THE ROLE OF DOMESTIC POLITICS

IN THE 2006 CORPORATE TAX REFORM IN TURKEY

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DECLARATION OF ORIGINALITY

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ABSTRACT

The Role of Domestic Politics

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This thesis examines domestic political factors that made the 2006 corporate tax reform possible by exploring thematic patterns within the political debate around the reform. The 2006 reform decreased the corporate tax rate radically by 10 percent along with other regulations on corporate taxation. While the literature on tax policy changes explains the global trend of decreasing rates of corporate tax based on tax competition as an exogenous factor, this thesis investigates the role of domestic actors in the process leading to a corporate tax reform in the selected country case. The thesis relies on a thematic analysis of the following documents: policy papers published by two key business organizations and the government, media reflections of the discussions around the corporate tax reform between 2001 and 2007, and the parliamentary minutes. This thesis demonstrates that most political parties in the Turkish Parliament and the two business organizations perceived tax competition in their own interest and thus contributed to the 2006 corporate tax reform. There was a political consensus for the 2006 corporate tax reform and the preliminary legislations to ease the tax burden of corporations before the reform. The instrumental power of the selected business associations, MÜSİAD and TÜSİAD, provided them with an opportunity for interest representation during the policy formation process of the reform. This thesis argues that the 2006 corporate tax reform was one of the mechanisms of the governing party to strengthen its alliance with the business world, which sidelined the notion of tax fairness in the policy debates around the corporate tax reform.

ÖZET

Türkiye’de 2006 Kurumlar Vergisi Reformunda İç Politikanın Rolü

Bu tez, 2006 kurumlar vergisi reformunu mümkün kılan iç siyasi faktörleri, reform etrafında yapılan siyasi tartışmalarda tematik örüntüleri ortaya çıkarma yoluyla incelemektedir. 2006 reformu, kurumlar vergisindeki diğer düzenlemelerle birlikte kurumlar vergisini yüzde 10 gibi radikal bir oranda azaltmıştır. Vergi politikası değişiklikleri ile ilgili literatür, kurumlar vergisi oranlarındaki küresel düşüşü vergi rekabetine dayalı dışsal bir faktör olarak açıklarken, bu tez seçilen ülke örneğinde kurumlar vergisi reformuna yol açan süreçte yerel aktörlerin rolünü araştırmaktadır. Bu tez çalışması sayılan belgelerin tematik analizi üzerine kuruludur: 2001 ve 2007 yılları arasında yayınlanan iki kilit iş insanı örgütü ve hükümetin politika belgeleri ve kurumlar vergisi reformuna ilişkin tartışmaların medya yansımaları ile ilgili meclis tutanakları. Bu tez, Türkiye Parlamentosu'ndaki siyasi partilerin çoğunun ve iki iş örgütünün uluslararası vergi rekabetinde Türkiye’nin avantajlı konuma geçmesini kendi çıkarları doğrultusunda algıladıklarını ve böylece 2006 kurumlar vergisi reformuna katkıda bulunmayı seçtiklerini göstermektedir. 2006 kurumlar vergisi reformu ve reform öncesi kurumların vergi yükünü hafifletmek için yapılan öncül regülasyonlar üzerinde siyasi bir fikir birliği mevcuttur. Seçilen iş örgütleri olan MÜSİAD ve TÜSİAD'ın sahip olduğu araçsal güç, reformun politika oluşturma sürecinde onlara bir temsil fırsatı sağlamıştır. Bu tez, 2006 kurumlar vergisi reformunun hükümet partisinin iş dünyası ile olan ittifakını güçlendiren mekanizmalarından biri olduğunu ve bu durumun kurumlar vergisi reformu etrafındaki politik tartışmalarda vergi adaleti kavramını bir kenara ittiğini savunmaktadır.

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DEDICATION

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CHAPTER 1

INTRODUCTION

One of the key features of the modern state is its legitimate power to impose taxes. The modern state is a fiscal state that involves in the acts of taxation, revenue collection and spending. The interplay between the fiscal state and taxation makes tax policy formulation complex and multi-directional.

Tax reforms might be both a cause and an outcome of political and economic transitions. Taking into account that "in many areas of the world, economic transition goes hand-in-hand with political transition" (Profeta, & Scabrosetti, 2010: 2), tax reforms should be analyzed not only as economic reforms, but also as political reforms. Nevertheless, the political nature of tax reforms received limited attention in the literature. To contribute to the literature on the political analysis of tax reforms, this thesis examines domestic political factors behind a particular tax reform in the Turkish case.

The first period of Justice and Development Party (AKP) rule in Turkey was regarded as a reformist era in which several reforms took place covering a wide array of economic, political and social policy areas (Öniş, 2009). Taxation as a domain having economic, political and social aspects got its share from the reformist approach of the AKP governments. There have been countless interventions to the tax legislation (Zenginobuz, 2008); however, few could be considered as a comprehensive reform. Among those interventions, the corporate tax reform under consideration in this thesis was an exception due to its content proposing significant changes in corporate taxation.

Corporate tax law that has been in force since 1950 was replaced for the first time in June 2006 (The Grand National Assembly of Turkey [TBMM], 2006). The starting point was to make a new and simple corporate tax law that has been exposed countless interventions. The most prominent feature of this change was the decrease in corporate tax rate from 30 to 20 percent. In addition, this change introduced transfer pricing to be able to tax profits gained through transaction of goods and services. Investment subsidies for companies in production and export have been removed. Tax exemption of the profits gained from license plate sale and exemption of consumption and transportation cooperatives have been removed (TBMM, 2006). Prior to this reform on corporate tax, 3 percent decrease on corporate tax rate took place for the 2005 fiscal year along with the abolishment of inflation accounting in 2003 (TBMM, 2003a, 2003b).

Reduction in corporate tax rate along with other regulations to ease the tax burden of capital was not unique to Turkey. In addition to the spread of Value Added Tax (VAT) and the increase in the reliance on consumption taxes like VAT and Special Consumption Tax (SPT) -which are mostly regressive (Prasad & Deng, 2009)- in tax revenues overall (Corina, 2012; The Organisation for Economic Co-operation and Development [OECD], 2016; Buettner & Madzharova, 2018), there was a global trend to decrease corporate tax rates especially since 1980s (Devereux et. al., 2002; OECD, 2007; Gandhof & Genschel, 2008; Loretz, 2008; Piketty, 2014). Promoting investment was one of the key reasons for many governments to lower corporate tax rates (OECD, 2016). The abovementioned trends in tax policies were generally explained on the basis of exogenous factors such as the impact of economic globalization or tax competition on domestic tax systems (Genschel, 2002; Devereux et.al., 2002; Ganghof, 2006; International Labour Organization [ILO], 2008). While

the trend to decrease corporate tax rates were grounded on mainly external factors based on the globalization narrative, this approach may potentially sideline the domestic political factors throughout the discussion of corporate tax reform. With reference to these changes in corporate taxation, this thesis examines the following question: What are the domestic political factors that made the 2006 corporate tax reform possible in Turkey?

The current outlook of taxation in Turkey is characterized by four features: 1) heavy reliance on indirect taxation (The General Directorate of Accounting, 2019), 2) high levels of tax evasion (Buehn & Schneider, 2016), 3) frequent tax amnesties which creates an incentive for tax avoidance (Şanver, 2018), and 4) a narrow tax base, weak tax administration and the deficiency of social policy components in tax policy compared to the EU countries (Taymaz and Özler, 2004; Togan and Ersel, 2005). During the AKP period started in 2002, the share of direct taxes in overall tax revenue decreased from 33.7 percent in 2002 to 30.8 percent in 2017 while the share of indirect taxes in tax revenue increased from 61.8 percent to 67.1 percent in 2017 (The General Directorate of Accounting, 2019). This taxation outlook in Turkey encouraged me to study the political process that has led to such a picture. This question is especially important because the tax policies are important in shaping income inequality. It has been acknowledged in the literature that progressive taxation has positive effects on income distribution and social welfare (Ferrarini ve Nelson, 2003; Imai, 2010; Oishi et. al., 2012; Piketty, 2014; Iosifidi ve Mylonidis, 2017) and consumption taxes worsen the economic well-being of the poor (Terrell, 1986; Chernick and Reschovsky, 1990).

Taxation is surely a policy tool that can be used for different economic, political and social purposes. Hereby, everything merges on the fact that taxation can

have different impacts on social welfare depending on its design and implementation. Based on the findings of previous research on the Turkish case summarized above, it seems that tax policy in Turkey lacks a strong commitment to improved income distribution and increased social welfare. Nonetheless, tax system, in its current form, has a positive effect on reducing income inequality in Turkey (Toprak, 2018) despite its prevalent problems.

The corporate tax reform in 2006 put a 10 percent decrease into effect, which was 'a good surprise' even for the business world that had been demanding such a change for a long time. The reform on corporate taxation was specifically chosen as the focus of this thesis due to the radical change it introduced in the corporate tax rate. The time period that this thesis covers include the period between 2001 and 2007, which was chosen to match with the period leading to the 2006 corporate tax reform and to cover the earlier responses to this reform in its first year.

The thesis is inspired by the tax politics literature that examines tax reforms as platforms for domestic political struggles. The following hypothesis in the tax politics literature informed the thesis and its approach to the 2006 corporate tax reform in Turkey:

> "…taxation is the main nexus that binds state officials with interest groups and citizens. Not only can taxation enhance government accountability, it also provides a focal point around which interest groups (such as producer groups, labour unions and consumer groups) can mobilise to support, resist and even propose tax policies. In other words, taxation is as constitutive to state formation as it is to interest group formation" (Di John, 2010: 270).

In this regard, the corporate tax reform would particularly reflect the relations between the AKP and the business world in the period under consideration. The interest group that would be directly affected by a corporate tax reform would be the

corporations and their representatives. Business associations, as the organized power representing corporations, were selected to examine how interest groups formulated their demands around corporate taxation and responded to the corporate tax reform. The Turkish Industry & Business Association (TÜSİAD), as the business organization gathering the largest corporations in Turkey, and the Independent Industrialists' and Businessmen' Association of Turkey (MÜSİAD), as the business organization bringing together mostly small and medium-sized firms, were chosen as the business associations to be included in this study. The economic, political and social paradigms that lead to the selection of these two associations are explained in detail in the methodology sub-section of this chapter. The Union of Chambers and Commodity Exchanges of Turkey (TOBB) is another important business association having the power to represent the business's stances on the corporate tax reform. However, the association did not come forefront as a key player in tax policy at the time period under consideration. Also, a preliminary investigation during the data collection process evidenced that the stances of TOBB and TÜSİAD did not fundamentally differ whereas TÜSİAD played a more active role in the domestic political process behind the reform. Hence, TOBB is not included in the sample of this thesis.

The political parties in the Turkish Parliament in the selected period were also included in the analysis to lay out the parliamentary political debate around the corporate tax reform. By including political parties, my aim is to draw a holistic picture of the formulation process of tax policy legislation and to shed light on how different political parties' approach to the tax reform under consideration.

This thesis focuses on the corporate tax reform that took place in 2006, which led to a major decrease in the tax rate by 10 percent. It must be noted that,

nevertheless, the winds have changed in last couple of years. The 2017 amendment on corporate taxation passed with the temporary regulation increased the corporate tax rate from 20 percent to 22 percent, to be implemented in 2018, 2019 and 2020 (The Official Gazette, 2017a). This recent increase in corporate tax rate was justified by the rising public expenditures and serious budget deficit along with the risk not to comply with the Medium-Term Program by the government (TBMM, 2017). Even though this amendment might be considered as another tax policy shift towards the opposite direction, one has to take into account economic and fiscal outlook of the country significantly worsened in this period in concurrence with a major political system change. While this recent tax policy change falls out of the scope of this study, it still exemplifies how tax policy changes reflect the relations between different political actors –the government and business actors, in particular- in a given political and economic context; which may well be an interesting topic for further study.

1.1 Methodology

Main research question of this study is the following: What are the domestic political factors that made the 2006 corporate tax reform possible in Turkey? The rationale behind the selection of the 2006 corporate tax reform is the fact that it is the first significant change in corporate tax in Turkey since 1950.

To examine how domestic political factors contributed to the 2006 corporate tax reform, this thesis relies on a documentary analysis. The documents used in this study include the public statements of relevant domestic political actors, policy reports and media reflections of the debate on the corporate tax within the period

between 2001 and 2007. I selected the year 2001 as the start date due to three reasons: 1) The 2001 economic crisis might have elevated the corporate tax reform in the political agenda, 2), Starting from the post-economic crisis context might help me to embrace a wide array of domestic political factors that made reform possible in 2006, and 3) As the AKP came to power in 2002 general elections, starting the analysis from 2001 might help me not to miss the policy ideas with respect to the corporate tax reform preceding the new government and distinguish them from that of the new government . The practical reason to include documents published between 2006 and 2007 is the fact that the 2006 reform was put in practice in 2007. Covering that extra year between the legislation and implementation allowed me to include the political debates after the legislative victory for the reform, which has made important contribution to the data in the sense that it helped revealing the stance of business associations towards the reform more comprehensively.

To narrow down the documents to be included in this study, I focused on two set of actors involved in the corporate tax reform debates: 1) Political parties represented in the Parliament, 2) Business organizations. The first group of actors include the political parties that voted for the draft Corporate Tax Law in 2006, namely, the Justice and Development Party (AKP) that proposed the draft law, the Republican People's Party (CHP) –the main opposition- and the Motherland Party (ANAP). It must be noted that ANAP did not pass the election threshold implemented as 10 percent in the 2002 general elections. However, Erkan Mumcu, deputy of the AKP and the Minister of Culture and Tourism, resigned from his duties and became the chairman of ANAP. After the following resignations from other deputies from both AKP and CHP, ANAP increased its deputy number in the parliament and had the opportunity to be represented (Hürriyet, 2002).

The second group of actors are business associations, which are organized representatives of the business world. The selection of TÜSİAD and MÜSİAD has political, economic and practical reasons. First, from an economic point of view, TÜSİAD is the organization representing approximately 4500 companies that roughly represents the 50 percent of non-public national income. These companies carry out the 85 percent of export in Turkey, provide 50 percent of registered employment excluding public sector and agriculture, and last but not the least, pay the 80 percent of corporate tax (TÜSİAD, 2019). This being the case, TÜSİAD, no doubt, is expected to be one of the main actors during the corporate tax reform process. MÜSİAD, on the other hand, was chosen due to its political affiliation with the governing party. After its establishment in 1990, MÜSİAD, known for its close relations with the National Outlook political tradition that the AKP also takes its roots. Today, the Association represents approximately 60.000 small and medium-sized enterprises (MÜSİAD, 2019). Back in 2004, MÜSİAD has the highest number of members as a business association in Turkey (Türk, 2004) most of which are small and medium-sized enterprises, while TÜSİAD members constantly were the highest taxpayers of personal income tax (Ekonomi Servisi, 2007) and paid the highest amount of corporate taxes (TÜSİAD, 2004a). Given the profile of these business associations, TÜSİAD and MÜSİAD are selected to reflect the business side of the political discussions over the corporate tax reform.

Data on the domestic political factors that made the corporate tax reform possible was collected through the following documentary sources: parliamentary minutes, policy documents, news items and websites of TÜSİAD and MÜSİAD along with their publications on taxation. In the selected period, parliamentary minutes that involved any discussion regarding corporate taxation was reviewed.

However, the parliamentary minutes in which the new Corporate Tax Law was recorded (TBMM, 2006) was the one mainly used to analyze the political party stances to the reform. Development plans, the programs of political parties and the preamble of the 2006 corporate tax reform were reviewed as policy documents. Websites of both TÜSİAD and MÜSİAD were investigated in detail. Examining through the websites, the annual reports of the business associations, their online periodical publications, reports prepared specifically on taxation or economic or fiscal policy, and opening speeches made by the presidents of the business associations were reviewed. For the press review, Milliyet and Yeni Şafak were chosen due to their ability to represent different political views at the time and to develop a complete archive of the public debate on the corporate tax reform for the time period chosen. In total 525 news including the words 'TÜSİAD' and 'tax' were reviewed in Milliyet's online archive. In order to embrace all the news that might have a component that would affect the data analysis, 287 news in total were reviewed including the word only 'MÜSİAD' due to the limited number of news including both 'MÜSİAD' and 'tax'. In addition, the news included the keyword of only 'corporate tax' were reviewed so that any significant debate on the politics of corporate taxation would be involved in the data set. The same procedures were carried out for Yeni Şafak newspaper. Yeni Şafak lacks a systematized online archive allowing researchers to search within certain periods. Still, there are in total 48 news reviewed and included in the dataset from Yeni Şafak newspaper.

The study relies on a qualitative thematic analysis, which is a method of analysis that allows researchers to identify, analyze and report the qualitative data by constructing a thematic pattern that at the end would address the research question (Maguire & Delahunt, 2017). The fact that thematic analysis is not contingent upon a

specific epistemology or a theory makes the use of the analysis easier within a complex textual data set (Braun & Clarke, 2006). Although this methodology is described as a linear process starting with the data collection and coding and ending with the writing the analysis up, it is more like a duplicative process that requires continuous moving back and forward over time (Nowell et. al., 2017). This study was not an exception to this general trend.

1.2 Organization

The thesis is organized under five chapters including this introductory chapter. Chapter 2 presents a review of the tax policy and politics literature. In the first part of this chapter, the theoretical framework of taxation is outlined. The second part reveals the contemporary comparative trends in taxation and presents an overview of the diversity in national tax systems. The third part specifically focuses on the politics of taxation, which presents the factors that shape tax policies. The last part engages with the conceptual framework of taxation and summarizes the former literature on the theoretical framework, overview and the politics of taxation.

Chapter 3 puts forward an overview of the Turkish tax system with separate sections on before and after the 2001 crisis. This chapter also examines the key events in taxation history of Turkey with specific emphasis on the AKP period and the corporate taxation. Finally, the chapter situates the Turkish tax system into a comparative framework to reveal its distinguishing characteristics.

Chapter 4 offers an analysis of the role of domestic politics that made the 2006 corporate tax reform possible. After examining the ideas and stances of political parties and the selected business organizations towards the corporate tax

reform, this chapter explains the domestic factors behind the reform and political debates around the reform, with special reference to the relationship between the government and the business associations.

Chapter 5 is the conclusion, which explains the following main findings of this thesis. There was a political consensus over the 2006 to ease the tax burden of corporations; the critique by the opposition parties or labor organizations for the reform were hardly visible in public debates. The organic relationship between the MÜSİAD and the AKP, the lobbying activities of TÜSİAD to strengthen its relationship with the AKP and the AKP's motivation to work with TÜSİAD to decrease its political fragility all contributed to the 2006 corporate tax reform. A motive for the AKP to implement the 2006 corporate tax reform was to maintain and strengthen its alliance with the business associations. Social justice concerns were sidelined in the 2006 corporate tax reform debates.

CHAPTER 2

LITERATURE REVIEW

This chapter provides a general overview of taxation literature that mainly focuses on factors determining tax policy changes. The chapter is divided into four sub-sections. The first section presents a theoretical framework to study taxation. The second section offers an overview of tax systems and contemporary tax policy changes after the 1980s. The third section summarizes different approaches to the study of tax politics. Finally, the fourth section offers a list of factors that influence tax policy formulation.

2.1 A theoretical framework for taxation

One should address the key question why governments collect taxes in the first place to understand the political dynamics behind tax policy changes. This requires a brief flashback to the historical development of modern capitalist societies. John Locke's 'labor theory of value' offers a theoretical starting point. Locke justifies that private ownership of goods and land arises from the labor effort. He explains the concept of property as means of labor effort: "It is labor, then, that puts the greatest part of value upon land, without which it would scarcely be worth anything" (Locke, 1689: 16).

Differences among theoretical stances on what creates value and to whom value should belong to lead to diverse approaches to taxation. For example, Nozick (1973), a libertarian, claimed that taxation is theft, a compulsory seizure of the property of the state's inhabitants, or subjects and it is morally illegitimate. Hayek

(1960) considered progressive taxation as a discrimination against the wealthy and as a cause of inequality. Their arguments about taxation derived from their theories of minimum state. They did not believe that taxation is the optimum way of increasing social welfare. In contrast, some scholars argued that just taxes and the redistributive power of taxation might be redirected to achieve social justice. For instance, Rawls (1999), in his seminal work, *A Theory of Justice*, included taxation to institutions of the state required for achieving distributive justice. A tax on international transactions to deal with the negative effects of financial movements was introduced by James Tobin, an economist, who proposed to use the fund collected by the Tobin tax for development objectives for the poor nations (Bertram, 2008).

It should be noted that taxation does not always favor workers. Taxation may serve redistribution in two ways. While taxation could be used as a method of revenue generation for social expenditures that may positively affect the well-being of citizens, it could also be used to pay private sector external debt for the sake of financial stability. Second, taxation may affect the market distribution in an egalitarian way with progressive taxation; but it may also worsen the extent of inequality arising from the market distribution, for instance, by relying more on indirect taxes than direct taxes, which eventually could increase the burden on the low-income groups.

Tax system design including its revenue collection and reallocation of income components is thus a normative decision. These normative decisions have real life implications. While some market societies have better income distributions and high levels of social welfare, others witness simultaneous accumulation of wealth in the hands of the few and impoverishment of the masses.

Following the Second World War, the emergence of the welfare states especially in Western Europe led to an increase in tax capacities and revenues of these countries (Barry, 2005). Rampant social inequalities in the post-Second World War period have stimulated the mobilization to increase taxes on wealthy so that the burden of war could have been fairly distributed (Scheve & Stasavage, 2010). The status equality, which originates from the full membership of a community, as Marshall describes, laid the ground for the social citizenship rights (Marshall, 1965) in welfare state contexts. Along with the scope, type (money or service) and amount of benefits, the financing of these benefits is listed as an important factor that determines the degree of equalization (Marshall, 1965). Martin argued on this issue as follows:

> Taxes define the inequalities we accept and those that we collectively seek to redress. They signify who is a member of our political community, how wide we draw the circle of 'we'. They set the boundaries of what our governments can do. In the modern world, taxation is the social contract. (Martin et al., 2009: 1).

Indeed, tax policies redress social inequalities in two ways. With respect to the revenue collection, they can employ strategies to collect taxes fairly by avoid taxing the poor more than the rich. With respect to public spending, tax policies can collect the revenues necessary to be directed towards social transfers to increase social welfare.

While emphasizing the importance of social justice and equality in the analysis of tax policies, my aim is not to aspire for absolute equality where working is not rewarded, and private property is not protected. The normative reference point that this thesis adopts is the general conception of justice in Rawlsian terms, which requires everyone's position to be improved (Rawls, 1999). By equity, I refer to

meeting conditions for all citizens to live with dignity or with Marshall's definition, sufficient conditions enabling every man to be a gentleman (1965). By redistribution, I mean the distribution of scarce resources collected by the state at both spending and revenue sides to the benefit of low-income households. Social justice can be reached only if redistribution and equity are present for all; "injustice, then, is simply the inequalities that are not to the benefit of all" (Rawls, 1999: 54).

According to Rawls, the tax system is fair only if the institutions of a society work fairly and effectively at the background. Therefore, he did not limit the application of his distributive justice theory taxation only (Kordana & Tabachnick, 2006). In fact, in a society that runs smoothly with all its institutions ("society beyond justice"), tax would only become a means of financing (Sugin, 2004). However, the society we live in today is far from being a "society beyond justice", so the tax policy is still one of the most important tools remaining to achieve distributive justice.

Concepts such as equity, redistribution, justice and legitimacy occupy minimum space in the taxation literature since tax policy is regarded rather as a technical matter. The predictable result of this would be disregarding tax justice partially or completely in the process of policy design. Taxation literature is mostly dominated by the discipline of economics; political and sociological studies on taxation have been rather limited. Economics, however, focuses mainly on efficiency and avoidance from distortions in economic life such as creating disincentives for investment decisions caused by tax collection (Musgrave & Musgrave, 1989: 216). Emphasis on the distortions that taxation may create is so powerful in economics that an extensive literature has been devoted to optimal systems of taxation in line with fiscal discipline both in Turkey (e.g. Turan, 2014) and in other parts of the world

(Atkinson & Stiglitz, 1976; Darrat, 1998; Cremer et al., 2001). This search for optimal taxation generally comes with a call for low levels of taxation with broad based tax systems (Peters, 1991).

While economic growth-centered approach underlines the negative implications of taxes, the social policy scholarship shows that economic growth alone does not end up in comprehensive welfare states (Stephens, 1999). However, the volume of taxation seems to be more important than the equity of the distribution of tax burden on different income groups. For example, scholars found that large welfare states rely more on regressive taxation, while liberal welfare states have more progressive tax systems (Wilensky, 2002; Kato, 2003; Ganghof, 2006; Beramendi & Rueda, 2007; Martin et al., 2009; Prasad & Deng, 2009).

As a form of state intervention, taxation cannot be classified as inherently good or bad (Piketty, 2014); the way of collecting taxes and how states spend the revenue from taxes should be taken into consideration in understanding the particular functions of taxes in specific social contexts. Taxes might be used to decrease income inequality, for instance, or they might cause income inequality. To put it with concrete examples from the literature, progressive taxation is associated with the increased levels of subjective well-being (Oishi et al, 2012) and, progressive labor taxes positively affect the income distribution (Ferrarini & Nelson, 2003; Iosifidi & Mylonidis, 2017). On the other hand, Imai et al. (2010) concluded that the reliance on indirect taxes and a regressive tax system put a heavy burden on those at the bottom of the income distribution and made them extremely vulnerable. Tax policy may not only affect the burden of those who are at the bottom of the income distribution but also affect the well-being of those who are at the top of the income distribution. A study conducted in the United States between the years 1979 and

2007, tax policy changes increased income inequality by rising the income share of the top 20 percent high-income earners (Bargain et al., 2015). Piketty, Saez, and Stantcheva (2014) also showed that countries such as Germany, Denmark, Switzerland or Spain which retained an important part of top tax rates over years did not experience increases in top income shares while some among OECD countries like the US, Canada, the UK, Portugal and Ireland which implemented significant top tax rate cuts experienced large increases in top income shares.

2.2 An overview of tax systems and recent changes

Two key developments are noteworthy in explaining tax policy changes after the 1970s. First, the reliance on consumption taxes like Value Added Tax (VAT) and Special Consumption Tax (SPT) -which are mostly regressive (Prasad & Deng, 2009)- increased and they started to constitute an important part of tax revenues overall (Corina, 2012; OECD, 2016; Buettner & Madzharova, 2018). Total number of 168 countries now use VAT as a friendly alternative towards growth and international trade to collect revenue. 35 OECD countries out of 36 employ VAT excluding the US, which also uses a different form of sales tax (OECD, 2018). Second, many countries chose to decrease corporate tax rates especially since 1980s (Devereux et. al., 2002; OECD, 2007; Gandhof & Genschel, 2008; Loretz, 2008; Piketty, 2014). Most countries decreased the tax burden on employers and increased the share of consumption taxes and taxes on wages (Martin, 2015).

The 2006 corporate tax reform in Turkey, which is the reform under consideration in this thesis, put a radical 10 percent rate reduction into practice. Turkey was not the only country implemented such a reduction in corporate tax rate.

Among OECD countries, there were a few which experienced a radical rate reduction in 2000s such as Austria, Germany, Iceland and Lithuania (see Appendix, A). Germany comes to the forefront with a high level of reduction; from 42.2 to 26.4 in 2001 and finally to 15.8 in the 2008 reform. Scholars studying the German tax act argued that government officials were convinced that tax rates were high and discouraged investment (Schreiber, 2000), so the reform act was implemented to attract investment, to simplify the tax system, and to ensure neutrality in international area (Homburg, 2000).

Tax competition is addressed as a justification for the act of lowering the tax burden of capital in Germany. However, the discussion around the international neutrality and to have a 'Europe friendly' tax system was not mentioned at the very beginning and became a focal point at the very last stage of the reform. Hence, it may have been used as a disguise to justify the reform (Homburg, 2000). Moreover, the domestic political debate around the German tax reform in 2008 which reduced the corporate tax rate by 10.6 started in 2005 when early elections was announced. The Christian Union led by Angela Merkel was keen on to reduce tax rates along with other measures to ease the burden of corporations during the election campaign (Homburg, 2008). Although the corporate tax rate was reduced by the government as it was promised, there was resistance from both voters and the Social Democratic Party. As a result, the reform was implemented with a compromise; with trade tax and solidarity surcharge, the tax burden of corporations was calculated approximately still as 30 percent (Homburg, 2007).

The rationale behind many governments' decision to lower corporate tax rates has been the expectation to increase and promote investment (OECD, 2016: 42,43). However, the link between corporate tax rate and the investment climate in a country

is complex and depends on many variables such as the mobility level of capital (Abbas and Klemm, 2013). Another argument justifying low rates of corporate tax refers to higher wages for workers, cheaper products for consumers and a healthier economy (Eurodad, 2017). The large scale of tax avoidance and the substantial amount of income transferred to tax havens in especially low and middle-income countries may lead to lower tax revenues despite profits tend to increase (Cobham & Jansky, 2017). The result is that capital owners get more of the income while labor share in national incomes has been falling since the 1980s in the majority of countries (ILO, 2014; Karabarbounis & Neiman, 2014).

Loretz (2008) argued that governments would choose to decrease corporate tax rates for two reasons. Either the effects of tax competition are so strong that corporate tax rates may be decreased to maintain the level of investment and companies' profit and to attract foreign capital flow, or general views on corporate tax rates may have altered in the tendency to a decrease that high tax rates on all sorts of income are no longer desirable. One would expect that a tendency towards decreasing tax rates should be also visible in other domains of direct taxation, like personal income tax if the latter is true (Loretz, 2008: 642). It turns out that personal income tax rates have also been falling since the early 1980s in OECD countries (Loretz, 2008: 643). The joint downward trend in both personal and corporate income tax rates may be a sign that tax competition cannot solely explain the continuous fall in corporate taxation.

Decline in corporate tax rates was not the only major change in taxation. While indirect taxes which are mostly regressive and based on consumption are increasingly used in many developed and developing countries (Gemmell & Morrissey, 2005), income and corporate tax rates which are classified as direct taxes

declined on average (ILO, 2008). In addition, regardless of countries' economic development level, the share of taxes on international trade in tax revenue has decreased since the 1980s and VAT has become an important revenue source for governments (ILO, 2008; OECD, 2016; Eurodad, 2017). The reliance on indirect taxes as a source of government revenue is more starkly observed in developing countries. The fact that indirect taxes are levied on consumers and that it is easier to collect indirect taxes, which in general do not hinder production and investment incentives for the sake of economic growth, explains the preference of indirect taxation by developing country governments (Gemmell & Morrissey, 2005).

While corporate and income tax rates have been falling, consumers are asked to pay more taxes as corporations pay less in proportion to their revenue levels (Eurodad, 2017), which worsen the economic well-being of the poor (Terrell, 1986; Chernick & Reschovsky, 1990).

While the abovementioned trends in tax policies are generally explained on the basis of exogenous factors such as the impact of economic globalization or tax competition on domestic tax systems in the literature (Genschel, 2002; Devereux et.al., 2002; Ganghof, 2006; ILO, 2008), there are limited number of studies on how domestic politics contributed to this common policy trend. This thesis aims at contributing to the latter academic endeavor.

2.3 Key factors in the politics of taxation

Both the size of the total tax revenue and the distribution of tax burden among different sectors of society are products of political decisions, as they are also economic decisions. Nevertheless, generally the economic side gets all the attention

in the literature. As Haldenwang & Schiller (2016, p. 1685) clearly put it: “While thousands of tax economists and legal experts produce evidence on tax policy and tax administration issues, there are hardly any ‘tax political scientists’ engaged in this debate”. Hence, political processes behind tax policy changes is inadequately studied and a competent conceptual basis for tax policy making remained limited.

Although political processes behind tax reforms have started to draw scholarly attention in the literature since the 2000s (Appel, 2006; Fairfield, 2010; Osterloh & Debus, 2011; Osterloh and Heinemann, 2013; Haldenwang & Schiller, 2016; Herwartz & Theilen, 2016), globalization as an exogenous factor is still the most commonly cited explanation for tax reforms (e.g. Genschel, 2002; Tanzi, 2002; Devereux et.al., 2002; Ganghof, 2006). Indeed, globalization has shaken the autonomy of states to tax increasingly mobile capital and paved the way for the ongoing debate on tax competition (Genschel, 2004). In post 1980s period, financial mobility of capital has restricted nation states’ ability to tax capital or income. There are increasing concerns for globalization to undermine the tax autonomy of the state. Tanzi (2002) argued that globalization affect the governments’ ability to continue providing social protection since tax competition among jurisdictions, ballooning electronic commerce and increased mobility of the factors of production will cause significant falls in tax revenue. Multinational corporations and some companies move their assets to tax havens countries like Luxembourg (Genschel, 2002). Tax evasion and tax avoidance are contemporary problems of welfare states. Hence, on the one hand, welfare states try to reduce tax burden on capital for the sake of international flows and trade, on the other hand, they try to maintain revenue levels to deal with problems of the shadow economy and unemployment and to provide

distributive equity (Genschel, 2002). However, there is no visible evidence of a decline in tax revenues in OECD countries (OECD, 2018).

While globalization may have changed the political and economic framework within which tax systems operate, it can neither embrace nor justify tax reforms by itself. To fill the gap from this absence of a different approach to the political dynamics behind tax reforms, it is crucial to ask the role of domestic institutions and political process of a state's choice over those kind of tax reforms.

Within the scope of tax competition literature, there has been a wide support towards tax harmonization (Edwards & Keen, 1996; Zordrow, 2003), since a "race to the bottom" of corporate taxes jeopardize the revenues of welfare state (Osterloh & Heinemann, 2013). Nevertheless, tax competition is one of the many reasons explaining the decline in corporate tax rates over the last three decades. The motives shaping the support for minimum corporate tax rates could also be explained in reference to the ideologies of politicians or even individual characteristics of politicians, as it is found in the article written by Osterloh and Heinemann (2013) on the Members of European Parliament.

Interest group politics is useful in understanding the political dynamics behind the tax reforms. Organized interest is used to refer to both labor and capital. Organized interests of the capital in the form of employer organizations and business organizations are generally more powerful in the process of policy formulation than labor unions. As one of the interest groups, business –despite the fact that it is not always a unified actor– is a powerful actor in modern societies with its complex relations with governments (Coen et. al., 2010). The concept of 'organized interest' is useful in describing business organizations coming together to pursue shared

organizational goals that may include increasing profits and market shares. These agents may seek political allies to play a significant role in shaping policies.

Political regimes shape the opportunities available for organized interest groups to influence policy. Studies exploring the link between tax politics and political regimes are limited. One important exception is Steinmo's work that examined the political institutions as a determinant of tax policy by comparing Sweden, Britain and the United States (Steinmo, 1989). For example, corporatism, according to Williamson (1989), is a particular form of interest representation, in which organized interest is involved in the process of policy formulation with public bureaucracy and ministers (Wilson & Grant, 2010). Among one of the rare studies examining the political and institutional dynamics behind taxation, Summers et. al. (1993) explored the robust relationship between taxation and corporatism by using data over the 1980-1984 period. They argued that their results are not sensitive to the selected period and that corporatist political systems tend to implement lower taxes on capital, while they impose higher levels of taxation on labor. There was some evidence they found also supporting that distortionary effect of labor taxes, such as deadweight loss of taxation is reduced in nations with corporatist tendencies. Their conclusion also supports the hypothesis that employer organizations are more influential in pursuing their interest in corporatist political settings. However, another study showed that in countries where labor have some capacity to participate in policymaking process of taxation through corporatist institutions, tax burden on labor decreases (Campbell, 2005: 407).

Beramendi and Rueda (2007) drew attention to the limits of the impact of political systems on indirect taxation after the 1980s. While the theory suggests that social democratic countries are expected to adopt a tax system that favors the least

advantaged part of the society and not to increase consumption taxes too much to avoid taxing the poor, they found that even they failed to minimize consumption taxes as part of their redistributive strategy if corporatist arrangements exist. They explained this with reference to the presence of corporatist arrangements, which do not let political parties to increase or at least not to change corporate taxes. Political parties are left with no choice but to compensate the lost revenue from corporate taxation with increasing consumption taxes after the 1980s.

Steinmo and Tolbert (1998) pointed out the importance of institutional variation in shaping tax burdens. They bring forward three explanations to tax burden differentiation in industrialized democracies by analyzing OECD countries as sample. First, heavier tax burden could take place in richer countries while poorer economies among OECD sample keep tax burden lower. Second explanation relies on the fact that democratic states decide on tax policy by considering public attitude or voter preferences. The third and foremost institutionalist explanation argues that institutional structure may be determinative for political environment where different institutions can affect the decision-making process of policy actors whose choices are shaped by different interests. To illustrate, in the case of majority governments where a single party has the majority of seats in parliament, the party is reluctant to form an alliance with others on taxation and spending subjects (Steinmo & Tolbert, 1998). Having said that higher tax burdens is associated with highly centralized labor organizations and vice versa, they have enough evidence to suggest that levels of taxation are robustly influenced by the strength of labor organizations and political structures.

In addition to political regimes, electoral periods and ideologies of political parties are also studied as possible factors shaping tax reforms (Osterloh & Debus,

2011; Osterloh & Heinemann, 2013; Herwartz & Theilen, 2016). For example, Herwartz & Theilen (2016) observed that party ideology has the weakest effect on tax policy decisions for states because there is no noteworthy difference between the choices of right-wing and left-wing parties for the past 30 years, in the age of economic globalization. Left wing parties have also been decreasing the corporate tax rate in this period, for instance, despite the fact that left-wing ideologies generally aim at more egalitarian income distribution while relying more on redistributive tools. Electoral cycles seem to have strong influence on tax policy and social spending compared to party ideologies for a panel of OECD economies between 1980 and 2013 (Herwartz & Theilen, 2016). On the one hand, political parties use taxation is to affect the voting preferences (Foremny & Riedel, 2014). On the other hand, elections could negatively affect the tax collection before an electoral cycle due to the unpopularity of taxes for specific social groups (Prichard, 2018). Choosing to decline a special consumption tax, which appeals to a large part of society such as SCT on cars, could help political parties collect votes, while decreasing corporate tax rates could help them to win strong allies from the business. To broach to the subject of political regimes, a stable political regime could convince corporations to undertake a large share of tax burden since political regime offers stability and a low degree of uncertainty in economic life, parties have enough justification to increase or at least to keep the corporate tax rates at the same level (Haldenwang & Schiller, 2016).

Power resources approach emphasizes the comparative power of business and workers to explain their influence on the policy outcomes. A number of studies shows that the distribution of tax burden among different part of society such as labor or capital is substantially affected by working class power in a particular

country context (Korpi, 1980; Esping-Andersen, 1990; Campbell, 2005). Countries with high unionization rates and left-party control tend to have more progressive tax rates.

Steinmo (2003), as one of the pioneers of fiscal sociology, discussed the elite ideas as another key factor that has shaped tax policy reforms. He argued that the reduction in corporate tax rates and taxes on high income were not automatic results of globalization, although he agreed that it is a tempting conclusion to make. For Steinmo, they were products of policy makers' ideas and interests (2003: 229).

Another study (Osterloh & Debus, 2011) that investigated the effect of political factors, mainly partisanship, on corporate taxes for the last 30 years in Europe concluded that left wing leaders choose to have higher corporate tax rates. However, they found that the magnitude of this effect declines in the course of time due to intensifying international competition. In addition, this decision towards higher corporate tax rates of left-wing politicians was mainly driven by the desire to implement welfare policies that aims at redistributive spending (Osterloh & Debus, 2011). However, higher corporate tax rates have rarely succeeded to stand against the will to take part in the international competition, thus leading to lower tax rates on capital.

Moreover, structural power as a concept of business politics is also employed to describe the political dynamics beyond tax reforms. As Block (1977) argued, politicians avoid offending the business due to the latter's structural power. For instance, a price control over imported products to maintain the purchasing power of consumers can only be achieved if state ventures the exit of the capital from the country. Block suggested that policies implemented by the state that favor the

business can be explained by the structural theory (Block, 1977), that emphasizes the ability of corporations to move their investments out of the country as a punishment for state's policies against them (Fuchs, 2007).

In addition to the structural power of the business, instrumental power of business could affect the policy choice of states over taxation. It takes the form of lobbying, campaign and party finance activities (Fuchs, 2007), but it may have numerous forms in many ways to avoid or at least to minimize taxes 'the corporate rich' would pay. 'The corporate rich', as Mills (1956) defined, represents men with executive and political stance who are both the propertied classes and privileged. Above all, they have access to accomplished lawyers and accountants specialized in taxation that enhances their chances of increasing their untaxed income through legal means.

2.4 Conclusion

Tax policy, as a form of government intervention, may have different social implications. It may decrease income inequality, while it may result in favoring a privileged minority. Taxation also serves the objective of revenue collection that makes public expenditures possible. The usage of these tools to provide social welfare or to favor a particular interest group depends on the values and political coalitions upon which tax policy is established.

There are two fundamental tax policy changes after the 1970s. First, states started to rely much more on consumption taxes to raise revenue levels starting from the spread of VAT in 1980s (Prasad & Deng, 2009; Corina, 2012; OECD, 2016; Buettner & Madzharova, 2018). Second, there is a tendency to lower corporate tax

rates (Devereux et. al., 2002; OECD, 2007; Gandhof & Genschel, 2008; Loretz, 2008; Piketty, 2014).

These tax reforms are commonly explained based on economic globalization or tax competition in the literature (Edwards & Keen, 1996; Devereux et.al., 2002; Genschel, 2002; Tanzi, 2002; Zodrow, 2003; Ganghof, 2006; ILO, 2008). However, the political explanations are also necessary to provide an insight how domestic politics contributed to the abovementioned changes in tax policies.

In this chapter, three paradigms explaining tax reforms are reviewed, namely, interest group politics, institutionalist and structural approaches. In addition, the literature also lists factors such as political regimes, the strength of business and labor organizations, partisanship, electoral cycles, political parties, and ideas and interests of policy makers as potential explanations that account for the changes in tax policies.

Structuralist theory puts emphasis on the effect of business on tax policy by suggesting that the structural power of the business shapes the policy decisions on tax issues (Block, 1977). Institutionalist approach, on the other hand, is more comprehensive and includes many factors to look for possible explanations of the changes happened in tax policy. Political system is one major factor that influences the policy-making process. Corporations tend to bear more tax burden if they are engaged with stable political regimes due to the elimination of uncertainty in economy (Haldenwang & Schiller, 2016). Osterloh and Heinemann (2013) argued that ideologies of political parties and the partisanship of individual politicians itself have contributed to the process of corporate tax rate fall. In the ideational version of institutionalism, decrease in corporate tax rates was not explained as the automatic

result of globalization alone, but also as a product of the ideas and interests of elite policy makers (Steinmo, 2003). Electoral cycles are also among factors affecting tax reforms and social expenditures (Herwartz & Theilen, 2016). While governments tend to decrease tax rates or to ease tax burden to avoid any loss of votes prior to election periods (Prichard, 2018), taxation is effectively used during these periods (Foreemny & Riedel, 2014).

Interest group politics, the third approach to tax politics reviewed in this chapter, points out the impact of organizational goals of organized interest groups on tax policy formation. Business organizations are found more successful when pursuing their interest in the tax policy as Summers (1993) argued. Bringing in institutionalist insights, Summers (1993) and Breamendi and Rueda (2007) found that the existence of corporatist arrangements in a country stimulates lowering corporate tax rates to ease the burden on capital and relying more on taxes on labor or consumption. The instrumental power of business adopted in the form of lobbying or party finance can explain the reforms in tax policy (Fuchs, 2007). In another study, taxation level and tax burden are also found to be affected by the interests of labor organizations (Steinmo & Tolbert, 1998). Indeed, working class power plays a significant role in determining the levels of tax burden (Korpi, 1980; Esping-Andersen, 1990). Campbell (2005) found that high unionization rates with the help of left party control may result in more progressive tax systems and a high-level participation of labor in policy formation may decrease the tax burden on labor.

This thesis makes use of the institutionalist approach and the interest group politics in conceptualizing the domestic political factors that made the 2006 corporate tax reform possible in Turkey. Institutionalist approach is necessary to explain the stances of political parties towards to the reform that eased the tax burden

of corporations. Political regime in Turkey and the ideologies of politicians who participated in the legislation process of the corporate tax reform are also complementary factors to draw a holistic picture of the domestic political debate around the reform. Organized interest is referred in explaining the contribution of the business associations, TÜSİAD and MÜSİAD, to the corporate tax reform and the maintenance of the alliance between the AKP and the business associations.

CHAPTER 3

AN OVERVIEW OF THE TURKISH TAX SYSTEM

The Turkish tax system has been subjected to several reforms and a series of small changes since the post-war period in the 1950s. This chapter aims to highlight the significant changes made in the Turkish tax system and the economic and political motivation behind them. In line with this aim, the chapter is divided into four parts in which each part shed light on different periods of taxation or different approaches to the tax policy in Turkey.

The first section, named as 'Turkish tax system before the 2001 crisis', presents a historical background on the key developments of the tax system. The second section is devoted to the introduction and characteristics of special consumption tax in Turkey. Since it has had a strong position as a share of tax revenue and contributed to the substantial increase in the share of indirect taxes in overall tax revenue substantially since 2002, the development of special consumption tax is discussed in a separate section. The third section focuses specifically on the tax reforms and the general outlook of the tax policy during the AKP period. A separate sub-section of the third section describes the changes in corporate taxation in detail during the AKP period. Finally, the fourth section offers an overview of contemporary tax system in Turkey within a comparative perspective.

3.1 Turkish tax system before the 2001 crisis

Scholars observed that the mass misery of people in different countries experienced during and after the World War I and II stimulated an increase in social spending levels and consequently, an increase in the tax rates (Scheve & Stasavage, 2010). Between 1920 and 1980, the share of social spending in national incomes rose considerably especially in affluent countries such as the UK and the US, followed by increasing the tax burden (Piketty, 2014).

Turkey was not an exception to this trend. Although the state aimed at developing a modern tax system since the proclamation of the Republic, reforms towards a unified and modern tax system could be introduced in the 1950s (Batırel, 2016: 394). After the end of World War II, a modernization and reform process were initiated along with the transition to a multi-party system in Turkey. A combined tax on income was separated as personal income tax and corporate tax with the 1949 Tax Reform in which the very first Tax Procedure Law of Turkey was also introduced (The Official Gazette, 1949). Amendments to tax legislation in this period have mainly focused on direct taxes with the objective of easing the tax burden of disadvantaged communities until the end of the 1950s. The last significant change made in that period was to include income from the agricultural sector into direct taxation in 1960 (İnan, 2010: 358). Tax on agricultural income, namely, *Aşar*, which constituted the one-third of total tax revenues of the Republic of Turkey was abolished in 1925 to ease the burden on farmers and provide an incentive for agricultural production. This loss of revenue was substituted by an indirect tax on transaction and consumption (*muamele vergisi*) in 1926 (Önder & Okçuoğlu, 1987).

Another important change made in 1957 as a continuation of reforms implemented between 1950 and 1960 was to increase the highest ratio of personal income tax from 35 percent to 50 percent (Bulutoğlu, 2004: 111). An additional increase was introduced for personal income tax from 50 to 60 percent in 1960 while the corporate tax ratio remained the same as 10 percent for companies with share capital and co-ops and 35 percent for other corporations. This may be assessed as a political choice of policymakers to avoid taxing capital owners (Önder & Okçuoğlu, 1987: 359).

The salient change towards a neoliberal outlook in the global policy environment in the 1980s also affected Turkey, which resulted in Turkey adopting the principals of an open market economy (Buğra & Adar, 2008). For the sake of a more market-based economy and open borders, Turkey also cut trade taxes in the 1980s (Karanfil & Özkaya, 2013: 338). Implemented at a highest 66 percent ratio in 1981, personal income tax was also reduced to 55 percent in 1985, which also coincided with the date when the Value Added Tax (VAT) was introduced by the Özal government.

Turkey had intended to introduce a VAT long before 1985. Bulutoğlu and Thirsk (1997) described the rush of the state authorities to implement a VAT as early as 1963 when Turkey became an associate member of the European Community. Due to the lack of agreement among coalition partners, implementing a VAT was postponed to 1985. Once it was introduced, VAT was collected at a 10 percent rate (Bulutoğlu, 2004); the standard VAT rate in Turkey is now 18 percent and a reduced rate of 8 percent applies to basic foodstuffs, books, medical products, and some other basic consumption goods. In addition, a reduced rate of 1 percent is applied to agricultural products, newspapers, etc. (The Official Gazette, 2007).

The 1980s period were characterized by privatization, decentralization of production within the country that affected regions outside the traditional industrial centers (Buğra & Savaşkan, 2014). In the same period, flexible labor markets, financial deregulation, fiscal austerity, and central bank independence was followed (Cizre & Yeldan, 2005: 388). In addition, in this period, the economic strategy of Turkey shifted from import-substituting industrialization to export-oriented growth (Buğra & Savaşkan, 2014).

The objective to increase import and exports in line with the outward-looking economic growth strategy and to attract foreign investment necessitated a rethinking of the tax policy. While 91 amendments in the tax law and five codes on tax jurisdiction were enacted between 1980 and 1989, there were 20 amendments between 1990 and 1999 even under the purview of short-term coalition governments (Yılmaz, 2012: 65). In the attempt to promote economic growth particularly in the private sector, significant changes in the tax policy took place including the incorporation of certain exemptions into the tax code and significant reductions in taxes on wealth such as property tax, capital transfer taxes, endowment tax, and capital gains taxes (Kuş, 2014: 283). Even though the number of corporate taxpayers increased between 1986 and 1993 (Kuş, 2014), the share of corporate tax revenue as a percentage of total tax revenue steadily declined in the same period (see Appendix B, Figure B1).

Tax code provided entrepreneurs and self-employed professionals loopholes to avoid tax payments and opportunities for tax evasion (Bianchi, 1984: 269). Tax amnesties, which creates an incentive for taxpayers to postpone or even to call off the necessary payment until the next tax amnesty is declared, were also common in the 1980s (Yumuk, 2008). The choice offered to taxpayers here, consciously or not, did

not only encourage corporations to delay tax payments but also it caused a problem of fairness for those who pay their taxes on time with honest declarations of their income.

After the liberalization of financial markets in 1989, Turkey experienced a number of financial crises in 1994, 2001 and 2009. The crisis of 2001 was followed with IMF programs which put Turkish economy under the surveillance of IMF from 1998 to 2008 (Boratav, 2018: 213). The economic environment resulting from these crises was an environment with high inflation and unemployment rates; where both production and consumption levels fell alongside with the decreasing purchasing power. This economic environment has made the country more amenable to accept and adopt the tax policy recommendations of international actors (Öniş, 2006: 218). Furthermore, while the commonly accepted reason of the 2001 February crisis was the government's failure to adopt austerity measures determined by the IMF in 1999, some scholars argued that exposing the newly emerged and fragile capitalist market economy of Turkey to foreign competition might be the actual reason behind the 2001 financial crisis (Cizre & Yeldan, 2005: 389). This common view also contributed to the implementation of austerity policy for Turkey after the 2001 crisis. Moreover, the crisis of 2001 undermined the public support for the existing political parties at the time; which, in the end, caused the decline of coalition politics generally linked to economic and political instability (Öniş, 2009: 417). The early general election in 2002, which brought Justice and Development Party (AKP) to power, took place in the atmosphere described above.

3.2 The introduction of Special Consumption Tax

A special consumption tax (SCT), or excise duty in general, is a consumption tax levied on specific goods and services, which was introduced shortly before the AKP came to power, during the coalition government rule led by the then Prime Minister Bülent Ecevit. Special Consumption Tax Law was passed on 12 June 2002 as a tax levied only on one stage of consumption of specific goods (Republic of Turkey, 2002). There are four main groups of goods subject to SCT in Turkey. The first group involves petroleum products, natural gas, lubricating oil, solvents and derivative of solvents. The second is related to land, air and sea vehicles (cars, planes, yachts, etc.). Alcoholic beverages and tobacco products constitute the third group. The fourth and last group includes all the other goods such as caviar, furs, mobile phones, electronic, etc. (Revenue Administration, 2016). The SCT rates vary in each group and specific goods under these groups from one to 160 percent (Republic of Turkey, 2002).

The introduction of VAT has already led to the reliance on tax revenues on indirect taxes since the 1980s. Indeed, the share of indirect taxes in total tax revenue has started to increase substantially especially since the early 1980s (Karanfil & Özkaya, 2013: 343). SCT increased this reliance on indirect taxes, which is evidenced in the heightened share of consumption taxes in the overall tax revenue since 2002.

SCT was firstly on the Turkish policymakers' agenda in order to simplify the indirect tax system and to align it with the EU rules. However, member state sovereignty has always been a priority when dealing with the tax matters for the Union (Remeur, 2015: 4). Harmonization of the tax system with the EU practice is

considered difficult compared to other policy domains (Cavlak & Işık, 2015). Before anything else, the decision to tax personal or corporate income, to have a VAT or excise duty and to determine the tax rates are regarded as domestic policy choices. Even if tax policy harmonization takes place, convergence requires a detailed detection of legislation due to the technical structure of the tax system. Hence, the introduction of a flat rate consumption tax that has low administrative cost, namely, the SCT, was an easy choice (Cavlak & Işık, 2015).

Tax policies of Turkey and the EU differ in many ways. Hereby, three examples are listed. First, although tax rates, especially on consumption, is higher in Turkey, the tax base is quite narrow compared to the EU average. Second, the capacity to collect taxes is lower due to the weak administration process. Last, there is hardly any social policy component that aims at increasing social welfare in taxation, particularly in income taxes and social security transfers for the sake of disadvantaged groups compared to EU (Taymaz & Özler, 2004; Togan & Ersel, 2005). Despite such differences, the simplification of the tax code and harmonization of the tax system with EU were revealed as two main triggering factors for the introduction of SCT.

Unlike VAT, excise duties that are used to tax specific goods such as alcoholic beverages, mineral oils, and tobacco products, have been losing their share in total tax revenue since 1975 in OECD countries (OECD, 2018: 121). However, with the introduction of SCT, Turkey started to diverge from the OECD countries with its heavy reliance on special consumption taxes.

The literature defines the main objective of a special consumption tax as an intervention to change consumption behavior (Yeomans, 2018). High tax rates on

alcoholic beverages or tobacco products are imposed to decrease their consumption for the sake of health issues (Thygesen, 2013). Governments put special consumption taxes on mineral oils for environmental concerns (Cnossen, 2011; European Commission, 2015).

However, the use of SCT in the Turkish case cannot be explained solely based on the abovementioned objective only. For instance, SCT is applied to a range of luxury goods such as cars or yachts. However, it is peculiar that SCT on yachts classified as luxury goods is reduced to zero percent in 2017 (The Official Gazette, 2017b). Another example of the use of excise duties in Turkey that contradicts with the environmental purposes associated with this type of tax is the presence of higher taxes on gasoline than diesel consumption; while diesel consumption has greater environmental harm than gasoline in vehicles (European Commision, 2015: 66; OECD, 2017). Among OECD countries, the excise duty on diesel is higher only in Switzerland (OECD, 2017: 127). As these examples demonstrate, the use of SCT in Turkey cannot always be explained based on broader social objectives such as environmental and health protection.

Above all, it is expected that for a tax allocated to a certain public service, the taxpayers of this particular tax should have a strong interest relationship with the public service provided by this tax (Bulutoğlu, 2004). In Turkey, however, revenue extracted from SCT can be spent by the Defense Industry Support Fund, for instance, where there is no direct relationship between the taxpayers and the public service provided by the Defense Industry Support Fund. On the other hand, even if the revenue collected through the SCT can also be transferred to the Development Fund for Tobacco Production, the President of the Republic of Turkey is authorized to

decrease the shares to be paid from the SCT revenue to zero (Republic of Turkey, 2002).

By 2004, two years after the introduction of SCT, revenue collected through special consumption taxes quickly reached 26 percent of the overall tax revenue, almost equaling the combined share of personal and corporate income taxes (Zenginobuz, 2008: 166). Then, revenue from the taxes on goods and services as a percentage of GDP climbed above the OECD average for the first time in Turkey (see Appendix C, Figure C1) and the share of taxes on goods and services in total tax revenue reached a peak point as 52.1 percent in 2003, one year later of the introduction of SCT (see Appendix C, Figure C2).

3.3 The overview of tax policy changes in the AKP period

The economic crisis of February 2001 initiated a process of political change and economic transformation (Öniş, 2009: 410). The reforms after the 2001 economic crisis were intended to form a basis for a self-regulating market economy and to separate politics and economics in the policy formation process (Buğra & Savaşkan, 2014: 77,78). The fiscal discipline was a common phrase that had been started to be used by politicians. The IMF once again recommended austerity policy (Boratav, 2018).

Under these circumstances, the AKP government introduced the 'Urgent Action Plan' in 2002 promoting fiscal measures such as broadening the tax base, simplification of the tax code and implementing a comprehensive tax amnesty (Şimşek, 2007: 61). Introducing additional taxes or raising the rates of existing taxes were two alternatives to decrease public debt. The government's response, to

introduce new taxes on consumption like a tax on fuel, has served both business communities and the Turkish public as Patton (2006) describes. First, the introduction of new taxes was a sign of commitment to the IMF principals for the business community. Second, the government's decision of not to increase the direct taxes on income was used by the government as an impression showing that the AKP resisted the IMF proposals for the sake of pursuing a more social agenda (Patton, 2006: 518).

The IMF historically has a significant role in shaping both the economic policies in general and tax policies in particular in Turkey. The Stand-By Agreement signed in April 1994 was unable to reach a success due to political crises resulted in the collapse of the coalition government (Arpaç & Bird, 2009: 140). The following government formed by Democratic Left Party (DSP), Nationalist Action Party (MHP) and Motherland Party representing center-right signed the next Stand-By including fiscal corrections, structural reforms and tight monetary policy acts in 1999. The agreement signed in 1999 was a turning point because it was the first one in post-war history that Turkey willingly signed an agreement to implement IMF policies in the absence of crises (Öniş, 2009: 434). The sequent agreement signed in January 2002 by the coalition government was accepted by the AKP once it came to power, despite the expectations that a single party majority government would not choose to implement tight economic measures proposed by the IMF over following a populist agenda (Arpaç & Bird, 2009).

From the starting date of its term of office, the AKP implemented fiscal discipline and used privatization to control the budget deficit and high inflation levels in line with the Stand-By Agreements with IMF. The success of decreasing inflation level into single digits after a long inflationary period and lower levels of

public debt constituted the clear indicators of the commitment of the AKP to IMF rules and its success in implementation (Kalaycıoğlu & Civelekoğlu, 2011: 208). Tax policy, no doubt, has been the main tool to implement fiscal measures. The government was committed to simplify the indirect tax system, to remove the tax on foreign interbank transactions, to launch a tax peace and to design a direct tax reform in line with the letter of intents sent to IMF (Turkish Government, 2003a, 2003b). However, the domestic interest groups have constrained the policy implementation process, generally through the patronage network they established with political parties as Arpaç and Bird (2009) stated the view of IMF on this issue:

> Hugh Bredenkamp, the IMF Resident Representative to Turkey, argued that even the AKP government succumbed to special interest groups to a degree. By raising tax rates in one sector and reducing them in another, the government tried to maintain support from key constituencies, whereas the IMF favored a broad-based tax regime. (p.145)

Still, the government signed the nineteenth and last agreement with IMF in May 2005 that was expected to increase foreign capital flow and to control exchange rate fluctuations. By the end of the validity date of that Stand-By, negotiations between the AKP and IMF to sign an agreement collapsed while the government showed this collapse as a sign of regaining national autonomy (Arpaç & Bird, 2009: 133). The eagerness of the AKP to resign from the policy implementation process proposed by IMF was framed as an indicator of national strength by the party itself. In a way, the AKP also favored the growing population of small and medium-sized firms that were highly critical to IMF-led policies by washing its hand of the organization (Kalaycıoğlu & Civelekoğlu, 2011: 207).

Moving on to the taxation outlook during the AKP period, another major change in the overall outlook of taxation was the decrease in the share of direct taxes

from 33.7 percent in 2002 to 30.8 percent in 2017, while the share of indirect taxes in tax revenue increased from 61.8 percent to 67.1 percent in 2017 (Table 1). The government chose not to take action to alleviate the dominance of indirect taxes but instead chose to deepen the heavy reliance on indirect taxation.

Tax evasion has continued to be a prominent feature of the Turkish tax system during the AKP rule. The comprehensive study of Buehn and Schneider (2016) concluded that Turkey has the second highest average level of tax evasion after Mexico among OECD countries, while its tax morale is the lowest in the period between 1999 and 2010. They argued that high volume of informal economy explains high rates of tax evasion. Indeed, the volume of the informal economy as a percentage of GDP was estimated as 33.2 percent in 2001, while the share of informal employment, the major indicator of the informal economy, was calculated as 46 percent in Turkey (Schneider, 2004; Turkish Statistical Institute, 2019). The size of the shadow economy is explained based on the relatively high burden of indirect taxation over direct taxation and the level of self-employment for all OECD countries within the same period (Schneider & Buehn, 2012). Tax amnesties have also been commonly used tax policy instruments in the AKP period. There were six amnesties with various scopes over the period 2002 to 2017 (Şanver, 2018: 47). Approximately, within every two-year period, tax amnesty is declared, which might have decreased the taxpayers' willingness to pay regularly due to the expectation of a tax peace. Finally, among many amendments in different kinds of the tax code, minimum living allowance was started to be implemented within the scope of personal income tax (The Ministry of Development, 2014).

Tax regulations implemented in the first period of the AKP was summarized in the 9th Development Plan as follows: 1) Personal income and corporate tax rates

have been reduced, tax exemptions have been narrowed, 2) special consumption tax has been introduced, 3) a regulation has been studied to abolish the investment tax credits, and 4) agency costs have been decreased for the financial sector (State Planning Organization, 2006). These were the main actions of the government contributing to the process that aggravated the reliance of Turkish tax revenues on indirect taxes. Finally, as a major tax reform during the AKP rule, the corporate tax reform is discussed in the next section.

3.4 The 2006 corporate tax reform in the AKP period

Corporate tax became a widespread practice after World War I as a way to recover from the war. A separate tax on corporate profits and gains was adopted in Turkey with the 1949 Tax Reform. The introductory rate of the corporate tax was 10 percent, but frequent changes were made in corporate taxation. The corporate tax rate increased to 20 percent between 1960 and 1963 and 25 percent from 1964 to 1980. In 1980, the corporate tax rate reached a peak at 50 percent and again it gradually reduced to 46 percent in 1986 and to 25 percent in 1994 (Armağan, 2007: 233). These reductions were partially compensated by the partial abolishment of discount on tax payments, tax exemptions and allowances in the attempt to enlarge the tax base (Çelikkaya, 2010: 41). The acquisition of corporations was started to be taxed at 30 percent in 1999, which was followed by an amendment increasing the real corporate tax rate to 33 percent in 2005 (Armağan, 2007: 234).

The most recent reform on corporate taxation, which is also the research topic of this thesis, is the reduction of the corporate tax rate in 2006 (For the historical variance in the corporate tax rate, see Appendix D). The amendment in 2006 reduced

the corporate tax rate from 33 percent to 20 percent (Republic of Turkey, 2006). Reductions in tax rates may not always result in revenue losses, as long as the tax base increases simultaneously. The share of corporate tax revenue in total taxation did not decrease until 2009 after the 2006 reform. However, the share of corporate taxes in total tax revenue did not increase either between 2002 and 2017 (see Appendix B, Figure B2). Corporate tax revenues as a percentage of GDP show a slight downward trend in Turkey between 2002 and 2017 and always remained below the OECD average (see Appendix B, Figure B3).

The continuous decrease in the corporate tax rate is not unique to Turkey. In 1982, none of OECD member countries adopted a corporate tax rate lower than 30 percent; while in 2018, only France applies 34 percent corporate tax rate and only three countries have corporate tax rates equal to 30 percent (OECD, 2007)[1]. International attempts took place for the harmonization of corporate taxation by the European Commission in 1997 and 2001 and by OECD in 1998 (Çelikkaya, 2010: 48). Indeed, the most widespread practice used in previous corporate tax reforms was to decrease the tax rate and to extend the tax base in the 1980s and 1990s (Devereux et. al., 2002: 452). Since the reductions in corporate tax rate were compensated with the decrease in tax exemptions and allowances, which leads to enlargement in the tax base, corporate tax revenue has remained stable for most of the OECD countries since 1982 to early 2000s. Only a few countries including Japan and Turkey experienced slight decreases in taxes on corporate income as a percentage of total tax revenue (OECD, 2007: 21).

[1] Even if the decrease in corporate tax rate is not unique to Turkey, it must be stated that the corporate tax rate implemented as 30 percent during the first period of AKP rule in Turkey cannot be considered as a very high tax rate compared to OECD countries. After the reform, the corporate tax rate was started to be implemented at 20 percent which is below the OECD average of 25 percent (see APPENDIX A).

The low share of corporate taxation in both total tax revenue and GDP in Turkey may stem from reasons including the existence of informal economy causing revenue loss, frequent tax amnesties creating disincentives to pay taxes (Zenginobuz, 2008) or tax exemptions to increase investment levels and improve industrial base (OECD, 2016; Invest in Turkey, 2019). Turkey implements a number of exemptions to especially manufacturing companies and companies operating in free trade zones, in addition to the implementation of special tax regimes in some specific sectors and regions such as the Southeastern part of the country where industrial development level is quite low. These exemptions and special regimes adopted in taxation can reduce necessary tax rates by up to 90 percent (Abramovsky et. al., 2014: 574). 90 percent tax exemption is also valid for strategic investment schemes apart from the regional incentives, with certain conditions such as the creation of a minimum 40 percent added-value and a minimum of TRY 50 million as the investment amount (Invest in Turkey, 2019).

3.5 The contemporary Turkish tax system within a comparative perspective

The first distinguishing characteristic of the Turkish tax system is the lower share of tax revenues in GDP in Turkey. Tax revenue over GDP is 25.3 percent in Turkey, which places Turkey somewhere at the very bottom among OECD countries having an average of 34 percent (see Appendix E). Only Ireland (23.3) and Mexico (16.6) are with lower levels of taxation than Turkey. The increase of the share of tax revenues in GDP has been very slight since the 2000s; tax revenue over GDP follows a steady pattern despite the increase in GDP level. In fact, this slight increase is due to the rise of social security contributions; tax revenue even decreased for some years

(The Ministry of Development, 2014). The modest rise in tax revenue over GDP ratio is also partially due to the increase of indirect tax revenue as it is shown in Table 1.

In addition to rises in the share of consumption taxes in total tax revenue, tax rates on personal and corporate income have fallen due to a number of policy changes. Between 2000 and 2005, there were 46 amendments to major tax laws, while tax rates have been adjusted 157 times by the Council of Ministers (Zenginobuz, 2008). In 2004, the marginal personal income tax (PIT) rate was reduced from 40 percent to 35 percent for wage and from 45 percent to 40 percent for non-wage income, followed by an amendment in the PIT Law in April 2006, to reduce the number of tax brackets. Currently, there are four tax brackets and the corresponding tax rates are 15, 20, 27, and 35 (Republic of Turkey, 1960). The share of personal income taxes in total tax revenue was 20.9 percent, which equals to less than half of the revenue collected by taxes on consumption in 2017 (Table 1). Together with the indirect taxes other than VAT and SCT, including the tax on international trade and transaction, stamp duty, gambling tax, and banking transaction tax, the share of indirect taxes in total tax revenue reaches approximately to 65 percent in 2017 (Table 1).

Table 1. Share of Specific Taxes in Total Tax Revenue in Turkey (as percentages)

	Personal income tax	Corporate Tax	VAT	SCT	Other indirect taxes	Other taxes
2000	23.4	9.1	14.5	17.7	26.8	8.5
2001	29.8	9.7	14.6	18.0	25.0	2.8
2002	23.7	10.0	14.4	24.2	25.2	2.4
2003	21.1	11.0	13.0	27.4	23.9	3.6
2004	21.2	10.5	13.1	26.5	27.2	1.5
2005	20.5	10.1	11.8	27.9	27.6	2.2
2006	21.1	8.1	11.6	26.9	30.0	2.4
2007	22.5	9.0	11.0	25.6	29.5	2.4
2008	22.6	10.1	10.0	24.9	30.0	2.5
2009	22.3	10.5	12.1	25.3	26.8	3.1
2010	19.2	9.9	12.5	27.2	28.4	2.8
2011	19.2	10.6	11.8	25.3	30.5	2.5
2012	20.3	10.4	11.3	25.7	29.7	2.5
2013	19.5	8.9	11.6	26.2	31.3	2.4
2014	21.0	9.2	10.8	25.8	30.9	2.3
2015	21.0	8.2	11.4	26.0	31.1	2.3
2016	21.0	9.4	11.8	26.2	29.3	2.3
2017	20.9	9.9	10.4	25.8	30.9	2.2

Note: Other indirect taxes include banking and insurance transaction tax, gambling tax, special communication tax, tax on international trade and transaction, stamp duty and fees.

Source: Author's own calculations based on the statistics of The General Directorate of Accounting, https://www.muhasebat.gov.tr/content/genel-yonetim-mali-istatistik-detayi?tabId=1&pageId=2

Figure 1 demonstrates that the OECD average of both direct and indirect taxes as percentages of total tax revenue followed a steady pattern between 1990 and 2016 and direct taxes have always constituted a larger part of total taxation compared to indirect taxes for the OECD average. However, the opposite has been valid for Turkey approximately since the last two decades. The margin between Turkey and

OECD average in both direct and indirect taxes is considerably high. It is quite visible that Turkey relies more on indirect taxation.

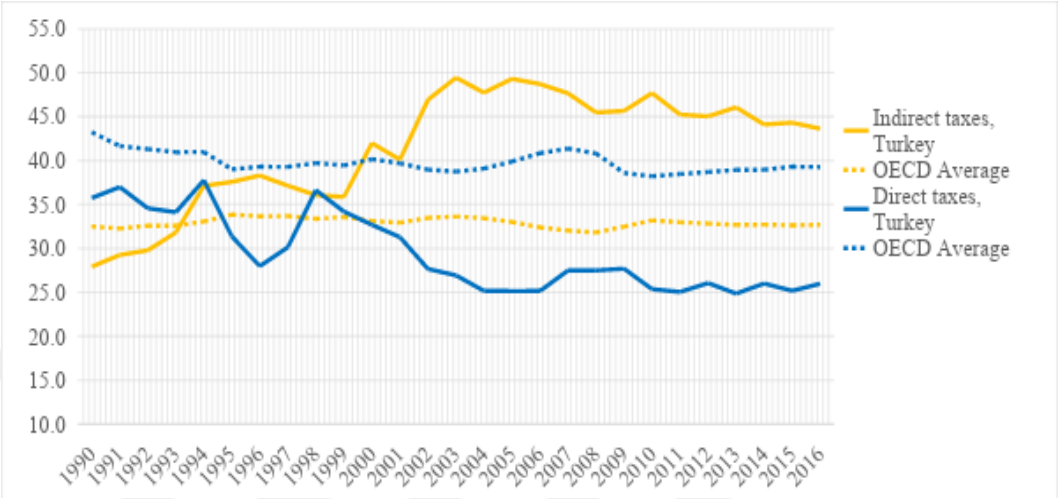

Figure 1. Direct and indirect taxes as percentages of total tax revenue

Note: Indirect taxes involve all types of taxes on goods and services including general taxes like VAT and taxes on specific goods and services like excise duties. Direct taxes involve the taxes on personal and corporate income, profit and gains and also the taxes on property. Social security contributions are not included in this figure, since the General Directorate of Accounting, an affiliate of the Ministry of Treasury and Finance in Turkey, does not classify social security contributions as a revenue item of total tax revenues in the income sheet of Central Administration Budget Law (Republic of Turkey, 2018) although social security contributions are regarded as a revenue source of taxation in OECD data classification.

Source: OECD Statistics, https://stats.oecd.org/#

Such a heavy reliance on indirect taxation may demonstrate the regressive character of the Turkish tax system. While both social expenditures and the tax system has a positive effect on decreasing overall income inequality and poverty, Toprak (2018) found that the impact of the tax system is minor, compared to social expenditures. Although VAT rates on basic consumption goods, which constitutes a significant portion of the poor's consumption basket, are reduced to 8 or 0 percent and progressive rates of SCT are applied at certain goods, consumption taxes are still

regressive and have very limited impact to reduce inequality (Toprak, 2018: 47). Moreover, Zenginobuz et al. (2008) explore the effects of taxation on poverty and social exclusion in Turkey. They found that the poor proportionally pay more taxes than the rich do and this is starker in the most vulnerable regions of Turkey, Eastern, and Southeastern Anatolia. Indeed, the regressive character of indirect taxes, in particular, affects the poor more (Albayrak, 2010: 141). Zenginobuz et al (2008) report that citizens find the tax system unfair and they do not feel that they receive the returns of taxes they pay in the form of public services. Due to the perception of corruption, unfairness and administrative failings, citizens are unwilling to pay taxes.

3.5 Conclusion

This chapter firstly examined the development of the tax system in Turkey briefly by emphasizing the efforts of the state to establish a modern tax system starting from the 1950s. Until the 1950s, Turkish tax system aimed at collecting revenue for the recovery of the war. It was clearly observed that agricultural sector was favored through taxation at the time.

The period started in the 1980s was a period of change for the tax system in Turkey as it was a transformation period for other policy domains in economic and political life. As Turkey adopted the principals of open market economy by removing taxes on international trade. In this period, special consumption tax (SCT) was introduced, which increased the existing reliance of the Turkish tax system on indirect taxation. Simplification of the tax code and harmonization of the Turkish tax system with the EU were stated objectives behind the introduction of the SCT.

Simplifying the tax system, implementing fiscal discipline with commitment to the IMF policy recommendations and broadening the tax base were the objectives of the AKP government. While some of these objectives informed policy changes, the period of the AKP rule was known for frequent tax amnesties and changes in the tax code, and increased reliance on indirect taxation. The 2006 corporate tax reform, which involved a significant rate reduction along with other regulations that eased the tax burden of the business, was implemented during the first period of the AKP government.

Finally, this chapter offered an overview of the main characteristics of the Turkish tax system in a comparative perspective. In contrast to other OECD countries, the share of total tax revenue in GDP is still low in Turkey. In addition, Turkey's reliance on indirect taxation has been maintained; there was hardly ever any attempt to reverse this in the AKP period. In fact, direct tax rates have been falling and the share of direct taxes in overall tax revenue has not increased.

CHAPTER 4

THE ROLE OF DOMESTIC POLITICAL ACTORS IN THE 2006 CORPORATE TAX REFORM IN TURKEY

This chapter presents an analysis of the domestic political processes that culminated into the 2006 corporate tax reform. The contemporary literature on tax politics emphasizes the key importance of globalization or tax competition in shaping the tax policies of countries. With this chapter, this thesis argues that while exogenous factors such as globalization or tax competition may be of critical importance in explaining the current worldwide trends in corporate taxation, a more comprehensive analysis that includes the role of domestic political factors will improve our understanding of contemporary tax politics. In this regard, this chapter offers a more dynamic analysis in which domestic actors such as the political parties as policy makers and business associations as interest groups play a part. Their parts might be both separate from each other or connected to each other in the sense that they might form an alliance or contest each other on the issue of corporate tax reform.

This chapter is divided into five sections. The first section focuses on the preliminary changes in corporate taxation, which was the first significant step of the AKP government to ease the tax burden of corporations. The second section presents the stance of political parties towards the 2006 corporate tax reform. The third section starts with an analysis of the economic and political environment that allowed business associations to influence the tax policy domain and then, presents the relations of MÜSİAD and TÜSİAD with the government to put forward how business associations were engaged in the process of tax policy formulation. The section also explores the business association stances that contributed to the

legislation of the 2006 corporate tax reform. Then, the fouth section analyzes the debates on the corporate tax reform from the perspective of social justice and improved income distribution in order to explore whether these issues came up in the political process that culminated into the 2006 corporate tax reform. Finally, the last part briefly outlines the analysis made throughout this chapter.

4.1 Preliminary changes in corporate taxation before the 2006 reform

Among several changes in the tax system regarding corporate taxation during the AKP period, introducing inflation accounting was the first move that eased the tax burden on corporate income. Thus, the data analysis starts with this change so that the political debate behind the corporate tax reform would be comprehensively presented.

Before implementing tax rate reductions on corporate income, the government put the inflation accounting into place (The Grand National Assembly of Turkey [TBMM], 2003a). Inflation accounting aims at ensuring the adjustment of financial statements with the purchasing power of money. It is needed when there is high inflation, because the rapid change in the purchasing power of money leads to significant value differences in the financial statements (Özulucan, 2002: 128). Hence, inflation accounting assures that taxpayers pay the right amount of tax in proportion to their decreasing income due to high inflation. In this way, tax revenues of a state would be expected to fall if inflation accounting takes place for inflationary economies. That is why inflation accounting has never been implemented in Turkey before despite of the existence of high inflation periods (Özulucan, 2002). High inflation, which has lasted for many years in Turkey, disrupted the financial

statements and caused them to move away from reflecting the real situation. The AKP government provided this as the justification for the draft law on inflation accounting. Thus, inflation accounting was introduced with the law no. 5024 to offset the negative effects of inflation on the financial statements (Çankaya & Dinç, 2004).

Inflation accounting, which was considered as a pursuant measure from a technical point of view on the tax policy, received no opposition from other political parties in the Parliament during the discussions when the draft law was firstly introduced in 2003. As the analysis of the parliamentary minutes shows, the only political party other than the governing AKP that commented on the amendment was the CHP (TBMM, 2003a). Deputies of the party strongly emphasized that this amendment was significant and the CHP supported this move. Another important aspect that the Deputies mentioned was about the timeline of the implementation of inflation accounting. The CHP wanted this law to be implemented immediately while the government wanted to extend the dates since business associations asked for some time to prepare their financial statements accordingly. The Deputy of the CHP criticized this decision by underlining that it was an urgent need of the whole business world and it should not be delayed because of the requests of TOBB or TÜSİAD. This is to say that two political parties, one as the government and one as the main opposition party, has supported the business and looked out for the interest of the business during parliamentary discussions in their own ways. One exception to this consensus was the fact that the main opposition CHP mentioned that the tax burden of wage earners would increase proportionally in 2004 since inflation accounting would decrease the taxable income of corporate taxpayers.

Kemal Unakıtan, the Finance Minister of that period, persistently declared that inflation accounting had been the dream and an important demand of the

business world for many years, yet no government except the AKP government had taken the risk due to high prices it would impose on the public budget. This price was the loss of tax revenue; the Minister mentioned that they were willing to face the revenue loss so that injustice in the tax system could be prevented and both domestic and foreign business actors could benefit. The government and Finance Minister insisted on the phrase 'reform' as referring to the amendment on inflation accounting since they considered this change as both a great challenge and a success (TBMM, 2003a).

Based on the analysis of the data collected from the press reviews and policy documents, it is observed that business associations demanded such an amendment on inflation accounting intensely before the law was introduced. While considering a tax reform as an absolute prerequisite to improve the investment climate for both domestic and foreign business and to reach economic growth in the long-term, Tuncay Özilhan, the President of TÜSİAD in 2002, focused on implementing inflation accounting and decreasing the tax rates as necessary steps to obtain these goals (TÜSİAD, 2002a). TÜSİAD repeatedly stated that the absence of inflation accounting in the Turkish fiscal system harmed tax fairness for corporate taxation and encouraged participation of business actors in the informal economy (Özyürek, 2002; TÜSİAD, 2002b). Mustafa Koç, the Vice Chairman of TÜSİAD, also emphasized the need for the implementation of inflation accounting due to the economic burden faced by corporations (Kıvanç, 2003).

MÜSİAD also considered the implementation of inflation accounting as a promising step while the amendment was on the agenda of the Parliament in 2003 (Çankaya, 2003). Meanwhile, the President of MÜSİAD at the time, Ali Bayramoğlu, presented tax policy proposals including inflation accounting to the

IMF as necessary steps to be taken to avoid informal economy and to increase tax revenues. The IMF's response was positive (Yıldız & Kocaman, 2002). The act of business associations giving policy advice to the government have been a usual practice; however, a domestic business association representing mostly small and medium-sized firms, giving policy advice to an international organization can be regarded as a novel practice. This may be the sign of potential influence of IMF on the government by keeping close ties with other domestic actors, taking into account that stand-by agreements between IMF and Turkey was still honored in that period.

The period of change for corporate taxation between 2002 -when the AKP came into power- and 2006 -when the substantial decrease in corporate tax rate took place- started with the 'The Amendment on Tax Procedure Law, Income Tax Law and Corporate Tax Law' that included the introduction of inflation accounting (Republic of Turkey, 2003a). A follow-up reform on corporate taxation was made with 'The Amendment on Corporate Tax Law' (Republic of Turkey, 2003b). Besides a tax rate reduction, which is explained detailed below, donations to the Directorate General of Foundations are extracted from the corporate tax base of taxpayers with the new Corporate Tax Law. The amnesty also included tax exemptions like the exemptions of corporate profits derived from real estate sales, a full exemption of corporate tax for the research and development companies in technology zones. Hence, this amnesty also included measures that ease the tax burden on corporate income.

The first reduction in corporate tax rate implemented during the AKP period was the 3 percent decrease, which was carried into effect starting from the 2005 fiscal year. This reduction was actually assured with the amnesty on Corporate Tax Law that included a 3 percent rise for corporate tax rate due to the abolishment of

fund share on corporate income in 2003 (TBMM, 2003b). Fund share mentioned in Corporate Tax Law enabled the authorities to collect more revenues for the Defense Industry Support Fund, the Social Assistance and Solidarity Promotion Fund and the Apprenticeship, Vocational and Technical Education Development and Dissemination Fund. 10 percent fund share of corporate tax allowed the governments to tax corporate tax revenue collected from the taxpayers at a 10 percent rate. This extra amount calculated as the 10 percent of corporate tax ratio made the tax burden on corporate taxpayers as 33 percent (TBMM, 2003b). Hence, the abolishment of fund share on corporate taxation was compensated with a 3 percent increase in corporate tax rate with the amnesty in 2003. This amnesty projected the 33 percent corporate tax rate to be implemented only in 2004, then, the rate would automatically fall to 30 percent as the 2005 fiscal year starts (The Official Gazette, 2003). With the reform that removed the fund share on corporate tax, the tax burden of corporate taxpayers calculated as 33 percent in 2003 was gradually reduced to 30 percent in 2005. It is striking that the AKP government did not risk a revenue loss due to a 3 percent decrease in corporate tax rate for the 2004 fiscal year, while it afforded a 10 percent decrease in corporate tax rate in 2006.

Once again, there were no opposition from the political parties in the Parliament to the amendment that removed the fund share from corporate tax. The CHP criticized the government for not being consistent about its attitude towards decreasing corporate tax rate (TBMM, 2003b). For the main opposition party, the government should not increase the corporate tax rate to compensate the revenue loss derived from the abolishment of fund share on corporate tax, even if this increased rate would apply temporarily.

Öniş (2006: 207) pointed at the success of the AKP to form a cross-class alliance, which also included the significant support of business. Öniş's argument (2006) is important to explain the AKP government's decision to reduce corporate tax rate by 13 points in total with two separate amendments. Over the years, the AKP showed commitment to the support it received from the business by gradually decreasing the corporate tax rate and risking the revenue loss that comes with the rate reduction. The AKP, indeed, has secured its alliance with business by also successfully dealing with economic recessions, which was also observed by Öniş (2006). The economic outlook of Turkey has overall improved during the first period of AKP rule. Economic growth level has started to increase while public debt stock has started to decrease (Table 2); leaving enough room for the government to afford reductions in tax rates.

Table 2. Public Gross Debt Stock as Percentages of GDP and GDP Growth Over the Period, 2001-2007

	2001	2002	2003	2004	2005	2006	2007
Public gross debt stock (% GDP)	77.0	71.5	63.6	57.7	52.1	46.3	40.3
GDP growth	-6.0	6.4	5.6	9.6	9.0	7.1	5.0

Source: General Directorate for Budget and Fiscal Control, http://www.bumko.gov.tr

In addition to decrease in the inflation rate to single digits, Table 2 shows that economic growth level significantly increased and reached a peak in 2004. Reduction in public debt may also has made it possible for the government to decrease the corporate tax rate. This outlook of a rapidly growing economy with falling debt levels has contributed the support of business for the AKP.

It must be noted that the government concurrently relied both on marketization and welfare expansionism while following neoliberal economic policies and populist social policies (Yılmaz, 2017). In this way, the party pursued to establish a cross-class alliance with both the general public and the bourgeoisie having economic and political power. The quest of the AKP for a broad political alliance may stem from the quest for a legitimacy of the party. The indications of the warning of the Turkish Armed Forces to the government for its acts and stance against secularism, known as the 'e-memorandum' (*e-muhtıra*), can be traced back in the previous years before the e-memorandum was published in 2007. There was critique for the AKP from the military and the CHP while the tension between those political actors intensified at the first period of the AKP rule (Aljazeera, 2016). Hence, the political process and the domestic tension that the AKP had to cope with has actually contributed the process of establishing political alliances of the party with a broader mass including both the public and the interest groups.

4.2 The stances of political parties towards the 2006 corporate tax reform

The Development Plan for the period between 2001 and 2005 did not include a reform on corporate taxation (State Planning Organization [DPT], 2000). Hence, it seems that the 2006 corporate tax reform was a product of the first period of AKP rule, rather than a policy change planned prior to the AKP rule. In 2004, the Investment Advisory Council agreed on altering the corporate tax rate in line with the principals of competition and accelerating privatization (Ekonomi Servisi, 2004).

The party program of the AKP included a sentence on a possible tax reform aimed at simplification of the tax system (Ak Parti, 2002). The program of the 58th

government in which Abdullah Gül was the Prime Minister included a tax reform planned to be prepared in line with the principals of public sector balance, real sector and social policy (TBMM, 2002). The program of the following government in which Erdoğan was the Prime Minister also included a short passage on a tax reform that envisaged possible reduction in tax rates and the enlargement of tax base (TBMM, 2003). The framing of tax reform in all these programs were quite general and there was no specific reference to corporate taxation and a reduction in corporate tax rate.

The corporate tax reform that was legislated in June 2006 included changes in the corporate tax rate, transfer pricing, investment subsidies and tax exemptions. Although political parties participated in the parliamentary discussions on the reform had some objections to some changes in the draft law, they unanimously favored the reduction in corporate tax rate as it is shown in detail below.

The main opposition party, CHP, agreed with the government that the most significant change in this law draft is the 10 percent decrease in corporate tax rate. In response to the AKP government's framing of this reform as a step towards harmonization with the EU, the CHP argued that the draft of law has no relation with the harmonization process with the EU. The party grounded its argument by stating that even tax policies of the EU member states was not yet harmonized. The EU had only been seeking convergence within the indirect tax rates that enable the free flow of capital, goods and services across the region excluding convergence over direct taxes (TBMM, 2006). This argument of the CHP is noteworthy as it evidences how domestic political actors do not passively accept international trends or are convinced about policy changes when those changes are framed as international trends, but develop their own assessments of proposed policy changes. Nonetheless, during the

discussions at the Parliament, tax competition was put forward as an acknowledged fact that boosted many countries to decrease tax rates by the political parties commented on the draft of Corporate Tax Law on June 2006.

Enhancing the investment climate and increasing employment were two important justifications of the corporate tax reform, which seemed to be accepted by all political parties voted for the amendment after the Parliamentary discussions. The government, in the first place, referred to high tax rates as the main obstacle against increase in investment and employment. The government argued that the reduction in corporate tax rate from 30 to 20 percent was a necessary step to strengthen the competitiveness of corporations in the global market and to encourage the foreign direct investment (TBMM, 2006). This view of the government was also shared by the CHP and ANAP, the political parties commented on the draft and both voted yes. Still, they had oppositions to some other provisions of the law draft such as the limited expansion of tax base.

The Minister of Finance of the first period of the AKP, Kemal Unakıtan, claimed that the rate reduction in corporate tax would not cause any deviation from the fiscal discipline of which the government was committed to apply and any increase in budget deficit thanks to the measures the government took against revenue loss (TBMM, 2006). These measures included expanding the tax base by eliminating tax exemption of consumption and transportation cooperatives and Turkish Drivers and Automobile Workers Confederation (TŞOF) were considered as rather political decisions instead of decisions taken in line with fiscal measures by CHP and ANAP. Taking into account that the scope of these tax exemptions was narrow so the revenue gained by eliminating exemptions would not compensate the revenue loss caused by the reduction in corporate tax rate, the CHP argued that this

decision stemmed from the tense relations between the government and the Confederation of Turkish Tradesmen and Craftsmen (TESK). Consequently, the CHP tabled a motion to maintain the tax exemptions, but the motion was rejected at the Parliament (TBMM, 2006). The government stated that these tax exemptions were eliminated just to prevent harmful competition in the market. In addition to accusing the government of adopting a biased attitude to TESK, the CHP claimed that the government did not want the existence of a powerful cooperative system; so, took a political decision against it (TBMM, 2006). Indeed, eliminating tax exemptions of only transportation sector and only certain type of cooperatives excluding building cooperatives, for instance, and adopting a narrow scope for tax exemptions casted doubts on the decision of the government to expand the tax base. The Parliamentary discussions also underlined that Turkey followed the EU and OECD countries by decreasing corporate tax rate; however, the opposition MPs mentioned that it failed to expand the tax base like many of the EU and OECD countries did to avoid a possible revenue loss.

Another criticism of opposition parties about the corporate tax reform centered upon the timing of the reform. The CHP questioned that if the reduction in corporate tax rate were preannounced, Türk Telekom, the public enterprise in telecommunication sector, would not have been sold at a cheap price.[2] Although the Finance Minister answered the question by simply indicating that the tax reduction would apply to all sorts of corporations, the main opposition party saw the timing of both the announcement of the reform and the privatization of Türk Telekom as a gesture made by the government for the benefit of new owners of the corporation

[2] It should be mentioned that TÜSİAD demanded to take Türk Telekom shares public promptly in 2001, before the government proposed the privatization of Türk Telekom for the agenda. (Milliyet, 2001).

(TBMM, 2006). Then party leader of the CHP, Deniz Baykal, also argued that implementing corporate tax rate as 20 percent just two months later than the privatization of Türk Telekom aimed at providing convenience to Hariri family, the new owners of the company (Yeni Şafak, 2008).

The CHP considered the elimination of investment tax credits, which was implemented to compensate the revenue loss stemmed from the rate reduction in corporate tax rate from 30 to 20 percent as a practice of injustice to small and medium-sized enterprises (SMEs). This is because the corporate tax rate reduction was in benefit for mainly banks and large companies that pays a great amount of corporate tax revenue while SMEs heavily used investment tax credits to expand their business (TBMM, 2006). The CHP argued that investment tax credits should remain intact for the sake of Turkish economy and SMEs. With the elimination of investment tax credits, corporations adding value to production and contributing to employment generation and financial actors gaining from monetary transactions pay their taxes at the same rate (TBMM, 2006). This regulation was criticized based on its failure to subsidize production or investment, which was expected to negatively affect the SMEs. It surely created a simpler system involving a flat-rate tax with low administrative cost. However, taking into consideration that the SMEs constitute a larger group compared to main taxpayers of corporate tax, it is doubtful that this reform served the interests of the SMEs as far as it did the larger corporations.

4.3 The positions of TÜSİAD and MÜSİAD on the 2006 corporate tax reform

As a late industrialized economy, Turkey experienced three waves of industrialization through the course of time since the foundation of the Republic as

Pamuk (2008) described. In the 1930s, industrialization was led by the state enterprises. After the World War II, the industrialization process was carried out mainly by the private sector albeit with state support, many of which were based in İstanbul. Since the 1980s, industrialization has been spreading to Anatolian cities. Within the scope of interest representation, institutions such as chambers of industry and commerce of which membership was obligatory were the strongest actors for interest representation recognized by the state (Buğra & Savaşkan, 2014). The most dominant interest group of the second wave of industrialization was the Turkish Industrialists' and Businessmen's Association (TÜSİAD), which was established by industrial elites of private sector based in İstanbul in 1971. The Independent Industrialists' and Businessmen's Association of Turkey (MÜSİAD) was established in 1990 following the last wave of industrialization expanded across Anatolia (Pamuk, 2008: 271).

Following its establishment in 1971, TÜSİAD seemed to be less dependent on the state in formulating its interests (Buğra & Savaşkan, 2014). TÜSİAD suggested that encouraging the private accumulation of capital is the only way to increase industrial capacity and to decrease trade deficit while showing great concern on social justice and public welfare (Bianchi, 1984). The Association endorsed that this could only be achieved through solving the problem of tax evasion by merchants and *esnaf* along with the introduction of a new value-added tax and increasing the tax burden on agricultural income (Bianchi, 1984: 269).

Contrary to expectations, TÜSİAD did not take a critical stance against the AKP government during its first period between 2002 and 2006. This stance of TÜSİAD, largely, could be explained based on the economic stability and fiscal

discipline that the government had shown commitment (Öniş, 2006: 221). However, the position of the TÜSİAD against the government has not remained constant.

As Buğra and Savaşkan (2014) argue, TÜSİAD, as a voluntary business organization, envisages a more liberal outlook for the society and considers labor unions as social partners. The Association aimed at consolidating big business in the policy formulation process along with vocal criticism of some government policies (Buğra & Savaşkan, 2014: p.115). In response, for example, the government punished Doğan Group as a powerful member of TÜSİAD which took a critical position against the AKP, with wide-ranging tax audits, resulting in a tax penalty of 3.8 billion US $ in the 2000s (Buğra & Savaşkan, 2014: p. 97). On the contrary, there were serious claims about Fettah Tamince, a well-known businessman with his ten enterprises having close ties with AKP government, stating that he did not pay any corporate tax or not even declared any taxable corporate income. Furthermore, there are strong links emphasized in the media between the exclusion of diamond sales tax from the VAT and the company exporting diamond that belongs to Cihan Kamer, who was favored by the government (Buğra & Savaşkan, 2014: p. 91).

While the MÜSİAD is the business organization that shared a political ideology and had close ties with the AKP government, strikingly, it voiced a more critical stance on the economic performance of the AKP in its first term in power. Although the MÜSİAD gave credit to the government due to its success over the inflation control, narrowing down the budget deficit and general performance during a post-crisis period, the organization strongly criticized the country's dependence on short-term foreign capital flows and especially the surveillance of IMF on the Turkish economy resulting in tight fiscal rules (Öniş, 2006: 222).

Besides the overall stance of the business associations towards the government policies, personal relations of the government with the businessmen might also shaped the social and political position of business associations. The ties of the government with the MÜSİAD might be considered as rather organic due to their shared political roots. The MÜSİAD was characterized as the roof that incorporates the businessmen affiliated with different Islamic cults and religious communities (Kardeşoğlu, 2001). The Association also became the center of attention with the victory of AKP in 2002 elections (Ekonomi Servisi, 2002a; Türk, 2002). One illustration of the close ties between the MÜSİAD and the AKP government was the then Prime Minister Erdoğan's decision to meet with the MÜSİAD President Ömer Bolat over the TÜSİAD summit where he was invited too (Milliyet, 2005b). Ömer Bolat was the CEO of the Albayrak Group that was known for its close ties with Recep Tayyip Erdoğan (Sabuncu, 2004). Furthermore, 21 members of MÜSİAD were elected as AKP deputies in 2002 elections; among them, one was the Finance Minister Kemal Unakıtan and one was the Minister of State Ali Babacan (Okur, 2003). Given that among many, the President of MÜSİAD at that period, Ali Bayramoğlu and the owner of Ramsey, Remzi Gür Erdoğan whom was an influential member of MÜSİAD (Türk, 2003a) were close friends of the then Prime Minister Erdoğan (Okur, 2003), it would be expected to see reflections of the opinions of MÜSİAD upon the policies of the government. During the General Assembly of MÜSİAD, Erdoğan stated, "If there is some sort of deadlock, it is my duty to solve that as your brother and Prime Minister" (Ekonomi Servisi, 2003).

Nevertheless, the liberal position of the government towards economic policies at times conflicted with that of the MÜSİAD. For example, in response to the MÜSİAD's demand for an interest-free financial system, Erdoğan replied as

follows: “Interest is a fact of life and if they have not get used to it yet, they can be members of ‘YOSİAD’ (The poor industrialists and businessmen’s association)” (Öğütçen, 2005).

Personal relations of the government officials with the TÜSİAD representatives might be considered rather weak, compared to the organic ties between the government and the MÜSİAD describes above into account. There were still some exceptions. For instance, a close friend of the Prime Minister Erdoğan, Cüneyd Zapsu, who is a TÜSİAD member, tried to introduce Erdoğan to TÜSİAD community (Türk, 2003a) although the Association was critical with certain actions of the government. Nonetheless, the TÜSİAD had managed to enhance its relationship with the government over time. Lobbying, as a form of instrumental power and as a tool for businessmen to take place in tax policy formulation process (Fuchs, 2007), was used well by the Association.

The TÜSİAD systematized its lobbying activities on tax policy before the AKP came to power by establishing a ‘Tax Working Group’ that aimed at changing the tax legislation (TÜSİAD, 2001). The basic tenets of TÜSİAD stance on fiscal policies included enhancing the competitiveness of corporations in both domestic and international markets and accelerating the harmonization process with the EU within the framework of fiscal policies (TÜSİAD, 2001). The report presented by the Tax Working Group to the Ministry of Finance in 2001 did not demand a reduction in corporate tax rate directly, still the report called for the legislation of the special consumption tax to simplify the taxes on goods and services and some improvements on the Corporate Tax Law (TÜSİAD, 2001).

The TÜSİAD had been actively undertaking lobbying activities after the electoral victory of the AKP in 2002, which eventually led its election to the most successful lobbying organization within the EU Mediterranean Economic Development Area Program (Türk, 2003b). The representative of TÜSİAD in Brussels explained this success as follows:

> The basic rule of lobbying is to be either a voter or a taxpayer against decision-making mechanisms. That means votes and money. Being a respected source of knowledge and sympathy also play a secondary role. The TÜSİAD is well-seated with its second-degree sources. Even if it is not in the position of a voter or taxpayer, it puts the ones who are either voters or taxpayers into place. (Türk, 2003b)

The TÜSİAD, for example, organized meetings and events with the government officials in charge of tax policy, made publications including evaluations and proposals on the tax system, and participated in the preparation process of draft laws such as the Corporate Tax Law passed in 2006 (see Appendix F). As an illustration, the TÜSİAD and the Tax Council published a study entitled 'The restructuring of Turkish Revenue Administration: Basic design' which proposed a comprehensive reform for tax administration. During the publicity meeting of the study, the TÜSİAD President Ömer Sabancı declared that they had the support of the Finance Minister and they established a working group with officials whom were nominated by the Minister himself (TÜSİAD, 2004b). The collaboration between the state officials and the TÜSİAD members was so close that the main opposition party claimed that the AKP is the government that served the TÜSİAD most while referring to the decrease in corporate tax rate from 30 to 20 percent (Milliyet, 2005a).

For example, in 2003, the Tax Working Group of TÜSİAD declared that the Association would build opinions on the government's letters of intent submitted to the IMF and these opinions would be circulated publicly in the seminar the

Association organized. The Group also keened on maintaining close relations it had with the Tax Council (TÜSİAD, 2004b). It must be stated that the relations of TÜSİAD with the key state institutions in charge of tax policy formulation is not unilateral. For instance, the Tax Council, on behalf of the Ministry of Finance, requested opinions of TÜSİAD in 2005, during the preparation phase of the 2006 Corporate Tax Law (TÜSİAD, 2006a).

The need for a comprehensive reform on taxation has been expressed by MÜSİAD and TÜSİAD before the AKP came to power. For example, the TÜSİAD argued that the tax reform was the most crucial step needed to be taken for economic stability (Uras, 2001). The following statements of TÜSİAD officials evidence that this position continued after the AKP came to power. "Starting from the end of 2004, Turkey should adopt a modern, sustainable, non-cyclical, tax policy that will expand its tax base" (TÜSİAD, 2003a). "We expect effective tax measures to be taken in 2005" (TÜSİAD, 2004c). "The upcoming period should be the period of reducing the tax burden of the heavily taxed segments" (TÜSİAD, 2005b). TÜSİAD's annual reports recommended a tax reform along with the proposed ways for a possible reform (TÜSİAD, 2002a, 2003a, 2004c, 2006a).

The demand for a reduction in corporate tax rate was at the center of the business associations' statements. The TÜSİAD proposed to decrease corporate tax rate gradually in 2002 (TÜSİAD, 2002c) and renewed its proposal in 2003 (TÜSİAD, 2003b). In 2004, the Association once again requested a reduction in corporate tax rate by mentioning that 1 percent of taxpayers paid almost 80 percent of all taxes based on income (TÜSİAD, 2004a). In 2005, a rate reduction in corporate tax rate was expressed by the TÜSİAD emphasizing that they were not part of the informal economy (TÜSİAD, 2005a).

The MÜSİAD also demanded a reduction in corporate tax rate as it was mentioned before (MÜSİAD, 2001a, 2005a). A call for a reduction in corporate tax rate as well as other taxes has been expressed by the MÜSİAD in its own publications since 2001 (MÜSİAD, 2001, 2002, 2005). Unlike the TÜSİAD, the MÜSİAD mentioned exact rates for taxes or discount rates. For instance, the Association demanded a progressive corporate tax structure, similar to the personal income tax structure, having equal brackets ranging between 10 and 30 percent. In order to increase domestic consumption, to decrease production cost and to encourage formal economy, the MÜSİAD also proposed VAT to be 10 percent (MÜSİAD, 2001). After the AKP came to power, the president of the MÜSİAD, Ali Bayramoğlu, stated that the government did not keep its promise to decrease tax ratios; no tax reduction had been made until that day (Yeni Şafak, 2004a). The MÜSİAD once again demanded significant decreases in the tax and social security burdens on small and medium-sized enterprises from the government in 2005 (Yeni Şafak, 2005b). Given the profile of its members, the majority of which are small and medium-sized firms, demanding a progressive corporate tax may be a rational choice for the MÜSİAD, while the opposite, a flat-rate corporate tax with a reduced rate would benefit the TÜSİAD more given its member profile consisting of large corporations. However, after the corporate tax rate was fixed to 20 percent in 2006, the MÜSİAD did not reiterate its demand for a progressive corporate tax rate structure.

Tax competition emerges as a theme that business associations referred in their calls for tax reform and reduction in corporate tax rates. For example, the TÜSİAD emphasized that tax rates had been falling worldwide; meanwhile, tax burden in Turkey reached around the OECD average. For the sake of a better

investment climate in Turkey, the TÜSİAD stated that tax rates should be compatible with nearby countries (TÜSİAD, 2005c). In addition, the TÜSİAD was not content with the reduction in corporate tax rate to 30 percent in 2005 (TÜSİAD, 2005d). The Association stressed that Turkey was falling behind the international tax competition (TÜSİAD, 2004d). The trend to decrease corporate tax rates across the EU was also pointed out as a justification for the reform by the Association (TÜSİAD, 2003c, 2003f, 2005e), while the MÜSİAD, in a similar manner argued that corporate tax rate was quite high in Turkey compared to other OECD countries (Öğütçen, 2005). The Association also argued that input costs for production and investment are high that they make fair competition harder for Turkish business world compared to their rivals in international trade (Yeni Şafak, 2004b).

The need for a tax reform was mainly grounded on the needs and problems of private sector by the business associations. To begin with, enhancing the investment environment was one of the issues that the business associations picked up. As a result, employment level and economic growth would be increased (TÜSİAD, 2002b, 2003b, 2003c, 2003d). For the TÜSİAD, high levels of taxes including corporate tax and personal income tax are among the main reasons discouraging the foreign direct investment flow in Turkey (TÜSİAD, 2004c, 2005f). The MÜSİAD also agreed that high tax rates had negative impacts on international competitiveness of the country and the employment level (MÜSİAD, 2005).

Another theme that emerges from the analysis of business organizations' statements on the tax reform is the link between tax system and the informal economy[3]. The large volume of the informal economy was mentioned several times

[3] The estimated volume of the informal economy as a percentage of GDP was 31.61 percent in 2002 and 30.26 percent in 2006 (Elgin & Öztunalı, 2012).

by the TÜSİAD as one of the negative consequences of the tax policy at the time (Ekonomi Servisi, 2002b; TÜSİAD, 2002b, 2003c, 2004c, 2004d, 2005a, 2005f). From the perspective of TÜSİAD, informal economy created an unfair competition for the TÜSİAD members who are paying their taxes (TÜSİAD, 2002b). The Association, referring to the informal economy, also claimed that the state put the whole tax burden on whom the state was able to collect from taxes (TÜSİAD, 2004d). As the formal taxpayers of the state, the TÜSİAD had right to demand a reduction in tax rates, Ömer Sabancı argued (TÜSİAD, 2005a). The following quotation from Ömer Sabancı, the then President of TÜSİAD in 2004, indicates that the TÜSİAD saw a tax reform that would decrease tax rates and total tax burden on the business as an ultimate solution to major problems of the Turkish economy:

> A tax reform that foresees a serious fight against informal economy and promotes production and investment is a key element that can solve many problems in one move. Of course, it will be necessary to lower tax rates to at least the level of Central and Eastern European countries that have become members of the EU and to attract domestic and foreign investors, and to restructure the revenue administration in a way that will be autonomous. (TÜSİAD, 2004e)

Despite TÜSİAD's strong emphasis on its full compliance with the tax regulations, this claim did not fully correspond to their practice. The Finance Minister Kemal Unakıtan, for example, stated that there were members of TÜSİAD who did not fully fulfil their tax obligations (Ekonomi Servisi, 2006). Many TÜSİAD members employed legal strategies of tax evasion. To illustrate, Tuncay Özilhan, the president of High Advisory Council of TÜSİAD, was found to be both the beneficiary and shareholder of Albes Group Inc. registered in the British Virgin Islands, a tax haven listed in Panama Papers (Offshore Leaks Database, 2015a). One of the former presidents of TÜSİAD, Ömer Sabancı, among the many Sabancı family members

mentioned in Panama Papers, was in the list of officers who had connections to Cargus Management Ltd. again registered in the British Virgin Islands (Offshore Leaks Database, 2015b).

The arguments put forward by the business associations listed above to justify their demands regarding taxation and corporate tax in particular gradually contributed to the elevation of the tax reform in the political agenda. At the end of the process described above, the corporate tax rate was reduced from 30 to 20 percent in 2006. The business associations, both the MÜSİAD and the TÜSİAD, welcomed the amendment with great pleasure.

The MÜSİAD classified the reform as revolutionary in the sense that it would substantially benefit the investors and employers (MÜSİAD, 2007a). The TÜSİAD used the word 'radical' in describing the reform and evaluated the reform as an important step towards the sustainable growth reinforced by competitive power (TÜSİAD, 2005g). However, the business associations, especially the MÜSİAD, criticized the abolishment of investment tax credits. The Association commented on this regulation by emphasizing that it would create disadvantage for the production side of the economy (MÜSİAD, 2006a), and so it expressed its dissatisfaction with that decision (Yeni Şafak, 2005a). While indicating that TÜSİAD members were against the abolishment of investment tax credits in a meeting they held with the President of the Republic, Ahmet Necdet Sezer (Yeni Şafak, 2005c), the TÜSİAD also inconsistently considered that regulation as a compensatory measure taken against the revenue loss caused by the decrease in corporate tax rate by 10 percent (TÜSİAD, 2005h). The inconsistency between the evaluations of TÜSİAD may stem from its focus more on the rate reduction component of the reform rather than the investment tax credits.

Furthermore, the TÜSİAD released a report to express its opinions and evaluations on the new Corporate Tax Law passed in 2006 to the Revenue Administration and the Tax Council[4]. In that report, TÜSİAD's only negative feedback was on the article that does not favor corporations' interest; the article that put a tax on monetary transactions made by corporations based in Turkey to the countries classified as tax havens (TÜSİAD, 2007).

After the Corporate Tax Law was passed on June 2006, the then Prime Minister Erdoğan appealed to the business world as follows:

> You constantly call for a tax reform. We have given up from many revenue items in taxation since we arrived. We are continuously decreasing them. Isn't this the tax reform in action? We reduced the corporate tax, VAT and withholding taxes. It is not enough, of course, we will continue. We cannot make them all in one breath. If we do, what will happen to this country's economy? (Yeni Şafak, 2006)

The statement of the Prime Minister explicitly shows that the government paid strong attention to the demands of business and avoided damaging its relationship with them. It also shows that the fiscal policy, a potential tool that can be used to implement rights-based policies and achieve social justice, was used to please a minority but a powerful group, the business.

[4] The Tax Council was established in 1992 in order to establish a strong and effective tax system in line with economic policies, growth objectives and the rights of taxpayers. The operations of the Tax Council were actively started in 2003 with the aim to act like a bridge between the taxpayer and the entities that formulate tax policy and to build a platform for social reconciliation in which all parties are represented. The President of Tax Inspection Board, The President of Revenue Administration and The General Director of Revenue Regulations are permanent members of the Council from public sector. Non-governmental organizations and business associations are represented at the Council (The Tax Council, 2019).

4.4 Diverse uses of the notion of tax fairness in the debates on the corporate tax reform

How and to what extent do social justice and tax equity concerns play a role in the policy process leading to the 2006 corporate tax reform? The issue of tax fairness took a modest place within the scope of the political debate on the corporate tax reform. During the parliamentary discussions on the reform, firstly, the ANAP brought forward the issue of tax fairness while also indicating that states were competing to attract foreign direct investment by decreasing tax rates. In Muhsin Koçyiğit's own words on behalf of the ANAP group: "Throughout this process, unfortunately, tax competition prevails tax fairness and it causes a dilemma between tax competition and tax fairness for less developed countries" (TBMM, 2006). The ANAP raised the issue of increasing share of indirect taxes. The party indicated that value added tax rate known as the poverty tax was not decreased, despite the earlier statement of the Prime Minister in that direction, while the upper bracket of personal income tax was reduced by 5 percent for the high-income group. The CHP approached the issue of tax fairness in a similar manner by emphasizing that the share of indirect taxation in total tax revenue increased from 66 to 70 percent during the AKP period and the decrease in corporate tax rate would aggravate this negative trend (TBMM, 2006).

The Confederation of Turkish Trade Unions (TÜRK-İŞ) and the HAK-IS Trade Union Confederation (HAK-İŞ), as the largest private sector trade union confederations in Turkey, remained silent with respect to the corporate tax reform in 2006. Nevertheless, the Confederation of Progressive Trade Unions of Turkey (DİSK) -the smaller private sector trade union confederation- argued that tax burden was on the public, not on the employers. DİSK emphasized that the tax burden of

employers in Turkey was significantly lower compared to the EU and OECD countries (DİSK, 2007a). Moreover, the confederation emphasized that corporations' contribution to tax revenue through corporate taxation remained marginal, while they received large amount of interest payments by lending to the government (DİSK, 2007b). This issue was also expressed by the ANAP during parliamentary discussions by stating that the government paid large amounts of money to the business under the name of high real interest rate by means of collecting taxes from the poor (TBMM, 2006).

The issue of tax fairness was also brought forward by the MÜSİAD immediately before the legislation of the corporate tax reform in 2006. The MÜSİAD showed the intense reliance on indirect taxation in tax revenue as a sign of injustice (MÜSİAD, 2005). However, the unbalanced tax burden stemmed from the high tax rates according to MÜSİAD. In response to such formulation of the problem, the Association called for a reduction in both corporate tax rate and VAT rates (MÜSİAD, 2005).

Similar to MÜSİAD's position, TÜSİAD also used the notion of tax fairness to refer to the high tax rates that harmed the international competitiveness of Turkish corporations. The TÜSİAD also employed the notion of tax fairness to refer to the existence of informal economy that created injustice for the members of the Association (TÜSİAD, 2005i). TÜSİAD President Tuncay Özilhan stated that the first hundred corporations sorted by the income level paid 54 percent of the revenue collected through corporate taxation. Strikingly, he added that this might also be a sign of income inequality, but at the end, investment and employment are what matters, as they are the key to raise the overall income level (TÜSİAD, 2003a). The

concerns of business associations about tax fairness, therefore, were mainly based on their positions vis-à-vis those operations within the informal economy.

4.5 Tax politics during the 2006 corporate tax reform: Final remarks

This chapter firstly examined the domestic political debates leading to the 2006 corporate tax reform that eased the tax burden of corporate taxpayers. The first change in the corporate taxation was the introduction of inflation accounting, which aimed at erasing the negative effects of inflation on financial statements in 2003. TÜSİAD had been demanding this legislation before it was put in the agenda by the government, while MÜSİAD also found it as a positive step. During the parliamentary discussions, the CHP considered this legislation as an urgent need of the business world and the government saw this as a unique step no government had never imagined due to its price in terms of revenue loss. Hence, the AKP initiated a process in which corporate taxation was amended in accordance with the needs of the business world. There was a political consensus for having a relief for the tax burden of corporations. This amendment was followed by the abolishment of fund share in 2003 in order to compensate for the revenue loss in the public budget with a temporary increase in the corporate tax rate by 3 percent between 2003 and 2005. This step demonstrated that the government did not risk a revenue loss in a post-crisis period. Such decision for compensation might be explained based on the government commitment to implement fiscal discipline for the recovery of the economy. Indeed, the success of the AKP in the economy started to prove itself in the form of the single digit inflation coupled with a high growth rate helped the government to build the populist image it was known for. This economic success

later allowed the AKP to readily afford a revenue loss caused by the 10-digit reduction in the corporate tax rate.

The 2006 corporate tax reform is partly the product of the AKP government and domestic politics after the AKP came to power. This is because the content of the reform, such as the rate reduction or the transfer pricing or the regulation on tax exemptions were not included neither in the Development Plans nor in the party program of the AKP. Business organizations, however, demanded such a reform both before and after the AKP came to power.

The 2006 corporate tax reform included regulations on transfer pricing, investment subsidies, tax exemptions and a radical rate reduction. The government justified the reform for the sake of investment and employment along with its claim to have a tax system harmonized with the EU. However, as the CHP also argued, tax policy harmonization did not include direct taxes within the EU. The AKP, once again, claimed that the commitment to fiscal discipline would be maintained and the revenue loss would be compensated with removing tax exemptions. Yet, the opposition political parties agreed that the decision to remove certain tax exemptions from certain sectors was political and not enough to compensate the revenue loss originating from the corporate tax reduction. Moreover, abolishment of the investment tax credits harmed the interests of small and medium-sized enterprises, which are the largest group in the business world in number. It would be possible to argue that the 2006 corporate tax reform served the interest of large corporations more than SMEs.

The fact that the 2006 corporate tax reform served the interest of large corporations more than SMEs is interesting as the relations between the AKP and the

selected two business organizations would suggest a different outcome. While the AKP had more organic relations with the MÜSİAD stemming from the shared political roots, the relationship between the TÜSİAD and the AKP was rather weak in the beginning of the AKP rule. However, TÜSİAD had managed to strengthen its relations and to a certain aspect, its incidence, with the government through its lobbying activities. The Association organized meetings and events with the government officials in charge of tax policy, made publications including evaluations and proposals on taxation, and participated in the preparation process of the Corporate Tax Law passed in 2006. The AKP government also seemed to take the TÜSİAD's position seriously or agreed with TÜSİAD on the main tenets of the corporate tax reform. The policy outcome, thus, satisfied both these actors. Therefore, I argue that the 2006 corporate tax reform was the product of its assurance to maintain the alliance it formerly established with the business, and especially with the big business.

The prominent themes in the declarations of the business associations are diverse. Tax competition is one that was used by both TÜSİAD and MÜSİAD. Both organizations referred to lower tax rates in other European or OECD countries. Enhancing the investment environment and its possible positive impact on employment generation were other themes put forward by the business associations. Informal economy, which was substantially emphasized by the TÜSİAD, presented as a product of high tax rates on corporations.

Overall, the corporate tax reform was implemented with a 10 percent rate reduction, which was considered as 'radical' by even the business associations. Both associations were pleased with the overall result. However, the MÜSİAD criticized the abolishment of investment tax credits benefiting mainly its members. The 2006

corporate tax reform strengthened the alliance between the AKP and the domestic interest groups and the party managed to maintain support from key representatives of the business associations.

At the end, social justice and tax fairness concerns were not central in the debates on the corporate tax reform under consideration. When used, different domestic political actors employed diverse uses of the notion of tax fairness. First, political parties in opposition and partly the MÜSİAD portrayed the reliance of the Turkish tax system on indirect taxation as an indication of the absence of tax fairness. Second, business organizations presented the problem of high tax rates on corporate incomes as a tax fairness issue. They argued that high rates of corporate tax worsen the corporations' condition for international tax competition and the fact that a small group of corporate taxpayers pay a great amount of corporate tax were regarded as a sign of unfairness of the tax system by the TÜSİAD. The TÜSİAD's interpretation of tax fairness was solely based on its interest representation role. The MÜSİAD also sought for its interests by calling for a tax reduction as the solution of heavy reliance on indirect taxation. The opposition political parties approached the tax fairness issue with reference to social justice; nevertheless, their concern occupied a limited place in the 2006 corporate tax reform discussions. However, their reference to social justice concerns did not lead them not to support the reform in the parliamentary voting.

CHAPTER 5

CONCLUSION

This thesis explored the domestic political factors that contributed to the legislation of the 2006 corporate tax reform in Turkey. The 2006 Corporate Tax Law included a radical reduction of 10 percent in the corporate tax rate along with other changes. This reform was noteworthy as it accounted for one of the highest reductions in the corporate tax rate in the history of the Turkish tax system.

The 2006 corporate tax reform in Turkey was introduced in a context where the global trend was also towards lowering corporate tax rates and higher reliance on consumption taxes. Therefore, the 10 percent reduction in the corporate tax rate in Turkey was not an exception to the global trend.

The literature explains the countries' move towards lower rates of corporate taxes with reference to the impact of economic globalization and tax competition it has brought (Genschel, 2002; Devereux et.al., 2002; Ganghof, 2006; ILO, 2008). While the impact of economic globalization is of critical importance in creating an enabling environment for tax reforms in the above-mentioned direction, the disregard of the role of domestic political factors in filtering, localizing or sometimes contesting this global trend should not be underestimated. Given the complexity and diversity of national tax systems, the way domestic political factors inform tax policy decisions may also manifest in diverse ways. Nevertheless, limited number of studies (Summers, 1993; Steinmo, 2003; Breamendi & Rueda, 2007; Fuchs, 2007; Osterloh & Heinemann, 2013; Foreemny & Riedel, 2014; Herwatz & Theilen, 2016) takes into account the domestic political dynamics behind tax policy decisions. This thesis

contributed to this academic endeavor by examining the domestic political factors behind a corporate tax reform in a developing country context.

Latest figures indicate that the share of total tax revenues in GDP remained relatively low in Turkey, which continues to leave a room for the Turkish fiscal state to grow. The Turkish tax system's overreliance on indirect taxes was one of its distinguishing characteristic features before the 2006 corporate tax reform. Since there was hardly any attempt to reverse the heavy reliance of the Turkish tax system on indirect taxation, the share of indirect taxes in overall tax revenue has continued to rise throughout the AKP's first term. The 2006 corporate tax reform clearly contributed to this trend.

Against this background, this thesis firstly provided an overview of the literature to present the dominant paradigms, namely structural, institutionalist and interest group politics paradigms, about the factors determining tax policy decisions. Inspired mainly by the institutionalist and interest group politics paradigms, this thesis employed an actor-based approach to tax politics and examined how different actors, namely business organizations and political parties represented in the Turkish Parliament, to understand the role of domestic politics in the tax reform under consideration.

The institutionalist approach covers the factors such as the political regime, the ideologies of political parties and partisanship, the ideas of individual policy-makers and electoral cycles. The ideology of the AKP in its first term in power was oriented towards a liberal and open market economy, which has contributed to the 2006 reform that eased the tax burden of the capital. The absence of any strong

opposition from opposition political parties during the legislation process of the Corporate Tax Law also helped accelerating the reform process.

This thesis concludes that the stances of the political parties that took place in the legislation process of the 2006 corporate tax reform, namely, the CHP and the ANAP, were pretty much in full conformity with the positions of the AKP government and the business on the reform. They expressed no significant opposition to the reform on corporate taxation in 2003. The critique for the corporate tax reform in 2006 was also marginal. The opposition parties claimed that specific sectors chosen for removing the tax exemption like Turkish Drivers and Automobile Workers Confederation (TŞOF) were not large enough to increase the tax base so that the abolishment of certain tax exemptions would fail to compensate the revenue loss caused by rate reduction in corporate taxation. Maintaining the tax exemption for only the building cooperatives among all was also considered as a political decision due to the government's position with regard to promoting construction industry. Still, it is possible to observe that there was almost a national consensus on the 2006 corporate tax reform, taking into account that labor organizations kept silent except the DİSK's general criticism that the real tax burden was born by workers but not by the employers.

Indeed, it is a striking result of this thesis that there were almost no opposition or protest to the 2006 corporate tax reform in Turkey. For a similar reform act took place in Germany, for instance, the resistance from both political and social actors actually ended up in a tax system that deploys more or less 30 percent of tax burden on the corporate income even if the statutory corporate tax rate was reduced to 15.8 percent in 2008 (Homburg, 2007). Reasons for the absence of any opposition to the reform in Turkey are twofold. First, the economic indicators showing an

upward trend for the economic growth and downward trend for the public debt stock, inflation level, unemployment and informal economy contributed to the process in which a stable economic environment was created. This environment provided the necessary conditions to decrease the corporate tax rate with minimum opposition. Second, the systematic domestic tension experienced within the period of rule of the AKP before the e-memorandum was announced by the Turkish Armed Forces in 2007 reflected as a legitimacy crisis for the government. The 2006 corporate tax reform was a mechanism used by the government to resolve the legitimacy crisis by establishing political alliance with the business.

The ideologies of politicians may also result in minimum corporate tax rates (Osterloh & Heinemann, 2013). For the Turkish case examined in this thesis as well, key politicians of the AKP in its first term adopted a liberal approach supporting lower rates of the corporate tax. The fact that the 2006 corporate tax reform was a product of the AKP government is evidenced by the lack of any projections for such a reform in the Development Plans that preceded and covered the time period under consideration. These reforms were not explicitly mentioned in the AKP's party program as well. Therefore, it could be argued that the 2006 corporate tax reform was a product of the domestic politics in the AKP's first term in power.

To explore how the business associations contributed to the process leading to the 2006 reform, interest group politics approach is widely employed. For the 2006 corporate tax reform in Turkey, unlike the trade unions, business associations were actively involved in tax policy debates in the period under consideration. The TÜSİAD and the MÜSİAD were the key domestic players in tax politics, the positions and activities of which were analyzed through their policy documents, publications, websites and media coverage of their statements. Qualitative thematic

content analysis of these documents shows how business organizations framed their demand for a reduction in the corporate tax rate. In formulating their demands for a reduced corporate tax rate, business organizations referred to the need for enhancing the investment climate, supporting employment generation, strengthening the international competitiveness of the Turkish corporations and backing the formal sector against the informal sector. The framing of their demands for a decline in the corporate tax rate found echo at the level of the government, together which contributed to the legislation of the reform.

When business actors have institutionalized channels of communication with bureaucracy, they have the opportunity to be partially represented in legislative institutions (Wilson & Grant, 2010). Both TÜSİAD and MÜSİAD had their own institutionalized channels of communications with the AKP government before the 2006 corporate tax reform. TÜSİAD was actively represented in the Tax Council, an affiliated organization to the then Ministry of Finance, established with the aim of acting like bridge between the taxpayer and the tax policy makers. The Association also participated in the legislation process of the reform as a social partner. In this way, TÜSİAD acquired the chance to be represented in the intuitionalist structure of the tax policy design. MÜSİAD, on the other hand, did not actively use institutionalized channels to communicate with the government. However, approximately 20 members of the Association, including the Finance Minister, become the AKP Deputies in its first period. These members shared the ideas of the AKP as deputies, while they also shared the interest of the MÜSİAD. Steinmo (2003) found that ideas and interests of policy makers end up in minimum corporate tax rates. The “corporate rich” (Mills, 1965) who are the influential members of the two business associations for this thesis had executive and political power for

representation in the legislation process of the corporate tax reform. However, this thesis argues that the business associations have no institutionalized veto power or right to offer a legislative proposal despite their informal institutionalized communication channels with the government. Hence, institutionalist approach has its own limitations to analyze the domestic political factors behind the corporate tax reform in Turkey.

This thesis examined the relations of the business associations with the key government officials of the AKP such as the then Prime Minister or the Minister of Finance in its first period of rule and observed that the MÜSİAD had close ties with the government officials due to their shared political roots, while the TÜSİAD lacked such an organic relationship. However, the reform indicates that the TÜSİAD and the AKP built a relationship based on their mutual interest. The former literature on the politics of taxation also argued that this kind of linkage between the interest groups and the government indicates the existence of corporatist political settings and lower tax burden on the corporations (Summers et. al., 1993; Beramendi & Rueda, 2007). However, it is striking that the influential role of the interest groups on the government resulted in lower corporate tax rates while such formal corporatist political settings do not exist in Turkey. This fact indicates the willingness of the AKP government to maintain and even strengthen its alliance with the business as interest groups and highlights the effect of the ideas and interests of politicians on tax policy design. Interest group politics thus comes forefront as a more explanatory paradigm for the domestic political factors that made the corporate tax reform possible than the institutionalist approach. The finding of this thesis is also in line with the finding of Fuchs (2007) stating that instrumental power of the business,

either in the form of political support or in the form of lobbying activities, is effective on the policy choices over taxation.

The AKP government largely echoed the global ideas that justify a reduction in corporate tax rates. For instance, the abolishment of inflation accounting was justified with the purpose to ease the tax burden on income with reference to negative effects of inflation on the financial statements. This purpose then was linked with enhancing a better climate for investment and increasing employment level in order to justify the decrease of the corporate tax rate from 30 to 20 percent proposed by the government. In contrast to the portrayal of tax competition as an external factor that leaves no room for domestic actors but to align with the global trend in the literature, the analysis of the Turkish case demonstrates that domestic actors perceived tax competition in their own interest and were actively involved in changing the tax system accordingly. In other words, tax competition can well be treated also as a domestic factor. Indeed, the shared emphasis that both the AKP and business associations put on the necessity of decreasing corporate taxes to place Turkey in a better place in international tax competition was one of the factors that contributed to the formation of alliance between these two political actors. This thesis consequently argues that the corporate tax reform was a mechanism that strengthened the alliance of the AKP governments with the business world. The corporate tax reform, as an initiative of the AKP, might have created a clash between the effort put by the government to build a populist image and business friendly tax policy decisions it has taken. However, high rates of economic growth in that period helped the AKP government to avoid such clash.

This thesis thus argues that tax policy decisions of the AKP government are normative, biased in favor of value judgements and political objectives. The 2006

corporate tax reform that eased the tax burden of corporations was the subjective preference of the AKP which was the result of the party's intention to favor the corporations.

This thesis explains the position of the AKP towards tax policy in its first period in power based on its strategy to develop an alliance with the business. In the political debates leading to the 2006 corporate tax reform, the business associations and the government agreed that higher levels of investment would result in higher levels of economic growth which would then be a solution for social inequalities. However, economic growth alone does not automatically bring social welfare (Stephens, 1999). The 2006 corporate tax reform was a product of the balance of power and a compromise between the AKP government seeking business support and the business associations pursuing their self-interests. While this explanation does not necessarily disregard the conformity of this decision to the global trend of reducing corporate tax rates, it offers a new insight in explaining the domestic political factors behind the manifestation of a global trend in a particular country context.

This thesis also provides evidence for the striking absence of social justice concerns in debates on a significant tax policy reform. Modern concept of social justice should take place in a policy process that have an influence on the distribution of wealth. The notion of tax fairness used by the business associations was grounded on their self-interest. They framed their demands for lower corporate tax rate by using the notion of tax fairness and defined high levels of informality in the Turkish economy as a problem of tax injustice that the formal sector suffers.

The opposition political parties put the issue of the heavy reliance on indirect taxation forward as a concern for tax fairness. Still, their discourse could not transform into a wider criticism towards the 2006 corporate tax reform, which in the end aggravated the reliance on indirect taxes. Marshall (1965) envisaged that once market principals became superior to social justice, free bargain between unequals would replace social citizenship. The absence of social justice concerns in the political debate around the 2006 corporate tax reform was a step towards that direction.

This thesis finally argues that domestic politics should not be disregarded in explaining the global downward trend in corporate tax rates reflected as a radical rate reduction for the Turkish case. The way that the government responded to external pressures, how the government mobilize to act accordingly with the global trend or to diminish the effect of that trend matter to carry out the political analysis of the tax reform. This thesis demonstrates that political actors perceived tax competition in their own interest and contributed the legislation process of the corporate tax reform by establishing a political consensus. The absence of any strong opposition from neither the political parties/labor organizations nor the general public may be explained with the stable economic environment provided by the economic indicators showing an upward trend and the AKP's quest for the political allies to resolve its legitimacy crisis. At the end, the absence of domestic resistance to the 2006 reform smoothed the implementation of the corporate tax reform. This thesis also concludes that the instrumental power of business associations provided them an opportunity to be at least partially represented at the reform process, which puts the business in the domestic political debate as a significant actor.

The reliance on indirect taxation which is one of the main characteristics of the Turkish tax system was solidified with the 2006 corporate tax reform. The introduction of special consumption tax in 2002 also contributed to that reliance with its increasing share in the overall tax revenue over the years. This thesis offers to examine the domestic politics behind the combination of these tax reforms together by referring to sidelined measure of tax fairness in those reforms for further research. An analysis of domestic politics on a reform context which were commonly explained by the globalization narrative, namely, corporate taxation, with comparison to other country cases experienced a similar reform might be another topic for the future research.

APPENDIX A

CORPORATE TAX RATES OF OECD COUNTRIES FOR SELECTED YEARS

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Australia	34.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Austria	34.0	34.0	34.0	34.0	34.0	25.0	25.0	25.0	25.0
Belgium	39.0	39.0	39.0	33.0	33.0	33.0	33.0	33.0	33.0
Canada	29.1	28.1	26.1	24.1	22.1	22.1	22.1	22.1	19.5
Chile	15.0	15.0	16.0	16.5	17.0	17.0	17.0	17.0	17.0
Czech Republic	31.0	31.0	31.0	31.0	28.0	26.0	24.0	24.0	21.0
Denmark	32.0	30.0	30.0	30.0	30.0	28.0	28.0	25.0	25.0
Estonia	26.0	26.0	26.0	26.0	26.0	24.0	23.0	22.0	21.0
Finland	29.0	29.0	29.0	29.0	29.0	26.0	26.0	26.0	26.0
France	37.8	36.4	35.4	35.4	35.4	34.9	34.4	34.4	34.4
Germany	42.2	26.4	26.4	28.0	26.4	26.4	26.4	26.4	15.8
Greece	40.0	37.5	35.0	35.0	35.0	32.0	29.0	25.0	25.0
Hungary	18.0	18.0	18.0	18.0	16.0	16.0	17.3	20.0	20.0
Iceland	30.0	30.0	18.0	18.0	18.0	18.0	18.0	18.0	15.0
Ireland	24.0	20.0	16.0	12.5	12.5	12.5	12.5	12.5	12.5
Israel	36.0	36.0	36.0	36.0	35.0	34.0	31.0	29.0	27.0
Italy	37.0	36.0	36.0	34.0	33.0	33.0	33.0	33.0	27.5
Japan	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0
Korea	28.0	28.0	27.0	27.0	27.0	25.0	25.0	25.0	25.0
Latvia	25.0	25.0	22.0	19.0	15.0	15.0	15.0	15.0	15.0
Lithuania	24.0	24.0	15.0	15.0	15.0	15.0	19.0	18.0	15.0
Luxembourg	31.2	31.2	22.9	22.9	22.9	22.9	22.9	22.9	22.9
Mexico	35.0	35.0	35.0	34.0	33.0	30.0	29.0	28.0	28.0
Netherlands	35.0	35.0	34.5	34.5	34.5	31.5	29.6	25.5	25.5

New Zealand	33.0	33.0	33.0	33.0	33.0	33.0	33.0	33.0	30.0
Norway	28.0	28.0	28.0	28.0	28.0	23.8	28.0	28.0	28.0
Poland	30.0	28.0	28.0	27.0	19.0	19.0	19.0	19.0	19.0
Portugal	32.0	32.0	30.0	30.0	25.0	25.0	25.0	25.0	25.0
Slovak Republic	29.0	29.0	25.0	25.0	19.0	19.0	19.0	19.0	19.0
Slovenia	25.0	25.0	25.0	25.0	25.0	25.0	25.0	23.0	22.0
Spain	35.0	35.0	35.0	35.0	35.0	35.0	35.0	32.5	30.0
Sweden	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0
Switzerland	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5	8.5
Turkey	33.0	33.0	33.0	30.0	33.0	30.0	20.0	20.0	20.0
United Kingdom	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	28.0
United States	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0

Source: OECD tax database, https://stats.oecd.org/Index.aspx?QueryId=78166

APPENDIX B

STATISTICS ON CORPORATE TAX REVENUE

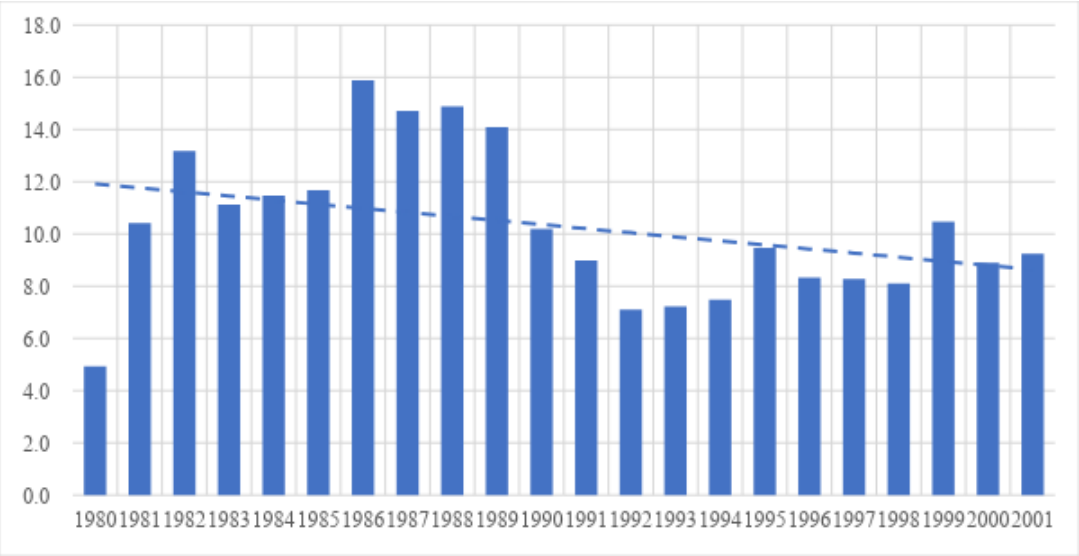

Figure B1. Share of corporate taxes as a percentage of total tax revenue, between 1980 and 2001

Source: The General Directorate of Accounting, https://www.muhasebat.gov.tr/content/genel-yonetim-mali-istatistikleri/konsolide-butce-istatistikleri

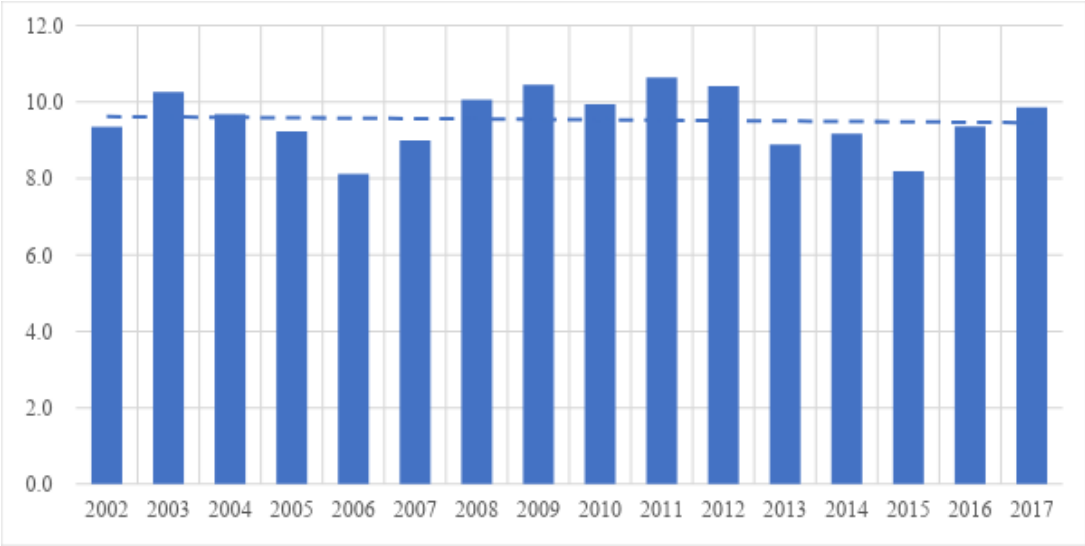

Figure B2. Share of corporate taxes as a percentage of total tax revenue, between 2002 and 2017

Source: The General Directorate of Accounting, https://www.muhasebat.gov.tr/content/genel-yonetim-mali-istatistik-detayi?tabId=1&pageId=2

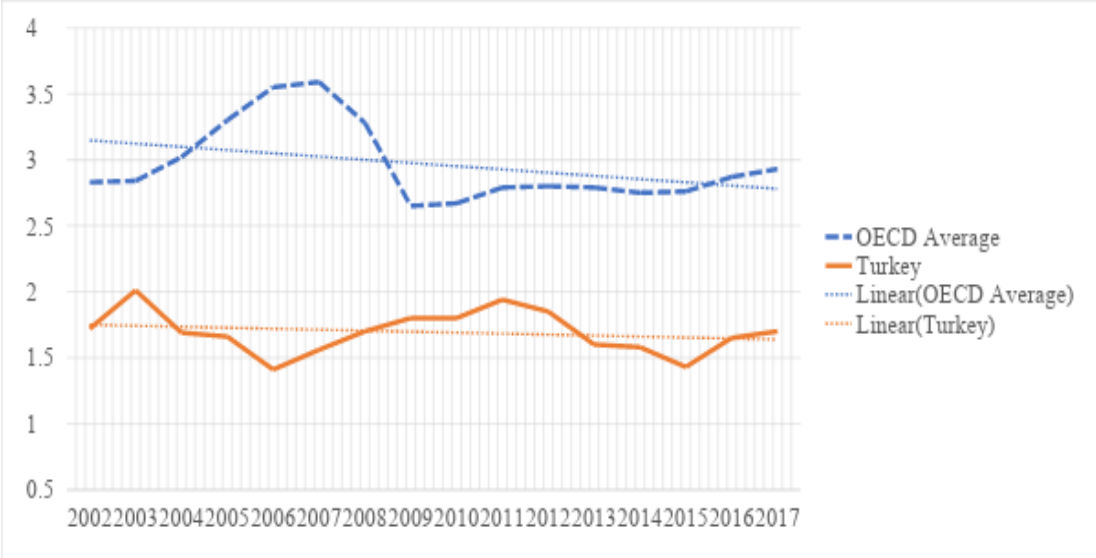

Figure B3. Tax on corporate profits as a percentage of GDP, between 2002 and 2017

Source: OECD Data, http://www.oecd.org/tax/

APPENDIX C

STATISTICS ON INDIRECT TAXES

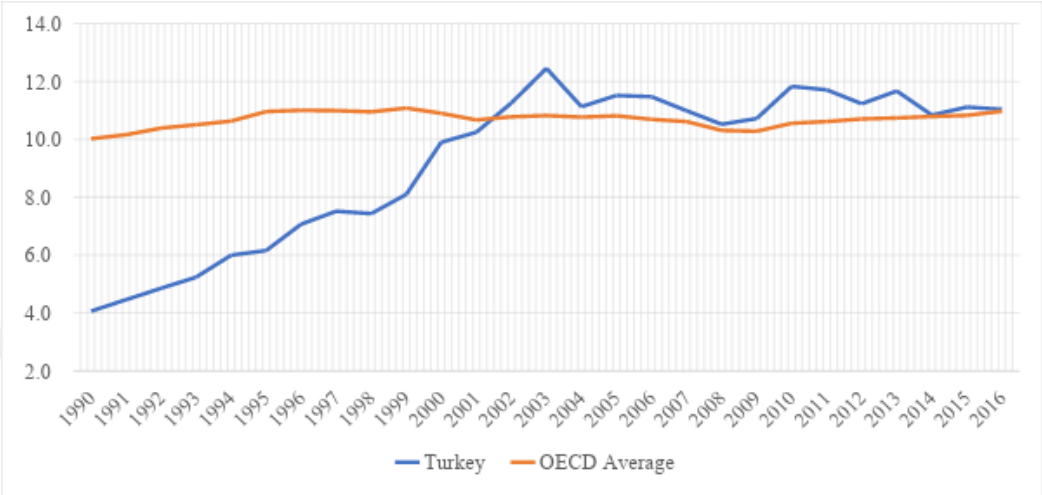

Figure C1. Revenue from the taxes on goods and services as a percentage of GDP, between 1990 and 2016

Source: OECD Statistics, https://stats.oecd.org/#

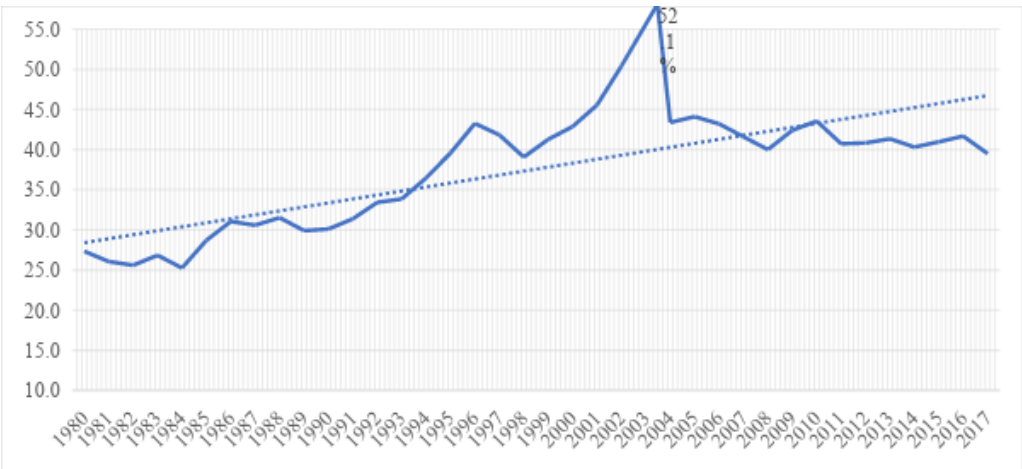

Figure C2. Share of taxes on goods and services in total tax revenue (%), between 1980 and 2017

Source: The General Directorate of Accounting, https://www.muhasebat.gov.tr/content/genel-yonetim-mali-istatistik-detayi?tabId=1&pageId=2

APPENDIX D

HISTORICAL VARIANCE IN THE CORPORATE TAX RATE IN TURKEY

Fiscal year	**Corporate tax rate**
1949	10
1960	20
1964	25
1980	50
1986	46
1994	25
1999	30
2004	33
2005	30
2006	20
2018-2020	22

Source: Revenue Administration Statistics, https://www.gib.gov.tr/yardim-ve-kaynaklar/yararli-bilgiler and (Armağan, 2007)

APPENDIX E

TOTAL TAX REVENUE AS A PERCENTAGE OF GDP IN OECD COUNTRIES

FOR SELECTED YEARS, BETWEEN 1990 AND 2016

Countries	1990	1995	2000	2001	2005	2009	2010	2011	2014	2015	2016
Australia	28.1	28.3	30.5	28.9	30.0	25.6	25.3	25.9	27.3	27.9	27.8
Austria	39.3	41.3	42.3	43.9	41.0	41.0	41.0	41.1	42.7	43.1	42.2
Belgium	41.2	42.6	43.5	43.5	43.2	42.4	42.6	43.1	45.1	44.8	44.1
Canada	35.2	34.7	34.8	34.2	32.8	32.4	31.1	30.9	31.3	32.7	32.7
Chile	16.9	18.3	18.8	19.0	20.7	17.3	19.6	21.1	19.6	20.4	20.2
Czech Republic	..	34.7	32.4	32.5	34.5	32.3	32.5	33.3	33.1	33.3	34.2
Denmark	44.4	46.5	46.9	45.9	48.0	45.0	44.8	44.8	48.5	46.1	46.2
Estonia	..	36.0	31.1	30.4	30.0	34.9	33.3	31.5	32.3	33.3	33.7
Finland	42.9	44.5	45.8	43.2	42.1	40.9	40.8	42.0	43.8	43.9	44.0
France	41.2	42.3	43.4	43.1	42.9	41.5	42.1	43.3	45.4	45.3	45.5
Germany	34.8	36.2	36.2	35.0	33.9	36.1	35.0	35.7	36.7	37.0	37.4
Greece	25.2	27.9	33.4	32.0	31.2	30.6	32.0	33.6	35.7	36.6	38.8
Hungary	..	40.8	38.5	37.6	36.5	38.9	37.3	36.3	38.0	38.7	39.2
Iceland	30.9	31.2	36.3	34.5	39.7	31.7	33.2	34.3	38.3	36.3	51.6
Ireland	32.4	31.7	30.8	28.6	29.4	27.3	27.0	27.4	28.4	23.1	23.3
Israel	..	35.4	34.9	34.7	33.7	29.8	30.7	30.9	31.2	31.3	31.3
Italy	36.4	38.6	40.6	40.3	39.1	42.1	41.9	41.9	43.5	43.1	42.6
Japan	28.2	25.8	25.8	25.9	26.2	26.0	26.5	27.5	30.3	30.6	30.6
Korea	18.8	19.1	21.5	21.8	22.5	23.8	23.4	24.2	24.6	25.2	26.2
Latvia	..	29.7	29.1	28.2	27.9	28.0	28.2	27.8	29.0	29.2	30.4
Lithuania	..	27.6	30.8	29.3	29.2	30.2	28.3	27.2	27.5	28.9	29.8
Luxembourg	33.5	34.9	36.9	37.5	37.8	38.2	37.4	37.0	37.4	37.1	38.1
Mexico	12.1	10.1	11.5	12.2	11.4	12.5	12.8	12.8	13.7	15.9	16.6
Netherlands	39.7	37.2	36.9	35.6	35.0	34.9	35.7	35.4	37.0	37.0	38.4
New Zealand	36.2	35.6	32.5	31.9	36.1	30.2	30.3	30.1	31.2	31.6	31.6
Norway	40.2	40.0	41.9	42.1	42.6	41.2	41.9	42.0	38.8	38.4	38.7

Poland	..	36.6	32.9	32.9	32.9	31.2	31.4	31.8	31.9	32.4	33.4
Portugal	26.5	29.3	31.0	30.8	30.8	29.9	30.4	32.3	34.3	34.4	34.3
Slovak Republic	..	39.6	33.6	32.7	31.3	28.9	28.1	28.6	31.1	32.2	32.4
Slovenia	..	38.4	36.6	36.8	38.0	36.2	36.9	36.5	36.2	36.4	36.5
Spain	31.6	31.3	33.2	32.8	35.1	29.7	31.2	31.2	33.6	33.6	33.2
Sweden	49.5	45.6	49.0	46.8	46.6	44.1	43.2	42.5	42.6	43.1	44.0
Switzerland	23.7	25.5	27.6	27.0	26.6	27.0	26.6	26.9	26.9	27.6	27.8
Turkey	14.5	16.4	23.6	25.6	23.4	23.5	24.8	25.9	24.6	25.1	25.3
United Kingdom	32.9	29.5	32.9	32.6	32.7	31.2	32.3	33.2	31.8	32.2	32.7
United States	26.0	26.5	28.2	27.2	25.9	23.0	23.5	23.9	26.0	26.2	25.9
OECD -Average	31.9	33.0	33.8	33.3	33.4	32.2	32.3	32.6	33.6	33.7	34.0

Source: OECD Global Revenue Statistics, https://stats.oecd.org/index.aspx?DataSetCode=REV

APPENDIX F

LOBBYING ACTIVITIES OF TÜSİAD

	Meetings with the state and government officials on tax issues	Other lobbying activities and participation in law drafts
2001	Meeting with the Minister of State in charge of economy, Kemal Derviş (April)	Presentation of the report on some tax exemptions and regulations to Real Sector Rehabilitation Fund Council (August)
2003	YOİKK Meeting on fiscal policy (January) Meeting with the General Vice Presidents of AKP	Seminar on the tax system with the participation of the Finance Minister (February) Participation at the Evaluation Council on the Economic Problems Participation in the draft of Foreign Direct Investment Law
2004	Meeting with the Finance Minister and the Secretary General of OECD on taxation Meeting with the Minister of State, Ali Babacan YOİKK Committee Meeting with the General Vice Presidents of AKP	Participation at the Evaluation Council on the Economic Problems
2005	Meeting with the Finance Minister (February and July) YOİKK Committee Meeting with the General Vice Presidents of AKP	Participation at the Economic Coordination Council
2006	YOİKK Committee Meeting with the General Vice Presidents of AKP	Participation in the draft of Corporate Tax Law Participation at the Economic Coordination Council

Source: Press review and (Barlas Yılmaz, 2013)

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