CHAPTER 12

THE COMPETITION STATE
The Modern State in a Global Economy

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1 The Competition State Thesis

Is there a general trend in the developmental trajectories of advanced capitalist states? The competition state thesis argues that there is and that the essence of this trend is a change of state form, from welfare to "competition state" (Cerny 1997; Hirsch 1998; Jessop 2002). In contrast to earlier state transformations, which were punctuated by wars, revolutions, and violent institutional ruptures, this transition is incremental, undramatic, and peaceful. The basic institutions of the welfare state remain in place but are gradually trimmed, rearranged, and "refunctionalize[d]" (Jessop 2002: 258) to serve a new purpose: to make society fit for competition. While the mission of the welfare state had been to protect national society from excessive competition by controlling cross-border economic transactions, by granting social rights and protection, and by nationalizing key public services, the competition state pursues "increased marketization" (Cerny 1997: 259). It liberalizes cross-border movements, re-commodifies labor and privatizes public services. The welfare state domesticated capitalism, whereas the competition state vies for capital.

The competition state thesis is attractive for intellectual and normative reasons. It offers a simple and general theory of state transformation that makes sense of a large and diverse set of changes in advanced capitalist states since roughly the 1970s. The explanatory leverage is potentially very large. At the same time, it resonates with widespread feelings of political disenchantment and decay. Explaining how the state loses power and autonomy in some respects while remaining a central and increasingly repressive governance actor in others, it rationalizes general misgivings about the "neoliberal" age. Many people suspect that more market simply means more big business (Crouch 2011): Large firms call on the state to protect them from competitive risks by shifting them onto small business and labor. The recent financial crisis is emblematic of this fear. Governments swiftly unburdened banks of bad debt, protecting management and shareholders from loss, and pushing the costs onto citizens via spending cuts and structural reforms—more welfare for capital, more competition for all the rest.

Yet, precisely because of its simplicity and generality, the competition state thesis is also problematic. Its propositions are precarious and not supported by rigorous empirical analysis. Three propositions are central. First, *structural determinism*: the structure of the global economy forces states to compete for mobile capital. Second, *convergence*: there is only one best policy response to inter-state competition, namely the implementation of a neoliberal agenda of supply-side policies, fiscal restraint, and the marketization of social relations. Third, *the decline of the welfare state*: since the welfare state is seen as a competitive disadvantage in global markets, it will wither away as market competition intensifies.

Neither of these propositions is uncontested among students of comparative political economy. For instance, globalization-skeptic scholars regard international competitive constraints as weak at best, even in an era of global markets. They see no strong structural determinism of national policies and institutions (Garrett 1998; Hay 2008). The Varieties of Capitalism School conceives of international competition as a source of cross-national divergence rather than of convergence (Hall and Soskice 2001). And, according to the so-called "compensation thesis," the welfare state is the institutional foundation rather than the victim of international competition. Without the welfare state, there would not be any substantial cross-border economic integration, and hence no competitiveness problem (e.g. Rieger and Leibfried 2003; Rodrik 2011). In sum, the mainstream literature in comparative political economy is not very impressed by the competition state thesis and largely ignores it.

Unfortunately, the proponents of the competition state thesis hardly engage the mainstream views and make no sustained effort to find empirical support for their own propositions in macro-quantitative, internationally comparative time-series data. They rely almost exclusively on qualitative evidence—rich and insightful, but also often quite anecdotal (but see Horsfall 2010). This is unfortunate: a more intense debate of other perspectives engaging macro-quantitative evidence could considerably strengthen the competition state thesis, both by demonstrating its validity and exposing its limits. It could also help correct the strange neglect of global market forces in the mainstream literature on comparative political economy. While the competition state thesis tends to overplay these forces, the mainstream clearly underplays them (see Streeck 2010).

Section 2 will now clarify the concept of the competition state by referring to some of its prominent proponents, such as Philip Cerny, Bob Jessop, and Joachim Hirsch. Section 3 reviews the causal mechanisms allegedly driving its rise. Section 4 takes up three critical questions addressed to the competition state thesis: How stringent are competitive constraints? How convergent are state reactions to competitive constraints? How detrimental are these constraints to the welfare state? The questions are discussed in light of contrasting arguments from other strands in the comparative political economy literature and of descriptive evidence of tax policy trends in Organisation for Economic Co-Operation and Development (OECD) countries. Taxation provides an excellent starting point for analyzing the transformative effect of international economic integration: it is an essential feature of both the welfare and the competition state, and it has figured prominently in the globalization debate, as it sparks contending views on whether international tax competition erodes the fiscal foundations of the welfare state. Many authors have used it as a crucial test case for the impact of global economic change on domestic policies and institutions (Garrett 1998; Swank 2002; Steinmo 2003; Campbell 2004). Section 5 concludes.

2 Defining the Competition State

What is a competition state? According to the proponents of the competition state thesis, it is a newly emerging state form that, from the 1970s onwards, has obtained dominance in advanced Western societies and worldwide. The key features of the competition state are defined mostly in terms of features of the old state form it replaces: the "Keynesian Welfare National State," or KWNS (Jessop 2002). The KWNS dominated the "golden years" of welfare expansion after World War II. The competition state is its historical successor and conceptual antonym.

First, the competition state is not a *Keynesian* state, because it has decidedly non-Keynesian policy priorities (e.g. Cerny 1997: 259 f.; Jessop 2002: 256; Horsfall 2010: 65): It is less concerned with managing the macro-economy than with ensuring micro-economic efficiency; it has a supply-side rather than a demand-side focus; it prefers rule-bound over discretionary policies; it prioritizes inflation control over full employment, fiscal restraint over fiscal expansion, and neutral taxation over tax progression; it promotes innovation and growth in general rather than picking winners through an activist industrial policy. The competition state relies on market mechanisms and avoids market interventions.

Second, the competition state is not a *welfare* state, because it aims to increase rather than decrease the market dependence of citizens and industry: It serves as a "collective commodifying agent," not as a "decommodifying hierarchy" (Cerny 1997: 267; also Jessop 2002: 251 f.; Bobbitt 2002: 241 f.; Horsfall 2010: 62–64). The competition state trims welfare entitlements to increase work incentives and to mitigate dependency traps; it cuts wage-replacing unemployment benefits and expands subsidized employment and training programs (active labor market policy); it emphasizes means-tested social assistance and de-emphasizes status-preserving social insurance; it privatizes the provision of public services, such as telecommunications, railways, hospitals, education, prisons, and cuts subsidies for private industry; it expands markets but refuses to guarantee market outcomes.

Third, the competition state is not a *national* state because its territory and people lack economic coherence and common identity (Jessop 2002: 173–181; Cerny 2010: 6; Lunt 2010: 28). While the welfare state had created a fairly self-contained national economy insulated from international markets by capital controls and trade restrictions, the competition state opens up to international trade and capital flows and exposes the domestic economy to global markets that no longer operate along national lines. While the welfare state had fostered a sense of national identity, solidarity and belonging through discriminatory policies of cultural and ethnic homogenization—including strict immigration laws, public schooling, and forced assimilation of minority groups—the competition state champions non-discrimination. It is basically indifferent to race, religion, income, or gender, and it welcomes social, cultural, and ethnic diversity as a productive resource. Interest, not identity, keeps national society together. The competition state is "a mere pragmatic association for common ends" (Cerny 1997: 255).

Finally, the competition state is not a *state* in the emphatic sense of untrammeled national sovereignty (Cerny 1997: 258; Hirsch 1998: 33 f.; Bobbitt 2002: 234; Jessop 2002: 252 f.). The sovereignty of the competition state is doubly constrained: first, by the rules of international economic regimes (European Union (EU), North American Free Trade Agreement (NAFTA), World Trade Organization (WTO), International Monetary Fund (IMF), etc.), and, second, by the ever-present exit threat of mobile capital—real, financial, and human—that forces governments to compete for capital through market-friendly policies. Both constraints restrict the policy space for protectionism, decommodification, and redistribution, leaving governments with no alternative to "neoliberal" policies. Formally, the competition state remains a democratic institution. In fact, however, democratically elected governments have no alternative to moving "policy in a market-conforming direction" (Swank 2006: 853). Without choice, the democratic machinery runs idle. The state transforms from an instrument of national self-government into an "enforcer" of the interests of global capital vis-à-vis domestic society (Cerny 1997: 258).

In short, the competition state is the institutional reflection of the global spread of pro-business, "neoliberal" reforms—low inflation, fiscal austerity, welfare retrenchment, marketization, deregulation, and privatization. It represents not just one variety of capitalism among others, but the general form of the state associated with the distinct period of capitalist development unfolding since the economic crises of the 1970s.

3 Explaining the Competition State

Most proponents of the competition state thesis see the rise of the competition state as an adaptive response to fundamental macro-social change including globalization, government overload, the crisis of Fordism, and the cultural hegemony of neoliberal policy ideas.

Globalization undermines the welfare state by exposing it to international competition (Cerny 1997; Hirsch 1998: 32 f.; Bobbitt 2002: 220 f.; Fougner 2006: 173–175). As the barriers to cross-border transactions erode, governments can no longer impose costly taxes and regulations on mobile assets and activities, but have to vie for them through deregulation and de-taxation. The external competitive constraint weakens the welfare state's capacity to shape and mitigate competition internally. To stay competitive, governments have to cut costs and slack, curtail redistributive policies, sell off public services, and focus public expenditure on economic rather than social needs, that is, on infrastructure, education, and research. Competitiveness supersedes national security and domestic welfare as the top political priority. While competitiveness had always been a concern for states (Reinert 1995), globalization significantly changes its salience and meaning. Until the 1970s, competitiveness mainly concerned the ability of national industry to sell goods in foreign markets. With the onset of deep economic integration in the 1970s and 1980s, however, it increasingly concerns the ability to attract and retain mobile assets and activities, especially human, corporate, and financial capital, for the domestic economy. Governments transform from sales representatives of national industry to landlords trying to lure in rich foreign tenants.

And, importantly, the proponents of the competition state thesis highlight the central role of states in creating and maintaining economic globalization. States do so through unilateral liberalization and through multilateral cooperation in international economic regimes, such as the one of the WTO, EU, NAFTA, and IMF. One motive is to better cope with internally generated problems of government overload.

Government overload undermines the welfare state from within (Cerny 1997: 262; Jessop 2002: 87 f.; Cerny and Evans 2004: 52; Lunt 2010: 26). It refers to the self-reinforcing escalation of welfare state commitments. The dynamic is fueled by disincentive effects of welfare state policies which aggravate the problems these policies notionally address (e.g. Offe 1984): The welfare state's commitment to Keynesian demand management triggers adaptive responses by economic agents, such as excessive wage deals between trade unions and employers, which cause stagflation; the commitment to provide for social needs spurs the invention of new needs and ratchets up political demands; the expansion of welfare programs creates constituencies with vested interests in further expansion, for example, welfare bureaucrats and professionals, public sector trade unions, or welfare clients (Rieger and Leibfried 2003); and subsidies to industry trigger investments in effective lobbying rather than efficient production. As the decommodified and subsidized parts of society absorb ever greater shares of economic output and political power, they slowly throttle the productive elements. Private investment is crowded out by public consumption. Public deficits grow and cause a chronic fiscal crisis of the state. Turning to the competition state is an emergency measure to break this vicious cycle. By exposing domestic society to international competition, it helps governments in "getting incentives right," and it forces citizens and industry to rely primarily on their own efforts rather than on public assistance.

The *crisis of Fordism* is, according to some authors, the deep cause of both globalization and government overload. Fordism was the "accumulation regime" of Western welfare states during the "golden" 1950s and 1960s (Hirsch 1998; Jessop 2002: 56–58). The regime was based on a virtuous, self-reinforcing cycle of mass production and consumption: mass production increased productivity through economies of scale; increased productivity led to rising wages; rising wages spurred mass consumption; mass consumption increased the utilization of capacity and, thus, profits; increased profits, in turn, allowed for more investment in productivity-enhancing technologies of mass production.

When the saturation of demand for mass-produced goods and a shift in consumption patterns towards services ended this virtuous cycle, the crisis of the welfare state began: mass unemployment, lower profit levels, and growth rates cut into public revenues; increased demand for fiscal stimulation and income maintenance pushed up public spending. The result was the overloaded state of the 1970s. In this reading, governments moved towards the competition state to shun the overload and to rescue capitalism from stagnation. By opening up the domestic economy to global markets and by commodifying essential state functions, governments created new profit opportunities for capital. It is not by accident that some of the biggest fortunes of the late twentieth century were made in newly privatized service markets such as telecommunications and television. Just think of Carlos Slim, Rupert Murdoch, and Silvio Berlusconi.

The *spread of neoliberalism* facilitated the transition to the competition state by focusing public attention on competitiveness and by discrediting policy alternatives to market-accommodating policies. For Paul Krugman, the "rhetoric of competitiveness" (1994: 40) is a publicity stunt by governments and opinion leaders to sell structural reform to reluctant mass publics. However, for most theorists of the competition state it is more than that: it reflects an entrenched cultural hegemony of neoliberal policy ideas that "naturalizes" international competition to the point where it is broadly accepted as a taken-for-granted constraint on domestic policy (Fougner 2006: 165 f.; Lunt 2010;

Taylor 2010). In this perspective, the exigency of international competition is more narrated than real: it is a political construction that has been promoted, since the 1980s, by powerful actors such as the Reagan government in the United States, the Thatcher government in Britain, and international organizations with a stake in market integration, such as the World Bank, the OECD, and the EU. Yet narrated competition is nevertheless a real constraint. Even social democratic or center-left parties are forced to adapt, as the aggressive marketization and retrenchment agendas of the Blair government in Britain and of the Schröder government in Germany show (Cerny and Evans 2004: 60). And even fundamental shocks like the recent financial crisis fail to break neoliberal hegemony (Crouch 2011).

The four explanations of the rise of the competition state are not mutually exclusive. Most proponents of the competition state thesis refer to all four of them but emphasize globalization as the most conspicuous and, supposedly, most consequential driver of transition.

4 Questions about the Competition State

According to one prominent commentator, the competition state thesis provides a "supremely well observed, yet nonetheless general, elegant and parsimonious" account of key changes in the political economy of contemporary states (Hay 2004: 39). But is it true? The thesis' validity is problematic for two reasons. It relies on a set of rather heroic propositions about state-economy relations, all of which are contested in comparative political economy: structural determinism, convergence, and the decline of the welfare state. Additionally, its proponents make little systematic effort to test these propositions empirically. While their predictions concern general patterns and trends in all countries, the competition state literature relies mostly on small-N qualitative studies focusing on particular developments in particular countries. Now we will discuss the three propositions in light of conflicting arguments from other strands of the comparative political economy literature and use empirical evidence from taxation in OECD-countries to demonstrate the potential of more quantitative approaches for elucidating the scope and limits of the competition state thesis.

Obviously, we cannot fully test the competition state thesis here. This would require a systematic empirical analysis of more policy areas (including public spending, labor market policy, education, social protection, market regulation, etc.) over an extended period of time and an extended sample of countries (including non-OECD countries). We simply use a crucial case, a case "that *must closely fit* a theory if one is to have confidence in the theory's validity" (Eckstein 1975: 118) to highlight some of the promises and pitfalls of the competition state thesis deserving more systematic study elsewhere.

Do States Compete?

Take the proposition of structural determinism: it holds that the changing structure of the macro-social environment—globalization, government overload, post-Fordism, neoliberal hegemony—forces governments to compete for real, financial, and human capital. According to Bob Jessop, the competition state is the "naturally necessary form of the capitalist type of state in a globalizing knowledge-based economy" (2002: 268). Other authors are less explicit but also see the transition to the competition state as an inevitable institutional adaptation to largely exogenous economic pressures (Cerny 1997; Hirsch 1998; Bobbitt 2002). Dodging competition is not an option.

Unfortunately, these authors do not address how the external pressure for increased competitiveness is internalized by states. Implicitly, they allude to two alternative mechanisms. One, suggested primarily by the spread of the neoliberalism explanation, is agency: powerful actors—government elites, business leaders, and the media—analyze the competitive constraints weighing on the domestic economy, develop reform programs for meeting them and cajole domestic society into accepting the necessary changes (Cerny and Evans 2004; Lunt 2010; Taylor 2010). The problem with this account is that it undermines the supposed inevitability of the competition state. Agency introduces contingency because different agents may perceive similar structural constraints differently, conceive different policy responses, and differ in their ability to sell these responses politically. The rise of the competition state no longer looks like the necessary outcome of non-negotiable, externally imposed structural imperatives, but like the contingent and potentially reversible outcome of a political process of "neo-liberalisation" (Hay 2004: 44). The competition state thesis loses much of its generality and persuasive power.

The other mechanism is natural selection: uncompetitive institutions and policies are weeded out by sheer competitive pressure. This is the mechanism the early proponents of the competition state thesis clearly had in mind. The problem with this account is finding evidence for it. According to a large body of globalization-skeptic literature, international competitive constraints are weak at best and leave considerable room for domestic choice. Authors note that the contemporary level of economic integration is not unprecedented, that the major share of economic activity is still geared to domestic markets, and that mobile capital still flows into non-liberal, high-tax, high-regulation economies such as Denmark (e.g. Campbell 2004; Hay 2008)—there "remains a leftist alternative to free market capitalism in the era of global markets based on classic 'big government' and corporatist principles" (Garrett 1998: 4). In light of these claims, the competition state thesis loses much of its empirical plausibility. How stringent are competitive constraints on national governments?

Consider some evidence from taxation. To the extent that taxes fall on capital or other mobile assets, the competition state thesis predicts tax competition: governments can no longer impose taxes on capital, but have to vie for it by undercutting foreign capital tax rates. Indeed, corporate tax rates conform to this prediction. As Table 12.1 shows, they have fallen across all core OECD-countries. The average is down from 46 percent in the late 1980s to 29 percent in the late 2000s.

Various indicators point to competitive constraints as the major cause of the race to the bottom in corporate tax rates. First, there is extensive evidence of corporate tax arbitrage. Foreign direct investment and, even more importantly, corporate paper profits are highly sensitive to international tax rate differentials. Multinational companies routinely design their internal but cross-border transactions so as to increase paper profits of affiliates in low-tax countries and reduce them in high-tax countries (Genschel and Schwarz 2011: 350).

Second, there is evidence of governments reacting to corporate tax arbitrage by strategic rate setting. Corporate tax rate choices vary systematically with rate levels in neighboring countries and in regional integration clubs like the EU (Genschel and Schwarz 2011: 358).

Finally, and most importantly, corporate tax rates vary with country size. As the bottom row of Table 12.1 shows, OECD corporate tax rates were essentially unrelated to country size in the 1980s (coefficient of correlation 0.1) but were positively and significantly related to country size in the 2000s (coefficient of correlation 0.6). This indicates increasing competitive pressure because, according to the standard model of tax competition (Wilson 1999), small countries have more to fear and less to lose from tax competition than large countries and will therefore undercut large countries' tax rates in the competitive equilibrium. Small countries, on the other hand, have more to fear, as—given their lack of market power—they suffer relatively larger capital outflows when keeping tax rates up; they have less to lose because, for the same reason, a rate cut results in a relatively larger capital inflow from abroad. Intuitively, preying on a foreign tax base instead of farming domestic tax resources is profitable when foreign economies offer lots of prey and the domestic economy offers little to farm on. If size differences are large enough, small countries may actually be better off under tax competition than in its absence.

Note, however, that the correlation between corporate tax rates and country size is far from perfect. Competition is not the only factor that matters in tax rate choice. Note also that the tax wedge (i.e. the sum of personal income tax, employee social security contributions, and payroll taxes as a percentage of labor costs) of the average production worker (i.e. single earner, married, and two children) has also fallen from 17 percent (OECD-average) in the late 1980s to 14 percent in the late 2000s. This is harder to square with the competition state story. The drop fits the marketization part of the competition state story: governments cut non-wage labor costs in order to increase labor-market participation rates and raise the international competitiveness of domestic gross-wages (Jessop 2002: 83). But, the drop is at variance with the idea of tax competition. The standard model of tax competition predicts a shift of the tax burden from mobile capital to less mobile tax bases. The available evidence suggests that labor is rather immobile. To the extent that workers move between countries at all, the movement is driven by income differences, not tax differences (Genschel and Schwarz 2011: 348). Hence, tax wedges should increase, not decrease, as competitive pressure on capital taxation mounts. The lack of any significant association with country size also corroborates the absence of competitive constraints on tax wedges (bottom row of Table 12.1).

Overall, a cursory look at the evidence from taxation provides partial support for structural determinism: competitive pressures are a significant constraint on corporate tax rates, and states are forced to compete for mobile capital. But small states are subject to stronger constraints than large states, and labor taxation is not directly affected.

Does Inter-state Competition Lead to Convergence?

The competition state thesis predicts a process of competition-induced convergence of domestic institutions and practices around a neoliberal script of the competition state. It

Table 12.1 The Competition State: Evidence from Taxation

Country/ Regime	Population (Million)	Corporate Tax Rate		Tax Wedge°		Total Tax Revenue (%GDP)		Corporate Tax Revenue (% GDP)		Deficit	
	05–09	85–89	05–09	85–89	05–09	85–89	05–09	85–89	05–09	85–89	05–09
Continental											
Luxembourg	0.5	*n.a.*	30	*n.a.*	−3	37.1	36.4	6.3	5.3	*n.a.*	1.4
Austria	8.3	50	25	8	8	40.3	42.4	1.4	2.2	−3.1	−1.9
Belgium	10.6	44	34	21	16	43.6	44.0	2.3	3.2	−4.3	−2.0
Netherlands	16.4	41	28	27	24	43.9	38.8	3.2	3.4	*n.a.*	−1.0
France	61.9	45	35	7	15	42.4	43.3	2.1	2.5	−2.6	−3.8
Germany	82.2	60	35	22	18	36.1	36.0	2.0	1.8	*n.a.*	−1.6
Average	*30.0*	*48*	*31*	*17*	*13*	40.6	40.1	*2.9*	*3.1*	*−3.3*	*−1.5*
Anglo-Saxon											
New Zealand	4.2	40	32	16	21	34.1	34.5	2.8	4.9	−2.6	1.9
Ireland	4.3	48	13	20	−4	35.2	29.9	1.2	3.1	−7.5	−3.4
Switzerland	7.6	31	21	11	8	26.2	29.4	1.9	3.1	0.8	0.8
Australia	21.3	44	30	*n.a.*	13	28.0	28.9	2.9	6.2	1.2	0.1
Canada	32.9	46	33	10	14	33.7	32.6	2.8	3.3	−6.0	0.0
United Kingdom	61.0	36	29	19	10	36.5	35.7	4.2	3.4	−1.2	−4.8
United States	301.8	44	39	21	10	26.1	26.6	2.2	2.7	*n.a.*	−5.5
Average	*61.9*	*41*	*28*	*16*	*10*	31.4	31.1	*2.6*	*3.8*	*−2.5*	*−1.6*
Nordic											
Norway	4.7	51	28	17	19	42.5	43.0	4.2	11.4	4.9	16.0

Finland	5.3	54	26	21	22	41.1	43.4	1.4	3.2	3.1	2.7
Denmark	5.5	50	26	35	29	48.2	49.2	2.3	3.6	*n.a.*	3.1
Sweden	9.2	57	28	25	22	50.5	47.4	2.2	3.4	1.2	1.8
Average	*6.2*	*53*	*27*	*25*	*23*	45.6	45.7	*2.5*	*5.4*	*3.1*	*5.9*
Southern											
Portugal	10.6	48	27	13	4	25.5	34.6	1.2	3.2	−6.5	−5.4
Greece	11.1	48	27	*n.a.*	17	25.6	31.6	1.0	2.2	−10.3	−8.7
Spain	44.5	35	33	11	11	30.2	34.7	2.0	3.5	−4.2	−2.1
Italy	59.2	46	31	15	15	35.4	42.7	3.5	3.4	−11.0	−3.4
Average	*31.3*	*45*	*29*	*13*	*12*	29.2	35.9	*1.9*	*3.1*	*−8.0*	*−5.0*
Japan	127.7		40	9	14	28.7	28.0	6.5	4.0	−0.2	−4.7
Average	*40.5*	*46*	*29*	*17*	*14*	*35.9*	*37.0*	*2.7*	*3.8*	*−2.8*	*−0.9*
Correlation with logged population	*n.a.*	*−0.1*	*0.6****	*−0.24*	*0.16*	*−0.3****	*−0.3****	*−0.02*	*−0.32****	*−0.12*	*−0.41****

Notes: n.a. = not available

° Single earner, married, two children, and average production worker. Data for 1985 and 2005 only.

*** The correlation with the logged population is significant at the 0.01 level.

Sources

- *Population*—OECD General Statistics (OECD General Statistics: http://stats.oecd.org/);
- *Corporate Tax Rate*, *Tax Wedge*, *Total Tax Revenue*, and *Corporate Tax Revenue*—OECD Tax Statistics (OECD Tax Statistics: http://www.oecd-ilibrary.org/taxation/data/oecd-tax-statistics_tax-data-en;jsessionid=af73600d4pmdf.x-oecd-live-02); and
- *Deficit*—IMF (IMF World Economic Outlook, September 2011: http://www.imf.org/external/ns/cs.aspx?id=28).

allows for different states adapting to competitive constraints differently reflecting different domestic institutions and political configurations (Jessop 2002: 67). There is "diversity within convergence" (Cerny 1997: 263). The competition state comes in different shapes—neoliberal, neo-corporatist or neo-statist (Jessop 2002); Anglo-Saxon, Nordic, or Conservative (Horsfall 2010)—but only if, and insofar as, these different shapes ensure comparable levels of competitiveness in world markets (Cerny et al. 2006: 21 f.).

There are various problems with the convergence argument. First, the proponents of the competition state thesis emphasize that the transition to the competition state is still in progress (e.g. Jessop 2002: 248). It is unclear how much convergence to expect to date. Perhaps the bulk is yet to come? This makes testing the proposition almost impossible.

Second, the variety of competition state forms makes it difficult to measure convergence. What is the unifying criterion that allows determining whether Norway, France, South Korea and the United States represent variant forms of the competition state or just different forms of state? Do "flexicurity" reforms in Denmark and Margaret Thatcher's labor market flexibility policies in the UK indicate institutional convergence (because both involve liberalization) or divergence (because the first accommodates labor interests while the latter does not)? A coherent framework explaining when distinct competition state forms emerge and how they can be distinguished from other forms of state, that is, from non-competition states, is lacking. This is all the more problematic as the proponents of the competition state thesis relentlessly extend the scope of their theory to non-OECD countries for which it was not designed, for instance to China, Chile, Malaysia, Mexico, Singapore, South Africa, or Jordan (Jessop 2002; van der Westhuizen 2002; Al-Jaghoub and Westrup 2003; Cerny 2010; Soederberg 2010; Taylor 2010). Most of these countries never had a welfare state in the first place. Their governments may be overloaded, but for different reasons than in OECD countries. Their economies often rely heavily on Fordist mass production. And the reigning ideology is sometimes explicitly opposed to neoliberalism.

Finally, the causal mechanism of the convergence hypothesis is unclear. Why should international competition homogenize state structures and not diversify them, as, for instance, the Varieties of Capitalism School argues? Proponents of this school hold that economic integration diversifies by forcing producers to specialize and forcing producers' home countries to support specialization through specific policies and institutions. Rather than converge on liberal market economies, non-liberal, "co-ordinated" varieties of capitalism move further away to defend their comparative institutional advantages (Hall and Soskice 2001).

What does the evidence from taxation say? Following common practice (e.g. Cerny 1997; Esping-Andersen 1999; Stephens et al. 1999; Bobbitt 2002; Jessop 2002; Campbell 2004; Pontusson 2005), Table 12.1 groups the 21 OECD countries of our sample into four distinct regime clusters—Continental, Anglo-Saxon, Nordic, and Southern.

If we look at corporate tax rates, there is clear evidence of convergence across clusters. The spread between the four regime averages shrinks from 12 percentage points in the late 1980s (Nordic 53 percent—Anglo-Saxon 41 percent) to only four percentage points in the late 2000s (Continental 31 percent—Nordic 27 percent). Corporate tax rates also converge within three of the four clusters. The extent of convergence depends on the cluster's heterogeneity in country size. The Nordic cluster is very homogenous in country size and, consequently, has the lowest spread in corporate tax rates: only two percentage point difference between the highest and lowest Nordic rate in the late 2000s. The Anglo-Saxon cluster, by contrast, is most diverse in country size and consequently has the greatest spread in corporate tax rates: 26 percentage points in the 2000s. Obviously, rate convergence is conditioned by country size, as predicted by the standard model of tax competition. This is corroborated by the fact that the regime with the lowest average country size, the Nordic regime, exhibited the lowest corporate tax rates, on average, in the 2000s, even though it had the highest rates in the 1980s.

If we look at tax wedges, we see divergence. While tax wedges in all four regimes follow a downward trend, the spread of the regime averages increases slightly from 12 percentage points in the 1980s (Nordic 25 percent—Southern 13 percent) to 13 percentage points in the 2000s (Nordic 23—Anglo-Saxon 10). With the exception of the Nordic cluster, the spread also increases in each of the clusters, most prominently in the Continental and the Anglo-Saxon clusters. In contrast to the corporate tax rate, which is driven by common external competitive pressure, the tax wedge reflects domestic differences in regime-type and political configuration.

Finally, with total tax revenues we see essentially no change. With the exception of the Southern cluster, which has increased its average tax take from 29 percent in the 1980s to close to 36 percent in the 2000s, the average tax takes of the other clusters remain basically unchanged. Also, within regimes there is little movement: The intra-regime spreads hardly change between the 1980s and the 2000s.

Conclusion: we see convergence on the policy variable directly exposed to international competition, the corporate tax rate. We see divergence on the policy variable sheltered from international competition, the tax wedge. And we see essentially no change at the aggregate level of total tax revenues. The overall pattern resembles "convergence within diversity" more than "diversity within convergence" (Cerny et al. 2006: 21). Confronted with the homogenizing pressures of international tax competition on capital taxation, states preserve the distinctness of the national tax system by increasing the diversity of labor taxation. Diversity is not erased but consolidated in those parts of the tax system, which are sheltered from international competition.

Does Inter-state Competition Undermine the Welfare State?

The competition state thesis predicts *welfare state decline*. The reasoning is simple: international competition for mobile capital requires tax cuts; tax cuts require spending cuts; spending cuts require welfare retrenchment; the welfare state is hollowed out. Key policies and institutions remain in place, but deprived of revenue they are little more than an "organizational Maginot line" (Cerny 2010: 13) against global markets (Hirsch 1998: 32; Bobbitt 2002: 220; Jessop 2002: 84).

There are three prominent counterarguments against this thesis, also often called "efficiency thesis." According to the globalization-skeptic perspective there is no evidence of international competition pulling the fiscal rug out from under the welfare state (e.g. Garrett and Mitchell 2001), but there is substantial evidence of the resilience of welfare state institutions and policies (e.g. Pierson 2001). According to the Varieties of Capitalism School, international economic integration results in welfare retrenchment in liberal market economies, which compete mainly on costs, but not in non-liberal coordinated economies, which compete mainly on quality (Hall and Soskice 2001: 57 f.). Finally, the "compensation thesis" holds that economic globalization buttresses rather than erodes welfare spending, as citizens call on governments to protect them from the economic risks associated with international competition. Hence, more open economies have larger welfare states (e.g. Busemeyer 2009).

Table 12.1 provides little support for the compensation argument. To be sure, total tax revenues are negatively and significantly associated with country size, indicating that small countries, which usually have more open economies, have larger public sectors. But the negative association already existed in the late 1980s, predating the integration push of the past 20 years. More importantly, this push did not result in any substantial tax increase. With the exception of the Southern cluster, the growth in total revenues was flat over the past 20 years. Support for the Varieties of Capitalism prediction is also scant. There is no evidence of increasing divergence between the liberal Anglo-Saxon cluster and the rest. While Anglo-Saxon countries tend to have lower total tax revenues than countries from other clusters, the difference is not substantially more pronounced than in the 1980s. By contrast, Table 12.1 broadly conforms to globalization-skeptic predictions. It provides no evidence of a general decline of the welfare state. Total tax revenues have been broadly stable since the 1980s. Corporate tax revenues increased, rather than decreased (from 2.7 percent of GDP on average in the 1980s to 3.8 percent in the 2000s), and budget deficits declined by almost two percentage points (from −2.8 percent of GDP on average in the 1980s to −0.9 percent in the 2000s), indicating a better ability of governments to meet spending requirements by available resources. Does it follow that economic integration is irrelevant for the welfare state? Again, consider the effect of country size.

As Table 12.1 shows, neither corporate tax revenues nor deficits were substantially related to country size in the late 1980s. In the late 2000s, by contrast, both variables were negatively and significantly associated with size. This suggests an ambiguous effect of tax competition on the welfare state: positive in small countries, negative in large countries. Tax competition buttresses the welfare state in small countries in two ways. First, it leads to a net influx of mobile capital and thus drives up capital tax revenues: as Table 12.1 demonstrates, small countries had significantly higher corporate tax revenues than large countries in the late 2000s even though their corporate rates were significantly lower. Second, the influx of capital fuels labor demand and wages, which in turn increase revenues from labor taxation and reduce demand for unemployment benefits and income support. Both effects combined help small countries to fund welfare programs without deficits and to keep unemployment and poverty in check (Genschel 2004: 631). This explains why left parties in small countries like Ireland often support aggressive tax competition strategies. Large countries suffer from the reverse effects: they lose capital and, hence, capital tax revenues, and see their employment and wage levels depressed. In conclusion, international competitive constraints affect the welfare state in more ambiguous ways than the competition state thesis suggests. They tend to challenge the welfare state in large countries but bolster it in small countries.

Note, however, that the standard model of tax competition suggests that large countries lose more than small countries gain, so the overall competitive impact on the welfare state may indeed be negative, as the competition state thesis suggests. Note also that while small countries may profit from tax-induced capital inflows in good times, they may be particularly hard hit by sudden capital-outflows in bad times. Ireland, the former poster child of successful tax competition, is also one of the main victims of today's European debt crisis. Note, however, that Ireland's coping strategy again relies on tax competition. Tellingly, the corporate tax is the only tax the Irish government stubbornly refused to raise following the crisis.

5 Conclusion

The competition state thesis offers a general and simple theory of state transformation in advanced capitalist societies. It is general in arguing that state change is caused by the same macro-social trends in all OECD countries and perhaps even in countries worldwide—that is, by economic globalization, government overload, post-Fordism, and the cultural hegemony of neoliberal thought. It is simple in predicting that these trends evoke the same type of change everywhere: welfare cutbacks, a broad marketization of social relations, and the transformation of the state into a "competitive entity" (Fougner 2006: 165).

As our cursory look at tax policy in advanced Western countries suggests, these propositions are overly general and too simple: Not even in the OECD are all states subject to the same competitive constraints in taxation, but small countries are more affected than large ones. Some reactions to tax competition are convergent, as the thesis supposes, for instance with respect to the corporate tax rate. Others are divergent, for instance with respect to the tax wedge. And while competitive effects on the welfare state are negative in some (usually large) countries, they are positive in others (usually small). The relationship between the welfare and the competition state is less clearly zero-sum than the thesis suggests.

Yet, equally importantly, the evidence confirms the basic thrust of the thesis: global economic change is a powerful driver of state change. Tax competition exists and constrains national tax policy choices in important ways. States are affected by their economic environment. Trite as it may sound, this is a point worth making given the strange pride that more mainstream positions in comparative political economy—for example, globalization-skepticism, Varieties of Capitalism, and the compensation thesis—take in being agnostic about external economic constraints on the welfare state. Where the competition state thesis is in danger of overplaying the impact of global economic change, the mainstream is underplaying it. Therefore the thesis should not be given up but developed.

One of the potential strengths of the competition state literature is its attention to political economies outside the OECD area. Mapping out and explaining variation in the social policies of these economies is clearly an important future research frontier (Carnes and Mares 2007: 882). However, it also exposes the main weaknesses of the competition state thesis that need to be addressed. On the theoretical side, scholars need to think more carefully about the mechanisms linking external constraints and governments' policy choices. The competition state argument was modeled on empirical developments observed in North America and Western Europe. It is not self-evident that the argument travels easily to other countries in other structural positions in the world economy and with different domestic institutions and practices. Is globalization really a threat for less developed countries, such as Malaysia, or is it an opportunity? One of Bangladesh's economic mainstays is Fordist mass production of textiles. Will it converge on a similar form of competition state as post-Fordist Singapore? Do we expect autocratic China to develop a similar social and economic policy profile as democratic Mexico? Deriving better predictions on the forms, timing, and levels that different countries should show on their way towards—or away from—the competition state makes the theory more convincing, as well as more amenable to rigorous empirical tests. This requires more systematic attempts to model the causal link between competitive constraints and policy choices and a more sustained effort to complement the rich qualitative work on the competition state by systematic quantitative analyses.

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