THE POLITICS OF ECONOMIC REFORM: DISTRIBUTIONAL COALITIONS AND POLICY CHANGE IN LATIN AMERICA

Hector E. Schamis

Working paper #250 – February 1998
The Politics of Economic Reform: Distributional Coalitions and Policy Change in Latin America

Hector E. Schamis

Working paper #250 – February 1998

Hector E. Schamis, former residential fellow at the Kellogg Institute (fall 1991), is Assistant Professor of Government at Cornell University. He has written on Latin American political economy and is currently completing a book on the politics of privatization in comparative perspective.

The author would like to thank Cornell University's Political Economy Research Colloquium (PERC), where an earlier version was presented, as well as Valerie Bunce, Eugenio D’az-Bonilla, Anna Eliasson, Edward Gibson, Béla Greskovits, Blanca Heredia, Peter Katzenstein, Robert Kaufman, Jonathan Kirshner, Mar'a Victoria Murillo, Guillermo O'Donnell, Jonas Pontusson, and two reviewers at the Kellogg Institute for comments.

Abstract

For Neoclassical Political Economy, the political organization of interest groups accounts for government intervention in the economy. In this view, a closed economy is reproduced due to the efforts of distributional coalitions and rent seekers to maintain sector-specific protections. Accordingly, current economic liberalization experiments are explained by the policy consistency of uncompromising reform elites. Students of the politics of economic adjustment in the developing world, in turn, have argued that economic reform programs concentrate costs in the present and disperse benefits in the future. Hence, potential losers are prepared to engage in collective action, but prospective winners, facing uncertainty about payoffs, remain disorganized. Again, the insularity and cohesiveness of policymakers is posited as the main variable explaining successful economic reform. Both economists and political scientists, therefore, adopt a state-centered approach that overlooks how societal groups organize in support of liberalization. Evidence from Latin America, however, suggests that several of these policies have distributed the costs of reform throughout society and concentrated the benefits upon a small group of firms which provided vital political support to and colluded with the reform elites, generating incentives for rent-seeking behavior and distributional coalition-building. In light of the Latin American reform experience, it is argued in this paper, modifications are needed in the leading theories of collective action and the dominant literature on economic reform: modifications that allow for a more detailed examination of the political behavior of interest groups during marketization.
Para la economía neoclásica, es la organización de los grupos de interés lo que da cuenta de la intervención gubernamental en la economía. En esta perspectiva, una economía cerrada se reproduce debido a los esfuerzos de coaliciones distributivas y buscadores de rentas por mantener protecciones sectoriales. En consecuencia, los experimentos de liberalización en curso son explicados en términos de la consistencia de las políticas diseñadas por intransigentes elites reformistas. Estudiosos de la dimensión política de los ajustes económicos en los países en desarrollo, por su parte, sostienen que los programas de reformas concentran los costos en el presente y dispersan los beneficios en el futuro. Así, los perdedores potenciales estarían dispuestos a participar de acciones colectivas, pero los prospectivos ganadores, sin certezas acerca de posibles beneficios, permanecerían desorganizados. Nuevamente, la insularidad y cohesión de los diseñadores de políticas se presentan como las principales variables para explicar el éxito de las reformas económicas. De este modo, tanto los economistas como los científicos políticos adoptan una aproximación al problema estado-céntrica que pasa por alto las formas en que los grupos sociales se organizan en apoyo de la liberalización. La evidencia de los casos Latinoamericanos, sin embargo, sugiere que varias de estas políticas han distribuido los costos de las reformas hacia toda la sociedad y concentrado sus beneficios en un pequeño grupo de firmas que proveyeron un apoyo político vital a y se aliaron con las elites reformistas, generando de este modo incentivos para comportamientos rentísticos y la construcción de coaliciones distributivas. A la luz de la experiencia de reformas Latinoamericana, este texto sostiene que es necesario realizar cambios en las teorías de la acción colectiva prevalentes y en la literatura dominante sobre reformas económicas: estos es, cambios que permitan un examen más detallado del comportamiento político de los grupos de interés durante los procesos de mercantilización.
Introduction

The Latin American development debate is history. There is widespread agreement that a prudent macroeconomic regime along with microeconomic policies based on market allocation, private ownership, and openness to trade and foreign investment is the way to renew economic growth. Economists, whether in public office or academia, have disagreed about the appropriate pace and sequence for implementation of specific policy reforms. Nevertheless, consensus on their necessity is unequivocal, as is awareness of the conflict associated with this process. Successful economic reform, it is said, requires policy consistency, and that precludes compromising with the powerful interest groups affected by it. The reform process is one in which courageous policymakers must ride roughshod over the groups that have their market reserves eliminated by liberalization. In a “handful of heroes,” claims a prominent advocate of economic liberalization, lies the “secret of success.”

The metaphor is telling. Pictured as heroes, the reformers appear alone, deprived of solid political support, and forced to overcome narrow interests. For much of the economics profession this is a standard formulation; it finds theoretical inspiration in the basic insights of the neoclassical paradigm. A liberal economic order is treated as a public good subject to familiar collective action problems: The completion of liberalization is in the interest of all groups in society, but vested interests which enjoy sector-specific protections will be tempted to maintain a closed economy. Thus, the former are prone to free-riding, while the latter have incentives to organize against economic liberalization. The most sophisticated version of this perspective has been developed by scholars enrolled in the field of “neoclassical political economy” who have explained the tendency of a closed economy to reproduce itself by pointing to the deliberate action of distributional coalitions—rent seekers who profit from state subsidies, tariffs, and regulations.

This formulation, however, renders certain facts particularly puzzling. If the foes of an open economy possess such a capacity for collective action, what explains the pace, scope, and length (in some countries more than 20 years, one should remember) of the liberalization trend in Latin America? How could reform-minded policymakers, on their own, launch policies to abolish the privileges of such powerful and well-organized interest groups and still survive the pressure exerted by such groups, often under conditions of extreme economic crisis and political instability? In other words, how did policymakers manage to resolve the collective action problem mentioned above?

Addressing these issues, a wealth of research has examined “the politics of economic adjustment.” For the most part, scholars in this research program have provided a rather straightforward answer to the questions above, though one that paradoxically, and despite displaying greater sensitivity to political factors, does not depart significantly from propositions based on the paradigm of neoclassical political economy. Forced to adjust due to the combination of external pressure and domestic economic crisis, governments require cohesiveness and institutional capacities sufficient to deliver reform packages in autonomous ways. Since economic liberalization concentrates present costs on those interest groups which benefit from a closed economy and disperses (initially uncertain) benefits in the future, potential losers have incentives to engage in collective action, but prospective winners, facing uncertainty about future payoffs, remain disorganized. Consequently, the reform process needs to be politically ‘managed’—groups who favor the status quo must be thwarted. The pro-reform coalition is seen as ‘fragile’ vis-à-vis pro-import-substituting industrialization (ISI) forces. Lacking adequate societal support, reform elites rely on enhancing autonomy, centralizing authority, and increasing institutional capacities in order to override opposition. Governments can expand their societal base of reform by appealing to a wider set of beneficiaries. But this process occurs later, in a consolidation phase, when winners are allegedly less uncertain about the payoffs of reform and losers have been dislocated.
Whereas the work of economists has generally emphasized the importance of consistency through time for successful reform, political scientists have stressed the resolve and insulation of policymaking elites, positing these factors as the main causal variable in the process. Both, therefore, adopt an approach ‘from above,’ borrowing extensively from a collective-action theory of neoclassical inspiration. While an explicit conception of power tends to be absent from the work of economists, the work of political scientists underlines the importance of negative power, as the capacity of the executive to disorganize forces opposed to reform is prioritized. The ‘politics of economic adjustment’ thus reads as little more than the ‘politics of neutralizing the losers.’ For even when taming the opposition is viewed as a critical component of political strategy, the lack of a conception of positive power means that a most crucial aspect of the reform process is overlooked: the manner in which coalitions organize in support of liberalization. The larger politics of economic reform thus goes unexplored, and the collective action driving policy change remains undertheorized.

Adopting an approach of structuralist persuasion, this paper represents an effort to step into this gap by viewing the politics of economic reform as the politics of empowering the winners. I do not deny the centrality of institutional capacities for the implementation of economic reform, but I regard these capacities as ones rooted in existing societal interests and economic structures. An examination of the economic reform process in Latin America reveals that the institutionally strongest state, the one most capable of launching policy reforms and sustaining them over time, is the state that has become the agent of powerful economic groups. The pace, scope, and distributional consequences of the reform process suggest that the influence and capacity for collective action on the part of the winners have offset that of the losers. Policymaking elites did, in fact, insulate themselves from the latter, but often by forming alliances with groups of beneficiaries well informed about the payoffs of the reforms at the very outset of or prior to the implementation of reform programs. From these links between policymakers and a handful of business groups, reformist governments drew organized political support for liberalization.

On the basis of such evidence, I suggest that the conceptual framework of theories of the rent-seeking society should be extended to the study of market-oriented reform. This step highlights the societal basis of those experiments, while simultaneously calling policy-autonomy arguments into question. The Latin American reform experience demonstrates that the coalitions which organized to induce the state to reduce intervention are most appropriately described as distributional ones; the ties policymakers built with the firms that benefited from the process account for collusion; and the behavior engaged in by interest groups in order to reap the benefits of state withdrawal can be adequately defined as rent seeking. The Latin American cases examined therefore suggest that modifications are needed in the dominant theories of collective action: modifications that allow for more detailed examination of the political behavior of interest groups during marketization.

The paper is organized as follows. In order to exhibit their limitations for an attempt to capture the politics of reform, I first discuss the approaches employed in the field of neoclassical political economy and the literature on the politics of economic adjustment. Secondly, I examine the political economy of reform in Latin America, with particular emphasis on Argentina, Chile, and Mexico. In an effort to shed light on the collective action of economic reform, I draw evidence from three policy areas: trade liberalization, stabilization cum financial liberalization, and privatization. By looking at these three different areas, I expect to unpack the umbrella term ‘economic reform’ and highlight the specific coalition-building dynamics involved in each. I conclude by summarizing the argument in a discussion of the need to place consideration of societal interests at the forefront of the field of political economy—something state-centered approaches reject—irrespective of whether the economy is closed or open—something neoclassical perspectives overlook.

Economic Policy and Collective Action: Mapping the Intellectual Terrain
For collective action theories inspired by neoclassical economics, the strategic behavior of individuals and groups accounts for political intervention in the economy. Interests have incentives to organize in small groups because organization is costly and large groups induce free-riding. When they ascertain that the benefits to be obtained exceed costs incurred, actors invest resources in seeking protection. Since additional output must be shared with the rest of society, distributional coalitions—says this theory—instead penetrate decision-making arenas in order to redirect existing wealth toward themselves.

This scenario increases state intervention in the economy. “The accumulation of distributional coalitions increases the complexity of regulation [and] the role of government,” affirms Olson. This theory is thus a capture theory; public officials are targets of well organized groups, the rent seekers who ‘demand’ protection. But there is also a supply side to this story. To the extent that politicians maximize their utility by exchanging policies for political support, they will have incentives to favor allocation through political bargaining rather than through market exchanges. Governments must repay the political debts that usher them into office; they distribute rents among their constituencies in order to remain in power. In a context like this, policy choices reflect an increasing politicization of public decisions. As such, they can only be suboptimal.

Applied to the developing world, the collective action approach sheds light on the persistence of many governments in pursuing ISI. Decades of protectionist policies, for instance, were delivered in order to allocate rents in favor of domestic-oriented industrialists, organized labor, and public enterprise, which groups together constituted the typical distributional—and often-populist—coalition behind ISI. Particularly in Latin America, decades of inflation and stagnation confirmed the assumptions of collective action: “The decline of nations necessarily follows the proliferation of distributional coalitions. The economy wanes because a great quantity of resources is expended in efforts to influence government decision making—resources are wasted in ‘directly unproductive profit-seeking (DUP) activities.’” Collusion thus accounts for too-large public sectors, inefficient resource allocation, and falling competitiveness; these, in turn, explain poor economic performance.

A government prone to intervention thus generates opportunities for interest groups to penetrate the state apparatus. Virtually any state intervention creates the opportunity for rent-seeking behavior. As James Buchanan puts it, “Rent-seeking activity is directly related to the scope and range of government activity in the economy, to the relative size of the public sector.” If rent-seeking behavior is to be eliminated, state intervention should be reduced to a minimum. A government committed to the market will thus be less penetrable and will discourage the formation of distributional coalitions. The matrix which in the past brought about those coalitions—import-substitution—will be eradicated and rents dissipated, along with accompanying levels of inflation and political conflicts. Within the field of neoclassical political economy the proposition is unequivocal: Economic liberalization eliminates incentives for rent seeking and distributional coalition-building. As a reviewer of this literature conveys, “the best way to limit rent seeking is to limit the government.”

At no point does this approach consider the possibility, entertained in this article, that rent seeking could be associated with marketization. To an extent, the bulk of the growing literature on the politics of economic adjustment presents a similar view, although by virtue of what it omits more than for what it proposes. Some see the reforms as inevitable, the consequence of previous economic disequilibria that constrained nations even further when combined with the pressure of foreign governments and international lending institutions. Together, these factors left domestic governments with few choices, no matter how painful economic adjustment appeared. It has become common to view these reforms as originating in the realm of insulated state-bureaucracies which design and implement
policy independently of society; they must do so because, as Haggard and Kaufman put it, “compared to those who gain from the status quo, the diffuse beneficiaries of the reforms may have substantial difficulty organizing, particularly when the gains from the policy reform are ambiguous and uncertain.”

This view is consistent with John Waterbury’s, in which the state sector is seen as “the lynchpin of a reputedly powerful coalition of beneficiaries with well-established claims to public resources,” whereas “the beneficiaries of reform and privatization remain unorganized”; this setting enhances the importance of “the coherence of technocratic policy change teams.” In this context, argues Joan Nelson, where “the benefits of structural changes are often delayed and accrue to individuals and groups who are not politically organized and may not even recognize their potential gains when the policy is launched, prospects for coalitions in support of the reforms are poor...it is hard to build a political alliance with them.” On the basis of these assumptions, it is consistent to restrict one’s focus to the role of negative interests, those which oppose economic reforms, and disregard the manner in which interests organize in support of reform. It is unsurprising, then, that factors such as international constraints and autonomous bureaucracies are used as explanatory variables.

Economic policy, however, always allocates wealth and income. Interest groups favor certain policy options and discourage others on the basis of the expected allocative consequences of policy. Divisions created by the allocative consequences of state policy generate different opportunities for collective action, and since interest groups rarely if ever pursue their goals in isolation, different coalitions will emerge, both in opposition to and in support of policy changes. Depending on the policy context, some of these coalitions will be distributional ones, and some of their members will plainly engage in rent-seeking behavior. Unless we focus on the role of structural power relations, namely, the systemic power of capital and the articulation of interests over time, the analysis of economic reform may well conform to a much needed description of government policy, though hardly to an inquiry along the lines of political economy.

A clarification is needed before I proceed further. Following Olson, I define distributional coalitions as groups “oriented to struggles over the distribution of income and wealth rather than to the production of additional output.” Following Buchanan, I define rent as that part of the payment to an owner of resources above the alternative earning power of those resources: that is, a receipt in excess of opportunity cost. Rents are profits, but the ‘in excess’ clause indicates that those kinds of profits are realized in activities where freedom of entry is curtailed (for market competitive conditions dissipate rents). In institutional settings where entry is blocked, profit seekers will invest resources in efforts to secure entry and the associated market reserves. As resources are increasingly utilized in politically-related activities, and the overall setting becomes conducive to inefficiency, individual efforts to maximize value will generate social waste rather than social surplus. In this context, profit seekers become rent seekers.

As discussed above, rent-seeking behavior is typical of interventionist-regulatory regimes—lobbying the regulator effectively allows particular firms and groups to enter restricted activities. Based on the Latin America experience, however, the argument of this paper is that liberalization policies, too, can generate incentives for rent-seeking behavior. It is not only that supporters of the reform process organized around short-term distributional considerations, nor simply that they captured policymaking arenas and colluded with the reformers in order to get their preferences translated into policy. In addition, particular combinations of liberalization policies can concentrate benefits upon the supporting coalition and disperse costs among a larger set of groups, leading to less than optimal aggregate results and a setting favorable to rent seeking.

For example, an opening of trade accompanied by premature capital account liberalization depresses the exchange rate, hindering export expansion and further squeezing the tradable sector’s profitability during a period of major productive restructuring. If the
nominal exchange rate is anchored as part of the stabilization strategy, the manufacturing sector will experience significant deindustrialization. Industrial firms will attempt to gain special concessions and subsidies in order to survive the adjustment, and the outcome of such efforts is normally a function of size and political clout. Likewise, in high-inflation contexts, financial deregulation increases opportunities for groups to access financial adaptation instruments (currency substitution and capital flight) in order to reduce their taxable base. This practice, in turn, leads to even further increases in inflation, but concentrates the welfare losses upon groups for which financial adaptation is not available, forcing them to bear the greater burden of stabilization. During privatization programs, the absence of adequate regulatory frameworks creates incentives for the transfer of public utilities as vertically integrated monopolies. This setting provides ample opportunities for collusion between policymakers and private firms involved in divestiture operations. It also allows those firms to enjoy sky-rocketing rates of return and windfall profits, without tangible benefits for consumers.

To the extent that these combinations of policies generate suboptimal aggregate results, profits made in this context qualify as rents. The examples above disclose central features of the Latin American economic reform experience. Below, I review in more detail the collective action patterns generated by economic liberalization in the region and the coalitions which organized in support of those policies. The main theoretical implication is that economic liberalization may not be sufficient to eliminate incentives for rent-seeking behavior, and may just as easily generate new ones. If this is so, state-autonomy arguments, widely used to explain market-oriented reform, should be reconsidered.

The Political Economy of Reform

Trade Liberalization

Rarely do trade economists problematize free trade. Free trade is Pareto superior; if protectionism prevails it does so because of ‘politics,’ they generally argue. The benefits of protectionism are concentrated on a small number of firms, and its costs are dispersed among a large number of consumers. Since firms have strong incentives to organize and lobby in favor of protectionism, gathering support for free trade is difficult.

Free trade, however, needs to be problematized. If protectionism comes about through politics, it is through politics, one may argue, that it will be undone. One examination of the politics of free trade, atypical even among political scientists, is Helen Milner’s work. Her analysis shows that the increased economic interdependence of the post-World War II period accounts for the maintenance of open trade during the 1970s, despite a context as conducive to protectionism as that of the 1920s. The greater integration of firms into the international economy strengthened their ties to markets overseas—manifested in increased exports, foreign direct investment, multinational production, and global intrafirm trade—and predisposed them against closed trade regimes. The growth of international economic interdependence, argues Milner, divided entire industrial sectors on trade issues. While the largest firms have tended to become more international, small and medium firms have retained their domestic base. More often than not, the preferences of the larger and more powerful firms prevailed—they resisted protectionism successfully.

Though focused on the industrialized nations, Milner’s account nonetheless highlights key factors for the political economy of trade in Latin America. The dynamism and integration of multinational corporations (MNCs) also transformed relations between industrialized and developing nations as foreign investment began to be directed toward manufacturing industry. ISI attracted foreign capital, for high trade barriers created new industrial sectors and forced MNCs to substitute for exports. Over time, firms linked to foreign manufacturing concerns expanded rapidly. Parent companies allowed them to
access foreign credit, secure more advanced technologies, gradually diversify their production and assets, and engage in export-oriented activities. The policy preferences of those firms changed, and intrasectoral conflicts developed over trade and industrial policy. Seeing it as a way to eliminate a relatively large number of small- and middle-size competitors from the domestic market while simultaneously lowering the cost of industrial inputs, the more internationalized and/or diversified firms preferred the opening of trade. In this fashion, quickly assuming control of local merchandise distribution systems, they were also in a good position to face foreign competition.

These trends coincided with the exhaustion of the so-called easy phase of ISI. Under ISI, a tightly staged strategy, the deepening from the production of consumer goods to that of higher value-added goods increased the vulnerability of the economy to foreign exchange constraints, at least until (and if) expansion into capital goods manufacturing took place. When import substitution advanced, import dependence grew; the acceleration of industrialization expanded demand for imported inputs and machinery, generating recurrent foreign exchange shortages. The balance-of-payments became the Achilles heel of ISI. In economies with high import dependence—the import intensity of import substitution, as Diaz-Alejandro puts it—full trade-closure became economically counterproductive and politically controversial. Pressures for freer trade (even if not fully fledged free trade) were heard among industrialists and export groups as of the 1960s. The availability of foreign exchange was a key factor both in amplifying or, alternatively, muting those voices, and in the shaping trade of policy.

The Mexican experience offers a relevant example. Hampered by high inflation, balance-of-payment crises, and the shortage of foreign loans, the De la Madrid administration (1982–88) launched a program of trade liberalization. Between 1985 and 1988, the government affected a trans-sectoral reform program. Licenses, quotas, and reference prices were all abolished, and tariffs, some of which reached 100% in the early to mid-1980s, decreased to a maximum of 20% toward the end of 1987. In December of that year, these and other reforms were all brought together under the Economic Solidarity Pact (PSE)—centerpiece of the stabilization cum structural reform program.

Two major innovations were institutionalized by the PSE. First, the government liberalized trade in the midst of a major balance-of-payments crisis, interrupting the tradition of adjusting external sector disequilibria through import restrictions. Secondly, by conceiving and portraying trade opening as a price-stabilizing device, protectionism was for the first time linked to inflation. Trade policy was thus placed under the control of the orthodox policymakers in public financial institutions who were commanding the fight against inflation and had been accumulating power since 1982. Industrial policy agencies were ostracized, severing the historical connection between trade and industrial policy. Import substituters, lacking the organizational backing they once drew from such agencies, were unable to generate coordinated action against free trade and merely engaged in individualistic behavior to obtain special privileges. As a result, sectoral and intra-industry cleavages soared.

As the consumer price index reached 160%, the connection between inflation and protectionism allowed policymakers to seek broader societal support for liberalization. The core of that support, however, was based on a small coalition of large exporting firms. Their political influence, added to severe macroeconomic constraints, converged into a set of choices amply favorable to those firms. Forced to prioritize the generation of foreign exchange, a consequence of the drought of foreign loans in the 1980s, the government decided to reinforce the competitiveness of firms capable of exporting a sizable volume in a relatively short period of time—provided that, given the high import content of their products, their demand for hard currency could be mitigated. Sector-specific programs were implemented accordingly. Firms under those programs received significant import concessions on inputs, high levels of protection for their final products, and preferential lines of credit. Non-oil exports grew rapidly, reflecting extremely concentrated growth in exports of a handful of products in the automobile, glass, steel, and electricity sectors.
The magnitude of the opening outweighed the undervaluation of the currency between 1985–87, thus exposing firms not included in those programs to heightened external competition. Foreign competition became more pressing after 1988, when the exchanged rate was fixed. Trade reform thus magnified existing asymmetries in the industrial sector, increasing the market power of the large and/or internationalized firms which, despite the opening, were sheltered from true exposure to fully-fledged free trade—as well as from domestic competition—and the support of which was essential to the prosecution of the overall process of reform. This coalition of beneficiaries provided the government with the necessary impetus to launch deeper reforms in the financial and parastatal sectors.

In Chile, in turn, the socialist experiment of the 1970–73 period brought all propertied groups—landowners, industrial groups, and the middle classes—together in support of the Pinochet government. The core constituency of the military government, however, rested on a coalition among a handful of diversified economic conglomerates, the main members of which were firms active in export production (mining, fishing, and agriculture), domestic-oriented manufacturing in internationally competitive industries (food-processing and paper), or liquid-asset sectors (finance, insurance, and real-estate). Tight links between the Armed Forces and the upper echelons of these conglomerates had been forged prior to the coup. When the military took power in September 1973, important executives and directors of these firms joined the government, mostly in second-tier positions. Their rise to top cabinet and central bank posts toward the end of 1974 signaled the acceleration of trade liberalization along with the deepening of the macroeconomic stabilization program.

By 1976 the government had eliminated all nontariff barriers and announced a uniform and flat tariff of 10%, reached in June 1979. As part of the ongoing stabilization effort, severe fiscal and monetary shocks were implemented in 1975, and the currency remained generally overvalued: first by an active crawling-peg rule and, after 1979, by a fixed nominal exchange rate (which remained in place until 1982). Currency appreciation, combined with the almost immediate financial and capital account liberalization, led to serious deterioration of the external balance.

The level of real protection plummeted and had unequivocal distributional consequences. Exports expanded in copper and noncopper mining, fish and sea products, forestry and wood products, and agriculture. Imports, however, increased faster than exports, especially in the consumer durable, food, intermediate, and capital goods sectors, in that order. The manufacturing sector thus experienced considerable deindustrialization, particularly in traditional import-substituting activities. Firms that were able to survive the loss of competitiveness had done so by engaging in financial speculation—benefitting from interest rate differentials and a fixed exchange rate—or by taking debts—taking advantage of the net-inflow of capital throughout this period. By the end of 1982, however, after international interest rates increased and the currency was devalued, private sector indebtedness—largely dollar-denominated—increased to 70% of GDP. A widespread recession followed, with unemployment reaching 28% and output falling by 14%, forcing the government to bail out the two largest private banks in order to avoid a massive economic collapse.

Pressure to reverse the liberalization process intensified thereafter, especially from protectionist business associations. For a while, and in light of the ensuing crisis, those demands were heeded: interest rates were lowered, and tariffs increased to 35%. Yet there was no return to ISI. As soon as the crisis was brought under control, the dominant coalition reconstituted itself around economic groups that survived the financial debacle of 1982–83 (these would later benefit from the privatization of state-owned enterprises). In 1985, tariffs returned to 15% (they eventually reverted to 11%), although this time accompanied by export-oriented policies—real devaluations and foreign exchange controls. Export orientation in the second half of the 1980s consolidated the structural reforms of the
1970s. Chile thus instituted a model of growth based on exports of products intensive in natural resources, the most dynamic producers of which belong to the same economic conglomerates that led the liberalization process begun in 1973.

Brazil, where trade liberalization has been and continues to be a gradual and open-ended process, provides a relevant contrast to the Mexican and Chilean experiences. The economy has opened significantly, but policy reforms have been plagued by resistance and reversals. The choice of a gradual and selective trade liberalization trajectory is accounted for by differences in the structural makeup of Brazilian industrial sectors and disparate patterns of collective action on the part of business leaders.

In spite of the recession of the 1980s, Brazil has been able to preserve a more diversified and integrated industrial base than any other Latin American nation. Faced with foreign exchange shortages, in the aftermath of the debt crisis Brazil resorted to the promotion of exports. Unlike its impact in other Latin American economies, this step bolstered the position of industrialists over financiers and prevented the formation of economic conglomerates based on financial capital with interests in multiple sectors, as seen in Chile and Mexico, for example. Despite declining competitiveness associated with the crisis of the 1980s, the country exhibited a positive trade balance that averaged over $11 billion between 1982 and 1992, 70% of which was accounted for by manufactured goods.

MNCs play a central role in the Brazilian economy. As central in Brazil as they are in any other country of the region, MNCs there are far more integrated with and oriented toward the domestic market than elsewhere. Taking advantage of ISI policies and a large internal market, multinational manufacturing firms invested heavily in Brazil, to the extent that the share of fixed-asset investment of total Foreign Direct Investment (FDI) is the largest in the region; the country has the second largest stock of foreign capital of any developing country. Due to the extraordinary expansion of consumer durables and capital goods industries throughout the tenure of the military government (1964–85), MNCs maintained close links with local suppliers, reducing the import content of inputs. This facilitated vertical integration of industrial producers of both foreign and domestic origin. Different industrial sectors maintain dense and extensive linkages with one another, and there is no clearcut demarcation between export- or domestic-oriented firms: The latter factors have heightened the perceived costs of free-trade and, as a result, a trans-industry basis of support for selective and gradual liberalization has formed.

The reviewed experiences of trade liberalization thus reinforce the argument of this paper. First, sectoral cleavages account for the kinds of strategic alliances built between societal groups and government elites as well as for variations in access to policymaking arenas. State-autonomy arguments do not grasp these attributes of the reform process. Secondly, economic reform can concentrate benefits on beneficiary firms (and distribute costs among other groups) through subsidies or the particular mix of policies implemented. In Mexico, large firms enjoyed the best of both worlds: low tariffs for their imported inputs, high protection for their finished products, and preferential credit throughout. In Chile, the combination of trade, capital account, and exchange rate policies adopted created a competitive structure that could not be absorbed by the manufacturing sector. Finding themselves in a situation that would have been unthinkable in Brazil, Chilean industrial firms were simultaneously besieged on three different fronts: open trade, currency appreciation, and high interest rates. Capital account liberalization, in turn, forced them into debt in order to survive the adjustment. In the long run, the balance-of-payments deficit could not be sustained and the government devalued the currency. Given the volume of the private sector dollar-denominated debt, massive defaults led to a banking crisis that required government bailouts in order to be resolved. Resources used for that crisis equaled 5% of GDP annually for five consecutive years. These policies reflected the preferences of a group of firms in extractive and financial activities which captured key policymaking agencies. This highlights a third issue: Neither collusion between political and economic powers nor the formation of distributional coalitions are
necessarily limited to interventionist settings. Such phenomena should not be excluded from consideration in the study of liberalization experiments.

Stabilization cum Financial Liberalization

The stabilization programs of the late 1980s and 1990s represent the main achievement of the economic reform process in Latin America. Given the vast experience of the region with frustrated stabilization efforts, what appears to be a decisive victory over inflation has renewed interest in the subject. These societies had been racked by distributional conflicts among well organized, contending socioeconomic groups which regularly blocked stabilization programs by exercising de jure or de facto veto powers over proposed distributive patterns. The decades-long resilience of inflation has made an examination of those current conditions which have led to price stability all the more important, sparking research on “delayed stabilization.”

As part of that endeavor, recent work in economics captures the intertemporal and structural dimensions that explain the behavior of groups in this context. In the initial stages of inflation, it is rational for contenders to postpone an agreement and try to displace the increase in taxation toward each other. As stabilization is delayed, however, groups who cannot access assets that protect them will increasingly be hurt by inflation and will reduce their demands on the poststabilization distribution of costs. Groups with access to financial adaptation technologies (currency substitution, dollarization, capital flight, etc.) will be shielded because they can reduce their tax base in an optimal way. They can displace the costs of inflation to groups for which financial adaptation is either not available or too costly. Inflation thus leads to financial adaptation, which further increases the average rate of inflation. In the long run, incentives to stabilize will increase, especially among groups that do not have access to tax shielding instruments, forcing them to relax the conditions under which they are willing to accept stabilization. Access to financial adaptation therefore increases the average rate of inflation over time, raising the welfare losses of not reaching an agreement, and increasingly redistributes the burden of stabilization.

This setting is thus propitious for the formation of distributional coalitions, not just along class lines, but also along sectoral ones. Not only do the rich have better access to financial adaptation technologies than the poor, as in the Labán-Sturzenegger model, but groups with liquid assets are also more capable of reducing their taxable base than groups with fixed assets. Groups with high asset mobility are more likely to tolerate higher inflation for longer periods, inducing groups who cannot protect their assets in the same way to accept stabilization conditions that they were not willing to accept before the delay. For actors who can access them, the availability of financial adaptation technologies significantly decreases the uncertainty associated with inflation and substantially lengthens their time horizon. If they can ‘wait and see’ during inflation, their ‘exit threats’ become more credible. At the same time, this capacity increases the costs incurred by policymakers not willing to defer to such groups when designing stabilization packages. In other words, the timing (length of the delay) accounts for the nature (distribution of costs) of stabilization.

As economists have noted, the spread of financial adaptation technologies is a product of the liberalization of capital markets in the 1970s and 1980s, which allowed greater competition in monetary and financial services. Internationally transmitted, these technologies make governments more dependent on capital markets, forcing them to relinquish portions of their policymaking autonomy in deference to the preferences of groups demanding greater openness of financial markets and implementation of conservative macroeconomic regimes. The experience of Argentina and Brazil in the middle to late 1980s confirms these assumptions. In those years, both governments painfully bore the costs of turning a deaf ear to such groups during the post-debt crisis—a context marked by rapidly integrating capital markets, but high interest rates, too, which
largely constrained their ability to finance deficits with foreign borrowing. Their respective heterodox stabilization plans—Austral and Cruzado—placed emphasis on price controls and income policies, for the implementation of which governments depended on relatively loose fiscal and monetary policies. The reluctance of the authorities to introduce additional structural reforms affected the credibility of the stabilization plans. The perception of unsustainable fiscal imbalances recurrently led to spontaneous and concerted runs against the currency, flight from money, and other forms of financial adaptation. As a result, further demonetization translated into several hyperinflationary peaks in the late 1980s and early 1990s.

Financial liberalization, however, can also be endogenously produced by the political economy of countries exposed to high inflation: namely, by governments that decide to resolve recurrent macroeconomic crises by undoing entrenched distributional stalemates. They veer away from policies that—however precariously—sustained a longstanding alliance among protected industries, public sector bureaucracies, and organized labor to collude, instead, with financial and export-oriented groups. This is the experience of the Southern Cone countries in the mid-1970s, a period of significantly less financial integration than that of the 1980s. At the time, military governments launched stabilization programs which included the customary contractionary monetary and fiscal policies, price and interest rate deregulation, and exchange rate devaluations. These packages included the unprecedented step of opening up the economy to trade and financial flows. This strategy was part of a proposed long-term structural transformation, but was also intended to prosecute short-term stabilization goals. Under the monetary approach to the balance of payments, in the context of open trade and liberalized external capital flows, interest rates were expected to homogenize and domestic inflation rates to converge toward the lower international rate.

The reforms eliminated controls and permitted residents to hold foreign exchange. In a context of excess liquidity in international markets, dollarization expanded further, from a traditional role of store of value to the less conventional ones of unit of account and medium of exchange. Liberalization proceeded sequentially; permission to operate without interest rate ceilings was first granted to private financiers and later to the banks, reallocating resources toward the former. The exchange rate was either tied to a preannounced crawling peg (Argentina and Uruguay) or fixed (Chile had both), while domestic interest rates remained significantly higher than international ones. Limits on foreign borrowing were gradually relaxed until, simultaneously with the liberalization of capital inflows, they were eliminated. This policy context created broad incentives for arbitrage, private sector indebtedness, and redirection of resources from the real to the financial sector.

In the specific case of Chile, interest rate liberalization granted to financial intermediaries coincided with the initiation of the privatization of the banking sector. A small group of booming financial houses purchased the banks. Interlocking ownership and increasing deregulation allowed these newly privatized banks to favor lending to related companies within these groups (auto-prestamo), which led to a marked concentration of resources in the hands of a few integrated financial-industrial conglomerates. This practice has often been identified as the main reason for the near-collapse of the entire system in 1982–83, at which time, in fact, the government was forced to take over the holdings of a handful of groups which together controlled 67% of the deposits, 57% of the accumulated pension funds, and 70% of the firms privatized between 1974 and 1981. The Minister of Finance at the time, Rolf Lüders, was the number-two executive of one of these financial conglomerates. It was common for key members of the Pinochet economic teams to serve on the boards and in the executive offices of these conglomerates before and after holding cabinet and central bank positions.

The case of Mexico also illustrates the creation of a pro-liberalization coalition between the government and financial groups, though one that is better explained by structural attributes of the economy than by the capture of policymaking posts. Mexico has
historically had a more open financial system than the rest of Latin America. Financial adaptation was a common practice among economic elites, especially when political events threatened their property rights, such as immediately after the revolution and during implementation of the land reform program in the 1930s. Governments generally tried to neutralize capital flight by creating attractive conditions at home. They maintained free capital and currency markets and, for the most part, allowed fully convertible dollar-denominated accounts, while setting high barriers of entry in order to limit the activities of foreign banks.

As Sylvia Maxfield puts it, these policies sustained the “bankers’ alliance,” based on a close relationship among the Finance Ministry, the Bank of Mexico, and the largest private banks. The bankers became the main link between the government and the business community as a whole. An implicit tradeoff was established: the government would safeguard an auspicious, yet protected, financial environment and a prudent macroeconomic regime, and business elites would refrain from intervening in politics. A moderate public deficit was financed through domestic and international financial capital markets, and the private sector was willing to mobilize rapidly growing domestic savings. Governments managed to redirect investment toward the manufacturing sector and finance import-substituting industrialization without the distortions commonly seen in other Latin American nations. A period of low inflation, exchange rate stability, and rapid growth—so-called ‘stabilizing development’—followed in the 1950s and 1960s.

This relationship became strained in the 1970s, when the Echeverria Administration pursued overly expansionary policies and devalued the currency. After 1976 the Lopez Portillo government was able to ease tensions thanks to vast oil reserves (and positive price shocks) and foreign borrowing. When the price of oil decreased and interest rates rose in the 1980s, the government limited currency movements, imposed exchange controls, and, after defaulting on debt service payments in August, nationalized the banks toward the end of 1982. As a result, capital flight reached levels never before seen in the country’s history, accompanied by close to three-digit average inflation over the following six years. Initially moderate criticism turned into outright confrontation. In the process, the private sector had become politically active. The bankers’ alliance broke down.

Both the de la Madrid (1982–88) and Salinas (1988–94) administrations made the recovery of private sector confidence the centerpiece of their respective economy policy strategies. Accordingly, one of the priorities of the De la Madrid government was to promote the mobilization of voluntary domestic and foreign savings in order to restore higher investment rates. As noted above, its first step was to grant a virtual monopoly over economic policymaking to a technocratic elite linked to public financial agencies—for the most part, the central bank and the Ministry of Budget and Planning—renowned both for their economic orthodoxy and for their close ties with major economic elites. Soon after assuming office, the government provided generous compensation to the expropriated bankers, returned their nonbanking assets (industrial-commercial firms, brokerage houses, etc.), and allowed private investors to purchase up to 33% of the nationalized banking sector.

Bank nationalization had prompted private financiers to move their resources from the banks to other financial concerns, mainly brokerage houses. Forced to raise credit domestically (due to the drying up of foreign flows) and curb capital flight, the government used treasury bonds (Tesobonos) as the main instrument and granted exclusive trading rights to private brokerage houses. This caused the stock exchange to boom, which led to a colossal expansion of these brokerage houses, not merely as traders but as suppliers of a range of financial services. As a result, from 1982 to 1990 the participation of brokerage houses in the overall flow of funds increased by 587%, while that of the (nationalized) banking system decreased by 40%. In the process, not only did this sector grow; it also restructured itself. The highest rates of expansion were not necessarily experienced by the exbankers, but were instead enjoyed by relatively newer firms owned by younger and more innovative entrepreneurs who took advantage of the financial volatility of the 1980s.
Booming domestic financial markets fostered capital repatriation and attracted foreign investment. Inflation came down to about 20% after 1989. The context was propitious and, accordingly, the Salinas government launched the denationalization of the banks and deepened the privatization of other public companies. The winners of the stock exchange boom, the new financiers, purchased the banks. In some cases they included former owners, but only as subordinate partners. In most cases, new bank owners benefited from promising market conditions, legislation specifying stricter property rights, and a convenient regulatory environment that included high differentials between active and passive rates in a deregulated domestic capital market, but combined these with high barriers of entry to foreign banks. A new bankers’ alliance was cemented.

In sum, the Latin American experience with inflation and financial policy reform shows that in societies marked by intense distributional conflict it is rational for some groups to induce delays in order to reduce their taxable base and displace the costs of inflation toward groups which cannot access adaptation technologies. The longer the delay, the less demanding will be the conditions under which the latter are prepared to accept stabilization. To the extent that such delays will increase inflation further, and to the extent that the associated welfare losses as well as the post-stabilization costs are distributed according to the capacity of groups to access financial adaptation, this context becomes favorable to rent seeking. In other words, in this setting certain groups profit more from stabilizing later than from stabilizing earlier. Given these distributional implications, liquid asset holders will try to secure a policy context that favors financial adaptation.

The time lag between the onset of inflationary crises and the materialization of stabilization and accompanying financial sector reforms highlights these propositions. In the Southern Cone, financial intermediaries obtained permission to operate without interest rate ceilings before the banks did so. Capital account liberalization and currency appreciation further reinforced their competitiveness. Resources were massively reoriented, from the real to the financial sector, and from the banks toward those intermediaries. Specifically in Chile, as a result of these policies, financial firms were able to purchase most of the banks and companies reprivatized between 1974 and 1978. Financial-industrial integration in a deregulated context induced them to engage in questionable lending practices, which led to a financial crash in 1982–83. In Mexico, in turn, stockbroking houses were granted exclusive trading rights over the main instrument designed by the government to restore investment after the default of 1982, while a rather open financial sector was maintained. Later on, Mexican stockbrokers emerged as the beneficiaries of the reprivatization of the banks in a domestically-deregulated, yet protected, banking environment.

Privatization

Comprehensive privatization experiments in Latin America in the recent past have become a conduit for the uncompetitive appropriation of state-owned monopoly-wealth by a handful of economic conglomerates. The divestiture process has facilitated the formation of distributional coalitions and created a setting as prone to rent seeking as that of the interventionist state. The strategic behavior of those conglomerates is similar to that necessary to obtain tariffs, subsidies, or any other form of market reserves. In a scenario unforeseen by the literature dealing with rent-seeking behavior, the Latin American privatization experience demonstrates that private groups may, in fact, have incentives to organize, collude with the wielders of political power, or capture policymaking agencies in order to induce the state to reduce intervention.

This type of behavior is partly explained by the structural position of the firms that participate in privatization (generally, only large firms can afford to purchase SOEs, which allows them to become even larger), but it is also a consequence of the very method of privatization, which further reinforces the market power of such firms. When privatization leads to a concentration of assets and interlocking ownerships, as has occurred in financial
and industrial sector privatizations, banks tend to engage in unhealthy lending practices, if not in outright price-fixing activities. When companies are sold as monopolies in the absence of effective regulatory frameworks, as has frequently occurred in the case of public utilities, newly private firms enjoy sky-rocketing rates of return and windfall profits, while not necessarily providing a better service. This type of setting is exacerbated by governments with severe macroeconomic constraints which, in order to maximize the sale-value of those companies, carry out privatization with short-term fiscal priorities and thus rush the sale of SOEs—as monopolies and before adequate regulation has been instituted. In a context like this, incentives for collusion are established. Large firms provide vital political support—in some cases they even manage to appoint their own executives in policymaking posts. In exchange, they receive an advantageous bargaining position, information, credit to purchase stock, tax incentives, and other forms of subsidy which allow them to take over public monopolies and secure the associated rents.

In Chile, for example, privatization was carried out in two distinct phases. The first one (1974–78) involved the sale of approximately 180 firms and 19 banks. Purchases were effected with a down payment provided by a direct loan from the state agency CORFO (Chilean development corporation) at a preferential interest rate and guaranteed by the very assets privatized. The subsidy involved in these loans amounted to 30% of the net worth of the firms divested. Receipts from privatization equaled $543 million, and 65% of all assets were purchased by eight economic conglomerates. By 1978, four of these eight conglomerates—the most politically involved, Cruzat-Larrain, Vial, Matte, and Edwards—owned assets equivalent to 20% of GDP, including the largest banks.

In the second phase (1985–89), the government privatized the natural monopolies. If, in the 1970s, the direct beneficiaries of privatization were traditional economic conglomerates which had manoeuvred their own people into top policymaking posts, the 1980s phase generated the conditions for the emergence of new economic identities based on investing groups and former officials of the Pinochet government. The example of electricity is revealing in the context of this discussion. Presided over by ex-Minister of Labor and Social Security José Pi-era (and with ex-Foreign Minister Hernán Errázuriz on its board), the ENERSIS-ENDESA holding acquired property rights over 80% of usable water streams, and control of generation, transmission, and distribution grids. Following the privatization of long-distance telephone company ENTEL, which acquired exclusive satellite access rights, the name of former Minister of Finance Jorge Cauas appeared on its list of board members. The post-privatization board of nitrate company SOQUIMICH included president of the board Julio Ponce-Leroux—Pinochet’s son-in-law—and directors Sergio De Castro (ex-Finance Minister), Juan Carlos Méndez (ex-Budget Director), and Enrique Valenzuela (ex-Mining Minister).

In Mexico, privatization was the key mechanism for reshaping and consolidating private economic groups. The divestiture process was begun during the De la Madrid administration and accelerated under Salinas, at which time the large public industrial and financial companies and the natural monopolies were transferred to the private sector—93% of them to national firms. The proceeds from the sale of SOEs amounted to US$ 20 billion. Most enterprises were not sold on the capital markets but at auction. In order to participate, private firms were required to meet technical, financial, and operational standards. For the most part, only large businesses were able to do so. Resources for the purchase of SOEs were obtained through the organization of financial packages which, for the purchasing firms, implied gaining control of large amounts of
capital from investors in domestic and international capital markets. To the extent that it involved players from different arenas, this method provided a most decisive impetus to privatization. The divestiture process thus became an important vehicle for the reorganization of the private sector; it strengthened traditional groups which had adapted to the new environment and created the conditions for the emergence of new industrial-financial conglomerates.

Privatizations in the industrial sector generally entailed the participation of traditional groups with a previous presence in related activities. For example, the Cananea Copper mine was purchased by the Minera Mexico group, and several sugar refineries were purchased by the Gemex/Esctorpion group, franchiser of Pepsi-Cola Mexico. In both cases, privatization served to integrate their production processes, catapulting them to unchallenged positions of leadership in their respective sectors. The privatization of the banks and the natural monopolies was conducted through more innovative strategies, involving asset diversification and the formation of new economic groups. In the financial sector, it led to the consolidation of a highly concentrated and considerably protected sector, largely under the control of the booming stockbroking houses of the 1980s, as it did in the instances of the Bancomer, Comermex, and Somex Banks—respectively the first, fourth, and fifth largest operations. For several banks, privatization has given rise to further sectoral integration, as their ownership is now shared between stockbrokers and large exporting industrial concerns in the brewery, glass, and agribusiness sectors, such as Banamex-Accival, Serfin, and Banorte banks—respectively the second, third, and sixth largest operations. Bancomer-Banacci, for example, the largest financial concern in Latin America, also lists 14 of the country’s top industrial leaders on its board.

The most notorious privatization, however, was that of telephone company TELMEX, purchased with a six-year monopoly over domestic and long distance service for $1.76 billion by the group CARSO, in association with France Telecom and Southwestern Bell. Headed by Carlos Slim, CARSO was originally a stockbrokerage firm that diversified into other activities. In the TELMEX operation, CARSO pursued an aggressive strategy of procurement of funds, taking advantage of the issue of nonvoting shares on the international market. In this way, CARSO gained control of the company, purchasing only 20.4% of the stock. The economic power distributed by means of this and other privatizations can hardly be exaggerated. At the beginning of the Salinas Administration in 1988, just one Mexican businessman was ranked among the world’s billionaires by Forbes magazine. In 1994, 24 Mexicans appeared in the same ranking: more than France, Italy, and Britain together, a figure surpassed only by the US, Japan, and Germany. Together, these 24 billionaires own 12% of the nation’s GDP. One man, Carlos Slim, controls 25% of the market capitalization of the Mexican stock exchange. And the three largest banks control 60% of assets in the financial system.

Their political clout is unequivocal. While sectoral organizations enjoy ‘institutional relations’ within the archaic corporatist framework designed by the party-state in the 1930s, the ‘conglomerateurs,’ organized under the exclusive CMHN (Mexican Businessmen Council), have direct access to the government hierarchy and vice versa. A well-known anecdote illustrates the point. In February 1993, in order to raise funds for the 1994 electoral campaign, Salinas de Gortari presided over a dinner at which were present 27 of Mexico’s wealthiest men; each one was asked to donate $25 million to the official Partido Revolucionario Institucional. This is the distributional coalition, a veritable ‘plutocracy,’ that sustained ten years of economic policy reform.

In Argentina the large industrial concerns were once popularly nicknamed patria contratista (literally, contracting fatherland), a term that described their role as prime suppliers of the state and direct beneficiaries of industrial subsidy regimes and government contracts in public works and petrochemicals. They epitomized the affluent Latin American rent seeker—close to power, forging fortunes through politically-managed auctions, and sheltered by complex regulations. For decades, state contracts constituted a major mechanism by which governments exercised selectivity in the distribution of subsidies,
becoming main conduits through which inter- and intra-industry rivalries were resolved. Macroeconomic difficulties in the 1980s limited the government’s largesse in the overall distribution of subsidies, magnifying the allocative function of state contracts and increasing the selectivity of the process. The predominance of this redistributational mechanism induced firms to pursue ‘economies of scale’ in rent seeking, thus encouraging industrial concentration and leading to the fusion of companies from different sectors as centralized economic conglomerates. Toward the end of the 1980s, the contractors controlled finance, industry, and commerce.

When Menem was inaugurated in July 1989, public finances had been devastated: the monthly inflation rate was 190% and central bank reserves were at an all-time low. Distribution of rents through subsidies and government contracts could no longer be sustained. The new government needed to prioritize the reconstruction of the state’s fiscal base, but could not afford the opposition of the large economic conglomerates, the corporate culture of which had, in fact, been forged in the political arena more than in the marketplace. At the beginning of his term, President Menem cultivated their support by distributing cabinet appointments among big business. Later on, the privatization of SOEs allowed the government to replenish state coffers and permitted the large conglomerates to make up for earlier lost contracts.

The divestiture process outlined a payment method that included foreign debt paper. Consequently, purchasing consortia typically included a creditor bank, an international firm operating in the area to be privatized, and a large domestic economic conglomerate. The case of the telephone system is illustrative. The public monopoly was privatized as a duopoly, which included Citibank, Telefonica de España, and the local Techint group in one half, and Morgan Bank, France Telecom, and the Perez Company conglomerate in the other. Similar patterns were seen in other areas, as local groups strategically allied with foreign banks and firms in order to take over energy, petroleum, highways, and railroads. Firms previously specialized in contracts in certain areas used their comparative advantage at the time of privatization and concentrated on their sector of expertise. A true distributional coalition was formed, one that consolidated the leadership of Argentina’s largest economic conglomerates.

In sum, the strategy of these firms was directed toward the perpetuation of rent-seeking behavior: behavior concerned, as Olson observes, with distributing existing wealth toward themselves, rather than with increasing output. What Olson and other scholars within the neoclassical political economy approach have overlooked is that such opportunistic behavior is not restricted to contexts of state intervention. It can occur in privatization settings as well. Groups willing to appropriate state assets engaged in political action and built coalitions in order to affect the divestiture process for their own benefit. In so doing, however, these coalitions constituted themselves in distributional coalitions, taking over state-owned monopoly-wealth within amply favorable regulatory contexts. These privatization experiments demonstrate that a reduction of government economic activity is not only incapable of curbing rent-seeking behavior, but actually creates opportunities for the further organization of lobbies, cartels, and other distributional coalitions.

Concluding Remarks

This paper has discussed the politics of economic reform, that is, the collective action and coalition building associated with economic liberalization. The flaws of the approaches reviewed above account both for their incomplete reading of the behavior of interest groups during the reform process and, crucial in political economy, for the type of state theory they construct on the basis of that reading. The approach of neoclassical political economy links the strategic action of groups to government policy only under
conditions of state intervention. Scholars working within this program of research present a theory of collective action that is largely a capture theory, though one which only travels in the direction of increasing government intervention. The reverse situation, however, remains untheorized: namely, interests organize themselves and capture decision-making arenas in order to induce governments to withdraw from the economy. Economic liberalization is thus explained by the actions of enlightened policymakers—Harberger’s ‘heroes’—but the manner in which they are supposed to prevail over societal forces seeking protectionism is not specified. In this sense, neoclassical political economy furnishes a theory of the ‘interventionist’ state.

Most of the literature dealing with the politics of economic adjustment, in turn, has adopted the premises of the neoclassical paradigm. As noted above, Haggard and Kaufman, and several of their collaborators hold that economic liberalization diffuses benefits and concentrates costs. Potential winners are said to be uncertain about the payoffs of reform and are therefore characterized as passive and disorganized, while prospective losers are considered to have stronger incentives to engage in collective action against those policies. On the basis of these assumptions, only cohesive and insulated policymaking elites are thought capable of delivering reform packages successfully. This approach, then, merely advances a theory of the ‘autonomous’ state.

The economic reform experiment in Latin America makes evident the limitations of the approaches used by the literature which deals with the politics of economic adjustment and in the field of neoclassical political economy. Neither the claim that state policy can be implemented independently of the preferences of powerful groups in society nor the claim that economic interest groups necessarily prefer interventionist and regulatory policies is supported by the empirical evidence. Theoretically, these two claims are based on a profoundly negative view of politics and an idealized view of the market economy characteristic of neoclassical economics (that is why protectionism is expected to follow invariably when societal groups engage in political organization), and on what appears to be an increasingly prevalent trend in the field of political economy: viewing political institutions—particularly the state—as autonomous structures with their own distinctive configurations, ideas, and interests, and treating them as the independent variable which explains various socioeconomic outcomes, government policy among them.

Despite different points of departure, the approaches used by economists and political scientists reviewed in this paper converge in their understanding of the process of economic reform. To postulate, as neoclassical political economy does, that only pro-protectionist forces have the capacity and incentives to engage in rent-seeking behavior and distributional coalition building is a questionable step in light of market-oriented reform experiments in Latin America. Whether or not and, if so, which interest groups will lobby in favor of intervention or liberalization varies from country to country. As has been argued in this paper, such outcomes are largely a function of national economic structures expressed, for example, by differences in factor endowments, sectoral cleavages, and the organization of markets. Together, these factors are reliable predictors of the preferences of groups and the distribution of political resources among them, resources they will mobilize in order to have their preferences translated into policy.

As shown above, free trade combined with fixed exchange rates and capital account liberalization drives small and mid-size import-substituting manufacturing firms out of operation; large industrial firms have incentives to lobby in favor of such a regime, especially if the import content of their products is high. Financial deregulation increases the availability of financial adaptation instruments, allowing those who can access such instruments to protect themselves from inflation. Over time, such activities will lead to further inflation. Welfare losses will be disproportionately borne by groups which cannot access financial adaptation, forcing them to accept stabilization conditions previously considered unacceptable. Given these distributional consequences, one should expect liquid asset holders to attempt to secure a policy context that facilitates their access to financial adaptation. Public utilities privatized as vertically-integrated monopolies consolidate
disproportionate economic power in a few private firms, establishing incentives for collusion between those firms and policymakers, without tangible benefits for consumers. Firms with political clout will use it to appropriate the assets of such SOEs.

Recognition of these patterns of collective action also highlights the need to rethink the propositions of the state-centered approach in political economy. Scholars adhering to this perspective, political scientists for the most part, have sought to reject views of the state as epiphenomenal with respect to societal forces. Far too often, however, state-centered explanations have gone far beyond a welcome analytical distinction between the state and the economy—a distinction needed to underscore the specificity of the political—to instead reify the state as an apparatus unrelated to the economic domain, indeed, almost as a separate object of study. This intellectual operation has not only limited the explanatory power of this type of approach to political economy. It has also obscured our very understanding of the state and other political institutions. To the extent that the ruling institutions of a society affect its economic performance and distribution of wealth, they become battlegrounds for interest-group politics; because of this, institutions are generally created not by actors pursuing optimal choices, but by those seeking strategic advantage in ways that secure distributional outcomes. If, in the study of those institutions, we approach them as autonomous domains, they can only be treated as independent variables. If institutions are uncoupled (insulated) from the preferences and strategies of societal groups, factors crucial in accounting for the process of institutional creation and change are missed.

The causal primacy assigned by the approaches reviewed above to the policy consistency, insularity, and institutional capacities of the reformers, at the expense of the structural power of the beneficiaries of economic reform, displays an unwarranted state-centered emphasis on the liberalization process. By contrast, this paper has sought to bring interests to the forefront of political economy and, thereby, highlight the impact of group preferences on government policy and institutions. Having developed a more accurate picture of the behavior of these groups, we can link the preferences and coalition-building strategies of societal actors to policy choices and the institutional forms accompanying economic reform experiments. In market economies, asymmetries among interest groups are largely based on differences in market power. Interest groups seek market reserves and the accompanying rents because that is the most effective and least uncertain way to increase their market power. In closed economies (for example, those in which ISI is pursued), market reserves take the form of tariffs and government regulations—the rent-seeking literature has highlighted the political activities behind this process. In liberalizing contexts, however, interest groups can obtain market reserves through identical political activities which allow them to consolidate positions of leadership in their respective economic sectors.

The evidence presented in this paper makes it clear that collusion between political and economic power and the formation of small distributional coalitions have driven the policy reform process in Latin America. Frequently, such collusion was explicitly present in ‘revolving door’ relationships between corporate and executive posts. Uniformly, distributional coalitions were organized through the appropriation of state-owned wealth by groups which secured monopoly positions in key economic sectors. On the basis of these findings, it has been suggested in this paper that the insights of the theories of the rent-seeking society be extended to the study of market-oriented reform, which step would simultaneously place state-autonomy arguments under more detailed scrutiny. To conclude, only if the structural power of capital and the centrality of sectoral cleavages are taken into account, and only if the redistributive nature of policymaking and the institutional framework that makes up the market economy are recognized, can we properly explain ‘the politics of economic reform.’

Reform in Eastern Europe: Conversations with Leading Reformers in Poland, Hungary, and the Czech Republic (Brookfield, VT: E. Elgar, 1995).

For a summary of this field, see David Colander, ed., Neoclassical Political Economy: The Analysis of Rent Seeking and DUP Activities (Cambridge: Ballinger, 1984); for a review, see T.N. Srinivasan, “Neoclassical Political Economy, the State, and Economic Development,” Yale University Economic Growth Center 375, 1986.


Olson, The Rise and Decline of Nations, 73


Haggard and Kaufman, “Introduction” in The Politics of Economic Adjustment, 27. In a more recent volume, The Political Economy of Democratic Transitions, 157, Haggard and Kaufman claim that “the costs of reform tend to be concentrated, while benefits are diffused, producing perverse organizational incentives; losers are well organized, while prospective winners face daunting collective action problems and are not.” In another piece, Stephan Haggard and John Williamson, “The Political Conditions for Economic Reform” in John Williamson, ed., The Political Economy of Policy Reform
it is argued that “the costs of the reform are often concentrated and readily evident while the benefits are diffuse and the beneficiaries are unknown.” A similar view is offered in Robert Bates and Anne Krueger, eds., Political and Economic Interactions in Economic Policy Reform (Oxford and Cambridge, MA: Blackwell, 1993), especially 444–72.


- For a recent statement highlighting this point, see Jonas Pontusson, “From Comparative Public Policy to Political Economy: Putting Political Institutions in their Place, and Taking Interests Seriously,” Comparative Political Studies 28 (1) (April 1995): 117–47.

- Olson, The Rise and Decline of Nations, 44. The end of the paragraph reads as follows: “...(or organizations that engage in what, in one valuable line of literature, is called ‘rent seeking’).”

- Buchanan, “Rent Seeking and Profit Seeking.” In the same volume, Gordon Tullock states that “an individual who invests in something that will not actually improve productivity or will actually lower it, but that does raise his income because it gives him some special position or monopoly power, is ‘rent seeking,’ and the ‘rent’ is the income derived”; Gordon Tullock, “Rent Seeking as a Negative Sun Game” in Buchanan, Tollison, and Tullock, eds., Toward a Theory of the Rent-Seeking Society, 17.


- For an account of the architect of the PSE, see Pedro Aspe, Economic Transformation the Mexican Way (Cambridge: The MIT Press, 1993).

- See Miguel Angel Centeno, Democracy within Reason: Technocratic Revolution in Mexico (University Park, PA: Pennsylvania State University, 1994).


- The debt crisis of August 1982 led to the interruption of foreign borrowing and, subsequently, to capital flight. Negative capital flows caused a devaluation, although a moderate one due to large receipts from oil exports. The fall of the price of oil in 1986 worsened the negative balance of payments and the inflation rate, forcing a sharper devaluation. Under the PSE, however, the government adopted a fixed exchange rate in order to contain inflationary pressures, leading to a further decline in effective protection in the manufacturing sector, from an average 34.8% in 1988 to 13.8% in 1991.

- Most of the contributors to “El Ladrillo,” the economic policy document—commissioned by the Navy and written during 1972–73—that served as basis for the Pinochet economic model, were leaders of three economic conglomerates. For accounts of this process by insiders, see Centro de Estudios Públicos, “El Ladrillo”: Bases de la politica econ-mica del gobierno militar Chileno (Santiago: CEP, 1992), with a foreword by former minister Sergio de Castro; and Arturo Fontaine Aldunate, Los economistas y el Presidente Pinochet (Santiago: Zig-Zag, 1988). For a more recent coalitional analysis of this process, see Eduardo Silva, “Capitalist Coalitions, the State, and Neoliberal Restructuring: Chile 1973–88,” World Politics 45 (4) (July 1993): 526–59.

- For a detailed study, see Jaime Gatica, Deindustrialization in Chile (Boulder: Westview Press, 1989).


Brazilian industrial policy avoided many of the negative shocks seen in other nations of the region. Export incentive programs, along with gradual trade liberalization, had actually been instituted in the 1970s, allowing for a restructuring process without the deindustrialization experienced by Argentina and Chile in the 1970s. Brazil was also exempt from symptoms of the Dutch disease, which severely affected Mexico in the late 1970s and early 1980s.


This parallels Jeffrey Frieden’s proposition, in his Debt, Development, and Democracy (Princeton: Princeton University Press, 1991), 19–22, that holders of liquid assets are better shielded from unfavorable government policy. This does not mean that, as Frieden suggests, they are “indifferent to policy” or do not have a preference ordering. On the contrary, the Latin American experience with financial liberalization exhibits increasing and decisive influence upon government policy by those groups.


For a review of these policies, see Nicolas Arditto Barletta, Mario Blejer, and Luis Landau, Economic Liberalization and Stabilization Policies in Argentina, Chile, and Uruguay: Application of the Monetary Approach to the Balance of Payments (Washington, DC: A World Bank Symposium, 1983); for a criticism, see Alejandro Foxley, Latin American Experiments in Neoconservative Economics (Berkeley: University of California Press, 1982), 114–119.


As further evidence of the need to qualify arguments that view liberalization as the consequence of the systemic pressures of international financial capital, one should recall that, even under NAFTA, Mexican bankers have managed to negotiate a gradual opening which restricts the operation of foreign banks to no more than 15% of the market in the first six years of the agreement. In the wake of the currency crisis of December 1994, however, this process has accelerated. See Carlos Elizondo, “The Making of a New Alliance: The Privatization of the Banks in Mexico,” CIDE Documento de Trabajo 5 (1993).


On privatization in Chile, see Fernando Dahse, El mapa de la extrema riqueza (Santiago: Aconcagua, 1979) for the first phase, and Dominique Hachette and Rolf Lüders, La privatizaci-n en Chile (San Francisco: CINDE, 1992) for an overall evaluation.

This information is drawn from the annual reports of those companies between 1985 and 1991. Note the similarities between these attributes of privatization and the East European process, where well-positioned excommunists have become wealthy entrepreneurs by taking over state assets. See, for example, David Stark, “Privatization in Hungary: From Plan to Market or From Plan to Clan?” East European Politics and Society 4 (3) (fall 1990): 351–92, and “Recombinant Property in East European Capitalism,” American Journal of Sociology 101 (4) (January 1996): 993–1027; and Jacek Tarkowski, “Endowment of Nomenklatura, or Apparatchiks Turned into Entrepreneuriks, or from Communist Ranks to Capitalist Riches,” Innovation 4 (1) (1990): 89–105.


In the first year and a half of his administration, Menem literally distributed the most important economic policymaking posts among top executives of Bunge & Born—the country’s oldest economic conglomerate—and leaders of the Ucede political party—the earliest and most articulate advocate of economic liberalization, renowned for its ties with finance.

