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# **Hierarchical Market Economies and Varieties of Capitalism in Latin America**

Ben Ross Schneider  
Department of Political Science  
Northwestern University

[brs@northwestern.edu](mailto:brs@northwestern.edu)

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**Abstract.** The extensive scholarship on ‘varieties of capitalism’ offers some conceptual and theoretical innovations that can be fruitfully employed to analyze the distinctive institutional foundations of capitalism in Latin America or what could be called hierarchical market economies (HMEs). This perspective helps identify four core features of HMEs in Latin America that structure business access to essential inputs of capital, technology, and labor: 1) diversified business groups, 2) multinational corporations (MNCs), 3) low-skilled labor, and 4) atomistic labor relations. Overall non-market, hierarchical relations in business groups and MNCs are central in organizing capital and technology, and are also pervasive in labor market regulation, union representation, and employment relations. Important complementarities exist among these features especially between MNCs and diversified business groups, as well as mutually reinforcing tendencies between these forms of corporate governance and general under investment in skills and in well mediated employment relations. These four features of HMEs, their common reliance on hierarchy, and the particular interactions among them add up to a distinct variety of capitalism, different from those identified in developed countries and other developing regions.

## I. Introduction<sup>1</sup>

The comparative institutional analysis of different varieties of capitalism has been elaborated extensively for some developed countries, especially the “liberal market economies” (LMEs) in the United States, United Kingdom, and other Anglophone countries and “coordinated market economies” (CMEs) in Germany, Japan, and other northern European countries.<sup>2</sup> In recent years scholars of other areas, especially Asia, Southern Europe, and Eastern Europe have been asking whether distinctive varieties of capitalism exist in these regions as well (for example, see Amable 2003; Hancké, Rhodes, et al. 2007; Lane and Myant 2007). Although the comparative institutional analysis of capitalism has a long tradition in Latin America, new research has been sparse. Beyond helping to revive this tradition, a ‘varieties of capitalism’ perspective would bring several major innovations to the study of Latin American political economy. Most importantly it incorporates labor relations and worker training into analyses of overall capitalist coordination; it shifts attention from states to firms; and it directs the empirical focus away from recent policy changes toward enduring, underlying institutional features of capitalism in the region.

The study of distinctive forms of capitalism in Latin America went through several stages over past decades, before slipping down the list of research priorities. Early analyses began with the assumption that entrepreneurs drove capitalist development, studied the behavior and attitudes of Latin American capitalists, and usually concluded that business people were insufficiently entrepreneurial (see for example Lauterbach 1965). In the 1960s and 1970s this focus on individuals in a domestic setting shifted to a preoccupation with structures in the international

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<sup>2</sup> The original framework is from Hall and Soskice (2001). For more recent debates and extensions, see Boyer 2005; Crouch 2005; Hancké, Rhodes, and Thatcher 2007.

economy, namely dependency theory. Here the problem with Latin American capitalism was that it was dependent, externally constrained, and lacked internal dynamism. By the 1980s, the analysis of Latin American capitalism shifted again mostly toward the analysis of states and state intervention in the economy (Evans 1995) and later to changing development strategies (Haggard and Kaufman 1995).

These successive literatures highlighted crucial aspects of capitalism in Latin America but also left important gaps. First, they had little to say about distinctive forms of corporate governance in domestic firms. We know a good deal about the political activities of domestic business, and its relations with government and MNCs, but much less about how local capitalists built and organized their firms.<sup>3</sup> The firm's-eye view of the world characteristic of 'variety of capitalism' analyses offers a useful corrective to other perspectives that either deduce firm behavior or treat it as secondary and mechanically reactive to other forces. And, in practice, what has emerged in developing countries in the wake of market-oriented reforms of the 1980s and 1990s is neither state-led nor market-led development but rather business-led development. Second, and similarly, the large literature on organized labor focuses more on its role in politics than in collective bargaining and firm-level intermediation. Lastly, the study of worker skills, education, and training in Latin America has been largely left to a small group of policy experts, and the narrow literature on skills is rarely incorporated into general discussions of the performance of Latin American capitalism overall (Ducci 2001). A 'varieties of capitalism' approach directs attention precisely to these neglected areas and interactions among them.

The goals of this paper are several. Conceptually and theoretically, the goal is to extend the debate on varieties of capitalism beyond the narrow confines of developed countries and to consider the benefits of employing conceptual innovations like the analysis of institutional complementarities to illuminate continuities in developing regions like Latin America. This analytic lens helps to generate hypotheses on the contours of a distinct variety of capitalism, a

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<sup>3</sup> Nothing like the extensive subdiscipline of business history in developed countries exists in Latin America. For an important exception, see Dávila and Miller 1999.

hierarchical market economy (HME), that seems to characterize well most large countries of Latin America.

Following the ‘varieties’ focus on corporate governance and labor relations, the four core empirical features of HMEs in Latin America would be diversified business groups, MNCs, atomistic labor relations, and low skills. The dominant corporate form among large private domestic firms has long been the family-owned and controlled, diversified business group, also known in Latin America as a *grupo económico* or *grupo*. In 1980, for example, the largest private domestic firm in Mexico, Banamex, was a sprawling, conglomerated, family-owned group. By 2000, the largest private firm in Mexico, in fact in all of Latin America, was the Grupo Carso, also highly diversified and family controlled. Most of the rest of the large private firms were subsidiaries of MNCs. MNCs have long been dominant in manufacturing, but in recent decades they have also expanded into finance, utilities, and other services. On the labor side, the main focus is on the absence of institutions both for intermediating employment relations within firms and for fostering greater investment in skills and training. Unions are small and represent a decreasing share of workers, in part because the informal sector is so large. Moreover, turnover is very high so few employees establish long term relations with their firms. Lastly, education levels are comparatively low, despite recent advances, and public and private investment in training is minimal.

In some respects HMEs resemble CMEs (for example, in non-market forms of corporate governance) and in others they tend towards LMEs (as in labor markets). However, HMEs are not simple hybrids or mixtures (in what Hall and Soskice (2001, 21) identified as a possible Mediterranean variety). Rather, both the major components, and especially the interaction among them, constitute a distinct variety, and closer examination of apparent features of coordination and markets reveals in fact much more hierarchical relations. The economies of Latin America are of course deeply penetrated by market relations and private property (and therefore have little in common with socialist, command economies). Yet, hierarchy pervades the core relations of capitalism more in Latin America than elsewhere. The term ‘hierarchical market economy’ is

designed in the first instance to highlight differences among LMEs, CMEs, and HMEs. In addition, the oxymoronic coupling of hierarchy with market also suggests that the institutional components may not fit together as smoothly as those in LMEs and CMEs, and may in some instances be dysfunctional.

The next section analyzes briefly the empirical dimensions of the core features of hierarchical capitalism in Latin America.<sup>4</sup> Section III then considers some complementarities among these features especially interactions between MNCs and diversified business groups, as well as mutually reinforcing tendencies between these forms of corporate governance and general under investment in skills and in well mediated employment relations. Section IV concludes by considering some broader comparisons with other regions as well as implications of this hierarchical variety of capitalism for understanding economic policy and performance.

## **II. Core Features of Hierarchical Market Capitalism in Latin America**

An inductive survey of corporate governance and the organization of production in the larger countries of Latin America over the past half century reveals four enduring features: diversified business groups, MNCs, atomistic labor and employee relations, and low-skilled labor. The four core features of HMEs cover much of the ground that Hall and Soskice examine in their five spheres of strategic relationships: industrial relations; vocational education and training; corporate governance; inter-firm relations; and employee relations. In these generic spheres in HMEs, hierarchy often replaces or attenuates the coordinated or market relations found elsewhere. For example, whereas post-secondary or on-the-job training is more market based in LMEs and more negotiated in CMEs, it is often unilaterally decided by firms or business associations in Latin America. Such hierarchical relations also characterize more general

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<sup>4</sup> Elsewhere I elaborate on abstract conceptual and ideal typical distinctions among CMEs, LMEs, and HMEs (Schneider 2008a). In this paper the goal is more to use the varieties of capitalism framework to identify comparable empirical regularities in Latin America in corporate governance, labor relations, and skills.

employee relations where employees lack formal grievance procedures and representation and informally lack voice because most are quite temporary. Unions have little influence on hierarchies within the firm in part because so few workers are unionized and in part because where unions do exist they are often distant from the shopfloor. Lastly, industrial relations are further structured by top-down regulations issued by national governments and enforced by labor courts. On the dimension of corporate governance, relations are even more clearly hierarchical because most firms are directly controlled and managed by their owners, either prominent families or foreign firms. On interfirm relations, sometimes they are competitive, but other sectors are oligopolistic and others regulated by the state. Even in countries with strong business associations, most inter-firm coordination focuses on politics and policies rather than narrower issues of sectoral (self) governance as in CMEs (see Schneider 2004).

To simplify the exposition, the following discussion considers the broad contours of a single variety of capitalism in Latin America. And, in fact, in comparison to variations within regions like West or East Europe (Bohle and Greskovits 2007), these core aspects of capitalism in Latin America manifest greater homogeneity across the region. Of course, there are major variations in Latin America, especially in terms of country size, commodity rents, and degree of integration with the US economy. Yet, what is remarkable is that despite these variations, the similarities on the four core features remain significant. Elsewhere I examine intra-regional variation in greater depth, but the goal here is to cover briefly common features across the larger countries of the region (Schneider 2008b; Schneider and Karcher 2008 see also Boyer 2005).

1. Diversified business groups. While most varieties of capitalism are characterized by a single dominant form of corporate governance, large companies in Latin America are divided between large domestic business groups and MNCs. There are four things to emphasize about large domestic firms in Latin America (Schneider 2008b; Schneider 2009b). First, they are widely diversified into subsidiaries that have little or no market or technological relation to one another. Second, each large group maintains direct hierarchical control over dozens of separate firms. Third, small numbers of huge groups account for large shares of GDP, estimated sometimes as

high as 20 percent. And, fourth, groups are mostly owned and managed by families, often several generations.<sup>5</sup> Comparable data are scarce, but available estimates give consistent indications throughout the 20th century of the pervasiveness of diversified business groups. One of the most comprehensive recent studies of big business in Latin America begins by noting that the universe of big stand-alone firms “is very small in the region. Big firms are, by a large majority, part of formal or informal groups” (Garrido and Peres 1998, 13). A rare comparative study of the five largest grupos in eight countries of Latin America found that 34 of 40 grupos had diversified into 4 or 5 different sectors (out of five total: primary, manufacturing, construction, services, and finance) (Durand 1996, 93).

Contrary to expectations of convergence, diversified business groups survived and prospered through the liberalization and globalization of the 1990s and 2000s (Schneider 2008b). Competitive pressures of liberalization did lead some firms to spin off unrelated holdings, but at the same time privatization and regulation opened up other new opportunities for greater diversification. By the 2000s most business groups had significant holdings in regulated and non-tradable sectors. Even in Chile, the regional leader in liberalization, diversified business groups flourished, especially those based in commodities and services (Lefort 2005). As a top financial executive at the Grupo Matte (electricity, finance, forestry, construction and other sectors) explained it, the group strategy was to be big in 4 or 5 “sectors with high profitability, regulated, but also, as a consequence [por lo mismo], low risk and capital intensive” (*Qué Pasa*, 5 November 2005, p. 22). Another enduring characteristic of corporate governance in Latin America is family ownership and management (see IDE 2004). In the 2000s, over 90 percent of 33 of the largest groups in Latin America were family owned and managed (Schneider 2008b, see also La Porta, López-de-Silanes, and Shleifer 1999, 492, 494).

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<sup>5</sup> Although different from large firms in most LMEs and CMEs, such diversified business groups are common in most of the rest of the developing world (Khanna and Yafeh 2007; Morck, Wolfenzon, and Yeung 2005).



Both diversification and family control introduce more hierarchies into corporate governance. Diversification itself introduces hierarchies that do not exist where firms are more specialized and independent (as in LMEs). Blockholding (concentrated share ownership) in Latin America centralizes control and rarely requires negotiation among multiple owners or stakeholders, as it does in CMEs. In addition, family ownership in Latin America typically involves multiple generations of managers and overlays generational hierarchy on managerial relations. Lastly, the huge size of most groups, both in terms of overall proportion of GDP and market dominance in certain sectors, means that relations with competitors, suppliers, and clients are often unequal and imbued with a hint of coercive hierarchy.

2. Multinational Corporations. Foreign firms, mostly from the United States, made massive direct investments in Latin America throughout the 20th century: first in raw materials and railroads in the early 20th century, then in other infrastructure and public utilities through the decades up to World War II, then into Fordist manufacturing (especially consumer durables), and after market reforms in recent decades back into infrastructure and services and expanding into finance. By the 1970s the foreign share of manufacturing was 24 percent in Argentina, 50 percent in Brazil, 30 percent in Chile, 43 percent in Colombia, 44 percent in Peru, and 14 percent in Venezuela (Cunningham 1986, 46 citing Jenkins 1984). The percentages were usually higher in sectors like chemicals, electrical equipment, and transport equipment than in consumer non-durables like food, beverages, textiles, and clothing. By 1995, by another calculation, the stock of FDI as a percentage of GDP was on average 16 percent for the four largest countries of Latin America (compared to 2 percent for Korea and 10 percent for Thailand (Guillén 2001, 126)). MNC presence was especially visible among the largest firms. The share of MNCs in the sales of the 500 largest companies in the region ranged from 30 to 40 percent for most of the 1990s and 2000s, and the MNC share of the top 200 exporters grew to nearly half in 2000 before dropping back to a third in 2004 (ECLAC 2006, 11).

In terms of coordinating functions, MNCs administered in hierarchical fashion technology transfer, capital for investment, some relations with suppliers and customers, and especially trade.

Although difficult to measure precisely, estimates of intra-firm trade between Latin America and the United States vary between one third and two thirds (Petras and Veltmeyer 1999; Zeile 1997). Although the patterns are similar for other regions, it is important to note that this trade is not a market exchange between independent buyers and sellers, but more a shipping order between members of the same corporate organization. In addition, though not formally owned by MNCs, many export firms in Latin America are dependent on one or two international buyers in closely linked global commodity chains in which the inter-firm relationship is more vertical than horizontal (Gereffi, Humphrey, and Sturgeon 2005).

Before 1990, MNCs usually entered Latin America with greenfield investments in new plants and operations. After 1990 most FDI went into acquisitions of existing firms. In addition, new Translatinas or multilatinas (business groups that expanded into other countries of the region) contributed to the wave of mergers and acquisitions. In combination with domestic acquisitions, this buying spree resulted in significant concentration and a reduction of firms listed on local stock exchanges (as new owners often preferred to buy up remaining shares and delist their new acquisitions), and generally extended hierarchical control over a greater proportion of the economy (see Stallings 2006). For example, by one recent measure, the sales of the 63 largest firms in Chile in 2006 equaled 87 percent of GDP, meaning that a few dozen hierarchies controlled a large proportion of economic activity.<sup>6</sup>

In sum, on the side of corporate governance, diversified business groups and MNCs were the key conduits for organizing access to capital, technology, and markets through Coasian internalization and hierarchy.

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<sup>6</sup> This figure exaggerates the proportion of GDP controlled by these 63 firms because it includes foreign sales. At the same time it underestimates the degree of concentration because some of these 63 firms belong to an even smaller number of business groups, *América Economía*, 9 July 2007, p. 67.

3. Atomistic employee and labor relations.<sup>7</sup> Labor relations in Latin America are atomistic and often anomic because workers have fluid, short-term links to firms, and weak or no horizontal links to other workers through labor unions. Among other things, worker turnover is high, few countries in the region have any special institutions (like co-determination) for micro coordination within firms, and “organized labor . . . is extremely weak” (Huber 2002, 458–9). As a result, labor and employment relations are individualized, disintermediated, and consequently hierarchical (as employees have little leverage in relations with employers).

Table 1 summarizes key differences in labor markets among different varieties of capitalism (Table A in the appendix provides measures disaggregated by country). Very high turnover (half of workers have held their jobs for less than 3 years) is a first major factor contributing to atomized employment relations since workers enter firms with few expectations of staying long. Once in the firm, most workers are unlikely to have plant-level union representation, both because union density is so low and because even where unions do exist, they often do not have much of a formal presence on the shopfloor. In addition, there are few other well functioning mechanisms (like German-style codetermination), for mediating relations between workers and employers. Lastly, many people work in the informal sector without unions or legal protections. Labor market regulations, on the books, are surprisingly more extensive on average in Latin America than in LMEs or even CMEs. However, the de facto reach of these regulations is limited because they do not cover the large informal sector and compliance in the formal sector is uneven at best (for example, see Berg 2005).

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<sup>7</sup> This discussion of labor markets draws heavily on joint work with Sebastian Karcher (Schneider and Karcher 2008). This work analyzes separately and in greater depth the several components that comprise ‘atomistic labor relations.’ See Cook (2007) for a recent comprehensive overview as well as more coverage on variations across the region.

**Table 1. Labor Markets in LMEs, CMEs, and Latin America**

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

Source Schneider and Karcher 2008.

Compared to labor unions in much of the developed world, organized labor in Latin America tended to be more politicized and state controlled, and less effective at collective bargaining or ongoing intermediation at the plant and firm levels (Cook 2007). The unionization rate was relatively high in some countries in the mid 20th century, especially in concentrated industries like mining and capital-intensive manufacturing, but it declined thereafter. By some estimates unionization among wage earners fell over the 1990s from 67 to 39 percent in Argentina, from 60 to 43 percent in Mexico, and from 18 to 5 percent in Peru (Marshall 2000, 12).<sup>8</sup> Even where unionization rates were high (sometimes due to compulsory membership), unions were not necessarily a useful institutional vehicle for coordination between workers and employers, due largely to political and state intervention. States intervened both structurally in the sense of legislating levels and conditions of bargaining, and on an ad hoc basis through labor courts or direct intervention, so that both employers and union leaders often had stronger incentives to pursue their interests politically, with state actors, than with each other (see -----

<sup>8</sup> By another calculation (as percent of the total workforce) union membership declined from an average of 25 percent to 16 percent in Latin America (and from 40 to 31 percent in industrial countries) from the 1980s to the 1990s (IDB 2001, 117). Argentina was an exception to these trends after 2002 when union membership and coverage by collective bargaining recovered (Etchemendy and Collier 2007).

Buchanan 1995; French 2004). In Chile, for example, labor statutes imposed by the Pinochet dictatorship prohibit multi-union confederations from collective bargaining and thereby encourage them to engage in broader political activities rather than more concrete problem solving and ongoing dialogue with employers, as is common in CMEs. Labor statutes also forbid company unions from negotiating on anything but wages, thereby precluding precisely the kinds of discussions over work organization, working time, training, and other issues that are at the heart of plant level relations in CMEs (Berg 2005; Sehnbruch 2006; Haagh 2002).

In some respects the high turnover, combined with weak unions and limited regulation (as in the informal sector) would all seem to infuse markets into labor relations. And, many employment relations were like short-term spot transactions in open markets. However, most of these factors also shifted the balance of power in favor of employers and gave them more hierarchical control than is common in LMEs. For instance, translated into day to day relations, high turnover means that workers are almost always subject to dismissal, thereby enhancing employer leverage. Moreover, the absence of unions and weak enforcement of legal protections make workers even more vulnerable, and this vulnerability is even higher in the informal sector where workers by definition lack protection and representation.

4. Low levels of education and vocational skills. Educational levels in Latin America remain lower than those in developed countries and East Asia. From 1960 to 2000 the average years of school and levels of secondary education in Latin America almost doubled from 3.3 to 6.1 years (Barro and Lee 2000, 29–30). Yet, by 2000 educational attainment in Latin America lagged behind East Asia (6.7 years) and developed countries (9.8 years) (and even for 1960, 7.1 years), and especially for secondary education, the level most relevant for worker education and training where 8.6 percent of adults in Latin America had complete secondary education versus 14.8 in East Asia. Moreover, governments in Latin America spent far less on training unemployed workers (an average of .04 percent of GDP) than LMEs (.26 percent) or CMEs (.51 percent) (IDB 2003, 282). The IDB reported that “in a study of 47 countries including most developed countries, six Latin American countries and a sampling of countries in Asia and Africa,

Argentina was ranked 29th in productivity per worker, Mexico 34th, Chile 36th, Brazil 38th, Colombia 40th, and Venezuela 42nd. The reasons for these low productivity levels include slow progress in education, the failure of training systems, poor labor relations, and the absence of compensation mechanisms for workers who stand to lose their jobs or job standing due to innovations” (IDB 2001, 105).

What explains the low levels of investment in skills? The lack of spontaneous firm investment is the common result of free riding; if one firm invests in training workers other firms can then poach and hire away the trained workers, so rational firms do not invest in training in the first place. This is a generic coordination problem faced by all political economies, overcome, when it is overcome, by either public provision or third-party enforcement of private provision. The further questions for Latin America are why incentives for public provision and individual investment in education and training are weak. For a fuller answers to these questions, as well as a deeper understanding of why the other features persist, we need to look at complementarities among these features and reinforcing aspects of the broader context.

### **III. Compatibilities, Complementarities, and Resilience in HMEs**

Some of the core features, as well as other background factors, reinforce one another in ways that sustain many institutional aspects of HMEs in Latin America (see Figure 1). For Hall and Soskice, “two institutions can said to be complementary if the presence (or efficiency) of one increases returns from (or efficiency of) the other” (2001, 17). In addition to such positive complementarities, HMEs also manifest negative complementarities and weaker reinforcing tendencies and compatibilities. The following sections elaborate on some of the crucial relations in Figure 1.

**-- Figure 1 about here --**

MNCs and business groups. Over the course of the second half of the 20th century, the complementarity between MNCs and domestic groups was primarily negative. The existence of MNCs in higher technology manufacturing reduced the returns for domestic groups to investing in proprietary technologies and R&D generally, and increased the returns to business groups that invested in other areas such as natural resources, commodities, and services that used lower skills and technologies.<sup>9</sup> The few domestic firms that did invest in developing technologies were often in the end bought out by MNCs entering the market, thereby reinforcing the division of labor between MNCs and domestic groups. In addition, government policy towards MNCs encouraged business groups to diversify. Before the deregulation of foreign investment after the 1990s, governments often obliged MNCs to arrange joint ventures with domestic partners. These joint ventures usually pulled groups into new sectors and expanded the scope of their diversification. Even in the absence of specific policies, MNCs sometimes preferred partnering with domestic groups in order to tap into political (rather than technical or managerial) expertise and capacity.<sup>10</sup>

MNCs and domestic business groups impeded movement towards both markets in corporate governance and coordination in inter-firm relations. MNCs and groups substituted for domestic stock and financial markets, and thus slowed their expansion. In fact, as noted earlier, MNC acquisitions of domestic firms contributed to the fall in the number of listed firms in the 1990s, because MNCs often prefer to de-list local subsidiaries (see Stallings 2006 generally on financial markets) . Groups too, because they internalize capital market functions, supplant stock and credit markets. Moreover, while many groups list subsidiaries or parent holding companies on stock markets, the family owners usually maintain voting control, so minority investors have fewer incentives to buy in, which further depresses potential expansion in stock markets (La Porta, López-de-Silanes, et al. 2000).

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<sup>9</sup> In one recent survey of Latin America, “the most striking result [was] the low level of R&D conducted by firms” (de Ferranti, Perry, et al. 2003, 5).

<sup>10</sup> For instance, the directors of Banamex, the largest, and very diversified, bank in Mexico (until its nationalization in 1982) were on the boards of most important business associations, so any partner of Banamex would automatically gain crucial representation (Schneider 2004).

Similarly, in terms of inter-firm relations, MNCs and domestic groups impede coordination and at times other market relations. MNCs often join local business associations, but they tend to participate less actively and have difficulty coordinating with local firms because many management decisions are taken abroad. When managers are foreign, then language, culture, and shorter time horizons further undermine potential coordination. At times relations between MNCs and local firms degenerate into acrimonious divisions and ultimately splits into separate associations (as in the Chilean mining associations (Schneider 2004)). Subsidiaries of business groups may also make unreliable interlocutors -- top management is outside the sector and may ultimately decide to exit (or attempt, as often happens, to use financial leverage to buy up other firms in the sector). More abstractly, sustained coordination is unlikely among agents (in subsidiary firms) of distant principals (MNCs or grupo owners) with opaque and diverse interests.

Because they substitute for financial markets, MNCs and domestic business groups constitute non-market forms of organizing investment and technology, yet, in contrast to the effects of non-market coordination in CMEs, there are fewer institutional incentives for their investment to be patient. A crucial function of coordinating institutions in CMEs, for both labor and capital, is to lengthen time horizons (Estevez-Abe, Iversen, and Soskice 2001). In contrast, non-market organization of investment in HMEs allows business groups and MNCs to respond flexibly and rapidly to market signals; both forms of corporate governance are well suited to managing swift entry and exit. The agility of closely controlled business groups in short term adjustments and transitions in and out of sectors contradicts the arguments that dispersed ownership in LME corporations is a functional adaptation to the larger policy swings associated with majoritarian governments in LMEs, and of the need for firms to be able to accommodate quickly these swings (Gourevitch and Shinn 2005, 10; Hall, P. and Soskice, D. 2001). Hierarchy may be an even better adaptation for facilitating adjustment.

MNCs/grupos and low skills. Both MNCs and business groups had relatively low demand for skilled labor and weak incentives to invest in training (see Berg, Ernst, and Auer 2006; Miyamoto 2003). With MNCs dominating higher technology manufacturing, domestic business



groups concentrated in lower technology commodity sectors and services had fewer incentives to invest in R&D, hire scientists and engineers, or train highly skilled workers.<sup>11</sup> R&D expenditures in Latin America have rarely exceeded the comparatively low level of .5 percent of GDP and over three quarters of that is public (Katz 2001, 4). Even when they hire skilled workers, business groups do not hire very many. Overall, the IDB emphasized, “the low employment generation at of large Latin American companies” (IDB 2001, 36). Moreover, MNCs pay higher, sometimes much higher, wages than local firms (Berg 2005), so MNCs can easily poach skilled workers which reduces even further the incentives for domestic firms to invest in training.

MNCs for their part typically opted to invest in established product markets with stable technologies and predictable market demand (market seeking rather than efficiency seeking FDI (ECLAC 2008)). By the 2000s, MNCs were investing virtually nothing in R&D in Latin America. According to a 2005 report, Latin America and the Caribbean ranked “last out of all the world’s regions in terms of percentage of research and development investment companies have made in the last three years or expect to make in the next three years” (ECLAC 2005, 17). Intra-firm trade may also reduce incentives for MNCs to upgrade skills. In sectors characterized by low transport costs and decentralized production -- automobiles for example -- MNCs can locate plants with varying skill requirements in areas where skills are readily available.

The lasting, perverse complementarities of a low-skill trap or equilibrium are well known (Booth and Snower 1996). The basic coordination problem is that workers do not invest individually in acquiring skills because firms do not offer high-skill, high wage jobs. Firms in turn have incentives to invest in production processes that do not require skilled labor because skilled workers are scarce. This low skill trap seems to hold strongly for Latin America (Schneider and Karcher 2008).

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<sup>11</sup> In Brazil, for example, domestic commodity firms were split between capital intensive sectors like steel and cellulose that had mostly skilled workers, though not many employees overall, and labor intensive firms in sectors like meat processing with large numbers of unskilled workers (Schneider 2009a).

Atomistic labor relations and low skills. When turnover is high and unions at the firm level are weak, then employers have even weaker incentives to invest in worker skills both because they expect them not to stay long and because they lack institutional means for negotiating with workers an explicit distribution of gains over time from investing in training. For workers, short tenure also limits their time horizons and lowers their interest in investing in firm specific skills, or even in sector specific skills if they move regularly among different sectors. Among Chilean workers who changed jobs in the 1990s, over half switched from one sector to another (Sehnbruch 2006). Moreover, the frequent movement of workers between formal and informal employment presumably involves shifting among sectors with different skill requirements. High turnover also reduces the incentives for both labor and management to improve plant- and firm- level intermediation (see Schneider and Karcher 2008). The negative impact of high turnover on incentives for investing in skills and dialogue is one of the clearest complementarities among the components of HMEs.

Low skills and business groups. The absence of a large pool of skilled workers further discouraged domestic firms from investing in upgrading their production or in other higher technology sectors, and instead encouraged domestic firms to target lower technology investments where appropriate skills were abundant in the labor market. Studies in the United States have shown that technology acquisition did not lead firms to upgrade training and skills, but rather firms that already had skilled workers invested more in new technologies (IDB 2003, 188). Low technology investment coupled with high labor turnover may also facilitate diversification. That is, lower technology investment and the management of homogeneous flows of temporary, low-skilled workers can become elements of, and increase returns to, economies of scope. Once a firm develops a successful strategy for borrowing one technology and using it successfully with a flow of low-skilled workers, then the barriers for replicating this strategy in other sectors are lower (see Amsden 1989).

Hall and Soskice also expect that, “nations with a particular type of coordination in one sphere of the economy should tend to develop complementary practices in other spheres as well”

(2001, 18). Although they do not elaborate, the mechanisms promoting this isomorphism seem to differ between CMEs and LMEs. In CMEs, it is largely a positive function of learning: as economic agents realize joint gains from coordination in one sphere they will be more likely to replicate coordination into other realms. In LMEs, isomorphism seems to result more from managerial expectations and preferences. If relations in some spheres are market based, then managers have incentives to press for flexibility in other spheres, or reasons to chafe at non-market constraints. A similar logic informs complementarities in HMEs. It is less that agents realize joint gains from hierarchy and agree to extend them to other spheres. Rather, hierarchy is the default preference, especially for state and business elites who have greater influence in initial institutional formation. Longer term complementarities and path dependence arise from the fact that hierarchies impede movement to either coordination or markets. Overall, these complementarities and weaker compatibilities contribute to the stickiness of the core features of HMEs, but this resiliency is less the result of internal equilibrium and more resistance to exogenous pressures for change.

Beyond the four core features and their interactions, capitalists also faced other regular aspects of their economies -- what Hall and Soskice call "shared expectations" -- that influenced longer term strategies. Among the major shared expectations of business people in Latin America, volatility, pervasive but weak state intervention, and socioeconomic inequality stand out. Each of these further reinforce hierarchy in one or more of the four core features in ways that resemble the political underpinnings of LMEs and CMEs in particular electoral systems, respectively, majoritarian and parliamentary with proportional representation (Hall, P. and Soskice, D. 2001; Iversen and Soskice 2007 (forthcoming)).

Economic and political volatility and endemic uncertainty, for instance, encouraged defensive diversification precisely into unrelated sectors -- a trademark of Latin American groups (Schneider 2009b). The annual IDB report for 2003 concluded that, "Latin America suffers from an extremely volatile macroeconomic environment" (2003, 133). For the period 1970-2000, volatility for output, terms of trade, and capital flows in Latin America was higher than Asia and

almost twice as high as in developed countries (IDB 2003, 116). In addition, within particular firms and plants, volatility encouraged managers to maintain flexibility with regard to labor (given expectations that downsizing could be necessary at any moment) which reduced incentives for long-term employment arrangements, for investing in worker training, and for establishing enduring institutions for ongoing intermediation with employees. Volatility greatly shortened time horizons.

The state is the main external institution that historically reinforced the core features of HMEs as it regulated markets for capital, labor, and technology. States invited MNCs in and regulated the terms of their entry. States encouraged and shaped -- directly or indirectly -- patterns of diversification in business groups (Schneider 2009b). States, especially after the 1930s, intervened deeply in labor markets and initial worker training, at the same time they provided (low quality) public education. Pervasive state intervention, especially in the 20th century, both aggravated uncertainty and made the state the primary intermediary for labor. Restrictions on labor markets were extensive and resemble CMEs on some dimensions, especially employment protections. However, in Latin America weak enforcement and informal employment undermined these protections. Moreover, the long history of deep state intervention may have 'crowded out,' or inhibited the emergence of, other kinds of non-state, non-market institutions common in CMEs like life-time employment or stronger unions and employers' associations. In general, states in Latin America have been supportive enablers of the core features of HMEs.

Lastly, Latin America has long been a world leader in socioeconomic inequality which works in the contemporary period to reinforce hierarchies as well as thwart efforts to promote education and investment in human capital. Without resorting to more cultural interpretations of class divisions, it is nonetheless plausible to hypothesize that vast differences in education, norms, ethnicity, and sometimes gender and language create a gulf between workers and managers that makes both sides less eager to engage in coordination and negotiation. And, inequality reduces incentives on both sides for incremental investment in education and training, because the gap

between actual and desired skills is so great. Perversely, in Latin America the returns to education are lowest for poor households (Perry, López, et al. 2005).<sup>12</sup>

In sum, numerous factors reinforce HMEs in Latin America. Some interactions, as in the low skill trap, represent strong (negative) complementarities. In other instances, hierarchy is more a default that is at least compatible with other hierarchical components.<sup>13</sup> Other contextual factors like state intervention and volatility tend to reinforce hierarchy and the four core components. Even without reinforcement, hierarchies have some inertia and create obstacles to coordination and markets that would require extraordinary effort or circumstances to overcome. Yet, in all, it would be overstated to conclude that HMEs are in immutable equilibrium. Change is possible on a number of dimensions, including state reform, lessening volatility, and improving education, and might shift some of the HMEs of Latin America toward some other variety of capitalism. If so, then incremental movement towards markets may be easier than transition to coordination (Finegold and Soskice 1988). Some aspects of HMEs -- growing stock markets, for example -- may gradually displace more hierarchical corporate governance. However, for the time being most large economies of Latin America are better characterized as HMEs, than emerging CMEs, LMEs, or other possible hybrids.

#### **IV. Comparisons and Conclusions**

My analysis has stressed commonalities among the larger countries of Latin America on the core features of HMEs, but there is of course wide variation across the region, and some countries deviate sufficiently from the mean to warrant consideration for separate classification.

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<sup>12</sup> In terms of 'shared expectations,' long standing historical patterns, including slavery and forced labor, and cultural norms could be invoked to explain the lasting resilience of hierarchy. For the most part, however, the incentives are more immediate, though social acceptance of hierarchy may ease its imposition as new opportunities arise.

<sup>13</sup> Chilean training programs provide an apt illustration. The government offers firms tax write offs for spending on training and an additional deduction if the firm negotiates a training plan with its workers. But, even firms that have created labor-management training councils choose to forego the additional subsidy and make unilateral decisions on training (Sehnbruch 2006).

Venezuela's oil rents, for example, make it an outlier, especially in terms of the weight and role of the state in the economy. Venezuela still shared many HME features with other countries in the region such as low skills and large business groups, but analytically it may have more in common with other large petro-states like Indonesia and Russia in a variety of 'rentier market economy' (Karl 1997). Oil and gas rents in Ecuador and Bolivia may be pushing their political economies in a similar direction.

Beyond the petro-states, the other countries of the region often diverge on one or another dimension from the mean, but not significantly or consistently enough to conclude that they do not fit the general HME framework. Moreover, countries that diverge on one dimension are often close to the median on others. Country size, for example, affects the extent of FDI, as most FDI in the region flows to the larger countries. However, Intel and other high technology MNCs are central to development strategies in Costa Rica, and global production networks dominated by MNCs are crucial to development elsewhere in Central America and the Caribbean. Moreover, most of the large firms in the region are located in the larger countries -- three quarters of the firms with revenues over \$1 billion are from Mexico or Brazil (*América Economía*, 14 July 2006, p. 53). Yet, the largest domestic firms in smaller economies like those of Central America still adopt the structure of diversified business groups (Segovia 2005). Geography also differentiates countries of the region in term of proximity to and integration with the US economy. Mexico and other countries of Central America and the Caribbean have had stronger growth in manufacturing and FDI mostly via integration into to global production networks. However, the impact of this integration has yet to alter fundamentally the main HME features. The effect may also be transitory as outsourced manufacturing moves to Asia.

On the industrial relations dimension, collective bargaining experienced a surprising and broad based revival in Argentina in the 2000s to the point where a large majority of formal sector workers were covered (Etchemendy and Collier 2007). Argentine business groups also declined precipitously as many of the largest moved or sold out to MNCs. However, given the volatility

that has characterized the Argentine economy in recent decades, it is too soon to conclude that these dramatic swings of the past decade will end up as lasting institutional shifts.

Another change that affected most of the larger countries was a significant expansion in equity markets in the 2000s (Stallings 2006). One hypothesis would be that the countries at the vanguard of this expansion, Chile and Brazil, would be trending toward LME forms of corporate governance. Although there are some signs of more dispersed ownership and greater participation by institutional investors, both foreign and domestic, nearly all companies in both countries still have controlling blockholders, in most cases families. Overall, though these variations -- more of degree than kind -- do not yet warrant excluding countries from the HME category, they do help identify potential sources of future change and movement away from HME complementarities towards other possible types of capitalism.

Outside Latin America, the core features of HMEs also seem prominent in some middle income countries of southeast Asia and possibly Turkey, but Latin America and East Asia, especially Taiwan and Korea, differ greatly along all four dimensions. East Asia had higher educational and skill levels, as noted earlier, and lower levels of FDI and socioeconomic inequality. The two regions also differed with respect to the presence of MNCs. In 1982, foreign affiliates of US and Japanese firms controlled 19 percent of manufacturing in Latin America versus 8 percent in East Asia (Amsden 2001, 209). Diversified business groups dominate the domestic private sector in both regions, but Asian groups were more active in manufacturing and ultimately moved into higher technology sectors (Schneider 2009b). Part of the explanation lies in the lack of MNCs that in Latin America boxed domestic firms out of higher technology sectors and in relatively less volatility of the kind that led business groups in Latin America to diversify out of manufacturing and into finance, services, and agriculture. A last difference is the stronger role in East Asia of business associations and other forms of inter-firm cooperation, usually enforced or subsidized by the state. Overall, despite some inter-regional similarities, countries like Korea and Taiwan differ significantly enough to exclude them from the HME category (and hypothesize that they may approximate more CMEs) (Schneider 2008a).

One of the major analytic benefits of the comparative institutional perspective is its focus on enduring features of capitalist development. Most of the contemporary literature on the political economy of Latin America looks at various policy issues or changes in development strategy, aspects that have changed frequently and dramatically over the last century. Although these policy and strategy shifts often had profound effects on the functioning of capitalism -- from hyper to low inflation, for example -- they nonetheless divert attention from possible underlying institutional continuities, that in turn affect how economies are likely to react to different sets of policies and opportunities. The lackluster performance of most economies of Latin America in the wake of market reforms of the 1980s and 1990s confounded reformers' optimism and raised a number of big questions. Why were growth rates higher under ISI than after the market reforms of the 1990s? Why did Latin American exports in the 1990s not grow as much or as quickly as expected? And, why did market reforms do so little to generate more and better jobs?

Although beyond the scope of this essay, the comparative institutional approach offers some hypotheses on these puzzles. For instance, both business groups and MNCs struggled initially when governments rolled back ISI protections. In most countries, new MNC investment initially gravitated out of manufacturing into services and raw materials, or to countries with better skills, lower wages, and closer proximity (like Mexico). Absolute flows of FDI into Latin America reached all time highs, but much of this investment went to acquire firms (some through large privatization programs) rather than new production. Most domestic business groups were able to survive and adjust to market reforms but did so mostly by exiting uncompetitive industries and expanding into non-tradable sectors and commodity exports. Reformers hoped that trade liberalization would rapidly increase overall trade, especially through higher value added exports. However, outside the special case of post-Nafta Mexico, the proportion of higher technology exports did not expand in the 1990s (Baumann 2002, 59). A possible explanation lies in a convergence of disincentives. MNCs often kept the higher technology parts of their commodity chains in developed countries or East Asia and had few incentives to move them to the low-skill (and often high-wage due to currency over valuations) economies in Latin America. Domestic



business groups lacked core competencies based on proprietary technologies and hence had few incentives to bet heavily on specializing in particular sectors for export, except for natural resources and commodities.

In the wake of the commodity boom of the 2000s and the resumption of moderate growth in the region, the debate faded over what went wrong with the market reforms of the 1990s. Most aspects of the new commodity-led development played to the relative strengths of HMEs. MNCs and business groups were well positioned to expand commodity production. Many of the largest business groups such as Votorantim (aluminum and pulp and paper) in Brazil, Grupo México (mining), and Luksic (mining) in Chile were concentrated in commodities prior to 2000, and some business groups, especially in Brazil and Mexico, leveraged commodity rents into aggressive expansion abroad. Hierarchical labor relations were not an obstacle to expansion; commodity production relies on fairly standard technologies and bonanza prices reduced pressures to improve efficiency, so managers and workers had few incentives to seek more institutionalized forms of coordination. As the commodity boom progressed, skill shortages did emerge in some sectors, but for the most part commodity production is very capital intensive and overall requires few workers, skilled or unskilled. In Chile, for example, the copper sector accounted for some 15 percent of GDP but employed less than two percent of the labor force. At the same time the commodity boom reduced pressures, as growth rates stabilized and currencies appreciated, to find higher skill niches in the global economy that could generate more and better employment. In sum, commodity led growth seems compatible with, and likely to reinforce, most features of HMEs.

Finally, on a more theoretical level, a focus on hierarchy facilitates the incorporation of factors like the state and MNCs that have been so prevalent in most late developers yet so absent in most analyses of varieties of capitalism (see Hancké, Rhodes, et al. 2007). While a firm's eye view has some advantages over earlier statist perspectives, the state is rarely out of sight in Latin America. In addition, elements of hierarchy in several spheres of the economy, especially labor markets, are directly or indirectly reinforced by states. In terms of international influences, when

scholars invoke globalization, they often have in mind integrated markets for goods, services, and especially finance, or the geographical contraction resulting from the spread of new information and communication technologies. These factors have had profound effects on developing economies, but for most people, especially workers, the palpable face of globalization is the MNCs that organize, hierarchically, so much of employment, investment, and technology transfer. One of the neglected ironies of liberalization in the 1990s is that market oriented reforms in trade, privatization, and deregulation often resulted, in the end, in more hierarchy than market.

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**Figure 1: Core HME  
Complementarities in  
Latin American**

