Economics Elite, Political representation and Taxation Level: The case of Chile

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THE CASE OF CHILE

- Chile is the 7th most unequal country in the world (World Bank, 2016).

- The Chilean government collects only 21% of GDP on taxes. Second lowest in the OECD.

- Wealth is concentrated: the wealthiest 1% of the population owns 33% of the income. Wealthiest 5% owns 51.5% of the income. (Martinez-Aguilar, Fuchs, Ortiz-Juarez, & Del Carmen, 2017; PNUD, 2017).

THE CASE OF CHILE

- Chile has a conflicting history of political instability

- Every forty year the country has a major crisis (1851, 1891, 1931, 1973)

- And history is repeating…

Chile is today in a major crisis

CHILE TODAY

A protest in Santiago, Chile, on Monday after a weekend of riots and clashes with soldiers and police that left 11 dead. Cristobal Olivares/Bloomberg, via Getty Images

Chile Today

CHILE TODAY

- Main cities were militarized

- Demands for social services (retirement, education and health).

- Biggest protest in the history of the country (1.2m in Santiago + 1m in other cities)

CHILE TODAY

- Protests are against benefits of the elite

- Collusion of private companies (supermarkets, pharmacies, and others)

- Corruption

- Transport prices

CHILE TODAY

- General unrest in the Population

- 100+ Buses, 12 Subway stations Burned

- ¼ of all Supermarkets burned or sacked

- 20+ deaths, thousands injured
- 1000+ in detained or in jail

Chile Learns the Price of Economic Inequality

Protesters are demanding a larger share of the nation's prosperity — a reality check for its celebrated economic model.

By The Editorial Board

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Oct. 22, 2019

THE CASE OF CHILE

- Economic Elite Capture in the context of highly unequal country

- Influence of Economic Elite on Taxes
  - The main source of State revenue
  - Vital for State building and provision of services
  - One of the most effective way to reduce economic inequality (OECD 2016)

INTRODUCTION

- Political Elite Capture: the process of wealthy elites taking steps to influence regulatory and fiscal policies.

- Elite capture is linked to:
  - Monopolies
  - Import quotas
  - Rents extracted from mining profits
  - Reductions and restrictions on welfare programs
  - Privatization of State companies
  - Haiti, Ghana, Indonesia, and Russia (Alatas et al., 2019; Appel, 2004; Singh & Barton-Dock, 2015; Standing & Hilson, 2013).
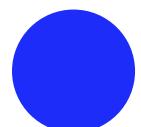
INTRODUCTION

- The political dominance of landed or rural elites is related to:
  - rural labor oppression,
  - voter suppression,
  - slow emergence of democracy,
  - The return to authoritarian governments in Latin American countries (Acemoglu & Robinson, 2005, 2008; Albertus, 2017; Baland & Robinson, 2008).

- Intra-elite conflict has been associated with changes in taxation policy (Beramendi et al., 2018; Mares & Queralt, 2015)

EMPIRICAL CHALLENGES OF CAPTURE
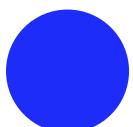
- Capture is hard to detect (Carpenter, 2004)

- Capture is intangible (Dutta, 2009),
  - corruption, lobby, or direct influence

- Mares & Queralt (2015) and Fresh (2016) use the direct identification of politicians.

- "Politicians whose interests were tied to owners of fixed assets were more willing to support their policies". Mares & Queralt (2015)

Two Theoretical Models:

I will test/review two complementary theoretical models.

- Intra-elite competition: Beramendi et al. (2018)

- De Facto Power of the Elites: Acemoglu & Robison (2006)

TWO THEORETICAL MODELS: INTRA-ELITE CONFLICT

- Landowner elites and Industrials elites historically in conflict.

- In late industrializing countries the economic elites will unite and foster incentives to reduce, or control the taxation. Beramendi et al. (2018)

- Beramendi and company argue that indirect taxes are the reason of coordination..

- Use proxy of political exclusion and participation variables to detect economic elites.

- This paper will review this theory using a direct identification of wealthy firm and landowners and associate their representation in congress to the tax level.

TWO THEORETICAL MODELS: *DE FACTO* POWER AND INSTITUTIONS

- Elites with power will affect institutions. Acemoglu & Robinson (2006),

- The income distribution and resources define the allocation of *de facto* power (money, influence, armed forces, or others).

- Groups with *de facto* power have incentives to change or modify institutions to maintain or increase their power.

- This generates new institutions, that define future economic distribution

Two Theoretical Models
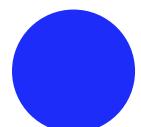
- If a group of the population has sufficient *de facto* power, they will invest in political and economic institutions favorable for them. Acemoglu and Robinson (2006)

- This paper tests if shock in *de facto* power affects the influence elites: Price shocks and institutional shocks.

- This will be used to re-test the theory of Beramendi et al.

DATA: THE POLITICAL ELITE

Can we identify the Economic Elite in a country?

- The book *Chilean Rural Society* showed that between 1854 and 1918, around 50% of all Chilean legislators were large landowners (Bauer, 1975).
- In the mid-1960s, over 60% of the landowning class in Chile was related to the business elite in the mid-1960s (Zeitlin & Ratcliff, 1988a).
- Strategy: Direct identification of Economic Elite members in Congress and Government.

Data: The Political Elite

- Data: Biographies National Congress, Biographic Dictionaries etc. Congress and Secretaries of state between (1891-1973).

- (2500+ Bio, 4000 seats, 98%)

- Methodology: Two RAs code the biography, a third double checks differences.

DATA: THE POLITICAL ELITE

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- Land-owners: owners of big farms (over 500 hectares)

- Firm owners: owners of mines, newspapers, factories, industries, etc.

Descriptive Results

Firm and Land Owners - Congressmen
(Proportion of Chilean politicians)

Firm Owners — Land Owners

Author's own work

DESCRIPTIVE RESULTS
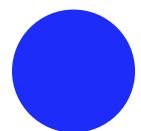
A proxy for upper-class: Private Education

- In many countries the economic elite attends private high schools and Universities.

"the school, rather than the upper-class family – is the most important agency for transmitting the tradition of the upper classes, regulating the admission of new wealth and talent"
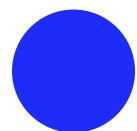
(Mills, 1956).

- Similar to England and USA, upper classes in Chile tend to attend private high schools and elite Universities.
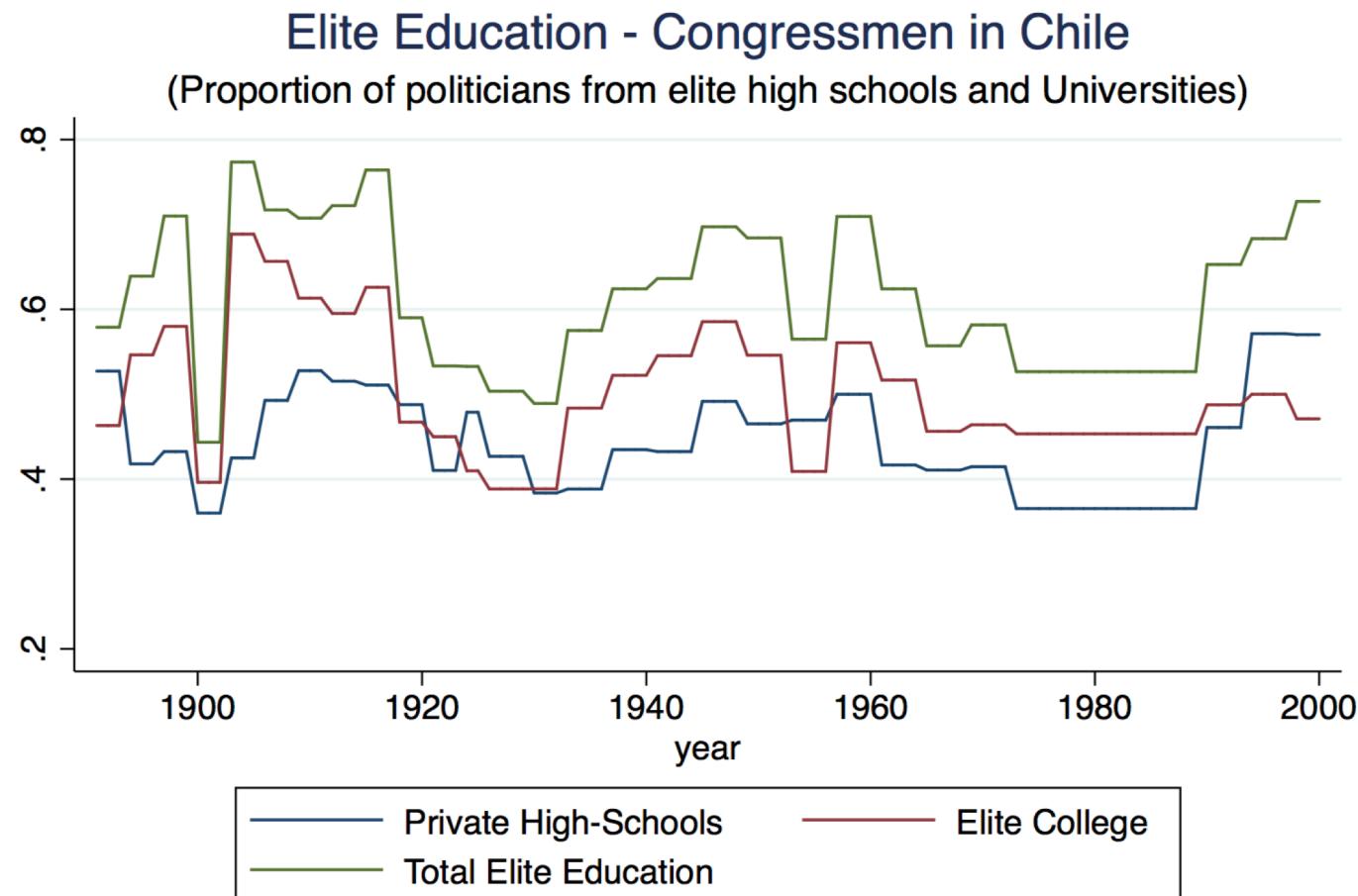
ELITE SCHOOLS IN BUSINESS AND POLITICS

- In 1954, in the first cabinet of President Jorge Alessandri, 81% of his secretaries of state attended private high schools; of these, one half came from just three private high schools.

- Using data from Zeitlin & Ratcliff. analyze bank CEOs in 1960; of these, 54% attended private school and 23% went to the same three high schools.

- In 2010, 86 %of the secretaries of state of President Sebastian Piñera. 50% attended the four private schools.

- An analysis of the top 100 Chilean companies by market capitalization, reported by a Chilean newspaper, revealed that 86% of their CEOs attended private schools; and 50% of them attended the same high schools (La Tercera 2012)

DESCRIPTIVE RESULTS

Elite Education - Congressmen in Chile
(Proportion of politicians from elite high schools and Universities)

Author's own work: Elite College: University of Chile and Catholic University

DATA: THE POLITICAL ELITE

- Coded Biographies: Congress and secretaries of state (1891-1973).
- Taxation level and Direct Tax Share: Beramendi et al. (2018)
- GDP, Industrial production and other controls from World Bank.
- International Commodity Prices (Source EH Clio Lab PUC)

METHODOLOGY

Coordinated Elite

- Methodology: OLS: explain Taxes using the proportion of wealthy landowners and firm owners in congress, following Beramendi et al., (2018)

De Facto **Power**

- Methodology: IV.

International Prices of commodities that disproportionally affect landowners and firms owners

- Methodology: Structural Shock

The 1958 electoral reform introduced secret ballot, reducing the patronage in rural areas (Baland & Robison 2008)

METHODOLOGY

- Methodology: OLS

$$Tax\ to\ GDP_t = \beta_0 + \beta_1 Land\ Owners_t + \beta_2 Firm\ Owners_t + \beta_3 GDP_t$$

$$+\beta_4\ Tax\ to\ GDP_{t-1} + others + \epsilon_t$$

$$Tax\ to\ GDP_t = \beta_0 + \beta_1 [Land\ Owners_t + Firm\ Owners_t] + \beta_2 GDP_t$$

$$+\beta_3\ Tax\ to\ GDP_{t-1} + others + \epsilon_t$$

METHODOLOGY

- Methodology: IV

  - Use of external price shocks that disproportionately affect the economic elite, but should have a smaller impact on the Economy.

  - International Prices of Wheat, Copper & Salpeter

METHODOLOGY

- Methodology: IV

  - Stage I:

$$Land\ Owners_t = \beta_0 + \beta_1 Land\ Owners_{t-1} + \beta_2 Wheat\ Prices_t + \beta_3 GDP_t$$

$$+others + \epsilon_t$$

  - Stage II:

$$Tax\ to\ GDP_t = \beta_0 + \beta_1 \widehat{Land\ Owners}_t + \beta_3 GDP_t$$

$$+\beta_4\ Tax\ to\ GDP_{t-1} + others + \epsilon_t$$
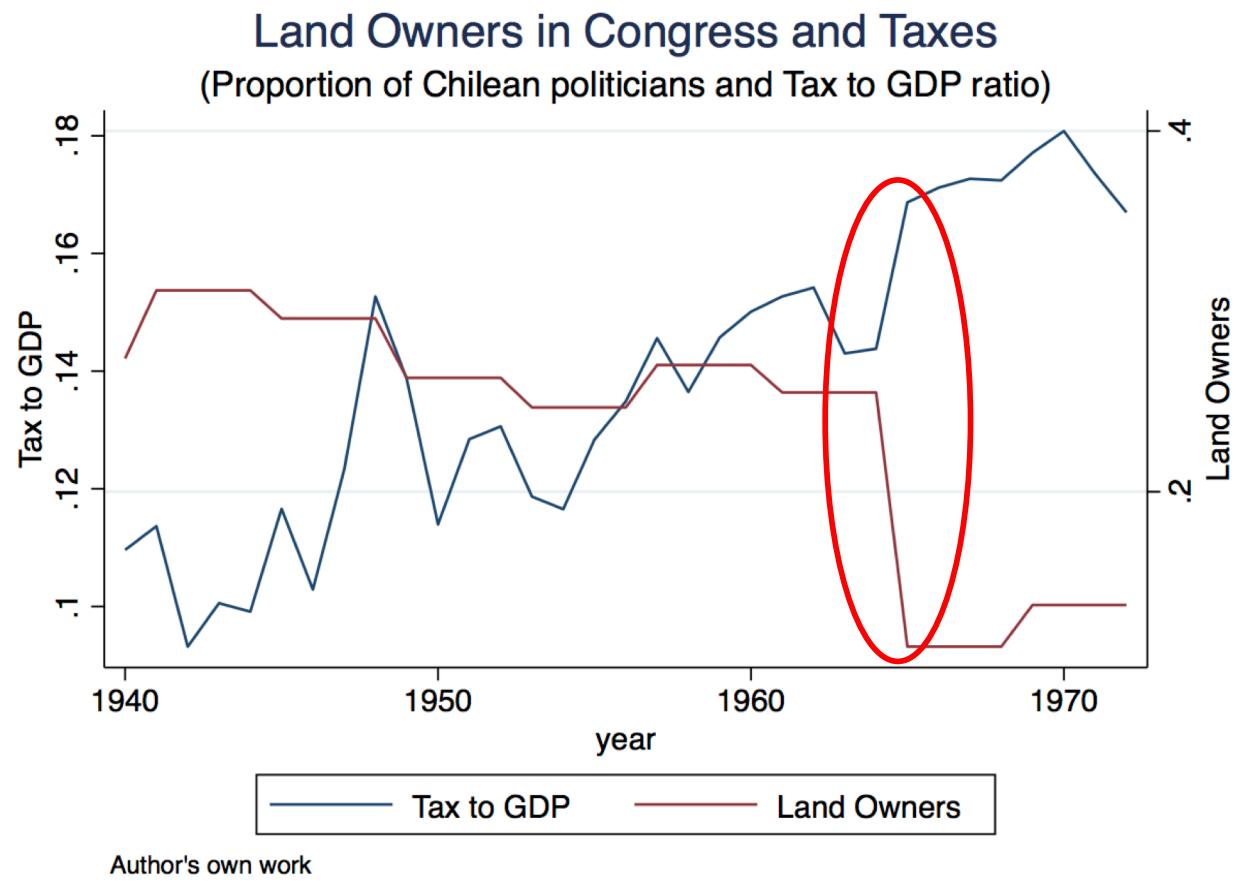
METHODOLOGY

- Methodology: Policy Shock

- 1958 Electoral reform that implemented the secret ballot.

- This policy significantly reduced electoral patronage.

- Reduced votes in rural areas for right wing parties, traditionally associated with the landed oligarchy (Baland & Robinson, 2008)

METHODOLOGY

- Methodology: Policy Shock

Land Owners in Congress and Taxes
(Proportion of Chilean politicians and Tax to GDP ratio)

Author's own work

$$Tax\ to\ GDP_t = \beta_0 + \beta_1 SHOCK\ 1965 + \beta_3 GDP_t + \beta_4\ Tax\ to\ GDP_{t-1} + others + \epsilon_t$$

RESULTS: OLS TAX TO GDP

TABLE 1
OLS REGRESSIONS(1890-1973)
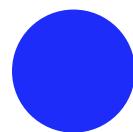
	taxgdp	taxgdp	taxgdp	taxgdp	taxgdp	taxgdp
Elite School Secretaries	-0.00220					
	(0.00638)					
lngdppc_lag	0.0353***	0.0370***	0.0354***	0.0402**	0.0407***	0.0383***
	(0.0117)	(0.0113)	(0.0109)	(0.0176)	(0.0112)	(0.0111)
leftgov_lag	-0.00488	-0.00356	-0.00495	-0.00237	-0.00264	-0.00431
	(0.00391)	(0.00354)	(0.00348)	(0.00319)	(0.00350)	(0.00349)
directtaxshare_lag	0.0425**	0.0378*	0.0540***	0.0374*	0.0368*	0.0403**
	(0.0198)	(0.0199)	(0.0197)	(0.0220)	(0.0188)	(0.0195)
taxgdp_lag	0.593***	0.580***	0.577***	0.497***	0.495***	0.520***
	(0.0946)	(0.0943)	(0.0930)	(0.131)	(0.104)	(0.0967)
Elite School MPs		-0.0339				-0.104**
		(0.0331)				(0.0467)
Elite College MPs			0.0267			
			(0.0179)			
Landowners MPs				-0.0435*		
				(0.0251)		
Firm MPs				-0.0344		
				(0.0249)		
Land + Firm					-0.0377**	
					(0.0184)	
Elite School and College						0.0978**
						(0.0469)
Constant	-0.243***	-0.240***	-0.258***	-0.258**	-0.262***	
	(0.0844)	(0.0796)	(0.0805)	(0.126)	(0.0790)	(0.0469)
Observations	82	82	82	82	82	82
R-squared	0.877	0.878	0.880	0.883	0.883	0.885

RESULTS: OLS DIRECT TAX SHARE

- No significant results.

RESULTS: IV

RESULTS: IV: FIRST STAGE

	TABLE 2					
	FIRST STAGE REGRESSIONS					
VARIABLES	Elite Secretaries	Elite School MPs	Elite College MPs	Firm MPs	Land MPs	Land +Firm MPs
Elite School MPs Lag		0.327***				
		(0.0685)				
Agriculture GDP		0.0416***	0.0545***	-0.0208	0.00763	-0.0141
		(0.0133)	(0.0186)	(0.0143)	(0.00954)	(0.0178)
Manufacture GDP	0.0145	7.39e-05	0.00915	0.0200*	0.00601	0.0257*
	(0.0404)	(0.0110)	(0.0165)	(0.0116)	(0.00793)	(0.0144)
Wheat price	0.0133*	0.00673***	0.00469*	0.00536***	0.00246*	0.00907***
	(0.00691)	(0.00180)	(0.00266)	(0.00199)	(0.00137)	(0.00268)
Copper price	3.81e-06	-7.02e-07	3.81e-07	-9.94e-07	-2.58e-06***	-3.96e-06***
	(3.71e-06)	(8.93e-07)	(1.33e-06)	(9.46e-07)	(7.22e-07)	(1.27e-06)
Elite Secretaries Lag	0.791***					
	(0.0667)					
Elite Colle MPs Lag			0.585***			
			(0.0659)			
Firm MPs Lag				0.800***		
				(0.0598)		
Land MPs Lag					0.765***	
					(0.0652)	
Land+Firm Lag						0.721***
						(0.0662)
Constant	-0.112	0.206***	0.0998**	-0.00905	0.0505**	0.0572
	(0.0848)	(0.0403)	(0.0450)	(0.0271)	(0.0226)	(0.0385)
Observations	82	83	83	82	82	82
R-squared	0.724	0.395	0.575	0.759	0.798	0.775

RESULTS: IV: SECOND STAGE
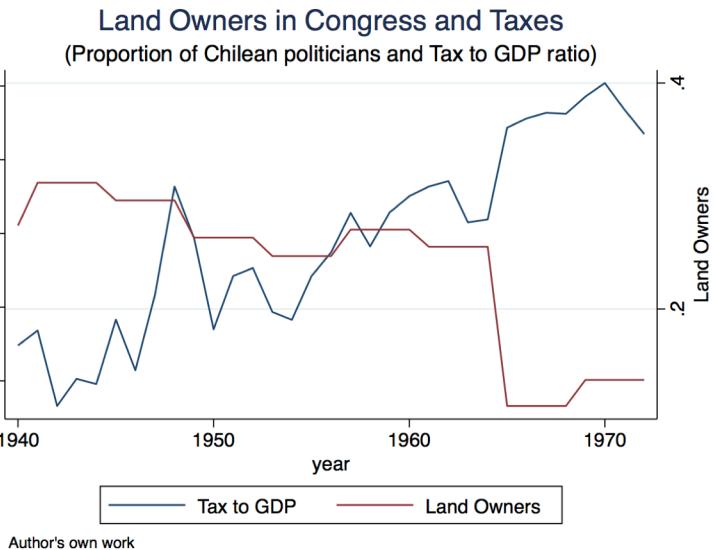
TABLE 3 **Second Stage Regressions**						
	(1)	(2)	(3)	(4)	(5)	(6)
VARIABLES	taxgdp	taxgdp	taxgdp	taxgdp	taxgdp	Taxgdp
Elite Secretaries	-0.00146					
	(0.00886)					
execrecruit_lag	-0.0228	-0.000288	-0.0429	-0.0458	0.0277	-0.00940
	(0.0432)	(0.0446)	(0.0498)	(0.0435)	(0.0537)	(0.0410)
polcontest_lag	0.254	0.0128	0.478	0.505	-0.309	0.101
	(0.461)	(0.482)	(0.526)	(0.462)	(0.579)	(0.434)
lngdppc_lag	0.0254	0.0354	0.0272	0.0281	0.0366***	0.0365***
	(0.0176)	(0.0223)	(0.0175)	(0.0173)	(0.0193)	(0.0180)
leftgov_lag	-0.00419	-0.00341	-0.00474	-0.00361	-0.00144	-0.00184
	(0.00424)	(0.00381)	(0.00353)	(0.00345)	(0.00390)	(0.00358)
directtaxshare_lag	0.0449	0.0322	0.0616	0.0411	0.0402	0.0363
	(0.0348)	(0.0344)	(0.0387)	(0.0326)	(0.0335)	(0.0328)
taxgdp_lag	0.644***	0.573***	0.600***	0.576***	0.556***	0.509***
	(0.104)	(0.110)	(0.0991)	(0.109)	(0.120)	(0.122)
Elite School MPs		-0.0428				
		(0.0679)				
Elite College MPs			0.0338			
			(0.0292)			
Firm MPs				-0.0476		
				(0.0295)		
Land MPs					-0.0636	
					(0.0443)	
Land + Firm MPs						-0.0474***
						(0.0238)
Constat	-0.162	-0.224	-0.186	-0.163	-0.244***	-0.223***
	(0.130)	(0.150)	(0.130)	(0.128)	(0.142)	(0.131)
Observations	81	82	82	81	81	81
R-squared	0.880	0.878	0.882	0.885	0.879	0.885

RESULTS: POLICY SHOCK

o Results: Shock

Land Owners in Congress and Taxes
(Proportion of Chilean politicians and Tax to GDP ratio)

Author's own work

	TABLE 4 OLS REGRESSIONS- STRUCTURAL CHANGE(1940-1973)		
	Tax to GDP	Direct Tax Share	
tendency	0.00330**	0.00210	
	(0.00128)	(0.00376)	
dummy1965	0.0124**	0.0611***	
	(0.00476)	(0.0218)	
lngdppc_lag	-0.112	-0.241	
	(0.0776)	(0.181)	
taxgdp_lag	0.262	0.322	
	(0.202)	(0.633)	
Constant	-5.425***	-1.911	
	(1.941)	(6.043)	
Observations	32	32	
R-squared	0.875	0.283	

CONCLUSIONS

- Aligned with theory: Proportion of wealthy landowners and firm owners in congress is related to taxation level.

- Economic shocks that disproportionally affect the Economic Elite, have and effect in their hold on power, and later taxation level.

- Political shocks that reduce patronage reduce hold on political power, and later influence of the Economic Elite.

FUTURE WORK

- Improve IV Regressions

- Look for details of debate of Tax discussions and votes in congress.

- Add recent time period, with a focus on indirect taxation

THANK YOU