even further in a neo-liberal direction. At the core of the reform was a tax switch from personal income taxes to taxes
on consumption. All personal income tax rates were lowered significantly – the top rate dropping from 38 to 33 % - while the GST rate was raised from 12,5 to 15 % (see Treasury 2010). The reform also reduced the tax rates on corporations and various savings vehicles from 33 or 30 % to 28 %, and removed generous depreciation allowances for buildings.

The persistence of neo-liberal tax policy in New Zealand cannot be fully explained by political factors. First, the Labour government that came to power in 1999 represented a reaction against the neo-liberalism of the previous 15 years and was dominated by the left wing of the party. It had ambitions for significant tax policy changes, not just higher rates, but also tax breaks for people on lower incomes and tax incentives for savings (White 2009, p.123). So why did the neo-liberal tax system survive their nine years in government?

Second, the National government that came to power in 2008 initially had no ambition or clear ideas about tax reform. National had proposed a plan of personal income tax cuts over the period 2008-2011. But beyond these minor tax reductions the government was not planning to make significant changes to tax policy14. Then how come a major neo-liberal tax reform was introduced in 2010?

In order to answer these questions, we again need to turn to the role of the bureaucracy. Under the Labour governments, the economic ministries defended the existing tax system, convincing the Minister of Finance to abstain from making greater policy changes. By the time National came back to power, the bureaucracy had developed clear ideas about tax reform. Officials used a new policy advice institution to pitch their reform proposals to ministers, who were eventually persuaded to introduce reform.
Crucially, the tax policy role and ideas of the economic ministries in this period reflected changes and continuity in bureaucratic structures: changes in organization and continuity in terms of economic specialization and open recruitment.

The most important change was an organizational reform that divided the responsibility for tax policy advice between Treasury and the Inland Revenue Department (IRD), ending the Treasury’s monopoly in this area. Yet, the split did not imply the death of the Treasury way of thinking about tax policy. Rather, the old tax policy group from the Treasury was reborn in the IRD. The new IRD tax policy advice division was dominated by economists, had strong analytical expertise, and conserved the Treasury’s neo-classical tax policy ideology and ‘free and frank’ approach to policy advice.

The IRD was the dominant force in tax policy advice over the next 10-15 years (see Marriott 2010, p.141). Its insistent defense of a tax system with aligned rates and without concessions for particular types of income or investments can be seen as an important reason why the Labour governments did not make bigger changes to the system. In the words of a top IRD official, “the Minister of Finance was frustrated. He wanted to use tax system to encourage savings and investment, but at the end of the day we convinced him that he was wrong”.

The Treasury, on the other hand, lost manpower and tax economic expertise in the organizational split in 1995. The Treasury tax team was left with little capacity for strategic, long-term thinking and mostly went along with the IRD’s views on tax issues.
However, the Treasury reasserted itself in the tax area from about 2007 when the tax policy section was strengthened by academic tax economic expertise from abroad. The openness of administrative institutions in New Zealand allowed the Treasury to draw on foreign expertise, something that would have been unthinkable in the Irish Department of Finance. Based on the new intellectual impulses, the Treasury carved out a tax policy position that put more weight on growth and dynamic efficiency (see Treasury 2009b).

These developments in the economic bureaucracy laid the foundations for a common Treasury-IRD push for tax reform towards the end of the decade. Within both departments, officials voiced concerns about the state of the New Zealand tax system and put forward proposals for change (see IRD 2005; 2008; Treasury 2009a). Although the problem definition differed somewhat, both the IRD and the Treasury were motivated by neo-classical micro-economic thinking and advocated tax reform as a means to improve economic efficiency. Officials advised ministers to cut personal income tax rates and suggested to do this as part of a tax switch from labor income to consumption.

Bureaucrats took an activist role in promoting these reform ideas. When their policy documents failed to create any political interest in reform, officials started looking for new ways to raise the tax issue on the agenda. The first initiative was a tax conference with international academics, which stimulated the interest of the ministers of finance and revenue. Subsequently, the ministers endorsed a working group composed of officials, tax practitioners, business people and academics to look into tax policy issues for the medium term.
The Tax Working Group constituted “a new policy advice ‘institution’” (Gemmell 2010, p.1) – it was formally independent and did not have the status of an official commission of enquiry, yet IRD and Treasury officials were heavily involved. Officials clearly stated their preferences in the background documents for the working group, and the group’s final recommendations strongly reflected these views (see Tax Working Group 2010, pp.10–11). The group thus mainly served as a vehicle for transporting the tax policy ideas of bureaucrats into the public sphere, with the goal of “generating and influencing public debate around tax reform” (Gemmell 2010, p.23; see also Buckle 2010).

Through this reform advocacy process, bureaucrats exerted a major influence on the policy preferences of the National government. Despite the government’s initial lack of interest in tax reform, the tax conference and the Tax Working Group convinced key ministers that reform along the lines of a tax switch was both economically advantageous and politically possible. The final reform adopted in 2010 followed the major recommendations of the Tax Working Group and reflected the policy preferences of officials to a remarkable extent.

**Ireland 1990-2007: Tax cuts, base-narrowing and specific incentives**

While New Zealand moved further in the direction of low rates, broad bases and neutral taxation, Irish tax policy took a different path. From the middle of the 1990s Irish policy-makers reduced tax rates considerably, while at the same time narrowing the tax base and expanding specific tax incentives.
The 1987 Irish ‘Social Partnership’ tripartite agreement was based on a commitment to personal income tax cuts in exchange for wage moderation (Hardiman 2000, pp.829–30). Yet, it was not until 1992 that a government composed of the large centrist Fianna Fàil (FF) party and the small liberal Progressive Democrats (PD) introduced the first round of tax cuts.

The bulk of the personal income tax cuts was introduced from 1997 onwards with the FF-PD coalition back in power. The government reduced the top income tax rate from 48 to 42 % and the standard rate from 26 to 20 %, as well as radically widening tax bands and increasing general tax allowances. As a result, the tax wedge on labor for an average earner was cut in half – from 25.6 to 12.8 % - between 1998 and 2007, and half of all income earners were taken out of the income tax net (see Commission on Taxation 2009, pp.54, 184). The policy changes thus both reduced rates and further eroded a tax base that was already narrow due to large deductions for pension savings, private health services and mortgage interest payments.

Moreover, rather than moving towards greater neutrality in taxation, Ireland introduced a host of specific tax incentives that distorted economic choices. In particular, incentives were targeted at the construction sector. First in the 1980s and then from 1994 onwards governments of all persuasions initiated generous tax incentive schemes for urban, town and rural renewal, as well as the construction of hotels, seaside resorts and multi-storey car parks (McDonald & Sheridan 2009, p.5).

How come Ireland moved towards lower rates, narrower bases and more distortionary taxation? First of all, these developments were driven by a political logic. The tax policy changes were almost exclusively conceived by politicians,
and in particular by Charlie McCreevy (FF), Minister for Finance 1997-2004. At the outset, the changes were motivated by a strong political desire to stimulate economic activity through the tax system (Leahy 2010, chap.5) and legitimated by the Social Partnership agreements. However, other driving forces amplified the policy changes: in the case of tax reductions populist political competition and an economic context of spectacular growth and buoyant tax revenues (OECD 2009); in the case of tax incentives constituency-based politics (Adshead & Tonge 2009, pp.35, 45) and the strong influence of vested interests in the construction sector (McDonald & Sheridan 2009).

At the same time, the tax policy developments were shaped by the character of Ireland’s economic bureaucracy. The absence of micro-economic thinking, the lack of technical economic expertise and the passive approach to policy advice in the Irish Department of Finance allowed for the complete domination of political ideas and concerns in tax policy-making. The role and ideas of the department can be linked to the persistent lack of economic specialization and closed nature of the Irish economic bureaucracy.

The persistence of the generalist civil service model within the Irish Department of Finance is remarkable in international perspective. Whereas economists came to play an increasing role within ministries of finance around the world (Fourcade 2009, p.259), there was no trend towards economic specialization in Ireland. In 2010, only 39 out of 542 officials in the Irish Department of Finance had economics training at Master’s level or higher, a number which according to an independent organizational review of the department is “extraordinarily low by international standards” (Independent Review Panel 2010, p.45).
Furthermore, Irish administrative institutions have remained very closed in terms of recruitment. While the economic ministries in New Zealand hired academics, foreign experts and people with private sector experience into top positions, the Irish Department of Finance continued to recruit from inside the civil service class. The closed nature of the department is also manifested by the lack of engagement with the broader economic community (Independent Review Panel 2010, p.6).

These continuities in bureaucratic structures had important implications for economic policy-making. First of all, the Department of Finance lacked technical economic expertise. According to the Independent Review Panel, the department had “too many generalists in positions requiring technical economic and other skills” (2010, p.6). This meant that the department did not have the economic tools to critically evaluate the proposals politicians put forward. The department also failed to gather data on measures such as tax expenditures, implying that the factual basis for decision-making was thin (Commission on Taxation 2009, p.240).

Second, micro-economic thinking about tax policy never gained a foothold in the Department of Finance. Bureaucrats did not identify with academic economists and their theories. Instead, they emphasized the differences between the bureaucratic and academic worlds and described academic economists in rather pejorative terms:

"We do applied economics, not academic. People think within an economic framework, but in this business we have to reach conclusions. This is not
giving four hours of lectures a week, going around and presenting papers, and earning a high salary. This is doing a job, 60 hours a week.”

Academic economists confirmed this point, describing an “anti-intellectual atmosphere among the senior people in the Department of Finance.” Thus, officials in the department were alien to theoretical economic ideas about things such as neutrality in taxation.

Finally, Finance bureaucrats identifying strongly as public servants took a submissive approach to policy advice. With reference to the Westminster model, officials emphasized that the “Minister decides” and that they were “very much the Minister's servants.” Based on this conception of the relationship between minister and bureaucrats, officials did not insistently offer the minister ‘free and frank’ policy advice on the flaws of the existing tax system or the consequences of new political tax proposals. The Independent Review Panel finds that the department “should have shown more initiative [...] in its advice on the construction sector, and tax policy generally”, as there was “no analysis or advice on the broader risk to the tax system from a more general downturn in economic activity” (2010, pp.6, 32).

Discussion and conclusion

Why did New Zealand adopt one of the most neo-liberal tax systems in the world, while Ireland pursued a heterodox tax policy of low rates, deep deductions and distortionary tax incentives? This paper has argued that the diverging tax policy trajectories of these two small liberal market economies are best understood as
the result of differences in the institutionalization of economic knowledge within the state. This speaks to a growing body of literature which argues that the state/bureaucracy has been forgotten for way too long and needs to be brought back into analyses of economic and social policy (Levy 2006; Marier 2005; Schmidt 2009).

The comparative analysis of tax policy-making in New Zealand and Ireland has shown that distinct administrative institutions in these countries gave rise to profound differences in the expertise, economic ideas and identities of tax policy bureaucrats, as summarized in Table 1.

TABLE 1 ABOUT HERE

I have argued that these differences had a major impact on the policy role of officials, leading bureaucrats to play a prominent part in the formulation of tax policy in New Zealand while giving Irish officials a marginal position in policy-making. But exactly how did expertise, ideas and identity shape the policy role of officials? One part of the story is that these factors affected the reactive and proactive role of bureaucrats in policy-making, that is, their capacity to evaluate and counter the policy proposals of politicians and to warn politicians about the flaws of existing policies. The juxtaposition of tax policy-making under Irish Minister for Finance Charlie McCreevy and New Zealand’s Roger Douglas illustrates this point well.

Initially, McCreevy and Douglas had fairly similar ideas and ambitions in tax policy. Neither of them was an economist or a neo-liberal thinker; both wanted to stimulate enterprise and reward effort. Yet while Douglas was
confronted with the strong economic expertise, neo-liberal thinking and policy activism of the New Zealand Treasury, McCreevy faced a Department of Finance with weak technical expertise, few clear economic ideas about tax policy and little willingness to give critical policy advice.

The New Zealand Treasury used its economic expertise actively to challenge Douglas’s crude tax policy proposals and its clear policy ideas to transform Douglas’s desire for reform into neo-liberal tax policy measures. The Irish Department of Finance, by contrast, did not have the expertise or ideas to counter McCreevy’s crude tax policy proposals or to warn ministers properly about the growing pathologies of the Irish tax structure. One cannot avoid speculating that Ireland would have steered clear of some of the most egregious policy mistakes that contributed to the economic meltdown in 2008 if politicians had faced the New Zealand Treasury rather than the Irish Department of Finance.

The second part of the story is that expertise, ideas and identity shaped the active role of bureaucrats in policy-making, that is, their capacity to formulate and pursue reform goals and solutions. The prominent role of officials in the 2010 tax reform in New Zealand was a product of the interaction between these factors: A clear policy-specific ideology provided the substantive reform ideas and the motivation to initiate a reform process; strong economic expertise gave officials the ability to set and control the agenda through the production of solid policy documents; and identification as economists contributed to the willingness of officials to actively pursue this reform agenda through an expert commission.
In this regard, an issue worthy of discussion is the function of investigative commissions as vehicles for bureaucratic policy advocacy. Weir and Skocpol argue that the crucial feature of state structures that conditions the policy influence of experts is “the institutional mechanisms provided for allowing economic experts to participate in public policy making” (1985, p.120), such as the Swedish tradition of investigative commissions. However, my comparative analysis suggests that it is not so much the existence of a commission that matters, but rather how the commission is instrumentalized. The empirical cases show that commissions are malleable institutional mechanisms that can be exploited for different purposes. While officials in New Zealand set up the Tax Working Group in a way that allowed them to use it as a vehicle for reform, the Irish Commission on Taxation of the 1980s was organized in a manner that kept its ideas and proposals at arm’s length from the loci of decision-making.

The final link in the argument is the connection between the policy role of bureaucrats and particular tax policies. In New Zealand, the strong policy influence of bureaucrats directed tax policy change in a neo-liberal direction, i.e. towards low rates, broad bases and neutrality. In Ireland, the weak role of officials allowed politicians to dominate policy-making, producing a tax policy of low rates, narrow bases and specific tax incentives.

To what extent can we generalize these findings to other countries? Will countries with specialized, open economic bureaucracies see more neo-liberal economic reform than those with generalist systems? On the one hand, I would contend that the causal mechanisms specified in the paper are of a general character and can be found also in other cases. On the other hand, I would be reluctant to generalize the overall relationship to other settings, as a number of
other variables might play in. While this paper has focused on the factors *internal* to the bureaucracy that shape the policy power of officials, *external* factors also matter. These include the political color of the government, the political-institutional setting and public opinion. An important task for further research is thus to look into how we can integrate factors internal and external to the bureaucracy in explanations of the influence of officials in economic and social policy-making.
Notes

1 Neutrality implies that the tax system does not discriminate between different economic choices, e.g. whether to put your savings in the bank, in stocks or in a pension fund.

2 While the period of investigation runs all the way up to 2010 for New Zealand, we cut off the study of Ireland in 2007, since the tax policy changes from 2008 onwards were emergency measures in the context of deep economic crisis.

3 I carried out interviews with public servants, politicians, interest group representatives, practitioners and academics in Ireland in April and May 2010 and in New Zealand in February and March 2011.

4 Ireland introduced a preferential corporate tax rate for export industries in the late 1950s, and this became a cornerstone of its industrial policy over the following decades. In 1997, Ireland moved to a single corporate rate of 12.5 % - by far the lowest in Western Europe [for discussions see O riain and Smith]. The formulation of corporate tax policy stands apart from the rest of tax policy-making, as it in recent decades has been the domain of the Department of Enterprise rather than Finance.

5 Interviews with two former Treasury officials, 16 February 2011 and 1 March 2011.

6 Interview with Roger Douglas, 15 February 2011.

7 Interview with Roger Douglas, 15 February 2011.

8 Interview with Alan Dukes, Minister for Finance 1982-86, 4 May 2010.

9 Interview with former top official, 4 May 2010.

10 Interview with a leading economist at the University College of Dublin (UCD), 20 April 2010.

11 Interview with a member of the Commission on Taxation of the 1980s, 19 April 2010.

12 Interviews with senior bureaucrats in the Department of Finance.

13 In a progressive tax system, inflation will push income-earners into higher tax brackets when the cut-off points between brackets are not adjusted for inflation, giving rise to ‘bracket creep’.

14 “I think it’s fair to say that we didn’t have clear and formed ideas [about what to do in tax policy]. I don’t think the government quite envisaged the scope of the changes in 2008” (Interview with Minister of Revenue Peter Dunne, 03 March 2011).
The head of the new IRD division Robin Oliver and his deputy both had Treasury backgrounds, so did several of the economists that joined the division then and later.

This assertion is based on interviews with senior IRD and Treasury officials.

Interview with Robin Oliver, head of the IRD tax policy division, 16 February 2011.

Interviews with tax policy officials in the Treasury.

Interview with Minister of Revenue Peter Dunne, 03 March 2011.

Interview with senior tax policy official in the Department of Finance, 21 April 2010.

Interview with a leading economist at the University College of Dublin (UCD), 20 April 2010.

Interviews with senior officials in the Department of Finance.
References


### Tables and figures

**Table 1: Comparison of tax policy bureaucracies in New Zealand and Ireland**

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