

Whose idea was it anyway? The dynamics of
international policy transfer and the case of
consumption tax reform

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There are a number of unresolved debates among scholars concerning the nature of policy transfer and its implications for policy analysis. For example, scholars of a rational-functionalist orientation see the exchange of policy knowledge in positive terms – providing governments with evidence of the benefits and problems associated with policy experiments elsewhere. On the other hand, scholars of a more critical orientation regard policy transfer as having the potential to constrain policy choices and privilege structurally dominant actors in the policy process. Empirically it would seem that many different processes result in policy transfer and that models of policy transfer are best regarded as heuristic devices used to guide research into the policy transfer process. This paper employs such an approach by using the policy transfer literature to gain insights into the origins of one of the most politically contested policy agendas both in Australia and across most industrialised nations in recent years – the introduction of VAT-style consumption taxes.¹

The paper begins by mapping the proliferation of VAT-style taxes in the final decades of the 20th Century. The paper then briefly review the policy transfer literature before using it to guide a detail examination of process of policy transfer that led to the proliferation of VATs. The paper concludes by assessing the implications of the VAT case study for both theoretical debates within the policy transfer literature and broader debates about the nature of the policy process.

Introduction

The rise of a value-added tax (VAT) is an unparalleled tax phenomenon. The history of taxation reveals no other tax that has swept the world in some thirty years, from theory to practice, and carried along with it academics who were once dismissive and countries that once rejected it (Tait 1988 as cited in Ishi 2001, p. 196).

The international proliferation of VATs in the later decades of the 20th century has been truly remarkable, perhaps doubly so given the political challenges associated with establishing a substantial new tax base. Rather than focus on the politics surrounding the enactment and consolidation of broad-based consumption taxes, this paper considers the foundational issue of what prompted policy makers to attempt such reforms in the first instance and the origins of the indirect tax reform agenda. It begins by documenting the proliferation of VAT-style taxes in the last half of the 20th century. After first being introduced in France in the early 1950s, 50 years later broad-based consumption taxes

with a systematic crediting of tax on inputs represent a significant part of the revenue base in all but one OECD country and in 115 transitional and developing nations (Keen 2005).

In order to improve our understanding of this ‘unparalleled tax phenomenon’ we turn to the policy transfer literature which seeks to explain the process through which policy innovations spread from one jurisdiction to the next. The goal here is to highlight the policy problems which governments were trying to address with new consumption taxes and why, of the numerous options, national policy makers almost invariably opted for a type of VAT. While the spread of VATs was initially promoted through what is now the European Union, by the 1970s there was a growing consensus among public finance economists and policy elites that VATs both provided an effective revenue base and had the potential to alleviate many of the fiscal problems confronting advanced industrial nations at the time. Despite political resistance a process of elite policy transfer occurred such that VATs were proposed as an important part of the tax reform agenda in industrialised economies in the late 20th century. Yet as John Kingdon (1984) has noted, with contested policy issues the political agenda is not shaped by policy elites alone. In the first instance political problems are defined by complex political and economic forces, while solutions are politically more likely to be promoted if they are aligned with prevailing preferences and values. While there has been a tendency in much of the literature on policy transfer and economic constructivism more generally to regard dominant ideas as auto-legitimising, there are many cases in which society remains hostile to elite agendas (Seabrooke 2006). This is certainly true in a highly contested policy arena such as taxation. Indeed while there has been a strong general trend towards the introduction of VATs in recent decades, it is important to note that distinctive national political contexts have resulted in significant variations in how these taxes are structured and administered. Overall there has been a process of policy *emulation* in which different countries adopted the idea of a VAT, although with variations designed to meet domestic political conditions (Hudson and Lowe 2004, p.175). In short, the tax reform agenda in specific countries was shaped by a combination of the structural conditions facing the economy, the nature of the policy transfer network in the tax policy arena, the political solidarity and autonomy of policy elites and the broader process of domestic political legitimation.

The paper will describe the proliferation of the VAT, first across Europe and then other developed and developing economies. Then using the policy transfer literature as a guide it will explore the specific processes that led to the spread of VATs across the OECD and beyond.

Charting the global proliferation of VATs

Taxation is as old as government and in ancient times practical considerations such as ease of collection and administration took precedence over the more abstract aims that dominate contemporary tax debates. Adams (1982) reports that the Egyptians imposed general sales taxes at major markets, while in the early Roman Republic Caligula was exalted for abolishing the general sales tax in AD 40. Excises and tariffs were the mainstay of tax systems during mercantilist times and it was not until the early 20th century that governments imposed more coherent and comprehensive sales and income taxes to fund their rapidly expanding activities. Ironically VATs, with their aim of taxing the value added at each stage of the production process, actually had their origins in the United States in the 1920s where national economic statistics were more comprehensive than other countries (Lindholm 1980; Steinmo 1993, p. 94; Wells and Flesher 1999).² If national economic activity could be accurately measured influential tax experts such as T.S. Adams, who drafted the Federal income tax legislation of 1913, argued that the most efficient form of business taxation would be a small uniform tax on each stage of the production process (Wells and Flesher 1999). Adams and other proponents of VATs continued to have some influence on the US tax policy up to and during World War Two when Senator Joseph O'Mahoney of Wyoming unsuccessfully introduced VAT legislation into the Congress in an effort to finance the war effort (Lindholm 1984).

Interest among US tax experts in VATs resulted in the world's first legislation for a staged consumption tax being enacted in another country where consumption taxes have evoked a great deal of controversy; Japan. In the aftermath of the Second World War Japan's public finances were in a state of disarray prompting the Allied powers to initiate a comprehensive review of the Japanese tax system conducted by American tax experts led by Professor Carl Shoup (Ishi 2001, pp. 25-56). It was the Shoup Mission, completed in August 1949, that recommended the introduction of a VAT style tax at a rate of between four and six per cent at the Prefecture level to replace existing business taxes. While the VAT legislation was enacted the implementation of the tax was

postponed several times, before finally being abandoned in 1953. (Ishi 2001, pp. 272-274; Shoup 1989).

Despite its American origins the first modern VAT was introduced in France on 10 April 1954, although it must be noted that the tax only applied up to a wholesale level (Wells and Flesher 1999; Ebrill et al 2001, p. 4). While the French VAT certainly proved to be an efficient and effective tax base the structural development which served as a catalyst for the diffusion of VATs across Europe was the formation of the European Economic Community (EEC) as a result of the Treaty of Rome in 1957. The driving philosophy behind the EEC was to promote economic integration between member states. In terms of taxation the original Charter sought to achieve the harmonisation of indirect taxes across the Economic Community in the hope of promoting cross border trade and commerce. The type of sales tax that would become the European norm was decided by the Neumark Report of 1963 (Neumark Report, 1963). At the time there was general support for a staged consumption tax because many European countries already used a turnover-tax style of consumption tax, which although effective in raising revenue artificially discriminated against multiple-stage production processes (Sandford 2001, p. 77). The solution advanced by the Neumark Report was that all member countries should introduce identical VATs by 1 January 1970, owing to the tax's technical superiority (Schiff 1973; Kato 2003, p. 41). While this arguably amounts to a form of indirect coercive transfer in that the Neumark Report and subsequent directives created an expectation that member states would introduce identical VATs, it is important to note that these Commission directives were not binding (Dolowitz and Marsh 1996). In fact while EEC members did adopt VATs member states chose to vary the VAT rate depending on political pressures and their fiscal needs. This policy discretion was later formalised in 1987 with the European Commission (EC) allowing member countries to set their 'standard' VAT between 14 per cent and 20 per cent, while discount rates were to be between four per cent and nine per cent (Kato 2003, p. 54). The 'first wave' of European countries to introduce VATs are listed in Table 1 (below).

Country	Adoption Date	Original VAT Rate
Denmark	July 1967	10%
France	January 1968	13.6%
Germany (West)	January 1968	10%
Netherlands	January 1969	12%
Sweden	January 1969	11.1%
Norway	January 1970	20%
Luxembourg	January 1970	8%
Ireland	January 1972	16.37%
Italy	January 1973	12%
Austria	January 1973	16%
United Kingdom	April 1973	10%

Table 1. 'First Wave' of European Countries to introduce a VAT. Source: Sandford 2000, p. 78; Wells and Flesher 1999; Ebrill et al 2001.

With a foothold in the EC VATs spread to all parts of the globe. By 1988 Alan Tait of the IMF calculated that 59 countries had introduced a pure or partially modified VAT tax at a national level (Tait 1988). Sandford calculated that by the late 1990s over 100 countries used VAT systems, leading to the conclusion that 'Value added tax is probably unique in fiscal history. A generation ago it was virtually unknown. Now it is approaching universal.' (Sandford 2001, p. 77). This trend continues unabated and as of 2004 29 of 30 OECD member countries had introduced VAT style taxes at a national level (the exception being the United States) (OECD 2004) and 135 countries globally use the tax as a major source of revenue (Keen 2005).

Beyond the sheer number of countries having established a VAT base many governments have subsequently increased VAT rates contributing to a general trend away from direct income taxes to consumption taxes. The OECD reports that between 1965 and 2000 the share of general consumption taxes as a percentage of GNP for member countries has almost doubled from 3.8 per cent to 6.8 per cent and remains relatively steady at this level in the new century (OECD 2005, p.20).

Understanding policy transfer

Thus far we have documented the rapid spread of VAT taxes in the second half of the twentieth century. What are less clear are the political and economic processes which led to this proliferation of consumption taxes. Was the spread of VATs documented above the result of increasing economic competition in the international political economy – the ‘race to the bottom’, or perhaps the need to fund increasing budget deficits? Alternatively, was it a consequence of policymakers’ ‘rational’ decision that the introduction of VATs was in their respective countries’ best interest? Did other processes and mechanisms influence the transfer of VATs? Understanding the dynamics of policy transfer is central to policy analysis because despite a tendency in some sections of the public policy literature to treat the agenda setting and decision making phases of the policy process as separate (May and Wildavsky 1978), in reality the forces driving the policy agenda have a significant impact on policy outcomes. For example structural change such as the stagflation of the 1970s not only exposed deficiencies in national tax systems but also transformed prevailing ideas and interests in relation to taxation policy. Given increasing evidence of policy transfer in recent decades, a specific literature has evolved which seeks to better understand this process and its implications. Using this literature as a guide the remainder of the paper will explore the dynamics of VAT transfer with a view to furthering our understanding of the origins of the consumption tax reform agenda.

The empirical evidence on the spread of VATs outlined above amounts to a *prima facie* case of policy transfer, a phenomenon which can be defined as:

a process in which knowledge about policies, administrative arrangements, institutions etc. in one time and/or place is used in the development of policies, administrative arrangements and institutions in another time or place (Dolowitz and Marsh 1996, p. 344).

While early research on policy transfer focused on the diffusion of policies between sub-national governments (Walker 1969) more recent studies have tended to concentrate on the dynamics of international policy transfer. A second feature of early accounts was a tendency to adopt a rationalistic view of the policy process. Policy transfer resulted when policy makers systematically evaluated experiences in other jurisdictions in the search for ‘optimal’ policy solutions (Rose 1991). The normative implication here is

that the voluntaristic adoption of policies from abroad was regarded as ‘opening up’ the policy agenda rather than constraining policy choice. Such depictions of the transfer process were called into question in an influential review article by Dolowitz and Marsh (1996). They argued that rationalist accounts tend to overlook cases of coercive transfer, or more subtle cases where underlying structural forces may influence the process of problem definition and costs or benefits of various policy options (Howlett and Ramesh 1996, p. 121). Such arguments seem particularly relevant in an era of increasing economic internationalisation in which inter-state competition creates incentives for policy makers to develop internationally competitive regulatory regimes (James and Lodge 2003, p. 7). Indeed it has been argued that tax competition between countries has been an important driver of reduction in statutory capital tax rates in recent years (Swank 2002; Ganghof and Eccleston 2004).

Despite the significance of structural factors in shaping the context in which policy transfer occurs there, is ample evidence that domestic politics and individual actors also influence the transfer process. For example while structural accounts of policy transfer tend to imply policy convergence, as the considerable revisionist literature on globalisation points out there has been significant variation in both the timing and content of economic reforms generally and tax reforms specifically in recent years (Sandford 2001; Swank 2002 ch. 7). So while structural developments increase the opportunities and incentives for transfer the process also requires the engagement of active agents. This is the central claim of Evans and Davies’ (1999) model of policy transfer which provides a clear framework to assess the dynamics of VAT transfer in recent decades.

Evans and Davies (1999) argue that many models of policy transfer are compromised by the fact that they define the transfer process too broadly. They rightly point out that very few policies are truly innovative – aspects of almost all programs draw on past experience to some extent (1999, p. 367). In other cases policy makers in different jurisdictions might quite independently decide on similar policy responses to common political problems without any transfer taking place (Peters 1997). In view of such criticisms the important question on which models of policy transfer should focus is: how do the specific mechanics of policy transfer shape the policy agenda and outcomes? This implies a two-pronged approach to research.

Firstly, building on the argument advanced by Dolwitz and Marsh (1996), Evans and Davies argue that ‘it is crucial that we place social and political action within the structural context in which it takes place’ (1999, p. 370). We need to consider the underlying economic, social and ideational forces driving the transfer process. While context is important they stress that we can only assess the influence of policy transfer on decision making if we also focus on the actors who are the agents of transfer – their motivations and their impact on the policy process. The aim here is to differentiate intentional transfer, where one group of actors consciously engages with elites from another jurisdiction as part of the policy process, from less clearly defined instances in which one country mimics the policy initiatives of others for unknown reasons. This second point demands a clear focus on what Evans and Davies define as policy transfer networks or ‘ad hoc action-oriented phenomena set up with the specific intention of engineering policy change.’ (1999, p.376).

Methodologically this approach, with its dual focus on both the actors involved in policy transfer and the structural context in which they are situated, draws on structuration theory – the notion that agents and structures are conceptually separate yet mutually constitutive. The framework implies that consideration needs to be given to the economic, institutional and ideational context in which transfer takes place and how this context influences the motivations and resources of actors in transfer networks. At the micro-level we need to assess how situated actors actually influence the policy agenda. In practical terms if we are to develop an appreciation of how policy transfer as conceived by Evans and Davis influenced the proliferation of VATs in the second half of the 20th Century, we need to explore three distinct aspects of the process.

Firstly we need to understand the structural context in which transfer occurred. In the case at hand this requires documenting how the economic and ideational context changed from the 1970s. The next section of the paper will outline the structural drivers of the international shift towards VATs. The sustained high levels of economic growth associated with the post-war boom and buoyant revenue flows that resulted presented few reasons to reform national tax systems. However the economic crisis of the 1970s forced policy makers to restructure national tax systems (Boskin and McLure 1990). Beyond the economic imperatives of reining in rampant budget deficits and attempting to enhance economic competitiveness, the recession of the 1970s also precipitated a paradigm shift in macroeconomic policy making (Hall 1993). In terms of tax policy

traditional aims of using tax systems to redistribute wealth and promote specific types of investment were gradually displaced by a new public finance orthodoxy which argued that tax systems should be neutral in their economic impact and should encourage economic growth by minimising marginal tax rates on capital and wage income (Steinmo 2003).

Secondly while the economic and ideational shifts highlighted above acted as catalysts for reform the shift towards VATs experienced in the final decades of the 20th century was by no means inevitable. In order to understand the origins of the consumption tax reform agenda we need to follow the lead of Evans and Davies (1999) and identify the policy entrepreneurs who formulated VAT proposals and the mechanisms through which this reform agenda was transferred between countries. We shall see how the structural developments outlined above resulted in a fundamental shift in the way public finance experts viewed consumption taxes. This contributed to a new consensus that increasing the relative importance of consumption taxes would result in a more stable and efficient tax base, and that of the many forms of broad-based consumption taxes a staged VAT was the most desirable. Having outlined these debates among public finance experts we then describe the process which resulted in the transfer of these ideas to policy makers across the industrialised world and beyond.

With the seeds of the VAT agenda sown in the minds of policy-making elites across the globe, the final task of the paper is to outline some of the domestic political and economic conditions that are required for the uptake of the consumption tax agenda. The international experience suggests that consumption tax reform evolved from being a policy option favoured by policy elites to a mainstream agenda item when there was an acute political awareness of structural problems confronting the tax system of the country concerned. For example large budget deficits, popular discontent with the fairness of the prevailing system, and/or high personal income tax rates have historically created windows of opportunity for enterprising policy entrepreneurs or politicians to advocate a VAT as the policy solution to the acute problems facing national tax systems. In short this paper will outline how a combination of structural factors, the actions of policy elites and specific windows of political opportunity explain why at different times VATs have gained prominence on the political agendas of the vast majority of nations over the past three decades.

Whilst this paper focuses on the proliferation of VATs across the OECD, it is important to note that consumption taxes have also become one of the most important tax instruments in transitional and developing countries. According to the IMF in 2001 VATs raised \$18 trillion annually, accounting for almost a quarter of global taxation. Considering such figures there is little wonder that senior economists in the Fund's Fiscal Affairs division concluded that 'The VAT is probably the most important tax development in the latter part of the twentieth century, and certainly the most breathtaking.' (Ebill et al 2001, p. 1). We now turn our attention to explaining this 'breathtaking' phenomenon.

Policy transfer in the case of the VAT: Structural pre-conditions

The initial decision by the EC to adopt a value-added tax as the European norm was the result of policy elites (in the Neumark Report of 1962) deciding that a VAT represented an incremental improvement on established and largely successful turnover taxes. However the spread of VATs from the EC across the OECD and beyond was driven by structural developments, or in the words of Boskins (1990, p.3): 'This extraordinary series of tax reforms occurred in response to intellectual, historical and political currents that appeared in the 1970s.'

Prior to this period of macroeconomic upheaval the stability of the post-war period underpinned a strong consensus on the broad parameters of taxation policy. While policy settings and instruments varied from country to country there was general agreement that the Keynesian welfare state should be funded by progressive income taxes and relatively high rates of taxation on capital, albeit with numerous concessions aimed at promoting industrial investment (Swank and Steinmo 2003). This post-war tax paradigm had strong foundations. The redistributive aspects of progressive taxation stimulated aggregate demand, while the concessional taxation of capital was the cornerstone of an important class compromise which underpinned the political stability of the post-war period (Steinmo 1993). Most importantly the legitimacy of the Keynesian paradigm and the associated commitment to progressive taxation was sustained by the ongoing economic prosperity experienced under the policy regime (Hall 1993; Steinmo 2003).

Yet as Steinmo (2003) points out dominant ideas about tax policy evolve in response to changing economic circumstances and the political pressures associated with such events. In reality a complex combination of factors undermined the Keynesian consensus. By the mid-1970s the onset of stagflation and a global recession called into question whether governments could actively manage the economy. With the credibility of Keynesian economic management increasingly being called into question, policy elites backed by powerful financial interests promoted neo-liberalism as the new macroeconomic orthodoxy (Hall 1993). This policy paradigm shift effectively established new intellectual terrain in which tax policy would be debated (Boskins 1990; Hallerberg and Basinger 1998). Whereas policy makers in the 1950s and 1960s had regarded progressive taxation and tax expenditures as effective tools of economic management and an efficient means to fund the welfare state, a decade later a new public finance orthodoxy was emerging.

At the broadest level the economic crisis of the 1970s called into question the logic and effectiveness of active state intervention in the economy. In the tax policy arena there was growing consensus that high marginal tax rates and the proliferation of tax concessions and investment incentives were seriously distorting economic activity and contributing to the general economic malaise (Browning 1978). By the mid-1970s there was a consensus among public finance experts that there were clearly defined structural problems with taxation systems across the OECD. In keeping with neo-liberal theory it was argued that tax systems should be reformed to improve their neutrality so that market forces, rather than the intricacies of the tax code and the political compromises they embodied, dictated patterns of investment and consumption (McLure 1984; Steinmo 2003; Swank 2003).

Not only did the economic crisis of the 1970s result in a policy paradigm shift which led tax experts to advocate more market-conforming tax systems, but the subsequent recessions and associated budget deficits meant that governments had to achieve reforms without compromising revenues. These structural pressures forced policy makers to explore and expand new tax bases. In short the economic conditions of the 1970s and the increasingly liberalised and competitive international political economy that resulted created structural conditions that favoured a policy shift from income taxes to neutral consumption taxes, including broad-based VAT consumption taxes.

According to proponents of broad-based consumption taxes they offered the following advantages:

- If levied on a broad base, VATs would not distort patterns of savings and investment.
- If used to fund reductions to income taxes on capital and labour VATs would improve incentives to work and invest.
- Relative to taxes on income, VATs encourage savings, thus improving domestic capital formation.
- VATs can be levied on services (which represent an increasing proportion of consumption in a post-industrial society) as well as tangible consumer products.
- Exports can be 'zero rated' improving trade competitiveness.
- The revenue yield is less volatile across the business cycle relative to income taxes. (Tait 1988; Ebrill et al 2001)

In summary the end of the post-war boom and the policy paradigm shift that resulted led to a fundamental reassessment of the manner in which governments could and should raise revenue. By the 1970s there was a strongly held view among policy elites that tax systems should be designed in a market-conforming manner. Indeed Ganghof (2005, p. 78) argues that the tax reform movement of the period was 'a textbook case of how powerful ideas, supported by particular countries and international organisations, spread around the world.' More specifically while many reforms concentrated on broadening the income tax base and lowering income tax rates there was a growing acceptance that broad-based VAT taxes were consistent with these goals and should become a more prominent part of the tax mix. Clearly the structural factors described above undermined the post-war tax policy status quo and created the pre-conditions for the diffusion of VATs beyond the EC. However this diffusion process was by no means inevitable and the fact that there was significant variation in the timing and content of reforms across the OECD suggests that both the mechanisms of policy transfer and the prevailing political conditions in recipient countries influenced the transfer process.

Agents in the transfer processes

A central contention of the contemporary literature on policy transfer is the importance of actors in the dissemination of policy ideas and how values held by policy elites, and the manner in which they engage with colleagues in international organisations,

influence the transfer process (Evans and Davis 1999, p. 363). An actor-orientated approach not only allows us to distinguish between policy transfer and mere coincidental mimicry, but through identifying transfer agents and establishing their motivations and the manner in which they interact we can enhance our understanding of the factors that drive, and the variables that mediate, the transfer process. This emphasis on transfer networks is particularly relevant to the diffusion of tax reform proposals in the late 20th century where ideas about tax reform were exchanged by high-ranking Treasury and Finance officials at the OECD, IMF and other international forums (Ganghof 2005; Swank 2003).³

The OECD was established in 1961 to promote economic development, world trade and financial stability (Molle, 2003, p. 121). While the OECD avoids an advocacy role and regards itself as a 'clearing-house' for economic and policy data for the use of member governments, in many policy arenas, including taxation policy, the Organisation has played a pivotal role in disseminating specific policy agendas. In a recent (2005) address to the US President's Advisory Panel on Tax Reform the OECD's chief of Tax Policy and Administration, Jeffrey Owens, acknowledged that the 'OECD's main functions are to encourage countries to share their experiences, develop best practices and set international standards' (OECD 2005). The influence of the OECD is heightened by its 'working party' structure in which research and report writing is conducted by seconded experts from member countries rather than a professional staff (Fратиanni and Pattison 2000). Such an approach gives member countries 'ownership' of OECD research, while senior officials returning from the OECD to their home agencies serve as powerful personal conduits of economic ideas. Indeed because senior OECD officials are situated at the intersection of a number of national-level policy networks they possess a unique and privileged position to drive policy and institutional change (Clemens and Cook 1999; Pierson 2004, 137) When combined with member countries' commitment to unanimously supporting published research the OECD represents a powerful forum to develop common positions on economic policy issues as well as an influential network for policy professionals. In this sense the OECD is widely regarded as enhancing the international exchange of policy expertise (Rose 1991, p. 105).

The IMF while traditionally focusing its economic policy advice on debtor nations has, through its staunch advocacy of fiscal reform, also had a broader impact on the policy transfer process. The Fund has long been a firm advocate of broad-based consumption

taxes, recommending such taxes in their technical assistance to transitional and developing nations and commending their introduction in OECD economies. Indeed according to the IMF an ideal tax system should feature a ‘heavy reliance on a broadly-based sales tax, such as a value-added tax, preferably with a single rate and minimal exemptions, and excise taxes levied on petroleum products, alcohol, tobacco and a few items that are considered luxuries.’ (as quoted in McBride 2005). Such advice has resulted in ‘half of all countries which have introduced a VAT during the last twenty years [making] use of FAD (The IMF Fiscal Affairs Department) advice’ (Ebrill et al 2001, p. xi). In addition to such direct advice the IMF generally and senior economists in the Fiscal Affairs Departments have also published widely both on the merits of a VAT and how to best to implement and administer the tax (Tait 1988; Ebrill et al 2001). Finally increasing economic liberalisation and the associated potential for tax competition has led to the creation of new international forums such as the International Tax Dialogue designed to encourage discussion between policy experts and the sharing of good tax policy.⁴

In the tax policy arena it can be argued that the OECD, IMF and associated forums have served as the basis for an international epistemic community or a ‘network of professionals with recognised expertise and competence in a policy particular domain’ (Haas 1992, p. 2). Haas argues that policy making in the late 20th century has been influenced by increasing complexity and interdependence on one hand, and the increasing prominence and influence of bureaucratic policy experts on the other. In this context policy knowledge and expertise is an important power resource, capable of defining policy problems and framing possible alternatives. In order to achieve such influence members of an epistemic community need to possess a common professional culture, norms in relation to their policy objectives, and shared causal beliefs (1992, p. 3). Indeed Pierson (2004, p. 104) has recently argued that policy transfer has a strong sociological basis with international policy ‘fads’ being shaped more by what elites regard as being appropriate than any objective policy analysis.

Examination of the role of international agencies in the global tax reform movement suggests they have acted as a node for a global epistemic community playing a pivotal role in the policy transfer process. Firstly, as outlined above, OECD and IMF research staff are predominantly seconded from member countries’ central finance and budget agencies, increasing the likelihood that staff hold similar world views. Secondly the fact

that researchers are senior officials from the central economic agencies of member countries promotes a common professional culture and shared causal beliefs. In summary the OECD, IMF and their specific Committee structures such as the OECD Committee on Fiscal Affairs (established in 1971) and the IMF's Fiscal Affairs Department provide tangible institutional structures which increase the opportunities for policy transfer. While there is general evidence that international agencies are the loci of policy transfer in the tax policy arena (Sandford 2001, p. 77; Tanzi 1987), we need to look to specific case studies in order to understand how policy ideas filtered through epistemic communities to influence the policy agenda across the OECD (Evans and Davis 1999, p. 317).

In Australia the 'modern' tax reform agenda was effectively established by the Asprey Committee of Inquiry (1975) which was notable for strongly advocating the introduction of a VAT tax despite little community support for the tax (Eccleston 2004). The fact that Inquiry insiders highlighted the influence of Treasury Officials and their strong advocacy of the introduction VATs along the lines of the tax that existed in the EEC and had been recommended by the OECD (Treasury 1973), amounts to *prima facie* evidence in the Australian case of public officials using their professional expertise and positions of authority to act as agents of policy transfer (Asprey 1974, pp. 6-8; Wallace 1976, p. 80; Thompson 1976). While historical accounts of the activities of individual public officials are scarce there is also strong evidence of the dissemination of OECD research on consumption taxes in Canada and Japan. In the Japanese case the Ministry of Finance's long standing interest in the introduction of a VAT as a means to stabilise public finances has been attributed in part to VAT study exchanges between Japan and EC in the early 1970s, which led to the Government Tax System Research Council's 1971 proposal to introduce a VAT (Kato 1994, pp. 112-113; Wright 2002, p. 239). Similarly in Canada Hale (2002, pp. 207-209) notes that Ministry of Finance officials such as the influential Douglas Hartle were the main proponents of a national VAT in the agenda-setting Carter Commission Report of 1967. More recently Steinmo (2003, pp. 18-19) obtained further evidence of converging elite opinion when he interviewed senior finance ministry officials from OECD countries as diverse as Japan, Sweden and Australia and found remarkably similar tax policy preferences and reform priorities. Such evidence points to the existence of an international epistemic community of senior economic policy officials based around the OECD and other international forums which served as the basis of a policy transfer network. Moreover

the prominent position occupied by these powerful bureaucrats in the central economic agencies ensured their considerable influence over the tax reform agenda in their respective countries.

However this is not to say that the transfer process was inevitable or automatic. As we shall see below, while the transfer networks outlined above ensured that VATs were high on the policy agenda of state elites, such proposals had to be linked to specific political problems before politicians would be prepared to risk promoting such controversial taxes. We now examine the domestic political and economic conditions required for consumption tax proposals to move from being a reform possibility to assuming a prominent position in the national decision agenda.

Domestic Politics and Policy Windows

In his influential analysis of the agenda setting process John Kingdon (1984) highlighted an important distinction between the policy stream, or the policy proposals and solutions which experts promote, and the broader political pressures and policy problems confronting governments. Thus far we have focused our analysis on the circumstances and processes which have led policy elites and senior officials in central economic agencies to change their tax policy priorities. However Kingdon argues that for a policy issue to make the transition from being on the governmental agenda or the extensive list of policies to which insiders and policy experts give consideration, to a government's decision agenda or the small number of priority issues which the political executive actively promote, requires an alignment of policy options with perceived political problems.

Kingdon's framework is significant because it emphasises that both domestic political circumstances and elite opinion influence the overt political agenda. A number of scholars have built upon this model by exploring the dynamics of 'problem definition' and the circumstances that influence demands for new policies (Anderson 2000). Some scholars argue that the political context in the form of prevailing policy ideas and material interests shape the overt decision agenda and that political problems can be objectively defined (for a summary see Wood and Vedlitz 2005), while others of a constructivist orientation highlight the contingent influence of culture, norms and discourse in shaping interests and defining policy problems (Kuran 1995; Stone 1997).

Beyond the debate about how political problems come to be defined there is a general agreement that in the tax policy arena governments are reluctant to promote significant tax reform in the absence of widely held perceptions that the policy status quo is unsustainable. It was only when the costs of policy inaction outweighed the risks of reform that the tax reform movement gathered momentum in the 1980s. In Kingdon's terms there needs to be an alignment of the policy (expert advice) and political streams. So while new tax policy initiatives may capture the imagination of senior bureaucrats in Treasury and Finance Departments political leaders are unlikely to risk promoting reforms until there is political support for such proposals.⁵

The politics of taxation literature provides important insights into the domestic circumstances under which tax reform proposals make the transition from the governmental agenda to the decision agenda. It seems that a combination of domestic economic factors and broad societal attitudes towards the prevailing tax system create windows of opportunity for bureaucratic elites and policy entrepreneurs to promote tax reform (Hallerberg and Basinger 1998). Firstly it will come as no surprise that in an era when economic and financial issues dominate both the media and political debate changing economic conditions influence community perceptions of the need for economic reform. This is especially true in times of recession and fiscal crises which in turn create circumstances in which politicians and policy entrepreneurs can credibly argue that the policy status quo is untenable and that comprehensive reform is necessary. For example with neo-liberalism firmly entrenched as the economic orthodoxy, since the 1970s deteriorating public finances have been presented as an acute policy problem that has served as a catalyst for tax reform (Steinmo and Swank 2002; Swank 2004).⁶ Hallerberg and Basinger (1998) also provide clear evidence that governments presiding over low growth economies are more likely to engage in tax reform in an attempt to stimulate the economy. More subtly, as we shall see in our case studies, advocates of consumption tax reform have used related economic arguments such as the need to improve national savings and export competitiveness to undermine the policy status quo. While policy 'problems' are socially constructed and influenced by prevailing ideas in relation to economic governance (Howlette and Ramesh 1995; Wood and Vedlitz 2005), it nonetheless seems that when economic performance deviates from parameters acceptable under the prevailing orthodoxy, the electorate will accept and may even expect corrective policy action.

A second set of domestic issues that provides a window of opportunity for tax reform is provided when the legitimacy and effectiveness of the existing tax system is called into question. We have already noted the coercive nature of taxation. Indeed effective tax systems are backed by a range of sanctions to encourage compliance. However in order for a tax system to be sustainable it must be regarded as legitimate and fair by the vast majority of taxpayers (Levi 1988; Braithwaite 2005). Given the scope of modern tax systems the state can't possibly force compliance or enforce the tax code in more than a small minority of cases (Mann 1993; Hobson 2000, pp. 199-201). Instead the state must rely upon what Levi (1988) refers to as quasi-voluntary compliance, a situation in which the vast majority of taxpayers choose to pay tax because they regard the tax system and the public expenditure that it funds as being legitimate. However when there are widely held perceptions that the tax system is arbitrary and unfair and that significant segments of the community are evading their tax obligations, a rapid decline in taxpayer morality (and revenues) may follow. As Steinmo points out (2003) such circumstances have the potential to trigger mass dissatisfaction with the tax system creating an acute policy problem for government and pushing tax reform to centre stage as a political issue. Perhaps the best example of such a back lash was the popular opposition to the Thatcher government's poll tax in early 1990s which culminated in the abolition of the loathed tax (King 1993). Similarly in Australia in the early 1970s increasing publicity of rampant tax avoidance by the rich while wage earners were facing increasing tax burdens acted as a catalyst for a Commission of Inquiry into the tax system (Groenewegen 1982, p. 7). In the United States growing awareness of the abuse of tax expenditures contributed to the momentum of the tax reform movement (Surrey 1973).

In summary we can conclude that tax reform generally and consumption tax proposals in particular seem to achieve political prominence when policy elites are in agreement about the goals of tax reform and there is also a wider political acceptance that there are significant problems with the tax policy status quo. This analysis conforms closely with Kingdon's view that windows of opportunity for agenda setting occur when policy proposals are linked with acute political problems. However it is important to recognise that policy problems and associated solutions are socially constructed and critically dependent on how actors interpret their context (Seidman and Rappaport 1986). While policy opportunities are influenced by the interaction of structural forces and prevailing ideas there is widespread agreement that actors play an important role both in promoting ideas within policy communities (as Evans and Davies (1999) suggest) and in linking

proposals to the political problems confronting government leaders. In short actors and policy entrepreneurs in particular play a vital role in capitalising on windows of opportunity in the policy process.

For example Kingdon stresses that agenda setting is the product both of structural processes and of autonomous participants. Central here are:

Policy entrepreneurs, people who.... are responsible not only for prompting important people to pay attention, but also for coupling solutions to problems and for coupling both problems and solutions to politics (Kingdon 1984, p. 21).

Often the most effective policy entrepreneurs are located outside the state, and by reinforcing formal bureaucratic advice they prompt political decision makers within government to take decisive action. It is in this role that many analysts believe that think tanks have their greatest influence over the policy process (Kingdon 1984; Abelson 2002). Similarly Campbell argues that entrepreneurs with diverse backgrounds and experiences are valuable because they may offer innovative solutions and can lend political legitimacy to a policy proposal (Campbell 2004, p. 178). This seemed to be the case in Australia in 1997 when a cross-class coalition of state elites, business leaders and welfare activists convinced Prime Minister Howard to reintroduce a VAT proposal onto the national political agenda despite the fact that he had given a very public assurance that he would not introduce such a tax (Eccleston 2000, Bell 2006). A second set of actors that has been increasingly important in the 'market place of economic ideas' is the financial press. Hall (1993, p. 288) notes that in many of the economic policy debates of the late 20th century, not only has the media reported policy views held by economic and financial experts, but the financial press has actively advocated certain policy views and thus is an important political actor in terms of defining policy problems and proposing policy solutions.

If an innovative policy idea is going to achieve prominence on the overt political agenda it must be endorsed by a critical mass of authoritative policy elites. In the case of economic policy making these elites are often senior officials in key economic policy making agencies. However as Kingdon (1984) highlighted over two decades ago, for an idea to move from the realm of elite consideration to the mainstream policy agenda the

policy program in question must be able to address a defined policy problem and be acceptable to the voting public. While we have seen that there has been a high degree of international agreement among policy elites in terms of the merits of introducing VATs, this convergence of preferences has been tempered by differing economic and fiscal conditions experienced in specific countries. Such cross-national variation in the onset of budget deficits and other administrative problems associated with national tax systems has meant that the domestic circumstances conducive to promoting a VAT have varied from country to country. Similarly, and as will be explored in more detail in our case studies, variations in political conditions in specific countries have resulted in policy makers tailoring the VAT proposals to suit domestic political imperatives and minimise electoral opposition. As Radaelli has observed, while there has been significant cognitive convergence on issues of tax reform, domestic political circumstances have a powerful mediating effect on the transfer process.

No tax system has been 'diffused' from one country to others, although among policy-makers there has been a process of cognitive convergence around certain paradigms and fiscal emergencies (2000, p. 29).

Conclusion

This paper has outlined the origins of the VAT agenda which swept the world in the final decades of the 20th Century. In keeping with the contemporary literature on policy transfer I have argued that a combination of structural conditions such as the economic crisis of the 1970s and changing ideas about taxation policy created circumstances conducive for fundamental tax reform. However the changing structural context in which tax policy was being made over the period only provided the pre-conditions for the global proliferation of VATs. Indeed a cursory examination of the public finance literature in the 1970s reveals a number of credible alternative policy solutions to a VAT.⁷

In order to understand why VATs became an important element of the tax reform movement of the last quarter of the Twentieth Century we turned to the policy transfer literature. A central claim here is that the process through which policy ideas are exchanged has a significant impact on the extent of policy transfer. The dynamics of VAT transfer supports such claims in that, after early successful experimentation in the

EC, the VAT became the consumption tax of choice among tax policy elites. The spread of the VAT across the industrialised and the developing world was then accelerated by the existence of an epistemic community, or what Evans and Davis call a policy transfer network based around the OECD, IMF and other associated international economic forums. Indeed the transfer of the VAT to member countries was expedited by the fact that members of this transfer network were drawn from senior officials in central economic policy making agencies in the recipient countries. Not only did these bureaucrats have policy expertise, they were also in positions of unrivalled authority with respect to providing policy advice. At this level the evidence suggests that the dynamics of policy transfer did have a discernable impact on the proliferation of VATs (James and Lodge 2003).

An interesting exception to this pattern is the United States – the one OECD country that does not have a VAT. It seems that the American political system features a much more open marketplace for economic advice in which state officials do not enjoy the monopoly powers which they do in other countries. In such an institutional setting it has been more difficult to present a VAT as a preferred solution to American fiscal problems.

Despite an emerging elite consensus on the merits of VATs it is important to note that there has been considerable variation in terms of when VATs were introduced and the rates at which they have been levied as well as the manner in which they have been administered. In terms of the policy transfer literature this amounts to a case of policy ‘emulation’ in which policy ideas, rather than specific policy settings, have been transferred from one jurisdiction to another (Hudson and Lowe 2004; Radaelli 2000, p. 33; Rose 1991, p. 132). This cross-national variation can be explained in terms of Kingdon’s (1984) policy streams framework. The argument here is that while the process of elite policy transfer ensured that VATs held a prominent position on the decision agenda in the majority of countries, political leaders were generally not willing to risk promoting comprehensive tax reform in the absence of widely recognised problems with the existing tax system. Even when problems were apparent the VAT had to be presented as a credible solution. In short domestic political and economic circumstance combined with the actions of policy entrepreneurs to influence when VAT proposals make the transition onto the overt political agenda.

¹ While Australia's national VAT is called the GST (Goods and Services Tax), in the interests of consistency this paper describes such taxes as VATs.

2. According to Ebrill (2001, p. 4) such a tax was apparently promoted by German businessman von Siemans in the 1920s quite independently of Adams while Steinmo (1993, p. 94) highlights the fact that Andrew Mellon, Treasury Secretary in the Republican Harding administration, also proposed a national consumption tax at this time to cut what was regarded as being prohibitively high taxes on capital.

3. It should be noted that whilst the IMF and the World Bank strongly encouraged and perhaps even coerced many developing countries to adopt a VAT, these international organisations have played a less significant role in the spread of VATs among advanced industrial countries which are the focus of this volume.

4. The International Tax Dialogue was established in 1999 and is jointly hosted by the OECD, IMF and World Bank < www.itdweb.org >.

5. Indeed scholars using an epistemic communities approach – which tends to emphasise the pervasive influence of knowledge and shared norms among elites on the policy process – widely recognise economic policy as a limiting case in which ideas and political and economic interests shape the policy agenda (Ikenberry 1992).

6. In an interesting extension to this argument Kato (2003) makes a case that although the deficits of the 1970s and beyond prompted government to promote the tax reform agenda, the very existence of such deficits undermined the political support for reforms generally and new VATs in particular because the revenues from these new taxes would repay public debt rather than fund public services. For a critique see Ganghof (the article sent to me).

7. Possible alternatives include a Kaldor Tax or a single-staged Retail Sales Tax (RST).

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