EDGS WORKING PAPER

Number 12

"Hierarchical Capitalism in Latin America: Business, Labor, and the Challenge of Equitable Development"

Ben Ross Schneider
Massachusetts Institute of Technology

January 28, 2014

Presented as part of the "Comparative Politics Workshop" speaker series at the Equality Development and Globalization Studies (EDGS) program at Northwestern University, with generous support from the Rajawali Foundation.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-FM CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 20, 2013 20:35

Hierarchical Capitalism in Latin America

Business, Labor, and the Challenges of Equitable Development

BEN ROSS SCHNEIDER
Massachusetts Institute of Technology

CAMBRIDGE
UNIVERSITY PRESS

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-FM CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 20, 2013 20:35

Contents

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-FM CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 20, 2013 20:35

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-FM CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 20, 2013 20:35

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

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.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

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).

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

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 Winter1993) 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).

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

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.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

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."

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

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 it 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.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

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.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

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 thirty-three 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 20th 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; Guillén 2001, 126).

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

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

TABLE 1.1. *Labor Markets in LMEs, Latin America, and CMEs*

	LME	Latin America	CME
Union Density (percent)	28	15	45
Job tenure (median years)	5.0	3.0	7.4
Index of labor market regulation	1.0	1.8	1.4
Informal economy (percent)	13	40	17

Source: Schneider and Karcher (2010).

MNC presence was especially visible among the largest firms. The share of MNCs in the sales of the 500 largest companies in the region ranged from 30 to 40 percent for most of the 1990s and 2000s, and the MNC share of the top 200 exporters grew to nearly half in 2000 before dropping back to a third in 2004 (ECLAC 2006, 11). In terms of coordinating functions, MNCs administered in hierarchical fashion technology transfer, capital for investment, some relations with suppliers and customers, and especially trade.[11] In addition, though not formally owned by MNCs, many export firms in Latin America are dependent on one or two international buyers in closely linked global commodity chains in which the interfirm relationship is more vertical than horizontal (Gereffi et al. 2005).

In sum, on the side of corporate governance, diversified business groups and MNCs were the key conduits for organizing access to capital, technology, and markets through Coasian internalization and hierarchy. The 1990s and 2000s brought a flurry of changes to big business in Latin America with privatization, concentration, and increased FDI, both inward and outward. What emerges from a composite picture of these changes is an unmistakable Coasian onslaught: a pervasive strategy by large private businesses to extend corporate hierarchies through mergers and acquisitions. In an oversimplified sense, economic activity in Latin America is still largely subject to planning, rather than to the spontaneous free play of market forces, but the planning shifted after the 1990s from ministry offices to corporate boardrooms.

3. *Segmented Labor Markets*

Labor relations in Latin America are atomistic and often anomic because most workers have fluid, short-term links to firms, and ephemeral or no horizontal links to other workers through labor unions. Table 1.1 summarizes key differences in labor markets among different varieties of capitalism. Very high turnover (half of workers have held their jobs for fewer than 3 years) in Latin

[11] Although difficult to measure precisely, estimates of intrafirm trade between Latin America and the United States vary between one-third and two-thirds (Petras and Veltmeyer 1999; Zeile 1997). Although the patterns are similar for other regions, it is important to note that this trade is not a market exchange between independent buyers and sellers, but more a shipping order between members of the same corporate organization.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

America is a first major factor contributing to atomized employment relations because workers enter firms with few expectations of staying long. Once in the firm, most workers are unlikely to have plant-level union representation, both because union density is so low and because even where unions do exist, they often do not have much of a formal presence on the shopfloor, and overall "organized labor . . . is extremely weak" (Huber 2002a, 458–59).[12] In addition, there are few other well functioning mechanisms (like German-style codetermination) for mediating relations between workers and employers. Labor market regulations, on the books, are surprisingly more extensive on average in Latin America than in LMEs or even CMEs. However, the de facto reach of these regulations is limited because they do not cover the large informal sector and compliance in the formal sector is uneven (Perry et al. 2007).

Labor markets in Latin America also differ in patterns of segmentation that are obscured by these averages. In simple terms, the three main segments are (1) a large informal sector, (2) a large group of workers in formal jobs but with low skills and short tenure, and (3) a small segment, a labor elite, that has long tenure, high skills, union representation, and significant benefits from high labor regulation. Few precise measures exist for the size of these segments, but my estimates (see Chapter 5) put the labor elite at less than a fifth with the other four-fifths divided between formal, low-tenure workers and the informal segment.

4. *Low Levels of Education and Vocational Skills*

Educational levels in Latin America remain lower than those in developed countries and East Asia. From 1960 to 2000, the average educational attainment in the adult population in Latin America almost doubled from 3.3 to 6.1 years of school (Barro and Lee 2000, 29–30). Yet, by 2000, educational attainment in Latin America lagged behind East Asia (6.7 years) and developed countries (9.8 years), and especially for secondary education, the level most relevant for technical education and vocational training, and these regional disparities were similar in 2010 (Barro and Lee 2010). In cross-national regressions, education levels in Latin America fall far short of what would be expected for their income levels (de Ferranti et al. 2003, 3). On achievement tests like PISA, most countries of Latin America scored well below averages for the OECD and below what would be expected for their income levels (OECD 2010c). Lastly, governments in Latin America spent little on training unemployed workers (IDB 2003, 282).

Overall, problems in labor relations and skills explain a large portion of lagging productivity in Latin America (Pagés 2010). The Inter-American Development Bank reported that,

> in a study of 47 countries including most developed countries, six Latin American countries and a sampling of countries in Asia and Africa, Argentina was ranked 29th

[12] Chapter 8 considers the exceptional strength in the 2000s of organized labor in Argentina.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

> in productivity per worker, Mexico 34th, Chile 36th, Brazil 38th, Colombia 40th, and Venezuela 42nd. The reasons for these low productivity levels include slow progress in education, the failure of training systems, poor labor relations, and the absence of compensation mechanisms for workers who stand to lose their jobs or job standing due to innovations. (IDB 2001, 105)

What explains the low levels of investment in skills? Why are incentives for public provision and individual investment in education and training so weak? For fuller answers to these questions, as well as a deeper understanding of why other institutions and organizations persist, it is essential to examine complementarities among them.

III. Institutional Complementarities

The core features, as well as other background factors, were complementary and reinforced one another in ways that sustained key institutions of hierarchical capitalism in Latin America and impeded convergence towards either liberal or coordinated capitalism. For Hall and Soskice, "two institutions can be said to be complementary if the presence (or efficiency) of one increases returns from (or efficiency of) the other" (2001, 17). Complementarities are fundamental because they connect the four sets of institutions in hierarchical capitalism and make the whole (the Gestalt or configuration) greater than the sum of the parts (Crouch 2010). At first glance the four components – business groups, MNCs, atomized and segmented labor, and low skills – seem incommensurate. This is the result of using a descriptive shorthand in which atomized and segmented labor is a composite of formal and informal institutions (including labor unions, collective bargaining, rapid turnover, and labor market regulations), and the label of low skills comprises educational institutions and corporate training practices. When the discussion turns to complementarities among these composite shorthand terms, it is focused on the institutional subcomponents, as, for example, between rapid turnover and on the job training.

Complementarities have a positive connotation in the varieties of capitalism lexicon, as in raising incentives for investing in skills. However, strictly speaking, complementarities are just neutral relationships; it is their consequences that are positive or, as is often the case in hierarchical capitalism, negative. References in later chapters to negative and positive complementarities refer to these consequences, not any fundamental differences in the logic of complementarity. This section summarizes a few crucial connections, especially those related to skills. Chapter 2 examines complementarities in greater detail.

MNCs and business groups. Over the course of the second half of the twentieth century, the existence of MNCs in higher technology manufacturing reduced the returns for domestic groups to investing in these sectors and increased the returns to business groups that invested in other areas such as natural resources, commodities, and services that used lower skills and

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

technologies.[13] The few domestic firms that did invest in developing technologies were often in the end bought out by MNCs entering the market, thereby reinforcing the division between MNCs and domestic groups.

MNCs, business groups, and low skills. Both MNCs and business groups had relatively low demand for skilled labor and weak incentives to press for widespread investment in education and training. MNCs and business groups were divided between capital-intensive firms that did rely on skilled workers, but only small numbers of them, and labor-intensive activities that employed lots of unskilled workers. Neither MNCs nor business groups invested much in R&D and related innovation that would have generated abundant jobs for very skilled workers.

Short tenure and low skills. When turnover is high, then employers have few incentives to invest in workers' skills because they expect them not to stay long. For workers, short tenure limits their time horizons and lowers their interest in investing in firm specific skills, or even in sector specific skills if they move regularly among different sectors.

Low skills and business groups. The absence of a large pool of skilled workers discouraged domestic firms from investing in upgrading their production or in other higher technology sectors, and instead encouraged domestic firms to target lower technology investments where appropriate skills were abundant in the labor market.

The overall skill regime is the central nexus linking business and labor markets. Firm and worker strategies are in aggregate closely related and codependent and, in individual firms, may be deliberately coordinated or imposed. In the short run, firm strategies depend on the stock of available skills, and workers' skill strategies depend on the jobs firms offer. Skill regimes are also a core dimension for distinguishing varieties of capitalism. The prevalence of general skills, and firm strategies based on them, differentiates liberal economies from coordinated economies in which firms and workers invest in, and rely on, more specific skills (Estevez-Abe, Iversen, and Soskice 2001). The low-skill equilibrium distinguishes hierarchical capitalism from both coordinated and liberal models.[14] Skills are also fundamental to rethinking development strategies. Overall, education has not been contributing much to growth in Latin America:

> in contrast to Asia, Latin America shows a distinctive growth pattern, primarily supported by the accumulation of labor, combined with a remarkably minor contribution of human capital and technological knowledge, usually included as the main component of total factor productivity. (Lora, 2008, 124)

[13] I use commodity in the broadest sense of mass produced, unspecialized goods including agricultural and agro-industrial products, minerals, metals, pulp and paper, and simple manufactures like basic foods, beverages, and textiles.

[14] In earlier work, Finegold and Soskice (1988) refer to a low-skill equilibrium in British industry; however, they did not develop the concept. Although this suggests some similarities between liberal and hierarchical capitalism, in general skills in service sectors in LMEs have a much higher skill equilibrium.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

Complementarities reveal the use-value of the concept of hierarchical capitalism beyond typological extensions by showing, among other things, why business groups do not converge on the types of corporate governance found in developed countries, why the strategies of business groups and MNCs are not geared toward upgrading and innovation, and why these firms do not in turn help break out of the low-skill equilibrium.

These core complementarities, analyzed in detail in later chapters, are also embedded in, and sustained by, their institutional environment. The state is the main external institution that historically reinforced the core features of hierarchical capitalism as it regulated markets for capital, labor, and technology. States invited MNCs in and regulated the terms of their entry. States encouraged and shaped – directly or indirectly – patterns of diversification in business groups (Schneider 2009b). States, especially after the 1930s, intervened deeply in labor markets and initial worker training; at the same time, they decided how much (or little) public education to provide and to whom. Moreover, the long history of deep state intervention in the economy may have "crowded out," or inhibited the emergence of, other kinds of nonstate, nonmarket institutions common in coordinated capitalism. Some typologies of capitalism include the state as an integral part of a statist variety (Schmidt 2003). Yet, except in extreme cases of where the state controls much of the economy, more can be gained by keeping the state analytically separate to better understand its role in shaping a country's type of capitalism (see Chapter 2).

Latin America has long been a world leader in socioeconomic inequality that worked in recent decades to reinforce hierarchies as well as stymie efforts to promote education and investment in human capital. Vast differences in education, norms, ethnicity, and sometimes gender and language create a gulf between workers and managers that makes both sides less disposed to engage in coordination and negotiation. And, inequality reduces incentives on both sides for incremental investment in education and training, because the gap between actual and desired skills is so great. Perversely, in Latin America the returns to education were lower for poor households (Perry et al. 2005). Yawning sociocultural inequality, both partial cause and consequence of hierarchical capitalism, impeded movement toward either market or coordinated capitalism.

Political systems in Latin America worked to reinforce hierarchical capitalism in ways that resemble the political underpinnings of liberal and coordinated capitalisms in particular electoral systems, majoritarian and PR (proportional representation) respectively (Hall and Soskice 2001). In Latin America, these political influences were both formal and informal (and covered in greater depth in Chapter 7). On the informal side, insiders like business groups and labor unions had easy access to policy makers in large part because the bureaucracy was generally porous and because most top positions were appointive and usually filled with appointees who were open to talking to labor leaders and owners of business groups. On the formal side, electoral systems for legislatures based on proportional representation, common across

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

Latin America, fragmented party systems and facilitated access and influence by business groups and labor unions.

In the 2000s, renewed commodity-led development played to the relative strengths of hierarchical capitalism. MNCs and business groups were well positioned to expand commodity production. Many of the largest business groups such as Votorantim (aluminum and pulp and paper) in Brazil, Grupo México (mining), and Luksic (mining) in Chile were concentrated in commodities prior to 2000 and expanded production thereafter. The lack of a pool of skilled workers was not a major obstacle as firms, reaping bonanza prices, could absorb the cost of training. At the same time, the commodity boom reduced pressures, as growth rates stabilized and currencies appreciated, to find higher-skill niches in the global economy that could generate more and better employment. To the extent that hierarchical capitalism has a competitive advantage, it is in commodities. In contrast, liberal economies have advantages in radical innovation and high-end services, and coordinated economies excel in incremental innovation and manufacturing (Hall and Soskice 2001). In the case of commodities, competitive advantage derives first from geography, but the institutions of hierarchical capitalism are well suited to exploiting that advantage.

In sum, complementarities were mutually reinforcing, and other contextual factors like state intervention and inequality tended to shore up hierarchical capitalism. Institutional complementarities help explain past resilience in hierarchical capitalism, especially through the profound transformations of industrialization under ISI and the political and economic liberalization of the late twentieth century. Yet, in all, hierarchical capitalism is not in immutable equilibrium, nor is it impervious to change and reform. In fact, the negative consequences of some complementarities generate political pressures for change, pressures that are analyzed further in Part III.

By the 2000s, the governments of Latin America managed to overcome the main economic scourges of the twentieth century by vanquishing inflation and balance of payments crises and then restoring growth and lowering unemployment. By the 2010s, two of the most important remaining barriers to sustained, shared development were lagging productivity and entrenched inequality. Although most countries reduced inequality in the 2000s, levels remained among the highest in the world (López-Calva and Lustig 2010). Less noted, but highly problematic, was the comparatively very low rate of increase in productivity. From 1961 to 2008, total factor productivity in the seven largest countries of Latin America grew by 0.3 percent per year compared to 2.2 percent in East Asia. The rate of increase picked up in Latin America in the 2000s to 1 percent, but that was still half the rate in East Asia (World Bank 2011, 30). Lasting solutions to both inequality and lagging productivity require more skilled, productive, and well-paid jobs. Understanding the causes of low productivity and the potential sources of more and better jobs in turn requires an in depth analysis of institutions and institutional complementarities in hierarchical capitalism.

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

IV. Plan of the Book

Chapter 2 explores types of capitalism at greater conceptual and comparative length in order to highlight the distinctive elements of hierarchical capitalism in comparison with liberal, coordinated, and network economies. Chapter 2 also elaborates more on the complementarities in hierarchical capitalism among business groups, MNCs, low skills, and segmented labor. Readers more interested in empirical material on Latin America can skip ahead to Part II.

Part II has chapters on each of the four main components of hierarchical capitalism. Due to the neglect of business groups in most scholarship on Latin America political economy, Chapter 3 provides extensive empirical coverage and examines their resilience over time, and contrasts business groups in Asia and Latin America. Chapter 4 turns to MNCs to highlight their renewed influx into Latin America to analyze the consequences, often negative, for the growth of local firms and high-skill employment and to examine their political exclusion. Chapter 5 covers segmented labor markets and atomized labor relations, focusing especially on informality, weak unions, rapid turnover, and extensive regulation. Chapter 6 delves into the low-skill trap, in which employers do not invest in activities requiring skilled workers because so few are available and workers do not invest in their human capital because of the lack of skilled jobs on offer.

In Part III, Chapter 7 enters into the political dynamics in hierarchical capitalism, concentrating on the formal institutions and informal practices that favor business groups and analyzing how firm strategies and general institutional complementarities inform their policy preferences. Chapter 8 examines some contemporary variations on hierarchical capitalism in Mexico, Argentina, Chile, and Brazil, highlighting the potential in the latter two countries for breaking out of the low-skill trap. Chapter 9 concludes with some reflections on further theorizing in the study of comparative capitalism and on institutional origins and change.

The core arguments of the book revolve around an interlocking set of complementarities. The analysis of institutional complementarities has a long tradition in economics and has been ubiquitous in research in the past decade on Europe and other developed countries, but almost never comes up in Latin America.[15] Examining complementarities is a different analytic enterprise from traditional causal approaches that take an outcome and attempt to single out the main cause. With complementarities, the goal is to find out how the existence or strength of an institution in one realm of the economy affects incentives and institutions in another realm, without intending to establish that the complementarities are the main or single cause. In fact, some complementarities do have the force of sufficient causes, such as in the way the dominance of

[15] See, for example, Milgrom and Roberts (1994), Amable (2000), and Aoki (2001) and other works by these authors. For reviews of institutional complementarities in developed countries, see Höpner (2005), Crouch et al. (2005), Deeg (2007), and Deeg and Jackson (2007).

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

MNCs in higher technology manufacturing increased incentives for, or caused, business groups to invest in other sectors. In other complementarities, the relationship is more probabilistic – one of a range of likely causes. So, for example, the lack of skilled jobs in business groups lowers incentives for students to invest in education, but it is only one of several factors constraining school achievement.

The analysis of complementarities opens a novel window on Latin American political economy, and this book works to develop the concept in several directions. The book first extends the concept of complementarities to explain negative as well as positive outcomes. And, while the central complementarities are among the four core components – MNCs, business groups, atomized labor markets, and low skills – later chapters uncover crucial additional complementarities within the corporate governance of business groups (Chapter 3) and within labor markets (Chapter 5). These "within realm" complementarities go beyond the basic interactions in most studies in comparative capitalism and are instrumental in explaining the workings of hierarchical capitalism. Overall, complementarities are indispensable to understanding many of the anomalies of Latin American political economy such as Why is labor regulation higher than anywhere else? Why did big business not oppose trade liberalization? Why did so many business groups start in cement? and Why is family capitalism thriving?

The book provides original research from archives, government documents, periodicals, firm histories and annual reports, and scores of interviews (see the Appendix), much of it collected through field research in six countries: Argentina, Mexico, Colombia, Peru, Brazil, and Chile (with special emphasis on the last two). Additional evidence and insights come from synthesizing existing research and integrating extensive but dispersed scholarship on corporate governance, business groups, MNCs, global production networks, R&D, labor markets, education, and worker training.

In focus, this book runs counter to – but in the end complements – a recent wave of research focused on the poor, the bottom of the pyramid. The analysis of hierarchical capitalism concentrates attention instead on the top of the pyramid in terms of both corporate governance and the higher-skilled labor elite. Much groundbreaking research, and innovative policies following from it, tackles the question of how to bring the bottom of the pyramid out of poverty. The boom in experimental research, which revived development studies in economics, looks almost exclusively at the very poor (Banerjee and Duflo 2011). Without doubt, it is essential to find ways to provide basic subsistence needs, education, and health care, but longer term, it is equally pressing to provide more good jobs and increase productivity (Amsden 2010). For a concrete example, the popular and ubiquitous conditional cash transfer (CCT) programs are succeeding in keeping more children in school longer. But, these successes will not mean much over the longer run if these students cannot find jobs that let them use their new skills. Understanding whether those jobs will

Trim: 6in × 9in Top: 0.5in Gutter: 0.75in
CUUS1986-01 CUUS1986/Schneider ISBN: 978 1 107 04163 9 April 22, 2013 19:39

materialize and where they might come from requires closer attention to the top of the pyramid where decisions are made on what jobs to create.

This book, and the varieties of capitalism framework generally, focuses attention centrally on the quality of jobs. The skill regime is the crucial analytic nexus between business and labor through several of the main complementarities. The central policy and normative implication is that the quality of jobs, not just the quality of labor markets, should be central concerns in devising development strategies and policy packages. The quality of jobs can be a guiding issue of course in various direct kinds of labor reforms and active labor market policy (unemployment insurance, training programs, skill certification, etc.), but an abiding concern with jobs can also be built into broader policies in science and technology, trade, and education, as well as the industrial policies that came back in fashion in the 2000s.

2

Comparing Capitalisms

Liberal, Coordinated, Network, and Hierarchical

I. Introduction[1]

For a number of years now, scholars of comparative political economy have been asking how many types of capitalism exist in contemporary societies. To date the most common answers – based almost exclusively on comparisons among developed countries – are one, two, three, four, five, or many. The answer offered here is four, based primarily on ideal types constructed around four basic mechanisms of allocation that are compatible with various ways of organizing capitalism: markets, negotiation, networks, and hierarchy.

For those seeking a more inclusive and exhaustive taxonomy of capitalisms, the lament over Hall and Soskice's (2001) original dichotomous formulation was that it was too inductive, empirically complex, and geographically narrow (only developed countries).[2] However, even their original formulation contained hints for possible extensions. For one, their category of coordinated capitalism lumped together two different subtypes, Japanese and European CMEs, that operated on distinctive principles: group-based versus industry-based coordination, respectively (p. 34). Moreover, they speculated that some countries of southern Europe might be hybrid "Mediterranean" varieties, with more coordination on the capital side and more markets for labor. However, these possible subtypes remained undeveloped.

Without going into a full review of other attempts to differentiate types of capitalist systems, it is still worth noting that most offerings continue to focus on inductive clusterings that usually exclude developing economies.[3]

[1] This chapter draws on Schneider (2012).

[2] Hancke et al. (2007a) review these and other critiques.

[3] Coates (2000, 9–10) distinguishes three "ideal types of capitalist organization:" market-led, state-led, and negotiated or consensual. Representative cases of each include, respectively, the United States and the United Kingdom, Japan and South Korea, and Germany and Sweden.

For example, Bruno Amable (2003) provides finer distinctions among European capitalisms and attempts some broader geographic comparisons. Amable's distinction among five types of capitalism – market-based, social-democratic, Continental European, Mediterranean, and Asian – steps further south and ventures a bit out of the developed world. But his approach is heavily inductive, more multifaceted as he folds in social welfare and educational systems as well as other features of the productive system, and not designed to extend to developing countries.

My more deductive point of departure is that capitalist systems – defined by the predominance of mostly free markets and private property – accommodate a limited number of alternative mechanisms for allocating resources, especially the gains from investment, production, and exchange. These mechanisms are markets, negotiation, trust, and hierarchy, and correspond in systemic terms to, respectively, liberal market economies (LMEs), coordinated market economies (CMEs), network market economies (NMEs), and hierarchical market economies (HMEs).

My typology takes a firm's eye view on comparative political economy and focuses primarily on the internal organization of large private firms and their relations with their political and economic environments. Alternative typologies that focus instead on state activities like social spending or development promotion are useful for other purposes, but are less helpful in identifying distinctive features of business and the kinds of development, jobs, innovation, and competitive advantages large firms are likely to generate. In some instances, to which I return, states and politics overwhelm the private sector, making a "state's eye" perspective more appropriate.

This fourfold typology offers several advantages over previous formulations. First, it provides additional conceptual tools for analyzing capitalism outside the developed world. To date, most discussions view capitalism in poor countries as transitory, dependent, premodern, developing, emerging, or some other gerund, with the implicit presumption that the trajectory is toward some already recognizable form of capitalism in rich countries. The conceptual addition of the new hierarchical variety (HME) allows us to conceive of a distinct, rather than derivative, kind of production regime that has its own reinforcing dynamics and institutional advantages and disadvantages. Middle-income regions such as Latin America may still lag as far behind developed

Schmidt (2002, 112–18) uses a similar three way typology of market capitalism, managed capitalism, and state capitalism with France and Italy in the last category. Kitschelt et al. (1999) distinguish four main types: uncoordinated liberal market capitalism (same countries as LMEs), national coordinated market economies (labor corporatist) in Scandinavia, sector-coordinated market economies (Rhine capitalism) in much of Continental Europe, and "group-coordinated Pacific Basin market economies" in Japan and Korea. For Boyer (2005, 509), regulation theory "recurrently finds at least four brands of capitalism: market-led, meso-corporatist, social democratic and State-led." See Crouch (2005) and Jackson and Deeg (2008) for extended reviews of typologies, and Boschi (2011) for a recent extension to Latin America.

countries in terms of GDP per capita as they did decades ago, but on many social and economic indicators contemporary middle-income countries are as "modern" as developed countries were by the middle of the twentieth century when varieties of capitalism there became institutionalized and consolidated (Hall 2007). Thus, there are good reasons to think that capitalism in many middle-income countries may have settled into institutional foundations of its own, and therefore requires analysis on its own terms rather than as some form of capitalism manqué or in formation. In short, it may be that capitalism in many developing countries is what it is, rather than on its way to becoming something else.[4]

Second, a typology based on core allocative principles offers an option for theoretical closure on the question of how many varieties there are. This closure is conceptual and does not imply that all countries are, or are transitioning toward, one of the four varieties. The point is that the number of alternative principles for allocating resources in a capitalist economy is limited. Third, the proposed typology helps distinguish different forms of capitalism within particular countries.[5] Even if comparison of national models is the primary purpose, it need not require us to ignore intracountry variation. So, for example, the expanding service sectors in most CMEs look more liberal than coordinated. Although the analysis here is based primarily on cross-national variation, for some purposes, it may be more useful to think of all national economies as evolving mixtures of various sorts (Boyer 2005; Crouch 2005: 26, 41). Assessing patterns in these mixtures, however, requires prior delineation of clear conceptual ideal types, rather than the often scumbled categories derived from empirical clusters of national-level indicators.

Section II explores in greater detail the main differences across the four varieties in the basic allocative and commitment mechanisms, corporate governance, labor relations, and skills. This section also briefly assesses the fit of various countries to these ideal types. Section III analyzes complementarities and other interactions that knit varieties together, focusing primarily on hierarchical capitalism. The conclusion considers some further regional comparisons.

II. Allocative Mechanisms: Markets, Negotiation, Trust, and Hierarchy

Markets and coordination, the mechanisms in the original CME/LME dichotomy, do not exhaust all the primary logics or principles of allocation in capitalist economies. Hall and Soskice (2001) themselves note two quite

4 Hancké et al. (2007b, 4) use the term "emerging market economy" (EME) to categorize countries "in transition with only partially formed institutional ecologies." This may apply to particularly fluid postcommunist political economies of Eastern and Central Europe but less so to other poor countries with longer trajectories of capitalist development.

5 There is a long research tradition that compares within-country variation by sector or region. For example, see Piore and Sabel (1984) and Hollingsworth and Boyer (1997).

TABLE 2.1. *Basic Relations in Four Ideal Types of Capitalism*

	Liberal (LME)	Coordinated (CME)	Network (NME)	Hierarchical (HME)
Allocative principle	markets	negotiation	trust	hierarchy
Characteristic interaction among stakeholders	spot exchange	institutionalized meeting	reiterated exchange	order or directive
Length of relationships	short	long	long	variable
Representative case	United States	Germany	Japan	Chile

different mechanisms for coordination in CMEs, negotiation in Europe and networks in Asia (hereafter network market economies, NMEs). These three mechanisms resemble Hirschman's (1970) trichotomy of responses to decline – exit (LMEs), voice (CMEs in Europe), and loyalty (NMEs in Asia; though for Hirschman, loyalty was less a third principle and more a factor mitigating voice and exit). However, loyalty implies trust, which figures centrally in most analyses of Japanese networks, lifetime employment, and business-group coordination. Last, in terms of basic principles, hierarchy is a fourth crucial mechanism for nonmarket allocation. In post-Coasian economics, hierarchy is a feature of all modern firms and a universal response to higher transaction costs (Williamson and Winter 1993). However, transaction costs and hierarchy vary considerably across national institutional contexts, and hierarchy should also be considered an option adopted by economic agents in place of market, network, or negotiated alternatives.

Table 2.1 starts with abstract distinctions underlying each variety. Subsequent tables incorporate more empirical regularities associated with real-world manifestations. The issue of skills provides a useful illustration of the core principles of allocation. When workers and their employers invest in training, how are the gains from that investment divided? Following the possible mechanisms in Table 2.1, both parties can let the market decide the value of the new skills, and employees can sell them to the highest bidder. Or, workers and employers can negotiate a plan for sharing the gains from skills in the context of long-term employment relationships. Or, workers can invest in skills and trust that they will be compensated in some way in the future, such as seniority-based pay. Or, finally, employers can decide unilaterally who gets trained and how the gains are distributed. Of course, the power asymmetries between employees and employers are enormous in all types of capitalism, but shared expectations vary on how that power is wielded. Workers may expect employers, variously, to play the market, return regularly for negotiations, keep them on for lifetime employment, or just tell them what to do next.

The typical interactions in Table 2.1 characterize relations among different sets of stakeholders. So, for example, managers in LMEs would expect most relations with shareholders, creditors, suppliers, competing firms, and employees to be short term and market based. Managers in NMEs, in contrast, would expect these relations to be longer term, and each iterated exchange helps build trust for the next round. Managers in CMEs can count on many more meetings with formal, bargained commitments. In HMEs, relations among owners and managers tend to be hierarchical and longer term, whereas relations with other firms and with workers are shorter term and based on some combination of markets and hierarchy.

For a comprehensive and coherent set of ideal types, it is important to separate out the distinct network variety (NME). The conceptualization of NMEs draws on work on economic sociology, social capital, and sociological analyses of Asian capitalism (see Lincoln and Gerlach 2004; Granovetter 2005; Feenstra and Hamilton 2006, especially 44–45). The common thread in this work is the conviction that informal norms and nonmarket relations of trust and reciprocity are at least as relevant as strictly economic and formal relations in determining the performance of firms, regions, and countries. These informal relations are based on long-term, noncontractual, face-to-face interactions. In more complete NMEs, informal networks can permeate business groups (as in keiretsu), as well as relations with employees, banks, government agencies, and sectoral competitors (Witt 2006). In other cases, network capitalism may be confined to particular sectors or regions.

Hierarchy and the concept of a hierarchical market economy have not been considered in previous analyses of comparative capitalism.[6] In a Coasian perspective, hierarchy is of course the day-to-day result of firm decisions to "make rather than buy." In an HME, however, hierarchy regulates and orders much more than just internal relations of vertical integration. Hierarchy also informs relations between owners and managers (concentrated ownership) as well as employee relations (unmediated by labor unions) and decisions on investments in skills and training. Hierarchy is also evident in relations among firms both within sectors where large firms dominate economically (oligopoly) and in associations as well as across sectors and borders in that business groups and MNCs buy and control firms that would be independent in other varieties. As such, hierarchies replace relations that in other varieties would be mediated by markets, networks, or coordination. Empirically, as discussed later, hierarchy is more common in developing countries, yet conceptually it is a distinctive mechanism of allocation that merits inclusion along with the other three better-known principles.

Conceptually, the four principles are mutually exclusive in the sense that they cannot be combined in equal measure. An allocation based on a hierarchical order, for example, cannot simultaneously be the result of negotiation.

[6] Hierarchy comes up occasionally (Hall. and Soskice, 2001, 9; Crouch 2005, 33; Nölke and Vliegenthart 2009), but not as the basis for a distinct variety of capitalism.

TABLE 2.2. *Corporate Governance and Interfirm Relations*

	Liberal (LME)	Coordinated (CME)	Network (NME)	Hierarchical (HME)
stock ownership	dispersed	blockholding	blockholding and cross ownership	family blockholding
predominant type of large firms	specialized managerial corporations, MNCs	bank controlled firms, business groups	informal business groups (keiretsu)	hierarchical business groups, MNCs
firm relations within sectors	competitive	sectoral associations	associations and informal ties	oligopolistic
firm relations across sectors	few	encompassing associations	informal connections	few (save acquisitions)
supplier relations	competitive bidding	long term, negotiated	long term, informal	vertical integration

Of course, in everyday relations, elements of all four may come into play, and firms (all complex organizations, in fact) have at least some relations based on each of the four mechanisms. And, over time, particular economic relationships may evolve from, say, hierarchy to market, to network. However, for most major commitments of time and resources, the economic agents involved presumably have few doubts over which is the primary operative principle. The four core principles should also be collectively exhaustive in that other possible mechanisms of distribution such as theft, lotteries, or communalism are not compatible with capitalist systems based on free markets and private property. However, as multidimensional ideal types, these four varieties are not meant to be empirically exhaustive, and many countries may be hybrids that do not fit any of the four types.

How are these four abstract principles manifested in various spheres and relations of capitalist production? Tables 2.2, 2.3, and 2.4 turn to more specific distinctions and start to draw in more empirical examples. On the dimension of corporate governance, the first distinction is between dispersed ownership in LMEs like the United States and Great Britain and blockholding (concentrated ownership) in the other three varieties (Table 2.2) (La Porta, López-de-Silanes, and Shleifer 1999; Roe 2003; Gourevitch and Shinn 2005). Concentrated ownership and patient investment facilitated the longer-term relations in network and coordinated capitalisms as in Japan and Germany historically. Although ownership is concentrated in all three blockholding varieties, the type of control varies. In particular, large firms in Japan (NME) and Germany (CME) had more cross-shareholding by other firms and financial intermediaries that crowded out dispersed shareholding and shielded firms from outside takeovers

(Dore 2000, 34). In HMEs in many developing countries, ownership in business groups is more concentrated (without cross-shareholding, in part because of the relative underdevelopment of stock markets) and mostly held by families (which adds another element of hierarchy) (La Porta et al. 1999). Hostile takeovers, common in liberal capitalism, are rare or unknown in the other varieties.

Share ownership feeds into different types of corporate structure and authority in the large firms in each variety. Dispersed ownership in LMEs shifts power to managers, but also subjects them to short-term monitoring and performance pressures. Owners have greater control in the other nonliberal varieties where investors tend to be more "patient." Although business groups are common in nonliberal varieties, they tend to be different types, more informally connected in NMEs and more hierarchical in HMEs (see Granovetter 2005; Khanna and Yafeh 2007). As noted in Chapter 1, the relatively minor role of external finance – equity and credit – means that many of the traditional concerns of corporate governance and relations between external financiers (principals) and managers (agents) are less relevant in hierarchical capitalism. Business-group owners, mostly families, have full ownership and usually direct managerial control.

Direct hierarchical control is also the rule in MNCs that are common among the largest firms in both liberal and hierarchical capitalism but rarer in CMEs and especially NMEs. The debate about varieties of capitalism in developed countries pays little, if any, attention to MNCs, yet even among OECD countries the contrasts are large: the proportion of sales accounted for by MNCs was 21 percent in the United States, 31 percent in the United Kingdom, 11 percent in Germany, and just 2 percent in Japan (Barba Navaretti and Venables 2004, 5).[7] The presence of MNCs in most developing countries is even larger, especially in more complex manufacturing (such as autos and electronics), with the significant exceptions of Korea and Taiwan (Amsden 2001). MNCs are compatible with market and hierarchical varieties though not logically necessary.[8] MNCs though are logically inconsistent with coordination and networks, and in practice, when MNCs expand in CMEs and NMEs, they undermine interfirm coordination through business associations and informal networks.

[7] Soskice (1999, 118) devotes only a paragraph to MNCs, noting mostly that MNCs often seek out CMEs or LMEs to leverage their respective institutional advantages, as in German chemical companies with biotechnology investments in the United States. Other extensions to Hall and Soskice or contending perspectives on comparative capitalism also devote little attention to MNCs (Huber 2002b; Crouch 2005; Hancké et al. 2007a). See Morgan (2009) and Chapter 4 for more empirical details on MNCs across different varieties of capitalism.

[8] MNC subsidiaries are subject to hierarchical control, which adds a nonmarket element to liberal capitalism. However, LMEs are mostly large, open economies where MNCs are therefore subject to stronger market forces. In developing countries, MNCs often have greater market power or collective dominance of whole sectors, so the hierarchical element is more evident and consequential (see Shapiro 2003).

Comparisons across three dimensions of interfirm relations – within sectors, across sectors, and with suppliers – reveal differences that are closely related to the guiding principles of each variety.[9] In LMEs, relations are competitive within sectors, largely absent across sectors (encompassing associations are weaker or non-existent), and competitive among suppliers. At first glance, HMEs seem to resemble LMEs in their shared absence of interfirm coordinating mechanisms. However, firms in HMEs tend to encounter many more hierarchies than market relations. High concentration ratios in many sectors structure markets as oligopolies with a few dominant firms (that are likely to exercise control over industry associations; see Chapter 3).[10] Moreover, across sectors and across borders, firms in hierarchical capitalism are more likely to be owned and controlled by either large business groups or MNCs, and relations with suppliers are typically hierarchical, either through direct vertical integration or through general dependence of small suppliers on large or monopsonist buyers.

In CMEs, employer and sectoral associations are better organized and more encompassing, and they perform crucial coordinating functions such as bargaining collectively, managing vocational training programs, and negotiating sectoral standards. Relations with suppliers are based on long-term, negotiated relations that often involve joint efforts at upgrading. Relations with government are also likely to be mediated by strong business associations. As noted earlier, Hall and Soskice (2001) distinguish this formal, industry based coordination in Europe from the more informal, group-based coordination in Japan, or NMEs in my typology.[11]

In NMEs, crucial coordination also takes place through informal networks of firms, best typified by the keiretsu in Japan. Such network based business groups are multisectoral and provide strong links across sectors. In practice, formal associations in network economies may also be important and help to mediate coordination within sectors, often with government support as in deliberation councils and publicly supported R&D consortia. However, in addition to formal association ties, informal networks also permeate sectoral relations among firms, in "intra-industry loops" (Witt 2006). Relations with

[9] In a Coasian perspective, supplier relations are also dependent on sectoral and product characteristics. Where transaction costs are high (and contracts therefore difficult to write), buyers will shy away from market relations and favor longer-term networks, ongoing negotiations, or outright hierarchy. However, in the grayer, more uncertain range of make-or-buy decisions, an institutional perspective would expect more cross national variation, with suppliers relations tending to be closer and longer term in NMEs and CMEs, and vertical integration more widespread in HMEs.

[10] On hierarchical relations among firms in Chile, see Taylor (2006, chap. 6), and for those in France, see Hancké (1998).

[11] Among others who draw distinctions between Japanese and European capitalism, see Kitschelt et al. (1999), Streeck (2001), Yamamura and Streeck (2003), Pontusson (2005), and Whitley (1999).

TABLE 2.3. *Labor Relations and Skills*

	Liberal (LME)	Coordinated (CME)	Network (NME)	Hierarchical (HME)
Employment relations	short term, market	long term, negotiated	life time employment	short term, market
Industrial relations	fewer unions	encompassing unions	company unions	few unions
Labor-management committees	no	yes	yes	no
Skills	general	sector specific	firm specific	low

suppliers are often long term with formal negotiation, but there are additional network and informal relations (as in the practice of shifting employees from buyer to supplier firms).

On the labor side, there is a greater resemblance between liberal and hierarchical capitalism, on the one hand, and coordinated and network capitalism, on the other(Table 2.3). In hierarchical and market varieties, employment relations (for the majority of workers outside the small labor elite) are short term and unmediated by unions that are generally few or absent. Workers therefore lack incentives to invest in sector or firm specific skills, and invest, if they do invest, in more general skills. In CMEs and NMEs, in contrast, employment relations are longer term, and employees therefore have greater incentives to invest in sector-specific skills. The difference between CMEs and NMEs derives largely from expectations of longer-term employment (as in Japan) where employees trust that they will be able to amortize investment in firm specific skills. In CMEs, training is organized on a sectoral basis and government policies such as generous unemployment benefits allow laid-off workers to wait for jobs that match their skills and therefore allow them to amortize sector specific training (Estevez-Abe et al. 2001; Iversen and Soskice 2001).

In the abstract, unions do not mesh well with the organizing principles in market and hierarchical varieties, and in practice, large majorities of workers in purer cases of each do not belong to unions. Beyond, or alongside, unions, there is a further issue of additional forums for consultation and negotiation over work organization and other shop-floor issues. On this dimension, both theoretical expectations and practice are more black and white: LMEs and HMEs have none whereas CMEs and NMEs have a range of different forms of ongoing consultation between management and labor, including statutory bodies like works councils (codetermination), representation on company boards, and shop-floor work teams.

Overall, each variety has distinctive strengths and weaknesses(Table 2.4). For Hall and Soskice (2001), the adaptability of LMEs combined with high-level skills in cutting-edge technology and service sectors promotes radical innovation in new products and businesses. CMEs and NMEs, in contrast, manage

TABLE 2.4. *Comparative Institutional Advantage and Empirical Cases*

	Liberal (LME)	Coordinated (CME)	Network (NME)	Hierarchical (HME)
Comparative institutional advantages	radical innovation, services	incremental innovation, manufacturing	incremental innovation, manufacturing	commodities, simple manufacturing
Cases	United States Great Britain Estonia	Germany Scandinavia Slovenia	Japan Taiwan	Latin America (South East Asia?)

through longer-term relationships to innovate incrementally, especially in manufacturing, and to make constant improvements in quality and productivity in more established lines of activity. HMEs lack both of these kinds of innovative capacities due to lower skills overall and short-term hierarchical relations that impede collaborative shop-floor relations needed to promote incremental production innovation. Firms in hierarchical capitalism develop instead competitive advantages in commodity production, often based on natural resources and low-complexity manufacturing in sectors such as agro-industry (pulp and paper, vegetable oils, fish and meat packing, and ethanol), minerals and metals (steel, aluminum, copper, and cement), and more industrial commodities (textiles, electronic components, and auto parts) in which the design and marketing are located in developed countries and production is subcontracted to firms in developing countries through global production networks (Gereffi et al. 2005).

Table 2.4 categorizes some major empirical cases, based primarily on the leading sectors and big firms in each country. The LME, CME, and NME classifications follow the conventional wisdom on developed countries that most closely approximate each ideal type and add in some emerging cases of each. Many of the larger, middle-income developing countries approximate the HME variety. The economies of large countries of Latin America and Southeast Asia, as well as countries such as Turkey and South Africa, have many hierarchical business groups and MNCs, short job tenure, and lower skills, and generally weak labor unions that lack capacity to negotiate effectively (on Turkey, see Özel 2011). Section III and later chapters provide more empirical and comparative indicators.

Among the emerging capitalist economies of East Europe and the former Soviet Union, some governments adopted more or less explicit programs of transition to a particular variety, other countries gravitated towards particular models, and others are still in transition or at least not yet recognizable as one of the four varieties. The Baltic countries (Lithuania, Latvia, and Estonia) adopted the most extreme market reforms, pushing them in a liberal direction, whereas Slovenia stands out for the sustained reliance on CME kinds of institutions such as strong business associations, labor unions, and tripartite negotiations (Bohle and Greskovits 2007).[12] Russia and some of the other former Soviet Republics seemed to be moving toward hierarchical capitalism, but several cases have ended up better classified as state or patrimonial capitalism (discussed later).

Among the rising industrial economies of East Asia, Korea, Taiwan, and China seem to hover between CMEs and NMEs, and on some dimensions drift over to HMEs (however they are pretty clearly not LMEs).[13] Taiwan, for example, had extensive business networks but also strong business associations that coordinated CME-style standards, R&D, and exports (Cheng 1996; Fields 1997). Taiwanese business groups were smaller and relied more on network ties to buyers and suppliers (S. J. Chang, S.-J. 2006; Feenstra and Hamilton 2006). In contrast to Taiwanese groups, chaebol in Korea tended to be more vertically integrated and hierarchical. Because of the apparent similarities between keiretsu and chaebol, Japan and Korea are often classified together as group-based CMEs (Kitschelt et al. 1999; Soskice 1999). However, chaebol and keiretsu rely on quite different coordinating mechanisms: loose, informal networks in keiretsu, and rigid hierarchical control in chaebol (see Whitley 1990). To the extent that Korean business associations perform important coordinating functions among chaebol and that Korean labor unions are less company based than in Japan, then Korea starts to look more like a European-style CME (however with faster labor turnover). Moreover, in the late 1990s, the Korean government mandated that all large firms create internal labor-management committees (Haagh 2004), and by the 2000s, CME-style firm-level dialogue had emerged in several leading chaebol (Kong 2011).

The ideal typical distinctions also help identify significant within case deviations and combinations. In the United States, for example, networks are crucial to Silicon valley as well as smaller niche sectors like diamonds and fashion design (see Uzzi 1996). Moreover, some privately held firms in the United States (some in commodities like Cargill) resemble hierarchical HME business groups. In the case of the other three varieties, the growing service sector has many LME features: general skills, smaller firms without network or association ties, and shorter-term employment. Lastly, some firms in HMEs (some of the best known cases are Embraer (aircraft, Brazil) and Techint (steel tubes, Argentina), have managed to create pockets of lasting investment in skills and well-mediated employment relations and consequently look more like CME firms. For the most part, these anomalies are exceptions that prove the rule, and their exceptionalism can often be traced to peculiar and determined efforts not

[12] Feldmann (2007) provides a detailed analysis of Estonia and Slovenia as prime examples of, respectively, new LMEs and CMEs. Poland and Hungary (and other countries of Central Eastern Europe) are dominated by MNCs and foreign banks. King (2007) calls these cases of "liberal dependent post-communist capitalism." Nölke and Vliegenthart (2009) call them DMEs (dependent market economies). See also Bohle and Greskovits (2012).

[13] China has not only networked groups like keiretsu but also shorter-term employment relations and many MNCs that are characteristic of hierarchical capitalism (Keister 2000). For arguments that China is trending in a more liberal direction, see Steinfeld (2010).

to conform to the prevailing complementarities, as, for example, was the state's long-term subsidization of skill development in Embraer (Goldstein 2002), or the decisions of family-owned hierarchical business groups in the United States not to list their firms.

This section would be incomplete without a foray into the controversy over the appropriate place of the state in defining types of capitalism (see Coates 2000; Schmidt 2002; Boyer 2005; and Hancké et al. 2007a). For other analytic purposes, it may be more useful to start with categories based on the state's role in the economy as, for example, in comparisons of welfare states (Esping-Anderson 1990) or of development strategies in poor countries (Woo-Cumings 1999). However, these characteristics of different states do not necessarily correlate with the kinds of relations – especially among firms and between firms and workers – that are at the core of the "varieties of capitalism" framework.[14] States are, of course, the primary actors in regulating many of these relations, and impeding, enabling, or shaping their evolution, as discussed in the next sections. But the fact that states are crucial to the emergence and functioning of any capitalist system does not in itself create an analytic imperative to incorporate state features or aspects of relations between business and governments into typologies of capitalism (see Hancké et al. 2007b). Moreover, leaving the state out of the typology facilitates subsequent analysis of the impact of the state on the emergence, institutionalization, or unraveling of particular types of capitalism.

However, states in some developing countries so overwhelm the economy that it is less appropriate to use an ME (market economy) suffix to describe them. There may be enough private property or private profits to merit calling them capitalist, but markets are not primary factors in distributing gains. Common names for these state dominated economies include rentier capitalism, predatory states, petro-states, developmental states, crony capitalism, or just state capitalism. For the most part, these statist types belong under Weber's umbrella concept of political capitalism where private profits depend more on politics than markets (Gerth and Mills 1958, 66). In such extreme cases of state dominance, the nature of the state is more important than the organization of private firms in determining the type of political economy.

Among varieties of political capitalism three general types stand out: state capitalism, developmental states, and patrimonial capitalism. In instances of state capitalism, the public control of the economy, especially in the largest firms and sectors, exceeds the private sector, either by virtue of public property (as in China through the 1990s) or by natural resource rents (see Musacchio

[14] Although most CMEs in northern Europe have large welfare states, welfare spending among LMEs varies greatly. Similarly, although state intervention through industrial policy and credit markets has been substantial in France and Japan, such intervention was also vast in pre-Thatcher Great Britain through public enterprises or in the United States technology policy during the Cold War (see Crouch 2005).

and Lazzarini forthcoming). In the latter case (rentier or petro states), the state, by virtue of its control massive natural resource rents, dominates economic activity and forecloses the emergence of a large, independent private sector (Karl 1997). Second, at extreme levels of intervention, developmental states (perhaps in Taiwan and Korea in the 1960s and 1970s) regulate so much of economic activity that they can be considered cases of political capitalism (Amsden 1989; Schneider 1999).[15] Third, political leaders may favor particular businesses in what is variously termed crony, clientelist, booty, or patrimonial capitalism.[16] Patrimonial capitalism is often associated with natural resource rents, but political leaders can also engage in clientelism without them. In the wake of market reform and globalization in the 1990s, political capitalism faded, but the subsequent commodity boom and renewed state intervention after the 2008–09 crisis brought it back. In Latin America, it is most evident in Venezuela, Bolivia, and Ecuador (though these countries account for only a small part of the region's economy).

The goal of this section was to lay out the main static differences among the four varieties and examine how distinct principles of markets, negotiation, trust, and hierarchy generate different relations among firms, between owners and managers, and between workers and managers. In turn, reassembling these distinct sets of relations lays the foundation for four ideal-typical varieties of capitalism. The next sections turn from static differences to dynamic interactions, especially within hierarchical capitalism.

III. Complementarities and Compatibilities

As introduced in Chapter 1, the glue holding different capitalisms together is institutional complementarities across different spheres of the economy where the presence of one institution increases returns to, or efficiency of, another institution, or where "one institution functions all the better because some other particular institutions or forms of organization are present" (Amable 2000, 647). The benefits of the complementarities approach are several. First, it incorporates linkages across different realms of the economy. Second, strong institutional complementarities generate a system where the whole is greater than the sum of the parts (suggesting skepticism of conceptions of capitalism that are just lists of factors or sums of parts). Third, institutional complementarities shape the preferences and strategies of economic agents (Hassel 2007). Fourth, as traced out empirically in Chapter 7, these distinctive preferences motivate economic agents to engage in politics and institution building and maintenance in ways that reinforce existing complementarities. Moreover, in a

[15] Among those who advocate for a statist variety, Weiss (2010) proposes a governed market economy (GME) similar to a developmental state.

[16] See King (2007) on patrimonial capitalism in Russia and other former Soviet republics. Hutchcroft (1998) uses the term "booty capitalism" to characterize banking in the Philippines.

less conscious and deliberate manner, institutional complementarities can also take alternative strategies off the table, thereby also reinforcing continuity in a more passive fashion. Tracing this process from institutions to complementarities to preferences and back to mobilization to reinforce the initial institutions is crucial to fend off charges of mechanistic equilibrium and functionalism.

Applied to the broader range of capitalisms considered here, the concept of complementarity requires some further elaboration and extension (see Crouch 2005, chap. 3; Deeg 2005; Höpner 2005). For one, institutional complementarities should include the possibility of negative outcomes or effects. Negative effects almost never come up in analyses of liberal and coordinated capitalism where the focus is the alternative institutional configurations that generate different competitive advantages.[17] For some, international competitiveness is a necessary element of a variety of capitalism (Nölke and Vliegenthart 2009). In other frameworks, appropriate institutional complementarities generate higher growth than in hybrid institutional mixes (Hall and Gingerich 2009). Limiting institutional complementarities only to the wealthiest, best performing economies does not though make analytic sense – complementarity in any abstract definition is neutral with respect to outcomes – and impedes our ability to understand poor and under performing economies. Moreover, in a last conceptual extension some connections across realms of the economy may fall short of complementarity, and should be better understood as compatibilities, where the existence of one institution does not interfere with or impede another (but may also foreclose other institutional alternatives; see Streeck 2005).

The real litmus test for identifying a distinct variety of capitalism is the existence of institutional complementarities that link separate realms of the economy together and shift the incentives of firms and workers; "complementarity is what makes taxonomies of capitalisms possible" (Jackson and Deeg 2008, 683). Yet, many of the new varieties proposed, such as statist (Schmidt 2003), dependent market economies (DMEs; Nölke and Vliegenthart 2009), mixed-market economies and emerging market economies (MMEs and EMEs; Hancké et al. 2007a), and governed market economies (GMEs; Weiss 2010) lack significant complementarities. As such, they are more descriptions of clusters of traits, and perhaps useful for other typologies, but they lack the coherent dynamics and self-reinforcing complementarities of a variety of capitalism.

Because the complementarities in CMEs, NMEs, and LMEs are well covered elsewhere (see, for example, Hall and Soskice 2001; Crouch et al. 2005), this section concentrates on complementarities in hierarchical capitalism. Then, to illustrate differences in complementarities across the four varieties, the last part of this section briefly contrasts one type of complementarity – between skill

[17] In one exception, Amable (2005, 374) mentions briefly possible negative effects and notes that institutional complementarities may also generate benefits only for a some groups, which is a useful point of departure as well for thinking about complementarities in hierarchical capitalism.

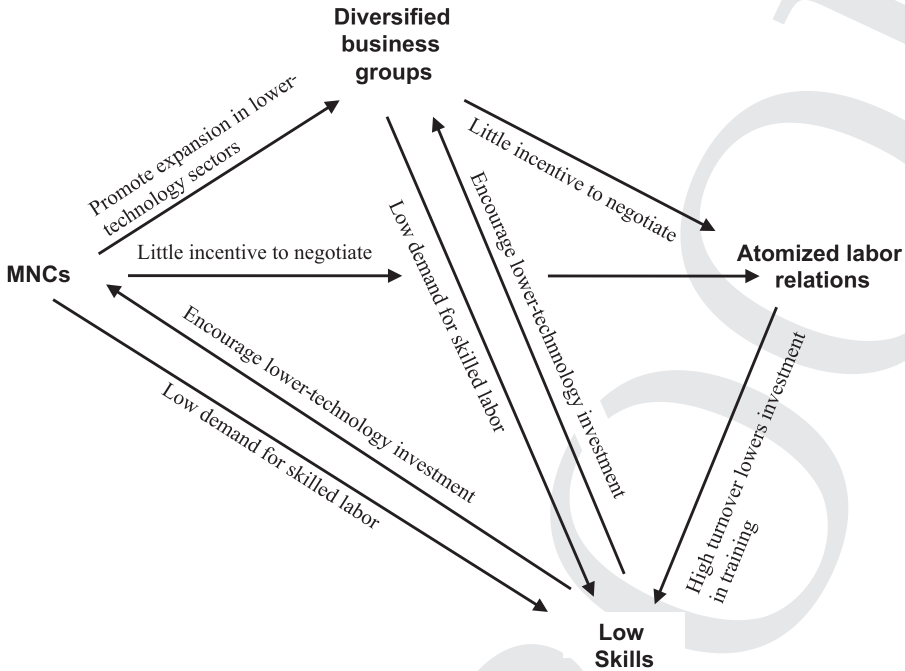

FIGURE 2.1. Core Complementarities in Hierarchical Capitalism

regimes and employment relations – across all four varieties. This set of comparisons highlights the particular negative complementarities in hierarchical capitalism.

In hierarchical capitalism, complementarities are strong, though variable across spheres, and work to reinforce hierarchical relations among and within firms and foreclose alternative interactions based on networks, markets, or negotiation (see Figure 2.1). The following discussion briefly considers the main pairwise complementarities, with empirical illustration from Latin America. Despite occasional apparent similarities with LMEs or CMEs, complementarities in HMEs have distinct logics, and the analysis highlights how these complementarities impede evolution away from hierarchical capitalism to another variety.

MNCs and business groups. MNC dominance of higher technology, complex manufacturing, and tradable sectors increased the returns to business groups to invest elsewhere in commodity, simple manufacturing, and nontradable sectors. In terms of interfirm relations, MNCs and hierarchical business groups both thwart coordination of the sort found in CMEs, especially in business associations. MNCs often join local business associations, but they tend to participate less actively and have difficulty coordinating with local firms because they are subject to hierarchical control and management decisions taken abroad. When managers are foreign, language, culture, and shorter time horizons further undermine potential coordination among firms. Subsidiaries of domestic business groups may also make unreliable interlocutors – top management is outside the sector and may ultimately decide to exit (or attempt, as often happens, to buy up competitors). Hierarchical business groups also lack the networks that promoted "group-based" coordination in NMEs. Put abstractly, sustained coordination, formal or informal, is unlikely among agents (in subsidiary firms) of distant hierarchical principals (MNCs or group owners) with opaque and diverse interests.[18]

MNCs, business groups, and atomized labor. In political economies where they negotiate frequently, business and labor have incentives to organize to match their counterparts (Schmitter and Streeck 1999). If labor is well organized, then returns to business investment in collective action are higher, and vice versa. In hierarchical capitalism (as in most LMEs), business and labor rarely negotiate, and the disorganization of one reduces returns to organization for the other. In Latin America, the relative disengagement of business and labor with each other means that both groups tend to organize more to engage the state (Collier and Collier 1991; Schneider 2004). Low union density and the absence of other intermediating forums like works councils or factory committees reduce the potential gains to managers from negotiation and thereby increase the relative returns to hierarchical employment relations.

MNCs, business groups, and low skills. The lasting, perverse complementarities of a low-skill trap or equilibrium are well known (Booth and Snower 1996). The basic coordination problem is that workers do not invest individually in acquiring skills because firms do not offer high-skill, high-wage jobs. Firms in turn have incentives to invest in production processes that do not require skilled labor because skilled workers are scarce. This low-skill trap held through the 2000s for most of Latin America where both MNCs and business groups have relatively low demand for skilled labor. As noted earlier, domestic business groups specialized in lower technology commodity sectors and services, and had fewer incentives to invest in R&D, hire scientists and engineers, or train highly skilled workers. In one survey of Latin America, "the most striking result [was] the low level of R&D conducted by firms" (de Ferranti et al. 2003, 5). R&D expenditures in Latin America rarely exceeded the comparatively low level of .5 percent of GDP and more than three-quarters of that was public (Katz 2001, 4). Even when they hired skilled workers, business groups did not hire very many; "with respect to other regions of the world, the large Latin American companies . . . generate little employment" (IDB 2001, 37).

[18] MNCs and business groups also supplant LME-type markets. Because they substitute for financial markets, MNCs and domestic business groups constitute nonmarket forms of organizing corporate governance, yet, in contrast to the effects of nonmarket coordination in CMEs, there are fewer institutional incentives for their investment to be patient. Nonmarket organization of investment in HMEs allows business groups and MNCs to respond flexibly and rapidly to market signals; both forms of corporate governance are well suited to managing swift entry and exit.

Some MNCs are prominent in higher technology sectors, but several factors limit their demand for highly skilled workers. Where manufacturing FDI was higher, as in Mexican maquiladoras, the new jobs were low skill (Berg, Ernst, and Auer 2006, 124). Moreover, MNCs keep their R&D at home. By the 2000s, MNCs were investing very little in R&D in Latin America (ECLAC 2005). Last, MNCs are not likely to be a force (voice) pushing for upgrading education and skills in any given country because they have so many options in other countries (exit). In sectors characterized by low transport costs and decentralized production – automobiles, for example – MNCs can locate plants with varying skill requirements in areas where skills are already available. Moreover, MNCs pay higher wages than local firms (Berg 2006), so MNCs can easily poach skilled workers, which depresses even further the incentives for domestic firms to invest in training.

Atomistic labor relations and low skills. Median job tenure in Latin America was only 3 years, compared to 5 years in LMEs and 7.4 years in CMEs (including Japan; see Chapter 5). Changing jobs also often means changing sectors. For example, among Chilean workers who changed jobs in the 1990s, more than half switched from one sector to another (Sehnbruch 2006). Moreover, the frequent movement of workers between formal and informal employment presumably involves shifting among sectors with different skill requirements. This rapid turnover also reduces the incentives for both labor and management to put energy into improving plant- and firm- level intermediation, let alone establish the bases for longer-term trust and personal loyalties characteristic of NMEs. The crucial negative complementarity is that short job-tenure reduces returns to investing in skills.

Low skills and business groups and MNCs. In turn, the absence of large pools of skilled workers in hierarchical capitalism further discouraged domestic firms from investing in upgrading their production or in other higher technology sectors. Studies in the United States, for example, have shown that technology acquisition did not lead firms to upgrade training and skills, but rather firms that already had skilled workers invested more in new technologies (IDB 2003, 188). MNCs base decisions on new investment in part on the skills available in particular economies and can always move new investment to different countries (exit) rather than upgrade in an economy where they already operate. As Paus put it, “human capital is the single most important factor in attracting high-tech FDI to a small latecomer” (2005, 158).[19] Low technology investment coupled with high labor turnover may also facilitate diversification. That is, lower technology investment and the management of homogeneous flows of temporary, unskilled workers can become elements of, and increase returns to, economies of scope. Once a firm develops a successful strategy for borrowing

[19] Decisions based on skills are most important for efficiency-seeking FDI. MNCs may undertake market-seeking or especially resource-seeking FDI with less regard for available skills. See Chapter 4.

one technology and using it successfully with a flow of unskilled workers, then the barriers for replicating this strategy in other sectors are lower (see Amsden 1989). Last, the fewer skills workers have, along with high levels of turnover in the labor market (as well as a pervasive informal sector), the more easily workers can be replaced. This vulnerability to substitution on the labor side further bolsters hierarchical employment relations.

In sum, a range of complementary dynamics across multiple spheres of the economy reinforces core components of hierarchical capitalism. Later chapters elaborate on the brief summaries provided here. Most complementarities in HMEs reinforce, or increase returns to, hierarchical arrangements and encourage economic agents to extend hierarchy throughout their relations with managers, other firms, and workers. And, though insufficient to fix a stable equilibrium, these complementarities stem movement toward any of the other three varieties.

The issue of skills provides a revealing dimension for comparing complementarities across the four varieties of capitalism. In liberal economies, short-term employment and greater labor market mobility encourage incremental investment in general skills, while the returns to workers are lower for investments in sector and firm specific skills (Estevez-Abe et al. 2001; Hall and Soskice 2001). For LME firms, the wide availability of general skills encouraged (i.e., increased returns to) new start-ups (and associated markets for venture capital) drawing on high-end general skills (as well as low-end service sectors like restaurants and retail that relied on low-wage, short-term employment). In hierarchical capitalism, as just noted, the complementarities were negative: short-term employment, and low demand for skills generally, discouraged worker investment in human capital overall. For employers in HMEs, the lack of high-end skills discouraged investment in complex manufacturing and services and favored instead concentrating in commodity production.

In CMEs, longer worker tenure encourages up-front investment in sector specific skills (and generous unemployment benefits reduce the risk of this investment). Moreover, multiple and encompassing forums for bargaining – industrial unions and plant level representation for workers through institutions like codetermination – provide opportunities for negotiating the distribution of gains in productivity from investment in training. These negotiations also give employers some assurance that, if they invest in workers' skills, skilled workers will not later exploit their (hold up) leverage over the firm. For employers then, investments in skill-intensive manufacturing and long-term incremental innovation have higher returns. In NMEs, the outcome, in terms of returns to investment in high-skill manufacturing are similar, but the logic is different because NMEs lack similar mechanisms for negotiation. Instead, trust based expectations of lifetime employment and seniority-based pay increased returns to workers from investing in firm-specific skills (see Dore 2000; Thelen 2004).

Beyond the issue of skills, Hall and Soskice (2001, 18) argue further that the internal logics of different varieties of capitalism encourage stakeholders over time to adopt the full package of complementary institutions: economies with coordination or with markets in several spheres of the economy will tend to develop more of the same in other spheres. Once workers or employers in CMEs, for example, realize the benefits of coordination in one realm, they are more likely (and have the organizational capacity) to extend coordination to other areas, as well as to push the state to help them achieve coordination. This process of recognizing joint gains and extending them is also a plausible mechanism for isomorphism across institutions in NMEs.

However, isomorphism has a different dynamic in market and hierarchical capitalism where economic agents are not realizing joint gains through bargaining or trust.[20] Rather, managers and owners in LMEs and HMEs use their power and autonomy to push for, respectively, markets and hierarchies in other realms. Managers in liberal economies seek greater flexibility, and in fighting external restrictions, coming from either government or unions, they push for market relations in other realms. Managers in LMEs (who themselves have relatively brief tenure) are subject to the short term monitoring of the stock market, and want maximum flexibility to meet immediate targets. In hierarchical capitalism, the goal is less market flexibility and more managerial control; however, the process and politics often look similar to LMEs as owners and managers work to restrict interference by unions and government in order to maximize returns to private hierarchy.

Similarly, the process of institutional maintenance differs across varieties. Over time, the institutional foundations of CMEs and NMEs such as business associations, keiretsu networks, labor unions, and codetermination require continual investment and repeated commitment by the stakeholders, as well as the state, to sustain them (Thelen 2001). In contrast, markets and hierarchies have greater institutional inertia and need less active support to persist. Moreover, it requires less effort to shift from coordination to markets and hierarchies than vice versa (Hall and Soskice 2001, 63). In most realms, it is more difficult to build networks of trust or institutionalized negotiation in LMEs and HMEs than it is to introduce markets and hierarchy to undermine or displace networks and bargaining in NMEs and CMEs.[21]

Overall, however, these various pressures for isomorphism are uneven and limited, and have not pushed all countries towards purer types. Many countries sustain anomalous features (strong unions, for example, in liberal countries like Great Britain [historically], Ireland, and Australia) for long periods despite employer pressures to make them more institutionally compatible. Other countries maintain clearer hybrid mixtures of institutions over long periods (what

[20] See Höpner (2005) for a full review of different theories of institutional coherence.

[21] On the weakening of networks and coordination and the increase in market forces especially in equity and labor markets in Japan and Germany, see Yamamura and Streeck (2003), Lincoln and Gerlach (2004), and Lincoln and Shimotani (2010).

Hall and Soskice call the Mediterranean variety including France and Italy).[22] Moreover, other pressures may counter isomorphism. For instance, the recent expansion in stock market activity (spurred in part by the entry of foreign portfolio investment) is displacing banks and cross-shareholding, reducing blockholding, and, in the process, making many CME and NME economies resemble LMEs more, at least on the dimension of corporate ownership (Lane 2003; Streeck 2009). However, some of these same exogenous pressures, especially increasing capital flows, as well as high demand for commodities, seem to reinforce isomorphism in LMEs and HMEs, which underscores the main point that the sources of isomorphism are variable across types.

In sum, a range of different kinds of complementarities and compatibilities give coherence and continuity, though not stable equilibria, to each of the four varieties. Capitalist systems are always evolving; complementarities make that evolution incremental and path dependent rather than abrupt and radical. In individual cases, complementarities are among a range of pressures that shape a process of constant evolution, alongside a series of large exogenous shocks, from economic crises of the twentieth century to globalization pressures of the twenty-first century, that have reverberated through all varieties of capitalist economies. However, to the extent that economies sustain divergent institutional configurations, their respective complementarities are a large part of the story.

IV. Conclusions and Comparisons

My analysis has stressed commonalities among the larger countries of Latin America on the core features of hierarchical capitalism, but the region is quite heterogeneous, and some countries deviate sufficiently from the mean to warrant consideration for separate classification. Venezuela's oil rents, for example, make it an outlier, especially in terms of the weight and role of the state in the economy. Venezuela still shared many HME features such as low skills and large business groups, but analytically it may have more in common with other large petro states such as Indonesia and Russia in a variety of political capitalism (Karl 1997). Oil and gas rents in Ecuador and Bolivia pushed their political economies in a similar direction.

Another change that affected some of the larger countries was a significant expansion in equity markets in the 2000s (Stallings 2006). One hypothesis would be that the countries at the vanguard of this expansion, Chile and Brazil, would be trending toward LME forms of corporate governance. Although there are signs of more dispersed ownership and greater participation by institutional investors, both foreign and domestic, nearly all companies in both countries still have controlling blockholders, in most cases families. Overall, these variations –

[22] For a stronger argument that purer types generate higher growth than do hybrids, see Hall and Gingerich (2009).

more of degree than of kind – do not yet warrant excluding countries from the category of hierarchical capitalism, but they do help identify potential sources of future change and movement away from HME complementarities toward other possible types of capitalism. Chapter 8 returns to an analysis of intraregional variation.

Outside Latin America, the core features of hierarchical capitalism also seem prominent in some other middle-income countries. However, East Asia (especially Taiwan and Korea) differs greatly from Latin America along all four dimensions of HMEs. East Asia had higher educational and skill levels and lower levels of FDI and socioeconomic inequality. Diversified business groups dominate the domestic private sector in both regions, but, as discussed in the next chapter, Asian business groups were more active in manufacturing and ultimately moved into higher-technology sectors (Schneider 2009b). A last difference is the stronger role in East Asia of business associations and other forms of interfirm cooperation, usually enforced or subsidized by the state. Despite some interregional similarities, countries such as Korea and Taiwan differ significantly enough to exclude them from the HME category. The general point, examined further in Part II, is that not all developing countries have hierarchical capitalism, nor is hierarchical capitalism a necessary consequence of low levels of development.

For now, to recapitulate, this chapter sought to make four contributions to the debate on comparative capitalisms. First, it proposed ideal types structured by four guiding principles – markets, bargaining, trust, and hierarchy – that consistently inform a diverse set of relations among stakeholders. Second, this fourfold typology introduced a new principle, hierarchy, that was missing from earlier debates in comparative capitalism, but that has long been a basis for a wide range of nonmarket relations in capitalist systems. Third, the inclusion of hierarchy allows a broader consideration of types of firms, especially MNCs and diversified business groups, that dominate production in much of the world. Bringing MNCs back in as more than simple institution takers is crucial to understanding the potential impact of globalization, economic integration, and the evolution of economies outside the developed world. Last, the incorporation of HMEs extends the potential geographic scope of the varieties of capitalism perspective to include many developing countries.