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Inequality in developed countries and Latin America: coordinated, liberal and hierarchical systems

Ben Ross Schneider and David Soskice

Abstract

The first half of this article explains the enduring disparities in inequality and welfare states across advanced economies in terms of varieties of capitalism and political systems. Where capitalism is coordinated, as in much of northern Europe, political systems are consensus-based with proportional representation (PR); consensus politics and coordinated capitalism reinforce each other in generating relatively low inequality and strong welfare states. Where capitalism is liberal – the Anglo-Saxon countries – political systems are competitive with majoritarian voting: mutual reinforcement of politics and capitalism generates relatively inegalitarian outcomes and safety-net welfare states. The second half of the article develops a model of hierarchical capitalism to show how this reinforces and is reinforced by a Latin American political system with majoritarian presidents and PR legislatures to generate high and persistent inequality and reduce development options.

Keywords: inequality; electoral system; varieties of capitalism; Latin America; diversified business groups; multinational corporations (MNCs); skills.

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Inequality in developed economies

With much discussion of inequality and welfare states, most of the analysis – as in this article – is at the national level. This is not because regional or local, or international, dimensions are unimportant, but because the key framework institutions (e.g. education system, political system, taxes, welfare state and the legal system) are still mainly nationally defined. International influences are of great importance; but they are best seen through the filter of, or interactions with, national institutions – even when they challenge those institutions. Of equally great importance are the structure, powers and areas of responsibility of regional and local government, but it is most illuminating to examine micro-developments within the national framework.

Two approaches, one economic, the other sociological, have dominated academic debate on inequality at the national level. The economic hypothesis was put forward by Meltzer and Richard in one of the most frequently cited articles of recent decades (Meltzer & Richard, 1981). Their model predicted that democratic institutions were biased towards equality on the grounds that the higher the inequality of incomes before taxes and transfers the greater would be the redistribution from rich to poor as a result of the political process. Here is why: voters with below-average income would gain from redistribution (at least if it took the form of a proportional income tax redistributed as a uniform benefit). The median voter has below average income – the consequence of a small number of rich and a much larger number of poorer voters. And the median voter is the decisive arbiter of government policies and so would be in favour of redistribution. Moreover the more unequal the initial distribution, the lower would be the median voter's income and therefore the higher the level of redistribution he or she would choose.

Figure 1 shows this is not the case. It measures income inequality (the pre-tax and transfer Gini coefficient of heads of household income for 25–65-year-olds) on the vertical and redistribution (percentage reduction in Gini coefficient post compared to pre taxes and transfers) on the horizontal axis. As can be seen, the data show the roughly opposite relationship to that predicted by the Meltzer-Richard model. The most inegalitarian economies, the United States and the UK, have low redistribution, while egalitarian countries, notably in Scandinavia, the Netherlands and Belgium, redistribute the most. The dashed ellipse contains what will be defined below as liberal and the continuous ellipse coordinated countries. Moreover, the more egalitarian the distribution of income in a country, the more egalitarian the distribution of educational competences, as shown in Figure 2. Here data from the OECD and Statistics Canada International Adult Literacy Surveys (OECD/Statistics-Canada, 2000) are portrayed.

The sociological hypothesis, power resources theory (PRT), argues that egalitarian outcomes are a consequence of the strength of the left politically

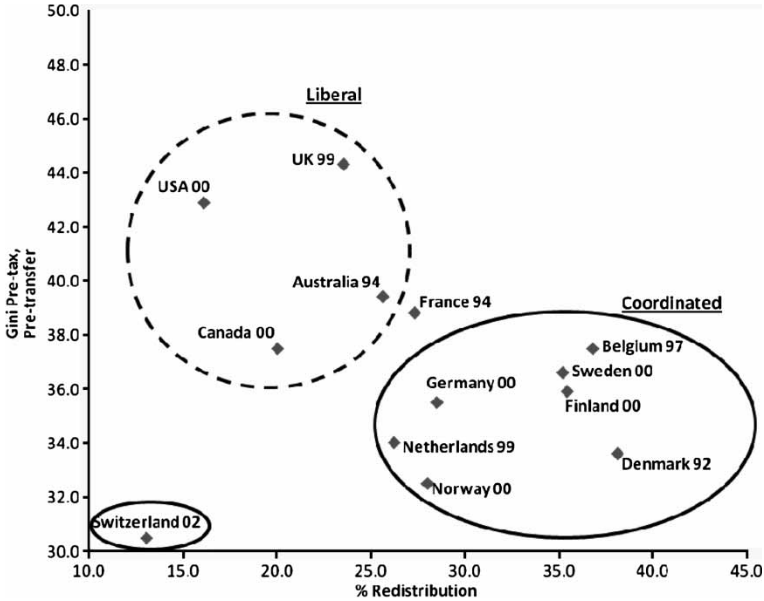

Figure 1 Market inequality and political redistribution in developed economies
Source: Luxembourg Income Study.
Note: Gini indices of private-sector income distribution pre-tax and transfer, and percentage redistribution, 25–59-year-old household heads, dates labelled.

and industrially (Esping-Andersen, 1990; Korpi, 1978, 2006; Korpi & Shalev, 1979; Rueschmeyer *et al.*, 1992; Stephens, 1979). The argument is that strong unions and centre-left governments lead to both egalitarian income distribution and to high redistribution. Esping-Andersen (1990) has further buttressed this approach with his classification of welfare states. While we have not included data on unionization or centre-left governments in Figure 1, it will be evident that PRT sits quite comfortably with it. By and large the egalitarian countries in the bottom right of the diagram have had both a relatively high proportion of centre-left governments and relatively strong unions, just as the reverse is true of those in the top left.

This article is sympathetic to PRT. But it goes further in seeking to explain why, in the current globalized world economy, some advanced countries should have retained effective industrial relations and centre-left governments. First, different *varieties of capitalism* (Hall & Soskice, 2001) can prosper in the globalized economy because companies located in them possess different *comparative institutional advantages* to compete successfully in different world markets: coordinated capitalism, as in much of northern Europe, benefits from cooperative employee relations and skilled workforces, which require effective long-term employee representation both at company and at sectoral level.

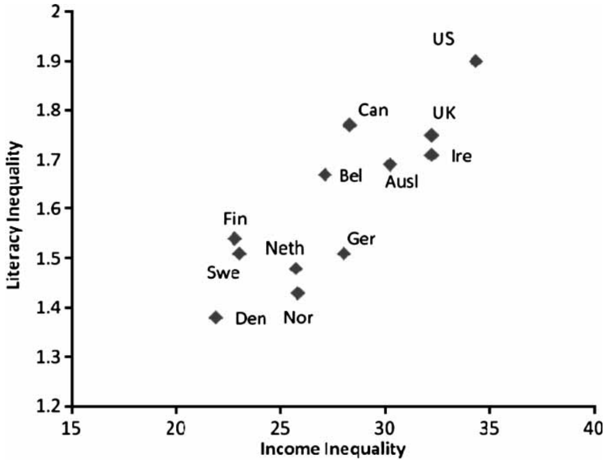

Figure 2 Economic inequality and educational inequality
Sources: International Adult Literacy Survey, 1994-98; OECD, *Trends in Income Distribution and Poverty in OECD Area*, 1999.
Notes: Relationship between economic inequality (Gini coefficient) and inequality in the distribution of literacy (9th decile/1st decile) within countries, prose scale 1994–98.

Union strength – at least in the traded sectors of the economy – is thus endogenous to a complex system of company–employee relations: effective representation is as important to management as it is to the workforce. In addition, because business and employees invest in co-specific skills, both business and the median voter accept the case for welfare state insurance to protect those investments over time (Estavez-Abe *et al.*, 2001; Iversen, 2005; Iversen & Soskice, 2001). By contrast, in liberal capitalism managers think unilateral control is most effective, so that employee representation, let alone unionization, is problematic.

The second argument lies in the difference between *political institutions*: political systems which are *consensus*-based (typically with proportional representation) embody *de facto* representation for groups to negotiate out change, and, as will be shown, these political systems have a structural centre-left bias (Iversen, 2005). The opposite is the case with majoritarian or competitive political systems. What is of particular interest is that consensus political systems, derived from a classification by Lijphart (1984), are almost co-extensive with coordinated systems of capitalism or coordinated market economies, CMEs, just as majoritarian political systems are almost coextensive with liberal market economies, LMEs (Hall & Soskice, 2001). If Esping-Andersen's (1990) classifications of social democratic and of conservative (or continental) welfare states are combined, that combined grouping is almost co-extensive with consensus political systems and CMEs; while there are important differences between the Scandinavian and continental welfare states, they are both relatively generous.[1] Each of these classifications,

Table 1 System classifications in OECD countries: varieties of capitalism, welfare states and political institutions

	Liberal (Anglo-Saxon): US, UK, Canada, Australia, New Zealand, Ireland	Coordinated (Northern European): Denmark, Finland, Norway, Sweden, Austria, Belgium, Netherlands, Germany, Switzerland
Variety of capitalism (Hall & Soskice)	Liberal market economies	Coordinated market economies
Welfare state (Esping-Andersen)	Safety net	Insurance plus redistribution
Political system (Lijphart)	Majoritarian	Consensus (PR)

Lijphart's classification of political systems into consensus and competitive, Hall and Soskice's classification of varieties of capitalism into coordinated and liberal and Esping-Andersen's classification of welfare states, was derived independently of the others; only recently has the mapping across the classifications become understood. Table 1 provides an *aide-mémoire*.

In what follows these central consequences – of political systems, on the one hand, and of production regimes, on the other – will be set out independently for the sake of clarity. Yet these two systems, political and capitalist, are tightly interwoven and have co-evolved, in two very different forms, over time.

Political systems

The nature of the political system is probably the single most important determinant of the partisan colour of government. Systems of proportional representation (consensus systems in Lijphart's terminology) are biased towards centre-left governments, while majoritarian systems are biased towards the centre-right. In addition, consensus systems, with coalition governments and 'representative' parties, give many different groups access to policy-making, and this permeates through to the way the bureaucracy works and the importance attached to the role of professionals (in education, social work, probation, etc.), contrasting with the autonomy of government over decision-making in majoritarian systems. We turn first to the partisan effects of electoral systems.

Table 2 shows the relationship between types of political system and the partisan colour of government (Cusack & Engelhardt, 2002; Iversen & Soskice, 2006). Governments are classified on a left–right scale of 1 to 5; in coalitions this is a weighted average of the government parties. The small number of pure centrist government years with a score of exactly 3 (mainly majoritarian

Table 2 Electoral system and number of years with left-of-centre and right-of-centre governments for seventeen developed countries (1945–98)

	Years of left-of-centre government	Years of right-of-centre government	% right of centre government
Proportional representation	342 (8)	120 (1)	0.26
Majoritarian	86 (0)	256 (8)	0.75

Source: Iversen & Soskice (2006).

countries) are excluded from the table. As can be seen, nearly three-quarters of government years in proportional representation electoral systems have had left-of-centre governments; exactly the opposite is true of majoritarian electoral systems.[2] Electoral systems show a remarkable stability in advanced countries. In the nineteenth century all countries had majoritarian systems, and with one exception the countries which have PR today switched to PR in the first quarter of the twentieth century. The exception is New Zealand which switched in 1996: before switching it had nine years of Labour government since 1945, while since switching it has had three Labour governments in four parliaments.

An explanation for this partisan effect of electoral systems is put forward by Iversen and Soskice (2006). Imagine – in a highly simplified model – there are three classes in society, the wealthy, the middle classes and low-income groups. In majoritarian systems, Duverger's law holds that there will be only two major parties, centre-right and centre-left, competing for the middle-class vote. Although both parties will focus electorally on middle-class voters, a key element of the competition is that neither party has any means of committing to carry out their electoral promises once elected. Moreover the activists of neither party are motivated purely by concern for the middle class – the centre-left activists will often represent unions and low-income groups as centre-right activists represent the right. A major concern for the median voter is therefore that a centre-left government may shift left and a centre-right government shift right. Critically, it is argued, middle-class voters are more concerned by the consequences of a centre-left party moving left than of a centre-right party moving right: this is because the middle-class 'worst' fear of a left government is that it will raise taxes on the middle class and redistribute them to lower-income groups, while the 'worst' fear of a right government is that it will cut taxes and services, thus compensating the middle classes with private spending power. Other things (competence, Blair-type middle-class identification, etc.) being equal, the median voter will play it safe by voting for the centre-right party.

With proportional representation – again in this highly simplified manner – imagine that each class is represented by its 'own' political party. No one party has an overall majority of legislative seats at an election, so the centre party can choose to form a coalition with either the left or the right party. It will generally choose the left party, since a centre-left coalition can tax the rich while a centre-right party gains little from taxing the poor. Hence there will be a bias to centre-left coalitions. The centrist parties in the coalition ensure that the coalition will not move too far left, so middle-class voters have less to 'fear' from centre-left coalitions under PR.

This two-part argument is reinforced by differential participation: in majoritarian systems low-income groups have lower voting-participation rates than high-income voters, particularly with the decline of unions, but that is not the case to the same extent with proportional representation.[3] Low-income groups in LMEs from the 1980s on, in increasingly fragmented labour markets and excluded from employment-social networks, may have been pushed out of the stable social structures which appear to encourage voting. CMEs by contrast, with more organized labour markets as well as training systems, more extended unionization and more effective welfare states, have stronger and more stable social structures. We return later to the question of social structures.

The partisan effects of PR

With these provisos we can examine the effects of partisanship. Centre-left governments affect distribution and redistribution in three main ways, as shown in Figure 3. The primary effect is to increase redistribution and the effectiveness of welfare states, at least relative to the preferred position of the middle classes. The econometric evidence for this is strong (Iversen & Soskice,

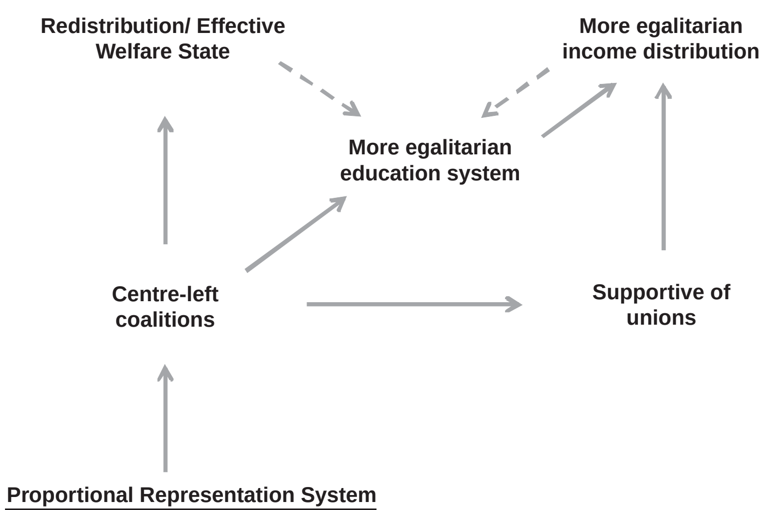

Figure 3 Proportional representation and partisan effects

2006). This effect is indicated by the vertical arrow above 'centre-left coalitions'. But centre-left governments also affect the underlying distribution of income, through creating a favourable environment for unions and through the education system. They create a favourable environment for unions through arrangements for collective bargaining in the public sector, as well as through a whole raft of legislative provisions. And it is well-established that the greater the union density the more equal is the distribution of earnings (Freeman, 1980; Wallerstein, 1999).

Less work has been done on the effect via the education system. Education performance at the bottom end is strikingly better in the coordinated/PR economies than in the liberal/majoritarian ones. But two different effects need to be disentangled. The first effect is the direct 'partisan' effect: centre-left governments, partially representing lower-income groups, are concerned to maintain the quality of education for children with low-income parents; this implies greater expenditure on those parts of the primary and secondary education systems which benefit low-income groups. (The previous discussion suggests that this effect is probably stronger in PR/CMEs than in majoritarian/LMEs.) It is indicated by the continuous north-east arrow in Figure 3 from centre-left coalitions to egalitarian educational distributions.

But there is a second indirect effect on the educational performance of low-income groups. This follows from income distribution and redistribution. There is also considerable evidence that parental resources influence educational performance: hence the more equal is the income net of taxes and transfers (income distribution after redistribution), the more equal will be educational performance. This is indicated by the dashed downward-sloping arrows in Figure 3. Both direct and indirect effects are important. Moreover in PR/CMEs these effects go in the same directions.

The partisan effects of majoritarian systems

Now we turn to look at the quite different effects with majoritarian systems. These are shown in Figure 4. The relentless need of the main parties in a majoritarian system to pursue the median voter, and the particular need of the centre-left party to downplay its low-income and union constituencies, has led in the post-Fordist world to an increasingly safety-net welfare state. This has been embodied in and amplified by the centre-right bias in governments. It has equally meant that educational policy, especially at secondary level, has been highly responsive to middle-class concerns over preparation for competitive access to good universities – granting greater autonomy to secondary schools and to parents. This does not imply that governments have been uninterested in raising standards for children from lower-income backgrounds, but policies designed to do so have often had low resource costs such as testing (children and sometimes teachers) and curriculum interventions; while much more study is needed, the available evidence does not point to successful outcomes.

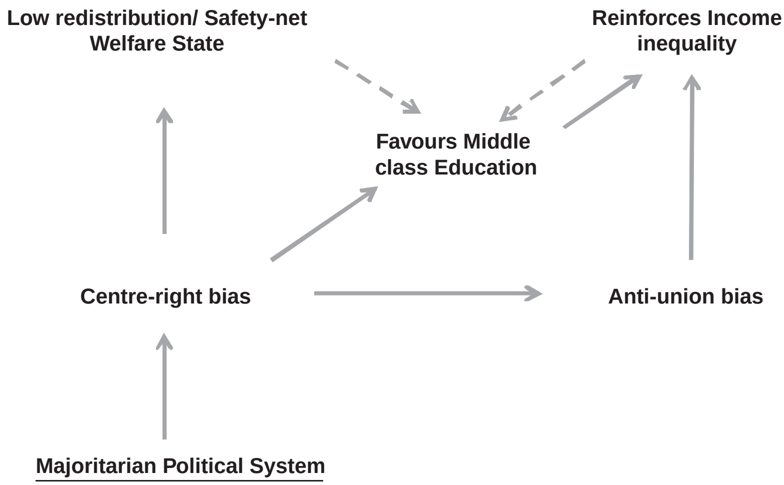

Figure 4 Majoritarian systems and partisan effects

Finally, in the post-Fordist period, liberal state governments, reinforced by their centre-right bias, have moved against unions. For this there are two reasons: a general belief that there was no politically feasible way to move towards a coordinated system with cooperative unions and strong vocational training (whether or not desirable) implied that a combination of flexible labour markets, effective general education and unilateral management control was the route to international competitiveness – and unions impeded progress along such a route. In addition, for reasons already spelt out, centre-left parties believed that strong unions reduced their credibility with the electorate. In both cases, governments had no brief to provide unions with a supportive environment.[4]

Systems of capitalism: coordinated capitalism

Coordinated capitalism reinforces consensus-based political systems in producing egalitarian outcomes and a strong welfare state, and vice versa. The issue on which this paper most diverges from power resources theory is in the analysis of capitalist systems. According to PRT, the first preference of business in coordinated economies is an environment of flexible non-unionized labour markets and safety-net welfare states, an LME-type system; business accepts unions, employee representation and effective welfare states as a second-best outcome, because unions and perhaps the state are sufficiently powerful to impose it. The argument here, by contrast, is that employers in coordinated economies prefer to cooperate in a range of areas with unions, notably covering skills and training, cooperation and to some extent co-management within the workplace and wage determination; given the depth of investments made by companies in skills, the need to give skilled workers and technicians responsibility and the power which this in principle gives their workforce to hold them up (in Williamsonian terms), long-term framework cooperation with unions is important. The institutions in coordinated market economies which make this possible give comparative institutional advantage to companies as they compete in world markets. It is these institutions in two of the world's most successful exporting nations that have allowed German and Swedish companies to dominate world markets where competitive success depends on skilled, cooperative and experienced workforces. Indeed of the major advanced economies Germany is the only one to have increased its share of world markets during the last decade despite the increase in the share of China and India. So increased globalization reinforces this institutional system rather than putting it under pressure. There is not necessarily a trade-off therefore between increased market openness and the relatively egalitarian distribution of market incomes in CMEs, which result from unionization and widespread collective bargaining. Moreover, there are implications for the welfare state: since businesses want workers to invest in specific skills and since this reduces their mobility across occupations if they become unemployed, the case for an insurance-based welfare state is accepted by employers. Where many highly-skilled employees have long tenure, it may be difficult for such workers to find appropriate new jobs if they are made redundant. Equally, if pensions are inadequate, it may be hard for older or retired workers with particular occupational skills to find work (other than at a very low level) because of the lack of occupations open to those without relevant occupational skills. Thus employers can see the case for adequate state pensions and unemployment benefits – even if they do not wish to see redistribution for its own sake as opposed to the need for insurance of specific human capital.

The varieties of capitalism (VoC) perspective on redistribution and the welfare state set out here is sometimes described as an 'employer-centred' approach (Korpi, 2006). This may be misleading. What is argued is that business organizations in CMEs support the existence of unions, co-determination and some measure of state insurance against unemployment and old age, in order that the system works from their perspective. This does not mean that they support the welfare state *per se*: they are, for example, opposed to redistribution beyond what is necessary for insurance purposes. As an argument against the approach here, Korpi (2006) cites evidence that Swedish business, though superficially friendly to the left in the 1930s, in fact provided funding to try and bring down the Social Democrat government. Yet this is quite consistent with our view of CME business strategy and motives: it makes perfect sense that business should object to the excessive redistribution for which they saw the Social Democrats as responsible. This paper is not painting a view of CME business as roll-over cuddly – far from it, as any historian of Swedish or German business knows.

At the same time, business has not sought to eliminate unions or erase the welfare state. We discuss the history of the different systems of capitalism and the welfare state briefly in the next section. But by and large the CME story is of powerfully coordinated business seeking to centralize national unions so that they could discipline local unions. Indeed, a prerequisite for employers in coordinated economies has been that they are well organized and operate from a position of strength. It is a problem for power resource theory that business in coordinated economies is more strongly organized and coordinated than business in liberal economies. For, if business is more strongly organized, why have they had have no other choice than to accept the CME institutionalized environment?

Figure 5 summarizes diagrammatically how coordinated capitalism affects equality. Just as the nature of the political system impacts both on distribution and redistribution, so too does the variety of capitalism. Coordinated capitalism does so via two main routes. The first route is political and it has two components, via business and via middle-class voters. Business is coordinated and is thus a more effective political actor than if it were not: because it can discipline its members it can bargain with governments by being able to deliver on agreements; moreover, in so far as political involvement requires resources which individual businesses have little incentive to pay individually, there is a classic collective action problem which coordinated business can solve. Given the access of coordinated business to the political system, it is also, as we have just seen, supportive of the welfare state and redistribution: this is the case up to a precise point – where the insurance-based needs of protecting a skilled workforce with its perceived difficulties of

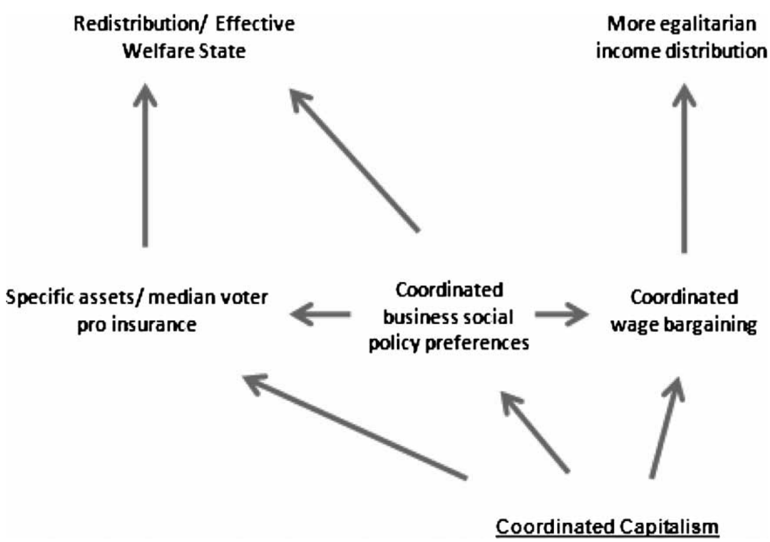

Figure 5 Coordinated capitalism, inequality and welfare states

moving across occupations and sometimes across companies within the same sector in the event of redundancy are met.

There is a second political route, via the median voter. Middle-class voters are also unlikely to want redistribution for its own sake, but since they are skilled employees with specific occupational skills they have the same concern about effective insurance that business has. This linkage is shown on the left-hand side of the diagram.

Finally, again as discussed above, business in CMEs needs widespread collective bargaining, and this implies a more egalitarian distribution of market incomes. This is shown on the right hand side of Figure 5.

Liberal capitalism

Next we turn to liberal economies. The corresponding diagram for liberal market economies is Figure 6. In this figure, liberal (uncoordinated) capitalism impacts both on the market distribution of income through labour markets and on redistribution and the welfare state through the preferences of middle-class voters and business on the political system. In all the liberal market economies, the period since the 1970s has seen the development of flexible labour markets, the substantial dismantling of collective bargaining

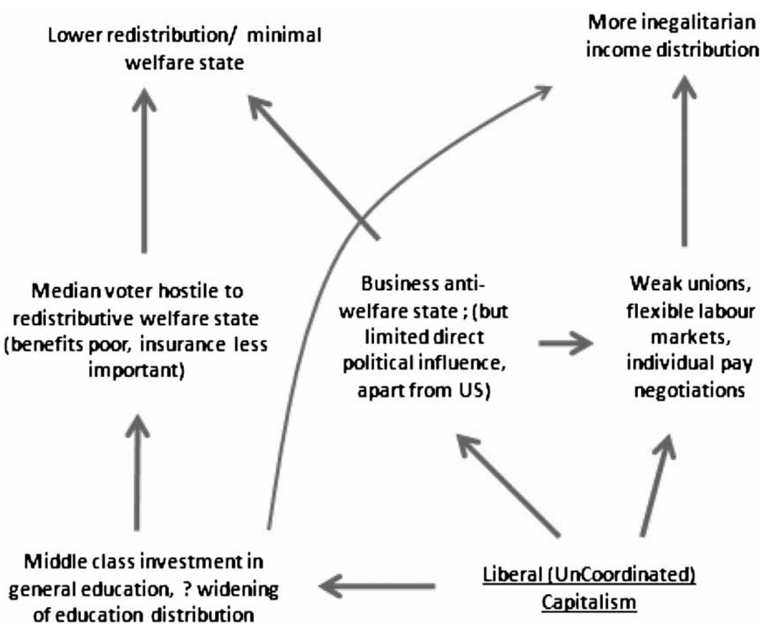

Figure 6 Liberal capitalism, inequality and welfare states

and effective unionization, the ending of most private sector-driven apprenticeship systems and a massive, largely middle-class, expansion of staying-on rates in secondary and increasingly higher education. It is, of course, still a matter of great debate what the complex drivers of these huge and conflictual changes were, and how they came about. From a VoC perspective they are best represented as a response, initially state-driven but increasingly reinforced by business needs, to the perceived need for international competitiveness in a post-Fordist environment of skill-biased technological change. What is clear is that companies have increasingly needed the ability to hire and fire at low cost in order to be competitive in product markets which required rapid movement both in search of profits and in avoidance of losses; the competitive upside of this has been an ability to take big risks in radical technological and organizational innovation; and the competitive downside a focus on low-cost standardized commodities and services. This has had a major implication for labour: it has meant a focus on general skills and competences which allow movement across companies. And a flexible labour market environment which rewards general education and general portable skills – just as it penalizes those with low educational attainments and competences – implies a greater middle-class concern for education. While there are no comparable data across LMEs, it seems likely that this concern has widened the distribution of educational outcomes, hence of the market distribution of income. Thus strong complementarities have emerged between flexible labour markets, companies with unilateral control by top management, employees with general skills and a widening distribution of income inequality.

These ways in which liberal capitalism has impacted on the market distribution of income are shown in Figure 6. Flexible labour markets worsen the distribution. This is reinforced by middle-class investment in the education system and the resulting inequality of education outcomes. And flexible labour markets and the focus on general education have been both driven by and drivers of the reconfiguration of companies.

The particular nature of liberal capitalism also shapes the interests of both the middle classes and business and hence their operation in the political system. This works in quite different ways than in coordinated economies. In liberal economies, the effect of flexible labour markets and the need for general portable skills has had a twofold effect on middle-class preferences on the welfare state. General skills mean that the median voter does not want a strong insurance-oriented welfare state. And, because of the high market inequality implied by flexible labour markets, the major concern of the median voter is that the recipients of welfare state benefits are the poor. This is amplified by the fact that the poor are more frequently out of work. Thus, in comparison with coordinated economies, lower-income groups benefit disproportionately from the welfare state. Hence the median voter under liberal capitalism, with no pressing need for insurance and opposed to redistribution, is hostile to the welfare state.

Equally for business: it has no interest in a protective environment for employees, since it neither wishes to nurture specific skills nor does it want to make unemployment more attractive and thus impede hiring and firing. So the interests of business under liberal capitalism are different from those of business in coordinated economies. There is a twist, however: because business is uncoordinated it has in general less political influence than in the coordinated world where business is better organized collectively. The only exception to that is in the US, as a result of its unusually decentralized political system.

Political systems and varieties of capitalism

What has been argued above is that the persistence of two clusters of advanced countries with relatively different levels of inequality and welfare protection is a consequence of conjunctions of the key institutions governing the operation of politics and the operation of capitalism. Consensus, PR-based political systems and coordinated market economies have together tended to produce more egalitarian countries with stronger welfare states; competitive, majoritarian political systems and liberal market economies have together led to less equality and weaker welfare states.

The key driver which has permitted the persistence of relatively egalitarian societies in the early twenty-first century is the comparative institutional advantage which coordinated capitalism brings to companies competing in that range of world and domestic markets for goods and services in which success requires experienced and cooperative workforces, with deep knowledge of company, occupational and/or sectoral products and technologies. Since globalization removes barriers to trade, it reinforces coordinated capitalism by increasing its comparative advantage.

Coordinated capitalism has in turn been reinforced in basic ways by consensus political systems. Two are most important. The first is education. If business is to be prepared to co-invest in training most of the workforce, then literacy and numeracy need to be relatively high even for children from less advantaged backgrounds. As has been argued, that is easier in a PR system which pays attention to the interests of lower-income groups than in a majoritarian system where the political focus is on the middle class. Further mutual reinforcement takes place as a result of the egalitarian bias of the coordinated economies: because of an egalitarian market income distribution, reinforced by a strong welfare state and redistribution, the extent of child poverty is much more limited, and, because of the egalitarian educational outcomes, the market distribution of incomes is more egalitarian.

The second way in which consensus political systems reinforce coordinated capitalism is equally important. Companies depend on a range of institutions (vocational training, labour market regulation, collective bargaining and employee representation, corporate governance, technology transfer and competition policy are probably the most important) whose rules need to be continually negotiated across industrial sectors, between different levels of business association, as well as between business associations and unions. But, as in any polity, the legislature and/or executive is ultimately sovereign, and the operation of these institutions is not of indifference to governments. Thus, for both companies and individuals who make deep long-term investments (in skills, products and technologies) which depend on the future existence of these CME institutions, it is important that they are politically underwritten in a way which gives a high degree of representivity to these groups. Proportional representation systems achieve this representation in two institutional ways. First, PR systems in CMEs tend to have parties organized on a representative basis, as opposed to the 'leadership' parties of majoritarian systems. The different societal or economic interest groups in CMEs with which parties are associated negotiate policies within their 'representative' party. Second, the legislative committee system in PR polities provides space for opposition parties to negotiate issues of importance with the governing coalition. This is a much more marked feature of PR than of majoritarian systems.

This provides an explanation of the coupling of coordinated capitalism with consensus political systems. Until the end of the First World War electoral systems were (more or less) majoritarian. In the ensuing decade, those countries which currently have PR switched from majoritarian to PR electoral systems. This coincided with the working class becoming an important political force as democracy was accepted and/or forced on most Western societies. In fact, the countries which switched to PR were countries which had had a long tradition of corporatist-style group representation, especially at local level (Crouch, 1994; Cusack *et al.*, 2007), typically but not always excluding unions. This is still an unclear area, but it seems likely that, while these countries had technically majoritarian electoral systems in the nineteenth century, their political systems were consensus-based at least as far as business interests were concerned and in particular at local and regional levels. Thus these interest-organized societies wanted an electoral system after the First World War which would preserve representivity. What is interesting is that there have no pressures to change to a majoritarian political system in any PR country (with the partial exception of Italy after the collapse of Christian Democracy). This is despite the fact that proportional representation seems to have favoured the left as far as redistribution is concerned, and that there has always been a majority in these legislatures of the centre and the right. This suggests that business has seen the advantages of representivity in PR systems as outweighing the redistributive costs.

Latin America: inequality in hierarchical political economies

In this section we attempt to explain levels of inequality and social welfare provision in Latin America. The focus is on the recent decades in which most

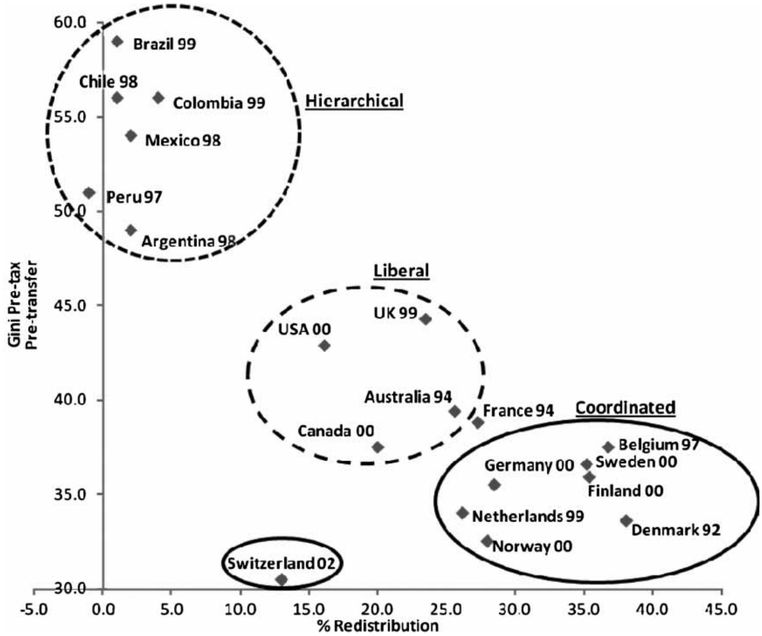

Figure 7 Market inequality and political redistribution in selected Latin American countries in comparison to developed countries
Sources: As in Figure 1 and Goñi *et al.*, 2008.

Latin American countries adopted democratic political institutions and more market-oriented development strategies. Specifically we want to try and understand why the main countries of Latin America have had persistently high inequality (Gini coefficients over 0.5 with the close exception of Argentina), why social security systems have been regressive and why expenditure on health and education has had insignificant effects on inequality. In doing so, we emphasize the type of explanation used in the first section, namely the interacting and reinforcing effects of the production regime (variety of capitalism) and the political system. Figure 7 reproduces the LME and CME clusters from Figure 1 to highlight the contrast with Latin America where levels of inequality are much higher and where redistribution through the government is minimal.

Despite the shifts away from import-substituting industrialization (ISI) and authoritarian rule, neither of the two advanced country models (liberal or coordinated) fits Latin American political economies. In this section we make use of a model of an ideal–typical Latin American production regime or variety of capitalism, a hierarchical market economy (HME).[5] This is supplemented by a model of the political system common to many Latin American countries, which also has many hierarchical characteristics.

This framework methodology is focused on the national political economy in an international context. It is useful to think of the national–international as a two-way relationship. One does not have to be a profound observer to see that changes in the international regulatory environment or international institutions or markets or multinational corporations (MNCs) have not reduced states to night-watchmen. While some pressures for the raft of ‘liberalizing’ measures introduced in many countries in the last two or so decades – central bank independence and fiscal constraint, labour and capital market liberalization, privatization, free trade and so on – have come from conditionality by IFIs or other external pressures, they have also been choices of national actors, including governments. As stressed in the first section, national environments have generated different solutions to the complex of conflicts associated with the collapse of the political economic regimes of the post-war period and the end of the *trente glorieuses*. In Latin American countries as well, national governments had their own motivations, as had their allies in the business community, for accepting liberal rules – at least within certain limits (Kingstone, 1999; Schamis, 1999). Thus the focus is national, but the solutions which governments developed in the 1980s and 1990s make sense only within an international environment (Hirst & Thompson, 1999).

The paper does not deal with the transition from authoritarianism and ISI to a more liberal political economy. In both the last section and in this the analysis is on understanding how national political economies work currently – *après le deluge*. Just as LMEs are discussed after the onslaught of Thatcherism, so the HME model sketched in this section is one of a world in which many elements of market reform, including privatization, trade liberalization and freer capital mobility, have already been imposed. This HME model is very different from the liberal model of the advanced world. To understand why it is different requires an understanding of the earlier political economies of the major Latin American countries and their transitions. But the concern in this article is to see how the different parts of the current model fit together – why, however limited the model may be in its potential both for economic development and for equality, it may be sustainable in the global economy and arguably difficult to change.

We begin by setting out the HME and understanding its direct effect on inequality, then turn to the Latin American political system and how it reinforces and is reinforced by the HME.

Hierarchical market economy (HME)

We start with the production regime or variety of capitalism, setting out the HME model. There are some similarities between HMEs and LMEs as far as labour markets and to some extent education and training are concerned.[6] Table 3 provides some comparisons of median trends in labour markets in LMEs, CMEs and HMEs.

Table 3 Varieties of labour markets: median trends in LMEs, CMEs and HMEs

		LMEs	HMEs	CMEs
Labour representation	Union density (percentage)	28	15	45
	Shopfloor coordination	No	No	Yes
Labour-market regulation	Botero *et al.* index	0.33	0.53	0.51
Job tenure	Median years	5.0	3.0	7.4
Informal economy	Percentage of GDP	13	40	17
Skills	Average years of schooling	11	5.7	9.9

Source: Schneider & Karcher, 2008.

Labour market regulation

The labour market is segmented with a small share of workers – core workers in the public sector and large firms – that have long tenure, union representation and significant legal protection. However, for most workers, labour markets overall are broadly flexible in the sense that employers have unilateral management control over hiring and firing, work organization and wage-setting. Much of the workforce has low skills and relatively general skills. Tenure rates are low, significantly lower even than in LMEs. Only a small proportion of the labour force is unionized and unions are non-existent in the large proportion of labour markets which are 'informal'. Although formal-sector employment provides access to welfare benefits and to the protection of labour market regulation, the 'effect is diluted by high rates of evasion and noncompliance' (IDB, 2003, p. 203). But the divide between formal and informal is not absolute, with some relatively high-level informal-sector employment and significant transit between the two before a worker ends up with a stable job in the formal sector, and there are substantial grey areas especially where self-employment is concerned.

Even in those formal sectors of the economy which are semi-unionized – including the public sector – unions operate through the political system to maintain labour market regulation and collective bargaining. Indeed, in the few areas, such as public education, in which unions can operate effectively within establishments this results from their strong political position. In part because unions are weak, employer associations tend to have a limited role in most sectors of the economy (Schneider, 2004). We will see that all these features are reinforced by the operation of dominant companies. There is certainly a spectrum of the quality of employment, with a small proportion of good and stable careers in the public sector, in MNCs and in large domestic groups for those with higher education, but a large share of the workforce – with low or very low educational attainment – are in badly-paid, insecure jobs with no possibility of training.

Education and training

For a large proportion of the population education is at a very low level, instanced by the relatively small proportion of students who complete secondary education. Thus it is general as opposed to specific (or vocational), and for the majority limited and of low quality. The structure of education and training is determined by three factors: first and most important, the incentives thrown up by labour markets; second, the incentives to undertake specific training provided by businesses, employer associations and/or unions; and, third, the role of the political system nationally, regionally and locally. We will see that these determinants are interrelated, but we will leave the political determinants as far as possible until the next section.

The *first* major characteristic of the education and training system is that it focuses on the acquisition of general competences rather than specific skills, whether the latter are occupational or company-related. This goes right through the education system; the logic is the same as in LMEs and relates to labour market flexibility – both from the student/employee perspective and from that of business. If job tenure is short, it makes sense for employees to have competences which are useful in a wide range of activities, and for students to focus on acquiring them. Thus, even if training schemes are available, it may make little sense for workers or students to devote time investing in them rather than working.

There are indeed few effective schemes for the vocational training of less-educated young people, and even much-trumpeted attempts, notably in Chile, have had limited impact (Sehnbruch, 2006). Apart from lower-level tertiary education in basic computing, accountancy, English, etc., which are relatively general skills (and even then concern a small proportion of the workforce), and at university level in areas such as medicine, the law and civil engineering where there are relevant careers, vocational and technical training is unimportant. The major exception to this for less-educated workers is where companies can hold out credible employment prospects contingent on specific training: auto manufacture is one such area where MNCs require some level of skills even for assembly operations.[7]

To discuss this question further requires understanding the strategies of dominant MNCs and diversified business groups, and these are examined in the next subsection and in looking at complementarities. It will be seen that their strategies are not generally conducive to strong business or employer associations at sectoral level which can solve the collective actions associated with business involvement in training, including underwriting the quality of the training and penalizing the poaching of skilled workers.

The second major issue is the low level of general education for a large proportion of the population. In fact, there has been a slow and gradual rise in secondary completion rates in most Latin American countries, just as literacy and numeracy rates are gradually increasing. How are we to make sense of this, and why has progress not been more rapid?

In this production regime subsection, we focus just on the demand side of secondary education: why do not a larger proportion of children from low-income families choose to complete? A common view of the failure to complete secondary education (or to reject subsidized training) is that children or their families are ignorant of the rate of return on education or that their families have liquidity constraints – so that better information or access to low-cost borrowing or both would increase completion rates.[8] Disadvantaged children may lack information about rates of return and face credit constraints. But this is also an economist's marginalist argument which may neglect the underlying systemic reality. This systemic reality is that non-completing children may be behaving quite rationally, because they understand that secondary completion may have low returns to those outside the relevant social-employment networks and without the right cultural capital or that employment at the end of subsidized training may not exist as promised. High rates of return to secondary completion may then reflect the fact that only those who have the necessary cultural capital and social-employment contacts complete secondary education.

On the assumption that the problem is not ignorance or credit constraints, what is happening? In the first place there has been in many areas a very broad, slow-moving but positive trend towards increased absorption of young people in higher-quality service-sector employment.[9] This depends on overall positive economic growth and on the slow shift of demand towards services in which greater communication and education is required. As in the UK after the collapse of Fordism and with the impact of information technology on most areas of the service sector, the need for better-educated young people precipitated an increase in staying-on rates in secondary education. The speed at which such a transition can take place depends critically on the skills which are demanded. Differentiating services from industry, the requisite skills are not just literacy and numeracy, but also – because of the communicative nature of many services – social and cultural. But social and cultural skills are only partially provided by the education system. Instead, membership of the relevant social-employment network is necessary for the acquisition of the necessary social and cultural skills; and this is a long-term process. (Membership of the right networks is, of course, also useful for acquiring information about vacancies, as well as introductions to potential employers – this may give the employer an informal guarantee about the suitability of the background of a young person.)

As more young people become employed in the modern service sector, so relevant social-employment networks expand to those who were not previously in them. What happens is a slow process of the spreading-out of networks and cumulative acquisition of social skills. It is more likely to happen through family contacts than within the secondary school. Young people divide themselves socially within secondary schools. This is often reinforced by tracking systems within schools, with children from better-off backgrounds typically dominating top streams. Moreover, in much of Latin America the secondary school system is itself typically fragmented on class lines. The highest class barrier is between the large private school system (typically 10–20 per cent of enrolments and more in major cities), which caters to the top end of the income distribution, and the public system for lower-income families.[10]

Thus, as service-sector markets develop and want better-educated workers, the incentive to remain in secondary education rises. This accounts for the slow but steady rise in secondary completion as well as increasing literacy and numeracy. But this process is lubricated by social-employment networks and their gradual spreading-out. Yet, the more fragmented and stratified society is, the more slowly do networks expand, and therefore the less pressing is the demand for staying on at secondary school.

Finance, corporate governance, diversified business groups and MNCs

Big business is dominated by large domestic diversified business groups (almost all family-owned and frequently with ties to MNCs) and by mainly US-owned MNCs. MNC corporate governance in their home markets reflects largely LME diffused ownership, but their subsidiaries based in Latin America are hierarchically controlled and rarely listed on local stock exchanges. The wave of acquisitions since the 1990s, fuelled in part by the entry of MNCs, contributed to a decline in the number of listed firms on many exchanges, as buyers took their acquisitions private (Stallings, 2006). Similarly, some diversified business groups, also known as *grupos económicos* or *grupos*, are not listed on Latin American stock exchanges, but, when they are or when companies formally or informally part of a group are listed, there is almost always a single controlling shareholder. Thus LME-type diffused share ownership does not exist, save the occasional rare exception.

The prediction of the LME model, that financial globalization would imply diffuse shareholding and the end of block-held companies, is simply wrong in Latin America. Why is this? Standard arguments for block-holding do not work in the group context. The argument that block-holding is explained by the strength of left governments and unionization – requiring owners to stiffen the backbone of management (Roe, 2003) – carries little weight in the current Latin American context, given the extreme weakness of unionization within companies. Nor is another argument for CMEs – that the need for owner commitment to long-term patient capital to sustain long-term relationships with skilled employees requires identifiable block-holders – persuasive in a Latin American context of high labour market turnover and lack of company training (Franks & Mayer, 1990).

Indeed what is most notable about *grupos* is their hierarchical nature – the extent to which decision-making power is retained by family members and top managers who rarely have to engage with other stakeholders (Schneider, 2008b). The internal corporate governance of the groups allows little role for consultation with lower-level employees and none for codetermination. The group level, not the company level, is where important decisions about companies are taken. This is reinforced by the typically very large number of companies which are formally or informally directly controlled by a group. It is reinforced again by the degree of diversification of these companies across economic sectors. In a study of the five largest groups in each of eight Latin American countries, thirty-four of the forty groups were active in four or five of the five possible broad sectors – primary, manufacturing, construction, services and finance (Durand, 1996). And it is reinforced again by the absence of technological or market links across the companies of a particular group. These characteristics explain how strategic decisions about individual companies can be taken at group level without concern for positive or negative spillovers among companies, and groups can easily take decisions to dispose of companies or operations and to acquire new companies.

From a modern LME perspective there are in effect two puzzles. What accounts for this structure of corporate ownership? What accounts for catch-all conglomerates? Whether correctly or not, finance theory argues that, in the absence of spillovers, companies should be confined to particular areas and high-powered incentives given to their CEOs to maximize shareholder value. Given financial capital mobility and minority shareholder protections, we should expect to see diffused shareholding since block-holding in this situation implies risk with no gain (aside from a takeover environment). And stock markets, understanding this logic, impose a penalty on diversified groups or conglomerates.

Yet diversified business groups have dominated Latin American economies for at least the past fifty years (though their shapes and names have changed with some frequency). And in the last decades their dominance has increased in many countries. This is partly because they have been major beneficiaries of privatization, together and sometimes in partnership with MNCs, the shift to services and the commodity boom of the 2000s.

Clearly the families which own and control groups believe this is a profitable organizational structure. Why? The answer to this is one of the keys to understanding the political economy of Latin America, and lies in part in their privileged access to information and capital and in part in the symbiotic relationship between the groups and the political system (Schneider, 2008b). This is explained here and in more detail below in the discussion of the 'current' democratic political system. But, while the particular form it now takes is geared to the current political system and its mode of insertion into the international economy, this has always been the case in some form or other, despite major changes in both political regimes and development strategies.

In the current regime, despite liberalization of trade and capital movements, most political systems have neither initiated strong competition policies nor passed and implemented effective arms-length legislation on public contracts or regulating public utilities (see 'Intercompany relations' below). So, despite both democratization and the existence of a neo-liberal economic regime, many profitable opportunities for business are available within the political system.

Politicians in Latin American politics do not specialize (as in the United States) in particular industries. While 'spot transactions' with the political system doubtless occur, longer-term informal relationships with groups are preferable, in which the help, financial or otherwise, of the latter is available over time in many areas of activity and different geographic locations. The corporate governance of a family group is ideally set up to take advantage of this: while a group may not last for ever, it can make informal medium or long-term commitments because it can avoid being taken over. This is reinforced by the trust nature of family relationships. And the likelihood that a group will be of future use to a politician who cannot predict where he or she will need it is enhanced by the wide geographical and sectoral spread of a typical group's activities.[11]

Nor is it difficult to see that, if a major comparative advantage of the family group lies in the network of reciprocal relationships it can develop with the political system, it makes sense for the group to 'specialize' in diversification. Companies which do not have strong specific investments in technology or technical or marketing skills can still be highly profitable if their markets are protected or they leverage natural resource advantages. In the 1980s and 1990s many groups moved out of manufacturing and into naturally protected, non-tradable or service sectors (Schneider, 2008b) in order to be in sheltered markets. In particular highly profitable moves for groups have come from acquiring public assets via 'privileged' privatization, but profitability has been conditional on the absence of serious subsequent competition policy or regulation designed to push down prices rigorously. The case in Mexico of the fixed-line telephone monopoly Telmex and its buyer the Grupo Carso is one of the best-known examples. In these ways the corporate governance structure of groups has provided them with comparative institutional advantage in their symbiotic relationship with the political system. Their institutional advantage lies in privileged access to the political system; while power in the political system changes on a regular basis, their access affords business groups inside information on policy-making, opportunities to negotiate specific deals as policies shift and open channels to lobby for regulating competition in their markets in the non-traded sectors of the economy. The next subsection on the political system will offer an explanation of why it is open to this form of business permeation.

We have focused on groups in this discussion of corporate governance. MNCs have been the other main players in Latin America. Their corporate governance is quite different. MNCs, frequently North American-based, are typically organized as large LME companies on company–product rather than on diversified group lines. MNCs sometimes operate in alliance with groups, in effect exchanging the comparative advantage of the groups, political access, for the comparative advantage of the MNCs, access to technology and products: in both cases the relevant access remains under the control of the relevant party. What is difficult for LME MNCs to do is to build credible long-term relations with domestic actors, public or private, because managers are often short-term expatriates and because corporate headquarters makes major decisions on investments and strategy. As noted above, MNCs do sometimes make long-term investment in employee training, but only for the core workforce, which accounts for a decreasing proportion of total employment.

Intercompany relations: competition policy, associational activity and innovation systems

With a few exceptions, business associations do not have the capacity for strong self-governance at industry level because they have no power over the decisions which groups or MNCs take in relation to the companies they own in the relevant industry or sector. This is reinforced by union weakness within companies and hence at industry level – so business has no need to give compensating power to an associational interlocutor (Schneider, 2004). Thus, in contrast to the strong industry- or sectoral-level associational activity in CMEs, there are few effective employer associations and/or unions available to solve the collective action problems involved in creating public goods, most notably skills transferable within particular sectors or occupations, which require company involvement in training.

The lack of business self-governance at industry and sectoral level also rules out the type of industry innovation system common to CMEs, based on technical associations closely linked to different levels of the technical university system. These receive state funding but are typically run for business by business associations and the research community. This reflects, on the one hand, the refusal of companies to allow public authorities into plants while, on the other, the need to integrate company research and product and technology development into the innovation system. Business associations in CMEs have the confidence of business as well as the confidence of the state that they will use public money properly.

From this perspective, the HME innovation system is minimal even when broadly defined, and technology is largely imported from advanced economies, whether embodied in goods or equipment or software or organizations. R&D expenditures in Latin America have rarely exceeded 0.5 per cent of GDP and over three-quarters of that is public (Katz, 2001, p. 4). In most advanced LMEs, some proportion of large domestically-based companies are at the core of innovation systems, whether in manufacturing (e.g. pharmaceuticals, electronics) or services (finance, media, communications, retail, etc.), supplemented by small scientific companies usually linked to research universities. But few *grupos* have any incentive to undertake the risks of substantial research and development since they are not in innovation-driven export markets nor is product development crucial for success in the oligopolistic markets that the business groups dominate. This lack of market competition is then a key difference from LMEs. In addition, MNCs have little incentive to conduct research in Latin America, since it is generally more efficient for them to bring technology with them, as well as being easier to control. Finally, in LMEs, universities with strong research departments in the sciences have co-evolved with public or private scientific sectors to offer high-esteem careers to those who have been educated at these universities, so it is not difficult for science-based start-ups to prosper. In HMEs, in contrast, university graduates with the prospect of stable careers in the public sector or in business groups have few incentives to join risky start-ups.

One of the sharpest differences between LMEs and HMEs lies in the ineffectiveness of competition policies. As a World Bank working paper noted:

> competition policies are barely making their apearance, and rarely being taken seriously. . . . Competition policies in Latin America and the Caribbean are still in their infancy. . . . both in terms of countries having passed modern effective legislation and particularly in the extent of enforcement, even though many countries had laws going back a few decades. . . . Yet enforcement has been mostly absent. . . . even when there is [a specialised agency] the budget and resources are minimal and inadequate and dependent on executive branch largesse, and thus subject to political capture.
>
> (Guasch & Rajapatirana, 1998)

This weakness of competition policy further reinforces the symbiotic relations between the business groups and the political system, and encourages both the diversified structure and the block-holder control.

Implications of the HME production regime for inequality

There are four direct effects of HMEs on inequality:

Low collective bargaining coverage

The limited presence of unions and collective bargaining directly increases inequality for the reasons discussed in the first section on advanced countries. This is similar to the LME effect.

Large informal sectors

Besides lacking a collective contract, informal workers are also denied access to a range of protections and benefits. Informality is of course rampant among small firms, but some workers in large firms are also informal. In addition, large firms may tap into the informal sector through the increasing subcontracting and outsourcing of employment (*tercerización*).

Low class-integrated secondary education, cultural capital, flexible labour markets

This third effect has a parallel in LMEs – the logic is similar – but the effect is of a different order of magnitude in HMEs. Good employment in the service sector requires not just general education but also the right sort of social skills (sometimes called cultural capital). The less integrated the secondary education system between children from poor families and those from middle-income families, the more difficult it is for poor children to acquire social skills through secondary education. But, because the distribution of cultural capital is so unequal, middle-income parents are typically successful in preventing class integration – both via class-residential sorting and via the political system (see below). Thus the rate of return from secondary education may be correctly perceived by poor children as too low to justify it. So, the diminution of inequality via educational upgrading in HMEs can get stuck or move very slowly, the larger the starting gap in cultural capital.[12]

Lack of effective vocational training

Large-scale vocational training, in particular for industrial or technical employment, and carried out with substantial business involvement, may override the problem of cultural capital if it can credibly provide good employment, so that it would be worth the while of poorer children to complete it. Underlying this is an argument that cultural capital or social skills are less necessary in industrial employment than in employment in the service sector. But such vocational training seldom exists in HMEs: associational activity is not available to support it; and because of HMEs' market strategy it would not necessarily pay diversified business groups to switch to a skilled labour route even if skilled labour were available.

As far as training is concerned, MNCs can adopt two strategies. MNCs looking for markets or resources enter countries with little consideration of available skills. Lacking a pool of skilled workers to draw from, these MNCs tend to invest a lot in training a small core workforce. However, this training has limited repercussions for the labour market as a whole because of the small numbers involved and the ability of MNCs to thwart poaching in part by paying significantly higher wages. Other 'efficiency-seeking' MNCs in global production networks are looking for lower-cost labour. These MNCs raise a major question about the possibility of development through industrial upgrading for Latin America economies. As Berger has noted, initial enthusiasm by MNCs has waned as successful MNCs – with a need for rapid product change and a concomitant range of available skills – have moved operations from Latin America to China where 'full-skill portfolios' are available (Berger, 2006). Exceptions like Intel in Costa Rica serve to highlight the absence of similar upgrading elsewhere. Behind this is a market failure: it would pay efficiency-seeking MNCs to locate operations requiring skill upgrading in Latin America if technical skills were available in sufficient quantity – they do not because the skills are not available there but are available elsewhere; and it would pay students in Latin America to complete secondary education and invest in acquiring technical skills if the jobs were there – but they are now in China. This is a classic low-skills equilibrium trap which reinforces low wages in flexible labour markets because the demand by MNCs is for less skilled labour.

The political system: majoritarian presidentialism, PR legislature

A common element to most Latin American societies over recent decades is that they are electoral democracies. If a large proportion of society is relatively poor, why can they not correct income inequalities through the political system? This was after all the claim of Meltzer and Richard with which this article started. Countries in Latin America with longer traditions of democracy have reduced inequality as measured by lower Gini coefficients, but not by very much and not enough to bring them close to the least equal of the LMEs, the United States (Huber *et al.*, 2006). Huber *et al.* also show that social security systems are significantly regressive in their effect on inequality, though less so in countries with a democratic tradition, and expenditure on health and education is also regressive though insignificant. Put another way, most social welfare programmes do not benefit the poor, and, as Figure 7 shows, overall taxes and transfers have at best a marginal impact on inequality in most countries of Latin America.

Are there characteristic features of political systems in the region that impede redistribution? There are enough similarities in the political systems of the main democratic Latin American countries in the current democratic period to sketch out the two core elements of a model of political systems in Latin America:

1. Majoritarian presidentialism (necessarily majoritarian, though with different run-off procedures).
2. Proportional representation elections for the legislature [at least for lower houses, with only a few cases in recent decades of majority or mixed system elections (Golder, 2005)].

The presidency is endowed with unusually strong constitutional powers, including the ability to resort to decree legislation, but legislatures have a growing importance, especially where, as is often the case, the president's party is in a minority (Morgenstern & Nacif, 2002). While there are many other differences across the political systems of Latin America (party discipline, decentralization, number of legislative chambers and so on), the majoritarian presidency/proportional representation legislature (MP/PRL) model is a good starting point, especially since this combination is ubiquitous in Latin America

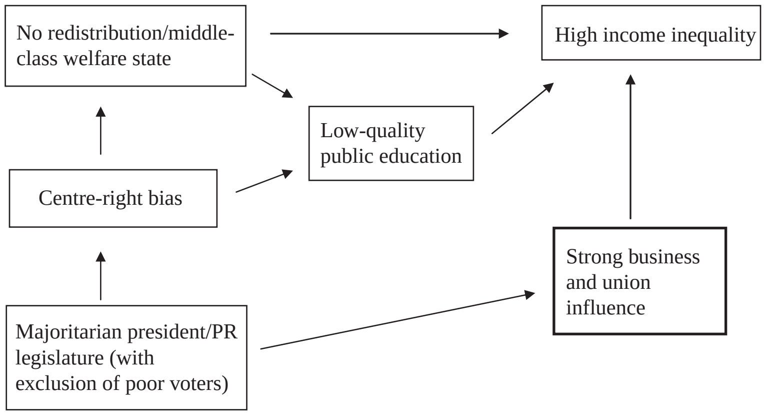

Figure 8 Politics and inequality in HMEs

and rare elsewhere. We show in this section how this political model is reinforced by and reinforces the HME in contributing to the reproduction of inequality. Figure 8 summarizes some of the main implications of this political system.

Five key conclusions can be drawn by integrating the MP/PRL model of the political system with the HME model of the production regime:

The median-voter focus of the presidency

With all the usual qualifications, winning the presidency requires the median vote of those voting programmatically. We argue in '*De facto* exclusion' below that the poor are less likely to vote programmatically, thus raising the broad income level of the median voter. These middle-income voters fear redistribution towards the poor financed by them.[13] Middle-income voters can support increased expenditure on health and education or on social security benefits so long as these benefits are primarily directed towards them and not to the poor – and because they are financed from the population more generally via taxes and higher prices. This explains recent results that show how a higher level of democratic tradition implies higher levels of health, education and social security spending (Huber *et al.*, 2008), and that at the same time this spending is neutral or regressive in its impact on equality (Huber *et al.*, 2006). Overall, roughly 70 per cent of public transfers flow to the richest 40 per cent of the population (Goñi *et al.*, 2008: 19). In terms of the interest of the median voter there is an interesting contrast between the attitude to social security spending across production regimes: positive in CMEs because of insurance and specific skills; negative in LMEs where social security is usually seen as directed redistributionally at the poor; and positive in HMEs because it represents redistribution *to* the median voter. Overall, this regressive social spending reinforces the low skill equilibrium in the HME production regime.

De facto *exclusion of low-income groups from programmatic voting*

For many low-income groups, the consequence of labour market flexibilization and the collapse of prior patterns of corporatist incorporation has been social fragmentation, and this has limited the capacity for political participation (Kurtz, 2004). Instead, poverty makes it possible to buy votes, either literally or via clientelistic relations, including jobs or other public-sector resources. The broad effect of hierarchical capitalism and flexible labour markets is to fragment both the economic and social structures of the poor in countries where low skill and educational levels are endemic. It then becomes individually rational to vote for a vote-buying party or candidate over one with a programme of redistribution. Thus the political system is 'unanchored' from the poor and allowed to drift further to the centre or centre-right: this applies both to the presidency and to legislators who are elected by low-income votes.

Centrist PR and the ability to strike legislative bargains

The broad logic of PR is for the creation of multiple parties, and for these parties to tend not to be tightly centrally controlled in the absence of strong links with well-organized social groups (as in CMEs), especially in electoral systems where parties have little or no control over candidate selection. The presidency thus needs to create majorities in the legislature in which it seldom itself commands a stable and disciplined one. Traditional, programmatic left parties have not been successful in the recent past (Coppedge, 1997), one reason having just been set out in the subsection above. For democratic periods from 1970 to 2000, the average ideological 'centre of gravity' for legislatures was on the right in nine of thirteen countries in Latin America (Huber *et al.*, 2006, p. 956). The weakness of parties also opens them to greater pressure from business (as in 'PR and diversified business groups' below).

There are also two strategic considerations: first, major parties are more interested in the presidency than the legislature, and hence cannot stray electorally too far from the centre of the political spectrum.[14] Second, within the PR legislature, parties (and politicians) closer to the president's position are going to be less costly for the president to ally with. Fragmented electoral systems with more parties tend to generate some centrist, clientelist parties that do not seek the presidency but are willing to join coalitions with whichever party does (Brazil is the best example) (see Amorim Neto, 2002). Both calculations push coalitional strategies to the centre.

These coalition calculations, the lack of success of programmatic left parties, and the veto power and agenda-domination of the president mean that the type of coalitions in coordinated societies with PR between centre and left – to tax the right – is seldom reproduced in Latin America. Thus the PR legislative component has tended to reinforce centrist presidential positions. When, in a minority of cases, the left holds sway for an extended period, it is likely to reduce inequality (Huber *et al.*, 2006). However, it is significant that this reduction comes not through overall spending but more through regulation (e.g. minimum wages) (Huber e*t al.*, 2008), a result which fits with the privileged access of business considered below.

Occasional exogenous shocks can alter the usual logic of the MP/PRL system. Where government revenues depend as much or more on rents from commodity exports as on taxes from voters, then median voters have less to fear from leftist candidates and parties who promise more social spending on the poor. Similarly, poor voters may be less inclined to sell their votes and prefer instead to risk voting for candidates who might shift significant public spending to the poor, especially during commodity booms. This logic helps explain the recent success of left candidates in Venezuela, Bolivia and Ecuador, part of the anomalous leftward shift in the region in the 2000s.

PR and union political strategies

The PR legislature is well set up for sectoral interests. This is in particular the case where there are already social organizations and potentially compliant voters such as unions and their members. Thus labour market flexibility and the increased inability of unions to operate effectively in the industrial sphere of the HME, while at the same time their members have social security systems to defend, makes it rational for them to invest in the political system. And this is encouraged by a PR legislature, and in turn reinforces an insider/outsider cleavage in labour markets and consequently overall inequality.[15]

PR and diversified business groups: business permeation of politics

We have already noted that a core strategic element of domestic business groups is their ability to access the political system. A critical aspect of this ability is that parties and politicians have enough individual clout for it to make sense for a business group to 'invest' in the party or the individual politician. With a PR legislature and a majoritarian presidency, as noted under 'Centrist PR and the ability to strike legislative bargains' above, deals normally have to be made with parties and, when strong party discipline does not hold, with individual politicians as well. When parties are weak, the executive often has to negotiate individually with legislators over pork spending but also measures favourable to business groups. Moreover, legislation has to go through committees, so committee chairs and members have the ability to slow down and amend legislation, and hence the derived ability to intervene with ministries and agencies on questions not directly related to ongoing legislation. Investment in individual legislators as well as in parties thus has a potentially high rate of return for businesses whose profitability depends in part on government regulations.

Doubtless the large groups would still have influence in the absence of a PR legislature. Moreover, several other features of Latin American political economies facilitate privileged access for business groups. For one, the size of groups relative to their domestic economies gives them substantial structural power, and ministers and presidents consult with them regularly. Moreover, bureaucracies in Latin America are porous and staffed at the top by political appointees. Appointees in top economic positions are sometimes suggested or vetted by business groups (and sometimes are ex-employees), and most consult regularly with business groups (Schneider, 2004).

Still we suggest that with a majoritarian legislature and presidency it would be harder for groups to have the range of effective contacts with many different politicians each able to intervene in the political process. This is because a two-party system would be more likely to emerge, so that there would be some internal discipline on legislators, especially with a powerful presidency; and hence limits on what legislators could supply to companies. In the UK key decisions are taken by the prime minister, whose concern is (to put it simplistically) with the median voter – it is not easy for *individual* businesses to influence the political system, in particular to gain protection from competition. The closest case in Latin America would be Chile, where electoral statutes force a fragmented party system into two stable coalitions. Individualized access is somewhat easier in the United States because individual politicians have greater power and parties less discipline. But the basic point is that a PR legislature is well designed to give individual politicians and parties power independent of the presidency, and this is what business groups can exploit.

Conclusion

The inclusion of Latin America in theorizing on varieties of capitalism extends the analysis from virtuous cycles of institutional complementarities in variably competitive economies to less virtuous complementarities in the developing political economies.

Although institutions, especially formal institutions, in Latin America do not seem as consolidated as those in developed countries, most of the institutional features we highlight have deep historical roots. Diversified business groups, MNCs, weak plant-level labour representation, low skills, high inequality and majoritarian presidents with PR legislatures all have roots in the mid-twentieth century or earlier. Since the last wave of democratization, constitutional tinkering and electoral reforms have been constant but have not altered the basic MP/PRL combination (Remmer, 2008). Moreover, the basic features of CMEs and LMEs took shape in the immediate post-war period (Hall, 2007). Latin American countries have reached levels of socio-economic development (per capita income, literacy, urbanization, etc.) that are similar or above those of post-war OECD countries, giving further reason to believe that capitalism in Latin America is what it is rather than still on its way to becoming something else.

Our focus has been on institutional continuities; however, these varieties of capitalism are not immutable. In fact the varieties of capitalism perspective, by identifying core institutional complementarities and interactions, helps identify potential sources of change (as well as obstacles). Many thought that diversified business groups were the malformed progeny of import substitution and that market reforms would force them to converge on US-style corporate governance. In fact, business groups survived market reforms. However, the recent expansion in local stock markets and the growing weight of institutional investors, both domestic and international, may pressure business groups to specialize, open their capital and professionalize their boards and management. On the political side, programmatic left parties may on occasion still provide opportunities for the poor to try to follow Meltzer and Richard to impose greater redistribution through elections. Lula's re-election in 2006, for example, was attributed in large part to the redistributive policies he enacted in his first term and voters split more clearly along class lines than in previous elections. However, inequality in Brazil remains very high and spending regressive. The HME model presented here would point to the quality of representation and the quality of jobs as key obstacles to furthering this trajectory of reform.

Another recent exogenous shock is the commodity boom of the 2000s. Strong international demand and accompanying Dutch disease effects have increased growth rates, wages and demands for services (and service-sector employment). However, in most other areas the commodity boom has reinforced the basic underlying dynamics of HMEs. The main firms active in commodity production are large business groups and MNCs. Moreover, commodity production requires few workers, so, even as shortages of skilled workers emerged in some sectors, these narrow sectoral demands were unlikely to reverberate through the rest of the labour market. At the same time the commodity boom reduced pressures, as growth rates improved and currencies appreciated, to seek higher skill niches in the global economy that could generate more and better employment.

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Notes

1 Key differences lie in public-sector and gendered provision of social services; universal versus earnings-related is no longer so salient.
2 The numbers in brackets are the numbers of countries with the relevant electoral system which have had more than 50 per cent of government years in the relevant partisan category: thus eight of nine PR countries had a left-of-centre government more than 50 per cent of the time, and eight of eight majoritarian countries had a right-of-centre government more than 50 per cent of the time.
3 Voting participation is higher under PR than in majoritarian systems, and this is sometimes explained by the efficacy of a vote in the two systems – a vote in a majoritarian election is less likely to affect the outcome than with PR. While this is true, from a rational actor perspective the effect is virtually zero in both cases and so should not affect participation. This argument moreover says nothing about why the poor should vote less than the rich; in a rational choice perspective, the rich – to whom time is more valuable than it is to the poor – should vote less than the poor.
4 Ireland is a special case.
5 For background and elaborations, see Schneider (2008a,b,c, 2009) and Schneider and Karcher (2008). These elaborations also address further issues of fit, nuance and intra-regional variation that cannot be accommodated here.
6 Phillips notes that 'The model is fundamentally neoliberal in character, although its traits are not necessarily consonant with conventional understandings of the Anglo-American variety of capitalism' and it includes '"flexible" labour markets and/or ongoing processes of labour flexibilisation, with high levels of informality in the labour sector and frequently high levels of structural unemployment' (2004).
7 High-end employers (some MNCs, some large business groups) rely increasingly on a dual strategy where they outsource most unskilled jobs and hire a small core workforce in which they assume they will have to provide most of the necessary training. For the small number of core workers, turnover is low and firms invest heavily in training. However, the net impact of these training policies is to reinforce the low incentives individuals have to invest in their own skills, because high-end employers are less looking to acquire skills in the labour market than seeking workers to whom they can impart the skills they need.
8 One major study on the constraints that kept students from investing as much as they should in education concluded: 'Thus, in order to increase schooling levels in Latin America, it will be necessary to disseminate information on the economic returns to education, as well as find alternative forms of care for young children so that older siblings do not have to drop out of school' (Menezes-Filho, 2003, p. 143).
9 In the 1990s, outside Mexico, the service sector generated the vast majority of new jobs in the region, though most of these were low-end jobs in areas like restaurants, hotels and domestic service (Stallings & Peres, 2000).
10 Beyond private education, residential class sorting, where higher income areas have their own public schools which then largely cater to children of parents in that area, adds class barriers and fragments potential employment networks.
11 The relationship is looser than the view of 'entrenchment' in Morck *et al.* (2005), because privileged political access in Latin America does not guarantee survival or stem a steady turnover in the ranks of the top business groups.

12 The rapid expansion of tertiary enrolments in the 2000s in countries like Brazil and Chile may address some of the skill shortage. However, much of this education is part-time and of dubious quality, and may do little to help overcome deficits in networks and cultural capital.
13 Liberalized financial markets further fuel these fears, in two different ways. First, they penalize governments that pursue Keynesian strategies premised on deficit spending which in turn can compromise overall growth. Moreover, they also increase the already well-developed ability of higher-income groups to evade taxation and protect their wealth abroad. Middle-income voters have fewer options for evasion, and hence greater reason to fear that proposals to tax the rich may in practice fall disproportionately on them rather than on the truly rich. In addition, widespread clientelism and patronage (due in part to weak parties, discussed later) promote a suspicion that proposals for redistribution are unlikely to succeed and more likely to end up going for particularistic ends.
14 This is especially true in systems with a small number of large parties (as in Mexico, Argentina and Chile) where each party has presidential ambitions. When not in the presidency, these large parties also have more to gain, with an eye on the next presidential elections, by attacking presidents from opposing parties rather than entering coalitions with them.
15 In the wave of market-oriented reforms, individual labour rights were reduced or made more flexible and union membership declined. However, unions managed to shore up collective or union rights and regulations (Murillo & Schrank, 2005).

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