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**Working Paper**

## State-business relations and the financing of the welfare state in Argentina and Chile: Challenges and prospects

UNRISD Working Paper, No. 2014-23

**Provided in Cooperation with:**

United Nations Research Institute for Social Development (UNRISD), Geneva

*Suggested Citation:* Moudud, Jamee; Caldentey, Esteban Pérez; Delamonica, Enrique (2014) : State-business relations and the financing of the welfare state in Argentina and Chile: Challenges and prospects, UNRISD Working Paper, No. 2014-23, United Nations Research Institute for Social Development (UNRISD), Geneva

This Version is available at:

<https://hdl.handle.net/10419/148734>

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# UNRISD

United Nations Research Institute for Social Development

Working Paper 2014-23

## **State-Business Relations and the Financing of the Welfare State in Argentina and Chile**

*Challenges and Prospects*

*Jamee K. Moudud  
Esteban Perez Caldentey  
Enrique Delamonica*

prepared for the UNRISD project on  
Politics of Domestic Resource Mobilization

December 2014

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This paper is part of a series of outputs from the research project on The Politics of Domestic Resource Mobilization for Social Development.

The project seeks to contribute to global debates on the political and institutional contexts that enable poor countries to mobilize domestic resources for social development. It examines the processes and mechanisms that connect the politics of resource mobilization and demands for social provision; changes in state-citizen and donor-recipient relations associated with resource mobilization and allocation; and governance reforms that can lead to improved and sustainable revenue yields and services. For further information on the project visit [www.unrisd.org/pdrm](http://www.unrisd.org/pdrm).

This project is funded by SIDA and UNRISD core funds.

Series Editors: Katja Hujo and Harald Braumann

## ***Working Papers on The Politics of Domestic Resource Mobilization for Social Development***

*State-Business Relations and the Financing of the Welfare State in Argentina and Chile: Challenges and Prospects.*

Jamee K. Moudud, Esteban Perez Caldentey and Enrique Delamonica, December 2014.

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## Acronyms

AFJP	Administradoras de Fondos de Jubilaciones y Pensiones (Pensions and retirement accounts fund managers) – Argentina
ANSES	Administración Nacional de Seguridad Social (National social security administration) – Argentina
CMEs	Coordinated Market Economies
CPC	Confederación de la Producción (Production confederation) – Chile
CRA	Confederaciones Rurales Argentinas (Argentine rural confederation)
FAA	Federación Agraria Argentina (Argentine agricultural federation)
IMF	International Monetary Fund
ISAPRES	Instituciones de Salud Previsional (Pensioners' health institutions) – Chile
KPMG	Audit, tax, and advisory services international firm formed in 1987 when Peat Marwick International and Klynveld Main Goerdeler merged
LMEs	Liberal Market Economies
OECD	Organization for Economic Cooperation and Development
PPD	Partido Por la Democracia (Party for democracy) – Chile
PPM	Political and policy mix
PRA	Power resources approach
PS	Partido Socialista (Socialist Party) – Chile
RN	Renovación Nacional (National renewal) – Chile
SRA	Sociedad Rural Argentina (Argentine rural society)
T S & L	Tax, social, and labour
UDI	Unión Democrática Independiente (Independent democratic union) – Chile
UIA	Unión Industrial Argentina (Argentine industrial union)
VAT	Value added tax
VoC	Varieties of Capitalism

## Summary

In this paper we examine the ways in which taxation, social, and labour (T S & L) policies in Argentina and Chile have been shaped by state-business relations and capital-labour relations in a context where business organizations/ associations have different degrees of cohesiveness through time. At the heart of our theoretical framework is the view that social democratic/egalitarian/progressive policy proposals must incorporate the role of unequal power relations in the shaping of such policies. We suggest that the implementation and maintenance over time of such policies by the state is a contested process that mediates between business pressures for pro-business policies and the larger society's demands for social justice. This suggests the need for what we call a political and policy mix (PPM) that *could* maintain business confidence in the presence of strong unions and a strong welfare state—at least for a while. Yet we suggest that designing a well-functioning PPM is hardly an easy task, given the contested and turbulent terrain in which the state operates. Finally, we argue following Schumpeter, Kaldor, and others that there is a need for a fiscal sociology of taxation in order to understand historically determined economic, social, political, and institutional factors that shape the level and composition of taxation which is central to financing of social democratic policies.

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The opinions are the authors' own and do not necessarily represent those of UNICEF, Sarah Lawrence College or ECLAC.





## Introduction

The implementation of market reforms across much of Latin America in the 1980s and 1990s exacerbated glaring inequalities and created increased penury for large segments of the population (among others see Ffrench-Davis 2003; Morley 2000). While popular struggles for social justice have a long history in Latin America,<sup>1</sup> the return of democracy in the 1980s and 1990s revived civil society. This, and the discrediting of the Washington Consensus at the turn of the century, generated a backlash against neoliberal policies in several countries including Argentina, Bolivia, Brazil, Chile, Ecuador, Nicaragua, and Uruguay in the 2000s. These countries implemented policies that contributed to a decline in inequality, a reduction of monetary poverty and an increase of the middle class (ECLAC 2012, World Bank 2012). However, profound levels of inequality (ECLAC 2012) and poverty in its many dimensions remained. These in turn have generated popular demands for social justice.

In this paper, our goal is to situate attempts to construct social democratic<sup>2</sup> taxation, social, and labour (T S & L) policies in the context of unequal power relations in Argentina and Chile. We argue that, as elsewhere, employers tend to oppose such policies and use various formal and informal mechanisms to “push back” against them.<sup>3</sup> We characterize the design and implementation of social democratic T S & L policies as a contested process since popular pressures for social justice have had to contend with business support for neoliberalism in the two countries after the fall of their respective dictatorships. Our basic argument is that the combination of profitability and productivity growth shape the types of pressures put on the state by organized business groups and also influences labour market outcomes (Schneider 2013). Further, we argue, that the power relations between state and business are shaped by the political cohesiveness<sup>4</sup> of the latter while pressures to build egalitarian policies by workers and social movements may in turn generate counter-measures by the state to implement such policies.<sup>5</sup> In short, we situate current policy challenges in Latin America in the context of their relatively recent (post-1980s) history in order to understand what scope there is to re-shape and re-form<sup>6</sup> T S & L policies and the institutions which determine them. We investigate these issues by drawing on insights from the varieties of capitalism (VoC), historical institutionalism, fiscal sociology, and power resources approaches.

The paper is organized as follows: Section 2 discusses our theoretical framework. Section 3 discusses the evolution of business-state relations in Argentina and Chile and the ways in which political and institutional factors have evolved in these two countries to create opportunities and challenges for the implementation of progressive T S & L policies. Section 4 analyses fiscal policy in Argentina and Chile as a way to gauge how successful the states have been in going beyond orthodox policies pushed for by

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<sup>1</sup> Collier and Collier 1991; Riesco 2007; Sandbrook et al. 2007.

<sup>2</sup> In this paper we will use “social democratic”, “egalitarian”, and “progressive” interchangeably to refer to rights-based policies that attempt to create fairer, more inclusive, cohesive societies (ECLAC 2010, Kastning 2013).

<sup>3</sup> Furthermore, competitiveness and profitability vary greatly by sector and often within sectors. While sometimes this leads to cleavages among business elites, at other times business associations can form a solid block which enhances their political bargaining power to oppose higher taxes, labour regulation, as well as redistributive and social investment policies.

<sup>4</sup> By political cohesiveness we mean the extent to which firms from within and across industrial sectors have been able to come together in what Schneider has called encompassing associations. We follow Schneider (2004: 8) in defining business encompassing associations as cross-sectoral alliances between firms that may have little in common in terms of the nature of the market served or technology used. The degree of political cohesiveness will determine how effectively diverse firms and sectors can articulate their interests.

<sup>5</sup> This does not imply that the state will inevitably act as a passive transmitter of leftist demands. As Paster (2012) and others argue in the context of Germany, a state may implement progressive social and labour policies in an attempt to undermine leftist politics.

<sup>6</sup> To borrow a term from the title of Streeck’s (2009) book *Re-forming Capitalism*.

business groups. Finally, section 5 concludes by summarizing key findings and discussing some policy challenges.

## Theoretical Framework: Institutional Variations, Power Relations, and Fiscal Sociology

At the heart of our framework is the proposition that T S & L policies need to be analysed in the context of business power. Businesses will attempt to push back or mould those policies that are perceived as threatening profitability or their room to manoeuvre. However, the political influence of business groups is shaped by their cohesiveness and inter-business rivalries. These are not constant through time and may be partially shaped by economic growth, distributive policies, market regulation, etc. Inter-business rivalries are usually based on different economic needs; for example, in contrast to firms whose sales are limited to domestic markets, internationally-oriented firms would oppose protective tariffs for fear of retaliatory tariffs from overseas. As firms and their policy preferences are heterogeneous, the state may increase its bargaining power via some sort of a “divide-and-rule” policy, that is a political and policy mix (PPM) that manages to produce a (temporary) policy accord on T S & L. Finally, the availability and determination of public finance is crucial to the construction of an appropriate PPM; quite simply, cash-starved states will have little leeway to create appropriate PPM’s.

### *Fiscal sociology*

Politics and the availability of tax revenues shape the PPM. In contrast to the macroeconomics literature, including that dealing with social and economic rights,<sup>7</sup> our framework deals explicitly with structural and instrumental power relations (see below) and the political context which shapes them. At the same time, Gourevitch emphasizes that policies are strongly shaped by the political context:

Policy requires politics. Ideas for solving economic problems are plentiful, but if an idea is to prevail as the actual policy of a particular government, it must obtain support from those who have political power. Economic theory can tell us a lot about policy alternatives, *but unless our economics contains an understanding of power*, it will not tell us enough to understand the choices actually made.

In prosperous times it is easy to forget the importance of power in the making of policy... In difficult times this comfortable illusion disintegrates. (Gourevitch 1986: 17. Emphasis added)

For example, the taxes the state is able to impose are the consequence of a political process which reflects the power relations in society at a given historical moment. This was emphasized by Nicholas Kaldor (1963) who, in writing about the challenges for Latin American governments to extract taxes from economic and business elites, observed:

But the advocacy of fiscal reform is not some magic potion that is capable of altering the balance of political power by stealth. No doubt, expert advice on tax reform can be very useful... But what can actually be accomplished does not depend merely on the individual good will of ministers or on the correct intellectual appreciation of the technical problems involved. It is predominantly a matter of political power (Kaldor 1963: 418).

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<sup>7</sup> See for example Godley and Lavoie (2007), which has become well established in non-neoclassical macroeconomics, or Sen (1999) and Nussbaum (2011) with their focus on human capabilities and a rights-based approach to policy.

Simply put, the state would face “political resistance” (Kaldor 1963: 414) in implementing taxes on businesses with the challenges, according to him, being “more complicated” (Kaldor 1963: 414) for industrial and commercial capitalists. One may surmise that the latter two types of capitalists pose a greater challenge to the state’s pursuit of higher business taxes because of their relatively “footloose” nature in comparison to agricultural capitalists.

Kaldor’s approach was in the tradition of Schumpeter<sup>8</sup> who discussed at length the need for a fiscal sociology of taxation that would incorporate interlinked economic, political, sociological, and historical factors to understand a society’s tax structure. What Martin et al. (2009) call the new fiscal sociology

suggests that economic development does not inevitably lead to a particular form of taxation, but rather that institutional contexts, political conflicts, and contingent events lead to a diversity of tax states in the modern world ... that because taxation is central not only to the state’s capacity in war, but in fact to all of social life, the different forms of the tax state explain many of the political and social differences between countries. (Martin et al. 2009: 14)

### **Forms of power and their evolution**

We need to next clarify how business power is exercised in order to understand why some states have been more successful than others in raising taxes on the wealthy and corporations. Some recent literature on this question distinguishes between instrumental and structural power.<sup>9</sup> Businesses exercise structural power because economic activity in capitalism is determined by capitalists’ investment decisions, which are regulated by the profitability criterion. The exercise of this power, or even its threat, takes the form of reduced investment in domestic production activity and increased flows either into speculative activities and/or overseas (for example capital flight) when there is a decline in business confidence or profitability.<sup>10</sup> This power of disinvestment exists independently of any political organizing by capitalists. Instrumental power arises from planned political actions by businesses via different institutions such as business interest associations, government-business policy coordination, informal business networks, business lobbying and campaign contributions, business ties to political parties, etc. (Fairfield 2010).<sup>11</sup>

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<sup>8</sup> Other authors such as Goldscheid and Weber also emphasized political factors in the shaping of tax policy. Max Weber in fact argued that states need to be “cautious toward the propertied” (Weber 1968: 352. Cited from Martin et al 2009: 5-6) in enacting tax policy because of the mobility of capital (Martin, Mehrotra, and Prasad 2009: 5-6), leading to inter-state rivalries.

<sup>9</sup> Hacker and Pierson 2002; Fairfield 2010; Farnsworth 2004.

<sup>10</sup> Even though from policymakers’ standpoint it may, particularly in economically turbulent times, be difficult to gauge *ex ante* the policy mix that may or may not trigger a fall in business confidence. Hacker and Pierson (2002) emphasize the disinvestment that follows from capital flight as a prime way by which structural power is exercised. However, one could equally well argue that a relative increase in speculative activity, as opposed to long-term production-oriented investment, can also have a deleterious impact on an economy. As Keynes put it: “Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done” (Keynes 1953: 159). It should be remembered that just refraining from investment (even without channelling funds into financial “casinos”) and keeping resources idle is also a form of speculation.

<sup>11</sup> Instrumental and structural power may or may not be linked to each other. For example, capital controls may reduce structural power somewhat and yet the political reach of business associations may be considerable because of political donations and informal business networks. However, as Tsai (Tsai 2007) points out with regard to China, until 2004 when private property ownership was officially recognized by the Chinese constitution, capitalists in that country wielded virtually no political power and thus, presumably, minimum instrumental power. And yet because of the gradual disengagement of the Chinese state over the past several decades, the increased role of private investment which filled the vacuum conferred the latter with considerable structural power.

The political and institutional context within which structural and institutional power are exercised is crucial to an understanding of variations of policies in different countries or within a given country over time.

Capitalist democracies take widely divergent forms, and the specifics of institutional design—for example, the number of “veto points” built into formal structures—will have a significant impact on what business employers seek, how they pursue their goals, and the likelihood that their concerns will be addressed. (Hacker and Pierson: 282)

The issue of business power is of course broader than business taxes. Before we ask how power is exercised we must ask why businesses would oppose progressive T S & L policies given that they might benefit from associated positive effects such as a healthier and well-educated workforce. The problem is that the productivity gains may not be immediate while firms may have to absorb higher taxes and perhaps other costs. Clearly, a key issue that policy-makers need to deal with concerns how T S & L policies are likely to affect actual and expected profitability and thus the state of business confidence. For example, if social programmes are funded via higher sales taxes or taxes on wages/salaries then employers may not be opposed to such policies. However, if the programmes are funded by higher current business taxes it is not obvious why businesses would support them even if they yield future productivity gains quite simply because of the greater uncertainties involved the farther they look into the future.

A number of authors in what has been called the Power Resources Approach or PRA (Korpi 2006; Paster 2013; Paster 2012)<sup>12</sup> have observed that employers in the US, Sweden, and Germany came to accept social reforms as a form of strategic accommodation when faced with massive political pressure (in particular from unions).<sup>13</sup> Following this PRA perspective, one may argue that businesses may accept egalitarian T S & L policies, even as a secondary preference, if they are accompanied by an acceptable policy mix such as subsidies or protection from foreign competition. However it is important to not conceptualize the PPM in mechanical terms, as business will continuously attempt to mould or block those policies that are opposed to their interests, as has been the case, for instance, in the US during the New Deal (Rose 2009) and in Germany (Streeck 2009; Paster 2012). This push back by businesses will clearly be a function of their political power and of changed economic conditions, for example going from booms to slumps of profitability or the rise of new international competitors.<sup>14</sup>

Since business confidence is shaped by a wide range of policy and political factors, many of which are interlinked via different institutional combinations, it is not surprising that PPMs will vary across countries and through time. For example, if banks, whether in the private or public sectors, maintain close ties with non-banking firms by providing credit relatively easily, then the latter are likely to be in a better position to absorb higher employee compensation costs. With such an institutional arrangement, workers’ demands for higher wages may be quite successful. In the same way, if the central bank is development-oriented and provides credit to both the treasury and possibly the private sector in line with socio-economic goals, that could alleviate the burden of budgetary constraints and provide greater space for egalitarian policies (Epstein 2005). At the same time, the erosion of such bank-firm arrangements is also

<sup>12</sup> It should be pointed out that Paster (2012) was critical of the PRA with regard to his discussion on Bismarckian Germany. We have included Paster in the PRA because of his emphasis that left political pressure, rather than employer initiatives, is the primary impetus for social democratic (or egalitarian) reforms.

<sup>13</sup> This political mobilization took many forms such as strikes, leftist party organizing etc.

<sup>14</sup> Nell (1998) and White (2002) analyse how economies and markets change endogenously in ways that the relative position of firms in a market (or sectors within the economy) is altered.

likely to disrupt industrial and labour relations with rising pressures on workers to accept cuts in employee compensation.<sup>15</sup>

The above discussion should make it clear that social policy outcomes will be strongly shaped by cross-sectoral linkages. In other words, the analysis and design of social democratic policies need to take into account the institutional matrix within which firms are embedded, and the interaction of social policy, capital accumulation, the availability of finance, and the political-institutional mechanisms via which power is exercised. This is an issue which raises the importance of institutional variations to which we turn next.

### ***Varieties of capitalism and historical-institutional analysis***

In addition to fiscal sociology, our analytical framework is also related to the so-called Varieties of Capitalism (VoC) approach (Hall and Soskice 2001) that investigates the cross-sectoral interlinkages which shape and are shaped by business investment decisions.<sup>16</sup> At the heart of the VoC approach is the firm and its institutional embeddedness:

In contrast to standard economic analyses, however, it treats the firm as a relational network: the firm, operating in its markets and other aspects of the relevant environment, is institutionally embedded. These institutional frameworks, in turn, are mutually attuned in systemic ways, leading to institutional complementarities, and conferring comparative and competitive advantages to countries. These are reinforced through specialization in rapidly integrating international markets. (Hancke 2009: 2)

The VoC framework has challenged the neoclassical claim that globalization will (or should) lead to a policy convergence across nations, with neoliberalism establishing itself as the “best practice” policy framework. VoC authors argue that in spite of global integration a diversity of institutions, and thus entrenched policies, across the OECD and Latin America are found (Schneider 2013; Schneider 2010).

However, the VoC perspective has been challenged by a number of authors who have correctly pointed out that it is fundamentally static since it allows for institutional change only via exogenous shocks.<sup>17</sup> It should be noted that a number of authors have argued that business competition, capital accumulation, and debt financing generate instability endogenously.<sup>18</sup> This in turn implies that PPMs and institutions may mutate across time as the ones successfully implemented in one historical period may fail in another one.

Authors in what one may call the critical historical institutionalist literature<sup>19</sup> have drawn on historical evidence to demonstrate the slow processes of endogenous change that have re-shaped and re-formed institutions in advanced capitalist economies. Streeck (2009) has argued that the spur of national and global competition in Germany made businesses alter and shape the corporatist arrangements that at least until the late 1970s were seen as immutable in the so-called *Modell Deutschland* version of capitalism.

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<sup>15</sup> One can conceptualize another very important linkage here. The recourse to IMF loans will certainly put an end to expansionary development-oriented monetary policies and thus restrict the state's fiscal space to invest in social sectors. A monetarist framework will also restrict the availability of public finance to private firms, thereby reducing their space to accommodate labour demands. Clearly a country running trade surpluses (as Argentina in recent years) will not face such pressures as it focuses on improving social protection mechanisms.

<sup>16</sup> See chapter 1 by Hall and Soskice in Hancké (2009).

<sup>17</sup> See for instance Paster 2012; Streeck and Thelen 2005; Crouch 2005; Deeg and Jackson 2007; Streeck 2009.

<sup>18</sup> The theme of endogenous cycles of instability has been a persistent one in the writings of major authors such as Marx, Schumpeter, and Minsky. For an analysis of some of this literature see Wolfson (1994).

<sup>19</sup> See Streeck (2009) and Streeck and Thelen (2005).

Based on Germany's experience since 1980, Streeck points out that the imperatives of capitalism's historical-varying dynamics lead to increased pressures by businesses to jettison socially mandated regulations if they are deemed to be burdensome. However, and this is a key point, this increased drive toward market-friendly policies may produce new types of institutional configurations which may not necessarily involve a rolling back of the welfare state,<sup>20</sup> but rather its mutation or "redeployment" as Levy (2005) characterizes the French case.

## **State-Business Relations and Taxation, Social and Labour Policies in Chile and Argentina**

In this section we describe state-business relationships and T S & L policies in Chile and Argentina and explore the impact of changing business cohesiveness in both countries, given our central premise that this cohesiveness as well as political institutions and unequal power relations shape such policies. While similar in many ways, secular economic growth has been higher in Chile (with real GDP per capita outpacing that of Argentina by the 1990s) and in the Global Competitiveness Index ranking Chile stands at 34 and Argentina at 104 in 2013-14.<sup>21</sup> Also, Chile's Gini coefficient has been persistently higher suggesting greater difficulties in pursuing redistributive policies. We would argue that these empirical facts reflect relatively stronger business power in Chile.

### **Chile**

#### *The Pinochet era and the Confederación de la Producción*

The return to democracy in Chile generated enormous pent-up socio-economic demands by labour, while Chilean business groups' central preoccupation was to ensure that their privileged position in Chilean society would not be challenged. This hegemonic position of Chilean businesses began to be constructed after Pinochet's coup d'état in 1973. Before the severe financial crisis of 1982-83, the military-dominated state apparatus benefitted business groups with a combination of labour repression, regressive social policies, and greater access to international credit via a strengthening of ties with major international financial companies (Silva 1997). The deep financial crisis of 1982-83 brought about a new phase in the Pinochet regime that Silva has called *pragmatic neoliberalism*, in which the state intervened to provide various supportive policies to businesses as it courted the latter to revive the economy.<sup>22</sup> During the 1980s Chilean business associations consolidated their political power, with members of different ministries being businessmen who sat on the boards of directors of companies from a wide range of industrial sectors (Silva 1997:166). In all this the Confederación de la Producción (CPC), a multi-sectoral peak business organization, played a central role.

#### *The Confederación de la Producción (CPC), its Policy Influence and Legacy*

Two features of the pragmatic neoliberalism phase post 1982 are significant. First, the newly-empowered business groups, under the umbrella of the CPC, pushed for counter-cyclical deficit spending policies including selective public investment policies that benefitted certain sectors such as the building and construction sector. These policies were accompanied by steep cuts in social welfare expenditures and large-scale

<sup>20</sup> See for example Steinmo's discussion of Sweden (Steinmo 2010).

<sup>21</sup> Data obtained from *The Global Competitiveness Report 2013-14*, The World Economic Forum. In the entire Latin American and Caribbean region Chile is below Puerto Rico which is ranked at 30.

<sup>22</sup> See also Ramos (1986).

privatizations of pensions, health, and education sectors.<sup>23</sup> In short, the CPC was not supportive of a text-book style Keynesian demand management policy since its goal was to only support selective types of public expenditures.<sup>24</sup> The military government, for its part, was forced to back off from its earlier radical neoliberal policies given widespread social unrest and strong opposition from the CPC during the crisis (Silva 1997: 165-172).

Second, policy reforms lowered employers' contributions to social insurance and increased workers' contributions (Illanes and Riesco 2007: 396). Although non-wage labour costs were thus reduced, this policy enabled firms to raise gross salaries. This alteration in the composition of employee compensation had the effect of exposing workers to a greater degree to the vagaries of labour markets since it tied their well-being more strongly to their employment status and their wages in a context of suppression of labour by the regime. Such measures, together with reliance of value-added taxes (VAT) and sharp cuts in top marginal rates on personal income and corporate taxes (Schmidt-Hebbel 1999), increased inequality (Sandbrook et al. 2007: 151).<sup>25</sup>

Democracy brought with it demands by workers for social justice and the elimination of repressive labour policies codified during the Pinochet era. Not surprisingly, businesses saw these developments with unease. A key challenge for the new government was to simultaneously calm investor fears, revive business confidence, and satisfy some of the demands from civil society. However, state-business networks were strengthened in democratic Chile. The military, given its control of the transition to civilian rule, managed to maintain a lopsided representation of conservative and pro-business members of parliament and the senate. This led to most economic and social policies being "business-friendly", contributing to private investment growth (which also benefitted from the global economic boom of the 1990s) and providing legitimacy to this development model. The model generated robust profitability since then so that the country is currently ranked very highly in terms of its business investment potential (Schwab and Sala-i-Martin 2013).

This development strategy enhanced the instrumental power of businesses, in particular their political influence through institutions and organizations and enhanced tensions within it. On a range of issues such as corporate taxation and labour policies, centre-left Chilean governments have had to counter considerable instrumental power wielded by well-organized and –established business groups, in particular the CPC (Fairfield 2010). The instrumental power of the CPC and other business groups comes from the particular set of political institutions crafted in the Pinochet years (Roberts 2011). For example, one of the enduring problems in the Concertation period was the persistence of what has been called "authoritarian enclaves" (Roberts 2011: 332), which had privileged the military's political autonomy and institutionalized the appointment of several unelected conservative senators with veto power over those policies that threatened business privileges (Fairfield 2010: 51). Furthermore, what is called a "binomial" voting system has conferred disproportionate positive advantages to right-wing political candidates (Roberts 2011: 332). Currently business groups constitute the "core constituency" (Fairfield 2010: 50) of the two main right-wing parties, Renovación Nacional (RN) and

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<sup>23</sup> Sandbrook et al. 2007: 151; Illanes and Riesco 2007: 395-396; Silva 1997: 165-172.

<sup>24</sup> Keynesian macroeconomics generally does not deal with the composition of government spending.

<sup>25</sup> Pragmatic neoliberalism also implemented some limited social policies that targeted the very poor, the physically disabled, and the mentally challenged (Sandbrook, et al. 2007: 151).



the Unión Democrática Independiente (UDI).<sup>26</sup> While the veto power of unelected senators has dwindled over time, their political power has nonetheless been strong enough to block major increases in tax rates on corporations (Fairfield 2010: 51) and wealthy households (Solimano 2012).

The fusion between business groups and the political right increased the instrumental power of the former considerably. As former tax agency director Javier Etcheberry put it:

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. (Cited from Fairfield 2010: 53)

### *Taxation policies*

In general, business groups have been able to oppose policies that could potentially affect profitability adversely. Looking at the past two decades, the corporate tax rate was about 14 per cent in the 1990-2001 period and about 17 per cent in the 2002-2009 period (Fairfield 2010: 55, Table 2) although between 2009 and 2013 it was raised from 17 per cent to 20 per cent with a brief dip to 18.5 per cent in 2012.<sup>27</sup> These figures are well below the Latin American average of around 30 per cent.<sup>28</sup> Significantly, as Fairfield (2010) points out, the government's target corporate tax rate during this period was in the 20-30 per cent range. All in all, while the VAT was raised by one per cent and royalty taxes on private mining companies were successfully imposed, aggregate tax rates remain very low (Roberts 2011: 340-341). This tends to constrain funding for social programmes and limits the prospect for redistribution.<sup>29</sup>

Interestingly, low productivity and internationally uncompetitive firms<sup>30</sup> give their owners a particular type of structural power. Business leverage is likely to be high to the extent that such firms eke out some export revenues on the basis of slim profit margins. Furthermore, the state faces even greater constraints in extracting taxes and social contributions from firms in the large informal sector.

### *Social and labour policies*

Similarly, only limited success has been achieved in the rolling back of Pinochet era labour laws which had weakened worker solidarity and their bargaining power. On the one hand, eliminating these laws has been a key demand of unions but every government's attempts to satisfy these demands has been met with successful and effective business opposition (Huber et al. 2010: 90-91). On the other hand, since 1990 the democratic governments have been successful in almost doubling the real minimum wage (Pribble and Huber 2011). As Huber et al. (2010: 91) suggest, there is an implicit *quid pro quo* here: in return for increases in the real minimum wage and monetary compensation to laid off workers on the basis of the number of years worked (Huber et al. 2010: 90), businesses have been successfully intransigent in opposing efforts to roll back the "flexible labour market" policies dating from the Pinochet era.

<sup>26</sup> There is some evidence to suggest that the UDI gets generous amounts of funding from powerful business groups (Fairfield 2010: 51).

<sup>27</sup> See KPMG tax database.

<sup>28</sup> See footnote 8.

<sup>29</sup> For a discussion of inequality see also "Will Inequality Hamper Chile's Economic Prospects?" in Centre for International Governance Innovation (<http://www.cigionline.org/articles/2013/02/will-inequality-hamper-chiles-economic-prospects>, last accessed on 28 December 2013).

<sup>30</sup> Latin American firms have historically devoted much less to R&D than those in developed countries or in Asia with correspondingly low levels of employment for researchers (Schneider 2013: 119).

Not surprisingly, across Latin America low productivity firms employing low-wage unskilled labour thrive in a context where workers are easily hired and fired. Roughly 40 to 50 per cent of employment in the region is in the informal sector (Schneider 2013: 92) although the proportion of non-agricultural informal employment is about 25 per cent in Chile (Schneider 2013: 97). A significantly large proportion of formal sector employment is also precarious with high rates of turnover. Unionization and education levels of workers remain low. While Chile is only second to Puerto Rico in the Latin America and Caribbean region in the 2013 Global Competitiveness Index, a number of factors, including relatively low levels of education and the proportions of R & D and the number of researchers (Schneider 2013: 116) have impeded transition to higher value-added production, reflecting “poor innovation capacity” on the part of private investment (Schwab and Sala-i-Martin 2013: 37).

From a policy standpoint the above stylized facts have several implications. First, as Schneider (2013: 92-94) shows, measures of labour market regulation indicate that Latin American countries tend to rank as more regulated than what the VoC literature refers to as liberal market economies or LMEs (such as the US) and even the coordinated market economies or CMEs (such as Germany) (Schneider 2013: 92-94).<sup>31</sup> In contrast to developed economies, high levels of labour regulation tend to reduce median job tenure (Schneider 2013: 106). Because severance pay proportional to the number of years of service is the norm, low productivity firms with limited cash flow prefer to fire workers preventively before it becomes costly (Schneider 2013). While neoclassical/conservative writers would say it is regulation that leads to informality, this would be an incorrect interpretation of the evidence. The problem is the divergence between intention and practice because of the limited capacity to monitor and implement regulations by state agencies—in turn the result of insufficient financing of the state due to low overall taxation. Also, in particular among low productivity firms, the effect labelled Devil’s Deal by Tendler (2002, 2004) takes place, as firms and politicians fail to realize that the costs of complying with the regulations (labour or environmental ones) could be more than compensated by better labour morale, tax revenues that can finance subsidies (for example for training), access to markets, etc. This status quo persists making it difficult for either party to be the one to get out of it first. Second, the “human capital” expansion approach to social policy<sup>32</sup>—so widely favoured by neoclassical economists and the World Bank—is of limited use in such a context. Such supply-side measures ignore the fact that the demand for skilled labour by firms is very limited. Third, such labour market outcomes tend to deepen not only economic but also political inequalities by lowering the instrumental power of workers and social movements. In Chile the two main social democratic parties, the reconstituted Socialist Party (PS) and the Party for Democracy (PPD), have weak organizations because their monetary resource base is low (Huber et al. 2010: 81-82).

The lack of a large dues-paying base and of close ties to popular organizations that could be mobilized at election time empowers the moderate sectors of the leadership in still another way. It renders the left *parties dependent on large private donors for financing elections*. This is a particularly serious problem in light of the very high cost of Chilean elections. (Huber et al. 2010: 82. Emphasis added)

This does not imply that the centre-left governments have not been able to push through important social policies. Rather than only focussing on extreme monetary poverty alleviation, successive governments in the 2000’s have attempted to take seriously the

<sup>31</sup> See Soskice and Hall (2001) for the analysis of CMEs and LMEs.

<sup>32</sup> According to which providing health and education by the state is supposed to raise economic growth which will lead to employment, so monetary poverty will decline due to a “trickle down” effect.

notion of social citizenship by creating more universalistic and solidarity-based policies – even if these initiatives have been promoted within the constraints of a pro-business development model (Huber et al. 2010). Among the most important initiatives has been the creation of an accessible healthcare policy (the AUGE programme) by the Lagos government and pension reform under Bachelet, both of which have “constituted major departures from the neoliberal model of narrowly targeted and market-driven social policy” (Huber et al. 2010: 95).

Beginning with the Lagos administration the goal of health care reform has been to make it more universal, affordable, and inclusive of a greater number of illnesses. Yet its coverage leaves out informal sector workers and does not adequately deal with the inequities of the existing system (Huber et al. 2010: 89). Finally, the AUGE programme was initially to be financed via a national solidarity fund, partly dependent on health care contributions. However, the private health insurance companies and the right opposed such a funding policy. Instead it is financed via a small increase in the value-added tax and additional co-payments (Huber et al. 2010). Annual caps on co-payments by low-income beneficiaries exist to ease the financial burden on them and reduce regressivity (Pribble and Huber 2011: 124).

Given the inequities of Pinochet-era privatized pension system, there has been widespread support for a public one (Ewig and Kay 2011: 78). A signal policy of the Bachelet government has thus been to “transform social security into an economic and social right” (Consejo Asesor Presidencial para la Reforma Previsional 2006: 29. Cited from Ewig and Kay 2011: 85). Despite the presence of a highly profitable pensions industry, the state was able to re-insert itself so as to incorporate universalistic and solidaristic features. Those too poor to contribute (the lower 60 per cent income group) are provided public pensions (the universalistic component) while those not wealthy enough to have accumulated sufficient savings are given supplementary benefits (the solidaristic component) (Huber et al. 2010: 92).

By July 2011, the solidaristic component covered about 60 per cent of the people from households in the three poorest income quintiles. Pension reform has also reduced gender disparities in several ways. First, the non-contributory component has benefited women because a greater proportion works in the informal sector or is out of work for varying lengths of time. Second, each woman’s pension is augmented per each additional live birth. Third, gender equality has been reached in terms of survivors’ pension and disability insurance. Fourth, in the event that a couple divorces pension savings accumulated during the time they were married can be split equally (Hujo and Rulli 2014).

The financing of the public component of pension policy is accomplished partly via the Pension Reserve Fund and partly from general tax revenues where the former is funded via structural budget surpluses (Huber et al. 2010: 84 and 92). The challenge is for the Chilean state to obtain adequate sources of tax revenue, given business groups’ political success in limiting corporate tax rate increases. The other option of raising indirect taxes is likely to exacerbate the high levels of inequality because of the generally regressive nature of such taxes (Mehrotra and Delamonica 2010).

The key barrier to the implementation of a more “radical” pension policy was that the pension fund industry saw certain components of it as inimical to its interests. Although the industry did not object to providing public subsidies to the bottom 60 per cent of income earners (the Basic Solidarity Pension), it was, unsurprisingly, opposed to the

creation of a state-owned pension fund which would compete with private ones. This policy initiative failed (Ewig and Kay 2011: 86). Thus, pension reform served to merely redress some of the inequities of the private system rather than replace it *in toto*.

Both the private pension and healthcare (Instituciones de Salud Previsional or ISAPRES) industries wield significant structural and instrumental power, catering to some of the wealthiest Chileans (Ewig and Kay 2011: 82 and 87). In terms of instrumental power, one-third of the Marcel Commission, which was the Bachelet administration's Advisory Council for Pension Reform, consisted of individuals from pension funds (Ewig and Key 2011: 87). In the same vein, the ISAPREs had created a peak association with close linkages to the government, legislators, and the conservative Institute for Liberty and Development that could provide the intellectual firepower needed to push the ISAPREs' policy agenda (Ewig and Kay 2011: 82-83). Thus it was well-nigh impossible for the governments to seriously challenge such an entrenched power structure without provoking grave political opposition instability.

## **Argentina**

### *The so-called lost decade*

The 1980s for Argentina have rightly been called the "lost decade". External debt obligations, high and variable inflation, rising trade and budget deficits, unemployment, and growing monetary poverty made the challenges for the new democratic governments acute. Real wages fell steadily from 1974 to 1991. Nevertheless, the democratic government that came to power after the demise of military governments in 1983 tried to introduce progressive reforms and increase social expenditures. Real social spending in the 1980s was around 30 per cent higher than in the 1970s. In proportion to total public spending social spending showed a general increase, with fluctuations, from 41.4 per cent in 1983 to 58.6 per cent in 1990 (Beccaria and Carciofi 1995).

Despite these increases in social expenditures, the health care, education, and pension system experienced growing financial problems. This was due to the difficulties of raising revenues by the government, in particular in a context where, after losing mid-term elections, its political power was waning. This made raising taxes or even enforcing existing tax rules difficult. While public health care and education spending in proportion to GDP remained relatively high compared to other Latin American countries, it declined in real terms and it became more inequitable (Beccaria and Carciofi 1995). This resulted in deteriorating quality of services due to poor infrastructure, low-quality care, and underpaid teachers and medical professionals. Falling tax revenues and lower per capita income contributed to the decline of these once highly efficient social sectors. Various routes converged to produce inefficiencies. Insufficient funding resulted in the impossibility of maintaining and repairing previous investments (health equipment, instruments, hospitals, etc.) at the same time that current expenditures (salaries) had to be paid. In addition, funding constraints created shortages of vital inputs such as medicines, cotton, x-ray film and anaesthetics. Finally, the quality of service delivery plummeted because of falling real wages and workforce retrenchments in the healthcare sector.

The government responded to the falling resources available for health services by increasing co-payments which added to the financial burdens of low-income households. Similarly, because of financial constraints and a lack of indexation of benefits in a context of rising inflation, the pension system deteriorated progressively, negatively impacting the real value of pensions (Feldman, Golbert, and Isuani 1986).

### *Fragmented business associations*

Unlike the Chilean case in the pragmatic neoliberalism phase, the Argentinian business groups had not coalesced into a politically powerful encompassing association such as the CPC even though individual businessmen continued to be appointed to senior government positions throughout the 1990s (Schneider 2004).<sup>33</sup> Because of their historic fractiousness several competing business associations (both in the industrial and agricultural sectors) have existed and to this day engage in temporary alliances among themselves or with other political actors. Lack of cohesiveness in the aftermath of the debt default continued, hindering creation of a common business position regarding neoliberal or state-led policies. To a large extent, the existence of a politically fragmented business class shaped the nature of policy in both the neoliberal and post-neoliberal periods but in different ways.

The pursuit of austerity and privatization policies under the Menem government (1989–99) was actually accompanied by some narrow social assistance programmes consistent with the Washington Consensus. Such measures<sup>34</sup> did little to alleviate the precarious nature of jobs or hardship (Barbeito and Goldberg 2007). Nevertheless, they constituted an attempt to garner political support for the Menem government and reduce opposition to shock therapy programmes. The neoliberal project, with its deep roots in the interests of business elites, received the financial support of international organizations to implement (and expand) policies similar to the ones set up during the military dictatorship which the Alfonsín administration (1983–89) had tried to revert. The project was supported by shifting alliances of both organized labour (which was, in any case, greatly weakened) and organized business groups. The government secured support from business groups via its privatization policies (Weyland 2003: 1100) as well as from some union leaders who converted themselves into managers of the privatized firms, including private pension funds.

### *Taxation policies*

The pro-business policy framework, which made Argentina a particularly attractive investment site (Fairfield 2010: 55), contained increases in corporate tax rates (an example of a PPM) which nevertheless have been kept high and generally ranked among the highest in Latin America. Tax policy changes in 1989–91 increased corporate tax rates from 20 to 35 per cent. They have remained at that level in the 2003–2013 period.<sup>35</sup> However, the relative weight (and rates of increase) of different taxes kept on shifting in the early 1990s within a context characterized by high economic instability and shifts towards macroeconomic stabilization policies within the neoliberal agenda of privatization and market reforms (Cetrangolo and Gomez Sabaini 2007). Higher tax rates on firms with significant labour costs were attained by linking these to cuts in firms' non-wage labour costs such as contributions to social insurance (Cetrangolo and Gomez Sabaini 2007).

This said, the taxation system generated insufficient revenues and remained regressive as overall government revenues were still too dependent on consumption taxes. This

<sup>33</sup> Schneider argues that encompassing business associations were generally kept at arms' length by governments, even by the pro-neoliberal Menem administration, and so they lacked the institutionalized access to state power that the CPC does have in Chile. However, it is hard to argue that Menem's government had any autonomy from business groups nor that it pursued a neo-populist agenda (on the contrary, it pursued a radical Washington Consensus one). It distributed most ministries to conspicuous members of major corporations, corporate lawyers, business associations, and leaders of business financed think-tanks.

<sup>34</sup> For example the cash-for-work programme known as "Jefes y jefas" (For "Plan Jefes y Jefas de hogar", which means male and female heads of households).

<sup>35</sup> See Fairfield (2010). Also Global Finance and KPMG's global corporate tax rate data.

also meant that the tax structure was biased towards consumption taxes that were procyclical (Cetrangolo and Gomez Sabaini 2007). When, due to Washington Consensus-aligned policies, external payments crises and escalating unemployment ensued, it was not possible for the government to stem the external deficits without engaging in an economically dubious scheme of ever increasing external debt accumulation to pay the interests on the existing debt. As the scheme could not be sustained,<sup>36</sup> it finally collapsed in 2001-2002.

The financial crisis of 2001-02 significantly altered the state's relationship to business interests. This is reflected for instance in the introduction of export taxes by the government in 2002 (Richardson 2009), a policy which had been discontinued under Menem in line with standard free trade theory (Bräutigam 2008). Growing political power of the state enabled it to raise the tax rate on soy exports a number of times, with the rate reaching about 35 per cent by November 2007 (Fairfield 2011: 426). The soy sector had experienced impressive growth of profitability (Fairfield 2011) both because of the commodity price boom in the 2000s and the increase in Argentinian agricultural productivity. The government also raised tax rates on other agricultural commodities (Richardson 2009: 243). Similarly, although corporate tax rates were not increased after the 2001 sovereign debt default, the government did not hesitate to clamp down on other corporate tax privileges to raise revenue from this sector despite significant business opposition (Fairfield 2010: 56). Such measures were facilitated by further weakening of business structural and instrumental power as the nature of the economic model changed after Kirchner's election (Fairfield 2010: 60). This neo-developmental model (Félic 2012), whose nature is elaborated below, was one that reinforced state intervention on various types of social and labour policies while promoting capital accumulation and exports.

The backdrop to the state's success in raising the corporate tax rate was the profitability increase of the export sector in the post-2002 period.<sup>37</sup> This increase took place in a context in which the new government confronted a twin challenge. Unlike the 1990s, when persistent current account deficits were financed by infusions of foreign capital flows (Félic 2012: 116), in the post-2002 period the country was largely blocked from international capital markets (Weisbrot et al. 2011) because of its foreign debt default. There was thus great pressure to lower unit labour costs to boost net exports and stimulate private investment. At the same time growing unemployment and domestic instability as well as pressure from unions and social movements required the government to provide social relief and create jobs via public works projects (Cornia and Martorano 2010). The key compromise strategy for the state to meet these rival demands was to promote productivity growth accompanied by various progressive T S & L policies. The result has been high rates of capital accumulation, falling unemployment rates, and current account surpluses.<sup>38</sup>

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<sup>36</sup> Although clearly unsustainable, even in the short to medium run, in the very short run it was profitable to intermediaries and speculators. Moreover, many of them speculated that even if a default were to occur, as it eventually did, they would find ways to recover their investments, for instance through after-default negotiations (as some of them have done) or litigation (as some of them are still trying to do).

<sup>37</sup> Argentina is a major global exporter of genetically modified (GM) crops whose production has involved considerable increases in capital intensity and land concentration (Newell 2009).

<sup>38</sup> Compared to the 1990s, there has been a huge transfer of funds to the public sector in the 2007-12 period (see table 2 section 4). This has been used to pay down the external debt (thus gaining degrees of freedom in policy-making), infrastructure construction, and redistribution (in the context of innovative T S & L policies as discussed in the text). Such policies have generated confrontations with domestic and foreign capitalists as well as domestic upper classes. As a result there have been speculative attacks on the exchange rate and attempts to constraint foreign financing (also a backlash of the default earlier in the decade). The state has in turn responded to these pressures, sometimes in an ad hoc fashion.

Improved net exports also significantly increased revenues. This enabled the state to engage in what Richardson calls export-oriented populism, i.e. redistributive policies based on the increased revenue from exports. In this strategy, the state used a part of export revenues to provide subsidies to a wide range of domestic business sectors such as those in poultry, beef, dairy, wheat, flour, energy, and transport and to increase the pensions and nominal wages of public sector workers (Richardson 2009: 242-243).

Moreover, the Kirchner government was able to exploit the internal divisions between various business sectors. As mentioned above, many firms across different sectors were clearly beneficiaries of the export tax increases because of the subsidies they received. Thus major business associations such as the Asociación Empresaria Argentina and the Unión Industrial Argentina (UIA) supported this tax (Fairfield 2011: 445) or at least did not oppose it.<sup>39</sup> Within the agricultural sector, divergent production structures resulted in different policy preferences, which precluded a unified front against the new government efforts (Richardson 2009: 251). For example, the Sociedad Rural Argentina (SRA) and the Confederaciones Rurales Argentinas (CRA) consists of large agricultural farms. While the Confederación Intercooperativa Agropecuaria (COINAGRO) represents smaller farmers organized as cooperatives, the Federación Agraria Argentina (FAA) represents the very small farmers. Even though all the farming groups were opposed to having agricultural exports taxed, the FAA were less hostile provided the taxes were connected to subsidies that benefited them (Fairfield 2011).

The government in the 2000's was able to “get away” with raising export tax rates until 2008 without adversely affecting business investment in the agricultural and biotechnology sectors one reason being the overall policy package that the Office of Biotechnology of the Secretary of Agriculture established to promote productivity growth of these sectors (Newell 2009: 32). On the one hand, the Argentinian state was able to raise export tax rates quite successfully in the 2002-2008 period (Fairfield 2011). On the other hand, the state confronted an economically important sector that was not passive (Newell 2009). In fact, the lobbying power of large landowners' associations (for example the SRA) and that of important multinational corporations (such as Dow, Monsanto, and Cargill) involved considerable influence over the policy-making process:

External events, therefore, created conditions favourable to those elements of national and transnational capital well placed to deliver technological packages that would generate much needed export earnings. Not only does agricultural biotechnology derive from—and depend upon—the broader structure of agro-hegemony for its predominant position in the Argentine economy, it also reinforces that structure by consolidating power and wealth in the hands of political and economic elites and legitimising an export-led agribusiness model underpinned by GM [genetically modified] technology. (Newell 2009: 37)

Matters came to a head in 2008 when the government proposed a new export tax policy and faced an important challenge (Fairfield 2011). This challenge came in the form of widespread protest (led by a coalition of rural association leaders) against the new policy to create an adjustable export tax rate that would increase up to a maximum of 95 per cent if commodity prices, and thus profits, would rise. The tax measure also included a provision that it would actually decrease if profitability fell with prices. This tax reform law, proposed by the Kirchner administration, came on the heels of an increase in export tax rates on soy from 35 per cent to 44 per cent, which hit small farmers particularly badly (Fairfield 2011: 439). Not surprisingly, the cap on future

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<sup>39</sup> They recognized the need for additional revenues and an export tax did not affect them directly. Moreover, successfully opposing this tax might have led the government to look for alternative sources of revenue which might have affected them.

profits aggravated business opposition as it would have given the state an important lever to control investment in this sector.

What is of significance here is the form that the business opposition took, which resorted to the unusual means of protest. Protest involved, in addition to road blocks and demonstrations, commercial strikes which constituted “a defining feature of the conflict” (Fairfield 2011: 442). Adverse effects on the domestic economy and exports; declining popularity of the government; and unified protests by big and small businesses and other political groups added to the enormous pressure on the government. Resorting to coordinated protest suggests that, despite its economic importance, the agricultural sector’s instrumental power was relatively weak (Richardson 2009; Fairfield 2011). Otherwise it could have used it to preemptively stop the 2008 tax reform proposal (or modify it through the normal parliamentary process) avoiding strikes and protest – desperate measures which affected profitability adversely (Fairfield 2011: 442). The well-coordinated business and popular pressure led to the proposed tax policy being defeated in the senate by a tie-breaking vote by the vice-president (who belonged to a different party). Nevertheless, another sign of the relatively weak instrumental power of the sector was that the core policy of export-tax populism remained in place after the protests stopped, with the tax returning to its *status quo ante* of 35 per cent. The soy sector accepted this rate “begrudgingly” (Richardson 2009: 251) as a second-best option that they were forced to accept. The fact that the tax rate remained at 35 per cent confirms the relative power of the state over the business sector. While the agricultural leaders were able to garner support from other sectors of society, they found it very difficult to get sympathy to try to reduce their contribution to revenues – a generalized tax reduction crusade was also not politically feasible at the time.

### *Social and labour policies*

In short, despite the central role of the private sector (Schneider 2013: 165) in the post-neoliberal period, the state has been in a politically dominant position given its core base of support amongst a number of well-organized unions, movements representing the urban unemployed (*piqueteros*), other social movements (Etchemendy and Garay 2011: 292), and support from sizeable segments of the re-emerging middle class whose material conditions improved but also due to other policies, for example prosecution of human rights violators during the military dictatorship and expansion of LGBT rights.<sup>40</sup>

Compared to many other countries in the region the demand for skilled labour is high in Argentina given the country’s relatively high (by Latin American standards) importance of research and development sectors (Schneider 2013: 116).<sup>41</sup> This in turn has shaped and been shaped by the country’s particular labour market characteristics with unions playing a major role in the wake of the debt crisis. Compared to the Latin American median in the 2000s, while the extent of labour market regulation is low, union density and the length of workers’ job tenure are high and the size of the informal sector is relatively smaller (Schneider 2013: 167).<sup>42</sup> Thus, relative to other Latin American countries, the labour market is less “flexible” giving formal sector workers, especially

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<sup>40</sup> On 15 July 2010 Argentina became the first Latin American country to allow same sex marriages with equal rights and provisions as heterosexual marriages (law 26.618). On 9 May 2012, Law 26.743 recognized equal treatment based on gender identity.

<sup>41</sup> Although the proportions of R&D and researchers are miniscule compared to, say, Taiwan or South Korea (Schneider 2013: 116). Argentina has higher secondary school enrolment levels compared to other Latin American countries (Engerman and Sokoloff 2012).

<sup>42</sup> Schneider (2013: 167) does not report the size of the informal sector. On the other hand, the International Labour Organization (2012) reports that the share of workers employed in the informal sector in Argentina is 32.1 per cent while the share of workers in informal employment outside the informal sector 17.9 per cent. These are the latest data according to this report and pertain to the non-agricultural sector.



those with skills, greater political leverage. We would suggest that these stylized facts about the Argentinian labour market partly explain the particular type of state-business relations that have come about under the neo-developmental paradigm.

Partly because of union pressure, the Argentinian government has pushed for corporatist arrangements of a type which has involved workers in the formal sector. The government's wage policy has involved increases in the minimum wage as well the inclusion of nominal wage increments in contract negotiations in all sectors. Active labour market policies (Weller, 2009), have reduced labour market flexibility somewhat and increased the bargaining strength of national unions who have been involved in peak-level negotiations with employers' groups and the state around a range of job-related concerns (Etchemendy and Garay 2011).

It would be a mistake to conclude that only formal sector workers and unions have been the beneficiaries of the neo-developmental strategy. The observation by Féliz (2012) regarding a qualitative change in the nature of the class composition supporting the current development strategy is borne out by the fact that unemployed and informal sector workers as well as community action groups have engaged in various types of collective actions to support the government's policies. Such groups have been successful in forging alliances with certain unions (Garay 2007), resulting in social policies that have also benefited workers outside the formal sector:

First, the government continued with the Heads-of-Household Programme (or Jefas programme) implemented first by the Duhalde administration (2002-2003), which involved transfers to reduce poverty among informal sector workers and the unemployed. Several job programmes were initiated which involved community projects and cash subsidies for microenterprise development. The community jobs projects involved the provision of social services (care for the elderly and children, health care etc.) and consumer goods (baked goods, garments, etc.) as well as infrastructure projects (sewerage, irrigation, construction and repair of public buildings etc.) (Etchemendy and Garay 2011; Kostzer 2008). Second, because of political pressures from the unemployed in the post-2008 crisis period and responding to policy initiatives proposed by the opposition (de facto taking it away from them and presenting it as a government initiative), the state initiated a major increase of family allowances that targeted families in the informal sector (Etchemendy and Garay 2011). This programme, called the Universal Child Allowance (Asignación Universal Por Hijo), has been characterized as "the most important social right created since the return of democracy in 1983" (Etchemendy and Garay 2011: 296). However, it is neither universal nor a simple allowance. The programme provides cash assistance to some families with children (for example if parents are unemployed or work in the informal sector), with some of the cash provided as a grant and some of it being conditional on sending children to school and being immunized. While laudable these conditions are not imposed on parents in the formal sector when their wages are topped up with family allowances because they have children (as it is clearly seen in the wage labour laws).<sup>43</sup>

All such measures have yielded very tangible social benefits since the early 2000s, including a decline in monetary poverty (Weisbrot et al. 2011). They have complemented other social initiatives, especially in regards to adolescents, children, and elderly persons. Important changes have indeed occurred in the pension system. As part

<sup>43</sup> See, for instance, the explanation in <http://www.trabajo.gov.ar/derechos/#ancla18> and the actual text of the law in <http://www.infoleg.gov.ar/infolegInternet/anexos/35000-39999/39880/texact.htm> which clearly indicates no restrictions or conditions are imposed on middle class/formal workers in order to receive their additional compensations due to having a child.

of the drive toward neo-liberalism in the 1990s the public sector pay-as-you-go pensions underwent privatization and were transformed into a mixed public-private system in 1994. Its institutional make up was biased toward the accelerated development of the private component (Mesa-Lago 2009; Arza 2012). The private fully-funded component was administered by Administradoras de Fondos de Jubilaciones y Pensiones (AFJP).<sup>44</sup> Privatization was beset with numerous problems.<sup>45</sup> First, high levels of unemployment and labour market informality led to widespread inequality in coverage, preventing universal access to pension benefits. Second, privatization led to the divergence of funds from the public to the private system, thereby leading to growing financial imbalances in the former. Between 1994 and 2005 the state had to increase its own funding of the National Social Security System (NSSS) from 31.7 per cent to 62.4 per cent of aggregate revenue while contributions less current and capital expenditures of the NSSS deteriorated from -27.4 per cent to -50 per cent of total expenditures (Arza 2009). These increased public subsidies added further pressures to the state's fiscal imbalances.

The onset of economic recovery in the 2000s improved the finances of the public system as the fall in unemployment and declining informal employment generated increased worker contributions. From 2005, a sequence of steps redressed the inequities of the pension system making it more inclusive and universalistic. The 2007 Pension Act went the farthest in reversing the pro-private nature of the pensions system, followed by outright nationalization in 2008. One important result of the pro-public nature of the mixed system after the reform that allocated the insured by default to the public system was a massive improvement in the finances of the public system whose surplus increased as more workers shifted to it from the private component (Arza 2009: 18-19). Yet attempts to make the system more equitable were limited by the poor level of inflation indexation. However, the 2008 Pension Indexation Act approved by the National Congress attempted to redress this issue (Arza 2009: 23).

Given the poor performance of the private system and the global financial crisis of 2008, the nationalization had the support of a large majority of the population as per the Latinobarómetro survey (Arza 2012). Pension nationalization also contributed to the state's coffers in the post-2008 crisis context (Kay 2009). The nationalization absorbed the private pensions system into the public National Social Security Administration (ANSES). Assets in the individual retirement accounts were transferred to the Guarantee and Sustainability Fund, which constitutes a reserve or buffer fund in order to provide long-term financing (Arza 2009). Currently, the ANSES is flush with cash from the funds that had collected in the private system accounts, although it is unclear what its future financial viability is as the proportion of tax-financed benefit obligations have risen relative to contribution-financed ones (Hujo and Rulli 2014: 25). Another major challenge is universal coverage for all workers (including informal ones) and proper indexation of benefits.

In terms of the impact of pension reform, between 2005 and 2010 the coverage of persons over 65 increased from 68.9 per cent to 90.7 per cent with the main beneficiaries being women, the elderly below 70, and those with low income and little education. Both non- and semi-contributory benefits have increased social solidarity.

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<sup>44</sup> See Barrionuevo (2008) "Argentina Nationalizes \$30 Billion in Private Pensions," ([http://www.nytimes.com/2008/10/22/business/worldbusiness/22argentina.html?\\_r=0](http://www.nytimes.com/2008/10/22/business/worldbusiness/22argentina.html?_r=0), online newspaper accessed January 2014).

<sup>45</sup> Etchemendy and Garay 2011; Mesa-Lago 2009; Arza 2009.

The efficiency and viability of the public pensions system in Argentina depends on the resources it gets from workers' and employers' contributions, the relative growth of the formal sector, and transfers from the state. All of these sources of funds are to a large extent dependent on the ability of the country to maintain its high export-led growth trajectory. In short, this crucial arena of the Argentinian welfare state is very closely shaped by the neo-developmental business investment strategy and thus the nature of state-business relationship. While Etchemendy and Garay (2011: 297) claim without offering any evidence that the private sector pension fund companies were not opposed to nationalization, investor opinion was clearly reflected in the negative impact on Latin American stock indexes including Argentina's Merval index.<sup>46</sup> However, given Argentina's much reduced dependence on international finance (relative to the 1990s), the low credibility of international finance given its role in Argentina's debt default, and the 2008 global crisis, the state was in a politically strong enough position to push through the nationalization policy. Since then, it has expanded coverage and currently reaches almost 100 per cent, including many poor elderly who could not make contributions while they were young.

Another important social policy area is health. The health sector is divided into a public sector (mainly financed through taxes); a social health insurance or Obras Sociales sector which is mainly administered by unions and largely autonomous of the state; and the private sector (Cavagnero et al. 2006). The system is also fragmented geographically and by market segments, which increases its inequity (Maceira 2009). In spite of efforts to set up an integrated health system in the mid-1980s, these features have not changed since the recovery of democracy (Neri 2008). Nevertheless, major laws and reforms were implemented since 2003 including on reproductive health, generic drugs, primary health care, and tobacco consumption.

With regard to the public sector, neoliberal restructuring in the 1990s included decentralization, reducing the role of the Ministry of Health, which in the 1940's and 1950's had played a prominent role in the creation of a well-funded and effective health care system (Lloyd-Sherlock 2005). From the 1990s on, provincial and municipal governments have shouldered a greater burden of the public health cost and have relied on regressive out-of-pocket expenses (Cavagnero et al. 2006). The federal government accounts for around 2 per cent of total expenditure. The decentralization was primarily motivated by the goal of reducing business payroll taxes (Lloyd-Sherlock 2004: 103). This generated regional disparities between poorer and richer provinces in terms of the quality of health care provisioning (Lloyd-Sherlock 2004: 100).

The Obras Sociales are financed by mandatory payroll taxes on employers and workers. In the 1990s, employers' contributions to social insurance were reduced from 6 to 5 per cent although the former was restored with the onset of fiscal crisis of 2001-02 (Lloyd-Sherlock 2006: 358 and 359). This system is not egalitarian as there are inequalities between different Obras Sociales because of differences in wages. Further, the benefits of the Obras Sociales have only accrued to formal sector workers and their dependents (Lloyd-Sherlock 2006).

Finally, private health insurance companies and hospitals and clinics now constitute a large share of the health care sector. Even the Obras Sociales make use of their services

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<sup>46</sup> See McDonnell and Kraul (2008) "Latin Stocks Plummet Again on Argentina's Move," (<http://articles.latimes.com/2008/oct/23/business/ft-argentina23>, online newspaper accessed on December 25 2013).

as well as wealthier Argentinians who can purchase services not affordable to the rest of the population (Cavagnero et al. 2006).

### ***Comparison of fiscal policy in Argentina and Chile***

This section provides a comparison of tax and expenditure policies in the two countries as a way to understand their relative political trajectories. The purpose is to investigate the ways in which both business and popular mobilization after the return to democracy have shaped the fiscal priorities of the respective states.

Fiscal policy in Chile and Argentina has mainly served as a stabilization tool rather than a development instrument since the mid-1970s when both countries, under military rule, abandoned their state-led development model and embarked on free market-outward oriented policies that eventually came to be known as the Washington Consensus. This development approach focused on stabilization, the liberalization of trade and finance, and extended privatization.

In the case of Chile the country only managed to consolidate its neoliberal reform process after the mid-1980s following several setbacks including a major financial and banking crisis during 1981-1983. This market-led model has guided economic (including fiscal) policy to the present day, even after the restoration of democratic rule at the beginning of the 1990s, albeit with a greater focus on regulation and social policies. In comparison, the case of Argentina is more complex as following the restoration of democracy in the 1980s, the country has oscillated between regimes that support a greater level of government involvement (Alfonsín, Nestor and Christina Kirchner), while others (Menem) have tended to pursue greater market participation in social and economic activity.

In both Argentina and Chile, fiscal policy has maintained the objective of stability and promoting public and private savings. This materialized into a regressive and pro-business fiscal regime whose main pillars were established during the respective dictatorships, and which were not substantially modified following the restoration of democracy. The fiscal structure has, grosso modo, three features: low income and corporate taxation, high consumption/VAT taxation, and (as a result of the previous two) a regressive tax structure which does not raise sufficient funds to properly finance social investments.

Income taxes play a secondary role in revenue. Specifically, in Chile, corporate taxes and other fees that negatively affected the cost structure of firms and capital gains were eliminated or reduced decades ago. In the case of Argentina the state had more leeway to resist a decline in the corporate tax rate but the exemptions and levels of evasion remain high. As a result, these fiscal regimes have tended to rely heavily on regressive indirect taxation, in particular on VAT.

In Chile the current corporate tax regimes dates back to the beginning of the 1980s. The main goal of income and corporate taxation was to reduce the disincentive to save that was assumed to be typical of income taxes. Increased savings would result in greater levels of investment. In the case of firms, this meant that the portion of profits that was reinvested had to be taxed at a lower level than that part of profits that was distributed to shareholders or households. Moreover, the tax legislation unified individual and corporate tax income.

In practice, the tax regime for corporations currently in place is as follows. Firms are taxed on their investment returns with a ‘first category’ tax that involves a flat tax of 18.5 per cent.<sup>47</sup> The owners or shareholders also pay a personal tax called Global Complementary with a tax rate ranging from 5 per cent to 40 per cent (or additional tax in the case of non-residents with a tax rate of 35 per cent) which has an increasing progressive rate and is applied only when profits or investment returns are withdrawn or distributed. When this happens, the first category tax acts as a credit used to offset the additional taxes that have to be paid by firm owners or shareholders. In other words, the corporate tax is not a tax as such but is viewed rather as a credit that the owner or shareholder of a firm can deduct from her/his income tax payment.

While this lightweight corporate tax regime also includes capital gains as a part of the corporate gross income subject to taxation, it incorporates a large number of exceptions. These include: gains on the transactions of shares in corporations, publicly traded stocks, mining rights, and real estate. Given its importance for the economy, mining is granted a preferential tax regime with progressive tax rates ranging from 0 per cent to 5 per cent. The corporate tax regime is not only favourable to firms but also to individuals or households that are situated in the higher income brackets because it allows them to avoid or pay lower taxes.

In line with the corporate tax approach of Chile, Argentina also sought to reduce the tax burden on corporations (and also individuals) at the beginning of the 1990s. The corporate tax rate which stood at 33 per cent in 1985-1986 was reduced to 20 per cent. Also the personal income tax rate went from 45 per cent to 30 per cent in the same period. However, the reductions in the corporate tax rate turned out to be temporary and by 1998 the it was raised again to 35 per cent. In addition several other measures to widen its base were put in place. The changes over time within the corporate tax rate structure reflected the government’s capacity to increase its revenue potential. The tax on corporate income is the major income tax, accounting for more than 60 per cent of total income tax revenue (Cetrángolo and Gomez Sabaini 2007; WTO 2013).

The secondary role played by income taxes has placed indirect taxation as the cornerstone of revenue collection. One of the first and most important economic measures of the dictatorial regimes implemented in the early seventies in both Argentina and Chile was a fiscal reform that put indirect taxation, and, more precisely VAT, at the centre stage of its revenue collecting efforts.

The valued added tax was put in practice in 1975 with a general rate of 16 per cent (Argentina) and 20 per cent (Chile). Thereafter in both cases, the revenue potential of the VAT was augmented either by increases in the tax rate and/or tax base.

In Argentina, the VAT tax rate was increased from 16 per cent to 18 per cent in 1992 and then to 21 per cent in 1996. In tandem with the increase in the VAT rate the Argentine authorities also widened progressively its base to include basic goods and services. In a first stage between 1975 and 1980, the VAT was only applied to goods (non-service transactions) and its legislation included a wide array of exemptions. In the second stage (1980-1990) telecommunication services became subject to the payment of the VAT and the list of exemptions was reduced. From 1990 onwards the number of services subject to the VAT increased. Since 1998, exports and imports transactions

<sup>47</sup> Prior to the 1984 tax reform, corporations were taxed at a 46 per cent rate. The 1984 reform reduced the tax to 10 per cent which was increased to 15 per cent with the 1990 tax reform which remained in place until 2001. Thereafter the tax rate increased to 16 per cent at the beginning of the 2000s and 17 per cent in 2010. In 2011 and 2012 the rate was 20 per cent and 18.5 and it is supposed to settle in 2013 at a permanent level of 17 per cent.

were also included under the VAT legislation. Currently, although the VAT rate still stands at 21 per cent, some basic services are taxed at a higher rate of 27 per cent. In Chile, the VAT tax rate declined from 20 per cent to 18 per cent in 1998 and since 2003 has remained at 19 per cent. Since the implementation of the VAT its base has expanded over the years to include a wider number of goods and services such as insurance, constructions activities, and real estate property transactions. The VAT has currently very few exceptions and is applied on all goods, including basic necessities, and most services.

The implementation of the VAT in both countries no doubt helped to increase tax revenues. In the case of Argentina and Chile, between 1990 and 2010, tax revenue increased from 16 per cent to 33 per cent and from 17 per cent to 19.6 per cent of GDP, respectively. In both cases the VAT explains more than 40 per cent of that increase. As a result of the relative importance of VAT, the Argentinian and Chilean tax systems are regressive. Households at the lower end of the income bracket tend to spend a higher proportion of income on goods and services that are taxed by the VAT than households at the upper echelon of the income bracket.<sup>48</sup> Household surveys evidence shows that in Chile the poorest quintile and the richest quintile spend 91 per cent versus 88 per cent respectively of their income on VAT taxable goods (Iñiguez and Selva 2007). In Argentina, the 20 per cent poorest of the population bears 52.3 per cent of the tax burden (measured by the tax to GDP ratio), whereas the richest quintile bears 40 per cent of the tax burden (Gomez Sabaini et al. 2002). Classifying taxes according to their level of progressiveness by different periods in Argentine history since the middle 1980s to 2004-2006, it can be seen that the taxes which have a regressive distributional component have increased from 30 per cent of total revenue in the mid-1980s to 36 per cent in 2006 (remaining around that level since).

The regressive nature of the tax system exacerbates income inequalities. The Gini coefficient in Argentina before taxes equals to 48.7 and increases with the inclusion of income, VAT and payroll taxes to 55.9 (Pessino and Fenochietto 2007). The VAT tax accounts for seven percentage points of that increase alone. In Chile the imposition of taxes also increases the Gini coefficient albeit by a lower percentage than in Argentina: from 48.8 to 49.6 (Engel et al 1998).

Finally, the focus on stability, the secondary role of direct taxes, and heavy reliance on indirect and regressive taxation have limited the states' capacity to finance social investments. Chile shows a weak social expenditure base. Table 1 shows the functional classification of income as a percentage of GDP in Chile for the period 1990-2010 averaged by presidential period corresponding to Patricio Aylwin (1990-1994); Eduardo Frei (1995-2000); Ricardo Lagos (2001-2006) and Michelle Bachelet (2007-2010).

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<sup>48</sup> As put by Cetrángolo and Gomez Sabaini (2007: 53) for the case of Argentina: "the tax system behaves in the aggregate similarly to the VAT, and more generally to that of the taxes on consumption. Given the greater relative importance of these in the total, the result is regressiveness."

**Table 1. Chile. Functional classification of total expenditure by governments 1990-2010 (In percentages of GDP)**

	1990-1994 Aylwin	1995-2000 Frei	2001-2006 Lagos	2007-2010 Bachelet
Total expenditure	21.5	22.3	20.5	22.1
General functions	4.3	4.0	4.1	4.1
Social functions	13.4	14.8	13.7	14.2
Health	2.3	2.6	2.9	3.6
Housing	1.1	1.0	0.2	0.3
Social Protection	6.1	6.4	7.0	6.6
Education	2.7	3.5	3.6	4.0
Employment programmes	0.0	0.0	...	...
Others	1.1	1.4	...	...
Economic functions	2.7	3.0	2.5	3.3
Other	1.0	0.5	0.2	0.2

**Notes:** From 2001 onwards housing is classified under social protection.

**Source:** Government of Chile. Ministry of Finance. Estadísticas de las finanzas públicas, 1990-1999 (2000); 1999-2008 (2009); 2001-2010 (2011).

Social expenditure accounted on average between 13 per cent and 14 per cent of GDP for the entire period.

The table shows that in both the Frei and Bachelet governments social expenditures increased compared to the previous governments. On average, social expenditure accounted for 62 per cent of total expenditures during the period 1990-1994 increasing to 66 per cent in the periods 1995-2000 and 2011-2006, and settling at 64 per cent of the total in 2007-2010. In terms of its composition the table shows a trend of increasing expenditure on social protection, health and education. More importantly, however, is the fact that the rise in social expenditure has not reversed the rise in the profit share and the concomitant fall in the wage share since 2000 as shown in Figure 1 below.

**Figure 1: Chile. Evolution of the profit and wage share (Percentages of GDP), 1985-2011**

**Source:** Central Bank of Chile (1990-2011)

In Argentina, the social expenditure component has traditionally been higher than in Chile (more than 40 per cent higher than that of Chile, tables 1 and 2) and above that of the Latin American average (ranging between 15 per cent-19 per cent of GDP between

the middle of the 1990s and 2012). Social expenditure in the 1990s exceeded that of the early 2000s (right after the economic crisis). Nevertheless, social expenditure began to pick up after 2007. The largest increases in social expenditure are registered in the areas of social protection and education.

**Table 2: Argentina. Functional classification of social expenditure by governments 1990-2009 (In percentages of GDP)**

	1990-1999 Menem	1999-2001 De la Rúa	2002-2003 Duhalde	2003-2007 Kirchner N.	2007-2009 Kirchner C.
Social functions	20.2	21.8	19.4	20.3	24.9
Health	4.6	5.1	4.4	4.4	5.4
Housing	0.5	0.4	0.3	0.6	0.6
Social Protection	8.0	8.0	6.8	6.7	8.6
Education	4.1	5.0	4.2	4.7	6.0
Employment programmes	0.8	1.0	1.6	1.3	1.0
Others	2.0	2.2	2.0	2.4	2.9

**Notes:** The data refers to the consolidated public sector (central government and state owned firms) 1990-2010.<sup>49</sup>

**Source:** Secretaría de Política Económica y Planificación del Desarrollo (2014)

Moreover, the increases in social expenditure since 2007 should be understood as a transitory change in the country's fiscal regime. These expenditures are partly explained as a response to the 2008-2009 global financial crisis and its effects. Given the deceleration prospects of Argentina<sup>50</sup> and the recent uncertainties created by the US court decision on Argentina's defaulted bonds<sup>51</sup>, and thus lower expected tax revenues, it will be difficult for the government to sustain its current level of social spending given its fiscal responsibility laws and fiscal stability objectives unless revenues are increased.<sup>52</sup>

The construction of an effective and stable tax base, the challenge faced by Argentina and Chile, depends to a large extent on whether or not civil society deems taxes to be coercive rather than contractual (Moore 2008). In order to make taxes contractual, public services should be perceived (and be) fairly and efficiently delivered. For example, public investments of different types can benefit private investment while contributing to broader social and economic goals.<sup>53</sup> This eases the bargaining process between the state and civil society.

However, "civil society" is too vague a term given the huge inequalities within it. Thus low-income households may find higher indirect taxes coercive because of their regressive nature while economic elites may not do so at all. Corporations are likely to find higher tax rates coercive while the rest of society may find them necessary to

<sup>49</sup> See Latin America Consensus Forecast (February 2014).

<sup>50</sup> See, Latin America Consensus Forecast (February 2014).

<sup>51</sup> In 2001 Argentina defaulted on over US\$81 billion dollars of bonds issued in 1994. In 2005 and 2010 Argentina offered the holders of the 1994 bonds new bonds but at a loss of 70%. The majority of bondholders (91%) agreed to exchange their bonds. However a minority bond holders (called holdouts and also known as "vulture funds" due to their strategy to acquire defaulted sovereign debt issues at a very low price, only to later demand the totality of the payment via a judicial process) demanded the full value and interest of the 1994 bonds and won litigation process against Argentina led by a New York court.

<sup>52</sup> Argentina passed the Federal Fiscal Responsibility Law in 2004 and entered in force in 2005. It established rules for fiscal consolidation and to facilitate financial management by the national government and provinces. It set targets with respect to the rate of growth of primary public expenditure in the national and provincial budgets in relation to that of nominal GDP. It also established limits on provincial debt.

<sup>53</sup> See Moudud and Martinez Hernandez (2014) for the theoretical arguments made by different schools of economic thought regarding the positive effects of public investment as well citations to the considerably large empirical literature on this topic.



reduce inequality and fund the social safety net. In short, there is no mechanical formula or optimal tax composition.

## Conclusions

A key difference between Chile and Argentina is the high level of business cohesiveness in the former. This has allowed business-encompassing associations such as the CPC to effectively influence the policy-making process, thereby limiting the creation and extension of egalitarian T S & L policies. On the other hand, the greater level of inter-business rivalries in Argentina, and concomitantly fluctuating instrumental power, has enabled the state to push through important social policies demanded by many civil society groups.

Thus, the political pressure by civil society groups in Chile and the logic of capitalist investment in Argentina have produced distinctive PPMs in the two countries. In the former, this pressure has involved some important social achievements such as pension reform and more accessible healthcare, both of which have involved a significant departure from the market-driven model pushed for by business groups. At the same time, in Argentina, the new social model after the sovereign debt default has been coupled with policies that benefit private investment together with a push for export-led industrialization.

In both cases we see that the processes of political mobilization by business groups as well as unions and social movements over the past several decades have also produced changes in institutions which had been erected to promote neoliberalism. However, these institutional changes have occurred in the same deeply contested political context<sup>54</sup> as T S & L policies and shaped by the same forces described by the power-based approach to fiscal sociology and institutional development.

Thus, our paper has emphasized the constraints that the state faces in implementing egalitarian T S & L policies and in increasing social investments. These constraints are shaped by business structural and institutional power even as the democratic state is pressured from the larger society from which it seeks political legitimation to expand social protection. One constraint, which is common to both countries, pertains to the nature and levels of taxation with its excessive reliance on regressive taxes—key issues that relate directly to the structure of power relations in these two countries. With demands to reduce inequality and raise social protection from civil society, the political battle over the level and composition of taxes remains a key issue in these countries' attempts to become developmental welfare states. However, neither structural nor instrumental power is given and constant since they evolve due to political cycles (and elections) as well as economic cycles and development.

While low business productivity and competitiveness constrain progressive policies, paradoxically their relative economic weakness could work to the advantage of such policies if elements of these are coupled with incentives to promote productivity growth. Although difficult to design and negotiate, a suitable PPM could encourage such firms to gradually expand their markets (locally and internationally). This might

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<sup>54</sup> In this sense, our paper investigates the theme of business opposition to social democratic policies which other authors have studied with regard to OECD countries. See for example Phillips-Fein (Phillips-Fein 2009) and Paster (Paster 2012) who study the historically evolving nature of business opposition to progressive policies in the US and Germany, respectively. As Prasad (2006) points out, even in a highly socially coordinated economy such as Germany, employers have always been proponents of deregulation and policies to make labour markets more flexible.

increase the state's leverage over firms to implement egalitarian T S & L policies since both export-led and domestic market expansion can go hand in hand with higher profits, wages, and (social and productive) subsidies.

Concerted political pressure by unions and social movements is clearly necessary (if not sufficient) for democratic states to expand and sustain progressive T S & L policies. A PPM that includes these policies should also incorporate a more egalitarian tax base and promote private investment (involving, for example, direct subsidies or infrastructure investment) to garner business confidence. This is, today, the key challenge facing Argentina and Chile.

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