PART I

# THEORY AND FRAMES

# 1

# Hierarchical Capitalism in Latin America

## I. Introduction: Perspectives and Arguments

In the many intense debates over development in Latin America in recent decades, the question rarely arose, as it had in previous decades, as to what kind of capitalism existed or whether capitalism in Latin America was somehow different. If anything, the homogenizing Washington Consensus of the 1990 sidelined such queries with expectations that market reforms would soon make the economies of Latin America resemble liberal economies elsewhere. Market reforms and globalization have transformed many aspects of capitalism in Latin America, but areas of convergence are often, as elsewhere, less interesting and less consequential for development than are the areas of continued divergence. So, it is worthwhile to raise again the question of what sort of capitalism exists in Latin America.

Most attempts to characterize the political economies of Latin America as somehow distinctive can be roughly classified as internationalist or statist.[1] The former was famously staked out in various dependency arguments of the 1960s and 1970s that claimed that international economic ties created a stunted form of capitalism with limited possibilities for autonomous development. The internationalist perspective later resurfaced in several guises including global production networks (Gereffi, Humphrey, and Sturgeon 2005), natural resource curses (Karl 1997), and other macro perspectives on debt and international capital flows (Maxfield 1997). Internationalist perspectives are indispensable in some places (such as oil exporters or export zones) or some periods (such as the debt crisis of the 1980s), but these are only partial views because they miss most of the domestic political economies of the rest of the region in more normal times.

[1] Many narrower political economic studies of particular areas or policies do not necessarily fit this binary classification, but I am thinking here of broader studies of the whole political economy.

By the 1980s, the mainstream focus shifted to the domestic economy and emphasized comparisons across development strategies (import substitution vs. export promotion) and the variable role of the state, often invoking revealing comparisons between Latin America and East Asia (Haggard 1990; Gereffi and Wyman 1990; Amsden 2001). After 1990, research on the political economy of Latin America mostly concentrated on the changing role of the state, especially during market reforms of the 1990s, but then on into the 2000s with attention to social welfare, the new left, and various forms of renewed state intervention.[2] Of course, not all past work in political economy fits the division between internationalist and statist, but little research, save specialized publications, asked whether there was something distinctive about the domestic private sector.

Much of the recent statist bias is fully warranted as shifts in the role of the state in Latin America have been epochal. However, the statist perspective tends to overstate the extent of change and to obscure the pivotal economic agents – firms and workers – that are driving development in the wake of state retrenchment in the 1990s. Key questions – such as Why is education so low? Why has productivity not increased? Why have good jobs been so scarce? and Why do firms not invest more in research and development? – cannot be answered in a statist framework and require instead an analysis of the types of firms, labor markets, corporate strategies, and skill regimes that constitute the institutional foundations of capitalism in Latin America. Moreover, recent scholarship on change, in policies and development models, has missed significant continuities in patterns of organization and behavior by business and labor.

This book starts with business and labor and develops four main hypotheses: (1) that Latin America has a distinctive, enduring form of hierarchical capitalism characterized by multinational corporations (MNCs), diversified business groups, low skills, and segmented labor markets; (2) that institutional complementarities knit together features of corporate governance and labor markets and thus contributed to the resiliency of hierarchical capitalism; (3) that elements of the broader political system favor incumbents and insiders who pressed governments to sustain core economic institutions; and (4) that hierarchical capitalism has not generated enough good jobs and equitable development nor is it, on its own, likely to.

Developing these arguments requires a new approach to the study of Latin American political economy. Theoretically, drawing on the literature on comparative capitalism and especially varieties of capitalism (Hall and Soskice 2001), the analysis brings three main innovations. First, it uses a "firm's-eye"

[2] For example, on social welfare, see Haggard and Kaufman (2008) and Huber and Stephens (2012); on the new left, Levitsky and Roberts (2011) and Weyland, Madrid, and Hunter (2010); and on state intervention, see Musacchio and Lazzarini (forthcoming).

focus on the structure of corporate governance and labor markets and on the predominant economic strategies of firms and workers. Second, it examines interactions across realms of the economy. The separate literatures on business groups, MNCs, labor markets, and skills are large, but they rarely overlap or speak to one another. This book tries to link them. Third, I use the economic strategies of firms and workers, and the institutional complementarities that animate them, to reinterpret the sources of policy preferences and political strategies of business and labor. Again, existing research on business and labor politics is extensive, yet it rarely connects political activity back to firm strategies and institutional complementarities.

The best way to answer the question of what kind of capitalism Latin America has is to compare it to other varieties, especially liberal market economies (LMEs) in the United States, Britain, and other Anglo economies; coordinated market economies (CMEs) in Northern Europe and Japan; and to other developing economies. These broad comparisons, elaborated in Chapter 2, help pinpoint the distinctive configuration of hierarchical capitalism. Within this comparative framework, my focus is primarily on Latin America, especially the larger countries of the region, but hierarchical capitalism is not just Latin capitalism. The model should also apply, with modifications, to other middle-income countries outside the region, such as Turkey, Thailand, or South Africa. Moreover, within Latin America, not all countries are equally close to the ideal type of a hierarchical market economy (HME).

This book draws on a long tradition of comparative institutional and historical institutional analysis, but with a crucial shift in analytic focus to incorporate firms and organizations. Following Douglass North, many institutional approaches have assumed organizations such as firms and paid them little heed. North (1990, 4) insisted on a “crucial distinction” between institutions and organizations: “institutions are rules” of the game and firms and other organizations are merely the “players.” The implication, followed in most institutional analysis in political economy, was to concentrate primarily on the rules and neglect organizations that were assumed to adapt more or less automatically to the rules.[3] My focus instead problematizes firms and makes them core components of an institutional approach to Latin American political economy (Evans 1979; Guillén 2001). Organizations in Latin America – from the Church, to state-owned enterprises, to business groups – have always been hybrid, syncretic, complex, interrelated, and politicized, and understanding them requires the full analytic toolkit from comparative institutional analysis.

[3] Ronald Coase (1937) and later Oliver Williamson (Williamson and Winter 1993), of course, focused on organizations and firms, though in the end firms were rational responses to their environments and transactions costs that derive largely from overall rules. Thus, ultimately, rules still largely determined firm behavior. For a discussion of various definitions of institutions, some that include organizations, see Aoki (2001, chap. 1).

Thus, beyond the macro Northian rules of the game, the analysis needs always to have in mind the incentive structures that variable organizations create for politicians, managers, workers, and outsiders. Organizations often are not mere reflections of the rules-as-incentives structure and vary independently from rules, and thus have direct, independent impacts on political economic outcomes such as equity, innovation, skills, and political representation. For instance, despite operating under the same rules in any given country, the core corporate organizations of MNCs and business groups differ greatly from each other in terms of their corporate structure, skill strategies, and political behavior. Conversely, rules can vary independently from organizations; despite variation across Latin America in basic rules of corporate governance (competition, stock market, financial, and other regulations), similar sorts of business groups – the dominant organizations of the domestic private sector – exist throughout the region. In sum, rules and organizations require equal treatment in institutional analysis.

This neglect of organizations feeds into policy as well. Policy makers in Latin America rarely ask what kinds of firms they want to have.[4] Instead, the primary focus of institutional reform is on the preferred kinds of markets needed to promote development: competitive, regulated, protected, and so on. The firms that are likely to result either are presumed to be outside the range of policy targets or are assumed in Northian fashion to form naturally, and optimally, in response to market signals. In contrast, in the 1960s and 1970s, policy makers were more concerned with promoting specific kinds of domestic firms, mostly because states were already actively managing both MNCs and state-owned enterprises (SOEs). By default, they were thus also making decisions on where domestic firms would operate. However, with market reform, states mostly relinquished both SOEs and regulations on MNCs and stopped worrying about policies to shape domestic business. One of the policy implications of this book is that it behooves policy makers to think again more actively about the kinds of firms they want to lead development (as they have been recently in Brazil).

## II. Core Institutions of Hierarchical Capitalism

What are the institutions in Latin America that organize investment, labor, technology, and skills into an overall production regime?[5] The comparative capitalism framework for developed countries gives a guide on where to look, but that framework cannot be imported wholesale. On the side of capital and investment, scholars of developed countries start with capital markets – banking systems and stock markets – and the myriad rules and practices that

[4] The policy community in multilateral development agencies in Washington, D.C., has published almost nothing on business groups and little on MNCs.

[5] My point of departure here is inductive. Chapter 2 provides a more deductive and abstract formulation of an ideal type of hierarchical capitalism.

regulate them (Zysman 1983). However, in Latin America, equity markets and banks were not the sources of long-term productive investment (nor markets for corporate control). Instead, the private institutions (as organizations) that mobilized capital for investment were business groups and MNCs. In terms of strategic interactions, CEOs in developed countries are usually preoccupied with managing relations with stock markets (quarterly earnings and guidance, institutional investors, etc.) in equity-based financial systems or with bankers in bank-based systems. In contrast, managers in hierarchical capitalism are most keenly attentive to relations with family owners in business groups or with headquarters in MNC subsidiaries. Most research on corporate governance, narrowly conceived, examines relations between financial principals (shareholders or creditors) and their managerial agents; in hierarchical capitalism, these external financial principals have little leverage over managers.

Similarly, scholars of labor in developed countries focus on overall regulations, collective bargaining, and employment practices. Such a focus in Latin America would underscore the high levels of regulation, but it gets only part way because almost half of jobs are informal and not subject to formal regulation. Moreover, employment practices point less to long-term relations (save for a few) as in Japan and Germany but rather very short-term employment. For lack of a better term, I use the shorthand of atomized labor relations and segmented labor markets to characterize the result of this complex institutionalized mix of formal regulations and informal practices. On skills, the institutions in Latin America resemble those in developed countries, and the overall skill regime comprises basic education, technical education, universities, public training programs, unemployment insurance, regulations on company spending on training (compulsory in-house training, tax incentives, etc.), and general private practices on training.[6]

Capitalism in Latin America might first be characterized simply by weak or missing formal institutions: undeveloped financial markets, unenforced labor regulations, and shallow and partial coverage by the skills regime. One could then write, as others have (Levitsky and Murillo 2009), about how and why these institutions are weak and develop a comparison of weakly versus strongly institutionalized varieties of capitalism. My approach is less concerned with standard formal institutions – and how and why they lack force – and focuses instead on the organizational and behavioral responses to weak or absent institutions, namely, diversified business groups, MNCs, segmented labor markets, and a low-skill regime. Thus, business groups and MNCs mobilized capital without stock markets or banks. Unlike firms in other varieties of capitalism

[6] As should be clear, my understanding of institutions is expansive, along the lines of Peter Hall (2010, 204) who defines institutions "as sets of regularized practices with a rule-like quality [that] structure the behavior of political and economic actors," or earlier of Samuel Huntington (1968, 12) as "stable, valued, recurring patterns of behavior."

whose strategies were conditioned by bank-centered or equity-centered financial systems, business groups and MNCs are freer from these constraints, and thus, their internally generated strategies and behaviors are more consequential for development outcomes (hence the importance of organizations or institutions in corporate governance).

In labor markets, the responses to unevenly enforced regulations and limited training and education were segmented labor markets, atomized labor relations, and low skills. These responses are not recognizable organizations such as business groups, but rather are dispersed, though regular, patterns of behavior. However, these patterns of behavior in informality, in school leaving, and in high job rotation are enduring, and shape long-term expectations of workers and managers and, as such, constitute themselves informal institutions that regulate labor markets in the absence of formal rules. By analogy, albeit imperfect, much of the comparative institutional literature looks at the mold (the formal institutions and rules that shape behavior) whereas I focus more on the object that emerges with only a partial mold (behaviors and organizations in the absence of constraining formal institutions). However, the end goal of each approach is the same – to explain the strategic interactions and behaviors of owners, managers, and workers.

In HMEs, hierarchy often replaces or attenuates the coordinated or market relations found elsewhere. For example, whereas postsecondary or on-the-job training is more market based in LMEs and more negotiated in CMEs, it is often unilaterally decided by firms or business associations in Latin America. Hierarchical relations also characterize more general employment relations where employees lack formal grievance procedures and representation and informally lack voice because workers rotate quickly through firms. Unions have little influence on hierarchies within the firm because so few workers are unionized and because where unions do exist they are often distant from the shop floor. Industrial relations are further structured by top-down regulations issued by national governments and are enforced by labor courts.[7] On the dimension of corporate governance, relations are even more clearly hierarchical because most firms are directly controlled and managed by their owners, either wealthy families or foreign firms. In sum, hierarchy, in simple descriptive terms, is apt for characterizing the economic institutions and organizations in Latin America.[8]

Some might object to comparisons between Latin America and developed countries on the grounds that large income disparities explain differences in

[7] At first glance, labor markets in hierarchical capitalism resemble liberal economies. However, as will become clearer, workers in hierarchical economies lack the legal protections and market leverage of workers in LMEs. Moreover, a minority of workers in Latin America are subject to some of the strictest regulations in the world, quite different from the minimal regulations in liberal economies.

[8] See Nölke and Vliegenthart (2009), who also emphasize hierarchy as the core mechanism of allocation in the "dependent" variety of capitalism they identify in East Europe.

the core institutions of capitalism. However, most of the differences would remain if we adjusted the comparison for levels of GDP per capita by comparing Latin America in recent decades with liberal and coordinated economies in the mid-twentieth century when levels of GDP per capita in now developed countries were around what they are today in Latin America (Maddison 1983). CMEs and LMEs took distinctive shape in the early postwar period (Hall 2007; though historical roots go back further; Iversen and Soskice 2009). By then levels of union density were high in both liberal and coordinated economies, shop-floor coordination existed in CMEs, basic patterns of labor market regulation were established, financial markets were consolidated, and the informal economies were not large. Moreover, by the end of the twentieth century, the larger, richer countries of Latin America had completed the major modernizing transition from rural to urban societies and much of the postindustrial transition to service-based economies. So there is less reason to expect that ongoing economic growth will automatically push corporate governance and labor market indicators for Latin America closer to patterns in developed countries. The adjectives of "emerging" or "developing" continue to give the false impression that middle-income countries are in flux and unformed and have not already consolidated enduring economic institutions.

On most dimensions, hierarchical capitalism was in fact reasonably consolidated by the last quarter of the twentieth century. By the 1970s, MNCs were well ensconced, and major, diversified business groups had emerged in most countries. Labor unions were bigger then, but were more politically constrained or repressed. Education had progressed but attainment was still low. As in coordinated and liberal economies, many components of hierarchical capitalism have deep historical roots (some considered in Chapter 9). Overall, however, this book has less to say about the origins and consolidation of hierarchical capitalism in order to delve deeper into the evolution and consequences from the 1980s to the 2000s.

Much of the book analyzes a single variety of capitalism in Latin America. And, in fact, in comparison to variations within other regions such as West Europe, East Europe, or Asia, these core aspects of capitalism in Latin America manifest greater homogeneity across the region. Of course, countries of Latin America differ greatly in terms of size, level of development, commodity rents, degree of integration with the U.S. economy, and ability of governments to mitigate the effects of negative complementarities in hierarchical capitalism (variations that are explored in Chapter 8). Yet, what is remarkable is that despite these variations, similarities on the four core features remain, especially across the larger and richer countries of Latin America: Argentina, Brazil, Chile, Colombia, and Mexico.[9]

9 The field research for this book is drawn from these countries, but much of the quantitative data and the secondary literature cover more or all countries of the region.

***1. Diversified Business Groups***

One of the most comprehensive studies of big business in Latin America begins by noting that the universe of big stand-alone firms "is very small in the region. Big firms are, by a large majority, part of formal or informal groups" (Garrido and Peres 1998, 13). There are four things to emphasize about large business groups in Latin America.[10] First, most are widely diversified into subsidiaries that often have little or no market or technological relation to one another. Second, a typical large business group maintains direct hierarchical control over dozens of separate firms. Third, small numbers of huge business groups account for large shares of economic activity, estimated sometimes as high as a fifth or more of GDP. And, fourth, business groups are mostly owned and managed by families, often spanning several generations.

Contrary to expectations of convergence toward U.S.-style corporate governance, diversified business groups survived and prospered through the liberalization and globalization of the 1990s and 2000s. Competitive pressures of liberalization did lead some business groups to spin off unrelated holdings, but at the same time, privatization and regulation opened up other new opportunities for greater diversification. By the 2000s, most business groups had significant holdings in regulated and nontradable sectors. Even in Chile, the regional leader in liberalization, diversified business groups flourished, especially those based in commodities and services (Lefort 2005). As a top financial executive at the Grupo Matte (electricity, finance, forestry, construction, and other sectors) explained it, the group strategy was to be big in four or five "sectors with high profitability, regulated, but also, as a consequence [por lo mismo], low risk and capital intensive" (*Qué Pasa*, 5 November 2005, p. 22). Family ownership and management also survived and thrived, adding another layer of hierarchy (see IDE 2004). In the 2000s, more than 90 percent of 33 of the largest groups in Latin America were family owned and managed (F. Schneider 2008).

***2. Multinational Corporations***

Whereas most varieties of capitalism are characterized by a single dominant form of corporate governance, large companies in Latin America are divided between domestic business groups and MNCs. Foreign firms, mostly from the United States, made massive direct investments in Latin America throughout the twentieth century: first, in raw materials and railroads in the early twentieth century, then in other infrastructure and public utilities through the decades up to World War II, then into Fordist manufacturing (especially consumer durables), and after market reforms in recent decades back into infrastructure and services and expanding into finance. By 1995, the stock of FDI as a percentage of GDP was, on average, 16 percent for the four largest countries of Latin America (compared to 2 percent for Korea and 10 percent for Thailand;

[10] See Colpan, Hikino, and Lincoln (2010) for a full comparative analysis of business groups.