PART I

THE INTELLECTUAL TERRAIN

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Overview

Models of Economic Liberalization in ISI Economies

introduction

The crisis of the early 1970s and its aftermath was a watershed for modern capitalism. In advanced countries, it signaled the end of the golden age of postwar development based on Keynesian demand stimulus, low unemployment, and welfare state consolidation. In the less developed Southern Europe and most of Latin America, it began to show the exhaustion of postwar strategies of economic growth predicated on domestic market expansion, state intervention, and high tariff walls, the so-called model of Import Substitution Industrialization (ISI). Indeed, the pace and scope of the market transformations that have developed since then were arguably more dramatic in these semiclosed economies than in most of the advanced countries or the East Asian Newly Industrialized Countries (NICs), which were already more open to international markets and had achieved consistent rates of export-led growth *before* the phenomenal acceleration of capital mobility and trade started to sweep the world in the early 1980s.

Market-oriented officials in the semiclosed economies of Latin America and Southern Europe, by contrast, were caught between formidable external economic pressures for reform and the hostility of entrenched domestic interests with little to win, and much to lose, from a move toward more open markets. Unlike their counterparts in Eastern Europe, where civil societies were generally weak and organized actors had not been autonomous from the state for decades, market reformers in ISI economies often faced the opposition of powerful unions, industrial associations, or domestic business groups quite independent of state control. Indeed, if democratization was often seen in Eastern Europe as positively associated with economic reform and liberalization (Pop-Eleches 2009: 166; Ekiert 2003: 113; Hellman 1998: 232) and as strengthening pro-market actors (independent firms, parties, or occasionally unions), in the Iberian-American world[1] the reverse was generally true: democratization was accompanied by the activation and empowerment of popular (and often

[1] I use the terms “Ibero-America,” “Iberian-American world,” and “Iberian world” to refer to Latin America (the book analyzes Argentina, Chile, Brazil, Mexico, and Peru) plus Spain and Portugal.

business) groups long opposed to economic liberalization. For these reasons, ISI economies became the center of the debate on the "politics of economic adjustment" two decades ago.[2] In politically unstable contexts, academics and officials in multilateral institutions observed that strong executives and state autonomy from hostile economic interests, such as unions or domestic business groups, were essential for the imposition of economic liberalization.

Now, however, the "critical juncture" of economic opening and reform in formerly semiclosed countries seems to be over. The main economies in Ibero-America have liberalized substantially and have deepened economic integration into the European Union, NAFTA, and MERCOSUR, often under democratic polities. Though the international financial crisis of 2008–9 has put into question the paradigm of radical economic deregulation and has redeemed Keynesian and interventionist tools, it is doubtful that trade and financial integration will be drastically reversed. So the question now is not *whether* mixed, semiclosed economies reoriented their models of development to the market, but to explain the alternative ways in which they did, and the consequences that these alternative transitions had for the workings of the liberalized political economies.

Initially, the examples of Chile and the East Asian NICs such as Korea and Taiwan, where presumably authoritarianism and bureaucratic insulation made possible the effective outward reorientation of the models of growth, loomed large in the scholarly work on the politics of economic adjustment prevalent in the late 1980s and 1990s.[3] At the same time, international political economy–oriented approaches abundantly explored the external and macroeconomic conditions under which liberalizing reforms and trade integration were more likely.[4] More recently, however, the former scholarly emphasis on bureaucratic autonomy and international economic constraints has been replaced by a wide variety of approaches that have assessed the bargains between governments and specific constituencies in the construction of market-reform coalitions (see Schneider 2004b), particularly those most hurt by liberalization. These scholars have considered the complexities of economic reform in more open polities, emphasizing the territorial,[5] economic-sectoral,[6] and partisan[7] dimensions that underpinned negotiations between reformers and insiders or "stakeholders," be they rural interests and provinces, protected business and labor groups, or populist parties.

This most recent literature, however, has not built a framework that systematically accounts for the type of established actors that are bought

[2] This literature was vast; seminal volumes were Haggard and Kaufman (1992, 1995), Haggard and Web (1994), Nelson (1990), Przeworski (1991), and Acuña and Smith (1994).
[3] See, for example, Haggard and Kaufman (1995) and Bates and Krueger (1993).
[4] This literature was equally copious; examples are Stallings (1992), Haggard and Maxfield (1996), and Remmer (1998); more recently see Brooks and Kurtz (2007) and Pop-Eleches (2009).
[5] See Gibson (1997), Eaton (2004a), Snyder (2001b), Montero (2001), Kurtz (2004), Remmer and Wibbels (2000), Wibbels (2005), and Falleti (2010).
[6] See Murillo (2001, 2009), Etchemendy (2001), Shadlen (2004), and Schneider (2004a).
[7] See, for example, Eaton (2002), Corrales (2002), and Levitsky (2003).

off (or marginalized) in the domain of economic interests, and the different ways in which stakeholders are drawn into market reform coalitions. Indeed, we still lack a theory that explains the different ways in which countries achieved successful market reorientation in ISI, protected economies. This book is an attempt to fill this gap. It seeks to provide a unified framework for understanding economic liberalization in Ibero-America by focusing on the interactions between reforming governments and business and labor actors. My primary concern is not with whether general economic liberalization occurs – as has been the norm in the literature – but rather with variations in the modes or types of market transitions, and with the legacies they produced. Based on the compensatory measures employed to make reform politically viable and the policymaking strategies, this study posits three alternative types of industrial and labor adjustment in countries that have liberalized after decades of ISI, which I call Statist (Spain 1982–96 and Brazil 1990–2002), Corporatist (Argentina 1989–99 and Portugal 1985–95), and Market (Chile 1973–89 and Peru 1990–2000). The main goal of the book is to conceptualize and explain the principal causes of these three different models of economic liberalization, which are summarized in the next section. I will also contend that neoliberal Mexico (1982–94) constitutes a "Mixed" or "Hybrid" mode of adjustment in terms of my framework.

The book will argue that the most important factors that account for the alternative adjustment paths[8] in Argentina, Spain, and Chile, the main empirical cases analyzed, as well as those in the other major ISI economies, are the type of regime (whether reforming countries were democracies or not) and the nature of the prior ISI actors, namely, the economic and organizational power with which industrial business and labor emerged from the inward-oriented model. These two variables, the degree of the liberalization of the polity and the power of actors and the institutional legacies from the old order, have been crucial in the assessment of alternative paths of liberal economic reform and institutional building in the post-Communist literature.[9] Curiously enough, they have not been investigated systematically in the mixed, ISI Iberian-American economies, which had generated their own set of powerful insiders.

Three Models of Economic Liberalization: Statist, Corporatist, and Market

By the early 1980s it was pretty clear that constraints posed by the international economy had rendered autarchic strategies of growth in Latin America and Southern Europe scarcely viable. Not all economic groups were, however, equally

[8] The idea of "adjustment path" has been increasingly used in the political economy literature that analyzes alternative national responses to globalization pressures (Hall 1999: 159; Stark and Bruszt 1998: 101). In this book I use the concepts "path," "mode," and "model" to/of economic liberalization or adjustment interchangeably.

[9] See Stark and Bruszt (1998), King (2002), Eyal et al. (1998), and Ekiert (2003).

affected by these epochal changes. The working class, especially its most protected formal sector, and domestic industrial firms saw many of their past privileges jeopardized by the advent of economic opening. Import liberalization and enhanced competition, monetary and fiscal stringency, and the need for more flexible labor markets undermined domestic firms, unions, and workers that have historically benefited from protection, subsidies, and state-sanctioned monopolies. Moreover, in addition to the contractionary effects of stabilization, most of these liberalizing governments established variants of fixed exchange rates to tame inflation – such as fixed parity in Chile and Brazil, a currency board in Argentina, and integration into the European Monetary System in the cases of Spain and Portugal. Thus, in the context of financial deregulation and capital inflows, increasingly appreciated domestic currencies undermined local industrial actors even more. In sum, for domestic industrial firms, unions, and individual workers economic liberalization could simply mean bankruptcy, organizational disarticulation, and unemployment and poverty.

This study examines the relations between state and economic actors in the subset of liberalizing policies that affect established industrial firms, unions, and workers most: tariff liberalization, industrial privatization, labor deregulation and downsizing, and aspects of social policy reform. These measures will be referred to alternately throughout the book under the labels of "industrial and labor adjustment" or more simply "economic liberalization." The book studies adjustment through the lens of the compensatory policies that a reform government can bestow on the "potential losers" under neoliberal reform – that is, on formerly protected actors such as industrial firms (especially domestic), unions, and workers. Liberalizing governments often forged alliances with these actors through the administration of compensation. These alliances facilitated rather than obstructed neoliberal reform.

The paths of industrial adjustment essentially signal who got what, and how, in the domain of compensation. The "how" concerns the policymaking formula. I identify three patterns of policymaking under industrial adjustment: *unilateral state imposition*, *concertation* with the relevant interest groups, and *state dirigisme*, that is, a policymaking style in which the state formulates the major restructuring plans from above but is willing to bargain about aspects of their implementation.

The "what" refers to the menu of compensatory measures available to the neoliberal reformer. They can be broadly divided in two types. The first type of compensation policy includes various forms of *subsidies*, such as direct monetary infusions, soft credits or tax exemptions to industrial firms, and employment programs (in which the state provides temporary jobs) or unemployment subsidies in the context of labor downsizing. The second general form of compensatory measure is *market-share compensation*, which serves to protect the economic roles of established actors in more open markets. This includes the direct award of ownership to firms and their workers or unions through privatization and the partial deregulation (i.e., preserving barriers to entry or establishing tariff regimes) of different markets, such as labor, or specific industries.

This study argues that such "partial" or "protectionist liberalization," which grants market reserves to specific actors in business and labor – for example, barriers to foreign firms in particular sectors or monopoly of representation in collective bargaining – while the rest of the economy is opened and subjected to unfettered competition, constitutes an important type of side payment. Hence, the basic distinction (which is more fully developed in the theory of Chapter 2) is between policies that help business, unions, or workers to face increasing competition through subsidies and state-backed programs of technological innovation or labor training and those that allow for the concentration of future open markets by bestowing state assets or administering a biased deregulation or tariff regime.

Finally, the "who" refers to the target of compensatory policy. For analytical purposes I first broadly distinguish two general types of actors. ISI *insiders* are the formerly protected industrial firms, their workers, and the national unions. Domestic industrial firms were often part of broader "business groups," that is, the family-controlled multisectoral holdings under the same direction typical of developing economies (Leff 1978). Thus, I term "ISI business group" those large domestic holdings that originated and maintain a substantial part of their assets in manufacturing and/or oil/fuels businesses. ISI *outsiders* are the unemployed or poor workers in the informal sector who either had been employed in the distant past or had never made it to the formal sector or stable employment.

These three dimensions of policymaking style, compensatory measures, and target cohered in a way that produced the Statist, Corporatist, and Market models of liberalization. The Statist path involves subsidy compensation to certain ISI insiders and state *dirigisme* as the main policymaking strategy. The government formulates reconversion plans for selected ISI sectors from above (most often core manufacturing sectors such as steel and transport equipment) and provides monetary subsidies to firms and laid-off workers affected by enhanced competition. Although the process of formulation of these restructuring plans is heavily centralized in the executive in a *dirigiste* manner, implementation – for example, the amount and type of subsidies involved or the timing of plant closures or mergers – is usually subjected to negotiations with affected companies and unions, particularly at the local or firm level. Crucially, privatization in the Statist mode *is not* used as a massive reward for established ISI business groups. Rather, ownership is more diversified among institutional and financial investors, and the state preserves substantial leverage in selected privatized "national champions" through golden-share mechanisms and management supervision. The Statist mode is represented by the Spanish case between 1982 and 1996, most extensively analyzed in the book, and by Brazil under the Collor and Cardoso governments (1990–2002).

The Corporatist path combines market-share compensation channeled to certain ISI business and labor insiders with more negotiated, concertational policymaking. The state compensated established industrial business and national labor leaders (rather than laid-off workers) through state assets directly awarded to firms and unions amid a generally vast privatization process, and through the partial deregulation of certain markets, especially labor and specific industries. These compensatory measures were delivered through formal or informal concertation and negotiation with national unions and the selected domestic industrial groups largely rewarded through privatization. Argentina under the Menem presidency between 1989 and 1999 is the main instance of Corporatist adjustment studied in the book, but Portugal under the Cavaco Silva (1985–95) administration closely resembles the Corporatist model.

A central point is that in both the Statist and Corporatist paths the bulk of compensatory measures (albeit of different types) were bestowed on the *insiders* of the ISI model, that is, industrial firms and segments of the union-represented working class – national union leaders in the Corporatist mode and laid-off workers backed by local unions in the Statist model. Unlike the other two modes, in the Market path the government did not negotiate any major compensatory measure with ISI organized actors, and tariff liberalization and downsizing were unilaterally imposed. Industrial sectoral readjustments were largely left to the market. Yet, we find an explicit government attempt to compensate, subsidize, and eventually mobilize politically the unorganized and poor workers in the informal sector, or *outsiders*. Unmitigated commercial liberalization combined with extended means-tested social compensation renders "Market" an apt label for this mode of adjustment.[10] Chile under Pinochet (1973–89) and Fujimori's government in Perú (1990–99) are instances of this type.

Significantly, in all models a crucial component of the effort to impose market reform and industrial adjustment involved the administration of compensatory measures for some of the losers among manufacturing firms and/or the working class. Yet, the *political process*, *type of compensation*, and *target* differed among the cases (Table 1.1). In a language borrowed from Barrington Moore (1966), one finds three main roads to industrial liberalization in Ibero-America: the Statist one in which the government reconverted strategic industrial sectors from above and gave out subsidies to ailing firms and workers, the Corporatist in which the state rewarded domestic industrial groups and national unions with market share in the future order, and the Market in which policymakers excluded ISI insiders and focused compensation on the informal poor.

Of course, the identification of Statist, Corporatist, and Market as three distinct models of national industrial adjustment echoes the lineage of classic political economy works by Shonfield (1965), Zysman (1983), Berger (1981), and Hall (1986) on advanced countries. My typology has similarities with this tradition. For example, the book explains modes of industrial/sectoral reconversion that are more state led, collaborative or negotiated with peak-level actors or associations, and company led (see Zysman 1983: 94).Yet the conceptualization of Statist, Corporatist, and Market paths is adapted here to the realities of adjustment in developing, semi-closed, economies, essentially denoted by more abrupt and extensive economic liberalization, and by profound crises that made compensation crucial for political survival.

[10] To quote Esping-Andersen's classic work (1990: 22), means-tested poor relief "will compel all but the most desperate to participate in the market."

TABLE 1.1. *The Outcome: Compensatory Policies and Models of Economic Liberalization*

Defining Features	**Statist Model Spain 1982–96 Brazil 1990–2002**	**Corporatist Model Argentina 1989–99 Portugal 1985–95**	**Market Model Chile 1973–83 Peru 1990–99**
Nature of Policymaking	State *Dirigisme* (centralized formulation, negotiated implementation)	Concertation	Unilateral State Imposition
Main Compensatory Measure	Subsidy	Market Share Compensation (partial deregulation and/or state assets)	Subsidy
Main Actors Compensated	ISI Insiders (domestic industrial firms/ groups and laid-off industrial workers)	ISI Insiders (domestic industrial firms/ groups and national unions)	ISI Outsiders (atomized informal poor)

It is also worth stressing that I study the dominant from of compensation. Of course, countries did a lot of things under neoliberal reform: that is, governments granted protection (e.g., an antidumping measure) to this or that subsector, while a single protected firm may have been rewarded in various cases. The question is what compensatory scheme was clearly prevalent, deliberate, and politically more relevant under neoliberalism. Statist, Corporatist, and Market configure a typology of adjustment paths around which most of the major countries of Ibero-America cluster.[11] The typology is the result of the combination of "values" or categories in these three dimensions of policymaking strategy, compensatory measure, and target. Certainly, a number of other combinations of these dimensions would be, in principle, theoretically possible in the typology property-space. For example, a policymaking style based on unilateral imposition could be combined with market-share compensation targeted to ISI insiders Or, alternatively, concertational policymaking could be in principle compatible with subsidy compensation.

Still, most of the dimensions are logically connected, and the major Iberian-American countries (except Mexico) empirically fall under each type. *Dirigiste* officials (who want to redesign industrial sectors from above) will be more ready

[11] Seawright and Collier (2004: 311) define a typology as a "coordinated set of categories or types that establishes theoretically relevant analytical distinctions." The models of liberalization constitute both a conceptual or descriptive typology (a set of types defined by different dimensions) and an explanatory typology (that is, outcomes to be explained) in the terms of Collier et al. (2012).

to give out subsidies in strained sectors and preserve leverage than simply to hand over the control of state assets or market reserves to private groups. Concertational policymaking seems to be more feasible with nationally organized actors such as ISI business groups and national unions rather than with informal workers. Likewise, the atomized informal poor could hardly be compensated with market-share deals such as the control of state assets or sectoral tariff regimes.[12]

The cases compared in more detail in this book, Spain, Argentina, and Chile, are the most complete instances of each type, in the same way that, for example, political economists often consider Sweden the model-case of a social democratic welfare state, or Germany and the United States as the embodiment of Coordinated and Liberal market capitalism, respectively (Esping-Andersen 1990, Hall and Soskice 2001). They show the most extended repertoire in their type of compensation: a series of top-down reconversion plans based on subsidies to industrial firms and dismissed workers in Spain, various forms of market-share compensation negotiated with ISI insiders in Argentina, and a wide array of informal sector-targeted antipoverty and employment programs in neoliberal Chile.[13] Other cases of extensive neoliberal reform in the Iberian-American world can be assessed in the light of the same dimensions (for example, if major ISI actors were rewarded through privatization, subsidies, or not rewarded; if a massive national program for the informal poor was implemented during adjustment or not) and located under each type.

The approach is not meant to suggest that the politics of neoliberal reform and its long-run consequences were restricted to the interaction and deals with the ISI potential losers in industry and labor – some of which became in fact political winners. Alliances with "straight winners" such as internationalized finance and multilateral institutions, transnational corporations (TNCs), or competitive agriculture were also vital in the crafting of market-oriented coalitions, and their complexity also worth studying. Indeed, the role played by some of these more internationalized actors will surface recurrently throughout the book – especially that of TNCs in the sectoral studies on business.

Yet, the analysis concentrates on how neoliberal reformers grappled with domestic industry and popular actors, for three reasons. First, dealing with industry and the working class (whether through effective marginalization/repression or via compensation) was crucial for the governability of market reform. Established unions and sheltered businesses were simply the most dangerous foes of liberalization in the domain of economic interests. Second, in most

[12] Besides, as the methodologists George and Bennett (2005: 235) argue, to be heuristically useful, a typological theory need not show empirical instances of all its possible property-space combinations. On the extensive use of typological theory in comparative historical analysis see also Mahoney (2004: 86) and Collier et al. (2012).

[13] I refer to Spain, Argentina, and Chile as model cases of each path rather than ideal types, given that the latter rarely can be found in practice. In Goertz's (2009: 192) terms, ideal type concepts have zero extension.