Hierarchical Capitalism:
Business, Labor, and the Challenges for Equitable Development in Latin America

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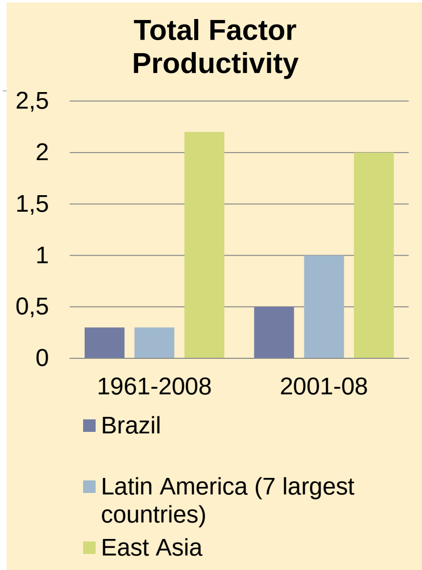
Macro versus Micro

- Macro indicators doing well
  - Growth and exports buoyed by commodity boom
    - Chile joined OECD
  - Employment expanding
    - "Brazil is a middle class country" (60%)
  - Inequality falling
- Micro not faring so well
  - Total factor productivity (TFP) stagnant
  - Human capital low
  - Low R&D (.5%) and investment (around 20% of GDP)
  - Many jobs, but low quality



Main Arguments

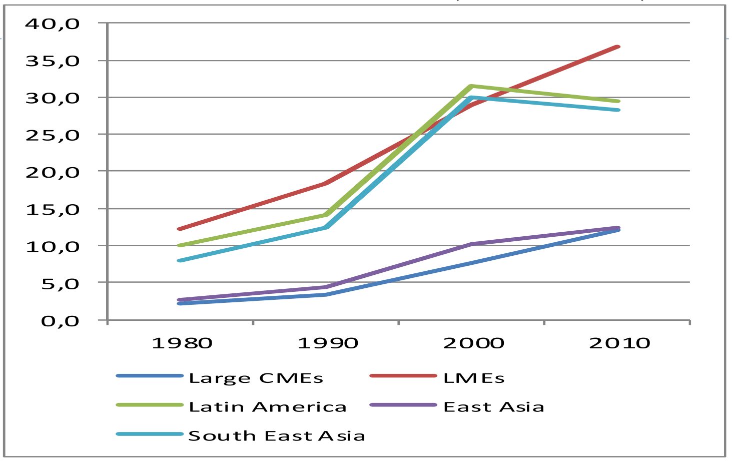
- Latin America has distinctive form of hierarchical market economy (HME)
  - Multinational corporations (MNCs)
  - Diversified business groups
  - Segmented labor markets
  - Low skills
- HMEs are institutionally resilient
  - Internal complementarities
  - Counters much work that emphasizes transformation in recent decades
- Hierarchical capitalism helps explain why micro economy is faring poorly

Four Ideal Types of Capitalism

	Liberal (LME)	**Coordinated** (CME)	**Network** (NME)	**Hierarchical** (HME)
Mechanism of allocation	Market	Negotiation	Trust	Hierarchy
Characteristic interaction among stakeholders	Spot exchange	Institutionalized meeting	Reiterated exchange	Order or directive
Duration of relations	Short	Long	Long	Variable
Classic case	USA	Germany	Japan	Chile

Each variety requires a different kind of developmental state

Core Features I: Stock of FDI (% of GDP)



- A third to half of large enterprises are foreign
  - particularly in higher technology manufacturing and services
- 30 to 60 percent of trade between United States and Latin America is intra-firm

Core Features II: Diversified business groups

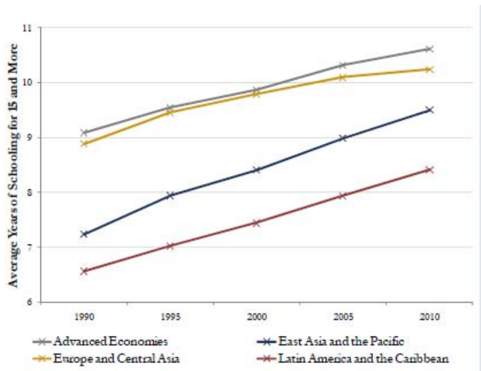
- Why does no one talk about business groups?
- Largest domestic firms are widely diversified
  - Concentrated in lower technology commodities and services
  - Direct hierarchical control of dozens of unrelated subsidiaries
- Control a large share of GDP
  - In Chile, sales of 20 largest firms equal 50 percent of GDP
- Family capitalism
  - 90 percent of largest groups are family owned and managed (hierarchically)

Core Features III:
Atomistic and Segmented Labor Markets

- Weak unions
  - No alternative plant-level intermediation
- High turnover
- High labor market regulation
- Large informal sector

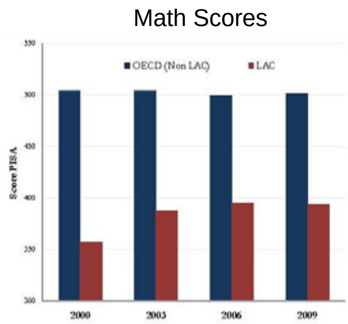
	LME (US, UK, etc.)	**HME** (Latin America)	**CME** (N. Europe & Japan)
Union density (percent)	28	15	45
Job tenure (median years)	5.0	3.0	7.4
Labor market regulation	.33	.53	.51
Informal economy (percent)	13	40	17

Quantity:
Educational attainment improving



IV. Skills: PISA scores among 15 year old students in 2009

	Mean reading score	% of boys below level 2
OECD average	493	25
Selected Comparisons		
Korea	539	9
Finland	536	13
Slovenia	483	31
Turkey	464	33
Thailand	421	55
Latin America (median)	**413**	**51**
Chile	449	36
Mexico	425	46
Uruguay	426	51
Colombia	413	50
Brazil	412	56
Argentina	398	59
Peru	370	70



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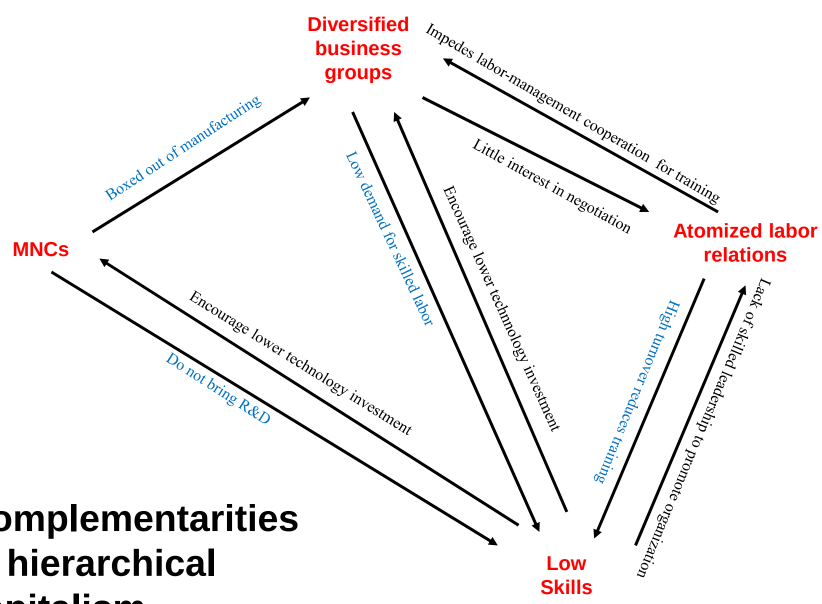
- level 2 is minimum needed for moving on to more training, education and higher skill employment
- Low expenditures in Latin America on vocational training
  - .04 percent of GDP in Latin America
  - .26 in liberal economies (LMEs)
  - .51 in coordinated economies (CMEs)

Complementarities, Context, and Continuity

- Complementarities, often negative
  - Low skill equilibrium
    - Workers do not invest in skills because there are no jobs
    - Firms do not invest in technology because there are no skilled workers
- Adds up to institutional resilience



Complementarities in hierarchical capitalism

MNCs and Domestic Business Groups

- Why did so many business groups grow out of commodity production?
  - MNCs dominated higher technology manufacturing
  - Domestic business groups developed other organizational, financial, and political advantages
    - Lower technology sectors (cement, mining, pulp & paper, food, metals) where MNCs were not active

MNCs, Business Groups, and Low Demand for Skills

- MNCs
  - MNCs do almost no R&D in Latin America (outside Brazil)
  - Labor intensive manufacturing is unskilled (maquilas)
  - Capital intensive firms employ few workers
- Domestic business groups
  - Low skills in sectors like construction or food
  - Low employment in commodities like steel, mining
    - Mining in Chile: 16 % of GDP but only 1 % of employment
- Make instead of buy skills
  - Large firms 'hire for attitude, train for skills' (IDB study)
  - Segmented labor market: high tenure and training for a few

Research and Development by business groups in Brazil (Percent of sales)

	Sector	2009	2010	Average
Vale	Mining	4.1	1.9	3.0
Odebrecht/Braskem	Construction & Petrochemicals	.39	.31	.35
Itaú (Duratex +Itautec)	Building materials & informatics	3.4	2.2	2.8
Oi/Telemar	Telecommunications	.06	.04	.05
Gerdau	Steel	.48	.68	.58
Camargo Correa	Diversified	.09	.11	.10
Cosan	Sugar & Ethanol	.04	.04	.04
Usiminas	Steel	.08	.16	.12
Median		.24	.24	.23

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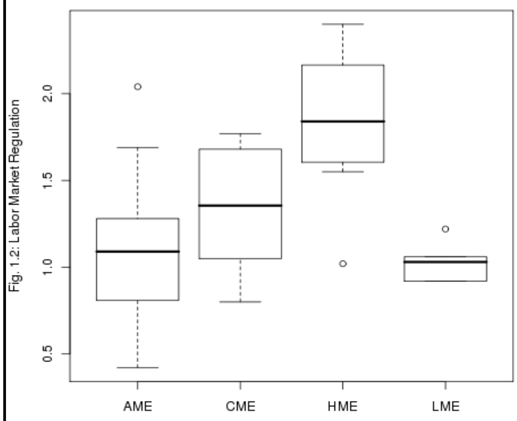
Turnover and Skills

- High turnover discourages investment in skills
  - Firms do not expect workers to stay long
  - Individuals have few incentives to learn firm or sector specific skills
    - In Chile, half of those who change jobs move into a different sector
    - Turnover higher among lower income, lower education workers
- Camargo Corrêa (Brazil) employs 57,000 workers
  - 60 % have 6 or less years of education
  - Average job tenure is 3 years
  - Annual employee turnover is 40 percent

Anomaly of high labor regulation



Key: bold line is median, box is 25-75th percentile. AME – Southeast Asia; HME – Latin America; CME – Europe; LME -- Anglo

- Labor regulation high by international standards
  - Dismissal costs (average monthly salaries):
    - .5 in LMEs
    - 1.2 in CMEs
    - 3.1 in Latin America
- Labor regulation was least reformed of 10 dimensions of Washington consensus
- Why so resilient?
  - Residual labor power
  - Regulations are optional

Low skills, high training costs, and high severance pay

- High severance pay helps big business
  - Big firms invest a lot in training for small, stable workforce
    - Face challenge of poaching by other firms
  - High severance pay ties worker to firm and protects investment in skills
    - A month's pay per year of service
  - Cross national studies find positive correlation between level of regulation and in house training
- Policy implication
  - Economic complementarity reduces political pressure for reform
  - In house training reduces market demand for skills and political pressure for better public education

Reinforcing political factors

- Most business groups and many MNCs benefit from favorable regulations and subsidies
  - Barriers to entry and take over
- Porous political system
  - PR electoral systems lead to fragmented parties
  - Appointive bureaucracies facilitate access by big business
- Families have advantages in politics
  - Interests more intense; commitments longer term
- Yet, negative complementarities mean politics not in equilibrium

Implications for Policy

- Negative impact on equality and social welfare
  - HMEs generate fewer good jobs
  - Low demand for education by firms and individuals
- HMEs are resilient
  - 4 features are resistant to change
  - Isolated reforms may have limited impact

Escape routes?

- Scandinavian (natural resources)
  - Requires commitment to public education and private R&D
    - Nokia – forestry to cell phones
- Chile and supply shock in education
  - Huge investments in education
  - But private education and public R&D
    - Why La Papelera is not Nokia
- Brazil and demand shock in technology
  - Technology intensive commodities
    - Ethanol, oil, and precision agriculture
  - MNCs and public R&D
    - 10,000 Phds per year
- Yet, hierarchical capitalism still constrains options
  - Low skill trap and other negative complementarities

New developmental states and countering negative complementarities

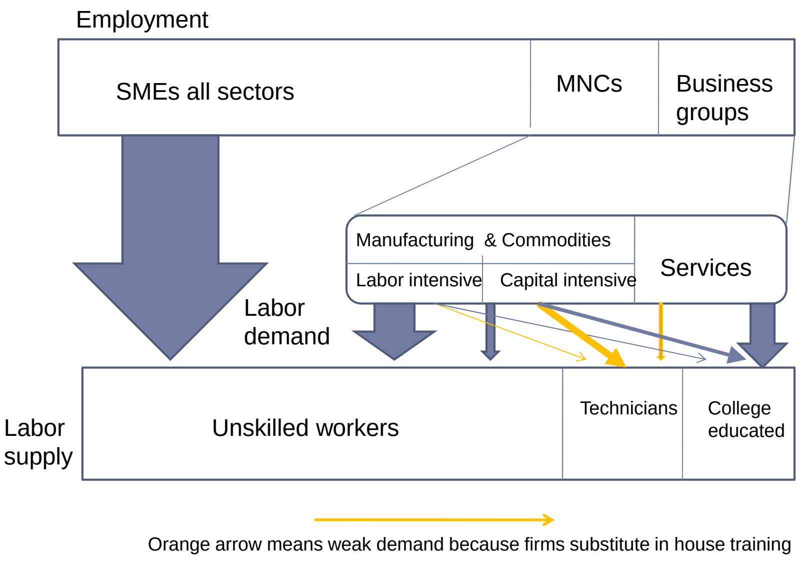
- Model of hierarchical capitalism shows necessity for state action
- Model also helps identify crucial areas for remedial intervention
  - R&D, productivity well known
  - But emphasis greater on skills and labor markets
- Model highlights connections across areas of economy
  - Isolated interventions may have less impact
    - Training programs cannot have much impact if turnover is so high

Challenges and developmental states

- Skills
  - Government provides supply
  - Incentives for firms to provide demand
- Technology
  - Incentives to private firms
  - Complementary public investment
- Diversification
  - All developed countries are diversified, especially exports
  - Difficult to create new firms in new areas
  - Business groups well suited to diversify

Implications for theory

- Institutional complementarities provide systemic explanations
  - Complementary relations are endogenous, mutually reinforcing
    - Better than searching for single causal relationship
  - Explain continuity better than change
  - Systemic analysis: helps to identify ramifications of change along one dimension
    - e.g., stock markets, institutional investors, and business groups
- Distinctive varieties of capitalism exist outside developed economies
  - Developing countries do not have just hybrid, emerging, or incomplete varieties
  - Robust complementarities essential for identifying varieties
    - Not clusters of variables (DME, MME, EME, GME…)
  - Hierarchical capitalism is not just Latin capitalism
    - Possible extensions to other middle income countries (Turkey, Thailand)



Schematic distribution of employment and demand for skills

(arrow width signifies relative amount of demand)

Distribution and Redistribution in Selected Latin American Countries in Comparison to Developed Countries