Institution: London School of Economics and Political Science		
Unit of Assessment: 22B – International Development		
Title of case study: Tax reform in Chile		
Period when the underpinning research was undertaken: 2011-2014		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	**Role(s) (e.g. job title):**	**Period(s) employed by submitting HEI:**
Tasha Fairfield	Associate Professor in Development Studies	2011 to present
Period when the claimed impact occurred: 2014-2020		
Is this case study continued from a case study submitted in 2014? No		

1. Summary of the impact (indicative maximum 100 words)

Dr Tasha Fairfield's research on taxation and top income shares in Chile has had a significant and direct influence on the design of a major tax reform initiated by the Bachelet government in September 2014. This reform has increased income tax receipts from economic elites, with additional revenue contributing to increases in social spending, notably via education reform. The research has made - and continues to make - important contributions to public debate on inequality in Chile.

2. Underpinning research (indicative maximum 500 words)

Dr Tasha Fairfield's comparative politics research analyses the political economy of inequality and redistribution, the politics of policy formulation, and business-state relations in Latin America. She has a long trajectory of research on Chile, dating back to extensive fieldwork on the politics of taxing economic elites initiated in 2005. The specific research that underpins the impacts described here grew out of that earlier work and was initiated with the goal of providing more detailed information to inform public debate on the very light tax burden that Chile's economic elites paid, in a context where strong business associations and aligned political parties regularly used their political influence to preclude redistributive reforms **[1]**.

Fairfield's 2016 *Review of Income and Wealth* article **[2]**, co-authored with Michel Jorratt and previously published as a working paper **[3]** in January 2014, contributed to research on inequality and world top incomes by presenting the first calculations of Chilean top income shares and effective tax rates using individual tax return microdata from 2005 and 2009. This research paid special attention to business income, which dominates at the top. The analysis included not only distributed profits but also the large proportion of accrued profits retained by firms, which were rarely the subject of analysis given the difficulty of identifying individual owners. This was the first study to explicitly include data on undistributed business profits, which were able to be imputed to the owners.

Analysis of the data revealed even the most conservative estimate of the income share of the top 1% to be 15%, the fifth-highest in the top incomes literature at the time. When distributed profits were adjusted for evasion, the share of the top 1% reached 22-26%. After broadening the income concept to include accrued profits, which were imputed to taxpayers using ownership shares calculated from business tax forms, the top share increased to a minimum of 23%. Despite this impressive concentration of income, the top 1% paid modest average effective income-tax rates of just 15-16%. Based on this evidence, Fairfield and Jorratt concluded that "there is substantial room to increase taxes on the rich in Chile. Such initiatives could contribute to reducing inequality, both by raising more revenue to finance social spending, and by helping to curtail the growth of top incomes" **[3]**, while paying close attention to redressing the incentives for evasion and avoidance that were created by the country's peculiar integrated income tax system.

This research was a collaborative effort by Fairfield and Jorratt. Fairfield initiated the research, specified the data required to bring the work into conversation with the world top incomes literature, obtained the funding, convinced the Chilean tax agency to grant access to the data, carried out the data analysis, and wrote the paper. Jorratt compiled the datasets, given his expertise as a long-term Chilean tax agency functionary. The authors regularly consulted on the procedures employed and the conclusions reached. It is worth highlighting that while two years of micro-data might strike economists as relatively meagre, this work represented a significant breakthrough given Latin American tax agencies' reluctance to provide any access whatsoever to tax returns information. Fairfield submitted multiple requests over a period of seven years, all of which were turned down, before ultimately obtaining approval from the Chilean tax agency.

This study builds on Fairfield's previous research, published in *Private Wealth and Public Revenue in Latin America: Business Power and Tax Politics* **[1]**, which analysed political obstacles to enacting more progressive taxation in Chile, specifically, and in highly unequal democracies more broadly. In Chile, increasing the corporate tax and, in particular, taxing retained business profits is critical to raising revenue and improving progressivity (i.e. a system in which tax rates increase as taxable income increases) **[1]**. Chile's integrated income tax, which taxed retained profits at very low rates, was intended to increase investment, but in practice business owners found many ways to consume these profits without ever paying the higher taxes owed on distributed profits. Business's very strong instrumental (political) power, arising from close ties to right-wing parties, strong organisation, and institutionalised consultation with the executive branch, had long hindered efforts to increase progressive taxation, until student movement mobilisation counterbalanced business power and created opportunities for reform in 2014. Fairfield's later works **[1] [4] [5]** have analysed the political circumstances leading up to reform.

3. References to the research (indicative maximum of six references)

[1] Fairfield, T. (2015). *Private Wealth and Public Revenue in Latin America: Business Power and Tax Politics*. Cambridge University Press. ISBN: 9781107088375.

[2] Fairfield, T. and Jorratt, M. (2015). Top income shares, business profits, and effective tax rates in contemporary Chile. *Review of Income and Wealth*, 62 (S1), pp. 120-144. DOI: 10.1111/roiw.12196.

[3] Fairfield, T. and Jorratt, M. (2014). *Top Income Shares, Business Profits, and Effective Tax Rates in Contemporary Chile*. International Centre for Tax and Development Working Paper 17. Available at: https://cutt.ly/lhqLpTB

[4] Fairfield, T. (2015). Structural power in comparative political economy: perspectives from policy formulation in Latin America. *Business and Politics*, 17(3), pp. 411-441. DOI: 10.1515/bap-2014-0047.

[5] Fairfield, T. and Garay, C. (2017). Redistribution under the right in Latin America: electoral competition and organized actors in policymaking. *Comparative Political Studies*, 50(14). pp. 1871-1906. DOI: 10.1177/0010414017695331.

[6] Fairfield, T. (2013). Going where the money is: strategies for taxing economic elites in unequal democracies. *World Development*, 47, pp. 42-57. DOI: 10.1016/j.worlddev.2013.02.011.

This research was funded by a peer-reviewed grant awarded by the International Centre for Tax and Development. **[1]** won the 2016 Latin American Studies Association Donna Lee Van Cott Award for Best Book on Latin American Political Institutions. **[5]** won the 2019 Latin American Studies Association prize for Best Article (Politics and Economics). A Spanish-language translation of **[6]** was also published in *Revista de Economía Institucional,* Universidad Externado de Colombia.

4. Details of the impact (indicative maximum 750 words)

The underpinning research has had a significant and direct influence on the design of a major tax reform in Chile, which was enacted into legislation in September 2014. The research has contributed to continuing parliamentary and public debate on the issue of tax and inequality, and its importance has been recognised by a former President of Chile. The reform has had its intended redistributive effect: average taxes paid by the top 1% of earners rose by 47.5% between 2014 and 2018, with the additional revenues contributing to increased social spending, notably in public education. Further details on these impacts are included below.

Direct influence on Chilean Government tax policy

Shortly after her inauguration in March 2014, President Bachelet's administration seized the opportunity created by student mobilisation to propose an ambitious tax system overhaul. In the 1980s, the Pinochet dictatorship had established an integrated income tax regime: the corporate tax (20% in 2012) served as a credit against personal income taxes capital owners became subject to upon receiving dividends or distributed profits. Since the top marginal personal income tax rate was much higher (40%), capital owners left most of their profits in their firm, where they paid only the low corporate tax. While this system was intended to promote investment, the large gap between the corporate and personal income tax rates also stimulated massive tax avoidance and evasion **[1]**, which meant that in practice, capital owners in the top 1% paid low effective tax rates of roughly 15% **[2] [3]**.

To eliminate these problems, the Bachelet government proposed an innovative imputed profits tax regime. This was designed by Jorratt, who was known to the administration as a previous Head of the Studies Division at the Chilean Internal Revenue Service. Jorratt has subsequently confirmed that the government's proposal drew extensively upon the underpinning research. Particularly, its previously unavailable data on undistributed profits provided an evidence base that "*had a major impact on the design of the reform*" **[A]** in four key ways:

1. By quantifying the scale of the problem of undistributed profits (in the form of under-declared business withdrawals and dividends).
2. In identifying the high concentration of the Taxable Profits Fund (FUT) - the mechanism by which companies could gain tax exemptions on reinvested profits - held by the richest (at least 70% of the retained earnings on which income tax had not been paid belonged to the richest 1%).
3. In identifying the high concentration of accrued earnings (not currently subject to the higher rates).
4. By revealing the low tax rates paid (the richest 1% in Chile paid just two-thirds of what the richest 1% were paying in the USA) **[A]**.

According to the government proposal, the FUT would be eliminated, meaning all profits, whether reinvested or distributed to owners, would enter the individual income tax base **[A]**. These important modifications, while having only a small impact on the vast majority of Chileans, would ensure that wealthier taxpayers would pay higher effective rates.

An International Monetary Fund (IMF) analysis welcomed the tax reforms, noting how the substantial increase in tax revenue would finance greater outlays on education and health, and also help to address inequality in Chile: "*Improving access to high-quality education will help improve both Chile's long term growth prospects and reduce Chile's skewed income distribution. And eliminating the structural fiscal deficit will help preserve Chile's strong public finances and fiscal buffers*" **[B]**. The key Fairfield and Jorratt paper **[3]** is cited in the IMF analysis **[B]**. Press reports at the time (e.g. CIPER-Chile) also make clear the critical contribution of the underpinning research **[3] [C]**.

The extensive reform package included multiple other measures to curtail evasion and avoidance **[D]**, many of which were considered in prior years but deemed politically infeasible given business's strong instrumental power. This has been acknowledged by former President (2000-2006), Ricardo Lagos, who also paid tribute to the research: "*To increase taxes in Chile has always been very difficult politically, but today we have the opportunity to make a very important advance in this matter, thanks to the contribution of Fairfield and Jorratt*" **[E]**.

Overall, the government's projections for increased tax revenues were equivalent to 3% of national GDP **[D]**.

Informing parliamentary and public debate on proposed tax reforms

The underpinning research continued to have an important role informing parliamentary and public debate in Chile following the announcement of the reform initiative in March 2014. Findings from the research **[2] [3]** were cited in a June 2014 parliamentary session by a legislator speaking in favour of the reforms **[A]**, while copies of the original working paper itself **[3]** were delivered to the

Finance Commission where they were made available for review by senators **[A]**. Fairfield also presented the research to informal groups of academics and party activists and discussed its findings during informal meetings with members of the governing coalition **[4]**. National news reports (e.g. *El Mostrador*, *Diario Financiero*) picked out Jorratt as a key figure in the reforms and noted the circulation of the key paper **[3]** among private sector tax lawyers and their clients **[F]**.

Changes to tax legislation and subsequent social and economic benefits

In September 2014, Chile's Congress approved the tax reforms bill **[G]**. According to the *Reuters* report: "*The passing of the bill into law is Bachelet's biggest political success since she returned to the presidency of Chile*" **[G]**.

While the administration succeeded in moving the tax reforms quickly though the lower house with only minor modifications, in December 2015, concerted opposition from business and associated concerns regarding investment in the context of an unforeseen economic slowdown prompted the Finance Ministry to draft a compromise bill in the senate, introducing some amendments to the original proposals. The imputed profits regime was adjusted, meaning taxpayers could instead opt into a partially de-integrated income tax system with a 27% corporate tax, where 65% of the tax paid by the firm is creditable against the personal income tax **[H]**. Even in spite of this politically-imperative compromise, the reform remained a major tax increase on the wealthiest Chileans - the most significant since democratisation in 1990 - and, crucially, government officials indicated that the proposed simplifications would not result in a reduction of projected tax revenues, and the bill would not fundamentally affect the redistributive changes that were at the core of the original 2014 legislation **[H]**.

The reforms have proven successful in redistributing income in Chile, a country known for its extreme levels of inequality **[2] [3] [I]**. Increased tax revenues have helped, for example, to finance a major education reform, which extended scholarships for low-income university students (i.e. those in the bottom 60% of the household income scale), among other measures to strengthen public education **[J]**. Citing World Bank data **[K]**, *Americas Quarterly* reports the success of the reforms in achieving their primary goal of increasing tax revenues from the highest earners: "*Above all, the reform made the tax code more progressive, raising taxes on corporations and top earners. The top 1%, for example, saw their average taxes rise by 47.5% according to the World Bank. The reform also removed opportunities for tax evasion and implemented new excise taxes on tobacco, alcohol, and sugary drinks, and 'green taxes' on carbon and motor vehicles – part of the reason Chile is now a regional leader in renewable energy, with half of Latin America's installed solar capacity*" **[I]**.

The reforms have helped to underpin a gradual increase in social spending from 15% in 2014 to 16.4% in 2018 **[L]**. More detailed analysis of the tax reform's impact on revenue and inequality is a pending project for economists to carry out, that will require extensive additional data and assessment of many complex modelling assumptions.

Continuing contributions to public debate on inequality in Chile

The findings and analysis of the underpinning research continue to inform public commentary and debate on wider issues relating to inequality in Chile. The research **[1] [3]** has been cited in media articles on the strategies of control used by political elites **[M]**, on corporate corruption **[N]**, on Thomas Piketty's analysis of inequality in Chile **[O]**, and in various pieces on tax avoidance and evasion **[P]**. More recently, anecdotal evidence conveyed to Fairfield by a previous member of the Bachelet administration indicates that the research **[3]** played an important role in strengthening the centre-left coalition's campaign to push back against the subsequent right-wing Piñera administration's (2018-present) unsuccessful efforts to overturn the 2014 reform and revert to the less equitable integrated income tax system that previously prevailed **[Q]**.

The enduring impact of the research is perhaps best exemplified by former President Lagos: "*I believe that the document written by Tasha Fairfield and Michel Jorratt **[3]** is very important. For a long time this document will be the source for discussing the issue of income and wealth distribution in Chile...I believe that there will be a before and an after in Chile in this matter. It will be very important for Chile in light of the debate that is taking place, especially after Thomas Piketty's work*" **[E]**.

5. Sources to corroborate the impact (indicative maximum of 10 references)

[A] Supporting statement from Director of the Internal Revenue Service, Chile. English-language translation and Spanish-language original provided.

[B] IMF Country Report No. 14/219, Chile: Selected issues paper, International Monetary Fund, July 2014.

[C] "La radiografía del cerebro tributario de Bachelet al 1% más rico de Chile", CIPER, 14 February 2014.

[D] "Factbox: Chile tax reform set to be approved", *Reuters*, 10 September 2014

[E] Supporting statement from Ricardo Lagos, President of the Republic of Chile (2000-2006), July 2014. English-language translation and Spanish-language original provided.

[F] "The key men for the success of the tax reform: Alberto Cuevas in Finance and Michael Jorrat 'fine-tuning' the SII", *El Mostrador*, 13 March 2014.

[G] "Chile passes landmark tax reform into law", *Reuters*, 11 September 2014.

[H] "Chile: Legislation intended to simplify provisions of 2014 tax reform", KPMG, 16 December 2015.

[I] "Michelle Bachelet's Underappreciated Legacy in Chile", *Americas Quarterly*, 9 March 2018, which cites "Chile Efectos Distributivos de la Reforma Tributaria de 2014", World Bank (**[K]**; see Table 7, p. 35).

[J] "Why Chile's Controversial Education Reforms Are Likely to Last", *World Politics Review*, 14 April 2017.

[K] Blanco Cossio, Fernando Andres (2016). Chile - Distributional effects of tax reform 2014. Washington, DC: World Bank Group. (See Table 7, p. 35).

[L] Economic Commission for Latin America and the Caribbean, social investment database.

[M] "Researcher at the London School of Economics breaks down strategies of the Chilean elite to avoid tax hikes", CIPER, 21 December 2015.

[N] "The zombies that Penta, LAN and Falabella used to try to evade taxes", CIPER, 27 March 2017.

[O] "Rolf Lüders and Juan Andrés Fontaine confront Thomas Piketty's approaches", *Economía y Negocios*, 16 January 2015.

[P] "Portrait of the elite who evade taxes and declare themselves respectful of the law", CIPER, 25 March 2019.

[Q] Source: former Bachelet government employee – corroborating contact details provided.