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Private Wealth and Public Revenue in Latin America

Business Power and Tax Politics

Tasha Fairfield

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### Chapter

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## Tax Policy and Economic Elites

### *Going Where the Money Is*

Policymakers around the globe have faced contentious debates and high-stakes political battles over tax policy as they struggle to satisfy a wide range of pressing revenue needs, from closing gaping budget deficits that threaten macroeconomic stability to securing sustainable funding for welfare state maintenance or expansion. In Latin America, tax reforms that target economic elites are an obvious option – this region is home to some of the world’s most unequal democracies, yet the rich generally pay very low taxes. Although at first glance, many readers might expect democracy to empower average citizens at the expense of the rich, policymakers often have either avoided initiatives to tax economic elites or failed in their efforts to do so. Others might anticipate that economic elites enjoy inherent advantages that privilege their interests over those of average citizens. Yet economic elites are not always able to secure the policies they prefer. In some cases, governments have proposed and successfully enacted reforms that increase taxation of economic elites. Through comparative analysis of tax policy reforms in Latin America, this book develops a broad theoretical framework for explaining how and when economic elites’ interests prevail in market democracies and how much scope policymakers can create for equity-enhancing reforms.

To meet revenue needs during the decades following economic liberalization and structural adjustment, governments in Argentina, Chile, and Bolivia all considered initiatives to tax the extensive income, profits, and wealth concentrated in the hands of economic elites, be they capital owners, big businesses, landowners, or high-income professionals. Yet the scope and fate of these initiatives varied across the countries. Whereas Argentina enacted significant tax increases on economic elites, reforms were marginal in Chile and Bolivia. Closer scrutiny reveals that reforms also varied across distinct tax policy areas and over time, particularly in Argentina and Bolivia. Leading theories, including those that attribute progressive tax increases to elite cohesion or to median

voter preferences, as well as those that associate lack of reform with capital mobility or the overwhelming influence of money and wealth, cannot explain this variation.

The framework I develop to explain the scope of tax policy proposals, legislative outcomes, and the timing of reform focuses on the power of economic elites, especially business actors. Business – whether as individual firms and investors or as organized political actors – plays a central role in tax politics and economic policymaking more broadly, particularly in Latin America’s highly unequal democracies. I draw on the classic concepts of structural power and instrumental power from early business politics literature. Structural power can be thought of as “investment power,” while instrumental power can be thought of as “political power.” I argue that when economic elites have strong power of either type, their interests shape policy outcomes.

Structural power arises from the profit-maximizing behavior of individual firms and capital owners. If policymakers anticipate that a reform will provoke reduced investment or capital flight, they may rule it out for fear of harming growth and employment. Structural power requires no organization or political action on the part of economic elites; instead, market signals coordinate their behavior in the economic arena. In contrast, instrumental power entails engagement within the political arena and deliberate actions to influence policy, such as lobbying. I identify sources of instrumental power that fall under two categories: relationships with decision makers that provide access and may create bias in favor of economic elites, and other resources, including cohesion, that help economic elites pressure policymakers more effectively. Both structural power and instrumental power vary over space and time. Instrumental power may also vary across sectors or subtypes of economic elites within a given country. Structural power, meanwhile, is highly context-specific; it cannot be reduced to capital mobility or a sector’s economic importance, but also depends on the incentives a particular policy creates and ultimately on policymakers’ expectations about the aggregate economic outcomes of multiple individual investment decisions.

The power of economic elites is a critical and often underemphasized variable in political economy,<sup>1</sup> and it is particularly important for taxation, a policy area that affects elites’ core material interests. Whereas business politics literature historically posed a dichotomy between structural and instrumental approaches, I treat structural power and instrumental power as complementary. I argue that taxing economic elites will be difficult when either their instrumental power or their structural power is strong – policymakers may even eliminate tax increases from their agenda in anticipation of costly political battles and/or disinvestment. The more types and sources of power economic elites enjoy, and the more institutionalized their sources of power, the more

<sup>1</sup> Likewise, Schrank (2007: 191) calls for a return to “old-fashioned power politics” in political economy.

significant and consistent their influence will be: their interests will prevail to a greater extent in policymaking. Popular mobilization can occasionally counterbalance or even overwhelm the power of economic elites. And strategies that cultivate favorable public opinion or temper elite antagonism can help governments legislate incremental tax increases. However, governments have much more scope to tax economic elites whose structural power and instrumental power are both weak.

To briefly sketch how this framework applies to the country cases, economic elites in Chile had multiple, strong, and institutionalized sources of instrumental power, including cohesion and ties to right parties, that discouraged governments from attempting to legislate anything but marginal tax increases. In Argentina, economic elites lacked these sources of power and tended to be much weaker; governments therefore were able to legislate more significant tax increases. However, certain sectors did have other sources of power (instrumental and/or structural) during specific periods that allowed them to defend their own particular interests. Bolivia in the early 2000s is an intermediate case; economic elites' instrumental power was weaker than in Chile but stronger than in Argentina. During this period of extreme social unrest, economic elites were not able to keep reforms they disliked off the agenda as in Chile, but they were more successful than their Argentine counterparts at defeating initiatives later in the policy process – unless popular sectors mobilized in favor of reform.

By carefully examining tax policymaking processes, including the critical but often overlooked stages of agenda formulation and proposal design, this book yields insights about the mechanisms through which economic elites exert influence in market democracies. These insights contribute to a reemerging literature on business power and inform ongoing theoretical debates on the relationship between democracy, inequality, and redistribution. The book further contributes to research on state-society fiscal bargaining by providing a systematic basis for assessing elite taxpayers' bargaining power and by offering a distinct perspective on the causal effects of elite cohesion on extractive capacity.

In addition, this book helps fill major empirical gaps in two important literatures: research on welfare provision in developing countries, and research on economic reforms in Latin America. Many authors argue that sustainable and inclusive social protection requires tax capacity, yet this aspect of welfare state development has received much less attention than the politics of social spending (Haggard and Kaufman 2008; Huber and Stephens 2012).<sup>2</sup> In some cases, major political constraints to expanding social protection lie on the tax policy side of the fiscal equation. Likewise, despite the fundamental importance of taxation – which is critical for political and economic

<sup>2</sup> Others note that reallocation can finance welfare expansion despite tax constraints (McGuire 2010, Garay 2014).

development – political scientists studying Latin America’s far-reaching economic reforms have paid much more attention to policy areas such as trade liberalization and privatization.<sup>3</sup>

Finally, although business’s importance for economic development is widely acknowledged, business actors in Latin America remain understudied (Ames et al. 2012, Karcher and Schneider 2012). Conducting research on business politics is a difficult and labor-intensive endeavor. Business’s political engagement often takes place out of the public eye, and accessible, quantifiable indicators of business influence are rarely available (Karcher and Schneider 2012: 281).<sup>4</sup> By drawing on extensive fieldwork, hundreds of interviews, and documents unavailable outside the studied countries, this book advances our empirical knowledge and understanding of business’s potentially far-reaching role in policymaking.

### 1.1 DIVERGENT REFORM EXPERIENCES

Argentina, Chile, and Bolivia stand out as leading Latin American cases of economic liberalization and market-oriented tax reform in the 1980s and 1990s. Value-added taxes (VATs) with broad bases and relatively high rates were established, and VAT revenue as a percentage of GDP reached European averages by the mid-1990s – around 7 percent of GDP.<sup>5</sup> Despite this success, each country experienced recurrent revenue needs during subsequent decades. Whereas consumption was heavily taxed, income and profits were under-taxed by roughly 6 percentage points of GDP in Chile and Argentina and 3 percentage points of GDP in Bolivia, given these countries’ level of development (Perry et al. 2006: 96; Appendix 1.1). Accordingly, governments in each country contemplated “going where the money is” by increasing direct taxes on economic elites’ income, profits, and/or wealth. Yet the reforms they enacted varied substantially.

Argentina enacted noteworthy direct tax policy reforms after currency stabilization in 1991. The country’s corporate tax rate increased gradually from 20 percent to 35 percent, the highest in the region. Additional reforms closed loopholes and helped control corporate tax avoidance and evasion. Meanwhile, personal income tax modifications increased the burden on individuals in the top brackets. A modest national wealth tax was created and gradually increased. And the tax agency gained essentially unrestricted access to bank information. Bank information is critical for fighting tax evasion because it

<sup>3</sup> Exceptions include Weyland (1996), Eaton (2002), Mahon (2004), and Arce (2005).

<sup>4</sup> Accordingly, even scholars in the quantitative tradition recognize the need for intensive qualitative research (Ames et al. 2012).

<sup>5</sup> Consumption taxation in Chile and Bolivia exceeded expectations for countries of their GDP per capita (Appendix 1.1).

facilitates detection of assets that taxpayers have underreported or neglected to declare on their income tax returns.

In contrast, Chile and Bolivia enacted at most marginal direct tax policy reforms. In Chile, increasing the very low corporate tax rate was arguably one of the most important revenue-raising reforms, given the design of the country's integrated income tax system. Little progress was made on this key front; in 2009 Chile's 17 percent corporate tax rate remained the lowest in the region, aside from Paraguay. Meanwhile, reforms to close loopholes and fight evasion emphasized consumption taxes rather than income taxes, and tax agency access to bank information remained highly restricted. In Bolivia, legislating an individual income tax is critical for increasing taxation of economic elites. This tax was eliminated in 1986 because technocrats believed the tax agency was too weak to actually collect it, but tax agency capacity improved dramatically in the 1990s. A 2003 initiative to reinstate the income tax failed; to date, Bolivia still has no personal income tax. A wealth tax initiative was also defeated, and little progress was made in other direct tax policy areas like closing corporate tax loopholes.

These policy differences were not merely cosmetic. Argentina's reforms contributed to a notable increase in direct tax revenue. While direct tax collections held basically constant in Chile and Bolivia at averages of 4.3 percent and 2.3 percent, respectively, Argentine collections grew from less than 2 percent of GDP in 1992 to almost 6 percent of GDP in 2005 (Figure 1.1),<sup>6</sup> the largest increase in Latin America (Sabaini 2005: 32). Argentina enacted revenue-raising reforms in other tax policy areas as well. Thanks to these reforms, as well as improvements in tax administration, overall tax revenue in Argentina grew by almost 8 percent of GDP from 1995 to 2004, again the largest increase in Latin America; the region's average revenue increase during this period was only 2 percent of GDP (Sabaini 2005: 7). In fact, Argentina's tax revenue in 2008 was second in the region only to Brazil and exceeded expectations based on its level of development by a remarkable 5.5 percentage points of GDP (Jiménez et al. 2010: 26).<sup>7</sup>

This cross-national variation is striking, especially considering that Chile has been portrayed as a regional success case for progressive tax reform (Weyland 1997) and for development more broadly, whereas Argentina is often considered to have a weak state, volatile economic governance, and limited extractive capacity (Levitsky and Murillo 2005, Melo 2007, Kurtz 2013). Yet cross-national variation is not the only aspect of tax policy in Latin America that

<sup>6</sup> The dip corresponds to Argentina's 2001 economic crisis. Figure 1.1 shows revenue collected by the central state, before transfers to provinces.

<sup>7</sup> Direct tax revenue in Chile and Bolivia increased substantially after 2005, but gains resulted primarily from exogenous commodity booms affecting mineral exports (Appendix 1.2). Total tax revenue in Chile nevertheless remained almost 4 percentage points of GDP below expectations based on per capita GDP (PPP).

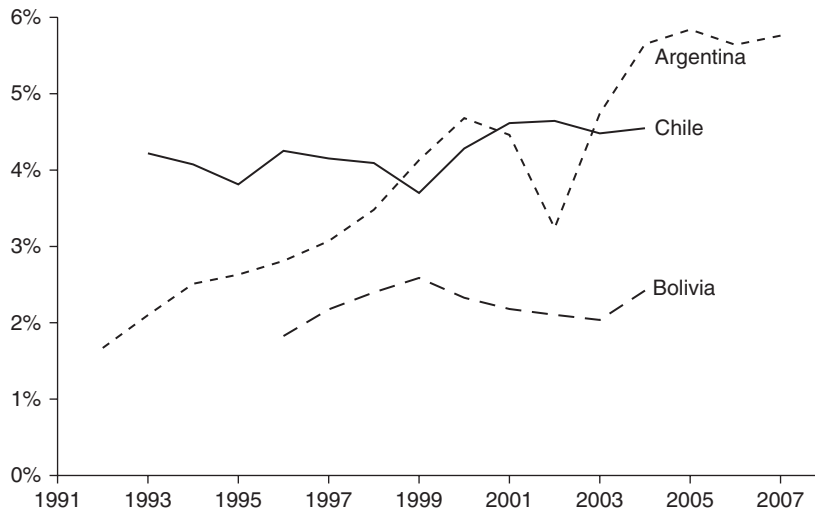


FIGURE 1.1. Direct Tax Revenue (% GDP).

Sources: SII 2009; SIN 2006; DNIAF 2012.

requires explanation. Outcomes also varied within countries, both across tax policy areas and over time. For example, despite Argentina's many successes, governments were not able to eliminate a costly income tax exemption for interest earnings that benefited upper-income individuals, and expanding tax agency access to bank information proved impossible until after the 2001 economic crisis. Further, whereas governments were able to repeatedly increase agricultural export taxes from 2001 through 2007, a 2008 tax increase had to be revoked due to sustained producers' protests. Turning to Bolivia, although efforts to tax domestic elites failed, the country dramatically increased taxation of foreign elites, namely multinational hydrocarbon firms.<sup>8</sup>

The range of policy variation across and within these Latin American countries poses challenges for several well-known theories of taxation (Table 1.1). Approaches treating direct taxation as a collective-action problem resolved through elite cohesion predict incorrect cross-national outcomes for the countries I examine. Economic elites were far more fragmented in Argentina than in Chile or Bolivia, yet Argentina legislated the most significant direct tax increases, contrary to the theoretical expectation. These collective-action approaches emphasize that organization and cohesion encourage elites to focus on shared long-term interests in fiscal stability and other benefits that strong tax capacity affords, thereby making elites more willing to pay direct

<sup>8</sup> See Appendix 1.2 on commodity taxation.

TABLE 1.1. *Theoretical Predictions and Latin American Anomalies*

| Prediction  | Unexpected or Unexplained Outcomes*                     |
|---|---|
| Elite cohesion facilitates direct taxation (Weyland 1997, Lieberman 2003, Slater 2010)  | Chile (1991–2009), Bolivia / <i>Argentina</i>           |
| Capital mobility discourages corporate tax increases (e.g., Rodrik 1997, Williams and Collins 1997, Appel 2011, Swank 2006, Hart 2009)                    | Argentina (1990s)                                       |
| Economic importance or wealth confers influence (e.g., Handley 2008, Winters 2011, Gilens 2012)   | Argentina, esp. agro-export taxes (post-2002)           |
| Public opinion trumps business interests on high-salience issues (e.g., Smith 2000, Culpepper 2011) <sup>a</sup>  | Chile, esp. failed 2004 copper royalty initiative       |
| Benefits for economic elites are necessary for increasing their taxes (e.g., Timmons 2005, 2010)  | Argentina, esp. agro-export taxes (post-2002)           |
| Instability discourages policymakers from increasing direct taxes <sup>b</sup> (Melo 2007 drawing on Spiller and Tommasi 2000, Levitsky and Murillo 2005) | Argentina, Bolivia (2003–04) / <i>Chile</i> (1991–2009) |
| Dire macroeconomic need facilitates direct tax increases <sup>c</sup>   | Bolivia 2003–04   |

\* Normal type indicates the cause is present but not the outcome; italics indicate the cause is absent but the outcome is present.

<sup>a</sup> See also Murillo (2009).

<sup>b</sup> Melo (2007) links instability to short time horizons and hence policymaker preferences for easily collected indirect taxes rather than direct taxes. Argentina has been plagued by instability – institutional, economic, and political – yet direct tax increases were more significant and had a greater cumulative effect than in Chile, its enviably stable neighbor. Likewise, policymakers proposed taxes on income and wealth in Bolivia during the early 2000s, a period of extreme political instability associated with radical threats to the status quo from mobilized popular sectors.

<sup>c</sup> This argument cannot explain variation across the two countries in this study that were afflicted with economic crises. Argentina legislated direct tax increases in the run-up to the 2001 crisis, but Bolivia's efforts to tax income and wealth failed despite perilous budget deficits.

taxes (Weyland 1997, Lieberman 2003). Yet this logic does not always operate; elites may or may not perceive strong incentives to accept tax increases independently of whether they are cohesive or fragmented. And when they do not perceive incentives to accept tax increases, I argue that cohesion is a source of power that enhances their ability to resist reform. This view agrees with earlier literature that emphasized the potential for cohesive elites to mount collective action *against* progressive reforms.

Explanations focusing on capital mobility as a determinant of direct taxation are incomplete. Many authors have argued that international capital mobility forces governments to compete for investment by reducing



corporate taxes.<sup>9</sup> Yet governments increased corporate taxes in Argentina in the 1990s, despite high levels of capital mobility. And although outcomes in Chile agree with the capital-mobility prediction, I will argue that this variable plays at most a secondary role in the explanation. Capital mobility can be a key component of business's structural power, but tax competition arguments often fall short because they are not sensitive to the context specificity of structural power.

Innovative recent research on wealthy individuals and business, discussed further in Section 1.4, leaves important cases unexplained. Theories emphasizing the power of money, wealth, or a sector's economic importance overpredict elite influence in my cases. Argentine elites were often unable to thwart initiatives to tax their income and profits, and economically important sectors were occasionally subjected to heavy tax increases against their wishes. In contrast, theories emphasizing that issue salience and public opinion moderate business influence tend to underestimate economic elites' ability to resist taxation and redistribution. In many cases, tax policy decisions reflected the interests of economic elites much more closely than those of median or marginal voters, despite intense media coverage. Issue salience theories predict instead that when citizens pay attention to an issue, politicians pay attention to public opinion rather than to economic elites (Culpepper 2011: 6).

Arguments that the distribution of the tax burden mirrors the allocation of spending elaborated in literature on fiscal contracts and credible commitments are also incomplete. This perspective cannot account for variation across the cases in which left governments pursued redistributive taxation. In accord with this literature's expectation that states must provide benefits for economic elites in exchange for their tax dollars, Chile's left governments were able to legislate only minor direct tax increases to finance social spending for the poor. Yet left governments in Argentina were able to tax agricultural elites heavily after 2001, even though spending favored urban sectors. This anomaly arises because fiscal-bargaining approaches often do not adequately specify the sources of power that necessitate providing benefits to win elite acquiescence; elite opposition to tax increases is politically irrelevant if elites lack strong sources of power. Political resources in particular often receive insufficient attention.

Table 1.1 includes two additional perspectives that leave Latin American cases unexplained: arguments focusing on instability and on economic need.

One final plausible hypothesis proves unconvincing upon closer scrutiny: that tax increases are easier to legislate in countries with low compliance because economic elites ignore policy initiatives in anticipation that tax increases can be evaded. Contrary to common perceptions, direct-tax evasion in Chile is

<sup>9</sup> Others disagree (Inclán et al. 2001, Gelleny and McCoy 2001, Basinger and Hallerberg 2004) or find mixed results (Wibbels and Arce 2003).

essentially as high as in Argentina: around 50 percent (Jiménez et al. 2010: 58, Jorratt 2009: 47–56). Arguments based on evasion levels therefore do not provide traction for explaining Argentina's more significant direct tax policy reforms. Furthermore, my interview data indicate that economic elites do care about statutory tax laws, irrespective of aggregate evasion levels. Tax increases are often designed in ways that curtail or eliminate opportunities for evasion – by implementing withholding regimes, by eliminating loopholes and exemptions, thereby simplifying the tax code and making it easier to detect evasion, or by strengthening the tax agency's auditing powers – for example, through access to information about taxpayers' bank accounts and financial transactions. During the studied period, experts considered tax agencies in Chile, Argentina, and Bolivia to be highly professional with similar levels of institutional capacity and technical competence (Bergman 2009: 76–83, Bolivian Finance Ministry-D 2007: interview),<sup>10</sup> and economic elites recognized that administrative improvements could lead to effective implementation of tax increases in the future, if not the immediate present. Moreover, the large firms and wealthy individuals who are most closely monitored by large-taxpayer units prefer to lower their tax burden through avoidance, which entails use of legal loopholes, rather than through evasion, which is illegal. Accordingly, reforms that close loopholes directly affect their tax burden.

This discussion highlights the need for “middle-range” theory that can account for broad tax policy variation without sacrificing explanatory leverage for parsimony or generality. The instrumental and structural power framework accomplishes this goal by examining multiple potential sources of power rather than focusing on a single causal factor and by recognizing that these sources of power will vary in kind and in strength across different contexts. Moreover, this framework clarifies the need to distinguish between actors' preferences and their ability to obtain the policies they prefer, which is a necessary step in accounting for several of the theoretical anomalies highlighted in Table 1.1. Although my analytical approach introduces complexity, this complexity is structured within a clear overarching conceptual framework that can be broadly applied in political economy beyond the specific issue of taxation.

## 1.2 AGENDA FORMULATION AND PROPOSAL OUTCOMES

This book systematically examines the tax policymaking process, from agenda formulation to the fate of reform initiatives – how they are modified and whether they are enacted. Close attention to agenda formulation is imperative for assessing to what extent economic elites influence policy decisions because they may be able to shift the set of options under consideration

<sup>10</sup> High evasion reflected problems with tax legislation that made administration difficult and noncompliance equilibriums that are hard to alter even when tax administration follows best practices (Bergman 2009).

toward their own policy preferences. Influence over the agenda may in fact be much more significant than influence after the government has initiated a reform proposal.<sup>11</sup> Some authors are pessimistic about prospects for analyzing agenda formulation given the challenges it poses for empirical research (Smith 2000: 149, 159, Fuchs 2007: 59, Falkner 2009: 120, Culpepper and Reinke 2014: 12–13) – alternative reform options that policymakers consider but discard often are not publicly discussed. Baumgartner et al. (2009) tackle the agenda-formulation problem in U.S. politics through interviews with interest groups that reveal which policies they advocate, regardless of whether those issues are a matter of public debate or have entered the legislative agenda. My approach is similar, but I bring the policymakers who actually make decisions about reform initiatives to the forefront of analysis.<sup>12</sup> In-depth interviews conducted for this project with high-level executive-branch officials in charge of tax policy, including three former presidents and twelve former finance ministers, yielded extensive information about their actual policy preferences and the reasons that compelled them to rule out certain reform options.

Agenda formulation can be divided into five idealized stages, in which distinct considerations delineate increasingly restricted subsets of reform options (Figure 1.2). Although policymakers do not explicitly follow these steps, these stages serve as useful heuristics. The first stages involve technical and administrative considerations that shape how policymakers select appropriate tools to tax elites. I briefly discuss these considerations and then focus on the third and fourth stages, in which structural power and instrumental power – the main explanatory factors in this study – lead policymakers to rule out appropriate options. The third and fourth stages of agenda formulation constitute the primary emphasis of this book.

I treat the existing tax system and the relative importance of different types of income and assets as initial conditions that determine the set of relevant revenue-raising reforms. Under-tapped revenue bases are associated with different kinds of investments, wealth, or income flows in different countries and at different times. The nature of under-tapped revenue bases will not only vary across tax systems but may also shift with international economic trends, changes in national development models, or economic crisis. Together, the prevailing tax system and the structure of income and assets determine whether new taxes are needed, which exemptions or loopholes could be most lucratively eliminated, whether rates should be increased, and what additional powers would best help the tax agency fight evasion.<sup>13</sup>

<sup>11</sup> For excellent discussion on these points, see Hacker and Pierson (2002: 284).

<sup>12</sup> Baumgartner et al. (2009) interview only policymakers identified as advocates on issues advanced by interest groups. Their study is not designed to analyze policymakers' decision-making processes.

<sup>13</sup> Examples include broader access to bank information and authority to regulate transfer prices.

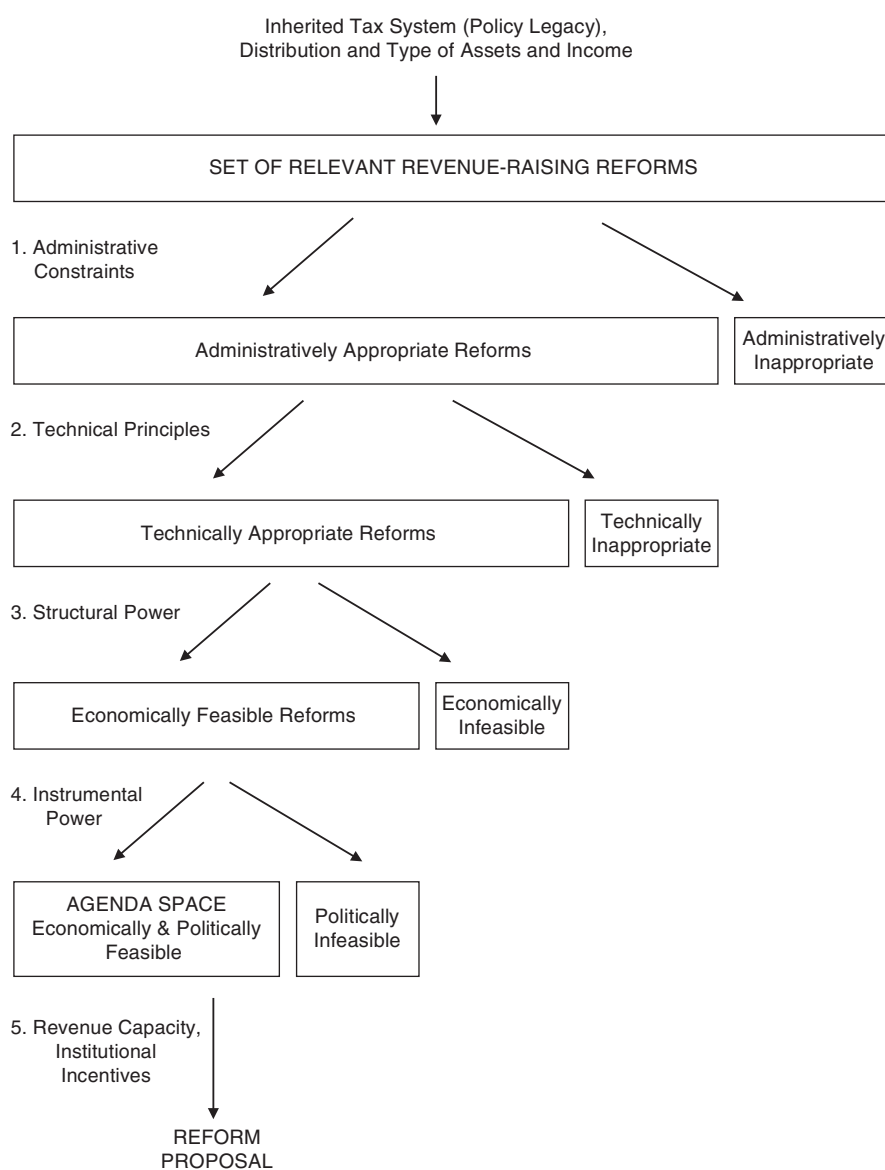


FIGURE 1.2. Defining the Tax Agenda.

Administrative constraints may lead policymakers to rule out some revenue-raising reform options (Stage 1). Where the tax agency's administrative capacity is weak, or where tax agencies face low-compliance environments (Bergman 2009), policymakers may avoid reforms that are comparatively easy to evade,

that increase the number of taxpayers to be monitored, or that place greater demands on the tax agency for gathering and processing information.

However, even where administration is weak, reforms targeting economic elites' income, assets, and profits can often be designed to limit opportunities for evasion and place minimal additional demands on the tax agency. For example, taxes on previously exempt forms of income accruing primarily to upper-income groups can be collected through withholding regimes, which essentially preclude evasion, rather than relying on taxpayers to voluntarily declare these income sources on tax returns. In addition, eliminating exemptions and loopholes simplifies tax administration and facilitates detecting evasion. Given these evasion-curtailing options, theories that attribute taxpayers' bargaining power exclusively or primarily to their ability to reduce compliance or hide assets (Timmons 2005, Gehlbach 2008) have limited explanatory scope.

Policymakers may also rule out revenue-raising reforms that are inconsistent with technical principles and economic ideas that they or their advisors espouse (Stage 2). Some economists reject high marginal income tax rates on the assumption that they create work disincentives; others do not ascribe significant efficiency costs to progressive direct taxation or treat the matter as an empirical question.<sup>14</sup> Orthodox economists may rule out sector-specific taxes as inherently distortionary; heterodox economists may view sector-specific taxes as appropriate for both revenue raising and industrial policy. The subset of technically appropriate reforms defined at this stage will thus vary according to policymakers' economic ideology and training.

Regardless of policymakers' technical views, some tax initiatives that target economic elites usually remain on the agenda after Stages 1 and 2. For example, many reforms that eliminate exemptions or loopholes both target economic elites and promote efficiency; orthodox and heterodox economists alike often view these reforms favorably. Furthermore, technocrats of all backgrounds tend to advocate reducing tax evasion and may therefore consider broadening the tax agency's purview for auditing upper-income taxpayers or large businesses.

In sum, administrative and technical considerations, along with the structure of the tax system and the configuration of income and assets, tend to affect *how* policymakers propose to tax economic elites, but not necessarily *whether* they propose to tax economic elites. The critical decisions of whether to propose such reforms, given real-world economic constraints and political considerations, are made during the subsequent two stages of agenda formulation that are the focus of this book.

Economic elites' structural power may compel policymakers to eliminate additional reforms for fear of provoking reduced investment or other negative economic outcomes (Stage 3). In practice, this stage may be intertwined with

<sup>14</sup> See Saez et al. (2012) on estimating behavioral responses to tax increases.

Stage 2, in that policymakers' technical training may affect how they model the private sector's reactions to a given reform and hence how they assess structural power. However, reforms considered technically appropriate in theory may be ruled out in practice due to structural power considerations that arise in real-world situations. I have separated Stage 2 and Stage 3 analytically to emphasize these practical considerations and the context specificity of structural power, elaborated in Chapter 2.

Instrumental power shapes a final subset of revenue-raising reforms that policymakers view as not only administratively and technically appropriate and economically feasible but also politically desirable and/or feasible (Stage 4). Where economic elites have strong instrumental power, reforms they oppose may be stricken from the agenda given anticipations that the ensuing political battles will be too costly or will end in defeat. Alternatively, instrumental power arising from favorable relationships with policymakers may lead the latter to prioritize elite interests and refrain from proposing reforms that elites oppose. I subsequently refer to this final subset of reforms as the tax agenda space.<sup>15</sup>

Once the agenda space has been delineated, institutional incentives and potential revenue capacity help determine which reform options policymakers choose to initiate (Stage 5). Institutional incentives, created for example by exclusive executive authority in a particular tax policy domain or by rules governing the distribution of tax revenue between the central government and subnational units, may motivate the executive to favor some tax reforms over others. All else equal, policymakers facing revenue needs will choose reforms with greater revenue-raising capacity. Where the tax agenda space includes more than one feasible option, they may be bundled together into a single reform package.

The fate of reform initiatives – whether they are enacted and the extent to which their original content is modified – depends once again on the power of economic elites. Where reforms require congressional approval, both structural power and instrumental power may influence legislators' votes. Where initiatives take the form of executive or administrative decrees that do not require congressional approval, economic elites may still be able to block enactment or extract concessions from the authorities in charge by deploying their instrumental power.

Government reform strategies can also affect both agenda formulation and proposal outcomes, although they play a less significant causal role. Strategies that rely on astute reform design may circumvent structural power by reducing concerns over disinvestment. Strategies that cultivate public support or temper

<sup>15</sup> Economic elites' power in previous time periods may have shaped the prevailing tax system and hence the set of relevant revenue-raising reforms, or administrative capacity, thereby constraining reform choices made during Stage 1. However, explaining the origins of tax systems and administrative capacity lies outside the scope of this book.

elite antagonism may also enhance the political feasibility of reforms that might otherwise run aground due to economic elites' instrumental power.

### 1.3 OUTLINE OF THE ARGUMENT

The power of economic elites, and their instrumental power in particular, explains most of the variation in tax policy outcomes across the countries examined in this study. Where economic elites' power was strong, governments were able to enact only minor tax increases, even when they skillfully applied multiple reform strategies. In contrast, governments had leeway to enact much more substantial tax increases when economic elites' power was weak. However, governments' strategic errors occasionally contributed to the defeat of tax initiatives in contexts of comparatively weak elite power, and in extraordinary cases, popular mobilization prevailed over economic elites' power.<sup>16</sup>

The following chapters develop this argument in detail. Chapter 2 further elaborates my conceptualization of the power of economic elites, identifies and operationalizes the sources of instrumental power and structural power, and expounds the logic of the causal model. The second part of the chapter identifies and analyzes six strategies for mobilizing public support and/or tempering elite antagonism that can facilitate incremental tax increases in contexts where economic elites have strong sources of power.

Chapters 3 and 4 examine tax reform in Chile, where organized business's strong instrumental power precluded all but modest tax increases while the center-left governed from 1990 to 2010.<sup>17</sup> Chapter 3 focuses on the politics of increasing the corporate tax rate, an important way to raise revenue from economic elites due to unique features of Chile's income tax system. Chapter 4 analyzes alternative revenue-raising and equity-enhancing reforms that governments initiated in other tax policy areas.

Chapter 3 argues that three sources of instrumental power – linkages to right-wing opposition parties (partisan linkages), cohesion, and informally institutionalized government-business consultation – allowed business to keep significant corporate tax increases, and direct tax increases more broadly, off of the government's agenda, even when structural power was weak. Partisan linkages gave business the ability to block reforms in Congress with the help of the right parties, and cohesion allowed business to effectively mobilize against tax increases. Meanwhile, government-business consultation on all aspects of economic policy created incentives for the government to avoid conflict with business on taxation. I argue that strong instrumental power constrained direct tax policy throughout the center-left's tenure in power,

<sup>16</sup> The former dynamics are important in two cases and the latter in two distinct cases among the twenty-eight aggregate reform proposals analyzed. See Appendix 1.3.

<sup>17</sup> Chile's well-known 1990 reform is a partial exception.



although additional factors including large fiscal surpluses associated with high international copper prices also contributed to lack of reform during the late 2000s.

Although strong instrumental power discouraged corporate tax increases, Chile's center-left coalition developed a broad repertoire of strategies to facilitate incremental revenue-raising reforms in other tax policy areas. Chapter 4 examines the tax reform agenda and explains the fate of proposals initiated to address three policy goals: controlling tax evasion, eliminating technically unjustified and regressive tax benefits, and strengthening mineral-resource taxation. The case studies demonstrate the key role played by business's instrumental power in restricting the reform agenda; concerns over structural power and other constraints occasionally contributed as well. The case studies also elucidate the potential and the limitations of reform strategies. Overall, while these strategies were critical for increasing taxation, the political space they created for reform proved narrow, given business's strong instrumental power.

The next three chapters analyze tax policy in Argentina. Overall, economic elites in Argentina were much weaker than in Chile, and governments therefore had more leeway to increase taxes on income, profits, and wealth, as expounded in Chapter 5. Business and wealthy individuals lacked reliable allies in Congress, given the absence of a traditional right party in Argentina. Business cohesion was weak at the cross-sectoral level; sectoral divisions and organizational fragmentation made it difficult for business to stage collective action against corporate tax increases. Meanwhile, relationships between business and executive-branch policymakers created instrumental power only at the sectoral level or lower. Given very weak business cohesion, those sectors and firms that did enjoy favorable relationships with the executive pursued their own particular interests rather than defending the interests of the business community at large.

Despite economic elites' weakness at the aggregate level, some sectors in Argentina did have strong instrumental and/or structural power during delimited time periods that allowed them to block tax increases with sector-specific impact. In fact, business power varied not only across sectors, but also across time and across specific policy areas in Argentina, in contrast to the uniformity and stability that prevailed in Chile. Chapters 6 and 7 examine tax reforms affecting two major economic sectors – finance and agriculture – and explain when and why reform proposals succeeded or failed by analyzing changes in business power. The case studies illustrate the mechanisms through which turnover within the executive branch, economic crisis, and change in economic development models can alter business power, facilitating reforms that had been impossible during prior periods.

Chapter 8 turns to Bolivia, a case of intermediate elite power and extreme popular mobilization. From 2003 to 2006, economic elites' instrumental



power was significant – much stronger than in Argentina though weaker than in Chile – thanks to cohesion and informal ties to policymakers. However, the threat of mass protest against policies perceived as regressive in a context of massive social unrest compelled cash-strapped governments to propose tax increases that targeted economic elites. And popular sectors could overwhelm opposition from economic elites if they mobilized in favor of reform. Tax policy became a high-stakes balancing act for governments seeking to walk the line between antagonizing the mobilized masses and antagonizing organized business and economic elites. The results were unsuccessful initiatives to tax the income and wealth of national elites, but major tax increases on foreign hydrocarbons companies.

Chapter 9 briefly addresses tax policy developments after elections that brought new political actors to power in Bolivia (2006) and Chile (2010). The rise of Bolivia's heterodox left ironically ended efforts to tax domestic elites, whereas Chile's new center-right government confounded expectations by increasing the corporate tax. The problematic legacy of Bolivia's prior income tax initiatives, along with the government's interest in natural-resource revenue and a broader transformative agenda, explain the first outcome. A new development in Chilean politics – sustained popular mobilization that altered business's strategic calculations – plays an important role in explaining the second outcome and endows this case with similarities to tax politics in Bolivia six years earlier.

#### 1.4 BUSINESS POWER, FISCAL BARGAINING, AND REDISTRIBUTION IN DEMOCRACIES

Analyzing tax policy with close attention to the power of economic elites advances our understanding of business politics and business power, state-society fiscal bargaining, and the relationship between democracy and inequality. These areas have sustained growing interest within comparative politics in recent years, yet much research remains to be done.

Business power was a critical concern for political scientists from the mid-1950s through the 1980s. Scholars including Mills (1956) and Miliband (1969) emphasized business's extensive power based on "instrumental" means, especially connections to state officials. In contrast, Dahl (1961) and other pluralists asserted that nonbusiness actors were equally likely to achieve influence by participating in politics. Other authors subsequently questioned the approach of assessing influence based on active political participation alone. Lindblom (1977) and Block (1977) posited that the "structural dependence of the state on capital"<sup>18</sup> afforded business an automatic veto over a wide range of policies that might affect growth and employment. Since market

<sup>18</sup> The phrase is Przeworski and Wallerstein's (1988).

democracies rely on the private sector to create wealth and prosperity, they must enact policies that create incentives for productive investment, or else face economic decline and unhappy voters. But other scholars objected that empirically speaking, the market did not appear to be a prison – as Lindblom (1982) portrayed it – and argued that business interests were sufficiently heterogeneous to give state officials significant leeway for crafting policy coalitions (Vogel 1987).

Despite or perhaps because of these unresolved debates on the nature and extent of business power, political economy turned away from the concept of power in recent decades and focused instead on business interests and policy coalitions. Ensuing research on rich democracies contributed valuable insights on varieties of capitalism, highlighted the importance of business actors in welfare-state development, and called attention to significant variation in employers' interests and preferences across countries and across sectors.<sup>19</sup> Yet this research has not paid sufficient attention to the key questions of how, why, and when business actors influence policy in market democracies.<sup>20</sup> Understanding the preferences of firms and employer associations is certainly critical,<sup>21</sup> but this step is insufficient for explaining policy decisions and assessing business influence. Literature on economic liberalization in Latin America contains many insights on the means and mechanisms of business influence, and I build on these insights in the following chapters. Yet business reactions to reform and policy outcomes have often been analyzed without systematic attention to sources of power.<sup>22</sup> This omission is problematic because strategic calculations based on assessments of business power may affect both the initiatives policy-makers propose and business responses to those proposals.

Recent literature begins to remedy this deficit of attention to business power and the means and mechanisms of influence, yet further theorizing is needed. Hacker and Pierson (2002) convincingly illustrate that instrumental power and structural power can be analyzed together to explain variation in the extent to which business interests shape policy outcomes. However, they stop short of systematically specifying concrete sources of instrumental power or theorizing the ways in which instrumental power and structural power can reinforce each other and augment business influence.<sup>23</sup> Within the international relations

<sup>19</sup> Hall and Soskice 2001, Estevez-Abe, Iversen, and Soskice 2001, Swenson 2002, Mares 2003, Thelen 2004: 32–3, Iversen 2005, among others. See Schneider 2013 for an important extension of varieties of capitalism to Latin America.

<sup>20</sup> Within varieties of capitalism, Iversen and Soskice (2009) and Schneider and Soskice (2009) call attention to the importance of business's "political representation" and "permeation of politics," yet their analyses still focus on business preferences.

<sup>21</sup> The empirical chapters of this book carefully establish business actors' tax policy preferences based on interviews and written documents.

<sup>22</sup> Exceptions include Schneider (1997) and Thacker (2000), who discuss structural power, and Etchemendy (2011), who focuses primarily on material resources and to some extent collective action.

<sup>23</sup> Hacker and Pierson do not employ the classic business power concepts in subsequent work.

literature, Falkner (2009) also advocates a multidimensional treatment of power, but he leaves open critical questions about operationalizing and measuring business power.<sup>24</sup> Culpepper (2011) argues persuasively that technical expertise affords business strong and largely unvarying influence on low-salience issues, whereas public opinion prevails on high-salience issues. Yet the sources of business power and the extent to which business interests prevail, regardless of issue salience, vary more widely than his argument anticipates.

With the conceptual refinements, guidelines for operationalization, and additional causal specifications I elaborate, the instrumental and structural power framework provides strong leverage for causal inference in comparative political economy. My emphasis on multiple sources of power that may vary over time, across space, and across policy areas redresses problems with earlier treatments of business power that tended to either overestimate or underestimate the extent to which business interests prevail in policymaking.<sup>25</sup>

This framework also contributes to research on taxation and state-society bargaining by systematically specifying sources of taxpayers' bargaining power. Classic studies in this literature, including Bates and Lien (1985) and Levi (1988), provided enduring insights about strategic interactions between states and taxpayers, but they did not adequately theorize taxpayers' political power. Bates and Lien (1985) focus on asset mobility to explain the extent to which taxpayers can shape government policies, without considering political factors.<sup>26</sup> Their research can be seen as part of the reaction against pluralist approaches that focused narrowly on active political participation without considering that owners of mobile assets could influence policy through anticipations of their ability to exit or to evade taxes (Winters 1996). Yet neglecting other sources of power is also problematic. As this book will demonstrate, instrumental power can be as or more important than asset mobility (whether in relation to structural power or to compliance). Levi (1988) considers political resources, along with coercive and economic resources that can underpin bargaining power. Yet she discusses these resources at a very general level, without delineating a concrete set of factors to be observed across cases, independently of policy outcomes. As other authors have noted, this under-specification opens the analysis to potential problems of post hoc assessment (Lieberman 2003: 25). These problems are more pronounced in recent literature on tax bargaining in developing countries. Few studies elaborate a clear, systematic basis for explaining taxpayer influence on state policies, and hence many provide largely

<sup>24</sup> For example, Falkner (2009: 20) describes structural power as an "elusive category" that remains "difficult to pin down."

<sup>25</sup> See also Hacker and Pierson 2002.

<sup>26</sup> A similar critique applies to Timmons (2005); his model focuses exclusively on quasi-voluntary taxpayer compliance without considering any other means through which societal groups might influence fiscal policy.

descriptive accounts of bargaining episodes and outcomes.<sup>27</sup> My framework maintains the emphasis on strategic state-society interactions advocated in the classic fiscal bargaining studies, while also identifying observable sources of power that strengthen economic elites' bargaining position and indicate how and when they are likely to shape policy outcomes.

This book also advances our understanding of redistributive politics and the relationship between democracy and inequality. This literature encompasses diverse approaches ranging from theories emphasizing median voter control to theories emphasizing the materially based influence of the rich. My analysis of tax politics suggests that the former theories tend to underpredict economic elites' ability to resist redistribution, whereas the later approach tends toward the opposite extreme.

The fact that Latin America's economic elites are often able to stymie efforts to tax their income, profits, and assets may not be surprising, yet it poses challenges for a large body of research on democracy and inequality that builds from the premise of median voter control.<sup>28</sup> Works within this literature advance a variety of explanations for the apparent paradox of stable, highly unequal democracies that effect little redistribution, contrary to the material interests of the poor median voter. Authors attribute limited redistribution to skewed voter turnout or restrictions imposed by asset mobility (Boix 2003), voter myopia or ignorance (Bartels 2008), and unclear relationships between voters' views on inequality, their socioeconomic class, and the extent to which they favor redistribution (Kaufman 2009). However, ample research on political representation suggests that there is little *a priori* basis for expecting a clear link between median voter preferences and policy outcomes. Strong partisan identities (Campbell et al. 1960), cross-cutting voter preferences, multiple issues dimensions that can be exploited (Jacobs and Soss 2010), nonprogrammatic linkages, and segmented electoral strategies (Luna 2014) may allow politicians to escape punishment at the polls when their policy positions deviate from median voter preferences. Moreover, designing policies in ways that weaken voters' ability to ascertain negative consequences or identify who is responsible can free politicians from the constraints of public opinion (Pierson 1994, Hacker and Pierson 2005, 2010), even on high-salience issues. Reformers who

<sup>27</sup> Gallo (2008: 163) notes the "ability of taxed groups to mobilize allies and political resources" with little further specification and no systematic scoring across cases. Easter's (2008) interesting discussion of revenue bargains does not fully explain how and why they emerged; Easter (2012) provides a more complete analysis, but taxpayers' sources of bargaining power remain more implicit than explicit. Gehlbach's (2008) systematic analysis of fiscal bargaining focuses on economic sectors' organization and their ability to hide taxable assets, yet his model omits sources of power that I find are as or more important, particularly when reforms by design curtail opportunities for evasion.

<sup>28</sup> For instance, Meltzer and Richard (1981), Boix (2003), Acemoglu and Robinson (2006), McCarty et al. (2008).

wish to tax economic elites can strategically design policies to cultivate popular support. Nevertheless, I maintain that in order to explain varying levels of taxation and redistribution in democracies, we need to look beyond voters and pay much closer attention to economic elites.<sup>29</sup>

My view that the power of economic elites matters more than voter preferences for tax policymaking falls closer to Winters's (2011) innovative work on oligarchy – a radical departure from median-voter approaches that identifies wealth as the ultimate source of power. Winters (2011) emphasizes the ease with which the super-rich convert their wealth into political influence and argues that concentrated wealth overwhelms all other sources of political power that are more equitably distributed. Accordingly, ordinary citizens have little if any say on policies that affect oligarchs' income and assets; the only force that can challenge their power is sustained mobilization from below, which is rare.

Winters's theory emphasizes the uniformity of oligarchic influence in core policy areas like taxation, yet I find substantial variation in Latin American elites' ability to block reforms that increase their tax burden, even in the absence of popular mobilization. I also find that sources of power beyond raw money and wealth, including cohesion and partisan linkages, play an important role in explaining the extent of elite influence. These differences arise partly because the economic elites examined in this book are a broader group than Winters's (2011: 19) oligarchs. Winters argues that oligarchs – extraordinarily wealthy individuals located roughly within the top 0.01 percent of the income distribution – generally do not have collective-action problems when their wealth is threatened because their material interests are automatically aligned. The economic elites relevant for tax policy dynamics and revenue generation in Latin America include domestic businesses and multinational firms, along with high-income professionals and capital owners who belong to the ranks of the “merely wealthy.” Though still a tiny elite, these actors may have collective-action problems, even when initiatives to tax income and profits are at stake.<sup>30</sup>

<sup>29</sup> Within the formal literature, Acemoglu and Robinson's (2006, 2008: 268) work on elites' “de facto power,” arising from “wealth, weapons, or ability to solve the collective action problem,” is a step in the right direction. While they begin from the median-voter assumption that “in a democracy, policies are determined by majority voting,” they add that elites' de facto power can subvert the majority will. However, this conceptualization of elite power remains underspecified. In practice, it lumps together all means and mechanisms beyond voting through which economic elites exert influence. Political parties, interest organization, and the dynamics of collective action remain largely absent from the analysis.

<sup>30</sup> Regarding my finding of significant variation in tax policy outcomes, it is possible that some direct tax increases left oligarchs relatively unscathed, in line with Winters's emphasis on the ability of the superrich to deflect the burden of redistribution onto the “merely wealthy” strata beneath them. For instance, the actual incidence of corporate tax increases is difficult to assess, since firms may pass some of the burden on to consumers and workers. Additionally, I analyze policy change, whereas Winters (2011: 211–54) analyzes effective tax burdens that oligarchs actually pay; these are distinct dependent variables. However, it is important to emphasize that

Material resources by definition set economic elites apart from other political actors, and their wealth may underpin or facilitate acquisition of other relevant sources of power. As “anti-pluralists” argue, economic advantages do generate major political advantages (Jacobs and Soss 2010: 352). In practice, however, these other sources of power – like cohesion and partisan linkages – vary extensively throughout Latin America’s unequal democracies, and they provide significant causal leverage for explaining when and to what extent elite interests prevail; an emphasis on money and wealth alone would overpredict the influence of the economic elites studied in the following chapters. Furthermore, examining other sources of power elucidates the wide range of means and mechanisms through which economic elites influence policy decisions.

My emphasis on elite cohesion and ties to political parties builds on recent work by Hacker and Pierson (2010) as well as research on power resource theory in welfare state literature (Korpi 2006, Huber and Stephens 2012). In Hacker and Pierson’s (2010) view, levels of redistribution and inequality in democracies depend not just on the money economic elites bring to bear on politics, but also on the extent to which interests, including business, are organized; in my framework, organization is a key indicator of elite cohesion. Power resource theory also emphasizes organization and ties to parties, but it tends to focus on labor and left parties. The instrumental and structural power framework complements that approach by specifying a comprehensive set of power resources for economic elites.

The concluding chapter of this book explores further theoretical implications regarding business politics, the public good, and the politics of policy change. Whereas leading literature views strong business associations and institutionalized government-business consultation as promoting socially desirable outcomes, I emphasize that these factors can hinder efforts to promote equitable development in highly unequal societies. I revisit arguments that elite cohesion facilitates progressive taxation and analyze why previous research arrived at different conclusions from those presented in this book. Finally, in accord with literature on policy feedback, I illustrate that the politics of policy change can be much more variable than is often assumed in literature on economic reforms and business politics.

## 1.5 RESEARCH STRATEGY

This book’s theoretical insights emerge from systematic qualitative research that combines multilevel comparisons with process tracing. At the highest level of analysis, I contrast characteristic national tax-politics dynamics and policy

many reforms I examine were explicitly designed to curtail evasion and avoidance and therefore likely did affect oligarchs along with other upper-income taxpayers. Unfortunately, reliable, comparable data on effective tax rates paid by adults within the top 1 percent are not available for the countries I examine and are unlikely to exist in the near future.

outcomes across the three countries examined. In addition, I conduct multiple structured, focused comparisons (George and Bennett 2005) of tax proposals. At the cross-national level, I compare outcomes in analytically equivalent policy areas. At the national level, I compare successive initiatives designed to address persistent tax issues within each country in order to identify factors that contributed to eventual success or repeated failure. For Argentina, my comparisons follow a sectoral logic, in accord with the nature of variation in business power in that country. I compare reform proposals in different tax policy areas affecting a single sector and also contrast tax politics across sectors. These multiple cross-national and within-country comparisons help highlight the role played by different causal factors while holding others relatively constant.

Process tracing complements these cross-case comparisons by providing a distinct source of causal leverage. Whereas cross-case comparisons give rise to correlation-based inference, process tracing entails inference based on within-case analysis (Collier, Brady, and Seawright 2010). Methodologists have elaborated distinct types of hypothesis tests, loosely based on the logic of necessary and sufficient conditions, that underpin causal inference in process tracing (Ven Evera 1997, Bennett 2010, Collier 2011, Goertz and Mahoney 2012).<sup>31</sup> These tests adjudicate between plausible alternative explanations and lend varying degrees of support to hypotheses by using key diagnostic pieces of evidence to evaluate their likelihood. Recent methodological research explicates the Bayesian logic underpinning inference in process tracing (Bennett and Checkel 2014, Humphreys and Jacobs 2014). Process tracing is ideally suited for theory generation and identification of causal mechanisms, which are major goals of this book. Through careful analysis of multiple within-case observations, I establish the sequences of events through which economic elites succeeded or failed to influence tax policy decisions and identify the sources of power that were most relevant.<sup>32</sup>

My analysis draws on a large body of new data gathered during twenty months of field research in Chile, Argentina, and Bolivia.<sup>33</sup> I conducted 446 in-depth, semi-structured interviews with 358 informants: top-level government officials including three former presidents and almost every finance minister who served in each country during the studied period, tax agency experts, politicians from all major political parties, business leaders and tax advisors, and other actors who participated in policymaking. Interviews with high-level government policymakers provided unique information about decision-

<sup>31</sup> See Fairfield (2013: Appendix 1) for explicit applications of process-tracing tests.

<sup>32</sup> Beyond causal inference, process tracing is critical for assessing tax reforms, given the multiple modifications that bills undergo and the significant ways in which seemingly small changes can affect their substantive content and potential impact.

<sup>33</sup> Primary fieldwork was conducted from 2005 to 2007, with follow-up trips in 2008, 2011, and 2012.



making processes, reform options that were considered but discarded, and negotiations with business associations and political parties that shaped reform outcomes. I obtained multiple interviews over extended time periods with key informants, which allowed me to pursue new lines of inquiry that developed as my research progressed. These informants often shared information that was not part of the public record; several informants provided access to internal government documents. I detected and resolved factual inconsistencies that occasionally arose by triangulating between multiple informants and written records. In addition to interviews, I draw on congressional documents, newspaper articles, business publications, tax agency reports, and tax return data.

When working with interviews, care must also be taken to evaluate whether informants have incentives to dissemble or misrepresent motives for past actions (Bennett and Checkel 2014). I address these issues in the empirical chapters where relevant and explain my rationale for the conclusions drawn. Various informants, including politicians interested in self-promotion and businesspeople concerned with portraying their actions in a socially acceptable light, offered candid responses that ran against the expected direction of bias. In addition, the technocrats who often served as key informants had fewer incentives to skew their accounts for political ends. While technocrats may have clear partisan commitments, they do not face the same pressures that elected politicians and party officials experience.

It bears emphasis that this book aims to explain tax policy change, not revenue collection, but with the understanding that the former has important implications for the latter. Building tax capacity in Latin America is no longer simply a matter of administrative or bureaucratic capacity but requires legislative reforms to increase tax burdens, curtail avoidance, and reduce opportunities for evasion. To assess and compare the relative revenue-raising capacity of tax policy changes across countries, I triangulate between my own analysis and expert opinions of reform content and importance, expected revenue estimates available to policymakers while reforms were under debate, and actual revenue-collection trends. Qualitative analysis of reform content is critical for cross-country comparisons, but statutory changes alone do not necessarily establish relative revenue capacity (for example, increasing the corporate tax rate by two points may have a distinct impact in different countries). Expected revenue estimates shape actors' evaluations of reform proposals and are critical to the policymaking process. They provide an important basis for comparison, although estimates may diverge from true revenue yield. Actual revenue changes effected by policy reforms are at best difficult to assess, since revenue collection depends on multiple factors beyond tax policy (including effectiveness of implementation and administration, evasion, and economic variables). However, revenue trends serve as a rough but useful check on whether the other indicators employed capture the relative extent to which governments were able to legislate revenue-raising tax policy reforms.



I chose to analyze Chile, Argentina, and Bolivia based on several criteria. First, these countries encompassed significant variation in the strength and type of economic elites' sources of power, the primary explanatory factors in my theoretical framework. For example, national-level sources of instrumental power like elite cohesion and ties to right parties were strong in Chile, weaker in Bolivia, and largely absent in Argentina. Second, these countries are leading Latin American cases of market-oriented tax reform and economic liberalization more generally. By the early 1990s, VAT revenue in Chile, Argentina, and Bolivia reached European averages. Taxing under-tapped income and profits was therefore a logical and highly salient option for governments facing revenue needs, given that the alternative tax base – consumption – was already heavily tapped. Accordingly, these countries served as “most-likely cases” for initiatives to tax economic elites. This criterion was of practical importance given the infeasibility of obtaining comprehensive information on tax proposals prior to field research.

Third, a paired comparison of Chile and Argentina holds constant several background conditions and institutional factors that are not central to my theoretical framework. These countries share similar levels of economic development, and the central government, which is the focus of my research, collects the great majority of total tax revenue in both countries, despite the fact that Chile is a unitary state whereas Argentina is a federation.<sup>34</sup> These countries' tax agencies were both highly professional and had similar enforcement capacity during the studied periods (Bergman 2009). Fiscal policymaking authority is concentrated within a single ministry, and executives have strong formal legislative powers – the Argentine and Chilean executives are among the strongest in Latin America in terms of formal policymaking powers (Mainwaring and Shugart 1997, Eaton 2002). Chile and Argentina have comparatively stable party systems consisting of two major blocks (*Concertación de Partidos por la Democracia* vs. *Alianza por la Democracia* in Chile; Peronists vs. Radicals in Argentina) with high levels of party discipline.<sup>35</sup> While the Radical Party has fragmented in recent years, Argentina has avoided the party system collapse characteristic of other Latin American party systems with labor-mobilizing parties (Venezuela and Peru). Where party systems are volatile, highly fragmented, and/or party discipline is low, multiple veto players and weak support for the executive in Congress may make government reform proposals difficult to pass regardless of content.<sup>36</sup>

<sup>34</sup> The central government collects 96 percent of tax revenue in Chile and 85 percent in Argentina (Cetrángolo 2007: 33).

<sup>35</sup> See, for example, Mainwaring and Scully (1995), Carey (2002), Jones (2002), Eaton (2002), and Luna (2010).

<sup>36</sup> See Carey and Shugart (1998), Mainwaring (1999), Mainwaring and Shugart (1997), Weyland (2002).

Including Bolivia extends the scope of analysis to a country with a lower level of economic development and a very different party system. Bolivia's historically patronage-based party system (Gamarra and Malloy 1995) experienced dramatic change with the emergence of an electorally successful indigenous-left party and the partial demise of the more conservative traditional parties. The Bolivian case also provides an opportunity to apply my theoretical framework to a context in which organized and highly mobilized popular sectors played a far more substantial role in influencing the tax agenda and proposal outcomes than in Chile or Argentina. Indeed, the fact that Bolivia differs from the other two countries on so many dimensions, including strong regional conflict and ethnic politics in addition to the factors already mentioned, provides grounds for contending that my framework travels across very different national contexts.

The time period analyzed for each country commences with the advent of revenue-raising initiatives subsequent to the completion of market-oriented tax reforms that accompanied economic liberalization. The relevant periods are 1990–2010 for Chile, 1992–2010 for Argentina, and 2003–06 for Bolivia.<sup>37</sup> In Bolivia, other issues superseded taxation on the national agenda after Evo Morales's election in 2006. Chapter 9 briefly analyzes these dynamics as well as new tax policy developments in Chile after the 2010 election that brought the right to power. The primary time periods analyzed span five major presidential administrations in Argentina, four in Chile, and two in Bolivia, supplemented with two additional administrations in Chapter 9. This breadth allows me to identify changes in business power over the medium term as well as the short term and to assess the impact on the tax agenda and the fate of reform proposals.

I identified all major revenue-raising reform proposals, as well as proposals with more minor revenue capacity that targeted economic elites, through expert interviews and review of legislative records and newspapers. I gathered data on a case universe of more than eighty tax measures embedded within fifty-four reform packages across the three countries. Although my arguments are informed by and incorporate examples from this full set of proposals, the empirical chapters emphasize direct tax proposals designed to tap economic elites' income, wealth, and profits, which are of primary theoretical interest for my research.

The following chapters include case studies of forty-three proposed tax measures embedded in twenty-eight reform packages, along with six instances of "non-reform," in which policymakers considered but decided against

<sup>37</sup> In Argentina, VAT base-broadening reforms were enacted in 1990 and 1991, and currency stabilization, a key objective of structural reforms, was achieved in 1992; I begin analysis from this year. In Chile, market-oriented tax reforms occurred under the Pinochet dictatorship; subsequent initiatives to increase taxes occurred after the 1990 democratic transition. Bolivia overhauled its tax system in 1986; significant subsequent revenue-raising reforms did not arise until 2003.

proposing initiatives they felt were important.<sup>38</sup> When the tax measure of primary interest is bundled with other measures in a broader tax reform package, I treat the reform package as a contextual factor with implications for government reform strategies and the fate of the measure of primary interest. When political dynamics and outcomes did not vary across a set of measures bundled into a single reform package, I treat that aggregate set of proposals as the unit of analysis. Through this qualitative, medium-N analysis, I substantiate my argument regarding the importance of business power across multiple cases and contexts.

<sup>38</sup> See Appendix 1.3 for further discussion of case selection.