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The Role of Transnational Corporations in Peru

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The Faculty of Economics and Social Sciences at the University of Fribourg neither approves nor disapproves the opinions expressed in a doctoral dissertation. They are to be considered those of the author (decision of the Faculty council of January 23rd, 1990).

To Andrée and Raymond, my parents

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Preface

This work examines an intricate case of today's international economy. Based all at once on an abstract construction and on applied analysis, the study timely researches on current economic and political mechanisms in a sound and pertinent way.

A major asset lies in the double perspective of this research, which draws from a background in human geography as well as in political economy. Both fields favour an interdisciplinary approach, which rigorously combines space and productive labour. Besides, political science and sociology are engaged in an effort to gauge economic power and the state's external relationships.

A second emphasis is placed upon the economic change linked with globalisation, and focuses on present-day mechanisms of transnational corporations, beyond the more straightforward operations of foreign companies in times past. The research is partly inspired by the topics set forth for about two decades by John Dunning, and leans further on the recent work of Teivo Teivainen.

Concern for the development of poorer countries is felt throughout the book, and is, indeed, essential for the Latin American continent, particularly Peru. The country has suffered frequent crises and political upheavals, especially over the past fifty years. More than its neighbours, its economy has experienced contrasted, even extreme conditions, with momentous changes in its international capital flows. Attempts at efficient political governance have been numerous, but, according to Durand, the hoped-for results have rarely been achieved, due to unstable relations between private elites and governments.

This dissertation is rich in many ways. For example, to uphold its developments, original graphic constructions are resorted to. First rigorously establishing the foundation of reasoning, their transformations are brought in the conclusion as a basis for the final synthesis. As for the spatial aspect, it gives a major part to the relations between economic, political and social spheres, as well as to international institutions, in principle

endowed with constraint, yet in reality often devoid of influence on the transnational stage. Moreover, the idea of deterritorialised situations does not appear to be extravagant.

In sum, this work is welcome as it responds to the needs of a new transnational spatial economy. It deserves the attention of a large audience.

Marly, January 31st, 2005

Gaston Gaudard
Professor of International Economics

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Abbreviations

ADEX	*Asociación de Exportadores*
AFP	*Administradora de fondos de pensiones*
APEMIPE	*Asociación de Pequeños y Medianos Industriales del Perú*
APRA	*Alianza Popular Revolucionara Americana*
BA	Business Association
BCRP	*Banco Central de Reserva del Perú*
BG	Business Group
BIT	Bilateral Investment Treaty
BSCH	*Banco Santander Central Hispano*
CADE	*Conferencia Anual de Ejecutivos*
CCU	*Compañia Cervecerías Unidas*
CEA	*Consejo de Empresarios Andinos*
CEAL	*Consejo Empresarial de América Latina*
CEPRI	*Comité Especial de Privatización*
CNC	*Compañia Nacional de Cervezas*
COMEXPERU	*Sociedad de Comercio Exterior del Perú*
CONAMYPE	*Confederación Nacional de la Micro y Pequeña Empresa*
CONASEV	*Comisión Nacional Supervisora de Empresas y Valores*
CONFIEP	*Confederación de Instituciones Empresariales Privadas*
COPRI	Comisión de Promoción para la Inversión Privada
CPC	Cerro de Pasco Corporation
ECLA(C)	United Nations Economic Commission for Latin America (and the Caribbean)
EFTA	European Free Trade Agreement
EPF	*Empresa Petrolera Fiscal*
EU	European Union
F&A	Fusions and Acquisitions
FDI	Foreign Direct Investment
FITEL	*Fondo de Inversión en Telecommunicaciones*
FPI	Foreign Portfolio Investment
FREDEMO	*Frente Democrático*
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
IDB	Inter-American Development Bank

ILO	International Labour Organisation
IMF	International Monetary Fund
INDECOPI	*Instituto Nacional de Defensa de la Competencia y de Protección de la Propiedad Intelectual*
IPAE	*Instituto Peruano de Administración de Empresas*
IPC	International Petroleum Company
ISI	Import-substituting Industrialisation
ITU	International Telecommunication Union
M&A	Mergers and Acquisitions
MEF	Ministry of Economy and Finance
MRTA	*Movimiento Revolucionario Tupac Amaru*
NAFTA	North American Free Trade Agreement
NGO	Non-governmental Organisation
OECD	Organisation for Economic Co-operation and Development
OSIPTEL	*Organismo Supervisor de Inversión Privada en Telecommunicaciones*
R&D	Research and Development
RCP	*Red Científica Peruana*
REG	Regional Economic Group
SIN	*Servicio de Inteligencia Nacional*
SNA	*Sociedad Nacional Agraria*
SNE	*Sociedad Nacional de Exportadores*
SNI	*Sociedad Nacional de Industrias*
SNMPE	*Sociedad Nacional de Minería, Petróleo y Energía*
SOE	State-owned Enterprise
SPCC	Southern Peru Copper Corporation
SUNAT	*Superintendencia Nacional de Administración Tributaria*
TdP	*Telefónica del Perú*
TNC	Transnational Corporation
UCPBJ	*Unión Cervecerías Peruanas Backus y Johnston*
UFC	United Fruit Company
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre of Transnational Corporations
WEF	World Economic Forum
WIR	World Investment Report
WTO	World Trade Organisation

Introduction

"Because the political sphere has lost vis-à-vis its internal other, the internal economy, and the internal economy is increasingly connected to the global economy, the sovereignty claims may become increasingly illusory."

Teivo Teivainen, Enter Economism, Exit Politics, 2002

The juxtaposition of territories separated by boundaries represents the established world-order, that is, political spaces in which a single authority is the holder of coercive power. In modern times referred to as nation-states, these realms and their political limits have, more or less straightforwardly, shaped and nurtured societies as well as economies based on national identities. But the political logic, alongside with its corresponding spatial construction, turns out to offer only a partial appraisal of the functioning of these very nations, on the one hand, and of our world-system on the other.

Recent and current transnationalisation processes have exposed the deficiencies of the traditional territorialist mapping of our world, and suggest that other forms of social spaces exist. The ones primarily addressed are economic spaces, frequently qualified as simultaneously "non-territorial" and "non-political". In this context, transnational corporations as principal agents of such spaces are perceived as weavers of world-wide economic networks, which are disconnected from political geography.

Due, notably, to a political component, transnational economic activity should not be merely considered non-territorial. While representing an organisational space of their own, transnational corporations remain, to various degrees, anchored in national realities and working with the latter's characteristics and peculiarities. Precisely, they establish themselves in particular political and economic settings which may vary substantially.

Thus while economic activity is increasingly overflowing the national rationale, the actuality of nation-states remains intact, if considered under a different point of view which integrates the concept of political and economic spheres. This distinction, as such, does not represent an innovation. However, it is the blending and the interaction of both spheres that prove to be essential: It is a major endeavour of this study. Articulated by a model of economic power, it can be stated that both spheres interact on common playgrounds within, between as well as beyond national spaces.

Based on the hypothesis that the national and the transnational intertwine and that both are political as well as economic, the present research engages hence in a double aim, which is the study of political and economic spheres as well as of national and transnational spaces. This examination is conducted in Latin America's particular context, and is then applied to a single national space, Peru. The choice to analyse the evolution of the economic and the political through the relations of business and the state, the main agents wielding economic power, sets the stage for the introduction of a third component: The transnational corporation.

This triangulation of economic power finds its originality in the combination of both frameworks. Put together, these bring about an understanding of processes and relations that go beyond common monochrome pictures, such as the ones simply opposing transnational corporations and governments for example, or exclusively focusing on domestic and foreign business. This investigation sheds new light on the role domestic and transnational economic actors may play, and the issues related to their trilateral interactions within a national space. Furthermore, it aims at positioning the latter in the wider system of world economic and political relations.

The research is divided into two parts, followed by a concluding chapter:

- In Part I, Chapter One aims at defining a model of economic power and its principal agents. Chapter Two focuses on business and state interactions, specifically depicting their dynamic relations in Latin America. A special element of business is the principal object of Chapter Three, which contemplates the features of transnational economic activity, as well as its connection to national spaces, mainly in the developing world and more explicitly, in Latin America.
- Part II is dedicated to Peru and its three main carriers of economic power, the Peruvian State, domestic business and transnational corporations. In Chapter Four, the characteristics of the state in a changing economic context is analysed. Chapter Five deals with the Peruvian business community and its relation to political power. The position of foreign companies, or transnational corporations, is examined in Peru's national space by confronting them to the two local agents of economic power, in Chapter Six.
- Chapter Seven means to bring the major results of the present research to the fore and to put together some conclusive considerations in this regard.

PART I: Theoretical aspects of business and state relations

CHAPTER ONE: Economic power in developing countries

In addition to initial geographic and cultural diversities, world regions, and within these, countries, evolve differently. The result reveals striking discrepancies, particularly when so-called developed countries and developing ones are compared. A multiplicity of factors may be raised to give some sort of explanation, punctual or structural, why a particular country is doing better than another. The point of departure chosen here is the interaction of the political and economic environments, doubled by an analysis of the influence of international dynamics.

1.1 A model of economic power

Sovereignty over a national society is commonly attributed to the state. At the same time, it is agreed that a multiplicity of other forces contribute in the shaping of a country, from within or from the "outside". The introduction of a model of economic power suggests, more concretely, that in addition to the traditional state, three agents need to be considered when analysing the determinants of a country's economic and political course. More than a mere participation, their importance gives them a segment of control over national decision-making.

1.1.1 The concept of economic power

Over the past centuries the concept of power has been much debated in various disciplines. In social sciences, philosophers, historians, political scientists and sociologists have been confronted with this fundamental trait of social interaction, which represents a core issue in these various fields. Surprisingly enough, a vast majority of economists have been reluctant to include this concept in their research, reducing it today to a marginal field in economics.

Power generally implies the capacity of social agents to affect one another. In this sense, power is not specific to an individual or a group, but reflects a type of relationship between two or several agents in a given social context. This relationship is asymmetric, or

in other words, characterised by inequality, and suggests the domination of one or several agents over the other (Schutz, 1999, 245).

For Marx, power marked, in England and the Western Europe of the second half of the 19th century, the relationship between social agents in industrial society. It was considered the main feature of interactions which, according to the economist and revolutionary, was fundamentally of an economic kind: Between workers, possessing only their personal work force, and the capitalist bourgeoisie, able to create surplus. In short, society was led by a ruling class wielding the economic means to dominate the wider share of the population lacking property. It can be argued that for Marx, power was based on an economic[1] relation, because it was nurtured by an economic action: The accumulation of capital, which paved the way for a new order called capitalism (Marx, 1867).

Marx's theories have had deep and long-lasting effects and, in the wake of historical materialism, many leftist economists have analysed market systems attributing them "capitalistic" flaws, and accepting the idea of a power struggle based on appropriation. In this context, the distinction between an economic and a political sort of power has been widely considered an artifice, since this political power was in the hands of the same surplus-appropriating class. Indeed, according to this view, such political power is exercised directly or indirectly by those who own the means of production. In this train of thought, the "rigid and conceptual" separation of the *economic* and the *political* is considered to be a "discovery" made by classical economists who "began emptying capitalism of its social and political content" (Meiksins Wood, 1995, 19).

Weber, in contradiction to Marx's way of thinking, founded his political sociology on a difference in essence between economics and politics. While an economic activity reflects one's capacity to satisfy utility needs, it is the political activity which is characterised by force and domination. This conceptual distinction, however, is meant to help analyse the tangle of economic and political actions, as both cannot, concretely, be separated. Economic action may undeniably include force and therefore a political dimension, while every political action, namely the domination of one person or several people over others, requires an economic action, as it involves the possession or the disposition of the necessary means to satisfy needs. There is, according to Weber, the "economics of politics", and "the politics of economics" (Weber, 1922; Aron, 1992).

[1] The *economic* implies a political face here, and needs hence to be understood as a broad complex including political and social aspects, and is therefore not the *economic* understood by classical economics, where the term generally stands in opposition to those very aspects.

The glance at these two distinct approaches is not meant to bring out the many aspects of this rich and subtle debate theorised by many, such as the two thinkers mentioned above, a task for which the author would not have the necessary background. Rather, this somewhat schematised dualism is meant to show the basic methodological issues linked to the concept of power, as well as its importance in the discussion on the tangle between the *political* and the *economic*. Two comments may be formulated in this respect. First, the nowadays readily accepted separation - in theory, in empirical research as well as in common use - between politics and economics is not a "natural" one, and remains a relevant theoretical and practical debate. Second, the concept of power, or domination of people over other people, is a central feature of this debate, since it is on the grounds of its presence or absence that politics and economics can be defined in both approaches mentioned above. Ultimately, the discussion leads to the question whether power fundamentally *is*, can be part of or is totally absent from the *economic*.

To sum it up, for economists with Marxist views, power is based on class domination. Talking about *economic* power might therefore be seen as a redundancy, or rather, as a shift away from the fundamental meaning of power. Politics is only an adjunct, or a deviated form of power, the state only a mediation of, or a complement to the power of the ruling class. In this sense, it has been argued that capitalism evolved from the demands of the bourgeois classes upon the state to protect their enterprises and precarious social status. In a way, governments became the handmaiden of capitalism, giving a legislative frame to its evolution (Polanyi, 1957).

On the contrary, in mainstream economics, power is usually understood as exclusively political, associated with the state, a concept based, one could suggest, on a Weberian-type of understanding of power and domination. In this perspective however, economics is widely detached from the concept of power, the latter being left aside and considered a subject of study in the field of political science or sociology only. Economic relations are basically run by the rational invisible hand, in an economic system from which the concept of power is mostly absent or perceived as an anomaly.

Figure 1 is an attempt to schematise the fundamental difference between the two scopes. It represents the two extremes of a continuum, where the political and the economic are, at the one end, an indivisible entity of relations based on power, or, at the other, two distinct types of relations – one based on the concept of power and the other not.

Figure 1: Power in economics and politics[2]

Economic power finds its justification somewhere on the continuum, which has been ventured by advocates from both ends: Coming from the left, some economists may admit that it is necessary to differentiate two types of power: "the two moments of capitalist exploitation – appropriation and coercion – are allocated separately to a private appropriating class and a specialised public coercive institution" (Meiksins Wood, 1995, 30). Coming from a neoclassical background, some will agree that "certain circumstances may give a firm power over its customers or suppliers" (Schutz, 1999, 245), admitting that a sort of market power exists.

Based on these arguments from two radically different perspectives, one parallel can be drawn: Both imply the existence of some sort of economic power which is distinct from political power. This leads to a middle way on our continuum, where both the political and the economic spheres "overlap" in terms of power: Both hold power, although it is of different kinds.

In order to move on from the basic concept of power and dominance to a political reality, Weber suggests that the idea of the *political group* needs to be introduced. The political group implies continuity, territory and the menace of the application of physical force in order to impose the respect of orders or rules. Out of all the political groups, it is the state which has the monopoly of physical constraint (Aron, 1992, 553). Accordingly, power appears then to be the tangible proof of political practices by the state institution, which is recognised through its legitimacy to use force on a given territory over a given

population since the Treaty of Westphalia in 1648. Hence it can be argued that historically and traditionally, there has been – in Western societies - a widely accepted "pure" definition of political power, which broadly reflects the global political understanding of our fragmented world: A great amount of small pieces of juxtaposed territories, one sharply demarcated from the other, or a group of scattered islands of functional political spaces.

Economic power, on the contrary, remains a much more diffuse concept, since somewhat "footloose" of widely accepted definitions. It is, however, loaded with economic as well as political connotations. Generally, it is agreed that it is involved in society's economic structures, namely in the process of property appropriation and accumulation of capital, which leads to a pattern of economic concentration. In a specific market, this concentration is based on the quest of economic agents to generate profits and, as a corollary, gain control over the market. Ultimately, this process of concentration can lead on to an oligopolistic situation or even to a monopoly or a monopsony - a final stage comparable in some ways to the political monopoly. The predominant situation on a market – which could be called market power – is, in our opinion, the fundamental premise, or in other words, the objective component of economic power. Economic power, however, reflects the transformation of the acquired market power into a tool to be used in different spheres of society, and notably the political sphere. It is hence mainly in its application and effects that the perspectives on its content differ. We consider economic power to be the expression of market power in society.

1.1.2 Agents of economic power in the national economy

In market system societies, economic power is most present in public and private institutions, namely in governments and firms or corporations (Schutz, 1999, 245) In order to explicit this, a first *model of economic power*, where economic, or market space and political space coincide, can be drawn (figure 2). In consideration to (recent) economic history, the argument for the congruence of both spaces is not farfetched. Roughly up to the middle of the 20th century, this model was generally valid in most Western market-oriented countries, and has been, up to the present day, a pattern still found in a few developing countries.

[2] Figure elaborated by the author.

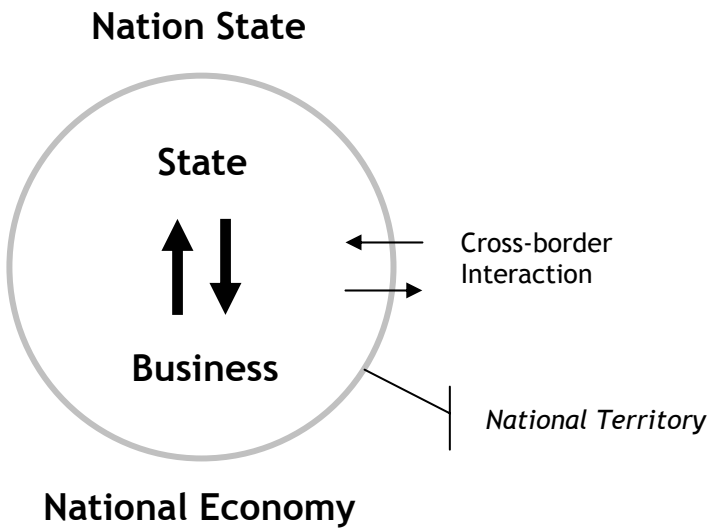

Figure 2: The model of economic power in autarky[3]

This model of economic power in autarky considers the political and the economic space to be two major components of the national space and that it implies, more concretely, a dialectic between two national, or domestic, agents – the state, as the leading public institution, and the business community, mainly represented by private firms and corporations.

The legal holder of political power has always played an important role in the economic sphere, and it is not a coincidence if both the political and economic spaces have had the tendency to correspond. Indeed, the state has actively shaped economic activity by giving it a frame and by regulating it within its political realm. It is the guarantor for the ultimate choice, the implementation and the functioning of a particular economic system. But the state represents, on the domestic territory, an active economic agent as well, producing goods and offering services through its public firms and corporations. In this sense, the state can fulfil both roles of *regulator* and *entrepreneur*. Unlike its private counterparts, the state is never entirely dependent on the profits generated through its economic activities, but can create capital thanks to its funding mechanisms – like the collection of taxes - based on its force and legitimacy.

The private initiative, on the other hand, is supposed to work within the limits given by legislation and standards set by the state in the economic space. If the principle of

[3] Figure elaborated by the author.

competition is applied, the different sectors and, accordingly, the different markets of the national economy, are the radius of action of national economic agents and the stage for competitive practices between private agents as well as, possibly, public firms. For private agents, interaction with the public sphere is not restricted to the national economic sphere, however. On private business initiatives, interests of the private sector can be represented in the political sphere through specific parties, lobbies or business groups and business leaders may even take office in key positions of the government. Dependent upon the state's – or more directly, the government's – decisional powers over the economic sphere, private business seeks to defend its interests and, if possible, participate in the decision-making of economic policies. In many cases, the government will be careful to include key business actors in this task. Economic agents in strategic sectors with great producing or capital capacity, have a major bargaining power towards the state. In some circumstances, in the presence of a few important firms or corporations, it can lead to a dependence of the government upon such economic agents.

If this brief portrait reminds us of the fundamental dialectic between the public and the private sphere, it is also meant to underline the tangle between political power and economic power, two concepts clearly intertwined when analysing the national sphere. We believe that this dialectic is the base of all currents of economic thought, which explicitly or implicitly, have had to face up to questions related to power. Again, a glance at opposed economic approaches is insightful in this respect.

To make it simple, for classical economists, a threat to rational economic relations is the excessive use of political power in the economic sphere by the traditional holder, the state. Its participation as an economic agent in economic sectors and markets is not welcome, since it is not "purely economic" and rational. Further, if other economic agents do wield some sort of power, it is only because they entered the political sphere, and the reason for this is extra-economic. On the contrary, for "leftist", as well as for Keynesian economists, the state has proved, in the end, to be the best - or only - option to keep excessive economic power in check and to correct the faulting economic mechanism and the concentration of wealth in a few private economic agents. In this context, participation and heavy intervention of the public agent in the economic sphere is requested.

1.1.3 National and extra-national spaces

In accordance with our model presented in figure 2, economics in general and political economy in particular have been confronted with this fundamental public–private debate within a given frame, the *national economy*, which has been the main "stage" of research in the discipline of economics for a long time and which is still important today.

It is true that for centuries, international economics have been a topic of research. However, the mercantilists' zero-sum game, and later, Adam Smith's and David Ricardo's absolute and comparative advantages had the national entity in the centre of their concerns, restricting the discipline to mere trade relations between countries or territories. Hence, for a very long time, international economics has kept the pattern of scattered national spaces mentioned earlier, focusing on the "economic bridges" between them. In international economic relations as well, the world order of juxtaposed national spaces has traditionally been the theoretical framework of research. With the idea to compare different states according to their economic attributes and measure economic influences between countries[4], this field of research has been complementary and closely related to comparative politics, accepting the various national spaces with their respective public/private ratios as conceptual base for research.

Today still, the "national unit" remains the main tool in international economics, and this for good reasons: The state as a political and economic entity stays the predominant organisational model world-wide. However, the changing patterns of economic interaction, mainly over the last fifty years, as well as a growing interest of scholars to understand new dynamics have required the inclusion of more differentiated tools in economic research, in addition to the usual cross-border approach between national spaces. In regional economics, the concept of the region as an organisational and economic space was already tackled in the fifties by François Perroux (1950), giving the word a sense going beyond a basic geographical content. Similarly, in international economics, regions have been increasingly considered potential economic entities: What used to be a geographical

[4] In this context, it is worth mentioning that the concept of economic power has been widely accepted in international relations, as a sort of outward power, usually seen as a complement to sheer political power: Specifically perceived as a trait of countries, it has been considered a tool of governments as it would sometimes actively serve their purpose. This sort of economic power has often been coupled with economic dependency, another "nationalised" concept fitted for use in an international context. A striking example would be the accession of former colonies to political sovereignty. Virtually no one would, in this case, equal *political independence* to *economic independence*.

region, a continent, a sub-continent, or a group of individual states could be seen as an organisational entity at an *extra-national*[5] level.

Clearly, new organisational spaces, within and beyond national boundaries, have appeared in economics, and not as chimeras of bored scientists but in concordance with the reality of actual dynamics. One of the most insightful examples in this context is certainly the economic cooperation of a group of European countries triggered by the need for reconstruction after the Second World War. Many decades down the road, this economic – and in the meantime, political – entity, as a precursor[6], has been joined by other regions across the globe which are trying to translate de facto economic relations into international agreements to regulate existing integration and encourage the trend.

In addition to this making of economic world-regions, another trend needs to be addressed, namely the appearance of inclusive international world institutions, such as the United Nations, the Bretton Woods institutions or the GATT, the precursor of the actual WTO. Both phenomena, the world regional one as well as the world-wide one, have had arduous developments and need to evolve further to become fully functional organisational and institutional spaces. Still, they exist, and they have greatly participated in and contributed to the change of international economic relations in theory and reality (Gaudard, 2000).

Even though the processes and scopes of these two mechanisms remain quite different, the difficulties they have to evolve are similar. Indeed, they are linked by the trouble they have to transcend national organisational spaces. These spaces are widely dependent upon the authorities issued from national spaces. Their existence and evolution, as seen in the making of the WTO, relies on intensive negotiations between individual, or groups of states (Bhagwati & Hirsch, 1998). Talking about the United Nations, Rubens Ricupero, Secretary-General of the United Nations Conference on Trade and Development (UNCTAD), argued that the existence of international organisations is based on the will of states, and they

[5] The term *extra-national* has been preferred to *international*, *multinational* or *supranational* due to the multiplicity of their meanings in use. Furthermore, the term "extra" emphasises the non-national component.

[6] In spite of being the first of its kind, the evolution of the European Community towards the current European Union (EU) can hardly be considered an example for the regional integration attempts on other continents. Indeed, its political aspect involving a supranational instance is exceptional. Rather, the European Free Trade Agreement (EFTA) could have been a model, considering the prevalence of free-trade agreements in the world.

therefore reflect their weaknesses[7] - their main failings being their lack of influence on the governments of strong states, upon which they remain dependent. In other words, it can be argued that world institutions are shaped by strong states and are strong towards weak states mainly.

But this sort of extra-national spaces, ruled by "quasi-public" institutions is not the only one that has emerged during the second half of the 20th century. Another type of spaces, principally of private nature, has surfaced since the sixties essentially, partly coupled with the first sort. Commonly known as multinational companies, but also transnational corporations (TNCs), and more and more as global companies or business networks[8], such businesses can be quite diverse in nature and functioning. Yet they all have one main characteristic in common: Their economic presence – in terms of production and sales - in various countries. Through direct investments mainly, but through financial flows as well, these private businesses integrate and participate in different national spaces all at once. Every TNC – or network – creates its own economic space (Gaudard, 1999, 47), according to its own strategies and needs, as well as to the opportunities and constraints of national spaces. This second sort of extra-national spaces is quite different from the former which, roughly speaking, is indeed derived from national spaces, thus tending to be more static and heavily marked by political considerations. The limits or borders of such spaces of TNCs can greatly vary, and may be subject to quick changes, since they are mainly maintained by economic flows of goods or capital.

In sum, new institutionalised extra-national spaces exist and have strongly developed, mainly over the past decades. In an economic perspective, two main groups can be distinguished: On the one hand, the world and regional economic agreements form institutional spaces based on the effort and actions of states and their governments, on the other, international strategies of private businesses compose the multiplicity of interconnected corporate economic spaces.

These agents participate in national spaces depending on the composition of their own space. Looking at it the other way around, the traditional national agents mentioned earlier are not the only ones in charge of a national space; in fact, these new organisational spaces with new agents overlap and interfere with the national space. From

[7] Rubens Ricupero in "droit de cité", political talk-show on Swiss Television TSR 1, February 23rd, 2003.

this perspective, when analysing the political and economic environment of a country, one would need to consider at least four main agents: Two national, and two extra-national ones.

1.1.4 The model of economic power in an open economy

Based on our earlier consideration on the keepers of economic power in the autarkic model, a new model, including these two additional extra-national agents, can be drawn. Accordingly, figure 3 suggests a more complex distribution of economic power in a world not only composed of a juxtaposition of individual states with limited horizontal interaction, but also of overlapping extra-national ones.

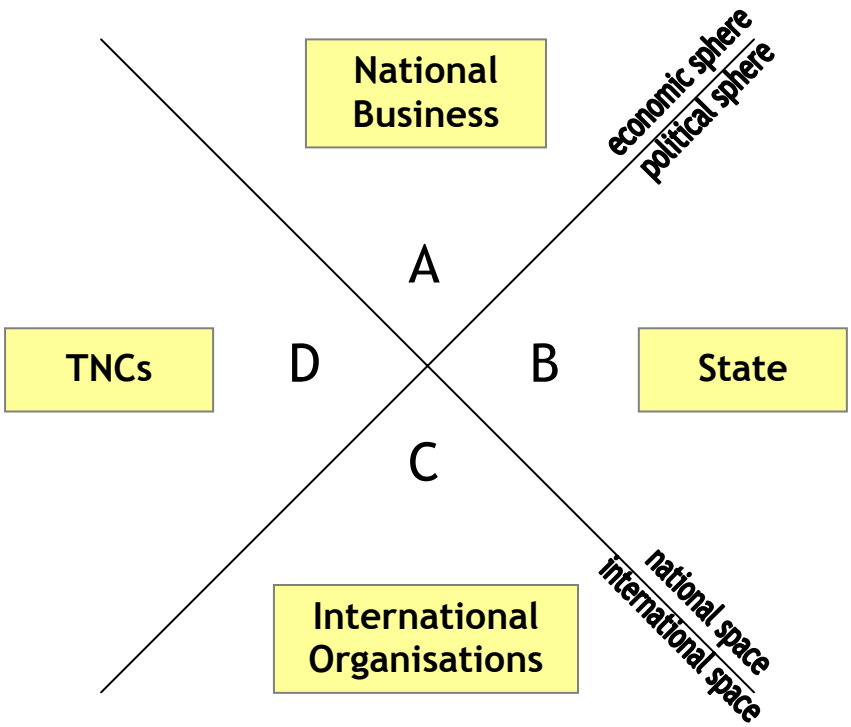

Figure 3: The model of economic power of an open economy[9]

[8] Due to the multiplicity of the definitions and the heterogeneity of the phenomenon, a single term, *transnational corporation*, will be used, except in Chapter Three, were particular distinctions will be dealt with.
[9] Figure elaborated by the author.

The *model of economic power in an open world* implies, in continuity with the previous model, an economic as well as a political sphere, but introduces the opposition between the national and the extra-national, or international[10], space. Consequently, the model combines four quadrants: **national-economic (A)**, **national-political (B)**, **international-political (C)** and **international-economic (D)**[11]. To each quadrant corresponds an agent of economic power. In the national sphere we find, again, the national business community and the state. The two additional agents considered are the above-mentioned transnational corporations on the one hand, and international organisations – world-wide ones such as the the WTO, IMF or the Worldbank, and regional ones such as the EU, OECD or NAFTA - on the other.

When connecting the various agents as presented in figure 3, the model of economic power in an open economy suggests a diamond-shaped system of relations. While in our autarkic model the relation between two agents remained one-dimensional, the international model displays six distinct axes of interaction likely to affect a particular country (figure 4).

It is worth mentioning that out of these six axes, only one relation is purely national (**relation 1**) and one purely extra-national (**relation 3**). The four remaining **relations 2**, **4**, **5** and **6** represent interactions that imply national and international agents, hence including two different sorts of space, national and extra-national. Expressed in political and economic spheres, only one relation is truly economic (**relation 4**) and one apparently only political (**relation 2**). Again, the other four connections suggest relations which combine spheres.

Beyond the **relation 1** between the two national agents considered earlier, relations 2 through 6 need to be examined and illustrated in order to understand their scopes as well as their effects on an open economy.

[10] For convenience, *international* is used in the model.
[11] A similar grid, however in a different context, can be found in Charles P. Kindleberger, *Power and Money, The Economics of International Politics and the Politics of International Economics*. Basic Books, Inc. New York, 1970.

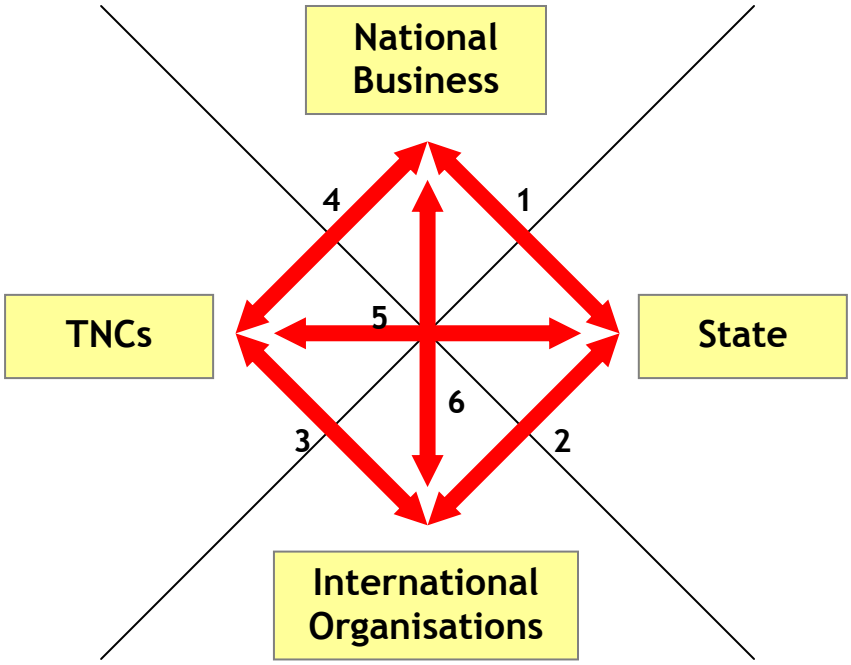

Figure 4: Relations in the model of economic power of an open economy[12]

In our model, **relation 2** implies the participation of countries in international regional and world-wide agreements. Regional integration, such as free trade associations, or the participation in world organisations, come along with a set of rights and obligations. As a member of the WTO for example, a country enjoys freer trade with other members but has to fulfil specific requirements in the implementation of economic policy since it accepted the rules by joining the institution. In this context, another, maybe even more constraining relation for emerging developing countries is the one with the IMF and the regional development banks. The necessity for financial support represents a huge pressure on states and governments, which have to comply with international institutions' directives to become borrowers. In some circumstances governments may use this dependency to justify the implementation of severe adjustment measures and present these organisations as responsible for the country's economic hardship to hostile public opinions.

Relation 3 is truly extra-national, since it involves TNCs and international organisations. One interesting aspect of this relation is certainly the attempt by the OECD and the UNCTAD to monitor and regulate the evolution of TNCs and foreign direct investment (FDI)

in general (see OECD, 1994) and in developing countries in particular (see UNCTAD, 1999). These institutions have tried to elaborate codes of conduct for TNCs where their responsibilities are defined. The scope of such attempts has been very limited however. Looking at it from the other end of the relationship, it can be argued that TNCs have evolved partly with the expansion of the GATT and its consolidation in 1994 with the founding of the WTO. Thanks to the economic directives of the institution, such as liberalisation and national treatment for example, the integration in new markets has been simplified. Barriers to the implantation of subsidiaries disappear, rules are "FDI-friendly" and familiar to Western investors and, most importantly perhaps, have a global scope. In this context, the WTO has been regarded by some as an instrument of big transnational corporations. In 1999, the WTO conference in Seattle had to be aborted due to demonstrations based on anti-globalisation considerations[13]. From then on, other conferences with global scopes, such as G8 meetings and WEFs, have had to be held under high security measures.

Relation 4 involves principally two private actors, a national business agent and a TNC. It roughly suggests the entrance of the latter in a specific market through the acquisition of a domestic firm or an alliance with it. Often times under the pressure of international competition and rapidly changing economic policies in emerging countries, national companies need to adapt, modernise and re-capitalise. In this context, mergers and joint ventures might save them from bankruptcy. For TNCs, such alliances represent a swift entry in a specific economic space, since they participate in an already functioning economic unit, are able to secure shares of a specific market immediately and take advantage of the know-how and knowledge of local conditions. This relation represents an important component of what is commonly called globalisation: The process of *strategic* alliances is one of the major mechanisms contributing to the appearance of complex webs, or networks, linking companies beyond national spaces. These alliances can, of course, take place in one national space, when two national companies merge, or may include two TNCs, as often occurs nowadays in developed countries. However, the national - international scenario seems to be the most relevant one when considering emerging and developing countries in the world system of economic power, as FDI trends and capital flows tend to underline.

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[12] Figure elaborated by the author.

[13] The anti-globalisation movement, which is mostly present in developed countries, is reflecting two main fears. On the one hand, the alienation of developing countries stripped of any economic defences against the Western capitalist invasion, on the other, the threat of cheap competition in industrialised countries, due to massive incoming flows of goods and labour from emerging economies.

Relation 5, which involves the international-economic and the national-political agents, is another important component of economic change which has been extensively discussed, since it concerns the question "how to reconcile the international preoccupations of transnationals with the national responsibilities of governments" (Panić, 1998, 259). This relationship is quite special, since involving different spheres as well as different spaces. Much like in relation 1, the economic – political debate is central. Should the state, beyond regulation, participate in national economic activity or should private businesses be the main agents of economic activity and holders of economic power? The present relation is, however, more complex due to the foreign component, which adds another dimension to the discussion. Indeed, sometimes the national - international argument prevails over the public - private one: In such case, the problem is not whether the economic agent is public or private, but whether the economic power remains national or not. Concretely speaking, the relationship between TNCs and the state has two levels. The state, as *regulator*, can facilitate or, on the contrary, undermine the entry of FDI, making it almost impossible for foreign economic agents to set up in its national space. As an *entrepreneur*, or economic agent, the state can sell its companies, which leads to privatisation, or with the help of its political power it can, on the contrary, nationalise foreign private companies to run them itself or "hand them over" to national private companies. We believe this relationship, similar to relation four, is fundamental when trying to understand the mechanism of globalisation, and it is a major aspect of the present work.

Our last relationship, **relation 6**, does not seem to be quite as relevant. It could be argued that national businesses are mainly concerned with the specific national space they are active in, and that they are affected rather indirectly by international organisations, principally through the implementation of their directives by the state. Some international organisations may get in touch directly with national business, mainly through funding of programmes to fortify certain sectors of a national economy in order to make it more efficient, productive and competitive. Clearly, a modernised business community acquainted with the Western-style corporate organisation has a better chance to perform well in a changing economic environment. Some international institutions might further support the consolidation of business associations, financing their expenses for conferences or research. Hence, even if this relation does not seem to have the same scope as the other ones, it should not be neglected.

This international-national model, which schematises the six relations between the four main holders of economic power, is an entry gate to understanding tendencies in terms of

economic power in a specific country in an inter-connected world. We believe that by integrating the national and international spaces, a country's both internal and external evolutions can be brought to the fore.

1.2 The model of economic power and developing countries

While the relations between the different agents could be analysed in any type of countries, the main aim of the model presented above is, in this research, to use it in the context of developing countries.

1.2.1 The dynamics of the model in developing countries

If the model of economic power with its four quadrants, the political and economic spheres and the national and international, or extra-national, spaces, is regarded as an integrated system of relations, there seems to be a general dynamic in terms of economic power that can be drawn. In this respect, two major tendencies seem to unfold.

Teivo Teivainen, a specialist of transnational studies, argues that while the boundary between the national economic and the extra-national economic space appears to diminish in importance, the economic sphere conquers space previously occupied by the political: "Because the domestic political sphere has lost space vis-à-vis its internal other, the internal economy, and the internal economy increasingly connected to the global economy, the sovereignty claims are valid in a relatively small sphere. [...] the norms of the economic sphere expand to the political sphere" (Teivainen, 2002, 181). In other terms, the process of receding political borders between states, representing less and less definite limits in economic terms, is linked to an increased spatial entanglement of powers, suggesting multiple modes of governance (De Montbrial, 2000, 20) of traditional national and extra-national spaces.

This multiplicity of spaces is connected to a sort of global society, whose scope is more extra-national than national, and more economic than political. Indeed, "while for many practical purposes the world is still organised in terms of discrete national economies, the transnational capitalist class increasingly conceptualises its interests in terms of markets, which may or may not coincide with a specific nation-state, and the global market, which

clearly does not" (Sklair, 2000). In this context, there is an "increasing acceptance of the norms produced by the transnational diffusers of liberal orthodoxy", which have contributed to the erasure of boundaries and, at the same time, to the increasing importance of *economism* over politics (Teivainen, 2002, 181). Robert Boyer expresses a similar idea when stating that Keynesian economics at the scale of the nation has been replaced by a new international orthodoxy aiming at monetary stability and international competition (Boyer, 1996).

These general tendencies in terms of spaces and spheres are particularly compelling in the context of emerging and some developing countries[14], in which the general pattern of the ideas mentioned seem, to a certain extend, to apply. However, the economically peripheral situation of such countries comes along with major economical, political and social specificities which need to be considered. In this context, the present model, with its four components, seems to be particularly appropriate when considering the national and global economic development of such countries.

For many non-Western states, there is no doubt that the eighties, and even more so the nineties, represented deep changes, not least economic ones. Most countries turned away from planned economies and, in the same dash, started to open their national markets to integrate into the world market. Internally, a clearer distinction between public and private appeared, as for example in the former satellite states of the Soviet Union, and, a little later, in the latter's freshly independent republics. Many developing countries which had chosen isolation and promoted a type of import-substitution model in previous decades were forced to seek support from the "outside", and to rethink their bureaucratic state apparatus in order to overcome the hardship of the seventies and the eighties. One by one, countries of Latin America which had been protectionist and nationalistic by reaction, were brought to negotiate debts and credits with, among others, international financial institutions and to attract foreign capital to revive their sluggish economies.

The trajectory of these countries is closely linked to the four agents represented in figure 3, which require further commentary. As for the **two national agents**, it is true that the panorama of actors in a national society is not reduced to the binary system including the state and a national business community only. Again, especially in developed countries, other organisations have surfaced in the wake of the economic - political debate briefly

[14] Indeed, if the model were to be applied to one of the least developed countries the TNC-component would almost be non-existent.

referred to earlier in this chapter. Political parties, unions, business associations and other public or private institutions and organisations are important components of well-established democratic market economies such as Western European countries. In the majority of the developing countries which have turned towards economic liberalism however, such social actors are rather weak or even markedly absent, since the democratic debate remains limited, obstructed among other things by historical, cultural and social factors. In this sense, such countries often experience relatively weak institutions, in general but especially within the state, with a very strong central authority. As for the national-economic component, the business community is usually a reflection of high disparities in terms of wealth in the population. A small percentage of businesses active in key sectors on the national market have extensive access to capital and important investment opportunities. In some cases, more than 90 per cent of the population are working in micro-enterprises or in the informal sector, on the fringe of regulated economic activity. In such circumstances, the holders of economic power are, in a way, easier to identify in the absence of truly democratic mechanisms and a more balanced redistribution of wealth in society. Thus, in this context, it can be argued that often, a president and his administration and a small group of national top managers have a firm grip on the political and economic power at stake.

Regarding the **international-political agent**, the differentiation between global and regional/multilateral agents is important when considering developed countries, but to a lesser extent in developing countries. Regional economic integration exists on all continents, but generally it still remains limited and weak, with little coercive and economic power on various countries. In addition, developing countries tend to be more oriented towards the developed world, seeking economic opportunities with wealthy states, hence neglecting their partnerships with regional neighbours. Multilateral institutions, on the contrary, tend to be more influential, mainly due to the ascendancy exerted by members of developed economies. It can be suggested that the biggest influence comes with the financial support granted by international financial institutions.

Finally, considering the **international-economic agent**, it is – as in developing countries – a crucial component of emerging economies. As mentioned above, one of the methodological challenges might be distinguishing it from the national-economic agent. This problem applies rather to the widely interconnected and interdependent developed countries however. In other parts of the world, the distinction between TNCs and national business is particularly relevant due to the trends of capital flows. While there is a strong tendency in

developed countries to invest among themselves, there is also an important outward trend towards less developed countries. Between 1997 and 1999, Central Europe and South America were both the most targeted sub-continents: FDI represented 14 per cent of the gross fixed capital formation of the former and 23 per cent of the latter. Their outward percentage of FDI remained quite low however, namely 2 per cent and 3.5 per cent respectively (UNCTAD, 2001, 32). While investments towards the developing world slightly declined after 2000, the stark gap in these ratios persists.

1.2.2 The application of the model to developing countries

Unlike political power, which is a monopoly of coercive power over a limited territory and a population, economic power can more easily transcend political borders through the channels of economic liberalism thanks to its main tool - capital. Without directly affecting the protected – however currently debated - concept of political sovereignty, the entry of foreign economic power through capital as an instrument can play a significant role in national economics and politics.

This integration of national markets in the world economy and the need for foreign capital have been the quasi-exclusive model of development since the nineties. Indeed, it can be stated that the combination of democracy and market economy has become the only viable model of governance for peripheral countries which want to fit in the project led, at the beginning, by the Western world. This has not always been the case: Some nations and their leaders have, in the past, felt threatened by foreign capital, as recent Latin American history shows. In the seventies for example, some governments, seeking alternative models of development, tried to expel agents of foreign economic power - namely TNCs - from the national territory. Their main goal was to internalise the "freed" economic power in the state by nationalising production. A few years down the road many resigned themselves to turning towards the other kind of extra-national agent likely to help the depressed national economies to overcome long-lasting recessions. Then, countries were losing economic power in terms of debt. Today, both types of foreign capital are pillars of many emerging economies.

If we consider our model in figure 4, **relation 1** between the state and national business has been redefined, owing to required structural adjustments. The state has largely given up its role as *entrepreneur*, while adapting its role as *regulator* of the national economy to international standards. In order to finance the state, governments have had to turn

towards international lending institutions (**relation 2**) and private foreign capital (**relation 5**), as did national firms, facing international competition (**relation 4**). The inward flows of "quasi-public" and private international capital in developing and emerging countries have given the extra-national agents two sorts of *transnational economic power* (figure 5).

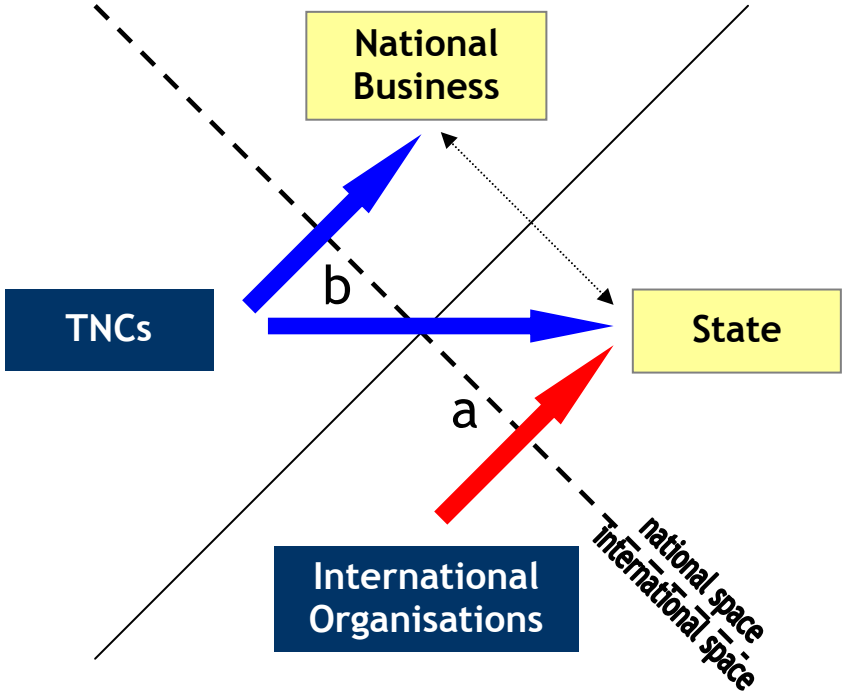

Figure 5: International capital flows towards emerging and developing economies[15]

The financial support of **lending institutions (a)** comes with a schedule of down-payments, and more importantly, with clear conditions and requirements towards the borrowing government mainly in terms of economic policy. The negotiations and the assignation of "quasi-public" international capital create a situation of dependence on external creditors.

Private capital flows (b) operate quite differently, since they are investments and follow a logic of appropriation. Through this process, TNCs enter the national market and consequently obtain (through privatisations or acquisitions) or create (by developing new markets) a share of national market power, thus changing its distribution. In other words, with their subsidiaries, TNCs have actually become a national economic agent in a

[15] Figure elaborated by the author.

particular country in addition to being an extra-national one. Even though in this latter case, the economic power is still not a national one, the economic process connected to it evolves in a national context, abiding by the rules and mechanisms of a specific political and economic space.

Further, in contrast to public and "quasi-public" institutions, these corporations are objectively independent from international political relations, which can represent a "burden". As mentioned earlier, institutions such as the IMF, the World Bank and the WTO have traditionally been regarded as intruders in the state's sovereignty. On the contrary, the arrival of FDI is today usually considered necessary and merely "normal", even welcome in the context of globalisation. As a matter of fact, TNCs are often times perceived as valuable allies since they increase the quality of national economic networks (Sachwald, 1999, 165).

In this research, the focus will precisely be the "transnational private economic power" in a national economy. Concretely, we will reduce the scope of our model to the active foreign component in a national economy: The transnational corporation. Thus, by modifying the previous model and keeping the "internalised" elements of a national economy, three main agents remain: the state, domestic business and the TNC.

1.2.3 The tripartite model of economic power

The collection of literature on TNCs is extensive. The privileged approach often chosen by business researchers has been to analyse primarily the organisational aspect of such firms in order to understand the way they work. The meaning of place is given less attention and the different national spaces are kept in the background as a type of passive stage on which the TNC acts. The actual interaction between the functional space of TNCs and national spaces has started to become an important topic of research in the context of a globalising economy.

John Dunning defines this "systemic interaction" as the "interface between the global strategies of multinational companies designed to advance corporate profitability and growth, and the strategies of national governments designed to promote the economic and social welfare of their citizens" (Dunning, 1993a, 330). In an economic perspective both spaces are facing each other as potential partners with their respective assets. The

country's competitive advantage and internal situation[16] counterbalance the TNC's interests, possibilities and needs to invest in a specific country. The outcome of the relation between the two agents is hence reliant on a government's will and bargaining capacity to attract foreign investment and the TNC's will and capacity to expand its operations - incidentally, as explained through Dunning's OLI (Ownership – Localisation – Internalisation) paradigm.

In this context, the "higher the priority afforded by governments to achieving goals consistent with those of [TNCs] the more likely it is that the relationships will be cooperative" (Dunning, 1992, 549). On the other hand, their stance will be rather confrontational if their aims differ, notably when a government's economic and non-economic goals do not coincide with the foreign firm. In that case, economic policy imposes additional costs or even restrictions upon TNCs, e. g. through policies protecting the environment or cultural values or, more importantly, when the state favours national autonomy.

Hence, beyond economic considerations, the relation between TNCs and governments has also raised questions as to a government's autonomy in the presence of transnational oligopolies or monopolies. Raymond Vernon already tackled the question of political control and governmental intervention in *Sovereignty at Bay*[17]. Clearly, the relation has been identified as going beyond strictly economic mechanisms. It has actually been stated that governments do not only have "to worry about economic distortion as a result of the behaviour of transnational corporations, but [that] they confront legitimate concerns about the impact of TNCs on national power and national autonomy, in particular in small and medium-sized countries" (Moran, 1996, 418). Such considerations have widely contributed to the questioning of the reliance of national economies on foreign investments over the past decades.

The TNC - government relationship has mainly aimed at understanding the mechanisms of interaction in developed countries, and legitimately so: The Triad receives more than 75 per cent of world-wide FDI and emits 80 per cent of it (UNCTAD, 2001, 121). This suggests further that the TNC - government relationship is particular in that part of the world, due to the fact that developed economies are host as well as home countries to TNCs at the

[16] The former has been extensively synthesised in Michael Porter's diamond of competitive advantage, the latter schematised with Dunning's ESP (Environment-Systems-Policy) - paradigm (Dunning, 1992, 271).

same time. In developed market economies, many bigger companies are transnational to a certain extent; above all in small countries such as Switzerland or The Netherlands. Hence the issue for such states is not only to deal with foreign companies on the national territory but to prevent the domestic TNCs from taking advantage or pulling themselves out of national jurisdiction, as mentioned by Kindleberger in 1970 already (Kindleberger, 1970, 181).

But even if such jurisdictional and economic aspects linked to TNC activity and home - host relations may be an issue for the companies as well as for the governments of, say, intertwined European states, they seem to be much less disturbing than in emerging markets. Indeed, Western economies with similar systems have developed an extensive economic integration and it is where the modern sort of globalisation has found its first playgrounds. The economic interdependence between these countries is by far more advanced in comparison to emerging and developing countries, as the intense and complex net of transnational spaces in that part of the world suggests. This interdependence also implies similar legislation, reinforced with international agreements, practices and habits, which have drawn the various national spaces nearer over the last fifty years.

It is in a space of relative political and economic compatibility that transnational activity has become more intense and diversified, interconnecting and bringing the national spaces even closer together. It is in this context that "national boundaries have become increasingly irrelevant in the definition of market and production spaces, while regions other than countries are emerging as the key policy arenas" (Glassner, 1995, 407). This evolution is based on a common denominator developed countries share, namely Western market democracy, and which describes and regulates their political and economic relations.

On the "outside" of the Triad however, the denominator often remains very small, if not entirely absent. The relative compatibility cannot be taken for granted when considering Asian, Eastern European or Latin American countries that are somewhat involved in the transnationalisation of economy but whose political and economic background do not quite fit in the Western frame. Consequently, transnational activity will have to be adapted to the conditions linked to a particular national space, or the national space will have to

[17] Raymond Vernon, *Sovereignty at Bay: The Multinational Spread of US Enterprise*. Basic Books, New York, 1971.

make a specific effort to promote economic and political criteria fitting international – or rather, Triad – standards.

Since their political, economic as well as social and cultural environments remain quite different from the ones experienced in developed economies, developing and emerging markets have been, in a way, TNCs' "Frontier", because mostly peripheral to their usual institutionalised playground. For a firm, these economic border regions usually represent more lee-way, but also more risk in terms of economic activity, since they do not share the "institutional thickness" (Amin & Thrift, 1993) of developed countries. In other words, the TNCs' additional freedom of action, returns or costs are directly related to the political, economic and social differences between market democracies and host countries, or inversely proportional to the host countries' degree of interdependence with the globalising world. Their strategies are thus specific to the environments they are investing in.

In this context, the political and economic setting of a particular country and the relation between its main agents, namely the state and national business, will be our focus here. The proposed model in figure 6 is therefore especially appropriate since the national aspect has an important role to play, if we consider the public and the private agents. Indeed, if the evolution of developing and emerging economies as well as those in transition is taken into account, the sharp changes and important differences in politics and economics that have shaped these countries cannot be left aside. The role of the state, of economic agents and their interaction are essential to the comprehension of a country's political and economic systems.

In Latin America for example, many countries have experienced oscillating economic policies in the past few decades; their national economy has often been protected and has evolved in a way based on other habits and customs than those in Europe or North America. In such economically peripheral countries, some national, public or private, firms may have experienced a strong concentration of wealth without having left their national space and transformed into TNCs "surfing" the global economy, but remaining a powerful economic agent within their home country. In other words, the mechanism of a national economy and of its components can be out of step with the world economy, and this justifies the inclusion of national business as third agent of economic power in our last model when considering a specific developing or emerging country.

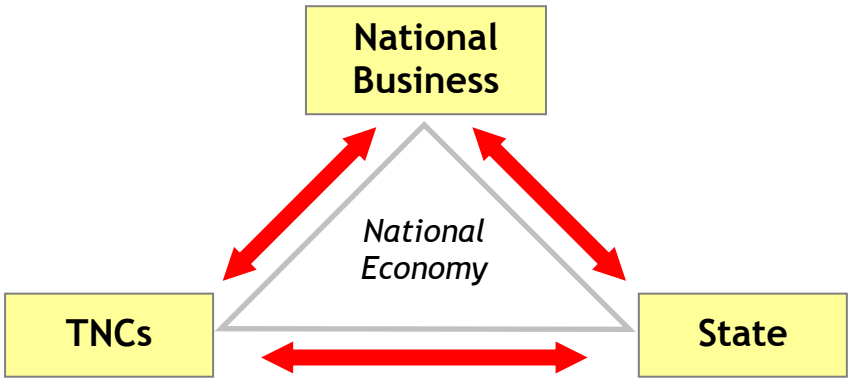

Figure 6: The triptych of economic power in an open economy[18]

The thought process which has led to this last model of economic power has important implications for the present study. The triplet of economic agents suggests - as did the previous models - a systemic approach, where agents interact in an integrated structure of relationships. Beyond the study of the three agents in particular, the network of relations represents a major focus of this research.

The conceptual combination of the two spheres and the two spaces allows developing our analysis in two steps. The distinction between the economic and the political brings primarily business and state relations to light. Subsequently, the introduction of differentiated spaces adds the necessary division between domestic and transnational business, and with it an essential component of the complex geography of globalisation; the double analysis of state, domestic and transnational business and their interactions is a step towards understanding it.

Based on the model introduced in the present chapter, Chapter Two will focus on the political and economic spheres in Latin American states and define the characteristics of the business - state relationship in that context.

[18] Figure elaborated by the author.

CHAPTER TWO: State, business and policy change in Latin America

In market economies, the state and private business are the two main agents of political and economic change. On the one hand, the structure of the state gives a frame to economic activity and the state leadership its orientation, on the other, business evolves in this particular economic environment. Looking at different national environments leads to two basic observations: First, every national economy keeps evolving, and second, economic spaces differ from one another.

If the economic environment is dependent upon its main agents, then the following may be suggested: State and business are different from one economic space to another, and so is therefore their interaction. Further, if a particular economic space is changing, then, one may conclude that, the state, or business, or both are changing as well. Finally, the changes do not occur in an isolated way, transforming agents will affect each other. Thus, the relations between them are not static, but in constant evolution: "The state and business reshape each other in reciprocal iteration" (Evans, 1997, 65).

How are these conclusions interesting for the scholar, beyond the mental exercise? Following on from the above-mentioned assumptions, we presume that these may be used as a frame to analyse basic features of specific environments, such as economic performance or governance. Indeed, the former is not only reliant on business, and the latter not only on states and their governments; the relations both entities create are central to the political and economic developments of a given space.

To elaborate these statements, an anchor in a particular environment seems to be appropriate. We have chosen to have a closer look at a region of the world which displays a definite number of economic and political spaces, namely Latin America. In our opinion, the analysis of the evolution of these environments – which share many common features – will set a dynamic stage for the understanding of changing state and business structures. Hence, before we specifically analyse the two main agents of political and economic change and their relations, we will glance at Latin Americas' political and economic evolution.

2.1 Latin America's political economy

Latin America is, in many aspects, a puzzling region of the world. More than just a geographic entity, this sub-continent shares many common characteristics, not least an incredibly rich, yet very troubled history.

When setting foot on the new continent half a millennium ago, the *conquistadores* encountered a multiplicity of cultures, from the hunter-gatherer tribal type to sedentary, highly organised and technically advanced societies. Soon upon the arrival of the Southern Europeans, the multiple American Indian societal structures collapsed, and three centuries of submission to the two Iberian empires drained the indigenous population. Hence, at the fall of the Spanish monarchy it was a heterogeneous ethnical and social mix which sought its independence. The latter was proclaimed after two waves of revolts early in the 19th century, as most colonies in Central and South America transformed, one after the other, into new nation-states. Then, the political map of the region was greatly remodelled, and has been relatively unchanged since[19], in comparison to Europe for example. The last 180 years turned out to be far from smooth for the subcontinent however, as states have attempted to sort out their inner conflicts and problems while trying to define their roles and relationships on the international arena. Indeed, up to the present day, the twenty republics of Latin America have been shaken internally and tormented by their traditional and economic ties with developed countries. Since independence, more than 370 political coups have punctuated Latin American politics (Durand, 1996, 30).

The centennial of independence was, for most countries in the region, far from glorious. The quest for a national identity had not been very successful, since the social reality did not possess the ingredients necessary for a sense of citizenship to develop. The wars fought between neighbouring military governments barely managed to save the different countries' precarious cohesion, since some of the conflicts degenerated into internal insurrections. Clearly, the old social order had been renewed with independence: In a world led by Europeans and their free trade, a landed aristocracy had acquired political, economic and social power while a new sort of capitalists was emerging, taking part in the soaring international trade through primary products exports.

[19] Indeed, all the sovereign states founded by the late 1820s in South America still exist today. Their boundaries, however, have been subjected to some major changes due to the many wars fought mainly during the second half of the 19th century. The political history of Central America and the Caribbean has developed somewhat differently, influenced by a strong American presence.

2.1.1 From the ISI model to neoliberal reform

The relative failure of these "caricatures" of nations (Favre, 1998, 22) to resemble their European models was undoubtedly linked to the growing quest for proper roots in Latin America's pre-Hispanic history as well as for a fairer redistribution of wealth among the population. Economically, it is the Great Depression which gave the decisive impetus for more self-centred development strategies, since Latin America was deprived from its export revenues to finance the importation of industrial products, leaving many workers, craftsmen and farmers in disarray. "The abrupt plummeting of prices of primary products, as well as the breakdown of the multilateral trading system" led Latin America to the pursuit of deliberate import substitution and protectionism (Cohen, 1998, 98). In a new political environment guided by national-populist ideology, strong welfare-type of states emerged with the priority to resolve balance of payments problems and to industrialise their countries from within, through *import-substituting industrialisation* (ISI) and tariff protection.

This introverted tendency was far from being a clear strategy at first. In fact, inward-oriented development based on economic planning was theorised only later, in the fifties, by a group of development economists. The main contribution to this current of thought certainly came from Raúl Prebisch, "the 'father' of structuralism" (Dietz & Street, 1987, 75), who demonstrated that the process of deteriorating terms of trade for primary products on world markets was due to structural differences between developed countries and developing regions (James, 1998, 43)[20]. His model prevailed in the region well into the second half of the century[21]. Its most central policy instrument, ISI, was advocated forcefully by the ECLA (United Nations Economic Commission for Latin America), convinced of its potential to pull Latin America out of its economic underdevelopment.

[20] The Argentinean argued that Latin America was suffering from a relative long-term decline of raw material prices versus prices of manufactured goods imported from developed countries (Ward, 1997, 10). It is worth mentioning the fact that he later considered the model to be a failure: "A healthy form of internal competition failed to develop, to the detriment of efficient production" (United Nations, *Towards a Dynamic Development Policy for Latin America*, New York, 1963, cited in Davis & Wilson, 1975, 39).

[21] The transition to an auto-centred model of development was very country specific in terms of time as well as modality. In Peru and Ecuador for example, developmentalist projects appeared gradually in the fifties and their breakthrough came much later with military interventions. "By the end of the 1960s, economic liberalism had few defenders [in the central Andes]. Like the rest of society, the military became convinced that the state should take a proactive role in modernising and developing the economy" (Conaghan & Malloy, 1994, 53).

A first, *easy* phase of ISI (Boris, 2001, 11), coupled with a general agrarian reform, meant deep changes for Latin American societies. While modern urban classes formed thanks to a growing public economy, the old export oligarchies gradually lost grounds. Meanwhile, a few national private industries benefited from the state's supervision (contrary to foreign companies, which were often confronted to expropriation and nationalisation). The success of the powerful state apparatus and its self-centred economic development programme seemed to bear fruit: By withdrawing from the international division of labour, the Latin American countries seemed to have found a development strategy that helped them to rise to economic independence and simultaneously create the social premises necessary to the nation-building they had been lacking. From the mid-fifties on however, first doubts as to the ISI model were raised.

After the Second World War, the importance of a recovered international trade grew steadily while some leading countries of the region were subject to backlashes which corresponded to a second, *difficult* phase of ISI (Boris, 2001, 49). The main symptoms of the latter were the increasing balance of payment deficits, overvalued national currencies and further deteriorating terms of trade. Internally, industrialisation had reached a degree where, in order to progress further, high investments and technological know-how were essential. Several countries were at a point where "tinkering" consumer goods was not enough since the production of equipment would have been necessary for further growth (Léon, 1969, 443). At the same time, some markets were clearly too small for a weakening state to open a production line for specific products[22]. The only way to keep the model working was to turn towards foreign capital and technology; protection thus softened[23].

The second phase, roughly after the mid-fifties, of self-centred economic development was thus further characterised by the presence of multinational companies which had found friendly playgrounds in terms of economic policy as well as production and market conditions. By establishing subsidiaries, foreign firms were not only skirting trade barriers, but also taking advantage of the protected economies to conquer substantial shares of the national markets. In the absence of "decent" local competitors, such companies managed

[22] Regional integration during the sixties was supposed to allow Latin American countries to benefit from larger markets and economies of scale, and increase intra-regional trade – in other words, apply the ISI model on a region of countries. The main attempts were the Latin American Free Trade Association (1960), the Central American Common Market (1960), the Caribbean Free Trade Association (1968) and the Andean Group (1969).

[23] High protection in terms of tariffs and quotas kept imports out, but the drop in foreign exchange demand contributed to the appreciation of national currencies and thus put a severe additional tax on exports. Moreover, taxes on intermediate goods hurt the export activities using these goods. A

to maximise profits by keeping production costs low. Under the cover of tariffs and quotas, even if they brought FDI, technology and knowledge, they "may not [have done] their best" (Dornbusch, 1992, 75). Without much effort and preferring labour intensive technologies already obsolete in industrialised countries to more expensive ones[24], such firms often found themselves in quasi-monopolistic situations, with comfortable margins of profit (Boris, 2001, 50). In addition, dependency theorists pointed at the exit of wealth created locally through transnational activity.

In the end, the higher the trade deficits, the more foreign capital was a necessary premise for the ISI model to be functioning – a somewhat ironic development, away from the initial aim of an economic strategy lauding the capacities of national productivity, as explained, in essence, by the dependency theory often attributed to Fernando Henrique Cardoso in the late sixties (see Cardoso & Faletto, 1969, 1979[25]). With the dependency theory as background, intellectuals and activists interpreted Latin America's precarious situation as a new form of submission of the peripheral states to the central states in a world system led by capitalism (Bulmer-Thomas, 1998, 14)[26]. To avoid becoming only the managers of foreign interests, the only possibility for Latin America to develop was to exit from capitalism by breaking the chain it maintained between rich and poorer countries. In this regard, the main target of critics was at home: The *weakest link* of the chain was the state.

Still, the protectionist and interventionist model that had been, in different forms, lasting for half a century, had improved economic performance overall. Between 1950 and 1980, the region's average annual growth rate reached 5.5 per cent, which was more than post-industrial Europe (Cardoso & Fishlow, in Boris, 2001, 47). Structural problems had become more and more evident however. Most Latin American countries were plagued with high inflation rates while their governments were facing chronic balance of payment difficulties and incessantly increasing debt burdens. The growing inefficiency of a protected and subsidised economic environment of "legions of losers" (James, 1998, 44) contributed to the disastrous social situation. With a lagging job supply and a persistent unequal pattern

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first step towards trade liberalisation was hence to neutralise this "anti-export bias" (Dornbusch, 1992, 72).

[24] There are many famous examples - in Brazil, Mexico or Argentina - of foreign industries making products which had long disappeared on the markets of developed countries. The most striking ones may come from the car industry. In Mexico, Volkswagen's original Bug stopped being assembled in Puebla in 2003. The model dated from Hitler's Third Reich.

[25] The English version of their work, *Dependency and Developement in Latin America*, was published ten years after the Spanish version.

of income distribution, urbanisation was synonymous with the pauperisation of a great share of the population. Hence, the inward-oriented industrialisation running out of steam, coupled with a demography in transition, reversed the timid positive trends that had been developing in Latin American societies.

Finally, the debt crisis of the early eighties was fatal to the model, and while the sub-continent was muddling through with half-hearted economic policies, for an entire, *lost*, decade, industrialised economies were paying greater attention to the good performances of the South East Asian region. Latin America was excluded from the international financial market[27].

In the context of the region's economic disarray, countries were ready for a change of economic paradigm. In this sense, *neoliberalism*[28] appeared more and more as a viable alternative. Yet, while the term might have been new, the content of the policies were not. Several Latin American countries had, sporadically, tried to apply *monetarism*; "neoclassical-based policy packages during the fifties and the early sixties" (James, 1998, 47). It is only after the debt crisis, however, that governments started to apply the "revisited" packages more systematically.

Several reasons - international and national - were liable for the gradual economic turn around from the seventies on, beyond the above-mentioned discredit of the ISI-model in Latin America and the dramatic debt situation in the early eighties. The main following causes should be mentioned: 1) dissatisfaction with Keynesian economics and conservative governments in leading economies such as Britain and the United States 2) a relative increase of influence of international monetary institutions (IMF, World Bank) in contrast

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[26] Defended vehemently by advocates of socialism, the dependency thesis was often connected to an exacerbated anti-Americanism, especially in Central America.

[27] The devastating debt crisis of 1982 was of internal, long-term structural nature, although combined with external trends as well as short-term changes in the overall economic situation. Then, the entire region had a debt burden of 430 billion US$, approximately 1000 US$ per capita considering an average GDP of 2000 US$ per person (Boris, 2001, 69). Externally, the steadily increasing oil prices contributed to the intensive inflow of cheap private credit, readily available since the monetary deregulation of the world markets in 1973. This trend ceased by 1980, mainly due to drastically increasing interest rates in the United States, which ultimately reversed capital flows and subsequently led to an expensive dollar. This sequence of events was followed by the discontinuity of debt payments by the main debtors such as Mexico, Brazil, Argentina and Venezuela. Devaluation, inflation and capital flight further deepened the region's depression.

[28] We understand the concept of *neoliberalism* as a contextual expression, combining theories of monetarism and new classical economics with particular circumstances. In fact, the term has been mostly used in a pejorative way by the detractors of intensive liberal reforms mainly since the beginning of the nineties in order to condemn the disastrous social effects radical changes of economic policies have had in developing countries, and particularly in Latin America.

to the loss of influence of organisations traditionally sensitive to developing environments (ILO, UNCTAD) 3) the scientific influence of the *Chicago school* 4) the accession to power of military regimes usually receptive to neoliberal policies 5) difficult as well as opaque relationships between the public and business actors[29].

Adepts of neoclassical economics defended the idea of reintroducing pure and scientific economic analysis, based on microeconomic foundations and on rational behaviour. Pulling the government out of economic activity could only improve the situation of Latin American countries, freeing them from heavy interventionist measures and thus "politicised" economic policies. These were "thwarting individual effort related to productive activity, encouraging unproductive rent-seeking activity, [...], and leading to a predatory state invested with powerful and privileged groups" (James, 1998, 47). Combined with this negative perspective of the state as economic actor came the belief that markets were by their very nature producing efficient results (Weeks, 1995, 113) and market failures were but trivia in comparison with interventionist distortions.

This perspective was mirrored in the policy packages of the Bretton Woods institutions. Concomitantly with creditors and the Paris Club, they proposed, combined with stabilisation measures, a set of *orthodox* economic policies for economic reform, including trade liberalisation, deregulation and privatisation of state enterprises. From 1990 on known as the *Washington Consensus*, these policies represented, in essence, the project of a more or less radical and simultaneous application of the entire scale of neoclassical principles[30] on Latin American economies. While stabilisation measures were meant to stop the region's vicious cycle of inflation in the short run, the reform packages, consequently implemented, should break the systemic inefficiency of the economy. Simultaneity was an important component, not only to keep the expected post-stabilisation recessions from lingering (hence it should be "painful but short"), but also because the different adjustment measures were intertwined and represented, together, a complete restructuring of the economy. Faithful to its theoretical background, this programme had a universal feel in Washington[31], and was considered a must for all the troubled economies of

[29] The last two reasons, rather domestic in nature, will be discussed later in this chapter.
[30] See Chapter Four for additional facts on the Washington Consensus.
[31] To Williamson, "the Washington Consensus should become like democracy and human rights, a part of the basic core of ideas that we hold in common and do not need to debate endlessly". Yet he wishes he had chosen another, perhaps more politically independent denomination, such as "universal convergence", because, as he argues, the Consensus is an outcome of a "world-wide intellectual trend to which Latin America contributed" (Williamson, 1998).

the region. Yet, its realisation in terms of time, sequence and extent had a strong local emphasis (Fishlow, 2000, 293).

Indeed, while the debt crisis, the shock to global financial markets and the subsequent pressures from international financial institutions pushed most of Latin America towards adopting some kind of orthodox economic adjustment, the situation at home still played an important role in the governments' choices related to economic policy. The application of the advocated "shock-therapy", implying economic austerity, was not very appealing to political leaders, who feared popular reactions, and was generally not welcomed by business either. Thus, a variety of options were, once more, tested: "The responses ranged from short-term austerity, to more ambitious neoliberal projects, to complicated 'heterodox shock' programs like those undertaken in Brazil and Argentina in the mid-eighties. [...] Latin America in the eighties became an extraordinary laboratory of economic policy experimentation yielding a wide range of results" (Conaghan & Malloy, 1994, 11).

The attempt by some to continue with a gradualist approach revealed to be a failure once more. Undeniably, the application of a mix between Keynesian *heterodox* type of policies and orthodox reforms only added to the inconsistency of the state's political economy. The short-lived success, and ultimately failed attempts of statist programmes to tame inflation without liberal austerity measures, severely sanctioned the countries with hyperinflation and deep recessions, and smoothened the way towards the structural adjustment alternative advocated by the IMF.

2.1.2 The post-Washington Consensus debate

This neoliberal alternative is an extreme one, be it taken internally, or especially from an international perspective: In fact, it represents the removal of "all barriers that insulate domestic decision-making by the private sector and the state from the influence of world markets" (Weeks, 1995, 130).

For Latin American governments however, neoliberalism – and with it, the package of adjustment measures - appeared to be the only possible alternative to find the way to macroeconomic stability and, most importantly, to be rehabilitated into the world economy. Yet, this option meant a considerable shift in development strategy. The choice to apply liberal measures represented a switch from the protection of outer economic

influences towards an immediate, almost total, immersion into the competitive global economy (James, 1998, 47). Metaphorically spoken, it is - almost - like pushing a chess player into an on-going American football game, without proper gear.

Remaining in a sort of autarkic situation was not an option, since internationalisation affects even countries whose economies are not open[32] (and since autarkic nations imply, nowadays, underdevelopment and totalitarian regimes, as current examples in the world suggest). However, many have stressed that integration should be adjustable to a country's possibilities and needs: "The choice is not between free trade integration into world markets or 'delinking', but among a range of options that determine the extent, both quantitatively and qualitatively, to which fluctuations in world markets will be transmitted to the domestic economy" (Weeks, 1995, 130).

In the basic model, trade liberalisation should encourage developing states, when re-entering the stage of world competition, to re-centre around their tradable goods, which represent their comparative/competitive advantage. This, then, would lead to an efficient export-led industrialisation, which should gradually replace the previously protected, and inefficient non-tradable sectors. As counter argument, some say that general trade liberalisation leads developing countries back into a *metropolis - colony* type of relation, condemning such countries to be in competition with their equally underdeveloped neighbours for the sale of relatively cheap primary goods on a world market with constantly deteriorating terms of trade, due to the widening *added-value gap*. While exportation of primary goods may be beneficiary to a state in the short run, it cannot be satisfying in the long term. Further, a sudden increase of imports may destabilise a stagnant economy by immediately out-competing the local economic agents.

Financial liberalisation, on the other hand, is even more delicate than trade liberalisation. FDI, often favoured by governments' aggressive privatisation programmes, have induced, as a consequence, an increased denationalisation of the economy in terms of ownership. Deregulation of capital markets, coupled with floating currencies and the dependence upon foreign capital also "resulted in a virtual elimination of the ability of all but the largest Latin American countries to pursue independent monetary and fiscal policies. [...] In effect, capital market liberalization had the tendency to reduce the role of Latin America's central bankers to a close reading of the *Wall Street Journal* to keep up with the actions and pronouncement of the U.S. Federal Reserve" (Weeks, 1995, 131-32). This

[32] For an explanation of autarchic countries and internationalisation, see Frieden & Rogowski (1996).

caricature expresses bluntly justified worries, which have, in the meantime, even reached the IMF, though not for quite the same reasons: Capital inflows have often induced high growth rates, but also expensive crises, mainly in emerging countries (FMI Bulletin, June 2003).

In sum, the neoliberal package has involved, in essence, a major loss of autonomy of Latin American states in terms of economic policy. The price to pay - the switch from structuralism to monetarism, and in a way, the denationalisation of policy-making – was not rewarded, as expected, with an economic miracle financed by foreign investment and a thriving export-led growth. Instead, the growth rates remained far too low to pull the countries out of their economic stagnation.

While in most cases stabilisation measures successfully contributed to reducing inflation below two-digit figures, the results of the reforms have been much more mitigated. Austerity induced recessions longer than anticipated and sustained growth did not occur in spite of some improvements. Rudiger Dornbusch suggested – based on Schumpeterian analysis – it is *change* that is the source of increased productivity. "Deregulation and trade reform can shake an economy out of a slow-growth trap", but "there is no basis here for a *sustained* increase in growth" (Dornbusch, 1992, 76). Applied to Latin American economies, one may assert that structural adjustments have merely achieved what heterodox shocks had often provoked, namely short-lived booms (simply without subsequent hyperinflation).

Advocates of reforms, on the other hand, would certainly seek the reasons for the disappointing results in the application rather than in the actual policy packages. It is true that some governments have had difficulties to consequently apply their reform programmes due to internal pressures, and many argue that "those countries which reformed most [...] have done better than those [...] which did least". But such voices also agree, after more than a decade of Washington Consensus measures, that while some reformed more effectively, "the reforms themselves have been unable to eliminate some of Latin America's deep-rooted weaknesses. This is true on both the political and economic fronts" (The Economist, November 30th, 2000).

The fact that average growth rates in the nineties remained well below the levels of the sixties and the seventies is only an introduction to the internal economic - and social - situation. Average real incomes were, in the mid-nineties, still 40 per cent below the 1980 figures, while the world's worst income distribution is still rather getting worse. Poverty

and extreme poverty have not improved much in relative terms since the beginning of the eighties, while absolute numbers indicate 200 million poor in 1997, up 70 million from 1980. Almost half of this number lives in extreme poverty (IDB, figures used by Boris, 2001, 84).

Due to the mediocre results on the economic fronts of Latin American countries, and their dramatic social situations, *post*-Washington Consensus discussions surfaced in the early nineties already. Gradualists, who had been hostile to drastic adjustment measures, saw in these disappointing results their fears confirmed by the economic model. On the contrary, most adepts of neoclassical economics, as well as international institutions, sought to explain them through non-economic factors[33].

This stance has led to the suggestion of a *second phase* to the reforms, often added to the usual discourse on free market measures. This new adjunct has been more society-oriented, referring to institutional and governance issues, including alarming problems such as poverty alleviation as well as concepts currently *en vogue*, such as *sustainable development*. This type of discourse has been extensively used by the main international organisations such as the World Bank, the IMF or the WTO. Beyond implicitly explaining why the reforms have, so far, failed to improve the developing economies in Latin America, these adjuncts smooth down the edges of the more and more criticised Washington Consensus. The policy package was generally not questioned however, let alone the sequence of both first and second phase reforms. It was generally agreed that economic reforms should be followed closely by political ones (since failing to happen in an *impromptu* way).

In 1998 however, Joseph Stiglitz, then senior vice-president and chief economist at the World Bank, addressed the deficiencies of the Washington Consensus more globally. In an important paper, he stated that its policies were incomplete and sometimes misguided, and that in order to make markets work, it needed more than simply low inflation: "We have broadened the objectives of development to include other goals, such as sustainable development, egalitarian development, and democratic development. An important part of development today is seeking complementary strategies that advance these goals *simultaneously*" (Stiglitz, 1998).

[33] Analysing the Inter-American Development Bank 1997 Report, Boris notes a contradiction between, on the one side, the energetic pleading for the reinforcement of market forces and its private protagonists, and on the other, weak arguments blaming non-systemic factors, such as education, for the strong social and economic inequalities.

Still, sceptics, such as neostructuralist economists believe that drastic stabilisation and adjustment measures may have further biased wealth and income distribution and therefore weaken social and political cohesion, necessary to long-term growth and sustainable development[34]. Thus, market failures "echo the old structural bottlenecks". Yet, "through propaganistic popularization, the free market advocates conveyed the impression that markets by their nature produced efficient results. But this conclusion is a priori theoretical, not empirically based on actual results on markets". Perfect competition of all markets would have been, then, a prerequisite. In absence thereof, when "unregulated markets are tainted by seller or buyer market power, then the result is private sector regulation, which in effect on the orthodox concept of efficiency is strictly equivalent to state regulations" (Weeks, 1995, 112). It is therefore necessary to tackle the subject of adjustment in the particular context they have been applied, namely on imperfect, highly oligopolistic markets. By avoiding questioning the model in their specific political, economic and social environment and by applying market reforms drastically, liberal reformers may have increased specific negative structural characteristics, such as economic concentration.

The debate raging between politicians, technocrats and intellectuals from both Latin America and the developed world affects, in the end, entire populations as well. In this context, the Latin American societies, which have experienced the internal austerity induced by the new economic policies are, apparently, still favourable to free market policies, notwithstanding the degradation of the situation in general and for most, in their own lives. Perhaps it is the "ghost of populism" (Boris, 1998, 92) with all its bad memories which keeps them from wishing a comeback of an interventionist "welfare" state.

In the meantime governments are, on the whole, sticking to the model – with minor heterodox backlashes. Beyond the lack of an alternative, it is the limited state capacity, the will of technocratic elites to stick to the programme as well as international pressures and the dependence on foreign capital – public and private – which keep them from looking carefully at the obvious market failures in their respective societies. However, while most

[34] This intellectual current does not reject the market mechanism as an instrument for resource allocation, still "retains some important facets from their structuralist root, including a holistic methodology that weds economic analysis to political, social and cultural considerations, often within a historical context" (James, 1998, 50). In this perspective, the state should have a crucial role in fulfilling its traditional functions, and promoting the value of institutions: "Neostructualism emphasises the great variety of intermediaries that exist between the individual and the state (cooperatives, associations of producers, tradespeople, labor unions), which form a rich and varied network with substantial power over economic decisions and the feasibility of economic policy" (Salazar-Xirinachs in Sunkel, 1993, 382).

countries have implemented a policy environment reasonably close to the basic *ideal-type* package, and have reformed parts of the state to increase its efficiency, the next steps, or the second phase reforms, are far from granted.

In fact, authors and international institutions, whose hopes count on an *institutional renaissance* of Latin American societies with small state structures and democratic features in a context of economic stagnation and austerity, might get increasingly worried by the political power of the executives, a rather negative signal in terms of democratic institution building.

In the end, beyond the actual issue of the proper development model, the feature of power concentration has remained, at all times, a central element of Latin American societies. Almost invariably during periods of state interventionism or economic liberalism, power, wealth and means of production have been concentrated. While over time, political and economic power have been shifting back and forth – but only horizontally – between government and business elites, today as well, they share the exclusive "power-pie".

On a background of market economies, economic power has been re-centred around business elites, while political power remains in the hands of a relatively insulated state elite. Both agents are central in our thought process and are dealt with in the following two sections.

2.2 States and governments in Latin America

"Government-business relations cannot be interpreted without first specifying the internal structure of the state" (Evans, 1997, 74). This section focuses on the *state*, and on the evolution of its leading elite over the past few decades in Latin America.

2.2.1 The role of the state

Until the 19th century, the role of the state was largely ignored by economists, since economy was, for the classics notably, such as David Riccardo and John Stuart Mill, largely subject to a natural order. Karl Marx, meanwhile, developed an explicit state theory where

the state is the instrument through which the ruling class dominates the other, oppressed classes. In the twenties, Keynesian economics developed a global approach of economic phenomena giving the state a global – macroeconomic – role (Deiss, 1988, 10). These days, "most economists accept a theory which implies that the basic services of government can be provided, [...] only through compulsion. This is the theory of 'public goods'" (Olson, 1971, 98), which is essentially based on an *individualistic* conception of the state.

Even though "we live, [...], in an ideological climate that systematically attempts to obscure the state's possible contribution to economic transformation" (Evans, 1997, 65), recently, some social scientists have re-oriented themselves towards a *Weberian* perspective of the state: "The state must be considered as more than the 'government'. It is the continuous administrative, legal, bureaucratic and coercive systems that attempt not only to structure relationships between civil society and public authority in a polity but also to structure many crucial relationships within society as well" (Stepan, cited in Skocpol, 1985, 7). In this perspective, the state is acknowledged to play a key role in society, without being the only collective organisation, since other agents also shape social relationships and politics.

In a context of economic change, two aspects can be retained as essential features of relationships between the state and other agents over time: *state capacity* and *state autonomy*. The state capacity concentrates on the state's ability to deal with fundamental issues such as territorial integrity or financial resources, or more specifically, on its capability to implement policies and achieve projects of collective interest. The state autonomy has been mainly focusing on the ties between the state's policymakers and businesspeople, under the light of the collective and individual interests of bureaucrats. In this context, Peter Evans' major conclusion is the need for a state to have an "embedded autonomy", where insulation prevents the state from corruption and where embeddedness reflects the necessity of a dense social network when pursuing societal goals (Evans, 1995). State capacity and state autonomy are thus closely connected.

These two main characteristics are precisely the attributes of the *developmental* state, in opposition to the *predatory* state, which lacks autonomy[35] and represents clientelist relations with society. To move away from corrupt structures, in addition to the "carrot and stick" approach - an effective corruption control based on a credible system of rewards

and punishments which keeps bureaucrats from being tempted (Rose–Ackerman, 1999, 78) – an appropriate degree of independence from outer, as well as inner-state influences should be guaranteed.

But "insulation" should not become "isolation". Some Latin American governments have, in a context of economic crises or reforms, precisely chosen the latter option, believing that economic technocrats – cut off from any corruption incentives and outer influence that may be seeping in – would do a better job formulating new policies by disregarding formal and informal networks[36], avoiding any sort of contagion. This choice may be justified over a short period in a highly predatory state. However, "if bureaucracy were sufficient in itself, state socialism would not have suffered the economic humiliation that it did in the Soviet Union" (Evans, 1997, 73).

This conception of the state, based on the study of the state institutions' connection to other agents of society, goes beyond the more narrow *economic sense* of what the state *does* to the economy, by promulgating economic policy, and by actively participating in the production process. For our present research on business - state relations, we believe that the broader concept of the state is more fitting. As a matter of fact, the role of the state is not to be reduced to the state's increasing or shrinking presence on markets. Besides giving the size of the state *apparatus*, such an approach remains superficial since not tackling the actual role and power of the state. Experiments in market reform have shown, among others, a stricter definition and enforcement of property rights, revamping tax collection procedures and the centralisation of policy-making within the state. Thus, market reforms "can hardly be associated with 'less' state, but, rather, with 'more'" (Schamis, 2002, 178).

Latin America, whose states have gone through precisely such reforms, is an interesting study case in terms of "more" or "less" state. While their participation in the economy has generally been reduced, there has been a tightening of state regulation in the economy. In their quest for increased state efficiency in societies marked by numerous dysfunctional elements, governments have chosen an *executive* approach rather than a *consensual* one to administrate economic transformation. The aim of the next section is to portray this evolution starting with the military dictatorships in the sixties.

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[35] To Evans, a predatory state is where "rules and decisions are commodities, to be sold like any other commodity to the highest bidder" (Evans, 1995). The developmental state is, in contrast, based on a Weberian bureaucracy.
[36] The network theory, from a business perspective, is dealt with in the next section.

2.2.2 From the military regimes to democratic transition

Due to deeper cleavages and distortions in Latin American society during the sixties and seventies, political and social tension reached new levels. In a backtracking society, social unrest and conflict rose and favoured the advent of leftist revolutionary movements but the downfall of populist civilian governments as well, and thus helped the accession to power of bureaucratic-authoritarian military regimes. By the late eighties, most Latin American nations were considered democratic. In spite of these generalised political switches, a steady feature of Latin American politics remained in its predatory state structures, weak institutions and concentration of power in the executive.

The rampant wave of political militarisation throughout Latin America, which started in Brazil in 1964, has been a much debated subject among political scientists as well as economists. How could almost an entire world region move, within a decade, from civilian governments to clearly non-democratic regimes?

A first general approach would be to consider a parallelism in the evolution of Latin American societies towards political, social and economic *bottlenecks*. In countries where populism and its development model had been weakening while tensions were escalating within political and social spheres, the intervention of the military appeared to be the one of a saviour (Boris, 2001, 62). However, rather than coups of opportunistic *caudillos*[37], the setting up of authoritarian regimes mostly corresponded to an institutional takeover aiming at freeing the countries from the economic deadlock by readjusting and stabilising a process of capital accumulation that had grown more and more erratic. Three main goals characterised the military regimes: With the participation of civilian technocrats, the regimes were committed to reforming and transforming the existent political structures. Then, these governments aimed at developing some sort of market or mixed economy, in alliance with business[38]. Finally, the objective of the new statecraft was the concentration of power in the executive (Conaghan & Malloy, 1994, 48).

Common or similar cultural and social features as well as parallels in political and economic evolution and, finally, geographic proximity are only a partial explanation for the quasi-simultaneity of regime changes on the sub-continent. The Cold War atmosphere, and more importantly, the US administration's active role in the region through Kennedy's

[37] This expression is commonly used when referring to authoritarian leaders in Latin America.
[38] It was the national bourgeoisie or foreign capital that was chosen as main partner, depending on the economic development advocated by the regime.

"Alliance for Progress" strategy since the beginning of the sixties, is inevitably linked to the subsequent "domino-militarisation".

The Cuban debacle had prompted the United States to put in place a new set of strategic measures. While the economic and social development and the support of progressive reformist and anticommunist governments as an antidote to insurgency failed, the reorganisation of Latin American military turned out to be quite effective[39]. Hence the counterinsurgency and containment elements took precedence over progressive and democratic considerations. Through this new hemispheric security system the military regimes developed a new mission, namely fighting subversion. But "the change in military doctrine from the defence of territorial security to fighting the 'internal enemy' with special forces was [also] a final blow to the precarious sovereignty of the Latin American countries" (Nef, 1995, 87).

Not surprisingly, the armed forces were considered the most stable and capable institution to promote the modernisation of capitalist development and protect it from socialism (Horowitz, 1967, 175). In fact, the mere existence of capitalism – the interventionist and protectionist as well as the liberal sort - would have been at risk in some countries without military dictatorships. The military governments did not have an inherent statist orientation based on any particular ideology, nor did they refer to a specific sort of public policies. Hence, the dictatorships which unfurled in the region[40] did not fundamentally turn away from the national populist goal or the introverted model of development, but rather tried to carry out what weakening civil governments had not been able to follow through, such as raising taxes or restoring foreign investors' confidence. At the same time, some liberal-monetarist measures were introduced. Mainly through agrarian reforms and intensification of internal industrialisation the regimes led top to bottom national revolutions, mostly oblivious of trade unions' and popular classes' claims, using repressive measures against leftist insurrections to avoid the much dreaded Cuban scenario.

It needs to be underlined that the military *juntas*, their evolution as well as their policy-making, remained strongly country-specific and the chosen combinations were numerous. The striking extremes of the two neighbouring countries Peru and Chile underline the

[39] In this context, the aid and trade policy of the United States during that period was depicted as follows: While there was a trend toward military assistance over civic assistance, the "supply effect" of trade gave way to the "influence effect", in using trade strategically. "Thus, the concept of development as an instrument of national interest [gave] way to development as an instrument of American interest" (Horowitz, 1967, 147).
[40] The three only countries preserved from military coups were Mexico, Columbia and Venezuela.

heterogeneity of the development paths chosen by the armed forces. While the military putsch of 1968 in the former represented a late breakthrough of developmentalism and a crusade against the American imperialist, in the latter General Augusto Pinochet, advised by his Chicago Boys, forced radical neoliberal measures upon the country from 1973 on.

While the Chilean experience induced high social and political costs, but brought some substantial economic improvements, "sooner or later every [other] country under military rule suffered a recurrence in aggravated form of the macroeconomic imbalances that had characterised populist, civilian ISI" (Ward, 1997, 57). In this worsening economic situation, pressures from business and from "below" underlined the soft spot of military governments, namely their lack of legitimacy. In this difficult social, political and economic context, most military dictatorships came to an end, when armed forces "restored democracy" and retired from the (visible) political scene.

The international context did certainly play its role as well, as for example the changes in the US administration, which tended to apply, in the late seventies, a more progressive approach to Latin American politics. Another reason for this withdrawal of the military from the executive was the fact that it had generally intended to introduce bureaucratic authoritarianism[41] for a limited period only, to put the countries back on track economically and build the foundations for "tidier" and stronger states, and perhaps democracies.

Whichever of these reasons[42] prevailed case by case, the results regarding this very challenging combination were globally unsatisfying. While the political aim was somewhat successful – often new constitutions and new party systems were introduced – it did not suffice to fulfil the economic one: Relying on the market while repressing unions and counting on increased FDI-inflows by "securing" the country was not enough to foster sustained growth, neither could stabilisation measures advocated by the IMF lastingly master inflation.

In sum, the institutional leadership of the military left the region in an economic situation similar to the one experienced under earlier civilian rule, when considering the main

[41] Guillermo O'Donnell, a US-Argentinean political scientist, depicted and theorised this concept in: *Modernization and Bureaucratic Authoritarism: Studies in South American Politics*. Institute of International Studies, University of California Press, Berkeley, 1973.
[42] International geopolitics such as liberal-democratic tendencies on the Iberian Peninsula and a weakening Soviet Union coupled with a declining support of authoritarianism by the United States contributed to the already lukewarm stance towards the military dictatorships at home.

macroeconomic indicators such as GDP, inflation, debt and investments (Boris, 2001, 67). While there had been an increase in FDI, the escalating debt burden presented worrisome perspectives for future growth due to heavy debt services. In fact, it is not farfetched to pretend that, in the end, they had led their countries to a degree of vulnerability and economic dependence that became fatal in the difficult exogenous economic environment of the early eighties. The myth that authoritarian governments could restore growth had proved to be wrong.

2.2.3 Democracy and populism

As a definition, political transition is delimited on the one hand "by the launching of the process of dissolution of an authoritarian regime and, on the other, by the installation of some form of democracy, the return to some form of authoritarian rule, or the emergence of a revolutionary alternative" (O'Donnell & Schmitter, 1986, 7). While there is no doubt that the entire sub-continent moved away from the authoritarian military regime, there have been hesitations among scholars as how to label the outcome of the political transition. Presidentialism, polyarchic democracy[43], tamed democracy (Nef, 1995, 90), or delegative democracy[44], indicate a variation on the political structure commonly understood as democracy in the Western world.

In fact, the "democratic transition" brought the dilemma deeply rooted in Latin American societies back to the fore, namely the difficulty of combining mass-based democracy with an efficient economic management. This task seemed even more dramatic for the economies because of the on-going economic crisis: "However welcome the transition from authoritarianism, the political opening came at a time when economic choices for Latin America seemed to be narrowing" (Conaghan & Malloy, 1994, 4). Indeed, the costs of either the orthodox or heterodox path were high at a moment when the economy stagnated and the state was head over ears in debts.

Yet, the return to civilian rule, or *democratisation*, did not necessarily coincide with a radical change in economic policy, or, expressed the other way around, "liberal trade regime has not always been the by-product of a more democratic society" (Dornbusch,

[43] This idea comes from Robert Dahl, *Polyarchy: Participation and Opposition*. Yale University Press, New Haven, London. 1971.

1992, 69)[45]. There are, in fact, three possible sequences in the combination of political and economic transitions, as shown by the following examples: In Chile and Uruguay, drastic orthodox economic reforms had been undertaken in the mid-seventies, long before the military withdrew from power. In the Venezuelan case, economic liberalisation took place in a frame of long-existing political institutions. Finally, in most countries, such as Argentina and Brazil, economic liberalisation and the consolidation of democracy came about more or less at the same time.

According to Waisman, "the three sequences are fraught with dangers, but the third is the least favorable. The reason is that economic liberalization and the consolidation of democracy are governed by what I call two opposing social logics": Liberalisation, on the one hand, follows a logic of *differentiation*. Democratic consolidation, on the other, is controlled by the logic of *mobilisation*. "The two logics have the potential for inhibiting each other and, consequently, for blocking or derailing economic liberalization, the consolidation of democracy, or both" (Waisman, 1998, 90).

In such difficult circumstances, shared by most countries in the region, the question is whether the attempt to combine democracy and the market is worth trying[46]. Brought together, they do represent opposition rather than convergence, since the former concept implies equal rights for citizens while the latter inherently favours inequality. In effect, democratisation inhibits economic reforms: "By limiting the concentration of power, democracy [...] makes drastic change difficult. It may thus impede marketization, the political process of instituting a capitalist market economy" (Weyland, 1998). Thus, in cases where governments were opting for orthodox approaches to the economic crisis, the

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[44] Again, twenty years after his work on military regimes, Guillermo O'Donnell seemed to have given the most complete picture of the socio-political structure found mainly in South America in his article: Delegative Democracy, *Journal of Democracy*, January 1994.

[45] Incidentally, this observation is relevant insofar as it suggests no direct congruence between political democratisation and liberal reforms, nor causality between military dictatorship and interventionist and protectionist policies. However, as will be discussed later in this chapter, domestic business supported democratisation as a means of reducing the uncertainty of military rule and wanted, at the same time, to move away from statism towards economic liberalism. In this sense, business has been an element encouraging, in certain circumstances, the combination of both democracy and liberalism.

[46] In developed Western countries, it could be argued empirically that democracy and market economy seem to be somewhat congruent since they are both based on freedom and individual initiative. The outcome of the same relation has proved to be quite different in developing countries, and notably in Latin America. Indeed, the tensions between democracy and market capitalism have been lastingly apparent in that part of the world.

democratic process was marked by repression and the exclusion of most social agents in policy deliberations (Conaghan & Malloy, 1994, 4)[47].

Przeworsky maintains that structural transformations of economic systems are a "plunge into the unknown; they are driven by desperation and hope, not by reliable blueprints". And for political reasons, the reform strategy usually taken is not the one that minimises the costs, but the "bitter-pill strategy" that combines a turn toward markets with transformations of property. In such a context, "authoritarian temptations are thus inevitable" (Przeworsky, 1991, 189). Democratic transition, combined with market reforms have, in sum, led to an authoritarian style of governance[48]. But what type of model of representation developed in the aftermath of military rule then, and how was it articulated around the civilian governments?

If economically, the military dictatorships had not totally moved away from the introverted model of development, they had certainly weakened national populism as a political and social structure, broken up its political coalitions, attacked the vested interests of the population and, ultimately, "[torn] down the welfare state scheme" put in place by populist governments since the thirties (Nef, 1995, 88). The military had undermined national populism by dismantling its mode of representation and its corporatist features, in order to dissolve the bottlenecks of the industrialisation process and to facilitate capital accumulation.

The debt crises that followed eventually led to market-oriented structural adjustments, which gave the final blow to the economic component of traditional populism. In a way, by adhering to the Washington Consensus, Latin America "solemnly abjured national populism" (Favre, 1998, 55) as it represented a drastic and irrevocable departure from the ISI-model. Internally, it also meant flexible labour markets, cuts in wages and social programmes and the state's withdrawal from its income redistribution responsibilities. In short, all the acquired rights during the populist period, which were premises for traditional mass mobilisation, have been constantly eroded during the last decades. With the orthodox reforms, the states further showed the will to re-integrate the world markets by opening their economies to international market forces and to move away from the state-nurtured

[47] In countries where economic managers chose the "politically more palatable heterodox programs", economies were hit by hyperinflation.
[48] However, authoritarianism has not, in our opinion, been causally linked to a specific model of capitalism. Both heterodox or orthodox policies - nation-centred, protectionist and statist, as well as liberal, market-oriented ones - have been combined with power concentration in the executive.

industrialisation. As it seemed, the ISI model was finally eradicated, as did, jointly, populism.

However, "populism [...] has proven to be far more resilient and adaptable than its detractors ever imagined". Indeed, looking at the countries like Peru, Argentina, Brazil and Venezuela in the nineties, Kenneth Roberts argues that different forms of mass politics are at work, often times in a context of economic austerity and neoliberalism, the supposed antithesis of the very concept of populism[49]. Thus, he suggests a second wave of populism which often "corresponds to the erosion of the social, economic and political architecture erected during the era of state-led ISI, much of it built by the first generation of populist leaders" (Roberts, 2000).

This resurgence of a top-down mass mobilisation as a political structure has its roots in a profoundly disarticulated Latin American society. In this sense, some (striking) parallels can be drawn between today and the "traditional" sort of populism of the first half of the 20th century. Indeed, there has been a return to an "atomised society", an unorganised social structure similar to the one existing in the twenties and thirties[50]. Interestingly, each period experienced its deep economic crisis – the Great Depression and the debt Crisis – which further put societies under pressure and set the stage for radical political and economic changes. An impoverished, jobless population in a highly unequal and non-distributive society is more receptive to the calls of a *caudillo* personally challenging the political and economic order in place. This direct connection between such a leader and unorganised masses is synonymous with non-existent – or, in the eighties, deliquescent – formal structures of representation.

During the first wave of populist mobilisation, it was the oligarchic power that was challenged. More than fifty years later, it was the remnants of the institutional structures built by the old generation of populist leaders which were being attacked by *modern* populists. In fact, their anti-institutional stance and disdain for formal political structures and channels of representation is the main point of departure from the traditional concept

[49] He suggests that until recently, the concept of populism was often anchored in history and thus combined with a specific economic model of development. Yet, scholars should direct their attention to its essentially political character. In this sense, populism is not confined to statist economic policies.

[50] In the context of neoliberalism, most workers and employees have experienced a worsening of their already precarious work conditions. In disarticulated populations, liberalisation and deregulation have not necessarily induced an increased solidarity which could lead to social mobilisation. On the contrary, under pressure, people are, in fact, in competition. The worker who

of populism[51]. Such direct attacks have been aimed at neutralising the two main threats to direct mass politics, that is to say, a well-organised civil society and strong state institutions and party system.

The most complete dilution of the latter occurred most certainly in Peru, where the representational gap due to their collapse had been filled by short-lived political movements whose unique *raison d'être* of promoting candidates and gathering votes disappeared after presidential elections. Incidentally, this strong emphasis on presidential elections reflects the volatility of an electorate disconnected from any sort of party participation, and represents a shift of power, away from parliamentarians towards the executive (Novaro, 1995, 316).

In addition to the changing composition of society, whose growing informality (in terms of work force) had made former forms of civil organisation and adherence to political parties difficult, it is the people's mistrust of the existing formal political structures and inefficient states that played a main role in the accession to power of a new generation of leaders. The technocratic-bureaucratic labyrinth of subsidies and privileges towards powerful elites (Boris, 2001, 97), as well as the omnipresent corruption and rent-seeking within weak and predatory states (Evans, 1995) are certainly further factors which explain why entire populations had grown weary and suspicious of the political structures in place and the relations at work between political and economic elites[52].

This sort of *anti-institutional* populism, advocated by leaders such as Peru's Fujimori and Argentina's Menem, seems to have experienced new developments in the nineties, based on an individualised society and combined with the modalities of economic neoliberalism[53]. Meanwhile, another, apparently more traditional sort of populism based on mass organisation linked to the state, personalised by President Chavez' leadership in Venezuela, may still exist in today's Latin America.

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has a job is not inclined to assert social rights. Thus, the concept of "atomisation of society" (Favre, 1998, 55).

[51] Robert notes however that throughout the 20th century, both types of personalistic leadership were applied; one was combined with statist nationalistic economic policies, the other was closer to economic liberalism. While the former was based on mass organisation, the latter had little incentives to organise its followers and was similar to what has been called "neopopulism" in the nineties.

[52] In such circumstances, Fujimori's claim, in 1990, to be "*un hombre cómo tú*" (a man like you), was appealing to an alienated electorate, more than any particular abstract policy programme.

[53] Interestingly, both presidential candidates had, during their campaign, called for stabilising the economy without imposing hardships and claimed their intentions to favour state ownership and intervention in the economy (Stokes, 1999a, 98-99).

In this sense, from a political point of view, what matters "is that the populist concept has been dusted off and is now widely adopted in the analysis of a new generation of political leaders who mobilise mass support while bypassing representative institutions and suppressing democratic checks and balances" (Roberts, 2000). In other words, populism is versatile and its economic modalities may vary. This methodological clarification opens the way to the analysis of various combinations of economic policies with populist leadership.

Its resurgence, in the aftermath of military regimes, in a context increasingly favourable to liberal economics, is particularly striking. Yet, if one considers classic economics and monetarism, in contrast to developmentarism or structuralism, one might recognise in practice what is believed in theory. Indeed, economics is considered a *pure* science and has thus a universal scope, somewhat like natural sciences. Derived from such beliefs, the Washington Consensus is, itself, seen as a universal solution for economic performance, which may be completed, if necessary, with "local seasoning". This perception of the necessity for economics to be detached from any social – and above all political – interference can be found in the combination of neoliberalism and authoritarianism/populism. A striking example is Fujimori's self-putsch, when he shut the Peruvian Congress down, because they did not allow him to be an efficient state *manager*. In most cases however, "*authoritarian bubbles* have permitted to hive off economic policy from normal politicking" within the bounds of democratic constitutionalism (Conaghan & Malloy, 1994, 168).

Overall, transitions towards democracy in Latin America have been mitigated. Even if some sort of democratic institutions have been introduced, check and balance between the executive, the legislative and the judiciary remain a formal artifice in many countries. Political power remains, in fact, mere "*espejismos de la democracia*"[54] (Tanaka, 1998). In most cases, the quest for an efficient management has prejudiced the rather abstract idea of democracy. As pointed out by several authors, the experiences of the nineties have severely weakened Fukuyama's thesis of the "end of history" (Fukuyama, 1992) stipulating the joint victory of capitalism and democracy.

While this combination seems to be lastingly spoiled by an unstable state with an overly concentrated executive, one needs to consider the other determinant agent of political and economic change of a given national economy. The next section will thus represent business, and will be followed by an analysis of its relations with the state.

[54] Translated: Mirrors, or reflections of democracy.

2.3 Business and state relations

States evolve to the rhythm of the changes in governments, and both shape a specific political and economic space. But business does not only take it all in. Private business has, in most countries, a decisive impact on the economic and political environments, through its economic activity as well as through its relation with the state and its politicians. Often, this relation affects governments' decisions concerning economic policy and political economy, and, more generally, its political orientations.

Before we specifically focus on what private business is to the Latin American environment, and how it evolves in a context of constant political and economic changes, we will consider the business - state relations more globally, trying to define how business may be represented in connection with political power.

2.3.1 Business and the state in developing countries

The political relations between business and the state[55] and their implications for society have been a long-lasting issue for scholars. Yet, beyond the multiplicity of research, this field of study remains theoretically rather diffuse. First, this topic, at the fringe of several disciplines, is not part of either political sociology or economics in particular, economists even being usually reticent about including it in their research. This leads to a second fact, a much debated issue: The state's implication in the economy – as well as business in the political arena - have often been connected to negative assumptions (not to mention the sort of relationship state and business leaders may nurture): "Whenever capitalists organize and meet with government officials, consumers and taxpayers should hold on to their purses"[56]. Indeed, close and congenial relations between business and the state have generally been perceived as threats to democratic ideals, economic efficiency, and social welfare, particularly in Latin American countries. Rent-seeking has been – not without strong arguments - the Trojan horse of adepts for drastic market-oriented reform: By eliminating rents, business could concentrate its efforts on competition and efficiency

[55] The type of relation described here is not restricted to those relations within the economic space, such as competition between public and private firms, or privatisation, where the state's role is more the one of an *entrepreneur* rather than *regulator*.
[56] Haggard et al., expressing Adam Smith's mindset according to business and state relations (1997, 51).

(Maxfield & Schneider, 1997, 4)[57]. The policymakers and their technocrats, on the other hand, should avoid any contact with business, to prevent clientelism and other types of pressures.

In order to lead the debate beyond the received negative assumptions, a closer look at business and its roles is necessary: The diversity of interpretations of what it may be in relation to the state leads to competing or even contradictory ways to theorise it, and thus to analyse it. Haggard et al., distinguish five typologies of business, namely business as *capital*, *sector*, *association*, *network* and *firm* (Haggard et al., 1997, 36). It is worthwhile to consider each approach with its particular focus on the private sector – state relationship.

Business as capital

Capital represents perhaps the most homogenous and universal, yet most abstract approach to business when considering its relations with the state. As suggested in Chapter One, capital *per se* represents economic power in the political process, and again through private investment decisions in a national economy. Further, the main feature of capital is its mobility, which implies options such as *voice* and *exit* when bargaining with the state (Hirschmann, 1970).

With financial liberalisation, liquid assets can move more and more freely between countries, limiting any government's hold on it. Topics such as macroeconomic instability, foreign capital dependency and the nature of capital flows are part of the general concern of the effects of financial globalisation on vulnerable developing countries (FMI Bulletin, June 2003). Thus, apart from "conventional", internal pressures (for concessions on taxation, wages, etc., mainly on social democratic governments), global ones (for financial convergence and uniformisation of financial markets) strongly reduce the regulatory lee-way of states (Haggard et al., 1997, 39).

These international impediments to financial market opening operate mainly through two distinct mechanisms. First, increasing interdependence expands the weight of domestic business with foreign ties. Second, and more importantly, balance of payment crises force

[57] Yet, even if freer markets may eliminate traditional rent-seeking to a certain degree, it would be simplistic to conclude that they resolve all problems of business - government relations. In fact, new sorts of interactions – and potential rents - appear in a liberal reform process, such as the privatisation of state firms.

developing countries to resort to deeper liberalising measures to encourage foreign capital inflows. Thus, "the clearest effect of internationalisation has been to undermine governments' autonomy in the domain of macroeconomic policy, and this has resulted largely from rising capital mobility, rather than trade" (Haggard & Maxfield, 1996, 256). On the contrary, business – as an internationally mobile capital – has seen an increase of its domestic political leverage (Milner & Keohane, 1996, 18).

Business as sector

Literature viewing business as sectors suggests that business within an economic space does not have homogenous preferences. Thus, a country's economic characteristics are crucial to its policy-making, since different production profiles will lead to different sectorial coalitions favouring various types of policy-options (Haggard et al., 1997, 42). It can be claimed, then, that policy is largely reliant upon the country's leading economic sectors. According to Rogowski, cleavages among sectors run along factorial lines, determined by a state's *resource endowment* and exposure to trade. Then, based on standard trade theory, it can be argued that in an economy, the abundant factors gain while the scarce ones lose (Rogowski, 1989). In other words, "producers closest to their countries' comparative advantage are expected to favor policies that promote increased openness, while disadvantaged producers should oppose them" (Milner & Keohane, 1996, 14).

Consequently, an increase in economic importance of the traded good sector could "be associated with concomitant decreases in the use of Keynesian demand management, capital controls, industrial policies and welfare provision" providing certain institutional requirements are fulfilled (Garrett & Lange, 1996, 69). Thus, such a pattern could favour an increase in trade liberalisation.

Business as associations

Business associations have, in scholarly work, appeared as a threat or as an ally to the state and society, in terms of economic performance or political governance. But whether "positive or negative, political or economic", the arguments put forth underline the fact that "business associations are central independent variables in explaining variations in economic and political development" (Schneider, 1998).

As for the positive side, some social scientists see business associations as mediators between the government and capitalists, and underline their potential propensity to enhance economic performance. First, they can "maximize the positive effects of government-business collaboration by limiting the pursuit of particularistic benefits". Then, they can "promote collective self-governance of business", which can be more effective than state intervention (Haggard et al., 1997, 49). Further, in a context where the market tends to replace the state as the main regulatory force of our societies (Touraine, 1999, 19), above all in countries which have faced neoliberal reforms, the importance of business associations has grown compared to other weakening social and political actors such as political parties and unions. Business associations may thus broaden the spectrum of representation through "enhanced concertation", and thus improve the governance of emerging democracies (Schmitter, cited in Schneider, 1998)[58].

A more negative perspective of business associations suggests that "common interests do not necessarily lead to effective organization or concerted political action because of the free-rider problem" (Haggard et al. 1997, 49), and sceptics "claim that business associations devote themselves to rent seeking which necessarily reduces overall growth and social welfare" (Schneider, 1998). Politically, such scholars - mostly inspired by Mancur Olson's work - would rather perceive strong business associations as factors able to destabilise the democratic process.

In fact, the associative aspect of business cannot be analysed without a reference to Mancur Olson's path-breaking work on collective action. Distancing himself from institutional economists like John Commons, and from the pluralist view, which perceives large economic groups working for their economic interests as absolutely fundamental in the political process, he suggests that "the small oligopolistic industry seeking a tariff or a tax loophole will sometimes attain its objective even if the vast majority of the population loses as a result. The smaller, privileged groups can often defeat the large – latent – groups, which are normally supposed to prevail in a democracy" (Olson, 1971, 125-26). The Latin American context, with "thousands of narrow associations that organize 'privileged' groups of small numbers of homogenous members" (Schneider, 1998), such as sectorial associations, seems to confirm his assumptions. Olson's small number concept seems to fit the region's high economic concentration: A business organisation representing a handful of leading businessmen may exert great influence on a government. "At such extreme

[58] This perspective is, in our opinion, not antagonistic to pluralists' view; they believed that pressure groups counterbalance each other and, more generally, that private associations limit the control of the state (Olson, 1971, 111).

levels of concentration, organization is easy; but interaction is likely to take a highly personal form" (Haggard et al., 1997, 49) shifting to informal, non-public relations, in other words, *networking*.

But differences between countries in terms of business organisation are flagrant due to another phenomenon. In all countries – except for Brazil and Argentina – so-called encompassing associations have emerged. In this regard, Schneider argues that "endogenous, economic explanations lead researchers away from the real sources of collective action by business in Latin America", and defends the idea that the source of variation of business organisation is, in fact, the state (Schneider, 1998)[59]. The appearance of encompassing – or multisectorial, peak – associations, are encouraged by political executives who seek support for their economic programme or who want to have a good grasp on business preferences as a whole. In "normal" times, the state issues positive (access to policy forums) or negative (compulsory membership) incentives to achieve these goals[60], since encompassing associations tend to fade away without them.

However, he claims further that collective action by business is not always an intentional creation of the state: Indeed, multisectorial business mobilisation may appear in situations of political conflict. To put it dynamically, "the more the state intervenes in the economy, the greater the incentive of business to mobilise politically to influence that intervention" (Haggard et al., 1997, 50). In a confrontational context, the broad state-like perspective of the business association gives way to a global front of protest which can put governments under extreme pressure. But in the absence of threats, they tend to weaken or vanish.

In this regard, the confrontation of the Peruvian government with the Peruvian peak umbrella association – CONFIEP – in the late eighties is a distinctive example that will be discussed in detail in Chapter Five and will consider how business associations and their relation to the state may contribute, or on the contrary, undermine growth and have an influence on state governance.

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[59] According to Schneider, research on collective action of business has progressed on three distinct tracks: Micro-economic, embedded/sociological and political. The first refers to Olson's work, the second is rather empirical and includes specific social contexts, considering them decisive. Both, however, omit the state as explanatory variable, giving it only a passive role. Clearly, analyses have focused on "the demand side – why groups would ask the state to organise them – not the supply side – why state actors would want to organise them". This perspective, then, would be the third track, drawing from the analysis of state corporatism and neo-corporatism (tripartite negotiations of business, labour, and the state).

[60] Schneider argues that if benefits are collective goods, then the Olsonian logic of free-riding may prevail. If they are selective and available to members only, there is a tendency of over-representation of big business in the peak association.

Business as networks

Rather than formal channels of pressure groups or business associations, relations between business and government may be perceived as connections between individual capitalists and bureaucrats[61]. This perspective has often emphasised the shared views and habits of a power elite and, in the tradition of a rent-seeking approach, pinpointed the negative social outcome of such closed networks, namely narrow personal interests over broad common goods.

Understandably, research on informal networks in Latin America, which is characterised by deep social and economic disparities, predatory states as well as by a concentration of political and economic power, has mainly focused on clientelism and corruption. However, according to some authors, such networks may, as business associations, enhance the performance of institutions. Indeed, research in other parts of the world, mainly East Asia, has unveiled long-lasting and dense networks between businessmen and bureaucrats.

The adepts of business-as-network perspective, drawing from Karl Polanyi's work, perceive the economy as an outcome of social action rather than a realm separate from social life. "Because economic action is socially embedded, there is no way, the new economic sociologists argue, that economic action can be understood and attributed to economic rationality alone" (Yeung, 1998, 58). Thus, rather than coming from atomised actors, economic action rests on networks of personal relationships. This embeddedness of economic action in on-going social networks corrects the prevailing concern with economic rationality in modern organisations. In the end, these are both "economising devices and power-laden entities". Thus, economic perspectives are inadequate to capture the multidimensional nature of complex organisations (Granowetter, in Yeung, 1998, 57). In fact, public and private sector networks may be intricate in such a way that "the formal distinction of government and business [becomes] almost meaningless" (Johnson, cited by Haggard et al., 1997, 56).

In spite of this, Haggard, Maxfield and Schneider note that such network analysis in economic sociology tends to neglect the state as central component of social networks. It has precisely been Peter Evans' effort to reintroduce the state in sociological research on

[61] Game theorists are another set of scientists who have analysed how decision-makers interact. Yet, the approach is quite different, since "the power of game theory is its generality and mathematical precision" (Camerer, 2003, 2). Another discrepancy with the network is the individual, rational nature of decision-making in behavioural game theory.

networks. His concept of embedded autonomy, mentioned earlier, encompasses both "the internal organizational characteristics of the bureaucracy that give it independence", as well as the networks linking bureaucrats and capitalists (Haggard et al., 1997, 55)[62]. Thus, the state may only evolve towards a Weberian democracy through its connection with business, since they are inextricably linked and mutually determined.

Evans analyses this *connectedness* dynamically, in the context of economic change in developing economies. First, he emphasises the fact that the character of business can be reshaped by economic policy. Yet, in case of economic success, a transformed business community - more powerful and independent - may spoil the patterns of business - government relations that made the policies effective in the first place. Business may become less tolerant of the state's autonomy, transforming connectedness into *capture*. Then, counterweights are necessary to keep public-private networks oriented towards collective action; this might be achieved through consolidation of networks including other social actors. In sum, as business - government relations evolve, a more encompassing and stable set of society-state networks could appear (Evans, 1997, 67)[63].

Business as firms

Big firms are readily associated with *concentration* in terms of assets and market power[64], a process leading potentially to situations of oligopolies and private monopolies. In emerging countries and in economies in transition more than in industrialised countries, the private sector is dominated by *business groups*[65]. Through cross-sector investments and acquisitions, business groups tend to diversify their activities through a process of *conglomeration*, avoiding placing "all their eggs in the same basket". Towards the state, both concentration and conglomeration of economic activity suggest market power; their leverage over one or several strategic sectors of the national economy implies latent economic power that may be used by big groups to pressure government action. However, conglomeration cannot be assimilated to concentration. In fact, diversification of activities rather suggests a weakening of power, since various branches of one business group may

[62] In this sense, without autonomy, the state degenerates into a "super cartel", yet if embedded in a concrete set of ties binding officials and society, the state may be strengthened.
[63] In his article, Evans empirically analyses South Korea's economic take-off under the light of evolving business - state relations.
[64] In economic terms, concentration is mainly the result of increasing economies of scale and scope on contiguous national markets.
[65] One of the first scholars to tackle the subject was Nathaniel Leff in: Industrial organization and entrepreneurship in the developing countries: The economic groups. *Economic Development and Cultural Change*, vol. 26, 1978, 661-75.

defend sector-driven interests. "The conglomerate form cuts across a variety of different types of activities: traded and non-traded goods, import-substituting and export-oriented activities, manufacturing, services, land development. A conglomerate's preferences may therefore be conflicted or ambiguous" (Haggard et al., 1997, 47).

States are not absent from the process of business concentration and conglomeration. Authoritarian governments for example, promoting ISI models of development, strengthen big groups through an industrial policy of subsidies, tax alleviation and other special treatments with the specific goal to enhance the creation of national *champions*. Indirectly, firms may have sought concentration to increase their bargaining power towards an authoritarian state (Thacker, 1998). Conglomeration, on the other hand, may be a strategy to avoid or reduce sector vulnerability. The group structure permits to shift capital between sectors and helps thus to absorb quick changes in economic policies, in turn influencing the pattern of specific sectors such as production and competition. In a protectionist national economy, diversification may be the "easier way" to grow for a business group, taking advantage of state-subsidised sectors and avoiding international competition abroad.

It is thus in these aggregate compounds that private economic power is distributed; in this sense, the political economy of the diversified group is central to future research on business government relations in developing countries in general, and Latin America in particular (Haggard et al., 1997, 48).

2.3.2 The business-as-association and business-as-group approaches

The five entry gates to business analysis treated above suggest various ways to appraise the role of business in its relationship to the state. While the two first approaches put forth actual business components, such as capital and goods, the associative, network and firm approaches represent the less conventional *business-as-actor* angle[66].

Coming back to the prevalent assumption that business, which occupies a privileged position in any capitalist economy, will use it to its particular advantage, these various conceptions suggest that a differentiated analysis needs to be undertaken to go beyond negative conclusions. Business - state relations may enhance general economic

performance. The nature of the relation is fundamental however. Schneider and Maxfield consider the business - state relation *a priori*, concluding that the interaction may be *collusive* as well as *collaborative* (1997, 5). They further suggest disaggregating "collaborative relations between bureaucratic and business elites and assess their impact of separate features of these relations on specific aspects of economic performance".

The authors wrap all these essential features[67] in a global trait that collaborative relation should include: *Trust*. "Effective collaboration between capitalists and officials implies extensive mutual dependence or vulnerability. Bureaucrats depend on managers to implement policies, and capitalists depend on bureaucrats to ensure the profitability of the investments made in furthering these policies". However, trust here is not what has often been considered *social capital*[68]; what developed countries have and developing ones do not. "Trust in business-government relations is a more specific, calculated, contingent phenomenon where protagonists on each side expect those on the other side not to betray them" (Schneider & Maxfield, 1997, 12).

Departing from the very much used business-as-capital perspective, the example of the businessman's choice between investment and withdrawal of capital is quite explicit. Depending on a conservative or reformist view, this power of capital may be perceived as positive or negative; the former may see it as a restraint on predatory states, the latter as a limitation of a government's options. Yet, the "trust-criteria", such as transparency, and credibility have a "calming influence" on capital flight while encouraging investment (Haggard et al., 1997, 58), and play an important role beyond purely economic and/or purely political criteria. This example resolutely suggests that business - state relations need to go beyond this particular perspective by including the other *business-as-actors* approaches, where modes of interaction are central to the analysis.

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[66] The firm approach could also be mentioned individually, since it may include all other four perspectives.

[67] Considering positive aspects only, the following should be mentioned: *Information exchange* and *transparency*. With accurate information flows in both directions, the state is more likely to formulate appropriate policies, and business can enhance its performance. Readily available information and transparency will "remove information from the hands of those who might manipulate it". *Credibility* and *reciprocity*; governments must be credible in order to reduce political uncertainty, and when negotiating with business, give long-term commitments. Agreements must be reciprocal, and the state needs therefore the capacity to require improved performance in return for subsidies for example.

[68] For the concept of social capital, see Robert Putnam: The prosperous community: Social capital and public life. *The American Prospect*, no. 13, 1993.

For our analytical purposes, we will split them into two groups: The *business-as-association* approach and the *business-as-group* approach. This choice is justified by the different channels of interaction used to cooperate with the government[69].

A relatively new phenomenon in Latin America, the *encompassing-association* approach is interesting because it suggests a new sort of institutionalised voice, replacing the traditional social actors such as political parties and unions in an environment where the economic is overtaking the political. Encompassing associations are different from sectorial associations, since, due to their composition, they tend to defend broad ideas according to what economic path a society should take: "Encompassing, multisectorial associations are more likely to press for policies that promote growth throughout the economy rather than favour particular sectors at the expense of others" (Olson[70], in Haggard et al., 1997, 51). Such peak associations will, for example, defend *private property*, rather than specific issues concerning taxation or subsidies. Thus, while "associational density of civil society constitutes a prerequisite for democratic consolidation" (Silva & Durand, 1998, 3), it is the encompassing ones that seem less inclined to seek particularistic relations with the state, rather using formal channels of interaction such as forums or, if necessary, resort to the media to pressure the government.

While fairly promising, these peak associations remain relatively fragile and context-driven. Interesting to medium-sized and small enterprises, they tend to be less attractive to big firms, and even less so to business groups which do not need to unite to make themselves heard by the policymaker. In fact, they may join in absolute necessity, probably muffling weaker voices within the peak association: "A source of conflict between individual capitalists and their business associations is the opportunity that managers of large firms often have to influence government decisions through informal, personalised channels" (López, 1992, 3).

Thus, the *business-as-group* approach has been and still is, in our opinion, the most substantial entry to business - state relations in Latin America, since the conglomerates are the most influential counterpart of the state and its leaders in terms of economic power. It is precisely this approach that has to be connected primarily to the *network*

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[69] According to Evans, "trust and reciprocity are built around continually iterated patterns of interaction. Formal organisations such as firms and business associations institutionalize the normative bases of collective action. Informal ties and networks accomplish the same thing in different ways" (Evans, 1997, 65).

[70] Mancur Olson: *The Rise and Decline of Nations*. Yale University Press, New Haven, 1982.

approach, as well as to the *capital* approach, since both logics are superposed. A brief look at the Latin American group will allow us to apply both perspectives.

Even though Latin America has a long tradition of capitalism – much more than many parts of Asia – most firms of Latin American origin are unknown outside their region, or even their country, unlike their Asian counterparts, which are truly present in our daily lives. Year after year, out of the 500 largest companies in the world, only a single-digit number come from Latin America. "What [...] is stunting their growth? The first place to look for explanation is that archetypal Latin American business, the loose, family-owned conglomerate" (The Economist, December 4th, 1997).

Beyond straightforward figures such as age and size, comparisons with firms from other continents are not an easy task. Indeed, a different business culture exists in Latin America, whose main representatives are the conglomerates. Also known as business groups, they embody the most powerful share of private property in Latin American countries, and thus the domestic part of private economic power. As market actors, the dominant capitalists frequently operate through these groups which are "multicompany firms under the control of family and friendship cliques" (Conaghan & Malloy, 1994, 16).

While many groups may coexist, the ones that "really count" in terms of economic power concentration are few. In fact, what singles out the select "native top of the business pyramid" is not only several leading firms in different sectors, but a group's presence on the capital market through financial services such as banks and insurance companies. Hence, the big groups are horizontally and/or vertically diversified industrial and financial powers (Durand, 1996, 18).

Property is the basic link between firms and creates a network of administrative and economic relations. Depending on the degree of dispersion of shares – usually low – a leading family has often more or less control over a group. According to Durand, who is a specialist in the matter, business groups have their wealth placed in different firms and branches of the economy, but form together an articulated entity. While the business group is an *ensemble* of firms tied through capital, inter-group relations exist as well, through crossed investments in a logic of *alliances*.

In terms of property, Durand (1996, 174) differentiates three types of corporations which appear in different economies and which, in turn, tend to have specific, contextual

relations to their respective environments or networks. Concretely, in developed countries, a distinction exists between *stakeholder capitalism* and *shareholder capitalism*. The former sort refers to big corporations, such as the German *Konzerne* or the Japanese *Keiretzus*, with a major degree of concentration of shares. A main objective of such firms is (or was) to offer particular advantages to their social networks, committing themselves to their employees in terms of job security, training and giving them the option to participate in the firm's decision-making by making shares accessible to them. Shareholder capitalism on the other hand applies to an Anglo-Saxon model of corporation, which suggests high property dispersion and less preoccupations with immediate social networks. Led by a hired *manager*, such firms are highly committed to their shareholders as well as their consumers.

Finally, there is a third system – found in Latin America – which could be called *patrimonial concentration capitalism*[71], where more than 50 per cent of property – hence the majority – belongs to one or two families from the business elite, or local *bourgeoisie*. Commitment to their employees is low and property is inaccessible, at least to "normal" buyers. Thus, any kind of *vertical* social ties are very scarce[72].

Traditionally however, power elites have been sharing *horizontal* networks. Business influence over government comes from common world views, personal ties and overlapping roles. The network goes thus beyond the actual business group. Through restaurants and clubs, attending meetings and sending their children to the same universities, the business elite is constantly in informal contact, sharing ideas, interests, expectations and visions. In political issues, such common ties might be of importance when uniting to defend a cause.

These *extra* economic networks between elites – coupled with economic ones, have been a striking reality of Latin American societies for a long time. Today they remain the base of economic concentration.

[71] Translation of Durand's Spanish version *capitalismo patrimonial concentrador*. Harry Makler used the term "patrimonial capitalism" in a conference on Brazilian banks in Rio de Janeiro, 1992.
[72] In this context, even if present on the stock market, such groups are far from being dynamic. Sales are rare, but when they happen they tend to be important, contributing to big changes in property and thus to the volatility of Latin American stock markets.

2.3.3 Business groups and governments in Latin America

Needless to say, economic power concentration is far from new in the region. It became particularly considerable during the second half of the 19th century. Then, society was under the yoke of aristocracies whose embezzlement of land and enslavement of the population on the *hazienda* was a source of economic wealth, social prestige and political power (Favre, 1998, 17). For the big families, the limits between public and private were a mere formality. These old oligarchies, a fusion of exporters, merchants and traditional landholding groups, dominated the scene until the thirties.

From the twenties on however, the economic crisis weakened the export dependent economies, announcing the demise of the landed oligarchies. "The capacity to dictate public agenda began to shift away from the old elites and toward new elites" which "began to articulate ideologies and economic programs that assigned a leading role in economic development to the state" (Conaghan & Malloy, 1994, 19). In this context, modernising politicians and technocrats did not exclude domestic capitalists from economic development. However, traditional business elites objected to the quest for deep structural changes as they found their process of wealth accumulation further destabilised. In this changing political context, land ceased to be synonymous of great economic power, while big state industries and a new private sector were appearing.

Political instability due to increased tensions between old elites and challenging developmentalism contributed to the accession to power of bureaucratic military governments, which, for the most part, increased state involvement aimed at recomposing a national capitalist class: "The restructured bourgeoisie that emerged in the seventies was melded together from traditional economic groups and newer maverick capitalists who were able to take advantage of government incentives" (Conaghan & Malloy, 1994, 20). Most military governments, such as the ones in Brazil, sought an alliance with the capitalist upper class by introducing leading industrialists into the decision-making. The clear aim was to encourage the appearance of a national bourgeoisie which would lead the country's economic modernisation and opening. In fact, the clear exclusion of masses and social agents from the political stage and the attempt to include the new economic elites was an important trait of the new militarism of the sixties and seventies.

These new elites, meanwhile, had transformed into diversified entities. With changing governments, the business groups applied a strategy of accommodation, depending on

their informal and discrete, yet direct relation to the executive (Durand, 1996, 41). Still, the economic role the domestic bourgeoisie was assigned, and from which it benefited, was not in any way tantamount to a restitution of political power. In fact, capitalists felt a growing uneasiness due, on the one hand, to their relative isolation from the masses and, on the other, relative to the involvement of the state in the economy and the absence of formal channels of interaction with the military governments.

These frustrations led the bourgeoisie to seek political alternatives to military authoritarianism and look for an economic model suited to their vision of capitalism. Weakened economically in a period of increasing debts, the governments, who had grown more and more vulnerable to pressures, were finally compelled to negotiate with external forces. In this context, economic change occurred with the incentive of the unified front of anti-statist domestic capitalists, an internal force which also strove to reduce political uncertainty. "Business groups supported democratisation as the means to escape from the uncertainty that reigned during the military governments of the 1970s" (Conaghan & Malloy, 1994, 5). Transition from a closed authoritarian regime towards a more open form of governance took place in an atmosphere of compromise and consultation. Hence, the democratic transition in the hemisphere was largely the result of a negotiated pact among elites (O'Donnell & Schmitter, 1986).

Economically, domestic business was divided as to which economic model to choose. Industrialists anchored to their internal markets and previously sheltered by state intervention in the economy, opposed the growing pushes of a new forceful alliance including the leaders of export-led industries, international monetary organisations and neoliberal technocrats. Under these circumstances, the diversified business groups adopted cautious strategies, delaying change to give themselves time to adapt to the rules. In the end, their position favoured those who advocated change, since they contributed to isolate the defenders of the old model – yet without being at the forefront of modernisation (Durand, 1996, 45). This shift, from the retreat of the state in the economy towards a reaffirmation of the private sector, encouraged the comeback of business groups to the foreline of national economic power. While they, too, had lost state support and had been affected by liberalisation, their sheer market power grew with the acquisition of state enterprises and the entry in new areas formerly reserved to the state. Their main tactics of influence, trying to negotiate laws sector-wise, were derived from their proximity to political power.

Politicians however, while more receptive to outer influences and eager to apply economic reforms, sought isolation from direct societal pressures, from below as well as especially from the domestic business community. Technocrats regarded domestic businessmen as "rent-seeking and inefficient mercantilists", who complicated the implementation of adjustment measures necessary for the countries' reintegration in the world economy and the attraction of foreign capital. In this new setting, business leaders went more public than before, asserting their role as political actors while adapting to liberalism, yet frequently arguing for a "fine-tuning of promarket policies to suit the 'national reality'" (Conaghan & Malloy, 1994, 219).

While the relations between political power, concentrated in the executive, and private economic power keep drifting under the cupolas of Latin American societies, few of the on-going debates really include the wide majority of the population. This coalition building remains at all times strictly an elite affair, but leading to a new economic "consensus-alliance" between top state representatives and top managers of business groups in a context of populist neoliberalism. The demise of statism and the *economisation* of society have favoured the position of the leading business groups while neoliberal reforms have encouraged further concentration of property and wealth, among other things through privatisation[73].

We have suggested that there has been a general trend in the evolution of business and of states in the region, and thus in their relations. At the same time, it is important to insist on the divergent sorts and sequences of political and economic transition when comparing various countries. It is precisely the aim of several social scientists to demonstrate the role of business - state relations in the course of a country's political and economic transformation, and comparative studies emphasise the different paths chosen in development strategies in this particular light.

In a study, Schneider argues that the "political economy of neoliberal reform, for Brazil and Mexico as well as other developing countries, often either neglect or misconstrue the multifaceted dynamic interaction between big business and top state officials" and shows that discrepancies in timing, scope and implementation of reform "depended heavily" on business - government relations (Schneider, 1997, 192). In Chile, a peculiar case, Silva

[73] These privatisations, in fact, represented a shift from big state enterprises directly to big private enterprises. Meanwhile, the returns of the sales landed directly in the hands of the state executives and were used to fuel their interests and political goals.

stresses the high degree of autonomy of the state in the mid-seventies, and particularly the existing ties between idealist technocrats – the Chicago Boys - with a small group of internationalist financial conglomerates, which participated extensively in policy formulation (Silva, 1997, 160). Here again, relations between political and economic elites were the determining factor to the country's development strategy and economic transformation.

This chapter has emphasised the necessity to grasp the many-sided aspects of business in relation to the state. It has attempted to show how, in Latin America in particular, the choice and the results of economic policy are linked to the structure and character of both the state and business, and to the interaction of the holders of economic and political power in the public and the private spheres. The distinction in the latter, of the *extra*-national private agent, introduces the analysis of the TNC and its position and role in regard to both domestic agents, state and domestic business, in Chapter Three.

CHAPTER THREE: Transnational economic activity and the national space

In the extensive interdisciplinary forum on globalisation, two main subjects have been much debated by social scientists in the last twenty years: First, the changing meaning and role of the nation-state; second, the evolution of transnational economic activity: "In short, globalization is a process leading to the structural transformation of firms and nations" (Dunning, 2000, 13)[74].

3.1 Transnational economic activity

Transnational economic activity has been particularly scrutinised in the context of a transforming world economy. Moving away from the pattern of rather clearly definable units, transnational business has evolved towards a more intricate composition, qualified as *networks*. In network models, the social embeddedness, beyond economic alliances, is central, and anchors the firm in a specific space.

3.1.1 Transnational corporations and foreign direct investment

While national spaces have changed substantially in the past few decades in reference to the "outer world", transnational economic activity seems to have become more intricate and *thicker*, in a context of world-wide trade and financial liberalisation and economic uniformisation. Contrary to international flows of goods and capital, which imply a cross-border interaction between two or more national spaces (and thus more than one economic agent) the concept of *transnationalisation* is assimilated to the one of the firm. As explained earlier, TNCs are present in different national economies, creating their own *firm-specific* space (Gaudard, 1999, 19).

[74] Dunning quotes a definition of Anthony McGrew (Conceptualizing global politics. In: *Global Politics: Globalization and the Nation State*, The Polity Press, Cambridge, 1992): "Globalization refers to the multiplicity of linkages and interconnections between the states and societies which make up the present world system. [...] [It] has two distinct phenomena: scope (or stretching) and intensity (or deepening)".

To the United Nations Conference on Trade and Development (UNCTAD), the *transnational corporation* (TNC) is:

> *"... an enterprise, which is irrespective of its country of origin and its ownership, including private, public or mixed, which comprises entities located in two or more countries which are linked, by ownership or otherwise, such that one or more of them may be able to exercise significant influence over the activities of others and, in particular, to share knowledge, resources and responsibilities with the others. TNCs operate under a system of decision making which permits coherent policies and a common strategy through one or more decision-making centres".*

However, for working purposes, the UNCTAD greatly simplified the definition, merely considering the TNC as an entity controlling assets abroad (UNCTAD, www.unctad.org).

It has been the UNCTAD's aim to "further the understanding of the nature of transnational corporation"[75], and this second, basic definition upholds the use of foreign direct investment (FDI) as principal measure of transnational economic activity. *Mapping* a geography of FDI has thus been central to the organisation's *World Investment Reports* (WIR), showing mainly quantitative FDI trends of countries world-wide. As to the *transnationality* of a firm, in addition to foreign assets, foreign sales, employment and location[76] were introduced by the UNCTAD in the nineties, in an effort to explicit its transnational character. These instruments are valuable to trace quantitative trends in international production, since they measure spatial evolutions as well as firms' global *weight* in the world economy.

In the past few years, the WIR have illustrated the unprecedented increase in international production in absolute terms, as well as the intensification of FDI relatively to traditional

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[75] Since 1993 the UNCTAD has served the United Nations Secretariat for matters related to FDI and TNCs. Before, the Programme on TNCs had been carried out by the United Nations Centre of Transnational Corporations (UNCTC) since 1975.

[76] The common differentiation of FDI inward/outward stocks and flows indicates the amount of foreign-owned assets within particular political spaces, respectively their assets owned abroad/externally. This perspective keeps country and region as the central object of study. Looking at the actual vehicles of FDI, foreign assets alone are a scant measure of the *transnationality* of a firm. Indeed, a big company may have substantial foreign assets, but these represent perhaps only a fraction of its total assets and/or may be concentrated in few countries only. To this purpose, the UNCTAD has included the *Transnationality Index* and the *Network Spread Index* in their reports since 1995 and 1998 respectively. The Transnationality Index is composed of the average of three ratios: Foreign/total assets, foreign sales/total sales, foreign employment/total employment. The Network Spread Index represents the amount of countries the TNC is present in, with regard to the amount of countries the TNC could be located in, that is, the sum of all states in the world.

trade. Simultaneously, FDI flows show a strong concentration of transnational economic activity in the Triad, suggesting a very uneven distribution of FDI around the world. A similar statement is made for firms, as the largest 100 TNCs account for roughly 15 per cent of foreign assets, sales and employment in the world. "Concentration [...] characterizes the number of firms that are important players: even though there are over 60,000 TNCs, only a handful of them accounted, in the major countries, for the bulk of outward FDI" (UNCTAD, 2001, 47). A vast majority of these leading companies come from developed countries.

The purpose of FDI, *a priori* in opposition to portfolio investments, is to achieve partial or total control over production, marketing or other economic activities in an economy other than its home economy, rather than maximise returns on interest rates[77]. Firms may invest in new production facilities, so-called *greenfield* investments, or purchase parts, or the entirety, of an existing facility. For a long time directed primarily at extractive and agricultural products, FDI was then increasingly used by the manufacturing industry and ultimately in services. Investing abroad has been a means to access specific raw materials and control its extraction and later, increasingly to circumvent trade barriers. Particularly for the last three decades, it has been part of TNCs' integrated strategy of production.

Business economists have undertaken to explain why and how FDI actually happened; major contributions came from Raymond Vernon with his *Product Cycle Theory* (1966)[78] and particularly from John Dunning with the *Eclectic Theory* (1977)[79], which became later a reference in the theory of FDI.

> *"The theory of FDI is concerned chiefly with explaining why firms extend their territorial boundaries outside their home countries, and why they do so by setting up new subsidiaries or acquiring existing foreign value-added activities, rather than by exports from their domestic production units, or by selling the right to use their competitive advantages, especially non-financial assets, through intermediate product markets. In doing so, it draws upon and integrates several branches of economic theory of the firm and those of trade, of location and of market structure" (Dunning, 2001).*

[77] In his doctoral dissertation, (*The International Operations of National Firms: A Study of Direct Investment*, MIT Press, Cambridge, 1976) Stephen Hymer showed that FDI could be explained as a firm's expansionist strategy, and emphasised the advantage of the monopolistic nature of ownership.

[78] Raymond Vernon: International investment and international trade in the product cycle. *Quarterly Journal of Economics*, 80 (2), 1966, 190-207.

[79] John Dunning: Trade, location of economic activity and the MNE: A Search for an Eclectic Approach. In: B. Ohlin, P.O. Hesselborn and P.M. Wijkman (Eds), *The International Allocation of Economic Activity*. Macmillan, London, 1977, 395-418.

FDI has been the tool used by economists to study TNCs, yet it does not seem to be altogether appropriate to grasp TNC activity. Vernon states that the exclusive study of FDI was justified as long as foreign affiliates were standing "on their own feet for extended periods". However, new functions of affiliates, notably squeezing out rents from intangibles such as patents, managerial systems or trade names, have been carried out; and "by the 1970s it had already become clear that the FDI approach would not be sufficient to deal with the various consequences attendant on the growth of TNCs". The phenomenon should therefore not be considered simply another capital movement, although this view is spontaneously espoused by many economists (Vernon, 1996, 561). In the same train of thought, the role of TNCs can be thought of as undervalued in FDI statistics, because they consider only capital, omitting the variety of contractual relations TNCs have been weaving with their partners (Andreff, 1995, 380).

Dunning points at another delicate matter relative to FDI. By attempting to develop a general paradigm of foreign direct and foreign portfolio investment (FPI), he suggests that even though FPI and FDI are traditionally two differentiated capital exports, in today's global economy, they are interconnected in such a way that FDI is increasingly taking on characteristics of FPI in terms of ownership, thus making a "holistic explanation of international asset movements" necessary (Dunning, 2001, 147)[80].

These two comments suggest that FDI cannot pretend to give an encompassing explanation of transnational economic activity. Mergers, alliances – as will be described further ahead – as well as FPI are usually part of TNCs' strategies to establish a permanent position in another economy. In order to consider these evolutions in international corporate strategy, a closer look at the qualitative changes in international production is necessary.

3.1.2 From internalisation to alliances

It is widely agreed that the internationalisation of production passed, mainly in the seventies, from one form to another. While the former implies autonomously producing *clones* located near foreign markets and fully-owned by the *mother-firm* (Perriard, 1995, 23), the latter sort suggests a centre with various subsidiaries or affiliates, each segment contributing partially to the production of particular goods. In opposition to the

[80] In his book, Dunning shows how direct investment can be "portfolio in nature", giving explicit examples.

multidomestic strategy[81], localisation (and re-localisation) is production oriented, determined by natural and human endowments as well as by legal and political constraints of national (or regional) spaces[82]. Through the decomposition and the segmentation of its production, a TNC can choose localisation rationally, and each affiliate is specialised in a particular component. This form of industrial organisation evolved with the dwindling of transportation costs and improvements in information technology. Centralised and mainly hierarchical, this structure favours intra-industry trade and a two-way coordination (UNCTAD, 1993).

Beyond TNCs' traditional subsidiary, acquisitions as well as joint equity ventures, a whole "spectrum" of "new forms" of industrial cooperation with reduced TNC capital participation - such as outsourcing, licensing agreements, franchising, management and financial agreements - have been increasingly used, forms that contrast with the traditional technology transfer through a wholly-owned subsidiary of a TNC (Buckley, 1985, 39). TNCs have diversified their investment strategies, controlling production without relying on traditional forms of FDI but through contracts. With the transnationalisation of production, TNCs have, since the seventies, watched over foreign affiliates through industrial cooperation and technical assistance, without necessarily owning the majority of foreign assets (Andreff, 1995, 381).

The use of FDI as an instrument of transnational economic activity was implicitly justified by the theory of the firm and the concept of internalisation, to which Ronald H. Coase is an important contributor. According to this theory, the choice between more or less internalisation is determined by surveillance/control costs versus transaction costs. Thus, as stated by Coase in the late thirties, a greater degree of internalisation is likely to occur the higher the market imperfections (Coase, 1937). The substitution of the market through the homogeneous space of the firm allows the free flow of capital, products, technologies and know-how. In international production, this objective of internalisation is best fulfilled by the use of FDI to create subsidiaries[83].

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[81] This term was used by Michael Porter in: *Competition in Global Industries*. Harvard Business School Press, 1986, to describe the presence of fully functional subsidiaries in various countries and their "stickiness" in a particular national space.

[82] This type of organisation of transnational economic activity has been well explained through Dunning's eclectic paradigm.

[83] In his *Multinational enterprises and economic analysis*, Richard Caves developed theoretical models of the firm's choice between exporting and FDI (1982, 36-39).

Hierarchical capitalism or *Fordism*[84], which favours internalisation over markets, had been preferred as a mode of organisation with the increasingly specialised and technologically complex production. The limit of the firm was thus believed to be where majority ownership ended, and minority ownership joint ventures were regarded as second-best alternatives to full ownership. In this context it was supposed that the prosperity of the firm was maintained by internal management only. Particularly in fabricating and assembling mass products, firms had engaged in vertical integration and horizontal diversification in order to capture economies of scope and scale (Dunning, 1997a, 70). Yet these organisational structures, adapted for mass production, where increasingly displaced by new ones, based on vertical disintegration, known as *Toyotism*. The result was vertical outsourcing, often coupled with horizontal links with small and medium-sized enterprises, which increased the flexibility[85] and reduced production costs (Castells, 1999, 197). In international production, the old industrial division of labour splitting up tasks on an assembly line in *one factory* was thus replaced by what has been called the *New International Division of Labour*, dividing manufacture into sub-assemblies, mostly located in countries with favourable labour conditions. This new setting based on contracting represents the TNCs' evolution towards externalisation of transactions, which had previously been intra-firm (Buckley, 1985, 52).

In the last two decades, business has embraced yet another trajectory of market capitalism. The particular feature of this new kind of organisation involves simultaneously cooperation and competition with other firms. This *alliance capitalism*[86] was, at first, interpreted as part of the continuum of the hierarchy-versus-markets transaction model. But rather than being *hybrids* between the two poles of hierarchy and markets, alliances – typified by reciprocal patterns of communication and exchange – represent a distinctive mode of coordinating economic activity and economic organisation. As suggested by an OECD report: "the notion of the continuum [between market and hierarchies] fails to capture the complex realities of know-how trading and knowledge exchange in innovation" (OECD, 1992, 78). In this sense, this new form of cooperation between firms contrasts with the well-anchored assumption, since Adam Smith, that collaboration among firms is a symptom of structural market failure (Dunning, 1997a, 73).

[84] The fully integrated production facilities of the carmaker Ford in the sixties embodied this mode of organisation.
[85] This flexibility favoured *just-in-time* as well as "tailored" production.
[86] Term used principally by Dunning.

It is in technology and information-intensive product and service sectors that alliances have thrived, where costs and risks for research and development (R&D) are massive. Thus, "alliances are an indicator that the scale of technology – the cost, risk and complexity of R&D – has grown to the point where it is beyond the reach of even the largest and most global firms. [...] The cost of a competitive R&D budget has risen to the point where it is no longer possible to 'go it alone'" (Kobrin, 1997, 150-51). The alliance modality is thus combined with an increasingly innovation-led economy, where the so-called *strategic* alliances are concluded mainly for competitiveness enhancement[87]. Cooperative arrangements, unlike mergers and acquisitions (M&A), often only involve a minor part of collaborating firms' activities and may not affect ownership. Thus, alliance formation is a means of accessing specific ownership advantages without integrating them. A consequence of this mode of organisation is that the once autonomous firm is now often part of a web of inter-firm cooperative alliances. In other words, alliances are a manifestation of the substitution of a single firm by a *network* for trade and investment.

Referring to international production, the appearance of this new mode of business organisation dampened down multinational Keynesianism, a concept predicting the expansion of big consortiums through the conquest of expanding world markets (Piore & Sabel, 1984). Big firms remain, but similar to organisms, "are inextricably linked with each other, and according to the nature and strength of the link, affect each other's form and structure" (Dunning, 1993b, 610). In order to integrate the advantages of supple networks and to remain competitive and face a versatile demand, the firm had to become a network itself, with dynamic and independent but interconnected units, since the multiple-unit, vertically integrated and hierarchical firm appeared to be ill-adapted in the global economy. Relying on the synergies of the network, TNCs have abandoned some of their activities to re-centre around their mainly technology-intensive core businesses. In this context, it is the network, rather than the TNC, that has become the main vehicle of global economy. The TNC is, however, assuming the role of orchestrator of the network[88].

Far from being homogenous and rigid, the resulting *transnational space* represents a multiplicity of arrangements between the firm and its *incorporated* or *unincorporated* affiliates such as subsidiaries, associates, or branches (UNCTAD, www.unctad.org). Clear

[87] According to Dunning, alliances are concluded for four main reasons: 1) to obtain new product or process technologies and organisational competence 2) to spread the risk of high investments 3) to capture economies of synergy and scale 4) to access new markets (Dunning, 1997b, 29).
[88] The TNC can be disaggregated to a point where the firm comes near to a name attached to a large number of subcontractors, such as *Nike*, and become a *virtual* corporation (Cutler et al., 1999).

limits between the intra- and inter-firm structure tend to blur through the very nature and the dynamic aspects of the network. This new form of horizontal alliances implies only agreements for specific products, periods or practices, and does not, otherwise, exclude fierce competition between enterprises. Alliances are often highly specific in character and a transitional means of extending or reinforcing competitive advantage (Porter, 1990, 67).

In sum, the principal *modus operandi* of this transformation of international economic transactions from hierarchically structured TNCs to networks is represented by strategic alliances[89]. Thus, "in addition to FDI as a mode of exploiting or augmenting the competitive advantages of firms, there has been a huge growth in cross-border non-equity alliances and networking relationships. The motives for alliances are varied, but they all have one thing in common, namely they involve the international transfer of assets without any FDI on the part of the parties to the alliance or the participants in the network" (Dunning, 2001, 146). Technology and innovation, rather than capital, has become the main incentive for alliances and the most important flows across transnational networks are intangible: Knowledge and information. In turn, in opposition to internalisation, it is the *connectivity* of the network, or in other words, its structural capacity to facilitate communication between its components, as well as its *coherence*, namely the degree of concordance of objectives between the network in its entirety and its components, that will determine the performance of the network (Castells, 1999, 207).

3.1.3 Business networks and localisation

These fundamental changes in business organisation, leading TNCs to resemble a dense web of cross-border operations, brought about an increased interest in network theory. In this sense, while "traditional" forms of ownership and organisation have not disappeared, there has been a shift away from the analysis of the firm as monoliths towards the study of business networks. Many scholars have taken East Asian business structures as subject of study, since it is particularly in societies such as Japan, South Korea or China that the mode of organisation based on cooperation and agreement has been integrated into

[89] Narula and Sadowski (2002) differentiate networks and strategic alliances, arguing that the former have rather a cost-minimising objective rather than a strategic one. Yet they admit that in most cases, both motivations are linked and cannot be parted.

business practices[90]. It appears that in the last part of the 20th century, it is clearly the Far-Eastern network organisation that has been the most successful in world competition. However, as noted by Castells, the respective networks in that part of the world reveal distinct features. Consequently, he concludes that it is in the *institutional* and *cultural* characteristics of these societies that similarities and differences should be analysed (Castells, 1999).

A distinctive feature of alliance capitalism is its corporate governance structure. Decisions, rather than being taken according to a formal structure of authority, rest on a consensus of agreement between parties, in turn based upon commitment. Concretely, "in the modern factory practising flexible manufacturing or Toyota-like production methods, labour is not thought of as a cog in the wheel, as it is in traditional Fordism, but as a partner in the wealth-producing process". Similarly, suppliers are supposed to work actively with the purchasing firms to continually upgrade the quality or lower the prices of their outputs (Dunning, 1997a, 77). Thus, this form of organisation includes specific social and cultural features which are determinant to its economic success.

More generally, it may be stated that "the firm [...] goes beyond being an economic entity, it is also a sociospatial construction" and accordingly, the definition of the business network outreaches the economic scope. To Yeung, an industrial geographer, networks are both a *governance structure* and a *process of socialisation* which connect different agents "in a coherent way for mutual benefits and synergies". To him, business networks are, in fact, often based on interpersonal ties, informal information flows, resource sharing and decentralised learning and knowledge. Furthermore, basing his argument on Granowetter's work (1985), he notes like Castells that "these networks are often embedded in localities with very strong institutional legacies and linkages" (Yeung, 2000).

Applying this concept to TNCs presupposes a distinct approach from former economic theories, which, according to the author are *under-socialised*[91] because they work in isolation from other disciplines. In order to develop a network approach to the understanding of TNCs, insight needs to be drawn from international business, organisational theory, international political economy and economic geography (Yeung, 1998, 3).

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[90] For Japan see Michael Gerlach: *Alliance Capitalism: The Social Organization of Japanese Business*. University of California Press, 1992. For South Korea, see Alice Amsden: *Asia's Next Giant: South Korea and Late Industrialization*. Oxford University Press, New York, 1989.
[91] According to Granovetter, Economic actions should be embedded in social structure (1985).

A business network can be defined as an integrated and coordinated structure of on-going non-economic relations embedded *within*, *among* and *outside* business firms. In a network model for TNCs, Yeung conceptualises three different types of networks. To the two intra and inter-firm networks mentioned above, he adds the *extra*-firm network which corresponds to the firm's *embeddedness*. Briefly brought up in Chapter Two in the context of the state, this notion can be applied to business in general and TNCs in particular, which in the same way as other institutions, is "embedded in on-going networks of relationships – economic, social, cultural and political" (Yeung, 1998a). Such processes of network relationships change with varying historical and geographical contexts. Thus, the understanding of business networks should include their relationships with other institutions and structures.

Clearly, according to network theory, spaces and their components play an active part regarding business. The institutional frame has thus been the object of closer attention by scholars such as Castells (*état développeur*), Evans (*developmental state*), Perriard (*état médiateur*, *état interstitiel*), who have given a new and active role to governments in the context of a knowledge-based economy.

In general, the concept of the state as the keeper of political economy has to be reappraised in today's context of international production; to limit it to a central government of a nation-state is an over-simplification of reality. In fact, the state is, in itself, a system of networks as well (*réseau-état*) with a web of institutions at different levels (Perriard, 1995, 152), notably at the local and regional ones. In a particular space, the state contributes, with the civil society, to promote and create specific resources, in turn valued by TNCs. Private and public can thus be considered to be connected networks[92].

These intangible assets (technology, social capital), created or "captured" in particular spaces, redefine the nature of interaction between places and TNCs, spurred by an *asset-augmenting* logic rather than by a more traditional *asset-exploiting* one. In opposition to tangible and location-bound assets (immobile factor endowments) sought by hierarchical TNCs which base their production on traditional Heckscher-Ohlin type of trade models, the knowledge-based economy is reliant on intangible and mobile assets, redefining the

[92] In this sense, public and private networks do not, in principle, oppose each other, but are in fact locally connected and interdependent. Dunning notes that "interesting features of leading market economies has been the extent to which the hierarchical form of governance of both

geography of location of *business-network TNCs* and their affiliates since *specific*, rather than *generic* endowments and the capacity of a particular space to create resources are valorised by firms with global scope (Perriard, 1995, 48).

With the knowledge-based economy, regions and places which hold particularly knowledge-intensive agglomerations – clusters – of economic activity (see Ratti et al., 1997), have thus become attractive to TNCs. These are eager to participate in locally-bound R&D to increase their own competitiveness, notably in information technology. In fact, the changing geography of transnational-related activity is a "microcosm of that of the world economy". While TNCs are expanding and intensifying their value-added activities, they are increasingly drawn to specific geographical areas, operating as platforms for concentrated networks of competitors, suppliers and customers (Dunning, 2000, 21).

Spatial clustering reveals a dual process of international economic organisation: The geographical dispersion of transnational economic activities and their simultaneous concentration in particular places: "An irony of globalisation is that even as the relevant geographic market for most goods and services becomes increasingly global, the increased importance of innovative activity in the developed countries has triggered resurgence in the importance of local regions as a key source of comparative advantage" (Audretsch, 2000, 77). This apparent paradox of *sticky places* in *slippery space*[93] is, to Dunning, "opposite sides of the same spatial coin": Globalisation is nothing without localisation, and vice-versa, as the somewhat awkward term *glocalisation*[94] may suggest.

The strategy of a TNC, particularly in activities with high levels of R&D and technology, is thus global and local altogether. The leading firm, neither independent nor auto-sufficient, yet more mobile and flexible, is less anchored in *national* spaces but present locally through its network. Innovation tends to become a horizontal collective process in multiple locations, which will in turn strengthen the firm as a whole. In this context, geography and place still matter fundamentally in the ways in which TNCs are constructed and in how they behave: Firms, "produced" through an intricate process of embedding in

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private and public organizations has been complemented with, and in some cases replaced by, a variety of interorganizational cooperative agreements" (Dunning, 1997a, 10).

[93] This paradox, formulated in these terms by Ann Markusen (Sticky places in slippery space: A typology of industrial districts. *Economic Geography*, 72(3), 1996, 293-313) has been cited by several authors.

[94] The term appeared in the late eighties in articles by Japanese economists in the Harvard Business Review. According to the sociologist Roland Robertson, who is credited with popularising the term, glocalisation describes the simultaneity of both universalising and particularising tendencies.

which cultural, social, political, and economic characteristics play an important role, "interact with the place-specific characteristics of the […] communities in which they operate to produce a set of distinctive outcomes" (Dicken, 2002).

In the developed and economically interdependent world, a shift away from a national perspective of public-private interaction towards regional economic analysis has been taking place. Indeed, in cross-border relationships – such as strategic alliances as well as TNC – government interaction – less attention has been paid to nationality, whose economic importance seems to wither with the uniformisation of economic policies, and the functioning of TNCs: "We are still interested in what happens within a territory delimited by national frontiers; yet the firms that operate within it have different territorial horizons as well as strategic and optimisation fields" (Ietto-Gillies, 2004). Indeed, globalisation implies that the national economy is no longer the frame of reference for economic strategies, or as bluntly said by Krugman in the early nineties already, "states aren't really the right geographical units" (Krugman, 1991, 57).

Several scholars have suggested that, while the role of national governments is declining, that of supra- and sub-national authorities[95] is becoming increasingly significant. Especially since the nineties, the emergence of a broad spectrum of enabling policy initiatives that fall outside the jurisdiction of the traditional regulatory agencies, yet rather at other levels of government, have been observed (Audretsch, 2000, 78). An increasingly regio-centric economic activity favours the dilution of national authority in economic policy and regional states develop "into mini-countries in their own right" (Ohmae, 1995).

While the economic meaning of national boundaries tend to shrink, since national spaces are *fused* transnationally (Kobrin, 1997, 148), regional differentiation and disparities seem to increase. Spanning national borders, central regions of various countries become more interdependent, while their domestic links to peripheral regions tend to get relatively weaker, a sign of internal economic disintegration. It appears that two *microregions* of different countries may have more in common economically and socially than with other regions within their respective countries[96]. In the end, it could be suggested that in the knowledge-based economy, TNCs *de facto* connect microregions rather than entire nation-states. Hence, in the developed world, economic space is no longer primarily

[95] Governments in charge of *macro*- and *micro*regions respectively.
[96] Regions home to metropolitan clusters such as Zurich and Frankfurt have presumably greater economic linkages than Zurich would have with Swiss peripheral regions such as the Jura, for instance. These centre-regions are usually favoured by TNCs.

differentiated along national borders - which used to define the national economy – but through the transnational web woven by TNCs between specific spatial knots.

3.2 Transnational corporations and the political sphere

The conclusion of the previous sub-chapter describes changes in the world economy through the transformation of the organisation of its major promoter, the TNC. Simultaneously, it redefines de meaning of place, suggesting the increasing importance of its local or regional components. While these processes are undeniably taking place, even quickly, we pretend that in many circumstances, decision-making at the highest authority level of a country still largely influences transnational economic activity.

3.2.1 Transnational corporations and national governments

To begin with, if neither national borders nor nation-states mattered, any relationship between a firm and a political authority could be summed up to a private-versus-public issue, since, with the risk of mentioning the obvious, "TNCs would not exist if all entreprises were confined to single nation states, just like they would not if the entire world was organised as a single state" (Panić, 1998, 259).

Beyond this straightforward statement lies a dynamic reflection. Does globalisation and the role played by TNCs in that process indicate the demise of the anachronistic nation-state and the politically fragmented world economy, or do states continue to set the rules in terms of international economy? Less antagonistically, the question arising is, how and to what extent have TNCs affected "the nature and organisation of international economy and the relative significance of the Nation-state in its functioning" (Gilpin, 2002, 294).

In this context, a first observation could be that nation-states very much matter in regard to international economy. This conviction resides in two main realities of today's international political and economic landscape. First, even though a vast majority of countries has subscribed to free-market structures and is becoming increasingly interdependent economically, important differences between economies of various continents remain in terms of economic policy, and even a certain degree of economic convergence is a privilege reserved to the OECD club. Second, the global-local paradigm

cannot be applied to all types of transnational economic activity[97], but only to specific ones, mostly in highly technological and innovative sectors. While in the Triad countries, traditional comparative advantages seem less and less relevant due to the considerable increase of intra-industrial trade, immobile factor endowments and economic policies remain the foremost assets of developing countries. Accordingly, this implies an intact importance of hierarchical systems of transnational production, such as mineral extraction, agribusiness, food and textiles to mention but a few. These two observations are, here too, the two sides of the same coin, and can certainly be applied to those world regions peripheral to the "global" Triad-networks. Yet even within the Triad and regional groupings, where economic policies are drawing together, borders still represent an important demarcation in economic, political and social terms.

The debate on the national political sphere is thus to be included here. While it has been mentioned in Chapter One that this sphere was losing grounds on behalf of *economism*, national reality is nonetheless very present in some strategic sectors and in important transnational deals[98]. It fact, it is perhaps precisely because of this greater international economic integration that national economic issues, traditionally incumbent upon the state for strategic reasons such as autonomy and security, have come under economic scrutiny, in turn unleashing intense political debates. Should France deregulate its power market and let foreign competitors in? Would Switzerland suffer from the disappearance of its main independent airline? Is Finland excessively dependent on its telecommunication sector, whose major company Nokia is sensitive to a fluctuating world telecom market? Such issues, technically of economic nature but political in scope, are much debated in developed countries. They are highly relevant in developing ones as well, as suggested by the overwhelming presence of private international investments in strategic domains of national economies world wide, and have raised multiple debates on *autonomy*.

In economic terms, TNCs are similar to big domestic firms on imperfect markets, since they are raising questions as to monopolistic and oligopolistic patterns, and thus susceptible to governmental intervention. Yet, "by operating at any one time in number of different economic and political environments and, what is more, exploiting these differences, TNCs are even more powerful and 'unpredictable' than oligopolies confined to

[97] "Not all, indeed, not even the majority of [TNCs] have reached this last stage of evolution and most never will" (Dunning, 1993, 602).
[98] While national considerations seem to have faded in a globalising economy, it is worth mentioning the fact that important changes since the beginning of nineties have occurred in strategic sectors, such as air transportation, energy, telecommunications, banking and pharmaceuticals.

a single country" (Panić, 1998, 245). Indeed, TNCs tend to prevent governments[99] from successfully applying fiscal, industrial, monetary and income-related policies to achieve national goals such as economic and social welfare[100].

What is more, governments have, beyond economic goals, a whole range of other objectives. While economic aims – such as the opening up of new markets – may coincide with the ones of TNCs, others, relative to the preservation and protection of social structures, cultural values, environment and not least, economic autonomy, do not. Thus, "not only do governments have to worry about economic distortion as a result of the behaviour of TNCs, but they confront legitimate concerns about the impact of TNCs on national power and national autonomy" (Moran, 1996, 418).

The question, then, is how may TNCs' concerns be conciliated with governments' national worries and responsibilities. state autonomy has never been absolute and the power of decision-making has always been constrained by international economic transactions. Governments' aim has been to balance the *trade-off* between the efficiency and gains from transnational economic activity and the loss of autonomy. Every government will attempt to defend as much autonomy as possible when opening up its economy and favour an increased integration in the world economy. In this regard, "the economist and business analyst – along with the political scientist – can only speculate on the balance of likely economic gains versus the uncertain loss of political power or influence" (Dunning, 1993b, 530).

In a dynamic perspective, it can be suggested however that the relative influence of transnational actors has increased in the context of globalisation: The shift of mode of business organisation towards networks, blending markets transnationally, and the growing importance of technology for strategic industries do not allow states, if they want to stay competitive internationally, to keep from integrating global networks (Kobrin, 1997, 156). This, in turn, makes it even more difficult to implement national industrial policies, since it is impossible for any state to disentangle the web. Thus, the nature of interdependence of a single country towards the global economy has qualitatively changed, and it is precisely today's TNCs that are prime mediators of this transformation.

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[99] If not specified otherwise, *government* stands for the highest national authority.

[100] In his article, Panić explains how TNCs prevented various policies, or reacting to them differently than national economic actors - thus weakening the general impact of macroeconomic management of the state on the economy.

While all countries are increasingly connected to the world economy through TNCs, the nature of the relation between TNCs and national governments needs to be differentiated. Indeed, provided that logically, the political fragmentation of the world is taken as a reference for the study of the relationship between TNCs and nation-states or their governments, two distinct situations need to be considered. In fact, a TNC will be, by definition, bridging at least two national spaces, one representing its *native* economy – or home country, the other its *receiving* economy – or host country. The former relation, between TNCs and home country, is particularly relevant to developed countries[101]. In the latter, both developed and emerging/developing countries are concerned. Even if today, developed countries are the main addressees of foreign investment, the question of *inward investment* has been central to the development of national economies in developing and emerging countries in general, and in Latin America in particular. The TNC – host government relationship is thus our focus here.

Depending on how the TNC is perceived by a host government as to its potential contribution to the particular objectives of the country, the range of actions may go from a *laissez-faire* attitude to a *complete outlawing* of inward investment – both approaches representing the extremes of the continuum of relationships TNCs and host governments may have. In a chronological perspective, the general tendencies of TNCs - host government relations have shown a somewhat tumultuous evolution. Three main phases can be roughly differentiated. There was, at first, the *honeymoon phase* until the fifties and mid-sixties, followed by a *confrontational stage*, with very acute attacks against TNCs at the beginning of the seventies. Transnational firms were then perceived as "big, irresponsible, monopolistic monsters". They went later through "a period of being sneered at as yesterday's clumsy conglomerates", but were soon "lauded in the 1990s as the bringers of foreign capital, technology and know-how" (The Economist, January 24th, 2000). In that *reconciliation phase*, governments had refined and modified their policies, while foreign companies did not seek to maximise their rent out of their investment: "a more

[101] Having enterprises involved in the world economy may suggest a competitive national economy; the national economy might profit from returns gained abroad by "their" TNCs. But worries as to the organisation of "home-bred" TNCs have not been uncommon in developed countries. Downsizing and relocalisation of US TNCs in the late eighties, followed by the industrial *hollowing out* of Japanese firms through outward FDI have notably shaken these economies home to TNCs (see Bailey, 2003). Beyond economic concerns, strategic interests may be a reason for governments to examine some of "their" TNCs' behaviour abroad. Indeed, companies may have the incentive to share their technology, even sometimes *dual-use technology* (with economic as well as military significance) with foreign states or business. The United States has had some fears in that regard towards US companies in China (Gilpin, 2001, 180).

sensitive and better trained breed of managers and civil servants [had] emerged", leading to a more "mature and symbiotic" relationship (Dunning, 1993b, 557-58)[102].

Research in international business has attempted to set up economic one-to-one bargaining frameworks, in order to typify the determinants of economic interaction between the two agents leading to rational deals. While TNCs attempt to gain as many concessions as possible from the host economy – in terms of taxes or trade protection – host governments impose *performance requirements* on the firm meant to contribute to national economic growth (Gilpin, 2001, 174). Beyond the static, situation-specific bargain, changes over time will affect the stance of both parties: Changing governments, altering patterns of transnational economic activity and what is more, the learning process on both sides will induce shifts in the TNC – host government relation.

3.2.2 Transnational corporations and international political economy

In the liberal approach to TNC – government relationships, TNC nationality is not a decisive criterion. Considered mainly rational and economic but non-political entities, TNCs are perceived as companies likely to promote global welfare, while governments, threatened by TNCs, tend to intervene to reassert their authority within their territory of jurisdiction. Yet, government interference, at home and in host countries, should be limited to enhancing competition and correcting market failures. Even if TNCs do have their roots in a particular country, some argue, with the waning importance of hierarchical patterns of economic organisation and the increased multi-directional flow of information in business networks, home nationality does not matter as much as it might have in the past, and TNCs are increasingly *a-national*.

Others object that a TNC, in spite of transnational alliances overriding national boundaries and political differences, remains primarily a national firm. Indeed, TNCs "appear to follow tracks of coordination and control in which they have become embedded in their country of origin" (Harzing & Sorge, 2003). As for business alliances, these are, in the end, matters of power and interest and not any more stable than alliances among states. Furthermore, while some distancing from its national identity has taken place, strategic activities of the firm – such as R&D and finance – have often remained in the home country. More generally, domestic structure and economic ideology of the home economy have continued to affect

[102] By the end of the nineties, some hostility against TNCs had partly returned, yet mostly only in

the strategies and activities of TNCs (Gilpin, 2002, 298)[103]. In cultural terms, TNCs have been perceived as ambassadors, spreading cultural substance and values to other countries[104].

This difference in perspective has had important implications for the appraisal of TNCs and their activities. If the focus shifts from the specificity of the TNCs' *transnationality* towards their actual *degree of nationality*, their main influence does not come primarily from their transnational structure and governance, but from the country they originate, directly or indirectly working in favour of the latter's cause. Such considerations imply that, beyond the one-to-one confrontation or collaboration, both TNC - home and TNC - host government relations are in fact intertwined. A major contribution in this regard has been the state-centric, *neo-mercantilist* perspective on transnational economic activity.

While acknowledging the economic benefits of foreign investment, authors and administrations in Europe and Japan notably raised concerns as to the possible *satellisation* around the United States[105]. The United States had, later, similar concerns looking at some of their most dynamic industries become dominated by outsiders, notably Japanese firms (Franko, 1983). Viewing the world economy as a competitive *zero-sum* game between countries and alleging TNCs to be an instrument serving the interests of its home country, neo-mercantilism proposed that a nation should nurture its own firms to preserve control over vital sectors in national hands as a means of enhancing the country's power and autonomy[106].

With the concept of *twin personality*, Vernon referred to the conflict that might arise simply by the fact that a foreign affiliate, complying with the laws of the host country, is at the same time subject to the authority of its parent company, itself abiding by the rules of the home country. In line with the above-mentioned state-centric arguments, examples

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public opinion.

[103] As seen in Chapter Two, major differences exist between German, American and Japanese entreprises for example.

[104] TNCs were present on particular national markets before leaping beyond their borders, thus "keeping a nationality". Nestlé is still considered to be Swiss, Coca-Cola and Mc Donald's definitely American, and Telefónica Spanish.

[105] The Frenchman Jean-Jacques Servan-Schreiber wrote on the invasion of US TNCs which, he claimed, were threatening to dispossess much of the world of its identity. He insisted on the necessity for European states to resist American influence brought by American business (*Le défi américain*. Denoël, Paris, 1967).

[106] Interestingly, so-called *national champions*, if successful, tend to behave like their international competitors. Once engaged in outward investment strategies, their goals tend to diverge with the national objectives of the state-sponsor. However, preventing such companies

often cited in this context are often the imposition of *extra-territorial* application of home-country laws on foreign affiliates abroad. Significant examples in this respect are the application of US laws, for anti-trust or embargo purposes, on foreign subsidiaries of US companies. Other measures, known as *Home Country Measures*, are specifically formulated for foreign investment, and influence its impact in host countries, particularly developing ones (CUTS, 2003).

For TNCs, the fact that they are sitting astride two national spaces often represents an advantage, as they can profit from differences in regulations[107]. This however, will potentially create tensions between state authorities. Notable examples are transfer pricing or taxation. If a TNC is switching income from a country A to a country B by manipulating prices of products internally traded, a conflict will be arising between the countries, since A will regard the TNC strategy as going against its interest while B will stand up to the additional tax revenue. This will result in having the TNC be caught as "pig in the middle" (Dunning, 1993b, 582).

These different cases may lead to the following statement: First, apparent conflicts of interests between TNCs and host governments often conceal conflicts between nation-states. Second, instead of being a mere instrument of such conflicts, TNCs are active agents shaping, alongside governments, international relations. These conditions, combining both the state-centric and the liberal approach, suggest that transnational economic activity is still a matter of nation-states, but not exclusively. Two models, *triangular diplomacy* and *double-edged diplomacy*, can be used to place the TNC in international political economy, underlining its explicit role.

Strange and Stopford (1991) introduce a higher level of complexity in the TNC – government relationship in their model of triangular diplomacy, and present three sets of international relationships, as shown in figure 7.

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from playing according to market mechanisms and inhibiting their outward expansion might turn *national winners* into *domestic losers* (Moran, 1996, 426).

[107] A consequence of this situation not tackled here is the potential tensions *within* firms, which refer to the TNC's internal governance structure, and notably the relations between home base and foreign affiliates. In this perspective, social and cultural discrepancies between national spaces may raise internal frictions.

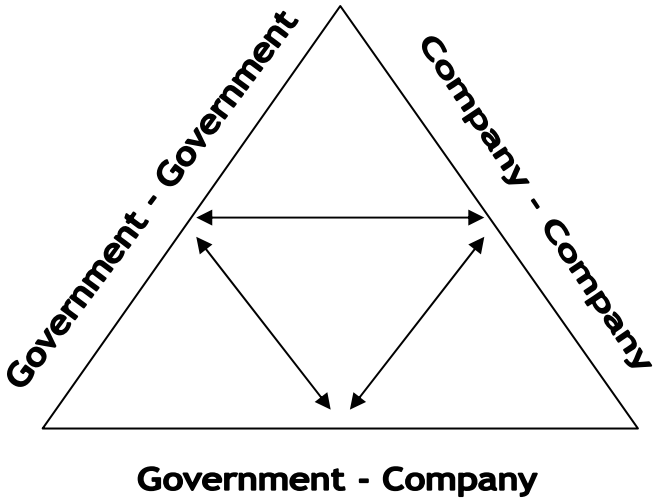

Figure 7: The model of triangular diplomacy

One side of the triangle represents traditional diplomacy between nation-states, another side the transnational interactions (alliances or rivalries) between companies, and the third, TNC - government relationships. This model emphasises the fact that, "no longer can national boundaries define the rules, for the game is now one where negotiation and action is carried out on a triangular basis". Diplomats and other state officials, the traditional agents of international relations, have been joined by an "emerging managerial technocracy", which participate in the system of world political economy.

Thus, looking at only one side of the triangle would lead to partial understanding of international political economy. By the same token, a global and lasting effectiveness of a deal between two agents is dependent upon the equilibrium of the entire triangle. As an example, if a government takes international action against a particular country, the government of the latter might retaliate internally by boycotting the foreign affiliates of the former. Similarly, if a government and a TNC come into conflict, the TNC might seek support from its home country[108]. If the home government does get involved, the conflict will turn into a state – state dispute. Thus, "unexpected risk can be created on another side of the diplomatic triangle" (Strange & Stopford, 1991, 23). The triangle-of-diplomacy model is a contribution to the understanding of international relations, since transcending

[108] This situation will be discussed further ahead with an example of a US company in Central America.

the traditional acceptance that international political and economic relations are a matter of state diplomacy only. Indeed, TNCs have enough autonomy to function as significant agents in the world political system, letting the idea of *private political authority* be more than just an oxymoron (Cutler et al., 1999).

Some scholars have tackled another commonplace in economics and politics, namely the distinction between international and national spheres. An integrated theory of both spheres requires a "two-level-games approach", recognising "that domestic policies can be used to affect the outcomes of international bargaining, and that international moves may be solely aimed at achieving domestic goals" (Evans et al., 1993, 17). This approach – coined *double-edged diplomacy* - should facilitate overcoming the institutionalised division between comparative politics and international relations, as suggested by Milner & Keohane: "Cross-national comparisons are meaningless without placing the countries being compared in the context of a common world political economy within which they operate" (Milner & Keohane, 1996, 257).

Mainly aimed at analysing strategies of states and their effects, we consider – with the previous model in mind – this concept valid for TNCs as well. While companies are no states, the idea of a *double-edged* strategy brings the essential difference between domestic companies and transnational business to the fore: Whereas the former is involved on the national level only, the latter combines single-market strategies with the global scope of the company. If changes on the firm's domestic market occur, the TNC might adjust its global strategy, indirectly affecting foreign markets. Or a TNC may use its *international weight* or possibility of arbitrage between countries to bargain its position on a particular market, threatening governments with exit.

Both for TNCs and states, the concept of double-edged diplomacy includes the possibility to rely on actions of international authority to achieve their goals in particular economies. The fourth quadrant in our model of economic power of an open economy (Chapter One), including international organisations such as the IMF and the World Bank, even if not treated as such in our study, plays an indirect role in the home – host – TNC relationship, as will be shown in the next sub-chapter, and needs thus to be acknowledged.

In developed countries, besides specific issues, home – host – TNC relationships, and with them, nationality altogether, have lost most of their relevance these days. Except for some strategically sensitive sectors, transnational investment – inbound as well as

outbound – is not perceived as a threat, but as beneficial to the national economy. In this sense, government policies draw, for the major part, from liberalism rather than from neo-mercantilism[109]. Since the Triad is the biggest issuer and receiver of foreign investment, most countries experience important inflows and outflows simultaneously, a condition considered the best option in an interconnected world. The first reason for this acceptance resides in the fact that "being economically interdependent is politically preferable to being economically dependent". As an example, small countries such as Switzerland and the Netherlands "are almost completely dependent on – they might prefer to think interdependent with – the rest of world" (Dunning, 1993b, 532). Big countries, such as the United Kingdom and the United States are important recipients of inflows, yet they are at once strong outward investors. Second, if dependency there is, it is mostly diversified (relative to the origin of investments and to production) rather than specialised.

The main fears relative to foreign investment were raised in developing countries, where it has long been considered a new, particular kind of dependency showing up in the wake of the "traditional" political and economic dependency, at work since colonial times. In this context, *neo-imperialism* emerged as third historical paradigm besides liberalism and neo-mercantilism in TNC-government literature.

3.3 Transnational corporations and developing countries

The presence of TNCs, mainly coming from the developed world, in developing and emerging countries presents particular features. Thus, bargaining between the foreign firms and the host governments cannot be simply assimilated to the framework applicable in the industrial countries, but needs to be approached specifically, embracing the historical and political context of developing regions. Based on the example of Latin America, TNC and host government relations are considered in a context of changing patterns of transnational economic activity and placed in the more general setting of a globalising world.

[109] Still, some economists argue for example that Japanese trade policy, up to the eighties, was in large part based on mercantilist concepts. In Western Europe and the United States as well, some forms of protectionism have been criticised as being mercantilist in nature.

3.3.1 Transnational corporations in Latin America

The political and economic trajectory of many developing countries has been profoundly affected by international production. In the aftermath of their colonial past, Latin American countries in particular endured the presence of ethnocentric foreign investors. Later, governments included transnational activity into their economic development scheme, in an attempt to escape underdevelopment. Today, Latin America is, more than ever, a major haven for foreign investment, but issues as to the region's situation of dependency remain.

In the TNC – host government literature on developing countries, authors such as Osvaldo Sunkel[110] and Frederico Henrique Cardoso (1979), mentioned earlier, have expressed criticism towards the structure of the relationship, above all in the Latin American context. In addition to the neo-mercantilist concern of an imbalance between states resulting from transnational economic activity, their dependency - or neo-imperialist - perspective revealed an exploitation by TNCs which benefits both the ruling classes of home and host countries[111]. This debate on economic dependency has a long tradition, and is rooted in a complex political, historical and cultural context. In addition to earlier chapters of Latin American history, most of Central and Latin America has perceived, behind the heavy hand of American TNCs, a "US-style capitalism and culture controlling their destinies" (Dunning, 1993b, 532)[112].

Beyond the worry of becoming economically dependent has lain the deeper fear of a loss of political sovereignty and cultural identity. It is certain that TNCs' activity - as well as, sometimes, their home countries – have contributed to this image up to well into the second half of the 20th century. Even the not so distant histories of foreign companies in the region, such as the one of the United Fruit Company (UFC) in Guatemala[113], enlighten the difficult legacy for contemporary TNCs.

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[110] Osvaldo Sunkel, big business and dependencia: A Latin American view. *Foreign Affairs* 50, 1972, 515-31.

[111] As Cardoso and Faletto put it, the relationship between internal and external phenomena are "a complex whole whose structural links are not based on mere external forms of exploitation and coercion, but are rooted in coincidences of interests between local dominant classes and international ones, and, on the other hand, are challenged by local dominant groups and classes" (Cardoso and Faletto, 1979).

[112] In this context, it is important to mention that in the seventies, the US still provided about half of all FDI in the world, while Latin America attracted the bulk of it.

[113] In 1944, a coup toppled a dictatorship close to American interests. The reforms initiated by a new independent, socially-oriented government was putting pressure on the American firm and irritated the United States which accused the regime to be drifting towards communism (Beyhaut, 1965, 287-90). A plot involving the company, Washington, the CIA and some Guatemalan officers

In some instances, managers of foreign companies have been arrogant and self-centred, defending their rights to take unfair advantages and making use of their monopolies. Sometimes, governments - respectively their officials - have had predatory behaviours, seeking to increase their personal rents disregarding the country's economic development, or, in the case of the home government, adopt an "imperialist" attitude to defend the interests of the company. The UFC episode is a striking example of a combination where all the parties involved - namely home, host governments as well as the firms - abused their respective powers to defend their interests on grounds of political uncertainty (see Litvin, 2003).

In the Latin American context, it is precisely political uncertainty combined with corruptive practices which has often kept the economic discourse on the tumultuous relationship rather marginal. However, on the one hand, provided that governments are not predatory[114], but approximating a state of Weberian democracy (see Chapter Two), these will pursue collective ends and will thus be interested in maximising the future productive potential of the territory they govern – for the welfare of its citizens or simply to increase state revenues. On the other hand, if TNCs perceive the rules imposed by the state as necessary to political and economic stability, a prerequisite for their welfare, they will attempt to generate profits while complying with the rules. In such a context, state and TNCs have strong shared interests, that is, the country's long-term economic growth.

Admittedly, this ideal-type of rational behaviour was rarely found in the context of early investments. A foreign presence was often synonymous with an exploitative monopoly, backed by a predatory government. Yet, from the thirties on, changes in international production, in state behaviour as well as in the up to then prevalent economic paradigm in international trade, require an analytical approach of the evolution of TNC – state relationship.

In order to deal with international production in Latin America, it makes sense to introduce three different ideal-types. The analytical differentiation between *internationalisation of production* (extraction of raw materials), *multinationalisation*

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led to another coup in 1954, which reinstated a right-wing dictatorship. For decades, Guatemala would then face civil war and social regression. The aftershocks of the coup were felt across Latin America. For a generation of left-wing activists, it came to symbolise what they saw as the malevolence of American influence and investment in the region (Litvin, 2003, 137).

[114] On the side of Latin American governments, the issue with foreign investment has often been how to extract the greatest personal share from whatever wealth of income might be generated by private actors, trying to strike deals with transnational capital for personal profit.

(production as in the mother-firm) and, finally, *transnationalisation* (production scattered in multiple countries) is an entry gate to the understanding of the changes that have occurred in transnational economic activity as well as to the role played by states since the Second World War. While the first pattern of production has subsisted up to this date, remaining an important component of foreign presence in the region, multinationalisation of production was partially replaced, from the mid-seventies on, by transnationalisation[115].

Well into the 20th century, foreign investments were exclusively destined to exploit the natural resource base of developing countries, by extracting materials or taking advantage of the climate and the soil. The FDI mechanism was thus based on the classic paradigm of comparative advantage, in a general mood of economic liberalism. The resources gathered according to this traditional pattern of international production were almost exclusively intended for the companies' home markets. After the Great Depression however, increasingly protectionist states disrupted the liberal atmosphere, bargaining with extraction companies to increase their say in primary product industries: "After the slump of 1929, companies could no longer rely on not being interfered with the state. Suddenly, political boundaries became meaningful for the national economies and especially their frontier-crossing transactions of production factors, goods and services" (Baumer et al., 1983, 6).

A combination of developments contributed to a new trend in FDI, meant for the multidomestic production of manufactured goods. While growing demands for such goods made the markets of larger developing countries more attractive, sophisticated manufacturing abroad became possible through technological improvements. Another major incentive came from the states' shift towards import substitution. Disillusioned by economic liberalism and export-led strategies, states increasingly erected restrictions to trade. This recent protectionist stance of governments did convince TNCs that it was worth trying to supply developing markets locally rather than relying on exports. In fact, "instead of being an obstacle, most of these barriers [provided] TNCs with an incentive to locate their activities in a country protected by them"[116] (Panić, 1998, 247).

[115] For convenience, companies involved either in multinationalisation or transnationalisation processes will be, as hitherto, called TNCs, or at times, simply foreign companies.
[116] TNCs, like domestic firms, were taking advantage of protectionist policies as well as of their privileged position in highly imperfect markets. Thanks to the very mechanisms of TNCs, namely the internalisation of their cross-border activities, they could skirt the obligation of reinvesting locally, over- and under-pricing imports and exports respectively (Favre, 1998, 40).

Complementing the traditional primary-product FDI, this model of import-substitution FDI represented a fundamental shift in international production in developing countries. It qualitatively transformed the interaction between them and the world economy. Production and consumption in developing countries became internationalised in a new way, since they were being integrated into foreign corporate organisations by more than a mere legal definition. This "defensive market-seeking FDI", being only a replacement for trade, did little to promote a more efficient regional or global division of labour (Dunning, 2000, 18). Developing states however hoped it would upgrade industrial productivity from within their respective countries. Investments in manufacturing capacity thus united TNCs and governments in a joint ISI project. By the early seventies, "after virtually two decades of expansion by manufacturing [TNCs], a substantial share of the newly-diversified industrial base was controlled by [TNCs]" (Hamilton, 1986, 45).

From the mid-seventies on, another mode of international production was laid on top of internationalisation and multinationalisation, changing again the developing countries' insertion into world economy. As mentioned earlier, the organisation of TNCs moved away from the multidomestic type of production towards a more sophisticated pattern of production, based on the coordination of a multiplicity of affiliates around the world. Hence, a vision of global networks replaced the one of multinationalisation, where the TNC worked as a parent presiding over a dispersed set of smaller replicas. Rather than based on market proximity, production started to be organised on a world scale: Scattered parts of the network being dependent on each other. This transformation in TNC activity weakened the state's ability to affect TNCs, less dependent upon specific markets and economic policies.

Mounting tensions between the option of letting TNCs work on national markets without government interference and the necessity for governments to intervene to prevent exploitation and distortion was continuous. Critics of TNCs were holding foreign investors responsible for the distortions and postponement of countries' development and states were seen as their main opponent which could force them into a viable bargain for developing countries or exclude them. Advocates of TNCs on the contrary, saw states "as carriers of irrational nationalism whose parochial fear of TNC economic power robbed their countries of a crucial source of economic betterment" (Evans, 1998, 195).

Tensions between TNCs and host governments reached their climax in the mid-seventies when the relation was more conflictual than cooperative. First, the assessment of TNCs'

contribution to productivity in Latin American countries revealed to be mitigated, because contrasted: Larger markets were more successful in attracting FDI than smaller and poorer countries. Correspondingly, TNCs' input to industrial development varied from sector to sector. In particular branches of major Latin American markets, manufacturing had become a channel to the creation of additional economic capacity. Meanwhile, in other cases, TNCs imposed their monopolies, which affected local production negatively.

Second, governments' learning process had often led them to reappraise their arrangements, pushing for more concessions from the part of TNCs to increase their share of economic rent and imposing more requirements to foster TNCs' contribution to national economy. Developing states had become increasingly worried about the concentration of TNCs in the high-technology sectors that benefited from the greatest growth rates and had an organisational pattern over which governments had little control (Gwynne, 1986, 128).

National goals and specific expectations towards foreign companies matched less and less TNCs' international scope and attitude, and governments tried to push foreign firms to concede some control of the sectors that were essential to their economic growth. In doing so, host governments attempted to break the structure of the wholly-owned hierarchical subsidiary, mostly directed by headquarters in the home country. While developing states were invoking the right of sovereignty and development, TNCs felt threatened in their quest for ownership and investment security. Businessmen were willing to work within any system, they accepted "the rules of the game", but only as long as they allowed them to keep control over the oligopoly rents and their technology (Moran, 1975, 24).

3.3.2 Transnational corporation - host government bargaining models

As in inter-state diplomacy, elements of both cooperation and conflict exist simultaneously in the bargaining process of host governments and TNCs (Stopford & Strange, 1991, 22). And again, as it is in diplomacy, the bargaining process is essential to both parties who have different interests and who intend to strike the best possible deal. In this context, one-to-one bargaining models have been applied to TNC – host government interaction in developing economies to study their respective strengths in the relationship.

For developing countries, scholars tried to conceptualise the bargaining process between TNCs and host governments in highly imperfect markets with strong tendencies of public intervention. Penrose and Kindleberger both first applied an economic "framework of

bilateral monopoly, with the firm controlling sector-specific capabilities and the host country controlling the conditions of access" (Moran, 1996, 421). The bargaining model, rather clear-cut in extractive industries, is more intricate with manufacturing TNCs, since new criteria going beyond a specific project needed to be included.

Particularly, while manufacturing TNCs had the additional potential to play countries against each other, by making them compete for FDI, developing economies could also strengthen their bargaining power by increasing competition among several TNCs (Lecraw, 1984). Among the characteristics enhancing TNC bargaining leverage are usually cited a company's technology, overall size, type of products offered – in sum, Dunning's ownership advantages. As for governments, the localisation advantages of the national territory are determinant, notably the access to big and rapidly growing markets as well as appealing policy incentives.

In the so-far static bargain a dynamic perspective in the TNC - host government bargaining model was introduced, with the argument that the evolution of risk and uncertainty of investments induced re-negotiating the deal struck initially, at the time of the investment. This corresponded, in other words, to the wish of either party to change the terms of TNCs' presence at a later date, as their relative negotiating strength had evolved. Based on his product cycle theory, Vernon argued that the bargaining position of TNCs eroded with time – with risk and uncertainty dissipating - giving the host government a better hand in the negotiation (Vernon, 1971). This dynamic phenomenon, expressed as the *obsolescing bargain* model was, as Moran notes, a breakthrough in the conceptualisation of TNC - government relationships in developing countries. The model offered "the beginnings of a theory of economic nationalism based on rational self-interest" (Moran, 1996, 422).

Besides their tendency to tax more heavily, governments also sought majority ownership, in certain cases moving all the way to nationalisation. Unlike earlier *mass* nationalisations, based on political and ideological motives, from the late sixties on nationalisations had become *selective*, driven primarily by economic purposes. While nationalisations were used as a measure to make economic gains, governments' intentions was not always to deprive the TNCs of ownership, but to manipulate them. Still, both taxation and nationalisation were instruments used by Latin American states notably, and by the early seventies, the increase of the former was often combined with the growing frequency of the latter, peaking in the mid-seventies (Andersson, 1991, 12-14). Mexico initiated "Mexicanisation" and Brazil pressured for joint ventures in sectors were the state felt it had real leverage.

Parallel to a gradual shift from high tax rates and majority ownership to demands for the expansion of domestic processing and increased training for indigenous management in extractive industries, host governments searched, in the increasingly important manufacturing sector, to focus their requirements on local value-added activities, domestic R&D, job creation and exports. Governments expected TNCs to contribute to their countries' industrialisation and growth, and later sought to take advantage of economies of scale by increasing exports.

In the early seventies however, while host countries felt more confident in maximising their leverage vis-à-vis TNCs, the bargaining game was altered as "the global structure of TNC operations was undergoing a metamorphosis on its own" (Evans, 1998, 205). This process was taking place in a changing international political economy. While Latin American states had been pressing for changes in the structure of multinationalisation, transnational economic activity was experiencing a transformation, changing the dynamics of TNC – host government relationships.

The experience of Mexico and its car industry illustrates the on-going bargaining between state and TNCs on a large and rapidly expanding developing market. In a thorough study[117] on transnational auto makers in Mexico, Bennett and Sharpe concretely distinguish several determinant socio-economic areas in which the host government's industrial policy and TNCs' behaviour were subjects of intense bargaining[118]. They concluded that: "The experience of Mexico shows that the interests of the auto TNCs often led them to pursue courses of action that were detrimental to Mexican welfare, but also shows that the state was able to alter their behaviour to make them contribute more to industrialization and economic growth" (Bennett & Sharpe, 1985, 253). But the transnational character of the industry made it hard for the state to influence its logic on the Mexican territory.

[117] Douglas Bennett and Kenneth Sharpe, *Transnational Corporations versus the State. The Political Economy of the Mexican Auto Industry*. Princeton University Press, New Jersey, 1985.

[118] The Mexican State's pressure on the car industry was manifold. It wanted the TNCs to make investments spurring industrialisation, and not only to set up assembly lines. It pushed for a standardisation of production, since cars where ill-adapted for poorer classes. It further attempted to limit the number of foreign competitors since Mexico's small domestic market was better suited to an oligopolistic pattern of production. Finally, it was the state's goal to reinforce domestic control over resources and industry as well as to fortify the domestic private sector. Overall, these endeavours to shape the sector were a modest success. International patterns of production were stronger, and the auto industry was too important to be threatened with the exclusion from the Mexican market.

Interventionist policies became rather inconspicuous, and were increasingly combined with incentives to attract foreign investment. More and more, "an ambiguity in host country behaviour had become evident – on the one hand the desire to expropriate, and on the other the need to attract new investment" (Andersson, 1991, 13). By the late seventies, nationalisations had decreased and the long-lasting conflict between TNCs and host countries faded while a harmonisation of policies towards FDI-liberalisation was put in place, alongside with the general trend of economic reform packages: "Now the controversy has died. Whether or not TNCs are optimal instruments of development is a moot point since no Third World country considers excluding them" (Evans, 1998, 195)[119].

As seen in Chapter Two, Latin America had gradually turned towards economic liberalism. Thus, by the end of the eighties, economic nationalism had mostly vanished, and governments were increasingly concerned about reforming their economies as well as getting their FDI-policies adjusted to international standards to attract foreign capital. Indeed, as TNC activity began to change once again, a shift in governments attitude occurred as their bargaining power declined and the external pressure for a shift in economic policies was increasing.

In the context of the multinationalisation of production, some developing countries had been able to increase their bargaining leverage and build up sophisticated strategies to screen the entry of TNCs and regulate their operations. Relations between TNCs and governments could be analysed in terms of each side's bargaining power and the TNC – host government bargaining models were very useful for study cases, as the subsidiary was, in itself, a *complete* production unit meant to supply a particular host country. Thus, these bargaining models assume that TNC entry into developing countries involves negotiations on a *case-by-case* basis, with the actual entry conditions depending on the bargaining power of the two sides. Today, "many governments [still] try to analyze proposals project-by-project through what might be called ad hoc approaches" (Wells, 1998).

But the one-to-one, case-by-case bargaining model is inadequate to appreciate the general shift of Latin American states from increasingly strong pressures on TNCs to a progressively more liberal attitude towards foreign capital[120], which led, ultimately, to the

[119] Evans further notes that even Fernando Henrique Cardoso - *dependista* theorist in the seventies and Brazil's president at the end of the nineties – made only "few pronouncements regarding TNCs, except to indicate the country's interest in attracting foreign investment".

[120] FDI liberalisation in developing countries is not simply the result of a unilateral shift in developmental strategy. Nonetheless, this change was partly voluntary and connected to internal reasons. A few were: weariness towards the ISI development model and its distortions, a new

strengthening of foreign companies' position. We suggest that with the transnationalisation of production as a background, an exclusive focus on the actual TNC – host government relationship only provides a limited understanding of the evolution of the respective bargaining leverage of foreign firms and national governments.

The decrease of multinationalisation in favour of transnationalisation of production outdated the previously attractive assets of developing countries, such as large and protected markets, as production strategies of TNCs became more global in scope with fragmented modes of production and international retail. While multinational organisation already played a major role on national markets, strains on national economies grew when corporate strategies became more global. Thus, if on the one hand, there have been fundamental changes in TNC activity which transformed TNC - host government relations, and, on the other, "if FDI screening and case-by-case negotiations with [TNCs] are no longer desirable or necessary from the host country's point of view, the [one-to-one] bargaining model ceases to be a useful paradigm for thinking about [TNC]-host government relations" (Ramamurti, 2001, 27). Consequently, a reappraisal of TNCs and host government interaction is necessary.

The concrete suggestion at this stage is to include another *external* agent to the model, since in an increasingly liberalised world, economic bargaining occurs as much on the international level as within national markets. The more elaborate tripartite model evoked earlier - including the home country as third component - may be a more accurate bargaining model to capture the changes in the relationships of TNCs and host governments.

Including the home government in the relationship is nothing new at all. In fact, until multinationalisation, it was not conceivable to consider TNC – host government relationship without including home governments. Even more so, it has been argued that home countries had gradually distanced themselves from "their" TNCs and that the conflict became more the one between TNCs and host governments, thus less than previously between home and host country (Andersson, 1991, 15). Moran further suggests that "the overarching international regime in which TNCs were able to appeal to their home governments for pressure against Third world governments underwent a considerable transformation in the mid-seventies, leaving TNCs much more on their own vis-à-vis

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generation of well-trained, often US educated civil servants, a stronger local private sector, more diversified samples of TNCs in term of nationality, and the confidence of states to have gained valuable experience in bargaining with them (Ramamurti, 2001, 27).

nationalistic host countries" (Moran, 1996, 424). In the particular case of Mexico, Bennett and Sharpe note that in the late seventies, home-country governments responded to state interventions, yet with less effectiveness: "The increased ability of the Mexican state to resist pressures of foreign governments can be accounted for by its enhanced technical sophistication, greater internal cohesion, and new-found oil reserves, and by the gradual weakening of the hitherto unquestioned 'natural' alliance between the auto TNCs and their home-country governments" (Bennett & Sharpe, 1985, 258). While home country governments did retaliate, reprisals became less and less consistent.

These observations would suggest that home governments, mostly Triad governments, were intruding less in the TNC – host country bargaining. Yet, arguably, their involvement did not disappear but changed its form: While beforehand, home governments used to intervene politically, directly in specific issues, they transformed their punctual reactive support into a proactive and global one: Shaping economic policies internationally in order to prepare and facilitate the establishment of TNCs on developing markets. In this regard, the policy shift in favour of foreign investment was forced, to some extent, by a powerful pool of actors including home governments and international institutions. By systematically pressuring for liberalisation and agreements, they strengthened TNCs' and weakened developing countries' bargaining power all at once. Thus, a new level had become far more important in determining host countries' FDI policies.

In this regard, Ravi Ramamurti introduced, in his paper *The Obsolescing 'Bargaining Model'? MNC-Host Developing Country Relations Revisited*[121], a "two-tier bargaining model". The basic idea of this model are the two levels of bargaining: Tier-2 is the level of bargaining considered so far – it is driven by *micro* variables, as for example the TNCs' technology or the market size of the host country. Conversely, tier-1 bargaining is determined by macroeconomic and political variables (figure 8).

It is worthwhile considering more attentively the newly introduced agent, labelled *home* in the model. The inverted commas put forward an extended meaning of the home country's role, which goes beyond its *direct*, or bilateral, negotiations with developing countries. Indeed, Ramamurti proposes an *indirect*, or multilateral system of bargaining. In our opinion, it is precisely this additional component, respectively the combination of both direct and indirect bargaining, which represents the main contribution of the model, and which is absent in Stopford and Strange's model of triangular diplomacy presented earlier.

[121] *Journal of International Business Studies*, 32, 1, 2001, 23-39.

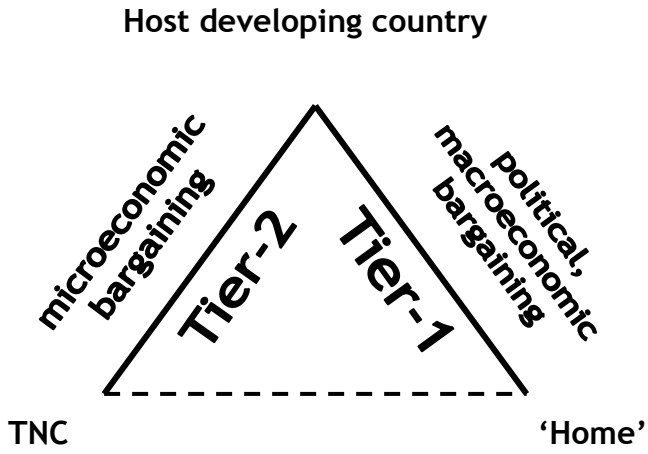

Figure 8: The two-tier bargaining model[122]

Bilateral bargaining is influenced by the economic links between two countries, such as the importance of trade (and notably, the surplus) or aid, but also by the historical and cultural ties, not to mention geopolitics. *Multilateral bargaining* refers to the IMF and the World Bank for the most part, whose stance towards the borrowing host country is strongly biased by the industrialised countries' perception of the borrower.

More tangibly, Ramamurti argues that in the eighties and nineties, two major changes occurred in the bilateral interaction between developed and developing countries. Both were decisive in increasing the TNCs' leverage in host countries. First, due to the decline of commercial bank lending (principally since 1982) and official bilateral and multilateral loans, TNCs became once again important sources of capital, as had been the case in the fifties and the sixties. Second, he highlights the appearance of the *bilateral investment treaties* (BITs) phenomena, mainly introduced by the United States. Indeed, US BITs removed from the negotiation agenda most of the issues on which TNCs and host governments used to haggle earlier, such as performance requirements, local content, financial transfers, compensations etc. (Salacuse, 1990).

As to the indirect, multilateral bargaining, the control of the Bretton Woods organisations grew in spite of the gradual diminution of loans. Indeed, the latter were increasingly combined with *conditionalities*, notably in terms of privatisation and FDI liberalisation.

Salient examples for Latin America were the Brady Plan in the eighties, and later the Washington Consensus. A significant fact is that such structural adjustment programmes were set up alongside the G8, and particularly the United States.

In both cases, the reduction in official lending capital and the simultaneous requirement towards the relaxation of national policies had as a consequence a greater reliance of developing countries on private capital flows. In addition, owing to the broad trend of FDI liberalisation throughout the developing world, the bargaining power of TNCs was further enhanced. Ramamurti thus concludes that the impact of these developments was to strengthen the bargaining power of TNCs, and further deteriorate the one of developing host countries. Expressed through the Two-tier model he then adds that "industrialised countries have used tier-1 bargaining to weaken the hand of host governments in tier-2 bargaining, while strengthening that of their [TNCs]" (Ramamurti, 2001, 34).

Ramamurti's model may appear to come close to the state-centric view of TNCs' activities. But instead of dwelling on comparative politics to explain the influence of TNCs on developing countries, he sets international political economy as a stage to explain the shift in bargaining power between TNCs and host governments, since today "it is far from clear which, if any, government, represents the home country" of the TNC (Kobrin, 2001).

This model is complementary to our general model of international economic power which we applied in the context of developing countries (Chapter One). Referring to our model, the subtlety of Ramamurti's approach is to combine relations **2** and **6** (see figure 4 in Chapter One), with a home – host - TNC model, showing that powerful *public* and *quasi-public* agents (states and international organisations) are shaping a framework of international political economy in favour of private transnational actors.

3.3.3 Transnational corporations and domestic business

Our focus has been chiefly the TNC – government relationship so far, with the indirect inclusion of other external agents. To make our analysis of the interaction between TNCs and nation-states in developing countries more complete, the relation between TNCs and domestic business, represented in our main model by the relation **4** in figure 4**,** needs to be considered.

[122] Representation by the author, based on Ravi Ramamurti's model.

It is not surprising that the relations between TNCs and nation-states in developing countries were often understood as the mere interaction of foreign companies and national governments in a context of protected markets. Particularly in Latin America, most foreign investments were greenfield investments, and in the context of multinationalisation, subsidiaries were wholly-owned and hierarchically governed entities. Meanwhile, states in developing countries had largely withdrawn from their role as economic agents principally through privatisation and, particularly in the nineties, the focus of government action had turned towards adjustment policies to encourage liberalisation. This trend becomes evident when considering the modifications of FDI regulations during that period throughout the world[123].

The shift in economic policies thrust the actual economic components into the limelight, leaving behind the faded national political element. However, the transfer from the predominant TNC – host government relation to an increasingly important interaction between the TNCs and national private actors does not (should not) imply the state's vanishing in terms of regulation. The state assumes a new role, or rather, has taken upon itself the task to connect its country to the global network economy by promoting its national business actors[124].

The new mode of organisation of TNC activity was perceived as a chance by national authorities. Indeed, "in theory, the declining hegemony of geography in determining where production [takes] place could work to distribute new investments more evenly and benefit developing countries". With the waning of hierarchical structures and wholly-owned affiliates, transnationalisation represented an opportunity for Latin American countries to become part of strategic alliances of TNCs (Evans, 1998, 207). The idea to anchor TNCs in their national economies in order to participate in intra-industrial trade and export back to TNCs' home markets was appealing.

While, according to Ricardian comparative advantage, a country simply needs to "discover" its tangible assets to attract foreign investment in a world economy led by economic specialisation, the *new* comparative advantage is one that has to be constructed in order to generate the intangible, specific resources sought by transnational business networks.

[123] Every year, an increasing number of countries change their set of laws, of which only a fraction are detrimental to FDI. In 2000, 69 countries initiated 150 modifications, out of which 147 were FDI-"friendly" (UNCTAD, 2001).

[124] In this context, the "schizophrenic" attitude of Latin American states in the late seventies and early eighties towards foreign investment may suggest the slow and painful abdication of their traditional role and the transition to an acceptation of the global economy's changing rules.

Their competitiveness relying on creativity and technology, TNCs will choose to invest in spaces endowed with the complementary factors that will contribute to keep the firm at the leading edge of innovation. The main drawback of most developing countries is precisely the fact that they have few complementary assets that would justify investment (Dunning, 1993b, 533).

The plot gets even thicker when considering a country's attempts to develop new assets through education, infrastructure or flexible institutions. Indeed, *constructing* a comparative advantage does not guarantee results, and "success-stories" cannot be foreseen but take form and are recognised only later on (Porter, 1990/1998). TNC managers have thus "every reason to stick to the traditional view that emphasizes the opportunity for profit consistent with existing local endowments rather than theoretical potentials". This situation condemns developing countries to remain in their existing position in the global division of labour. Thus, relying on TNCs "is a risky strategy for countries trying to avoid remaining trapped in low return activities that exhaust existing productive resources". Indeed, if TNCs are willing to invest, they are unlikely to take the risks involving long-term productivity enhancing investments (Evans, 1998, 201). It is, in a sense, Vernon's obsolescing bargain overturned.

In fact, developing countries run the risk of being further neglected by the dynamics of transnational production by failing to offer the geo-strategic advantages sought by TNCs. It appears then that getting the national policies in line with the TNCs' strategies, while necessary, does not suffice to "tap" the global economy. TNCs are, as mentioned earlier in this chapter, on the look-out for specific production assets – mainly technology and skilled labour – concentrated in a local network whose synergies could be of advantage to foreign firms.

Conversely, in the absence of such dynamic industrial groupings, a country will have difficulties attracting foreign investment of *quality*. The latter would imply the presence of foreign affiliates which fortify the competitiveness of local enterprises through their embeddedness in a particular sector. To be more precise, it is mainly the *backward linkages* that TNCs may develop with domestic business that represent the main advantage of the global network economy. Local supplying will increase TNCs' local integration, making them less footloose. Links could further favour knowledge and technology transfer (UNCTAD, 2001).

The main problem for developing countries is hence the absence of such competitive economic environments and groupings of suppliers which could contribute to the TNCs' overall competitive strategy. This issue of linkages is not new – in the case of the auto-industry in Mexico, the state attempted to introduce restrictions on vertical integration to foster the Mexican auto-parts industry, but the TNCs sought to internalise their production (Bennett & Sharpe, 1985, 257). In the context of liberalisation, foreign affiliates operating in networks will, for the most elaborate elements, search for suppliers on other markets or turn to other foreign subsidiaries on the spot, yet fail to connect with domestic suppliers and anchor locally. While foreign affiliates producing for a local market may still choose to get most of their supplies from national firms, with transnationalisation and export-led production, a TNC's strategy will, given the absence of satisfactory suppliers on a particular market, rationally decide to get its supplies globally rather than locally.

Some regions have created an *ensemble* of characteristics which have attracted TNCs in quest of specific assets to contribute to their global strategies. An example is Bangalore (India), standing out as a computer programming centre with competitive local companies and a multitude of highly qualified engineers (UNCTAD, 2001). In contrast, in the context of Mexico and the transnational auto industry, TNCs were unwilling to make investments that would have spurred industrialisation and economic growth. "Their reluctance stemmed from their global strategies in the international industry" (Bennett & Sharpe, 1985, 254). In this sense, if transnationalisation did occur, it did not necessarily accomplish the spill-overs hoped for. In the former case, quality investments contribute to enhance local productivity, while they do not in the latter.

Generally speaking, Latin American states had been most successful in engaging TNCs in projects of local industrialisation under multinationalisation, but with the new paradigm of transnational production they were no longer the main winners. Indeed, the era of transnationalisation favoured East Asia, a region that had largely been bypassed during the earlier wave of international production (Evans, 1998, 208).

While heterogeneous, oriental business shows common features as to the mode of organisation. As briefly mentioned earlier, economic entities such as Japanese *Keiretzus* and Korean *Chaebols* have developed coherent networks based on cooperation and mutual trust. Interestingly, these industries were nurtured by at times authoritarian states and maintained on the grounds of a long-term collaborative relationship of public - private reciprocity (Fields, 1997, 122). The dynamics between big business and the state, typified

by well-developed internal and external networks, has been interpreted as a reason for East Asian countries' success in the knowledge-based economy. In other words, it is the combination of a particular (business) culture and institutional frameworks that have laid the foundations for synergies sought by transnationalisation (Castells, 1999, 208). Such foundations have been essential assets to participate actively in the information and technology industry, of prime importance in the knowledge-based economy.

In Latin America meanwhile, as shown in Chapter Two, relations between the *grupos economicos* and the state were not based on such productive interactions. Just like public - private ventures, productive economic linkages between national governments and TNCs were widely absent from Latin American reality. Up to the eighties, the structure of economic power in Latin America was divided into three distinct compartments, referred to as the *triple alliance* (Gwynne, 1986, 118). Besides the state in charge with public services and the increasingly influent business groups, TNCs participated in national economies, but their governance structure was closed. TNCs were doing "their own thing", mostly supplying the national market, only considering to buy locally when forced to do so[125]. In the nineties, the privatisation process initiated a change in this pattern by setting public property free. The state's economic power was transferred to domestic firms as well as TNCs, the former being at first the main acquirers. Trying to adjust to the sudden changes in economic policy, groups and *conglomerados* attempted to change their strategies by re-centring around their core-competencies and seeking to become transnational themselves (SELA, 2001). In the meantime, TNCs focused on the purchase of national banks or dismantled public firms – notably in telecommunications - and soon sought to acquire big domestic firms. Even if some national groups managed to increase their efficiency, it often did not suffice to play alone on open markets.

For TNCs, the choice to enter Latin American markets through mergers and acquisitions with majority ownership was the most convenient: It removed a competitor, offered immediate access to a working distribution network, local know-how and connections. Since most TNCs possessed both technology and capital, controlling was the prime aim of purchases, mainly to improve their strategic position on national, regional and global markets. Also, due to the unstable stock market of emerging markets, acquisitions were relatively cheap, encouraging TNCs to invest. By the end of the nineties, the TNCs'

[125] Foreign and domestic big business did interact and were habitually on cordial terms. Their connections however were less based on economic grounds than on financial and, above all, political ones.

aggressive investments had transformed some Latin American markets into real "battlefields" where TNCs from the Triad were competing (Business Peru, February 1999).

TNCs modernised their operations in Latin America mainly by *regionalising* their activities. For example, IBM reshaped, "making each business activity rather than each country a profit centre: [...] the boss of public-sector programmes for Latin America is based in Brazil, the manager for telecom business in Chile, the education specialist in Mexico City and the banking-systems manager in New York. IBM has also fused 16 back-office operations, one for each country, into a single one for the region" (The Economist, December 4th, 1997).

Meanwhile, Latin American business groups did not disappeared altogether. Some, notably groups from Brazil, Chile and Mexico, managed to become *regional* TNCs[126]. Others remained in their home markets but carried on existing through joint ventures with *Triad* TNCs. Converted into important partners of foreign companies, the groups connected national and foreign capital (Business Peru, September 1996) and became the entry gate onto national and regional markets for TNCs.

TNCs presence in Latin America has, within a few years, drastically changed. Their impact on the development of developing countries "is significantly greater than it was during the years of controversy" (Evans, 1998, 196): For the big TNCs today, investment in small countries represent sometimes a tiny fraction of their total assets, often a marginal location in their global strategies. As to developing countries, they seem to remain with virtually no bargaining options and no alternatives but to open up their economies.

Peru, a small market, even compared to some of its neighbours, will be our focus in Part II of this research. Based on our model exposed in Chapter One, on the business – state relations dealt with in Chapter Two, as well as on the analyses of the changing role of TNCs in developed countries in general and in Latin America, the next chapters will depict the particular setting of the Peruvian economy, analysing the three agents in an erratically changing economic and political environment. Policy switches, and principally the switch to neoliberalism at the beginning of the nineties and the continuation of the economic model up to the present date, will represent the main stage of the tripartite system of relations.

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[126] See Daniel Chudnovsky, *Las multinacionales latinoamericanas: Sus estrategias en un mundo globalizado*. Fondo de cultura económica, Buenos Aires, 1999.

PART II: The tripartite system of economic power in Peru

CHAPTER FOUR: The Peruvian State and the economy

The state's role in the economy has always been – and will probably always be – a much debated issue. Mainly since the late eighties however, this controversy seems to have momentarily lost its vigour as the tendency of *laissez-faire* has been firmly spreading beyond the limits of the Western, developed world, into a maze of disillusioned countries searching for the right dose of state intervention. With the heartening prospect of weaving a liberal democracy, an ideal-type where, apparently, politics mingle with economics in an optimal way, many accepted the challenge, and so did most countries of Latin America.

At the end of the *lost decade*, state intervention was doomed in Peru as well, and the Andean country reconnected with the global economy, embracing the world's free-market system. But similarly to most experiences in the region, the results of transition did not match expectations. Most liberal experiences on the sub-continent suggest that economic *orthodoxy* does not necessarily induce a political one, neither does it generally reduce social disparities and poverty – an evolution confirmed by the Peruvian case.

4.1 Peru's new political economy

The crisis situation the country was facing by 1990, after several policy switches, opened the way to the steadiest, yet most extreme economic reforms since the *comeback* of civilian rule in the late seventies.

4.1.1 Policy switches

At the end of President Alan García's turbulent mandate in 1990, Peru was on the brink of an economic and political collapse, as it was facing unprecedented hyperinflation[127], economic decline and violent insurgencies with a weakening state and a deteriorating public order. It is in this dramatic setting that Alberto Fujimori, an independent candidate, was elected to be the country's 54th president. Large segments of the population, weary of economic disasters and political unrest, had been convinced by his vision of a smooth

economic recovery. Only a few weeks later however, the moderate perspective represented by the political outsider during his campaign had disappeared as the freshly elected president was leading Peru into an economic transformation similar to the ones in the ex socialist bloc (Stokes, 1999, 202).

After several meetings with important officials abroad[128], Fujimori realised he had "zero room to manoeuvre in implementing a gradualist reform strategy" (Wise, 2002), and that a clear break from the failed statist approach had become a necessary step if relations with the international financial system were to be improved (Wise, 1997, 83). These had indeed been deteriorated mainly by Garcia's negative stance towards the main multilateral organisations – above all the IMF – and the reduced payments to external creditors. Internally, the incoherent interventionist policies and its catastrophic effects had discredited the neostructuralist approach and the notion of progressive redistribution (Pastor & Wise, 1991, 24). This, in turn, paved the way for a structural change towards a new era of orthodox economic policy.

Reforms to foster the development of market structures had been undertaken by the Belaúnde administration (1980-1985) a decade earlier, but they had been poorly conceived and did not withstand exogenous factors such as the abrupt drop of external credit and the price shocks of the world economy (Pastor & Wise, 1991, 7). Furthermore, it was a modest and superficial attempt to shift to liberalism, as many structures put in place in the late sixties and early seventies were dragged along, such as the untouched state bureaucracy[129]. The subsequent aggravation of the economic situation made the government's and the IMF stabilisation policies increasingly unpopular, and by 1985, there was a strong tendency to search for alternatives to orthodoxy (Crabtree, 1992, 31).

Even though the economic policies of the Belaúnde's and the García's administration represented two different approaches in political economy, in practice they had a similar pattern of decay. Indeed, even before having done half of their term, both experienced a severe crisis, which did not only affect the consistency in implementing the respective policy programmes but induced erratic backtracking measures and arbitrary policy shifts.

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[127] That year, Peru experienced an annual inflation rate of 7650 per cent.

[128] Fujimori met with the presidents of the IMF, the World Bank and the Inter American Development Bank (Gonzales, 1998, 44).

[129] The different terms used to describe Belaúnde's political economy translate the ambiguity of his economic policies and his political strategies: Often considered a neoliberal enterprise, Carlos Boloña, Fujimori's ultraliberal minister of finance, referred to it as concealed populism. Several scholars described his political economy a "hybrid", a mix of neoliberalism and populism.

As Pastor and Wise point out: "On these fronts, the Peruvian record may be the worst in current-day Latin America" (Pastor & Wise, 1991, 24).

Whereas the choice to carry on an agenda based on orthodoxy can be partly explained by the 1988 – 1990 economic crisis and the need for the new government to distance itself from the interventionist style of the previous term, the intensity and rapidity of Fujimori's venture is certainly connected with the multiple shifts and switches of the previous administrations. Indeed, in order to avoid the mistakes of his predecessors as well as the pressures they were exposed to, the president, as he was acting in a quick and determined way, did not give other national economic and political actors a true chance to question or negotiate his decisions. This new political economy was giving a signal of irreversibility, as the government was pushing through market economy principles.

However, the reasons for the radical policy switch and the following structural adjustment go much further back than the lost decade, insofar as the government "sought to bury once and for all the business model introduced in the late 1960s and early 1970s by General Juan Velasco" (Iguiñiz, 1998, 27). The authoritarian revolutionary, whose goal was to reform Peruvian society[130], had redesigned the country's political economy according to his nationalistic and progressive convictions, as he planned to undermine oligarchic rule and foreign imperialism by bringing the economy under state control and launching import-substituting industrialisation. Since Velasco's fall, the state had neither been able to resolve inflation problems nor to invert the constant real living standards decline, and for nearly twenty years, the country had been in a sort of long haul crisis, with violent cycles of recession and apogee (Dancourt, 1999, 51). Still, for almost two decades no important changes occurred in the economic model imposed by Velasco's structural reforms, "and until 1990 each successive administration handed over an even bigger bundle of economic and political problems than it had inherited upon taking office" (Wise, 2002).

For some authors, the time span between two structural adjustments is a recurrent fact (Gonzales, 1998, 10): Since the thirties, Peru has faced fundamental economic changes every twenty years, oscillating from one extreme to the other, like a pendulum, which in 1990 swung forcefully to the right. This led the country back – to a certain extent – to the

[130] General Hurtado, who was one of the leading philosophers of the revolution, proclaimed in October 1968 that a series of social and economic reforms would be undertaken to create the "new Peruvian man". In order to achieve this, the traditional obstacles, such as underdevelopment, imperialism and concentration of power, would be destroyed (Davis & Wilson, 1975, 365).

economic strategy introduced in the fifties (Dancourt, 1999, 50): An economy with minimal state participation in favour of foreign investment.

4.1.2 Stabilisation and reforms

Latin America's recent economic and political history is scattered with policy shifts followed by structural adjustments. This has been especially true since the beginning of the eighties, when the region was hit by a severe crisis, which had an impact only comparable to the Great Depression of the thirties. Although by no means an exception, Peru stands out not only for its record of alternating economic policies, but also for the thorough reforms applied by Alberto Fujimori. Indeed, one of the features of structural adjustment in Peru after 1990 was its radical nature, especially compared with other countries in the region (Iguiñiz, 1998, 27). The main goals were the removals of protection and import substitution and the return to full participation in the world economy.

As a first step, the principal aims of the drastic stabilisation programme, also called *Fuji-shock*, were to stop inflation and restore external acceptance by resuming payments on the external debt. The former, an internal objective, was dealt with by imposing a tight monetary policy to reduce domestic demand, whereas the latter, an external goal, was tackled with fiscal policies, such as price readjustments of gasoline and public utilities, emergency taxes, and spending cuts, measures that were meant mainly to increase the government income which "had practically disintegrated during the eighties" (Sheahan, 1994, 915).

Unlike in other countries such as Chile and Bolivia, which had experienced tough adjustment programmes as well, the government did not choose to devaluate the sol, the Peruvian currency, but introduced a floating exchange rate instead[131]. The decision-making with the new exchange policy, after eliminating the interventionist system of multiple exchange rates, was somewhat hesitant and confused and led to a "dirty float", with sporadic interventions of the Central Bank (Pasco-Font, 2000, 20). Still, it announced, alongside the simplification and the reduction of external tariffs, the upcoming of an early trade and financial liberalisation. These first adjustment measures were initiated "as it had

[131] Even though the main political parties in the opposition were pleading for devaluation, the Fujimori team decided to follow the suggestions made by the World Bank and the IMF, which ruled out devaluation. A depreciation of the sol was expected once the inflation had been tamed. Another reason might have been the dread of a popular reaction (Iguiñiz, 1998, 29).

become clear that stabilisation was not possible without structural reform aimed at reducing state intervention and freeing up the market system" (Iguiñiz, 1998, 28).

Another set of reforms was soon put in place: The one of fiscal administration was urgent, as fiscal policy was the government's main instrument (Gonzales, 1998, 48). The Peruvian tax system was thoroughly inconsistent and weak, and in order to implement the freshly invented taxes and monitor the raise of the old ones, a restructuring of the fiscal system was necessary (Durand & Thorp, 1998). This especially because the government needed a sharp increase of its revenue at the moment when external tariffs were being quickly removed.

In sum, the macroeconomic stabilisation and structural adjustment programmes led to the elimination of price controls, a floating exchange rate and interest rates, the liberalisation of trade, a reduction and harmonisation of tariffs, an elimination of non-tariff barriers, the initialisation of a tax reform and the deregulation of the labour market. Table 1 shows an overview of the different policies implemented by the government during the structural adjustment.

Type of policy	**Macroeconomic instruments**
1. Price	• *Price deregulation in goods and factor markets*
2. Fiscal	• *Reform of the tax system* • *Fall in government deficit*
3. Monetary and financial	• *Floating exchange rates; elimination of the multiple system of exchange rates* • *Restrictive monetary policy*
4. Trade	• *Withdrawal of quantitative restrictions on trade* • *Reduction in dispersion of tariff rates from an average of 56% to only two rates (15% and 25%)*

Table 1: Main policies implemented by the Fujimori government[132]

[132] Source: Raúl Hopkins, The impact of structural adjustment on agriculture (in Crabtree & Thomas, 1998, 90), partial representation.

This quick pace in implementing reforms "was decided as it would give a definite sign that the changes were irreversible and mending relations with the exterior" (Wise, 2002). This step was important for the executive, as it needed a better image abroad in order to launch a successful privatisation programme, probably the most important reform due to the changes that occurred within the state, the impact on the structure of Peruvian economy and the inflow of foreign capital that followed (Gonzales, 1998, 55). The speed at which foreign investment incentives were put in place by the government confirmed the major role international economic support was playing in Peru's recovery plan.

Clearly, the structural reforms were launched before the end of stabilisation and they aimed at drastically improving the country's macroeconomic situation by thoroughly applying free-market structures, which left other priorities, such as social equity, aside. According to Gonzales, the absence of a sequenced implementation of the reforms and the explicit focus on economic efficiency suggest that the Peruvian transition can be considered extreme. As can be seen in table 2, the reforms in Gonzales' *extreme model* are characterised by total market deregulation, privatisation of public enterprises and utilities, extreme liberalisation of external trade, and a floating exchange rate. Unlike more flexible models of adjustment, political economy is restricted to tight macroeconomic control with very few instruments, mainly fiscal ones, and thus does not imply social and sector-based policies (Gonzales, 1998, 32).

	REFORMS			POLICIES			Autonomy
	Liberalisation	Deregulation	Privatisation	Macroeconomics	Sectorial	Social	
Extreme model	**Extreme**	**Total**	**General**	**Restricted Fiscal Free exchange rate**	**No**	**No**	**Little**
Intermediate model	High	Major	Major	Moderate Fiscal and monetary Supervised exchange rate	Partial	Partial	Moderate
Flexible model	High or intermediate	Intermediate	Selective	Active Manipulated exchange rate	Advanced	Advanced	High

Table 2: Models of structural adjustment[133]

[133] Source: Gonzales de Olarte, *El neoliberalismo a la peruana* (1998, 33), translation by the author.

Gonzales argues that the choice of a model of adjustment is strongly related to a specific economic and political context. A dramatic situation calls for drastic measures when there is only little flexibility for policy implementation. Following this argument, the priorities set by the government were rational and pragmatic, considering its dependence on external credit. In other words, the Peruvian circumstances seemed to account for a programme oriented towards economic efficiency and many agreed that strong reforms were inevitable, due to the inherited precarious situation.

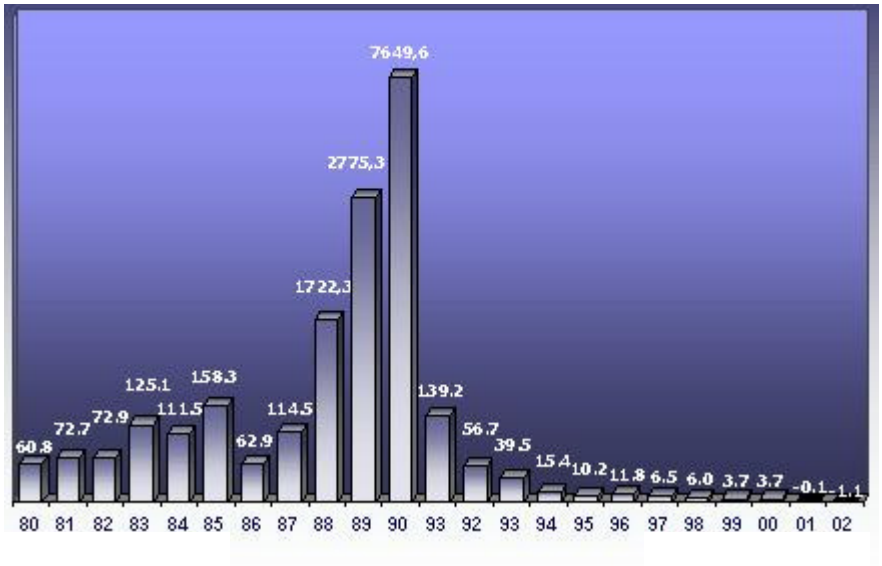
There was, however, also a "general consensus [that] the adoption of structural reforms of this magnitude in the midst of the initial stabilisation plan could detract from achieving the goals of the latter" as policies could interfere. Indeed, even though Peru's situation in 1990 was at a point were "the best of all possible economic strategies would be bound to run into trouble, this particular version has created special difficulties of its own" (Sheahan, 1994, 911). The overlapping reforms and missing temporary measures suggest that the overall economic strategy lacked a global and long-term plan (Iguiñiz, 1998, 26). Mainly due to Fujimori's pragmatism, the short-term aspect as well as the insistence on a hands-off attitude always prevailed in the government's decisions. This will of the government "to do everything at once, failing to pay sufficient attention to issues of sequence and appropriate degrees, has impeded recovery of production and employment" (Sheahan, 1994, 921).

4.1.3 Economic achievements

The immediate action taken by the government was to raise the prices on public products and eliminate price controls on private ones. The aim of this price adjustment – the biggest in Latin American history – was twofold: To increase the government's revenue and to reduce internal demand quickly. Subsequently, the falling real wages were further measures that helped slowing down inflation, alongside the reduction of government expenditures and, most importantly, tight credit. However, the sharp drop in liquidity, implied by the jump in domestic prices combined with strict monetary constraint, generated very high interest rates (Sheahan, 1994, 914) and created further pressures for inflation and exchange rate appreciation (Wise, 2002).

As can be seen in graph 1, inflation was a primary concern by the end of the eighties. But the fiscal and monetary policies greatly helped to reduce the inflation rates from 1990 on: The annual rates of 1991 (139 per cent) and 1992 (57 per cent) show the important

improvement when compared to the catastrophic levels of the previous years[134] - a positive trend that was going to be maintained throughout the decade. But during the first two years of adjustment inflation remained rather high compared to similar adjustment episodes in the region[135] and it kept being the government's main worry.



Graph 1: Evolution of inflation in Peru, 1980 – 2002[136]

The Peruvian economy, which had failed to be fully stabilised, was facing a difficult economic transition with an overvalued exchange rate and a deeply depressed economy, as a result of the drastic application of stabilisation policies. Due to the constant risk of a reactivation of the inflationary process, no recovery measures were put in place. Incentives such as accessible credit and lower interest rates on domestic currency were considered too delicate at that point, and the government decided to carry on with the

[134] Inflation had been worsening since the mid-seventies, and reached relatively high levels throughout the eighties. The real crisis and hyperinflation appeared in 1988 only. The accumulated inflation during García's mandate reached a rate of 2.2 million per cent and culminated at a monthly rate of 78 per cent in July 1990. The slowly, but steadily declining two-digit rates of the first half of the nineties stood in contrast with these impressive numbers.

[135] The Peruvian stabilisation lasted 37 months, whereas the Argentinean and Bolivian ones took four and thirteen months respectively (Dancourt, 1999, 58). However, Peru's exceptional hyperinflation needs to be taken into consideration.

[136] In percentages of annual variation. Source: www.inei.gob.pe (April 2002). In order to display the annual variations clearly in the same graph, the Peruvian institute of statistics chose to use an adjusted bar chart.

strict stabilisation policies instead, a choice that blocked the actions needed for the stimulation of the economy.

The Fujimori team opted nonetheless for trade and financial liberalisation reforms, hoping for a depreciation of the domestic currency after the removal of controls on capital flows and the introduction of a floating exchange rate. But this expected reversal did not occur[137], and the dollar remained cheap, a further impediment for recovery, as it worsened export incentives whilst enhancing import. Both the reduced protection and the currency appreciation generated an increase of 40 per cent in imports in two years (Sheahan, 1994, 913) while any stimulus for rising exports – a condition for short-term recovery as well as longer-term growth - was missing. Tariffs were dwindling at the same time as taxes were increased, a rise of government income being desperately needed. Yet, this shift from foreign trade revenue to tax revenue was certainly another tricky move at a time of deep depression.

It has to be mentioned however that trade liberalisation had promoted efficiency and competitiveness within the domestic industrial sector, and that the suppression of quantitative restrictions and the new tariff policy were providing a more coherent structure (Santiago, 2000). However, too much liberalisation at once, in the wrong conditions, aggravated the distortions left by the previous administration. Thus the main argument brought by many authors was that trade and financial liberalisation were premature and certainly interfered with stabilisation policies. This is also true for the revision of the Peruvian tax system. Even though change was necessary as the inherited system was inconsistent and weak, it certainly did not achieve the expected results and was working against recovery in such twisted economic conditions.

In spite of this, the government kept focusing on its two initial aims, namely stopping inflation and re-entering the world market system. The mixed measures were meant to stabilise the immediate macroeconomic imbalances and to create a new economic environment compatible with the exterior. In this field, some important improvements were achieved, and by 1993, eventually, after a loss of more than 20 per cent of GDP from

[137] The strict monetary policy had forced the private sector to repatriate dollars since the beginning of the stabilisation programme. With the financial liberalisation the dollar remained cheap after the introduction of a floating exchange rate. Two reasons could explain this trend: The falling interest rates in the United States and the subsequent capital outflow at the moment of the removal of financial restrictions in Peru, the drug dollars entering the Peruvian economy. In the end, this combination of an early liberalisation, restrictive monetary policy and currency overvaluation

1988-1992 (Wise, 2002) the country resumed its growth and the GDP showed an increase of 6.4 per cent that year. Both public and private investments were recovering and boosting economic expansion. The two following years confirmed this positive trend, and led Peru to Latin America's highest GDP growth during the 1993-1997 period (Tanaka, 1999, 9).

However, "while economic stabilisation programs [had] put an end to hyperinflation, the basic problems of unemployment, underemployment, and mass poverty remained" (Conaghan & Malloy, 1994, 230). These fundamental problems became even more urgent as this macroeconomic priority was chosen to the detriment of a sustainable recovery, which would have implied giving particular attention to poverty and inequality. Hence, "the short-run costs of the present programme in terms of worsening poverty and unemployment have been dangerously high for an economy under the strain of continued depression and multiple form of violence" (Sheahan, 1994, 921), and contributed to perpetuating some deep social problems in the in Peruvian society.

As mentioned earlier, the extreme model of adjustment put in place had the application of a liberal economic programme as a priority, aiming at efficiency and not redistribution. From the government's pragmatic perspective, the main goals had been eventually achieved. Accordingly, the new economic environment favoured mainly big business with trade and financial adaptation capacity and foreign capital (Gonzales, 1998, 32), as its priority was to eliminate inefficiencies and market distortions, but did not tackle other issues, such as inequality.

Due to the common belief, in most international financial institutions, that sound and stable macroeconomic indicators were the cornerstone of a healthy economy, Peru was quickly regarded as an example for emerging markets, as it had been capable of substantially reducing its inflation and resume growth, and had brought a less erratic approach to policy-making in favour of business. The political and the social costs of this enterprise, which were more of an internal issue and therefore less relevant to non-Peruvians, did not tarnish the economic success much.

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contributed to an accentuation of the dollarisation of the economy, which was reaching 60 per cent at the beginning of the decade (Liébana, 1997).

4.2 Power concentration

In opposition to the economy, which was transfigured by an extreme switch to free-market structures, the political structures experienced a certain degree of continuity with the inherited frame: The beginning of the nineties even reinforced the trend of power concentration in the hands of the executive, a commonplace in Peruvian politics.

4.2.1 Autonomy and world economy

The shock treatment in August 1990 had brought immediate structural changes in economic policy, and had opened the way to the extreme model of adjustment. This, however, had been only starter, as the transformation became deeper and broader, at a quickening pace. It was a progress that had not been planned at the time.

It is true that during the first few months of Fujimori's presidency, the first drastic stabilisation measures were put in place, but it was early 1991, when a new minister of finance came into office, that the main set of reforms were launched. Carlos Boloña's "fundamentalist liberalising zeal" and "the speed and radical nature of the institutional changes which were introduced took even the multinational institutions by surprise" (Iguiñiz, 1998, 28) even though they exercised a strong pressure on economic policy-making. A year later, the president, who could not get more discretionary powers from a reluctant congress, decided to close it, with the backing of the armed forces and the support of public opinion. He also "suspended the constitution, fired the judges and declared emergency rule" (Cameron, 1998). The *auto-golpe*, or self-coup, gave the executive even more room to manoeuvre to implement the reforms, and to do so rapidly, as the contestants within the government had been annihilated.

However, Fujimori's position towards the international community and developed countries was in sharp contrast with his univocal rule at home. Little economic autonomy was given to the team who was dealing with Peru's difficult situation, as macroeconomic instability required the implementation of a strong programme of reforms introducing market-type structures, along with debt re-negotiation. According to Gonzales' model (table 2), this dual pattern of autonomy is closely linked to the type of adjustment chosen: The extreme model partly results from the combination between the high degree of autonomy towards the various internal groups of interests – such as business and political

leaders or worker unions weakened by an earlier crisis – and the lack of autonomy towards the exterior due to the state's financial weakness (Gonzales, 1998, 32).

Indeed, in addition to the institutional crisis and the failure of the previous economic model, it is mainly the external debt crisis which forced the government to seek intense cooperation with the international financial community. This state of *triple crisis*, a well-known combination in Latin American economies, clearly involved the IMF in the decision-making, and the Fujimori team rapidly endorsed the policy package of the *Washington Consensus*[138]. Another approach to structural adjustment was given by the UN's Economic Commission for Latin America and the Caribbean (ECLAC), but this option was soon ruled out because of the pressures of the multilateral organisations and the creditors.

At the beginning of the nineties, the Washington Consensus had quickly gained a high degree of popularity world-wide, and was achieving the status of a dogma or even an ideology, at a time when socialism was collapsing: "The world was under the impression that a clear and robust consensus existed about what poor countries should do to become prosperous" (Naim, 2000, 86), the universality of the concept being reinforced by the fact that is was thoroughly advocated by the IMF. The creator of the initial reform recipe, John Williamson, stressed, ten years later, that his compilation merely referred to the "lowest common denominator of policy advice to Latin American countries as of 1989". But the aura obtained by his concept led to a multiplicity of interpretations, which posed "serious dangers not only of misunderstanding but also of inadvertently prejudicing policy objectives" (Williamson, 2000, 252).

The debate over the various meanings or interpretations will not be discussed further here[139], but it is worth mentioning that the Washington Consensus was not a radical "neoliberal package" *per se*, as it implicitly left space for different outlooks (Perez Santiago, 2000). Indeed, "the way countries interpreted such ideas varied substantially, and how they chose to implement them did even more so" (Naim, 2000, 86). This means that the consensus, which had a huge influence on economic reforms in numerous countries, was often connected with overrated expectations of the implementation of

[138] The term stands for a "recipe" containing 10 elements for structural adjustment put together by John Williamson in 1989/90: Fiscal discipline, redirection of public spending priorities, tax reform, interest rate liberalisation, a competitive exchange rate, liberalisation of inflows of foreign direct investment, privatisation, deregulation and secure property rights.
[139] For an overview on the different uses of the term "Washington Consensus" and the controversies linked to it, refer to the article by Williamson: What should the World Bank think about the Washington Consensus? *The World Bank Research Observer*, vol. 15, no. 2, August 2000, 251-64.

market-oriented macroeconomic fundamentals and with a partial or even erroneous application of the basic principles.

This observation has its importance when the Peruvian case is considered, inasmuch as it reflects a "boosted" application of the consensus: The Fujimori team took some liberty in modelling the Peruvian version of the imposed recipe, only focusing on macroeconomic stability and growth. This in spite of the suggestions of well-known economists, such as Sachs and Paredes, who had put an emphasis on several nuances especially concerning the use of the exchange rate as a price anchor, the proper sequencing of market reforms as well as the need for adequate social measures in their analysis of the Peruvian transition[140]. But "in Peru of 1990, and in the light of the urgent need to rebuild the country's ties with the multilateral and international investors, the president opted for the reform strategy that he and his advisors deemed most likely to entice foreign capital back into Peru" (Wise, 2002).

4.2.2 Crisis, popularity and presidentialism

Internally, it is mainly the curbing of hyperinflation that had a global positive effect on the population[141], and which contributed greatly to Fujimori's growing legitimacy. Furthermore, the economic policies hit some big businesses severely in some traditionally protected industries; subsidies and tax exemptions were abolished and large-scale tax evaders prosecuted (Roberts, 1996, 103). The removal of such long-lasting privileges was welcomed by the small enterprise workers and the informal sector, even though they were also suffering from the drastic measures imposed by the government.

But Fujimori's high approval rate was possible thanks to another, non-economic factor, which was the government's progress in its fight against insurgency[142]. The country had been shaken by the internal war that had cost ten of thousands of lives, this mainly in the mountainous countryside. By the end of the eighties, insecurity had reached new levels

[140] Their proposals for the Peruvian reforms was published in the following book : Sachs, Jeffrey D. and Carlos Paredes: *Peru's Path to Recovery: A Plan for Economic Stabilization and Growth*. Brookings Institution Press, Washington D.C., 1991.

[141] In a society characterised by strong disparities, the popular sectors are especially affected by inflation, as they do not have access to foreign currencies and have their already low wages lagging behind climbing prices.

[142] In the chaos of Garcia's ending term and at the beginning of Fujimori's rule, terrorist acts had been intensive (approximately 3000 a year from 1989 to 1992) and the Maoist "Shining Path", more

when the *limeños*, too, were facing terrorist acts in the capital with widespread acts of sabotage. Fujimori's decision to endow his administration with emergency rule was crowned with an outstanding success, namely the capture of the messianic rebel leader, Abimael Guzmán, in September 1992. This event represented a turning point in the guerrilla war that had started twelve years earlier, since, from that moment on, the subversive actions sharply declined.

Both the control of hyperinflation and the Shining Path's defeat can be considered the main achievements of the reforms (Dancourt, 1999, 53). The government's success in these fields would explain the Peruvians' acceptance of the Fujimori regime, a trade-off of economic stability and political security for loyalty. Yet, to grasp Fujimori's success, the on-going crisis of representability has to be considered.

As widely agreed among political scientists, the nature of representation had been evolving during the eighties and "the collapse of political parties as 'mediators' between the state and society [was] one of the most obvious developments in the political sphere during these years" (Crabtree & Thomas, 1998, 270). The parties, trapped and isolated in their ideological ghettos (Cameron & Mauceri, 1997, 41) were detached from society and perceived as corrupt, inefficient and unresponsive to the people's needs. Even though more institutionalised in the eighties than during previous decades, political institutions had been traditionally weak, and did not withstand the widening gap with the changing electorate. Mainly as a result of the economic crisis, organised labour had weakened while the informal workforce was growing, which "created a fragmented heterogeneous mass electorate" (Roberts, 1996, 100). This situation was favourable for outsiders not already tied to existent parties or political institutions, as people had faith in neither and as their vote had become more and more volatile.

As a forerunner of the presidential elections in 1990, an independent candidate was elected to be Lima's mayor a year earlier. At the national level, Fujimori, son of modest Japanese immigrants and director of the Peruvian Agrarian University, was a political novice who had never been affiliated to any parties, nor interest groups, and was unknown to the crowds just weeks before his unexpected election. His major opponent and the

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than the MRTA (Movimiento Revolucionario Tupac Amaru), was dreaded as a highly dangerous and violent organisation.

favourite, the famous writer Mario Vargas Llosa, did not represent any traditional party either[143], but had his own *movimiento* as did Fujimori[144].

Just like other neoliberal *caudillos,* Fujimori disdained autonomous institutions in civil society as well as independence in the legislative and judicial branches of the government. As he had not been dependent on any parties nor any particular interest groups, he sought neither dialogue nor consensus with either of them. On the contrary, he was "unwilling to play by the established democratic rules of the game" (Cameron & Mauceri, 1997, 48) and sought to undermine the leftovers of party representation by discrediting them. The refusal of the congress to approve a package of 126 decrees the executive had submitted in September 1991 was used as an argument to justify his self-coup. He pointed at it, arguing that they were blocking his attempts to reform the economy and to effectively fight against terrorism. The former president's immunity was a further argument to defame the party system and in particular his own, the APRA. Strong with the backing of polls and his allies in the armed forces, he dared to close congress – an enterprise that would not have been possible with strong parties and opposition.

The *auto-golpe* was consistent with Fujimori's anti-political style. He further continued to concentrate the power in the executive by remodelling the composition of congress and the procedure for elections (Tuesta, 1998, 20) and rewriting the constitution. According to Cameron,

> *"the 5th of April was one event, albeit the decisive one, in a series of democratic setbacks that demonstrated that the president intended to rule by decree, subordinate the Congress to presidential authority, increase the powers of the armed forces, expand the intelligence service, purge the courts, attach the church and political parties, offer amnesty to soldiers convicted of human-rights violations and turn a blind eye to corruption among civilian and military advisors" (Cameron & Mauceri, 1997, 224).*

This democratic setback, however, did not start in 1990, even though the deterioration had been drastic during the first years of Fujimori's rule. Some authors, comparing Velasco

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[143] However, for many Peruvians, he represented the will of the economic elite, a feeling perhaps strengthened by his overwhelming campaign.

[144] These loose, timely-bound units were a new feature of the tendency towards "depoliticised" democracies. Pragmatic and incumbent upon the candidates' image only, this group of followers does not have a purpose on its own and its existence depends on the leaders' political achievements. According to Tuesta (1998, 12), 90 per cent of the electorate voted for movimientos during the various elections held in the nineties.

and Fujimori, see "striking similarities" in their governance and their goals, as they were both "executive-dominated governments that sought dramatic changes in Peru's economy, society, and polity" (McClintock & Lowenthal, 1997, ix). Surprisingly, the former was a leader of a revolutionary government of the armed forces, whereas the latter was the head of state of a Democracy. In fact, a strong *presidentialism* had been passed on and institutionalised with the 1979 Constitution, which contained some anti-democratic aspects. This imbalance of power between a strong executive and obedient legislative and judiciary grew during the eighties, as both Belaúnde and García were increasingly ruling by decree and doing favours to interest groups. Hence, this newly established democracy can be considered to be "weak" (Zegarra, 1999) as its structure did not encourage political dialogue but rather a regime of imposition. Power concentration in the hands of the executive had been a reality throughout Peru's recent history of democracy and Fujimori did reinforce this trend, which culminated in the self-coup and was legalised with the new constitution of 1993.

This political *continuity* stands in contrast to the economic switches occurring at the beginning of every presidential term. In fact, these changes in economic orientation are a consequence of the power distribution in the government. Just as power concentration in García's hands had given him enough lee-way to push through his excessive interventionist policies, it facilitated Fujimori's venture to implement a radical pro-market programme once in office. In order to distance himself from his predecessors, the president did not seek to change the democratic structure of the Peruvian government, but set forth further centralisation of authority in the executive.

Yet, this one-man rule is not linked in any particular way to a certain type of economic structure. In other words, just the way Fujimori switched to neoliberalism after a statist period, a future president could decide to reverse the economic trend and implement opposite reforms again (Zegarra, 1999). Hence, presidentialism favours radical economic switches, and this for two main reasons: First, the lack of democratic consensus, which settles usually for moderate economic measures. Second, the short period of time the executive disposes to make its reforms irreversible. It is certain that these two aspects, that is to say, radicalism as well as fast implementation of economic reforms, were present in Fujimori's first term. This further confirms the fact that "the progress on the economic front during the early 1990's […] was combined with a reversal in democratic development" (Cameron & Mauceri, 1997, 223) as institutions were growing still weaker. In

other words, the economic adjustment was of an orthodox kind, whereas the political one was heterodox (Gonzales, 1998, 23).

4.2.3 Neoliberalism and neopopulism

In fact, the accepted assumption that free market and representative democracy are one global process towards liberal societies stands in contrast to these conclusions, and to numerous examples of other countries which experienced political and economic transition. As seen in Chapter Two, several scholars have further "noted a coincidence between neoliberal economics and populist politics, raising basic questions about the meaning of populism and its relationship to different economic models" (Roberts, 1996, 82). Although neoliberal reforms restricted traditional forms of populism, commonly embodying socialistic features such as redistributive policies and a distaste for the oligarchy, it did favour the emergence of a new type of populism. Presidential rule transforms into neopopulism[145] when the institutional channels of participation and representation disappear, replaced by a more direct communication with the unorganised masses, mainly transmitted through the media.

"Garcia, the 'last gasp' of economic populism already had features of political neopopulism as he tried to distance himself from his own party and counted on his charisma to convince the crowds and rule" (Crabtree & Thomas, 1998, 266). With the breakdown of the parties and the appearance of the "movimiento phenomenon" on the national level, 1990 revealed a change in political representation. Managing the widening gap between the politicised organisations such as parties and labour unions and the electorate in his favour, Fujimori established direct contact with the masses, bypassing any organised structure of representation to address the individual in particular.

The main challenge of neopopulism seems to be the ability to cultivate popular support when extreme economic adjustments are increasing misery and redistributive possibilities are scarce. As mentioned earlier, the economic reforms induced by the Fujimori team were increasingly successful on a macroeconomic level, displaying high GDP growth rates.

[145] According to Perelli, a neopopulist leadership in Latin America generally implies the following characteristics: Support of business, acceptance of the change imposed by developed countries, leadership remaining within the margins given by the type of system of government, individual-oriented communication. Triggering common sense, the leader is presenting himself as an ordinary person, is not representing a party and offers his person as alternative (Perelli, 1995, 186-88).

Meanwhile, the microeconomic level experienced continuing stagnation, as microeconomic adjustments were up to the free hand of the market (Wise, 1997, 103).

In order to maintain broad support from popular sectors, several small-scale social programmes[146] were put in place by the government. Concretely achieving only limited poverty alleviation, this selective, but mediated social spending heavily increased with the prospect of a re-election for a second term in 1995. These targeted actions included neither municipal governments nor independent community organisations, therefore limiting their diffusion and sustainability, but connected Fujimori directly to the poor. Managed directly by the Ministry of Presidency, the actions were financed mainly with privatisation revenues and international credit:

> *"Peruvian social policies have relied upon direct, highly paternalistic relationships to the microlevel exchange of material benefits for political support, even in a context of relative macroeconomic austerity. […] Fujimori has thus demonstrated how populist economic measures – at times, remarkably traditional ones – can be incorporated into an overarching neoliberal project, and how privatisation programmes that are central features of neoliberalism can easily spawn new types of populist agendas" (Roberts, 1996, 107).*

Roberts' observation goes beyond the assumption that a certain type of political populism survived and evolved alongside economic reforms towards free-market structures. His analysis suggests furthermore that the revenues induced by orthodox economic policies can be pumped into specific government projects led by the executive for propaganda. Oriented towards poorer sections of the Peruvian population, these projects did not interfere with the macroeconomic orthodoxy advocated by international organisations and expected by foreign and national investors.

The targeted programmes, which stand in contrast to universal measures applied in welfare-oriented economies, have a modest impact but can create a clientelist bond where material rewards are exchanged for political support. This particular dynamic suits a society with great inequalities and wide-spread poverty – both fundamental features of the Peruvian society, which further worsened with the advent of structural reforms. In sum, macroeconomic orthodoxy favoured microeconomic populism for the two following reasons: First, it set the stage for austerity, which gave the target programmes its *raison d'être*, and second, it provided the resources to finance them.

On the other hand, it should be repeated that extreme market reforms could only be implemented thanks to a strong head of state, weak institutions and a disorganised population of *informales* (Grompone, 1998, 13) – a combination which implies a representative structure with populist features. In this sense, it could be argued that under certain conditions, as in the Peruvian case, neopopulism and neoliberalism are not merely tolerating each other but may develop into an integrated political and economic strategy where the two concepts nurture each other.

4.3 State institutions

Institutions are the basic structure which creates order in human interaction and by which the aspect of uncertainty in exchange is reduced (North, 1990, 118). In modern societies, stable institutions are best organised in an *état de droit*, where direct human intervention remains low due to the rule of law, which prevents arbitrary decisions and unexpected changes. Hence, in a democratic society, the state's role appears to be essential for the economy, as it shapes the rules, protects them and enables their application through its political and economic institutions.

4.3.1 Economic institutions and autonomy

In order to fulfil the objective of regulating economic activity in a market-based society, a relative autonomy of the state towards immediate interests of dominant capitalists is necessary – this with the purpose to assure a long-term functioning of the free-market system (Conaghan & Malloy, 1994, 7). This fundamental feature, in turn, implies a high degree of impermeability of state bureaucracy towards attempts of the private sector to bypass legal procedures. To secure such loyalty within state institutions, bureaucracies need to be corporately coherent and include "meritocratic criteria for recruitment and promotion" (Evans, cited in Cameron & Mauceri, 1997, 225). Such impartial and efficient institutions strengthen the state and optimise its role of supporting markets.

This concept of the autonomy of state institutions as well as their efficient functioning have often been a headache for Latin American countries, where the interests of dominant classes were largely influencing the state's policy-making and the implementation of its

[146] Mainly poverty relief, food assistance and residential programmes.

policies. This observation is valid for the Peruvian case of the early nineties as well. By the end of García's mandate, democratic institutions had barely set roots during the twelve-year period of civilian rule. The leftist head of state had left a weak state behind, where institution building had been further undermined by deep recession, repeated policy switches and political insecurity. These elements greatly contributed to the continuing deterioration of the large developmentalist state into a predatory state (Durand & Thorp, 1998, 211), consumed by high degrees of corruption, rent-seeking and inefficiency.

Subsequently, the success of the extreme economic reform Fujimori embarked upon was closely related to his ability to reinstate functioning economic institutions capable of supporting market mechanisms. As a first step, key state institutions, such as the Central Reserve Bank (BCRP), the Ministry of Economy and Finance (MEF) and the Ministry of the Presidency, were changed as they were meant to become the main policy-making entities of the central government. The second initiative in economic institution building was the bringing into play of several autonomous agencies, creating an efficient and professional regulatory framework, mainly responsible for revenue collection and market regulation.

The revenue collection imperatively requested an adequately recruited and well-trained bureaucracy, as it was to be in charge of collecting the revenues that fund most expenses of the state (Durand & Thorp, 1998, 224). The attempt of the former administration to renovate the tax system, renamed SUNAT (National Superintendency of Tax Administration) had been a failure, as changes had not been as thorough as they should have been, mainly due to the lack of strong political backing and the difficult economic situation. At the time of structural reforms however, Fujimori's advisors were determined to push through a total transformation of the agency, by giving it more financial independence and by revamping its structure and functioning, an audacious and drastic enterprise which was quickly crowned with positive results[147]; to the extent that it is considered by some the most successful reform of the Fujimori administration (PREM, 2001).

This example demonstrates the will of the executive to regulate the new free-market structures put in place through economic institution building, and this to an extent perhaps unparalleled in the region. But these largely independent agencies, framing economic activity, remained *islands of efficiency* within a state apparatus sapped by the old

[147] This even though the system was facing some global problems inherent in the society's structure: Due to a growing informal sector, the number of registered taxpayers was low, which implied that the main tax income was, as often in such circumstances, indirect and regressive.

bureaucratic structures. Due to the Fujimori administration's priorities – in line with its macroeconomic ones - traditional ministries in charge of, among others, social issues and infrastructures were left aside. The administration tackled the institutional shortcomings in a selective and uneven way, but its choice was rational considering the immediate importance, on the one hand, of the BCRP and the MEF for stabilising the economy and sustaining market reforms (Wise, 2002) and, on the other hand, of the autonomous agencies to make the free-market system work. Thanks to their relative autonomy and insulation within the state, this selection of institutions was immune to the influence of other state bureaucracies, which prevented them from misusing their discretionary powers.

The islands of efficiency put in place by the Fujimori administration strongly improved the state's capabilities, professionally handling important economic issues that were formerly dealt with by gangrenous ministries. This greatly contributed to the state's reputation in general, and to Fujimori's in particular. In this sense, the relative economic success justified the president's tendency to centralise decisional powers in the executive. The two *super-ministrie*s, closely linked to the president and his crew of technocrats were in charge of all the important economic and political decision-making (Grompone, 2000, 117). The MEF, manager of the state budget and the Ministry of the Presidency, Fujimori's personal instrument for social relief[148], were covering – with the aid of the regulatory agencies - the main mechanisms for the economic functioning of the state.

4.3.2 Regulation and the rule of law

With only two main central government ministries and with a group of autonomous agencies, Fujimori was keeping a tight rein on governance. The partial and centralised state reform, which found its main justification in the macroeconomic improvements, was impeding further institutional reforms within the government.

This fact is approached by Becker in his analysis on INDECOPI[149] – the government's main body for market regulation – and its role within the state[150]. The Peruvian National

[148] The Ministry of Presidency had been created by García and reappeared in 1992 to promote a wide range of social project directly led by the president. It was independent from other ministries and agencies and was not refrained by accountability. As mentioned above, its main role was to support the president's popularity through targeted poverty relief programmes. Wise notes that "even Fujimori's most polite critics refer to as the president's own 'mafia'" (Wise, 2002, 13).
[149] *Instituto Nacional de Defensa de la Competencia y de Protección de la Propiedad Intelectual*.

Institute for the Defence of Competition and the Protection of Intellectual Property, the country's main agency for market regulation, was created during the reforms and was designed to assume responsibilities mainly in consumer protection, from unfair business practices, antitrust, dumping and subsidies, bureaucratic barriers to market entry and enforcement of intellectual property rights. The new regulatory institution rapidly gained a high degree of independence from political forces and organised interest groups as well as approval from a large part of the population through its professionalism.

High salaries[151], adequate budgets and a corporate identity gave the well-trained staff an efficient and motivating setting, thus eliminating the bribery incentives that plagued other parts of the state apparatus. INDECOPI's prosperity would not have been possible without Fujimori's support, who had been convinced by the agency that it was an indispensable element of his effort to modernise the Peruvian economy and to monitor its transition to full participation in the global market system (Becker, 2000, 9). Greatly independent from other state authorities and outer influences, INDECOPI, as a strict defender of property rights, was giving a secure frame to economic activity in Peru.

This led Becker to believe that INDECOPI was, to a certain extent, fulfilling the tasks usually incumbent on the judiciary in a modern democracy. He wondered further whether the prestigious regulatory agency was not, in the end, a substitute for judicial reform. This question is truly relevant considering the judiciary's role in modern societies in general, and is even more so for Peru, where the guardian of the rule of law - meant to be independent from governmental and private interests - is weak. As a matter of fact, the judiciary "has never enjoyed the political autonomy required for it to protect individual rights against abuse by the state or from the excesses of the country's rulers" (De Belaúnde, 1998, 173). Consequently, it has been viewed as slow and incapable of fulfilling its primary functions properly, namely the protection of the constitution and basic rights, as well as providing a system of conflict resolution between individuals. To a certain extent, INDECOPI filled this gap thanks to its high reputation and its wide discretionary powers (Pasco-Font, 2000, 63). Accordingly, Becker suggests that the regulatory agency was partly assuming a role usually played by the judiciary, "answering to some of the most urgent needs of both powerful economic interests and ordinary Peruvian citizens". He also notes however that INDECOPI was regarded by some "as something of an antidote to pressures for more thorough judicial reform" (Becker, 2000, 14). Meanwhile, "foreign

[150] David Becker: Is the good the enemy of the better? Peru's INDECOPI and judicial reform. Paper, 2000.

observers tended to be somewhat bemused by the way in which market economy was being espoused, along with respect for the rule of law, without there being an efficient and active judiciary that commanded wide respect" (De Belaúnde, 1998, 180).

But this tacit substitution of the - potentially - better option for a "second best", which, in fact, did not satisfy the fundamental requirements of a judiciary power, is revealing. For the executive, the strengthening of the shaky judiciary would have cost too much effort for too small immediate rewards. But more importantly, a renewed judiciary could have eventually become upsetting to the ones in power, contesting their decisions. By supporting this alternative institution regulating economic activity, the central government participated in further eroding the judicial institution, and chose to do so to protect itself and to keep all the decisional powers in its quarters.

INDECOPI, and the entire system of professional agencies were, in fact, under the direct control of the presidency, and represented a means for controlling the market reform agenda advocated by the central administration. The president had delegated some authority to the agencies, but he did it in such a way that they would have sufficient lee-way to help him to establish his own policy objectives, but not enough to gain any significant independence from his command. Subject to clear performance, the group of autonomous agencies were tied to the president's goodwill, and were "relatively easy to create and easy to disable" (Shepherd, cited in Wise, 2002).

4.3.3 Second phase reforms and inclusion

While trying to reach an appropriate degree of efficiency in the bodies decisive for macroeconomic success within the state, Fujimori never really initiated institutional change for the entire administration. By undermining deeper institution building, he intended to secure discretionary power for himself and his circle of advisors, mainly to push through the reforms that he deemed necessary. Similar to other central governments in the region, the president and his technocrats managed to redesign the economic framework of the country on their own, leaving other political and social actors aside.

In general, the centralisation of power within the executive can be perceived as an asset in a destabilised country with a weak and gangrenous state administration, as difficult macroeconomic decisions need to be taken without social pressures and various reforms

[151] It is worth noting that the salaries offered in some renewed ministries and agencies, even though as high as in the private sector, reached competitive levels thanks to a special fund based on self-financing and the aid from the World Bank and the Inter-American Development Bank.

have to be initiated swiftly, for example when implementing an adjustment programme based on the Washington Consensus. Once this first step achieved, however, a continuous centralisation of authority will eventually turn into an impediment to second phase reforms, which imply a democratisation of decision-making, as issues of greater social complexity are at stake and mean subtler gains than the obvious benefits of macroeconomic stabilisation (Wise, 2002).

Suspicious of connections between the state and society, synonymous with rent-seeking and corruption, and reticent to any interference in their decision-making, technocratic executives isolate themselves to rule more effectively. In doing so, they protect themselves from political pressures and social demands and accept clientelistic behaviours as a necessary means to implement their policies. But beyond blocking a more thorough change of the entire state apparel, the Peruvian executive failed to shift to a more accountable style of politics and a more inclusive debate for policy-making and implementation. Such changes would be crucial in order to pave the way for Evans' *embedded autonomy*, a concept implying a connection between state bureaucracy and the private sector. According to his analysis, the failure of neoliberal governments to achieve transformation is due to their incapacity to balance autonomy and embeddedness (Cameron & Mauceri, 1997, 226). The absence of such efforts of integration prevented second phase reforms which, in turn, impeded a sustainable development of Peruvian economics.

In the end, the key question whether the Fujimori administration weakened or strengthened institutions has, as Durand and Thorp put it, no simple answer. It cannot be denied that Fujimori was responsible for enhancing state capacity, but also for blocking the process whenever he thought it was necessary, for instance when political conditions changed (Durand & Thorp, 1998, 210). Indeed, although the institutional bases for a coherent economic policy had been laid, paving the way for outstanding improvements in macroeconomic policy-making and market regulation, the increasingly dominant president and his team of technocrats "apparently came to associate political survival with a strict adherence to the status quo that had been established during this first phase of market reforms" (Wise, 2002).

Worse, during his second mandate, clear signs indicated a further shift towards autocratic decision-making as economic success crumbled and support dwindled. Anti-democratic and even unlawful elements such as threats and corruption began to surface. Yet the degree and the extent of the cleptocratic system put in place under the Fujimori administration would only become public after the collapse of *Fujimorismo*.

In the meantime, with the changing role of the state, a new frame had been given to the economy, turned upside down by the freshly implemented free-market policies. The private sector, forced to adapt quickly to the new circumstances imposed by the liberalisation of the markets, experienced strong changes in its relationship with the government. A close look at the interaction between the changing public and private sectors is necessary when attempting to bring the evolution of Peruvian business into light.

CHAPTER FIVE: The Peruvian business community

In Latin America, business - state relationships have, in the last three decades, often been subject to strong ups and downs, mainly due to very inconsistent political and economic conditions.

In the sixties, Central as well as South American countries found themselves at a turning point in terms of political and economic power, as previous models of governance were overthrown. Military interventions or social revolutions had been preparing economic models alternative to the "feudal sort" of orthodoxy, giving a final blow to the already weakening type of oligarchic politics mixed with the liberal economic model (Conaghan & Malloy, 1994, 46). While most of the old mechanics of elite control over politics stayed in place after the Second World War, developmentalism had surfaced with various new political forces in the central Andes, creating a more complex political arena.

5.1 The national "bourgeoisie"

In this perspective, Peru was, at the end of the sixties, subject to particularly difficult business - government relations under the revolutionary military government of General Juan Velasco Alvarado. Similar to earlier episodes in the region and elsewhere, the progressive and nationalistic movement was based on a strong will of the Peruvian top officers to overturn the shaky, yet deeply rooted, oligarchic order and to increase the country's political and economic independence (Bullick, 1999, 164). As a strong bureaucracy and a professional institution, the Peruvian *ejército* perceived the national political, economic and social modernisation as an inescapable necessity for the population's sake and its own.

The fact that these nationalistic aspirations had been growing and reached their peak when the country was experiencing a slowdown in the process of economic growth can hardly be considered a coincidence. Indeed, the quite successful "almost pure primary-export strategy" (Dancourt, 1999, 53) was running out of steam in the late sixties. A worsening balance-of-payment problem, mainly due to increased imports and stagnating exports, as well as a lack of private investment, were casting a gloom over Belaúnde's first

mandate (1963-1968). The weak restructuration initiatives towards an ISI-type of industrial production attempted by the government did not manage to reactivate the economy (Thorp and Bertram, 1978, 287ff.). The public investments, however, had the effect of notably increasing the foreign debt. The subsequent devaluation of the sol reinforced two tendencies in the Peruvian public opinion: The disapproval of the Belaúnde government and a strong discontent with foreign firms and the oligarchy. Both groups were regarded as the culprits for Peru's economic misfortune; the former for draining the resources of the country, the latter for preventing their more egalitarian distribution. Under such difficult conditions, all Velasco had needed was a pretext for military intervention. A long-lasting feud between the government and the International Petroleum Company (IPC) gave him the impetus for the coup of October 3rd, 1968. The nationalisation of the IPC was the first measure taken by the military dictature (Angulo, 1999).

Denying any influence from either the communist or the capitalist ideology, Velasco's priority was to give the state a privileged role within the national economy, as the agrarian and industrial reforms[152], introduced respectively in 1969 and 1970, rapidly suggested. It was not so much the aims of the reforms that caught the attention abroad, but rather the determination of the military government to implement them, expressed among other things through non-negotiable expropriations and the creation of state companies (Thorp & Bertram, 1978, 301). The idea was that these companies would be a complement to private sector growth, in an economic environment restricting foreign investment, hence opening up the most lucrative business to domestic investors. Through the newly established network of public companies, which were replacing foreign capital in strategic sectors, a favourable environment for national companies to develop was to be created. The military government, with the participation of civilian technocratic elites, was thus planning on establishing "some sort of market or mixed economy in which the local national bourgeoisie would play a crucial role" (Canaghan & Malloy, 1994, 48) in the *Peruvianisation* of the economy.

These changes in economic policy were forcefully affecting the positive foreign investment trend that had been steadily growing since the beginning of the fifties, and which had led foreign companies to own a large share of private enterprise in Peru: "by 1968, the three quarters of the mining, a third of the fishing industry, and half the manufacturing firms

[152] The agrarian reform affected most large landowners and foreign mining companies which were hit by expropriation or deprived of concessions previously approved by the state; the industrial reform decreed the establishment of "industrial communities", which were meant to represent the

were under the direct control of foreign capital" (Conaghan & Malloy, 1994, 44)[153]. With the changes in the policy implemented by the military government, foreign economic activity had regressed, and by the mid-seventies, the state was assuming "the role previously held by foreign capital in mining, oil, electricity and railways, had taken over much of the banking system, virtually all export marketing, and the entire fishing sector, and had pushed through reforms designed to benefit the employees of enterprises in the modern sector of the economy" (Thorp and Bertram, 1978, 302). These changes in ownership structure were the application of Velasco's will to put in place an interventionist state, which would play the main role in Peruvian economy. The state, which had traditionally been absent and passive in the economy, was from then on meant to be leading the country – thanks to the creation of more than one hundred state-owned enterprises - towards a sustained economic development.

In general, in the early seventies military rule coincided with economic expansion, increased public spending as well as higher levels of domestic consumption, and some segments of the Peruvian business community did enjoy benefits induced by the new policies. The government's record of expropriations and the delicate investment climate led many foreign companies to sell their operations to domestic economic groups. The *industrial* bourgeoisie - mainly urban - developed, taking advantage of the government's initiatives to shift capital from the agrarian sector towards the secondary, a move that was meant to encourage industrial production.

According to Becker, since the "archaic aspects of Peruvian capitalism" had already fallen into decay by 1968[154], it did not take more than a change in state authority to make a "corporate national bourgeoisie" bloom. In this perspective, the military played a crucial role: "The military establishment, whose basis in expertise makes it a wing of the corporate national bourgeoisie, and which was already present within the institutional state, was the logical entity to lead the requisite reorganisation" (Becker, 1983, 332). In other words, the military apparatus functioned as a "replacement bourgeoisie" (Bullick, 1999, 165). The evolution of the state towards a more autonomous bureaucracy was made possible by the slow degeneration of an old oligarchy, giving way to a more industrial,

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workers and participate actively in the companies' management, have shares in the management and the profits made.

[153] It is worth noticing that according to Thorp and Bertram, the then usual observation of foreign companies displacing local firms is not quite appropriate. Indeed, foreign companies tended to invest in new developments, and foreign investment was largely welcomed by the local elite.

more professional and technocratic type of business – features that had been incorporated by an increasingly developmentalist military. Once in power, the state precipitated the doom of traditional landowning and export-led economy and encouraged, directly and indirectly, the establishment of the emerging *new* bourgeoisie. In this sense, the state, embodying corporatist features ahead of time, was a sort of catalyst for the changing political and economic order. Hence, in the end, public incentives during the military era of the seventies favoured the emergence of a more heterogeneous and diversified private sector; and "as much as businessmen would later complain about statism, they were in fact the creatures of state intervention and developmentalist policies" (Conaghan & Malloy, 1994, 45).

Even if the structural changes initiated by the military government were meant to strenghten the still relatively weak and dependent domestic industrial capitalists, the latter did not necessarily perceive the state's interventionism as salutary. There is no doubt that during Velasco's era, business environment had become more problematic, and the radical stance of the reformer undermined what could have been a more harmonious period of ISI (Abugattas, 1998, 63). Even though business did, to some extent, benefit from the new economic situation, they perceived the government as being more and more intrusive and overbearing. Under the changing circumstances, the future of private business appeared quite gloomy as the long-term perspective of investments seemed insecure. And although the Peruvian army concentrated its pressure on the "obstacles of reform", namely the landowning oligarchy and the large foreign firms, most capitalists were more than sceptical about Velasco's *state capitalism* and did not rush into new investment projects.

Adding to this concern for insecurity and uncertainty about the future of business was the lack of involvement in decision-making. No channels of regular representation existed in a system that tended to concentrate powers in an exclusive group of military and civilian technocrats: "Policies were developed by the network of military groups with access to Velasco, with little in the way of public debate or even consultation with the affected groups. Once a consensus had been reached inside the government, the policies were abruptly unveiled and imposed" (Conaghan & Malloy, 1994, 65). This absence of consultation with the private sector did not fail to contribute to the uneasiness of businessmen towards the rather arbitrary government.

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[154] As will be discussed later, foreign presence had been a factor of acceleration for economic modernisation, which, in turn, led to deep social reorganisations; among others the state, which, at that point, was hostile to foreign capital.

In the long term however, the implications of the Velasco era policy were, in the end, limited. Many have argued that the capitalist orientation of the economy was never really endangered. Indeed, for all its assertive nationalism, the 1971 Plan offered little in the way of a new economic structure for Peru, even though the opportunities for a fundamental reorientation of the country's social and economic structures existed (Thorp & Bertram, 1978, 305).

By the time of the coup, heterogeneity in ideologies was prevailing within the army beyond the obvious will among the leading officers for a sharp change, and no clear and definite programme had been elaborated. This absence of consensus translated to a certain extent into what was a backtracking or incoherent application of policies at times (Bullick, 1999, 163). Furthermore, the military's subsequent refusal "to choose sides" put the state in a difficult position: Failing to move to the left, but attacking a large part of the right, the military government hardly gathered any support from the masses at the moment when local and foreign capitalists had already lost confidence in the state's policy-making.

Hence, while some striking changes in the structure of ownership were accomplished, the fundamental goals of the military government, which were the reduction of disparities in the population[155] and a greater autonomy, could not be achieved for two main reasons: "the conceptual inadequacy of the military's programme and the harsh realities of Peru's position in the international system" (Thorp & Bertram, 1978, 319).

But it cannot be denied that this "Peruvian Revolution", launched by the Military in 1968, marked the most important turning point in the history of the Peruvian economy since the end of the 19th century[156] and the "broad shifts in government policy in both foreign and domestic matters have reflected a profound change in the nation's social structure" (Davis & Wilson, 1975, 366). The military era of the seventies is indeed a key period with deep changes in politics and economy, which also had lasting disruptive effects on the structure of the relationship between business and the state. Indeed, during that period, the Peruvian society found itself at a point of political and economic "rupture", where the

[155] Webb notes that even though some positive measures for income distribution had been taken, other, indirect effects of policy change penalised the poor and accentuated economic and political dualism. Hence, during the Velasco period, little change as to the degree and direction of redistribution had occurred (Webb, 1977, 88-90).

[156] It is worth mentioning that according to several authors, the ideological trends and economic goals of the military government was nothing new, but in fact closely akin to the traditional anti-oligarchic stance already very present in the thirties and forties. "The novelty lay in the idea (…) that breaking the monopoly positions of the elite and the foreign firms would be a sufficient

signification of the state institution and the structure and composition of business changed and, finally, where the relationship between the two took a definite turn towards new channels of interaction. Unleashed by the fading of the old oligarchy's influence and the reduction of foreign presence in the Peruvian economy, there was space for a new distribution of economic power at stake.

5.2 Peru's peak business association

As a matter of fact, the traditional public – private relationship had changed: The state had become an important economic actor and was more independent from private interests. On the private side, business had become more diverse, with a growing national and industrial component. In this changing context, two - sometimes distinct, sometimes overlapping - ways of business behaviour need to be analysed.

On the one hand, domestic industrialists, who had developed into conglomerates in spite of, or perhaps thanks to, the sporadically changing policy environment, felt strong enough to approach the government on their own, directly or through their associations. On the other, from the seventies on there had been a growing need for business to address demands in unison to the "new" state institution. For the first time there was the will to form a so-called *peak business association*, an "umbrella" organisation which reassembled a multitude of companies of various sizes from different sectors.

Unlike traditional sector-based lobby groups, such a contender's agenda would confront the government with global and fundamental economic and political issues rather than specific ones, and it would be doing so with respectable bargaining power. The accession of this new dimension in business - government relations needs to be considered, as it has, at times, played a decisive role in Peruvian politics and economics over the last twenty-five years.

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condition for the release of a great reserve of latent dynamism in the Peruvian economy" (Thorp & Bertram, 1978, 304).

5.2.1 CONFIEP's accession to the Peruvian political sphere

During the long period of export development and incipient industrialisation, the ruling class was led by the *agrarios,* a pro-export landed oligarchy, allied to traditional landowners, import-export merchants, mine owners, and foreign enclaves. Defending similar interests, such as pro-market policies, and commonly opposed to protectionist measures benefiting manufacturing industries (Durand & Silva, 1998, 255), this economic group - which had the undisputed economic power and was respected by the growing urban and industrial bourgeoisie – failed to unite into a politicised umbrella association. Indeed, the panorama of business associations was fragmented at the end of the sixties, with the old SNA (*Sociedad Nacional Agraria*) as the most influent among associations of similar and opposite interests. Among the latter sort, the equally old[157], but traditionally weaker, SNI (*Sociedad Nacional de Industrias*) and a growing number of associations representing modern business ideology had not, at that point, contested the oligarchic supremacy.

Velasco's move to abolish the SNA shook up these long-lasting foundations, as most same minded associations vanished while modern business sector institutions hastened to approve the military government's initiative. Very quickly however, business – as mentioned earlier – did not feel at ease with a more demanding state apparatus, no longer controlled by the privileged classes (Conaghan & Malloy, 1994, 68), and by 1973, the SNI had become the government's main conservative opposition, a situation that led to fierce altercations. This tense situation held out until General Bermúdez' coup in 1975, when a conservative policy shift eventually favoured business interests.

But business had been irreversibly changing, and so had the associations representing it. Unintentionally, the developmentalist military government had forced business to rethink their relation to political power and hence encouraged the conversion of their "previously unprofessionalised interest associations into effective instruments of political combat". This combat based on anti-statism coupled with a call for liberal democracy, seemed to represent an ideal formula for both "beating back an all-too-intrusive state" and resolving their problems (Conaghan & Malloy, 1994, 69). By the end of the seventies, factors such as aggressive union movements against the newly established "business-military dictatorship", the new challenges and opportunities of a potential transition to civil rule and democracy, as well as the remaining uncertainty as to its relation with the state accelerated organised business activism. Thus, despite discrepancies resulting from the recession and economic

[157] Both institutions were founded in 1896.

policies (Durand & Silva, 1998, 260) and the government's actions to undermine cohesion between exporters and industrialists, incentives for the creation of a peak association were high.

After a failed attempt in 1974 and a short-lived Peruvian experience of collective business action in 1977, it is during the recovered civilian rule that a more durable peak business association was founded. Indeed, at the beginning of the eighties the circumstances were increasingly favourable to economic cohesion between economic sectors after the approval of a new constitution reaffirming the rights to private property, granting the concept of "concerted action" (Durand, 1992), but also giving the executive more powers. However, it is the dramatic economic situation which gave a major push to collective business activity, at a moment when other social forces, such as unions and peasants' organisations, were getting weaker while the political left grew stronger and violence escalated (Roberts, 1998, 201).

The long-haul crisis, the highly confusing signals issued from the various technocratic groups[158] during Belaúnde's second mandate (1980-1985), as well as the chronic failing of formal channels of interaction encouraged the heterogeneous private sector to overcome their differences and to found an encompassing business association in 1984. That year, CONFIEP (*Confederación de Instituciones Empresariales Privadas*) was formed, as economic differences among businessmen were becoming less important than their common claim to stop continuous changes in policy orientations (Durand, 1992). Within a year, the association, representing notably industry, mining, construction, fishing, radio/TV and commerce, was joined by the exporters' and bank associations. CONFIEP was then composed of nine key trade associations (Durand & Silva, 1998, 265).

While the pattern of autonomous representation – usually by sector or specific interest – still prevailed during the seventies, businessmen developed the capacity to negotiate among themselves, which suggests that the business community had acquired an important prerequisite for the making of a peak association, by acting as one entity[159] - at the highest

[158] According to Vásquez, three different governmental entities were trying to shape economic policy at the beginning of the eighties: First, there was Belaúnde's cabinet, rather concerned about the president's popularity. In the meantime, a second team from the MEF, Peru's "Chicago boys", was advocating the implementation of neoliberal policies while yet another group was working towards a consensus between economic actors, based on a rather social democratic approach (Vásquez, 2000a, 56).

[159] According to Durand, a peak association emerges when "the business sector develops the ability to distinguish between general and particular interests, when it learns to mediate conflicts among members, when it becomes politically able to speak with a single voice and to avoid outside interference" (Durand, 1992).

possible level of national business cooperation[160]. This did not mean that CONFIEP did not compete with "peers" - existing powerful business organisations. There was, especially, the SNI and the younger, but nonetheless influential ADEX (*Asociación de Exportadores*) which, despite being part of CONFIEP, wanted to preserve their acquired role and public recognition. The IPAE (*Instituto Peruano de Administración de Empresas*) was significant as well, as the organiser of a highly mediated annual conference where political and economic executives meet (CADE, *Conferencia Anual de Ejecutivos*). In a sense, CONFIEP was challenging these well-established institutions and forums with its growing reputation (Campodónico, 1993, 24).

Beyond the general dissatisfaction of Peruvian business with their relationship with the government, some specific issues in the government's political economy changed the business community into an active force pulling on the same rope, and gave CONFIEP the opportunity to enter the tricky arena of business – government relations. Indeed, in addition to the cohesive effect of emergency and the evolution of private sector interaction, CONFIEP experienced a first decisive event during Belaúnde's second mandate. "The turning point that triggered business unity" was a victory over a tax issue with the minister of economy. This success made businessmen realise that collective action had brought immediate and tangible results (Durand & Silva, 1998, 265).

But it is through a compelling wrestling match with President García that CONFIEP earned a broad acceptance and legitimacy in the so-called "battle of the banks" in 1987. At the climax of the state's fiscal crisis, García publicly pointed fingers at big business as the culprits for speculation and capital flight and announced the nationalisation of the banks[161]. In this highly confrontational context, CONFIEP was the only organisation capable of defending the interests of the banking sector, thanks to its public and inclusive nature (Durand & Silva, 1998, 266). Often considered a weak medium of representation before by most powerful economic groups which enjoyed a more direct access to the government – a general trait usually actively encouraged by the other party as well – the young Peruvian peak business association gained a great deal of popularity among businessmen of various

[160] It is, according to Campodónico's classification, the fourth level of business representation, the first being interests at the level of the firm, the second, of a specific branch of producers and the third, of an entire sector. He further adds that it is only through *fourth level* organisations that strategically important parts of society can be rallied in order to defend fundamental objectives (Campodónico, 1993, 240).

[161] Interestingly, the World Bank had ended its loans to Peru at the beginning of 1987 (Teivainen 2002, 111).

sectors, as it was clearly concentrating on fundamental issues dear to the Peruvian business community as a whole.

This moment proved to be the main turning point in business representation, as business could, from then on, count on a valuable association to represent their interests. In fact, the strengthening of Peru's peak business association had been indirectly promoted by García, who, in his search for *concertación*[162], had tried to ignore the institutionalisation of business representation. From the association's perspective, open criticism had been a delicate matter, as CONFIEP's leader was, at that point, an important economic actor involved in the informal dialogue with the president – a recurrent factor blocking the strengthening of the umbrella organisation. But in July 1987 this ambiguous situation came to an end. Failing to find a clear arrangement with the main domestic enterprises, García had misjudged the public opinion and underestimated business capacities to build an organised and mediated defence. His strategy backfired, as it gave CONFIEP the opportunity to publicly confront him by turning the battle into a global issue on private property. As Vásquez puts it (2000, 74-75), whereas concertation had been the result of an elitist arrangement involving only a little, manageable group, the *estatización* spilled over and reached the degree of a social conflict including all sorts of social actors. CONFIEP, which had not been able to be considered a real partner in García's exclusive circle, was propelled up the ladder to become a significant voice of protest.

Business, which had already been suspicious of the arbitrariness of the president's heterodox strategies, saw its fears confirmed with this attempted nationalisation, and sought new political alliances. At the end of 1987, due to its internal isolation and a growing consciousness of the significance of the imbalances, the government worked on rebuilding relations with the main multilateral financial institutions; a move which represented a major "shift in official policy thinking" (Crabtree, 1992, 123). But it was too late to reassure the business community[163], which perceived this switch as another erratic attempt to improve the country's situation in the short term. Many turned towards the neo-conservative political movement FREDEMO, led by the two intellectuals Mario Vargas Llosa and Hernando de Soto. This new political contender, of liberal and anti-statist nature, surfaced as a result of the on-going economic and political crisis, and it seemed as

[162] This concept stands for García's privileged direct interaction with important economic leaders. These informal relations will be discussed later on in this chapter.
[163] When entering office, García had a popular backing of 96 per cent. By 1988, his popularity curve was down to less than 10 per cent (Crabtree, 1992, 159). To illustrate the deep cleavages between the political, economic and social actors at the end of the eighties it is worth mentioning the meetings of the economic leaders and the armed forces, held to stage a putsch.

if Peruvian business had finally found a political voice capable of defending their interest in the political arena. This new movement was being supported by CONFIEP, business' main official channel of political interaction. But the results of the presidential elections a couple of years later brought another social reality to the fore: By failing to rally a broader share of the popular sectors, which regarded Vargas Llosa as the candidate chosen by the Peruvian economic elite, the movement lost the elections[164]. Again, the business community was facing a huge disappointment and for a second time within a few years, rumours of a coup where circulating. But according to Durand (2002a), CONFIEP had turned to the political novice Fujimori even before the runoff election, in spite of his apparently heterodox tendencies, his vague campaign and his hostility towards politicised business associations (Cotler, 1998a, 34).

The political newcomer, at the same time, was quick at weaving contacts with the "real forces" of the country, namely the military and the business community, in order to avoid persistent isolation (Cotler, 1998b, 13). As shown in the previous chapter, the freshly elected president's insulated and autocratic governing style quickly resembled the one of his predecessors, but this tripartite connection between the government and these two crucial allies represented a new type of lasting coalition, which would become the cornerstone of the Fujimori regime. Indeed, domestic business and military had not had regular access to the higher instances of the executive during the two previous mandates; his predecessors had tried to cultivate rather informal links with the business community, but both failed to reassure the private sector – Belaúnde with a "constant waffling on market measures" and Garcia with his "highly erratic behaviour" towards private initiatives (Wise, 2002). Fujimori, on the contrary, did not wait long before putting in place thorough economic measures, which did not fail to reassure apprehensive businessmen. Then, he kept a steady line in the announcement and implementation of further market reforms, which reinforced his credibility. In the process of economic institutionalisation, his administration and some important ministries gained respect within the business community as well, as economic rules were becoming clearer and regulation more professional and transparent. Thus, particularly during the first two years, Fujimori regained a long-lost business confidence (Vásquez, 2000b, 16).

Regarding business, the institutionalisation of CONFIEP as Peru's business peak association was an important aspect in the business - government relations of the beginning of the

[164] Ironically, it is APEMIPE, another business organisation representing small business, which actively opposed Vargas Llosa's election, as the proposal for policy changes during his campaign threatened the small businesses.

nineties as well. As mentioned above, the nationalisation attempt was a "catalysing moment" for CONFIEP – as it was for business - government relationships on the whole - and "domestic business had come a very long way from the days when bank owners chained themselves to their desks in protest" against Garcia in 1987 (Wise, 2002). Since the beginning, CONFIEP had represented the will to be a permanent and inclusive business organisation, able to go beyond simple reactions to global crisis situations (PUCP, 1987, 51) and by the beginning of the nineties, the circumstances seemed to be propitious for this aim. With the García fiasco, CONFIEP had drawn attention outside the country, and from then on could count on substantial financial support from external sources. This helped the association for its expenses such as office space, staff, conferences and publications[165] (Wise, 2002) and, ultimately, its professionalisation and institutionalisation.

In this context, the institutionalisation of a peak business association represents a superior stage of interaction in comparison to the one found in a reactive movement that retaliates when its interests are being flawed. It reflects a new level of organisation, where a permanent and representative body is defending global business interests by collaborating through formal channels of interaction. Finally, it also suggests a constructive behaviour towards the government, as concrete propositions in policy-making can be made, with a line of conduct and medium-term strategies that go beyond the rent-seeking attitudes of one firm or sector, and which could favour the entire national economy.

Such evolution, however, would not be conceivable without the state's own institutionalisation and the willingness of the government to accept the dialogue with business representation. In this sense, the advantages brought by Fujimori's governing style was two-fold for CONFIEP, as a direct and an indirect positive change for the encompassing organisation can be distinguished. As for the former, the president recognised CONFIEP as an important voice of global business interests. As for the latter, the optimisation of key agencies and the normalisation of formal interaction between them encouraged the modernisation of business representation in general and CONFIEP's in particular. Under Fujimori, for example, the various ministries established regular contact with the heads of the corresponding business associations (Durand, 2002a, 18).

These improvements were made possible thanks to Fujimori's pragmatism. Realising that he needed the support of a broad coalition of businessmen – and not only of a dozen important companies – he had promised that the government would consider requests and

[165] CONFIEP even founded its own think tank, the "Political Economy institute".

suggestions coming from business associations. However, for CONFIEP, the task to get to the highest level of the executive remained difficult. And due to the high degree of power concentration in the hands of the president, his advisers and some key ministries, it was precisely at the top of the ladder that lobbying was necessary.

In spite of this, CONFIEP remained loyal to the president's politics and endorsed his pragmatism, as suggests its strong support of Fujimori's *auto-golpe* in 1992. This act, which was a clear step towards further centralisation and authoritarianism – and a stunning one against democracy – was welcomed by most businessmen. Arturo Tello, manager of CONFIEP, explained openly that it was a matter of order (Durand & Silva, 1998, 274), and for the business community, Fujimori had set the right priorities in a country devastated by economic and political insecurity and an inefficient and gangrenous state. The fact that a president had consistently turned away from the protectionist import substitution model and resumed relations with the international community again played a major role in this opinion. CONFIEP's approval of the president's draconian actions certainly had a positive impact for its image in the country. First, as its support indeed reflected the mood of many Peruvians, its popular credibility was confirmed five years after its revelation. Second, Fujimori certainly appreciated this affirmative and public backing of his *Fujimorismo*, which could only improve the relationship between the head of state and the peak business association.

5.2.2 Challenges to CONFIEP's consolidation in the nineties

With weakening social actors, such as political parties and grassroots organisations, and the changing economic and political environment, business organisations and associations were given a new and more important role in Peruvian politics and economic policy-making. CONFIEP, which had become the official voice of business, was, in fact, not all that united in the dialogue sought with the Fujimori government. In his research on the mechanisms of representations of business associations[166], Julio Cotler depicts the great web of existing organisations with, accordingly, the multitude of interests and interrelations among them and their differentiated relationship with the government. A main distinction can be made between the associations representing big business, medium size and small enterprises.

CONFIEP was, initially, composed of associations from the two first groups, which basically implied a potential discord due to their respective positions in the national economy and their divergent aims. Whereas associations like the SNMPE (*Sociedad Nacional de Minería, Petróleo y Energía*) represented a rather homogeneous and strong sector, inclined to support the neoliberal policies of adjustment, others, such as the SNI, tended to be less organised and backed interests that differed from the government's policy-making. The former group, whose members already enjoyed better access to higher spheres of the government, did not usually seek confrontation, but tried to make itself heard through direct and rather informal interaction. The latter group however needed to go through the public scene to make itself heard, hence associations defending medium-sized enterprises tended to be more virulent as their requests often remained unheard.

In addition to those two main coalitions, the role of a third group, composed of small and *micro* companies, cannot be omitted even if, due to their absence in key economic sectors, their high degree of heterogeneity and their great informality, their organisation and representation through associations remained extremely weak (Cotler, 1998a, 38). Furthermore, the aspirations of the various associations on this level were rather linked to specific and local demands. Yet they represented a total of at least 97 per cent of the enterprises in the country, which in turn implied a close link to the popular sectors of the population. Hence, in spite of their organisational weakness, organisations defending micro and small enterprises had a decisive influence during critical political events such as elections, as they could rally a large part of the vast lower class to get their requests fulfilled. These, in turn, were usually not far-reaching and did not represent big economic costs for the government. By complying with their demands, the government could assure itself of a good strategic position as it was able to count on the backing of the common people (Cotler, 1998a, 46). Recognising the "strength of the numbers" (Wise, 2002), and in order to reinforce its independence towards other important associations, several attempts of renewal finally led to the foundation of a Confederation of Small Business (CONAMYPE) in 1995, which, shortly afterwards, joined CONFIEP.

The growing number of participants in the Peruvian umbrella organisation was certainly an important asset and matched with CONFIEP's global scope to represent the business community as a whole. While this broadening integration can be seen as a progress towards more political influence, it can also generate internal discrepancies due to the

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[166] Julio Cotler, *la articulación y los mecanismos de representación de la organizaciones empresariales*, documento de trabajo No. 97, IEP, Lima, 1998.

fragmentation of members of different nature, economic importance and power. This increased heterogeneity could clearly indicate an intrinsic fragility when formulating requests or defending endangered rights. With different expectations from the government's policy-making, such an amalgam of associations would inevitably be composed of *winners* and *losers*, according to Cotler (1998a, 45), a tendency that could be clearly observed since the beginning of the nineties.

However, it would be an oversimplification to put CONFIEP's lack of unity down to internal motives only. In order to grasp the challenge which the Peruvian peak association was facing during the nineties, it is necessary to take the changing economic and policy environment into consideration. Just as the entire economic sector at that time, the business associations needed to re-evaluate their positions in this new context, a process that induced a remodelling of Peru's main business organisation. As a matter of fact, the first major observation is that the chronology of the relationship between *gremios* – or business association - during Fujimori's reign illustrates a constant tendency to disagreement and even confrontation between the two groups of business organisations mentioned above.

The duality involved traditional exporters, the banks and the construction sector – who expressed their support through CONFIEP, and industrialists *internalistas* and non-traditional exporters, members of the SNI or ADEX. In this long-lasting contention, the *winners* were regrouped in CONFIEP's wake, while the *losers* were the nationalist industrialist group represented by the SNI and ADEX. This fission within Peru's peak business associations, more than just a traditional internal quarrel, was a reflection of the new trends of the national economy: "a new map of economic power and political influence developed, centred around exporters, foreign capital and a new cluster of business associations" (Durand, 2002a, 14), and provoked an internal restructuration of CONFIEP under the pressure of globalisation. The foundation of the SNE (*Sociedad Nacional de Exportadores*, later COMEX) by traditional exporters in 1990 emphasised this fact: The new organisation was meant to be the negative of ADEX, and recognised by CONFIEP - reinforcing the influence of traditional exporters (Castillo & Quispe, 1996, 41) in a generally favourable climate to liberal ideology. The new associations linked to the export and financial sectors which emerged and joined CONFIEP helped diminish the influence of older trade associations representing traditional industries and non-traditional exports.

CONFIEP did also oppose some of the government policies and a more united opposition surfaced at times. However, it was not one that questioned the concept of stabilisation and the adjustment programme in itself, but rather one which had specific complaints about fiscal policies, interest rates and public prices, leaving temporarily other dividing issues – mainly import taxes – aside. The umbrella organisation did fundamentally support the government, just as the two main non-economic happenings clearly showed. Indeed, at the moment of the *autogolpe* of April 5th, 1992, all business organisations part of CONFIEP seemed to support Fujimori, as the necessity for order was more pressing than economic issues. A few months later, the unexpected capture of Abimael Guzmán did again rally a resounding support from business. This second major event of Fujimori's first mandate can even be considered a trigger for renewed investments and, ultimately, the reactivation of the Peruvian economy.

Considering the entire panorama of interests represented by the various business organisations, we can state that their relationship with the executive had stabilised. While discrepancies in relation to the implementation of the adjustment programme and the reforms remained, there was little doubt about the model chosen by the government. The gap between political and private business rationality was filled by various important landmarks of compatibility that go beyond short-term economic situations (Castillo & Quispe, 1996, 65), such as political stability and economic growth. The relations between business and the government were smoother and CONFIEP's proximity to the executive obvious. Access to the government had indeed improved, but only for business leaders loyal to the president.

In this context, it was hard for industrialists to address their complaints within CONFIEP and towards the president, at a moment when his popularity reached impressive rates. During the following years, rather specific demands surfaced again, coming from the industrialists as well as from the umbrella organisation, but the industrialists did not really dare to publicly confront the government anymore, choosing accommodation over open opposition. At times keeping a low profile while at other times publicly evoking the government's basic policy bias, the SNI and ADEX remained, as in the past, the only voices of protest against Fujimori's economic programme. As the two trade associations penalised by the economic model, they constantly demanded policy changes such as more differentiated trade tariffs and tax rebates for non-traditional exports in order to improve Peru's competitiveness in value-added products. Too simplistic according to *industrialistas*, Fujimori's economic programme managed to attract foreign investment in

the short-term in services and primary sector, but undermined a sustainable economic development, only possible through an intensive industrialisation process. In their opinion, the on-going economic model did not only prevent an impulse for a national industrialisation process, but forced it into extinction (Gerbolini, 2002).

While the internal discrepancies were growing, CONFIEP's leaders established a close partnership with the government approving the executive's macroeconomic policy (Castillo & Quispe, 1996, 61). This situation further degenerated after the recession of 1997, which highly affected the industrial manufacturing sector, when the then Prime Minister Camet and CONFIEP's president maintained particularistic practices. The SNI and ADEX joined their efforts in order to counter the dominant interests represented by the government and the group composed of the "big business" associations (Cotler, 1998a, 25). In 1998 they formed a *Coordinadora Gremial* and publicly condemned the co-optation of CONFIEP's leaders, demanding a greater independence from the government. These pressures, backed by some powerful firms, led to some cabinet changes and forced CONFIEP to distance itself from the executive and to be somewhat more critical of policy matters. In the end however, "CONFIEP leaders remained closely linked to the government and consistently supported *fujimorismo*" and the ruling coalition was not threatened (Durand, 2002a, 18).

The shift of influence within Peru's peak business association mirrors the actual displacement of the national industrialist bourgeoisie during the Fujimori decade. Apparently stronger due to the facilitated access to the higher spheres of the government, CONFIEP experienced an increased dependency on the government by being the vehicle of the particular interests of a few business leaders. In the end, this scenario left CONFIEP more divided than united.

Meanwhile, in the second half of the nineties, another phenomenon had surfaced with the 1998 crisis: The globalisation process had put important national businesses in difficult positions. Some could not pay their dues, others went bankrupt or were swallowed up by foreign companies, jeopardising CONFIEP's publicly recognised role as the voice of the Peruvian private sector (Durand, 2002a, 14). As it will be analysed later, the private sector was not all that Peruvian anymore, since many leading companies – among others banking conglomerates – did not have much choice but to search for alliances with foreign capital. Business - government relations were slowly shifting towards associations intrinsically linked to the globalisation process, which represented TNCs. This evolution contributed to

CONFIEP's fading role: "The American Chamber of Commerce, the Peruvian-Spanish Chamber of Commerce and the North American Council [...] became more important channels of business - government relations in the second half of the 1990s" (Durand, 2002a, 17)[167]. This leads the specialist on business-government relationships to the following conclusion:

> *"As the Fujimori regime was consolidated and business leaders from top domestic conglomerates and multinational corporations, together with export-oriented trade associations, enjoyed special access to government, the peak association became weaker, less important and less credible".*

In spite of its modernisation during the first half of the nineties and its 22 members at the turn of the century, CONFIEP's role in the political spheres and its image in Peruvian society had been altered. The peak business association, which had consolidated in a situation of dramatic economic and political crisis, had had its moment of glory confronting García, proving to be a major political actor able to defend business rights. During Fujimori's first mandate, it had an important role to play once again in major events such as the president's self-coup. Notwithstanding the organisation's support displayed at the moment of the closure of congress, CONFIEP did, with other economic actors, publicly encourage the government to quickly reintroduce democratic rules in his governance. As the main voice of business, it did have a major part to play and its backing certainly made it an appreciated ally to Fujimori. In this sense, the system of representation had been modified, as it included an organisation that claimed to be the single spokesman of the private sector.

However, CONFIEP did not quite reach the level of maturity of a peak business association. Such an organisation would, according to Durand, be able to distinguish between general and particular interests and to mediate conflicts among members, while defending its interests with a single voice and avoid outside interference (Durand, 1992, 14). It can be argued, in the end, that the difficulties for the peak business association to consolidate permanently have been two-fold. Indeed, the obstacles to its institutionalisation and integration as an important political actor have been, in fact, internal as well as external. First, CONFIEP is, per se, a conglomerate of firms of varied sizes coming from different

[167] In another brief article (Business Peru, January 1999), Durand mentions other sorts of organisations, such as the *Consejo de Empresarios Andinos* (CEA), or the more exclusive *Consejo Empresarial de América Latina* (CEAL). These organisms surfaced as transnational business leaders could not deal with national peak business associations, as their scopes reached out well beyond national borders.

sectors. This heterogeneity is often a burden, as it keeps the organisation from taking a clear stance when negotiating with the executive. Second, the composition of economic power and the nature of business - government relations in Peru keeps the organisation from becoming a first rank negotiator. Indeed, it has been forced to stay in the shadow of big business, mainly due to the growing concentration of presidential power that seriously challenges the institutional channels of interaction. Fujimori did never really consider these representative bodies to be valid interlocutors, especially not when they were manifesting disagreement towards his policies (Cotler, 1998b, 34).

CONFIEP, an umbrella organisation which includes big, medium size and small business, has been all at once a shield and a window for the main Peruvian business groups, defending their interests and spreading their political opinions. The reason why CONFIEP could not go against big business is rather simple: The more economic power, the more stable, direct and effective access to the government. CONFIEP has remained, at all times, a possible channel and valuable tool of interaction, used in controversial issues by the mighty groups who kept their options as free-riders open.

5.3 The Peruvian business groups

In Peru, in the same way as in other countries in the region, wealth has always tended to be unequally distributed among the population. While most Peruvians have never possessed any economic resources of any kind and have lived in poverty, the acquisition process of property has traditionally been limited to a rather small upper-class. As a consequence, economic activity in terms of capital accumulation has only occurred in the higher spheres of the Peruvian society, leaving the lower classes "out of the loop". This duality, which sarcastically may seem to come straight out of Marx's work, was added to the cultural and historical ones, further stirring up long-lasting tensions in South American societies.

Over time property owners have learnt to avoid unnecessary display of wealth and power, thus reducing the risk of confrontation with the rest of the population. After the rough time given to the oligarchy, the national bourgeoisie chose to stay in the background of the political scene, using back ways to defend their interests and to get directly in touch with the executive. It is under the turbulent García period that the usually discreet business leaders were somewhat forced into the limelight, through two successive happenings.

At the same time as incentives for the reactivation of the national economy were put in place to encourage investments, García showed the will to have a dialogue with leading *empresarios* (PUCP, 1987, 48). Unfortunately, after an impressive upturn, the economic situation deteriorated quickly and the relations between the government and business groups turned sour and led, as mentioned above, to the "battle of the banks". The main cause of this battle, which represents a turning point in Peruvian politics and economics, was precisely the informal network of relationships between García and the big domestic groups[168], which from that moment on, were also known as the "twelve apostles"[169]. These groups, according to Vásquez' definition, represented a gathering of companies connected through property ties and common corporate management, which, thanks to their capital and diversification, had reached leading positions in the economic and political spheres (Vásquez, 2000a, 27).

Even though an official list of the groups has never existed and varies according to the sources, the following names have been repeatedly cited: *Romero* (core business: Textiles, agribusiness, Banco de Crédito), *Raffo* (textiles, real estate, banking), *Nicolini* (flour), *Bentín* (beer), *Lanatta-Piaggio* (beer), *Picasso* (banking, vine, mining), *Wiese* (banking), *Ferreyros* (imports, machinery) *Benavides de la Quintana* (banking, mining), *Brescia* (real estate, insurance, hotels, mining, industry), *Piazza/Cosapi* (construction), *Parker* (radio and TV), Bunge & Born (oil and grease). Other names, such as *Hochschild*, *Fierro* and *Arias Dávila*, *Olaechea* are cited as well, based on the Peru Report of 1989 (Durand, 2000, 2002b, Vásquez, 2000a; Campódonico, 1993, 119). Clearly, the actual composition of the twelve apostles is not clear cut. However, the same groups, such as Romero, Bentín, Brescia, Nicolini, Raffo and Lanata-Piaggio are always mentioned as leading economic and political actors in Peru.

Unlike the "conventional" business community, such as *gremios* and small and medium size, one-sector enterprises, as well as the Peruvian society in general, business groups had enjoyed some sort of privileged access to the successive administrations. Indeed, due to their economic power, it was necessary for any government to favour business leaders, albeit only with informal relationships. These personal channels, which had been common throughout the seventies and the beginning of the eighties, and which had been very present under Velasco, found their fulfilment during García's mandate, when the populist

[168] For a thorough portrait of these groups at the time, refer to Enrique Vásquez, *Estrategias del Poder. Grupos económicos en el Perú*, Universidad del Pacifico, Lima, 2000.
[169] This label appeared due to the informal coalitions García had tried to form with the powerful business leaders of Peru.

president actively sought an arrangement with domestic companies. In a way similar to his predecessors, García tried to promote national investment; at first perceived as a driving force for his heterodox policy programme, big domestic business was later meant to thwart the partly self-induced crisis (Crabtree, 1992).

This relation, or *concertación*, was overtly elitist, as legitimate social actors were simply not involved in the exclusive circle composed of García's technocrats and the economic groups. This coming together of public and private elites did have a negative effect on institution building, as it eroded the role of basic democratic institutions such as political parties, parliament, public institutions and business associations (Vásquez, 2000a, 80). The lack of institutional channels between the parties resulted in little transparency and responsibility. García wanted the groups' help to save his political and economic programme, and the groups used this direct access to the president to keep themselves informed of the government's moves. Cut off from the actual policy-making, they had at least the necessary information to evaluate the risks linked to García's decisions. Clearly, the president's team as well as the groups' arrangements were not based on a long-term partnership with clear and solid grounds, but were much rather focusing on immediate and pressing issues. This already shaky and shady relationship collapsed in 1987, during the "battle" described earlier, which degenerated into a severe public-private crisis which spilled over onto the entire Peruvian society.

Beyond the outburst and outcome of this crisis over the nationalisation of the banks, two questions need to be posed related to this important episode of Peruvian business-government relationships: Why did the bank issue have such a far-reaching impact? And more importantly, how was it possible for the president to neglect most social actors in order to deal only with a small group of businessmen to solve the economic problems of a country? While García's attitude, as well as his political and economic aims would be a point of departure to answer these questions, we believe that it is essential to investigate the composition and the role of the business groups, which, at that point, had been going through substantial changes for almost two decades.

5.3.1 The characteristics of business groups

One main factor in this context is the concentration of economic power. Indeed, similar to the one of political power analysed in the previous chapter, the concentration of economic power is a central characteristic in Peruvian society. A recurrent fact in many economies

and even more so in most countries of the region, power concentration seems to be even greater in Peru (Alcorta, 1987, 45). The concentration of political and economic power finds its roots in a society's structure, culture and history. But more specifically, in the seventies, a new sort of economic concentration developed in Peru, due to a unprecedented change in the political environment.

As a consequence of the policy shift during the military period, business conglomerates had surfaced and consolidated during the return to civilian rule and the state's gradual withdrawal from the economic scene in the early eighties. These emerging groups had become the main protagonists of post-Velasco economic power (Campodónico, 1993, 21). Thanks to the diversification of their activities, several families – which were already integrated in the Peruvian economic establishment of the country's oligarchic society – had managed to compensate for their losses as landowners or shareholders in real estate, mining and sometimes banking (Franco, 1990, 11) and had taken advantage of the nationalist trend of the developmentalist military government to develop in new and promising sectors and become clusters of economic power in Peru.

The rather small number of big business groups in Peru as well as their relative importance to the country's economy provided the leaders of the conglomerates with privileged access to channels of information regarding economic trends and policies, and gave them a certain influence over them. For two decades, from Velasco's accession until the end of García's mandate, the groups were the principal beneficiaries of the, all-in-all, rather heterodox policy trend, thanks to their leading position in Peruvian economy.

It should be mentioned that during the first half of the seventies, due to the expansion of manufacture production and the growth of the internal market, industrial concentration was somewhat reduced. Soon, however, in the wake of the economic crisis, many companies were forced to reduce their activities or to close them down. This gave the big firms another opportunity to increase their market shares, mainly in sectors where they had not, at that point, set foot yet[170]. It is not all that surprising that in the sectors with a traditionally strong concentration, the participation experienced only weak variations (Alcorta, 1987, 46). Indeed, an interpretation of this fact would suggest that while most

[170] In spite of the deep changes due to the military government's interventionist measures, most groups which developed during the seventies were based on old powerful families who had been part of the oligarchic stratum of Peruvian society for a long time. Mainly landowners, shareholders and owners in mining and import-export companies then, they oriented their activities towards industry, particularly manufacturing. The diversification of their activities did, for some, more than compensate for the losses experienced by the wave of nationalisation.

powerful groups kept the economic power they had in various sectors prior to 1969, they managed to expand their activities and diversify their production. This expansion was made possible by the state's interventionist economic policies.

Indeed, unlike trusts, which integrate horizontally or vertically within a specific sector, so-called conglomerates set foot in various important economic activities through companies which are not directly linked to each other by economic factors. This generally rather high degree of diversification is a fundamental feature of the composition of a group, which may include mainly industry and finances but also trade, construction, primary goods, mining, transportation and other services. In Peru, the leading groups had a predominant importance in up to six different sectors, often represented through more than a dozen companies[171].

Apart from an optimisation of participation in the various sectors, the goal of the decision centre of the conglomerate was, more globally, to increase its benefits to a maximum and, ultimately, to expand. The striking aspect of such a conglomerate is its ability to shift resources from one sector to another, according to conjuncture, in order to maximise profits (Malpica, 1989, 15). This capacity of setting foot in various sectors of the economy is a great advantage, as certain industries might thrive while others experience slowdowns.

In this context, another foremost organisational aspect of the economic groups often mentioned is their link to a financial institution such as a bank or an insurance company. Being the centres of financial flows in the national economy, such institutions are the "mediators of credit" (Anaya, 1990, 61), as they are the main holders of the monetary resources indispensable for the development of any economic activity. In a rather volatile political and economic environment, banks have a further undeniable advantage over other businesses, by being able to adapt to new economic policies and to the economic situation more quickly, notably through the basic creditor-debtor mechanism. According to several authors, more than just one important member out of many in an economic group, the financial institution represents the core of a conglomerate, around which the other firms are clustered (Caballero, 1993). In other words, groups form around commercial banks, and disappear or split when these go bankrupt (Anaya, 1990, 59-61) [172].

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[171] Depending on their sectors or predilection and their functioning, differences among the groups could be significant however; some, like Romero or Brescia, owned 32 and 40 companies respectively, while Raffo, another leader, had only four.

[172] Both Velasco and García shared this view and believed that financial institutions were the leaders of economic power and responsible for concentration. In the seventies, the forced fusion of commercial banks into the *Banco de la Nación* was meant to weaken the groups and strengthen the

Figure 9 visualises this assumption. Banking is perceived as the key sector of the economy around which various firms from different sectors will gather: The banks, thought to represent the most capital intensive sector, are the tool through which economic groups invest in the different sectors of the economy, reaching a high degree of articulation between sectors. At the intermediate level, medium size/moderate capital tends to be concentrated in one specific sector, possibly combining production, trade and services. However, a large part of medium size capital as well as the entire small capital section tends to be isolated.

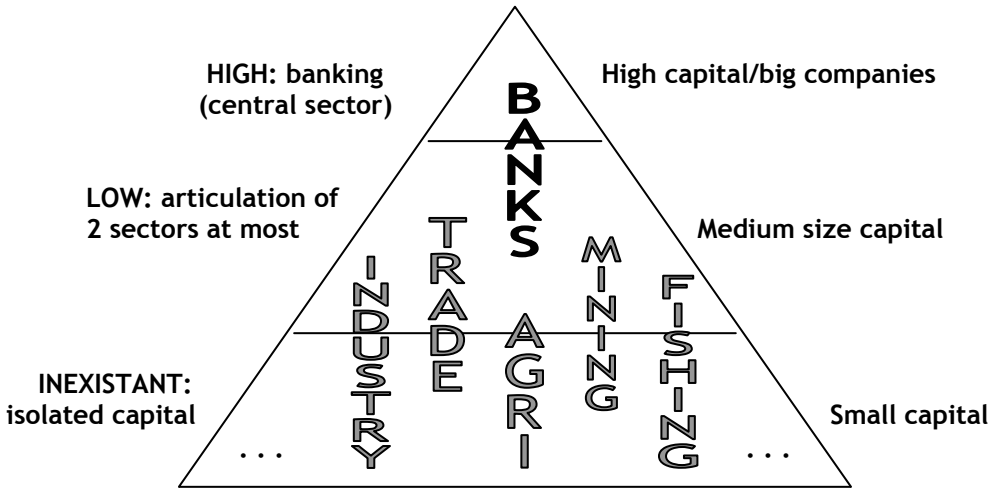

Figure 9: The degree of articulation of capital between sectors[173]

This rather simple figure is quite revealing as its contribution is two-fold: It confirms de role of the commercial banks as potential connecting centres of economic groups at the same time as it visualises the leading role of the financial sector in the centralisation process of capital. Being the cornerstone of a conglomerate, financial institutions seem to have a major influence on the concentration process as well; Anaya argues that these

government's financial position in the national economy. As for the latter, his attempt in 1987 to nationalise the banks was based on the argument that they represented the main obstacle to the democratisation of production and accumulation of benefits. Based on this perspective, he intended to paralyse the nerve centre of the main Peruvian economic groups. The virulent opposition to this move, in turn, is a proof of the importance of the financial system for the economy. Its role as economic connection between firms had developed at the end of the seventies and had, consequently, played a much less important part at the time of Velasco's nationalisation programme.

[173] Source: *Burguesía en el Perú 1968 - 1987*, Estudios generales letras, Pontifícia Universidad Católica del Perú. Translation by the author.

institutions tend to direct credit towards big firms which enjoy a dominant position on the market. This, in turn, favours further centralisation and concentration of capital (Anaya, 1990).

Vásquez, however, does not believe that commercial banks are the head of economic groups. Rather, he emphasises the fact that financial institutions are networking centres, and argues that this role does not necessarily imply a leadership position. According to him, groups have relied rather on their oligopolistic - or even monopolistic - position in core sectors such as manufacturing or services from the seventies on. Nonetheless, he considers the banks valuable tools under the control of the groups (Vásquez, 2000a, 316).

In spite of this divergent perspective as for the actual role of the banks, it is generally agreed that financial institutions are indeed a central element of the economic groups, which are their main shareholders. Campodónico further claims that it is the financial component that ultimately justifies the distinction between "only" big groups and the actual *grupos de poder económico*, or economic power groups (Campodónico, 1993, 113-27).

Accordingly, the most powerful groups tend to gather in a few top banks as suggested by Anaya and Vásquez. The former even mentions the existence of a *supergrupo* in the mid-eighties, which was formed by the five biggest groups represented by five commercial banks that were linked through *sociedades anónimas*, or holdings. The three most important banks, namely *Banco de Crédito del Perú*, *Banco Wiese* and *Banco de Lima*, were, according to him, the actual core of this "super group" which had an influence in almost all economic activities in the country (Anaya, 1990, 163-65). In a similiar way, the latter notes that the bigger the capital of a bank, the more diverse it becomes, and the most important economic groups are its main shareholders. In this way, close links in terms of property and management between the groups and the three biggest banks are woven (Vásquez, 2000a, 317, 325). In this respect, one of the main characteristics of the most important economic groups, such as *Brescia*, *Romero*, *Nicolini* and *Raffo*, was their link with Peru's number one financial institution, the Banco de Crédito del Perú (Campodónico, 1993, 129) owned by Romero.

Vásquez notes, however, that the role of public banks has been neglected as backers of the main economic groups. Similarly, during the García period, the state's share in private

commercial banks was equal to the one of the economic groups[174]. In other words, the groups did not have a crushing power over the Peruvian banking system, in spite of the president's statements. They were, however, capable of taking advantage of the state's institutional weakness and incapacity to reverse the concentration trend of credit. They managed, for example, to keep a privileged access to public low-interest credits put in place during Belaúde's mandate (Vásquez, 2000a, 340). Indeed, economic policy had been formulated in favour of the groups, as successive governments were attempting to revitalise national business. This behaviour came to a climax when García, through tributary subsidies, tried to encourage the groups' profitability (Caballero, 1993). This had, in turn, an effect on concentration, as capital tends to flow towards already profitable centres.

The Peruvian groups, in this context of concentration, differed from the big groups issued from the developed world. In general, the latter resort to the stock market, emitting and selling shares, in order to increase their capital. Consequently, a change in property occurs, as it is scattered and distributed to many shareholders. In Peru, on the contrary, the groups did not go through this process, mainly because they were still at a developing stage and, more importantly perhaps, because their access to capital was facilitated by their privileged relationship to a bank belonging to their own group or a related one (Trujillo & Astuquipán, 1998). The evolution of the groups shows that property and, accordingly, decisional power, had remained in the hands of the same families founders of the conglomerates decades earlier. In fact, most of these families, dynasties of European immigrants, had been part of the oligarchy for over a century. They had gone through the *new* bourgeoisie transformation process mentioned earlier, surviving the fall of oligarchy and later outlasting the "business state", taking advantage of its weakening to reinforce their presence in Peruvian economy. Hence some authors consider that by the mid-eighties, the oligarchic power had been reconstructed. Its base was not the control over land, export of primary goods and finance anymore, as it had been up to the late sixties. The grounds of this *poder oligarquico-familiar* was the control of a great share of the financial and insurance system and the industrial oligopolies (Franco, 1990, 17).

[174] According to the Washington Post (July 29th, 1987), at the time of the announced bank nationalisation, the government held "three commercial banks, three finance firms, five smaller banks, the country's largest insurance company and a system of development banks".

5.3.2 The groups' weaknesses and the change of economic environment

The two basic characteristics of the big economic groups considered so far, namely diversification and the participation in leading financial institutions, can be considered to be their main assets. They provided the groups with major flexibility, which revealed to be essential in unstable political and economic climates. Furthermore, the acquired importance in one or several industrial sectors gave the groups a high degree of economic power on the national level. However, the nature of their diversification represented, at the same time, their major weakness. First, even though many groups controlled companies in several sectors, they remained confined to the narrow domestic market. Second, due to the composition of their business, most groups were highly dependent on imported goods as well as technology, while the share of their revenues based on exports remained rather low (Vásquez, 2000a, 346). It can then be argued that the groups were facing two important deficiencies, namely an internal dependency coupled to a second, external dependency.

These two weaknesses are to be seen as a result of two major aspects of their corporate development. On the one hand, the groups did not venture into big high-risk investment projects in energy or other basic infrastructures, nor did they into technological innovation, but chose to seek more secure business opportunities in industrial assembly and production (Franco, 1990, 19). On the other hand, their economic expansion, to a great extent covering the domestic market, was being shaped and oriented by the successive administrations. The rather small and imperfect Peruvian market being their main playground, the groups always remained dependent on the policymakers, and their survival relied upon the interaction with them.

Not surprisingly, a main effort resided in the maintenance of channels of communication with the various policy-making entities, this to the detriment of strictly economic strategies (Vásquez, 2000a, 286). In other words, the focus on political networking prevailed and kept the groups from promoting longer term microeconomic improvements related to production, quality, competitiveness or corporate governance. Romero, the leader of the biggest Peruvian group, described this period later as *competencia entre mediocres*; competition among second-raters (Durand, 2000).

It is a fact that a stable and direct association with the state represented an essential component of the groups' corporate strategies. It is commonly argued that they provided

them with the opportunity to greatly influence its policy-making and use their implementation to their own convenience, thus reinforcing their monopolistic and oligopolistic positions in their various fields of activity (Franco, 1990, 21). Vásquez, however, suggests that literature has had the tendency to overestimate the groups' influence in the decision-making process (Vásquez, 2000a, 383) and notes that from their perception, the government resembled a "living organism controlling the oxygen valve for their survival and expansion" [175] (Vásquez, 2000a, 278).

Either way, the groups' fate in the Peruvian economy was linked to the national political environment and new orientations in policy-making would heavily contribute to either decline, consolidation or emergence. Consequently, similar to the way this dynamic evolution process of the groups had been shaped by successive administrations since Velasco's dictatorship, the switch, in 1990, to austere neoliberal measures induced important changes in the force and the composition of the groups. In fact, 1990 represented a rupture *con todo lo anterior* – with everything they had known up to then (Vásquez, 2000a, 385).

The stabilisation programme imposed by the Fujimori regime at the beginning of the nineties confronted the Peruvian business community with deep changes in economic policy. As seen in the previous chapter, the main adjustment allowed prices, interest rates and exchange rates to free-float, while subsidies were abolished. These drastic changes had a negative effect mainly on small and micro enterprises and contributed to the impoverishment of the already weary population who had experienced a depreciation of their standards of living due to the hyperinflation that had hit the country at the end of the eighties (Reyna, 1997).

Many property owners, however, were less negatively affected by both economic phenomena and had the means to convert the unstable situation to their own advantage. Hence, both the galloping inflation and the switch to neoliberalism redoubled the already existing tendency of upward capital concentration in Peru. In addition to this, the withdrawal, on the one hand, of the state as an actor in the national economy and the arrival, on the other, of foreign direct investments, were other factors contributing to the above-mentioned concentration for fewer private investors. The latter gathered supplementary wealth mainly through privatisation and acquisitions (Durand, 1997), and the existence of many firms relied upon these larger groups with "greater staying power"

[175] Translation by the author.

and their will to invest. It can be argued that "thanks to the neoliberal counter-reforms imposed by the government of Fujimori, wealth and political power again became highly concentrated, leading to the consolidation of a new oligarchy in Peru" (Reyna, 1997). If this process was indeed changing the Peruvian map of economic power substantially, it did it only in a horizontal way, shifting powers at the peak between leading business elites.

It is not surprising that in general, the Peruvian business elite was quite favourable to Fujimori's attempts based on a liberal ideology to open Peru's economy. Indeed, beyond the acquired political stability and the reduced risk of hazardous switch-backs due to closer links with the world economy in general and international lending institutions in particular, the *reinserción*[176] represented major business opportunities for leading firms. At the same time however, even important groups were facing a challenge, and not everyone was readily armed for it. Again, the survival of the groups was dependent upon their capacity to adapt and reconvert their activities in a quickly changing economic environment.

In this context, Durand depicts two scenarios for the national bourgeoisie, after Fujimori's introduction of "advanced competition": On the one hand, the groups had the capacity to adapt, thanks to several types of strategies (purification of the conglomerate through sales and fusion, seizing opportunities of privatisation, alliances with foreign capital), their control of financial institutions and their political contacts. This would lead them to a successful transformation from protected rent-seeking groups to competitive ones. On the other hand, tied down by their family-based organisational structure, affected by lasting recession, and too dependent on the vanishing help of the state, they could not face external competition with powerful transnational companies. In this second scenario, the groups would resemble "dinosaurs which go extinct due to the climatic change induced by the globalising meteorite"[177] (Durand, 2000).

According to Quispe, the thirteen most powerful groups managed to consolidate their presence on their markets and achieved restructuration. In this sense, he sees the groups as *free-riders* of the liberal reforms. Some of them, however, namely the ones owning banks, were better suited for adaptation, while industrialists, dependent on the precarious and ill-assorted internal market, were harder hit by Fujimori's structural adjustments

[176] The term *reinsertion* appeared as a catchword at the end of García's presidency. Later, under Fujimori, "participating in the globalisation" became the widely used expression to describe Peru's new economic orientation (Teivainen, 2002, 98).
[177] Translation by the author.

(Quispe, 1998, 37). The Peruvian industrial sector, relying on the access to credit to survive in a more competitive economic environment, was part of the domestic businesses who was "left high and dry"[178] (Castillo, 1996), further penalised by a difficult financial context. The banks were lending money at high interest rates to clamp down inflation, but also to attract foreign capital, a very lucrative source of revenue. Clearly, the pattern of *winners* and *losers,* expressed through the representation of business associations developed earlier, is equally valid for the distinction between groups.

Still, every group had to develop new strategies to make profits in order to keep afloat. While mainly seeking diversification on a saturated and protected market during the eighties, the groups restructured and repositioned themselves in strategic and highly productive sectors and intensively searched for niches during the nineties. This context opened the way to an increase of associative practices between the groups' firms and with new contenders on the Peruvian market, leading to a major redistribution of capital and leadership. Clearly, weaker groups became dependent on the more successful ones that acted as their life buoy for survival.

Some were assimilated by old competing peers, such as the Lanata-Piaggio group with the fall of its main company, the *Compañía Nacional de Cerveza*. Indeed, the Backus-Bentín group had swallowed it up by 1994, becoming de facto the national monopoly for beer (Vásquez, 2000a, 424-25), while neighbouring groups were lured by this lucrative business. It is in 2002 that the Peruvian beer monopoly finally succumbed to three foreign companies[179]. Another group, Nicolini (*Compañía Molinera del Perú*), due to its incapacity to face competition and its unbearable debt with the *Banco de Crédito* (grupo Romero), was rapidly acquired by Romero (Trujillo & Astuquipan, 1998). The strongest of all Peruvian groups also purchased *La Fabril*, part of the Bunge & Born group[180], expanding its processed food industry to become the main leader on the market. With *Alicorp*, "the new denomination for all fusions and acquisitions" in the food sector (Vásquez, 2000a, 422), the successful Romero group had the necessary arguments to invest abroad – a step that had also been undertaken by *Credicorp* in the financial sector.

[178] Translation by NACLA.
[179] The particular case of the national beer industry taken over by foreign companies will be treated in the next chapter.
[180] Bunge & Born was a foreign group active on the Peruvian market for over fifty years, that decided to withdraw from the country after the loss of its subsidiary. This particular event in Peru's reshaping private sector is worth noticing, since it reflects a deviation from the main trend, which is the entry of foreign capital and TNCs.

Even groups linked to primary goods, such as mining, fish industry and some agricultural goods - where prices are highly dependent on international competition and markets - were forced to invest in the financial sector or to participate in mergers and joint ventures with transnational companies. The Benavides de la Quintana group for example, and its association with a transnational mining company, was successful. At the same time as restructuration had helped displace some national groups in favour of others, it also helped new ones to emerge (Reyna, 1997) on the national level, and names like *Galsky* (fish industry), *Graña & Montero* (construction) and *Wong* (supermarkets) started to be very present on the Peruvian markets.

Globally, the *free-rider* scenario seemed to be quite adequate for the older groups' behaviour, when considering their course well into the second half of the nineties. In spite of some drowning, especially the demise of Lanatta-Piaggio or Nicolini, most of the groups had been surfing the wave of change, carefully shifting their activities and looking for the right partners. In other words, they had been doing quite well in dealing with the internal economic restructuration advocated by the Fujimori government.

From 1998 on however, the Peruvian groups' situation – older and newer ones – seemed to become far more precarious. That year, two external phenomena, namely the climatic anomaly known as *El Niño* and the successive crises on emerging markets, had devastating after-effects for the Peruvian business elite and on the entire economy. The financial sector, the groups' major tool, was facing a tough situation; the crisis had, notably, the negative effect to slow down the flow of international credits towards emerging markets or even provoke their withdrawal. At the same time, the banks could not expect higher contributions from national firms, since many of them, mainly in the fish industry and in agribusiness, had been strongly affected by *El Niño*. Consequently, the following year, the main moves in the sector were fusions between Peruvian banks with foreign ones, as well as governmental interventions (Vásquez, 2000a, 453, 458) in order to consolidate the shaky situation of the domestic commercial banks.

It seems as if on the Peruvian road to globalisation in the nineties, 1998 should be considered a breaking point. It was the moment when the progressive displacement of national capital by a transnational one took a quicker pace, and a situation where the country's centres of wealth concentration were being involved in this apparently ineluctable process. In 2003, only one major bank – namely the *Banco de Crédito* – was still

standing on its own feet[181], while almost all the other ones were relying on the participation of global partners. In the meantime, the traditional Peruvian groups had been reduced to a half by 2002, according to Astuquipán (2002). In fact, there were five left, and they too were vulnerable (Durand, 2002b).

Even though smaller and newer groups need to be included when looking at the economic power of the Peruvian sector, the decay of the big traditional groups is quite eloquent. Indeed, the evolution within the private sector in Peru suggests the downfall of the Peruvian business elite after a first period of apparent successful adaptation to the neoliberal model. More than a decade after the implementation of the latter however, another, apparently ineluctable tendency seemed to be prevailing: "The end of the apostles, and the beginning of the transnationalisation era of the Peruvian economy"[182] (Durand, 2000).

While the national business elite was in the process of losing its supremacy on national markets to foreign competitors and, subsequently, its previous economic power within the private sector, the relative importance of the latter had been growing in the Peruvian society. As an actor, the state had withdrawn from the economic stage, only to remain the stage manager behind the scene. This departure left the private sector alone with high responsibilities: Indeed, it represented the only actor through which economic processes, such as recovery, might happen.

In terms of political representation as well, national business proved to be a much more important player in a context of strongly weakening political channels of interaction such as parties or syndicates. In this context, it is essential to analyse its stance towards the government in power during the Fujimori era and beyond and evaluate the business-government relationships, in order to have a better understanding of the influence of national business on political power.

[181] The biggest bank seems to be doing quite fine, since by March 1st 2003, the Peruvian bank had assimilated the Peruvian subsidiary of a leading Spanish Bank, namely the *Banco Santander Central Hispano*.
[182] Translation by the author.

5.3.3 Business and state relations under Fujimori and beyond

The decade of the eighties had represented, as a whole, an unfavourable external situation as well as a delicate internal one. Inconsistent stabilisation programmes, a mix of neoliberal policies with populist behaviours and their inefficient implementation created a framework of macroeconomic instability and perpetuated the mistrust of the business community towards the state (Castillo & Quispe, 1996, 27).

The attempted changes induced by General Bermúdez[183] from 1975 on had not been sufficient to pull the country out of its national economic crisis. Meanwhile, public discontent had grown, and the frustration of business leaders deepened. Belaúnde's return as civilian president in a democratic system did not improve the lack of interaction between the state and society. Instead of considering the business community a potential ally, it was regarded as part of the inherited corrupt system that the technocratic staff was trying to eradicate (Vásquez, 2000a, 54). Under García, as we have seen, the elitist personalistic style of relations was in its heyday, while institutionalised channels of interaction could not have been more neglected and disrespected.

With "the sudden emergence of the Fujimori alternative" business finally had an option "to overcome the dilemma of supporting an unpopular and internationally isolated military regime, or of suffering the continuation of weak democratic governments in a context of escalating social threats" (Durand, 2002a).

According to Vásquez, Fujimori's government did, from the beginning on, set obstacles to prevent lobbies, which had been very active in previous administrations, from accessing its decision-making centres. The highly insulated technocrats did, at times, even show aversion towards leaders of business associations, perceived as potential rent-seekers. As a consequence, concluded Vásquez, the planning and execution of the stabilisation programme as well as the structural reforms were not a result of negociations with either business groups or business associations (Vásquez, 2000a, 473).

Surprisingly enough, Durand seems to prove just the opposite. He argues that at the moment of Fujimori's accession to the presidency, business, which had gone through

[183] The General, who was minister of economy during the Velasco period, took over and tried to save important companies from bankruptcy and face the growing dept, among others by resuming relationship with the IMF. In spite of fundamental corrections of the economic programme by the return of the civilian rule in 1980, the country remained in a critical situation.

internal changes, was prepared to negotiate with the newcomer and to establish "collaborative relations" with the government. More concretely, he shows that CONFIEP had, in fact, a very active role in the making of Peru's new economic policy environment: "CONFIEP accepted Fujimori's gesture to participate in policy changes". According to his sources, the association was involved in the elaboration of 126 executive decrees in 1991 (Durand, 1998, 19-21).

These seemingly diametrically opposed commentaries relative to business-government relations at the beginning of Fujimori's mandate, may, in fact, be perceived as complementary. As Vásquez' research mainly focused on big firms and groups, drawing the conclusion of a rupture in business-government relations in this context is quite legitimate. Indeed, the new president did not, at first, seek a García-type of direct, exclusive and informal deal with the groups. On the contrary, the state had established institutionalised channels to regularly interact with business leaders and associations. In addition, Fujimori even made efforts to attend business conferences, especially at the beginning when business support was absolutely essential. Hence, In spite of the president's general mistrust towards the private sector and the relative distance of his government towards businessmen, the latter recognised the positive changes in the state's organisation and expressed their will to resolve tensions by using the institutional mechanisms of communication and negotiation put in place (Cotler, 1998b, 29).

Again arguing from the perspective of leading firms, Vásquez further asserted that due to the relative impermeability of the government, these turned away from their habit of developing means to influence the policymakers – a tradition which had been part of the Peruvian business-government relations since the rise of the powerful state two decades earlier. Instead, they concentrated on their own reorganisation, in order to be fit for the quickly evolving economic environment (Vásquez, 2000a, 472). For the first time in decades, firms could start developing strategies that went beyond the search for short-term solutions to concrete problems.

In this context, satisfaction replaced the former worries linked to policy-making and sudden changes thereof, and business and government had something in common that was much more valuable than the traditionally unstable and shady informal links; they had similar basic expectations as far as governance and favourable political conditions for economic growth were concerned. Furthermore, the private sector was, in the end, comforted by the president's "managerial executive-style and the aloofness implied", and

the consistency and clarity of the new economic rules (Wise, 2002). Indeed, the "hybrid regime led by a *caudillo*" had quickly proved to be capable of eliminating most forms of business uncertainty (Durand, 2002a, 27).

Being given the advantage of a continuous presence within the higher spheres of the government was equally determinant. By assigning leading ministries to renowned businessmen, Fujimori was clearly giving signs of intense collaboration with business. Not only did he continue the tradition of assigning the Ministry of Industry to entrepreneurs, he also incorporated personalities linked to the private sector in other key positions such as the Ministry of Economy and Finance, and the presidency of the cabinet – positions held mostly by party leaders or technocrats up to then (Durand, 2002a, 15). The regime favoured effective business access on a more regular basis and to the highest levels of decision-making.

For Fujimori, business was, besides the military, the cornerstone of his regime: "The military/business project found its man and Fujimori found his project, thus arose a distinctive political regime: *Fujimorismo*" (Quijano, 1996, 50). During the various stages of his presidency, the president had certainly needed the strongest economic interest group of the country on his side in order to fulfil his political and economic projects. At the moment of the 1992 self-coup for example, the business community, like the public opinion, interpreted Fujimori's move as a brave attempt to face the serious problems the country was confronted with (Rodrich, 1992, 18), and voiced public support to the president notably through CONFIEP.

Durand notes however that this support was not unconditional, as business considered this extraordinary measure to be only temporary – the business community clearly encouraged the government to return to a more democratic governance. The signal that a fully-authoritarian regime would not be supported (Durand, 2002a, 11) was certainly understood by the president. A year later, fundamental democratic elements, such as a new constitution and a new congress were reintegrated in the Fujimori government[184].

"Peru's business class [was] aware that market reforms [had] cast them as the main economic protagonists, and that their leverage over the government [had] therefore increased" (Wise, 2002). The channels of interaction were, however, far from perfect, and

[184] It is worth mentioning the worries sent out by the international community under these circumstances. Peruvian business did not want Peru's freshly restored image to be tarnished again, with the risk to scare foreign capital away.

lobbying was still practised in a context of intensified power concentration in a few key persons. In fact, the access to Fujimori himself and his advisers was only granted to a select bunch of business groups and transnational companies. Moreover, some ministers were engaged in corrupt and rent-seeking practices, using their public functions to promote personal business matters.

At the same time, the military, which had had a rather legitimate role to play at the beginning of the decade in their fight against terrorism, had never left Fujimori's side. On the contrary, the president seemed to rely more and more on his two main advisers, Chief commander Hermoza Rios and above all Vladimiro Montesinos from the National Intelligence Service (SIN), a modern *Rasputin* who was pulling the strings behind the scenes[185]. Several signs, mainly since 1996, of the hardening of Fujimori's authocratic rule were brought to the fore by severe excesses that had leaked, such as human rights violations, muzzling of the media or disrespect of democratic rules within the government.

In the context of the 1997-1998 recession, while business fears over arbitrary changes were relatively scarce, criticism towards the government grew. Yet a large share of the business community remained unenthusiastically loyal to the Fujimori regime until its final collapse, defending the president's litigious candidature for a third term and even accepting the highly questionable results of the 2000 elections. One of the main reasons for business to choose pragmatically to adhere to *continuismo* was the anxiety about change, since the political sphere lacked, in their eyes, a decent opposition, and there was no personality that could have brushed aside their fears of a "return to the past", suggesting political and economic disorder.

Clearly, the business-government coalition of the nineties did last for the full ten years of Fujimori's office. Looking back on it, two main results stand out quite clearly: The coalition had been successful in launching the first phase market reforms in Peru; this same coalition, however, "emerged as the main bottleneck in the pursuit of second phase reforms" (Wise, 2002). While the difficult transition to competitive economics had been very thoroughly executed, the threshold leading to competitive politics had, in fact, never been crossed by the *fujimorismo* coalition. The business elite had valued the "politics of

[185] The Intelligence Service was the centre of power of the *fujimorista* government, according to several authors and surveys (Debate, September/October 2000). *The Economist* reported that Montesinos had been attributed control over the armed forces, the courts, the prosecution service, the tax service, congress and the media. The magazine paraphrased Cotler who had compared the SIN's reach with the Stasi's, back in the days of the secret police in East Germany (The Economist, November 2nd, 2000).

economism" much more than democratic procedures (Teivainen, 2002, 150). Durand concludes that the business community had had an ambivalent stance to democracy, which, in the end, contributed to its decay. It helped to establish a "disguised dictatorship" and had benefited from it, but had also paid the price through the weakening of their institutions and a growing dependence on the state (Durand, 2002a, 26).

Even if the context of the late nineties had been favourable to the consolidation of centrifugal forces nourishing growing tensions, it took a huge scandal, probably triggered by external actors[186], to break this stable coalition. The latter had been strained, but up to September 2000, never to a point of rupture of the pact, in spite of serious accusations - such as ordering death squad killings, taking protection money from drug-traffickers, manipulating the media and corrupting the armed forces and the courts - against Montesinos (The Economist, September 23rd, 2000).

The departure of the head of the Peruvian intelligence service, and shortly thereafter Fujimori's, represented, in the eyes of many, a "democratic spring" after a drawn out period of political non-reforms. Thanks to a generally more institutionalised and collaborative pattern of relations with the state, and because of the development of modern business values, the business community could have been, in the new context, a pillar for democratisation. In this sense, it can be said that the changes induced by Fujimori's stable period could have contributed to generate better conditions for democratic renovation. However, in the end, "the question is not so much whether business will contribute to democracy but whether democracy (and the state) can contribute to business interests" (Durand, 1998, 33).

In this sense, the newly elected president, Alejandro Toledo, quickly tried to reassure the unsettled business community that he would go down the same economic road constructed under his predecessor. "I believe the role of the government is to create conditions for the private sector to flourish", were his words at the Economic Forum 2001 in Davos even before his election (Business Week online, February 12th, 2001). Once elected, he asserted that his economic programme would be combined with the democratic consolidation the country desperately needed. But the latter would want to be much more stable than in the numerous past Peruvian experiences.

[186] It appears as if the US government and its agencies, among others the CIA, had been part of the tactical scheme, drawing in a chess game that implied much more than the dismantling of the corrupt state only (Tanaka, Debate September/October 2000). Indeed, according to The Economist

Unfortunately, after three years in office, the Peruvian president failed to really convince business, both at home and abroad. Countrywide, the approval of his governance was abysmal, similar to García's fifteen years earlier. Polls in summer 2004 suggest that his unpopularity has discredited the restored democracy and may even have generated nostalgia for his predecessor, among businesspeople in general (The Economist, August 12th, 2004). Indeed, economic uncertainty resumed after a period of admittedly imbalanced, but rather stable business - state relations. And in the end, what business loathes most is uncertainty.

Following the analysis of the business and state relations in Peru, the distinction between national and transnational business is introduced in the last Chapter of Part II. By integrating the transnational factor, and with it its particular role and effect on domestic actors, the one-dimensional relation between the economic and the political sphere converts into the tripartite model of economic power.

(November 2nd, 2000), not only Fujimori, but the CIA and its drugfighters had been "happy" to rely on Montesinos for a decade.

CHAPTER SIX: Foreign economic presence in Peru

Peru has experienced strong economic and political switches during its recent history. In this regard, two major pendulum swings prevail: The accession to power of the military dictatorship in 1968, and the election of Fujimori in 1990. These two events were the landmarks for drastic changes in Peru in general and in economic policy in particular. Foreign investments were strongly affected by both types of regime, though in opposite ways. While under military rule, the well-established foreign companies were put under pressure, and in some cases expropriated for the purpose of nationalisation, for its part, the Fujimori regime initiated the comeback of foreign capital through ambitious liberalisation and privatisation programmes.

6.1 The period of decline of foreign companies in Peru

Firmly anchored in the Peruvian economy up to the late sixties, the multinational companies had seen their presence being gradually challenged. But it is only at the end of the decade that the dismantling of the solid economic structure started. The oil and mining industries, traditionally in the hands of big foreign corporations, were directly concerned by it. In this context, the enduring presence of the International Petroleum Company represents a distinctive and unique plight, while the changes in the mining sector exemplify the transformation of foreign company – government relationships.

6.1.1 Oligarchy, foreign companies and the state

In peripheral states such as Peru, foreign capital has always played a key role in economic development. For the major part of the 20th century, the Peruvian State had been welcoming foreign investments, notably in mineral and oil extraction, and later in banking and manufacturing. From the fifties on, foreign presence grew substantially[187], until 1968 when the military government of General Juan Velasco Alvarado took over the Peruvian State, swiftly advocating fundamental changes in the country's economic structure. Far

[187] Foreign investment of American companies, by far the main investors in Peru, quintupled between 1950 and 1968 (Alcorta, 1990, 91).

from being a political accident or an ideological irrationality, the military coup, followed by the establishment of the *Gobierno Revolutionario de la Fuerza Armada*, occurred in an economic and political deadlock which had been mounting particularly from the beginning of the sixties on.

Historically, the Peruvian economy had been controlled principally by the coastal oligarchy[188], later joined by foreign enterprises. The predominant role of the latter was the result of the close collaboration between domestic economic groups and foreign capital; for the most part, their common interests had led them to maintain cordial ties. The local economic groups had frequently handed their entrepreneurial function over to foreign companies and chosen to act as financial or political intermediaries for them; these in turn made sure that their products would be exported and reach world markets (Dodd, 1975, 368). The main consequence of this economic pattern was a *dual* economy[189], in which, firstly, export-led growth fostered imbalances between large monopolies and small enterprises in terms of income distribution, and where, secondly, the degree of external control over technology and productive assets by foreign corporations grew (Fitzgerald, 1978, 7).

In this context, similar to other countries in the region, *structural* models of economic development had become popular in Peru. They originally proposed a set of economic strategies, such as agrarian reform combined with tighter controls on foreign capital to counter the two above-mentioned major contradictions in capitalist growth on the periphery of the world economy. However, without any apparent changes and due to the difficulty to apply such reforms, the late sixties were marked by the influence of the *dependency* school, which focused much more on the forces obstructing them rather than on their actual purpose. In Peru too, identifying groups whose power needed to be broken before reforms could be deployed had become the main concern, notably among radical military officials. By the end of the decade, "there was a tendency to suggest that a

[188] In his book, *pouvoir et société dans le Pérou contemporain*, François Bourricaud depicts the nature of the oligarchy as well as its functioning in a remarkable way (1967, 23–32).

[189] Indeed, this alliance had a double consequence: "On the one hand, the domestic elite had effectively handed over much of the 'entrepreneurial task' of modernising the economy to foreign capital by the end of the fifties, while retaining the role of 'financier' and supplier of government support and appropriating a substantial share of the profits generated thereby. On the other, this alliance prevented the development of small but independent industrial capital fraction, initially by occupying the available terrain and then by controlling access to markets, credit and government facilities. […] this very flexibility of the traditional elite prevented further progress towards the formation of the truly *national* bourgeoisie with an autonomous industrialisation project" (Fitzgerald, 1978, 118).

political assault on the 'oligarchy' and their foreign allies would be not merely a necessary condition for structural reform and economic growth, but also a sufficient condition" (Thorp & Bertram, 1978, 295).

Looking at the three governments in office during the sixties, the shift in political economy and in the distribution of economic power between the three main economic and political protagonists is eloquent[190]. Departing from a situation of *laissez-faire* at the beginning of the decade, leading to democratic reformism and finally, to a radical social change, the governments were searching for alternative solutions for a stagnating export-led economy. In this quest, the tendency was to turn increasingly to state-sponsored development strategies. "By the late 1960s, a state-led development strategy evolved mainly as a matter of default" (Wise, 1997, 77).

The main obstacles to the country's development were the foreign domination of the export sector, the structure of land tenure and the concentration of finance and industry. Yet the central political issue was the extent of foreign and oligarchic ownership. In this context, the changes brought about by the state, particularly from 1968 on, are best described as *capital restructuring* (Fitzgerald, 1978, 8). The concept involved both the promotion of a different model of capital accumulation and an altered pattern of ownership. Particularly, "restructuring and restricting the role of foreign capital in the Peruvian economy was a top priority after 1968" (Conaghan & Malloy, 1994, 59). This process led the state to take control over much of the means of production; an undertaking meant to curb dependent dualism and underdevelopment of the economy - the outcome of the traditional alliance of foreign companies and domestic oligarchic finance. Thus General Velasco initiated the establishment of a new structure of economic power, which modified the actors and their access to power (Malpica, 1989, 47) and represented a fundamental shift in the balance of public and private influence in the economy where the state turned into a national entrepreneur (Wise, 2002).

[190] The government of president Prado (1956-1962) was the last one under oligarchic control; political economy was oriented towards export-led growth of natural resources and experienced considerable penetration by foreign companies. The military intervention preventing a leftist election victory at the end of the period was, however, a clear sign of the waning oligarchic power. Belaunde (1963-1968) inherited a country hit by slow growth and inequalities, and the attempted reforms meant to establish a basis for domestic industrialisation failed. Opposition from the left and the right paralysed the government, while the concentration of the already oligopolistic ownership system and foreign presence further increased. Velasco's dictatorship (1968-1975), attempted, through a "revolution from above" to reduce the power of both multinational companies and oligarchy.

Starting with the International Petroleum Company (IPC - whose particular role will be exposed below), the reformist government soon undertook the expropriation of a large amount of foreign enterprises. Expropriations were part of general sectorial policies, but due to the predominance of foreign capital in some sectors, measures were inevitably shaped by their presence (Fitzgerald, 1976, 29). As will be seen further ahead, mining and oil – traditionally held by foreign companies - went through extensive changes. But most sectors were affected by Velasco's restructuring of ownership.

In the fishing sector, the industry had, in less than twenty years, gone from small-scale production through competitive capitalism to oligopoly, foreign penetration and finally state capitalism. The manufacturing sector had experienced a rapid growth through import substitution carried out by foreign companies connected to domestic capital. Mainly at the end of the fifties and during the sixties, foreign companies had penetrated already highly oligopolised branches. The reforms initiated by the military government were based, as seen earlier, on the belief that private industrialists, once freed from the shackles of the oligarchy would generate their own dynamic. Thus, at first, the government aimed at handing control over to domestic companies. Soon however, the state extended its presence to the entire basic industry (Alcorta, 1990, 94).

As to the banking sector, it had seen an increase in foreign presence in the sixties as well, as foreign control of commercial bank assets raised from 36 per cent of the total in 1960 to 62 per cent in 1968. By taking over several foreign banks, nationalising a major domestic bank (*Banco Popular*) and restricting operations, the military government inverted this tendency and brought about 85 per cent of private bank credit under state control. Important banks such as *Continental* (*Chase Manhattan*), *International* (US), *Lima* (French) and *Crédito* (Italian) were nationalised. In the telecommunication sector, American and Swedish telephone companies were taken over; in the transport sector the British-owned railways became state property, while American car companies pulled out of the country. Toyota remained the only company chosen for a monopoly joint venture on the Peruvian car market (Fitzgerald, 1976, 1978).

This brief summary reveals a heavy intrusion of the state in most sectors of the country's economy – an interference meant to alter the oligopolistic patterns of ownership of production, to change the relationship between foreign companies and domestic capital and to reduce foreign dependency. Concomitantly, the state ownership grew substantially; the contribution to GDP of state-owned companies jumped from 1 per cent in 1968 to 20

per cent in 1975 (Wise, 1997, 78). This incursion of the state in the economy happened principally through nationalisations[191]. Notably, *Petroperu* emerged mainly from the *International Petroleum Company* (IPC), *Centromin* from *Cerro de Pasco Corporation* (CPC), *Hierroperu* from Marcona and *Entelperu* from *IT&T* and Swedish telephone firms. In other cases, the state was majority shareholder but the firms remained under private law, as it was the case with the bank expropriations for example (Fitzgerald, 1976, 33).

These shifts of ownership between foreign capital and the Peruvian State had been carried out by the military government in the wake of a particular foreign company – government relationship which had set off the pending intrusion of the state in the economy. Indeed, what triggered the reforms was the outcome of the long-lasting disagreement between the IPC and the Peruvian government. A close look at the oil industry and its leading company in particular gives an insight into the circumstances related to the drastic changes in economic policy at the end of the sixties.

6.1.2 The oil industry: The International Petroleum Company

In Latin America, criticism towards foreign companies had been mounting for a while, and their effect on populations and governments were increasingly perceived as a mixed blessing. Negative assessments were based on social, economic and political arguments. From a sociological point of view, foreign oil companies were seen as contributing to the *dualisation* of the economy by splitting the working class and absorbing local capacities, which, in turn, prevented the development of a national industrial class. Economically, the state became aware of the net outflow of capital induced by foreign companies' investments and was irritated by its incapacity to tax transactions, which was mainly due to the arbitrary transfer pricing applied between the various subsidiaries of a single company. Politically, their sheer size and economic power granting them some sort of domination over the political agenda, and their illegal meddling in internal politics – reaching from bribery to financing coups – stirred up suspicion and tensions (Pinelo, 1973, ix-xii).

In this context, the oil industry had made up a larger share of foreign investment than any other activity in the world for a long time. In Latin America, subsidiaries of US oil companies had, except for mining perhaps, preceded other American investments by

[191] A few state enterprises were newly established entities, some were domestic companies taken

decades, doing business in most countries as early as the 1910s. All at once, the fundamental role of oil for economic development in Latin America had made the oil industry one of the main concerns of national economies. This, combined with the fact that the oil companies - producing and supplying crude oil, owning and operating the refineries as well as distributing and selling the petroleum products - were foreign and had the reputation to be "agents of economic imperialism", brought about two major reasons for government action. Early on, the economic power of such firms had in fact led several states to intervene. Indeed, the up to then rather unhindered private sector had already had to face reactions from notably Argentina and Chile in the twenties, through the establishment of state controls to organise the supply and distribution of oil. Mexico was so annoyed by the so-called international petroleum cartel that the inevitable nationalisation of the sector followed in 1938 (Penrose, 1968, 274-75).

In Peru, it is the oil sector as well which has traditionally been a sensitive political topic regarding the presence of foreign companies. Similar to other oil subsidiaries in most countries of the region, IPC had been a thorn in the flesh of the Peruvian State and population for a while. Represented by its subsidiary, it was in fact Standard Oil (New Jersey) that Peru had to deal with. In the sixties, the foreign company had annual revenues that were triple that of Peru's GNP, and its payroll exceeded the Peruvian government's budget (Pinelo, 1973, xiv). Standard Oil was said to be very American in its outlook, in terms of foreign policy, of attitude towards government, social and economic measures, and of its views of the relation between big business and government (Penrose, 1968, 101). Standard Oil's subsidiary IPC itself had been present in Peru since the 1910s, and a singular conflict over the legal status of the La Brea and Pariñas oilfields had emerged early on[192].

IPC, with its output at times exceeding 80 per cent of the total of Peruvian oil industry, was making formidable profits in the twenties and thirties. While, for the company, margins were extremely high, the fall outs for the country were non-existent beyond the payments to the labour force and government. Virtually no backward linkages existed since equipment and materials were imported, and export production left the country directly by tankers, except for the share of production that was consumed in Peru (Thorp & Bertram, 1978, 102).

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over, but for a large part, they concerned foreign companies.

[192] In 1826, Simón Bolívar had permitted the state to sell "abandoned mines" - the La Brea and Pariñas oilfields - to entrepreneurs in order to pay the government's debts. This decision

Soon however, production declined; IPC had pushed its production in the existing oilfields, clearly aiming at maximising its short-run output and was increasingly less willing to invest, due to political uncertainty and growing nationalism. Thus, from being an exporter of petroleum, Peru became a net importer, with the consequence that, with the waning importance of the sector, the willingness of the government to regulate the industry increased (Thorp & Bertram, 1978, 169). Towards the end of the fifties, while profit margins were sinking, foreign companies attempted to pressure the government to raise local prices of oil by cutting back their drilling, a pressure strategy which was not new. A complacent decision caused a political uproar, further stirring up opposition. While other companies prepared to pull out of the country, attacks on the legality of the award attributed to IPC as early as 1922 in relation with the La Brea and Pariñas oilfields set the stage of the conflict throughout the sixties.

Thus, one decisive factor in the feud and the government's intrusion lay in the fact that the oil industry was looking back on years of fruitless – and decreasing – exploration. Given that IPC was not making any new exploration efforts and that the existing state enterprise *Empresa Petrolera Fiscal* (EPF) seemed capable of carrying on with refining and distributing operations, the profits of the foreign firm appeared unjustified and were even increasingly perceived as an offence[193].

The Belaúnde administration inherited the exacerbated situation, which the president attempted to settle with an arrangement that would be acceptable to his political supporters as well as to IPC[194]. The president, moderately nationalist and cautious, was aware that the US government was watching the developments of this long controversy, and that any rash unilateral action would antagonise the US government which was, at the time, studying plans to finance important infrastructure programmes in the country (Penrose, 1968, 222).

Within the country meanwhile, opposition grew with the economic decline and the disapproval of the president was generalised by the end of 1967, when the currency suffered an important devaluation to the US dollar. That year President Belaúnde, who had

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established the precedent whereby the nation's resources were inextricably linked with debt obligations to foreign power and private businesses (Dodd, 1975, 366).

[193] On the other hand, it must be mentioned that the state itself had been incapable of setting clear priorities in oil development policy. These were the signs of the government's short-term interests regarding revenues and image, reflecting an ambiguous position towards the foreign company.

always held IPC largely responsible for his political misfortunes, shifted from a policy of negotiation to one of confrontation (Pinelo, 1973, 136). Belaúnde pressured negotiators to settle for an agreement in which IPC, the American embassy, the executive, congress and the Peruvian EPF took part. At that point, the company's expropriation was inescapable. The negotiations on debt claims and operating contracts between the IPC and EPF, the government's representative, turned out to be difficult. As neither side was willing to yield, Belaúnde found himself in an extremely delicate situation:

> *"On the one hand, the opposition-controlled Congress had decreed expropriation – it was his responsibility to carry it out. How could Belaúnde undertake such a battle with the American giant and its allies at a time when he was so lacking political support? At the same time, the company showed an unyielding face to the Peruvian president, making what amounted to a demand for Belaúnde's head"*[195] *(Pinelo, 1973, 136-37).*

Finally, conscious of the vulnerability of the constitutional order in the country, IPC decided to acquiesce to the president's demands, which was transferring the La Brea and Pariñas oilfields and installations to the Peruvian State, as well as giving up the claims on the subsoil and on operating contracts. In return, the state would drop its debt claims and have EPF sell IPC the petroleum so that IPC could keep its refining and marketing activities in Peru (Pinelo, 1973, 139). Intense negotiations were necessary to finally agree on work force issues and the price of the barrel. A final official agreement was settled and signed in the *Acta de Talara*. But the political success was short-lived; soon the EPF manager declared that the last page of the contract, where oil prices had been determined, was missing[196]. The *página once* (page eleven) scandal led most political groups to distance themselves from the government, further weakening the president and giving way to the military coup (Angulo, 1999).

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[194] The centrist president proclaimed, the day of taking office in July 1963, that he would resolve the forty-year argument between the IPC and the authorities in a matter of eighty days (Bourricaud, 1967, 291).

[195] Indeed, IPC was in contact with generals of the armed forces which were well disposed to the company. It can be supposed that IPC was hoping for a military coup, one however that would have preserved the company's interests. It did not turn out to be the case. In her research on the Peruvian military, Bullick emphasises the plurality of opinions that existed among the leaders of the Peruvian army, which would surface within months after the military coup – a coup that had been perpetrated by a minority of the military (Bullick, 1999, 170-71).

[196] It is speculated that the page was removed while the document was in transit from one room to the other to be signed.

On October 4th, 1968, the Act of Talara was declared null and void by the military *junta*, and on October 9th, forty officers and a thousand troops took over the oil fields. Later, all the IPC concessions were expropriated. The new Peruvian government declared that IPC would be compensated as soon as the company had paid the alleged debt of 690, 524, 283 US$. "This sum represented the government's calculation of the value of all products extracted from La Brea y Pariñas from March 1, 1924 to October 9, 1968" (Pinelo, 1973, 145).

Since 1960, several members of the armed forces had perceived the oligarchic domination and the increasing dependence on foreign capital as the main cause of Peru's social, economic and political deterioration (Bullick, 1999, 169). Their growing belief that civil governments were not only not firm enough, but even incapable of negotiating with foreign companies found confirmation in the outcome of the bargaining between the Belaúnde administration and IPC. IPC's embodiment of US imperialism, the public opinion and the highly mediated issue represented the motive for the increasingly impatient military to initiate the coup. In fact, IPC had become the spearhead of the military's cause, and served its purpose in their fight against oligarchic and foreign domination.

When taking over the assets of IPC, the armed forces led by Velasco argued that it was a *unique* case – the company existed under historical circumstances unlike any other company in Peru. In a way, this choice could thus be considered *logical*, based on IPC's behaviour and its difficult relations with successive governments, as well as on the population's increasingly negative stance towards the company. Most Peruvians viewed IPC as an arrogant firm, seeking exclusively its own as well as US interests, or even believed it was conspiring against and defrauding their country[197]. There was also an intrinsic suspicion from the government's part, which often lacked expertise in negotiating with sophisticated organisations, that they got the shorter end of deals – a worry shared by the Belaúnde administration.

The long-lasting relation between IPC and the Peruvian government did not in itself explain the outcome of the controversy, however. The sole historical political role of IPC would

[197] Pinelo notes that ironically, IPC was convicted in the Peruvians' minds for offences it had never committed, while its actual transgressions remained unpublicised. Similarly, he suggests that "IPC probably gave more technical and managerial training to Peruvians than the Peace Corps could ever hope to give", yet these and other intellectual and cultural efforts reinforced suspicion that the company had some burden of guilt to hide. It is worth mentioning however that Standard Oil in general "contributed extensively to a wide variety of social welfare activities in the areas it

not have justified the decision to expropriate its assets in 1968. Pinelo maintains that anti-IPC arguments, apart from the above-mentioned *logical* ones, had a tactical value in the particular context of the sixties. Indeed, it was not the military that had made the company become the black sheep; for years, a very influential paper, *El Comercio*, had worked in favour of IPC's nationalisation, contrasting its misdeeds and imperialistic attitude with the merits of other foreign companies' activities. For years, the paper had led a battle based on nationalistic and legal arguments, claiming the property titles of the company as void, blaming IPC for defrauding as well as for trading with the neighbour and enemy, Ecuador (Bourricaud, 1967, 291). This anti-IPC attitude was endorsed by officials and eventually helped isolate it from other US companies, which perceived IPC as a potential spoiler of their image in the country. The Peruvian oligarchy too seemed to have supported the controversy: As long as a foreign scapegoat "could be made the object of popular hatred, Peru's pressing socioeconomic problems would remain out of the political vortex" (Pinelo, 1973, 149-53).

Thus IPC's behaviour was but one of the main factors that made its negotiations with the government break and caused its expropriation. The company did not fundamentally change its habits over the years; at best, it moved somewhat away from its traditionally rather "colonial" attitude. In fact, it was the political, economic and social environment in which the company was embedded that had evolved, making the expropriation inevitable.

First, there was the general pattern underlying Peru's gradual political and economic decline, that is to say, the demise of a model of development based on raw-material exports in the late fifties, which led to mounting tensions with extracting and exporting companies (Wise, 1997, 73). Second, the relations between the state and the private sector had started to turn sour, as governments were looking for alternative models of development for macroeconomic adjustment, pressuring foreign companies in place. In these circumstances, the IPC case happened to be the most controversial one. Third, in a context where popular sectors became more of a social force to contend with, the IPC controversy was elevated to a national debate, which in the sixties included a multiplicity of social forces[198]. Clearly, in a context of social change as well as economic and political distress, the issue reached well beyond one-to-one negotiations between a company and a government.

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operated abroad, subsidizing schools, hospitals, highways, and other amenities, promoting technical training, granting scholarship, etc." (Penrose, 1968, 101).

The outcome of the IPC controversy became a catalyst for further expropriations and nationalisations. However, as suggested by the isolation of IPC, even among foreign companies, during the period of highest tensions, not all foreign companies were equally endangered. As a matter of fact, the other major foreign company in oil industry, *Belco*, never faced similar threats. This duality of treatment shows particularly in the evolution of the mining sector.

6.1.3 The mining sector: The state's differentiated approach

Closely linked to the oil industry, mining was the other sector almost exclusively dominated by foreign companies. Three firms, *Cerro de Pasco Corporation* (CPC), *Marcona* and *Southern Peru Copper Corporation* (SPCC) dominated the sector and were interconnected. With IPC, they represented the network of North American companies which were at the centre of the political debate over the degree of foreign ownership. More than in other industries, policies had been shaped by their presence and activities. Favourable mining laws were passed, and in various new projects in the fifties and sixties, foreign capital put pressure on the Peruvian government. By 1968, three quarters of mining was directly controlled by the three foreign companies and about 85 percent of the production was processed and marketed through them (Fitzgerald, 1978, 111).

CPC, the biggest enterprise, had been operating in Peru since as early as 1901, and its history is "archetypal of overseas mine development during the pre-World War I era of resource imperialism" (Becker, 1985, 72). According to Becker, CPC took advantage of both state and oligarchy without any concern for in-depth development. Controlling a territorial enclave in the Andes, it was the authority in that zone, ruled over the largest work force of the country and watched over the agricultural production of the entire region (Lauer, 1977, 136). It polluted at will, recruited labour by fraud, operated with strong discipline and disregarded the workers' health and safety, while its foreign managers lived a nearly luxurious life. With rising costs in the fifties, CPC restructured its production, establishing local enterprises to manufacture mining supplies, and included Peruvians in managerial control while providing capital and technology.

[198] The fact that supporters of expropriation in the late sixties often referred to legal issues reaching back to the twenties and before underlines the change of attitude regarding foreign enterprises as to their role and their rights in the Peruvian economy.

> *"So Cerro, the resource imperialist, unconsciously repaid a part of the obligation to Peruvian posterity that it assumed when it usurped powers that by right belonged to a state controlled by local citizens on behalf of locally defined concerns. It did so by encouraging the growth of domestic entrepreneuriat and manageriat that ultimately acquired both their own interest in a stronger state apparatus and the political capacity to secure one" (Becker, 1985, 73-74).*

Less of a long-term political issue than the IPC controversy, CPC thus saw its condition become more difficult due to structural constraints and, most importantly, to social ones. By the sixties, the company ceased to be the central piece of the sector. Attempts at reorganisation did not succeed since the company's profitability depended on low labour costs, not on technical infrastructure. With a well-developed labour movement however, no government could have taken the risk to introduce a low wage policy, even for the biggest employer in the country. Sharing some interests with local mining companies, oligarchy and state did not suffice, since none of these forces had social control.

By 1968, never-ending labour troubles, combined with the "usual" arguments, namely the extent of foreign ownership in the sector, massive export of profits and evidence of transfer pricing opened the road to nationalisation. In addition, Marcona and SPCC, but above all CPC, had not worked towards a real expansion of the sector and were unwilling to embark on new projects. Finally, CPC proved to be of *poor corporate citizenship*, by investing profits generated in Peru in the country's traditional rival Chile, a decision which displeased even some oligarchs. The accession to power of the reformist officers "made Cerro ripe for naturalisation" (Becker, 1985, 75).

While the most immediate causal circumstance of the military takeover was the scandal over the oil concessions given up to IPC, the expropriation of CPC in 1973 represented the other, somewhat more fastidious, special political action taken by the reformist state against foreign capital. "In this way, the government eliminated two historic *bêtes noires*" (Fitzgerald, 1976, 29), emanating form the two key sectors of petroleum and mining.

Meanwhile, SPCC's outlook was brighter and its relation to the state stable. The comparatively young consortium, resulting from a joint venture of several companies in the fifties, and which combined several major mines, had signed a very favourable development contract with the state in relation to one of the biggest copper mines in the world. Although its operations were not integrated in the Peruvian economy as CPC's had

become, the company's contribution to the government had been substantial before, particularly with the enormous *Toquepala* mine. However, complaints started to emerge from the Belaúnde administration, whose needs for revenues grew. During the sixties, the Mining Code was changed twice, in 1964 and 1968, and the government sought negotiation to resolve the matter with SPCC in particular. Asarco, the main company, reacted as a *good corporate citizen* and accepted to be taxed at a standard rate for foreign-owned mining companies even though it still qualified for the old concessionary rate (Becker, 1985, 77-78). After the coup, the military government continued the same negotiation policy, and showed interest in the development of the *Cuajone* mine jointly with SPCC. Bargaining was arduous, as the state showed a tougher stance than in the past, yet the company acknowledged the government's objectives and understood the importance of leaving state officials with a politically satisfactory settlement. By late 1969, in spite of adverse circumstances, both parties reached an agreement surprising to many.

To Becker, SPCC was a *mature* business corporation whose planning was aimed at long-term capital accumulation strategies. Unlike the *colonial* or *entrepreneurial* company, in our case embodied by CPC, such a corporation combines global economic goals with the pursuit of non-economic goals. Managers of the former type, manoeuvring in risk intensive environments, generally acted only considering the aim of the company. Most of these companies evolved into "corporate maturity as they became fully transnational and are now risk minimisers" (Becker, 1985, 68-69). While CPC stuck to its colonial behaviour, SPCC could be considered of the latter kind. In its agreement settled with the Peruvian State, a major argument needs to be mentioned however. SPCC and the Peruvian economy had been, even before the new Cuajone venture, mutually dependent on each other. While for the Peruvian economy, the success of the Toquepala mine was central, Asarco was highly dependent on the same mine for its global profits and international market share.

On the government's side, the then valid mining policy suggests that from the beginning on, the intention was not nationalisation, but partnership with foreign capital (Thorp & Bertram, 1978, 308). While reforms brought about the expropriations of important foreign companies, the military government was seeking negotiations with some multinational firms, to obtain the exploitation of lucrative projects (Vásquez, 2000a, 46). Unlike traditional investments however, the military government sought the development of mines through mixed or state companies designed to operate with external credit (Malpica, 1989, 38). In the Cuajone project, the state did participate in the refining as well as in the commercialisation of the extracted copper. Thus, the state did not interfere, as it did in

other sectors, to fundamentally shift the ownership of production into national hands, public or private, even though the sector was largely foreign. By 1968, foreign investment in mining had been multiplied by eight in less than twenty years, mostly due to the SPCC (Alcorta, 1990, 92). But rather than being irritated by such heavy greenfield investments, the military government was, as the precedent administrations, bothered by the lack thereof. It did indeed pressurise other large companies into developing unworked concessions by threatening to hand them back to the state.

Apparently, this attitude was going against the nationalist convictions displayed in other circumstances. But the strategy chosen regarding mining and oil was based on rational arguments. Looking at the latter sheds light on the apparently schizophrenic attitude[199], mentioned in Chapter Three, which was the dictatorship's will to reduce external dependence while promoting private foreign investment. First, the government recognised the huge costs and technical complexity connected to mineral extraction. Second, its aim was to secure the finance needed to uphold its public investments in other sectors. The military regime was aware that, for its state-guided industrialisation programme, it would need to expand mining and increase the sector's exports. Hence, the plan was to couple export-led growth with inner industrialisation.

The government meant to achieve this by keeping a tough stance towards foreign companies. Their assertiveness, which defined the amounts and the pattern of investment, leaving the state as a mere acceptant, had gone with the uncertain and ineffective attitudes of previous administrations (Pease García, 1977, 204). In 1969, the regime was determined to build up mining, but it wanted to do so by linking it closely to national objectives. Officials had a clear idea of what they wanted and of what they were willing to give to get it, thus displaying strong will and pragmatism:

> *"It is clear that the Peruvian state has become stronger during the epoch of development led by mineral exports. [...] By the end [of it], it had assumed direct control over much of the mining economy and was effectively overseeing the rest; it had demonstrated managerial and technological skills of a generally high order; it had proved a hard bargainer with one of the major transnationals; and it was acting (not without error, to be sure) on behalf of a coherent strategy of national development" (Becker, 1985, 84).*

[199] In this regard, it needs to be mentioned that within the leading military coalition, discrepancies existed regarding the extent of reforms. Some ministers were closely linked to the oligarchy (as had been previous presidents), others showed, already soon after IPC's expropriation, their desire for reconciliation with the United States (Bullick, 1999, 175).

The outcome of negotiations proved to be disappointing for the military government however. Some partnerships were achieved in the oil industry, where *Occidental* and *Belco* Petroleum and the state-owned *Petroperú* worked together (Alcorta, 1990, 93). In mining, except for the Cuajone contract, the foreign firms had been disinclined to invest in the country to the terms of the regime in spite of its efforts to entice investors into new relationships[200]. In addition, some were probably suspicious of the ambiguous treatment regarding foreigners, notwithstanding improved relations with the United States sealed by an agreement over compensation for American shareholders: "The main problem in this bargaining process lies in the conflict between a desire to reduce dependence on the one hand and to acquire foreign co-operation on specific state projects on the other - in the face of opposition from international capital" (Fitzgerald, 1976, 67-68). Unrealistically, the military government's strategy was to reduce the subordination of the Peruvian economy to foreign companies, yet increase foreign capital inflows, an aim which could not be achieved.

The next disillusion came when the main scheme expected by the military failed to materialise. The conviction that the attack on foreign capital and on the domestic oligarchy would favour the blooming of local medium-scale companies was not confirmed, and local private investment remained very low in manufacturing, where the government had had the highest expectations. Thus, "faced with this abstention of private capital, the government had to move in to take over for itself the role as the economy's main investor. From the original aim of a mixed economy with a strong private sector, the Peruvian economy moved rapidly towards state capitalism" (Thorp & Bertram, 1978, 309). Bereft of foreign investment and lacking a strong self-confident private sector, the state necessarily became the motor of development (Crabtree, 1992, 7). Thus, the incapacity of domestic capital to modernise the economy had much to do with the massive extension of state intervention.

In this context, financing public investment proved extremely difficult. Besides the defaulting source of the private sector, the other source in the economy was the profits of the new state-owned companies (whose expropriations had, in most cases, required reparation payments). But the nationalised firms were permanently running at a loss for the most part, or had been decapitalised by their foreign parent companies.

[200] Still, the investment made in both sectors was substantial, since they represented an increase of one billion US$ between 1968 and 1980 (Malpica, 1992, 1251).

Thus, while the state had broken with the country's past in many ways, the period was characterised by a solidified pattern of debt-led state intervention (Wise, 1997, 77). Due to the absence of private capital, big investments and management needed to be financed by other means, notably with active external borrowing. In this sense, the military regime could not revert the trend started by the Belaúnde administration, that is, the haphazard launching of the industrialisation, and, in parallel, the swelling of the state and foreign debt. Between 1963 and 1967, the external debt had already almost tripled (Angulo, 1999); the military government continued this tendency, thereby contributing to the increase of a different form of external dependency. Thus beyond the key projects in oil and copper, negotiations with foreign capital were dominated by the need to renegotiate the external debt.

The excessive reliance on external borrowing, added to a negative balance of payments, increasing deficits and inflation led, in 1975, to an economic crisis. In fact, this crisis was a product of the country's long-standing structural difficulties combined with the effects of Velasco's economic strategies (Conaghan & Malloy, 1994, 101). The ensuing debt crisis forced the new military government led by Bermúdez to turn to the IMF and, under the pressure of the international financial community, to reintroduce a more liberal approach to economic policy with an emphasis on the market, not the state. Thus, the Bermúdez government "found itself beating the retreat from Velasco's development strategy, but unsure as to what to put in its place" (Crabtree, 1992, 6).

Undeniably, a new trend of foreign investment inflows could not be set off. The situation could not be reversed in the eighties, in spite of the comeback of civilian rule in 1980. While successive governments attempted to attract foreign capital through various incentives, investments dropped further, particularly after the Mexican crisis in 1982 (Malpica, 1992, 1255), a situation that would not improve in Peru until the beginning of the nineties.

6.2. Transnational corporations and the Peruvian State in the nineties

The economic policies of the successive governments following Velasco's dictatorship can be considered a gradual dismantling of the reforms which had introduced state capitalism. As seen in previous chapters however, it is only after Alan García's turbulent mandate (1985–1990) that drastic changes occurred in Peru's economic policy.

6.2.1 Fujimori's privatisation programme

The practice called *privatisation*, a term coined by the Thatcher government in the late seventies, became a procedure which, by the nineties, had become inevitable in the agendas of the governments of the region. Similar to other countries in South America, the privatisation of state-owned enterprises (SOEs) represented the third major aim of the Fujimori administration, after the taming of inflation and trade liberalisation.

The administration's privatisation strategy was a major component of the overall market-oriented policy approach, meant to achieve greater economic efficiency and competitiveness through the increased participation of the private sector in economic activity (Kisic, 1998, 48). In Peru as well, rather than inspired by an "ideological zeal", privatisations were motivated by the necessity to improve the government's accounts (The Economist, December 4th, 1997): Indeed, the fiscal collapse of the previous decade, and the high operating losses – mainly due to inefficient management, political manipulation, unrealistic pricing and bloated payrolls - of the 186 Peruvian SOEs[201] made privatisation inevitable (Wise, 2002). In 1990, their deficit culminated at four billion US$.

At the beginning of his first mandate, Fujimori emphasised the need to keep key enterprises under state ownership, notably in strategic sectors such as telecommunications, petroleum, water and electricity (Teivainen, 2002, 128). The initial plan was to sell off 23 companies only, principally minor SOEs. In phase with the other economic reforms, a more fundamental privatisation strategy did not transpire until 1991, and became really effective after the self-coup of April 1992. In spite of the "usual suspects within Congress and the private sector [lobbying] for the same gradualist approach that had thwarted all earlier attempts at privatization in Peru" (Wise, 2002), the executive radicalised its line on privatisation, announcing its will to sell off all state companies. The latter included, in the export-led and service sectors, mining, petroleum, social security, health, education and even pension funds. This stance was strongly promoted by Peru's minister of economy, Carlos Boloña, who declared on the government's privatisation programme: "Ethics needs to be left aside. I am pragmatic and search for solutions that work. The world is looking for efficiency and the market can give

[201] It is worth mentioning that the enthusiasm for nationalisation had led the Peruvian State to own not only strategic companies offering basic utilities and services to the public, but also hotels and even one of Lima's pornographic cinemas, as sarcastically mentioned by several authors.

it to us". He added that there were "no technical reasons for the state to have enterprises", and that "the only reasons for their existence [were] political" (Teivainen, 2002, 129)[202].

Several authors consider Fujimori's privatisation programme the most important reform overall. First, it fundamentally changed the ownership and business structures, assigning, in a way, the state the role it had had up to the sixties, before Velasco's *state-entrepreneur* era (Teivainen, 2000a). Second, privatisation consolidated the economic ideology based on liberalism and private property. Third, beyond the national public-private debate, privatisation contributed in bridging the gap between the *domestic* and the *external* in various ways. As a corollary to the executive's will to reintegrate Peru in the world economy, the external considerations on privatisation had a double aim. First, privatisation represented the reinsertion of foreign business presence in the country; second, the money earned selling SOEs meant a temporary solution to honour the international debt payments – the government's main financial worry.

A major step in the privatisation reforms was the establishment of the privatisation commission (COPRI), which quickly started to sell off state assets. While the economic recovery and general liberalisation contributed to effective privatisation, it is the creation of COPRI, and with it the professionalisation of the privatisation strategy, that marked a major difference with previous failed attempts[203]. The transfer of state ownership to private hands was carried out in different ways: Call for bids, public auctions, through the stock market or concessions. COPRI also initiated direct conversions between foreign debt and investment (Le Monde, July 20th, 1993) and in 1994 the so-called citizen's participation (*participación ciudadana*) was introduced.

The rapidity and depth of the privatisation process, were, as in other main reforms, sought to make the systemic changes irreversible – privatisation was a cornerstone in anchoring the liberal doctrine in the population. This was the sort of incentive the *participación ciudadana* was: Extending share-ownership in the privatised companies to the "general public" would make people feel that they had a stake in the privatisation reforms. "In the context of increasing privatisation of the public sphere, citizenship was increasingly

[202] In his article, *Restructuring the economy: lessons from Peru's economic history*, he attacks the "destructive" Keynesian notion and clearly condemns the "artificial" distinction between macro- and micro-economics (Boloña, 1994).
[203] In this respect, Wise mentions three key elements of the state agency: Precise legal guidelines for the assessment of SOEs and their divestment, the technical and financial expertise of the staff to restructure companies to be sold, and the commission's sell-off campaign, which dealt with smaller firms at first, instead of hinging on *grand privatisation schemes* (Wise, 2002).

connected to one's purchasing power" (Teivainen, 2002, 131). Another decisive step in that direction was the privatisation of the pension system through the creation of private pension funds. Indeed, "when people put their savings in such private institutions instead of the public social security system, they become investors themselves", thus developing the sense of saving, property and individual risk assessment (Teivainen, 2000a)[204].

On the whole, the policies were clearly geared to attracting TNCs and regional economic groups (REGs), that is, foreign investors (Durand, 2002b), since national business lacked capital to invest, particularly in large projects. At first however, international investors were not rushing in. The announcement made by the government that all state-owned enterprises would be privatised without exception by December 1994, at the rhythm of one per week, revealed to be over-optimistic. In order to make SOEs more attractive, their debt burdens were reduced, their workforce cut in half on average and they were often sold at discounted prices (Le Monde, July 20th, 1993).

While some foreign capital - mainly regional – entered the Peruvian economy, the real influx came in 1994, led by the deal on telecommunications with the Spanish firm Telefónica, overshadowing any other investment. The take-off permitted COPRI to account nearly five billion US$ of sold state assets by the end of Fujimori's first term, which represented in effect 72 privatised enterprises. In 1997, the privatisation process slowed down; the social costs endured for several years by the population and quarrels over key privatisations turned public opinion sour. Fujimori was forced to revise his stance towards some of the remaining big privatisation projects, notably the sale of Petroperú. At the same time, a depressed world economic situation reined in investors' enthusiasm. Still, by 2000, at the end of Fujimori's second term, 220 completed transactions amounted to a total of 9,2 billion US$. While not corresponding to the total of public companies, it made up a large share of it (table 3).

[204] The creation of the private pension funds came with strong incentives for people to switch from the public to the private system.

Telecoms	*100*	*Mining*	*90*
Finance	*100*	*Fishery*	*100*
Industry	*85*	*Agriculture*	*35*
Oil	*65*	*Others*	*75*
Electricity	*66*		

Table 3: State divestment by sector, 2000 (percentage)[205]

Some Peruvian groups, forced to restructure and regroup due to the deep changes caused by the neoliberal policy environment, managed to take advantage of the bigger opportunities opened up by the privatisation process. Yet such moves would not have been possible without an alliance with foreign capital. In 1995, the grupo *Brescia* won a bid with the *Banco Bilbao Vizcaya* of Spain for the control of the *Banco Continental*, the third-largest Peruvian bank. Peru's most powerful group, *Romero* - which had made the most of the reformist legislation of the Velasco dictatorship to consolidate its empire – took advantage of the financial measures as well as the privatisation process initiated by the Fujimori government.

Its Banco de Crédito, acquired from Italian owners in the seventies, benefited from the dissolution of the state-run development bank and the new regulations, which forced cooperatives to go bankrupt, inducing huge transfers of capital towards commercial banks (with higher interest rates). Jointly with Chilean and Spanish capital, the group purchased *Edelnor*, a state-owned electric energy enterprise propped up and made leaner for the sale by the state. Again with Chilean capital, Romero set up a private pension-fund administrative company (AFP). A very profitable investment as it is, it was made even more lucrative owing to the actively encouraged shift from the state-run to the private pension system by the government.

However, "while the Romero and the Brescia groups are among the most powerful and wealthy in the country, the profits they have made thanks to neoliberal economic policies pale in comparison to those garnered by transnational companies that operate in Peru" (Nacla report, 1997). Indeed, unlike in other countries, where the domestic impact of the

[205] Source: COPRI/ Investment Policy Review of Peru, UNCTAD, 2000.

privatisation process was more favourable, in Peru it was the foreigners who purchased the majority of state enterprises, due to the scarce resources of national groups (Gerbolini, 2002).

From a microeconomic point of view, privatisation fundamentally contributed to the attraction of foreign investment in two ways. On the one hand, in addition to their initial investment, new owners also committed to further investment, on the other, inflows of early capital encouraged other investments in other sectors, creating a favourable climate of *self-sustaining* confidence (Gonzales, 1998, 57). The privatisation programme indeed promoted a more positive image among investors and reduced the country risk perception. Yet, "while the present privatisation program stands out as the most successful and broadly agreed-upon aspect of the Fujimori reform effort, the administration has been criticised by the political opposition for acting too hastily in its attempts to liquidate those firms that provide crucial public goods (for instance, water, electricity, transportation)" (Wise, 1997, 89).

Apart from the blames relative to the maximisation of sales, early on some authors had pointed out the more fundamental issue of privatisation, namely the lack of democratic debate on the whole process: "Where and when did the national debate which needed to precede privatisation occur?" (Castillo, 1992) "The issue at stake in this privatisation process are the SOE's worth of billions of dollars, which constitute the heritage of all Peruvians. Thus there should have been a national debate defining the role of the state in Peru's development process"[206] (Compodónico, 1992). A frequent conclusion was that Fujimori was taking advantage of his executive powers and the absence of real opposition to push the privatisation process, choosing the modalities best suited to the executive's aims.

In Peru, while the UNCTAD Investment Report rightly suggests an improvement in infrastructure, prices rose substantially in comparison with pre-privatisation conditions, reaching levels higher than international ones. It has even been argued that overall, privatisation did not indicate an increased efficiency but a loss in welfare and was marked by a lack of adequate regulation (Gonzales, 1998, 57). In fact, the government's advertised aim to promote efficiency through competition was not fulfilled. Indeed, "in the absence of sufficient competitive policy to guide the process, the lack of transparency and solid financial information ease the way for new private owners to set above-market prices for

[206] Translations by the author.

public goods previously provided by the SOE's" (Wise, 2002). Thus doubts as to the transparency of rules were another worry. The absence of clear legislation and its enforcement opened the way to corruption and favouritism towards particular sectors.

A major issue was the passage of public monopolies directly to private ones. In public utilities, such as telecommunications and electricity companies, the potential benefits of privatisation for both businesses and consumers are likely to be very high. However, these "natural monopolies require tough, independent and technically sophisticated state regulation if the full benefits of privatisation are to be felt. That is one of the biggest challenges now facing Latin American governments. In their anxiety to extract the largest possible revenues, many of them have sold utilities on terms that favour investors over consumers" (The Economist, December 4th, 1997).

In this regard, the privatisation of the two national telecom companies represents a distinctive study case. Apart from being a unique transaction in terms of timing, amount of investment as well as overall impact and importance to the country, the deal between the government and the Spanish telecom company Telefónica portrays the features of a monopoly transfer.

6.2.2 The privatisation of telecommunications

In many developing countries on privatisation course, the sale of public telecommunication enterprises represented a major undertaking for governments. For decades, telecommunications had been regarded as a natural monopoly, since large investments and economies of scale justified the existence of only one entity with exclusive rights to provide telecom services (Business Peru, April 1998). However, rather than a novelty in the sector, competition merely made a comeback on the telecom market; in fact, in the 19th century telecom markets were highly competitive.

The return, in the eighties, to market practices in the telecom sector was generally driven by three main factors. First, the often disastrous service and performance of state-owned telecom firms were calling for reform. Second, international lending organisations were pressuring countries to divest. Finally, the telecom sector was caught, with other public utilities, in the general policy trend (Wallsten, 2000). Privatisation of the state-owned telecommunication monoliths seemed to be the only solution to bring telecommunication services up to international standards in terms of price, availability, quality and variety. It

meant escaping from government insolvency and its lack of capital for investment in modernising, as well as attracting foreign funds to finance the fiscal and balance-of-payments deficits (Carpinteyro, 2004).

Thus, the telecommunication sector switched hands in Latin America, shifting from the public to the private sphere. Often however, the basic argument and justification for reforms was left aside. Notwithstanding the main aim of privatisation, that is, promoting efficiency through competitive behaviour, public telecom companies transformed into private monopolies: Most countries in the region had gone through more or less encompassing private takeovers[207]. While usually not meant to last, the transition to market principles in the sector went with set periods of time during which the private incumbent was given exclusivity. Notably in Argentina, Mexico, Venezuela and Peru, governments chose to grant *exclusivity periods* to private operators. Time frames and modalities might differ, along with national particularities, but the basic idea remained the same. Beyond the often prevalent idea to consider telecommunications a natural monopoly and thus opt for exclusivity periods that would stimulate the investment of the company in question, the governments had other more pragmatic reasons to make concessions to a single bidder. In a context of financial distress, giving private firms monopoly rights increased the SOE's value and consequently the sales price.

At the beginning of the nineties in Peru, the situation of the public telecom companies as well as their services, was precarious. The density of telephone service was one of the lowest in the Americas. In 1993, Peru reached only an average of 2.9 lines for 100 people, and only one out of ten households had a telephone – figures representing a lower density and accessibility than in neighbouring Ecuador and even Bolivia[208] (UIT, 1994). The low telephone penetration was the result of a twenty-year lack of investment for the national network expansion; a lack particularly potent during the eighties. Campodónico sees three major reasons to explain this situation. First, since the state stopped paying its external debt, SOEs ceased to be the subjects of credit on the international financial market. Second, the contraction of fiscal revenues limited spending in public infrastructures. Third, telecom tariffs were set lower than the operating costs of the firms[209] (Campodónico, 1998).

[207] It is particularly in basic telecom infrastructure and services that monopolies had been granted; access to other areas such as mobile services had generally been given to several operators.
[208] In comparison, in the United States there were 57.4 lines for 100 people, and 100 per cent of the households had a telephone line.
[209] Campodónico emphasises the fact that prices were clearly set according to political criteria and not in accordance with the operating costs. For example, during the period of hyperinflation at the

While privatisation was commonly justified with the need to increase competition in the sectors to be privatised, the case of telecommunications shows that this justification did not always describe the process. The CEPRI Telecom[210] created for this privatisation process was clearly on the lookout for a major international operator which would have the financial and technological means to invest. It also decided to establish a period of *limited competition* and tariffs in order to allow the extension of the Peruvian telephone network. The chosen operator was to match these twists to open competition by fulfilling the main aims of expansion and quality of the network. The quantity and quality of phone services grew significantly after privatisation; however, at the same time, tariffs also reached high levels (Teivainen, 2002, 128).

In February 1994, *Telefónica International de España*, in a joint venture with the Peruvian firms *Graña & Montero* and *Banco Wiese*, acquired 35 per cent of *CPT* and *Entel*, the two public companies, obtaining the ultimate control over them. With a bid of just over two billion US$ in cash and investment commitments, the amount overstepped the minimum bid by 3.6 times (Cornejo, 1996)[211]. The two public companies were merged to form *Telefonica del Perú* (TdP).The new owner was to have a monopoly for five years.

Surprisingly perhaps, through an agreement between TdP and the state, the liberalisation of the services provided only by the main operator took place a year earlier than forecast. Yet the temporary monopoly conditions until 1998 had important consequences on the development of telecommunications in the country. A report published by the International Telecommunication Union (ITU) states that "a set of TdP's dilatory practices effectively delayed the beginning of the operation of new local and long-distance carriers". Anti-competitive behaviour was exercised to the detriment of other more specialised competitors, notably in the internet sector, as the amount of network disputes between 1996 and 1999 testifies. A general conclusion was that specific developments in the sector would be "closely tied to the market power of the leading telecommunication operator in the country" (Brisceno, 2000).

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end of the eighties, the García government attempted to control inflation by freezing the tariffs of public utilities.

[210] CEPRIs were special committees for the promotion of private investment nominated by COPRI for each privatisation.

[211] Several studies attempted to explain Telefónica's high bid. There was the fact that three consortiums participated in the auction rather than only one or two, as often in the region. Another argument was Telefonica's experience in the region, its forecast on Peru's economic growth and evaluation of returns, as well as the will to secure its leading position in the region.

Meanwhile, from the first year on, the transnational firm made substantial profits[212]. Indeed, the monopoly concession and the level of tariffs chosen made it possible for TdP to maximise returns on its investment, earning increasing profits, so that by 1997, the initial investment was almost paid off. According to J.P. Morgan, TdP was one of the most profitable telecom operators world-wide (Távara, 1999, 190).

Apart from the technical debate whether exclusivity periods limit competition, whether they are necessary due to the natural monopoly attributes of the industry or the lower stages of development of infrastructures, a broader issue needs to be considered. The role of regulation agencies and the type of autonomy they have are essential factors revealing the characteristics of the governance of states and their relationship to business. In the telecommunication sector, the main supervising body was praised as well as pointed at, showing contradictory perceptions as to its success to promote a truly transparent business environment.

6.2.3 Privatisation and transnational regulation

Privatisation does not imply the disappearance of the state in economic matters. Much more, it suggests the shift from a role as entrepreneur to the one of regulator. It is, then, precisely this new role that it is suitable to consider in the context of a redistribution of the ownership of the means of production.

Public companies were perceived as tools of political economy and were used by the government with the aim of stabilising the country's macroeconomic fundamentals, as well as for narrower political projects such as elections. In this context, privatisation represents an *economistic depolitisation*[213], where economic activity discontinues serving political purposes and evolves according to market principles. Simultaneously, the privatisation process is meant to establish a modern regulatory framework, transparent and flexible, which defines the state's role as the regulator and advocate of private investment (Paliza, 1999). In modern economies at the borderline of political and economic spheres, the regulation body holds a cornerstone position. Thus, together with the privatisation process,

[212] Telefonica earned 314 million US$ in 1995 (Nacla report, 1997).
[213] Expression used by Teivainen (2000a).

the government quickly created a general regulation framework[214] as well as specific governmental agencies in major sectors.

In telecommunications, things changed drastically. As SOEs, the two telephone companies were testified to the state's ascendancy over the infrastructure and the services of the sector. With their privatisation, the government decided to transfer the responsibility for the development of telecommunications to the private sector, maintaining a regulatory function for itself. It issued several laws setting a new legal frame to the telecoms, meant to promote competition in the services where it was "technically feasible". A supervising organism, OSIPTEL (*Organismo Supervisor de Inversión Privada en Telecommunicaciones*) as well as an investment fund for remote areas (FITEL – *Fondo de Inversión en Telecommunicaciones*) was created. The importance of the investment, the arrival of a private monopoly on the Peruvian market and the quick pace of evolution in the telecommunication sector were the main motivations for the government to establish a supervisory body.

The evaluation of the role and achievements of OSIPTEL is differentiated. On the one hand, it cannot be denied that the agency was given the essential features to its independent functioning. Made up of qualified personnel and based on a private remuneration structure, OSIPTEL was granted a certain degree of independence, but not constitutional autonomy, like the Central Bank for example (Távara, 1999, 199). On the other hand, the 1994 law stipulated that OSIPTEL was to report directly to the president (Cornejo, 1996) and that members of the executive board could be removed for "negligence, incompetence and immorality" (Távara, 1999, 200). In a new law in 1998, the representatives of the firms and the consumers were removed from the board, while the reasons for possible removals of the board members were no longer mentioned.

The regulation body was thus limited in the regulation of public services; the mechanisms necessary to include the citizens' participation were missing and the degree of autonomy of the agency towards pressure groups was not sufficient. But most importantly, the law gave too much discretionary powers to the executive on the whole and to the president in particular. As mentioned in Chapter Four, the absence of truly democratic institutions and an independent judiciary limited the autonomy of the agency, weakening in turn its authority towards the regulated firms (Távara, 1999, 206). In telecommunications, this

[214] As mentioned in Chapter Four, a general framework for the promotion of competition and the protection of consumers was put in place in 1992 with INDECOPI.

aspect was reinforced by the sectors' monopolistic feature and the possibility of *capture* by the main regulated firm (Bastos, 1999, 7).

Beyond the issue about the actual arrangement at the outset of the privatisation process, reinforcements of transparency and autonomy should be strengthened over time. In 2001, the president of OSIPTEL reminded that the policy framework of his agency had been designed in a "different era", and that necessities had deeply changed since (Caceres, 2001). In this train of thought, the gained experience fortified OSIPTEL, and adjustments in regulation were accomplished in the sector. Yet in 1999, a market research report on telecommunications warned that "without a more proactive overhaul of the existing regulatory framework, [...], competition will remain limited for the foreseeable future" (Global Information Inc., 1999).

Soon afterwards, during the unstable political situation of 2000 and 2001, regulation agencies did not seem to have initiated thorough changes in regulation, nor moved towards more independent decision-making. The interference of various ministries even after Fujimori's departure testifies to the regulation agencies' lack of autonomy towards the government. In Spring 2001, CONFIEP officially voiced its worries as to governmental interventions in regulation. The business association warned that such practices would harm investment and generate uncertainty (Gestion, May 25th, 2001). As to OSIPTEL, in a communiqué at the world conference of regulators in Geneva in 2001, its representative listed all the improvements that had been made since the agency's creation. He stressed that within eight years, infrastructures and services in telecommunications had greatly improved in Peru thanks to the modern regulation framework put in place in a context of a high degree of autonomy, transparency and independence. But the spokesman also admitted that in particular issues autonomy was still put under stress by different interests (ITU, 2001).

Referring to our triangle of relationships between state, domestic business and TNCs, it needs to be conceptually adjusted to represent the role of regulation agencies, which hold a key position in a market economy. Considering the fact that the state is not a black box, agencies are distinct from the executive and are a part of the administration that should not be directly involved in a political debate but work independently. In Peru, the structure of power does not guarantee this. The result then is that the government can interfere in the regulation of the market system via two biases (figure 10). Within its realm, it can use the regulatory agency for its purposes (1), notably by taking protectionist

measures, or it can deal directly with influent market players (2). These relations are outside the market system (relations 3, 4 and 5) and thus represent a deviance from market principles.

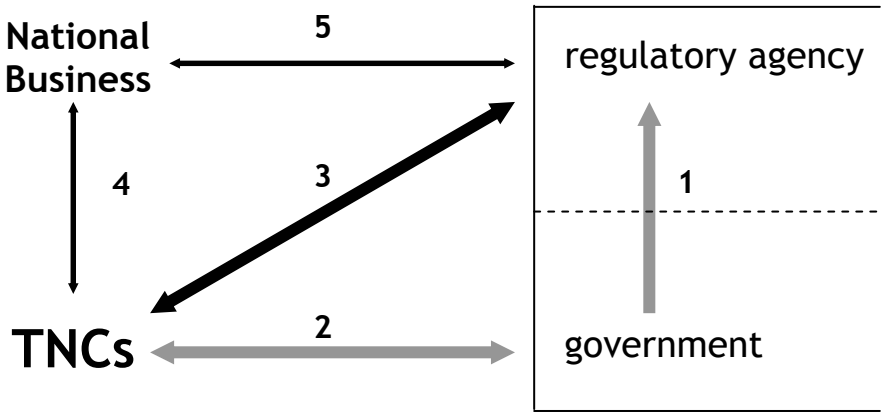

Figure 10: The role of regulatory agencies[215]

It can be put forward that a higher degree of concentration of economic power further favours deviation from market mechanisms. It this context, the Peruvian telecom sector is a suitable example. Due to the size and/or strategic importance of the major private company, in this case a TNC, the regulatory agency might be put under pressure either directly by that company (3), or indirectly with the government's support (2, 1). The alternative scenario would be the government initiating direct, *extra-market* relationships with the TNC to achieve particular political goals, or have the regulatory agency act to affect the monopolistic firm positively or negatively (1 and 3).

In the telecom sector, domestic business has not played a decisive role[216]: As in other countries of the region, foreign capital controls most wireline and wireless telecommunications and "domestic capital either plays second fiddle or is non-existent" (Carpinteyro). Hence relations 4 and 5 are rather less relevant here. Instead, other TNCs may be inclined to influence the supervising body (again, 3), particularly in a monopolistic

[215] Figure elaborated by the author.
[216] In the Internet services, The Red Científica Peruana (RCP), a non-profit organisation, which first set up academic Internet access services and coordinated efforts within the academic and scientific communities, is an important figure. In this context, disputes over unfair competition oppose TdP

and oligopolistic market, where they attempt to increase their small market shares[217]. Indeed, after 1998, telecom companies complained as to the lack of competition in the sector, blaming OSIPTEL for issuing anti-competitive regulations and favouring the dominant operator TdP (Bellsouth, January 26th, 2001).

By including other TNCs, the picture becomes even more multifaceted: Bereft of genuine domestic economic players, the telecom sector has, from the beginning on, been transferred to foreign capital, and continues to be solely transnational with the entrance of additional TNCs. In this perspective, the regulation agency is, in addition to being on the border between the private and public spheres, an entity between the national and *extra-national* spaces. In a way regulating a "transnationalised" sector, it is also being subjected to the scrutiny of international actors such as foreign administrations, for example. On a particular issue, the US government got involved to protect the interests of two American competitors, *Bellsouth* and *FirstCom*. Pressuring OSIPTEL to enhance competition, the US government based its claims on Peru's WTO commitments to prevent anti-competitive practices (Pipoli, 2000, 12).

Besides bilateral interventions, the increasing significance of multinational or supranational forums in favour of regulation bodies in telecommunications needs to be mentioned. These events suggest the influence international institutions – notably the ITU - wield on national agencies to have them restructure their legal frameworks and search for common ground concerning the liberalisation of telecommunication services through international regulatory agreements (Bastos, 1999, 8-9).

The regulation agency is put under stress by the advances of technology, the increasing importance of market niches and the constantly evolving business context. Dealing with the passage from public to private, it also finds itself propelled into a transnational as well as international environment with high expectations regarding regulation standards. Thus, comparing the telecommunication sector at the beginning of the nineties, Peru has come a long way. OSIPTEL appears to have done a fair job in regulating the market within the framework of its possibilities.

Indeed, during the Fujimori era, OSIPTEL was, like other regulation agencies, confronted with a lack of true political and economic independence from the executive, which in turn

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and RCP (IP Telephony and the Internet). RCP is a Peruvian organisation, but clearly does not qualify in our understanding of *national business*.

[217] Not represented in the figure are other pressure groups, notably users.

made it to a valuable instrument. The application of the neoliberal economic programme – and with it the privatisation programme - had not rooted out favouritism and cooperation (Castillo, 1996); clientelist connections remained out of reach of the supervising bodies, yet the government used them as institutional medium to implement and monitor what had been decided unilaterally or agreed upon in informal deals. Not surprisingly, suggestions of arrangements between the Fujimori government and TdP surfaced at different moments, making OSIPTEL look like the government's pawn.

More generally, the dichotomy between what an agency could achieve in the privatisation process and where its authority ended is expressed through COPRI's contribution. While the agency had been professional in selling the state assets, the revenues were meagrely used by the Fujimori government and in a populist and opaque way (Gonzales, 1998, 57)[218]. In the end, it can be hence stated that "as a result of privatisation, some notable advances were made in regulation, although much remained to be done in improving efficiency and transparency" (Kisic, 1998, 49).

6.3 Transnational corporations and Peruvian business in the nineties

The sale of the state assets was the point of departure of renewed private foreign investment. Concomitantly with privatisation, the domestic private sector was also affected by liberalisation. First, mostly a matter of internal reorganisation, domestic business was soon to be confronted with the entry of TNCs, seeking to establish themselves in successful sectors and markets of the Peruvian economy.

6.3.1 Domestic business and the entry of foreign capital

One of the first signs of fresh foreign presence perceived by the Peruvian people, particularly the ones in the capital, were the franchises which had started to bloom on the main *Avenidas* of Lima in the early nineties (Trujillo, 1999). Brands such as *Burger King*, *Pizza Hut*, *Credit Lyonnais*, *Avis*, *Visa*, *Seven Up*, *DHL*, *Diners* – largely representing US firms – were quickly adopted, as their presence was taken as a sign of economic change and progress. Often forerunners on emerging markets, franchises express a first phase of

entry of transnational business[219]. Typically present in consumer goods and some services, and particularly in the food industry, this organisational system allows tiptoeing into yet "immature" market economies.

While in developed countries, and particularly in the United States, individual entrepreneurs contribute to the expansion of this form of business organisation, in Latin America, due to the structure of ownership and the general lack of capital, partnerships have often been limited to bigger, already established companies. In Peru, a single company, *Losani S.A.* owned the food stores of Kentucky Fried Chicken, Pizza Hut and Burger King (Suárez, 1994). Quite remarkable in the capital, this first wave of – indirect - Western taste was merely a by-product of TNCs' entry and of the main changes that would affect national business.

Reforms affected sectors unevenly, favouring traditional export-led enterprises of the primary sector and services, where foreign investment was particularly active. The bigger share of foreign investments was linked to the privatisation process in mining, energy, telecommunications and service sectors, and represented mainly punctual large-scale investments in a few projects (Araoz et al., 2001, 37). The government's policies aimed at opening up the country to attract foreign investors susceptible and able to take over moribund public enterprises, while pressuring domestic business to increase its efficiency, above all in the industrial sector.

In a difficult position, the industrial sector had to adjust quickly to the changing conditions. In manufacturing, where Peruvian groups were playing a more significant role, domestic capital participated in the privatisation process. By 1997, it had acquired more than two-thirds of the state-held assets in the industrial sector (UNCTAD, 2000, 6). Comparatively however, privatisation played a minor role in the reorganisation of the ownership of production. The principal mode of capital restructuring occurred through the acquisition of other domestic companies. In this context, it appears that a process of fairly

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[218] After his departure, it was established that the balance of the privatisation money flowing into the ministries did not correspond to the actual sales, and allegations reached from poor deals to organised corruption.

[219] Generally, foreign companies provide local businesses with licenses, which allows them to produce and sell particular goods or services. While accessing a technological and organisational framework as well as an internationally established brand, local entrepreneurs have to come up with the major share of investments. They are responsible for the profitability of their enterprise and have to share their benefits with the franchiser. Typically, the impact of this organisational system cannot be fully grasped by FDI, since the principal transfer in this case are rights relative to the brand as well as to production processes and marketing.

rapid industrial concentration was happening, as some major domestic investors were displacing others, fortifying and preparing themselves for external competition.

The ensuing remodelling of domestic groups has been partly depicted in the previous chapter. At first, the big groups managed to participate in the transformation of markets caused by privatisation, fusions and acquisitions (F&As), strategic alliances and the entry of foreign capital. Modifying the composition of their conglomerates, the leading groups restructured their holdings mainly among each other on the one hand, and then took the opportunity to be an entry gate for foreign companies on the other. Some were quite successful and through joint ventures with foreign capital, particularly in mining, reinforced their situation (Vásquez, 2000a, 475). Indeed, newly arriving TNCs either formed alliances with leading local enterprises or bought them, thus improving the situation of the big groups' liquid assets.

Due to various reasons however, such as debts, lack of liquidity or unwise choices in business and internal quarrels in the families, the more fragile groups lost their importance, or fell apart. By the end of the Fujimori period, few had managed to remain economically powerful and the few that stayed were linked to foreign capital; their relative economic power in the Peruvian economy shrank. Minor, new ones such as *Rodriguez* or *Wong* appeared, yet the old bastion of Peruvian economic power declined. The remaining "old" ones, mainly *Brescia*, *Benavides de la Quintana* and *Ferreyros* (depending on the sources), concluded valuable alliances with TNCs. As for the *Romero* group, unquestionably the most successful Peruvian group with its two main assets *Credicorp* and *Alicorp*, is an exception in Peru's business panorama (Durand, 2002b)[220].

While in 1995, the diversified group reorganised its various financial companies, *Banco de Crédito* (first bank in Perú), *Pacífico Peruano Suiza* (insurance and reinsurance company) and *Atlantic Security Bank*, into a holding, Credicorp (Business Peru, December 1999), it took decisive steps in the industrial sector as well. The example of the creation of Alicorp bears evidence of the combination of national business restructuring and concentration with an accrued foreign presence. The purchase of the industrial and commercial food conglomerate *La Fabril* by the *Compañia Industrial Perú Pacífico S.A.* (Romero group) merged the two former rivals into a leader on the food market (including processed food and distribution). A year later, the La Fabril-Pacífico Consortium acquired, after their

[220] For decades, Dionisio Romero, who had been a great figure and played a major role in the controversy of the nationalisation of the banks under García, was, in the mid-nineties, considered to be by far the businessman with the greatest economic power (Business Peru, December 1994).

fusion, *Nicolini S.A.* and *Compañia Molinera del Perú S.A.*, two major companies of the sector. The resulting entity, named Alicorp S.A., is cited by several authors as a manifest example of how the presence of foreign competitors can be an incentive for an increased concentration of ownership on internal markets. In this particular case, it was the Anglo-Dutch food giant *Unilever,* which entered the Peruvian market in 1995 by acquiring 100 per cent of *Industrias Pacocha*, the mayor competitor of the Consorcio Perú Pacífico, and whose main shareholder was Dionisio Romero (Araoz et al., 2001, 66).

It is worth mentioning that the savings made through these multiple mergers were considerable, in terms of fixed costs (infrastructure and labour) as well as fiscal exoneration (Durand, 2002b). The restructuration improved the consortium's overall competitiveness and size, as well as its market shares, giving it a grip on the Peruvian processed food market. Alicorp is also one of the few examples of the attempts by Peruvian industry to access neighbouring markets, notably Bolivia and Chile, while Chilean investments on the internal food market were challenging the Peruvian leader on its home grounds.

6.3.2 The transformation of the beer industry

Beyond the particular case of the mergers in the food industry under the auspices of the Romero group – which has often been interpreted, within the country, as a successful case of keeping economic power in Peruvian hands by warding off foreign capitals – another more spectacular evolution developed in the beer industry.

At the beginning of the nineties, the three major Peruvian beer producers, *Backus* (grupo *Bentín*), *Cervesur* and *Compañia Nacional de Cervezas* (CNC - grupo *Lanatta*) tried to diversify and find new niches (Backus and Cervesur) or carry out operative changes (CNC) in order to face the opening of the market. In other words, while two groups were attempting to find solutions outside their firms, the third group's strategy was to solve its problems from within (Vásquez, 2000a, 405). In 1994, Backus acquired CNC and two other minor beer producers, owning from then on 65 per cent of the national market. The remaining big competitor, Cervesur, launched a restructuration plan for internal growth. In 1996, the sector was hit by economic recession, but the fusion of Backus and CNC into one *Unión Cervecerías Peruanas Backus y Johnston* (UCPBJ) represented major savings. By 1998, due to the negative effects of a slow-down in demand, pressure on the sector grew, as it did in other parts of the Peruvian economy. While in other sectors, notably in

banking, the TNCs' incursion had been unreserved, in the beer industry however, it translated into fierce confrontations between the two national oligopolies on a volatile and constricted market.

Finally, in 1999, the national borders were definitely crossed by dual dynamics. In an inauspicious economic situation both consortiums pushed international expansion, selling various labels in neighbouring countries as well as in the United States and Europe. Meanwhile, Backus was first infiltrated by the Chilean *Compañia Cervercerías Unidas* (CCU) which, by buying nearly 6 per cent of the shares, entered the company's board. In reaction and as a protective move, the Bentín group, main shareholder, turned towards a foreign ally, *Cervecería Polar* of Venezuela, which bought small shareholders' stakes on sale. The move was meant to stop the Chilean group *Luksic* to increase its stakes in UCPBJ. Cervesur, on the other hand, started negotiations for a possible alliance with *American Beverages* of Brazil (Ambev)[221].

At the beginning of 2000 however, Backus purchased 97 per cent of the Cervesur group through a Public Acquisition Offer. This new deal consolidated into an unambiguous domination of the Peruvian market and raised serious questions and doubts as to the free competition doctrine, since Backus became the only beer producer in the country[222] (Echaiz, 2002). At that point, UCPBJ ranked sixth biggest beer company on the sub-continent and was perceived as one of the few *top companies* of Peru by investors attracted by South American expansion.

Towards the end of the same year, the Chilean CCU first increased its participation, but facing the impossibility to acquire shares from the Bentín group, it withdrew a few months later, selling its shares to the former. At the end of 2001, the Venezuelan Polar bought shares from the grupo *Romero*, holder of 12.8 per cent of the company. From that moment on, control over the company was distributed between grupo *Bentín*, grupo *Brescia* and *Polar* (Dávila, 2002).

Soon, disagreements between Bentín and Polar[223] opened the way for a renewed external incursion in the form of two additional foreign groups, *Bavaria* (Colombia) and *Cisneros*

[221] Ambev was itself the product of a fusion between two big Brazilian companies, Brahma and Antarctica.
[222] According to Peruvian legislation, a position of dominance is permitted, and is sanctioned only if abuse is established.
[223] In May 2002, Polar said it discovered irregularities in the company's accounts and finally denounced the company for fraudulent purchases of hops abroad (La República, August 11th, 2002).

(Venezuela). In July 2002, both groups bought 50 per cent of the company's shares. In a matter of days, the grupo Bavaria acquired, outside the Lima stock exchange, the integrity of the participation of the Brescia family, while shareholders connected to the Bentín family sold 16 per cent to *Cheswick Comercial*, a subsidiary belonging to the grupo Cisneros. The latter also acquired another 7 per cent from minor shareholders through the stock market.

Immediately, Polar accused Bavaria and Cisneros of having acted in concert, the deal being endorsed by the Bentín group. Apart from the accusation bearing on the short lapse of time between the two transactions and the high price paid by Bavaria[224] – referring to a *control bonus* - the Venezuelan group also asserted that both groups were strategic partners in other companies in Columbia (La Republica, August 11th, 2002). Invoking a hidden attempt for the control of Backus, Polar appealed to the national supervising agency CONASEV (*Comisión Nacional Supervisora de Empresas y Valores*), to suspend Bavaria's as well as Cisneros' operations, arguing that the takeover violated the rules of public acquisition. Bavaria counter-attacked, alleging that Polar itself had bought additional shares of Backus, thus exceeding the legal limit of shares acquired without a public offer, that is, 25 per cent[225].

At first, CONASEV decided to put Bavaria's purchase on hold. The regulation agency intended to investigate alleged irregularities of the transaction and obtain more transparency on the market, but soon it accepted the transaction, supposedly under governmental pressure (Caretas, August 15th, 2002). CONASEV was further hindered by Bavaria's achievement to obtain jurisdictional protection, which shielded the company from the agency's investigation. The latter appealed, but could not in any way take on the firm's rights of property of 24.48 per cent of its shares.

As for Cisneros, the agency decreed the suspension of the last phase of purchases of the group, which reached almost 20 per cent (mid-August). At the same time, CONASEV was investigating Polar's first allegations that Backus had overvalued payments abroad, shifting the surplus to foreign bank accounts. Due to the complexity – only main issues have been mentioned here – and the importance of the quarrel, various administrative bodies, beyond

[224] While Polar had bought its *Clase A* shares (with voting rights) for 11 US$ each from Romero, Cisneros bought 16 per cent of the shares for 16 US$, and Bavaria paid 21.95 US$ for 21.96 percent of the shares (Echaiz, 2002).
[225] Comparing the various purchases of shares, it was quite evident that each group tried to reach a percentage just below 25 per cent in order to maximise their economic power in the company, that is, increasing their number of votes and seats on the board.

CONASEV and the Judiciary, got involved, such as the SUNAT, the *Gerencia de Mercados y Emisores*, and even the executive through its public Ministry. It markedly appears that the whole situation was going over CONASEV's head, and it is symptomatic that the final verdict and appeasement did not come from the supervisory agency.

The legal battle ended by a settlement between Bavaria and Polar around Christmas 2002. They agreed that the Colombian firm was to buy all the Venezuelan group's shares belonging to two of its subsidiaries. Consequently, the controversial move of pushing Polar out of the Peruvian market initiated by Bavaria and *Cervecería Nacional* of the Cisneros group came to an end with the announcement of the acquisition of Polar's participation in Backus (Revista Poder, March 3rd, 2002). The price paid per share amounted to 27 US$, an amount exceeding by a multiple its value on the stock exchange. The transaction included the withdrawal of the various accusations brought by the Bavaria, Cisneros and Polar groups against CONASEV.

Beyond the intricacy of the case, the technicality of the transactions and the legal strategies resorted to by the different protagonists, the main issue at stake was the control over Backus, Peru's leader of the beer market. The two major actors of the confused shift of ownership were the two foreign groups along with a third foreigner, Cisneros, and three major local groups, Bentin, Brescia and Romero, playing the second roles (Echaiz, 2002). In the end, the outcome of this fight for ownership was quite eloquent; a complete redistribution of production ownership had occurred, where domestic business had lost its stakes to foreign groups. Thus within a few months, the big domestic groups had resigned their leading position in a market that had been in the hands of Peruvians since 1954 (Casalino, 1999).

The role of national business groups in the shift of ownership

In January 2002, the Peruvian beer market was assessed as being in the domestic companies' firm hand. After having bought its main national rival, Backus seemed ready to confront foreign incursion. In addition, circumstances seemed to protect the industry. In terms of policy, existing tariff barriers against imports of key ingredients for production were a protecting factor. Then, there was the particularity of the industry itself, where the set up of a new production plant, of a distribution network and the promotion of new brands are costly and laid with traps (Roca, 2002, 810). In the knowledge of the outcome however, it can be said that, on the contrary, the above-mentioned arguments paved the

way to foreign infiltration in the beer industry. Indeed, since international trade is difficult (tariff barriers and transportation costs are high[226]) and greenfield investments are a pricey and tricky business, entering the market through the participation or the acquisition of existing companies is the most viable strategy.

However, the manner does not explain the timing – why did the incursion not happen sooner or later? Internal circumstances could be enumerated in this regard. With the changing policy environment (which meant, notably, high taxes), industries were facing the necessity to restructure, choosing, at different stages, either internal restructuring or expansion. The continuous rearrangement of the industry intensified with the difficult economic situation, hitting the already narrow beer market particularly hard. By the end of the nineties, the revamped industry had reached some sort of maturity in terms of efficiency, yet also as to its possibilities. The restrictions on the market itself and the financial weakness of the remaining competing firms were significant impediments to further internal growth.

The incipient accession of the Chilean group Luksic, through its company CCU, and the entry of Polar took place while the market was still a duopole – but the actual clash occurred after Backus had established its monopolistic position. It is highly probable that Bavaria, the biggest competitor involved, was lured by the extreme concentration of the Peruvian beer market. Foreign groups also considered its potential – its evolution had been negative since 1991 and consumption per capita was smaller by a half, in reference to the regional average. Hence, in that perspective, Peru represented attractive expansion possibilities in a quickly changing pattern of ownership in the industry.

In order to cause a shift to happen in the ownership of the means of production in the beer industry, it required more than internal circumstances combined with external interest. It took the will of the domestic shareholders to relinquish their assets in one of the country's key companies. Up to recently, it can be pretended that the Bentín, Romero and Brescia families had blocked the entry of new participants on the market, particularly trying to avoid direct intervention of foreign competitors. In fact, the purchase of CNC by Backus in 1994 was meant to impede the accession of the Argentinean *Quilmes* (English, 1999). The company reiterated this strategy when buying Cervesur, probably partly to keep Ambev out of the market.

[226] Due to the nature of the beer industry as well as to region's topography and lack of transportation infrastructures.

The entry of the Chilean CCU is somewhat distinct. So far, there had been an informal agreement between the three national families, whose members of the nucleus transferred shares among each other to keep third parties largely out of the loop of decision-making. This situation apparently changed when a branch of the Bentín clan decided to sell shares to the CCU, suggesting internal conflicts. The negative perception[227] of the accession of the Chilean group Luksic in Backus called for a new strategy of the main shareholders, considering the fact that the idea to include a foreign partner was not, at that point, unthinkable anymore. Indeed, the main shareholder Bentín was probably not against the partnership with a foreign group, yet it aspired to choose the association which suited best. While some pretend that the entry of foreign groups in the industry was inevitable, others regarded it as salutary. In this respect, the Polar option had several significant impacts. First, it spoiled CCU's scheme to gradually gain weight within the company. Second, Polar's presence as a partner probably played a role in Backus' move to buy the last Peruvian competitor Cervesur. Third, the major transaction with Polar in 2001 was a good deal financially; selling its shares to the Venezuelan group, through its insurance company *Pacífico Peruano Suiza*, permitted Credicorp (Romero) to cancel its heavy liabilities (Orozco, August 10th, 2002).

In sum, for the first time, domestic groups included foreign capital in their strategies. They were not simply undergoing foreign rule however, but much rather taking advantage of the interest Backus had brought externally. Later, with the disagreements within Backus, additional groups were let in by the remaining domestic groups, again with substantial financial gains for them. The short length of time between the two transactions in the summer 2002 was bewildering, and Polar's accusation of an arrangement between the two foreign groups seemed defendable. As to both domestic families involved, Bentín and Brescia, it is apparent that their respective decisions to sell were connected. In any case, it seems that the impetus to ownership restructuring was coming from within.

[227] The intrusion of the Chilean company was possibly perceived as an early attempt for a hostile takeover. Moreover, the Luksic group was entering the Peruvian market through other bias, notably with the pasta company *Lucchetti*, challenging Alicorp and perhaps indisposing Romero. Yet at the same time, Romero and Luksic could have arranged a trade-off. Another non-economic consideration is the image that the entry of the Chileans could convey to the company. Indeed, a lost war, even though long gone, and more recent rivalries have kept some resentment alive in both countries.

The shift from a national to a transnational[228] space

Meanwhile, in this quickly evolving world regional reorganisation of the beer industry, Backus' takeover had not only been strategic to foreign companies for its own sake. Peru, as a national space, turned out to become the battlefield of a quarrel that had started elsewhere, and whose scope was well beyond its beer market, respectively, its borders. Indeed, the Polar and Cisneros groups, both Venezuelans, which had been in conflict in their national economy, internationalised their hostility after their legal battle was settled at home by the indigenous supervisory body for competition. Through their companies, both shared the beer market in Venezuela, with 75 and 25 per cent respectively (Class & Asociados, 2003). In Columbia on the other hand, Cisneros and Bavaria were partners in various industries and drew on the same investment bank (Dávila, 2002)[229]. Thus, coalitions, negotiations and feuds may occur at the transnational level.

Looking at the Peruvian market only, the situation seems to have crystallised in a national monopoly owned by foreign groups. But the Backus story is meant to evolve still, with extended boundaries. In July 2003, grupo Bavaria acquired, through one of its subsidiaries, the *Latin Development Corporation*, 100 per cent of Backus shares from two companies, thus increasing their direct and indirect participation in Backus Class A shares to 73.7 per cent. Even though Bavaria is already the undeniable leader of the Peruvian beer market, it is still seeking to fortify its position with regard to its role on Latin American markets and beyond. At the end of 2003, grupo Bavaria ranked 11th beer producing company in the world and 3rd of the sub-continent[230]. In its home market, Columbia, it controlled 98 per cent of the market, 95 per cent in Ecuador, 80 per cent in Panama and 99 per cent in Peru[231] (Class & Asociados, 2003).

[228] In the case of the beer industry, considering groups or firms as being transnational is fair since they act in an integrated way covering several national spaces. In terms of production and consumption however, industry and markets remain broadly national: Beer is still produced in Peru, mainly for Peruvians.

[229] International links do not only exist between firms, they also exist at a personal level. For example, the ex-president of the assembly of ministers, and today Peru's ambassador to Washington D.C., is a friend of Bavaria's owner, and was to assume the presidency of the company's board.

[230] Bavaria is a diversified group too, leader of over 20 companies, and is notably present in the flight industry as well as in telecommunication and media sectors (Américaeconomía, August 2nd, 2001).

[231] In Peru, Backus brewed 81 per cent of the Peruvian beer, the rest was produced by Cervesur and San Juan, the two subsidiaries acquired before Bavaria's entry on the market. A residual share of the market remained for a few imported brands of beer from Germany (Dressler and Holsten), Mexico (Corona) and The Netherlands (Heineken).

The tumultuous scenario on the Peruvian beer market was, in 2002, surely the most intense in the whole region, yet the battle occurred in a regional context which needs to be analysed as such. The schemes of the groups and companies involved were carried out on an extra-national background. The fierce competition in Peru helped to remodel the industrial panorama of beer production in South America: Two major groups internationally embedded subsisted – Ambev in Brazil, Argentina (where it acquired the domestic leader, Quilmes) and Paraguay, and Bavaria in the four above-mentioned countries as well as two in their respective home markets: Luksic in Chile and Polar in Venezuela (after their failed attempt to conquer the Peruvian market). While options seem to vanish as do relevant actors, regional markets are but far from being stable. Ambev's aggressive expansion continues in Guatemala (with Pepsi) and with a little foothold it will probably pile into Venezuela. Cisneros, comparatively smaller in the beer sector, might still be a valuable ally, which could however, at one point, sell (to Bavaria for instance) and invest in a different sector. Polar is in a similar position; it is a diversified group in the food industry. The deal with Bavaria meant a substantial increase of its assets, but expansion would necessarily imply an alliance (Revista Poder, March 3rd, 2003). Bavaria, on the other hand, remained with debts and the difficult strategic task to create synergies between its various monopolies, notably between Columbia and Peru. Ambev was also allured by the Peruvian market. In autumn 2003, the group entered the national beverages market and purchased two bottling companies, to act as a franchise for PepsiCo. This particular approach was part of Ambev's global strategy to acquire direct distribution in key areas and regions (Class & Asociados, 2003).

REGs (or for that matter, TNCs in general) do not play on single, isolated national sectors or markets. Rather, their global corporate goal combines at least two sorts of strategies, one aimed at the established political spaces, and the other coping with the firm's own organisational space, the latter usually overcoming the former. Hence focusing on one national sector or industry involves taking into account this upper, *extra*-national level, where competition continues, according to the regional groups' global strategies, out of the reach of purely national groups.

6.3.3 The effects of denationalisation on the Peruvian economy

The above example taken from the beer market underpins two important features linked to the shifts in ownership of production, or in other words, economic power. The first statement is derived from the observation made that domestic groups not merely endured

the foreign takeover, but that they actively endorsed the changes by attempting to integrate them in their respective strategies: The loss of ownership in Backus was a calculated move to strengthen the groups' businesses in other sectors.

This fact suggests that an approach by sectors to ownership redistribution neglects the broader, *trans-sectorial* reality of economic power in the Peruvian economy: Groups have stakes in various sectors – and some decisions are not taken at the level of companies anchored in a particular branch or sector, but according to the more general logic at the level of the group. Consequently, pulling out of a company might have multiple reasons, at the level of the firm, the sector or the group. In addition to family matters, a combination of different motivations can push a group to act in a way that will not be intelligible from a strictly sectorial perspective.

This affirmation, deducted from the Peruvian groups' behaviour, leads to the second, underlying lesson drawn from the foreign acquisition of the Peruvian beer industry: For the TNCs entering a particular economy, there is more at stake than the very ownership in the sector or the market shares: The issue is not just an isolated national market courted by different foreign companies for its own sake only, but is one of several platforms on which powerful regional groups – or *multilatinos*[232] - interact. Clearly, negotiations, alliances and feuds in other economies matter to the outcome on a given market. Hence, the choice of a TNC to be present in a particular country is connected to the transnational or global scope of the company. When several TNCs dominate a particular sector, such as in telecommunications or the beer industry, then we are in the presence of a *transnationalised* sector or market.

It can be pretended then that just as analysing individual sectors will not allow grasping the role of economic groups, the analysis of a singular market will not cover the actual progress of transactions between various actors. Particularly, due to the structure of regional economic groups, which may own companies in different sectors as well as in different countries, transnational as well as trans-sectorial approaches should be combined for the understanding of the dynamic choices of groups. Referring to the approaches to business introduced in Chapter Two, the *business-as-sector* and *business-as-firms* do not suffice to tackle the intricacy of business organisation and re-organisation of Latin American groups. *Business-as-capital* and *business-as-network* perspectives need to be considered for a holistic understanding of changes in ownership in Latin America.

[232] Américaeconomía August 2nd, 2001.

In Peru, the trans-sectorial approach reveals to be essential when looking at the composition of domestic business. As to the transnational aspect of business reorganisation however, big Peruvian groups have been "victims" of foreign groups' expansion. To Francisco Durand, who has been analysing the national groups for a while, there is no doubt that the big economic groups – Durand calls them *Apostles* due to their role in president García's vision of national industrialisation (1985–1990) – are being gradually displaced and stand for less and less economic weight in the Peruvian economy. Simultaneously, save for a few exceptions (notably in the Romero group), Peruvian groups have not achieved exporting themselves and participating in neighbouring markets, in order to become regional or transnational groups themselves.

In the country, a sectorial approach bolsters the displacement thesis overall, when looking at the sectors and industries that were in domestic hands a short time ago. The withdrawal of national capital is particularly meaningful in the industry of consumer goods – such as beer – where national icons have been bought up either by regional economic groups or transnational companies. *Nestlé* acquired *d'Onofrio*, the favourite local ice cream; *Coca-Cola*, failing for decades to establish itself as the leader of the *gaseosas* market, decided to buy its rival *Inca Kola*; *Proctor&Gamble* bought local cleaning products, while much-enjoyed cookies were purchased by Chileans. Similar to the Backus situation, most of these brands were competitive and of quality, and most importantly, belonged to many Peruvians' everyday life (Durand, 2002b).

When TNCs entered Peruvian markets, a high level of concentration already existed, and had been favoured by the reforms of the Fujimori government. Thus beyond the direct policy incentives put in place in traditionally export-led and service sectors (contracts of jurisdictional stability, fiscal exoneration), revamped and concentrated industries had become more attractive to foreign investors. It has been assessed that both through privatisation and F&As, foreign investment occurred primarily through total or partial acquisitions.

A study in the industrial sector has shown that on average, foreign investors acquired up to 90 per cent of the shares of a company. This underlines the scarcity of other, joint venture type of associations. The strategy often used was to take over successful market leaders and replace them with one's proper products or continue selling already profitable existing ones. In both cases, concentration was sought in order to increase economies of scale and reduce competition (Araoz, 2002, 42). In many cases, a majority of shares were owned by

one family or group, or, as in the case of Backus, by two or three business groups. Unlike corporate structures of firms from developed countries, Latin American companies have a structure based *on patrimonial corporate capitalism* (mentioned in Chapter Two), which facilitate drastic changes in ownership.

When comparing the privatisation process of the two public telecom companies with the Backus takeover, there is a perplexing similarity between the two fundamentally different transactions. The concentration of decision-making in the executive, respectively in a few groups, favoured dubious arrangements with the incoming transnationals. It could be argued that the high degree of political as well as economic concentration set the stage for informal and direct settlements on the fringe of institutional supervision, and this particularly in weighty business negotiations. In both cases, it appeared that regulation bodies had been requested to intervene without necessarily having the means to shed light over the intricacy of the deal and take adequate sanctions. Thus, in both cases, a lack of transparency was deplored in these major transactions, where state, domestic groups and TNCs contributed to change the face of the Peruvian economy.

What then does the weakening of the Peruvian groups – and in parallel, the rise of foreign enterprises – represent for the country? The inquiry made by the Universidad Pacífico (2002) mentions distrust about the national economic groups, apart from scepticism towards the state and its questionable decisions regarding economic development and support of national business. Among the interviewed personalities, there is the impression that wealthy families were more inclined to keep their money outside the country than investing it at home. Thus, while the application of the neoliberal economic model by Fujimori put the national groups in a difficult position, the latter were not perceived as trustworthy or willing to make the national economy work. The lack of vision and their reluctance to invest in a shaky economy was reinforced by their relative disadvantage with respect to foreign capital.

Yet although they may be criticised, domestic groups are better perceived than TNCs. As mentioned earlier, the fact that the latter have focused on consolidated and successful sectors and markets leaves the impression that they are not disposed to invest in new, underdeveloped industries or regions. Furthermore, TNCs tend to be less anchored in the economy, notably in terms of human resources: Today still, most managerial staff and executives are not Peruvians. Yet in the eyes of the interviewed personalities, the question

on *corporate social responsibility* did not make the national groups look much better than the TNCs.

An exception to this was Backus, which to some extent, stood for an exemplary company, "close to its workers" (O'Brien, 2002). Up to 2002, Backus symbolised the most successful business in the country and, unlike other national companies, was also devoted to Peru's economic development. As a result, the incursion of foreign capital combined with a major mediated scandal had a double impact on Peruvians: The takeover stood for the advanced deterioration of national economic power and the unstoppable globalisation draining the country of major economic decisions in general. But the lack of transparency of the transaction also troubled most, making people doubt about the company's healthy corporate politics. The credibility of the "Peruvian" firm once looked up to was clearly damaged.

Interestingly, our two study cases, TdP and Backus, both part of the exclusive group of the five biggest companies in the country, have had to face problems notably related to their workforce[233] – giving negative impressions about their corporate responsibility. To pretend that such problems would not have occurred if ownership had still been national would be farfetched. But these observations show that the deep overhaul from state to private, and from national to transnational ownership, has not resolved the country's problems, nor clearly changed the population's life for the better.

*

Almost 15 years after the beginning of the reforms, TNCs play an important role in the Peruvian economy. Fujimori managed, during his 10-year rule, to lure private foreign capital back into the country, an achievement that previous administrations had failed to accomplish since the military reforms initiated by Velasco. Even if often pictured as a nationalist and anti-imperialist, the general had always wanted to include key foreign companies in his quest for the *Peruvianisation* of the economy. In fact, in spite of an overall relatively adverse environment for TNCs, some of them have never discontinued their activities. Thus from today's perspective, transnational companies in Peru can be divided into two groups: The ones, such as SPCC, that arrived decades ago and stayed in

[233] In the case of TdP, 9.000 of 12.000 employees were laid off in the nineties. In 2002, further dismissals occurred, provoking important strikes and virulent reactions of unions. The International Confederation of Free Trade Unions called TdP's account a "globalisation horror story" (Labournet, 2002). As for Backus, owned by two of the largest Latin American groups, it faced important strikes early 2004 for dragging its feet regarding its workers' modest wage increases (Celiberti, 2004).

spite of difficult political and economic circumstances, and the ones that came in the nineties. While the former related to the traditional export-led sectors such as oil and mining, the comeback of TNCs, backed by REGs, translated into a major takeover in various sectors of the economy, but notably in telecommunications, finance and industry – absorbing state ownership and disrupting the national bourgeoisie which had settled in.

Synthesis

CHAPTER SEVEN: Final considerations and synthesis

The present research attempts to consider an intricate subject from a particular perspective. In Part I, our first chapter is concerned with defining a model of national economic power whose principal agents are subsequently focused on. State and business, as well as their interactions in the Latin American context, are the main topics of Chapter Two; Chapter Three introduces TNCs as economic entities bridging several national spaces. Part II of this study is dedicated to Peru's three agents of economic power which have been previously determined, namely state, business and TNCs. The approach chosen is, firstly, to analyse the nature and the role of the state in that particular country in Chapter Four, before paying attention to the Peruvian business community and its relation to political power in Chapter Five. Finally, the place of foreign companies, or TNCs, in the Peruvian context and its relationship with state and domestic business are put into light in Chapter Six. This last chapter is meant to bring the major findings and thoughts related to our research to the fore.

7.1 The model of economic power applied to Peru: a revision

As a reminder, the argument in Chapter One is that, in spite of theoretical discrepancies in economic thought, the concept of *economic power* could be accepted as such and used in a model of economic power. The model illustrates the main holders of this type of power in a particular economy, which would at one point be in autarky, and later connected to the world economy.

To start out with, a major statement can be made as to the validity of the model of economic power presented in the case of a national economy in autarky. Indeed, our study case, Peru, undoubtedly suggests that the evolution from the autarkic model of economic power to the model in an open economy is not directly applicable to this particular country, and not, we believe, to other Latin American countries either. To be sure, in Peru, the autarkic model does not reflect the advent of the country as a national entity. Actually, the political and economic circumstances experienced by this nation during most of its modern and contemporary history have brought about a different distribution of economic power than suggested by our autarkic model. Clearly, in spite of the creation of an independent nation-state nearly two hundred years ago, *extra*-national agents have

been economic as well as political determinants at all stages of the country's development.

In general, spasmodic changes in Latin American countries throughout the 20th century can be partly brought back to a double, internal and external pattern which shaped the political and economic course of the independent states in their making. Internally, the distinction between the agent of political power and the ones of economic power was, for a long time, rather blurry, the two spheres being intimately connected by groups of families which combined wealth concentration and political power. In this old order, the public and the private mingled (Durand, 2003, 37-38)[234]. As to the external factor, embodied by foreign companies, it played, early on and increasingly, a decisive role in the state's development pattern. The modification of our basic model represents both the internal and external relationships of the agents of economic power, with the oligarchy as the pivotal element (figure 11).

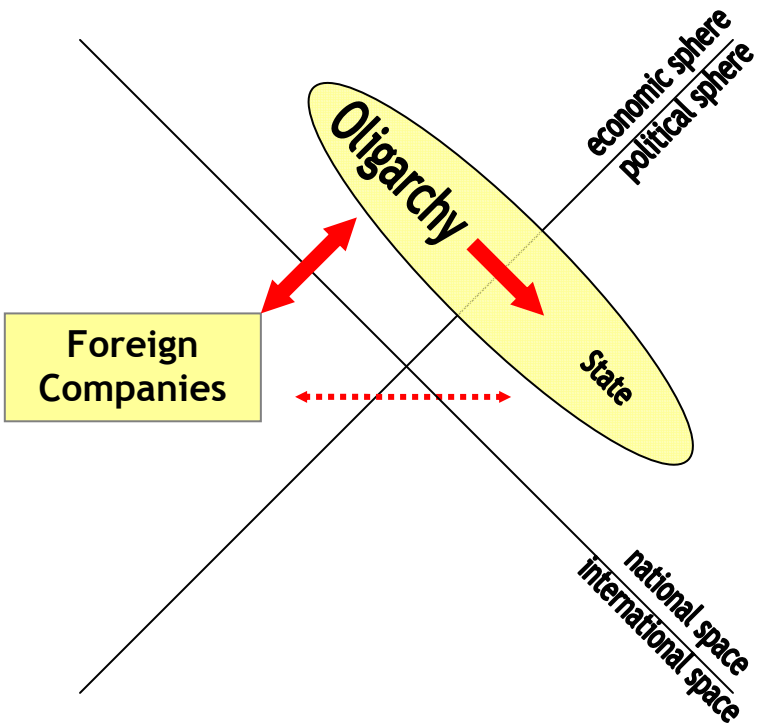

Figure 11: The Peruvian economy up to the fifties

[234] This stage of social structure corresponds, according to Durand, to *feudalism* and *monarchy* in Europe, and to *colonialism* and *oligarchy* in Latin America.

With the modernisation of the state, business and the political class separated, as positions in bureaucracy and government were increasingly filled by staff coming from a middle-class background. In Peru, the traditional pattern of economic power was gradually challenged by internal pressures in general and by the military in particular, which eventually took over in 1968. By breaking the links between the extra-national element and the oligarchy, as well as by undermining the latter's power, the military dictatorship contributed to disrupting the traditional informal connections between the public and private spheres. A new outline of relations between the three quadrants of our model established, and a redistribution of economic power occurred (figure 12).

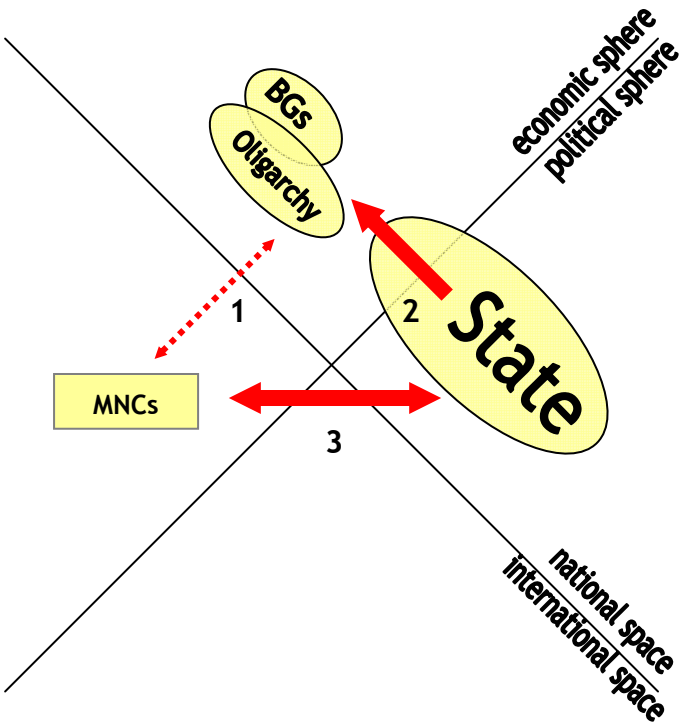

Figure 12: The Peruvianisation of the economy in the seventies

In this attempt to reverse the weak autonomy of the state vis-à-vis private interests, the state did not only reinforce its objective power in the political sphere, but marched into the economic sphere as an *entrepreneur* (see relation 2), acquiring economic power held previously by the landed oligarchy and foreign companies. The private ownership structure was reduced by means of expropriations and nationalisations, and the ties between foreign

companies and domestic business[235] weakened (1). At the same time, the state sought to establish joint ventures with a selection of multinational companies (3), which proved to be moderately successful[236].

In the end, the reversal of the trend of economic power in the Peruvian economy led to an emancipation of the state in terms of political power and to an internalisation, mainly through nationalisation, of economic development. In a way, economic and political power were again overlapping; this time however, it was the "public which dominated the private". The state had become the pivotal element.

The vacuum created by nationalisations and expropriations as well as the active support of the military government favoured the development of domestic industrialists in the Peruvian economy. But the creation of a dynamic national bourgeoisie committed to the economic development of the country was never really achieved, and within a few years, the state, forced to step in, faced insuperable obstacles in terms of debts and deficits towards external creditors.

It took Fujimori's accession to power and his neoliberal project to radically reform the system set up in the seventies. Even though successive administrations had gradually moved away from state-led development – with the exception of the García administration – and had attempted to establish liberal agendas, it is in 1990 only that drastic reforms gave a clear impetus to a new distribution of economic power (figure 13).

Alongside with liberalisation, privatisation meant the transfer of most public enterprises to the private sector, and mostly to foreign companies (relation 3). The latter penetrated the national private sphere more and more as well, acquiring shares of Peruvian businesses towards the end of the decade (relation 1). In this context, two sorts of foreign private agents can be distinguished: TNCs and regional economic groups (REGs). In this new configuration of economic power, they can be considered today's pivotal element of the Peruvian economy.

[235] BG stands for the emerging industrial business groups. The overlapping ovals indicate a certain congruence between the old oligarchy and the new bourgeoisie.
[236] In this context, at first Velasco attempted to favour European and Japanese investments over American FDI (UNMSM, 1997).

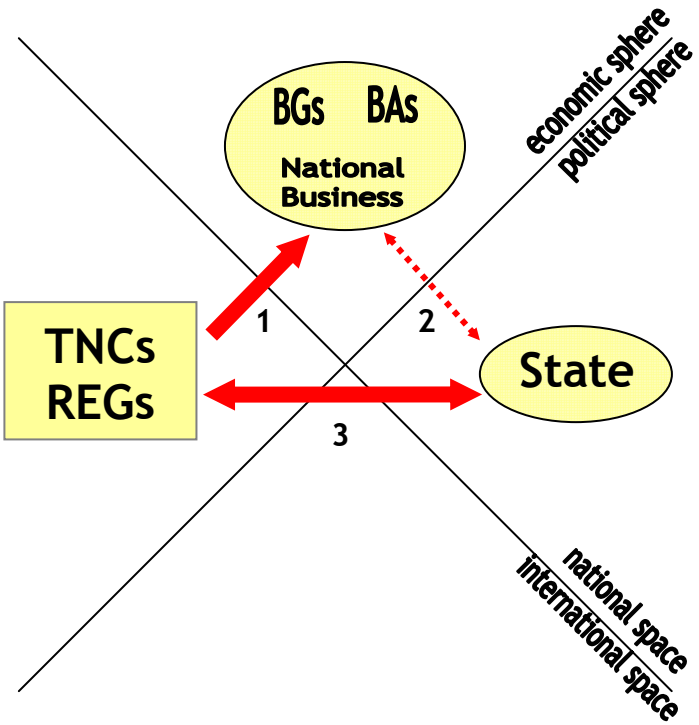

Figure 13: The Transnationalisation of the economy in the nineties

By and large satisfied with Fujimori's policy-making, national business did not have direct access to the *state manager* (relation 2). The president did not principally count on strong coalitions with the local business elite, but clearly sought connections beyond the national space, mainly to get public and private international capital to enter the country.

During the 1970 to 1990 period, some domestic industrialisation occurred and the industrial bourgeoisie developed, which was mainly expressed through the consolidation of domestic business groups (BGs) with diversified holdings – called the twelve apostles at their crowning moment - and the concentration of economic power. In the wake of the military dictatorship, new forms of interest groups were developing. Among more traditional sectorial business associations (BAs), an umbrella organisation was gradually taking shape. In the late eighties, this Peruvian peak business association even played a decisive role in preserving the property rights of the private sphere against an assault of the García administration. Under Fujimori, both national economic groups and business associations saw their position weakened.

Bearing in mind the fourth quadrant introduced in our model in Chapter One (figures 3 and 4), it is necessary to remember that due to the inconsistency and, eventually, the failure

of its development model, the military government increased its external borrowing. This gave the *international-political* agent a more important role and bound the country lastingly to other extra-national elements which differ in nature from TNCs. In spite of García's antagonism towards the IMF and his decision to suspend reimbursements in the mid-eighties, it was clear that the state, trapped in a spiral of debts which hooked it to international finance, would have to seek reconciliation and help from international organisations. Not surprisingly, from 1990 on it turned out to be one of Fujimori's prime goals.

This brief summary of Peru's evolution in terms of economic power suggests two ruptures which were followed by major restructurings of the relationships between the agents of the three quadrants considered. The first disruption meant a departure from the primary-export model towards an attempt at national industrialisation; this phase, induced by the military dictatorship, could be labelled *nationalisation* and *politisation* of the economy. The second transformation was a drastic change towards, simultaneously, the *economisation* of the political sphere, and the *transnationalisation* of the economy.

This transformation is still going on today, and represents our main focus in the next sub-chapters. First, a particular attention is given to the current business - state relationships, then to the domestic and transnational business relationships.

7.2 From Fujimori's to Toledo's relations with business

In Chapter Two, we argue that political and economic conditions are dependent upon the relations that business and state cultivate. The dynamic element of this premise suggests that the iterative process of interaction between the two agents is determinant for a country's evolution in terms of economic development and political orientation. This interaction is, in turn, contingent on business culture as well as statehood and statecraft. It has thus been our aim to tackle both agents in the Latin American context and in the Peru of the nineties in particular.

The application of a new economic doctrine by the Fujimori administration at the beginning of the nineties unfolded drastic changes in the private and public spheres on the one hand, while on the other it reinforced traditional traits in terms of economic and political governance, as shown in Chapter Four. In this sense, the neoliberal project,

possible only thanks to important disruptions to democratic principles, is in itself a witness to the state's weak political institutions. In fact, the project was clearly imbued with presidential centralism, expressed through authoritarian policy-making and a new form of populism. The political legitimacy of Fujimori was underpinned by an alliance with the military, whose leaders were connected directly to the executive.

Other national actors likely to influence policy-making, notably the ones within the state, did not have a stabilising effect on governmental decisions. Checks and balances were not guaranteed by congress and judiciary, while the public bureaucracy remained inefficient and corrupt even in the wake of the privatisation trend. Parties and with them labour unions lost their appeal among the population, and thus political leverage. Another important political voice, the media, was vulnerable to government manipulation (Morón & Sanborn, 2003).

Under these circumstances and in relation with the waning influence of the above-mentioned social actors, the relative political power of the private sphere grew. It appears that two entities were most liable to weigh on the policy-making process, namely *business associations* and *business groups*. As to the former, our considerations in Chapter Five clearly show the ephemeral and punctual role that even the peak business association played in the shaping of economic policy. While in the eighties, these associations were prompt to go public against the government under the influence of big business, they did not achieve anything important politically during the Fujimori decade. As for business associations representing sectorial interests, notably the ones of domestic industrialists, their questioning of the means and ends of policy-making remained rather flimsy and consensual.

Domestic business groups were, in fact, rather satisfied with the changes implemented by the government, even if direct access to the executive was not secured. In terms of economic power, the particular importance of some groups increased due to privatisation and the disappearance of others, and shifts occurred, as a few new groups emerged. But the Peruvian business structure was not given a face-lift, on the contrary: Existing trends of economic concentration were merely confirmed, if not reinforced. A main feature of such powerful *grupos* was, and has remained, family ties. This implies that, beyond being articulated by financial institutions, the groups are still controlled today by leading capitalist families. The "networking within power elite circles" is thus characterised by

informal interactions between the few key economic actors of Peruvian society (Ai Camp, 2002).

The double concentration, in the political and economic spheres, is of two different natures. Yet it has maintained and even amplified informal interactions also between the two spheres, in spite of the liberal economic reforms initiated by the Fujimori government within the state[237]. In this context, and particularly after his re-election in 1995, the government took definite steps towards a *cleptocratic* system, which was firmly established with the 1998 crisis, when excessive spending and generalised corruption were meant to secure the president with a third – unconstitutional – term in 2000. The political concentration within the executive, the MEF and the SIN (secret police), led to a mafia-type of network between the three entities. This network, led by Vladimiro Montesinos, had gangrened all sorts of agents with some degree of political and economic power in the country such as judges, media, leaders of economic groups and transnational companies.

Without entering into the analysis of the structure and procedures, or the making and the fall of these obscure alliances, which led to a multiplicity of articles in the press all around the world and called the attention of social scientists investigating on corruption, it is useful here to come back to the theoretical concepts relative to business - government relations in a country marked by strong inequalities. Indeed, the Peruvian case of cleptocracy is exceptional as to the extend of the phenomenon, but the premises which led the groundwork for such mafia-type structures can be found, more generally, in the fundamental discussion on the *collusive* or *collaborative* relationship between business and political elites exposed in Chapter Two.

Clearly, it is the type of interaction between the economic and political spheres that is essential, since it is at the interface of the public and private sectors that corruption occurs (Rose-Ackerman, 1996). The holders of economic and political power generate collaborative or positive links when there is a general climate of trust between the two spheres. In the context of collusion, particular interests of business groups and short-term arrangements with the executive prevail. The logic of such negative alliances is that business seeks to socialise private loss and privatise public resources (Durand, 2003, 43).

[237] To be sure, these considerations do not apply to standard procedures between say, medium size companies and some state office (which, incidentally, can be perfectly institutionalised or tainted by small-scale corruption).

It can be argued that such rent-seeking behaviour is favoured by a combination of various factors linked to the state, holder of the *political power*, including a lack of capacity, the misuse of discretionary powers within the government combined with the political instability generated by erratic policy-making. This type of *predatory* state, as argued by Peter Evans, will prevent the development of constructive networks, since "the best way of increasing the probability that networks will be growth-oriented is to have the public side of the network anchored in a Weberian democracy" (Evans, 1997, 71).

In the economic sphere, *economic power* represents the other important entry gate to understand the forces acting against the establishment of a truly market-oriented economy. Vested interests do not compete on the market to increase their economic power, or in other words, acquire their power through economic dynamism; rather, they attempt to establish themselves through the favours bargained with the government and protections offered by the state. Access to agents of political power is a rational option to circumvent uncertainty in market transactions and policy-making. Thus, the maintenance of the state apparatus in a predatory status is encouraged by the characteristics of business itself, as well as by its lack of legitimacy towards the masses:

> *If business had a relationship less distant and antagonistic with the ones from below, if economic power was more managerial than familial, more innovative than rent-oriented, more disseminated and less concentrated, and finally, if a greater national solidarity or unity existed between the classes [...] and less tribal and group solidarity, businessmen would suffer less from such decisions. There would be a greater necessity to control high concentration of [political] power*[238] (Durand, 2003, 78).

In other words, the fact that big business benefits directly from its relationship with the state and is protected by repressive policies against political opposition and social movements encourages it to support authoritarian regimes.

However, such regimes do not have a long-term vision and usually operate in a context of economic and political turbulence. Failing to apply policies systematically, to follow through with reforms, to build institutions and durable alliances, the state does not prepare the establishment of democratic structures. In fact, the discretionary capacity increases the propensity to make abrupt and isolated decisions which will affect business negatively. In the end these regimes collapse due to the abuse of their excessive powers,

generating further uncertainty, which again affects institutional development, and, eventually, economic development as well[239].

The fall of *Fujimorismo*, which incorporated neoliberalism and authoritarianism as well as a sophisticated mafia-type system of rents and corruption, represented a unique opportunity to re-establish democratic structures within the government. The provisory government, meant to run the state until elections in July 2001, was able to implement substantial changes within the state apparatus, notably by lessening the executive's power and balancing it out with the congress, and by restoring judicial credibility. A little later however, only one year after Alejandro Toledo's accession to the presidency, the democratic improvements looked rather bleak.

By the end of his third year in office, early scandals related to the presidency were confirmed[240]. It turned out that the administration had carried on with the government model applied by Fujimori. In terms of economic policy, the course chosen by Toledo was to keep following the liberal path, notably with the aim of resuming with the privatisation programme which had been stalling for several years. In spite of macroeconomic stability and some growth, urgent problems such as poverty and unemployment (which had been his spearheads during elections, alongside with democracy) had not improved and his ratings fell from 45 per cent at the beginning of his mandate to a mere 7 per cent in summer 2004. Fierce rejection of his privatisation programme and waves of strikes and protests against his labour policies, some violent, had increasingly been shaking the country.

Isolated from most social interest groups and in rupture with the population, Toledo has moved to the type of collusive relations and precarious alliances which have allowed him, so far, to stay in office. Under these circumstances, the president has not only failed to undermine the system put in place under Fujimori, but has resorted to similar procedures to establish himself, further nurturing the state's inefficiency: The pacts and arrangements with the elites have impeded the levying of taxes against them, failing to generate revenues for the state. This lack of revenues has to be compensated for, notably through attracting investors, who in turn count on rents and favours similar to the ones conceded

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[238] Translation by the author.

[239] In the Peruvian case, it is widely agreed that the Fujimori-Montesinos scandals widely affected the economy, notably by souring foreign investment.

[240] There were notably, the high salaries the cabinet administered to itself, the concession, in form of retroactive fiscal alleviation of 200 millions US$ given to an energy company (whose president was the minister of economy), the wire-pulling of Eliane Karp, the president's wife, and the appointment of family members (Arce Borja, 2002).

under the previous administration. At the same time, the burden of the state apparatus has moved downwards, pressuring the population with neoliberal policies and indirect taxation.

The continuation of the neoliberal orientation has perpetuated the model which only a small clique profit from, namely, within the government, the close collaborators and family members of the president, the remaining domestic economic groups and the TNCs. In this context, similar to the final period of Fujimori's reign only five years earlier, big business faces a paradox which leads to a confusion within their ranks. Being the direct beneficiaries of the economic policy shaped for their needs, economic groups feel, at the same time, uneasy towards the disastrous management of the state (Coronado, 2004). They are increasingly reluctant to support Toledo in a mounting political crisis which has shaken the government this past year.

In a succession of corruption and concession scandals, four ministers as well as the first vice-president resigned within a few months. Toledo himself has been repeatedly attacked for alleged fraudulent concessions and connected to corrupt practices involving family members[241]. Worse, links between a confidant of the president and the Fujimori-Montesinos mafias were discovered. These punctual scandals are perceived as the tip of the iceberg by a sceptical population and contribute to stir up opposition against the economic model as well as the political one, which in turn worries business leaders.

The solutions offered so far by the government to solve the political crisis have merely been the reshuffle of the cabinet. Within two years, there have been five changes in the ministries (Le Monde, February 21st, 2004). Moreover, the rotation has also implied the comeback of previously sacked technocrats and professionals, conferring a feeling of *déjà vu*, added to the one of instability. Projects are changed, plans abandoned with every new arrival, which also means a different perception and application of policies. The uncertainty as to the rules of the game further erodes the business' confidence in the legal

[241] The sister of the president was under the scrutiny of justice, since she presumably participated in the falsification of signatures, which in 1998 allowed Toledo's party to sign up for the presidential elections of 2000. Similar allegations have been formulated for the 2001 elections. At the same time, a major telecom concession allotted to a firm belonging to Pedro Toledo, the president's brother, was suspended due to several accusations of corruption (Swissinfo, July 21st, 2004).

dispositions and political institutions; investors commit to persons instead, reducing their immediate risks but also renouncing long-term development strategies[242].

At this point, it is unsure if or how Toledo will reach the end of his mandate in summer 2006. The only certainty is that in his three years in office he has failed to introduce some sort of democratic transition, including levelling out powers within the government and working on the state's institution building. In keeping alive both the political and economic system introduced during the Fujimori era, namely both an institutionally weak state and distorted markets, the ideal-type of capitalism combining democracy and competitive markets remains remote.

It is unclear for how much longer the neoliberal trend will last in Peru at a moment when Latin American states seem to gradually turn away from the neoliberal policies of the eighties and nineties. Yet it will take more than a comeback from the left, and with it, the potential return of an intrusive state, to resolve the deeper issues linked to the articulation of the public and the private spheres. Because, in the end, just as it is not possible to have a strong market system with a weak state, an institutionally strong state operating in a weak market is not conceivable. The weaknesses of both spheres, that is, the *doble baja institutionalidad*, needs to be considered all at once[243].

7.3 The transnationalisation of business in Peru

The second aspect examined in the present research is the dialectic between the national and extra-national spaces, in a context of growing and deepening world integration. The influence of the international and transnational over the national is an unavoidable debate, and even in seemingly strictly national issues, it appears that outer pressures, emanating from, notably, single powerful countries or multilateral organisations, cannot

[242] The solution of stability contracts between the government and investors has been applied, but represents only a mediocre substitute for real stability. Such conventions are, in fact, only a confession of the incapacity of the state, coupled with a compensation for it. These contracts contribute to favouritism, and accordingly, amount to market distortions. They also emphasise the excessive power in the executive. Thus, such formulas, often secretly conceded and maintained, underline once more the fact that some businesses survive thanks to special rules that depend on the proximity to political power rather than to its efficiency on the market (Durand, 2003, 542).

[243] Term used by Durand to express the double-sided aspect of the problem, namely a lack of institutionalisation both in the public and the private spheres. For Schneider and Maxfield, this problem had to be faced with, on the one hand a state with Weberian features, and on the other, an enhanced organisational capacity of business, leading to developmental organisations (1997, 25).

be denied: They represent decisive factors participating, directly or indirectly, in the shaping of nations' economic and political fate.

The traditional sort of outer influence is the one exerted by *states and their governments* towards other states and their governments. For instance, it appears that American policy after the fifties, evoked in Chapter Two, undeniably affected the economic and political course of all the countries of the region. It is worth mentioning however that this influence does not take shape through the formulation of foreign policy only. In fact, decision-making may be dealing with domestic policy, adopted to resolve internal issues (which were, possibly, induced by foreign events themselves) but affecting other economies. In the classical vision of the world order held by states, this issue was tackled in the concept of *double-edged diplomacy*[244], which expresses the fact that the domestic policy of a country can (purposefully or not) affect other states and international matters, or vice-versa.

The other more recent and commonly cited extra-national influence is of the supranational kind, involving the multilateral, or *world*, institutions. Instead of generating only punctual changes, the latter have had, particularly from the eighties on, the power to shape the course of developing nations, especially through international financial institutions. Haggard argues that from then on, international politics have moved from *shallow* integration – such as removing trade and investment barriers, to *deep* integration, which requires wider regulatory adjustments (Haggard, 1995, 4). These modifications do not only imply the adaptation of national rules to international standards, they also concern the change of institutions. In this context, debts and balance of payment crises push governments to open up to international financial markets and to turn away from inward-oriented developments, which have come with more and more costs in a context of increased financial integration.

The two above-mentioned instances remain the more traditional channels of international influence, emanating from the *political sphere*, and fall within the concept of international political bargaining – in other words, "conventional" diplomacy. But the combination of the national and extra-national distinction between the economic and political sphere model introduce a conceptual differentiation in the economic sphere between domestic and transnational business. Based on this model, the present research argues that, first, transnational business is more than a mere cross-border activity

[244] See Evans et al. (1993). The idea is mentioned in Chapter Three.

between national businesses, and second, new spaces have been shaped by *private transnational* entities, superposed on the traditional cutting up of states.

Acknowledging these entities in the international sphere, as suggested by the model of *triangular diplomacy*[245], underlines their role as global players, extending the meaning of diplomacy further than the political sphere. But beyond their international scope, we suggest that TNCs appear to be key players in the national spheres of the developing countries hosting them. Evidence of this predominant role within particular states can be derived from our theoretical definitions of business (Chapter Two), notably *the business-as-capital*, and *business-as-actors* distinctions. While the former presents the degree of ownership of a country's factors of production, the latter emphasises business - state relations, and differentiates foreign entities and domestic business.

In Latin America in general and in Fujimori's Peru of the nineties in particular, TNCs have played a double role in the liberalisation and privatisation of the economy, which could be perceived as two successive waves: First, foreign capital acquired state companies; later, TNCs mingled with a "purged" domestic business, principally by becoming major shareholders. *Ownership* is therefore characterised by a double shift from the public and private national agents towards private transnational ones. With ownership, it can only be assumed that the conditions of economic power in the Peruvian economy have been redefined. In order to grasp the actual weight of TNCs in the economy and on policy-making, it is of importance to illustrate its relative stance to, and its *relations* with, the domestic economic agents and governments in a context of changing internal coalitions. Indeed, "the arrival of transnational capital fosters new global alliances which replace the old ties" woven in a national space, and a redistribution of economic power occurs (Evans, 1997, 67).

As to domestic business, it can be argued that the weakening position of industrialists relatively to the standing of the export-led and financial sectors in CONFIEP, the encompassing business association seen in Chapter Five, is symptomatic of the orientation of business interests on the national level, in the context of a return to orthodoxy. With the decreasing weight of domestic capital, CONFIEP ceased to be an expression of economic power in general (Astuquipán, 2002). Owing to the increasing weight of domestic actors with foreign ties, the balance of economic power tilted in a more internationalist direction among local business, simultaneously widening the cleavage between various

[245] See Strange and Stopford (1991) in Chapter Three.

sectors[246]. The TNCs' presence reinforced the already transforming business coalitions in favour of the internationalisation and transnationalisation process of business, further deepening economic interdependence.

Governments as well see their autonomy as to macroeconomic policy reduced, due to the rising of capital mobility in a context of world-wide policy convergence. TNCs, in turn, are particularly favoured as to their relative influence in the process of trade and financial liberalisation (Milner & Keohane, 1996, 250-58). Internationalisation and transnationalisation increase the power of international mobile capital, since companies or sectors endowed with it have the opportunity to formulate threats of exit towards the government. Accordingly, TNCs see their leverage over economic policy enhanced.

At the same time, from the perspective of domestic business as well, the appeal of nationalist economic policies diminishes with the intensification of connections with transnational allies and the interest in international transactions. The business community is less ready to resolve problems at a national level and less willing to tolerate the level of state autonomy necessary to regulate high intensities of connectedness to the world economy (Evans, 1997, 82).

In Peru, the evolution towards an open economy has clearly had drastic effects on the internal coalitions between business and the government. The Fujimori administration purposefully oriented its policies so as to favour economic agents benefiting and fostering internationalisation, and particularly TNCs. In turn, leading national groups and TNCs backed the economic orientation taken by the Fujimori government. Liberalisation as well as privatisation were formulated to let the private transnational component re-conquer the national economic sphere: State property was taken over by large investors, such as consortiums of TNCs, neighbouring or Peruvian economic groups which shared the new holdings according to various forms of control. To be sure however, the association of foreign and domestic business took place under the leadership of the former. With the 1998 crisis, the already small core of TNCs and Peruvian economic groups transformed the national sphere into a place "without oligarchies nor bourgeoisie"[247], and a reinforced

[246] According to a Heckscher-Ohlin approach, the factors that gain and lose from the external changes form distinct political coalitions that mark the major political cleavages within an economy (Rogowski, 1989). Yet during Fujimori's rule, political opposition remained weak for most of the decade, and industrialists did not have a real possibility to defend their views politically.
[247] Translated from the Spanish: "*El Peru se convierte en un pais sin oligarquias ni grandes burguesias*" (Durand, 2003, 116).

leadership of foreign capital at the beginning of the 21st century was established (Durand, 2003, 115-16).

Save some notable exceptions, Peruvian business could not cope with the sudden shift from an overly sheltered environment to a liberal arena favouring big, and above all, foreign business. Particularly domestic industry, traditionally weak and underdeveloped, saw its state assistance disappear, and was at once confronted with the inherited difficult conditions of trade and production structure of the country. Looking back over a dozen years of neoliberal policy, it has been argued that economic policy had been adverse to the strengthening of domestic business - in fact, it had prevented, directly and indirectly, the creation of national capital and industrial activity, both necessary to any country's economic development[248]. To make matters worse, it is precisely in the sectors which do not involve value-added activities that TNCs have been particularly active (Gerbolini, 2002).

To a certain extent, international and transnational transactions are increasingly important in the world economy and no country can escape their effects. But as Milner and Keohane put it, the degree of openness also depends on national policy, while the impact of the world economy varies according to a particular country's factor endowments, group organisation, institutions and the leaders' political strategies. These produce specific reponses to the on-going internationalisation and transnationalisation (Milner & Keohane, 1996, 14). In Peru, the type of autocratic regime and the macroeconomic choice have produced a particular system of relations which has given external forces an exceptionally strong grasp on Peruvian economic and political power. International monetary organisations, governments of developing countries, TNCs and economic groups from neighbouring countries have linked national interests to international trade and financial flows.

While in the late nineties, Fujimori interrupted his privatisation programme due to growing social opposition, Toledo picked up where his predecessor had left off. He attempted to

[248] According to Gerbolini, the "neo-orthodox theorists" have favoured monopolistic and oligopolistic firms in the service and financial sectors as well as firms in the primary sector with a high comparative advantage, thinking that the promotion of the industrialisation process is not necessary. Yet, he argues, such activities are not only insufficient to develop an economy, they also prevent development: Indeed, due to the strong disparity of productivity, notably between the primary and the industrial sectors, the latter suffer from the overvalued currency relatively to its own reduced productivity. Under such circumstances the abrupt lowering of tariff barriers, for example, was a major mistake, helping to undermine any progress towards more value-added activities.

privatise the last important public enterprises, particularly in the energy sector. Again, antagonism towards his privatisation attempts was fierce and at times degenerated into social unrest. Meanwhile, the process of acquisition of domestic companies by foreign groups is continuing, further deepening economic concentration. While his accession to power – or rather the ousting of Fujimori – could have represented a unique opportunity to reverse this trend, in more than three years of presidency, Toledo has merely contributed to assert it: Markets lack efficiency and competitiveness and remain under the grip of monopolies and oligopolies.

But the persistence of the neoliberal model in Peru can be explained by the constellation of various evolutions: There was, first, a transformation of the structure of economic power, which involved its redistribution towards the private sector connected to the world economy. Second, the country's economic structure increasingly focused on TNCs, which displaced national business. Third, the state has been more and more dependent upon foreign capital, and has seen its autonomy towards foreign influences shrink. Finally, the weight of the globalisation bloc on the shaping of public policy-making and the diffusion of the capitalist structure has grown (Durand, 2003, 532).

These shifts of economic power, occurring between the various forces and affecting the economic course of the country, have established, away from any social debate, a sort of liberalism through profoundly anti-democratic channels. The results of the neoliberal era have increased scepticism towards an economic system where the most favoured sector is the primary export sector and where national business is weak and subordinated to foreign capital. This process was triggered by Furijmori and consolidated throughout his decade; but a real debate only surfaced under Toledo's presidency. More and more, opponents of economic liberalism are making themselves heard and social agents left aside by the neoliberal coalition wrestle to gain back their say in public policy-making.

In the meantime, signals in neighbouring countries seem to indicate a climatic change as to economic policy, a change that may indicate the end of the neoliberal era. Alternative ways are sought in Brazil, Argentina, Chile, Ecuador, Bolivia and, of course, in Venezuela, which, incidentally, would also imply a differentiated attitude towards the Bretton Woods institutions, the developed countries and the world's trade and financial markets (Die Weltwoche, February 2004). In Peru, it might just be a matter of time until strong voices claim another "swing of the pendulum".

But we suggest that today's Peru is pegged to the world economy in a deeper, and more complex way than in the late sixties. Thus while some ownership shifts could occur, and forces in the relationships between the different economic agents and the state somewhat redistributed – for example by preventing further transnationalisation and privatisation – it is doubtful that any government could or would attempt to reverse the trend of economic orthodoxy. The costs of economic heterodoxy and isolation would simply be immeasurable, both in economic and political terms.

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The two main subjects dealt with in our research, namely business - state relations and transnationalisation, are connected in an intricate way. Our aim was to show how both could hardly be addressed from an economic approach only. In this regard, we believe that changes in economic policy are unable, by themselves, to improve the deeper issues Latin American societies, and especially the Peruvian, are facing. The problem lays in the institutionalisation of both state and business, and the relations the various agents of economic power nurture.

As for the state, in order to promote a real economic survival, it would require a "deeper institutional reform [...], as well as a more inclusive and encompassing development coalition to move its economic policies forward". It will also need "to come to better terms with its domestic private sector" in general (Wise, 2002). In Peru, it is precisely the opposite that occurred. The large-scale corruption system established under Fujimori-Montesinos prevented not only the state from becoming more than a hollow democratic system, but it thwarted the private sector's development towards more accountability and responsibility. In a way, it is the conventional scenario of corruption, where rent-seeking business captures a weak and predatory state, only reversed (AAA, 2001).

Yet in any case, the mafia-type of relations could establish due to the existing double concentration in Peru. We suggest that as long as power in both political sphere and economic spheres remains concentrated, capture may occur both ways. A start could be to reassess the state's role in the economy, but more importantly, its governance structure needs reappraisal. The political system will have to turn away from a presidential democracy to become a participatory democracy, including voices of the Peruvian society long ignored. Some put forward the idea of a new start, leading the debate on the state's

institutions as far as the questioning of the country's constitution, written in 1993 to fit Fujimori's regime (Coronado, 2004).

As for TNCs, a sound economic policy will hardly be sufficient to lure them into the country, and, most crucially, make them behave like good corporate citizens once they have invested. It is clear that the Fujimori-Montesinos scandal generated uncertainty about the conditions of the country as a place where foreign investment could be comfortable. Yet simultaneously, TNCs have taken advantage, and are still doing so under Toledo, of the long-lasting weaknesses of the judiciary and regulation agencies[249]. While usually not directly part of the national business - state networks[250], TNCs have been given special treatment and favoured in their quest for alliances with domestic business groups[251]. The result is a dense network connecting groups and TNCs, which is only visible when researching on the composition of the shareholders and the executive boards of leading companies (Vásquez, 2000a).

While in the political system, a more encompassing democratic procedure is key, a greater accountability in inter-firm transactions and a better dispersion of ownership should be sought in the economic sphere. But TNCs accommodate to the *patrimonial concentration capitalism* traditional to Latin American family firms and groups to establish themselves, and public stock is rarely issued (Ai Camp, 2002, 55). Thanks to the concentrated economic structure favoured by neoliberalism, TNCs seek to achieve a high degree of concentration, which leads to oligopolistic and monopolistic structures of ownership of production and market shares. While interested in liberalisation in terms of labour policies and reduced taxes, they are not necessarily interested in the basic idea of a market economy, which means open and fair competition.

While in appearance, today's TNCs seem to have a hold on the Peruvian economy the way foreign companies did during the sixties, the situation reveals to be quite different. Their participation is more differentiated and their foothold more diffuse, as are their origins: The involvement of REGs in the process of transnationalisation underlines a trend almost

[249] The sale of Backus' shares to Bavaria, which implied CONASEV's intervention, seems to be a blatant example. Allegedly, two million US$ flowed into the presidential sphere to influence the agency's decision (Caretas, June 17th, 2004).
[250] TNCs "are generally not integrated into the encompassing business conglomerates, and usually keep a low profile in business associations. Moreover, expatriate managers circulate rapidly in and out of the country and are not embedded in either the local elite generally or in specific state business networks" (Schneider & Maxfield, 1997, 25).
[251] The participation of seven Peruvian groups in Telefónica's shares since 1998 is an example of the intensification of the concentration of economic power.

non-existent three decades ago. But most importantly, the acquired role of TNCs as main performers in the world economy's expansion has given them an influence that outreaches in many ways the one they had in the sixties or seventies. Backed by a "one-way only" world system, they contribute to transform national spaces by fusing them into regional or world-wide arenas.

But the subtlety of this integration of nations into the world system is its non-economic component. Today's TNCs contribute, with other, transnational organisations and institutions, to what has been quoted as globalisation; a social phenomenon including, yet going beyond the economic and political considerations dealt with in our research. In this context, countries are facing additional global players with great potential of influence on their national policies and their territory in general. Indeed, our model, if extended beyond our four quadrants, would include non-governmental organisations (NGOs) or other social movements (Teivainen, 2000b, 711) which take part in the integration of developing countries into the transnational networks contributing to the pluralism of *global governance* (Keohane & Nye, 2002, 214).

In developing countries, the retreat of the state from social commitment towards its population has given NGOs vast possibilities as to their intervention on a local level. They aim at responding to the urgent needs of the population by modestly improving their everyday lives, and stand in contrast to large-scale technocratic projects and policies. Yet these organisations, which come from developed countries for the most part, are financed with foreign money, and their local teams could be compared to subsidiaries, since often directed from headquarters located in Europe or North America. They too, and probably even more than TNCs, tend to spread their global scope on a local level (Favre, 1998, 78-80), and with it, their values and cultural traits. While technically not taking part in the national "economic power pie", some NGOs have developed into organisations almost powerful enough to influence economic and political decisions at all levels, national, international and transnational. Indeed, today, some are respected and even feared by TNCs, so much that these not only seek compromise, but adjust their behaviour abroad.

In Peru, a current example is all the stir about the exploration and exploitation of the Camisea gas fields, whose development threatened to be thwarted by NGOs. The colossal project is located deep in the Peruvian jungle, and Californian *Amazon Watch* managed, through its lobbying, to put off a major loan by the Inter-American Development Bank. Simultaneously, the Peruvian government and the developers were forced to take severe

precautions to move ahead with the drilling. The Economist cites Amazon Watch, which alleged that "the Camisea would enrich some of Mr Bush's closest corporate campaign contributors" (The Economist, August 9th, 2003). The British magazine concludes that lobbying had more to do with American domestic politics than with the interest of Peruvians. The conclusion is certainly straightforward. Yet to be sure, this example explicitly displays the reality of transnationalisation and developing countries: Peruvian business is absent from the massive project. An international financial organisation was meant to contribute to the financing. The TNC, or consortium, is American and faces fierce opposition by an American NGO.

Set on Peruvian territory, the debate hardly takes place in the Peruvian economic, political and social spheres. These are void since largely by-passed, for the issue has been *deterritorialised*[252], taken to an extra-national level. Domestic institutions, and particularly the state, *de facto* in power, remain with nearly no control and little influence over the transnational debate.

[252] Term used by Tevainen (2000b).

Conclusion

In this research on the relations that business and the state maintain in Latin America in general and in Peru in particular, two major ideas have been applied. The first objective was to consider the intersection of the private and public spheres by introducing the notion of economic power and raising questions as to the influences of the economic over the political, and vice-versa. The second approach was to embark upon the dialectic between national and transnational spaces, in a context of deepening world economic and political integration.

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The particularity of the model presented and embraced throughout this study revolves around these two levels on which the tripartite pattern of economic power is based. The relationships between state, domestic and foreign business find their actual significance when set in this double-axis perspective, since it combines two fundamental conceptual fields that together typify each agent and position them relatively to one another. The sequential distinction of economic and political spheres and of national and transnational spaces, as well as their superposition, are thus central to the analysis of the trilateral system of interaction.

The key lines of our reasoning, the interfaces between spheres and spaces, do not go without any methodological problems, notably when considering the broad but vague notion of the *transnational corporation*. Nonetheless, the model helped to stage and analyse the relations between the three major political and economic agents present in a given national space: Peru. What is more, driven by a dynamic perspective, the study looks into the evolution of the three relationships and with it, the changing relative role and position of each agent according to the temporal economic and political orientation.

Concretely, the time span considered in our study can be divided into three historical episodes in which major shifts of economic power occurred within the tripartite model: Two decisive political switches induced a reshuffling during which a pivotal agent of economic power was replaced. Up to the late sixties, it was the landed oligarchy which played this role when it was unseated by an intrusive state. The statist interlude lasted

until 1990, year when a clear change in Peru's political economy was kicked off in a time of economic and political turmoil.

This U-turn marks the start of the last period, the main focus of this research. Since then, the stabilisation and restructuration programme have delivered a policy framework which has promoted the comeback of the transnational component. With a receding public power and a scattered and heterogeneous domestic business elite, it became the de facto main element of economic power in the Peruvian economy. This qualitative analysis based on the tripartite model sustains thus the establishment of a double process composed of the *economisation* of the political sphere as well as of the *transnationalisation* of the national space over the last fifteen years in Peru.

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This double process is hardly unexpected, but the present analysis itself constitutes a significant exposure, as it uncovers the role of the domestic agents of economic power in this course. Taken in a broader perspective, this suggests that shifts of economic power towards transnational corporations are induced by external and internal circumstances: World political and economic changes as well as domestic ones favour the positioning of the foreign company as a key holder of economic power. While the influence of the former is commonly recognised, the latter is hardly ever acknowledged as such. Due to the intricacy and peculiarity of national realities the debate frequently deviates onto another level, in an attempt to unveil "global" explanations for principally "global" issues.

The transformation of transnational economic activity is, in this context, rightly chosen as an important entry gate to this matter: Studies on global strategies, on technological innovation and network models notably emphasise the multiplicity of the recourses at disposal of the transnational corporation to evolve internationally and today anchor itself locally in an overall *transnationally-friendly* atmosphere. Contrariwise, the range of national options appears to become thinner. Political and economic choices are narrowing down while international and transnational considerations are prevailing in the formulation of domestic policies of most medium and small size developing countries hooked to the world financial and economic platforms.

But while *extra-national* processes are central to the development of any country, they do not, on their own, enforce a universal course on individual states. The trilateral approach

applied in this research underlines the particular context, as well as the role and position of each component of the triangle of economic power and its active contribution to the shaping of the national reality. In Peru, it is apparent that the catastrophic internal economic and political environment prepared the radical switch of 1990 towards economic liberalisation. Subsequently, Fujimori's accession to power and the managerial-type of governance of his administration, the maintenance of an institutionally challenged state apparatus as well as the actions of a vulnerable domestic business concomitantly contributed to the *volte-face* of foreign presence and to shaping its entry and effect on the country.

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The liberal atmosphere and the redistribution of economic power altered the course of business and state relations and hoisted them beyond their up to then preponderantly national frame. But the attention of the state given to the attraction of the foreign element and the harmonisation of domestic policies to international standards on the economic front had no match on the political one. While the state was partially refashioned to let a liberal market economy develop, no institutional reforms meant to reinforce democracy were undertaken. On the contrary, the centralisation of political power was enhanced and consolidated in the hands of the executive. All at once, owing to increased competition and acquisition procedures in the economic sphere, economic power, too, clearly appears not only to have slithered away from domestic business, but also to have accelerated the process of economic concentration.

In this observation lies the critical point when dealing with the elites in Peru: The excessive concentration of both economic and political power set in an arrangement of relations marked by informality and often opaque practices. By extension, the distribution and connection of power and wealth in the canopy of Peruvian society addresses indirectly the issues related to that society's endemic social disparities: In the quest of understanding poverty in developing countries, it is frequently assumed that the fate of the poor and vulnerable has to be explored. So why not look into the rich and powerful to reach the same end, wondered Francisco Durand in discussion with the author. As surprising as it may appear, the attempt to decode the role of the agents of economic and political power of a country, their dynamics as well as the processes connecting them to the world economic and political system, can also be an entry gate to a better comprehension of the perpetuation of social inequalities and poverty.

Thus beyond its conceptual interest and its handling with political and economic, as well as national and transnational elites in a developing country, this study inherently deals with fundamental issues related to the understanding of the widespread systemic malfunctions of societies in the developing world.

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Appendix

Peruvian presidents since 1948[1]

Year	Head of State	Political orientation	Mode of acquiring power
1948 – 1956	**General Manuel A. Odría**	Conservative	*Coup d'état*
1956 – 1962	**Manuel Prado**	Conservative	partly controlled elections
1962 – 1963	*military junta*	*Moderately reformist*	*Coup d'état*
1963 – 1968	**Fernando Belaúnde Terry**	Moderately reformist	Free elections
1968 – 1975	**General Juan Velasco Alvarado**	Radical nationalist	*Coup d'état*
1975 – 1980	**General Francisco Morales Bermúdez**	"Neoliberal"	*Coup d'état*
1980 – 1985	**Fernando Belaúnde Terry**	"Neoliberal"	Free elections
1985 – 1990	**Alan García Perez**	Moderately reformist	Free elections
1990 – 1995	**Alberto Fujimori**	"Neoliberal"	Free elections
1995 – 2000	**Alberto Fujimori**	"Neoliberal"	Free elections
2000 – 2001	*transitional government*	*liberal democratic*	*Renunciation*
2001 - 2006	**Alejandro Toledo**	"Neoliberal"	Free elections

[1] Partly based on a representation by John Crabtree (1992, 15).