Abstract: This paper examines efforts to increase taxation of highly concentrated, under-tapped income and profits in Latin America. Argentina advanced further than Chile after 1991 in two policy areas: corporate taxation, which taps firm-level profits, and tax agency access to bank information, which helps reduce income tax evasion. I explain these outcomes by drawing on the classic concepts of business’s instrumental (political) power and structural (investment) power. In Chile, strong instrumental power arising from business cohesion, links to right parties, and government-business concertation removed reforms in both areas from policymakers’ agendas. In Argentina, much weaker instrumental power at the cross-sectoral level, due to business fragmentation and the absence of a traditional right party, facilitated corporate tax increases. Bank information access was expanded after Argentina’s 2001 crisis weakened the financial sector’s instrumental power and reduced structural power that had arisen from a threat that investors would withdraw their savings from the banks.
I. Introduction

Increasing tax revenue in Latin America, the most unequal region in the world, is widely acknowledged as imperative for development and redistribution. Because income distributions are so top-heavy, this task by definition entails tapping the resources of economic elites. In particular, highly concentrated income and profits constitute a major, under-tapped revenue base that could support higher social spending (Perry et al. 2006, Sabaini et al. 2006, Barreix et al. 2006). Progressive taxation can also make a direct contribution to redistribution (Zee 2004, Piketty and Saez 2006); many of the region’s tax systems are instead regressive (Chu et al. 2000, Sabaini et al. 2006). Yet taxing economic elites is a difficult challenge since they are often well-positioned to prevent reform.

This paper examines efforts to increase taxation of income and profits in Chile and Argentina, two countries that experienced continual revenue needs in the 1990s and 2000s. In Chile, center-left governments sought revenue to fund social spending while maintaining fiscal discipline. Although Chile’s poverty rate has greatly declined, beneficiaries of targeted spending programs remain in precarious economic situations, inequality is still extremely high, and limited tax revenue constrained expansion of social spending. In Argentina, governments sought revenue in the 1990s to maintain fiscal balance and sustain Convertibility, which pegged the peso to the dollar and tied monetary expansion to growth in reserves. After the 2001 economic crisis, governments sought revenue to reestablish fiscal solvency and to finance social services and state expansion.

Governments in each country considered reforms in two key policy areas: corporate taxation, and tax agency access to bank information. Corporate taxation taps profits at the firm level; bank information access deters and facilitates detection of personal income tax evasion.
Reforms in both areas were marginal in Chile but significant in Argentina. Whereas Chile’s corporate tax rate remains the lowest in Latin America, Argentina’s is now the highest; Chile’s corporate tax revenue stagnated around 2.6% GDP after 1990, but incremental rate increases and reforms that closed loopholes contributed to a gradual increase in Argentina from under 1% GDP in 1992 to 3.7% GDP in 2005. Chile’s tax agency still lacked access to checking account information as of mid-2009, but Argentina’s tax agency gained automatic access to all relevant bank information by 2006, making it more powerful in this regard than many European tax agencies.

These outcomes are surprising given prevailing understandings of state capacity and taxation in these countries. Overall, state capacity is viewed as much stronger in Chile than in Argentina. In fact, Chile’s tax agency was long considered the best in Latin America by far, whereas historically, Argentina’s was quite ineffective (Bergman 2001). Argentina has also been plagued by institutional, political, and economic instability (Tomassi and Spiller 2000, Levitsky and Murrillo 2005), whereas Chile has enjoyed notable stability in all of these aspects since the 1990 democratic transition. Recent work argues that instability shortens the executive’s time horizons and creates incentives to rely on easy to collect taxes instead of taxing income and profits and fortifying tax administration (Melo 2007). However, Argentina increased corporate taxation more than Chile, and Argentina’s tax agency is now more powerful than Chile’s, not only in terms of access to bank information, but in other aspects as well.

These outcomes are also unexpected in light of recent research on business cohesion and tax policy. Weyland (1996, 1997) and Lieberman (2003) argue that cohesion facilitates progressive taxation, whereas fragmentation hinders redistribution. I find instead that business
cohesion in Chile helped preclude progressive tax increases after 1990, while business fragmentation in Argentina gave policymakers much greater leeway for passing such reforms.

To explain tax policy outcomes, I employ the classic concepts of business’s *instrumental power* and *structural power*. Instrumental power entails concerted political actions to influence policy. Structural power arises from a perceived threat that a reform will lead to reduced investment. When either instrumental or structural power is strong, taxing economic elites will be difficult, and progress will tend to be marginal. If both types of power are strong, business will wield even greater influence. Instrumental and structural power can vary not only across countries, but also across sectors and over time.

In Chile, I will argue that strong instrumental power created political constraints that removed corporate tax increases and bank information access from policymakers’ agenda. In contrast, much weaker instrumental power at the cross-sectoral level in Argentina facilitated corporate tax increases. The financial sector’s instrumental power and a perceived disinvestment threat constrained tax agency access to bank information in Argentina during the 1990s, but reform proceeded without difficulty when both instrumental and structural power declined after Argentina’s 2001 economic crisis.

Chile and Argentina form a fruitful country pair for comparison. They share similar levels of development (GDP per capita), extensive integration into international markets during the 1990s, and similar tax systems. Both countries relied heavily on regressive consumption taxes after structural adjustment, and the central government, the focus of my research, collects the vast majority of tax revenue in each country, despite the fact that Argentina is a federal state. In addition, a Chile-Argentina comparison holds constant several institutional factors that may affect prospects for reform. In both countries, fiscal policy authority is concentrated within a
single ministry, executives have strong formal legislative powers, and party systems are comparatively stable with high party discipline and low levels of fragmentation. Where these features are not present, government reform proposals may be difficult to pass regardless of their content, due to the existence of multiple veto players and the likelihood of weak support in congress.

This paper emphasizes the importance of business politics, “a relatively neglected area of research,” (Schneider 2004). Business, whether organized or as individual firms and investors, is a key actor in tax politics. Many taxes directly affect profits, and business associations may defend the interests of upper-income individuals as well as corporations. Yet the role of business is often ignored in literature on taxation and state capacity and in analyses by financial institutions. The classic instrumental and structural power framework has not been systematically applied in literature on economic reforms in Latin America, yet it provides an analytically elegant and insightful way to encompass a wide range of causal processes through which business may affect reform outcomes.

II. Business Power and Tax Policy

Political scientists have conceptualized two types of power that correspond to different means of influence: instrumental power (Mills 1956, Miliband 1969), and structural power (Block 1977, Lindblom 1977, Przeworski and Wallerstein 1988).

Instrumental power entails deliberate political action to effect policy, like lobbying. I classify sources of instrumental power as either relationships with decision-makers that can create bias in favor of business interests, or resources that help business pursue its interests more effectively. Relationships with policymakers that create instrumental power include recruitment into government, government-business concertation, and partisan linkages. Recruitment into
government, whereby business leaders receive high-level executive branch appointments, allows business to participate directly in policy-making. Bipartite concertation between government and business associations can create incentives for the executive to cede on issues that affect core business interests, since conflict with business in a sensitive policy area may disrupt productive collaboration in other policy areas.\footnote{Partisan linkages describes the relationship between business and right parties whose core constituencies are economic elites (Gibson 1992). Partisan linkages provide representation of business interests where right parties are electorally significant. Among various resources that afford instrumental power, I focus on cohesion. When business is cohesive, it can coordinate opposition to reform. Cohesion can legitimate business demands and improve business’s bargaining position. The more sources of instrumental power, the more likely business will be able to influence policy.}

Instrumental power can act at various stages of the policy process. It can help business secure concessions after a reform has been proposed. Instrumental power may also restrict the executive’s agenda—the set of reforms considered as feasible options. If policymakers anticipate that a reform will entail a major political battle, they may rule it out as infeasible or not worth the effort.

Structural power arises from a perceived disinvestment threat. According to the classic conceptualization, market democracies are dependent on capitalists, who invest based on the logic of profitability. When reforms curtail profits, capitalists respond by reducing investment, and politicians pay the price for declining growth and prosperity at the polls. Politicians anticipate this scenario and avoid reforms that may provoke disinvestment. In contrast to instrumental power, structural power does not require political activity to influence policy. Instead, as Hacker and Pierson (2002: 281) observe: “the pressure to protect business interests is
generated automatically and apolitically. It results from private, individual investment decisions taken in thousands of enterprises, rather than from any organized effort to influence policymakers.”

Structural power acts primarily by restricting the agenda. If policymakers anticipate that a reform will stimulate reduced investment in an important sector or in the economy more broadly, they may rule it out for fear of harming growth and employment. Analyzing policymakers’ decision-making processes, their perceptions about the consequences of the reform in question, and the credibility of disinvestment threats is therefore critical for assessing whether or not structural power influences policy.

Instrumental and structural power may be mutually reinforcing. Lobbying (instrumental power) can augment perceptions that a reform will cause disinvestment (structural power). Likewise, policymakers may grant business more extensive access and participation (instrumental power) when they are concerned about investment. Nevertheless, structural and instrumental power are independent and need not covary.

Literature on business politics in Latin America does not always draw a clear distinction between instrumental and structural power. Some authors define structural power in terms of factors like concentration of production and profitability (Etchemendy 2004: 121-2), but those factors do not indicate a disinvestment threat. Instead, they may indicate lobbying capacity (Etchemendy 2004: 122-3). Concentration, for example, can contribute to cohesion, a source of instrumental power. But while “structural” factors may contribute to instrumental power, structural power and instrumental power per the classic definitions are conceptually distinct—each entails a different means of influence.
Instrumental power and structural power can vary across sectors or policy areas and over time. Business may have instrumental power at the cross-sectoral and/or sectoral levels. Strong instrumental power at the cross-sectoral level can block reforms that affect shared business interests. Cross-sectoral instrumental power may even block sector-specific reforms. Alternatively, a sector may have sources of instrumental power that allow it to influence reforms affecting its own sectoral interests, even if business’s cross-sectoral instrumental power is weak. Some sources of instrumental power can be fairly stable over time, while others, like recruitment into government, may vary across presidential terms. Structural power, meanwhile, varies according to policymakers’ expectations about how investors will respond to reform and their assessments of the economic impact of disinvestment. Country-level factors like the tax system, the broader policy environment, or sensitivities of investors shaped by historical experience can all affect the likelihood that a particular reform will provoke disinvestment. Structural power varies across policy areas, since different reforms may affect, or convey different signals to, investors with different types of assets (Maxfield 1997: 38-9). Structural power may be strongest during recessions, when policymakers prioritize growth and job creation (Smith 2000: 148-9). But economic crisis may reduce structural power (Block 1977, Vogel 1987: 394, Akard 1992: 609); if investment has already fallen dramatically, further disinvestment may be irrelevant (Hacker and Pierson 2002: 297).

I find that instrumental power explains most of the national-level variation in corporate taxation and bank information access across the countries I examine (Table 1). In Chile, strong instrumental power removed all but marginal reforms from the agenda in both policy areas. Strong instrumental power arose from cross-sectoral cohesion, partisan linkages, and government-business concertation. In Argentina, weak instrumental power at the cross-sectoral
level, due to business fragmentation and the absence of an electorally relevant right party, facilitated significant corporate tax reform. Weak instrumental power at the sectoral level, as well as the cross-sectoral level, facilitated tax agency access to bank information after 2001. The financial sector, which held a direct stake in this policy area, was a weak political actor after Argentina’s financial meltdown. In each of these four cases, I argue that structural power was weak because policymakers did not anticipate disinvestment in response to reform.

In the case of bank information access during the 1990s in Argentina, structural power, arising from a credible threat that investors would remove their savings from the banks, played an important role in hindering reform. The financial sector’s strong instrumental power, based on recruitment into government, also prevented reform. However, both structural power and the financial sector’s instrumental power declined dramatically after 2001, due largely to the consequences of the 2001 crisis.

Table 1: Business Power and Tax Reform Outcomes, 1991-2008

<table>
<thead>
<tr>
<th>Instrumental Power</th>
<th>CORPORATE TAX</th>
<th>BANK INFORMATION ACCESS</th>
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<tbody>
<tr>
<td></td>
<td>Chile</td>
<td>Argentina</td>
</tr>
<tr>
<td>Strong</td>
<td>Weak</td>
<td>Strong</td>
</tr>
<tr>
<td>Weak</td>
<td>Strong</td>
<td>Weak</td>
</tr>
<tr>
<td>Cross-Sectoral</td>
<td>Sectoral (Finance)</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Structural Power</th>
<th>CORPORATE TAX</th>
<th>BANK INFORMATION ACCESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weak</td>
<td>Marginal Reform</td>
<td>Significant Reform</td>
</tr>
<tr>
<td>Weak</td>
<td>No Reform</td>
<td>No Reform</td>
</tr>
<tr>
<td>Strong</td>
<td>No Reform</td>
<td>Significant Reform</td>
</tr>
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<tr>
<th>Outcome</th>
<th>CORPORATE TAX</th>
<th>BANK INFORMATION ACCESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marginal Reform</td>
<td>Strong</td>
<td>Significant Reform</td>
</tr>
<tr>
<td>Significant Reform</td>
<td>No Reform</td>
<td>No Reform</td>
</tr>
<tr>
<td>No Reform</td>
<td>No Reform</td>
<td>Significant Reform</td>
</tr>
</tbody>
</table>

1990s              | Post-2001
A number of alternative explanations from literature on tax policy and business power fail to account for outcomes observed in these cases. Several recent studies present rival hypotheses regarding business cohesion and policy influence. Weyland and Lieberman maintain that elite cohesion facilitates progressive taxation. Drawing on Olson, Weyland (1997) argues that fragmentation discourages business from coordinating around shared, long-term interests in fiscal stability. Each sector instead resists tax increases. In contrast, encompassing associations facilitate tax increases by streamlining bargaining and making agreements enforceable, as argued in literature on corporatism. Likewise, Lieberman (2003) argues that when elites are regionally or ethnically divided, each sub-group opposes taxation, perceiving that the benefits accrue to others at its own expense, whereas when elites share a common identity, they can agree to pay higher taxes. Smith (2000: 8), meanwhile, maintains that cohesion does not enhance business influence. In the US, he argues, issues that unite business are highly salient for voters, so politicians respond to their constituencies, not business, on these issues. In contrast to these authors’ predictions, corporate taxes increased significantly in Argentina, a state with politically salient regional divisions where business is sectorally divided and has difficulty coordinating opposition to reforms, whereas corporate tax increases were marginal in Chile, where regional divisions are less relevant, a strong economy-wide business association exists, and business tends to be highly united on economic policy.

Weyland’s and Lieberman’s arguments have limited scope because tax preferences cannot be predicted from business organization or levels of cohesion alone. Many factors affect business’s preferences and strategic calculations; if business opposes a reform, cohesion strengthens its ability to resist. Smith’s logic, meanwhile, does not always hold. Politicians can win votes based on factors other than policy positions, like clientelism (Luna 2006). They may

Many authors studying OECD countries have focused on pressures created by globalization, which give rise to another set of alternative explanations. Some argue that increased international capital mobility augments structural power and forces countries to reduce corporate tax rates in order to attract and retain investment (See Rodrik 1997, Williams and Collins 1997, Appel 2006, Swank 2006, among many others). Similarly, growing international pressure from the US and OECD to loosen banking secrecy, due to concern over money laundering in connection to terrorism and large-scale tax avoidance (Sharman 2006, OECD 2007), might facilitate tax agency access to bank information in the post-9/11 era. Both Chile and Argentina sought to attract investment in a context of high capital mobility in the 1990s. Likewise, pressures to soften banking secrecy affected both countries after 2001. These factors are not sufficient to explain the different outcomes. Business’s instrumental power must be analyzed, along with inter-national pressures and structural power. Moreover, while capital mobility is a key component of structural power, it does not ensure a credible disinvestment threat. Capitalists will relocate only if a reform significantly reduces profits relative to alternative investment options. Taxes are one of many policies affecting profits, and favorable policies in other areas may offset the costs of higher taxation (Hacker and Pierson 2000: 282, Gelleny and McCoy 2001: 510).

Several other plausible explanations for Argentina’s greater progress in the policy areas I examine prove unconvincing upon close scrutiny. One such argument is that governments in
Argentina pushed harder for corporate tax increases given more urgent revenue needs during Convertibility in the 1990s or after the 2001 crisis. Dire fiscal need can make policymakers less responsive to business lobbying. But governments in Chile were intent on raising revenue despite the context of greater fiscal stability. The Lagos administration waged several long and politically draining battles to increase tax revenue.

A second possibility is that a more liberal legal tradition or a stronger rule of law account for Chile’s lack of progress compared to Argentina on bank information access. However, banking secrecy laws in both countries greatly restricted tax agency access to all types of bank information in the 1970s and 1980s. Further, expanding access to bank information in Argentina did not entail violation of the rule of law or arbitrary action on the part of the state. Instead, governments legislated reforms with congressional approval in the 1980s and early 1990s that paved the way for full information access.

A third explanation focuses on the state’s perceived ability to enforce tax laws. One could hypothesize that business would be less concerned with policy outcomes in Argentina because evasion is viewed as a more feasible option than in Chile, where the tax agency was historically much more effective. However, my empirical evidence shows that large firms do care about statutory tax laws even where tax administration is viewed as weak in aggregate terms. First, large businesses are closely monitored even in countries where the tax agency lacks the capacity to detect evasion in the private sector more broadly, because large corporate taxpayers account for a large proportion of total tax revenue. Second, business anticipates that tax legislation may be effectively enforced in the future, if not immediately, and battles are often more effectively waged over policy changes than implementation of existing laws. Third, large firms prefer to
lower their tax burdens through tax avoidance, which entails use of loopholes, rather than
evasion, which is illegal. Reforms that close loopholes therefore directly affect profits.

Business preferences do vary across countries and over time, and these differences
contribute to the observed tax outcomes. Opposition to lifting banking secrecy was more
widespread in Chile compared to post-crisis Argentina. And taxation incited more intense
opposition in Chile, although business also invested significant resources to oppose tax increases
in Argentina. However, policy outcomes cannot be reduced to preferences alone; business must
have sources of power through which to exercise influence.

III. “Second-Generation Reforms:” Taxing Income and Profits

Many Latin American countries enacted extensive market-oriented tax reforms during
structural adjustment from the late 1970s through the early 1990s. These “first-generation”
reforms established the efficient but regressive value-added tax (VAT) as the main revenue-
raising engine. In Chile and Argentina, VAT revenue reached EU averages by the mid 1990s: 7-
8% GDP (EECTCU 2006). However, total taxation remained low, not only compared to
developed countries, but also controlling for level of development. There is a well-known
positive empirical relationship between per capita GDP and tax revenue; Latin American
countries fall well below the world regression line (Table 2).

Latin America’s revenue shortfalls are due primarily to under-taxation of income and
profits. On average, direct tax revenue in the 1990s fell below predictions by 3.4 percentage
points of GDP (Table 2). Chile and Argentina’s direct tax shortfalls both exceeded 5% GDP. In
contrast, revenue from the VAT and other consumption taxes in Chile surpassed predictions by
2.9% of GDP. While indirect tax revenue in Argentina fell below the prediction based on GDP
per capita, revenue actually surpassed predictions based on GDP per capita at purchasing power parity by 1% of GDP (Mahon 2009).

Continued revenue needs after market reforms made tax reform a salient issue throughout Latin America. Revenue needs, along with equity concerns, often motivated governments to consider “second-generation” reforms to increase taxation of income and profits. These reforms included increasing corporate taxation and expanding tax agency access to bank information. I discuss the importance these policy areas in detail below.

Table 2: Differences Between Actual and Predicted Tax Revenue (% GDP), 1990s
Source: Perry et al. (2006: 96). Predictions from regressions based on per capita GDP.

<table>
<thead>
<tr>
<th></th>
<th>Latin America</th>
<th>Chile</th>
<th>Argentina</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Tax Revenue</td>
<td>-4.4</td>
<td>-3.6</td>
<td>-12.3</td>
</tr>
<tr>
<td>Consumption Taxes</td>
<td>-0.3</td>
<td>+2.9</td>
<td>-3.4</td>
</tr>
<tr>
<td>Direct Taxes</td>
<td>-3.4</td>
<td>-6.4</td>
<td>-5.6</td>
</tr>
<tr>
<td>Personal Income Tax</td>
<td>-2.7</td>
<td>-4.0</td>
<td>-4.4</td>
</tr>
<tr>
<td>Corporate Taxes</td>
<td>-0.7</td>
<td>-2.4</td>
<td>-1.2</td>
</tr>
</tbody>
</table>

Corporate Taxation

Capital ownership is highly concentrated in Latin America. In practice, corporate taxes may be passed on to labor or consumers through wages and prices, but capital owners bear a substantial portion of the burden (Piketty and Saez 2006).

In Chile, increasing the corporate tax is especially important for raising revenue and improving equity. Chile’s income tax is integrated: the corporate tax (CT) is essentially a withholding on the personal income tax (PIT) on distributed profits. Profits reinvested in the firm pay only the 17% CT. But dividends enter the recipient’s PIT base and are taxed at much higher rates—up to 40%. The CT already collected at the firm level is credited against the recipient’s PIT when dividends are distributed, so that profits are not “double taxed.” Because
the CT is so much lower than the PIT, capital owners reinvest most of their profits in the firm—at least on paper. In practice, loopholes allow capital owners to consume profits without formally withdrawing dividends and hence without paying the corresponding PIT. Likewise, independent professionals form “investment companies,” transforming income that would otherwise pay the PIT into corporate income taxed at 17%. Under-reporting of distributed profits is also very high (Jorrat 2005). Average income tax rates for the wealthiest Chileans are therefore very low (Table 3).

Not only do the very rich pay low income taxes, but the tax base they control is significant. The top 1% of taxpayers accounts for 37% of all profits and income reported to the tax agency, but it pays an average income tax rate of only 12%; the top 0.1% pays only 13%. By comparison, in the US, the top 0.1% pays an average rate of 29% in federal income tax alone (Piketty and Saez 2006: 51). Because increasing the corporate tax is the most practical way to tap this under-taxed and highly concentrated wealth, it may be the most important reform for improving tax equity and tax capacity in Chile.


<table>
<thead>
<tr>
<th>Cumulative Percentile (Adults over 20)</th>
<th>Share of Total Income and Profits</th>
<th>Ratio of Profits to Other Income</th>
<th>Average Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 10%</td>
<td>80.7</td>
<td>0.4</td>
<td>6.8</td>
</tr>
<tr>
<td>5%</td>
<td>64.2</td>
<td>0.6</td>
<td>8.3</td>
</tr>
<tr>
<td>1%</td>
<td>36.9</td>
<td>1.2</td>
<td>11.9</td>
</tr>
<tr>
<td>0.1%</td>
<td>17.0</td>
<td>4.0</td>
<td>13.1</td>
</tr>
<tr>
<td>0.06%</td>
<td>13.7</td>
<td>5.4</td>
<td>12.5</td>
</tr>
</tbody>
</table>

In Argentina, in contrast, corporate profits are taxed at the top personal income tax rate (35%) and collected from the firm; dividends are exempt from the personal income tax. Comparable income and tax incidence data are not yet available. However, capital income is
also very concentrated. In 2004, the top 0.01% of adults received approximately 17% of all declared capital income.\textsuperscript{12}

**Tax Agency Access to Bank Information**

Fighting evasion is critical for tapping Latin America’s highly concentrated income tax bases, especially where top marginal personal income tax rates are already comparatively high, as in Chile (40%) and Argentina (35%).\textsuperscript{13} Income tax evasion is a major problem even in countries with more advanced tax agencies like Chile and Argentina. In both countries, income tax evasion is on the order of 40-50% (Alvaredo 2007: 15; Jorratt 2005). Personal income taxes in most of Latin America affect only the top 10-15% of adults. Within this elite, only the wealthiest can evade taxes. In Chile and Argentina, income taxes are automatically deducted from workers’ wages, whereas wealthier individuals with non-wage income must file tax returns and thus have opportunities to under-declare assets. In Chile, only 5% of adults received income from non-wage sources; in Argentina, fewer than 3% of adults file tax returns. Yet because income is so concentrated, the revenue these taxpayers contribute is significant. In Argentina, revenue from income tax filers amounted to fully 1% of GDP in 2004.\textsuperscript{14}

Tax agency access to bank information is crucial for detecting and deterring evasion (OECD 2000: 20). Information access allows tax agencies to detect undeclared assets by cross-checking tax returns against bank records. Requiring banks to routinely provide information on their customers’ accounts and transactions is particularly useful in this regard. In addition, access to bank information discourages taxpayers from under-declaring their assets, since the risk of being caught increases substantially (Etcheverry 2005). Where laws prevent bank information access, taxpayers can effectively hide large sums of money from the tax agency.
Laws vary worldwide in term of the types of information available to tax agencies and the conditions of access. In some countries, information is available only on a case-by-case basis; in others banks provide information in mass. In 2000, 19 OECD countries required automatic reporting by banks for at least some types of information, five maintained centralized databases accessible to the tax agency, and ten imposed no access limitations (OECD 2000: 36). A number of OECD and developing countries retain strict banking secrecy laws, but the worldwide trend is toward expanded access (OECD 2007).

IV. Business Power and Corporate Taxation In Chile and Argentina

Corporate tax reform after 1991 was more significant in Argentina than in Chile. After first-generation reforms and stabilization (1989-1991), Argentina’s corporate tax rate increased from 20% to 35%, the highest in the region; additional reforms closed corporate tax loopholes. Chile’s new center-left government increased the corporate tax from 10% to 15% in the context of the 1990 democratic transition, but progress thereafter was marginal. Chile’s rate remained the region’s lowest in 2005 at 17%;\(^{15}\) loophole-closing reforms focused on indirect rather than direct taxes. These policy differences contributed to distinct revenue outcomes.\(^{16}\) Corporate tax collections held essentially constant in Chile at an average of 2.4% GDP, but Argentine collections grew from 1.2% GDP in 1992 to 3.7% GDP in 2005. Argentina’s corporate tax revenue caught up to Chile by 1999 and surpassed Chilean revenue after recovering from the 2001 crisis (Figure 1).

In this section, I argue that much stronger instrumental power at the cross-sectoral level in Chile compared to Argentina explains these divergent policy outcomes.
Figure 1: Corporate Tax Revenue, % GDP. Sources: DNIAF, SII.\textsuperscript{17}

Chile: Strong Instrumental Power Hinders Reform

Top leaders in the Lagos administration (2000-05) felt tax revenue in general and corporate taxation in particular were too low. The former President and Finance Minister lamented in interviews with the author (Lagos 2006, Eyzaguirre 2007) that prevailing revenue levels could not support sufficient social spending and poverty alleviation programs. Former Finance Minister Eyzaguirre (2007) emphasized Chile’s low direct taxes and asserted that the corporate tax should be much higher. Legislators from the governing Concertación coalition, including Socialists and more conservative Christian Democrats, also agreed the corporate tax was too low (Eyzaguirre 2007, Lorenzini et.al. 2006: 28). However, the administration increased the corporate tax from 15\% to only 17\%, still short of the Concertación’s modest original target of 20\% for the 1990 reform.

Contrary to common perceptions, this marginal progress cannot be attributed to structural power. According to the former Finance Minister, “The argument that you favor investment if the personal tax rate is way above the corporate tax rate is fallacious,” (Eyzaguirre 2007). In his analysis, because Chile’s income tax is integrated (Section III), instead of promoting investment
in productive assets, the low corporate tax merely facilitates tax avoidance. Eyzaguirre (2007) viewed business’s complaints that increasing corporate taxation—either by raising the tax rate or by closing loopholes—would discourage investment as non-credible threats:

They were trying to argue that the economy was going to stop, that investment was going to stall, that …small and medium enterprises were going to collapse… my team was a very serious team, in terms of knowledge of sound economic theory—the arguments were nonsense.

I argue that business’s strong instrumental power created political obstacles to reform that kept all but marginal corporate tax increases off the agenda, even in the absence of structural power. Strong instrumental power in Chile arose from three main sources: cross-sectoral cohesion, partisan linkages, and informally-institutionalized government-business concertation.

**Business Cohesion**

Organization and shared ideology produced cross-sectoral cohesion in Chile, which helped business coordinate opposition to tax increases. Chile has a strong, prestigious economy-wide business association, the Confederación de Producción y Comercio (CPC), founded in 1933. Its directorate is composed of the presidents of each of Chile’s six sectoral peak associations. The CPC helped forge consensus across sectors and coordinated lobbying on issues of common concern. Although the CPC’s importance relative to the sectoral peak associations, which have substantial resources and membership, varied over time and across issues (Schneider 2004: 169), the CPC has been a key interlocutor between government and business since the democratic transition and is highly active on tax issues.

Second, business in Chile universally embraces neoliberalism and champions the small-state, low-tax model implemented by the Pinochet dictatorship. In the words of a former CPC
president: “business’s principle is that we do not want the state to grow.” (Ariztía 2005).

Business often framed taxation as approximating confiscation of property (Silva 1996: 232, CPC 2000). Partly for this reason, even tax increases that exclusively affected a single sector often stimulated opposition from business as a whole, as occurred with the 2005 tax on copper extraction. This dynamic dates back to conflict over redistributive initiatives in the 1960s and 1970s, which motivated business to band together in defense of common interests (Schneider 2004: 162-3, Silva 1996).

**Partisan Linkages**

Partisan linkages are a critical source of instrumental power in Chile. Business and the two right parties, Unión Democrática Independiente (UDI) and Renovación Nacional (RN), espouse common neoliberal positions on economic policy and strongly oppose taxation. The UDI in particular reaps electoral support from upper- and middle-class voters with conservative policy positions including opposition to taxation (Luna 2006). Moreover, UDI and the dominant business groups that emerged after economic restructuring in the 1980s shared close informal ties based on common origins in the dictatorship. Technocrats in Pinochet’s government who later became UDI members or sympathizers often served on the boards of business groups that benefited from privatization (Silva 1996, Schamis 1999: 250, Pollack 1999: 45, Etchemendy 2004: 333). Following democratization, business intervened in right-party politics, frequently imposing its preferred candidates (Pollack 1999: 169, 178). CPC leaders publicly endorsed right presidential candidates, including Pinochet’s Finance Minister in 1990 and UDI politician Joaquín Lavin in 1999 (La Tercera, March 26, 2000). Although it is difficult to trace party financing, evidence suggests that big business has funded the right disproportionately (Pollack 1999: 132-3; Angell and Pollack 2000: 364; Luna 2006: 305).
The right was a powerful business ally thanks to its strength in the Senate. Authoritarian enclaves gave the right veto power after the transition; Pinochet appointed nine “institutional” senators. This veto power eroded after 1998 when the terms of Pinochet’s designated senators ended and the government appointed two of the replacements, as stipulated in the Constitution. From 1999-2005, the right and center-left were nearly tied in the senate; four swing voters among the new institutional senators determined which side prevailed. These senators, named by the Supreme Court and Armed Forces, held more moderate views on economic issues (Zaldívar 2007). However, winning their votes on corporate taxation was not easy. Right party and institutional senator opposition discouraged the Lagos administration from attempting anything but marginal corporate tax reform. Lagos (2006) and Eyzaguirre (2007) asserted that they lacked the votes necessary to advance further on this front.

**Government-Business Concertation**

Concertation with business, in the form of regular government consultation and collaboration with the CPC and sectoral business associations, provides a third source of instrumental power. Concertation is important not simply because easy access to policymakers allowed business to communicate its interests and lobby for concessions, but because this informally institutionalized pattern of government-business relations created incentives for policymakers to avoid conflict with business over taxation.

During the transition, the Concertación cultivated business confidence by consulting with peak associations on economic reforms, a practice initiated by Pinochet in the 1980s (Silva 1996, Schneider 2004). Concertación leaders felt these measures were critical to ensure investment and growth during a time of uncertainty, given that business openly supported Pinochet throughout the transition. Credible threats of disinvestment or a coup backed by business
subsided after consolidation of neoliberalism and democracy. However, consultation on all facets of economic policy and economic governance remained a defining characteristic of government-business relations, even in the absence of the conditions that originally led the coalition to embrace this model.

Concertation created incentives for government policymakers to avoid conflict with business. Collaboration with business on a wide range of policy areas beyond taxation was valued in part because of excellent macroeconomic outcomes associated with this model (Schneider 2004: 210). For example, business-government collaboration led to a series of capital market reforms championed by the Lagos and Bachelet (2005-2009) administrations. The reforms were based on proposals made by the industrial association.

Further, business support and collaboration on issues like macroeconomic policy could be politically important for Concertación finance ministers, all of whom adhered to orthodox economic principles. They occasionally experienced significant pressure from the coalition’s left wing to deviate from the neoliberal economic model more than they felt prudent, as occurred during the 2000-2001 recession. Collaboration with business allowed the Finance Minister to counterbalance pressures from within the Concertación:

I did have a lot of opposition, because the ones ask[ing] for more state involvement were very vocal… The new generation of business leaders saw that Lagos and I were macroeconomically responsible, that [we] would defy the ones within our sector that wanted to be more Keynesian, and that at the end of the day when it comes to taxes we were sensible... In economic policy at the end [there] was a big coalition of the center, and the very ideological in both extremes were
isolated. From the political point of view that was a very important step.

(Eyzaguirre 2007)

Given the value of collaboration with business, conflict over taxes could be costly for the government. Taxes threaten business’s core interests, and business correctly perceives taxation as a tool for redistribution. As Eyzaguirre (2007) observed: “The big entrepreneurs understand that once we have agreed on a market economy, … taxation is the name of the war.” Conflict over taxes could jeopardize business support during critical periods or to disrupt productive government-business interactions on other issues.

Restricting the Agenda

Instrumental power restricted the tax reform agenda in Chile. The Finance Ministry anticipated that tax increases would stimulate costly, coordinated opposition from business and the right; concertation with business associations created additional disincentives for attempting significant reform.

The 2000 Anti-Evasion reform illustrates the mechanisms of business influence. Although the former Finance Minister observed that “the big money is in direct taxes” (Eyzaguirre 2007), the reform was designed to raise revenue by fighting evasion of indirect taxes so as to minimize conflict with business and the right. These actors were especially disinclined to accept tax increases in 2000, given their hostility toward the first socialist government since the 1973 coup, and the right’s belligerence following its candidate’s strong performance in the 1999 presidential election (Silva 2000).

Although the reform proposed only marginal tax increases associated with closing loopholes, business and the right aggressively opposed the legislation. Cross-sectoral cohesion and partisan linkages allowed business and the right to consolidate into a single actor. The right
often took instruction directly from business (Eyzaguirre 2007), and coordinated lobbying strengthened their bargaining position. Former tax agency director Etcheverry (2005, interview), who helped negotiate the reform, explained:

The right and the business leaders... it was the same thing. ... I didn’t know if I should negotiate with the senator leader of the opposition or with the president of the big enterprises. Sometimes I had to negotiate with both, because they work together. ... Sometimes they were both in the same meetings saying the same things.¹⁸

Although the administration secured its primary objectives, passing the reform required a major expenditure of political capital (Etcheverry 2005, Lagos 2006, Eyzaguirre 2007); the reform languished in congress for almost a year while the executive negotiated concessions with business and the right. This experience discouraged Lagos from proposing more significant tax initiatives later in his term. As Lagos (2006) explained:

When you are in government, what is important is to deliver. You have to count your chips, how many you have to fight. If I get involved in doing a profound tax reform, I lose two, three years arguing about the tax system, and there is no AUGE [health care reform], no education [reform], nothing.

My emphasis on influence over the reform agenda contrasts with earlier work by Silva (1996: 230, 1998: 38), who focused on business’s ability to win concessions to reform proposals based on easy access to executive policymakers. I find instead that influence after a proposal had been drafted tended to be insignificant compared to influence over the agenda, an earlier and more critical stage in the policy process.
Consider another example: the 2001 corporate tax reform. Eyzaguirre (2007) felt the corporate tax rate should be increased “notoriously [sic.],” presumably to between 20%, the Concertación's goal in 1990, and 30%, the Latin American average. However, the proposal entailed increasing the rate to only 18% and compensating business and the right by lowering the top personal income tax rate—the reform was revenue-neutral. During negotiations prior to debate in congress, business and the right managed to reduce the proposed corporate tax rate to 17%. But that concession was insignificant compared to their ability to prevent much more significant reforms from even being discussed.

Instrumental power thus shifted the range of tax rates under debate toward business preferences (Figure 2), removing important reforms from the agenda that the government may otherwise have sought to enact. My analysis agrees with Hacker and Pierson’s (2002: 284) observation that “the most significant aspect of influence involves moving the decision-making agenda toward an actor’s preferred end of the spectrum.”

**Figure 2: Corporate Tax Policy Space, Chile (Tax Rates)**

Status Quo: 2002-2009

15 17 18 20 30

Finance Minister’s Ideal Range


**The 1990 Reform in Retrospect**

The forgoing discussion validates Boylan’s (1996) emphasis on the 1990 tax reform’s limitations, which contrasts with Weyland’s (1997) portrayal of the reform as a progressive
taxation success story. I argue that the 1990 corporate tax increase is best understood as a limited, one-time business-right concession during an unusual conjuncture—the transition to democracy. Following Pinochet’s defeat, key business leaders felt that compromise with the new government was strategically opportune. A moderate tax increase to fund social spending would help legitimize neoliberalism, which was popularly viewed as benefiting only the rich (Bartell 1992, Boylan 1996, Weyland 1997). Similarly, RN leaders strategized that accepting the reform would enhance their electoral prospects by building the RN’s reputation as a non-obstructionist, centrist party (Boylan 1996, Pollack 1999). However, before accepting the reform, business and the right secured concessions that reduced progressivity and lowered the revenue target from 3% to 2% of GDP: the corporate tax increased to 15% rather than 20%, and a regressive two-point VAT increase was added to the package. Moreover, the factors that encouraged business to accept the tax increase were unique to the transition period. By the mid-1990s, the economic model was consolidated; business opposed further tax increases, and the more intransigent UDI gained seats in congress at RN’s expense. While business cohesion may have facilitated negotiation of the 1990 reform as Weyland argues, cohesion helped business block all but minor tax increases thereafter.

Argentina: Weak Instrumental Power Facilitates Reform

Weak instrumental power at the cross-sectoral level, in the absence significant structural power, gave Argentine governments much more leeway to tax corporations.

Structural power rarely restricted the corporate tax agenda. Policymakers from the Menem (1996-99) administration expressed little concern that the moderate corporate tax increases they pursued would discourage investment. Despite high capital mobility, these tax increases were not expected to set off a flight reaction, given that policies in multiple other areas greatly
benefited investors. In the words of former Economy Minister Fernández (2005, interview): “…we were completely friendly toward national and foreign capital. …At that time, everyone wanted to invest and take risks in Argentina. So we said to them: good, then pay income tax.” Only in 1999 did the executive avoid corporate tax increases for fear of negative economic consequences, given the context of recession and pressures on domestic firms associated with the overvalued exchange rate, as De la Rua’s (1999-2001) former Economy Minister explained (Machinea 2007, interview). After the 2001 crisis, governments avoided raising tax rates to promote investor confidence, but they viewed closing corporate tax loopholes as unproblematic (Miceli 2008, interview, former Economy Minister). For example, the Kirchner administration (2003-07) legislated stricter transfer-price regulations to control tax avoidance involving transactions with subsidiaries in tax havens. Exporters protested that the reform would destroy futures markets and undermine growth and investment in the grain sector, but former Economy Minister Lavagna (2006, interview) and former tax agency director Abad (2008, interview) asserted that they were always confident the reform would have no negative effects on the basis of their own technical assessments.

Most importantly, instrumental power at the cross-sectoral level was much weaker in Argentina than in Chile. First, Argentina has no electorally significant traditional right party (Gibson 1996). Legislators across party lines felt the tax system should be more progressive. Taxing big business and multinational corporations was especially popular. For example, reforms under both Peronist and Radical Party administrations that strengthened transfer price regulations were welcomed by the governing coalition and the opposition alike. In contrast to Chile, therefore, big business had no reliable partisan ally. Lobbying in congress tended to succeed primarily when a convincing case could be made that the proposed reform would
negatively affect small and medium businesses, as opposed to big business or multinational firms.

Second, business lacked cohesion. Argentina has no permanent economy-wide peak association, and sectoral divisions are pronounced. Sectoral associations struggle to forge common positions among their own members and lack capacity to build broader alliances (Acuña 1998, Schneider 2004). Neoliberalism is not as uniformly espoused among the private sector as in Chile and cannot help business coordinate against tax increases. Greater heterogeneity among business in Argentina compared to Chile also hinders cohesion (Silva 1996, Etchemendy 2004). While all of business tended to oppose corporate tax increases, lack of coordination and divergent interests on other issues created opportunities for the government to divide and conquer. The executive could buy acquiescence from key sectors with concessions in other policy areas,\(^\text{19}\) or simply ignore demands from sectors viewed as less politically or economically important.

Third, executive-business relations varied across sectors and did not create instrumental power at the cross-sectoral level. Governments consulted with capitalists of their own choosing on an ad-hoc basis (Schneider 2004: 193). In the 1990s, some firms and sectors, especially finance, were recruited into government. But given business fragmentation, they tended to lobby primarily on sectoral interests rather than cross-sectoral issues (Viguera 2000: 189). The financial sector and others that benefited from privatization and liberalization in the 1990s tended to tolerate corporate tax increases in the context of an economic model that greatly favored their interests.

The 1998 tax reform illustrates these dynamics. The major sectoral peak associations opposed the assets tax, the tax on interest payments, and the corporate tax rate increase proposed
in the reform. Early on, the “Group of Eight,” an informal group composed of presidents from each of the peak associations, met to coordinate a united cross-sectoral lobby. However, the government exploited divisions on non-tax issues by offering sector-specific benefits, and the Group of Eight’s efforts collapsed (Gall 1998, Bonelli 1998a, 1998b, 1998c). The construction association withdrew after the government announced it would halt a highway project that the sector opposed. Big businesses with large labor costs were given a special incentive to accept the new taxes: they would finance an eventual reduction of employers’ social security contributions. Meanwhile, the financial sector responded to government pressure to refrain from public criticism of the reform, given their support for the government’s other economic policies.

In the absence of coordination, the sectoral associations’ efforts to oppose the reform achieved little influence. Meetings with Economy Ministry officials bore no results. Government technocrats ignored the organizationally weak industrial association’s (UIA) complaints, which Former Secretary of Treasury Guidotti (2006, interview) viewed as responding to the interests of politically and economically weak inward-oriented industries hard-hit by the economic model. The Economy Ministry also ignored the organizationally stronger agricultural association (SRA), which decried the assets tax. Guidotti (2006) asserted that both associations’ demands reflected narrow and illegitimate sectoral interests. After this stage of lobbying failed, the UIA, SRA and other associations presented very similar negative assessments of the new taxes to the congressional Finance and Budget Committee (CPH 1998). However, legislators for the most part ignored the business associations as well, except for agreeing to increase the exemption level for the assets tax and place a cap on the interest tax in response to the UIA’s argument that these taxes would hurt small business.
V. Business Power and Bank Information Access in Argentina and Chile

Tax agencies in both Argentina and Chile sought access to bank information to fight income tax evasion. Although both countries made some progress in the 1990s, business in Argentina opposed access to time deposits (plazo fijos, akin to certificates of deposit), and business in Chile rejected access to checking accounts. These types of information were most relevant for reducing evasion in the respective countries, given different bank deposit structures and dominant forms of evasion (AFIP 2006a, Jorratt 2007).

Time deposits remained off-limits in Argentina during the 1990s, but the tax agency obtained access in 2006. In contrast, access to checking accounts remained off the agenda in Chile (until 2009, when the government proposed very limited reform). The Chilean tax agency could obtain checking account information only with judicial authorization and only in cases where fraud had already been detected. The tax agency therefore could not use deposit information to screen tax returns for un-declared assets. In Argentina, in contrast, banks now routinely provided all information on deposits and transactions that the tax agency deemed relevant for controlling evasion.

Argentina, 1990s: Structural and Instrumental Power Preclude Reform

In the 1990s, structural power prevented access to time-deposit information in Argentina. A widespread perception prevailed that tax agency oversight would make depositors withdraw their savings from the banks. In addition, the financial sector, which would suffer directly from that outcome, enjoyed significant instrumental power. Financial sector lobbying reinforced policymakers’ concerns about the consequences of expanding bank information access and therefore helped to keep reform off the agenda.
**Structural Power**

High mobility and potential incentives to relocate savings created a credible disinvestment threat. Financial assets are always quite mobile; funds can be transferred electronically worldwide. But in Argentina, savings were also physically mobile. Financial centers in Uruguay are located close to Argentina’s capital, making it especially easy for Argentines, who regularly vacation in Uruguay, to move financial assets abroad.

In addition, the financial sector and policymakers were genuinely concerned that giving the tax agency access to time deposits would scare investors away from the banks. Informants from both the public sector and the private sector expressed the view that memories of economic instability made Argentines very sensitive to any changes in banking conditions. For example, a financial sector informant explained that Argentina’s history of hyperinflation, economic crises, and bank failures that destroyed savings, as well as state interventions that froze and effectively confiscated bank deposits in 1989, “generated a terrible sensation of uncertainty. And that sensation remains, that the banks are not so secure,” (Wilson 2008). Similarly, former Economy Minister Miceli (2008) spoke of a “generalized psychosis produced by collective memories” of financial crises.

Strict banking secrecy rules in Uruguay created additional incentives to relocate savings in response to reform. Information about deposits and other financial operations in Uruguay was not accessible to the Argentine tax agency. Wealthy Argentines in fact regularly evaded taxes by registering assets to corporations constituted in Uruguay, and tax agency informants commonly called Uruguay a “tax haven” (AFIP 2006a, 2006b). A tax agency informant summarized the rationale against reform:
If you put in place this informational regime, the only thing you’re doing is forcing transfers to Uruguay, and you don’t know anything about deposits in Uruguay. So business gets done in Uruguay, and Argentina loses capitalization and investment, all because of [the tax agency]. That was the argument—that we were going to scare away deposits. (AFIP 2006a)

The disinvestment threat gave rise to strong structural power because of the significant potential impact on the financial sector and the economy more broadly. Time deposits represented a large fraction of total deposits by value—an average of 70% from 1995 to 2000 (BCRA), so massive withdrawals would have devastated the banks. Moreover, the financial sector played a key role under Convertibility, which stabilized the currency and spurred high growth rates. Large quantities of foreign capital in the form of portfolio and direct investment were critical for sustaining the economy. Much of the money entering the country was invested in the financial sector, which channeled funds to the productive sector as well as the public sector. Because of the financial sector’s economic importance, large-scale time-deposit withdrawals could have had macroeconomic consequences.

**The Financial Sector’s Instrumental Power**

The perceived threat of reduced investment motivated the banks to reject reform. Unlike corporate taxation, tax agency access to bank information was a core interest for the banks—they feared they would lose depositors, which would have had a much greater impact on their profitability and viability than higher corporate taxes. The financial sector had sufficient instrumental power on its own to influence policy in this area, even though other sectors did not have strong preferences on this issue.
The financial sector’s instrumental power arose from recruitment into government. Financial sector leaders occupied important ministerial positions during the 1990s. For example, the Secretary of Finance during Menem’s first administration had been the president of the banking association, and economists from think tanks with close ties to the financial sector were appointed to the Ministry of Economy and the Central Bank (Heredia 2004, Pagina 12 May 19, 2002). Recruitment into government was partly a reflection of the financial sector’s important role in the economic model promoted during the 1990s. Since government and financial sector interests coincided, it was natural for the executive branch to grant the banking association privileged access and to take seriously its concerns. As Menem’s former Secretary of Treasury remarked: “the banks were a central voice,” (Guidotti 2006).

Instrumental power allowed the financial sector to influence policy on multiple fronts, including social security reform, Central Bank reform, strengthening capital markets, and other aspects of financial sector reform. As a long-time ADEBA official recalled, “The process of modernization was accompanied by the banks. In reality, we were very listened-to, not only on tax issues” (Ehbrecht 2006). Similarly, Heredia (2003: 100) observes that “During the 1990s, the financial sector established itself as... one of the most powerful pressure groups.”

Instrumental power helped keep access to time deposits off the agenda despite the tax agency’s repeated requests. Thanks to recruitment into government, the financial sector had ample opportunity to reinforce concerns within the executive branch that tax agency access to time deposits would reduce investment in financial instruments. On the one occasion when structural power failed to keep the issue off the agenda, instrumental power helped the banks block reform. In 1995 during the onset of the Tequila Crisis, the tax agency issued a resolution requiring the banks to provide time-deposit information. The banks lobbied the executive
intensively (Lippi 1995), arguing that the resolution exacerbated incentives for investors to withdraw their deposits at a sensitive time: “The sensation that a crisis was possible had not yet arrived... until the tax agency announced that it would put in place an informational regime on time deposits. …the first reaction was that everyone wanted to take their time deposits out of the banks,” (Ehbrecht 2006). After meeting with the Secretary of Finance—the former ADEBA president—the Economy Minister retracted the resolution, the day after it had been issued (Clarín 1995).

Argentina Post-2001: Weak Structural and Instrumental Power Facilitate Reform

Both structural power and instrumental power declined after 2001, making possible tax agency access to time deposits. The 2001 economic crisis and increasing oversight of the financial system in response to international pressures drove these changes.

Argentina’s 2001 economic crisis undermined structural power by reducing the vulnerability of the economy and the financial sector to any potential disinvestment that the reform might have provoked. From a macroeconomic perspective, the financial sector played a much less important role in the economy after the crisis and the demise of Convertibility. The massive run on the banks leading up to the crisis and the freezing and subsequent devaluation of deposits that remained in the banks drastically reduced the relative size of the sector. Deposits in public and private banks as a percent of GDP fell from 28% in 2000 to an average of only 19% from 2003-06 (BCRA). While governments sought to strengthen the financial sector, maintaining a high value of deposits was much less critical for stability in the post-Convertibility era. Further, from the financial sector’s perspective, time deposits were less important. After the crisis, the value of funds in time deposits relative to other accounts declined significantly, partly because much lower interest rates made time deposits less attractive investment instruments, and
partly because customers preferred ordinary savings accounts with unrestricted access given their loss of confidence in the banking system. Time deposits as a percent of the total value of deposits in private banks dropped from an average of 70% from 1996-2000 to only 45% from 2003-06 (BCRA). Additional time deposit disinvestment would thus have had a much smaller impact not only on the economy as whole, but also on the banks, compared to the pre-crisis era.

In addition, widespread adoption of anti-money laundering measures in response to international pressure following the terrorist attacks in the US reduced the disinvestment threat associated with tax agency access to time deposits. The banks perceived that their customers would be much less likely to react negatively if the tax agency obtained time deposit information in this new context. As an ADEBA informant asserted, “Today it is not the same as in 1995. People were more sensitive during the Tequila crisis. …[Today] people are more and more aware that if they are going to do a transaction in a bank, it will be monitored,” if not to control tax evasion, then to control money laundering (Ehbrecht 2006). Accordingly, investors who did not want the tax agency to have information about their assets would not have deposited significant sums of money in the financial system after 2001. The banks’ clientele was thus less likely to include people who would have withdrawn deposits in response to expanded information access.

The banks’ instrumental power also declined after the 2001 crisis. Recruitment into government ended with Convertibility and the change of economic model. During the Kirchner administration, there were far fewer connections and much less ideological affinity between the financial sector and cabinet members. This new state of affairs was not surprising given the reduced economic importance of the financial sector as well as popular antipathy toward the banks in the aftermath of the crisis.
Weakened structural and instrumental power allowed the tax agency to obtain full access to deposit information in 2006 without difficulty. Once the threat and the impact of disinvestment declined, structural power no longer hindered reform. Not only were the banks less opposed to giving the tax agency time deposit information, they were also in a much weaker position to resist, given their reduced instrumental power. The tax agency’s involvement in other initiatives, including several major anti-evasion reform packages, explains why it did not turn to the issue of time deposit information until 2006.

The role of crisis in facilitating bank information access explicated above differs from other arguments advanced in literature on economic reform. Weyland (2002), for example, argues that countries are more likely to adopt reforms in times of severe economic crisis, because policymakers become more inclined to accept the associated risk. That argument and others that explain reforms implemented during crises do not apply to the reform at hand, which took place well after Argentina’s 2001 crisis. The tax agency obtained time deposit information not because policymakers were more willing to risk disinvestment, but instead because that risk had significantly declined. My argument that the 2001 crisis improved prospects for reform by helping to reduce structural power is similar to Hacker and Pierson’s (2002: 297) observation that if investment has already declined significantly, further disinvestment may have little affect.

Chile: Strong Instrumental Power Hinders Reform

Access to checking accounts in Chile remained off the agenda through 2008, despite international pressures to loosen banking secrecy after 2001 that were similar to those experienced by Argentina. Although the issue finally entered the agenda in 2009, proposals for reform were extremely limited.
Structural power does not explain this outcome; bank information access elicits no credible threat of disinvestment (Etchevery 2005). First, checking accounts are much less mobile than savings accounts. Because checking accounts are regularly accessed, it is much more difficult to move them offshore. Second, Chile’s banking system, currency, and economy have been remarkably stable since the late 1980s; the conditions that created incentives for depositors in Argentina to remove funds from the banks in response to changes in tax agency oversight are absent in Chile. Moreover, previous experience suggests that Chilean depositors would not alter their behavior in response to greater tax agency oversight. When the tax agency obtained access to bank records on interest earnings in 1995, the only observed response was an increase in interest earnings declared on tax returns (Etchevery 2005).

Business’s strong instrumental power and cross-sectoral opposition to reform explain the tax agency’s limited access to bank information. In contrast to Argentina, where business leaders outside the financial sector expressed little concern over the issue, business opposed softening banking secrecy much more broadly in Chile (Ariztía 2005, Etcheberry 2005, CPC 2000: 6). This opposition apparently stemmed from reluctance to empower the tax agency to better audit individual income taxes. Large firms are closely monitored and rarely evade taxes, so granting the tax agency access to checking accounts would have little impact on their tax burden. However, business associations in Chile tend to represent not just the interests of corporations, but also the interests of capital owners as individuals. A high-level tax agency informant explained:

Big business owners do not want the tax agency to look over their personal checking accounts—not the business’s checking account, but the personal account. The business associations say they have nothing to hide: our accounts
are open for review. But in a more concealed manner, they lobby against reforms to open checking accounts. (SII 2007)

As in the case of corporate tax increases, instrumental power arose from cohesion, partisan linkages, and government-business concertation that created incentives to avoid conflict with business. The tax agency requested access to checking accounts while the 2000 Anti-Evasion Reform was being designed, but the Finance Ministry dismissed the reform as infeasible. Tax agency informants interviewed in 2007 were quite pessimistic regarding prospects for reform in the foreseeable future (SII 2007).

In 2009, international pressure of a new kind helped place access to checking accounts on the agenda. During the final stages of Chile’s application process, the OECD made loosening banking secrecy an explicit requirement for securing membership in the organization. Whereas prior pressure from the US and other international actors to loosen banking secrecy laws had little effect, the national prestige and benefits associated with OECD membership created political space for reform. The executive proposed reform in April 2009 amidst significant controversy, but an agreement with right party legislators in August 2009 improved prospects for approval (Cisternas 2009).

However, as expected given strong instrumental power, the reform proposal was extremely limited in scope. The tax agency would be required to obtain express consent from the account owner authorizing the bank to release information, otherwise the case would be sent to the courts (Cisternas 2009). While the reform represents a step forward, it gives the tax agency very little additional capability to cross-check tax declarations against bank records in order to detect evasion.
VI. Conclusion

This paper offers new perspectives on tax outcomes in Chile and Argentina. Widely cited research on taxation in Chile characterizes the country as a success story, based on the 1990 corporate tax reform (Weyland 1997). Yet increasing the still very low corporate tax remains among the most important reforms needed to improve tax equity and tax capacity in Chile. Further, inadequate bank information access handicaps the tax agency’s ability to control income tax evasion. Argentina has been characterized as a case of persistently weak tax capacity (Melo 2007, Bergman 2003). Yet corporate tax revenue growth since 1992, due partly to rate increases and reforms that closed loopholes, demonstrates that Argentina has developed notable extractive capacity in this tax policy area over time. Further, Argentina’s tax agency is now more powerful than its internationally acclaimed Chilean counterpart in the area of bank information access.

Variation in business power explains why only marginal reform was possible in Chile in these policy areas, whereas Argentina made significant advances. Instrumental power accounts for most of the variation across the two countries. In Chile, strong instrumental power, arising from cross-sectoral cohesion, partisan linkages, and executive-business concertation, removed reforms in both areas from the agenda. In Argentina, corporate tax reform was more significant given much weaker instrumental power at the cross-sectoral level, due to business fragmentation and lack of partisan linkages. The financial sector’s instrumental power, based on recruitment into government, helped block bank information access during the 1990s, but weak instrumental power after the 2001 financial crisis made reform possible. Structural power arising from a disinvestment threat also prevented bank information access during the 1990s, but it too declined after 2001, largely due to the affects of the crisis.
More generally, instrumental power in Chile kept all but marginal increases off the agenda across tax policy areas, whereas much weaker business power in Argentina facilitated greater progress. Total tax revenue in Argentina increased by almost 8% of GDP from 1995 to 2004, the largest increase in Latin America, while tax revenue in Chile held essentially constant. Some sectors in Argentina enjoyed sufficient instrumental and/or structural power to block reforms with sector-specific impact, but their power in most cases was temporally delimited, as with the financial sector, or emerged only in response to extreme policy measures, like the 2008 export tax increase that provoked cohesive protest from the previously fragmented agricultural sector (Fairfield 2009).

This research also offers several more general observations regarding business power. In particular, the analysis highlights the importance of studying influence over the reform agenda. Business’s influence over the agenda can be much more important than influence during subsequent stages of policymaking, as illustrated by the case of corporate taxation in Chile. Focusing on more manifest aspects of business power, such as lobbying after bills have been drafted, without studying policymakers’ perceptions and actual preferences, may lead to underestimating business influence.

Further, I find that instrumental power can be as, or more important than structural power for setting the agenda, a possibility that many authors do not explicitly consider (Smith 2000: 115-141, Hacker and Pierson 2002: 279-286, Fuchs 2007: 56-58, 71-95). Instrumental power does not come into play only after the executive has delineated the core features of a reform. Just as policymakers may rule out reforms because they anticipate reduced investment, they may rule out reforms because they anticipate political resistance from business and business allies. This scenario may be most relevant in stable political systems where business has strong and
fairly constant sources of instrumental power, such that it is easy for policymakers to anticipate reactions to reform.

Turning to structural power, careful attention must be paid to policymakers’ perceptions regarding anticipated consequences of reform. Policymakers’ assessments of whether or not a reform is likely to provoke disinvestment may depend on multiple factors that vary across countries, over time, and across policy areas. Similar reforms may create different incentives for investors in different contexts. Capital mobility alone does not necessarily make a disinvestment threat credible.

Finally, I stress three issues. First, analyzing business politics and distinguishing between instrumental and structural power are critical for understanding tax policy. Second, disaggregating taxation into distinct policy areas can reveal significant variation in politics and outcomes that cannot be detected by examining total tax revenue or composite reform indices. Third, building tax capacity in highly unequal countries raises issues of redistribution that may instigate major political battles with economic elites.

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1Fieldwork supported by Social Science Research Council and Fulbright-Hays fellowships. This is part of a larger project on the tax reform agenda and the fate of revenue-raising proposals across tax policy areas in Latin America after structural adjustment.

2Effective corporate tax rates are not available for Latin America.

3Some authors fall on the instrumental side (Freiden 1991, Schamis 1999) while others tend toward the structural side (Mahon 1996, Maxfield 1997), but they do not explicitly apply these classic concepts or distinguish between the two forms of power.
European corporatism, which involves tripartite bargaining with strong labor unions, is distinct from concertation in Latin America, where labor is usually weak or absent.

Winters (1996: xv) also notes the importance of policymakers’ perceptions.

The financial sector could potentially have blocked corporate tax increases during the 1990s as well, but it did not actively oppose those reforms. See Section IV.


Both countries were highly integrated into international markets, although Chile in fact retained more capital controls than Argentina (Morely et al 1999).

The Pinochet dictatorship established strict banking secrecy laws in 1986, whereas in practice the tax agency had greater information access in prior periods (SII 2005).

Business power in the 1990s hindered access to bank information despite the reforms.

It imputes corporate taxes and retained corporate profits to their owners. This method is appropriate since few companies are publicly traded, and only 35% of profits are distributed annually (Jorratt 2005). Engel et al’s (1999) widely cited incidence study excludes retained corporate profits, which ignores the main income tax base and underestimates concentration of wealth and the redistributive potential of taxes. Neither Cantallopts et al. nor Engel et al. examine tax incidence within the top decile.

I.e., rents, interest, business income, dividends and capital gains, excluding reinvested corporate profits. Author’s calculations using AFIP (2005).

The Latin American average from 1999-2004 was about 29% (Sabaini 2006: 40).

Author’s calculations, AFIP 2005. Comparable data are not available for Chile.

Brazil’s minimum rate is 15%, but other corporate taxes apply.
Administrative improvements also helped increase revenue in Argentina (Eaton 2002).

Chilean data constructed with help from Jorratt. I end the Chilean series in 2004 since in 2005, booming copper prices exogenously increased corporate tax revenue. The Argentine series includes corporate income tax, corporate assets tax, and tax on corporations’ interest payments (applied from 1999 to 2001).

A new generation of more moderate businessmen who preferred less confrontational relations with government and avoided open association with the right assumed leadership of the peak associations in 2003, but business’s tax preferences and business-right relations remained basically unaltered throughout Lagos’ term.

Etchemendy (2004) also finds sectoral payoffs facilitated market reforms in Argentina.