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

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

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

<table>
<thead>
<tr>
<th></th>
<th>LME (US, UK, etc.)</th>
<th>HME (Latin America)</th>
<th>CME (N. Europe &amp; Japan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Union density (percent)</td>
<td>28</td>
<td>15</td>
<td>45</td>
</tr>
<tr>
<td>Job tenure (median years)</td>
<td>5.0</td>
<td>3.0</td>
<td>7.4</td>
</tr>
<tr>
<td>Labor market regulation</td>
<td>.33</td>
<td>.53</td>
<td>.51</td>
</tr>
<tr>
<td>Informal economy (percent)</td>
<td>13</td>
<td>40</td>
<td>17</td>
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Quantity: Educational attainment improving
IV. Skills: PISA scores among 15 year old students in 2009

<table>
<thead>
<tr>
<th></th>
<th>Mean reading score</th>
<th>% of boys below level 2</th>
</tr>
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<tbody>
<tr>
<td>OECD average</td>
<td>493</td>
<td>25</td>
</tr>
<tr>
<td>Selected Comparisons</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td>539</td>
<td>9</td>
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<tr>
<td>Finland</td>
<td>536</td>
<td>13</td>
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<tr>
<td>Slovenia</td>
<td>483</td>
<td>31</td>
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<tr>
<td>Turkey</td>
<td>464</td>
<td>33</td>
</tr>
<tr>
<td>Thailand</td>
<td>421</td>
<td>55</td>
</tr>
<tr>
<td>Latin America (median)</td>
<td>413</td>
<td>51</td>
</tr>
<tr>
<td>Chile</td>
<td>449</td>
<td>36</td>
</tr>
<tr>
<td>Mexico</td>
<td>425</td>
<td>46</td>
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<tr>
<td>Uruguay</td>
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<tr>
<td>Colombia</td>
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<tr>
<td>Brazil</td>
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<td>56</td>
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<tr>
<td>Argentina</td>
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<td>59</td>
</tr>
<tr>
<td>Peru</td>
<td>370</td>
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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)

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<th>Average</th>
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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

- 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

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

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 Papeleta 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)

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**Schematic distribution of employment and demand for skills**

(arrow width signifies relative amount of demand)

- SMEs all sectors
- Labor demand
- Labor supply
- Manufacturing & Commodities
- Services
- Unskilled workers
- Technicians
- College educated
- MNCs
- Business groups

Orange arrow means weak demand because firms substitute in house training
Distribution and Redistribution in Selected Latin American Countries in Comparison to Developed Countries