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Abstract

This article compares two competing models of income taxation, one of which was in many ways more successful than the other. While taxation of capital income is constrained by high costs, the high overall tax burden on labour makes it difficult to reduce tax rates on labour incomes. These conflicting pressures point towards separate tax rate schedules for capital and labour, as is characteristic of dual income taxes. The analysis has implications for the role of income taxation in achieving social policy outcomes. Most importantly, while progressive taxation of capital income is constrained by high costs, policy makers willing to separate capital and labour income taxation can use the income tax to reduce the tax burden on low wages.



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1. For a more complete and detailed conceptual discussion of different models of income taxation see Ganghof (2004; forthcoming-a).
2. Unweighted average for 21 advanced OECD countries. See notes to Figure 1 for data definitions and sources.
- 3.

3. In fact, the cut in tax subsidies created severe strains in the housing markets of the Nordic countries, which also added to macroeconomic problems. The cut was capitalized in prices and thus led to a drop in the value of real estate. A considerable number of homeowners could no longer cover their mortgage with the market value of their real estate and went bankrupt (e.g. Huber and Stephens, 1998; Nannestad and Green-Pedersen, forthcoming).

4.

4. This view, though far from new, has recently been highlighted and elaborated in the political science literature on ideas in foreign policy (e.g. Brooks and Wohlforth, 2000, 2002; Goldstein and Keohane, 1993).

5.

5. This section draws on Ganghof (2004; forthcoming-a).

6.

6. Policy makers may of course deliberately reject *both* models of income tax reform as too radical, as they did in Denmark in the 1990s. If they do, however, they have to sacrifice the goal of market-conforming capital income taxation. See Ganghof (forthcoming-a) for a more detailed exploration of the resulting 'trilemma' of income taxation.

7.

7. The following draws on Ganghof (forthcoming-b).

8.

8. Structural reforms of income taxes are perhaps easiest when relatively few people are paying it, as there are fewer vested interests in the system (Heady, 2002: 7).

9.

9. In line with my theoretical argument and the pattern visible in Figure 2, the Slovak Republic has one of the lowest total tax burdens of the new European Union member states (33% in 2002), Slovenia one of the highest (39.8%) (Eurostat, 2004: 210, 213).

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