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How States Shape Markets in Latin America

By

Tomas Bril Mascarenhas

A dissertation submitted in partial satisfaction of the

requirements for the degree of

Doctor of Philosophy

in

Political Science

in the

Graduate Division

of the

University of California, Berkeley

Committee in charge:

Professor Steven K. Vogel, Co-Chair
Professor Alison E. Post, Co-Chair
Professor Ruth B. Collier
Professor Neil D. Fligstein

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Abstract

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Doctor of Philosophy in Political Science

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Professor Steven K. Vogel, Co-Chair

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Latin American countries have recently reconfigured their national financial systems in ways that powerfully shape their growth strategies and economic performance in the twenty-first century. Some Latin American countries have developed large capital markets where companies issue equity or long-term bonds, while others have cultivated large long-term credit markets; and some countries have failed to develop adequate capital or credit markets. This dissertation studies this variation in financial system development with two contrasting cases: Chile, which has produced an impressive capital market, and Brazil, which has built up the capacity to deliver long-term bank credit for firms on a massive scale. Argentina, an additional case examined more briefly, scores low on both capital and credit markets. In contemporary Latin America, it is especially critical to understand the politics that drives the evolution of these financial systems, which provide the investment finance that ultimately shapes opportunities for long-run growth.

In 2008, the global financial crisis dried up credit throughout the world. Yet firms in Chile and Brazil continued to grow in this period because they had financial institutions that allowed domestic companies to raise investment capital at home. In the aftermath of the crisis, Chilean and Brazilian firms successfully obtained funds with unusually long-term maturities, albeit through very different channels.

What explains the varying configurations of national financial systems that underlie these new business strategies and opportunities for growth in contemporary Latin America? This study provides a distinctively *political* explanation of the puzzling contrasts among Latin American national financial systems. The dissertation uncovers the political origins of national financial systems by looking at how states shape domestic markets.

I argue that state involvement in markets hinges on two key policies: state-owned banking institutions' provision of long-term credit to a country's firms and the governance of the private segment of the pension system. While some modes of pension system regulation will lead pension funds to channel significant flows of finance to either the equity or the corporate bond market, or to both, other regulatory patterns generate inducements for pension fund investment in

other types of assets (e.g. foreign bonds, government debt, and short-term bank deposits), diverting financial flows away from the domestic capital market.

Since state action is the primary driver of variation in the configuration of national financial systems, I begin with the state and the politics within it. Political *técnicos*—entrepreneurial officials appointed to the top tiers of the executive branch who combine strong expert knowledge with brokering skills—dominate the highly technical, low-salience policy process that shapes domestic markets. I contend that the technical decisions that emerge from power shifts between competing coalitions of executive-branch elite officials with different policy orientations drive the different modes of state involvement in credit and capital markets.

In Chile, top-level officials with a neoliberal policy orientation initiated and then sustained a drastic retrenchment of government lending for the productive sector and designed and enforced formal regulation inducing private-run pension funds to channel major investments to the domestic equity and corporate bond markets. This neoliberal policy orientation underpinning Chile's mode of state involvement in markets was not predetermined: during its formative phase in the 1970s and 1980s, as well as in its reproduction stage in the 1990s and 2000s, elite executive-branch officials who challenged this economically orthodox orientation had to be defeated and their influence curtailed.

In Brazil, by the late 2000s, elite officials across several agencies successfully pushed for the adoption of a neo-developmental policy agenda. The power shift within the Brazilian state, with the displacement of a coalition of orthodox technocrats that had been strong until the mid-2000s, produced a significant increase in the scale of long-term credit provided by the state-owned National Development Bank (BNDES) and the redirection of giant state-owned-enterprise pension funds as major institutional investors in the domestic stock market and key players in the nascent Brazilian venture capital and private equity industries.

By examining these two contrasting cases, and setting them in the context of developments in Latin America more broadly, I develop a new characterization of Latin American political economies that diverges from attempts to apply the Varieties of Capitalism framework to the region. In that perspective, the largest and most advanced Latin American countries all fit under a single model of hierarchical market economy (HME). Yet since states have developed remarkably different growth strategies—from Chile's neoliberal continuity to Brazilian neo-developmentalism, to forms of neo-statism in Argentina—we must be careful to appreciate the diversity of political economy models in twenty-first-century Latin American capitalism.

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During the six years I spent working on this Ph.D., I developed a strange habit: almost every time I felt I would never finish it, I would open a colleague's dissertation and read the acknowledgements section. Having specialized in this literary genre, I know that most authors say that dissertations are never individual journeys—they are collective endeavors. In my case, the people who helped me are so many that, if all of them were gathered, they would probably be able to found a small town.

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UC Berkeley's Department of Political Science is a paradise where intellectual autonomy and methodological pluralism are still forcefully embraced. "If you want to be told what to do, Berkeley is not the place for you," Pradeep Chhibber told me back in 2010, during my first campus visit. He was right. I am grateful to Pradeep and other faculty members that opened my mind, including Sean Gailmard, Robert Powell, Nick Ziegler, and John Zysman.

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Chapter 1. Introduction

Latin American countries have recently reconfigured their national financial systems in ways that powerfully shape their growth strategies and economic performance in the twenty-first century. Some Latin American countries have developed large capital markets where companies issue equity or long-term bonds, while others have cultivated large long-term credit markets; and some countries have failed to develop adequate capital or credit markets. This dissertation studies this variation in financial system development with two contrasting cases: Chile, which has produced an impressive capital market, and Brazil, which has built up the capacity to deliver long-term bank credit for firms on a massive scale. Argentina, an additional case examined more briefly, scores low on both capital and credit markets. In contemporary Latin America, it is especially critical to understand the politics that drives the evolution of these financial systems, which provide the investment finance that ultimately shapes opportunities for long-run growth.

In 2008, the global financial crisis dried up credit throughout the world. Yet firms in Chile and Brazil continued to grow in this period because they had financial institutions that allowed domestic companies to raise investment capital at home. In the aftermath of the crisis, Chilean and Brazilian firms successfully obtained funds with unusually long-term maturities, albeit through very different channels.

In Chile, for instance, Arauco, a forestry products company, issued corporate bonds in the Santiago market with up to 21-year maturities, much longer than the debt that firms can aspire to issue in other Latin American countries—and even in most developed economies. Arauco used those financial resources to consolidate its internationalization strategy, buying industrial plants in the United States and Canada.[1] In Brazil, a new segment of middle-sized innovative firms continued to grow with remarkable ease because they could rely on an impressive long-term credit market supported by the National Development Bank (BNDES). Medium-sized companies, like the information technology firm Bematech, used substantial long-term BNDES loans to amplify their investments in R&D.[2]

What explains the varying configurations of national financial systems that underlie these new business strategies and opportunities for growth in contemporary Latin America? This study provides a distinctively *political* explanation of the puzzling contrasts among Latin American national financial systems. The dissertation uncovers the political origins of national financial systems by looking at how states shape domestic markets.

I argue that state involvement in markets hinges on two key policies: state-owned banking institutions' provision of long-term credit to a country's firms and the governance of the private segment of the pension system. While some modes of pension system regulation will lead pension funds to channel significant flows of finance to either the equity or the corporate bond market, or to both, other regulatory patterns generate inducements for pension fund investment in other types of assets (e.g. foreign stock and bonds, government debt, and short-term bank deposits), diverting financial flows away from the domestic capital market.

[1] Celulosa Arauco company reports filed at the Chilean Securities Commission, SVS; "Chile Celulosa Arauco Issues $202.2M In Local Bonds," *Dow Jones International News*, November 6, 2008; "Chile's Arauco places around $300 mln in bonds," *Reuters News*, April 10, 2014; *Arauco Corporate Presentation 2016*.

[2] See BNDES press releases, March 4, 2010 and May 16, 2014.

Since state action is the primary driver of variation in the configuration of national financial systems, I begin with the state and the politics within it. Political *técnicos*—entrepreneurial officials appointed to the top tiers of the executive branch who combine strong expert knowledge with brokering skills—dominate the highly technical, low-salience policy process that shapes domestic markets. I contend that the technical decisions that emerge from power shifts between competing coalitions of executive-branch elite officials with different policy orientations drive the different modes of state involvement in credit and capital markets.

In Chile, top-level officials with a neoliberal policy orientation initiated and then sustained a drastic retrenchment of government lending for the productive sector and designed and enforced formal regulation inducing private-run pension funds to channel major investments to the domestic equity and corporate bond markets. This neoliberal policy orientation underpinning Chile's mode of state involvement in markets was not predetermined: during its formative phase in the 1970s and 1980s, as well as in its reproduction stage in the 1990s and 2000s, elite executive-branch officials who challenged this economically orthodox orientation had to be defeated and their influence curtailed.

In Brazil, by the late 2000s, elite officials across several agencies successfully pushed for the adoption of a neo-developmental policy agenda. The power shift within the Brazilian state, with the displacement of a coalition of orthodox technocrats that had been strong until the mid-2000s, produced a significant increase in the scale of long-term credit provided by the state-owned National Development Bank and the redirection of giant state-owned-enterprise pension funds as major institutional investors in the domestic stock market and key players in the nascent Brazilian venture capital and private equity industries.

By examining these two contrasting cases, and setting them in the context of developments in Latin America more broadly, I develop a new characterization of Latin American political economies that diverges from attempts to apply the Varieties of Capitalism (VoC) framework to the region by Ben Ross Schneider (2013) and others. In that perspective, the largest and most advanced Latin American countries all fit under a single model of hierarchical market economy (HME). Yet the HME Framework reproduces VoC's original sin: not giving enough attention to the state. Since states have developed remarkably different growth strategies—from Chile's neoliberal continuity to Brazilian neo-developmentalism, to forms of neo-statism in Argentina—we must be careful to appreciate the diversity of political economy models in contemporary Latin American capitalism.[3]

1. Why Do National Financial System Matter?

The 2008-2009 global economic meltdown brought financial systems back to center stage in the field of political economy. The crisis reminded us that financial systems—conceived as mechanisms for channeling savings into productive investment—have huge effects on the real economy and highlighted how there are distinctive *national* financial systems. Moreover, as John Zysman's seminal work emphasized, financial systems shape the state capacities and the

[3] In a highly condensed form, I advanced some of the elements that I develop in this chapter in Bril-Mascarenhas (2015). The classic tradition of comparative political economy that contrasts national models of capitalism dates back to Shonfield (1965); the agenda has regained momentum since the publication of *Varieties of Capitalism* (Hall and Soskice 2001) and its application to developing countries (Crowley and Stanojevic 2011; Feldmann 2006; Nölke and Vliegenthart 2009; Schneider 2013).

repertoire of policy strategies that national executive-branch leaders can use to respond and adjust to changing circumstances in the world economy.[4]

Why should we care about national financial systems in contemporary Latin America? First I show that domestic financial systems are closely associated with a country's prospects of enjoying long-term economic growth, and then I provide real-world illustrations of the impact of reshaped national financial systems on Latin American firms' opportunities and strategies to raise investment capital.

1.I. National Financial Systems Matter Everywhere Because They Foster or Hamper Long-Run Economic Growth

There is growing consensus among economists that what they call domestic financial system "development" generates economic growth. As the Nobel Laureate economist Merton Miller once bluntly put it, the claim that "financial markets contribute to economic growth is a proposition almost too obvious for serious discussion" (Miller 1998: 14). The state of the art in economics holds that more domestic finance—be it through banks or through capital markets—leads to higher long-run growth.

Ross Levine is probably the foremost scholar working on the finance-growth nexus in contemporary economics. Over twenty years ago he revitalized this line of inquiry in an impressively influential co-authored article (King and Levine 1993) that disinterred a neglected side of Joseph Schumpeter's propositions: financial intermediaries make possible technological innovation and economic development. Among other activities, financial actors mobilize savings, evaluate projects, and manage risk. These authors found robust correlations between indicators of financial system development and long-run output growth, as well as evidence on the mechanisms that hypothetically connect the two sets of variables: the accumulation of physical capital and improvements in the efficiency with which economies employ capital.[5]

That seminal 1993 article motivated an important wave of new research in economics, including several contributions by Levine himself.[6] A decade later, this author took a step back to review decades of economics thinking and empirical testing to assess whether and how financial systems influence saving rates, investment decisions, and hence long-run growth rates (Levine 2005: 867). Levine suggests that growth-enhancing financial development occurs when there are improvements in the following critical functions that financial systems provide: producing information ex ante about possible investments and allocating capital; monitoring investments and exerting corporate governance after finance is provided; facilitating the trading, diversification, and management of risk; mobilizing and pooling savings; and, finally, easing the exchange of goods and services.[7] Systematizing an immense number of econometric studies, Levine (2005: 868) concludes that the majority of existing research indicates that "(1) countries with better functioning banks and markets grow faster […], (2) simultaneity bias does not seem to drive these conclusions, and (3) better functioning financial systems ease the external

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[4] Zysman (1983: 16, 56-7, 69, 75-6, 78-80).
[5] King and Levine (1993: 718-20).
[6] The two with most impact on scholarly debates were Levine (1997) and Levine and Zervos (1998).
[7] Levine (2005: 869-70).

financing constraints that impede firm and industrial expansion, suggesting that this is one mechanism through which financial development matters for growth."[8]

An additional finding of the economics literature on the finance-growth nexus is of particular relevance for my study, since I pay special attention to the *structure* or *configuration* of national financial systems. After reviewing roughly twenty econometric works that directly or indirectly assess whether the structure of domestic financial systems has significant economic effects, Levine (2005: 918-9) concludes: "In a cross-country context, there is no general rule that bank-based or market-based financial systems are better at fostering growth." He closes this inquiry by speculating that these econometric results may imply that there is not one optimal institutional structure for providing growth-enhancing financial functions to the economy. Interestingly, illustrating that for the most part scholars in economics neglect the work developed earlier on, and in non-econometric form, by political scientists, Levine's review does not cite the two probably most influential political science works—i.e. Zysman (1983) and Hall and Soskice (2001)—that put the contrast between bank-based and capital-market-based financial systems at the very center of political economy debates.

National financial systems differ in terms of their structure or configuration. Zysman (1983: 60) early on stated that what makes national financial systems different is the relative importance of capital markets and credit markets.[9] But before we enter into this fine-grained comparison of differently configured financial systems, at the most basic level, we can say that national financial systems vary in terms of the size of *long-term finance* that they provide.[10] The World Bank gives the following definition of the concept:

> *Long-term finance comprises all types of financing (including loans, bonds, leasing, and public and private equity) with a maturity exceeding one year. Maturity refers to the length of time between origination of a financial claim (loan, bond, or other financial instrument) and the final payment date, at which point the remaining principal and interest are due to be paid. Equity, which has no final repayment date of a principal, can be seen as an instrument with nonfinite maturity.*[11]

As firms seek to match the maturity of their assets and liabilities, when they invest in fixed assets and equipment they generally prefer resorting to long-term sources of finance.[12] The highly influential cross-national econometric study of Demirgüç-Kunt and Maksimovic (1998) was probably the first to provide empirical evidence indicating that, *ceteris paribus*, corporations grow faster if they rely more on long-term sources of finance external to the firm—namely, debt

[8] The econometric analyses that Levine (2005) reviews, which suggest that financial systems exert a first-order impact on economic growth, include firm-level studies, industry-level studies, individual country-studies, time-series studies, panel-investigations, as well as cross-national studies.
[9] Economists provide a similar definition of financial system structure, conceived as "the mix of financial markets and intermediaries operating in an economy" (Levine 2005: 918).
[10] The World Bank, utilizing the terminology preferred by economists—i.e. that of levels of financial system *development*—indicates that "[u]nderdeveloped financial systems are often distinguished from more developed ones by their lack of long-term finance" (World Bank 2015: 10).
[11] World Bank (2015: XVIII). It should be noted that the one-year benchmark is quite arbitrary; the Group of Twenty (G-20), by comparison, uses a maturity of at least five years to define long-term financing (World Bank 2015: 6).
[12] World Bank (2015: 24).

and equity—than they do if they instead rely exclusively on internally generated resources. In other words, as firms will tend to avoid financing investment with short-term loans, the availability of long-term finance in a financial system—be it in the capital market or in banks—is closely associated with the capacity of a country's firms to mobilize large investments and, ultimately, grow.

Drawing on Diamond's (1991, 1993) work, the World Bank unpacks the microfoundations of the claim that holds that the scarcity of long-term finance in a country's financial system negatively affects economic growth. Firms operating in countries where long-term finance is scarce are more exposed to liquidity risk—a risk that occurs when, at the time of debt repayment, the firm becomes unable to refinance debt due either to a negative shock to its earnings or to negative market conditions. In those countries with scarce long-term financing, the liquidity risk is higher than it is in countries in which long-term sources of finance do exist, because in the former set firms need to refinance their debts more frequently.[13] The implication is that, if the national financial system fails to provide abundant long-term finance, firms, concerned about liquidity risk, are highly likely to refrain from undertaking the large fixed investments that are the foundation for national productive capacity expansion.

1.II. National Financial Systems Matter in Twenty-First-Century Latin America Because They Affect Firms' Opportunities and Strategies to Raise Investment Capital

The recently contrasting trajectories of national financial systems in contemporary Latin America have huge real-world implications for firms in the region. I stress that key actors like the chief financial officers (CFOs) of large domestic business groups and the entrepreneurs leading middle-sized, technology-based enterprises nowadays face increasingly different realities across Latin American countries. In twenty-first-century Latin America, national financial systems affect firms in multiple ways, including firms' ability to internationalize and to insulate themselves from world crises, as well as from the instability produced by changes in domestic exchange rates.

Nevertheless, several analytical and empirical biases have until recently undermined scholars' capacity to cope with the new realities in a timely manner. For the most part, approaches to national financial systems in mainstream economics lack texture, sensitivity to context, and country-case knowledge that goes beyond the typical boxes that present colorful examples in reports published by international financial institutions.[14] Most economists look at highly aggregate variables such as "capital market depth" or domestic credit to the private sector (as a proportion of GDP); when they analyze capital markets in the developing world they use the United States-type of stock market as a comparative baseline, stressing that more diffuse share ownership has yet failed to materialize in countries with "underdeveloped" financial markets. The upshot is that economists assess the developing world through the lens of a case that is an outlier even within the traditional set of advanced market economies. Moreover, most economists implicitly adhere to a theory of convergence that is reflected in their insistent invocation of the econometrically obtained finding that as countries become richer they

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[13] This paragraph is based on World Bank (2015: 9, 41, 76).

[14] Some economists have acknowledged these shortcomings. Levine (2005: 920), for instance, has remarked that "recent research on financial structure and growth use aggregate, cross-country indicators of the degree to which countries are bank-based or market-based. These indicators may not sufficiently capture the comparative roles of banks and markets. They may not be sufficiently country-specific to gauge accurately national financial structure."

progressively shift from bank- to capital market-based financial systems.[15] When most economists look at the role of the state in markets and the performance of development banks, they tend simply to stress that state intervention does not solve market failures, but rather that it generates market distortions and political capture, or crowds out private investment.[16] Works like those of Dani Rodrik and Joseph Stiglitz are exceptions, rather than the rule, in mainstream economics.[17]

Since many economists examine national financial systems in the developing world with these peculiar theoretical lenses and using only econometric tools, they have not been well prepared to grasp the changes in national financial systems in contemporary Latin America. Economists' disciplinary biases, consequently, have limited their capacity to gauge how the newly structured financial markets in Latin America affect real firms, or how CFOs actually work with—and adjust their strategies to the evolution of—their countries' domestic markets. In short, important real-world implications have been missed for too long.

This is not to say that economists have not acknowledged their own biases. The editors of the background material prepared for a World Bank flagship report on financial systems in Latin America[18] recognized the economists' delay in acknowledging the changes underway in the region. The authors reflected retrospectively that the conclusions they—as well as other fellow scholars—had previously reached, based on data up to the early 2000s, "were somewhat pessimistic."[19] More recently, "new data from the mid- to late-2000s and several anecdotal accounts" have made these same economists recast their assessment: Latin American national financial systems, they now argue, "have become more diversified and more complex […] less bank based, with bond and stock markets playing a larger role."[20] The World Bank flagship report, for its part, found that "[Latin American] financial systems have deepened substantially over the past two decades […] new markets and instruments have sprung up, maturities have lengthened, and dollarization [of corporate debt] has been reduced." Moreover, the report recognized that there is "substantial heterogeneity in financial development within the region."[21]

The fact, so strongly highlighted in the new political science conventional wisdom (which quite inadvertently borrows from economics),[22] that none of the Latin American countries has transitioned to an U.S.-like financial system—where corporate ownership is atomized and there is a vibrant market for corporate control—should not obstruct our ability to identify the consequences of this growing divergence in domestic market structures for Latin American capitalism.[23] Critical recent phenomena that are reshaping capitalism in this region, such as the

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[15] See, for instance, Demirgüç-Kunt and Levine (2001: 83).

[16] See, for instance, Dinç (2005); La Porta et al. (2002); Shleifer and Vishny (1998). See World Bank (2015: 33-9) for an updated review of the literature produced in economics frequently used to support this claim. For more balanced assessments of this perspective, see Levy Yeyati et al. (2007) and Andrianova, Demetriades, and Shortland (2010).

[17] E.g. Rodrik (2007, especially pp. 18-19, 99-152); Stiglitz (1993: 40-5).

[18] World Bank (2012).

[19] Didier and Schmukler (2014: 28).

[20] Didier and Schmukler (2014: 26, 28).

[21] World Bank (2012: 29).

[22] See, for instance, Schneider (2013: 7, 45).

[23] Interestingly, in his earlier work on business groups Ben Ross Schneider himself warned against the negative effects that analyzing Latin America with the United States as a major point of reference could have on the formulation of our empirical puzzles and theory-building on comparative capitalism. Schneider (2008: 391) insightfully remarked that most theories on business groups are teleological,

emergence of Latin American multinational corporations, are closely related to these new trends in domestic financial systems.

I contend that the new conventional wisdom misses the target when—implicitly importing from economics—it assesses national financial systems in HMEs through the lenses of the prototypical Liberal Market Economies (LME) of the United States and Britain—two outliers even in the developed world precisely because they have evolved to have markets for corporate control.[24] As Schneider's earlier work (2008: 391) recommended, I sideline the United States and Britain as major points of reference, and in doing so I identify interesting variations in financial systems structures across Latin American countries. Far from the cross-national homogeneity and the lack of change over time emphasized in the HME Framework, my interviews with senior executives of some of the largest Argentine, Brazilian and Chilean business groups and investment banks, as well as secondary sources of evidence, consistently indicate that critical developments that have reshaped each country's national financial system do make a difference in the field.

My interlocutors in Chile[25] agreed that the country's biggest firms have grown so much since the 1990s that they simply cannot rely any more on their own resources to finance the large-scale investments that they make nowadays—the domestic equity and corporate bond markets, they argue, have become essential sources of investment finance. These informants highlighted that large Chilean firms issue debt and equity domestically for several reasons.[26] First, nowadays the domestic capital market involves lower transaction costs than foreign capital markets. Second, many groups have a significant amount, if not most, of their revenue in Chilean pesos; hence, they prefer domestic capital markets so as to minimize exchange rate risks associated with issuing debt abroad.[27] Third, all large firms—even those with most of their revenues in foreign currency—diversify their sources of investment finance so as to protect themselves from credit crunches such as the one that followed the 2008 world financial crisis;[28]

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insofar as they start "with the presumption that corporate governance in the United States and Britain is at the vanguard and other countries are arrayed somewhere behind them in a march toward U.S.-style [corporate governance]." He suggested that it may be worth "recasting the standard empirical puzzle; instead of asking why corporate governance in country X differs so much from the United States, the question should be why are practices in the United States so different from the rest of the world" (Schneider 2008: 391). Unfortunately, though his landmark application of VoC to Latin America deals extensively with business groups (Schneider 2013: 43-72), in this later work the concern about using the United States as a benchmark for comparison was removed altogether.

[24] The seed for this bias in the HME Framework could be VoC's "obsession" with corporate governance, which I think obscures relevant cross-national contrasts. Finance enters the VoC agenda through a narrow window: the focus is on how it affects the concentration or dispersion of share ownership of firms, and on how that in turn shapes the incentives of the major stakeholders in a corporation. Hardie et al. (2013: 692-3) make a similar critique for the context of advanced capitalist countries.

[25] See Author's Interviews at the end of this study for a complete list of my informants.

[26] For earlier quantitative evidence discrediting the thesis that Chilean firms prioritize issuing equity and bonds in foreign rather than domestic markets, see Zervos (2004: 7).

[27] Post (2014a: 24-5; 2014b: 112) makes the same point about domestic firms' preference to finance investment locally, refraining from contracting debt in foreign currency; my findings differ from hers, though, in that this preference does not imply that firms will only resort to retained earnings.

[28] The giant pulp maker Celulosa Arauco offers a prime example. With its sales concentrated in foreign currency, during the 1990s and 2000s it had continuously used international markets to finance its expansion. In 2008, however, Arauco issued bonds domestically for the first time in 17 years, a strategy

in turn, foreign buyers of Chilean firms' debt instruments value the fact that the latter will be able to repay their debts, even if international markets dry up, by using the domestic capital markets.

Celis and Maturana's (1998: 11) quantitative analysis shows that the development of the Chilean domestic stock market made "local companies realiz[e] that equity financing was a feasible opportunity"; the country's sustained economic growth, they add, "exerted pressure on the companies for new financing sources in order to meet their investment plans." As Agosin and Pastén (2003: 97) noted, initial public offerings (IPOs) were launched by a wide array of companies in multiple sectors, including pharmaceutical retailers, department stores, supermarkets, consumer goods, mining, and fisheries. The Chief Investment Officer of LarraínVial, one of the leading financial firms in Chile, described to me how business preferences shifted as the equity market expanded: in the past, large parts of the business community had been reluctant to launch IPOs, whereas they now face strong incentives to enter the equity market:

> *As we know, in Latin America the word 'profit' is often a taboo: as firms didn't want to release information about how much money they were making, they were not used to launching IPOs. However, when the domestic stock market starts to be so attractive, as was the case in Chile [beginning in the 1990s], the businessman starts to question his reluctance to launch an IPO because he can earn a lot by selling part of his firm's equity. The following example illustrates what happened in Chile more generally. In the 1990s I worked at Citicorp's IPO division. At the time, the retail sector was completely excluded from the stock market. One day we met with the family that owned a middle-sized firm in the retail sector... and the owner told us, "I've come to realize that if I don't do an IPO my competitors will do it, and they will receive so much capital that they will end up buying me or liquidating me."*[29]

Argentine firms operate in a domestic financial system whose structure differs markedly from that of *all* its upper-middle-income neighbors. Largely contrasting with Chile, Argentina's corporations face a remarkably small capital market; in contrast to Brazil, the Argentine state plays a minimal role in the provision of long-term loans for the productive sector. The real-world implications of this type of national financial system fit better with the characteristics that the HME Framework attributes to the whole region:[30] as that theory predicts, the largest domestic business groups in Argentina are in fact "forced" to rely on retained earnings and international loans to finance their investment projects.

The lack of domestic sources of long-term finance external to the firm affects Argentine corporations across the board, notwithstanding their size or sectoral profile. The case of Arcor offers a perfect illustration. Arcor is one of the only three Argentine-owned major industrial companies with global presence;[31] headquartered in Argentina—where 29 out of its 39 industrial plants are based—Arcor has become the world's leading producer of candy, with annual sales of

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that the company decided to repeat on several occasions between 2009 and 2014 (Celulosa Arauco company reports filed at the Chilean Securities Commission, SVS; "Chile Celulosa Arauco Issues $202.2M In Local Bonds," *Dow Jones International News*, November 6, 2008).

[29] Author's interview with José Manuel Silva, Chief Investment Officer, LarraínVial (1997-2014), Santiago, May 27, 2014.

[30] See Schneider (2013: 42).

[31] Llach (2014: xiii).

US$3 billion.[32] Had the company been headquartered in countries like Chile or Brazil, it would have probably resorted to both internal and external sources to finance its expansion; headquartered in Argentina, however, Arcor chose a strategy almost entirely based on using its own resources to finance investment projects.[33] According to Kosacoff, Porta, and Stengel (2014: 211), the strong restrictions Arcor faced to capitalize itself in the domestic equity market explains why the company has much higher dependence on self-finance than its main competitors in the global market of candies. During the late 2000s the company supplemented this strategy based on retained earnings with three large loans, totaling US$500 million, provided by the International Finance Corporation-World Bank Group.[34] Reflecting this situation of domestic financial scarcity, Arcor's president, Luis Pagani, once said to the press, "I told President [Néstor] Kirchner [2003-2007] that there are two constraints in Argentina: the lack of credit and [the absence] of a national development bank."[35]

Evidence from the experience of Argentina's largest industrial conglomerate—the Techint Group, which operates in the industries of steel, mining, construction, and engineering—points in exactly the same direction. Techint's financial director, who has been with the group for over 25 years, explained to me that the conglomerate on multiple occasions has had to privilege obtaining funds in international markets simply because the Argentine domestic capital market "cannot absorb large issuances" of corporate bonds.[36] Generalizing this finding, a leading investment banker, formerly an executive director at JPMorgan Chase Argentina, explained to me that the lack of capacity of the domestic capital market to absorb the type of issuances that large firms require pushes them to issue debt internationally rather than domestically.[37] Techint's president was once quoted as saying, "Argentina lacks support to obtain credits… an Eximbank capable of financing investments and exports is missing."[38] Argentina's large industrial firms frequently petition public officials to have the government launch a development bank to finance long-term productive investment.[39] The general manager of IMPSA, a major Argentine industrial group that provides integrated solutions for power generation, illustrated how the structure of the national financial system is connected with firms' hardships in beating foreign competitors:

> *Brazil[ian firms are] less competitive in terms of [the price of] capital goods but [they beat] you with the financial access that they have (...) a short time ago we lost a contract in Argentina even though we had lower costs. The foreign firm showed that it could secure better finance. The lack of [...] credit is an unsolvable problem for Argentine firms.*[40]

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[32] Kosacoff (2014: 253-4).
[33] Kosacoff et al. (2014: 208-9).
[34] Kosacoff (2014: 251-2). In 2010, for the first time in its history, Arcor issued a US$200 million bond with seven-year maturity.
[35] "Arcor: el mundo en las manos," *Clarín*, October 3, 2004.
[36] Author's interview with Carlos Franck, Financial Director at Techint, Buenos Aires, December 4, 2013.
[37] Author's interview with Fernando Balmaceda, Executive Director JPMorgan Chase Argentina (2000-8), Buenos Aires, December 23, 2013.
[38] Cited by Finchelstein (2010: 212).
[39] Author's interview with Carlos Franck, Financial Director at Techint, Buenos Aires, December 4, 2013. See also, "Nuevo pedido de los industriales de una banca de desarrollo," *La Nación*, November 29, 2005; "Pide la UIA apurar el banco de desarrollo e incentivos fiscales," *La Nación*, December 27, 2007.
[40] Cited by Finchelstein (2010: 212).

In Brazil, the reshaping of the national financial system during the last decade has had significant consequences for the country's firms. All of my top-level interviewees in the Brazilian corporate world coincide in stressing that the image of an economy dominated by enormous business groups that exclusively depend on retained earnings or foreign markets to finance their large-scale investment projects is highly outdated.[41] In contemporary Brazil, CFOs no longer prefer intra-firm or intra-group sources of finance exclusively, which hardly ever suffice to meet their ambitious long-term investment plans. In a country where the domestic market is so important for large firms—Brazil's population reached 200 million people—and with a long history of exchange rate volatility, solely relying on foreign credit markets is rarely an option: concentrating debt in foreign currency when revenues are mostly denominated in Brazilian Reais is too risky.[42] Moreover, even the CFOs of export-oriented companies, as I will show, nowadays choose to tap domestic sources of finance.

"It is true that up to the mid-1990s our group only used its own resources to finance investments," the former CFO of Grupo Votorantim—one of the largest industrial conglomerates operating, among others, in the cement, steel, pulp and paper, and energy sectors with annual sales of over US$11 billion[43]—told me; he added: "at the time Brazil did not have a domestic capital market and economic growth was sluggish; but nowadays, for large groups like Votorantim, their own resources are not enough to finance the investments they need to make… obtaining funds from outside the firm is essential, be it from the BNDES, from the domestic capital market, or by issuing debt abroad."[44] Votorantim—whose concentrated ownership, family control, and multisectoral diversification made it a prototype of the business groups that, according to the HME Framework, define hierarchical capitalism in Latin America[45]—has recently looked to raise US$5.4 billion in an initial public offering to fund acquisitions and expansion outside of Brazil, as well as to add more products domestically.[46] Similarly, other Brazilian corporate giants—such as Camargo Corrêa, Odebrecht, and Gerdau, all three selected in Schneider's (2008: 392) nine-case sample of major Brazilian business groups—either have recently resorted to the domestic stock market to raise capital for investment or are seriously considering doing so. Although Odebrecht and Camargo Corrêa are exemplars of groups that remain privately held—probably due to their reluctance to disclose information about the government contracts associated with their business in civil engineering and construction—in 2004 and 2007 they decided, respectively, to take advantage of the newly developed equity

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[41] Author's interviews with José Filippo, Executive Vice President & CFO of Embraer, São Paulo, April 1, 2014; Wilson Masao Kuzuhara, CFO of Grupo Votorantim (1986-1995) and CEO of Banco Votorantim (1996-2011), São Paulo, April 7, 2014; Roberto Giannetti Da Fonseca, CEO of Kaduna Consulting Group, former top leader at the Federation of Industry of the State of São Paulo (FIESP), São Paulo, March 25, 2014. Not-for-attribution interviews with: senior executive in top consulting firm; and with former CFO of top Brazilian business group, 2014.

[42] On this point, which can be extended to most Latin American countries, see Coutinho and Rabelo (2003: 62).

[43] Data from: *América Economía*, Top-500 Latin American Firms 2014 Ranking.

[44] Author's interview with Wilson Masao Kuzuhara, CFO of Grupo Votorantim (1986-1995) and CEO of Banco Votorantim (1996-2011), São Paulo, April 7, 2014.

[45] See Schneider (2013: 45-7, 56, 69).

[46] "Brazil's Set for Another Blockbuster IPO with Votorantim Cimentos," *Wall Street Journal*, March 31, 2013; "Votorantim Cimentos Pushes Brazil IPO Plans to $12.7 Billion," *Bloomberg*, April 17, 2013.

market to launch IPOs for some of their subsidiaries.[47] The steel giant Gerdau, for its part, raised about US$5 billion by issuing equity in 2008 and 2011 to finance its expansion.[48]

Companies that are partially owned by the state, such as Vale and Petrobras, actively take advantage of the domestic capital market as a source of investment finance. In the 1980s, at a time when the domestic stock market was remarkably small, Petrobras, the Brazilian semi-public oil company, was experiencing severe fundraising difficulties.[49] In 2010, after a decade of equity market enlargement, Petrobras carried out the largest share sale in history, raising US$70 billion to invest in the development of offshore fields known locally as the *Pré-Sal*. "It wasn't in Frankfurt, it wasn't in New York, it was in our São Paulo exchange that we carried out the biggest capitalization in the history of capitalism," said President Lula Da Silva on the day of the equity offering.[50]

But the enlargement of the Brazilian stock market did not just have implications for the corporate giants around which the HME Framework is organized: it has also had consequences for a large number of medium-sized companies whose future growth may undermine the hierarchical nature of Brazilian capitalism altogether. In 2000, new market segments that have stricter standards of corporate governance were created within the São Paulo Stock Exchange (see Chapter 5). A recent study has shown that, as opposed to the older, huge business groups, an important number of younger and smaller firms have voluntarily chosen to take advantage of the existence of these new segments of the domestic stock market—known as *Nível 2* and *Novo Mercado*—as a strategy to signal their good corporate practices and thus enhance their reputation in the eyes of investors.[51] Among many others, firms like Natura (cosmetics manufacturing), Marcopolo (manufacturer of buses), the airlines GOL and TAM, and WEG (electric engineering, power, and automation) have recently raised capital—and improved their future capacity to access credit—by listing their shares in these new, stricter corporate governance segments of the domestic stock market.

Another way to gauge the significant implications that the new structure of the national financial system has had for Brazilian firms is to look at one of the most important recent changes of capitalism in the largest Latin American economy: the emergence and growth of a group of firms with capacity to become multinational corporations (MNCs). In Brazil, a country with an unparalleled internal market, the successful internationalization of multiple domestic firms represents a big shift from its long history of inward-oriented growth to a new exports-fueled model. Finchelstein's (2010) seminal study on the international expansion of Latin American firms—as well as the more recent work by Sierra (2015)—concluded that a major driver explaining the success of the new Brazilian MNCs was the support provided by the National Development Bank (BNDES). As Chapter 3 examines in depth, the scale and scope of the BNDES within Brazil's financial system changed remarkably during the last decade; Finchelstein (2010: 59-60) finds that through the BNDES the state provided capital that was

[47] "The success of Braskem's IPO exceeds expectations," *Odebrecht Informa Online*, November-December 2004. See also: "Abertura de capital é possível para todas subsidiárias, diz Odebrecht," *Valor Econômico*, September 28, 2012.
[48] My calculations based on unpublished data from Dealogic and Ernst & Young Research. See also: "Oferta da Gerdau deve movimentar R$ 4,4 bilhões," *Valor Econômico*, April 24, 2008; "Gerdau capta R$ 4,5 bilhões," *Valor Econômico*, April 13, 2011.
[49] Lavelle (2004: 97).
[50] "Petrobras Raises $70 Billion in World's Largest Share Sale," *Bloomberg*, September 24, 2010.
[51] Finchelstein (2010: 87-90).

essential for firms' internationalization, as evidenced by the fact that the BNDES had some kind of relationship with virtually all the firms that expanded abroad.

Some examples illustrate the connection between the reshaped structure of the financial system and this major shift in the Brazilian corporate world. In the early 2000s, JBS-Friboi was a large meat packer but ranked only 58th in sales in Brazil; a decade later it had become the world's largest beef producer.[52] The BNDES played a crucial role in JBS-Friboi's meteoric expansion by financing several of the firm's foreign acquisitions, including the American Swift & Company. In some of these operations, the BNDES provided up to 85 percent of the required funding.[53] Likewise, among multiple other examples, the BNDES granted hefty long-term loans to firms such as Embraer (aircraft manufacturing) and WEG (electronics industry) to enhance their export capacity, and provided electronic company Itautec with 79 percent of the funding necessary to improve R&D processes and to purchase technology firms in the United States.[54]

A similarly successful process took place in Chile, where firms in industries such as forestry, shipping services, steel, mining, and retail have recently expanded internationally (see Chapter 6). A crucial driver of this process, as in Brazil, was the new availability of long-term capital in the reshaped Chilean national financial system. Yet in Chile the funds needed for firms' internationalization did not come from the banking side of the financial system: in their expansion abroad, most Chilean companies raised funds in the domestic capital market.[55] In stark contrast to both Brazil and Chile, Argentina is a negative case regarding the internationalization of its firms. The number of Argentine-owned internationalized companies has decreased over time: by the early 2010s, the country had only four relevant firms with assets abroad.[56] Finchelstein found that Argentinean firms' failure was critically driven by the absence of the large pool of long-term capital that successful international expansion demands; the shortage of capital was, in turn, rooted in the underdevelopment of the Argentine capital market and lack of a strong state-owned development bank.[57]

2. Varieties of National Financial Systems in Twenty-First-Century Latin America

Based on the evidence that I introduced above and will expand in this section, I propose differentiating Latin American countries on one key dimension: the *structure* of national financial systems, understood as the relative importance of domestic capital markets (stock and corporate debt) and credit markets. There is enough evidence to claim that different modes of state involvement in domestic markets have significantly increased cross-national contrasts in financial system configuration. This challenges the lumping approach of the HME Framework.[58]

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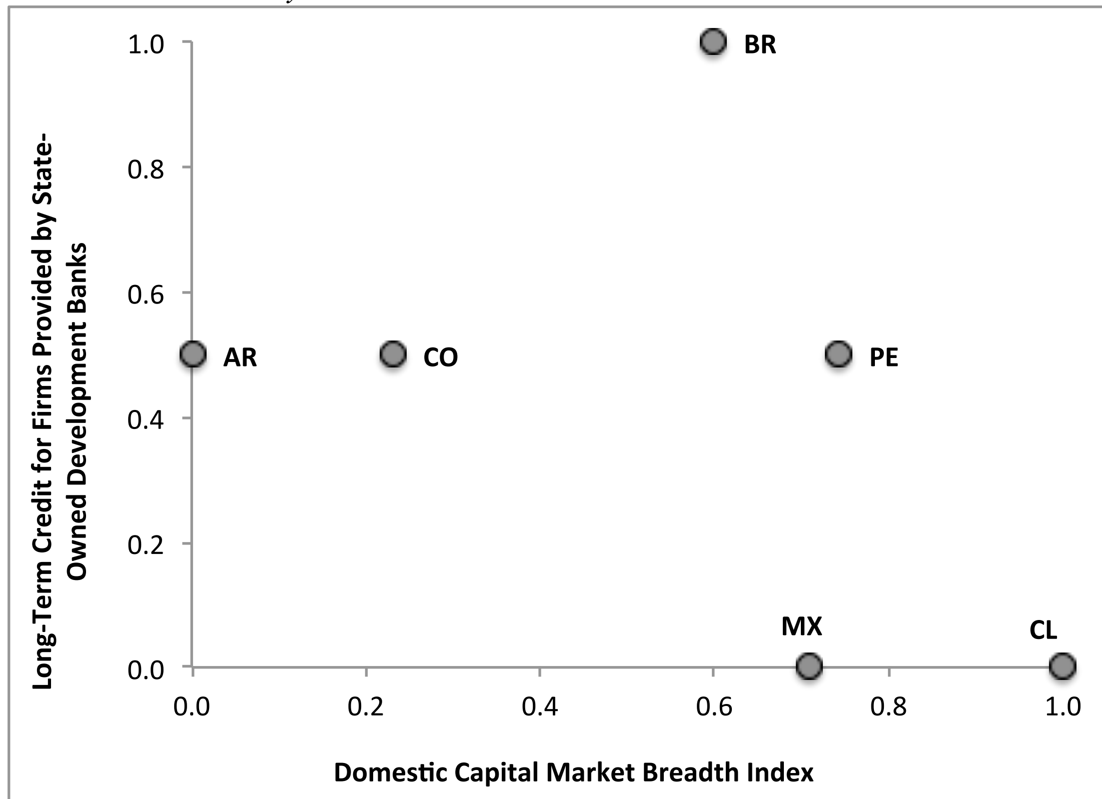
[52] Schneider (2013: 64).
[53] Finchelstein (2010: 75-6).
[54] Finchelstein (2010: 76, 78).
[55] Finchelstein (2010: 164).
[56] Finchelstein (2010: 173); he defines relevant firms as those with annual sales above US$1 billion.
[57] Finchelstein (2010: 213, 218, 225).
[58] I use Zysman's (1983: 60) definition of financial system structure. My interest in financial systems is motivated by the impact they have on investment in the real economy. Therefore, whenever I use the term "credit markets," I am only referring to markets for *corporate* credit, and I thus exclude any consideration of *consumer* credit markets.

Latin American countries share a common history of so-called “repressed” financial systems. In the early 1980s Chile’s domestic capital market was virtually nonexistent and even for the largest firms in the country obtaining finance through the issuance of equity or corporate bonds was not common practice.[59] Argentina, a country whose GDP per capita in the mid-1980s was about the same as the average of high-income (non-OECD) countries,[60] had a shallow domestic equity market in 1990, representing just 3 percent of GDP. In Brazil, stock market capitalization was low during the 1990s—14.9 percent of GDP[61]—and even as late as 2000 the São Paulo Stock Exchange was almost irrelevant.

This shared past as late financial system developers, however, has recently given way to substantial diversity. Figure 1.1 provides a snapshot of the significant variation in the structure of national financial systems across six of the largest and most advanced Latin American economies in the 2010s—Argentina, Brazil, Chile, Colombia, Mexico, and Peru[62]—by mapping cases along what this study considers the two most important dimensions: the breadth of domestic capital markets—stock and corporate debt—and the size of state-owned development banks’ long-term credit for firms. (See below for methodological considerations regarding Figure 1.1).

[59] See Celis and Maturana (1998: 11) and Corbo and Schmidt-Hebbel (2003: 175).
[60] Data from World Development Indicators, World Bank.
[61] My calculations based on data from the World Bank’s Global Financial Development Dataset. Figures are averages of the annual observations.
[62] In choosing this set of six Latin American countries I follow the convention of World Bank reports (e.g. World Bank 2012; Didier and Schmukler 2014), which pick the so-called LAC7 as an effective way of characterizing the region. However, my *N* is six rather than seven: I exclude Uruguay from my sample because its small economic and geographical size makes it an outlier within the LAC7 group.

Figure 1.1. The Structure of National Financial Systems in Large Upper-Middle-Income Latin American Countries by the 2010s.



Source: Author's calculations based on unpublished 2013 data from the World Bank and from multiple sources cited in the notes to Table 1.3.
Notes: AR: Argentina; BR: Brazil; CL: Chile; CO: Colombia; MX: Mexico; PE: Peru. See Section 2 for a definition of the concepts, their operationalization, and the decisions made with regard to measurement and data sources.

These recent changes in the configuration of national financial systems are important because they are setting Latin American political economies onto divergent paths that are unlikely to converge in the future. While it is still too soon to do a comprehensive assessment, these developments are likely to have important implications in the coming decades for the type and sectoral profile of the large domestic firms that will surge as the most competitive in each country, for the capacity or difficulty of middle-sized firms to grow and move towards innovative industries, and ultimately for national growth models. These contemporary variations are likely to reshape the economies of Latin American countries, affecting, for instance, whether they evolve to be more export-oriented or more dependent on the domestic market, more focused on commodity production or more focused on new comparative advantages in higher value-added production.

Figure 1.1 shows that Brazil and Chile are on the higher end of the spectrum in terms of the access or availability of long-term finance for the productive sector, whereas Argentina is situated at the lowest level and Colombia, Mexico, and Peru cluster around middle levels of long-term finance availability. While it would not be accurate to say that any of these developing economies is currently in an optimal position in terms of corporate access to long-term finance, the data synthesized in Figure 1.1 neatly indicate that some countries are closer to the optimum

and some others are in perplexingly suboptimal positions. Furthermore, Figure 1.1 suggests that there is no single road to success; rather, there are different "blends" that enable greater or lesser availability of long-term capital for a country's firms. Contemporary Latin American countries therefore differ with regard to modes of access to long-term finance: in countries like Chile, Mexico, and Peru the market plays the principal role in channeling funds for corporate investment while the state is minimally involved as a direct provider of finance; Brazil mixes a remarkably high level of state provision of finance with a rather large stock market; in Argentina, the provision of long-term capital is clearly dominated by the state, with the market playing a virtually negligent role.

I next unpack the summary scores snapshotted in Figure 1.1, shedding more light on the varieties of national financial systems in contemporary Latin America. Let us start with domestic stock and corporate debt markets, which together form and configure each country's capital market. There is no single, straightforward way of comparing domestic capital markets. Since multiple variables affect the nature of these markets and their modes of operation, no comparative metric exists that does not have some arbitrary assumptions and biases. Even capital market size, which may at first glance seem plain and simple to grasp empirically, is actually a slippery concept to operationalize. I have therefore chosen a two-step strategy. I first compare Latin American domestic capital markets through an index that is effective for mapping country cases with a single summary score and for conveying the range of within-region variation. Second, based on a close reading of the literature in economics as well as the insights emerging from field research, I choose the most important dimensions that characterize these markets in order to present a more complex picture (Tables 1.1 and 1.2).

Of all the options I have considered for arriving at a single score that succinctly captures where a Latin American country stands vis-à-vis its regional neighbors in terms of domestic capital market breadth, the following seems the most appropriate. I created an index that gives equal weight to the indicators measuring the size of the domestic stock and corporate debt markets (Domestic Capital Market Breadth Index, DCMBI). I then normalized the country scores to a 0-1 range. A country that receives a zero in the DCMBI has *both* a small stock market and a small corporate debt market; a country with a score of 1 has large stock *and* corporate bond markets; countries with scores in between have *either* a large stock market *or* a large corporate bond market *or* two medium-sized markets.

The selection of the input data for constructing this index deserves a note, as well, since it is not the most obvious choice. De la Torre, Feyen, and Ize (2013) developed a method for "benchmarking" what they call the level of national "financial development" in Latin American countries. Instead of just reporting, as virtually all studies do, each country's stock market capitalization and volume of outstanding domestic private debt securities (both as proportions of GDP), De la Torre et al. (2013: 139-40) provide these figures with the corresponding benchmark for each country.[63] That is, this measure assesses the size of a country's domestic capital market, taking into account its level of economic development (as proxied by income per capita) and structural factors, such as country size, that affect financial development.[64] I take the ratio of each country's observed value to its benchmark for the following two variables: stock market capitalization (as a percentage of GDP) and outstanding domestic private debt securities (as a

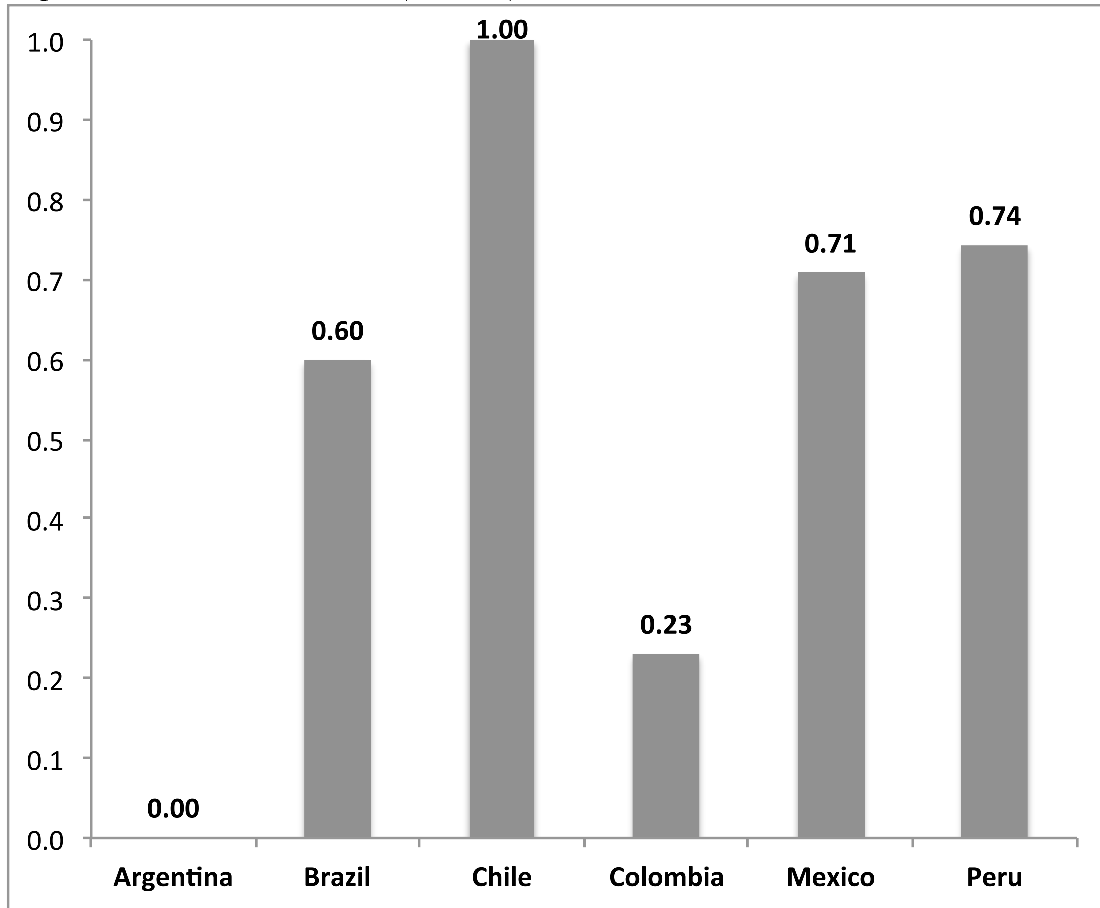
[63] The authors do not provide the exact data points. The input figures for my DCMBI come from unpublished World Bank data.
[64] De la Torre et al. (2013: 131).

percentage of GDP). I then normalize country scores to a range between zero and one, and finally give equal weight to each of these two normalized scores in the aggregate DCMBI.[65]

As a result of these decisions, my DCMBI should be read as a summary measure that not only indicates where each country stands in the region in terms of the breadth of its domestic capital market, but that is also sensitive to the fact that domestic capital markets do not develop in a vacuum; rather, the size of a country and its economy set the parameters that bound potential capital market enlargement. Figure 1.2 presents the score of my index for six upper-middle-income Latin American countries. Chile stands out in the region for having both a large stock market and a large corporate bond market. Argentina is at the antipodes: taking its own benchmark into account, both its stock and corporate debt markets are remarkably small relative to its regional neighbors. The medium scores reflect somewhat variegated situations: Mexico combines a large corporate debt market—comparable to that of Chile, with all controls considered—with an impressively small stock market, not too far from the smallness of the Argentine market, whereas Brazil and Peru score in the middle range for both segments of the domestic capital market.

[65] In giving equal weight to the stock and corporate debt markets I am consistent with my critique of the HME Framework. Notwithstanding the region-wide absence of markets for corporate control—an attribute associated with the stock, not the debt market—what is key is using a metric that comprehensively captures the new structures of national financial systems in Latin America, giving appropriate weight to all major forms of domestic finance affecting long-term investment. If our key underlying motivation is tracking down variation in national patterns of investment finance, centering our attention on the stock market to the detriment of the corporate debt market would be a mistake.

Figure 1.2. Large Upper-Middle-Income Latin American Countries by the 2010s: Domestic Capital Market Breadth Index (DCMBI).



Source: Author's calculations based on unpublished 2013 data from the World Bank.

In Tables 1.1 and 1.2, I present additional indicators that allow us to have a more complex take on domestic stock markets and corporate debt markets.

Table 1.1. Attributes of Domestic Stock Markets: Large Upper-Middle-Income Latin American Countries.

	Stock Market Capitalization to GDP (Average for 2008-2012)	*Average Number of Equity Issuances Per Year (1991-2014)*	*Annual Average of Capital Raised Through Equity Issuances, 1991-2014 (in millions of 2011 US$)*	*Capital Raised Through Equity Issuances as a Proportion of Gross Fixed Capital Formation in 2011*
Argentina	12%	9.0	791	0.77%
Brazil	58%	51.0	12,919	2.39%
Chile	112%	24.5	2,217	3.95%
Colombia	55%	8.5	943	1.19%
Mexico	34%	20.3	3,449	1.35%
Peru	56%	5.8	207	0.51%

Source: Author's calculations based on data from SDC Platinum (Thomson Reuters) and the World Bank.

Table 1.2. Attributes of Domestic Corporate Bond Markets: Large Upper-Middle-Income Latin American Countries.

	Annual Average of Capital Raised Through Newly Issued Corporate Bonds (in millions of US$, 2000-2013)	*Corporate Bond Issuance Volume to GDP (annual average for 2000-2013)*	*Corporate Bond Issuance Volume as Proportion of Gross Fixed Capital Formation (annual average for 2000-2013)*	*Corporate Bond Maturity (annual average for 2000-2013)*
Argentina	1,285	0.33%	1.8%	5.5 years
Brazil	21,045	1.40%	7.3%	8.2 years
Chile	3,419	2.04%	9.5%	12.9 years
Colombia	2,549	0.86%	3.7%	8.9 years
Mexico	15,639	1.89%	7.3%	11.2 years
Peru	1,260	0.83%	3.6%	10.5 years

Source: Author's calculations based on data from SDC Platinum (Thomson Reuters) and the World Bank.

In Table 1.3 I assess the contrast across large Latin American countries in terms of state involvement on the credit-side of the national financial system. In order to score cases, I identified the main "pure" development bank in each country and then analyzed its loan portfolio. Slightly adjusting IADB's (2013: XIV-XV) concept, I define a *pure* development bank as a state-owned financial institution whose exclusive mandate is to promote development by financing specific economic activities, sectors, or segments. As IADB (2013: XIV) states, this concept contains two key elements: "(i) public participation in the financial system, and (ii) the specific goal of providing financing for projects considered valuable for economic development or that are key elements of national public policy." Pure development banks are therefore quite different institutional "creatures" from public commercial banks, such as the Chilean BancoEstado or the Banco do Brasil, which are excluded from my study. The principal activity of this other type of state-owned banks is precisely commercial: they are inherently different from pure development banks because they replicate the functions of private banks and are focused on making a profit (IADB 2013: XIV). Following these criteria, Argentina is the only large Latin American country where the main public institution fulfilling development bank functions, the Banco de la Nación, is actually a commercial bank. All other countries have a relevant pure development bank. However, they contrast markedly in terms of the size or scale of *long-term* credit that these development banks provide to the country's firms.[66] My focus on long-term credit—and not on credit of all maturity structures—is rooted in the theoretical considerations presented earlier in this chapter.

As Table 1.3 indicates, Brazil and Chile stand out as prime examples of, respectively, large and small direct state involvement in credit markets: in Brazil, BNDES total loans equal 5.4 percent of GDP—in monetary terms, three times larger than World Bank's worldwide lending[67]—whereas in Chile, CORFO's loan portfolio represents just 0.3 percent of GDP (see Chapters 3 and 4). Colombia and Peru have middle-range development banks, while Mexico is a peculiar case since its development bank is actually focused on short-term lending.

[66] A final note is in order. My scoring strategy focuses on the provision of credit by state-owned institutions—be it directly as first-tier banks or indirectly as second-tier financial institutions—and, hence, does not include state-backed credit guarantees.

[67] Musacchio and Lazzarini (2014: 238-9).

Table 1.3. State Involvement in Credit Markets: Large Upper-Middle-Income Latin American Countries.

		Size of Long-Term Credit for Firms Provided By Main Public Institution Fulfilling Development Bank Functions		
		Small	*Medium*	*Large*
Is the Institution a Pure Development Bank?	*Yes*	Chile, Mexico	Colombia, Peru	Brazil
	No		Argentina	

Source: Author's elaboration based on multiple sources cited in the notes to this table.
Notes: All GDP figures utilized for calculating the relative size of national development bank portfolios are from the World Bank.
Chile: See Chapter 4 for an in-depth case study. CORFO's loan portfolio: 0.3 percent of GDP [My calculations based on data from Muñoz Gomá (2009: 12)].
Mexico: Nacional Financiera (NAFIN) is widely considered the main institution performing development bank functions in Mexico. Though in the last decade its loan portfolio has grown significantly, by 2014 it represented only 0.56 percent of Mexico's GDP [My calculations based on data from NAFIN (2014: 26)]. Data on the maturity structure of this loan portfolio is lacking but country experts consistently describe it as predominantly concentrated on short-term credit and highlight the insignificance of NAFIN's impact on the provision of long-term credit for investment (OECD and ECLAC 2012: 82; Lecuona Valenzuela 2009: 29, 35). Garrido (2011: 134) presents evidence indicating that over 83 percent of NAFIN's induced credit, channeled by private commercial banks, is dedicated to financing working capital.
Colombia: BANCOLDEX (Colombian Business Development Bank) is the development bank par excellence in Colombia (OECD and ECLAC 2012: 80, 82; OECD 2015: 153; Zuleta 2011: 68). Although it was originally conceived as a financier of Colombian exporters, it is nowadays focused on financing firms of all sizes, not limiting its domain of action to trade-related activities (OECD and ECLAC 2012: 82; Zuleta 2011: 78). The bank's portfolio has grown significantly during the 2000s, increasingly prioritizing SMEs, and shifting from a short- to a long-term focus (BANCOLDEX 2009: 14; OECD 2015: 153; Zuleta 2011: 78-83). One of the most important BANCOLDEX lines grants 12-year loans for upgrading firms' productive capacities (Zuleta 2011: 78, 83), a remarkably long maturity for Latin American standards. BANCOLDEX long-term credits to firms equaled 0.5 of GDP in 2008 [My calculations based on data from BANCOLDEX (2009: 14; 2015: 8)].
Peru: Peru's development bank is the Corporación Financiera de Desarrollo (COFIDE) (Castillo Torres 2005: 11; Ferraro and Goldstein 2011: 26; OECD and ECLAC 2012: 80). COFIDE long-term credits to firms of all sizes amounted to 0.96 of GDP in 2014 [My calculations based on data from COFIDE (2014a; 2014b)].
Brazil: See Chapter 3 for an in-depth case study. BNDES total loans equaled 5.4 percent of GDP in 2014 [My calculations based on data from dataset "Top 50 Banks in Brazil," Central Bank of Brazil].
Argentina: Argentina lacks a pure development bank; by far the most important public institution playing a comparable role is the commercial bank owned by the national government—Banco Nación (Ferraro and Goldstein 2011: 24). The Banco de Inversión y Comercio Exterior (BICE) is a public institution that could be considered a pure development bank since it allocates roughly 70 percent of its portfolio to long-term loans for the productive sector; however BICE is remarkably small (0.04 percent of GDP by 2012) and it lacks a clear mandate (Goldstein 2012: 8; Mercado 2007: 10-3). While the other two main public commercial banks—i.e. Banco Provincia and Banco Ciudad—do have some lines of long-term finance for corporations, they depend on subnational governments and are much smaller than Banco Nación.

Banco Nación's long-term credits for the productive sector amounted to 0.65 percent of GDP by 2012 [My calculations based on Goldstein (2012: 8) and ECLAC data].

3. The Politics of Financial Systems: How States Shape Markets in Latin America

My findings and argument—developed in Chapter 2—challenge two major, well-established scholarly approaches. Within the political economy subfield of political science, my study defies, at the most fundamental level, the new conventional wisdom: whereas the HME Framework posits that the largest and most advanced Latin American countries all fit under a single model of hierarchical market economy, I observe diversity across Latin American political economies. In accounting for contemporary cross-national diversity, my argument focuses on how national paths originated and evolved over time. The approach presented in Chapter 2 of this study, therefore, not only departs from the lumping spirit of the HME Framework but also adopts a different analytical perspective, reintroducing a focus on the role of the state in contrasting types of capitalism and tracing historical processes that unfold over a long period of time. Where the HME Framework finds one *variety*, I find *varieties*; explaining this diversity pushes me to challenge a rather static account in which the state receives limited attention, and to put forward a diachronic, state-centric argument.

My study also departs from economists' take on national financial systems. Economists overemphasize the importance of factors conventionally associated with the fate of domestic financial markets: the degree of protection of property rights, the rate of economic growth, the inflation level, and levels of fiscal surplus or deficit. I do not deny that these are important variables in accounting for the different trajectories and configurations of national financial systems. However, this conventional wisdom, which subsumes financial systems under too general and apolitical trajectories of macroeconomic and institutional stability (or the lack thereof), fails to observe that domestic financial markets are political constructions. Institutional engineering and political economy drivers are therefore critical:[68] the enlargement of domestic sources of long-term investment finance is not a product of the removal of obstacles to market activity; rather, credit and capital markets result from the interaction of economic *and* political variables—policy choice shapes the evolution of markets, which in turn shapes future policy choices. As a pioneering economist put it, we need to expand our vision of what states do—from "market fixer" to market shaper and creator (Mazzucato 2015: 15, 19).[69]

When trying to connect market outcomes with potential drivers of variation, mainstream economists' views of politics and the state are much too simplistic. When most economists talk about "the state," they do not unpack it, and so fail to see the tensions within it, and the multiple grey areas that lie between "market-oriented" and "statist" or "populist" policy orientations. The lack of texture in the approach of many economists to the politics of financial systems is reflected in the well-known, vague policy recommendations frequently proposed in many reports published by international financial institutions: guarantee "sound macroeconomic management," "fix the fundamentals," "ensure contract enforcement" or simply "eliminate

[68] This is inspired by and builds on Barma's and Vogel's (2008: 1-3) "market-institutional perspective" of political economy.

[69] An exemplary exception of this simplistic view within mainstream economics is Rodrik (2007). See Vogel (2016) for a comprehensive analysis calling political economists to go beyond mainstream models from economics and devote more attention to the politics of market development and "*marketcraft*."

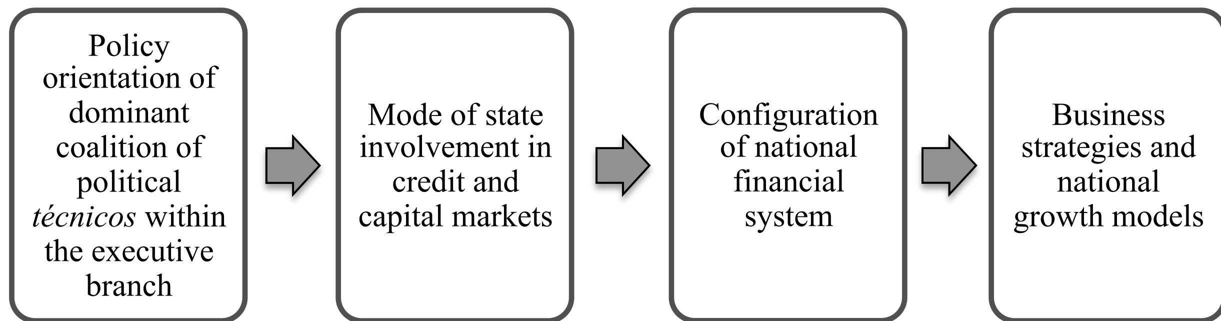
policy distortions." Furthermore, the econometric approach—most often deployed in cross-national studies with a large number of country cases—is ill-equipped to explain complex outcomes that result from slow-moving processes and to capture the sequential character as well as the interplay of market and political variables. Econometric models often miss critical interaction terms—the bread and butter of comparative political economy—, suffer from the difficulty of establishing the functional forms of certain relationships, frequently attempt to measure complex empirical realities with problematic proxies, and are often poorly specified, leading us only halfway toward our goal of understanding national trajectories.[70]

In Chapter 2, by leaving aside these two established approaches in political science and economics, I develop an argument to explain the politics of financial systems in Latin America. In contrast to the conventional wisdom, I start with the state and the politics within it. State action is the primary driver of variation in the configuration of national financial systems. Specifically, entrepreneurial political *técnicos* within the state are the first and key determinants of the highly technical, low-salience policies that shape domestic markets. Over time, state structures, features intrinsic to those early policy choices, and interest groups—partly "created" by those policies—tend to operate as mechanisms of path reproduction, stabilizing modes of state involvement in credit and capital markets that vary significantly across countries and are unlikely to converge. I by no means suggest that these modes of state involvement in markets are the only variables that shape the different configurations of national financial systems in contemporary Latin America. Rather, my claim is that it is impossible to understand how these different national financial systems formed without looking at these distinctively *political* factors. In the language of statistical approaches, the omitted variable bias would be too big.

Figure 1.3 presents a stylized version of the argument that I advance in Chapter 2. This introductory chapter has focused on the third and fourth steps of the causal chain in Figure 1.3. Parting company with the new conventional wisdom, I argue that the different configurations of national financial systems are generating increasingly divergent national models of capitalism in contemporary Latin America and, probably, different trajectories of economic growth. The large-scale outcomes in steps three and four of Figure 1.3 motivate this study. However, the theoretical framework (Chapter 2) and the empirical analysis (Chapters 3-6) focus predominantly on the first and the second steps of the causal chain in Figure 1.3. Because of the *political* nature of these variables, it is there that the disciplinary advantage of the comparative historical institutionalist approach of this study lies. Therefore, my primary focus—both in theory building and in empirical analysis—is on the causal link between politics and modes of state involvement in credit and capital markets. With a secondary degree of attention, in the upcoming chapters I also present some evidence suggesting that the politically originated modes of state involvement in markets have important implications for the configuration of national financial systems, for national patterns of corporate investment, and for national growth models.

[70] Some economists have recognized these disciplinary shortcomings. In his landmark review essay on financial systems, Levine (2005: 868) remarked that since "the financial system influences who gets to use society's savings, political forces have everywhere and always shaped financial sector policies and the operation of the financial system." However, reflecting the bias of economics, he then disclaimed that his literature review would not cover "these crucial themes," none of which has been "adequately incorporated into current theoretical or empirical research" (Levine 2005: 868, 920).

Figure 1.3. Stylized Argument.



Chapter 2. The Within-State Politics of Policymaking: Entrepreneurial Political *Técnicos* in the Configuration of National Financial Systems

1. A State-Centric Explanation of the Policies that Shape Market Outcomes

State action is the primary driver of variation in the configuration of national financial systems. Specifically, policy entrepreneurs within the state are the first and key determinants of the highly technical, low-salience policies that shape domestic markets. At the critical nodes of policy *formation*, state actors behave in different ways across countries, likely setting countries along different paths. Over time, state structures, features intrinsic to those early policy choices, and the action of interest groups—partly "created" by those policies—tend to operate as lock-in factors, stabilizing country paths that are unlikely to converge. Therefore, if we do not study the influence, preferences, and strategies of state policy entrepreneurs, whose policy choices set different modes of state involvement in credit and capital markets, it is impossible to understand the observed variation in the structure of domestic markets across nations. In the language of statistical approaches, without close attention to state actors' actions, the omitted variable bias is too great.

As will become clear in the following sections of this chapter, while my study is specifically centered on the policies that shape domestic financial systems, I aim more broadly to refine future research on state-centric accounts of policy outcomes. My framework builds on and challenges several disconnected scholarly traditions to enable scholars take a step forward in our understanding of the politics of policy in low-salience, opaque, and technically intensive policy arenas in developing countries. It shares the key insight of scholars working on "the rebirth of policy-focused political science" (Hacker and Pierson 2014: 643): an emphasis that runs contrary to mainstream, "Downsian" political science, which looks primarily at the competitive game of political parties in the electoral arena, and does not take us far in explaining major policy outcomes of interest. I expect the propositions of my framework to explain outcomes in polities in which two conditions hold: first, policy decision-making is centralized in the executive branch of government (i.e. with legislatures playing a marginal role in the policy arenas under study); and second, bureaucracies are weak or only partially developed.

Figure 2.1 presents a stylized version of the argument, serving as a roadmap for this chapter. Both the theoretical propositions in this chapter and the empirical analysis in the coming chapters of this study focus predominantly on the first and second steps of the chain in Figure 2.1. Because of the *political* nature of these variables, it is in these first two steps that the comparative advantage of a political science study lies. With this said, and without neglecting the effect of non-political, *economic* variables on the third and fourth steps in Figure 2.1, I do claim that the politically-originated modes of state involvement in credit and capital markets have strong implications for the configuration of national financial systems, as well as for business strategies and national growth models. Therefore, while the focus of this study is on steps one and two in Figure 2.1—and the mechanisms connecting them—throughout this and the following chapters I also present analytical claims and empirical evidence on the connection between steps two, three, and four.

Figure 2.1. Stylized Argument.

(1)		(2)		(3)		(4)
***Time 0*: Policy Orientation of Dominant Coalition of Political *Técnicos* Within the Executive Branch**	---->	**Mode of State Involvement in Credit and Capital Markets**	---->	**Configuration of National Financial System**	---->	**Business Strategies and National Growth Models**
***Time [1,...,n]*: Strength of Statist and Societal Mechanisms of Path Reproduction**						

The argument that I develop in this chapter serves as a framework for the empirical analysis that I conduct in Chapters 3-6. This new framework fulfills two main goals: first, it gives the reader a stylized analytical compass that both eases the navigation of the empirical complexity presented in Chapters 3-6 and hints that the logic at work is generalizable beyond the cases included in this study. Second, this framework is to my knowledge the first attempt to connect scholarly lines of inquiry and empirical observations that until now have only been studied separately, by scholars with different methodological and disciplinary affiliations. Despite its limitations, then, this framework marks a step forward in our understanding of major transformations taking place in the political economy of Latin America.

Panoramically, this chapter is composed of two main parts: the first is state-centric and deals with the politics of policy *adoption* (Sections 3 and 4), while the second focuses on both state and societal factors to address the likely *resilience* of those earlier policy choices and their evolution towards stable modes of state involvement in domestic markets (Section 5).

At a more detailed level, the organization of the chapter is as follows. Section 2 specifies the set of policies to which this framework applies, motivating their relevance both theoretically and empirically. The third section offers an introduction to my state-centric framework, distinguishing my approach from interest group-centered accounts of policy formation. The fourth section starts by asserting that in order to work causally with the *state as actor* we need to specify how the state acts, identifying the key agents with precision. I therefore introduce the claim that the action of entrepreneurial political *técnicos* within the executive branch is the first step in my causal chain. Subsection 4.I characterizes political *técnicos* and provides reasons to avoid confusing these policy entrepreneurs with presidents, members of congress, career bureaucrats, epistemic communities, and technocrats. I then proceed with Subsection 4.II, in which I engage with principal-agent theories to argue that political *técnicos* in the type of policy arenas that I study most often receive what I call "incomplete mandates"; hence, although they are appointed, these policy entrepreneurs are not simply agents: they are agenda-setters and relatively unconstrained designers of policy. In Subsection 4.III I take a step forward in characterizing the low-salience, opaque, and technically-intensive policy arenas of my study, and engage with recent scholarship on business power to provide the reasons for why business actors are not primary drivers of policy during the formative phases of state involvement in markets.

Subsection 4.IV is dedicated to the role that political *técnicos*' ideas play in my framework, followed by Subsection 4.V, which stresses the importance of identifying dominant and subordinate coalitions of entrepreneurial political *técnicos* within the state. While Sections 3 and 4 present a framework to study the formative moments of the modes of state involvement in credit and capital markets (time 0), the fifth section of this chapter unpacks the sources of positive feedback that are likely to make these modes resilient over subsequent time points (time [1,...,n]). This fifth section argues that there are both statist and societal mechanisms of reproduction in the path-dependent politics of state involvement in domestic markets, reintroducing interest groups into the analysis as a driver contributing to policy continuity. Business power, sidelined by my framework as a driver of policy formation, does become an important factor in explaining policy resilience. The closing Section 6 replaces the variables in this framework with proper names, foreshadowing the empirical analysis of the contrasting trajectories of Brazil and Chile, the focus of the next chapters.

2. The Two Key Sets of Policies: State Involvement in Credit and Capital Markets

I argue that there is a small set of policies that are key for understanding why the configuration of domestic markets in twenty-first-century Latin America differs so markedly across countries: state-owned banking institutions' provision of long-term credit to a country's firms and the governance of the private segment of the pension system. In this section I identify the empirical referent to which my analytic framework is applied (Chapters 3-6). It should be noted at the outset that the insights developed in this chapter are likely to apply to other policy arenas, including policies to promote innovation in industries ranging from information and communications to healthcare, biotechnology and green energy.[71] In this type of policy arena, policy does not clearly fall within existing sectors and/or target industries have not yet emerged; in these contexts it is unlikely that there will be business actors focused on technical policymaking.

States get involved in markets through multiple policy channels. Addressing the full set of policies that matter in explaining why national financial systems vary is well beyond the scope of this study (or, for that matter, any feasible doctoral dissertation). For instance, I am not including macroeconomic management in my set of policies, though its effect on domestic financial systems is rather obvious. My research strategy and my analytical claims are different: on the one hand, they are more modest, in that they address only some of the policies that shape domestic markets; on the other hand, they are more innovative than previous research on this topic. Variation in state-owned banks' provision of long-term credit for firms and the governance of the private segment of the pension system do not fully explain the observed outcomes. Yet this small set of policies does have significant explanatory power. In this study I prioritize somewhat arcane policy arenas that, to my knowledge, have not yet been studied as part of a single research project and under a unified framework. On top of that, while acknowledging at the outset that there is much more that should be analyzed to explain varying configurations of national financial systems, I do make a strong statement: if we do not study the policies on which

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[71] This insight about the potential to expand the logic I proposed to other policy arenas is inspired in Mazzucato (2015). Due to her disciplinary belonging to economics, though, her focus and contributions are very distant from mine.

this study is focused, it is impossible to understand over-time variation within countries and across nations in the structure of domestic markets.

Let us begin with the mode of state involvement in credit markets. As highlighted in the introduction of this study, my interest in financial systems is restricted to factors that affect firms' investment finance. Therefore, whenever I use the term "credit markets," I refer only to markets for corporate credit, and I thus exclude any consideration of consumer credit markets. In assessing the mode of state involvement in credit markets, I will look at the scale of government lending. This variable measures the size of long-term credit provided by state-owned institutions to the country's firms. In most Latin American countries the scale of government lending is well captured by observing the lending of state-owned development banks and/or state agencies that perform functions similar to those of development banks.

The empirical terrain I intend to capture with this dimension overlaps significantly with the "preferential credit schemes" analyzed by Haggard and Maxfield (1993),[72] which pioneered the study of government's role in the allocation of credit, preferential credit policies, patterns of state intervention in domestic financial markets, or credit programs favoring industry in developing countries.[73] "Preferential credit schemes," the authors posited, "typically rest either on direct subsidies or on government control of deposit and loan rates" (Haggard and Maxfield 1993: 299). By examining state-owned development banks in contemporary Latin America, I cover an important part of what states do in terms of providing direct subsidies to the private sector and controlling the loan rates of corporate bank credit; I do not cover, however, the empirics that refer to how governments intervene in the deposits side of credit markets.

In arguing that the policies that underpin the scale of government lending are an important driver of variation across national financial systems in Latin America, I am primarily inspired by the insights of Alexander Gerschenkron's classical work and by Joseph Stiglitz's more recent study of the East Asian experience, which brought the much earlier political science work on the developmental state into the mainstream discussion of economics.[74] Gerschenkron's (1962) was the most influential voice to claim that the role of the state as lender is, at least in theory, particularly important in late industrializing countries. In expectation, countries that enter world markets at a later period of time in history will require greater capital to catch up with countries that entered earlier; in those settings we expect the government to play a role in providing financial resources for long-term investment.

After the demise of the inward-oriented import substitution industrialization (ISI) model, all Latin American countries faced the common need to compete in world markets. Entering world markets at such a late stage as the 1980s and 1990s, at least in principle, provided Latin American countries with the common challenge of closing an enormous gap between the amount

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[72] This was the concluding chapter of an edited volume (Haggard, Lee, and Maxfield 1993) that could be seen, in retrospect, as the most ambitious, agenda-setting attempt to launch a comparative political economy of finance and state intervention in credit markets for the developing world. In a way, such book could have been what Zysman's (1983) was for the CPE of finance in advanced countries. While one could reasonably argue that such agenda failed to develop and thus deliver the book's promises, it seems important to note here that my dimension *scale of government lending* covers an important part of what Haggard and Maxfield (1993) studied.

[73] Haggard and Maxfield (1993: 293-4).

[74] See: Stiglitz (1993: 40-5; 1998: 8-9, 26-7), Hellmann, Murdock, and Stiglitz (1997). On the Asian developmental state see Amsden (1989), Deyo (1987), Johnson (1982), Öniş (1991), Wade (1990), Woo-Cumings (1999). For later work in economics, see Rodrik (2007: 18-19; chapter 4).

of private capital available and the amount required to take off and become competitive. While the sources of long-term capital for investment could potentially be multiple—including foreign inflows of portfolio and direct investment—there are good Gerschenkronian reasons to expect that state involvement in credit markets, mainly through the banking system, is a key variable to track in contemporary Latin America. This is particularly so because Latin American countries, as in the rest of the developing world, have historically had bank-based, rather than capital market-based financial systems (Stallings 2006: 111). In other words, the type and degree of state interventions in bank loan markets should be a key factor shaping varying national architectures of investment finance in Latin America. Gerschenkron very convincingly argued that what states do in credit markets did not matter in the case of early entrants into the world economy like Britain; such is not the case in the post-market-oriented reform period in Latin American countries.

Gerschenkron presented a functionalist account of the evolution of financial architectures that underpinned investment; one that implicitly predicted a monotonic growth of state intervention in the channeling of credit for production. By invoking his work to justify the importance of my variable scale of government lending I do not mean to imply that all Latin American countries will have large state interventions in loan markets. My claim is that what governments do in Latin American credit markets is important—even if they do very little or barely "nothing." In other words, the variable is important due precisely to these theoretical reasons… but the variable varies. What one could call "negative cases" of state involvement in credit markets—i.e. simplistically, cases in which the state has a hands-off approach regarding the availability of long-term bank credit, letting the market do—are as important as "positive cases"—i.e., again, schematically speaking, cases in which the state takes comprehensive actions in order to increase the availability of long-term bank credit. I expect the framework presented in this chapter to apply for accounting for both negative and positive cases of state involvement in credit markets, and I claim that such variation should be highlighted as a key factor contributing to contrasts across national financial systems.

State regulation of the private segment of the pension system affects the growth of domestic capital markets.[75] While some modes of pension system regulation will lead pension funds to channel significant flows of finance to either the equity or the corporate bond market, or to both, other regulatory patterns generate inducements for pension fund investment in other types of assets (e.g. foreign bonds, government debt, and short-term bank deposits), diverting financial flows away from the domestic capital market. I will supplement this primary mode of state involvement in capital markets with other, secondary policies that serve as tax incentives to capital market deepening and as legal underpinnings of capital markets—especially those affecting corporate governance standards. Interestingly, as I will show in the empirical chapters, in practice these policies of secondary causal leverage are rarely independent from the mode of pension regulation. The modes of regulating this private-run segment of the pension system are defined not just by the formal rules but also by long-standing informal practices. Thus, it is key to observe how regulation, which is heavily dependent on informal institutions and varying styles of rule enforcement, actually works.

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[75] A vast body of literature has already explained the macro-dichotomy across countries between those that privatized their pension systems and those that retained their state-run, pay-as-you-go systems (Brooks 2009, Kay 1999, Madrid 2003, and Orenstein 2008, are particularly influential). However, to my knowledge there is no research on the variation across private-run pension systems and the effects these different pension systems have on national political economies.

While pension regulation may at first appear unlikely to be a driver of variation of national financial systems, it is in fact an important factor: in modern economies, after all, pensions play a major role in determining where the funds for investment come from and how they are channeled.[76] This is particularly true in Latin America because, as the region has historically been strongly affected by the volatility of international markets,[77] the national pension system has become a critical source of patient capital. These privately run but heavily regulated capitalization accounts—in contrast with PAYG ("pay as you go") pension systems—by design pool large volumes of capital and have long-term liabilities, which turns pension funds into the most important domestic institutional investors. Although at any point in time foreign portfolio investment may surpass domestic pension funds in the amount of finance they channel to the domestic capital market, what this study stresses is the fact that, in contrast to the volatile behavior of foreign portfolio investors, pension funds are uniquely attached to the long-term "fate" of the country in which they operate. These domestic roots have major implications for the evolution of domestic markets in the longer run.

Hence, I argue that in contemporary Latin America understanding the contrasts between different modes of state involvement in capital markets and their effects on the breadth of domestic capital markets requires delving into the technical and opaque politics of pension system regulation. The modes of regulation shape pension funds' time horizon as institutional investors and are therefore key determinants of the extent and the form in which pensions' financial assets flow to two critical segments of the national capital market—the stock (or equity) market, and the corporate debt (or corporate bond) market. Compared to foreign institutional and other types of domestic investors, pension funds' investment behavior is more directly and strongly dependent on politically defined regulation.

In sum, I hold that there is interesting variation in the modes of state involvement in credit and capital markets. Studying how these different modes come to be formed—and whether and why they are resilient—is important because they are a critical factor shaping the structure of national financial systems, corporate investment strategies, and ultimately the nature of capitalism in contemporary Latin America. In order to ground the study of state involvement in credit and capital markets, I identify two key dimensions: *state-owned banking institutions' provision of long-term credit to a country's firms* and the *mode of regulation of the private segment of the pension system*. The former has a long pedigree in the scholarship on late industrialization and the developmental state, whereas the latter is relatively arcane and largely ignored by a political science community that often only sees pensions as part of the welfare state. To my knowledge this study is the first to connect these policy arenas and to offer a single framework for accounting for variation on these dimensions across and within countries over time.

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[76] In a seminal but rarely cited work, Estevez-Abe (2001) pointed that what she calls the "welfare-finance nexus" is a "forgotten link" in the literature that compares national models of capitalism. Her study of how Japanese pension funds affect investment finance sets a precedent to the line of inquiry pursued here. The small literature on this forgotten link includes Jackson and Vitols (2001) and Park (2004). More recently, scholars have extended this approach beyond advanced industrialized countries; however, they focus on outcomes different than that of my study. Naczyk and Domonkos (2016) traced the welfare-finance nexus in East European countries with the goal of explaining the reversal of pension privatization in the aftermath of the 2008 world financial crisis. Datz (2014) was the first to introduce a typology of Latin American pension systems with a focus on finance.

[77] See, for instance, Frieden (1991) and Wibbels (2006).

3. The State at the Center and the Politics Within

"States (...) may formulate and pursue goals that are not simply reflective of the demands or interests of social groups, classes, or society. This is what is usually meant by 'state autonomy.'"
Skocpol (1985: 9).

"The activity of interest groups often seems to follow rather than precede the adoption of public policies."
Pierson (1993: 598).

"The regulators are all at the table where the legislation is made—and we are not."
City of London lobbyist[78]

The argument of this study builds on the influential scholarship that brought the state back to center stage in comparative political economy.[79] I take this canonical approach as a point of departure to develop a framework that engages with lively contemporary debates, including those surrounding principal-agent theories of politics within the state and business power in policymaking. The renewed state-centric strand of research was a much-needed correction of the pluralist take on policy outcomes, which hinged on societal pressures. Reacting to pluralism entailed recognizing that the state actually has considerable autonomy from interest groups and electoral coalitions and therefore it is in itself an important driver of public policy (Hall 1993: 275). My causal chain, thus, starts with the state.

This analytical decision is heavily informed by a venerable tradition in Latin Americanist political science and by findings from the field. Latin America has a long history of state-centeredness that dates to the advent of the state-led import substitution industrialization (ISI) model in the first half of the twentieth century. In Latin America not only did pluralist patterns of interest intermediation never emerge, but this was also the region in which *state* corporatism was "created," in marked contrast with European *societal* corporatism (Schmitter 1974; Collier and Collier 1979). In some ways, for Latin Americanists the call to bring the state back in sounded awkward: for many scholars who had already been studying the region when the Evans et al. (1985) volume was published, the Latin American state had never ceased to be "in"—rather, it had always taken center stage. Canonical works in Latin Americanist political science long ago learned the apparently simple but actually remarkable lesson that state actors' goals should be taken seriously as independent variables;[80] if we do not treat the preferences of state actors as

[78] Cited by Vogel (1996: 19).
[79] Evans, Rueschemeyer, and Skocpol (1985).
[80] I am referring to the work of Ruth Berins Collier and David Collier in the late 1970s and its subsequent unpacking, refinement, and extension in *Shaping the Political Arena*. See, for instance, Collier and Collier (1979: 968-70, 974-7; [1991] 2002: chapter 5, especially pp. 162-7). More recently, Schneider (2004: xxi-xxii, chapter 2, especially pp. 26-36) explicitly drew inspiration from those works to build a

variables that vary across and within countries over time, then we simply cannot explain multiple proximate outcomes of interest and processes that unfold over long periods of time.

My claim is that even in cases like Chile, where business power is pervasive and state leaders are thereby strongly constrained,[81] we miss too much if we do not acknowledge, first, that in Latin America states have relative autonomy from societal pressures to *initiate* policy; and if, second, we do not take the micropolitics within the state seriously.[82] In certain types of policy arenas—which I will characterize in this chapter—business power, of course, matters a great deal—but it does so later on in the causal policy making sequence: it is a mechanism of path reproduction rather than the root cause of policy origination. I thus concur with Ben Ross Schneider in claiming that a very important task ahead is to reverse the under-theorization of the state in Latin America. In this region, as he has argued, it is necessary to incorporate a microscopic view that focuses on state actors and their goals and resources, and that considers the consequences of intended actions as well as unintended byproducts.[83]

I start the causal chain with a specific set of actors within the state—executive-branch political *técnicos*, who act as policy entrepreneurs (see Section 4.I)—to deal with the *formative* moments of policies that shape markets. But, building on the literature on path dependence and feedback effects, time and sequencing in politics;[84] I argue that the reproduction of earlier policy choices over time—and thus, the emergence of stable policy paths—depends both on state structures that those early policies shaped, and on pro-continuity action of interest groups that those policies either created or strengthened. In my argument, the *state as actor* is the primary—and temporally prior—source of policy variation, while the *state as structure* and interest group politics are posterior drivers that make policy paths stable—that is, they are sources of positive feedback that increase the likelihood that particular modes of state involvement in credit and capital markets lock in.[85]

Because Latin American states vary as actors, in the twenty-first century countries diverge remarkably in the pattern of state involvement in credit and capital markets. Contrary to expectations about a potential convergence to relatively homogenous forms of state-market relations in the period that started with the demise of the statist, ISI model, in the more than three decades that followed market-oriented reforms, Latin American states have done significantly different things in their relation to domestic financial markets. National patterns of state involvement in markets have thus emerged and stabilized, setting Latin American political economies onto divergent paths that are unlikely to converge in the future. While multiple other factors—many of which are economic—undeniably play a role in explaining variation across national financial systems, we cannot understand these contrasts without highlighting this political explanatory factor.

Chapters 3 through 6 examine within-country, over time variation in state involvement in credit and capital markets in Brazil and Chile. Since these two different national patterns resulted from a path-dependent process, my empirical analysis provides a state-centric political

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framework for the study of business politics that attributes a primary causal status to state actors' goals and behavior.

[81] Fairfield (2015a); Madariaga (2015); Maillet (2013).

[82] My decision to highlight the importance of micropolitical conflicts within the state was strongly inspired by Kurtz (1999).

[83] Schneider (2004: 22, 24).

[84] Notably, Pierson (1993, 2000) and Thelen (1999).

[85] On states as both actors and structures, see Skocpol (1985).

explanation of the *origins* of contemporary modes of state involvement in markets in Brazil and Chile and then proceeds to examine the causal mechanisms that explain their resilience, as observed in the mid-2010s.

The formative moments of policy paths (time 0) are characterized by their openness and, relatedly, by the key role of within-state agency in setting countries onto particular tracks. In the case of Brazil, the high level of state involvement in both credit and capital markets can be traced to power shifts within the state occurred in the early- and mid-2000s, which favored the adoption of a neo-developmental policy orientation. In the case of Chile, in order to track down the origins of the contemporary neoliberal mode of state involvement in markets we need to go further back in time: Chapters 4 and 6 therefore examine in-depth the power shifts that occurred in the mid-1970s and early 1980s. The empirical chapters then proceed to focus on the feedback effects that those early policy choices triggered. Chapters 3 through 6 show that in the later stages along the path—late 2000s and early 2010s in Brazil, 1990s-2010s in Chile—the original openness receded: state structures, organized actors, and/or policy-specific increasing return dynamics became causal levers that explain the reproduction of neo-developmental (Brazil) and neoliberal (Chile) modes of state involvement in markets.

As developed in Section 2, I argue that states take particular actions that matter a lot in accounting for why the structure of domestic markets varies so widely across countries. The pattern of state involvement depends critically on (a) the scale of government lending and (b) how states regulate the private segment of the pension system. These are domains of state action that most economists neglect because they typically assert that variation in what they term financial depth ultimately (and mostly) depends on whether states ensure the protection of property rights and adopt a stable macroeconomic policy (see Chapter 1). While I acknowledge that strong property rights protections and stable macroeconomic management lead to larger domestic financial markets, I stress that there is much more than those macro-variables of state action that matter in accounting for divergence in the structure of domestic markets. We need to reduce the abstraction in our analysis of the state, and look at widely neglected policy domains that constitute the missing steps between politics and market outcomes.

In contrast to conventional accounts in economics, I do not see the state as an abstract entity, but rather as an organization filled with competing groups of actors. Understanding the politics within the state is crucial for assessing the interplay between states and markets; the political disputes that take place during the formative moments of national trajectories of state involvement in markets are especially important.

As I explain in Sections 4.I, 4.II, and 4.III, state involvement in capital and credit markets is a highly technical and complex realm of state action. These are low-salience policy arenas to which top political figures pay little attention and on which business actors, at the time of policy formation, have cognitive handicaps, and therefore lack well-formed preferences. That is, during the phase of policy formation, the policies that ultimately shape domestic markets tend to be of low salience not just for mass publics but also for business. In policy areas without monopoly corporate players—or even without established companies—or when policy does not clearly fall within existing sectors and/or in policy areas that affect sectors in which corporate structures are diversified rather than specialized—which constrains business's capacity to pay attention to specific policies—rule-making is unlikely to be salient for major corporate actors at the time of policy adoption.

Entrepreneurial political *técnicos* within the executive branch of government are key players in defining modes of state involvement in markets. In these highly technical, low-

salience policy arenas, elite officials have the greatest leverage in shaping decisions such as what types of financial assets privately run—but highly regulated—pension funds should prioritize in their portfolios—or as what share of the government's budget should be channeled to firms through state-owned banking institutions. Therefore, uncovering the logic of state involvement in markets entails looking at specific parts of the state and at a specific set of state actors.

I argue that in the period under study policy entrepreneurs within the executive branch have systematically had capacity to define state policy proactively—that is, we cannot attribute policy choices to pressure from below by interested societal actors.[86] This argument resonates with two highly influential bodies of scholarly work. First, the literature on public utility regulation in both developed and developing countries (Vogel 1996; Murillo 2009), which found that state actors, rather than organized interests, took the initiative in rule making. Second, the recent work on the role of state technocrats in policymaking in Latin America,[87] which showed how the conventional wisdom had downplayed experts' autonomy to advance their own policy goals[88] and specified the conditions under which technocrats succeed in imposing their policy preferences even against those of other powerful actors, including organized business interests.

In the industrialized world the root cause of the varying forms of market regulation across countries since the 1980s, the literature has shown, was the policy orientation of national bureaucracies. Vogel (1996: 20) notes that, when he suggests that the state can be autonomous, he does not imply that state actors can ignore societal groups but, rather, that bureaucrats' preferences cannot be reduced to those of societal interests. In his case studies, Vogel (1996: 4-5) found that state actors were committed to regulatory reform and drove the process, whereas powerful business groups were "hopelessly" divided over, or at times simply not interested in, regulatory reform. Likewise, in his study of the contrasting development strategies adopted in the East Asian and Latin American newly industrializing countries, Haggard (1990: 43) claimed that the beneficiaries of policy reforms "frequently have ambivalent or conflicting interests and may not be important political players [;] [t]heir interest in a new policy course may be revealed only over time."

Drawing inspiration from these works, I argue that critical policy choices that originate modes of state involvement in financial markets cannot be understood without paying attention to the decisive role of policy entrepreneurs within the executive branch of government. I go a step further to argue that the action of entrepreneurial political *técnicos* was the *primary driver* in putting in motion the regulatory paths that we observe: interest group politics might have influenced policy entrepreneurs, but if these entrepreneurs had not been occupying the positions they occupied and had not behaved the way they did, the patterns of state involvement in markets that we observe would have not emerged.

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[86] This approach has a long pedigree in comparative political economy. For instance, in laying out the analytical terrain of his landmark book comparing development strategies in East Asia and Latin America Stephan Haggard argued, "[a] coalitional approach to policy looks at the interests and organizational power of dominant social actors; a statist or institutionalist approach, by contrast, explains policy in terms of the *preferences and organizational power of state elites* […] I focus mainly on *the role of top political leaders in the executive branch*" (Haggard 1990: 43, my emphasis).

[87] In particular, Dargent (2015), which is probably the most analytically sophisticated treatment of technocracy to date for any region of the world.

[88] Dargent (2015: 4).

4. Bringing Agency to a State-Centric Framework: The Key Role of *Political Técnicos* as Policy Entrepreneurs

"The definition of the alternatives is the supreme instrument of power."
Elmer E. Schattschneider[89]

Scholarly work that identifies the state as a key driver of policy outcomes typically lacks agency. Most arguments tend to emphasize the *state as structure* to the detriment of the *state as actor*. And even those that do stress the state as actor underspecify the complexity of agency. How does the state act? As Hall (1993: 275) has asked, "what motivates the actions of the state, if it is not the factors previously identified by pluralist analysis? How are we to conceive of the policy process if not as a response to societal pressure?" Who are the actors within the state that matter to put the state to work as an independent variable? And once we have identified the relevant agents in the policy arenas of our interest, can we advance our knowledge about the microfoundations of within-state behavior?

If we are to take seriously the state as a driver of policies that shape market outcomes, we need to look for the relevant agents within the state. *Political técnicos* or *altos funcionarios* (elite officials) within the state—labels that I use interchangeably—act as policy entrepreneurs who dominate the formative phases of the policies that, in the longer run, determine modes of state involvement in credit and capital markets. These highly ambitious top officials are career-driven and combine relatively high technical training with brokering skills in within-state politics. In the vast majority of real-world situations, these elite public officials are found in the first and second tiers of the hierarchy of executive-branch agencies and ministries; they are deputy ministers, secretaries, undersecretaries, presidents' or ministers' top advisors or chiefs-of-staff, and chiefs of other executive branch-dependent agencies. These elite state actors are rarely career bureaucrats; instead, they employ career bureaucrats to help them draft policy proposals that reflect their own preferences. At any given point in time, a country may have between a handful and a few dozens of such top-level policy entrepreneurs.

Without neglecting the fact that (as is true of any other political actor) elite public officials make choices that take into account what they perceive as contextual constraints, I argue that these state actors are not simply agents of more powerful principals.[90] At first, this may sound counterintuitive because the president directly or indirectly appoints all of these elite public officials. However, I claim we cannot understand the policies of state involvement in domestic financial markets without acknowledging that these elite public officials are at least partially autonomous actors—that is, that they can at the same time fulfill their role as agents of other principals and also push their own agendas.

I argue that when elite state officials are appointed they receive what I call *incomplete mandates*. Presidents do not care, and/or do not have the resources and capacity, to micromanage their appointees working on low-salience, technically opaque policies. This is especially true in developing countries, where decision-making is *de jure* or *de facto* concentrated in the executive branch, bureaucratic apparatuses are weaker, and presidents face strong incentives to be

[89] Cited by Haas (1992: 16).
[90] Especially on this point, this framework is strongly inspired by and builds on Dargent's (2015) theory of technocratic autonomy.

perceived as hyperactive in order to continuously counterbalance their countries' histories of political regime and economic instability. The overwhelmed chief executives of countries as those in Latin America focus their efforts on issues with major, short-run political impact, leaving mandates that are particularly incomplete to their appointees in charge of opaque and technically intensive policies.[91] Top-level appointees are thus key actors advocating the precise policy alternatives in Latin America.

Within every state apparatus, at any point in time, there are groups of policy entrepreneurs that are dominant and groups of policy entrepreneurs that are subordinated. The winning coalition of policy entrepreneurs, to use Schattschneider's words, gets to define the alternatives—that is, which policies are viable and which are not even considered as options. While formal policy enactment is later on carried out by political figures with higher public visibility, including presidents and ministers, policy entrepreneurs are key drafters of the low-salience, highly technical policies of this study because they have strong—but widely neglected—influence in setting the boundaries of the policy space, that is, in choosing what sorts of activities are "viable" for the state in its involvement in markets.[92] Explaining the origins of the policy processes that shape domestic markets entails identifying which was the group of policy entrepreneurs that prevailed in the phase of policy formation, and characterizing the ideas that oriented their actions. In this type of empirical analysis, an effective way to uncover the attributes of the winning group of political *técnicos* is by carefully identifying who were the losers—and tracking the process by which one group won, and the other lost.

Zooming into the micropolitics within the higher layers of the state is one of the most important contributions my framework makes to the current scholarly debate about policy adoption in technical and low-salience policy arenas in the developing world.[93] The most

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[91] Dargent (2015: 37-8), specifically referring to technocrats, makes a similar point: "Th[e] asymmetry of expertise between experts and politicians is considerable in Latin America. In much of the region, politicians lack the technical capabilities and institutionalized bureaucratic support of their counterparts in developed countries […]. Whereas politicians in the United States and Europe may have access to experts employed in their party or elsewhere in the bureaucracy who can evaluate technocrats' proposals and actions, the relative scarcity of such expertise in Latin America makes politicians more dependent on experts. Therefore, these stark technical asymmetries endow technocrats with considerable autonomy, even if they lack the institutional protections enjoyed by high-level bureaucrats in developed democracies." In his empirical analysis he documents "how several reforms that were implemented in Latin American states were not closely monitored by politicians. Rather than seeking to enhance their electoral interests through public policy, as expected by a political-agents theory, politicians often remained ignorant of technical procedures and the complex reforms taking place. Although these reforms frequently affected their interests, politicians were unaware of their full implications" (Dargent 2015: 23-4).

[92] Hacker and Pierson (2002: 284), in their study of business power in policymaking, make a similar point about the importance of identifying how policies come to be discussed within a rather narrow part of the policy space: "Although the final choice between (…) two 'viable' alternatives is the most visible part of the policy-making process, it is often not the crucial one. Rather, the most significant aspect of influence involves moving the decision-making agenda toward an actor's preferred end of the spectrum."

[93] Zeroing in on the micropolitics of policy adoption implies taking seriously the idea that the politics of policies in arenas to which presidents do not pay much attention does not stop, but rather starts after appointments are made. It requires taking seriously that policy adoption and change result from processes that unfold and are often affected by contingent factors. Zooming in on these micropolitical dynamics within the state does come with the drawback of downplaying the effect of factors exogenous to the state, ranging from coalitional, Gourevitch-like drivers to international political economy factors.

sophisticated existing theories on policy adoption in Latin America, in arenas—like the ones in my study—for which we have reasons to believe business actors will matter, have made enormous progress in identifying factors that constrain the spectrum of "viable" policies from which state actors can choose. In particular, scholars working on business power and the disciplining effects of international markets over governments (Fairfield 2015a; Campello 2014) have specified conditions under which some policy alternatives are perceived by policymakers as foreclosed. However, the existing literature systematically leaves us ill equipped to explain the specific *content* of policies adopted.[94] While the existing scholarship is very effective in laying out a logic to explain why certain policy choices will be ruled out, it fails to explain positive instances of policy adoption—as well as their *timing*: why are policies adopted when they are adopted?[95] The call of an earlier generation of scholars (Schneider 1991; Sikkink 1991) about the need to improve our knowledge about what happens within the "black box" of the Latin American state continues to indicate how to move forward. As Kurtz (1999: 424, 426) has argued, even if one wants to propose an explanation of policy adoption based on the societal coalitions that support governments, it is essential to study the "micropolitical" contexts and conflicts in which decisions are actually carried out.

The work on technocracy and epistemic communities (Dargent 2015; Haas 1992) is a great supplement to the cited perspectives on the constraints over policy choice insofar as it does take the micropolitics within the state seriously. However, this strand of research still leaves us dissatisfied because (a) it overemphasizes the political power of knowledge—neglecting the fact that elite state officials in technical policy arenas rely just as much on their political skills as on their knowledge to succeed in the micropolitics within the state;[96] and (b) it oversimplifies what expert knowledge is, virtually assuming that in technical arenas such as economic policymaking there is only one "right" policy orientation—which obscures our capacity to identify crucial conflicts within the state among groups of technically trained elite officials who disagree on "the right recipe," and ultimately leaves us unable to explain why technical policies adopt such different orientations across cases.

In studying technical-political arenas, Murillo (2009) offers a more helpful argument insofar as she finds variation in the types of experts that participate in the technical arena of

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Without neglecting the invaluable contributions of those bodies of scholarship, I contend that they explain policy choice from too "remote" a position because they fail to recognize that, no matter how strong the effect of independent variables exogenous to the politics within the state may be, it takes officials sitting in powerful executive-branch offices to design and advocate precise policy alternatives. I do not intend to argue that the question of "who calls the shots in policy choice?" could be fully answered by looking at the battles within the executive branch. Rather, my point is that, while we already know a lot about the factors exogenous to the state that constrain executive-branch leaders, previous scholarship has sidelined our capacity to deepen our thoughts about the within-state actors and political dynamics that necessarily play a role in shaping policy choices. I contend that reorienting our focus the way laid out here will ultimately improve the existing narratives of case trajectories and trigger new analytical debates.

[94] The literature on policy diffusion is an exception in this regard. See, for instance, Weyland (2005, 2006), and, more recently, Andrews (2013).

[95] Murillo (2009) and Weyland (2006) are notable exceptions, as well as the work on the diffusion of bilateral investment treaties (e.g. Elkins, Guzman, and Simmons 2006).

[96] Domínguez (1997: 4-7) characterization of "technopols" is in fact highly sensitive to this point. I do not employ his conceptual framework, however, because it deals with an empirical terrain with very different boundaries than that of mine: technopols include prominent political figures such as presidents and leaders of opposition parties in congress.

public utility regulation. However, while the experts that are studied in Murillo (2009) internalize partisan concerns, looking out for key constituencies, the elite state officials that are the focus of my study work on policy issues which—compared to issues such as public utility price regulation—are significantly less salient for the mass public and on which not only the mass public but even organized interest groups are unlikely to have well-formed preferences at the time of policy adoption. In explaining my cases, then, Murillo's framework is only of limited help: for top-level appointees to internalize the preferences of the mass public and then advocate for their reflection in policy content, those preferences need to be formed in the first place. We cannot assume that is the case when studying the policies that shape financial markets.

Before moving on to specify the defining attributes of elite officials who act as policy entrepreneurs, let us note an additional advantage of this approach: bringing policy entrepreneurs within the state to the center of the argument allows us to incorporate contingency into the analysis. While attempting to theorize contingency itself is probably not a fruitful avenue for research, I do contend that theories about policymaking processes should care more about contingent factors than they usually do.[97] My focus on policy entrepreneurs enables scholars to recognize *técnicos*' agency and incorporate contingency without falling into *ad hoc* explanatory claims. I argue that contingent factors do affect policy paths because they shape the balance of power among competing groups of political *técnicos*.

Some examples help to clarify these points. Corruption cases may or may not come to gain public salience, which depends on contingent dynamics. If corruption cases become corruption scandals, some groups of policy entrepreneurs may fall into public discredit, opening space for some up-to-then irrelevant entrepreneurs to rise to dominant positions within the state. Perhaps more importantly, contingency often enters through exogenous shocks. A world economic crisis that hits a country, for instance, is likely to alter the balance of power within the state, bringing change in the dominant groups of policy entrepreneurs.[98] Part of this shift in the balance of power is rooted in the fact that exogenous shocks affect the level of persuasiveness that the solutions and/or ideas put forward by a group *X* of policy entrepreneurs has vis-à-vis the ideas carried by groups *Y*, *Z* or *W*.[99] Events whose exogeneity is disputable, such as domestic banking crises—but which certainly have a certain degree of exogeneity for a state-centric perspective—also tend to trigger shifts that matter a lot to explain policy outcomes: some policy entrepreneurs lose power and others gain power. In short, instead of resorting to contingency as a "naked" explanatory factor—which seems rather uninteresting in theoretical terms—the approach I propose here allows for contingent factors to enter the explanation in a mediated form: that is, they alter the micropolitics within the state.

4.I. Entrepreneurial Political Técnicos Within the State: Who Are These Peculiar Political "Animals"?

"There are two different types of staff within the Ministry of Finance. One is the stable bureaucracy. The other is the body of advisors

[97] Mahoney's (2000) careful inquiry about contingency and path dependence is an exception.

[98] Haggard's and Maxfield's (1993: 305, 308) study on the determinants of preferential credit schemes make the point that episodes of macroeconomic stability, often triggered by international economic crises, alter the balance of power between conservative and heterodox financial-policy agents within the state.

[99] On the persuasiveness of policy ideas, see, for instance, Hall (1989: 9-10).

[cuerpo de asesores]. *This group serves only during the term the minister is in office, it is the minister's armed wing* [brazo armado]. *There are contrasts between these two groups of staff within the Ministry of Finance: the former are career bureaucrats of the highest level, the latter are technocrats that are willing to work 24/7 for a couple of years. Those who are part of the* cuerpo de asesores *feel that they are making the country: it is a very small group of people that makes very big decisions."*
Top-Level Official at the Chilean Ministry of Finance[100]

In this study, the *altos funcionarios*, or policy entrepreneurs of interest, are peculiar political "animals" that populate the state. If we are to attribute them significant causal leverage in explaining policy outcomes in the low salience, highly technical arenas that shape domestic financial markets, we must first have a clear sense of who they are and, relatedly, where they are found. Identifying policy entrepreneurs within Latin American states is an exercise that combines deduction and induction, prior theoretical insights with data from field research.

The claim made by the literature on policy entrepreneurs,[101] that these political actors are to be found at several loci within the state and can have lower or higher ranks within state hierarchies, is true. But while prior scholars argued that policy entrepreneurs could be seated in legislatures, I argue that—at least for the context of Latin America—*policy entrepreneurs are agents that work in the executive branch of government* or in agencies associated with it. In the state apparatuses of Latin American countries, entrepreneurial political *técnicos* typically occupy the echelons immediately below relevant ministers. So deputy ministers, *secretarios* and *subsecretarios* (in Spanish speaking countries) and *secretários executivos*, *secretários*, and *secretários adjuntos* (in Brazil) are often key policy entrepreneurs. They are appointed either by the president or by the president's appointees. That is, the chief executive is not directly involved in the appointment of all the key political *técnicos*. In many cases, policy entrepreneurs do not hold a formal appointment; rather, they are part of a very small, select group of top advisors or *asesores* to the president or to ministers. As for ministers, they could be policy entrepreneurs, but need not be.[102]

In the country cases and policy processes that I analyze empirically in this study (Chapters 3-6), some of the most important political *técnicos* were found in the Ministry of Finance (*Ministério da Fazenda*, in Brazil; *Ministerio de Hacienda*, in Chile). Within the Brazilian and Chilean finance ministries, there were between approximately five and fifteen elite officials, at any given time, who dominated the policy processes that I study. Other relevant elite officials were the heads of the main state-owned development agencies—the BNDES in Brazil

[100] Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014.
[101] Kingdon (1995: 179-80); Mintrom (1997: 740); Mintrom and Norman (2009).
[102] Providing this list I do not attempt to be exhaustive; instead, the goal is to give a sense of the empirical referent of the concept.

and CORFO in Chile[103]—and their top advisors, as well as the heads and top advisors of a small number of other ministries—the ministry of planning, the ministry of development, and the pensions ministry in Brazil,[104] and the economy ministry in Chile.[105] In my study of the politics of state involvement in capital markets (Chapters 4 and 6), in addition to the already mentioned groups of elite officials, key political *técnicos* were the heads of the three largest state-owned-enterprise pension funds in Brazil[106] and, in the case of Chile, the heads of two regulatory agencies associated with the executive branch of government—the superintendence of pensions and the superintendence of securities.[107]

How can we characterize the state actors whose role in policy adoption I am underscoring? Domínguez's (1997) notion of "technopol" is not as helpful for multiple reasons, including that it encompasses electorally driven figures such as presidents; in contrast, Schneider's (1991: 60-5) concept of *political técnico* is a good point of departure, and certainly more helpful than that of technocrat or pure *técnico*.[108] Similarly to pure technocrats, political *técnicos* typically have university-level training in fields like economics, engineering, accounting, administration or law; in exceptional cases, they acquired their highly technical knowledge by occupying previous elite-level jobs in the public or private sectors. Political *técnicos* recognize that expert knowledge does not suffice to attain their goals; rather, highly technical policy projects need to garner political support within the state, which often entails a significant effort in persuading other high level state officials and, in some cases, ministers or presidents themselves. Therefore, in order to promote policy change, top-level officials devote significant resources to developing and working with coalitions of actors within the state.[109] Lacking tenure, these policy entrepreneurs acknowledge that their term in office is likely to be counted in months or a few years rather than decades,[110] and they therefore prioritize getting policy changes done.[111] They work to build a reputation of competence and effectiveness that

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[103] Respectively, the Banco Nacional de Desenvolvimento Econômico e Social and the Corporación de Fomento de la Producción.

[104] Ministério do Planejamento, Ministério do Desenvolvimento, and Ministério da Previdência Social.

[105] Ministerio de Economía.

[106] Previ, Petros, and Funcef.

[107] Respectively, the Superintendencia de Pensiones (formerly, Superintendencia de Administradoras de Fondos de Pensiones) and the Superintendencia de Valores y Seguros.

[108] I hereby adapt that concept for my own purposes, adding several attributes not present in Schneider's (1991) work.

[109] On elite officials' need to assemble their own teams to succeed in advancing their policy projects, see Domínguez (1997: 4).

[110] For a general characterization of the high turnover of Latin American ministers, secretaries, and undersecretaries, see Spiller and Tommasi (2009: 164-6). Weyland (2006: 46-7) remarks the high turnover in the upper, decision-making echelons of Latin American states: unless top appointees "rush to enact changes, they cannot make any mark and thus miss the opportunity to boost their careers."

[111] Political *técnicos* should not be confused with the members of the "parallel bureaucracy" studied by Spiller and Tommasi (2009: 169-75). The parallel bureaucracy is formed by a very large group of *contratados* (non-civil service employees under special contracts), who could be as many as 22,000 in a country like Argentina (Spiller and Tommasi 2009: 171) and perform all sorts of activities, with negligent capacity to push for their own policy agendas. I am referring to a much smaller group of *elite* executive-branch actors—between a handful and a few dozen at any given point in time—occupying much higher echelons, typically immediately below the ministerial level. These two groups differ not just in terms of the place that each of them occupies within the state hierarchy but also in their levels of expertise:

could later be valued currency in the circles of public- and private-sector elites. For instance, certain relatively opaque policy choices—such as new forms of regulation of institutional investors—are likely to contribute to steering markets towards growth, and multiple future employers would reward political *técnicos* for having been entrepreneurial advocates of regulatory design and adoption. Political *técnicos* know that crossing the inter-agency borders within the executive branch is an effective way to overcome the bureaucratic inertia that they despise. In contrast with "pure politicians," these elite state officials rarely possess broad base: they do not have constituents to represent nor do they orient themselves to forging mass or electoral support.[112]

The *altos funcionarios*, or political *técnicos*, whose behavior I am stylizing here often look to increase their authority within the state "by placing themselves in new positions of power created by the implementation of policies they advocate."[113] However, due to structural traits of the societies that I study—crucially, the nature of the public- and private-sector job markets for top-level professionals—the career goals of elite state officials are *not* circumscribed to obtaining promotion within the state. Instead, these top-level officials are reputation-maximizers in a broad sense: they seek to augment their personal professional capital by pushing for new policy that could later be traced to their action. Aware of the high turnover that characterizes careers within the state, these entrepreneurs are particularly proactive in taking advantage of their time in high office as a means to raise the future value of their personal professional capital. While there could be multiple means of augmenting their capital, I argue that the technical profile of these high state officials—and their lack of political capital at the time of appointment—makes them particularly likely to deploy their technical resources intensely to seek policy change. These entrepreneurs calculate that the imprints they could leave in policy and their ability to signal professional competence will probably enhance their future reputation as they transition to new jobs in higher echelons in the state, the private sector, or other policy-related institutions such as think tanks and international organizations.[114]

In this sense, my stylization of the behavior of these elite-level appointed officials differs from M. Victoria Murillo's characterization of experts in public utility regulation, whose career options, she claims, heavily depend on public-sector jobs and political appointments (Murillo

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virtually all political *técnicos* hold university degrees—typically, they have also pursued graduate studies—whereas only half of the parallel staff studied by Spiller and Tommasi (2009: 174) graduated from the university.

[112] In line with a point made by Ben Ross Schneider in a later work, this way of approaching the microfoundations of state actors' behavior "draws a clear distinction between politicians' self-interest in reelection, which drives the bulk of theorizing about microfoundations of government action, and the interests of appointed officials [… whose actions are not geared] to promote directly their reelection" (Schneider 2004: 26-7).

[113] Genieys and Hassenteufel (2015: 281).

[114] In Latin America becoming a powerful figure within the state, even for a relatively short period of time, is one of the most effective ways of forging a career profile that is highly attractive to private corporations. I speculate that in contexts with weak institutions and where informal practices are at least as important as formal institutions, private firms will be willing to pay well professionals who can help them overcome informational asymmetries about the context in which they do business. More generally, for appointed elite officials bringing about policy change is probably the most effective way of increasing the value of their credentials, signaling that they possess insiders' knowledge of the state, and thus strengthening a reputation that—after leaving the office for which they were originally appointed—is likely to be sought, and well-compensated, by public- and private-sector organizations.

2009: 48). The scope conditions of Murillo's proposition about career paths and experts' behavior must be made explicit. It may well be the case that technically trained professionals working in the domain of public utility regulation basically depend on public-sector jobs; the same claim does not hold, however, for appointed officials working on policies that shape financial markets.[115] In her concluding chapter, Murillo (2009: 253) in passing says, "Admittedly, in the post-privatization period, the emergence of private-sector career options has reduced experts' reliance on political appointments for developing their careers," but she does not develop the implications of this change on experts' behavior. The bigger point that I want to make here is that the assumptions we make about the career paths of appointed officials have huge implications for how we understand their behavior and, more importantly for my study, for how we understand appointed officials' impact on the politics of policy adoption.

Just as important as identifying key attributes characterizing the elite officials or policy entrepreneurs whose action I study is to distinguish them from other types of political actors with whom they could be confused. While in Sections 4.II and 4.III I develop in depth some of the elements advanced here, the goal at this point is to provide a big-picture and simple map of the boundaries of the type of political actor of interest.

Therefore, as understood in this study, entrepreneurial political *técnicos* are *not*:

- *Presidents*

  The chief of the executive branch of government may facilitate and lubricate the policy choices that I study, and she may solve the within-the-executive battles that hinder policy adoption, but presidents are rarely the source of change in the policies that I study.[116] The microfoundations of this assertion can be derived from the work of Culpepper (2011: 178, 180): presidents do not have strong enough incentives to become personally invested in complex policy issues to which mass publics pay little attention.[117] Dargent's (2015: 8) book on technocratic autonomy makes a similar point. He argues that in issue-areas in which policy is very complex, technocrats are likely to be the key actors because there are high information asymmetries between technocrats and politicians, and because politicians are uncertain about the likely consequences of such policies.

- *Members of Congress*

  If policy complexity and low salience exclude presidents from the group of policy entrepreneurs, this rationale applies even more strongly to congress members in a region for which even the scholars that emphasize the relevance of legislatures acknowledge that congresses are reactive in the policy process, not proactive.[118] Members of Latin American congresses do not have the resources to acquire expertise on highly technical policies

[115] Career options outside the state abound not just in international organizations and in the multiple private-sector firms in the finance industry—ranging from investment and commercial banks to financial consultancy firms—but also in large non-financial corporations that have to deal, for instance, with state-owned development banks.

[116] This differs from an influential work that put forward an ideational explanation of policy outcomes in Latin America, which considers presidents as policy entrepreneurs (Sikkink 1991: 245).

[117] I unpack this rationale in Section 4.III.

[118] See Cox and Morgenstern (2001).

and they invest their political capital in issues with more potential for generating electoral returns.[119]

- *Career (or Weberian-like) bureaucrats*

  It is widely accepted that Latin America differs not just from developed countries but also from other developing regions—prominently, Asian countries during the period of successful, state-led developmental projects—in that it lacks well-institutionalized, Weberian-like bureaucracies.[120] While some cross-national, within-region variation on bureaucratic capacity does obviously exist, it does not seem controversial to argue that, even in the Latin American countries that have some "pockets of efficiency" within their states, career bureaucrats are highly unlikely to be the actual drivers behind policy orientations. In other words, if we are to look for effectively relevant policy entrepreneurship, we had better look elsewhere within the state.

  This is precisely what Murillo (2009: 101, 251-2) has convincingly shown: that Latin American bureaucracies are simply too weak—especially at the higher levels at which reform decisions in areas such as public-utility regulation are made—to attribute to them the causal leverage that is identified in the scholarship on industrialized countries. In Latin America, in contrast to the advanced world, the policy orientation of politically *appointed state actors* is significantly more important than the type of national bureaucracy in accounting for diverse national patterns of reform.

  A final clarification is in order here. While I underline that policy entrepreneurs in Latin American states are not career bureaucrats, this should not be interpreted as a dismissal of the possibility that career bureaucrats could be included in coalitions of policy entrepreneurs. In fact, career bureaucrats are often part of those coalitions—but they tend to play a secondary role vis-à-vis the leading position of appointed officials.

- *Epistemic communities or just technocrats*

  According to Haas (1992: 3), an epistemic community "is a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area." The professionals that form epistemic communities share: a set of normative and principled beliefs, which provide a value-based rationale for the social action of community

[119] See, for instance, Jones et al. (2002); IADB (2005: 53, 62). Authors like Spiller and Tommasi (2009: 86-8) have noted that there is variation in policy-making capabilities across Latin American congresses. Observing this within-region variation should not distract us from properly characterizing the bigger picture: despite the fact that the formal macro-institutions of Latin American presidential systems resemble those of the United States, there is no Latin American country whose legislature even remotely approaches the policy-making capabilities of the U.S. Congress. As such study acknowledges, most of the attributes that enable the U.S. Congress to develop its own legislative proposals and to play an active role in directing the policy agenda are absent or very attenuated in Latin America's party-centered democracies, including the degree of committee specialization, the longevity of congressional careers, and the human capital on which legislators rely (Spiller and Tommasi 2009: 53-4).

[120] See, for instance, IADB (2005: 67), Spiller and Tommasi (2009: 157-8, 160), Weyland (2006: 46-7).

members; causal beliefs; notions of validity for weighing knowledge in the domain of their expertise; and a common policy enterprise.

Undoubtedly, the empirical terrain covered by the concept of epistemic communities overlaps somewhat with the empirics that I aim to capture when I refer to Latin American entrepreneurial political *técnicos*. However, I suggest that the latter has significantly more potential than the former for understanding the politics of highly technical policies in Latin America. For my purpose, the concept of epistemic community becomes too restrictive because it overemphasizes the relevance of expertise and scientifically rooted knowledge in policymaking, while underemphasizing elite officials' brokering skills. The emphasis on expertise sacrifices explanatory power because it entails losing track of entrepreneurial activity within the state that, while drawing on technical knowledge, is primarily of a *politico-ideational*, rather than a *technical*, nature.[121] In a causal argument that relies on identifying with precision the right set of actors that pull the levers of policy change within the state, excluding state actors from consideration just because their behavior is not primarily rooted in expert knowledge is too restrictive and imposes too big of an analytical loss. Stressing that executive-branch policy entrepreneurs are carriers of ideas—rather than knowledge—is not only more empirically sound but also more useful for tracing the sources of policy outcomes. The concept of epistemic communities sidelines the relevance of political acumen in within-state struggles to bring about policy change, while the notion of policy entrepreneur highlights it.[122] The point I am making is, of course, a subtle one: often there is a technocratic aspect to groups of political *técnicos*, but overstressing the technical side of policy entrepreneurship implies more analytical losses than gains, because it comes hand-in-hand with losing track of the highly political side of such entrepreneurial behavior.

As we can see, the concept of epistemic communities comes along with too much rigidity, and may even be circular: as Jacobsen (1995: 302), for instance, observes, "[i]f the decision makers whom members of an epistemic community advise turn out to be themselves, then 'epistemic community' simply collapses as a concept."

A similar point should be made about the related concept of technocrat. In addition to the different emphasis that scholars of technocracy put on knowledge and expertise from that which I put on the concept of political *técnicos*, there is another important contrast to be made. Even the most sophisticated treatments of the politics of technocracy—which concur that technocrats are powerful drivers of policy outcomes—see technocrats as agents of politicians. In these accounts, if technocrats succeed in advancing their own policy preferences it is often due to their capacity to

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[121] Domínguez (1997: 4-7) makes a similar point to characterize so-called *technopols*, distinguishing them from technocrats.

[122] It could well be that the groups of policy entrepreneurs on which I am focusing include epistemic communities within them—but that needs not be the case.

> "adopt decisions that diverge from politicians' initial mandates" (Dargent 2015: 5). The distinction I make may seem minor but it is actually not: the literature of technocracy implicitly assumes that (elected) politicians give technocrats a complete mandate. I do not, a point on which I elaborate next.

4.II. "Incomplete Mandates": Appointed Political Técnicos Are Not Simply Agents

I contend that the president's motivation in appointing elite officials does not explain a significant part of what these entrepreneurial actors do once they are in office.[123] Of course, presidents can hire and fire elite officials at their will, but that does not hamper policy entrepreneurs' capacity to become *agenda setters* in policy arenas that are perceived by the chief executive as being of secondary or lower order. So, while it is true that politicians are the ones making the appointments, we cannot predict the behavior of these appointed officials based on their appointment *alone*. Moreover, very high turnover rates at the elite-level of executive-branch appointees—as those observed in Latin America—actually increase the incentives officials have to move quickly and proactively champion policy change that can leave a mark, strengthen a reputation of competence, and improve their career prospects.

In the executive-branch-centric Latin American polities, with state apparatuses that are at best only partially equipped to deal with the complex challenges they are expected to address, the mandates that appointees receive in the most salient and politically sensitive policymaking arenas—e.g. the ministries dealing with conditional cash transfer programs or crime and security issues—tend to be well-specified. In contrast, presidents and other key *political* figures in government perceive the policies that define state involvement in credit and capital markets as less politically relevant—if relevant at all. As a result, the appointees in these areas receive significantly more *incomplete* mandates: their alleged principals are unable and/or unwilling to micromanage the design and adoption of policies in these areas. Principal-agent models of bureaucracy typically assume that the principal will have an interest and at least some moderate capacity to prevent agency loss. Because of that, principals will try to constrain the agent's discretion by, for instance, writing highly detailed statutes (Huber and Shipan 2002). Yet I contend that in contexts like that of Latin America—with weaker bureaucracies, chronic shortage of expertise, and president-centric political dynamics—for certain policy arenas it is not reasonable to assume the president's interest and capacity to "write up" such detailed mandates.[124]

Presidents do not have strong enough incentives to become personally invested in complex policy issues to which mass publics pay little attention. My point here builds on Pepper Culpepper's argument about the relation among levels of policy salience and forms of policymaking. "It is costly for politicians (…)," Culpepper argues, "to acquire expertise about complex policy issues, and low public concern about such issues reduces the incentive of (…) political parties (…) to expend the resources to develop that expertise" (2011: 178). Where

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[123] The claim that state actors that are supposed to be simply agents of powerful principals do actually enjoy autonomy to push for their own policy agendas has some pedigree in the political science of developed countries (see Vogel 1996 and Carpenter 2001). In Latin America, a region with comparatively weaker bureaucratic capacity, the literature on technocracy (prominently, Domínguez 1997; Centeno and Silva 1998; Dargent 2015; Teichman 2001) has made a similar point not about bureaucracies but on the appointed experts that deal with areas such as economic policymaking.

[124] Referring to a different type of state actor, Dargent (2015: 24) makes a similar point.

political battles take place under conditions of low political salience, "[p]arties rarely matter (…) because voters do not care about the issue enough for parties to invest in taking hard positions on it" (Culpepper 2011: 180).

Taking advantage of mandate-incompleteness, political *técnicos* build their reputation by deploying their relatively scarce political capital to produce policy that, according to their calculations, can have long-lasting impact. Insofar as long-term career reputations tend to hinge on accomplishments that can last over time, elite officials, instead of aspiring to fleeting policy achievements, will prefer policy choices that have the potential to leave enduring marks and signal professional competence.[125] Technical knowledge enables top *funcionarios* to more accurately predict the effect of policy in the longer run. In particular, top state officials typically take advantage of situations in which seemingly minor policy changes may produce significant impact in the longer run. The policies that define modes of state involvement in markets are full of those opportunities, available to be grabbed: what may seem to be marginal changes over the years may contribute to bringing about big shifts in the structure of domestic markets.[126] As the Introduction chapter showed, these shifts have major consequences for a country's economic elites.

In short, top appointed officials in Latin America at the same time fulfill their role as agents of politically powerful principals in the executive branch *and* look for reputation-building opportunities in more opaque and less salient policy arenas. As the mandates these elite officials receive are sufficiently vague, they are able to become agenda setters, building coalitions with like-minded elite officials, and persuading politically powerful figures within the executive branch to adopt technically opaque policies that reflect their preferences. In drafting new policies and reorienting existing ones, appointed elite state officials in Latin America play a similar role to that of highly capable bureaucratic agencies in the developed world, which managed to forge their autonomy from elected politicians and become the key drivers of policy orientation in multiple issues.[127] In this creative endeavor in low-salience policy arenas, Latin American elite *funcionarios* face little competition from bureaucracies because the region's bureaucratic apparatuses lack the necessary technical resources or, in the case of the exceptional pockets of efficiency where they do, have not yet succeeded in forging enough autonomy from politicians.[128] For these reasons, in the context of Latin America some top-level officials, or *altos funcionarios*, despite being appointed, are not simply agents: they are agenda-setters and relatively unconstrained designers and executors of policy.

4.III. Elite Officials in Low-Salience, Opaque, and Technically-Intensive Policy Arenas

In this section, I elaborate on how the nature of the policies that shape markets affect the politics of policymaking. I have argued that in the highly technical and low salience micropolitics that defines the *formative* stages of state involvement in credit and capital markets,

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[125] Jacobs (2011: 256) makes a similar point referring to a broader set of state actors.

[126] To give but one example, slight changes in the rules regulating the inflow of foreign portfolio investment may have huge impacts in the long run over the domestic stock market.

[127] See: Baekgaard, Blom-Hansen, and Serritzlew (2015); Carpenter (2001); Vogel (1996).

[128] Based on Carpenter (2001), one can speculate that the forging of bureaucratic autonomy—a process that, in his account, took several decades—was largely not possible in Latin America due to the region's acute institutional instability.

it is elite executive-branch officials who call the shots.[129] My state-centric propositions challenge some of Culpepper's (2011) assumptions: while he argues that, in low-salience policy domains that affect firms, business representatives will succeed in imposing their preferences; I counter, in certain policy arenas which may later affect firms, policymaking will not be salient for business actors, and they will therefore be of marginal relevance.[130]

In building my argument about political *técnicos*' strong influence over policy at the time of adoption, stating the scope conditions of Culpepper's theory is essential: policy salience with voters (or mass publics) is not the only factor that matters; salience with business is just as important. In their examination of the formative phase of technical policy processes, existing theories neglect that policy salience for business is in itself a variable. The main problem in Culpepper's theory-building strategy is that he works inductively from one arena of rule-making for which most of us would have strong reasons to believe that business actors will be intense policy demanders. Who would doubt that business actors face strong incentives to attempt to affect the rules governing corporate control? In the policy arena that Culpepper studies, business actors place strong pressure on policymakers because they price policy change or continuity.[131] Yet I contend that in policy areas/industries without established players, or when policy does not clearly fall within existing sectors, and/or in policy areas that affect sectors in which corporate structures are diversified rather than specialized—constraining business's technical expertise and the associated capacity to pay attention to specific policies—rule-making will not be salient for major corporate actors at the time of policy adoption.

The in-depth empirical analysis of Brazil and Chile (Chapters 3 through 6) suggests that in multiple instances, during the formative phase of policy, state actors' choices were not salient for business. For instance, in Brazil, a substantial number of small- and medium-sized technology-based enterprises nowadays benefit from the recently developed local venture capital and private equity industries. Yet a decade ago these companies were either inexistent or unaware of major decisions being taken by state actors—such as state-owned-enterprise pension funds and BNDES Shareholdings—to enhance the regulation and drastically expand the domestic investor base of the venture capital and private equity industries. In Chile, some big business groups have recently decided to adjust their corporate finance strategies to raise investment capital with incredibly long-term maturities from the pension fund-fueled domestic corporate bonds market. Yet for some of these Chilean *grupos*—characterized by their multisectoral diversification and lack of specialization—the technical regulatory choices that originally shaped pension funds' behavior as institutional investors—and in turn fueled the market for corporate bonds—were not

[129] Hall (1993: 288) had early on remarked that in technically complex fields the state would be most autonomous from societal pressures.

[130] Culpepper includes a brief note of caution when he says that his book assessed his theory in depth only in one type of low-salience policies that he calls "informal rules" (Culpepper 2011: 185). However, this cautionary point does not stop him from claiming that his framework has leverage for explaining policy outcomes in the other low-salience quadrant of the governance space—that of "formal rules" (Culpepper 2011: 185-92). Moreover, he explicitly states that salience is more important than institutional formality in determining business capacity to influence policy outcomes (Culpepper 2011: 186).

[131] At one point the author recognizes the highly peculiar nature of the policy domain he studies: "[t]he issue of corporate control is *extreme*, in that it is so rarely of high salience" (Culpepper 2011: 190, my emphasis). Interestingly, however, he only acknowledges one side of the peculiarity—i.e. that related to issue salience—neglecting the fact that there are probably very few other issues on which the senior managers of the largest companies—Culpepper's proxy for business actors (Culpepper 2011: 188)—have such well-formed and intense preferences.

salient long ago, when these policies were adopted. In Brazil and Chile, Chapters 3 through 6 show that the regulatory underpinnings of expanded markets may be very salient for business several years or even decades after the phase of policy formation—but that they were not salient when state actors first engineered the new rules and made the original choices.

In the policy arenas that I study, then, I expect business actors *not* to be the primary drivers *at the time of policy adoption*. My point is that, in certain policy processes that shape domestic markets, business actors come to know only *ex post* that policy choices affect them—often, many years down the road. Only when business actors learn about the effects that the policies in place have on their corporate finance strategies do they recognize their incentives to invest in lobbying to get their preferences reflected in policy continuity or change. By then, however, modes of state involvement in domestic markets are likely to be quite or fully formed; hence, business pressure might become relevant in a scenario that will no longer be the same as the one that characterized the moment of policy adoption.

It sounds reasonable to assume that businesses have high cognitive capacity at the formative moments of policy change with respect to issues that have easily identifiable impacts in the short-run for business actors, such as rules of corporate control, vocational training or taxes on corporate profit. It also seems accurate to expect that policy adoption is likely to be salient for business when new state decisions clearly fall within existing business sectors or affect specific industries with well-established, specialized firms. As an extreme example, in arenas where technical policymaking affects monopoly corporate players—as in privatized public utilities—firms will have a strong interest in learning about possible regulatory decisions; under those conditions, opaque policy will be salient for business even during its formative phase.

But, I argue, in myriad other policy arenas—including those studied here—to assume that business actors possess high cognitive capacity is an analytical stretch.[132] In other words, in the market-shaping policies that I study, business actors can evolve over time to have intense preferences; however, at the time when key policy decisions are made, business preferences over these issues are either not intense compared to their preferences on other policy issues or, more often, have not yet cohered. This logic of low policy salience for business is likely to apply to policies to promote innovation in multiple industries, ranging from information and communications to healthcare, biotechnology and green energy. These areas illustrate that policy adoption is unlikely to be salient for business before regulation in a given sector has really gotten off the ground or before an industry has really come into being as such.

Identifying these scope conditions of Culpepper's theory allows us to appreciate the distinction between new policy arenas and established ones—and the implications these different sorts of policies have for the varying levels of policy salience for business, and not just for mass publics. We can think that, at any given time, the state produces more policies than business actors are able to assess systematically, overwhelming business cognitive capacities. The high cognitive capacity that business actors are assumed to have is less likely to be a reasonable assumption the longer and more opaque the causal chain connecting policy choice with effects

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[132] This cognitive handicap among business actors is likely to be higher in Latin America, where firms likely discount the future to a much larger extent than in the developed world due to the region's long history of economic volatility. If the discount rate is higher, business actors will be less likely to invest resources to develop expertise on policy issues that are perceived as indirectly related to business shorter-term interests. The very capacity of identifying the full spectrum of policies with potential impact on firms' profits seems highly taxing for business actors and more unlikely the more they discount the future.

over firms, and the more intense the "problems of attention"[133] affecting business actors, are—due to attributes of the context in which businesses operate and/or to attributes intrinsic to corporate structures.

In Latin America, business's problems of attention are significantly more severe than in the context of advanced capitalism studied so far by the scholarship on issue salience.[134] When large domestic corporations do not focus on a core business, but rather diversify across multiple unrelated sectors—as is common in Latin America[135]—they will be less likely to invest enough resources to compensate for cognitive handicaps. In other words, a country's dominant type of corporate structure affects the salience of technical policymaking for domestic business. Whereas the specialized firms of Europe and the United States can afford to pay attention to specific policies in their industries and develop technical expertise, for the diversified business groups of Latin America policy expertise is a much more costly investment. In Latin American countries, where diversified conglomeration is the norm—with most business groups covering not just a few but most of the main sectors of the economy[136]—I expect that business will be less likely to have the capacity to effectively monitor all new policies that may be on the horizon than single industry firms will have in other regions.

In short, I expect political *técnicos* to dominate the highly technical, low-salience formative phase of the policy processes that ultimately shape domestic markets. The political salience of an issue is key for understanding certain arenas of policymaking, including those that I study in Chapters 3 through 6, because an issue's salience affects who calls the shots in the adoption of new policies. Building on Culpepper's logic, I argue that when presidents believe that the mass public does not care about certain issues, they do not get personally invested in them. Presidents' relative indifference opens space for ambitious *altos funcionarios* in the executive branch to become agenda setters and ultimately key drivers of policy adoption.

The low salience of some policy realms matters, just as Culpepper highlighted, because it dampens top politicians' incentives to play a role in the decision-making process, opening up the space for other actors with more intense preferences on these issues to take the lead. Yet I part company with Culpepper because I do not expect business actors to call the shots. Quite to the contrary, *at the time of policy adoption* state decisions are likely to be of low salience not just for mass publics but also for business. Hence, business actors are unlikely to have well-formed (let alone intense) preferences on these issues, and are even less likely to invest what would be

[133] Alan Jacobs has systematized long traditions of research in psychology and behavioral economics for the profitable use of political scientists. "One of the most consistently observed constraints on human cognition is the scarcity of attention. [… H]umans make decisions in an 'information-rich world' in which the mass of signals overwhelms their capacity for processing: agents forming beliefs and making choices simply cannot attend to all available and potentially relevant information" (Jacobs 2011: 39). Building on Jacob's logic, we can argue that, due to business actors' finite cognitive resources, problems of attention will generate a constraint on the range and number of policy stimuli that they can take into account at a given time.

[134] Developing an exhaustive logical account of why firms' problems of attention are more acute in Latin America than in advanced countries or testing it empirically is way beyond the scope of my study.

[135] See the pioneering comparative work on Latin American *grupos*' multisectoral diversification by Schneider (2008).

[136] Schneider (2008: 383).

needed for them to have significant leverage during this formative phase of the policy process. (Note that such intense preferences do tend to emerge later on, as I explain in Section 5).[137]

4.IV. Ideas in the Micropolitics of Policy Adoption

> *"Practical men, who believe themselves to be quite exempt from any intellectual influence, usually are the slaves of some defunct economist."*
> John Maynard Keynes[138]

In this section, I argue that political *técnicos*' ideas are as important as their career goals. While low issue salience and the technical complexity of policy open space for executive-branch elite officials to act, they do not predetermine *técnicos*' policy preferences and decisions. Rather, ideas and cognitive causal models shape entrepreneurs' choices, and therefore modes of state involvement in credit and capital markets.

Few would dare to challenge the assertion that ideas influence policy outcomes.[139] That the roads available for finding convincing empirical evidence on this claim are slippery ones should not sideline the value of the proposition itself. If ideational factors are important everywhere, they seem to be even more relevant as drivers of policy outcomes in developing regions like Latin America. Murillo's study of the politics of privatized public utility regulation centrally builds on the insight that the weakness of Latin American bureaucracies "increases the policy relevance of policy makers' ideas and those of the politically appointed experts they delegate decisions to" (2009: 252).[140] She takes an additional step: in contrast to the literature that emphasized the homogenizing effect of ideas during the era of market-oriented reforms,

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[137] One of the most important analytical gains we make by laying out these propositions is that we are better equipped for understanding situations in which firms are highly organized in institutionalized and resource-rich business associations, but still behave as "cognitive misers." In these contexts, firms may be highly capable of exerting influence on some policy arenas but simultaneously be highly incapable of connecting policy choice to effects on firms in other policy arenas (On political actors as cognitive misers see Jacobs 2011: 39).

[138] Cited by Jacobsen (1995: 284).

[139] The scholarly tradition on the role of ideas in politics is vast. Prominent contributions include those of Blyth (2002), Goldstein and Keohane (1993), Haas (1992), Hall (1989, 1993, 1997), and Jacobsen (1995). For the most updated appraisal of the trajectory of the ideational approach, see Blyth, Helgadottir, and Kring (Forthcoming 2016). As I was writing the last pages of this manuscript, Dani Rodrik and a co-author released a preliminary draft of a paper entitled "Ideas versus Interests: A Unified Political Economy Framework." This new piece can be seen as the tip of an iceberg: we are probably witnessing growing inter-disciplinary disenchantment with the incapacity of interest group approaches to explain many policy outcomes of interest. The draft is an explicit attempt to revamp the analytical leverage of ideas—in particular, ideas championed by policymakers—putting them on more equal ground with that of interests: "[political economy's] exclusive emphasis on the primacy of interests is puzzling," they argue: "In one form or another, ideational politics seems at least as important as interest-based politics" (Mukand and Rodrik 2016: 2).

[140] Eduardo Dargent's study of the role of technocrats in economic and health policymaking in Latin America makes the same point: under certain conditions, bureaucratic weakness may allow (or even facilitate) state actors to impose their policy preferences on societal actors (Dargent 2015: 15).

Murillo claims, the ideational orientation of actors within the state is a source of regulatory divergence across countries, rather than convergence (2009: 10).[141]

The behavior of top-level *funcionarios* in Latin America cannot be understood without acknowledging that both individual career goals and ideas matter.[142] Policy entrepreneurs that determine modes of state involvement in capital and credit markets are *carriers of ideas*, understanding ideas as relatively coherent frameworks of policy-relevant knowledge that embody theoretically grounded beliefs about the relationships of cause and effect governing policy problems and policy mechanisms.[143] As Vogel (1996: 20-1) remarks, state actors' ideas incorporate beliefs about the goals, proper scope, and methods of government intervention in the economy, as well as about how this intervention affects economic performance.[144] In my empirical examination of the political drivers of state involvement in credit and capital markets in contemporary Brazil and Chile (Chapters 3 through 6), I thus pay careful attention to state actors' divergent *causal beliefs*, that is, differences in actors' mental maps of the causal relations linking policy alternatives to market outcomes.[145]

I focus on policy entrepreneurs' causal beliefs because an argument centered solely on the maximization of individual career prospects will not take us far in understanding the micropolitics within the state in policymaking that shapes market outcomes; however, an exclusive focus on ideas will not do either. What I am proposing, therefore, is an argument that is sensitive to insights from both the rationalist and the ideational traditions in political science.

Top-level appointed officials in Latin America utilize their technical skills to evaluate alternatives in opaque policy arenas. However, contrary to what is implied in the vast majority of the scholarship that highlights the importance of expert knowledge in policymaking, I argue that technically rooted policy choices are more often a source of variation across countries, and within countries over time, than a unifying force towards policy convergence. The reason is that elite state officials "navigate" the complexity and opacity of policy guided by ideas.

Hence, ideas matter, first, because they provide a cognitive device for elite-level public officials. While this may hold for most policy arenas, we now know that the importance of ideas increases the more cognitively complex it become to analyze a given potential policy option (Jacobs 2011: 261). Understanding the specific *content* that policy packages promoted by ambitious appointed officials adopt is impossible without looking at this ideational support.[146] But ideas matter in a second way too: they, at least partially, define the likely partners or teammates within the state. That is, ideas, widely conceived as focal points or coalitional glue

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[141] As Murillo points out, the most important contributions on the role of experts as agents of policy convergence during Latin American market-oriented reforms are those of Domínguez (1997), Centeno and Silva (1998), and Teichman (2001).

[142] On ideas and self-interest, see Kingdon (1994: 221).

[143] Haggard (1990: 46-7); Jacobs (2011: 54).

[144] The concepts of "policy paradigm" (Hall 1993: 279), "economic ideologies" (Haggard 1990: 46-7), and "programmatic ideas" (Schmidt 2008: 306) also match what I intend to capture.

[145] This is an adaptation of Jacob's (2015: 44) definition of causal beliefs.

[146] Jacobs (2011: 54) provides examples that are helpful to ground the theoretical discussion: "A traditional Keynesian model of the economy, for instance, captures the effect of government spending, via levels of aggregate demand, on employment – but, in turn, is silent on the effect of government spending on workers' inflationary expectations and wage demands, and all that follows from them. [… These frameworks] usually supply general propositions (e.g., 'higher taxes lead to reduced employment') that actors can use to resolve ambiguity about the consequences of specific options."

once coalitions are formed,[147] constrain the types of coalitions that are likely to form in the first place.

In sum, I argue that ideas shape the action of elite officials who seek to leave an imprint in policy to advance their careers. *My focus is on agents, rather than on ideas*; but one defining attribute of the groups of within-state policy entrepreneurs in the technical policy arenas that shape domestic markets, is that they have a relatively coherent, programmatic set of ideas about the orientation of specific policies and, more broadly, about what is desirable and undesirable for the state to do in markets. Thus, I embed ideas into the definition of the agent and then let the agent do the causal work.

In doing so, my strategy is twofold. First, I identify the worldviews of the key political *técnicos* using primary and secondary sources to connect policy projects with relatively coherent ideational frameworks. I also employ evidence on the career background of these officials, such as field and educational institution in which they received training, and prior professional experience inside and outside the state.[148] Second, I trace the way in which these actors secure positions of power from which they seek to translate their ideas into policy (Hall 1997: 184). Proceeding this way has better prospects for causal inference than the average idea-oriented research: as Hall (1993: 290) states, "[l]ike subatomic particles, ideas do not leave much of a trail when they shift." By contrast, shifts in what group of policy entrepreneurs dominates within relevant state agencies do leave tractable imprints. Looking at the losing group of policy entrepreneurs at key nodes of policy change—as well as how the group came to lose—is particularly telling of the attributes that define winning policy entrepreneurs, including the ideas or policy orientations that those winners carry.

4.V. Dominant and Subordinated Coalitions of Policy Entrepreneurs

Policy entrepreneurs seek to assemble and maintain coalitions to advance their goals in policymaking.[149] My take on this diverges from the Gourevitchean leaning of existing literature, for which policy choice is dependent on—or at least codetermined by—support from broad *societal* coalitions. I contend that in the highly technical policy arenas that shape domestic financial markets we need to distinguish between events occurring at time 0—that is, the formative moments of policy paths—and events that occur at subsequent nodes (time [1,...,n]), and that coalitions of support for policy are not the same at the initial instances of policy than at later rounds of the game.

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[147] On ideas as focal points and coalitional glues, see Goldstein and Keohane (1993).

[148] This resembles what Jacobs (2015: 67-8) calls identifying mobile carriers of ideas: "the availability [of ideas] can be established with evidence of the movement of individuals – individuals reliably known to hold a given set of ideas – into decision-making institutions. [… C]hanges in outcomes should follow the entry of identifiable 'carriers' of the relevant ideas into key loci of political authority. […W]hat makes a carrier analytically 'useful' is that her cognitive commitments are more readily knowable than those of other actors involved in decision-making, especially elected officials. Carriers' belief systems can often be inferred by reference to their sociological context – such as their embeddedness within professional networks or the site of their training – or from past verbal communication. In this respect, the most 'useful' carriers will have a prior track record of activity outside of politics –i.e., in an intellectual or professional setting in which the incentives for strategic misrepresentation of beliefs are limited."

[149] This point is widely emphasized in the literature; see, for instance, the key contribution by Mintrom and Vergari (1996). For their part, the most influential scholars working on the political power of ideas emphasize how the state actors who propel new ideas forward need to "solve the puzzle of coalition formation" (Hall 1989: 370).

I argue that, at time 0, entrepreneurial political *técnicos* are in fact oriented to coalition building, but those coalitions are *within the state* rather than with societal groups.[150] Political *técnicos*' efforts are focused on coalition formation between the multiple conflicting interests inside the state. This is true for the two reasons—one associated with the mass public, the other with interest groups—that I have elucidated in preceding sections. First, at the moment of policy choice, the policies I consider are of relatively low salience and thus unlikely to generate major public support or discontent. Consequently, the main challenge for entrepreneurial elite officials is to garner sufficient support within the state so that ministers and/or the president pay attention and enact policy decisions on technical issues that otherwise would fall outside the latter's radar. The persuasiveness of political *técnicos*' proposals increases when they are able to connect their proposed policy changes with higher salience issues that the president may care about. In addition, a coalition of political *técnicos* will be more likely to advance its policy orientation when it succeeds in showing presidents or ministers that adopting the policy proposals put forward by competing coalitions of political *técnicos* would generate political costs that the chief executive may prefer to avoid.

Chapter 6, on the politics of state involvement in capital markets in Chile, offers an illustration of this logic. By the late 1990s and early 2000s, Chilean presidents had become concerned about growing voter discontent with the incapacity of the private-run pension system to deliver the promise of paying good pension benefits upon retirement. In that context, a group of entrepreneurial and well-coordinated executive-branch political *técnicos*—whose stronghold was the finance ministry—took advantage of contingently emerging corporate scandals in firms where pension funds held equity to advocate for the adoption of highly technical corporate governance reforms. These executive-branch experts, in line with their educational background—many of them held Ph.D.s from top American economics departments—believed that fixing market imperfections was instrumental to promoting investment and growth. Creating new rules to prevent future minority shareholder exploitation in Chilean firms was thus presented as a way to foster growth and ensure the protection of pension funds' investments in the Santiago stock market. These elite officials' success in advancing capital market-enhancing corporate governance reform in Chile can partly be attributed to the fact that they managed to establish a convincing link between their technical agenda and the high-order political concern of avoiding an erosion of the legitimacy of the entire pension system—an issue to which the president had to pay attention so as to avoid voter backlash.

The second reason that political *técnicos* focus on assembling coalitions within the state rather than with societal actors is that, during the phase of policy formation, the latter strategy's payoff is likely to be low: at time 0 society is too disorganized around these issues and/or it is too hard to make society converge behind the position advocated by policy entrepreneurs. As Vogel has argued with respect to the politics of market reregulation in industrialized countries, "powerful private sector groups [are] often hopelessly divided over, adamantly opposed to, or simply not interested in regulatory reform" (Vogel 1996: 4). In contrast, in subsequent nodes, at time [1,...,n], it is increasingly likely that interest groups recognize that policy continuity or reversal does affect them, and so they organize to exert influence over policy entrepreneurs in the state (see Section 5).

[150] Relatedly, see Chwieroth (2007a: 445, 447; 2010: 31-2) on the importance that the success or failure to form a "coherent policymaking team" within the state has for the capacity of idea-carriers to persuade the chief of government on the desirability of adopting an specific policy X and discarding alternatives.

In short, because public salience varies not only *across* policy issues but also *within* policy issues over time, during the formative moments of the policies that ultimately shape domestic financial markets—that is, when they are most likely to be of low salience—the coalitions that matter are *not* of Gourevitchean nature. Winning coalitions of policy entrepreneurs emerge, for example, when a group of elite officials from several executive-branch agencies, who were previously unable to coordinate to support a given policy orientation, manage to reach a consensus and impose their policy orientation on other state actors. Often, it is entrepreneurs below the ministerial level who conduct these kinds of coalition building.

I argue that the ability of entrepreneurial political *técnicos* to craft coalitions with executive, elite-level officials beyond the boundaries of their own agency is a key factor that explains why certain groups of policy entrepreneurs become dominant within the state. In the policy arenas that I study, border-crossing policy entrepreneurs with the capacity to align previously unaligned state agents become empowered.[151] In other words, what coalitions end up as dominant and what others come to be subordinate hinges significantly on the ability of groups of policy entrepreneurs to connect the dots among previously unconnected state units, making their policy goals a focal point or a coalitional glue.[152]

5. Mechanisms of Reproduction: How Early Policy Choices Become Enduring Modes of State Involvement in Credit and Capital Markets

National patterns of state involvement in credit and capital markets result from a path-dependent process. I have argued so far that the formative moments of policy paths (time 0) are characterized by their openness and, relatedly, by the key role of within-state agency in setting countries onto particular tracks. This plasticity is associated with the fact that, at the early stage of paths of state involvement in domestic financial markets, organized societal actors and high-profile politicians tend not to care about these issues. Due to cognitive handicaps and asymmetries of expertise, it is not clear to them that these policies matter—let alone what specific positions they should adopt. At time 0, entrepreneurial political *técnicos* in the state do care about these policies and invest in promoting policy adoption. I claim, following Pierson (2000: 253), that sequencing is critical and "[e]arlier events matter much more than later ones."

I argue that even in these highly complex and technical policy arenas, the political dynamic present at time 0 shifts at later time points. If what happened in time 0 was driven by the winning coalitions of policy entrepreneurs within the state, what follows is driven by the feedback effects that those early policy choices trigger. By the time that time [1,...,n] comes, more actors do care about the policies shaping domestic markets—and they care with greater intensity. At these later stages along the path, the original openness recedes: state structures, organized actors, and/or policy-specific increasing return dynamics become causal levers. Policy paths lock in.

In Chapters 3 through 6 I utilize this two-step framework to empirically analyze the origins (or the formative moment) of a neoliberal mode of state involvement in markets in Chile in the mid-1970s and early 1980s and a neo-developmental mode in Brazil in the 2000s. I then

[151] Peter Gourevitch has argued that forging new linkages among societal actors strongly empowers those agents who manage to bring together those often-unexpected coalitions (Gourevitch 1986: 162).

[152] On ideas as focal points and coalitional glues, see Goldstein and Keohane (1993).

proceed to focus on the factors that made these national patterns resilient in the following decade/s.

We owe to Kathleen Thelen (1999: 391) the insight that *mechanisms of reproduction* are a key element to understanding path-dependent institutional evolution. Invoking concepts of institutional continuity—ranging from "lock-in effects" and "freezing" to "sunk costs" and "vested interests"—is not enough: as she claimed, we need to "generate insights into differences in the mechanisms of reproduction that sustain different kinds of institutional arrangements, or even the same kinds of institutions in different contexts." Patterns of reproduction need not be similar across the cases under study, but they do need to be identified for a path-dependent causal argument to have high analytical leverage. Getting serious about these mechanisms, specifying them with precision, is hence an essential task.

In this section I will argue that there are two broad, distinctive, though often combined, *sources* or *subtypes of positive feedback* that explain why early policy choices are likely to be resilient over time, forming enduring national modes of state involvement in credit and capital markets. The first mechanism of reproduction can be divided in two: (1) *state structures*, which get reshaped as a consequence of policy entrepreneur actions; and (2) *intrinsic features of policies* that make them resilient in and on themselves—that is, without much need of agency. The first mechanism of reproduction can be thought of as "statist." The second is societal: paraphrasing Schattschneider, these "new policies create a new politics,"[153] and thus a particular set of *interest groups* becomes invested in preserving the existing policy path.

Self-reinforcing or positive feedback processes, Pierson (2000: 251) has argued, "pinpoint how the costs of switching from one alternative to another will, in certain social contexts, increase markedly over time." In a conception of path dependence that stresses the relevance of positive feedback as a causal mechanism,

> *(...) the probability of further steps along the same path increases with each move down that path. This is because the relative benefits of the current activity compared with other possible options increase over time. To put it a different way, the costs of exit—of switching to some previously plausible alternative—rise.*[154]

Having laid out the key concepts and analytical machinery of this section, I will unpack the claim that positive feedback processes explain why modes of state involvement in credit and capital markets are likely to lock in. I will do so by reviewing each specific *subtype of positive feedback* at a time, thus lowering the level of abstraction with which I have discussed this second part of the causal argument so far.[155]

5.I. Statist Sources of Positive Feedback

As discussed earlier in this chapter, political *técnicos* aspire to much more than fleeting policy achievements—they look to leave enduring marks in policy. That is, winning coalitions of policy entrepreneurs seek to obtain "durable victories" that can resist the challenge of competing

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[153] Cited by Pierson (1993: 595).

[154] Pierson (2000: 252).

[155] I use the labels "sources" and "subtypes" interchangeably. On different levels of abstraction of causal mechanisms and the importance of identifying subtypes, see Falleti and Lynch (2009: 1149-50).

groups of policy entrepreneurs in the future.[156] My framework highlights two important means that policy entrepreneurs have to raise the likelihood of making their victories at time 0 durable: pushing for the redefinition of the institutional-organizational structure of the state and defining features intrinsic to the policies. These two mechanisms constitute key sources of positive feedback. In the real world, the two tend to occur together and are rather hard to untangle; but often, either one or the other is more relevant for explaining why a certain policy path is reproduced in time [1,...,n].

I argue that one of the most effective ways the winning entrepreneurs have to ensure that their policy preferences will continue to prevail in the future is by inscribing those victories into the institutional topography of the state itself. This builds on an insight with a long pedigree in historical institutionalism in general, and in idea-based approaches to political economy in particular: that changing state structures is a key explanatory factor of policy continuity over time.[157] Peter Hall's work on policy paradigms referred to how policy choices become entrenched in the organizational structure of the state: policy paradigm shifts, he argued, come to an end "when the supporters of a new paradigm secure positions of authority over policymaking and are able to rearrange the organization and standard operating procedures of the policy process so as to institutionalize the new paradigm" (Hall 1993: 281). In other words, this movement from one policy paradigm to another often involves a "shift in the locus of authority over policy" (Hall 1993: 280). In this sense, my framework, while it shares Vogel's insight that states, quite autonomously, drive variation in modes of regulating markets, differs from Vogel's work on a more subtle but still important point: while Vogel (1996) seems to conflate ideas/orientations and state structures as variables operating at the same point in time, I argue that ideas have a temporally prior causal effect—more precisely, ideas held by political *técnicos*—and that state structure—partially affected by such earlier entrepreneurship—comes as a lock-in, temporally posterior driving force.

Hall's (1986: 234-42) shadow case study of Germany is a textbook example of what I am arguing here with respect to how the preferences of a winning coalition of state actors can be reproduced over a long time period by reshaping the state's institutional topography. Germany's traumatic experience with hyperinflation in the 1920s enabled the rise of within-state leaders that embraced anti-Keynesian doctrines, which in turn probably explains why, in the postwar years, the German state was reconfigured in a way that granted enormous power to its central bank, the *Deutsche Bundesbank*. This new state structure, one could argue drawing on my framework, was instrumental in entrenching the policy orientation of what I call a pro-deflation coalition of elite officials. Just by noting that the anti-Keynesian coalition triumphed (in time 0) and that it succeeded in redrawing the map of the German state (in time 1), we can understand why and how, very peculiarly, German policymakers managed to create several artificial recessions during the postwar period (time [2,...,n]).

Often, the most powerful way to inscribe victories into the state structure is by pursuing two simultaneous moves: first, changing the rules that define the formal power of executive-branch agencies and/or ministries—which includes, but is not restricted to, insulating parts of the state from various external pressures—and second, altering the resource endowments of

[156] Here I am drawing quite flexibly on Hacker's and Pierson's (2014: 645, 651-2) concept of "durable victories."

[157] Skocpol (1985: 15) early on noted: "[A]utonomous state actions will regularly take forms that attempt to reinforce the authority, political longevity, and social control of the state organizations whose incumbents generated the relevant policies or policy ideas."

executive-branch agencies and/or ministries—in other words, strengthening allied executive agencies while weakening rivals.

In contexts like Latin America, where rule writers' behavior is affected by the calculation that formal institutions are not likely to endure or be enforced (Levitsky and Murillo 2009), we should expect policy entrepreneurs to seek to reshape state structures such that the new topography can endure even if formal institutions change. One means political *técnicos* use to achieve this goal is to kick off a process by which certain parts of the state—but not others—develop what Carpenter (2001: 14, 28) calls organizational capacities to analyze, to plan, to administer budgetary resources, and to solve problems. In countries with weak bureaucracies like those of Latin America, the development of these organizational capacities in certain pockets of the state, along with the weakening of organizational capacities in areas with propensity to challenge the status quo, reduces the likelihood that earlier policy choices will be reversed in the future.

While these strategies most often include some rewriting of the formal rules (e.g. the issuing of a new presidential or ministerial decree), the likelihood that they successfully generate new state structures that are stable over time does not depend on the formal rules but rather on informal rules and regular practices. In particular, if political *técnicos* are able to set up new agencies or units within the state with a clear advantage in terms of expertise vis-à-vis other technically handicapped agencies, and they endow these organizations with an esprit de corps and organizational "culture," the reshaped institutional-organizational structure of the state is likely to be durable even if formal rules are replaced later on.[158]

Understood this way, state structures are endogenous because they result from prior action by other policy entrepreneurs, sometimes in the very distant past. The key point here, though, is that at time [1,...,n] state structures become a path-reproducing mechanism insofar as they have an independent causal effect on the reproduction of the past choices that is independent of the action of current elite officials. At time [1,...,n], the state structures created or significantly modified at time 0 raise the costs of exiting the prevailing mode of state involvement in credit and capital markets, partly because those state structures are not well prepared to handle alternative modes of state-market relations.[159]

Entrepreneurial political *técnicos* at time 0 can also make their victories durable by inscribing those victories into the details of the policies themselves. That is, my claim is that *intrinsic characteristics of the policies* of state involvement in credit and capital markets can themselves be a source of positive feedback. Of course, in principle policies could be dismantled altogether at subsequent rounds of the game, but some features intrinsic to policies may make them resilient, and even propel "automatic" growth of a given policy. Examples are not hard to

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[158] Levitsky and Murillo (2009: 117) deal exclusively with the weakness of formal or written, or "parchment," rules. I build on their work by claiming that even in contexts where written rules tend not to survive the passage of time we can observe highly durable state organizations. Technical expertise can be a primary source of organizational durability even when the laws and decrees formally shaping the structure of the executive branch change frequently.

[159] The literature suggesting that structural features of states and policy legacies critically condition what different states "can do" in markets is quite vast, but probably one of the most influential references is that of Weir and Skocpol (1985). In explaining the way that particular development strategies are pursued, Haggard (1990: 46) argued that "[o]nce [policy instruments are] developed, state actors tend to view solutions to particular problems through the lens of the instruments that are available to them; their options are limited or expanded by the tools they have at hand."

find: policies that affect state-owned development bank behavior, for instance, can be drafted in a way such that the scale of state lending is tied to the economic cycle. Under those circumstances, if the economy does not perform well over a number of years, state involvement in credit markets may grow without need of new government actions. Inscribing sunset clauses into policies—especially if the clause is set to operate at a distant point in time—generates a similar dynamic.[160]

In short, winning coalitions of entrepreneurial political *técnicos* can make their victories at time 0 durable not just by altering the structural features of the state but also by writing the policy provisions in a way that allows them *de facto* to micromanage how policies unfold over time. Interestingly, by lengthening the time horizon of policies in such a way, winning coalitions of entrepreneurial elite-level officials may raise the likelihood of being perceived as indispensable within the state at time [1,...,n], as they cannot be replaced because they "know" the policy better than anyone else.[161] Together, state structures and characteristics intrinsic to policies themselves reduce the likelihood that, even in instances of partisan change in the executive branch of government, large path-departing changes will occur.[162]

5.II. Societal Sources of Positive Feedback: The Importance of Business Power

So far I have discussed statist mechanisms of reproduction. I now move to non-state dynamics. The second source of positive feedback that explains why national patterns of state involvement in credit and capital markets lock in is the emergence in time [1,...,n] of concentrated, well-organized interest groups that have an intense stake in maintaining the prevailing form of state involvement in markets and preserving the markets that such involvement contributed to generating. In short, "policies produce politics" (Pierson 1993: 595). While a new hot area of research has focused on how policies affect the political behavior of mass publics,[163] I argue that, because the type of policies examined in this study continue to be of relatively low public salience even in time [1,...,n], the behavior of mass publics or voter-rooted dynamics are *not* a reproduction mechanism of national paths of state involvement in domestic markets. Instead, what matters is that these policies reshape the interest group landscape.

In fact, societal groups' organizational structure and political goals change in response to the nature of the programs they confront and seek to sustain (or modify) because policies generate learning effects, coordination effects, and adaptive expectations.[164] The interest groups' cognitive handicaps that I underlined in Section 4.III recede over time: while the policies shaping markets continue to be largely opaque for the mass public, they are no longer so for interested societal actors. Furthermore, policy feedback is likely to be most consequential in issue areas in

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[160] In Bril-Mascarenhas and Post (2015) we found that in an entirely different policy arena than that of this study, broad-based consumer subsidies, specific features in the design of the policy can make program outlays grow over time rather automatically.
[161] This last insight is inspired in Dargent (2015: 4), who laid out a logic about how state technocrats or *técnicos* can achieve "entrenchment."
[162] Vogel (1996: 21) made a similar point about the survival of regulatory orientations after power is transferred to new administrations.
[163] Though Pierson (1993: 605-11) seminally addressed this type of policy feedback, a large body of research on "policy makes mass politics" only emerged thereafter. For a review, see Campbell (2012).
[164] Pierson (1993: 598, 2000: 259).

which interest group activity was not yet well established at time 0.[165] The policies that shape domestic financial markets, I argue, constitute one such issue area: over time, they tend to create actors where no such actors previously existed.

As I have shown in the introductory chapter of this study, in the long run the modes of state involvement in domestic markets come to have real-world implications for how firms finance their investment projects and expand. Hence, policies adopted at time 0 generate incentives and resources for business actors because they create new markets and/or reshape existing ones. At time [1,...,n], firms and the organizations that represent them learn about the advantages of operating in those markets and adapt their strategies to a new scenario that is marked, precisely, by the existence of these markets.

An example will help to illustrate this point: certain types of non-financial corporations, may adapt their corporate finance strategies so as to tap newly available sources of funding, such as growing equity markets or subsidized loans provided by growing state-owned development banks. In doing so, these firms become invested in the maintenance of the policies that underpin those capital and credit markets. For financial-sector actors—such as insurance companies, private pension fund administrators, investment banks, and other asset managers—what is at stake is even more important than for firms in the productive sector; therefore, financial-sector actors are likely to become "intense" groups that defend policy continuity.[166] In yet another example, state involvement in credit markets often gives private banks the role of intermediating state funding, allowing them to expand their credit base, which is likely to increase bankers' interest in the maintenance or expansion of this kind of policy.

If the cognitive handicaps affecting business actors that already existed at the time of policy formation decline over time, and if new firms come to be intensely interested in the continuity of policies that underpin newly structured financial systems, then *business power* may become an important factor contributing to the resilience of modes of state involvement in credit and capital markets. My study is not intrinsically interested in business power; rather, I resort to this factor when in empirical instances of interest we have good reason to believe that business power may have been a key driver of policy adoption or of the resilience of these modes over time—a belief that, admittedly, challenges my state-centric account of the formative phases of modes of state involvement in markets (Section 4).[167] The following propositions thus take from the literature on business power those insights that seem most relevant for stylizing the path-dependent dynamics of state involvement in domestic markets.

Since drastic reversals of the policies that shape financial systems can affect large swaths of the business community because they alter corporate investment strategies, the higher the score of business cohesion in a particular setting and the higher the capacity of business actors to use structural power strategically to credibly signal to executive-branch officials that policy reversal in this arena would trigger disinvestment, the greater the importance that business power will have as a mechanism of path reproduction. Under circumstances in which a well-organized, economically relevant segment of the business community prefers policy continuity, business power is likely to become an important lock-in factor mainly because, by credibly showing chief executives that drastic policy reversals would negatively affect the economic cycle, business can

[165] Pierson (1993: 602).
[166] On interest group intensity and policy, see Hacker and Pierson (2014: 649-51).
[167] The literature that has an intrinsic interest on business power is vast. Major works include Lindblom (1977), Vogel (1987), Hacker and Pierson (2002), Culpepper (2011, 2015), and Fairfield (2015a).

align its preferences with a top priority for any chief executive—avoiding political discontent at the mass level.

As Fairfield (2015a: 38) has argued, cohesion is a key resource of instrumental power because it strengthens business's bargaining position by increasing the costs that pursuing divide-and-conquer strategies could have for the national political executive, thus enhancing the effectiveness of business lobby with government officials. Business actors resort to strategic structural power[168] when, in their negotiations with executive-branch officials, they actively invoke disinvestment threats as a way to bring policy choices closer to their preferences. Instrumental and structural types of business power are mutually reinforcing (see Fairfield 2015a: 49, 2015b: 420-4).[169]

We can think of two polar examples. On the one hand, I expect this interest group reproduction mechanism to be *most relevant* in settings in which there exist business actors that have a high stake in these policy arenas—what I have called financial sector-intense policy demanders—*and* are embedded in broader, multisectoral business associations that can bring coherence and coordinate business lobby and interlocution with the government in defense of the existing mode of state involvement in markets, *and* where these actors resort to strategic structural power. On the other hand, in the opposite stylized example, I expect business action to be *least relevant* as a mechanism of path reproduction in settings in which financial sector-intense policy demanders are weak or absent *and* the level of cohesion among business actors is low, *and* business rarely or never utilizes structural power strategically.

In closing this section it is important to stress that in concrete empirical cases I expect both statist and societal mechanisms of path reproduction to be present to some extent. However, typically one of these sources of positive feedback will account better than other sources for the continuity of patterns of state involvement in credit and capital markets.

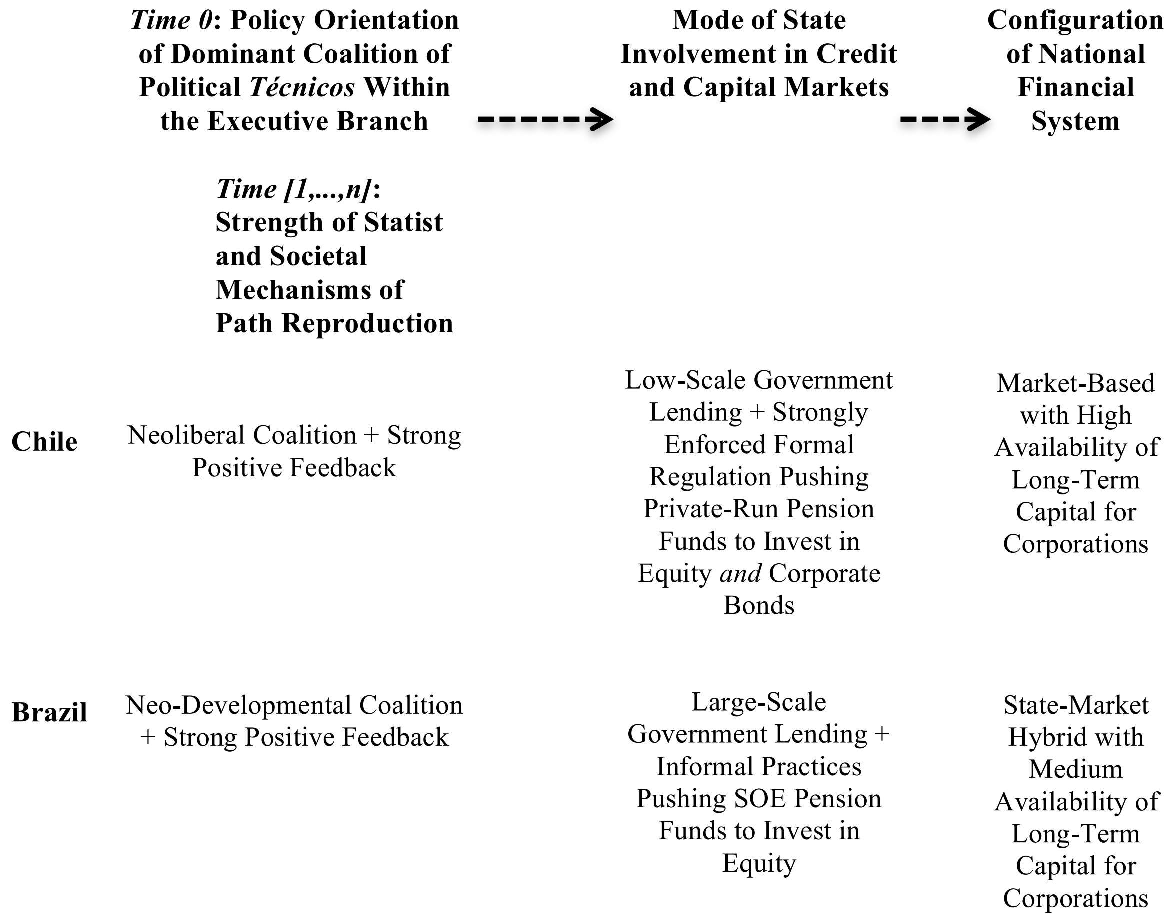
6. Replacing Variables by Proper Names: The Contrasting Trajectories of Brazil and Chile

Figure 1.2 utilizes the framework developed in this chapter to provide a snapshot of the contrasting trajectories of Brazil and Chile studied in Chapters 3-6. The empirical analysis to which I will now move delves into these national trajectories by dedicating one chapter to each country and market.

[168] The notion of strategic structural power is an innovation Culpepper and Reinke (2014) introduced to the prevailing conventional wisdom (e.g. Lindblom 1977; Hacker and Pierson 2002) that conceived that the exercise of structural power was automatic and apolitical.

[169] I follow Fairfield (2015a: 38) in emphasizing the importance of cohesion above other resources associated with business instrumental power, such as expertise and media access. This is consistent with Section 4.III of my framework for two reasons. First, the policy arenas of this study are of relatively low salience, which makes media access an unlikely source of business influence in this realm. Second, in these policy arenas business actors tend to be cognitively handicapped vis-à-vis elite officials, which reduces the importance of business expertise as a driver. In addition, I follow Culpepper and Reinke (2014) in focusing on strategic rather than automatic structural power due to methodological concerns: focusing on automatic structural power requires researchers to empirically assess "what is going on inside the heads of policymakers"; automatic structural power "changes when conditions change, as politicians alter their evaluation of the credibility of a threat of business disinvestment in the wake of different economic events [… hence], its short-term function is largely […] unobservable empirically" (Culpepper and Reinke 2014: 448-9).

Figure 1.2. Stylized Argument.



Chapter 3. The Politics of State Involvement in Credit Markets in Brazil

1. Introduction

This chapter traces the process by which the Brazilian state moved from low to high involvement in the credit markets channeling finance for the country's firms. After reviewing the marginal role the state played in loan markets in the aftermath of the market-oriented reforms of the 1990s, the chapter focuses on an in-depth analysis of the period started with the arrival of the center-left Workers' Party (Partido dos Trabalhadores or PT) to the federal executive branch in 2003 and the ensuing four consecutive PT administrations. At the end of this over two-decade process we observe a new configuration of the Brazilian financial system, a new stable equilibrium that is likely to be resilient even as the government's partisanship changes.

The National Bank for Economic and Social Development (or BNDES, for its Portuguese acronym)[170] is undoubtedly *the* actor that determines the scale and scope of state involvement in long-term credit markets in Brazil. Founded in 1952, the BNDES was a symbol of Brazil's first wave of developmentalism during the times of the state-led import substitution industrialization (ISI) model.[171] While the Bank has survived multiple political and economic regime transitions, its roles and relevance in Brazil's financial system have varied remarkably over time. The BNDES has long been the only relevant bank source of long-term investment finance in a country where the commercial banking industry only provides short-term credit.[172] This chapter traces the evolution of the politics that determines the state's direct involvement in credit markets through the BNDES since the market-oriented reform period in the 1990s and up to the present.

As Figure 3.1 shows, BNDES's loan portfolio has grown meteorically in this twenty-year period.[173] Table 3.1 relates the loans granted by the BNDES with the Brazilian GDP, bringing to light that in the post-2009 period BNDES lending came to represent roughly five percent of the country's GDP; this is a stark contrast vis-à-vis the modicum size the Bank had within the Brazilian political economy during the market-oriented reform period. In 2014 the ratio BNDES loans to GDP was over five times larger than that of 1995—5.4 and 1.0 percent, respectively. To grasp the magnitude of the change that Figure 3.1 and Table 3.1 summarize it suffices to say that, by the early 2010s, the total value of loans disbursed by the BNDES was three times larger than World Bank's worldwide lending (Musacchio and Lazzarini 2014: 238-9).

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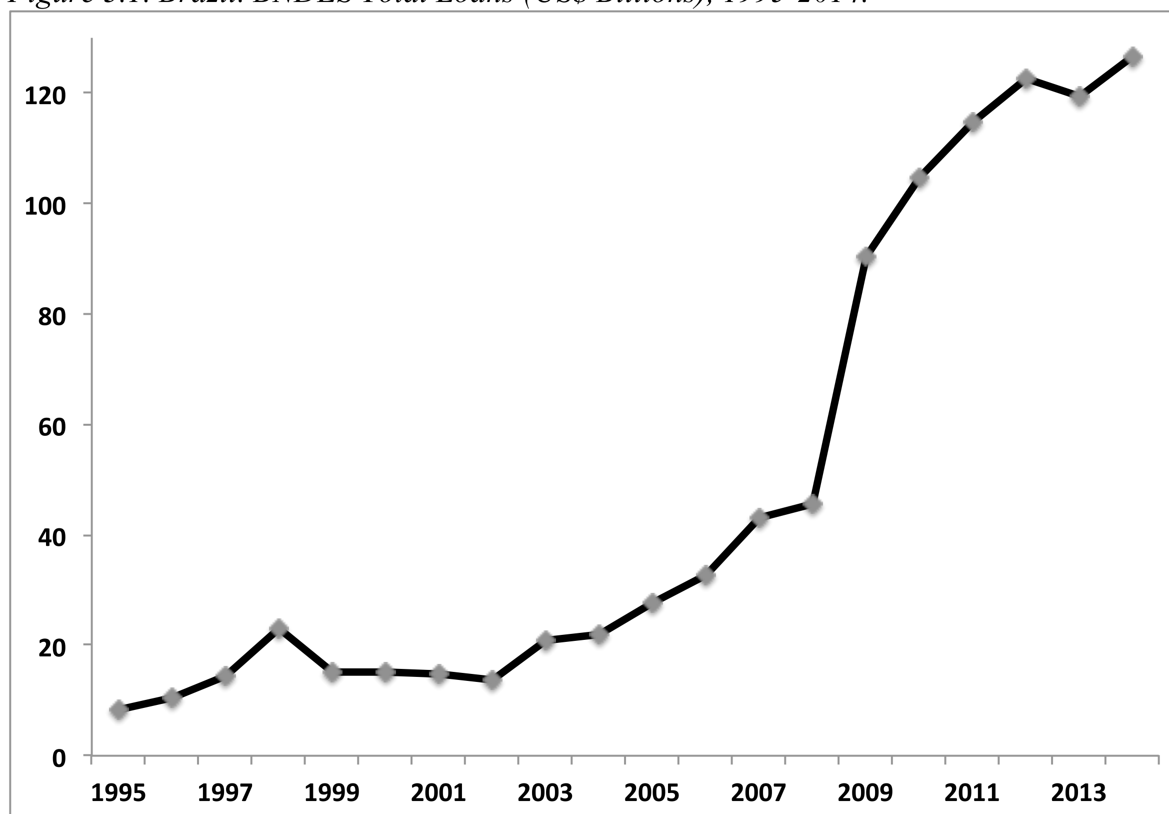
[170] Banco Nacional de Desenvolvimento Econômico e Social.

[171] For a longer historical perspective on the BNDES, see, among others, Schneider (1991), Colby (2013), and Mettenheim (2010).

[172] See Stallings (2006, chapter 8). The average term of BNDES loans is 96 months, whereas commercial bank credits have, on average, a 9-month maturity (Santana 2011: 146). On the microfoundations of private banks' short-term orientation, see, for instance, Schapiro (2010: 88-9).

[173] It is important to note that this growth of BNDES loans is not a simple mirror of the growth of the Brazilian bank credit market more broadly: while between 1995 and 2014 the stock of loans in the entire banking system (excluding the BNDES) grew 5.4 times, the stock of BNDES loans grew 15.3 times (*Source*: My calculations based on data from dataset "Top 50 Banks in Brazil," Central Bank of Brazil).

Figure 3.1. Brazil. BNDES Total Loans (US$ Billions), 1995-2014.



Source: Author's elaboration based on data from dataset "Top 50 Banks in Brazil," Central Bank of Brazil, and IMF's historical exchange rate data.
Notes: Data points are for December of each year, except for 2014, whose figure corresponds to September. Name of variable in Portuguese: "Total Oper. Créd. e Arrend. Mercantil."

Table 3.1. Brazil. BNDES Total Loans as a Proportion of the Brazilian GDP, 1996-2014.

1996	*1998*	*2000*	*2002*	*2004*	*2006*	*2008*	*2010*	*2012*	*2014*
1.2%	2.7%	2.3%	2.7%	3.3%	3.0%	2.7%	4.7%	5.1%	5.4%

Source: Author's calculations based on data from dataset "Top 50 Banks in Brazil," Central Bank of Brazil, IMF's historical exchange rate data, and World Bank's World Development Indicators.
Notes: Data points are for December of each year, except for 2014, whose figure corresponds to September. Name of variable in Portuguese: "Total Oper. Créd. e Arrend. Mercantil."

By the mid-2010s, the BNDES had come to occupy a new position within the loan markets that seems to have locked in. The Bank has become a key support of long-term investment finance for Brazilian firms of all sizes, ranging from SMEs to the largest, internationalized business groups: over 60 percent of bank loans with maturity of five or more years comes from the BNDES.[174] These thousands of firms have adjusted their corporate finance structure to the new context marked by the large presence of the state as a provider of long-term credit. A retrenchment of the large-scale involvement in these markets would have a substantial impact over the investment cycle in Brazil—and thus on economic performance.

[174] Data from EM Interministerial 194/2010.

How can we explain this rapid—but now resilient—shift in the level of direct state involvement in credit markets in contemporary Brazil? My analytical framework suggests that in the formative moments of policy change in this policy arena it is essential to look at the politics within the state. In particular, I argue that analyzing the balance of power among competing coalitions of policy entrepreneurs within the executive branch of government is key to understand changes in the nature of state involvement in credit markets.

Stylizing the Brazilian case that I will unpack in the following sections of this chapter, I identify three stages in the process, each characterized by different configurations in the balance of power within the state. Table 3.2 summarizes this stylized account.

Table 3.2. Brazil. Balance of Power Between Competing Coalitions of Political Técnicos and its Implications for State Involvement in Credit Markets.

Time Period	*Balance of Power Within the Executive Branch*	*Implications for State Involvement in Credit Markets*
1990s-2002	Orthodox coalition dominates	Low BNDES lending
2003-2006	Stalemate between orthodox and neo-developmental coalitions	Partial ideational shift in favor of larger state involvement in credit markets but low/intermediate BNDES lending
2007-2014	Neo-developmental coalition dominates	Large BNDES lending

Source: Author's elaboration based on data presented in the following sections of this chapter.

In the first period, from the 1990s up to 2002, orthodox political *técnicos* dominated the key executive-branch agencies that determine the nature of state involvement in credit markets. During that decade, these policy entrepreneurs instrumented a retrenchment of the scale of BNDES in loan markets. This was a state- rather than a business-driven outcome, as evidenced by the fact that during the 1990s the most important segments of the business community advocated in favor of expanding rather than contracting state-provided credit for investment finance. This was particularly the case of big Brazilian industrialists, which, in contrast with those in Chile, do not embrace a small-state ideology on issues affecting their capacity to finance investment (see Chapter 4), and who enjoyed significant clout over the government.

In 2003, with the election of Lula Da Silva as president, a long period of four consecutive presidencies of the Workers' Party was inaugurated. The first four-year term administration (2003-2007) was characterized by a stalemate between two competing coalitions of policy entrepreneurs—an orthodox coalition entrenched at the Ministry of Finance that pushed in favor of maintaining low levels of state involvement in credit markets and a growing but uncoordinated coalition of neo-developmental policy entrepreneurs, based in a couple of executive-branch agencies, who sought to expand state involvement in long-term loan markets. The conflict between the two coalitions between 2003 and 2007 is hard to overstate; the outcome was "mixed," in the sense that an ideational shift in favor of an expansion of the BNDES within the financial system started to take root while, at the same time, the powerful orthodox political *técnicos* at the Ministry of Finance managed to veto the possibility that these newly growing ideas within the Brazilian state actually triggered a significant expansion of government lending.

The data in Figure 3.1 is coherent with this account: the scale of BNDES loans grew starting in 2003—partly reflecting the victories that neo-developmental entrepreneurs achieved in launching new industrial policies—but it did so at a slow pace and starting from the low-level

baseline that had been the legacy of the market-oriented reforms of the 1990s. If government's partisanship, as an alternative hypothesis would hold, had been in and of itself sufficient to drive a major change in the level of state involvement in credit markets, such policy change should have occurred sooner. Yet there was a significantly long time lag in between: the Workers' Party reached the presidency on January 1, 2003 but the scale of state-owned banking institutions' provision of long-term credit was modest as late as in 2007.

The final period started during the last year of the first PT term in office, with the rapid decline of the orthodox coalition of political *técnicos* and the surge of a highly coordinated neo-developmental coalition. By 2007-2008, the latter had attained a position of dominance within the Brazilian executive branch that allowed *neo-desenvolvimentista* entrepreneurs to inscribe their ideas into policy decisions, which in turn explains the resulting high level of BNDES lending. The building up of state capacity to deliver long-term bank credit for firms on a massive scale that took place during this third period cannot be attributed to business pressure, as an alternative explanation would hold. Had business power sufficed to drive a shift from low to high state involvement in the credit markets channeling finance for the country's firms, we should have observed such outcome occurring way before, probably during Fernando Henrique Cardoso's administrations (1995-2002), when big business was a core ally of the president's party (the PSDB). In that period, however, the state did not step in to drastically increase its involvement in credit markets.

Table 3.3 serves as a roadmap to ease the reading of the following sections of this chapter.

Table 3.3. Brazil. Periods, Actors, and Milestones in the Politics of State Involvement in Credit Markets, 2003-Present.

Time Period	*Key Political Técnicos*	*Milestones Affecting State Involvement in Credit Markets*
2003-2006 *Stalemate between orthodox and neo-developmental coalitions*	*Orthodox coalition* Antonio Palocci (Finance Minister) Marcos Lisboa (Secretary of Economic Policy) Joaquim Levy (Secretary of the Treasury) Murilo Portugal (Executive Secretary of Finance) *Neo-developmental coalition* Carlos Lessa (BNDES President) Guido Mantega (Minister of Planning; later BNDES President) Luiz Fernando Furlan (Minister of Development)	Adoption of Multi-Year Plan 2004-2007 Adoption of PITCE industrial policy Conflicts around "appropriate" level of long-term interest rate, and the interaction between BNDES lending and monetary policy
2007-2014 *Neo-developmental coalition dominates*	Luciano Coutinho (BNDES President) Guido Mantega (Finance Minister) Dilma Rousseff (President's Chief of Staff; later President) Nelson Barbosa (Secretary, Ministry of Finance) BNDES Board Members, especially João Carlos Ferraz	Adoption of the Program for Growth Acceleration Adoption of the Productive Development Policy (PDP) Change in the BNDES funding structure

Source: Author's elaboration based on data presented in the following sections of this chapter.

This chapter is organized as follows. The section after this introduction offers a brief review of the neoliberal period of the 1990s, documenting the low level of state involvement in credit markets. The legacy of highly retrenched BNDES lending was the baseline for the period that I examine in-depth in this chapter: the four consecutive governments of the Workers' Party (2003-2016). The third section is dedicated to what I call the "stalemate" period (2003-2006); it identifies the two competing coalitions and the contrast between the ideas each of them carried, it tracks down how each coalition was partially successful in pushing policy as close as possible to its preferences, presenting evidence about the conflict between the two coalitions and connecting this politics within the state with the finding that direct government lending was still low during this period. The fourth section traces the process during which the neo-developmental coalition of policy entrepreneurs shifted the role of the Brazilian state in credit markets, drastically increasing the scale and scope of BNDES lending (2007-present). Up to the fourth section the chapter's exposition follows a chronological order. In the fifth section, instead, I take a step back to consider the sources of positive feedback that have reproduced this new equilibrium of high state involvement in credit markets; the section focuses (a) on identifying the intrinsic attributes of the policies that make them resilient, and (b) on documenting how the action of business associations—which did not drive the formative moments of the policies under study—may be contributing to the reproduction of the path of high state involvement in credit markets. The sixth section presents the final remarks to wrap up, revisit contending explanations of the policy process, and to further deepen the dialogue between the analytical framework of this study and the empirical findings of this chapter.

2. The Legacy of the 1990s Neoliberal Era as the Baseline for the Period Under Study

Brazil contrasts with Argentina and Chile because its market-oriented reformers did not dismantle the development bank inherited from the model of state-led import substitution industrialization. However, the scale of the BNDES as the state's arm in credit markets drastically shrunk during the "lost decade" of the 1980s,[175] and Brazilian government leaders during the 1990s did not fully revamp the Bank's historical omnipresence in the financial system. While in the 1975-1985 period that preceded the neoliberal turn BNDES's finance represented around 20 percent of Brazil's gross domestic capital formation, in 1990, with the market reforms already set in motion, that amount had dropped to 3 percent, and by 1999 it had only rebounded up to 6 percent (Mettenheim 2010: 158).

Several officials interviewed for this study argued that, during the period of market-oriented reforms, the BNDES ceased to be a development bank and "became an investment bank."[176] Two BNDES presidents during this period even questioned whether it was worth for the Bank to continue to exist.[177] The dictum that the economic advisors of the PSDB—the party in government back then—repeated in the 1990s was, "the best industrial policy is not to have industrial policy" ("*a melhor política industrial é não ter política*").

During the 1990s BNDES operations in long-term credit markets were concentrated in the Program of Denationalization (*Programa Nacional de Desestatização*). In that capacity, the

[175] See Colby (2013).
[176] Multiple interviews, Brasília and Rio de Janeiro, 2014.
[177] 'O Desenvolvimentista,' *Piauí*, October 2010.

BNDES was in charge of executing the privatization process and provided finance for acquisitions, granting credits to the new owners of the previously SOEs (Diniz 2004; Hermann 2010: 11); this BNDES action also had the goal of attracting private players to invest in the privatizing companies (Lisboa and Latif 2013: 25). Francisco Gros, a former Wall Street investment banker who was BNDES President between 2000 and 2002, stated,

> *In 2000-2002, when I came to the BNDES to serve as president, the biggest challenge was to develop a Strategic Plan for the 2000-2005 period (…). This had not been done for a while at the time because throughout the 1990s the BNDES (…) was focused on day-to-day operations. Managing everyday crises used to take more time and attention than long-term projects. At the time, the BNDES was essentially the bank of privatization.*[178]

The 1990s BNDES loans were larger than in the austere, debt-crisis-ridden decade of the 1980s (Além 1998; Mettenheim 2010): while in 1993 the BNDES had disbursed US$3 billion to lubricate the privatization process, in 1998 BNDES loans reached US$16 billion (Diniz 2004: 99). However, President Fernando Henrique Cardoso (1995-2002) shared with his two predecessors—Presidents Fernando Collor de Mello (1990-1992) and Itamar Franco (1992-1994)—the goal of reducing the role of the state in the economy. The decision to turn the BNDES into a privatization agent ended the Bank's historical focus on industrial policy and infrastructure development, hence circumscribing the Brazilian state's involvement in credit markets.[179] Tellingly, the BNDES flagship industrial policy effort during the late 1990s, the *Programa de Financiamento de Exportações* (Proex), a credit line that sought to push an export-led strategy among Brazilian firms reached US$1.2 billion in 1997 (Colby 2013: 213), a modicum amount vis-à-vis the loans that would be created to fuel the industrial policies of the 2000s and 2010s. This new small position of the BNDES within the financial system had stabilized by the time President Cardoso handed power to President Lula Da Silva in 2003.

3. The Stalemate Between Two Competing Coalitions of Political *Técnicos*, 2003-2006

During the Workers' Party first presidential term in power (2003-2007) there was a tie between two coalitions of political *técnicos*: one, orthodox and the other, neo-developmental (or *neo-desenvolvimentista*, as it is known in Brazil). As I argue below, we do not have good reasons to believe that President Lula intentionally set up the stalemate dynamic. The inability of any of these two coalitions to prevail in within-state struggles to define the nature of the Brazilian state involvement in credit markets is a key factor explaining the hybrid outcome emerging out of that four-year period. By the time President Lula Da Silva started his second term in 2007, this draw between competing coalitions of policy entrepreneurs had left mixed results: on the one hand, an ideational shift within the state in favor of a BNDES significantly more active in credit markets than it had been during the previous two decades was already well under way due to the action of neo-developmental entrepreneurs; on the other hand, orthodox entrepreneurs dominating the

[178] BNDES (2002).

[179] Kingstone (1999: 238) reports the substantial decline in loan disbursements in the critical capital goods sector, which mirrors the broader trend.

Ministry of Finance managed to operate as a veto player preventing a major increase in the scale of BNDES involvement in credit markets.

A detailed study of this period of parity in the balance of power between two coalitions is important because it contributes to explaining the relatively modest level of direct government lending up to 2008 (see above in Figure 3.1). This period shows that there is in fact within-country, over time variation in the explanatory factors highlighted in my analytical framework. The implications that the rise to dominance of a neo-developmental coalition had for the change in the level of state involvement in credit markets—the focus of next section—cannot be fully gauged without contrasting it with the blockades that coalition faced during the period studied in this section.

Identifying this quite long period of stalemate is also important in order to discredit a major alternative hypothesis that holds that partisan politics is the primary driver of the policy process studied in this chapter. The process-tracing analysis presented in this section indicates that a partisan politics argument is at odds with the facts. If the Brazilian state's building of capacity to deliver long-term bank credit for firms on a massive scale were explained by government's partisanship, such change should have occurred way before than it actually did. The Workers' Party reached the presidency on January 1, 2003. Yet state-owned banking institutions' provision of long-term credit was still relatively modest during this quite long period of stalemate. That is, the partisan politics hypothesis does not hold mainly because it cannot account for the time lag between the PT's accession to power and the adoption of policies that critically rooted the shift from low to high state involvement in the provision of long-term credit for corporations. Only when the stalemate studied in this section finally unraveled—that is, when neo-developmental political *técnicos* secured their dominance and the influence of orthodox officials' ideas was curtailed—did a massive expansion of direct state involvement in the credit market become likely to be set in motion. Uncovering the lag in between—the focus of this section—proves therefore essential in the exercise of causal inference.

This section proceeds as follows. The first subsection identifies the emerging coalition of neo-developmental policy entrepreneurs and tracks down its partial victories during the 2003-2006 period. The second subsection is dedicated to the orthodox coalition of political *técnicos* that dominated the Finance Ministry up to 2006, counterbalancing the power of the *neo-desenvolvimentista* coalition. The third and final subsection is centered on the inter-coalitional stalemate itself, delves into the evidence of conflicts between the two coalitions, and shows how the stalemate finally unraveled.

3.I. The Partial Victories of Neo-Developmental Political Técnicos, 2003-2006

The PT's arrival to power triggered the accession of multiple neo-developmental policy entrepreneurs to several key agencies within (or directly dependent on) the executive branch of government, including the BNDES presidency, the Office of the President's Chief of Staff, the Ministry of Development and the Ministry of Planning. The appointment of these elite officials is of course important in and of itself, but we cannot explain the policy process based on their appointments *alone*. A closer look at micropolitical factors affecting power shifts within the executive-branch is essential to understand how the mode of state involvement in credit markets shifted during the Workers' Party administrations.

While coordination among the BNDES presidency, the Office of the President's Chief of Staff, the Ministry of Development and the Ministry of Planning was challenging—and in same

cases, not possible—[180] the action of these newly arrived neo-developmental policy entrepreneurs was undoubtedly behind the launch of an industrial policy agenda, which would have been highly unlikely during the preceding neoliberal period. An important part of those new industrial policy programs would imply the BNDES to adopt a growing scope and scale in investment finance.

Though the action of these newly emerging *neo-desenvolvimentista* policy entrepreneurs suffered from both their incapacity to coordinate across the multiple government agencies where they were based and the veto of the orthodox coalition rooted in the powerful Ministry of Finance, they did manage to kick off an ideational shift regarding the role of the state in credit markets. Even during the three-year period during which the stalemate between the competing coalitions lasted (2003-2006), the neo-developmental policy entrepreneurs obtained partial success. The two most important traces of those partial victories within the state were the passage of the Multi-Year Plan 2004-2007 (*Plano Plurianual 2004-2007,* PPA) and the launch of the Industrial, Technology and Foreign Trade Policy (*Política Industrial, Tecnológica e de Comércio Exterior*, PITCE).[181]

Guido Mantega, a neo-developmental policy entrepreneur that would reach top prominence three years after the PT got to power, was instrumental in starting an ideational shift within the Brazilian state as early as in 2003. The contrast between Mantega's profile and the profiles of the orthodox entrepreneurs at the Ministry of Finance (see below) is hard to overstate. As opposed to the doctoral training in American departments of economics received by the entrepreneurs at Fazenda, Mantega did his PhD in the sociology of development at the University of São Paulo and at the Institute of Development Studies of the University of Sussex. He had been a close economic advisor to Lula Da Silva since 1993, at a time when the PT's economic platform was more radically left-leaning than it became once the party won the presidency. In 2003, as Minister of Planning (*Ministro do Planejamento, Orçamento e Gestão*), Mantega was the key organizer behind the Multi-Year Plan 2004-2007.[182] In the document there are clear traces of the ideas carried by the neo-developmental coalition of policy entrepreneurs, which have neat implications for the changing involvement of the state in credit markets:

> *The state has to use all the instruments and resources available to give the needed impetus to development.*[183]
> *(...) To launch such development project it is necessary that the state adopt a decisive role as leader* [condutor] *of development (...) and as inductor of economic growth.*[184]
> *[The state needs to] expand domestic sources of finance and democratize the access to credit for investment [and] production (...).*[185]
> *With regard to the large investment projects contained in this Plan, we must recognize the new role of the state as inductor and co-participant of the process of economic growth. (...) The feasibility of these investment projects depends on the implementation*

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[180] Multiple interviews, Brasília, São Paulo, and Rio de Janeiro, 2014. During 2003-2004, the tensions between the BNDES and the Ministry of Development were particularly strong.

[181] In an academic article, Fabio Erber—who, at the time, was himself an active policy entrepreneur based at the BNDES (De Toni 2013: 153-4, 211)—makes the same point that the PPA and PITCE were the two landmark successes of the *neo-desenvolvimentistas* (Erber 2011: 45).

[182] "Mantega é crítico da política econômica de Palocci," *Estado de São Paulo*, March 27, 2006.

[183] Ministério do Planejamento, Orçamento e Gestão (2003: 13).

[184] Ministério do Planejamento, Orçamento e Gestão (2003: 15).

[185] Ministério do Planejamento, Orçamento e Gestão (2003: 105).

of financial arrangements that imply new types of relations between the public and the private sectors.[186] *In this sense, (...) the government's actions will make the initial phases of public-private partnership projects viable by granting loans; (...)[and] strengthen the BNDES traditional funding role, as well as expand the BNDES presence in debt and equity markets (...). State-owned banks will thus adopt the role of agents of economic development (...), supporting this Multi-Year Plan. (...) The BNDES will orient its funding portfolio to the programs of this Plan.*[187]

The second partial victory of the neo-developmental coalition was the adoption in 2004 of the PITCE Industrial, Technology and Foreign Trade Policy. PITCE became the Workers' Party flagship industrial policy up to the launching of the much more ambitious Program for Productive Development (*Política de Desenvolvimento Produtivo*, PDP) in 2008. Along with PITCE, the government passed Law 11,080 (2004), which created the National Council for Development and Innovation (*Conselho Nacional de Desenvolvimento Industrial* or CNDI) and the Brazilian Agency for Industrial Development (*Agência Brasileira de Desenvolvimento Industrial* or ABDI). The goal behind the setting up of these new institutions was to strengthen coordination among the many agencies involved in the new industrial policy strategy (see Colby 2013; De Toni 2013).[188]

Assessing that in 2003-2006 there was a stalemate between two coalitions of policy entrepreneurs helps understand both the limitations and the importance of these new industrial policy instruments. On the one hand, PITCE did not allow the state to significantly expand its direct involvement in credit markets affecting corporate finance. On the other hand, PITCE and the new institutional structure with which it came along reflects the gradual but not insignificant ideational shift that was under way within the Brazilian executive branch: for the first time since the demise of the statist ISI model government leaders were forcefully arguing that the state had to play a relevant role in fostering industrial upgrading and that such goal entailed choosing sectors and industries to be incentivized. The veto power of the orthodox political *técnicos* at the Ministry of Finance sufficed to prevent these industrial policies from being attached to a major increase in the state's involvement in reducing the cost firms pay for credit, but those same orthodox entrepreneurs failed to impose their view that such type of industrial policy should be avoided because it generates rent-seeking dynamics and fiscal profligacy.[189]

The action of neo-developmental policy entrepreneurs was not limited to the offices of the federal government at the country's capital in Brasília: simultaneously, Rio de Janeiro, where the BNDES has its headquarters, was the stage of another, highly contested inroad by *neo-desenvolvimentistas*. Carlos Lessa reached the BNDES presidency after an over forty-year-long academic career as a left wing, developmental economist. He received his PhD from the heterodox bastion Unicamp and later became professor at the Federal University of Rio de Janeiro, another stronghold of heterodox approaches in economics. The interview evidence indicates that Lessa's presidency at the BNDES, though it generated policy gridlocks because of

[186] Ministério do Planejamento, Orçamento e Gestão (2003: 108).
[187] Ministério do Planejamento, Orçamento e Gestão (2003: 109).
[188] Both the CNDI and ABDI lost power during Lula's second term (2007-2010) (De Toni 2013: 300). That development, however, does not affect the point that I am making in this section: that the first PT administration marked a turning point vis-à-vis the 1990s insofar it adopted a new industrial policy, which would in turn serve as baseline for the major involvement of the state in credit markets that would start in 2008.
[189] Not-for-attribution interview with former top official at the Ministry of Finance, 2014.

his battles with the orthodox figures within the Lula government, generated an ideational shock within the BNDES technocracy.

During his first two weeks as BNDES president in 2003, Lessa changed the board and the superintendents—the two most important bodies in the Bank's hierarchy—arguing that he "could not work with all those people that were in favor of privatization." Lessa went on to launch a public contest to hire new *funcionários*, thus raising the size of the staff from 1,600 to 2,250. "I wanted to defend the BNDES from all the damages [*estragos*] that it had suffered during the Fernando Henrique [Cardoso] governments," Lessa explained.[190] As one top official put it, "the importance of Lessa's presidency was that he produced a cultural shock for the Bank's technical staff, reintroducing the idea that the BNDES needed to be developmental, that is, to do things that the market would never do on its own."[191]

Colby (2013: 222-3) describes a sequence of events that illustrate Lessa's entrepreneurial role at the BNDES:

> *[Lessa] assumed his new position determined to reorient activities and impose a new ideological vision (...). In the message from the president in the 2003 Annual Report, he argued '[t]he decade of the 1990s granted to us a legacy of a development bank that was progressively becoming an investment bank with strict market criteria. We gave ourselves the immediate objective to completely restore the development bank as an operational arm of industrial policies that also had to be recovered in the political context.'*
>
> *[Lessa] hired the UFRJ [Federal University of Rio de Janeiro] to create a course on neo-developmentalism in which new employees had to enroll (...). Lessa had previously served as a Director of the Bank and knew how to maneuver the bureaucracy to further his agenda. The research department, which Lessa perceived to be a bastion of neoliberal thinking, was totally reconfigured, and many of the people that had worked there were transferred to disparate areas of the Bank.*

Lessa's own recollection of his presidency at the BNDES offers first-hand evidence of how he had to counterbalance the power that orthodox entrepreneurs had within the bank:

> *My only condition for accepting Lula's offer of the BNDES presidency was to be allowed to make my own appointments at the BNDES board [Diretoria] because I wanted to avoid internal conflicts (...) I was aware that the BNDES was in the process of being liquidated: during the 1990s, its focus on financing privatizations had perverted the developmental nature of the BNDES. Privatizations are just a transfer of assets from the state to private investors, so the BNDES had become a simple brokerage.*[192]

Thus, Lessa initiated a significant change in the profile of the new members of the BNDES board (*Diretoria*). While during the Cardoso administrations most board members (*diretores*) had PhDs in economics from either American universities or from orthodox-leaning

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[190] All the data and quotations from this paragraph come from: 'O Desenvolvimentista,' *Piauí*, October 2010.
[191] Author's interview with Antonio Alves Junior, Chief of the Special Advisory Board of the President's Chief of Staff (2005-2009), Rio de Janeiro, August 20, 2014.
[192] Author's interview with Carlos Lessa, BNDES President (2003-2004), Rio de Janeiro, August 22, 2014.

Brazilian universities—namely, PUC-Rio and FVG-Rio—during the Workers' Party governments the BNDES board came to be predominantly staffed with economists trained in Brazil, most of whom were related to the UFRJ and Unicamp, traditionally the locus of heterodoxy within the Brazilian economics academic community (Santana 2011: 130-7).[193]

3.II. The Counterbalance to Neo-Developmentalism: Orthodox Political Técnicos Dominate the Ministry of Finance, 2003-2006

During PT's first term in office, the orthodox coalition of political *técnicos* had its locus of power in the Ministry of Finance (*Ministério da Fazenda*), with the Central Bank operating as a major ally.[194] The leaders of this coalition were Finance Minister Antonio Palocci, Secretary of Economic Policy Marcos Lisboa (*Secretário de Política Econômica*)—widely considered to have had crucial impact over the Ministry's orthodox policy orientation—[195] Secretary of the Treasury Joaquim Levy (*Secretário do Tesouro Nacional*, a position below the minister in the hierarchy of the Brazilian federal executive); and, during a shorter period, Executive Secretary of Finance Murilo Portugal (*Secretário-Executivo*). During this first PT administration, in the Finance Ministry "[there was] almost none of the heterodox and leftist economists from Unicamp [State University of Campinas] or UFRJ [Federal University of Rio de Janeiro] that one might have expected" (Loureiro 2009: 132).[196]

The core ideas tying the coalition together were the need to sustain a tight monetary policy to meet inflation targets that were remarkably low for the Brazilian historical record and the maintenance of a highly conservative fiscal policy so as to maximize the state's capacity to repay public debt.[197] These ideas had clear-cut implications for the nature of state involvement in credit markets: according to the orientation pursued by the orthodox coalition, the Brazilian state had to avoid any significant enlargement of the role of the BNDES—even in a context of growing fiscal largesse—because that would reduce the effectiveness of the monetary policy. This policy orientation at the Ministry of Finance could, in principle, be interpreted as an institutional legacy. Yet in countries like Brazil, where state structures are less "Weberian" than in the developed world, the policy orientation most often has to be traced to the people rather than to the organizational structure of the state. This will become more evident when we look at the shift in the policy orientation of the very same Ministry of Finance (Section 4).

The ideational background of the orthodox coalition is best illustrated by referring to the profiles of Lisboa, Levy, and Portugal. Lisboa did his PhD in economics at the University of Pennsylvania and was then hired as a professor at Stanford. In 2002, the electoral year that would end with the Workers' Party first victory ever at the presidential race, Lisboa gained public salience by publishing a policy paper titled *A Agenda Perdida* (The Lost Agenda). With his document, Lisboa sought to persuade the competing presidential candidates that Brazil's long-

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[193] Another evidence of that shift is that during the Workers' Party governments the number of BNDES board members with ties with the private-sector financial system declined vis-à-vis that of the 1990s (Santana 2011: 134).

[194] A good synthesis of the ideational framework dominating within the Central Bank during this period, which I am not covering here, can be found in Erber (2011).

[195] Multiple interviews, Brasília, Rio de Janeiro, São Paulo, 2014. Also, see De Toni (2013: 152); Loureiro (2009: 132).

[196] Unicamp and the UFRJ, two of the most prestigious research universities in Brazil, have historically trained heterodox economists.

[197] For a longer treatment of these guiding principles, see Erber (2011: 40-2).

term economic stagnation should be addressed by carrying out a series of microeconomic reforms that would improve labor and credit markets, among other domains. Though it was widely known that Lisboa self-identified as a non-partisan of the PT, the public repercussion of his agenda critically contributed to him receiving an offer to accept a prominent position in the Ministry of Finance.[198] Once in office, this market liberalism true believer pushed hard to put his ideas into motion; his imprint in the orientation of the policy between 2003 and 2005 is hard to overstate (see below). This entrepreneurial hyperactivity often included Lisboa overstepping other officials of the Finance Ministry on issues on which, at least formally, they had more power than Lisboa.[199] Several years after he had left the government, Lisboa authored an article in which he openly criticizes the Workers' Party governments for giving the BNDES a larger role in credit markets and thus "resuscitating the old rent-seeking mechanisms" (Lisboa and Latif 2013: 16).

Joaquim Levy received his PhD in economics from the University of Chicago and went on to become a high level official at the International Monetary Fund for most of the 1990s. In the immediate years before reaching the Secretary of the Treasury during the first PT administration, he worked at the European Central Bank and later served in top positions at the ministries of finance and planning during the market-oriented presidency of Fernando Henrique Cardoso. Murilo Portugal, for his part, was Secretary of the Treasury under Cardoso—a period during which he gained the nickname of "Doctor No" because of his tendency to reject the requests of his fellows in government to increase budget lines—and later served as the Brazilian director at the International Monetary Fund. He has strong links with the private banking industry, which was reflected in his later appointment as President of the Brazilian Federation of Banks (*Federação Brasileira de Bancos*, FEBRABAN).[200]

While Lisboa, Levy, and Portugal fit well my characterization of entrepreneurial political *técnicos*, Finance Minister Antonio Palocci (2003-2006) is a *rara avis*. In contrast to the policy entrepreneurs at the Ministry of Finance, Palocci is not an economist: a medical doctor, he is a career politician who started as mayor of a small village in the State of São Paulo and became Lula's presidential campaign coordinator in 2002. As an idea-carrier, Palocci was erratic: he went from defending statist policies during the 1990s to economic orthodoxy once he became finance minister. An economist who worked closely with Palocci explained: "in the Workers' Party leadership there is a large group of pure pragmatists; they don't have ideology, they are negotiators—Palocci was one of them."[201] As Loureiro (2009: 131) points out, however, in defining the orientation of the Ministry of Finance during the first administration of the Workers' Party what was relevant was not Palocci's profile but rather that of his staff. Palocci himself was more of an articulator or facilitator of this orthodox coalition within the first PT administration. He had power on his own because of his leading role in the electoral campaign that took Lula to the presidency and the close personal relation he maintained with Lula thereafter. And he used that power to articulate that orthodox coalition and to push for an agenda drafted by his highly technocratic *secretários*.

[198] This is the account made by Antonio Palocci himself in his memoirs about his years as Finance Minister (Palocci Filho 2007).
[199] For an illustration of this behavior, see De Toni (2013: 152).
[200] "Murilo Portugal assume Secretaria-Executiva da Fazenda na 2ª," *Estado de São Paulo*, May 13, 2005; "Divergências dificultam relação de Murilo Portugal com a Fazenda," *O Globo*, April 12, 2012.
[201] Not-for-attribution interview with former top official at the Ministry of Finance, 2014.

This coalition was only dominant in the Ministry of Finance during the first three years (2003-2006) of the Workers' Party four consecutive administrations (2003-2016). During this short but meaningful dominance, the Ministry of Finance published a highly relevant document entitled *Política Econômica e Reformas Estruturais* (Economic Policy and Structural Reforms).[202] Considered by many in Brasília as a white paper, its clear orthodox leaning led to public manifestations of discontent by traditional PT-associated economists.[203] I use this position paper as a proxy to document the ideas carried by the orthodox coalition.[204] At the outset, the text stated,

> *The new government's* primary goal [primeiro compromisso] *in economic policy is to solve the serious fiscal problems that have characterized our economic history, that is, to carry out an ultimate adjustment of public accounts (...). The importance of this long-term fiscal adjustment cannot be underestimated.*[205]

The pro-fiscal-austerity policy entrepreneurs included in the document the goal of attaining a comparatively very high annual fiscal surplus for over a decade. This target, which was even more conservative than the fiscal surplus goal put forward at the time by the International Monetary Fund,[206] implicitly curtailed future attempts of significantly enlarging the direct involvement of the state in credit markets. The paper embraced many of the ideas typical of economic orthodoxy policy repertoires. For instance, ten pages of the document were dedicated to underlining the "economic constraints" that both domestic and international markets were placing over the new government, and the need to reduce the "*risco Brasil*"—that is, the country's risk as perceived by markets and rating agencies.[207] Moreover, this Ministry of Finance position paper strongly advocated for increasing Central Bank independence,[208] a contested issue in a country historically marked by central bank dependence vis-à-vis the executive branch.

Silences are as telling of the ideational imprint of policy entrepreneurs as are explicit declarations. In this sense, it is interesting to note that in this over ninety-page policy paper there was only one mention to the BNDES: in passing, the document stated that the BNDES should contribute with the growing microcredit industry (Ministério da Fazenda 2003: 92). In its agenda-setting document, the Ministry of Finance made no mentions to any potential role the BNDES could play in affecting investment finance through credit markets.

In assessing what the orthodox political *técnicos* were pushing for—as well as what policy options they wanted to foreclose—it is helpful to look at how they diagnosed the situation of Brazilian domestic credit markets. While these entrepreneurs recognized that "the economy

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[202] Ministério da Fazenda (2003).

[203] "Sem medo de velharia," *Revista EXAME*, May 5, 2003.

[204] In his memoirs, Finance Minister Palocci explicitly talks about the leading role of Lisboa in writing this position paper, underscoring that he had to ask Lisboa up to fifteen times to rewrite the draft so that the final text had the "needed political carefulness" ["*os devidos e necessários cuidados políticos*"] (Palocci Filho 2007). On Lisboa's imprint on the document see also: "Sem medo de velharia," *Revista EXAME*, May 5, 2003.

[205] Ministério da Fazenda (2003: 8, emphasis in the original text).

[206] The target was to attain between 2003 and 2011 an annual primary fiscal surplus equaling 4.25 percent of GDP (Ministério da Fazenda 2003: 65-7). Also see: "Brazil's New Mr. Austerity Pleasantly Surprises Again," *Dow Jones International News*, February 12, 2003.

[207] Ministério da Fazenda (2003: 54-64).

[208] Ministério da Fazenda (2003: 13).

has exhibited a low level of private investment and a small volume of credit for the past several decades,"[209] they conceived that the role of the state had to be limited to improving the rules to correct for this failure of *private* banks to provide more credit to firms. A former top official at the Ministry of Finance, himself a member of the coalition of policy entrepreneurs that drafted the white paper, recalls: "all our agenda was geared towards fixing market imperfections."[210]

The orthodox political *técnicos* holding power within the Ministry of Finance diagnosed that the key for solving Brazil's shortcomings in investment finance was reducing the high interest rates the commercial banking system charged to loan demanders, including firms. Part of that goal was to be attained through the above-mentioned fiscal austerity, which would induce banks to lend more to private actors and less to the state. But on top of that, these entrepreneurs had a microeconomic take to solving the issue:

> *The [needed] reforms in the credit market have the goals of reducing [the existing] incentives to postpone loan repayments and [setting up] more efficient procedures to execute collaterals, [which] is a way of reducing the interest rate of loans. In order to move in this direction, it is necessary to pass a new bankruptcy law.*[211]

This way of diagnosing the deficiencies of the Brazilian banking credit market, the tools chosen to improve the situation, and the marginalization of the BNDES as a potential instrument contrast starkly with the diagnoses and tools put forward since the neo-developmental coalition secured its dominance within the state in 2007. As a former top member of the orthodox coalition anchored at the Ministério da Fazenda explained,

> *The resurgence of the BNDES as a major player [in the credit market], which started when Palocci left [the Ministry of Finance in 2006], was* just the opposite *of our plan.*[212]

3.III. The Stalemate Between the Coalitions and its Unraveling

While the dominance of the orthodox coalition in the Ministry of Finance lasted only during the first third of the over 12-year period that the Workers' Party has been in power, its leverage was strong enough to counterbalance the neo-developmental coalition of policy entrepreneurs that had been growing across multiple government agencies. As I have shown above, the key points of collision between the two groups of entrepreneurs were monetary and fiscal policy, which determine how active the Brazilian state could be in credit markets.[213] The

[209] Ministério da Fazenda (2003: 5).
[210] Not-for-attribution interview with former top official at the Ministry of Finance, 2014.
[211] Ministério da Fazenda (2003: 14).
[212] Not-for-attribution interview with former top official at the Ministry of Finance, 2014. The emphasis is mine.
[213] As a top official at the Ministry of Development who was an active neo-developmental policy entrepreneur throughout the 2000s explained to me, "*though the BNDES is officially subordinated to the Ministry of Development, the BNDES funding depends on the Ministry of Finance. This is a key determinant of what the BNDES can do*" [Author's interview with Ricardo Schaefer, Executive Secretary (2013-2015) and Deputy Executive Secretary (2011-2013), Ministry of Development (MDIC), Executive Secretary of the National Council of Industrial Development (CNDI) (2005-2006), Brasília, August 12, 2014].

stalemate between the two coalitions can be empirically tracked down by identifying episodes of dispute among members of each group of entrepreneurs.

During the 2003-2007 period, one the most salient sources of conflict between orthodox and neo-developmental political *técnicos* was the setting of the long-term interest rate (widely know for its Portuguese acronym, TJLP). As early as in 2003, Minister of Planning Guido Mantega publicly blamed Secretary of Economic Policy Marcos Lisboa, a key policy entrepreneur at the Ministry of Finance, for being too conservative in his forecast of the annual rate of economic growth,[214] and called for a looser monetary policy.[215] The fact that such top-level political figures used as harsh words as they did to confront their antagonists within government is eloquent of how deep the tension was. BNDES President Lessa once called the orthodox policies of Central Bank Chief Henrique Meirelles "*um pesadelo*" or "a nightmare."[216]

Neo-developmental presidents of the BNDES Lessa (2003-2004) and Mantega (2004-2006) often outspokenly criticized the leadership of the Ministry of Finance and the Central Bank for setting the interest rate too high, arguing that it was severely affecting the BNDES capacity as a financier of long-term investment.[217] Treasury Secretary Joaquim Levy and BNDES President Mantega did not do much effort to hide from the public eye their disagreements about the appropriate level of the long-term interest rate. On one occasion, Mantega found that it was worth giving an interview to the press with the explicit goal of refuting Levy's comments about the need to keep the TJLP at a 9.75-percent annual rate:

> *The statement made by Levy is a personal opinion, which I consider mistaken and does not reflect the executive branch's position. [Levy's proposal of keeping the long-term interest rate at such high level] can certainly affect investment because businessmen look at the current value of the TJLP to plan their investment decisions. [... Secretary of the Treasury Levy] expressed a financialist vision [*visão financista*], which lacks a vision (...) of the logic of production [*falta uma visão da lógica da produção*].*[218]

On another episode, Levy publicly criticized the neutralizing effect that loans granted by the BNDES were having on the monetary policy; Mantega, responded that reducing BNDES involvement in the credit market "would be a catastrophe."[219] My interview with Lessa offers further illustration of the conflicts generated by the stalemate among competing policy entrepreneurs:

> *When I got to the BNDES presidency my goal was to restore the Bank's historical role. But that goal entailed at least two things: significantly reducing the long-term interest rate and increasing the BNDES's own capital so as to enlarge long-term lending. However, those policies were dominated by people who believed in the Washington Consensus—[Finance Minister Antonio] Palocci and the Central Bank President*

[214] "Marcos Lisboa deixa Instituto de Resseguros do Brasil," *Estado de São Paulo*, March 28, 2006.
[215] "Top Brazilian central bank official resigns day after controversial rate decision," *Associated Press Newswires*, May 22, 2003; "Brazil's Meirelles Defends Conservative Monetary Policy," *Dow Jones International News*, July 28, 2003.
[216] "Carlos Lessa deixa a presidência do BNDES," *Folha de São Paulo*, November 18, 2004.
[217] Author's interview with Carlos Lessa, BNDES President (2003-2004), Rio de Janeiro, August 22, 2014; "Levy presses for coordination of monetary policy," *Gazeta Mercantil*, October 26, 2005.
[218] "O presidente do BNDES Guido Mantega contesta Levy," BNDES Press Release, October 27, 2005.
[219] "Mantega é crítico da política econômica de Palocci," *Estado de São Paulo*, March 27, 2006.

[Henrique Meirelles]. They were against my position, and Lula eventually chose to take their position instead of mine.[220]

A close advisor to Finance Minister Palocci narrates the tensions between Glauco Arbix—an active neo-developmental policy entrepreneur—and Marcos Lisboa in the drafting of the PITCE industrial policy:

Glauco [Arbix] contributed with the idea that it was necessary to launch an industrial policy with an emphasis on technological [development]. Marcos Lisboa [, for his part, pushed in favor of] a manuscript he had drafted, which he called "Development Policies" ["Políticas de Desenvolvimento"*]; on this issue the Executive Secretary of the Ministry of Finance was completely blocked by Marcos's pressures. He was the ministry's Executive Secretary, [but] it was almost impossible to work with him! Although [industrial policy] was an issue area that was [formally] under the Executive Secretary, Marcos Lisboa actually [...] took the lead.*[221] *[...][In the process of drafting the PITCE industrial policy, in which I personally participated], we wrote several versions that our friend Marcos Lisboa tried to discredit by writing an alternative document that rejected our text. As a result, in practice we were working on two [different] texts, and that led to a big tension! [*e ai chegou a um ponto de tensão grande!*]. A couple of weeks before [this industrial policy] was adopted [...], we reached a situation marked by a deep conflict between Glauco [Arbix] and Marcos Lisboa.*[222]

The tension between the two coalitions of policy entrepreneurs reached its highest level when in 2005 the president's Chief of Staff, Dilma Rousseff—a neo-developmental leader that would rise up to the presidency in 2011—accepted to be interviewed by one of Brazil's main newspapers and openly criticized a long-term fiscal adjustment championed by the Ministry of Finance:

*The [long-term fiscal adjustment project] presented was rather rudimentary [*rudimentar*]; we do not think that such discussion was held within the executive branch. […] It's not possible to do a ten-year [macroeconomic] projection thinking as if it were just an exercise in a spreadsheet. […] In discussing such a multi-year projection you cannot exclude the whole set of political, economic and social actors […]. For God's sake; that's not possible.*[223]

I argue that the failure of either of these two coalitions of political *técnicos* to dominate the policy process drove the mixed outcome observed between 2003 and 2007: the scale of state-owned banking institutions' provision of long-term credit to the country's firms grew, but only at a slow pace. Four years after PT's accession to the presidency, BNDES long-term lending was

[220] Author's interview with Carlos Lessa, BNDES President (2003-2004), Rio de Janeiro, August 22, 2014.

[221] In the original Portuguese writing: "*o Secretario executivo no Ministério da Fazenda, ele [...] era completamente paralisado ali pelas pressões do Marcos. Ele era o secretário executivo do ministério e trabalhar com ele era quase que impossível! Embora fosse um espaço do secretario executivo [...] na verdade o Marcos Lisboa [...], ele tomava um pouco a dianteira.*" (De Toni 2013: 152).

[222] De Toni (2013: 152).

[223] "'Plano de ajuste de longo prazo é rudimentar,'" *Estado de São Paulo*, November 9, 2005.

still relatively modest. A hypothesis alternative to that derived from the framework of this study may ask whether the president's preferences drove such mode of state involvement in credit markets. Did President Lula himself want to trigger an ideational shift in favor of a BNDES significantly more active in credit markets than it had been during the previous two decades *and* simultaneously ensure that such neo-developmental approach did not advance too much, preventing any major increase in the scale of BNDES involvement in credit markets? Do we have good reasons to believe that Lula intentionally set up the tie between the orthodox and neo-developmental political *técnicos* that would characterize within-state micropolitics between 2003 and 2006?

The alternative hypothesis attributing the observed outcome of the 2003-2007 period to presidential preferences is attractive because it relies on counterintuitive microfoundations of presidential behavior. However, in order for it to be more persuasive than my argument, such alternative explanation should have an answer for an important question: why would President Lula deliberately choose to produce stalemate dynamics in his cabinet during almost an entire presidential term? What goals would have oriented Lula's behavior if he, in fact, purposely appointed elite officials with such different policy orientations that they would generate conflicts in the policy process that defines state involvement in the credit-side of the financial system? An alternative hypothesis of this sort assumes that President Lula not only had the will but also the capacity to micromanage this highly technical policy process. It would further assume that the president was able to reliably predict the effects that choosing appointees with such different policy orientations would have four years down the road. Finally, such alternative explanation takes for granted that President Lula would have heavily discounted the self-inflicted political cost emerged from having key figures of his cabinet despise each other in front of the press.

Yet it seems more reasonable to argue—in line with the logic laid out in Chapter 2 and the process-tracing work done in this chapter so far—that we cannot predict the behavior of officials appointed to the top tiers of the executive branch based on their appointment *alone*, that they receive incomplete mandates, and that these elite officials' policy orientations and their capacity to act collectively across state agencies critically determines the policy process that shapes state involvement in credit markets. We can therefore argue that President Lula did not direct from above the stalemate between orthodox and neo-developmental political *técnicos*—the stalemate was, instead, an *unintended effect* of his decisions to appoint individuals with particular orientations to particular positions. Appointment decisions certainly pursued goals, but such decisions did not predetermine the stalemate. Once in office, these elite officials pushed for policy that fit their causal beliefs about the desirable role for the Brazilian state in markets. The hybrid outcome observed after four years of the Workers' Party in office—partial ideational shift in favor of larger state involvement in credit markets but low- or intermediate-scale BNDES lending—was not the materialization of the president's predictive calculations but rather the reflection of a tie in the balance of power between two coalitions of elite officials carrying opposing policy ideas.

Ultimately, the tensions between the two coalitions waned as soon as the stalemate started to unravel, around 2006. My framework holds that coalitions of policy entrepreneurs may come to positions of domination or subordination partly as a result of contingent factors. This case illustrates such analytical claim because the fall of the within-state orthodox coalition in 2006—which would in turn open the space for the consolidation of a neo-developmental coalition—cannot be explained without referring to the contingent emergence of a corruption scandal. Finance Minister Palocci had already been accused of being part of illegal operations to obtain

finance for the PT, but early in 2006 new information surfaced indicating that Palocci had frequented a luxury villa in Brasília, where some of his aides received bribes and consorted with prostitutes.[224] At the verge of an impeachment trial that would have severely affected Lula's chances of reelection, the president had no choice but to change the up to then widely praised Finance Minister. Palocci's dismissal was contemporary of the resignation of the most active orthodox policy entrepreneurs, such as Lisboa, Levy, and Portugal.[225] In line with my argument, contingency is important in explaining the Brazilian process because it opened a window of opportunity for the consolidation of a coalition of policy entrepreneurs "glued" around a very different set of ideas about the optimal role for the state in financial markets. Had that contingent factor been absent, that change in the balance of power within the state might have come with greater delay—or it might have not occurred at all.

In an interview, a top advisor to the Finance Minister who had been greatly enthusiastic about his group's capacity to make the Workers' Party adopt a fiscally orthodox policy that sidelined the role of the state in credit markets, lamented:

> *After Palocci left, a gradual change started: the developmental agenda came back step-by-step*.[226]

4. The Triumph of the Neo-Developmental Coalition of Political *Técnicos* and the Shift to High Direct State Involvement in Credit Markets, 2007-Present

In this section I trace the process that led the Brazilian state to drastically augment its involvement in the market for long-term credit for the private sector. This outcome contrasts with the relatively minor role the state played in credit markets during the period characterized by the stalemate between two competing coalitions of political *técnicos* (2003-2007). I argue that the new, highly enlarged direct state involvement in credit markets that started around 2007 can be attributed to the triumph of a neo-developmental coalition of policy entrepreneurs within the federal state.

The neo-developmental policy entrepreneurs managed to overcome the coordination problems that affected them during the first administration of the Workers' Party (2003-2007), aligning several crucial executive-branch agencies that up to then had been working in uncoordinated and often competitive fashion. My analytical framework predicts that contingent events can affect policy paths because they shift power equilibriums among competing groups of policy entrepreneurs. The politics of state involvement in credit markets in post-2007 Brazil cannot be understood without resorting to such analytical claim. I argue that, in building its domination within the state, the neo-developmental coalition of policy entrepreneurs skillfully utilized a window of opportunity opened by a contingent factor: the outburst of the world financial crisis of 2008. In particular, these entrepreneurs successfully used the crisis as a way to

[224] "Brazil's Finance Minister Quits Amid Continuing Political Scandal," *New York Times*, March 28, 2006.
[225] The press reported that Murilo Portugal requested his dismissal immediately upon knowing that Palocci would be replaced by neo-developmental Guido Mantega; Portugal's rush to leave the Finance Ministry was such that he did not even want to wait until the new minister was in power ("Divergências dificultam relação de Murilo Portugal com a Fazenda," *O Globo*, April 12, 2012).
[226] Not-for-attribution interview with former top official at the Ministry of Finance, 2014.

legitimize a new role for the state in credit markets, defeating the position of the up to then highly powerful coalition of orthodox political *técnicos*. In the unique context of the aftermath of the world crisis—which generated a credit crunch in the Brazilian domestic financial system—, a core idea carried by neo-developmental entrepreneurs—i.e. that the state should play a major role in channeling and boosting long-term credit for the private sector—came to defeat the orthodox political *técnicos*' position—i.e. that large state involvement in credit markets should be avoided insofar it was prone to generating major fiscal crises and inefficient rent-seeking dynamics.

Once the neo-developmental policy entrepreneurs managed to dominate within-state politics, they changed two features that are likely to make their victory durable over time. First, these entrepreneurs changed the source from which the BNDES is funded. Second, they succeeded in giving the BNDES the new role of being a key actor in the making of countercyclical policies. These developments are in line with my analytical framework, which underlines that new dominant coalitions of policy entrepreneurs typically push their ideas by inscribing them into the institutional architecture underpinning public policies.

This section is divided into two subsections. The first one documents the consolidation of a well-coordinated coalition of neo-developmental policy entrepreneurs within the Brazilian state around 2007 and identifies the ideas that served as the coalitional glue. The second subsection traces the process by which this newly consolidated coalition pulled the levers within the state to drastically shift the scale and scope of direct government lending; it concludes by presenting additional quantitative evidence scoring the magnitude of such change in the level of state involvement in credit markets.

4.I. A New Dominant and Well-Coordinated Coalition of Neo-Developmental Policy Entrepreneurs

In 2007, for the first time in the post-ISI period, a "perfect alignment" of developmentalist leaders emerged in the positions within the Brazilian state that matter most for defining the state's involvement in credit markets: the Ministry of Finance, the BNDES presidency and board, and the President's Chief of Staff. While appointment decisions made by President Lula and his top appointees enabled the surge of this neo-developmental coalition of elite officials, this section indicates that such neo-developmental dominance resulted from an incremental process in which contingent events and unintended effects of presidential decisions played a very important role. That is, in line with Chapter 2, the process-tracing analysis of this section suggests that the behavior of neo-developmental officials appointed to the top tiers of the executive branch could not be predicted based on their appointment *alone*, that they received what I have called incomplete mandates, and that these elite officials' causal beliefs and their capacity to act collectively across state agencies critically shaped the policy process that ultimately determined the dramatic growth in the scale of BNDES long-term credit to Brazilian firms. My fieldwork evidence also indicates that this alignment was further lubricated by the fact that the leaders of these agencies—as well as those of other executive-branch units that play a secondary role in this policy arena, such as the Ministry of Development—had common personal trajectories that raised the likelihood of trusting each other.[227]

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[227] Neo-developmental entrepreneurs' varying capacity to coordinate across several executive-branch agencies in Brasília and Rio de Janeiro should not be underestimated as an explanation of policy outcomes. Quite tellingly in this regard, during the first years of the Workers' Party administrations, neo-developmental entrepreneurs were not just battling against orthodox rivals but also were publically

The first step towards the consolidation of a coordinated coalition of policy entrepreneurs pushing for higher levels of state involvement in credit markets occurred in 2005, when future President Dilma Rousseff became President Lula Da Silva's Chief of Staff (*Ministra-Chefe da Casa Civil*). In Brazil, the Chief of Staff is a top-level political figure with great leverage to coordinate the action of the multiple agencies that belong to and are associated with the executive branch of government. My analytical framework holds that contingent factors can play a major role in bringing about a change in the balance of power between competing coalitions of policy entrepreneurs. Rousseff's case fits that pattern: she came to be Chief of Staff after the abrupt dismissal of her predecessor José Dirceu due to his involvement in the highly salient *Mensalão* corruption scandal.

Rousseff brought to the office of the Chief of Staff a new set of ideas that shaped policy priorities. Critically for the purposes of this study, in contrast with Dirceu, who is a lawyer, Rousseff is a developmental economist who received graduate training at the State University of Campinas (Unicamp), widely considered as a stronghold of heterodoxy within the discipline of economics in Brazil (Santana 2011: 133-4). Several of my interviewees underline this educational background in explaining why, as the coordinating minister of Lula, she privileged some issues over others in the policy agenda.[228]

Just as important as the rise of Rousseff at the Presidential Planalto Palace was the simultaneous fall of orthodox political *técnicos* at the Ministry of Finance. The 2006 dismissal of Antonio Palocci and his orthodox team and the accession of Guido Mantega as Finance Minister was the landmark event symbolizing that change in the balance of power in Brasília.[229] I have already referred to the stark contrast between the ideas carried by the policy entrepreneurs that were dominant in the Ministry of Finance during the first three years of the Workers' Party administrations and those carried by Mantega (see Section 3.II above). Let us just add here that

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challenging each other. An illustration of this coordination failure is the dispute between the first BNDES President under Lula, Carlos Lessa, and Luiz Fernando Furlan, the Minister of Development, Industry and Foreign Trade. While both shared neo-developmental policy priorities, and although the BNDES formally depends on that Ministry, the tension between these two leaders is hard to overstate. In an interview, Lessa recalled: "*My take was that, since the BNDES provides finance for multiple goals ranging from industrial development to infrastructure projects, it did not make any sense to be subordinated to a ministry whose focus is commerce. I was totally autonomous, I just obeyed the President, the Ministry of Development was nothing for me*" [Author's interview with Carlos Lessa, BNDES President (2003-2004), Rio de Janeiro, August 22, 2014].

[228] Multiple interviews, Brasília and Rio de Janeiro, 2014.

[229] In contrast with Palocci, who, as a medical doctor, personally lacked technical knowledge in economics and thus resorted more strongly on the advice of his top secretaries (see Section 3.II above), Mantega, with his long career as a practitioner economist, was an active policy entrepreneur himself in this policy arena. Just as Palocci had Lisboa, Levy and Portugal, Mantega was accompanied by a key below-minister-level entrepreneur, Nelson Barbosa, with whom he had been working shoulder to shoulder at the BNDES. Barbosa's profile differs significantly from those of Palocci's advisors: he was trained as an economist at the Federal University of Rio de Janeiro and received his PhD from the New School for Social Research in New York, two highly heterodox economics departments. Barbosa occupied several positions at the Ministry of Finance: Secretary of Economic Monitoring (*Secretário de Acompanhamento Econômico*, 2007-2008), Secretary of Economic Policy (*Secretário de Política Econômica*, 2008-2010), and Executive Secretary (*Secretário Executivo*, 2011-2013). On Barbosa's key role as coordinator of the neo-developmental coalition of policy entrepreneurs, see: "O câmbio, segundo Meirelles e Coutinho," *Valor Econômico*, September 23, 2009.

the fact that Mantega had served as BNDES President immediately before being appointed as *Ministro da Fazenda* not only evidences his developmental approach but also, and perhaps as importantly, his readiness to put the Finance Ministry and the BNDES to work in tandem, overcoming the gridlocks of the first years of PT in government. In the words of a former vice-president and later president of BNDES during this period,

> *The Ministry of Finance does not have an immutable position about what role the BNDES should have in the Brazilian economy—the Ministry's position varies depending on who is the minister. What matters is who is the person occupying the Ministry, not the Ministry itself. Palocci's stance was that the BNDES should be economically conservative; Mantega, instead, came to the Ministry of Finance thinking of the BNDES as a great ally.*[230]

The rise to power of neo-developmental policy entrepreneurs at the *Esplanada dos Ministérios* in Brasília was accompanied by a significant change at the headquarters of the BNDES in Rio de Janeiro. Luciano Coutinho reached the BNDES presidency in 2007, bringing coherence and political drive to the neo-developmental coalition. This is so because of two interrelated factors.

First, my field research across multiple parts of the Brazilian state indicates that Coutinho is far and wide considered *the* country's most knowledgeable expert on Brazil's industrial sector. As a top official at the Ministry of Development put it, "Coutinho is the brain of contemporary Brazilian industrial policy."[231] My interlocutors trace Coutinho's influence on industrial policy debates back to the 1994 publication of his book *Estudo da Competitividade da Indústria Brasileira* (Study of the Competitiveness of Brazilian Industry). The second factor, though, may have been even more important: Coutinho had a close relationship with then Chief of Staff and future President Dilma Rousseff; the personal tie dates back to the late 1970s, when Coutinho was Rousseff's professor at the State University of Campinas. Rousseff's aides at the Office of the Chief of Staff recall that Coutinho had intellectual influence over Rousseff;[232] she frequently consulted Coutinho on issues ranging from macroeconomic to industrial policy;[233] top officials underline that the confidence between these two leaders was instrumental for the emergence in 2007 of a new synergy between the executive branch ministries in Brasília and the BNDES.[234]

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[230] Author's interview with Demian Fiocca, Vice-President (2004-2006) and President (2006) of the BNDES, Rio de Janeiro, August 21, 2014.

[231] Author's interview with Alexandre Comin, Deputy Secretary, Ministry of Development (MDIC), Brasília, August 15, 2014.

[232] Author's interview with Antonio Alves Junior, Chief of the Special Advisory Board of the President's Chief of Staff (2005-2009), Rio de Janeiro, August 20, 2014. Journalistic evidence consistently points in the same direction; see, for instance, "O câmbio, segundo Meirelles e Coutinho," *Valor Econômico*, September 23, 2009. Schneider (2013: 171) hints at this point too.

[233] 'O Desenvolvimentista,' *Piauí*, October 2010.

[234] Author's interviews with: Antonio Alves Junior, Chief of the Special Advisory Board of the President's Chief of Staff (2005-2009), Rio de Janeiro, August 20, 2014; Alexandre Comin, Deputy Secretary, Ministry of Development (MDIC), Brasília, August 15, 2014. Stressing personal confidence as a partial driver of policy outcomes may not be as appropriate in many policy domains. However, it does seem important for explaining the behavior of an institution like the BNDES because, since the Bank allocates an enormous amount of the federal government's fiscal resources to particular firms, this is a highly sensitive policy arena. The corruption scandals that came to light in 2014 associated with

Another piece of evidence about the new domination of the neo-developmental coalition of policy entrepreneurs is that they secured a growing share of the BNDES board (*Diretoria*), the key governing body within the Bank. Table 3.4 serves as a proxy of the shift of power that took place at the BNDES board: it shows that the proportion of *diretores* who were trained in economics at American universities declined over time, that the share of board members connected to heterodox-leaning academic centers grew during the Workers' Party administrations, and that the ties with the private-sector banking industry shrunk significantly.

Table 3.4. Brazil. Selected Attributes of BNDES Board-Member Profiles: Comparison Before and After the Consolidation of a Neo-Developmental Coalition of Policy Entrepreneurs.

	1995-2002[1]	*2003-2009*[2]
BNDES board members who received a Ph.D. in economics from an American university	31%	6%
BNDES board members who were professors at heterodox economics departments in Brazil[3]	0%	29%
BNDES board members who had previously been consultants and/or board members at private banks	75%	18%

Notes:
1. N=16.
2. N=17.
3. This dimension counts the number of faculty members at the State University of Campinas (Unicamp) and the Federal University of Rio de Janeiro (UFRJ).
Source: My elaboration based on data from Santana (2011: 131-2).

As my analytical framework underscores, the politics of state involvement in credit markets is a highly technical arena. As such, in tracing how the within-state action of idea-carriers policy entrepreneurs shape outcomes, it is important to go beyond the superficial review of the labels that entrepreneurs use to define themselves, thus delving into the technicalities of their ideas. Just as our colleagues get lucky when situations characterized as natural experiments emerge, us qualitative researchers feel particularly fortunate when we find records that allow us to reconstruct the preferences of key political actors. For those purposes, it is particularly useful to find transcripts of statements made by the actors of interest in strategic contexts—which are shaped by the time-setting and the type of audience—where we have good reasons to believe that the observed actors do not have strong incentives to strategically misrepresent their ideas.[235]

We have such stroke of luck regarding the evidence we need for this chapter. In 2002, a year before the kick-off of the process that increased the scale of state involvement in credit markets, two leaders of the neo-developmental coalition of policy entrepreneurs, Guido Mantega and Luciano Coutinho, participated at a series of meetings called Panels of Brazilian Development (*Painéis do Desenvolvimento Brasileiro*). These were highly technical events bringing together professors of economics and policy practitioners with strong academic

Petrobras, a company heavily financed by the BNDES, and the impact these scandals had over the president's public opinion approval ratings is an illustration of how sensitive the management of the BNDES can be for the Brazilian executive branch in the new scenario that started with the massive expansion of BNDES lending.

[235] Here I am building on Broockman's (2012) methodological advice.

credentials. Participants were asked to present policy papers, normative in their nature, or serve as discussants about several issues related to economic policymaking and development. Mantega and Coutinho expressed their views in front of a close group of colleagues at a time that anteceded their reaching to top positions within the Brazilian government.

Mantega's and Coutinho's presentations were remarkably similar, especially when compared with those of other economists who attended the meetings. At this event that took place some time before their arrival to power, the future leaders of the neo-developmental coalition of policy entrepreneurs shared a common diagnosis: the two key obstacles for development in Brazil were the country's acute "external vulnerability" and its "perverse macroeconomic setting," which hampered productive investment due to the unparalleled high cost of credit. Mantega and Coutinho were also emphatic about the importance of two tools to overcome those bottlenecks: launching a more advanced industrial policy and having the state step in to fuel the development of infrastructure, both actions aimed at reversing the lack of competitiveness that had historically affected Brazilian firms.[236] Mantega and Coutinho, in short, diagnosed that if the state did not actively intervene (a) to reduce the price of credit as a way to boost aggregate levels of investment by Brazilian firms and (b) to reshape the productive sector's capacity to compete in international exports markets—partially by revamping infrastructure in sectors such as transport, which heavily impacts firms' cost structures in a country of continental size—Brazil would continue to be too vulnerable in the global economy and highly likely to suffer sudden stops of its growth cycles.

In Coutinho's perspective, Brazil's chronic macroeconomic instability could only be overcome with the adoption of an active industrial policy that, in the long run, manages to change the productive and export profile so as to prevent the recurrence of balance of payments crises.[237] For industrial policy to be effective, Coutinho argued, macroeconomic policy must guarantee both an underappreciated exchange rate and low interest rates in order to make long-term investment micro-economically feasible. He went on to say,

> *[W]hen they are compatible, macroeconomic and industrial policies reinforce each other positively. Under benign macroeconomic regimes [that combine low interest rates with relatively underappreciated exchange rates], not only does industrial policy perform efficaciously but it also becomes a key factor supporting the macroeconomic policy. The opposite occurs in malign [macroeconomic] regimes [with high interest rates and/or over-appreciated exchange rates], under which industrial policy faces serious troubles. For that reason it is of the utmost importance to make the two policies compatible. In the case of Brazil, attaining such compatibility requires economic policy authorities—i.e. the Ministry of Finance and the Central Bank—not just to understand but also, even more, to [actively] practice the attunement of the two policies […].*[238]

Let us unpack somewhat further what Luciano Coutinho had in mind when he referred to industrial policy back in 2002, five years before he became a key coordinator of the neo-developmental coalition of political *técnicos*. The issue is highly relevant since these ideas served as coalitional glue and oriented the within-state action that brought about significant shift

[236] Furtado (2002: 138-9), Hermann (2002: 24, 28). The authors of this and other citations referring to the ideas expressed by Mantega and Coutinho at the 2002 *Painéis do Desenvolvimento Brasileiro* were the rapporteurs of the event.
[237] All the evidence in this paragraph comes from Coutinho (2002: 193-6).
[238] Coutinho (2002: 196).

in the scale and nature of state involvement in credit markets—as it did in capital markets, as Chapter 5 shows. The industrial policy that Brazil needs, Coutinho argued, rests upon "the construction of new instruments, the selective use of old ones, and the reduction […] of the cost of capital […]" (Coutinho 2002: 193). In order to increase the "degrees of freedom" of macroeconomic policy, it is necessary that industrial policy adopt "a strong pro-exports inclination," whose "biggest objective must be to accelerate gains in the level of competiveness [of Brazilian firms]" (Coutinho 2002: 197, 199). In advancing this exports-oriented industrial policy, "[t]he credit to production (pre-shipment) must be expanded and have its 'costs' […] reduced, […] while investment in infrastructure and logistics cannot be avoided" (Coutinho 2002: 198).

Beyond these general definitions, in his presentation at the 2002 seminar "Panels of Brazilian Development" Luciano Coutinho listed some specific components of his vision of industrial policy that are particularly important for this study insofar as their adoption have clear implications for the scale and nature of state involvement in credit markets:

- The required "industrial policy must support the capitalization and internationalization of Brazilian firms. [...] The overcoming of Brazil's deficiencies in competiveness cannot be accomplished without a set of national champions. […] It is therefore urgent to have a strategy to form 'competitive national champions' […] that can project themselves as global actors" (Coutinho 2002: 200, 204). "As of today we have few global players […]. We can and we should develop world-class large firms in the sectors of steel, pulp and paper, petrochemicals and agribusiness. We should aspire to have strong firms in segments of the industry of ITs" (Coutinho 2002: 205).
- Financial instruments to promote technological upgrading must be adopted because "innovation in the development of products and in the improvement of processes that ensure high quality, flexibility, and adaptation to market demands is a critical requisite for attaining higher competitiveness in the overwhelming majority of sectors. [Industrial policy must contribute to solving] the weak performance of innovation activities within the Brazilian private sector and the persistence of a disconnection between firm strategies and R&D activities" (Coutinho 2002: 200).

In sum, by 2007 an alignment in favor of a more active role of the state in credit markets had formed. For the first time in the period under study, an ideationally coherent coalition of neo-developmental political *técnicos* with high capacity to coordinate across executive-branch offices secured positions of power in the Office of the President's Chief of Staff, the Ministry of Finance, and the BNDES governing apparatus. A shift towards a larger direct state involvement in the credit-side of the financial system was probably a *latent* outcome by then. However, it was only after the contingent emergence of a world financial crisis with strong impact over Brazilian domestic markets that this newly formed dominant coalition was able to impose its policy priorities.

4.II. The New Dominant Coalition of Policy Entrepreneurs Takes Advantage of Contingent Events to Adopt its Agenda

The consolidation of the neo-developmental coalition of political *técnicos* soon allowed them to successfully champion two landmark policy changes: the enactment of the Program for

Growth Acceleration (*Programa de Aceleração do Crescimento* or PAC) and the Productive Development Policy (*Política de Desenvolvimento Produtivo* or PDP). These policies, reflecting a change in the balance of power within the federal executive branch, were much more ambitious than earlier policies. They set a new institutional architecture underpinning industrial policy that came hand in hand with an extension in the scale and scope of the BNDES in credit markets.

PAC enabled the BNDES to lower its interest rates and spreads so as to increase the scale and scope of finance for infrastructure development—especially in the areas of energy, logistics, and urban infrastructure—through public-private partnerships. BNDES President Coutinho recalls:

> *[When I came to lead the Bank in 2007] we tried to accelerate investment in line with PAC; this exhausted practically all the financial potential the BNDES had as soon as by the end of 2007. The Bank ended 2007 with a total disbursement of 64.9 billion Brazilian Reais [US$37 billion], while the year before, 2006, it had disbursed 51 billion Brazilian Reais [US$24 billion]. We expanded and attempted to speed up the approval of new projects [financed by the Bank] but 2008 was a very tough year because the shortage of the Bank's funding was very significant. (...) Though we ended 2008 with a total budget of 90.8 billion Brazilian Reais [US$39 billion], it was obtained through a strong effort [*grande sacrifício*] because we had to look for and fight for [*disputar*] additional funding sources within the government.*[239]

The PDP, for its part, though presented as a continuation of PITCE,[240] was significantly more ambitious (DeToni 2013: 170). Introduced a few months before the international financial crisis of 2008, the PDP had major targets (or *metas-país*) for a three-year period: increasing the investment-to-GDP ratio by three percentage points, augmenting Brazil's share in world exports markets at an annual rate of 9 percent, boosting private-sector firms' R&D investment at an annual rate of ten percent, and expanding the number of domestically-owned, export-oriented small and medium-sized enterprises.[241] These goals had clear implications for the role of the state in credit markets as the PDP mandated the expansion of the funding of the BNDES, as well as the reduction of the spread of BNDES loans, combined with the lengthening of the terms of loan repayment.[242]

The process-tracing analysis suggests that PITCE was as far as neo-developmental entrepreneurs could get in a situation of stalemate in the early 2000s—when they faced vetoes from the then strong orthodox political *técnicos* at the Ministry of Finance. The adoption of the PDP, in contrast, indicates that such veto had been overcome by 2007.

While the PDP was formally presented as an inter-ministerial initiative, several top government officials who asked for anonymity argued that the policy was actually crafted in-house by the BNDES, critically building on the industrial policy orientation that Luciano Coutinho had been developing well before he reached the BNDES presidency.[243] The BNDES thus played the role of championing its industrial policy perspective and then led the coordination and later policy adoption with neo-developmental entrepreneurs at the Ministry of

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[239] 'O Desenvolvimentista,' *Piauí*, October 2010.
[240] On PITCE see Section 3.I above.
[241] ABDI-BNDES-MF-MDIC (2008: 19).
[242] ABDI-BNDES-MF-MDIC (2008: 24); "BNDES reduz custo de financiamentos para apoio à política desenvolvimento produtivo," BNDES Press Release, May 12, 2008.
[243] Not-for-attribution interviews with top government officials, 2014.

Finance and the Ministry of Development. This behind-the-scenes story of the PDP is highly relevant for my study insofar as it shows how tightly linked are developmental ideas carried by leaders within the state and the market configurations that result from inscribing those ideas into policies. In late-2000s Brazil, action within the state explains policy adoption in the arena of industrial policy and this, in turn, explains change in the scale and scope of state involvement in credit markets.

By mid-2008 the neo-developmental coalition of political *técnicos* had secured its hold on power within the Brazilian executive branch and it had successfully inscribed that victory into policy, setting in motion PAC and the PDP. The adoption of such ambitious policies would have been highly unlikely had the balance of power within the state been similar to that of 2003-2006: that is, a stalemate between orthodox and developmental coalitions. However, the dramatic shift of the BNDES role in Brazilian credit markets cannot be understood without referring to how a contingent factor exogenous to the Brazilian polity—the 2008 meltdown of global financial markets—affected the politics within the Brazilian federal executive branch.

In particular, what is important is that the actors of this neo-developmental coalition at the top-level of the Brazilian state used the international economic crisis *politically* to legitimize a new position for the BNDES in the domestic financial system. The world crisis opened a window of opportunity for a higher level of state activism; this heightened state involvement would have been very unlikely under "normal" circumstances because market-oriented reformers had succeeded in associating large state lending with fiscal crises, high inflation, and inefficiency emanating from rent-capturing.

The international financial crisis generated a credit crunch in Brazil, which produced a sudden stop of the trend of investment growth that the country had experimented during the first administration of the Workers' Party (2003-2007). Under such scenario, a key concern for government leaders was to avoid a long-term investment paralysis. Finance Minister Mantega and BNDES President Coutinho persuaded President Lula to carry out a major policy change: the federal government—through the National Treasury (*Tesouro Nacional*)—would launch a countercyclical policy that had the peculiarity of being channeled through the National Development Bank.[244]

A former BNDES Vice-President (2004-2006) and President (2006) argues:

> *The key decision that the second Lula administration made was assessing that there was a need to speed up and intensify the BNDES lending, and that the conventional way of funding the BNDES would not be enough to meet those goals. The international crisis legitimated that shift. In that specific context it became acceptable to expand the volume of the BNDES, as this was seen as a countercyclical device.*[245]

BNDES President Coutinho explains the decision-making process of this change in the way the Bank was financed:

> *It became very clear to me, and I explained this to President Lula, that the BNDES would not be able (...) to help the country face the crisis if it continued to have a hand-to-mouth operation in terms of funding (...); securing funding was key. It was then that President Lula decided—and this was a crucial political decision—with the support of*

[244] Multiple interviews, Brasília, Rio de Janeiro, São Paulo, 2014.
[245] Author's interview with Demian Fiocca, Vice-President (2004-2006) and President (2006) of the BNDES, Rio de Janeiro, August 21, 2014.

both Finance Minister Guido Mantega—whose merit in this decision was very important too—and (...) Chief of Staff Dilma Rousseff, to grant the BNDES a Treasury loan of 100 billion Brazilian Reais [US$57 billion] (...).[246]

In the immediate aftermath of the international crisis, the leaders of the neo-developmental coalition of policy entrepreneurs agreed that a BNDES-implemented countercyclical policy would have several advantages over the conventional "*keynesianismo de orçamento*" ("budgetary Keynesianism"). As the BNDES would use this injection of capital to provide credit to firms, these fiscal resources would flow directly to investment rather than consumption, which would have a positive impact on long-term growth. In addition, the BNDES's highly skilled bureaucracy ensured that credit risk would be assessed effectively, minimizing rates of non-payment.[247] Therefore, in contrast with traditional Keynesian spending through budget lines—e.g. public works—this alternative approach guaranteed that the federal government would recover part of the capital it would inject in the economy through the BNDES.[248]

Reconfiguring the role of the BNDES in Brazil so as to serve as a countercyclical tool for the federal government entailed a new interplay between the state and the financial market. More concretely, executive branch leaders decided to issue new government debt in order to absorb the capital needed for an enlargement of the BNDES lending capacity. The National Treasury would then lend to the BNDES the money raised in the market, with an interest rate below market levels. Finally, the BNDES would convert this capital into loans for firms at low interest rates (sometimes even negative rates in real terms).

A top official at the Finance Ministry explains the rationale behind such decision:

This mechanism was created as a way of capturing existing resources in the financial system and channeling them to long-term productive investment. That is, it is a mechanism intended to neutralize the short-termism and risk aversion that characterizes the Brazilian financial system. In doing this, the government acknowledged that the only way of achieving this goal was to get the National Treasury to step in and capture those resources by itself—private investors would not buy long-term bonds other than those issued by the state.[249]

This new form of state involvement in credit markets, articulated by the neo-developmental coalition of policy entrepreneurs that coordinated across the Ministry of Finance, the President's Chief of Staff, and the BNDES presidency, was soon inscribed into new rules. In January 2009 President Lula signed a decree instructing the National Treasury to grant the first of what would later become a series of hefty loans to the BNDES.[250] The accompanying text provided the following reasons for issuing the decree:

[246] 'O Desenvolvimentista,' *Piauí*, October 2010.
[247] See Mettenheim (2010) for an argument and evidence about BNDES's positive performance as a bank.
[248] Multiple interviews, Brasília, Rio de Janeiro, São Paulo, 2014.
[249] Author's interview with Dyogo de Oliveira, Deputy Executive Secretary (2011-2014) and Deputy Secretary of Economic Policy (2008-2011), Ministry of Finance, Brasília, August 6, 2014.
[250] Decree MP 453/09, later converted into Law 11,948/09 and updated by Law 12,249/10.

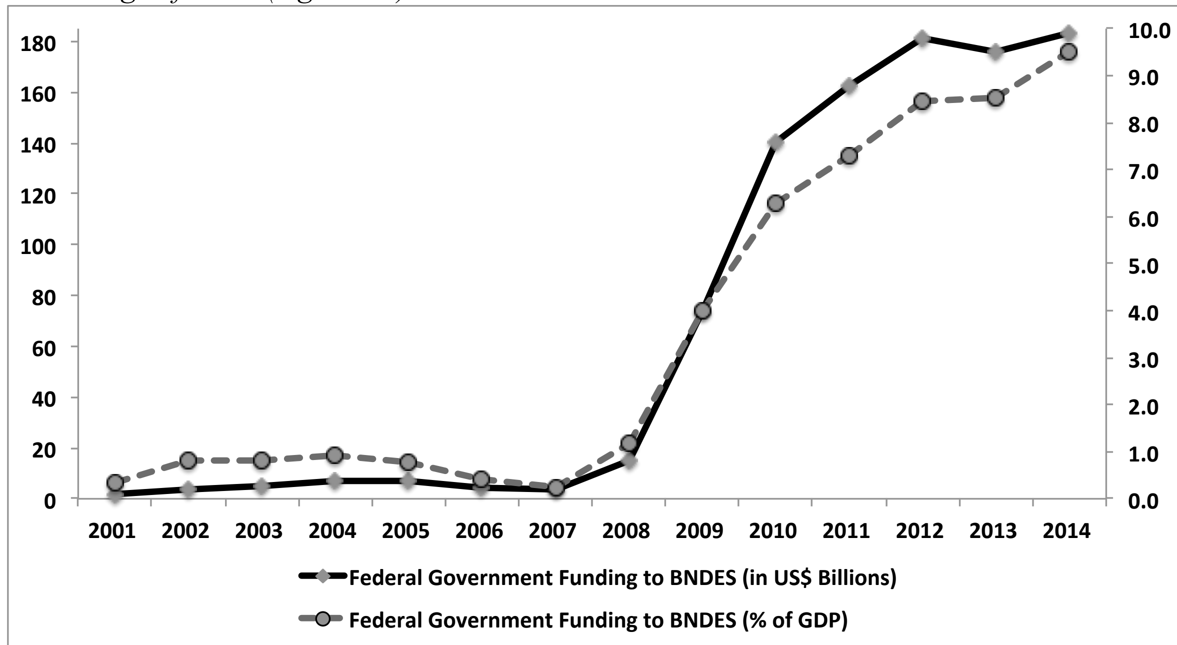
Last year there was a significant increase in the demand for the long-term finance that the BNDES offers (…). In that context, the BNDES's traditional funding sources (…) have become insufficient to finance [the Bank's] disbursements.
As the international financial crisis deepens (…) the situation of credit and equity markets is critical, reducing firms' ability to obtain resources (…).
[With this Treasury loan to the BNDES] the Brazilian economy will be able to face the crisis of foreign markets without having to abort the ongoing investment projects; this measure will enable the Brazilian corporations, that up to now obtained finance in foreign markets (…), to obtain finance in the domestic market, where the BNDES is the most important provider of long-term credit.
It is important to underline that the resources associated with this decree will be allocated to investment projects that will directly contribute with the expansion or the upgrading of national productive capacity, expanding gross fixed capital formation in the Brazilian economy.[251]

The 2009 decree and the ensuing laws changed the source of BNDES's funding. Since the early 1990s the Bank had mostly relied on the capital of the Worker's Assistance Fund (*Fundo de Amparo ao Trabalhador* or FAT)—a fund for workers' retirement and savings—which represented two thirds of BNDES's funding by 2006 (Machado dos Santos 2006: 13). At the end of 2014, the transfers from the National Treasury (US$183 billion) were 2.5 times larger than the funding the BNDES received from the FAT fund.[252]

Figure 3.2 shows the meteoric growth of annual transfers from the federal government to the BNDES, which peaked at over US$180 billion in 2014. This injection of capital came to represent over 9 percent of the Brazilian GDP.

[251] EM Interministerial nº 4/2009 - MF/MDIC.
[252] My calculations based on data from "O FAT e o BNDES" (accessed on BNDES website on February 6, 2015), the dataset "Dívida líquida e bruta do governo geral (metodologia vigente até 2007)," Central Bank of Brazil.

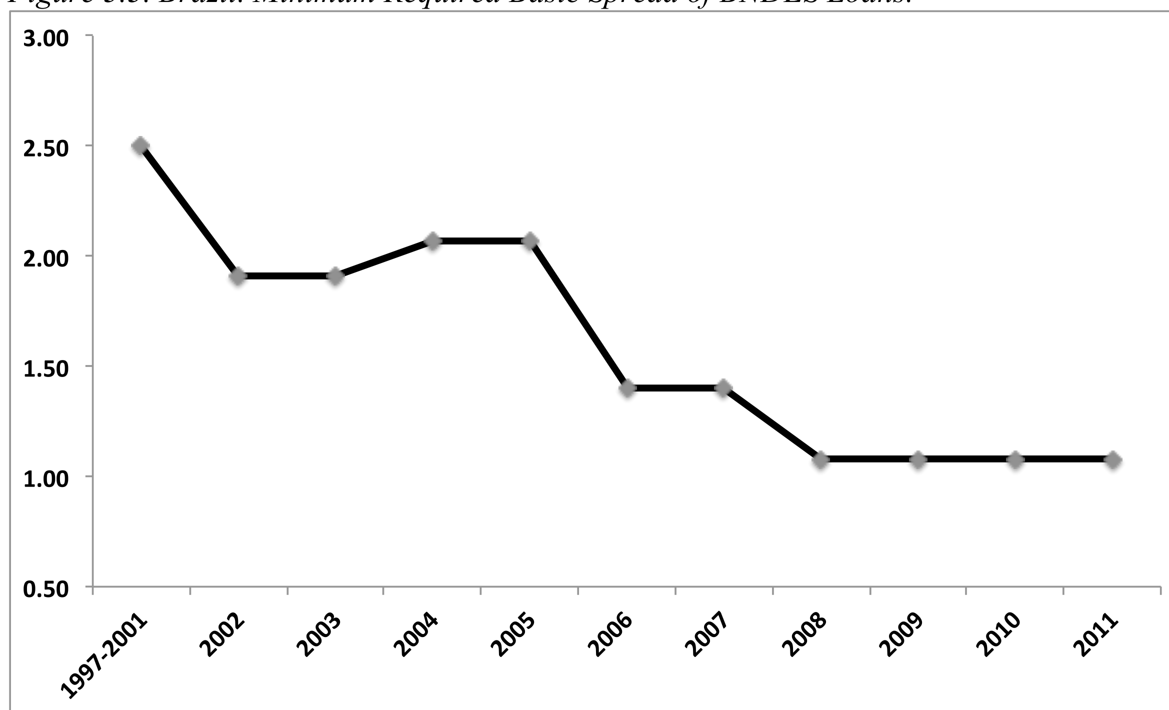
Figure 3.2. Brazil. Federal Government Funding to BNDES in US$ Billions (left axis) and as a Percentage of GDP (right axis).



Source: Author's elaboration based on dataset "Dívida líquida e bruta do governo geral (metodologia vigente até 2007)," Central Bank of Brazil, and IMF's historical exchange rate data. *Notes*: Data points are for December of each year.

This shift in the government's decision to boost funding to the BNDES had a remarkable impact on the scale and scope of BNDES's loan portfolio, as shown at the beginning of this chapter (Figure 3.1). Figure 3.3 shows the decline of the targeted spread (*spread básico mínimo requerido*) of BNDES loans during the 2000s. This is a politically set variable—approved by the BNDES board (Bazilio and Aronovich 2012: 23)—that affects the price of BNDES credit lines for firms, and thus indirectly determines the scale of state involvement in credit markets.

Figure 3.3. Brazil. Minimum Required Basic Spread of BNDES Loans.



Source: Author's elaboration based on data from Kramer Bazilio and Aronovich (2012: 23).

The shift in the scale and scope of BNDES's involvement in credit markets during the administrations of the Workers' Party had a clear effect on how Brazilian firms finance their investment. Looking at the evolution of gross fixed capital formation—which, for example, captures firms' long-term investment in the building of new plants or expanding existing ones, or the purchasing of new machines and other devices—it is evident that between the 1990s and the 2010s the BNDES transitioned from a residual to a prominent role in the financial system. BNDES's participation in gross fixed capital formation was 6 percent in 1999 (Mettenheim 2010: 158), it increased up to 12.5 percent in 2007, peaking at 24.5 percent in 2009 and it stabilized at over 20 percent since then (BNDES 2011: 82).

BNDES credit is highly relevant for the full spectrum of domestically owned Brazilian firms, ranging from the largest business groups to small companies—with gross annual revenues of up to US$9.5 million—and micro firms—with gross annual revenues of up to US$1.4 million. By 2013, roughly 80 percent of the firms in the Ranking of Top-1000 Brazilian corporations were receiving BNDES loans, and only nine firms in the top hundred did *not* receive BNDES credits.[253] By 2014, the number of BNDES credit operations for SMEs was over a million, ten times the number of operations recorded in 2005.[254] Company-level data also capture the importance that government lending has attained for corporate investment finance in contemporary Brazil. A study of over a hundred large companies found that the ratio of long-term debt to total assets jumped from an average of 16 percent for the 1997-2001 period to 23

[253] "'Cabe ao governo eleito pelo povo fixar as prioridades,'" *Valor Econômico*, October 22, 2014.

[254] My calculations based on the BNDES dataset "Desembolso Anual do Sistema BNDES – Porte da Empresa." By SMEs I am referring to the aggregation of firms of the following three BNDES categories: *microempresa*, *pequena empresa*, and *média empresa*. These are firms with a gross annual revenue of up to US$53 million (utilizing the 2010 exchange rate).

percent in 2008—an over 40 percent increase—with the BNDES playing a critical role in that shift, as evidenced by the fact that it provided a third of all the financial resources large firms utilized for investment (FECAMP 2009: 62-7, 90-6). Using a different measurement technique and more updated data, the enterprise surveys conducted by the CNI show that in the 2009-2014 period Brazilian firms have financed, on average, 20 percent of their annual investment projects with BNDES loans.[255]

In light of these facts, it is clear that the Brazilian business community at large benefitted from the massive expansion of the scale of government lending after 2008. Yet, as I develop further in Section 5.II, this outcome cannot be attributed to business pressures, as an alternative hypothesis would hold. The speed with which this highly comprehensive policy package was assembled, the multiple technicalities the plan involved—including the change in the funding structure of the BNDES—, the sophisticated causal beliefs that underpinned the crafting of the plan—e.g. its way of recasting old discussions on countercyclical government lending—, and finally the fact that this policy purposely sought to irrigate firms of all sizes and across sectors, all suggest that it is unlikely that the policy process that reshaped the mode of state involvement in credit markets was driven by business actors' pressure. In line with the propositions laid out in Chapter 2, the process-tracing analysis in this chapter shows that a state-centric argument fares much better in accounting for this deep transformation taking place in twenty-first-century Brazil. In Section 5.II I go back to this business-centric alternative explanation and further discredit it by providing additional original evidence.

5. Mechanisms of Reproduction: The Likely Resilience of Large State Involvement in Credit Markets in Contemporary Brazil

In the Introduction to this chapter I stated that, as we reach the mid-2010s, we observe a new configuration of the Brazilian financial system marked by the large scale of government lending. This is a new stable equilibrium that is likely to be resilient even as the government's partisanship changes. My analytical framework offers some clues for explaining why Brazil's new pattern of state involvement in credit markets is likely to endure over time. Some of the mechanisms of reproduction that my framework highlights are present in the case of contemporary Brazil, while others are absent. In the next subsections I treat statist and societal sources of positive feedback in turn.

5.I. Statist Sources of Feedback Making Large BNDES Lending Resilient

In contrast with what Chapter 4 on the Chilean case shows, I find no indication suggesting that in the case of Brazil, in the period under study, the winning coalition of neo-developmental policy entrepreneurs succeeded in inscribing its victories into the topography of the state itself. In other words, the institutional structure of the state seems unaltered even after

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[255] *Investimentos na Indústria*, Confederação Nacional da Indústria (CNI), various editions. Name of variable in Portuguese: "Distribuição média das fontes de financiamento dos investimentos realizados no ano corrente." An expert from the CNI explained to me that the category "Bancos oficiais de desenvolvimento" in that part of the enterprise surveys is the best proxy available for assessing the impact of BNDES loans at the company level (Personal communication with Danilo Cascaldi Garcia, former Analyst of Policies and Industry at the CNI, September 16, 2015).

roughly a decade of intense political activity within the state aimed at consolidating a neo-developmental policy orientation.

The framework of my study suggests that policy entrepreneurs have an alternative—though less effective—way of making their victories durable: namely, inscribing those victories into the fine-grain of policies themselves. That is, my claim is that *intrinsic characteristics of the policies* that underpin state involvement in credit markets can be themselves a source of positive feedback. Of course, in principle policies could be dismantled altogether at subsequent rounds of the game but some features intrinsic to policies increase the likelihood of resilience. Next I identify evidence pointing to the presence of this type of reproduction mechanism in the case of Brazil.

In a nutshell, the neo-developmental coalition of political *técnicos* succeeded in linking two previously unconnected policies: the management of the economic cycle—in particular, countercyclical policies—and industrial policy. In doing so, they gave the BNDES the role of bridging the two policy arenas and they crafted a new funding scheme that would enable the BNDES to play such new role. This move reflected the developmental ideas carried by the winning coalition: aggregate demand-management would bear more significant long-term benefits and be fiscally more sustainable if it prioritized injecting fiscal resources into investment—subsidizing credit for firms—rather than consumption.

But more important than underlining the ideational backing of policy change, it is spelling out how this policy innovation increases the likelihood of its own reproduction. My point is that once this connection between BNDES lending and the management of the economic cycle is established, it becomes increasingly harder to retrench the high level of state involvement in credit markets. The reproduction mechanism is rather automatic in the sense that there need not be further action by policy entrepreneurs to sustain the policy path in time [1,...,n].

I will be more explicit about the logic. Once a significant portion of the investment carried out by a country's firms comes to depend on credit subsidized by the state—as it came to happen in post-2008 Brazil—dismantling that scheme becomes *politically* more costly because it risks generating a deep recession. Thus, what in time 0 was a low-salience policy decision pushed by highly technical, development-oriented political *técnicos*, in time [1,...,n] becomes an issue of high politics to which electorally driven politicians must pay attention. In contemporary Brazil, shrinking the scale of BNDES lending—in a situation where such a large stock of long-term credits has already been granted—would require alternative capital inflows. That is, for a retrenchment to happen the federal government's funding that is now irrigating the long-term credit market should be replaced by other sources of long-term finance. In the absence of such new sources of finance, the pro-retrenchment executive branch leaders would be self-inflicting a severe decline in the country's economic performance.

The development of alternative sources of long-term finance is unlikely in contemporary Brazil. Private banks do provide patient capital in what Zysman (1983: 55) called "credit-based system[s] dominated by financial institutions" or what Hall and Soskice (2001) denominated Coordinated Market Economies. However, Brazilian banks are particularly short-term oriented and virtually provide no long-term credit (see Stallings 2006, chapter 8). In the past this lack of long-term bank credit was rooted in Brazil's macroeconomic instability, but the fact that private banks continue to be only short-term lenders after twenty years of relatively high levels of macro-stability suggests that this is a structural feature of the Brazilian political economy (see Coutinho and Rabelo 2003: 36). All my interviews in both the private and public sectors show that the actors that operate with or regulate the private banking system in Brazil take banks'

short-termism as a set parameter.[256] In the case of interviewees in the Finance Ministry or with close working relations with it, this virtually immutable character of private banks is expressed with a tone of frustration because throughout the last decade the Ministry has been proactive in setting a number of rules aimed and lengthening the time horizon of the private banking industry.[257]

Besides, in a region that has suffered major debt crises in the past (see, for instance, Frieden 1991) and that continues to have a much more volatile access to international flows of capital (Wibbels 2006), relying on inflows of foreign capital with a long time horizon also seems unlikely. This structural attribute of the Brazilian economy is compounded by the fact that the majority of the firms currently receiving BNDES loans do not have the option of tapping international markets to finance themselves. There are at least two drivers of such incapacity to utilize world markets as a source of corporate finance. First, issuing corporate bonds or equity in financial centers like Wall Street or London is so costly that only very large firms are in a position to balance costs and benefits favorably. Second, even for many large Brazilian corporations for which accessing foreign capital markets is both technically possible and "affordable," it is often too risky to become dependent on foreign currency denominated debt insofar, as their revenue is overwhelmingly in Brazilian currency, a currency devaluation can easily drive them to bankruptcy.[258]

BNDES President Coutinho, in explaining why scaling back the Bank's loan portfolio is not as easy as many think, refers to the importance of BNDES lending even for large corporations:

> *[Journalist:] Does it make sense for the BNDES to finance, at a subsidized interest rate, large corporations that have access to capital markets, even to foreign markets?*
> *Coutinho: That assertion is not reasonable. It ignores the fact that many large corporations have their projects centered on the domestic market or on infrastructure development and thus their revenue is in [the Brazilian currency] Reais. [For that type of large corporations] obtaining long-term finance in international markets would imply incurring in a high currency mismatch, which in the past has already endangered many firms and has had [negative] impacts on the financial system. This problem of exchange rate risk has not yet been resolved [... and thus] it is an issue that must be taken seriously.*[259]

In short, especially since 2008 the BNDES has come to play such a prominent role in the contemporary Brazilian political economy that any attempt to restore the much smaller size the Bank had during the 1990s or early 2000s seems highly unlikely. Intrinsic characteristics of the policies regulating state-led industrial upgrading and the funding structure of the BNDES set in motion a process that is now hard to reverse without causing a backlash in aggregate investment levels—and thus a political crisis rooted in the worsening of the already quite poor economic performance of today's Brazil.

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[256] Multiple interviews, Brasília, Rio de Janeiro, São Paulo, 2014.

[257] Author's interviews with: Manoel de Castro Pires, Director at the Executive Secretary of the Ministry of Finance (2011-2014), Brasília, August 8, 2014; Dyogo de Oliveira, Deputy Executive Secretary (2011-2014) and Deputy Secretary of Economic Policy (2008-2011), Ministry of Finance, Brasília, August 6, 2014.

[258] Multiple interviews, Brasília, Rio de Janeiro, São Paulo, 2014.

[259] "'Cabe ao governo eleito pelo povo fixar as prioridades,'" *Valor Econômico*, October 22, 2014.

State actors recognize that there is no easy way out of this new role of the state in credit markets. A BNDES board member with a highly technical profile and an over twenty-year career at the Bank says,

> *I don't believe that the scale of the BNDES can be reduced any time soon because there is widespread consensus that Brazil needs a higher level of investment, industrial upgrading, public investment that generates positive externalities, and investment to reduce cross-regional development inequality… and all of these goals require an active BNDES.*[260]

Similarly, a former BNDES Vice-President (2004-2006) and President (2006) argued:

> *Once the BNDES increased its volume in the aftermath of the international financial crisis, this enlarged scale was maintained because there was a need to continue with what had been started.*[261]

When speaking in public BNDES President Coutinho has had to moderate his defense of this new model because he has faced harsh criticism from opposition parties due to the growing fiscal debt generated by the new role of the BNDES in credit markets. However, even when he makes public statements, Coutinho's point is not that the BNDES will shrink in the future but rather that its scale will not continue to grow at the same rate it did during the aftermath of the 2008 crisis:

> *No credit system should grow annually by 40-50% for extended periods of time. Therefore, at one point it's necessary to* moderate the growth rate of credit operations. *Since [the Bank's loans] have grown a lot recently (…) it's not reasonable to* continue to expand them at such accelerated pace. *The expansion* was justified by the severity of the crisis*; now the gradual recovering of private credit and capital markets will allow the BNDES to* stabilize its operation*. We need to remember that during the crisis we not only increased our overall presence through credit lines that did not exist until then but we also increased the share of BNDES's finance in [already existing investment] projects. The projects in which the Bank used to provide between 60 and 70% of the overall finance came to receive BNDES finance for between 80 and 90%. [Hence, the BNDES] increased its level of participation in financed projects. Now we will go back to the pre-crisis status quo [in levels of participation]. By doing so, we will* moderate the rate of expansion *without affecting the continuity of the rise of investments.*[262]

5.II. Societal Sources of Feedback Making Large BNDES Lending Resilient: The Role of Big Business

In line with my analytical framework, in twenty-first-century Brazil the role of organized business actors in the *origin* of the major shifts in the scale of state involvement in credit markets has not been relevant. No one would reasonably argue that Brazilian business actors—not just the very largest but also small- and medium-sized enterprises—did not benefit from the massive

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[260] Author's interview with Julio Ramundo, BNDES Board Member (2011-2014) and top official at several BNDES units (1992-2011), Rio de Janeiro, August 25, 2014.

[261] Author's interview with Demian Fiocca, Vice-President (2004-2006) and President (2006) of the BNDES, Rio de Janeiro, August 21, 2014.

[262] *Cadernos do Desenvolvimento*, Rio de Janeiro, 6(9), July-December 2011, pp. 406-19.

increase in the scale of long-term credit provided by the state-owned National Development Bank. Yet close attention to the temporal sequence of events in the process that led from low to high state involvement in markets in the 2000s critically shows that power shifts within the state, not business pressure from below, was the primary factor originating this change.

Brazilian industrialists had demanded the state to increase financial support for corporate investment throughout the 1990s.[263] During that period, even though big business was a core ally of President Cardoso's party (the PSDB), the state did not step in to drastically increase its involvement in credit markets. What this earlier period shows is that in Brazil business pressure—even when it is somewhat coherently articulated and when the chief executive actively courts industrialists[264]—is by no means a sufficient condition to substantially increase the scale of state-owned banking institutions' provision of long-term credit to the country's firms. Going a step beyond that, the post-Cardoso process traced in this chapter indicates that business action is not even a necessary condition for a substantial expansion of the scale of BNDES lending as that set in motion after 2007.

The relative irrelevance of business power as a driver of the policy process that reshaped the mode of state involvement in credit markets in twenty-first-century Brazil is not surprising in light of the most influential work on business associations in Latin America (i.e. Schneider 2004), which puts Brazil as a case of particularly acute business disarticulation in the region, especially when compared to countries like Chile, Mexico, and Colombia. Business power was not the driver of policy formation. Yet it probably was one of the drivers of policy continuity: the empirical evidence I present in this subsection suggests that in time [1,...,n] the bottom-up pressure that business associations staged to support the already enlarged scale of government lending may partly explain the continuity of this policy path.[265] Before analyzing how business action may be considered a mechanism of policy reproduction, I will take a step back to review the logic and the empirics indicating that business pressure has no explanatory power to account for the formative stages of the policy path in the 2000s (time 0).

Though there is ample evidence that during the PT administrations business associations were *consulted* by the government in the regular meetings of the National Council of Industrial Development (CNDI), where industrial policy was discussed,[266] there is consensus among key

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[263] See Kingstone (1999: 214, 229, 234-5); Mancuso (2007: 28, 65, 67, 173-4, 178-9, 184).

[264] See Kingstone (1999, chapter 6 and pp. 229-30).

[265] In this subsection I focus on the role of business associations, leaving out from the analysis the role of one-on-one negotiations between the largest *individual* business groups and the executive branch. While these big *grupos* do enjoy good access to executive-branch leaders, my field research strongly indicates that, due to the overall attributes of the Brazilian polity and the fact that the policies under study are of such large scale—in terms, for instance, of the amount of fiscal resources involved—there are no reasons to consider rent-seeking and policy-capture dynamics as candidate explanations of how the policies of state involvement in credit markets have evolved in contemporary Brazil. In other words, while I do not neglect the possibility that the largest Brazilian industrialists exercised influence affecting specific features of BNDES credit lines and industrial policy, I am not interested in that type of outcomes. My claim is that in explaining the continuity of large-scale state involvement in credit markets—which is a more "structural" outcome, well above specific credit lines or features in industrial policy—individual action by big business leaders is not a relevant factor. The action of business associations, in contrast, does merit consideration as a reproduction mechanism of the policy path.

[266] These business-government dialogues were especially active during the presidencies of Lula Da Silva, significantly less so during Dilma Rousseff's administrations (Multiple interviews with private- and public-sector actors, Brasília, Rio de Janeiro, São Paulo, 2014).

interlocutors in both the private and the public sectors that business associations *react* to decisions made by the executive branch over BNDES's role. My field research suggests that business associations are not proactive first-movers, even with regard to policy decisions that end up benefitting many of the firms that these associations represent.

A top official who, throughout the last decade, held positions in some of the agencies within the federal government where interaction with business actors is most frequent—the Ministry of Development, the CNDI, and the Brazilian Agency for Industrial Development (ABDI)—replied in the following terms when asked about how active business actors had been in the decision-making process leading to the enlargement of the scale of the BNDES during the Workers' Party governments:

> *The state is proactive and thus surpasses the initiative of business actors. In general, the debates we have with businessmen aim at preserving the status quo rather than to think about sectoral upgrading. I would thus say that the private sector is reactive—it is conservative and it lacks an aggressive strategic vision.*[267]

In this sense, my field research coincides with the ultimate findings of De Toni (2013), who dedicated his entire PhD dissertation to trace the processes of industrial policy adoption and evolution under the Lula governments. While his argument makes him emphasize the participatory nature of the making of industrial policy up to the 2008 international crisis, and the relevant role of business actors in the CNDI, De Toni (2013: 152) recognizes that in the industrial policy arena "the initiative and protagonism has always come from the state."

The politics around the creation of the Program for Sustaining Investment (*Programa de Sustentação do Investimento* or PSI), one of BNDES's major initiatives in the late 2000s, is illustrative of the virtually irrelevant role of business in what my framework calls time 0. I found no evidence that bottom-up business pressure was an important explanatory factor of the program's adoption. The Director of the Brazilian Agency of Industrial Development (ABDI) (2008-2014)—in charge of coordinating the industrial policies of the federal government—argued:

> *Generally speaking, I would say that the government had the strong position* [tinha a certeza] *that private investment needed to be safeguarded [in the aftermath of the 2008 world crisis], and that was prior to receiving any demand from business. The Programa de Sustentação do Investimento, for instance, was much more a result of government moving first than of business pressure.*[268]

The organizational weakness of Brazilian business is certainly associated with the lack of explanatory power that bottom-up business action has had in the formative moments of the policies that enlarged the scale of state involvement in credit markets in the 2000s (time 0). Moreover, this weakness indicates that, if not entirely discarded, business action should not be overemphasized as a reproduction mechanism in time [1,...,n].

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[267] Author's interview with Ricardo Schaefer, Executive Secretary (2013-2015) and Deputy Executive Secretary (2011-2013), Ministry of Development (MDIC), Executive Secretary of the National Council of Industrial Development (CNDI) (2005-2006), Brasília, August 12, 2014.

[268] Author's interview with Maria Luisa Campos Machado Leal, Director of Brazilian Agency of Industrial Development (ABDI) (2008-2014), Brasília, August 13, 2014.

Brazilian business stands out in the Latin American setting for its historic incapacity to establish a lasting, economy-wide peak association (Schneider 2004: 125). Lacking an encompassing association that is relevant in the policymaking process—as the CPC and SOFOFA are in Chile—the most important business actors with potential to influence the politics of state involvement in credit markets are two industrial associations: the National Confederation of Industry (*Confederação Nacional da Indústria* or CNI) and the Federation of Industry of the State of São Paulo (*Federação das Indústrias do Estado de São Paulo* or FIESP), which represents the firms of a state where roughly half of the country's industrial output is produced.

Ben Ross Schneider has convincingly argued that both the CNI and FIESP have a misleading appearance of organizational strength that hides their structural debilities. The CNI's weak political leverage can be traced to its "little capacity to aggregate, and therefore represent, industrial interests"; the Confederation's fundamental flaw is that it is composed of 27 state-level federations with equal voting power (Schneider 2004: 94). This institutional feature severely underrepresenting the state of São Paulo and the center-south states—that is, the core of the territorially highly concentrated Brazilian industry—led the CNI to have most of its presidents coming from the northeastern states—which are peripheral in the country's industrial productive apparatus. In 2010, the CNI leaders chose the first non-northeastern president since 1968 in an attempt to gain political influence precisely by fixing this long-dated representational bias.[269] FIESP, for its part, has also suffered from the political weakness that is associated with underrepresenting the most economically powerful members of the group it is supposed to represent. The governing bodies of this São Paulo federation gives roughly equal power to traditional sectors (food, clothing, construction, and furniture) and to modern sectors (chemicals, pharmaceuticals, metal working, and electrical equipment), despite the fact that the latter sectors are four times bigger than the former in terms of the state's total value added. As a result of this deficit in interest aggregation, FIESP has typically had presidents who were marginal figures in the São Paulo industry.[270] More generally, big Brazilian industrialists have shown little interest in investing in both the CNI and FIESP (Schneider 2004: 123).

As the CNI Director of Policies and Strategy explains, "umbrella organizations [like the CNI and FIESP] are only able to reach consensus among its members on *horizontal* issues such as the country's low levels of competitiveness in international markets."[271] This quote illustrates the microfoundations underpinning the observation that the two business associations that would be top candidates to have influence over the politics of state involvement in credit markets actually do *not* have much leverage. Both the CNI and FIESP have managed to reach internal consensus and invest their political capital in pushing for broad agendas—namely, the softening of the tax burden over firms and a looser monetary policy that would reduce the interest rate. During the 2000s and early 2010s, a third issue, the containment of the overvaluation of the exchange rate, has often become another area on which the CNI and FIESP invest resources to lobby with government. These three issues tend to minimize inter-sectoral and inter-industry

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[269] "CNI faz escolha para unificar lobby industrial," *Valor Econômico*, May 10, 2010.

[270] The characterization of FIESP in this paragraph comes from Schneider (2004: 95).

[271] Author's interview with José Augusto, Director of Policies and Strategy of the National Confederation of Industry (CNI), Rio de Janeiro, September 1, 2014. The following interviewees stressed the same point: Reginaldo Braga Arcuri, President of the Brazilian Agency of Industrial Development (ABDI) (2007-2010), Brasília, August 7, 2014; Thomaz Zanotto, Director, Federation of Industry of the State of São Paulo (FIESP), São Paulo, March 31, 2014.

conflicts within the CNI and FIESP, facilitating collective action. In addition, these are policy domains in which even slight "victories" resulting from successful lobbying by the CNI and FIESP can immediately bring highly visible and significant positive effects over the cost structures of the vast majority of the firms that these two organizations represent. Though these issues are off the scope of my study, one can speculate that interest groups probably were partial drivers of policy choice in those arenas.

The contrast with the explanatory power of business action in the policies of state involvement in credit markets is clear. The decision to expand BNDES credit has always been tied to industrial policies that affect the industrial sector *vertically* rather than *horizontally*. Some sectors and some industries within sectors win and other lose—or are set aside from the group of winners—as a result of those policy choices. On these vertical issues such as the BNDES' selective interventions in credit markets, the CNI and FIESP have internal cleavages along the lines of the different parts of the production chains, and as a result they are unlikely to reach the internal consensus needed to craft a solid policy agenda and push it proactively in their interactions with government.[272]

While, for the reasons laid out above, the CNI and FIESP were unlikely to invest their political capital during the formulation stage of the industrial policies that underpinned the expansion of BNDES lending, the incentive structure that shapes business associations' behavior shifts in later rounds of the game. My framework suggests that business actors are likely to become a source of positive feedback *after* the policies structuring a mode of state involvement in credit markets have been adopted (time [1,...,n]). As Paul Pierson has argued, "[the] political goals of groups may change in response to the nature of the programs they confront and hope to sustain or modify" (Pierson 1993: 598). Policies, he later specified, generate learning effects, coordination effects, and adaptive expectations (Pierson 2000: 259).

In post-2008 Brazil, we find evidence indicating that the sort of interest group adaptation that the theory predicts did in fact take place. During those later rounds of the game both the CNI and FIESP frequently lobbied executive branch agencies with the goal of maintaining, or even expanding, the new role of the BNDES in credit markets. The microfoundations of that shift in business actors' strategy seem straightforward: for the CNI and FIESP, while in time 0 the costs of proactively pushing industrial policy change outweighed the potential benefits—basically because there was high uncertainty about the benefits to be reaped if policy was adopted, and because that political capital was considered to be better spent on the broader issues discussed above (i.e. tax reform, monetary policy, and exchange rate policy)—once those industrial policies had already been set in motion the costs of voicing support for policy continuity were low and the potential benefits had become high.

The Program for Sustaining Investment, though I found no evidence of significant business actors' activism at the time of adoption, did trigger demands in favor of policy continuity once it was in place. When I interviewed CNI's Executive Manager of Economic Policy, he said: "There is strong business pressure to maintain the PSI."[273] In 2010, the president of Marcopolo, a leading Brazilian multinational corporation specialized in manufacturing buses and coaches, spoke at a FIESP meeting that was covered by the press. He defended the continuity and expansion of the BNDES program Finance for Machines and Equipment (*Financiamento de*

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[272] Multiple interviews with business representatives, Brasília, Rio de Janeiro, São Paulo, 2014.

[273] Author's interview with Flávio Pinheiro de Castelo Branco, Executive Manager of Economic Policy of the National Confederation of Industry (CNI), Brasília, August 14, 2014.

Máquinas e Equipamentos or FINAME) by expressing threats about what would happen if the government chose to retrench those subsidized credits:

> *Up to August 2009 the annual interest rate of FINAME loans was at 13%. Then the government rightly extended the duration of the loans—from six to eight years—and reduced their interest rate to 7%. Those decisions pushed the manufacturing of transportation equipment in an extraordinary way. Now we are working with the factory at full capacity, seven days a week. If the government decided to raise the interest rate [of FINAME loans], the whole industry would be beheaded [*decapitada*].*[274]

Later in 2010 FIESP's Chief Economist publicly praised the PSI loans arguing that they "enabled the industrial sector to recover after the [world financial] crisis and they now provide the required fuel for the country to continue to have a good rate of economic growth."[275] In 2011, at a meeting with the Finance Minister, and in 2012, at a meeting with President Dilma Rousseff, the CNI Presidents requested the postponement of the sunset provision affecting those BNDES loans.[276]

Another example of the virtual irrelevance of business pressure at time 0 and its importance as a reproduction mechanism in the post-policy-enactment period (time [1,...,n]) is that of the BNDES Card (*Cartão BNDES*), a flagship program that has deepened the long-term credit market for small- and medium-sized enterprises (SMEs) in the 2010s. While bottom-up pressures by business associations does not explain its adoption, after the *Cartão BNDES* was set up business associations like the CNI did exert influence to maintain the program and enlarge its scope. Interestingly, the activation of this national association in defense of the *Cartão BNDES* program was driven by the much larger corporations that sell supplies to the SMEs receiving credits, rather than by SME pressure.[277]

The analytical framework of this study holds that certain business actors are likely to become particularly active in favor of policy continuity. Borrowing flexibly on the language of Hacker and Pierson (2014: 650), these business actors are "intense policy demanders" in that they see policy as the big prize—"these groups *really* care about their policy demands." Though my framework hypothesized that such intense policy demanders would be likely to emerge in time [1,...,n] among financial-sector firms, I found no evidence that such was the case in Brazil. However, a sector-specific association within industry did emerge as an intense demander of the continuity of expanded BNDES lending: the Brazilian Association of the Industry of Machines and Equipment (*Associação Brasileira da Indústria de Máquinas e Equipamentos* or ABIMAQ). As the CNI's Executive Manager of Economic Policy explained, "ABIMAQ is particularly vocal of the demand of maintaining BNDES PSI loans."[278]

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[274] "Empresários temem efeito de juros no PIB de 2010," *Valor Econômico*, January 21, 2010.

[275] "Abimaq e Fiesp defendem prorrogação de linhas do BNDES com taxa reduzida," *Valor Econômico*, March 23, 2010.

[276] "Governo deve prorrogar Programa de Sustentação do Investimento," *Valor Econômico*, February 2, 2011; "Com Dilma, CNI reitera pedido para prorrogação de PSI e Reintegra," *Valor Econômico*, December 5, 2012.

[277] Author's interview with José Augusto, Director of Policies and Strategy of the National Confederation of Industry (CNI), Rio de Janeiro, September 1, 2014.

[278] Author's interview with Flávio Pinheiro de Castelo Branco, Executive Manager of Economic Policy of the National Confederation of Industry (CNI), Brasília, August 14, 2014.

The following quote is but one example of the multiple demands that ABIMAQ publicly expressed in favor of maintaining or even expanding the scale of BNDES loans. ABIMAQ Director said,

> *[I] pressure the BNDES almost daily [to maintain the interest rate of PSI loans at the current low level]. Every time we have a chance, we pressure the BNDES. The current loan rate is not absurd [...], several countries with which Brazil competes have adopted interest rates as low or lower to finance investment in the productive sector.*[279]

To sum up, the evidence presented in this subsection indicates that the two business associations that would be top candidates to have influence over the politics of state involvement in credit markets actually were *not* key drivers during the formative moments of policies (time 0). Over time, however, the CNI and FIESP, as well as the less encompassing ABIMAQ, became sufficiently invested in the maintenance of large-scale BNDES lending so as to articulate political demands to prevent program retrenchment. Once policy is in place, for business associations voicing support for policy continuity has few costs—but it may help protecting large benefits. It thus seems reasonable to argue that this societal pressure from below contributed to the observed resilience of large BNDES lending.

6. Final Remarks

This chapter has traced the process by which the Brazilian state moved from being marginally involved in the markets of long-term corporate credit to a position of high direct involvement. During the last decade the National Bank for Economic and Social Development (or BNDES) drastically increased both the scale and the scope of its loans, coming to occupy a central position within the Brazilian domestic financial system. This shift in the size of government-financed lending gave birth to a new equilibrium that contrasts with that of the era of market-oriented reforms in the 1990s—a new equilibrium that is highly likely to be resistant to change.

In line with my analytical framework, the evidence presented in this chapter suggests that explaining how this new configuration of the Brazilian financial system came about requires looking at the within-state politics of policymaking. More specifically, I have shown that the technical decisions that emerge from power shifts between competing coalitions of executive-branch elite officials with different policy orientations drive the different modes of state involvement in credit markets. The in-depth study of Brazil showed that the state was the first mover and primary driver at the *origin* of the new mode of state involvement in credit markets. The evidence this chapter presented is not consistent with a business power explanation.

In twenty-first-century Brazil a turning point occurred around 2007 when the stalemate between orthodox political *técnicos* and a rival neo-developmental coalition started to unravel. The previously uncoordinated coalition of neo-developmental policy entrepreneurs gained capacity to act collectively—partly due to a new ideational coherence that had been lacking between 2003 and 2006—and managed to displace orthodox political *técnicos* from the Ministry of Finance, which had been vetoing earlier attempts to expand the level of state involvement in

[279] "Abimaq e Fiesp defendem prorrogação de linhas do BNDES com taxa reduzida," *Valor Econômico*, March 23, 2010.

credit markets. The exogenous shock of the 2008 world financial crisis provided a perfect opportunity for neo-developmental policy entrepreneurs to impose their ideas. As a result, the Brazilian state moved from low to high levels of involvement in credit markets, which was in turn a critical factor reconfiguring the national financial system. A significant part of this change in state involvement in markets can be attributed to the shift in the orientation of the BNDES, from promoter of state retrenchment in the 1990s to key developmental agent and active promoter of enlarging credit markets in the last decade. Several decisions in the arenas of industrial policy and infrastructure development, pushed by this newly consolidated coalition of entrepreneurs, underpinned the impressive expansion of BNDES loan portfolio.

No one would reasonably argue that Brazilian business actors—not just the very largest but also small- and medium-sized enterprises—did not benefit from this new mode of high state involvement in loan markets. What's more, in this chapter I provided evidence showing that the pressure of business actors in favor of policy continuity has probably been a relevant mechanism contributing to the consolidation and reproduction of such new mode of state involvement in markets. However, the findings in this chapter suggest that it was the changing micropolitics within the Brazilian state rather than business power that best explains why, how, and when this new mode of state involvement in credit markets was initiated in the first place.

Close attention to the temporal sequence of events in the unfolding of the causal process[280] that led from low to high state involvement in markets in Brazil was critical in judging whether the empirical record was in line with the observable implications drawn from Chapter 2—namely, that the micropolitics within the state, not business pressure from below, was the primary factor originating this shift. Business actors had been demanding the state to increase financial support for corporate investment throughout the 1990s. During that period, even though big business was a core ally of President Cardoso's party (the PSDB), the state did not step in to drastically increase its involvement in credit markets. But this did not happen during the first administration of the Workers' Party (2003-2007) either.

In this chapter I provided evidence that strongly suggests that in Brazil business pressure was by no means a sufficient condition—and probably it was not even a necessary one—for the dramatic—and now resilient—shift from low to high state involvement in credit markets. Rather, the primary factor triggering this process was a change—crystallized around 2007—in the balance of power between two competing coalitions of political *técnicos* with different policy orientations, one adhering to orthodox economic principles, one advocating neo-developmental tenets that combined the goals of state-led growth and the expansion of financial markets. Between 2003 and 2006, neo-developmental elite officials already advocated the ideas in favor of an expansion of state involvement in markets across several executive-branch agencies—but their leverage was effectively constrained by the orthodox coalition of political *técnicos*, whose stronghold was the Ministry of Finance.

I have shown that the neo-developmental political *técnicos* who eventually succeeded in articulating a well-coordinated and ideationally coherent coalition within the Brazilian executive branch advocated for a highly technical idea: they argued that the BNDES should be the protagonist of a new type of countercyclical policy that would have several advantages over the conventional "*keynesianismo de orçamento*" ("budgetary Keynesianism"). As the BNDES would inject a massive amount of capital to provide long-term credit to firms, these fiscal resources

[280] On sequences in process-tracing analysis see, Bennett (2010: 207-8); Collier (2011: 823-4, 828); Seawright and Collier (2010: 343).

would flow directly to investment rather than consumption, which would have a positive impact on long-term growth.

In line with the propositions laid out in Chapter 2, a careful look at the timing of events indicated that both ideas and power dynamics within the state mattered in the case of Brazil: only when the neo-developmental political *técnicos* secured their dominance by aligning several executive-branch agencies, and the ideas of orthodox officials were consequently sidelined, did their policy orientation become likely to be set in motion. Uncovering the lag in between, a period which I characterized as a stalemate within the executive branch, proved essential in the exercise of causal inference.

Matching the expectations of this study's framework, the findings in this chapter suggest that we cannot attribute to partisan politics the major shift observed in twenty-first-century Brazil in the highly technical policy process that shapes credit markets. If the Brazilian state's building of capacity to deliver long-term bank credit for firms on a massive scale were explained by government's partisanship, such change should have occurred long before than it actually did. The Workers' Party reached the presidency on January 1, 2003. Yet state-owned banking institutions' provision of long-term credit was still relatively modest as late as in 2007. That is, the partisan politics hypothesis is at odds with the empirical record mainly because it cannot account for the time lag between the PT's accession to power and the adoption of policies that critically rooted the shift from low to high state involvement in the provision of long-term credit for corporations.

While government's partisanship does not seem a relevant driver of the case trajectory studied in this chapter, in future work we may want to improve our understanding of President Lula Da Silva's (2003-2010) role in this technical policy process. Rather than focusing on partisan politics, we may benefit from refining our knowledge on the preferences and strategies of this particular president with higher-than-average policy entrepreneurial capacity. Undoubtedly the bottom-up action of elite officials during the two Lula administrations is of primary importance to understand the politics of policy adoption in the arenas that shape long-term credit markets. Yet there might be some reasons to continue to ask ourselves what precisely was Lula's role during the stalemate between the orthodox and neo-developmental political *técnicos* between 2003 and 2006, its unraveling, and the ultimate consolidation of the neo-developmental coalition in the late 2000s. It is hard to find definitive evidence to settle this question about the root causes of the changing balance of power within executive-branch agencies in Brazil; during my field research in São Paulo I requested an interview with former President Lula, which came close to being accepted but was ultimately declined. Still, given that I developed the case study resorting to multiple interviewees who worked closely with Lula himself, I am confident that the process traced in this chapter reflects with high accuracy what actually happened.

In addition, formulating an alternative hypothesis stressing President Lula's preferences as the primary driver of the policy process studied in this chapter comes along with important challenges. An explanation of that sort should provide a logic with microfoundations hinting at why a president would deliberately choose to produce a stalemate in his or her own cabinet for a rather long period of time. What goals would orient the rational behavior of a president who purposely appoints elite officials with such different policy orientations that they generate conflicts foreclosing policy adoption in technical policy arenas? Would this argument assume that the president has the capacity to predict that he or she will be better off ending, at time [1,...,n], the intra-state conflicts he or she deliberately chose to trigger when appointing elite

officials at time 0? What would the observable implications of this theory be? An argument of this sort would be appealingly counterintuitive insofar as it would introduce a type of presidential behavior that has not been theorized so far. Yet at least for the time being it seems more reasonable to argue—in line with the logic laid out in Chapter 2 and the process-tracing work done in this chapter—that we cannot predict the behavior of officials appointed to the top tiers of the executive branch based on their appointment *alone*, that they receive incomplete mandates, and that these elite officials' policy orientations and their capacity to act collectively across state agencies critically determines policy processes, such as those that have reshaped state involvement in credit markets in twenty-first-century Brazil.

Chapter 4. The Politics of State Involvement in Credit Markets in Chile

This chapter presents a political explanation of the low level of state involvement in credit markets in contemporary Chile. In line with the expectations laid out in the framework of this study, accounting for this stable equilibrium entails unpacking a process that unfolded over a long period of time. The organization of the chapter reflects the two main steps in such sequence. First, I study the formative period—or that of policy adoption—which took place during the authoritarian administrations of Augusto Pinochet (1973-1990). Challenging some of the most influential political economy works on the Chilean neoliberal reforms, this chapter argues that a state-centric explanation has more analytical leverage than a business-centric account of the origins of Chile's low state involvement in credit markets. I contend that the alternative explanation that emphasizes societal pressures as the main factor driving policy choice fails to understand the right causal status of business power in the policy process. Relatedly, these contending arguments do not succeed in highlighting that the specific point in the sequence where business power matters the most is the post-adoption phase of the policy process.

Second, I study the resilience of low direct state involvement in credit markets up to the present—or the period of policy maintenance—with a focus on the 1990s and 2000s. The continuity of a minimal role for the state in the provision of investment finance in this latter democratic period may first appear as an unlikely outcome in a context characterized by the two-decade, uninterrupted political dominance of the Concertación center-left coalition.[281] Yet the chapter argues that in the post-authoritarian period within-state politics interacted with societal pressures to produce policy continuity. While business pressure is not the primary factor explaining why the Chilean state originally retreated from the long-term credit market, business power does matter as a reproduction mechanism that locks in the neoliberal path.

Just as in the case of Brazil explaining the high level of state involvement in credit markets mainly rested on accounting for the trajectory of a major state-owned development bank (Chapter 3), in Chile the explanation of the state's marginal role in the credit side of the financial system cannot be accomplished without a strong focus on the changing size and functions of the state-owned development agency CORFO. Hence, this and Chapter 3 can be read in tandem as comparative historical institutionalist explanations of a "positive case" (Brazil) and a "negative case" (Chile).

The negative case of small state involvement in credit markets in Chile starts with its origins—what is the political explanation of the retrenchment of CORFO during the authoritarian regime?—and then proceeds to address the reproduction of this path over time. In post-dictatorship Chile, therefore, the key analytical challenge is accounting for "nondecisions"[282]: what explains that CORFO retained such small scale throughout the post-authoritarian period (1990s-2010s), despite the fact that partisanship and regime type shifted so markedly?

The chapter is organized as follows. The next section characterizes the Chilean statist model in place between the late 1930s and the early 1970s; this sets the baseline for the empirical focus of this chapter: the analysis of within-country, over time variation between the 1970s and the mid-2010s. Section 2 studies the shift from the statist to the neoliberal model that originated

[281] Coalition of Parties for Democracy (*Concertación de Partidos por la Democracia*). From now, in referring to this coalition, I will follow the common use in Spanish: *Concertación*.
[282] I am borrowing on Pierson's language here (2015: 126, 129).

the low level of state involvement characterizing contemporary Chile. The section first traces the politics within the executive branch that, during the authoritarian government of Augusto Pinochet (1973-1990), led to the radical retrenchment of the statist model and then proceeds to present the evidence of such retrenchment. In Section 3 I deal with the contending societal explanation that argues that such retrenchment resulted from coalitional dynamics or business pressure from below; I make the case that business power should be understood as a mechanism of reproduction of a path already in motion rather than as an explanatory factor of policy adoption. Section 4 identifies the drivers of and traces the process by which, upon the return of democracy and although the center-left Concertación uninterruptedly occupied the Chilean executive branch for two decades (1990-2010), the neoliberal orientation that shapes the role of the state in markets and investment finance was maintained over time. The section attributes the continuity of this mode of state involvement in credit markets to the presence of both societal and statist mechanisms of path-reproduction. In Section 5 I show that, as a result of the process examined in the preceding sections, by the mid-2010s Chile continued to be characterized by low levels of state involvement in credit markets. Section 6 concludes.

1. Baseline for the Period Under Study: The Chilean Statist Model (1930s-1973)

In contrast with Argentina but closer to the Brazilian experience, Chile had a powerful state-owned development bank through the 1940s and up to the early 1970s. As it is the case with the BNDES in Brazil, in Chile developmentalism and large state involvement in credit markets is associated with an acronym—CORFO. The Corporation for Development (*Corporación de Fomento de la Producción* or CORFO), a state-owned development agency, was founded in 1939 to provide long-term financing to Chile's emerging industrial sector.[283] Private commercial banks, the main financial intermediaries until the foundation of CORFO, only provided short-term loans, while the stock market was "little more than a social meeting place for the few members who traded among themselves".[284] CORFO was devised as a key underpinning of the government's developmental program. At the time of its inception, this was a remarkably original endeavor by comparative standards: CORFO was the first institution in Latin America to be specifically in charge of comprehensively planning and promoting economic development.[285]

Throughout the following three decades, CORFO was the main engine for industrial growth in the state-led model that was started in the late 1930s and would be dismantled by the Pinochet dictatorship inaugurated in 1973. Despite significant changes in partisanship—which included populist, conservative, and socialist presidencies—the level of state involvement in credit markets through CORFO systematically increased over the three decades after its foundation.[286] CORFO, which had a large Weberian bureaucracy and a technocratic leadership mostly composed of engineers,[287] became a financier, investor, and entrepreneur, providing loans at subsidized interest rates, making direct investments, and issuing guarantees for credits for

[283] Hastings (1993b: 204).
[284] Hastings (1993a: 94-5).
[285] Cavarozzi (1975: 115).
[286] Hastings (1993a: 100).
[287] Cavarozzi (1975: 129-30); Schneider (2004: 159); Silva (2008, chapter 3).

state-owned and private corporations.[288] By the late 1950s, CORFO supplied at least 30 percent of the country's investment in equipment and machinery and 15 percent of gross domestic investment.[289] The centrality of CORFO in the Chilean market was even speeding up since the 1960s, especially in the production of intermediate goods and in basic industry (e.g. steel, chemicals, cement, oil and paper).[290] By 1970, CORFO, along with the state-owned Banco Estado, were responsible for almost the entire portfolio of long-term loans in Chile; the investment carried out by the state went from 61 percent of the nation's aggregate investment in 1964 to 77 percent in 1970.[291] The left-wing administration of President Salvador Allende (1970-1973) took an additional step: CORFO started to buy shares from private bank stockholders so as to gain majority ownership of these financial institutions; by the time Augusto Pinochet took power the Chilean state controlled the majority of the commercial banking system through CORFO, i.e. 95 percent of the country's investments and deposits.[292]

While the Chilean statist model was in place, CORFO was highly involved in investment finance through the partial or complete ownership of multiple large corporations. Agosin and Pastén (2003: 82) noted that "[c]ontrary to conventional wisdom, the Chilean state was very successful as an entrepreneur and set up large companies— mostly fairly well run […]." By the end of the 1960s CORFO financed the activities of state-owned enterprises (SOEs) in, among others, the following industries: oil, steel, mining, fishing, production of machinery for agriculture, fertilizers, petrochemicals, forestry, and dairies.[293] By 1970, before Allende took power, CORFO owned 46 corporations.[294] During the three decades between the foundation of CORFO and 1970, the state deepened its role in directly financing production through SOEs but never attempted to oust the private sector—CORFO operated as a partner and complement of private business, preserving the capitalist nature of the system.[295]

As Vergara (1981: 122) has remarked, the socialist government of Allende that immediately preceded the Pinochet dictatorship, drastically changed the purposes of that thirty-year-old statist model. In its attempt to radically transform the Chilean economy, between 1970 and 1973 the Allende government adopted an aggressive program of nationalizations by which the state came to own the major industrial corporations, the copper sector, the banking industry—as described above—and even a large number of small- and medium-sized enterprises (SMEs).[296] Allende's administration sought to put the vast majority of production under state control. By 1973, CORFO had come to own 479 corporations;[297] subsidies to finance SOEs comprised 55 percent of public expenditure.[298] As a result, when the military Junta took power in 1973, the Chilean developmental state organized around CORFO was composed of two layers:

[288] Etchemendy (2011: 47); Hastings (1993b: 204).
[289] Hastings (1993b: 204).
[290] Etchemendy (2011: 222).
[291] Vergara (1981: 121). Banco Estado, founded in 1953, fulfilled commercial and development bank functions, channeling long-term loans for targeted industrial sectors (Hastings 1993b: 205).
[292] Hastings (1993b: 209; 1993a: 117-8).
[293] Ortega Martínez (1989: 183-4).
[294] Vergara (1981: 127).
[295] Vergara (1981: 122).
[296] Huneeus (2000a: 486).
[297] Vergara (1981: 122, 127).
[298] Sigmund (1990: 347); the figure includes subsidies to agricultural production under state control.

one that had grown gradually over thirty years and a newer one that was the legacy of the drastic statist push of the brief Allende government.

The retrenchment of the Chilean developmental state that would become a signature legacy of the Pinochet dictatorship was not an obvious outcome in the early 1970s. It was the result of a gradual victory of a neoliberal coalition of civilian elite officials over a statist coalition of military officials that managed to resist during the first part of the Pinochet regime. In order to understand the low level of state involvement in credit markets in contemporary Chile it is essential to go back to the process by which the state structure of the inward-oriented, statist model was reconverted and its functions curtailed.

2. The Origins of Low State Involvement in Credit Markets

This section studies the formative moments of a set of policies that pushed Chile away from its statist past towards a new market-oriented model, from large to small state involvement in credit markets. The policy adoption stage unfolded during the authoritarian administrations of General Augusto Pinochet (1973-1990).

At the most general level, the Pinochet dictatorship marked a restoration of a capitalist order immediately following the left-wing administration of Salvador Allende (1970-1973), which had gone far in calling into question the very nature of the capitalist system. Because Chile's neoliberal program under Pinochet was so radical and came so early in time comparatively—anteceding, for instance, the landmark neoliberal administration of Margaret Thatcher in the United Kingdom—analysts often make the retrospective mistake of portraying the Pinochet authoritarian regime as having been neoliberal at the outset and in its essence. However, as one of the foremost scholars on this period of Chilean history has noted, when it took power, the Pinochet-led Junta lacked a government project, a deficiency that was particularly evident in the field of economic policy (Valdés 1995: 16-7). Likewise, in a major contribution for the study of this period, Marcus Kurtz argued that during its first phase the Pinochet administration had *not* ventured into neoliberal policymaking; such model would only be started in 1975 and deepened in the late 1970s and early 1980s.[299]

For the purposes of my study, it is therefore key to note at the outset that the fact that the Pinochet authoritarian regime, from the very beginning, sought to restore capitalist relations in a country that had recently gone through a short experiment with socialism does not imply that the role of the state in credit markets was predetermined in 1973. Contrary to that, as this section will show, within the regime, other than the macro-consensus that rejected the Allende experience, there was little agreement about the role for the state in markets. Multiple issues that define the level of state involvement in the supply of investment finance generated strong disagreements within the Pinochet administration and were only decided much later in the authoritarian years. This section traces the micropolitics behind the settlement of those conflicts, which finally did put Chile onto a stable path that would prove highly resilient during the post-authoritarian period (Section 4).

A disclaimer is in order here. While in this section I focus on the transformations most directly associated with the radical reduction of state involvement in the provision of long-term credit, it should be noted at the outset that these transformations fit within the broader setting of the adoption of a full-fledged market-oriented model, which had underpinnings in multiple

[299] Kurtz (1999: 404).

policy arenas that I do not cover here, such as trade and exchange rate policies as well as inflation management. To the extent possible I will zero in on the micropolitics affecting the change in the role of the state in long-term credit for corporations but, in doing so, I will make references to the politics of fiscal adjustment, which cannot be fully disentangled from the fate of CORFO as a state-owned development bank and the dismantling of the industrial policies that had underpinned CORFO's activities.

Most of the empirical evidence in this section draws on secondary literature, which I supplement with some original data collection mainly based on government documents. While this historical period is well researched in the scholarship on Chile, my case study on within-country variation over time presents important new findings on this period. These innovations have three roots. First, the framework of this study (Chapter 2) provides a new compass to navigate this widely researched period, focusing our attention on the causal beliefs of competing groups of political *técnicos* within the state and their interactions with the chief executive; to my knowledge, this is the first study that zooms so carefully into these dynamics. Second, earlier scholarship was produced at a time when qualitative methods were less developed; in contrast, my case study applies some of the recommendations of the new literature on process tracing, especially the focus on timing and sequencing in the assessment of competing causal inferences.[300] Third, in contrast to most of the existing scholarship on this period of Chilean history, this section goes beyond the general orientation of economic policymaking, delving into the more technical arena of industrial policy. In short, this section, by deploying new tools to assess secondary sources, sheds new light on the origins of policies defining a new mode of state involvement in credit markets in authoritarian Chile.

2.I. Stalemate Within the State, 1973-1975

Far from being an obvious or immediate result of the authoritarian coup of 1973, the dismantling of the Chilean developmental state came about through intense political struggling within the state itself, which occurred during the years after the breakdown of Salvador Allende's statist regime. As the framework in Chapter 2 underscores, one of the most effective ways of characterizing winning policy entrepreneurs and their impact on policy adoption is by identifying who were the losers in within-state politics—and tracking down the process by which one group became dominant, and the other subordinated. This section thus traces how the neoliberal Chicago Boys gradually came to dominate decision making in areas that define the mode of state involvement in the credit market, sidelining rival factions of elite officials within the executive branch.

2.I.i. The Chicago Boys

Identifying one of the coalitions of policy entrepreneurs, the Chicago Boys, is simple because, as Dalgic (2012: 96-7) pointed out, these neoliberal technocrats "were a team par excellence; a group of economists with a common educational background, ideology, [and] esprit de corps, […]." As Huneeus (2000a: 395) portrayed them,

> *[The Chicago Boys that were recruited into government] were not attorneys [*mandatarios*] of the interests of big business—national or international—acting under their instructions. They were right-wing people, thus sharing the political goals of the*

[300] On sequences in process-tracing analysis see, Bennett (2010: 207-8); Collier (2011: 823-4, 828); Seawright and Collier (2010: 343).

[authoritarian] regime and accepting the opportunity that authoritarianism opened to push for a radical change in the economy [...].

Rolf Luders, a prominent Chicagoan technocrat, described how this technical "shadow team" formed and its defining traits:

> *[T]he work group's existence and success was probably made possible by their common educational background. In the mid-fifties, Chicago University and the Universidad Católica de Chile initiated a program for educational exchange. Under this agreement, Chicago University sent professors to Chile to do research and accepted Chilean graduate students. Through this program, and in combination with supplementary scholarships, approximately one hundred students had completed graduate studies at Chicago University by the early seventies… Up to 1973, on their return to Chile, many of these economists became professors at local universities. Others worked for the government [...]. The rest joined the main firms in Chile. But they all formed a single community—incremented annually by new generations of economists graduating from Chilean universities—sharing the same technical language, [and] a rationalistic approach to problem solving [...]. Most of these economists are currently known—whether they like it or not—as Chicago Boy.*[301]

The Chicago Boys had been a miniscule group with virtually negligent influence over and ties with the political and economic elites during the decade preceding the military coup; this character of outsiders gave them independence to push for a type of economic adjustment that would go against the interests of a good part of the traditional business elite (Délano and Traslaviña 1989: 39; Huneeus 2000a: 397). Soon after Pinochet became the de facto president, they started building power within the state from the margins and would only secure a dominant position within the executive branch—allied with the civilian conservative right—in the 1978-1983 period and then again between 1985 and 1988 (Huneeus 2000a: 302). During the first years of the dictatorship the Chicagoan neoliberal technocrats occupied secondary positions in several ministries. They started building their power from their positions in the State Planning Agency (*Oficina de Planificación Nacional* or ODEPLAN), which became their operational base within the government, a locus of recruitment of like-minded professionals, and the springboard for launching careers at the top echelons of the state apparatus (Silva 2008: 149; Huneeus 2000a: 305).

The three most important neoliberal technocrats were Sergio De Castro, Miguel Kast, and Hernán Büchi (Huneeus 2000a: 401). At different stages during the Pinochet administration, these three political brokers played a crucial role as builders and leaders of the neoliberal coalition of elite officials. During the 1973-1975 period of stalemate within the state, Sergio De Castro, a former dean of the School of Economics at the Universidad Católica, was an advisor in economic affairs—a position well below the ministerial level. From this position, he would rise to Economy Minister (1975-1976) and, once the locus of power was concentrated in the Ministry of Finance, he served as Finance Minister (1976-1982). De Castro fulfilled a pivotal role in providing inspiration and leadership to the Chicagoan group of technocrats; he became their undisputed leader for a long time (Silva 2008: 2, 55; Valdés 1995: 19). After finishing college at the Catholic University in Santiago (PUC), De Castro was one of the first awardees of a recently established scholarship to pursue graduate studies in economics at the University of Chicago,

[301] Cited by Valdés (1995: 18).

where he obtained an MA.[302] Back in Chile, De Castro served as a professor of economics at the Catholic University in Santiago, where he became a leader of several generations of students. He was one of the ten authors of a neoliberal economic program known as *El Ladrillo* (The Brick).[303]

Miguel Kast was the most prominent leader of the much younger, second generation of Chicago Boys; he was an outstanding political broker (Huneeus 2000a: 401, 404). Upon finishing his undergraduate studies at the Catholic University in Santiago, he went to the University of Chicago to obtain an MA in economics. In 1973 he joined the State Planning Agency. At ODEPLAN, Kast played a pivotal role in two tasks.[304] First, coordinating the design of multiple market-oriented reforms.[305] Second, recruiting and training new technocrats so that they could then be appointed at key posts in the executive branch. Within government circles, Kast was known as "*el gran reclutador*" or "the great recruiter";[306] he dealt with the CVs of hundreds of economists and engineers that could become technocratic advisors to ministers or even reach ministerial positions.

Miguel Kast recruited Hernán Büchi when the latter returned to Chile in 1975, after concluding his MBA at Columbia University.[307] Not belonging to the original Chicagoan group, Büchi had an ascendant career within the state combining a technical profile with a pragmatic political instinct and skills as political broker that Sergio De Castro lacked.[308] Büchi started as a secondary advisor in economic policymaking, rose up to the rank of minister at the State Planning Agency by 1983, and eventually reached the pinnacle of technocratic power within the state by 1985. During 1984, when he served as the chief regulator of the banking system (*Superintendente de Bancos e Instituciones Financieras*), Büchi further developed his reputation as an efficacious and skillful technocrat by drafting new regulations that would be instrumental in revamping the banking system that had collapsed during the 1982 crisis. These credentials were key in his appointment as Finance Minister in 1985, a position from which he built a popularity that transcended technocratic circles, allowing Büchi to run for president in the 1989 elections that marked the transition to democracy.

Juan Gabriel Valdés, the author of probably the most sophisticated and influential work on the Chicago Boys, remarked that these neoliberal technocrats were oriented at bringing about a revolution in Chile:[309] "their discourse went far beyond normal measures or the strictly economic [; r]ather, they posited an inclusive ideology that sought to modify the way that Chilean society was organized and functioned."[310] The Chicagoans introduced in Chile the

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[302] Fontaine (1988: 25). Much later, back in Chile, De Castro would write his dissertation and obtain the Ph.D. in economics from the University of Chicago (Huneeus 2000a: 430).
[303] Fontaine (1988: 18).
[304] Silva (2008: 150).
[305] For example, Kast was key in pushing for the privatization of the pension system, which is analyzed in Chapter 6.
[306] Huneeus (2000a: 404).
[307] Huneeus (2000a: 402, 404). As Silva (2008: 154), among others, has argued, the label "Chicago Boy" applies more broadly to the members of this network of technocrats that pursued graduate studies in the United States, endorsed the Chicago approach, and were active members of the economic team during the Pinochet years. Büchi is one prominent case of non-Chicago-trained Chicago Boys, but multiple examples abound.
[308] Fontaine (1988: 184); Huneeus (2000a: 403).
[309] Valdés (1995: 6-11).
[310] Valdés (1995: 7).

concept of the minimal state, diagnosing that the state was, by definition, inefficient, favored monopolistic groups and hindered market freedoms.

The Chicagoans were true believers in economic science and pushed for an orthodox economic program that they portrayed as technically sound. "More Catholic than the Pope," one scholar remarked, they imported "virtually without reservation the strict monetarist and laissez-faire doctrines inspired by Milton Friedman."[311] The organizing principle of their ideas was Chicago School monetarism:

> *When this theory is applied to economic stabilization, it means that optimal policies are those that tackle the problem of inflation at its origins. If a law of economics states that [, as Milton Friedman put it,] "inflation is always and everywhere a monetary phenomenon," it follows that the scientific way of dealing with the problem of inflation is by controlling money and the variables affecting its rate of expansion [...]. Monetarism provided the answer to that: money supply should not expand as rapidly as it did, and, for this to happen, the fiscal deficit must be reduced [...] Inflation was [...] attributed to the existence of too large a public sector [...]. Hence, for inflation to be controlled, public employment must be reduced, public enterprises ought to be turned over to the private sector, and government should decrease its regulatory and developmental roles.*[312]

In line with this neoliberal program, Pablo Baraona, a Chicago Boy that served as Central Bank president and Economy Minister, declared some years after leaving office that the reduction of the size of the state had been "the most important action the military government undertook in the area of economic policymaking."[313] During the stalemate period of 1973-1975 this radical retrenchment of the Chilean state, as well as its industrial policy and developmental instruments, was resisted by groups of elite state officials who proposed a more gradual approach to economic adjustment and, in some cases, the defense of elements of statism.

2.I.ii. Gradualists and Statists

Though the groups of elite officials that competed with the Chicagoans were less cohesive, for the purposes of this study it suffices to identify them as statist military officials and civilian "*gradualistas*" or gradualists—as Chilean scholars have labeled them in order to indicate their opposition to the radical adjustment proposed by Chicagoan technocrats—who were associated with the National Party and the Christian Democrats.[314]

Between 1973 and 1975, the gradualists controlled the Ministry of Economic Coordination (*Ministerio de Coordinación Económica*) and the Economy Ministry, and had strong bases of support amongst the statist military officers who dominated the Committee of Advisors to the Junta (*Comité Asesor de la Junta de Gobierno* or COAJ), CORFO, and the CORFO-controlled SOEs.[315] While this coalition of elite officials did favor a shift towards a more market-oriented economy, they were against the radical libertarianism of the Chicago Boys and wanted to preserve a larger role for the state in the economy.

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[311] Kaufman (1979: 180).
[312] Foxley (1983: 92-5).
[313] Délano and Traslaviña (1989: 162).
[314] Silva (2008: 149).
[315] Huneeus (2000a: 399); Sigmund (1990: 349).

The two most prominent leaders of the gradualist coalition were Minister of Economic Coordination Raúl Sáez and Economy Minister Fernando Léniz. Their profiles contrast markedly with those of the leaders of the Chicagoan coalition of elite state officials. Sáez was an engineer—trained at the public University of Chile—who had spent most of his career working for the state-led industrialization project.[316] Early in his career he designed a plan for the state to develop the electric sector; this led him to work for the state-owned electricity company Endesa, where he remained for twenty years and became its CEO. Sáez had been the chief of CORFO's National Planning Department and later served as CORFO's CEO. The appointment of Léniz as Economy Minister is attributed to Sáez, who recommended him when the Junta leaders, unclear about whom to choose, asked for his advice.[317] Léniz, for his part, an engineer trained at the Universidad de Chile too, had a long trajectory in the non-financial private sector; he worked for the state-owned electricity corporation and later worked for almost fifteen years at the pulp and paper company CMPC, where he became the production manager.[318] Neither Léniz nor Sáez had pursued graduate studies abroad.

Though less coherent than that of the Chicagoan coalition, the gradualists had a program and they brought it to a Junta. Moulián and Vergara (1981: 863-5) offer a good synthesis of the ideational support of the gradualist plan. The gradualist team shared with the Chicagoan coalition the goal of bringing about economic adjustment, but these elite officials pushed for a gradual reduction of the fiscal deficit because they thought that a radical deficit reduction would have "catastrophic consequences" on production and employment levels.[319] Gradualists saw the neoliberal Chicago Boys as too dogmatically orthodox and made public declarations in favor of developing an "authentically Chilean" model through "pragmatic and realistic" economic policies.[320] In a 1974 document entitled *Development Program for the Short- and Middle-Term*, gradualist leader Raúl Sáez advocated for substantial increases in public sector investment and infrastructure, as well as for direct production.[321]

While they shared with the Chicagoan approach the need to shift towards an open economy, removing the protections that had characterized the pre-1973 developmental model, the gradualists sought to preserve the industrial sector as the core of Chile's capitalism, rather than dismantling it altogether in favor of lower value added sectors where Chile had natural advantages—as implied in the draconian program of the Chicago Boys. In contrast with the outright deindustrialization implied in the Chicagoan ideas, the gradualists pushed in favor of triggering industrial upgrading—even acknowledging that this entailed fostering concentration in a small number of sectors capable of competing in international markets.[322] This resonated with the approach of military leaders, who had for a long time associated industrial development with the capacity to improve the national defense apparatus.

The gradualists were civilians, whereas the statists were high-rank military officials. In this period of stalemate, two institutions dominated by statist officials were key in counterbalancing the increasing influence of the Chicagoan coalition: CORFO and COAJ. The latter was a committee formed by elite officials from each of the three armed forces and the

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[316] Délano and Traslaviña (1989: 44).
[317] Fontaine (1988: 60).
[318] "Fallece Fernando Léniz, líder empresarial, político y gremial," *El Mercurio*, September 26, 2013.
[319] Vergara (1985: 30); Moulián and Vergara (1981: 854).
[320] Moulián and Vergara (1981: 860).
[321] Kurtz (1999: 407).
[322] Moulián and Vergara (1981: 863-5).

national Carabinero police with the mandate of studying and advising the Junta on the policy proposals in the economic arena.[323]

Their military background gave the statist elite officials an esprit de corps and an ideational coherence. These *oficiales* had been trained by military officials educated in the 1920s and 1930s. At the time, the dominant perspective amongst the military leadership was that the state had to be the guiding force of national development; CORFO was praised for having triggered the development of strategic sectors such as energy and manufacturing and for having provided financial support for domestic firms.[324]

These statist officials agreed with the gradualists that the time of the inward-oriented model of the ISI years had passed, and that economic reforms were much needed; however, as Huneeus (2000a: 412) argued, in neat contrast with the Chicago Boys, the statists did not distrust the state because they were part of it. Hence they believed that the state could play a role in the economy, including the efficient administration of the CORFO-dependent SOEs in the sectors of energy, communications, and petrochemicals.

General Sergio Nuño, who was in charge of CORFO in 1973 and 1974, in 1973 declared to the magazine *Qué Pasa* that he believed that the state, through CORFO, had to endeavor into a wide range of tasks in the economy, including "[carrying out] direct investments and the management of corporations." General Javier Palacios, CORFO's CEO between 1974 and 1975, once self-identified publicly by saying, "I have been a socialist all my life; I believe that people need to be under certain level of state control."[325]

2.I.iii. Evidence on the Stalemate Within the State

The 1973-1975 period was marked by the incapacity of any single group of elite officials to impose its policy program. Competing coalitions of policy entrepreneurs checked each other, leading to policy choices that lacked a neat perspective about the appropriate role for the state in the market. As Kurtz (1999: 407) has argued, the policy disagreements were greatest with regard to choices about the rate and depth of state retrenchment.

While gradualists occupied the top echelons in the ministries that, up to 1975, determined economic policymaking—the Ministry of Economic Coordination and the Economy Ministry—the Chicagoan coalition of technocrats occupied secondary advisory roles. During the stalemate period, the neoliberal officials had valuable weapons: they were very cohesive as a team and had a well-developed reform package, which was persuasive insofar it tackled in detail a broad range of policy domains. Moreover, the Chicago Boys profited from the weak performance of the economic adjustment adopted by the gradualists. However, the ministers who supported gradualism checked the ambitions of the radical Chicagoan technocrats (Silva 1996: 85). The leaders of the gradualist approach to economic adjustment, Minister of Economic Coordination Raúl Sáez and Economy Minister Fernando Léniz, were highly praised by the military elite in charge of the executive branch; each of them had credentials that were valued by the *militares*[326]—which the Chicago Boys lacked. Sáez had a very long career in several agencies of

[323] Fontaine (1988: 72). Among the COAJ advisors, the two most influential over the Junta on issues of economic policymaking were Luis Danús and Gastón Frez (Huneeus 2000a: 433). They had a very similar background: both Danús and Frez had pursued a military career in conjunction with university-level training in accounting at the Universidad de Chile (Fontaine 1988: 74-5).
[324] Valdivia Ortiz de Zárate (2003: 129).
[325] Both cites come from Valdivia Ortiz de Zárate (2003: 125-6)
[326] Délano and Traslaviña (1989: 29).

the Chilean developmental state and Léniz had strong ties with traditional business associations. Several sources coincide in pointing that, during this period, gradualist Sáez, himself having been part of the Chilean state apparatus for over three decades, had very strong leverage over the Junta and was granted a say on any major decision in economic policymaking.[327]

The gradualists' capacity to counterweigh the Chicagoans was facilitated by the presence of statist military officials in the Committee of Advisors to the Junta, CORFO, and the Junta itself. The Committee (or COAJ, for its Spanish acronym) due to its own nature—stipulated in Decree Law 460 of 1974—was dedicated to the revision and study of all major policy changes proposed to the Junta. In practice, on multiple instances COAJ operated as a check against Chicagoan technocrats' proposals of radical state retrenchment, formulating its reservations and objections or even straightforward rejections.[328]

The stalemate between neoliberals and statists was particularly intense with regard to decisions that shape the role of the state in markets and state involvement in investment finance. Some major economic policies were in fact adopted during this period of gridlock—e.g. trade and exchange rate liberalization—which suggests that the coalition of statist officials was unable to prevent them or unwilling to invest its political capital fighting against them. But the statists did have an intense preference—and were able to exert influence to defend it—in favor of preserving a large role for the state in the Chilean economy. In particular, during this period of stalemate, the statist officials successfully blocked the Chicagoan radical privatization program by associating the maintenance of a large number of SOEs under CORFO control with national security, a high-order political goal for the Junta in charge of the executive power. The statist military officials argued that CORFO should not privatize those SOEs that had strong implications for national security, be it for its monopolistic character, for what they produced, or for its large incidence over the domestic economy.[329] A piece of evidence indicating that the statists managed to persuade the Junta about the disadvantages of embracing the radical privatization pushed by the Chicagoans—which the Junta did eventually embrace after the unraveling of the stalemate within the executive branch—can be found in a declaration made at the time by President Pinochet himself: "not a single mine, industry or corporation pertaining to the 'strategic area' [of SOEs that support national defense] will be devolved [to the private sector]."[330]

Six months after the 1973 coup, the government published a Declaration of Principles of the Junta.[331] The document is in itself a testament of the stalemate among the competing groups of elite officials exerting expertise-based influence over the chiefs of the executive branch. The Declaration contained multiple paragraphs that reflected the influence of the Chicagoan technocracy, such as the following:

> *Private actors' freedom to venture into productive activities [...] is the only road towards a true development of the economy. State centralization of all economic activity will inevitably lead to a statist society, which not only will end up denying individual freedom but also will hamper private actors' creative capacity in business;*

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[327] See, for instance, Fontaine (1988: 66) and Fermandois (2007: 300).
[328] Fontaine (1988: 73).
[329] Valdivia Ortiz de Zárate (2003: 131).
[330] Valdivia Ortiz de Zárate (2003: 131).
[331] *Declaración de Principios de la Junta de Gobierno*, March 11, 1974.

> *replacing [businessmen] for bureaucrats harms the development of new sources of production and employment.*[332]

Yet the Declaration of Principles of the Junta, reflecting the influence of civilian and military elite officials who pushed to preserve an important role for the state in the market, included ideas that the neoliberal technocrats would have straightforwardly rejected:

> *The acceptance of entrepreneurial freedom described above must not be interpreted as a rejection of the active and major role that the state must have in the economy. The role of the state should not be restricted to […] ensuring competition and the necessary control of private actors' so as to avoid all forms of abuse and monopoly. A modern economy demands, on top of that, that the state fulfills the role of planning economic activity.*[333]

In 1974, a year after the coup, the newly appointed Finance Minister Jorge Cauas, a Columbia-trained member of the Chicagoan technocratic coalition,[334] declared that the government's goal was to create "a modern, *mixed* economy,"[335] which suggests that the Chicago Boys were still making some compromises, at least rhetorically, with those members of the executive branch who did not support or directly opposed the radical Chicago plan.

The stalemate among competing groups of technical elite officials and its impact over the management of economic policy between 1973 and 1975 was undoubtedly compounded by the fact that the statists had a presence in the Junta itself. In particular, General Gustavo Leigh, the Air Force representative in the Junta, was highly concerned for the social impact of the adjustment program put forward by the Chicago Boys.[336] The State Planning Agency Director Roberto Kelly said, "Leigh was totally statist, like all aviators [air force officers] and many uniformed people."[337] In an interview, Leigh himself referred to this tension: "I argued with the Chicago Boys […] because I did not accept this purely economic system of action that disregards social problems."[338] Chicago Boy Pablo Baraona later complained about this stalemate period saying that, "During the first two years [of military rule], until April 1975, little was done."[339]

Other sources suggest that Junta President Pinochet himself, who would later on be persuaded by the Chicagoans of the need to adopt a radical neoliberal program (see Section 2.II

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[332] The original text in Spanish read, "*La posibilidad de que los particulares puedan emprender actividades productivas [… es] el único camino que permite un verdadero desarrollo de la economía. La centralización excluyente de toda actividad económica por el Estado, no sólo conduce a una sociedad estatista que termina por negar prácticamente la libertad personal, sino que además prescinde de la capacidad creadora de los particulares en el terreno empresarial, cuyo reemplazo por el burócrata perjudica el surgimiento de nuevas fuentes de producción y de trabajo."*

[333] "*La aceptación de la libre iniciativa descrita no podría entenderse, eso sí, como un desconocimiento de la activa y principalísima labor que compete al Estado en el campo económico. No sólo es misión suya […] asegur[ar] efectivamente la competencia y el necesario control de los particulares, para evitar toda forma de abuso o monopolio. Una economía moderna exige, además, que el Estado cumpla un papel planificador de la actividad económica general*."

[334] Silva (2008: 154).

[335] Valdés (1995: 20); the italics are mine.

[336] Moulián (1997: 236), cited by Castiglioni (2002: 37).

[337] Castiglioni (2002: 37).

[338] Castiglioni (2002: 37).

[339] Castiglioni (2002: 37).

below), was initially torn between statists and market liberals. Admiral José Toribio Merino, a key member of the Government Junta, recalled that when the Junta leaders initially discussed the situation of the SOEs nationalized by the left-wing administration of Salvador Allende they agreed on the need to devolve them to the private sector, just as the Chicagoan technocrats proposed,

> *... but both Pinochet and Leigh soon expressed their wishes of continuing to have an economy controlled by the state; that's why at the beginning [of the military government] it was very hard for the [neoliberal program nicknamed]* El Ladrillo *to gain adherents [in the Junta]. They used to ask: "What is* El Ladrillo*?"*[340]

During this period, the conflicting agendas of competing coalitions of elite officials generated a lack of resolution over the role of the state in the economy, investment, and the provision of credit for production. As Vergara (1985: 33) remarks, during this first phase of the military regime, there was "no rigorous definition" about the respective domains of action for the state and for the market in the economy, there was "no single strategy" within the government's team of policymakers.

The measures took while the stalemate within the state lasted, "did not aim, not even implicitly, at producing radical changes in the economic system that Chile had had up to the 1970s, but only attempted to 'normalize' its operation and introduce gradual reforms in parts of the system."[341] This initial heterogeneity among elite officials, Vergara adds,

> *[...] was reflected in a strong dose of pragmatism and in the active utilization of the state apparatus in the implementation of a series of sectoral policies [...] that departed from the alleged "neutrality" of the market. In this sense, [some of those in charge of economic policymaking ("*conducción económica*")] insisted on the need to design developmental and support policies for small- and medium-sized enterprises implemented by state agencies [...]. In practice, [the proponents of that approach within the state contended that] the state had to create the conditions [...] for those [business] sectors to be able to compete in the market [...]. This 'realistic and pragmatic' approach included the direct support to industrial sectors deemed as important for national development so that they could expand and readjust their productive capacity. That way, [as stated in an official document from the Ministry of Finance in October 1973,] the industrial sector would play 'a new role in the Chilean economy' and would become 'the base of our export-diversification policy.'"*[342]

The comparison of these official documents with those of the post-1975 period offers another indication of the presence, between 1973 and 1975, of different visions about the role of the state in the market, which blocked one another. The mentions in the 1974 Declaration of Principles of the Junta (cited above) regarding the need to adopt policies to develop industrial

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[340] Valdivia Ortiz de Zárate (2003: 130). The original quote in Spanish is: "*La intención inicial fue devolver todas las empresas que tenían dueño, pero enseguida tanto Pinochet como Leigh manifestaron su deseo de mantener una economía controlada por el Estado. Por eso al principio fue muy difícil que entrara el plan 'Ladrillo'. ¿Y qué es el 'Ladrillo'?, preguntaban*."

[341] Tironi (1982), cited by Valdés (1995: 20).

[342] Vergara (1985: 34, 36).

sectors were removed in the December 1975 official document titled National Objective of the Government of Chile.[343]

2.II. The Chicago Boy Coalition Wins: The Radical Retrenchment of the Chilean Statist Model

In line with the propositions laid out in the framework chapter, skillful entrepreneurial action within the state, capable of taking advantage of contingent factors and bad performance of earlier policy choices, played a major role in changing the balance of power among competing groups of elite officials. Starting in 1975 and until the very end of the military dictatorship in 1990, the coalition of Chicagoan neoliberal technocrats successfully dominated the discussions within the government about the appropriate role for the state in markets.[344] Over time variation in within-state micropolitics seems to fare better as an explanation of policy change in this arena than arguments based on business power, which I will address in Section 3. Next I trace the process by which the neoliberal technocrats secured their domination within the executive branch, a precondition for the radical retrenchment of the Chilean statist model.

The economic policies resulting from the stalemate among competing groups of elite officials within the state came under widespread criticism by 1975. Policy performance was poor and this was the key background condition for the rise of the Chicagoan technocrats to a dominant position within the state and the shift to a full-blown neoliberal program of state retrenchment. At the end of 1974, the annual inflation rate was 369 percent, the fiscal deficit was dramatic—amounting to 8 percent of GDP—and the balance of payments was negative.[345] Since Chile is heavily dependent on copper exports, an exogenous shock complicated future prospects even further: the price of copper dropped almost 40 percent between the last quarter of 1973 and the end of 1974, and it continued on its downwards trend in 1975.[346]

The adoption of the 1975 "shock treatment," geared at curbing inflation through drastic fiscal adjustment, marked the defeat of gradualists and statists and the beginning of a long period during which the Chicagoan coalition was able to impose its policy program.[347] The neoliberal technocrats "employed the power of the state to cut it to a minimum" (Valdés 1995: 9). The major shift of state involvement in credit markets fits within this broader neoliberal revolution. As synthesized by Ernesto Tironi, the neoliberal program had three main objectives: "to reduce the magnitude of the public sector; to minimize the government's regulatory influence on the economy; and to eliminate the role played by the government in direct production and as a body, charged with promoting development."[348]

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[343] *Objetivo Nacional del Gobierno de Chile*, December 1975 (Vergara 1985: 34).

[344] The Chicagoan technocrats lost gravitation for a relatively short period following a major economic crisis. They were sidelined between 1983 and February 1985, when they regained control of the Ministry of Finance. For an analysis of this exceptional and brief part of the process, which is beyond the scope of my study, see Huneeus (2000a: 506-10) and Kurtz (1999: 419-21). Importantly, as Kurtz (1999: 421) insightfully remarked, the dismantling of the Chilean state apparatus between 1975 and 1982 prevented a departure of neoliberal policymaking during the 1983-1985 period.

[345] Data from Foxley (1983: 43).

[346] My calculations based on data from Foxley (1983: 50).

[347] In the preparation of the shock treatment, the Chicago Boys avoided to brief Minister of Economic Coordination Raúl Sáez, until then strong man in the economic cabinet; when the Junta endorsed the plan, Sáez resigned (Délano and Traslaviña 1989: 30).

[348] Cited by Valdés (1995: 23).

Bad policy performance was a facilitating condition for the radical retrenchment of the Chilean developmental state started in 1975. However, in line with the expectations laid out in my framework (Chapter 2), the micropolitics within the state seems to have played an important role in this process—economic conditions did *not* predetermine the direction and content of the policies adopted thereafter. As noted earlier in this chapter, although the Chicagoans had been in the executive branch since 1973, they had only occupied secondary positions. This allowed them to avoid blame for the bad performance of the economic policies and to make a stronger case in favor of their radical neoliberal agenda. While it is hard to weigh with precision the impact of all factors involved in within-state politics, it is reasonable to argue that the persuasiveness of the Chicagoan approach had increased by 1975 and that this had an impact over Pinochet's strategy for making key appointments in his cabinet.

A careful analysis of the micropolitics within the executive branch sheds light to understand why and how the Chicagoan technocrats rose to the top in 1975. Due to the lack of all the needed evidence, I do not aim to provide a concluding statement about the relative importance of each of the factors that follow. I do claim that all of them have mattered to some extent in shifting the balance of power within the state and in paving the way for the adoption of the radical program pushed by the Chicagoan technocrats.

First, the economic situation of 1974 and the beginning of 1975 put significant pressure on the Junta leaders to "do something"—and do so quickly. As Moulián and Vergara (1981: 876) have argued, this situation was characterized by the acceleration of inflation along with an unsustainable deficit of the balance of payments in the context of the post-1973-oil-crisis international recession, all of which damaged the legitimacy of the authoritarian regime and the type of gradual adjustment chosen until then. Under those circumstances, the only *comprehensive* policy package available was that of the Chicagoans.[349] The neoliberal technocrats' program promised to tackle at once all short-run concerns pressuring the Junta: by radically reducing government spending, the policy package would generate an economic downturn, which would in turn shrink imports and inflation. Building on Moulián and Vergara (1981: 878), it could be argued that the Chicago Boy technocratic group was particularly skillful in marketing to Pinochet, the Junta leader, a policy package that, while it addressed the Junta's *short-run* concerns, would at the same time set Chile onto the path they desired for the *long-term*—a full-fledged neoliberal *model* that redefined state-society relations privileging market mediation.[350]

In a particularly pressing juncture, no other actor within the state but the Chicagoan technocrats—let alone actors from the world of interest groups, as a contending hypothesis would hold—was able to articulate a program that simultaneously provided solutions for the short-term urgencies and also contained a developmental model. Chwieroth (2010: 43) has argued that the coherence of the Chicagoan economic policymaking team greatly enhanced its ability to persuade the military leaders of the benefits of adopting their program and discarding alternatives pushed by other groups of policymakers. When one of the military leaders was asked why the government had heeded the advice of the Chicagoan technocrats instead of the proposals

[349] Moulián and Vergara (1981: 877). Fermandois (2007: 300) makes a similar point, stressing that the gradualists led by Minister of Economic Coordination Raúl Saéz failed to react timely to the deepening of the economic crisis and to present a coherent policy package.

[350] I am borrowing Kurtz's (1999: 414) definition of the concept of "neoliberal model."

put forward by competing groups, the officer replied, "because [the Chicagoans] agreed with each other and gave us simple answers to our questions."[351]

This takes us to a second point about how the Chicagoans managed to steer the balance of power within the state and move forward with their program: they succeeded in convincing President Pinochet that their agenda of radically orthodox monetarism was both the only viable option at the time and also an efficacious way to build Pinochet's own political legacy.[352] Since Pinochet was one of the typical "authoritarians without an [economic] project"[353] who had early on expressed a desire to preserve a large role for the state in the economy,[354] his embracement of neoliberalism was not an obvious, predetermined outcome.[355] A historiographical account sheds some light on these developments:

> *The opposition [against the neoliberal program proposed by the Chicagoan technocrats] coming from business sectors and, above all, from multiple sectors of the armed forces, including the army […], brings to light the fact that [the Chicagoans succeeded in imposing their program] thanks to other factors in addition to their academic credentials […]. The virtually unlimited support that Pinochet [gave to the Chicago Boys] was key. Why did he make this decision? Pinochet himself understood very little [of the neoliberal proposal], but that was not as relevant […]. He wanted to consolidate his own power within the Junta and inside the state, as well as to associate his name to a great [national] renovation project. [… The economic crisis] demanded extraordinary measures […;] [the Chicago Boys] had a perfect fit with Pinochet's military mindset and ambitious project. They were not just one or two people; they represented a team and a plan with a high degree of internal coherence, which is often valued in the world of military officers. […] Besides, Pinochet interpreted that [the Chicagoan technocrats] had great professional ambition and love for their own ideas, but they practically had no political ambition […].*[356]

Other sources point in the same direction. In an interview, the Chicago Ph.D. Sergio de la Cuadra, who would rise to become Central Bank President (1981-1982) and Finance Minister (1982), explained that in order to understand the adoption of the program pushed by the Chicagoan technocrats, "it is necessary to analyze the junta, and our luck was that Pinochet controlled it, because he was an audacious, unhesitating guy, […] had Pinochet been replaced by another general, we would have been in trouble."[357] An important event in the process of persuading Pinochet to shift to radical neoliberalism—appointing the Chicago Boys to the top positions in the executive branch and sidelining the technocrats in favor of gradualism and statism—was Chicagoan leader Sergio De Castro's success in inviting University of Chicago Professor Milton Friedman to Chile to express public support for his model in March 1975.[358] Rossana Castiglioni provides the following narrative:

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[351] Chwieroth (2010: 43).

[352] The statists at the Committee of Advisors to the Junta, as well as the Air General and Junta member Gustavo Leigh, were against the adoption of the shock treatment (Valdivia Ortiz de Zárate 2003: 135).

[353] The label comes from Valdés (1995: 16).

[354] Valdivia Ortiz de Zárate (2003: 130).

[355] For an analysis of how Pinochet managed to secure his leadership within the military Junta, which is beyond the scope of my study, see Huneeus (2000a: Chapters III-VI).

[356] Fermandois (2007: 299-301).

[357] Cited by Castiglioni (2002: 51).

[358] Silva (2008: 70).

*The Chicago Boys needed Pinochet's support to implement their radical market-oriented policies without delay. In an effort to persuade Pinochet, they managed to bring Milton Friedman to Chile. Friedman presented a grim view of the future, asserting that Chilean inflation was the result of high fiscal deficit levels and that the only solution to the country's economic difficulties was to impose restrictive measures immediately; otherwise "the patient might die" (*Que Pasa *1998: 34-36). Pinochet met with Friedman, who insisted that the only way out was to implement the shock treatment suggested by the Chicago Boys. [According to Friedman, "Pinochet and the military in Chile were led to adopt free-market principles after they took over only because they did not have any other choice. They tried for a while to have military officers run the economy. However, inflation doubled in the first eight or nine months of their regime. ... By accident, the only group of economists in Chile who were not tainted by a connection with the Allende socialists were the so-called Chicago boys. ... They were untainted because the University of Chicago was almost the only institution in the United States at the time in which the economics department had a strong group of free-market economists. So in desperation Pinochet turned to them" (Friedman 1991: 5).] With Chile's poor economic performance and doubts about the gradualist policies of Sáez and Léniz, the Chicago Boys, with Friedman's help, thus were able to get Pinochet's seal of approval.*[359]

A third factor associated with the changing balance of power within the state is that the gradualist officials that had checked the Chicago Boys between 1973 and 1975 inflicted themselves a series of political defeats. In line with the propositions of my framework, the decline of the gradualist coalition of elite officials and their eventual dismissal from the executive branch can partially be attributed to the fact that the key *gradualista* figures, in pushing for their technical goals in economic policymaking, surpassed the technical domain, going against high-order goals of chief executive Pinochet. Carlos Huneeus had access to the secret transcripts of the meetings of the Junta; those transcripts show that at the end of 1974 Economy Minister Léniz warned the Junta members of the negative effects that human rights violations perpetrated by the Pinochet regime were having on Chile's reputation abroad and on his attempts to access foreign credit markets (Huneeus 2000a: 399-400). Gradualist leader Léniz went on to suggest that the government could release some political prisoners as a signaling strategy to obtain foreign investments.[360] In 1975 Minister of Economic Coordination Sáez, in a meeting with the Junta members, said that "[we haven't yet become aware of] how negatively the Chilean situation is assessed abroad, [… and such negative perception] affects the diligences we, as representatives of Chile, are carrying out."[361]

By the second quarter of 1975, the Chicagoan technocrats had secured Pinochet's support, while opposition within the executive branch had been reduced. Hence, the Chicagoan political *técnicos* moved quickly to apply their shock treatment. While 1975 ended with a major economic downturn—GDP fell 12.9 percent—in 1976 the Chicago Boys could claim the credit that their policies were performing quite well: GPD grew 3.5 percent, inflation was still very high but significantly lower than it was before their reach dominance within the state—the annual inflation rate was 369 percent in 1974 and 198 percent in 1976—fiscal deficit was

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[359] Castiglioni (2002: 50-1)
[360] Huneeus (2000a: 400).
[361] Huneeus (2000a: 400).

drastically cut—2 percent of GDP in 1976, down from 8 percent in 1974—and the balance of payments crisis had been fixed.[362] Good policy performance was an important factor behind the Chicago Boys' capacity to strengthen their hold onto power within the executive branch and move towards expanding their influence to other areas of policymaking, including pension reform (see Chapter 6).

As Moulián and Vergara (1981: 885) remarked, the dominance of the most orthodox neoliberals deepened with the appointment of Sergio De Castro as Finance Minister, replacing Jorge Cauas—a Columbia-trained economist with strong ties with the Christian Democratic Party who had only recently become an "adoptive" member of the Chicagoan group.[363] The difference between Cauas and De Castro was that "the latter expresses, without reservations, an ultraliberal vision of […] state-society and state-economy relations."[364] The appointment of the long-dated and undisputed leader of the Chicagoan group of technocrats as head of a now highly empowered Ministry of Finance had strong implications for the acceleration of the dismantling of the Chilean developmental state apparatus and for the adoption of a pension reform that would deepen the domestic capital market—changes that are examined, respectively, in the following subsections and in Chapter 6.

2.III. Reshaping the Structure of the Chilean State

In the framework for empirical analysis (Chapter 2) I argued that winning coalitions of policy entrepreneurs seek to obtain durable victories that can resist the challenge of competing groups of elite officials in the future. One of the most effective ways top-level officials have to ensure that their policy preferences will continue to prevail in the future is by inscribing those victories into the institutional topography of the state itself. In other words, I have argued that, once the balance of power within the executive branch turns in their favor, elite officials are likely to push for the redefinition of the institutional-organizational structure of the state. As Peter Hall claimed, policy paradigm shifts come to an end "when the supporters of a new paradigm secure positions of authority over policymaking and are able to *rearrange the organization and standard operating procedures of the policy process* so as to institutionalize the new paradigm."[365] This movement of one policy paradigm to another often involves a "shift in the locus of authority over policy."[366]

In the case of Chile, the shift in the balance of power within the executive branch that came about in 1975 opened the way for the Chicagoan technocratic group to push for a reshaping of the institutional-organizational structure of the state itself. In particular, the neoliberal elite officials succeeded in concentrating decision-making power and administrative capacity in the Finance Ministry (*Ministerio de Hacienda*), transforming it into a "super-ministry." In doing so, they disempowered the Economy Ministry (*Ministerio de Economía*), which had been the key locus of decision-making on industrial policy while the Chilean statist model was in place. As a former top-level official at the Finance Ministry analyzed in retrospect, "the Economy Ministry has since then lacked a clear mandate."[367] As I will expand later in this chapter (Section 4.II),

[362] Data from Foxley (1983: 43).
[363] Délano and Traslaviña (1989: 28).
[364] Moulián and Vergara (1981: 885).
[365] Hall (1993: 281, my emphasis).
[366] Hall (1993: 280).
[367] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), Santiago, 2014.

this institutional change has had implications well after the Pinochet dictatorship was over and the Chicagoan technocrats dismissed from their top positions in the executive branch: the democratic governments of the left-wing Concertación—inaugurated in 1990 and uninterruptedly in power until 2010—inherited an Economy Ministry with weak administrative capacity, which contrasted with the highly developed resources of the Finance Ministry.

Up to the 1973 coup, the Economy Ministry had been in control of most aspects of the economy, controlling fiscal policies, setting prices and subsidies, regulating industrial and commercial activity, intervening in firms, and supplying public credit through CORFO.[368] This came to an abrupt end. As Dalgic (2012: 173) pointed out, the transfer of power from the Ministry of Economy to the Ministry of Finance that unfolded as the Chicago School technocrats secured their hold onto power within the state "paralleled the increasingly important role that monetary tools played in the administration of the economy [… transforming] economic administration mainly into the administration of money." The ideational shift that the now empowered Chicagoan elite officials brought about is hard to overstate: for several decades the Economy Ministry worked at the center of decision-making under the assumption that the public budget had to be tailored to economic policy goals; starting in 1975, the opposite became the norm: fiscal policy decisions made at the Ministry of Finance would, from then on, drive the goals that officials at the Economy Ministry could pursue.[369]

Using evidence from interviews with top-level neoliberal technocrats Jorge Cauas and Hernán Büchi, Castiglioni (2002: 40) describes that in 1975 the newly dominant elite officials persuaded General Pinochet than in order to implement the radical retrenchment of the state along the lines of their proposed shock treatment, it was essential to centralize the decision-making process and the coordination of public administration under the exclusive umbrella of the Ministry of Finance.[370] Büchi explained that the main goal the Finance Minister pursued was "to correct the existing lack of coordination and to introduce homogeneity into an area in which there still remained undisciplined groups which could rarely agree on a consistent and coherent line of action." The Junta leader Pinochet came to agree with the Chicagoan technocrats and ordered his legal adviser to move forward with the decree that would turn the Finance Minister into a super-minister.[371]

The 1975 Decree Law 966 was written by Finance Minister Cauas himself[372] and signed by the Junta members. It stated,

> *[In light of:]*
> *[…] The need to deepen the retrenchment of the public sector and its current expenses.*
> *[…] The urgency to optimize the use of fiscal resources […].*
> *[… The need to] centralize the implementation of economic policies through the authority of a singly ministry.*
> *[…] [The Government Junta agrees to grant the Ministry of Finance the power to:]*
> *a) Manage, in all its dimensions, the Government's economic policy;*
> *b) Propose the legal norms […] needed to materialize the Government's economic and financial policies;*

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368 Hira (1998: 81), cited by Dalgic (2012: 173-4).
369 Délano and Traslaviña (1989: 161).
370 The narrative coincides with Silva's (1996: 108).
371 Castiglioni (2002: 40).
372 Silva (1996: 133).

c) Define and demand the execution of the policies, programs, and administrative measures related to the areas that are vital for the economy;
d) Oversee the actual compliance of the instructions that [it] imparts, sanctioning those responsible of [generating] interferences or inefficiencies in the execution [of those instructions].
[…] [The Ministry of Finance] will control that the following ministries [and agencies] comply [with the economic and financial policies it sets]: the Economy Ministry [… and] CORFO.

This decree granted the Finance Minister tight control over resource allocation, policy design, and independence from the Junta to appoint all officials below the rank of minister.[373] According to Castiglioni (2002: 41), "these new powers were given to the finance minister in such a subtle way that nobody really realized the consequences this would have on the concentration of authority."

Chicagoan Sergio De Castro's long tenure as Finance Minister (1976-1982) deepened the transfer of power from the Ministry of Economy to the Ministry of Finance. Since then, the function of the Ministry of the Economy was basically restricted to implementing the privatization of SOEs under CORFO control.[374] By 1978 the Chicagoan Economy Minister Pablo Baraona considered that there was little left to do at the ministry he headed other than converting CORFO—which depended on the Ministry—into a holding of state-owned enterprises and transferring a few departments to the Finance Ministry; with those tasks accomplished, Baraona argued in within-state discussions, the president could proceed to shut down the Economy Ministry altogether.[375]

While Baraona's radical proposal of shutting down the Economy Ministry was eventually dismissed, leading him to resign, the process of disempowering what had been the locus of statism was well underway. During the 1980s, several important functions that pertained to the Economy Ministry were transferred to the Finance Ministry, including foreign capital and trade regulation, and tax and custom policies.[376] The aggressive dismantling of the Ministry's institutional capacity contributed to the retrenchment of industrial policy instruments, lowering state involvement in investment finance, and, as Section 4.II below will show, it helped to lock in the neoliberal path well after the Chicagoan technocrats were out of power.

2.IV. CORFO: Agent of Privatization and Retrenched Involvement in the Provision of Investment Finance

The downsizing of CORFO unfolded as the neoliberal Chicagoan technocrats strengthened their power within the state and their capacity to persuade Pinochet of moving forward with an increasingly radical neoliberal agenda. The defeat of the statist resistance within the state by the Chicago Boys allowed them to pursue an agenda aimed at reducing the presence of the state both as a producer and as a developmental agent operating through targeted credit to the productive sector. CORFO was the key actor within the state performing these functions. By the end of the military dictatorship in 1990, CORFO had been heavily dismantled; as Álvarez (1993: 115) has argued, during this process CORFO lost its protagonist role and capacity as a planner of development.

[373] Castiglioni (2002: 41); Silva (1996: 133).
[374] Dalgic (2012: 173).
[375] Fontaine (1988: 132).
[376] Section "Historia," website of the Ministerio de Economía, Chile (accessed on January 5, 2016).

The statist coalition of military officers, who managed to counterbalance the power of the Chicago Boys during the first part of the authoritarian regime, did not oppose the gradualists' and the Chicagoan technocrats' proposal of re-privatizing the firms that had been nationalized—and put under CORFO control—by the left-wing Salvador Allende administration.[377] Consequently, this first round of privatizations took place at rapid pace and without much within-state tension. However, these statist military officials were not in favor of a much deeper privatization strategy that would only occur when they lost power vis-à-vis the Chicagoan technocracy. The statists in government made a clear distinction between two types of state-owned enterprises managed by CORFO: those that were aligned with CORFO's developmental mandate—which included the SOEs in the so-called "strategic sectors," such as steel, chemicals, and electricity, in whose inception and development CORFO had been instrumental—and those that had been nationalized as part of the socialist program of Allende. In contrast to the developmental purposes that, in the mindset of these statist military officials, motivated state ownership of the former group of SOEs, the nationalization of hundreds of firms by the left-wing Allende government had marked a deviation from CORFO's mandate. An official report issued by the time the Chicagoans had secured a tight control of key posts within the state made the point that in Allende's transfer of private firms to CORFO control, "the only thing that the government cared for was to ensure state control [of the productive sector], disregarding efficiency […] [; that] turned CORFO into a disorganized and bureaucratic agency—those years [1970-1973] will be remembered as the most disastrous for this institution."[378]

The timing of the several waves of privatization during the Pinochet regimes, as well as their effects on CORFO retrenchment, coincides with the changes in the balance of power between the statist and the neoliberal technocrats in government, and with the growing capacity of the Chicagoan technocrats to associate their state retrenchment agenda with political goals of high-sensitivity for the military leaders in charge of the executive branch. Between 1973 and 1975 the focus was on giving back to private owners those companies that had been nationalized by Allende—over three hundred firms ranging from SMEs to large corporations in multiple sectors[379]—but preserving the large developmental role CORFO had had up to 1970.[380] Starting in 1975, when the Chicagoan coalition secured its hold onto economic policymaking, the privatization of CORFO's corporate holdings acquired radical speed: out of the 527 corporations that were owned by the Chilean state when Pinochet took power in 1973, only 24 remained under state control by 1980.[381] To gauge the magnitude of the state retrenchment policy it helps to note that, for instance, in 1978, the transfer of assets from the state to private owners was equal to two thirds of the gross geographic investment for that year.[382]

As Moulián and Vergara (1981: 869) pointed out, while this first round of dismantling of CORFO was justified by the Chicagoan technocrats as a way to address the short-term goal of curbing the sources of high inflation—i.e. the SOEs generated fiscal deficit which in turn justified an expansive monetary policy—it actually was motivated by the longer term goal of radically modifying the role of the state, shrinking its functions as a direct economic agent. The

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[377] Valdivia Ortiz de Zárate (2003: 127).
[378] CORFO. 1979. *Privatización de empresas y activos: 1973-1978*. Santiago: CORFO, p. 9 (cited by Nazer Ahumada 2009: 170). See, as well, Valdivia Ortiz de Zárate (2003: 126-7).
[379] Huneeus (2000a: 440, 486).
[380] Valdivia Ortiz de Zárate (2003: 134).
[381] Álvarez (1993: 110).
[382] Valdés (1995: 23).

Chicagoans' proposal to deepen privatization did not respond to a need to curb the burden of SOE-associated fiscal deficit, an issue that had already been solved by the time they reached the top policy-making positions.[383] As Finance Minister Sergio De Castro explained in a 1978 article published in the weekly *Qué Pasa*,

> *[W]ithin the scope of economic activities which exist in Chile, none are forbidden to private enterprise; conversely the government is precluded from participation in almost all productive activities.*[384]

It can be argued that the neoliberal technocrats managed to defeat the remaining resistance amidst elite military officials against proceeding further with privatization—and the dismantling of CORFO it implied—by connecting the issue of privatization with two, related high-order political goals.[385] First, during the 1980s the military in power—and crucially, General Pinochet—started to perceive that they could lose the upcoming referendum vote on the continuity of the regime scheduled for 1988; as Huneeus (2000a: 439-40) convincingly points out, this scenario made it desirable for the military government leaders to accept the Chicagoan radical privatization program, deepening the dismantling of the state, so as to deprive future democratic governments from the possibility of controlling a large CORFO managing multiple heavy-weight SOEs.

Second, as the 1988 referendum approached, building a coalition capable of winning at the ballot boxes became an increasingly pressing goal for the Pinochet administration (Kurtz 1999: 419); under those conditions, a radical privatization program was framed by technocrats as an instrument to recover the support of business, a core constituency of the military government:

> *By 1983, relations between business and the military government were strained. The financial conglomerates, which between 1975 and 1982 had been the fundamental support base of neo-liberal policy, collapsed along with the bulk of the banking system. Domestically oriented industrialists had been devastated by the over-valued peso. The government's most fervent supporters had gone bankrupt or were seriously weakened, and the surviving business elites were increasingly oppositional in their attitudes. The military responded to this pressure [...]. Privatisation of the remaining state-owned industries was, for example, a policy used to obtain support from the business sector. Indeed, the scope of this second round of privatisation went well beyond that envisioned in the 1973-7 periods. Now several profitable and 'strategic' sectors were sold [...].*[386]

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[383] Sigmund (1990: 359).

[384] *Qué Pasa,* June 1-7, 1978 (cited by Valdés 1995: 24).

[385] The Chicago Boys who pushed for and implemented this second round of privatization were Finance Minister Hernán Büchi and ODEPLAN's Chief of Staff Cristián Larroulet; the high-level officials at CORFO followed through (Huneeus 2000a: 444, 487).

[386] Kurtz (1999: 421). The privatization process was undoubtedly a transfer of wealth to allied business actors; for an account of the corruption, abuses and clientelistic practices that marked the transfer of SOEs to private shareholders, see Huneeus (2000a: 442-4, 477-85).

As a result, starting in 1985, under the leadership of the Chicagoan Finance Minister Hernán Büchi,[387] the flagship SOEs of the Chilean statist model were privatized. These privatized corporations, which had been created and up to then managed by CORFO, included the telecommunications company ENTEL, the electricity giant ENDESA, the steel-sector Compañía de Aceros del Pacífico, and the chemical company Soquimich. In this process, CORFO provided subsidized loans to business actors willing to buy stock of the former SOEs;[388] that is, CORFO acted as a financier of its own dismantling. The retrenchment of the state as producer through the transfer of CORFO companies to the private sector continued at—and actually accelerated its—rapid pace until the very end of the authoritarian regime. According to Huneeus (2000a: 440) and Sigmund (1990: 346), this suggests that the authoritarian government leaders wanted to ensure that a future democratic government could not reverse that privatization.

Table 4.1 tracks down the steep decline in the importance of CORFO within the Chilean economy using the number and incidence of SOEs as a proxy. In the early phase, as no single coalition of political *técnicos* succeeded in dominating the policy process, small, comparatively less valuable companies were privatized, whereas larger, more valuable ones were only privatized after the Chicagoan political *técnicos* had strengthened their dominant role and statists' influence had been curtailed.

Table 4.1. Chile. State-Owned Enterprises (SOEs) Before and After the Retrenchment of the Chilean Statist Model.

	1973	*1983*	*1985*	*1989*
Number of CORFO-Controlled SOEs	228	23	N/A	24
SOE Value Added as a Proportion of GDP	39.0%	24.0%	17.7%	12.7%

Notes: The figure for CORFO-controlled SOEs in 1973 excludes both companies labeled as "intervened" by the Allende administration and nationalized banks; including those two categories would bring the number up to 571 SOEs. The indicator "SOE Value Added as a Proportion of GDP" includes SOEs that were not controlled by CORFO.
Source: My elaboration based on data from Hachette (2000: 113, 123).

While CORFO continued to inject capital in the Chilean economy, its purpose and time horizon changed dramatically: similar to what would happen in the 1990s with Brazil's BNDES (see Chapter 3), CORFO in the late 1970s and in the 1980s in practice ceased to be a development bank and became a short-term financier of the privatization process. CORFO's traditional function as a supplier of long-term credit for financing investment projects in the productive sector was drastically retrenched.

Data to accurately measure the evolution of the CORFO long-term loan portfolio for this period is particularly scarce. I chose not to use what is probably the most sophisticated study and dataset on Chile's fiscal profile (Wagner, Jofré, and Lüders 2000), which has the advantage of presenting a long time-series, because it does not allow us to separate credit (*subsidios y transferencias*) channeled to the productive sector from transfers to activities completely

[387] Büchi, who did his MBA in Columbia, is one prominent case of non-Chicago-trained Chicago Boys, but multiple examples abound; see Silva (2008: 154).
[388] Huneeus (2000a: 448-9).

unrelated to industrial policy and production, such as subsidies for the healthcare and defense sectors. I prefer using the following rather fragmentary data because it does capture what I intend to measure and it allows us to track down the direction of change; on the contrary, the careful study of Wagner et al. (2000) presents such aggregate indicators that even assessing the direction of change would seem slippery.

CORFO credit to the industrial sector significantly decreased after the retrenchment of the Chilean statist model: in 1970, it amounted to 2,924 millions of inflation-adjusted Chilean pesos, whereas it equaled 1,494 in 1977, and 1,126 in 1979.[389] That is, CORFO credits for investment finance in 1979 represented, in real terms, just a third of what they were in 1970—a 75 percent cut in less than a decade. Likewise, using different data sources, deflators, and over-time comparisons, Álvarez (1993: 110, 146) indicates that the inflation-adjusted annual average of CORFO loans to industry for the post-retrenchment 1977-1982 period was smaller than a quarter of what it had been during the pre-retrenchment 1964-1969 period.

As shown in Table 4.2, Madariaga (2015: 71, 84) uses the Wagner et al. (2000) dataset to construct a proxy of the fiscal effort in industrial policy: he shows that capital transfers represented 1.9 percent of the Chilean GDP for the 1971-1973 period, falling steeply to 0.5 percent for the 1975-1981 period; public expenditure in industrial policy stabilized at such low levels for the period between 1984 and 1989. This represents a retrenchment of roughly 75 percent.

Table 4.2. Chile. Fiscal Effort in Industrial Policy Before and After the Retrenchment of the Chilean Statist Model (Capital transfers as a proportion of GDP).

1971-1973	*1975-1981*	*1984-1989*
1.9%	0.5%	0.5%

Source: Author's adaptation of Madariaga (2015: 71, 84) based on data from Wagner et al. (2000).

This reduction of the presence of the state in markets came hand in hand with the shrinkage of CORFO's staff and administrative capacities. The offices in charge of sectoral industrial policies were eliminated and their officials dismissed.[390] The neoliberal technocrats in charge of the Ministry of Finance were against industrial policy as a principle; from then on, CORFO would not aim at fueling sectoral development and would cease to be a direct investor.[391] At the time of the 1973 coup d'état CORFO had over 5,500 employees, a year later, it had 3,100; by 1987, its staff had been reduced to 670 officials.[392]

3. Business Power: Mechanism of Reproduction of a Path Already in Motion Rather Than Explanatory Factor of Policy Adoption

Some of the most influential political economy accounts of the Chilean neoliberal reforms—Silva (1993, 1996), Schamis (1999), and Etchemendy (2011)—provide a societal or coalitional explanation of the politics driving the retrenchment of the Chilean statist model. Their

[389] Data from Marshall (1981: 72).
[390] Álvarez (1993: 109).
[391] Álvarez (1993: 110).
[392] Ortega Martínez (1989: 266-7).

argument is the most important contender for the state-centric account I present in this chapter. In this section I will address these perspectives in light of the empirical evidence. I will argue that these authors have done us a great favor in convincingly pointing out that business power is an important factor to understand neoliberal reforms in Chile; however, I contend that this strand of scholarship fails to find the right causal status of business power in the process under study and, relatedly, it has failed to identify the specific point in the sequence where business power matters the most. In line with my framework chapter, I will argue that while the pressure from below exercised by business actors is *not* the primary factor explaining the policy process in its origins, it does matter as a reproduction mechanism that locks in the neoliberal path.

The authors in this tradition do not develop a theory of business power. Their claims conflate different sources of business influence on policy adoption. Though these authors do not use the following concepts, at times they seem to privilege business structural power as a mechanism of leverage in accounting for the direction of neoliberal reform in Chile, at times it seems that instrumental power is doing the causal work in their arguments. Moreover, when these authors claim that business power is the main causal variable in the market-oriented reform process in Chile, they do so without a clear conceptualization of the private sector; in these works some times business is conceived as capital, some times as sectors, other times as individual firms, associations or networks.[393] This lack of precision makes it quite hard to test the plausibility of the arguments in such scholarship, identifying what counts as evidence in favor of the coalitional/societal/business power explanation and against the state-centric perspective of my study. In order to better contrast these two contending perspectives, whenever appropriate I will slightly "translate" the claims of these authors using more precise concepts that are better suited to asses business influence on policy choices.

While Schamis (1999: 238) starts by conceding that his argument "does not deny […] the significance of the choices made by reform elites," he moves on to claim that such "capacity and choice [... are] rooted in power relations among socioeconomic groups." In his perspective, the "strongest state"—i.e. the one most capable of launching neoliberal policy reforms—"is the one that has become the agent of powerful economic groups." It is from these links with parts of the business community that reformist governments draw organized political support for liberalization. In the case of Chile, Schamis (1999: 245) argued that the core constituency of the military government "rested on a coalition of a handful of diversified economic conglomerates whose main firms were in export activities (mining, fishing, agriculture), manufacturing in internationally competitive industries (food processing, paper), and liquid-asset sectors (finance, insurance, real estate)."

Silva (1993: 544) claimed that in order to explain the content of the "radical neoliberal" policy package adopted since 1975, which included the retrenchment of the Chilean developmental state apparatus, "it is necessary to examine the composition of a narrow but powerful coalition that not only supported them but also aided technocrats in their design."[394] As

[393] To delve into the concepts used in this paragraph and how to utilize them analytically, see Fairfield (2015a) and Haggard, Maxfield, and Schneider (1997).

[394] It should be noted that, in advancing the business power thesis, Silva (1993, 1996), Schamis (1999), and Etchemendy (2011) focus on a rather narrow segment of the Chilean business community, since an earlier generation of Chilean scholars had shown that at the time the Chicagoan program was adopted the military government kept the historically very powerful business associations at arm's length (see Campero 1984; Schneider 2004: 164-7; Silva 2002: 341-2). The Chicago Boys were explicitly against the prospects of establishing regular consultations between the government and business associations, which,

the presentation of Silva's argument makes it hard to judge the inferential value of the evidence he provides, it is best to reorganize it as follows. Silva explains policy choices during this period emphasizing that the upper echelons of "internationalist" conglomerates became highly powerful in economic terms and had high instrumental power mainly through recruitment into government.[395] Regarding the first point, Silva underlines that diversified business groups with assets in the export and domestic financial sectors took advantage of an unparalleled high liquidity in international markets, tapping these financial flows to grow their business domestically and thus rapidly becoming economically very powerful vis-à-vis other sectors of the Chilean business community, such as ISI industrialists.[396]

With regard to the instrumental power enjoyed by these internationalist conglomerates, Silva asserts that "[m]any of the key figures [of the Chicagoan group of technocrats] had close ties to ever more powerful radical internationalist conglomerates that were gaining coherence through their corporate acquisitions strategies."[397] Silva shows that multiple neoliberal technocrats who reached top positions in 1975—e.g. then Economy Minister Sergio De Castro and Central Bank President Pablo Baraona—had close business and/or personal ties to either the Cruzat-Larraín or the BHC internationalist conglomerates. Next he brings attention to the following correlation: "[a]s more Chicago Boys and their sympathizers gained high office in the next years, and as the internationalist conglomerates expanded, more neoliberal policies followed."[398]

A closer analysis of empirical data casts significant doubt about the plausibility of the economic power part of the Silva thesis, suggesting that the within-state-politics thesis presented in this chapter offers a more accurate fit with the actual sequence of events. As I have noted, Silva argues that the heightened economic power of internationalist conglomerates is a key factor explaining the shift to radical neoliberalism in 1975: by accessing foreign credit and taking advantage of domestic economic crises, these *grupos* were able to take over leading competing firms inexpensively, "soon overshadow[ing] the economic groups that had supported gradualism."[399] However, the timing in which actual events unfolded is at odds with Silva's depiction. According to his narrative, the international conglomerates attained economic supremacy within the domestic business community partly because the Chilean economy entered a deep recession in 1975-1976—which allowed these conglomerates to buy firms cheaply—and because they were able to reap the benefits of the privatization of highly profitable SOEs. The point is that these two events—i.e. the major economic downturn and the privatization of highly profitable SOEs—occurred *after* the radical neoliberal policy package was adopted, *not before*. In other words, how could the economic power of these groups be the main explanatory factor of

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they argued, would hamper their capacity to implement their economic restructuring program; such anti-business associations argument had significant impact over the military leaders of government (Campero 1991: 155).

[395] Let me introduce some mainstream political science labels to clarify the Schamis-Silva thesis. In my rephrasing, what they claim is that these internationalist conglomerates—mainly, Cruzat-Larraín and BHC—were the *principals* and that the Chicago Boy technocrats were their *agents*. These groups' strong economic or market power would be the *root cause* that facilitated the Chicagoans' recruitment into government; the action of the Chicago Boys then became the *proximate cause* of policy change.

[396] Silva (1993: 544).

[397] Silva (1993: 546).

[398] Silva (1993: 547).

[399] Silva (1993: 545).

policy change if two key drivers of these *grupos*' expansion only emerged after such policy shift had occurred?[400]

Kurtz (1999: 426) also resorted to the close analysis of the sequence of events to criticize the leverage of the societal/coalitional/business power thesis in explaining the radical retrenchment of the Chilean developmental state starting in 1975. In particular, Kurtz noted that the inflows of foreign finance fueling the growth of internationalist conglomerates—the main actors driving policy change in Schamis's and Silva's works—only became relevant after the neoliberal program was adopted:

> *Access to foreign savings helps explain the consolidation of a social coalition in favour of neo-liberal policies. But the question of timing is here essential. The level of private sector debt in Chile was relatively low between 1974 and 1977 (it grew from $443 million to $990 million USD). Only after economic neo-liberalism was fully imposed in 1978-81 did indebtedness soar to $8.14 billion USD. This suggests that the access to foreign savings was [... not as] important [for explaining the adoption of neo-liberal policies] in the 1975-8 period. In that phase, […] financial flows were too small to be determinant.*[401]

Along the same lines, attributing the shift towards radical neoliberal policy to the power of business actors in the export sector does not map well onto the actual chronology of events:

> *The other essential social actor [in the societal/coalitional thesis], export-oriented capitalists, were not yet important at the time of the turn toward economic orthodoxy. During the period when neo-liberals first came to dominate economic planning (1975-8), the massive expansion of non-traditional exports had not yet begun. As of 1978, 60 per cent of exports was still accounted for by the state-owned mining sector. Not only was there not yet a booming export sector, but most of the income from exports was concentrated in state hands. A large, export-oriented capitalist class did not exist at the crucial point in time. […] Coalitions constrained policy, but no group was so dominant as to be by itself determinative of outcomes.*[402]

If the Chilean business economic structure and the power resources associated with it had not changed enough by the time the 1975 major policy shift occurred, and still, as O'Brien put it, a "relatively small group of people [were able] to push through drastic reforms which, in the short run, went against the immediate interests of so many sectors of Chilean capital,"[403] how could we continue to hold that the formative stages of the Chilean neoliberal model were *primarily* driven by business actors?

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[400] Paul E. Sigmund's book review of Silva (1996) criticizes him on similar grounds: "The 1975 shift to full-scale radical neoliberalism is linked to the triumph over domestic producers of the 'internationally oriented conglomerates with a heavy concentration in liquid assets" (p. 97).' […] [Silva's explanation] focuses on *the changes in the pattern of ownership of the big conglomerates. Most of those changes took place after the shift in policy*, but because the conglomerates, especially the Cruzat-Larrain and BHC groups, benefited from them, they are seen as having 'wrestled control over policymaking from the gradualists' (p. 128)—a statement that clearly overstates their influence at a time when policy was made by a personalist dictator and a few of his advisors" (Sigmund 1997: 771, italics are mine).

[401] Kurtz (1999: 426).

[402] Kurtz (1999: 426-7).

[403] Cited by Kurtz (1999: 425).

The scholars pushing for a bottom-up explanation of neoliberal restructuring in Chile devote a large part of their efforts in empirical analysis to showing that, as a matter of fact, the internationalist business groups concentrated in liquid-asset sectors grew meteorically. While undeniably these conglomerates, alien to the traditional ISI business actors, grew rapidly—which, in turn, changed the economic structure of the Chilean private sector—the analysis above indicates that such growth occurred later in the process. Consequently, we are on a safer ground arguing that the growth of business groups favorable to radical neoliberalism was more an effect of policy change than a cause of it.[404] In line with the expectations laid out in my framework, the influence of business actors seems to have been *not* a main cause but, rather, a lock-in factor of the neoliberal path.

Although Marcus Kurtz (1999: 403) refers to a broader set of policies than those studied here—and although he does not use the analytical perspective and concepts of path dependence, mechanisms of reproduction, and business power on which my Chapter 2 framework builds—his characterization of the relevance of business influence in this process is very close to mine:

> *[A] focus on social coalitions is important in understanding the re-production and expansion of neo-liberal patterns in the later part of the military period—important interests had much to lose from deviations from free-market policies and the state's dependence on social support was heightened. But it is less compelling in explaining the emergence of such a model in the mid-1970s when most vested industrial interests were threatened by [... the neo-liberal program], and potential beneficiaries were either economically weak or public property.*[405]
> *[…] While capitalist coalitions may not have had the strength to have caused initial moves in the liberal direction, by the 1979-82 period those previous moves had dramatically strengthened the economic position of actors favouring liberalisation. Insofar as regime legitimacy depended on economic performance, the autonomy of the state vis-à-vis just such capitalist actors declined. They were the dynamic economic sectors of the time, and shifts in non-liberal directions could only bring a return of hard times.*[406]

[404] This mismatch between the time when the radical policy shift occurred and the time by which internationalist business groups had actually grown enough so as to speculate that their economic power was a strong source of political power leads Silva to repeatedly acknowledge that the coalition allegedly driving policy change was "*narrow*." I hereby include some examples of such form of argumentation. "[A] full explanation of the policy shift from import substitution industrialization to neoliberalism […] in Chile […] requires an examination of the social groups—however *narrow*—to which state elites turned for support" (Silva 1993: 529, my emphasis); "[R]adical neoconservative policies… could shore up an alternative base of support, *albeit a narrow one*, for Pinochet's government" (Silva 1996: 110, my emphasis); "this *narrow* constellation of business interests [played] an important policy-making role" (Silva 1993: 557, my emphasis). Barrett (1997: 340) criticized the business power thesis on similar grounds, highlighting the Chilean state's autonomy: "The evidence suggests that Pinochet […] allowed the Chicago Boys and their business allies such a considerable role in policy-making because they were marginal to Chile's traditional centers of political and economic power and thus did not pose a threat to his autonomy. If Pinochet had been in search of business support, rather than a way to neutralize business pressure or opposition, he likely would not have chosen such a narrow support base. It was Pinochet's endorsement of the model, moreover, that made these *grupos* economically powerful."

[405] Kurtz (1999: 403).

[406] Kurtz (1999: 418).

If the economic power part of the Silva thesis is directly at odds with some key facts, the second causal mechanism he proposes—i.e. the high instrumental power of internationalist business groups—is based on some major simplifications, which, to say the least, should be treated with extreme caution. As Silva (1996, chapters 5-6) shows, it is hard to deny that many of the Chicagoan technocrats—whom, starting in 1975, managed to shift policy to radical neoliberalism—had economic and personal links with internationalist business groups in liquid-asset sectors. Yet one should be careful in not falling into the temptation of retrospectively confusing business access to key state officials with business capacity to determine policy choices. Next I will provide several reasons to support my claim.

First, the business instrumental power thesis assumes—implicitly in Silva's work; explicitly in Schamis's—that the Chilean state during Pinochet's dictatorship was very easily susceptible to *capture* by a rather narrow part of the business community. Such assumption strongly neglects the complexity of within-state politics, whose close analysis—as I have shown—suggests that top officials of both military and civilian extractions were able to exert staunch opposition to the neoliberal program pushed by the Chicagoans, and overlooks the fact that President Pinochet himself was not by any means a free-market true believer. Moreover, the hypothesis of the feasibility of state capture runs against a quite convincing conventional wisdom that holds that Pinochet ruled over a state apparatus characterized by its autonomy vis-à-vis both opposing and supporting societal groups, and by its high capacity to repress dissent and the high concentration of authority in the president's office.

Second, identifying economic and personal ties between many Chicago Boys and some growing business groups does not suffice to get away with claiming that this was a principal-agent relationship, with technocrats acting as agents and big *grupos* as principals. Eduardo Dargent, whose masterful study of technocracy deals with a much broader universe of cases, has made an insightful remark that applies to the case of Chile:

> *[Many scholars] assume experts' proximity to the business sector is a sign that technocrats are dependent on dominant economic actors in Latin America. But proximity between business and experts is not sufficient evidence of technical subordination. Comparative studies of bureaucratic independence in developed countries consider careers in business as evidence of dependence on private interests […]. In developed countries, such an assumption seems adequate, as the state, think tanks, and academia can provide similar working conditions as private enterprises. In Latin America and other developing countries, however, this standard is inadequate because the private sector may be the only source of qualified individuals for state positions and the only form of employment for technocrats after they leave the state. The technocratic phenomenon is explained partly by the absence of a strong and professional bureaucracy from where to look for experts to deal with complex policy issues: politicians and state actors find such knowledge in the private sector.*[407]

Furthermore, notwithstanding how their private-sector careers evolved after leaving office, reducing the Chicagoan technocrats to the role of agents seems to be a flawed depiction of their actual rationality and behavior during their time in office. My framework chapter underlines that top-level officials in Latin America are reputation-maximizers seeking to augment their personal professional capital and leave an enduring mark in policy that is aligned with their causal beliefs. They push for new policy that could later be traced to their action. Aware of the

[407] Dargent (2015: 30-1).

high turnover that characterize careers within the state, these entrepreneurial political *técnicos* are particularly proactive in taking advantage of their time in high office as a means to inscribe their ideas into policy and raise the future value of their personal professional capital. In light of the evidence presented in the subsections above, Chicago Boys' behavior in office seems to fit this broader pattern of action of elite state officials in technical policy arenas. In addition to the empirical work carried out earlier in this chapter, the following analysis of two of the foremost scholars of the politics of neoliberal restructuring in Chile helps to further substantiate the claim that portraying Chicagoan technocrats as simple agents of principals in the private sector fails to capture the complexity of the process:

> *It would be a mistake to think that the [Chicagoan] economic team has simply been the state instrument of the business groups. Thinking [of these neoliberal technocrats] as pure instruments implies believing that they act […] without having their own social and political program, [… fulfilling their role as] "intellectuals." This perspective […] ends up being a conspiracy theory of politics.*
> *[In contrast with this perspective, we hold that the Chicagoan] economic team makes its decisions in line with a global rationality, guided by a conception of capitalist development that is deemed as desirable for Chile and by a diagnosis about the imbalances affecting the Chilean economy. This is why [the Chicago Boys in office] are less concerned about the fate of individual firms than about the consolidation […] of a [new] type of society. Consequently, […] there have been disagreements between the interests or demands of [representatives of the internationalist business groups] and the [members of the Chicagoan] economic team [… such as when the technocrats decided that Chile had to] leave the trade agreement Pacto Andino [Andean Pact], a decision that affected the BHC group.*
> *The main feature characterizing the relation between the [Chicagoan] economic team and certain important fractions of the business community is the affinity of ideology and interests underpinning the [broader] project for the [Chilean] society […]. Of course, in addition to that, there are numerous particularistic interactions rooted in old family or friendship ties […] or in past or current business partnerships that allow the large business conglomerates to have a very fluid access to the [Chicagoan] economic decision makers […]. But such direct influence [affects] the marginal aspects […] of public policy, whose broad contours were shaped by a conception of capitalist development, by a type of restructuring decided from above.*[408]

The coalitional or business power account of the adoption of radical neoliberalism in Chile severely downplays the dilemmas and calculations of state actors—i.e. the military leaders and the appointed officials serving as elite advisors—assuming that they did not have preferences of their own and that they could simply "absorb" the preferences of parts of the business community without risking to inflict damage on themselves. In line with the expectations of the framework chapter, the evidence suggests that the Chicagoan technocrats faced strong incentives to exhibit competence in the management of economic adjustment at a time when the Chilean economy was going through a deep crisis; while the contending hypothesis holds that above all the Chicagoans were driven by the need to secure rents and advance the interests of the internationalist conglomerates, I concur with leading Chilean

[408] Moulián and Vergara (1981: 892). Frieden (1991: 158), a proponent of an interest group-centric explanation of policy choice, himself acknowledged that during this period of Chilean history "there is little evidence that policy was made with sector-specific targets in mind."

scholars Moulián and Vergara (1981) and Huneeus (2000a) in arguing that these neoliberal state officials, during their time in office, were primarily driven by the goal of setting in motion an ambitious project of economic restructuring that was well above particularistic endeavors. These top-level officials were in fact true believers in that their highly ambitious neoliberal program, at the general level, and the dismantling of the instruments of state involvement in investment finance in particular, would pave the way for sustained economic growth in Chile. In those calculations—which prioritized inscribing their causal beliefs into policy, securing good policy performance, and exhibiting technical competence—the distribution of rents or the adoption of particularistic policies were byproducts or goals of secondary order vis-à-vis the neoliberal program as a whole.

Rethinking the way I have proposed about the causal status of business power in the process under study and more accurately specifying the point in the sequence where business power matters the most, brings additional analytical gains. By the early 1980s, several years after the Chicagoan technocrats had managed to adopt and implement the radical retrenchment of the Chilean developmental state, private business actors had come to be the main actors in the intermediation of credit and in financing and executing investment. That is, the dismantling of CORFO had the implication of opening new spaces for private business development. It is therefore reasonable to argue that business structural power grew significantly in Chile as a result of the policies adopted by the Chicagoan technocracy since 1975. Credible disinvestment threats became a much more powerful and widespread source of leverage in a new context marked by the state's circumscription to a minimal role in the economy; business power thus grew at large and in its structural form, locking in a path originally chosen from above (the state) rather than from below (society). This is why, in my perspective, the eventual collapse of the internationalist conglomerates[409] to which the Silva thesis attributes most of the causal leverage is not very relevant: the important point is that by the early 1980s the *structural* power of Chilean business *at large*—rather than the *instrumental* power of liquid-asset corporate sectors and specific business groups—had grown so much that it became a source of reproduction of a path originally started from above by a highly autonomous state. Since such high levels of business power are hard to reverse, they became a major legacy for the democratic governments of the left-wing Concertación (1990-2010); as Section 4.I argues, this legacy of heightened business power helps to account for why the state continued to have such low level of involvement in markets despite re-democratization and in spite of the drastic partisan change in the executive branch.

4. The Unexpected Continuity of Low State Involvement in Credit Markets During Two Decades of Center-Left Governments

When the center-left Concertación coalition took power upon the return of democracy in 1990, the Chilean statist model was already decimated and state involvement in investment finance had gone from high to low. Although the Concertación uninterruptedly occupied the Chilean executive branch for two decades (1990-2010), the neoliberal orientation of policymaking with regard to the role of the state in markets and investment finance was maintained over time. During this period, the government only adopted what I call "residual" industrial policies. This unexpected continuity is what needs to be explained. In this section I

[409] These groups went bankrupt in the aftermath of the 1982 financial crisis.

will therefore identify the key factors accounting for the "nondecision"[410] of the Concertación administrations to pursue any significant increase of the direct role of the state in the provision of finance for the productive sector.

Nondecisions characterize this period despite a change from dictatorship to democracy and from a right-wing to a left-wing political force occupying the executive branch, and even though at several points during these two decades elite officials in the executive branch tried to challenge the orthodox orientation. This small-state approach has proven resilient, moreover, in spite of an increasingly shared perspective within the Concertación leadership that recognizes that the Chilean productive apparatus is too dependent on exports of copper and low value-added products; according to this assessment, Chile needs to move onto a more advanced phase of export-led growth that should be more intensive in technology and should make the country less vulnerable to the ups and downs of international commodity markets.[411]

In line with my framework (Chapter 2), both societal and statist types of mechanisms of reproduction were critical in driving the continuity of the neoliberal path. As I have preliminary argued in Section 3 of this chapter, the retrenchment of CORFO as the key developmental agent of the Chilean state was in itself a strong boost to aggregate levels of business power. Most scholars have focused on tracing how specific sectors and groups within the business community were favored by the dismantling of the Chilean statist model; my focus here is different. What matters most in accounting for the resilience of the minimal state is that, by relinquishing a vast number of sectors and economic activities to private actors, and thus shifting from state-driven to market-mediated investment finance, the state under authoritarian rule strengthened the *structural* power of Chilean business *at large*, which is way more important than the enhancement of the *instrumental* power of individual business groups, however large they might have become. This dramatically heightened business power has contributed to shrinking the policy space regarding the role for the, now democratic, Chilean state in credit markets.

The continuity of a neoliberal approach in this policy arena, however, cannot be solely explained with a societal argument based on the strength of the Chilean business community. In line with the expectations laid out in the framework of this study, I will argue that path continuity in contemporary Chile can only be understood by incorporating statist drivers too, looking at within-state politics, the reshaped state structures, and intrinsic features of policies themselves.

4.I. The Legacy of the Dictatorship: Strengthened Business Power Contributes to Lock In Low State Involvement in Credit Markets

I have argued that the retrenchment of the Chilean developmental apparatus during the 1970s and 1980s significantly strengthened the structural power of domestic business. The virtual dismantling of the once omnipresent state-owned development agency CORFO empowered business at large because it shifted the primary source of investment and economic growth in Chile from the state to the private sector. Moreover, the privatization of SOEs previously under CORFO control also empowered a small set of diversified business groups with

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[410] I am borrowing on Pierson's language here (2015: 126, 129).

[411] On this latter point, according to Silva (1996: 234), the Concertación leadership, since its very first administration inaugurated in 1990, "recognize[d] the need for industrial policies to move Chile beyond the 'easy stages' of export-oriented growth [...]." See, as well, Barrett (1997: 437; 1999: 14) and Agosin, Larrain, and Grau (2010).

large asset holdings in the production for international markets.[412] This reconfiguration of the boundaries between state and markets and of the Chilean business itself, originated by the retrenchment of statism, facilitated the reproduction of a neoliberal policy approach that limited the direct involvement of the state in markets throughout the 1990s and 2000s. In this section I will provide evidence that suggests that strong business structural power—used strategically by business actors rather than occurring automatically without business agency[413]—along with comparatively very strong business instrumental power,[414] was a key mechanism in the contemporary reproduction of the path initiated in the 1970s and 1980s.

An analysis of the micropolitics within the state during the 1990s and 2000s shows that there were important attempts made by developmentalist elite officials of the center-left Concertación to challenge the continuity of such watered-down, poorly funded industrial policy, and the small role for the state in credit markets (Section 4.II). I argue that the evidence presented in this section is an essential contribution to our understanding of why these elite officials repeatedly lost their battles with the orthodox officials controlling the Ministry of Finance. The comparatively very strong power of Chilean business was key in putting a higher than "average" threshold for the developmentalist officials within the state:[415] in such context, for economically heterodox political *técnicos*, persuading the Concertación presidents that the benefits of pushing for larger state involvement in investment finance outweighed the costs of defying business opposition, was a daunting, ultimately insurmountable challenge.

It must be acknowledged at the outset that the empirical assessment of business power as a source of feedback reinforcing the low level of state involvement in credit markets in contemporary Chile is particularly difficult and, hence, cannot be conclusive. Why should we be cautious? This mechanism of path reproduction is less tractable than others—such as the institutional-organizational structure of the state—because it operates through anticipated reactions.[416] More specifically, detecting the impact of business power on the continuity of the small direct involvement of the state in investment finance in Chile is hard because it implies finding a way to show empirically that the center-left Concertación presidents chose to discard more developmental perspectives pushed by some elite officials because they anticipated a negative reaction on behalf of the powerful business elite.

The masterful work on business power in contemporary Chile is Fairfield's (2015a), whose policy empirical terrain is that of taxation. Importantly, in the Chilean context, as it was pointed out way earlier by Silva (1996: 232), tax and industrial policies were very different policy arenas: while in industrial policy the Concertación leaders seem to have self-censored—as Silva calls it—in tax policy the Concertación administrations did act, that is, they did not choose "self-censorship." Assessing the impact of business power on tax policy targeting economic elites in Chile—as Fairfield (2015a) does—means studying an issue on which business actors have huge stakes, which most of the times triggers open contestation. The taxation of economic elites is thus an arena where business power is more empirically tractable than it is in industrial policy and other arrangements shaping state involvement in credit markets. In this latter type of

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[412] I am referring to the post-1985 wave of privatizations (see Silva 1996: 195-202; Madariaga 2015: 193-6).
[413] For the key contribution on strategic structural power, see Culpepper and Reinke (2014).
[414] I do not claim that my study explains the origins of this business instrumental power.
[415] The threshold can be thought to be high vis-à-vis that faced by officials in other countries with prolonged center-left democratic administrations.
[416] On the empirical challenge of assessing power and anticipated reactions, see Pierson (2015).

policy arena, significantly less likely to trigger open contestation between government and business actors, anticipated reactions seem to be a stronger driver of the outcome. In short, the inferences about the effect of business power on the continuity of the neoliberal path on this specific policy domain are, therefore, more speculative.

For expositional clarity, I next divide the analysis into two subsections: one dealing with business preferences, the other with business power.

4.I.i. Business Preferences

Before assessing the evidence indicating that business *power* was in fact a source of positive feedback locking in the retrenched role for the state in credit markets, let us home in on the issue of business *preferences*. In particular, in contemporary, post-authoritarian Chile, were the business actors with most political leverage against an expansion of state direct involvement in the provision of finance for the productive sector? If so, why was that the case?

Two main points should be made about business preferences in contemporary Chile. First, the business community at large *in the post-authoritarian period* strongly and cohesively embraces an anti-statist or small-state ideology that emphasizes market forces and fiscal restraint.[417] In this regard, Chilean business starkly contrasts with that of Argentina, Brazil and most Latin American countries, where such market creed is endorsed less intensely and only by some business sectors. Second, the leadership of this cohesive business community is exercised by a small number of giant business groups that, primarily due to the sectoral profile of their assets, do not need—and thus, quite likely do not prefer—the state to step in credit markets or to adopt significantly well-funded industrial policies aimed at providing investment finance.

Regarding the free-market ideology that is so widespread in the business community in the post-authoritarian period, and how this is connected with business leaders' rejection of a stronger agenda of state-led industrial upgrading, a top-official at the Finance Ministry explained to me,

> *The Chilean business is very old fashioned, very influenced by the Chicago School, by the idea that the state has to perform only minimal functions, "and the rest leave it to us [business people,] that we can do it ourselves." [...] There's a big ideological prejudice in the business community against an industrial policy agenda.*[418]

The field research conducted by Tasha Fairfield offers a number of pieces of evidence that point in the same direction. A former president of the CPC encompassing business association asserted, "business's principle is that we do not want the state to grow;" likewise, a former president of the industrial association SOFOFA, explained that they were against the "increase in state participation in the economy [… because] the state invests badly, spends badly, and it is inefficient."[419]

Just as important as describing the general preference of the business community it is to infer the preferences of Chilean biggest business actors with regard to state involvement in credit

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[417] Fairfield (2010: 77); Silva (1996: 230).

[418] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), Santiago, 2014.

[419] Fairfield's interview with Ricardo Ariztía, CPC President (2000-2002), Santiago, December 13, 2005; and Pedro Lizana, SOFOFA President (1993-1997), Santiago, December 28, 2005 (Fairfield 2010: 77). The translation of the Lizana interview is mine.

markets. The foremost scholars studying the impact of business power on policymaking in Chile (Silva 1996, 1997, 2002; Fairfield 2015a) underline that in the contemporary, democratic period a key source of business influence was its highly cohesive and intense participation in formal and informal consultations with Concertación policymakers through a single, multi-sector encompassing business association (*Confederación de la Producción y del Comercio* or CPC) (see Section 4.I.ii). As Silva (2002: 341-2) argued, the CPC is dominated by Chile's leading firms; when policy proposals, initiated by state agencies, cut across economic sectors, the CPC represents the interests of large-scale capital.

Throughout the late 1980s, the 1990s and 2000s, the most economically dynamic and powerful groups within Chilean business were those that, though diversified across sectors, had a strong presence in the exploitation and export of natural resources where Chile has natural competitive advantages.[420] As scholars working on business groups indicate,[421] prototypical cases of these very large *grupos* are Angelini—strong in the industries of cellulose, wood, and fishing—, Luksic—whose stronghold is the mining sector—and Matte—strong in the cellulose, forest and paper sectors.[422] By 2007, the consolidated assets of these three groups equaled to 15 percent of the Chilean GDP.[423]

Kurtz (1999: 421-2) makes a similar argument: the Pinochet administration's policies reconfigured the productive profile of Chilean business, which was then reflected in a shift in the dominant preferences within business associations:

> *The structural transformations which Chile had undergone since 1973 had in important ways changed the composition of business's representative organisations. Within the National Agrarian Society (SNA), the Confederation of Production and Commerce (CPC), and the mining association (SONAMI), producers for international markets had become dominant. This shift was a clear product of outward-oriented economic policies, which in turn created a business sector likely to be strongly supportive of a neo-liberal developmental model.*

For the purposes of this study, what's important is that this type of business groups with growing importance within the Chilean business community can fully rely on *private* sources of long-term finance, both domestic and foreign. The *grupos*' long history of prudence in the management of their internal finance,[424] as well as their growing market power and cross-sector diversification, allowed them to become the most credit-worthy "guys in town" and thus easily absorb the vast majority of long-term credit provided by domestic private banks.[425] In addition,

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[420] The impressive power gained by two giant retail-sector groups—Cencosud and Falabella—is much more recent.

[421] See Castillo and Álvarez (1998) and Schneider (2008: 392).

[422] The data comes from Lefort (2012: 408).

[423] My calculations based on data from Lefort (2012: 393) and the World Bank.

[424] See Lefort (2012: 388, 391, 412-3, 420), Silva (1996: 195).

[425] For aggregate data on business groups' impressive capacity to obtain long-term finance from the banks, see Lefort and Walker (2000: 22-3). My qualitative assessment points in the same direction. A top-level official with over twenty years of experience as regulator of the banking industry, confirmed that, though systematic data is lacking, the largest Chilean firms have had great capacity to obtain long-term credits from commercial banks [Author's interview with Enrique Marshall, Banking Superintendent (2000-2005), Central Bank General Manager and Board Member (1991-1993; 2005-2014), Santiago, November 25, 2014]. In addition, a senior executive with over three decades of experience in the Chilean

their export-oriented business strategy enables these largest business groups to tap foreign flows of investment finance with ease, partly because having a good share of their profits in foreign currency reduces both the cost and the risk of being indebted abroad.

As a consequence, in a country that stands out for the high level of economic concentration in a few giant conglomerates,[426] the leading actors had a business strategy that simply did *not* depend on the availability of any form of state-sponsored credit. It can therefore be argued that these business groups were either indifferent about any potential expansion of state involvement in credit markets or, most likely, in outright opposition to such prospects. The latter seems more plausible because larger state involvement could benefit smaller competitors and, perhaps more importantly, would imply the need to expand the state's revenues through higher corporate taxes.

Unfortunately, these deductive inferences about the preferences of the largest business groups are speculative in nature because of the lack of primary or secondary data.[427] When I interviewed a former Concertación senior official at the Finance Ministry, he made a point coincident with these inferences about business preferences, arguing that state-led agendas of industrial upgrading are looked with indifference by the large groups because "big business in Chile have had it easy [*la tuvieron fácil*]; with macroeconomic stability they have made a lot of money, basically through two means: natural resources [exports] (not just copper but also fruits, forestry, and so on); and public utilities, which are very profitable; therefore big business often replies [to any proponent of an expanded industrial policy], 'why bother?'"[428]

The only segment of the business community whose preferences differ from those described above are small- and medium-sized enterprises (SMEs). These firms do not have the economic capacity to tap foreign credit markets or to issue equity or bonds in Chile's domestic capital markets;[429] in addition, in line with the evidence presented above, the risk-averse banking industry prefers to allocate the long-term credit that is available to the largest Chilean firms, discriminating SMEs.[430] Therefore, as recognized by multiple of my interviewees in the private

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banking industry, explained to me: "*In Chile, banks grant virtually all of their [long-term] loans to a very small number of family-owned groups, like Luksic, that concentrate the country's capital. These groups are the only relevant players in town and thus they absorb all [long-term bank] credits. Of course, concentration of bank credit in the largest firms happens in every country—but in Chile it's even more extreme*" (Author's not-for-attribution interview, Santiago, 2014).

[426] By the late 1990s, the biggest Chilean firms concentrated 75 percent of the country's sales and 95 percent of the total of exports; ten Chilean firms made it to the top-75 ranking of Latin American firms, an impressive number in light of the small size the Chilean economy had at the time (Castillo and Álvarez 1998: 286-7). By the 2000s, the twenty largest firms in Chile produced half of GDP (Schneider 2013: 45).

[427] Having access to the controlling shareholder of family-owned, Forbes-ranked business groups is hard everywhere but it seems to be particularly hard in Chile. In my two research trips to Chile in 2014 I failed to obtain interviews with *grupo* owners or top executive officers even though I came referred by top-level contacts from both the public and the private sectors. This contrasted with my experience in Argentina and Brazil, where I did manage to access this type of corporate informants.

[428] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), Santiago, 2014.

[429] Jiménez (2009: 75) argues that, by the end of the 2000s, such was the case not just of small Chilean firms but also of medium ones.

[430] The available data to assess SME access to long-term bank credit is very poor because the Banking Superintendence only provides a very rough indicator that just crudely distinguishes between loans with duration shorter than a year and loans with duration of over a year. This notwithstanding, one of the

and public sectors, Chilean SMEs do have an intense preference for the state to step in with a larger role in credit markets. However, unsurprisingly in light of the comparative evidence (Shadlen 2004), SMEs in Chile, while formally included in the powerful encompassing business association CPC, suffer from their weak instrumental power. Even CPC leaders acknowledge that the preferences of SMEs are politically weak within the CPC and thus not strongly represented by the association.[431]

4.I.ii. Business Power

Having laid out business actors' preferences, I will now provide evidence indicating that business power was in fact high and can thus be thought as a source of positive feedback in the 1990s and 2000s, contributing to the resilience of low levels of state involvement in credit markets. Throughout this period, the Chilean business community was highly capable of making its preference for a small-state bear in the policy process because it enjoyed a constantly high level of instrumental power and relatively long periods of strong structural power.

Chile's business community scored high in instrumental power throughout the four consecutive Concertación administrations (1990-2010). This was important in and of itself since it directly enhanced business's capacity to make the government more responsive to its preferences; but high instrumental power, as Fairfield (2015a: 49) has theorized, is also important because it can augment structural power by raising the credibility of disinvestment threats.

The Chilean business strong instrumental power during the Concertación administrations is well documented in the literature. Schneider (2004: 7, 152; 2010: 308) early on brought our attention to the fact that Chile stands out in Latin America for the strength of its encompassing or multi-sectoral business association CPC, which organizes and pushes for the interests of very broad segments of the Chilean private sector. The CPC articulates the interests of six peak sectoral associations—the industrial-sector Society for Manufacturing Promotion (SOFOFA), the National Agricultural Association (SNA), the National Mining Association (SONAMI), the National Chamber of Commerce (CNC), the Chilean Chamber of Construction (CCCh), and the Association of Banks and Financial Institutions (ABIF). During earlier periods, the CPC, founded in 1935, was not as relevant in intermediating business preferences but it became very important and the major voice for business since the 1990s.[432]

The literature on business power underscores that strong economy-wide associations coordinate business lobby and interlocution with the government, bringing cohesion to the different sectors they represent; this type of organizations provide "an institutional backbone for cohesion" (Fairfield 2015a: 39). The CPC empowered the Chilean business community throughout the 1990s and 2000s precisely because it has been highly successful in fulfilling these

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foremost experts on Chilean SMEs explained to me: "*despite the lack of the data needed to appropriately measure SME access to long-term credit, the general perception among those of who have worked for a long time on these issues is that the Chilean banks do not finance long-term investment projects presented by SMEs*" [Author's interview with Carlos Álvarez, CORFO Manager and CEO (1995-2004; 2006-2010), Deputy Secretary, Economy Ministry (2004-2006), Santiago, November 26, 2014]. Agosin et al. (2010: 20) assessed that SMEs "face difficulties in their access to investment resources, credit being available mainly for working capital; [n]ot only are interest rates high, but longer-term credit tends to be unavailable."

[431] Author's interview with José Antonio Guzmán, CPC President (1990-1996), Santiago, May 26, 2014.

[432] Bull (2008: 205-8); Schneider (2004: 160, 168).

roles. The CPC has been the central actor in aggregating business interests and negotiating with the state, reconciling differences among its members.[433] As a former CPC president explained,

> *The CPC enjoys an almost unconditional support […] from the entire private sector. In Chile, we as businessmen are absolutely united. We may have discussions over […] a thousand issues, but at the time of acting […] we have a single voice.*[434]

A former president of the CPC, who had been the president of the banking association (ABIF)—itself a member of the CPC—throughout the 1990s and 2000s, spelled out the political value of business cohesion and then explained to me how it was constructed:

> *During my term as CPC president I never allowed a decision to be subject to a vote: I always worked to bring the parts together so that all decisions were reached by consensus. Of course, there are always competing interests [within the Chilean business associations], but I always worked hard so that those internal infightings did not reach the press*.[435]

At a theoretical level, Fairfield (2015a: 38) has argued that cohesion is a key resource of instrumental power: it strengthens business's bargaining position by increasing the cost of government leaders' divide-and-conquer strategies, thus enhancing the effectiveness of business lobby with government representatives. This general claim is particularly insightful for the case of Chile since the 1990s in the issue under study, for two reasons. First, divide-and-conquer strategies could have been particularly attractive for the center-left Concertación governments as a way to push potentially more ambitious industrial policies; this was especially the case because, as Madariaga (2015: 94-100) has highlighted, one of the key features of contemporary Chilean politics is that a center-left coalition ruled for multiple consecutive periods without a business base. Business cohesion, catalyzed by and institutionalized in the CPC, significantly reduced the feasibility of divide-and-conquer strategies. Second, my argument is that business power operated as a mechanism of reproduction of a path characterized by low-level state involvement in credit markets; this means that business wanted to get reflected in public policy a "negative" preference, ensuring that a more aggressive industrial policy remained off the policy agenda. In achieving that, cohesion is key, since it prevents parts of the business community from defecting, falling into the temptations of acquiescing or favoring the expansion of state-sponsored credit.

As Fairfield (2010: 75) remarked, during the 1990s and 2000s Concertación administrations, an important source of instrumental business power was the informally institutionalized pattern of concertation between business associations and executive-branch officials. Silva (1996: 228-36) was probably the first to articulate an argument and to collect some evidence indicating that, under the Concertación, the interaction between business associations and state officials was particularly fluid and regular; during these meetings, business actors' disagreements with policy proposals initiated by the state were brought to the table and

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[433] Schneider (2004: 171).

[434] Fairfield's interview with Ricardo Ariztía, CPC President (2000-2002), Santiago, December 13, 2005 (Fairfield 2010: 76). The translation is mine.

[435] Author's interview with Hernán Somerville, President of the Association of Banks (1993-2011), President of the CPC encompassing business association (2004-2006), Santiago, November 20, 2014.

often taken into consideration. As described by a leader of the industrial association SOFOFA, "We may have our differences with the government, but if we are worried about something, or want to express our point of view on policy, all we have to do is pick up the phone and arrange a meeting. We may not get everything we want, but we rarely come away empty handed."[436] In a later work, Silva (1997: 173, 176) presented evidence showing that these consultations between business peak associations and government officials, though non-institutionalized, were very frequent and taking place to discuss multiple issues of economic policymaking.

The Concertación governments, even well after the transition to democracy had been accomplished, valued this wide-range collaboration with business because the excellent macroeconomic outcomes were associated with this model (Fairfield 2010: 82). A former CPC president explained this to me as follows:

> *The role of businessmen during the Concertación administrations was very important because the Concertación itself strongly valued this interlocution with business. The doors of the La Moneda [Presidential Palace] were always open [...], giving birth to what we may call "public-private partnership" [*"asociatividad público-privada"*]. In setting up [such concertation arrangements], we, as business association representatives, were careful not to make non-sense demands [*no pedir locuras*], particularistic demands... Since in this market-oriented model we, as businessmen, were key actors, we had to collaborate with the state [...], and that implied being credible [in the eyes of Concertación policymakers], avoiding non-sense demands.*[437]

High business instrumental power operated as a constant source of positive feedback for over two decades, locking in a minimalist approach to the role of the state in credit markets. But instrumental power was also reinforced by structural power. Though she does not make the argument I made earlier in this chapter about the strengthening of business's structural power as a result of state retrenchment, Fairfield (2010: 74-5) claims that business's structural power was strong during the first administrations of the Concertación in the 1990s. In this period, business actors in Chile were distrustful of the center-left coalition's willingness to commit to the neoliberal model that had been set up during the Pinochet dictatorship. The following interview with the President's Chief of Staff (1990-1994) is a testament of how important business power was in the calculations of the Concertación leaders:

> *Convincing the business community of the center-left's ability to govern was very important. Hence, a main economic goal of the transition was to build the trust of the business community. They were suspicious of the center-left coalition; not unreasonably presuming that it would be more statist/interventionist. The product of this skepticism was that the center-left coalition was determined to demonstrate their governability. This led to [...] more prudent policy aimed at assuaging the business and investment community."*[438]

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[436] Silva's interview with Pedro Lizana, then on the executive committee of SOFOFA (later its president), Santiago, June 10, 1992 (Silva 1996: 231).

[437] Author's interview with Hernán Somerville, President of the Association of Banks (1993-2011), President of the CPC encompassing business association (2004-2006), Santiago, November 20, 2014.

[438] Kaplan's interview with Edgardo Boeninger, President's Chief of Staff (1990-1994), June 6, 2007 (Kaplan 2013: 65).

In an interview, Finance Minister Alejandro Foxley (1990-1994) also invoked an argument compatible with the thesis holding that business power was a factor that contributed to reproducing low levels of state involvement in the provision of credit:

> *We had to reduce government expenditures to show the private sector that we were serious, that we were not populists, that we could control inflation, that the government would do its part.*[439]

In a seminal analysis of this period, Eduardo Silva linked business power with the continuity of a neoliberal approach to the role of the state in investment finance: he argued that the absence of any significant industrial policy during the first Concertación administration (1990-1994) could be associated with the government leaders' "recognition of the structural power" of business, and their perception that "[t]oo much tinkering with existing policies might have dampened the rate of investment and economic growth."[440] Barrett (1997: 450), based on a much larger sample set of interviews with elite officials of the Concertación, similarly claimed that the government was limited in its exploration of "more interventionist policy alternatives" because it needed to foster business confidence.[441] Interestingly, even officials working at the Central Bank, an institution that in Chile and most countries tends to recruit policymakers closer to macroeconomic orthodoxy and reluctant to praise industrial policies, have similar recollections of the impact of business power on constraining any departure from the neoliberal path: a Concertación appointee at the Central Bank during the 1990s noted,

> *[There were] things we wanted to do but we couldn't, [such as] industrial development policies; it was vetoed. If we talked about that, we had the press falling upon us and all the neoliberal extremism […]. [A more aggressive industrial policy was not possible because] we were suspect that we were going to do all sorts of nonsense, so for us it was completely impossible in the year 1990 to start saying: "look, we will privilege this sector, or that." There was no condition whatsoever to do that.*[442]

By the late 1990s, the sustained high economic growth rates and large business profits associated with them had made business disinvestment threats less credible. However, in the early 2000s, at the beginning of the third consecutive Concertación administration, the government's relation with business "soured dramatically" (Silva 2002: 339). When Ricardo Lagos sworn in as the first Socialist president of the center-left coalition in 2000, amidst the economic recession triggered by the East Asian crisis, business's structural power went up again and the executive branch leaders felt the need to "'prove' their ability to govern the economy."[443] The following quote from an interview with the finance minister who served throughout the Lagos presidency (2000-2006) is a piece of evidence indicating that business disinvestment

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[439] Kaplan's interview with Alejandro Foxley, Minister of Finance (1990-1994), September 29, 2011 (Kaplan 2013: 206).

[440] Silva (1996: 232).

[441] Barrett's interviews with Sergio Molina, Planning Minister (1990-1994); Óscar Landerretche, economic adviser of President Aylwin; Mario Lanzarotti, economic adviser of President Aylwin; Santiago, April-June 1993 (Barrett 1997: 450).

[442] Madariaga's not-for-attribution interview with Central Bank official during the 1990s, Santiago, October 18, 2012 (Madariaga 2015: 96, 197).

[443] Fairfield (2010: 74).

threats were relevant: "The Lagos government at the end of the day convinced the entrepreneurs that we are pro-market—not pro-businesses, [but] at least we were pro-market—that we were not old-fashioned socialists."[444] President Lagos himself, interviewed for an academic project, said that business distrust was high, as he was the first president associated with socialism since President Salvador Allende in the 1970s; Lagos explained,

> *There was something implicit especially when I became President. [Business leaders would say,] "Look what happened with the last Socialist President. This guy does not know how to run the economy." We were always under suspicion…*[445]

4.II. Statist Mechanisms Locking in Low-Level State Involvement in Credit Markets

The resilience of a neoliberal model by which the state continued to be minimally involved in the direct provision of credit for the private sector during the center-left administrations of the Concertación coalition in the 1990s and 2000s cannot be solely explained with a societal argument based on the strength of the Chilean business community. Matching the expectations laid out in Chapter 2 of this study, in this section I will argue that we cannot understand path continuity in contemporary Chile without looking at within-state micropolitics, the reshaped state structures, and intrinsic features of policies themselves. While analytically these are separable explanatory factors, in the concrete trajectory of the Chilean case these drivers were entangled and even interacted with business power; for this reason, this section presents evidence on these factors in their full complexity, not attempting to isolate them from each other.

As I have shown in Section 2.III, during the Pinochet dictatorship, neoliberal elite officials drastically changed the institutional-organizational structure of the Chilean state. This involved simultaneous moves of construction and destruction of administrative capacities: the Ministry of Finance (*Ministerio de Hacienda*) was strengthened so as to assume a dominant position in the policy making process, whereas the, until then very strong, Economy Ministry (*Ministerio de Economía*) and the development agency CORFO were dismantled, their resources drained.

While this reshaping of the institutional structure of the state was originally inscribed in the formal legislation, it would later on rest on the consolidation of a strong human-resource base in the Ministry of Finance—and the relative lack of resources in the other ministries and agencies—and on long-standing informal practices that are not affected by changes in who seats at the President's office—prominently, the involvement of the Finance Ministry's team of economic advisors in the design of all sorts of policies, including those that do not formally fall under its jurisdiction. For the purposes of this study, what is most important is conveying how the strengthened position of the Finance Ministry within the executive branch was in itself a strong source of positive feedback contributing to the continuity of a retrenched Chilean developmental apparatus, the adoption of merely residual industrial policies, and the consequent low level of state involvement in credit markets.

I have show in Section 2.III that, during the authoritarian period, the Chicagoan neoliberal technocrats reorganized the structure of the state through new legislation. This, as

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[444] Fairfield's interview with Nicolás Eyzaguirre, Finance Minister (2000-2006), Santiago, March 25, 2007 (Fairfield 2010: 118).
[445] Kaplan's interview with Ricardo Lagos, President of Chile (2000-2006), Brown University, April 16, 2010 (Kaplan 2013: 66).

Sandbrook et al. (2007) put it, gave the Finance Ministry "ultimate authority over all decisions with financial implications, a measure that weakened the policy strengths of other ministries and agencies within the state and bolstered fiscal conservatism."[446] Teichman (2001: 86-7) found that the Concertación administrations maintained this legislation; Pribble (2008: 114) argued that they even strengthened the law's original spirit: a 1990 rule stated that the legislation sent for the president's signature from then on had to come along with a report prepared by the Finance Ministry, assessing the financial implications of proposed reforms.

The Finance Ministry is not just institutionally strong: as Silva (2008: 178) claimed, it has enjoyed "relative autonomy" within the cabinet since the very first of the four consecutive Concertación administrations. Presidents have deferred to Finance ministers the appointment of the so-called *equipo económico* (team of economic advisors), with the argument that this was essential to secure policy coherence.

The distribution of human resources across the agencies of the Chilean executive branch is highly unequal, and the Finance Ministry stands out for having the largest technically trained teams.[447] Teichman (2001: 84, 88-9) remarked that the Finance Ministry stood out within the Chilean state for having the most "cohesive, integrated, and homogeneous" policy elite, with a strong esprit de corps, a strong institutional identity, and powerful loyalty to the state. An elite official who worked at the Ministry in the 2000s and 2010s depicts these technical teams as follows,

> *There are two different types of staff within the Ministry of Finance. One is the stable bureaucracy. The other is the body of advisors* [cuerpo de asesores]. *This group serves [...] as the minister's armed wing* [brazo armado]. *There are contrasts between these two groups of staff within the Ministry of Finance: the former are career bureaucrats of the highest level, the latter are technocrats that are willing to work 24/7 for a couple of years. Those who are part of the* cuerpo de asesores *feel that they are making the country: it is a very small group of people that makes very big decisions.*[448]

The key part of the bureaucracy in the Ministry of Finance—because of its influence in policymaking within and outside the Ministry—works at the Budget Office (*Dirección de Presupuestos* or DIPRES), deals with fiscal and budgetary affairs, and is highly stable; many officials have worked there for over thirty years.[449] The origins of this strength in human capital can be traced to the years of the dictatorship: in the Ministry of Finance civilians enjoyed most autonomy, whereas in the other ministries the presence of military officers was much larger[450]—civilian control of the Ministry was a precondition for establishing long bureaucratic tenure and developing in-house technical expertise.

Just as (if not more) important as the career bureaucrats at DIPRES is the Ministry's team of economic advisors. During the contemporary period (1990s-present) the team of economic

[446] Cited by Pribble (2008: 114).

[447] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), Santiago, 2014.

[448] Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014.

[449] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), Santiago, 2014.

[450] Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014.

advisors has been composed of between five and fifteen elite technocrats, each of whom has had on average a staff of five.[451] This body of advisors has "huge intellectual caliber," almost all of its members have PhDs[452] and receive wages well above those of career bureaucrats; belonging to this group is a source of great prestige and thus becomes a milestone in the career of these elite economists.[453] The body of advisors itself has evolved to have stability—some advisors were maintained across several Concertación administrations—"it is institutionalized in practice."[454] According to one of my interviewees, what makes the Finance Ministry's advisors so special within the executive branch is that—in contrast with all other ministries, which appoint advisors on the basis of "political friendship"—Finance Ministry advisors have always been appointed on the basis of technical knowledge; "this has given the *Ministerio de Hacienda* an advantage over the other ministries."[455]

The Finance Ministry's strength is associated with a long-standing informal practice that has reinforced its dominance within the executive branch: the members of the team of economic advisors appointed by the Finance Minister participate in the design of multiple policies that formally do not pertain to the ministry's tasks, often acting as veto players.[456] Certainly, this unwritten rule of politics within the state in Chile was originally championed and successfully established by the Chicago Boys during the late 1970s and 1980s; less obvious is the fact that elite officials during the Concertación administrations fought to sustain this informal institution. Montecinos (1998) indicates that this was the case since the very first term of the Concertación in office (1990-1994):

> *The economic team requested and obtained significant leverage in order to resist pressures for increased government spending. […] Against the complaints of sectorial ministries, but with the support of the President, the jurisdiction of [Finance Minister Alejandro] Foxley's team encompassed policy areas that were well beyond the traditional boundaries of the Finance Ministry.*[457]

Teichman (2001: 88, 231-2) found that the leverage of the Finance Ministry within the executive branch increased over time in the 1990s; she attributed this concentration of power to "the conscious attempt to block pressures for increased expenditure from within the state." A top technocrat who served in multiple top-positions at the Ministry of Finance said that, by the late

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[451] Author's interview with María Eugenia Wagner, Advisor to the Finance Minister (1994-2000), Deputy Secretary of Finance (2000-2006), Santiago, November 19, 2014; Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), Santiago, 2014.

[452] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), Santiago, 2014.

[453] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #3), Santiago, 2014.

[454] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #3), Santiago, 2014.

[455] Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014.

[456] Pribble (2008: 113-4, 172-4, 252-4) makes a similar point specifically about the Finance Ministry's strong leverage in designing and reviewing education and healthcare reforms.

[457] Cited by Silva (2008: 179).

2000s, this informal practice continued to be central to the functioning of policymaking within the executive branch:

> *Because of its advantage in human resources vis-à-vis the rest of the Chilean state, the Finance Ministry ends up participating in the making of multiple sectoral policies, even those that do not have anything to do with finance. The Ministry of Finance has strong capacity to design policies… [Thus,] it sends its troops [to other parts of the state] [*"manda su tropa"*].*[458]

Table 4.3 shows the highly technocratic profile of all five Finance Ministers that served during the coalition's four consecutive administrations; all of them received doctoral training in American departments that the specialized literature identifies as bastions of neoclassical economics.[459] The most systematic studies available on technocracy within the Chilean executive branch (Dávila-Avendaño 2010; Silva 2008) identified that the Finance Ministry stood out for having constantly concentrated elite officials with graduate training in economics in US American universities. Teichman (2001: 232) has noted, "graduates of schools with a strong neoclassical economic orientation tend to gravitate toward the Finance Ministry […] (for example, graduates of the University of Chicago), while those with training in other fields (such as sociology) and economists with more flexible training tend to find their way into other ministries […]."

Table 4.3. Chile. Finance Ministers' Educational Background During the Center-Left Administrations of the Concertación, 1990-2010.

Alejandro Foxley (1990-1994)	Ph.D. in Economics, University of Wisconsin–Madison
Eduardo Aninat (1994-1999)	Ph.D. in Economics, Harvard University
Manuel Marfán (1999)	Ph.D. in Economics, Yale University
Nicolás Eyzaguirre (2000-2006)	Ph.D. (c) in Economics, Harvard University
Andrés Velasco (2006-2010)	Ph.D. in Economics, Columbia University

Source: Author's elaboration based on data from Silva (2008).

My interview evidence coming from top-level politicians and officials systematically suggests that the Finance Ministry got stronger over time, operating as the most important veto within the executive branch to any attempts to expand the state's involvement in the provision of investment finance. A former Economy Minister—who, in contrast with the US-trained officials at the *Ministerio de Hacienda*, holds a Ph.D. in Economics from the University of Paris X-Nanterre—explained to me:

> *Paradoxically, the central role that the Ministry of Finance plays within the executive branch, which started during the dictatorship, only grew larger with the Concertación. This trend deepened during the terms of Eyzaguirre and Velasco…* Hacienda *became absolutely determinant. Eyzaguirre went as far as suggesting that the Ministry had to become a sort of vice-presidency, which revealed [*sinceraba*] his vision. Velasco was*

[458] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), Santiago, 2014.
[459] See Chwieroth (2007b: 10-2; 2010: 34-5).

in practice a vice-president; he was able to do whatever he wanted to do [...]. The Ministry imposes discipline through its control of the budget.[460]

A former elite official at the Ministry of Finance concurred with this vision: "the Minister is like a vice-president; it is as if there were a president for the nation and an economic vice-president;" and he added that such concentration of power "is politically troublesome: the other ministries resent it."[461] This is consistent with earlier findings by Teichman (2001: 89-90): "Intense conflicts occur between the Finance Ministry technocrats and the technocrats of other ministries […]. Such conflicts over policy priorities normally, however, do not become public knowledge; [h]ighly trained technocrats at the helm of the Finance Ministry, many of them with expertise in particular sectors, scrutinize the budget of other ministries each year and turn down programs they believe are expendable."

Throughout the 1990s and 2000s the orthodox officials at the powerful Finance Ministry worked to leave off the agenda any sort of significant expansion of the role of the state in credit markets. Analyzing this micropolitics is important insofar, in line with my framework, in Chile the disputes within the executive branch on this policy domain take place below the presidential level and rarely become publically salient; this issue is widely perceived as not having pertained to the set of highest-order political goals for the Concertación administrations and, hence, presidents have not got personally involved.[462] As a high-level official at CORFO in the 1990s and 2000s argued, "at the Ministry of Finance they are terrorized [*tienen terror*] by the idea of having a development bank."[463] As the following quote shows, this official traces this strong resistance to a combination of ideational drivers and business power:

All Finance Ministers are macroeconomists trained in the East Coast of the United States in the 1980s and 1990s, and they feel terrorized by industrial policy. Every once in a while, when an economic crisis hits, a window of opportunity opens up, and the option of talking about industrial policy opens too. In those contexts people like myself have argued that we need way stronger tools than those we have if we want to reconvert the productive apparatus, we contend that it is not enough with small [industrial policy] instruments. But then a second source of blockade emerges: that is, the terror for the fiscal cost of a potential development bank. And, as the Chilean business community is not even influenced by the East Coast [economic thought] but, rather, by that of the Great Lakes, then such discussion about industrial policy becomes tricky for the Finance Ministry officials—they understand it's best not to venture into such discussion because that would be received negatively by the private sector.

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[460] Author's interview with Carlos Ominami, Economy Minister (1990-1992), Senator (1993-2010), Santiago, December 3, 2014.

[461] Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014.

[462] Author's interviews with Carlos Álvarez, CORFO Manager and CEO (1995-2004; 2006-2010), Deputy Secretary, Economy Ministry (2004-2006), Santiago, November 26, 2014, and Eduardo Bitrán, Advisor at the Finance Ministry (1990-1994), Senior Executive at CORFO (late 1990s), CORFO CEO (2014-2015), Santiago, November 24, 2014.

[463] Not-for-attribution interview with top-level official at CORFO (1990s and 2000s) (CORFO Interviewee #1), Santiago, 2014.

Former elite officials at the Finance Ministry share most of this depiction regarding their rejection of the desirability of having stronger developmental banking functions in Chile. One of them told me, "within the Concertación there is no shared vision about the need to have a stronger involvement of the state in credit markets; the Finance Ministry never bought such idea."[464] Likewise, an official who occupied elite positions at the Finance Ministry for over ten years during the center-left administrations, said "Chile has a model built around the idea that the private sector is the one that carries out investment and generates development; in that model the role of the state is to regulate properly […] If you want to have fiscal surplus, you cannot have CORFO granting loans as it wishes."[465] A former top advisor at the Finance Ministry—whom Silva's (2008: 187) study of technocracy identifies as "a clear defender of market economy […] and [the] reduction of the entrepreneurial role of the state"—told me in an interview that the dominance of neoclassical macroeconomists among the economic team members (*equipo económico*) "gave an orthodox profile to the Concertación, which saw no role for the state" in providing investment finance.[466] One of the few top *Hacienda* advisors who had obtained his Ph.D. in France's EHESS, told me that during the 1990s "'industrial policy' was a taboo concept [*concepto hereje*]" for the economists that dominated within the Concertación administrations.[467]

The evidence indicates that this market-oriented elite officials at the Finance Ministry—who were not drawn from business circles but, rather, technocrats politically loyal to the Concertación (Fairfield 2010: 83-4)[468]—often invoked the likelihood of triggering business opposition as an argument to defeat the pro-industrial policy program championed by the more developmental officials within the administration, thereby vetoing any shift towards larger state involvement in credit markets. Business power can thus be thought as having an interaction effect with the orthodox appointees' own causal beliefs.

Fairfield (2010: 83) argued that during the Concertación administrations Finance ministers faced "significant pressure" from within the coalition to "deviate further from the neoliberal economic model than they feel prudent;" her own interview with Finance Minister Eyzaguirre (2000-2006) substantiates the claim that the threat of business retaliation was utilized by market-oriented technocrats to counterbalance the pressure they received from fellow members of the executive branch: Eyzaguirre said,

> *I did have a lot of opposition, because the ones that were saying that the model didn't work ... and ask[ing] for more state involvement were very vocal ... The new generation of business leaders… saw that Lagos and I were macro-economically responsible, that [we] would defy the ones within our sector that wanted to be more Keynesian […].*

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[464] Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014.

[465] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #3), Santiago, 2014.

[466] Author's interview with Eduardo Bitrán, Advisor at the Finance Ministry (1990-1994), Senior Executive at CORFO (late 1990s), CORFO CEO (2014-2015), Santiago, November 24, 2014.

[467] Author's interview with Guillermo Larraín, Coordinator of Policy at the Ministry of Finance (1997-2000), Santiago, June 2, 2014.

[468] Dávila-Avendaño (2010) does an excellent job in showing that these appointees combined a technocratic profile with long-dated *political* allegiances with the center-left parties.

Along these same lines, a top business leader that enjoyed very fluid access to Finance ministers, referred to an anecdote that illustrates how business power and politics within the state interact in contemporary Chile: "Once a Concertación Finance Minister, whose name I won't cite, told me, 'the best thing that can happen to Chile is to have a Congress dominated by the right parties [whose core constituency is business]; that way, I can blame the right and avoid adopting policy that in any case I don't want to adopt.'"[469] I presented this quote to two former elite officials with long trajectories at the Finance Ministry; they both agreed that it was an accurate depiction of the rationale of the Ministry.[470] A veteran Concertación Senator who criticized the dominance of orthodoxy at the Finance Ministry reacted as follows, "what the quote says is true: there were issues pushed by the left within the Concertación [coalition] that Finance ministers disliked, so they would invoke the argument that it was the opposition in the right who would veto those proposals, but in fact they were the ones vetoing them."[471]

I asked a veteran Concertación technocrat, who spent the early 1990s working as a top advisor at the Finance Ministry and would later move on to hold top positions at CORFO, whether the minimal role that CORFO continued to play during the Concertación administrations was more a product of conviction or a product of constraints posed by veto players outside the Concertación. He replied, "it was conviction… inhibition due to conviction," and he substantiated his argument by explaining that the institutional design enables CORFO to significantly expand its lending capacity without need to go through Congress: "CORFO can issue all the debt it wants [and use that funding to expand its credit portfolio], but in the 1990s and 2000s the Finance Ministry has been so strong that it has managed to impose its fiscal austerity [*fiscalista*] criterion."[472]

Ultimately, the conviction of the elite officials at the Finance Ministry against increasing the direct involvement of the state in credit markets cannot be dissociated from their proactivity in pushing multiple new regulations to strengthen the Chilean domestic capital market, the focus of Chapter 6. In this market-oriented technocratic approach, development banking and capital markets are seen as alternative rather than complementary sources of investment finance; hence, blocking the former is consistent with favoring the latter.[473] This is well captured in the memoirs of a former Economy Minister and veteran politician of the Concertación. In a chapter titled "[The Concertación's] Unfulfilled Promise of Development," he wrote that the existing state institutions "reproduce" the lack of "significant transformation of [Chile's] productive apparatus":

> *The primacy exerted by the Finance Ministry [...] does not contribute to opening spaces for new productive development. These years [1990s-2000s], the Finance*

[469] Not-for-attribution interview with top business leader, Santiago, 2014.
[470] Not-for-attribution interviews with top-level officials at the Ministry of Finance (1990s- 2010s) (Finance Ministry Interviewees #1 and #2), Santiago, 2014.
[471] Author's interview with Carlos Ominami, Economy Minister (1990-1992), Senator (1993-2010), Santiago, December 3, 2014.
[472] Author's interview with Eduardo Bitrán, Advisor at the Finance Ministry (1990-1994), Senior Executive at CORFO (late 1990s), CORFO CEO (2014-2015), Santiago, November 24, 2014. Another top official agreed that the driver of continuity was the "*conviction of the government's dominant economists rather than the fear of facing opposition*" [Not-for-attribution interview with top-level official at the Economy Ministry (1990s and 2000s), Santiago, 2014].
[473] This contrasts with the neo-developmental perspective, which sees development banks and capital markets as complements, as the chapters on Brazil show. I go back to this issue in Chapter 7.

> *Ministry has proven that it is a good safeguard of fiscal equilibrium, but this does not turn [the ministry] into a great creator of value. [The Ministry's] energies have been much more strongly devoted to the development of capital markets, under the questionable assumption that through [the capital market] channel we will end up expanding [the country's] productive capacities.*[474]

This perception of a critic of the dominant orthodoxy matches the self-assessment of a former elite official at the Finance Ministry, who told me, "In Chile, every time we want to do supply-side economics [to increase investment in capital] we focus our efforts on improving the regulation underpinning capital markets."[475]

4.II.i. State Structures, Policy Legacies, and the Repeated Defeats of Heterodox Officials Within the Concertación

The strength of the Finance Ministry throughout the post-1990 period contrasts with the weakness of the loci of industrial policy in the Chilean state, namely the Economy Ministry and CORFO. Weakened institutional capacity, along with legacies intrinsic to earlier industrial policy itself—i.e. poor standards in the allocation of CORFO credit during the late 1980s and CORFO's conversion from a first- to a second-tier bank—are therefore statist mechanisms of neoliberal resilience.

By the time the Concertación took power in 1990, CORFO had basically been turned into an agency in charge of administering the financial side of the privatization process and the relatively few SOEs that had not been privatized (Muñoz Gomá 2009: 12); CORFO's division for the provision of long-term credit for investment finance, for its part, had gone through years of decay and lack of institutional modernization (Jiménez 2009: 55). As Barrett (1999: 15) argued, the Concertación has "made no effort" to institutionally strengthen the developmental apparatus that had been greatly weakened during the authoritarian period. In contrast with what we have observed with regard to the Ministry of Finance, CORFO continued to lose institutional capacity: its mission was curtailed during the Aylwin administration (1990-1994), its payroll was reduced by 30 percent in 1995-1996, and in 1997 it lost ministerial status and it ceased to have control over the SOEs that had not been privatized. By 2010, CORFO had a small staff of 27 dedicated to the management of credits, not all with the required experience in banking.[476]

Though the Concertación's 1989 electoral platform had declared that it was necessary to reconvert the Economy Ministry into a Ministry of Industry and Commerce to revamp its developmental role,[477] this institutional strengthening never occurred; the Economy Ministry continued to be very weak vis-à-vis the Finance Ministry. Barrett's (1997: 451) evidence indicates that the Ministry lacked human resources with the required expert knowledge, and even technological equipment. A former elite official who worked at the Economy Ministry in the 1990s and 2000s said to me: "there is an institutional problem: the Economy Ministry is weak, it

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[474] Ominami (2011: 100).
[475] Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014.
[476] Agosin et al. (2010: 14).
[477] Concertación de Partidos por la Democracia, *Programa Básico de Gobierno*, 1989.

doesn't have the strength of the Finance Ministry—we would need a new Ministry of Development with enough power to be able to have discussions with the Finance Minister."[478]

Policy legacies played an important role too. When the Concertación took power in 1990, it became clear that during the last part of the military dictatorship, the already highly retrenched CORFO had been utilized as a tool of political clientelism rather than as a development bank. This use of CORFO as a source of credit for political friends[479] was contemporary to the privatization of some SOEs that were in practice given away to military officers or to close friends of the dictators—the showcase example being that of the formerly state-owned chemical company Soquimich, whose control was ceded to Pinochet's son in law.[480] It was calculated that these poor practices in CORFO's direct allocation of credit to firms generated a loss of US$555 million for the Chilean state (adjusting for inflation, the equivalent to roughly US$910 million of 2014).[481] The first Concertación Economy Minister, in charge of CORFO, recalled, "when I took office, CORFO had gone bankrupt as a consequence of decisions made during the dictatorship—CORFO had a loan portfolio that was impossible to get repaid; the military government had granted multiple credits to political friends, even the chief of the political police was a debtor of CORFO!"[482]

My interviewees agree that such ruinous past credit allocation was the main reason that led, by mid-1990, to the conversion of CORFO into a second-tier bank.[483] Instead of providing direct credit to firms, as it had done throughout its history, since then CORFO has been restricted to injecting investment finance into the productive sector through commercial banks.[484] At the time it was argued that a second-tier bank would be less prone to be captured by business actors, it would face lower risks, benefit from private banks' capacity to score firms requesting credits,[485] and that rates of loan non-payment—and the fiscal cost associated with it—would decline significantly.[486] The conversion of CORFO into a second-tier bank echoed the World Bank's skeptical vision in the late 1980s with regard to the state's capacity to directly allocate credit efficiently.[487] As my interviewees explain, however, the legacy of that 1990 decision to convert CORFO into an exclusively second-tier bank had major implications for the two decades that followed.

A former elite official that has challenged the dominant coalition of orthodox economists at the Ministry of Finance argued that, though it was true that CORFO's direct credit allocations

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[478] Not-for-attribution interview with top-level official at the Economy Ministry (1990s and 2000s), Santiago, 2014.

[479] Jiménez (2009: 55); Author's interviews with Carlos Álvarez, CORFO Manager and CEO (1995-2004; 2006-2010), Deputy Secretary, Economy Ministry (2004-2006), Santiago, November 26, 2014; and Felipe Sandoval, CORFO CEO (1994-1997), Santiago, June 6, 2014.

[480] Madariaga (2015: 96, 196).

[481] Foxley (1998: 10).

[482] Author's interview with Carlos Ominami, Economy Minister (1990-1992), Senator (1993-2010), Santiago, December 3, 2014.

[483] In addition to those already cited in this section, Author's interviews with Eduardo Bitrán, Advisor at the Finance Ministry (1990-1994), Senior Executive at CORFO (late 1990s), CORFO CEO (2014-2015), Santiago, November 24, 2014, and Gonzalo Rivas, CORFO CEO (1997-2003), Santiago, June 3, 2014.

[484] CORFO credit lines are auctioned to commercial banks on the basis of the interest rates that these institutions offer to charge corporate borrowers (Agosin et al. 2010: 13).

[485] Jiménez (2009: 56).

[486] Non-payment was, in effect, eradicated (Foxley 1998: 10).

[487] Author's interview with Gonzalo Rivas, CORFO CEO (1997-2003), Santiago, June 3, 2014.

had been poorly managed during the dictatorship, this assessment was incorrectly "extrapolated to the future: [orthodox officials] concluded 'nobody repays CORFO loans, therefore it's best for CORFO not to lend any more.'" He added: "this decision to turn CORFO into a second-tier bank should have been temporary, but it became permanent; the predominance of neoliberals in government contributed to the Chilean state not going back to having developmental banking functions."[488]

Another top official, who was among those pushing in the 1990s and 2000s to increase the level of state involvement in credit markets and was defeated by the dominant orthodoxy within the Concertación, vividly remarked, "this decision to turn CORFO into a second-tier bank made life easy for Finance ministers in the following years"[489]:

> *From then on, instead of working to develop institutions of good governance so as to potentially build a development bank that would avoid the rent seeking and bad practices of the past, it was decided that CORFO would continue to operate only as a second-tier bank. This was the perspective that the World Bank had always had: private commercial banks should be the ones in charge of all the analysis involved in allocating long-term credit to firms, the state bank is limited to providing the funds… [Those supporting this perspective] trusted that competition among private banks would guarantee an accurate analysis of the firms in need of credit.*

The heterodox officials in the Concertación administrations "once and again" brought up the need to have a development bank in Chile, "but they always lost."[490] Unsatisfied with the dominant orthodox vision, they attempted to take advantage of situations of sluggish economic growth to steer the debate within the ruling Concertación towards a larger state involvement in credit markets:

> *During the first Michelle Bachelet administration we started to have discussions about the possibility of having a development bank. In part, this was possible because Finance Minister Andrés Velasco was more receptive to this sort of ideas than all his predecessors at the Ministry… Velasco had worked with [Harvard Professors] Ricardo Hausmann and Dani Rodrik and he was more open to talks about industrial policy—on this issue he was less ideological than in other issues such as labor market regulation, in which he was much more conservative.*
> *[…] Our proposal was to have CORFO or a new development banking institution issue bonds and [with those funds obtained in the market] turn it into a first-tier bank. This initiative was based on the assessment that, in contrast with the diagnosis held until then, the low level of long-term credit for SMEs in Chile was not a problem of demand but rather of supply. Our proposal implied allowing ourselves to think once again that there was a problem of shortage of supply of long-term credit for SMEs.*
> *[…] But the Finance Ministry officials are always fearful [when they receive such type of proposals]… they always remember what they studied in Boston and respond with the World Bank's perspective. Such perspective is incomplete because it neglects the*

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[488] Author's interview with Carlos Ominami, Economy Minister (1990-1992), Senator (1993-2010), Santiago, December 3, 2014.
[489] Not-for-attribution interview with top-level official at CORFO (1990s and 2000s) (CORFO Interviewee #1), Santiago, 2014.
[490] Author's interview with Eduardo Bitrán, Advisor at the Finance Ministry (1990-1994), Senior Executive at CORFO (late 1990s), CORFO CEO (2014-2015), Santiago, November 24, 2014.

fact that Canada and several European countries have excellent first-tier state-owned development banks. That's what the officials at the Finance Ministry don't know… it's necessary to ask them to travel to get to know these [experiences].
Our proposal did not progress much and it was eventually paralyzed due to lack of support within the government.[491]

Throughout the four consecutive Concertación administrations in the 1990s and 2000s, an ideational dispute between "horizontalists" and "verticalists" has been in the background of the continuity of a minimal role for the state in the provision of investment finance.[492] On one side, orthodox elite officials strongly defended the need to maintain the state's neutrality towards the productive sector. On the other side, heterodox officials, whose strongholds were the Economy Ministry and CORFO, contended that a departure from neutrality and an embracement of some level of state-led selectivity, through the adoption of vertical policies, was needed in order to bring about a transition towards a higher value-added exporting economy. Barrett (1997: 447) nicely synthesized these competing perspectives:

[Horizontalists] argued for limiting state intervention to the maintenance of macroeconomic stability and the neutral application of policy to all economic agents. This position reflected a fundamental confidence in the strength of Chile's economy, in the allocative efficiency of market signals, and in the awakened "animal spirits" of Chile's new generation of entrepreneurs. By contrast, those advocating selective policies, drawing on lessons from East Asia, argued for some version of industrial policy which would actively favor those sectors seen as providing the greatest potential for a more advanced stage of export-led growth.

According to one of my interviewees, who worked as a senior advisor at a Finance Ministry where the horizontalist vision was prevalent, the economists that dominated in the Concertación administrations "had bought the Chicago School's argument against 'picking winners;' since the bureaucracy cannot know better than the market, it's best to just have neutral policies."[493]

A former Coordinator of Policy at the Finance Ministry who opposed this orthodox approach recalled, "the question we asked ourselves in the 1990s was how to convert CORFO from basically being just a support for SMEs into a real industrial policy agency […]; according to the dominant perspective, CORFO had to limit itself to horizontal policies, it wasn't allowed to privilege sectors so as to transform Chile's productive structure."[494] In a co-authored book, this same former top official was in charge of a chapter where he laid out the verticalist perspective, reviewing its defeats: "For over thirty years now [the position that holds that] the state must not privilege specific [economic] sectors has dominated Chilean politics. […] Chile is reaching the limit of what neutral policies can achieve, therefore it is necessary to move on to the

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[491] Not-for-attribution interview with top-level official at CORFO (1990s and 2000s) (CORFO Interviewee #1), Santiago, 2014.
[492] Agosin et al. (2010: 9) refer to this "active debate inside the [Concertación] administration" too.
[493] Author's interview with Eduardo Bitrán, Advisor at the Finance Ministry (1990-1994), Senior Executive at CORFO (late 1990s), CORFO CEO (2014-2015), Santiago, November 24, 2014.
[494] Author's interview with Guillermo Larraín, Coordinator of Policy at the Ministry of Finance (1997-2000), Santiago, June 2, 2014.

next stage, that of sectoral policies of growth promotion."[495] The chapter draws on the cases of Korea, Malaysia, and Taiwan to draft an industrial policy agenda for Chile. In the pro-vertical policies perspective, a "massive fiscal effort" over a long period of time would be essential; "in Chile there are some industrial policies but the amount [of resources] dedicated to this goal are marginal and thus do not have any significant impact."[496] Expressing the view of the defeated heterodoxy within the Concertación, this former top advisor at the Finance Ministry argued that the greatest impact of such more aggressive, selective industrial policy would be to "break the inertia by which the inputs utilized by the industries that exploit natural resources are imported instead of being produced domestically." This perspective supports a significant growth of state involvement in credit markets, making the case that "subsidies are better than tax exemptions" because they ensure higher levels of visibility and transparency.[497]

While verticalists did gain some leverage within the executive branch in the 2000s and some vertical industrial polices were in fact adopted on the margins,[498] these economically heterodox political *técnicos* continued to be a minority in an executive branch dominated by orthodox technocrats who preferred horizontality. Weighing with precision the impact of the repeated defeats of heterodox/verticalists on the continuity of low state involvement in credit markets is somewhat slippery in light of the presence of reshaped state institutions and policy legacies, as reviewed in this section. Is there an explanatory factor that prevails over the others? Had the heterodox/verticalists managed to advance their position in the internal debates among the elite officials of the Concertación, they would have faced the uncomfortable situation of trying to deepen state involvement in the recrafting of the Chilean productive apparatus with state institutions that were severely ill equipped for such daunting task. It suffices here to note that there probably were interaction effects amongst these factors, with past legacies affecting—but not entirely predetermining—the outcomes of these new rounds in the micropolitics within the executive branch.

5. Chile By the Mid-2010s: The Resilience of Low State Involvement in Credit Markets

During the over two decades that followed the restoration of democracy, societal and statist mechanisms have reproduced the pattern of minimal state involvement in credit markets, which has its origins in the dictatorial regime. Ten years after the end of the neoliberal authoritarian period, and after two consecutive center-left administrations of the Concertación, CORFO credit was virtually negligent:[499] its loans had come to represent 5.5 percent of Chile's long-term bank credit for firms, eight percentage points down from what they had been in 1989.[500] Figure 4.1 uses the available comparable data to portray this continuity, which stands in stark contrast with the baseline period of Chile's statist model that opens this chapter.

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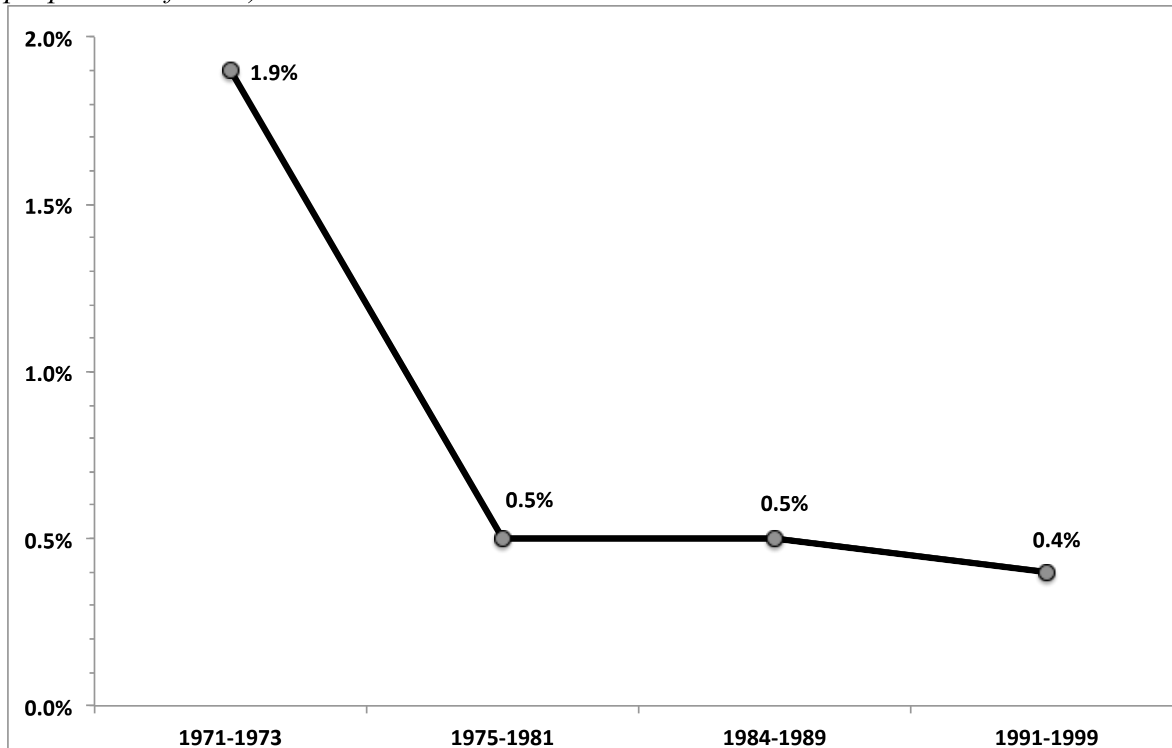
[495] Atria et al. (2013: 286-7).
[496] Atria et al. (2013: 306-9).
[497] Atria et al. (2013: 310).
[498] See Agosin et al. (2010); Atria et al. (2013: 283-90, chapter 17).
[499] Throughout the 1990s CORFO's loan portfolio for long-term investment was lower than US$100 million; it peaked in 1999 at a still very marginal figure, just above US$150 million (see data in Jiménez 2009: 62).
[500] Foxley (1998: 15).

Figure 4.1. Chile. Fiscal Effort in Industrial Policy, 1970s-1990s (Capital transfers as a proportion of GDP).



Source: Author's adaptation of Madariaga (2015: 71, 84, 100) based on data from Wagner et al. (2000).

By 2009, CORFO had a loan portfolio of US$550 million, which equaled to as little as 0.3 percent of the Chilean GDP.[501] This was even smaller than the volume of CORFO credit by the last year of the dictatorship.[502] By 2009, one of CORFO's most important new programs, FOGAIN, which provides collateral so that SMEs become eligible to obtain long-term loans from commercial banks, was considered a success—but it channeled an amount of funds that is residual in aggregate terms: US$330 million.[503]

As Agosin, Larrain, and Grau (2010: 13-4) point out, CORFO's lending capacity is small when compared to the needs of long-term finance by the country's SMEs—the business population that CORFO intends to target. CORFO credit represents just 1.1 percent of the total portfolio of Chile's financial system. This is a very small proportion when compared to similar institutions in other Latin American countries that have adopted market-oriented reforms, such as Mexico's Nafin (9.7 percent) or Colombia's Bancóldex (5.3 percent). When I asked two former CORFO top-level officials whether they thought that CORFO credit had a significant impact over the Chilean economy, they replied that it did *not* because of the small size of CORFO's loan portfolio.[504]

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[501] My calculations based on data from Muñoz Gomá (2009: 12) and the World Bank.
[502] Adjusting for inflation, the volume of CORFO loans in 1989 was equivalent to US$1.1 billion (my calculations based on data from Foxley 1998: 11).
[503] Data from Jiménez (2009: 63).
[504] Not-for-attribution interviews with two former CORFO top-level officials (CORFO Interviewees #2 and #3).

In the 1990s and 2000s, multiple initiatives were set in motion thanks to the action of elite Concertación officials who challenged the orthodox perspective entrenched at the all-powerful Finance Ministry. Though these policies were erratic and adopted spasmodically, they shared a diagnosis that differed from that of the orthodox officials at the *Ministerio de Hacienda*: Chile's "miraculous" growth had not succeeded in bringing about much-needed industrial upgrading so as to push the country towards higher value-added production; horizontal industrial policies would not suffice to bring about such industrial upgrading—hence, it was necessary to go back to policies that prioritized some sectors over others—; a new industrial policy for Chile required the state to play a larger role in credit markets; and such larger involvement in credit markets should not be restricted to the smallest firms in the country.[505]

While the implications of the diagnosis that underpinned the several initiatives pushed by officials challenging the orthodoxy were quite ambitious, in practice they all ended up being marginal changes made to an overall pattern of continuity. Thus, the adoption in the 1990s and 2000s of what I would call residual industrial policies should be interpreted as additional evidence of the resilience of the small-state model rather than as evidence of incremental change—let alone, a departure of such path.[506] A pro-industrial policy interviewee describes with resignation what he observed during these two last decades within the Chilean executive branch:

> *Those in charge [*los que mandaban*] had this conviction that CORFO had to have this limited role. And then it was us, those who thought differently, and who basically said to ourselves, 'our context is limited because of the Ministry of Finance, which categorically rejects the idea of having a development bank… and in this context it's best to do something than do nothing.'*[507]

In 2010 the Inter-American Development Bank (IADB) commissioned an assessment of industrial policy in contemporary Chile. Since it is hard to charge the IADB for having a statist bias, the report is particularly relevant as an external validation of my claims. One of its main findings was that, although most new industrial policy programs had a good design, they have been insufficiently funded (Agosin et al. 2010: 1). In the policy recommendations that concluded the report, the authors claimed:

> *[T]he financing activities of CORFO […] are indeed filling a gap in the financial system and are valuable to SMEs. […] [However,] the scale of [… CORFO long-term credit] is too small, and CORFO is not properly organized as a development bank. It may be useful to transform [CORFO's]* Gerencia de Intermediación Financiera *into a bona fide development bank and to increase the resources it has for on-lending to the segment of the business world it serves.*[508]

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[505] See Agosin et al. (2010).
[506] For a review of these policies with an accent on the role of CORFO, see Muñoz Gomá (2009) and Rivas (2012). Though referring only to the 1990s and only depicting the macro-orientation of the first two Concertación administrations, Barrett's (1999: 14) characterization is similar to mine: the Concertación, he says, "has maintained a cautious, hands off approach to fostering the economy's productive transformation."
[507] Not-for-attribution interview with top-level official at CORFO (1990s and 2000s) (CORFO Interviewee #1), Santiago, 2014.
[508] Agosin et al. (2010: 43).

By the mid-2010s, the Chilean state involvement in the provision of credit for the productive sector was remarkably low. This is surprising on several dimensions. Chile stands out in Latin America for its long history of state strength: it was one of the very few cases with a highly successful experience in state building in the 19th century, which placed it at the very top of the region's rankings of state capacity as early as 1900 and was followed by an accretion of state capacity over the course of the 20th century.[509] The Chilean state had been highly entrepreneurial since the 19th century—when it deployed revenues coming from nitrate- and copper-extraction to develop a large bureaucracy[510]—a trend that deepened with the creation of CORFO in 1939 and its erection and consolidation in the 1940-1970 period as the major financier and guiding force of early industrial development and later deepening into the intermediate- and capital-goods sectors.[511] Only a disruptive project of state retrenchment started and implemented "from above"—as Chile's in the 1970s and 1980s—can explain the depth of this country's shift from statism to neoliberalism, from such high to such low level of state involvement in the provision of investment finance for production. But the radicalness of such transformation may only be grasped by carefully looking at its remarkable resilience, even under conditions that would seem quite likely to have engendered change rather than continuity. Upon the return of democracy in 1990, Chile came to be ruled by a center-left coalition that managed to stay in power for four consecutive presidential terms. This coalition contained important political and technical figures that, departing from the portrayal of Chile as an economic "miracle," were highly critical about the productive profile of the Chilean economy and repeatedly pushed for the state to abandon its hands-off approach so as to foster industrial upgrading. However, the interaction of statist drivers—i.e. the organizational structure of key state institutions as well as features intrinsic to industrial policies themselves—and societal mechanisms—namely, the heightened business power that resulted from state retrenchment—kept Chile on the neoliberal track. In light of the evidence presented in this chapter, it is highly unlikely that Chile shifts to higher levels of state involvement in credit markets in any near future.

6. Final Remarks

This chapter traced the politics of the policymaking process that originated in Chile—and then reproduced over time—a mode of state involvement in markets characterized by the remarkably low level of state-owned development agencies' provision of long-term credit to the country's firms. I showed that top-level officials with a neoliberal policy orientation initiated and then sustained a drastic retrenchment of government lending for the productive sector. This neoliberal policy orientation underpinning Chile's mode of state involvement in markets was not predetermined: during its formative phase in the 1970s and 1980s, as well as in its reproduction stage in the 1990s and 2000s, elite executive-branch officials who challenged this economically orthodox orientation had to be defeated and their influence curtailed.

The resilience of low state involvement in credit markets in twenty-first-century Chile cannot be explained by partisan politics. Center-left coalitions occupied the executive branch uninterruptedly between 1990 and 2010, and then again between 2014 and the present. The

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[509] Soifer (2015: 3, 12-3; 2006, chapter 7).
[510] Sigmund (1990: 347).
[511] Etchemendy (2011: 242-4).

power of right-wing political parties with a stronghold in Congress, which was high in the aftermath of Pinochet's dictatorship, has declined over time. Moreover, while Christian Democratic presidents led the first two center-left administrations (1990-2000), the more recent coalition governments were led by Socialist presidents, to the left of their predecessors (2000-2010 and 2014-present).

This chapter also showed that the origins of low state involvement in credit markets in Chile was not driven from below by business pressure, as another alternative hypothesis holds. Yet my process-tracing analysis indicates that high business power through the 1990s and 2000s did become a relevant mechanism reproducing the path initiated in the mid-1970s. In post-authoritarian Chile, the business community at large strongly and cohesively embraced a preference for fiscal restraint. In this regard, Chilean business starkly contrasts with that of Brazil (see Chapter 3) and most Latin American countries, where such market creed is endorsed less intensely and only by some business sectors. The leaders of Chile's cohesive business community are a small number of giant business groups that, due to the sectoral profile of their assets, do not need the state to step in credit markets or to adopt significantly well-funded industrial policies aimed at providing investment finance. This chapter argued that, during the 1990s and 2000s, the Chilean business was highly effective in making its preference for a small-state bear in the policy process because it enjoyed a constantly high level of instrumental power and relatively long periods of strong structural power. In line with this study's framework, the evidence presented in this chapter therefore indicates that, in twenty-first-century Chile, within-state and societal factors interact to maintain state development agencies' provision of long-term credit to the country's firms at a remarkably low level.

Chapter 5. The Politics of State Involvement in Capital Markets in Brazil

During the last decade the structure of the Brazilian financial system underwent a significant change. Brazil evolved from having a small domestic equity market to one of the most dynamic in the developing world. Stock market capitalization equaled to 14.9 percent of GDP during the 1990s; in the 2005-2012 period it rose to 59.6 percent.[512] While, controlling for economy size, the Brazilian equity market is still smaller than Chile's, its evolution strongly contrasts with Argentina's continued stock market shallowness and with Mexico's small enlargement, even though the three countries started from a similar baseline in the early 1990s—all three with virtually inexistent domestic markets. Behind these aggregate figures evidencing the enlargement of Brazil's domestic capital market there was an important expansion in initial and secondary public offerings. Comparing two eight-year periods (1996-2003 and 2007-2014), the *average* of new corporate equity issuances *per year* in Brazil went from 24 to 80; in the latter period (2007-2014), Mexico, the second largest Latin American economy, scored significantly lower, with an average of 20 new corporate stock issuances per year. In 2011, the capital raised by Brazilian firms in the domestic stock market amounted to 4.5 percent of gross fixed capital formation—a variable that adds both public and private sources of investment—whereas that same ratio equaled to just 1.3 percent in Mexico.[513] Moreover, during the 2000s Brazil became *the* success story in Latin America in the development of domestic private equity and venture capital industries.[514]

In Brazil, the market-oriented reforms conducted during the 1990s were *not* a game changer in terms of domestic equity market enlargement. The partner and head of equities of a leading Brazilian asset management firm, formerly chief investment officer at Franklin Templeton Investimentos Brasil, depicted the situation with harsh terms:

> *[By 2000] Brazil's […] equities market was becoming increasingly irrelevant. In previous years, virtually no new companies had tapped the equity market. No initial public offerings. No secondary offerings. In other words, no money was flowing from private savings into the productive sector. [… B]etween 1995 and 1999 [the capital raised through] public offerings in [the domestic currency]* reals *[added up to] US$550 million. That was nothing.*[515]

In a study prepared for the World Bank, the former head of listings and issuer relations of the São Paulo Stock Exchange (BOVESPA), later on chairwoman of the Brazilian Securities and Exchange Commission,[516] remarked that by 2000 the only successful firms among the very few listing on BOVESPA were those that simultaneously issued equity in the United States: "[t]his fact highlights the weakness of Brazil's equity market in those days. Brazilian companies had no alternative but to 'rent' the credibility and depth of another better-regarded market if they wanted

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[512] My calculations based on data from the World Bank's Global Financial Development Dataset. Figures are averages of the annual observations.

[513] My calculations based on data from SDC Platinum (Thomson Reuters) and the World Bank.

[514] See, for instance, Musalem and Baer (2010: 42).

[515] Rodrigues da Cunha (2008: ix).

[516] *Comissão de Valores Mobiliários* (CVM).

to gain access to capital by issuing shares in their home market."[517] By 2000, virtually all of the existing depth of the Brazilian equity market was associated with the process of state-owned enterprise (SOE) privatization; the listed companies were listed on the exchange simply to fulfill the privatization auction's terms and conditions, and even multiple of those corporations were removing their shares from the São Paulo Stock Exchange and going private.[518] As a result of these processes, which included the perception that even blue-chip Brazilian companies were likely to delist and move on to depend entirely on foreign stock exchanges, by the end of the decade of market-oriented reforms multiple analysts were asking themselves whether they were facing the demise of the Brazilian equity market altogether.[519]

The decade of market-oriented reforms was not a game changer in terms of domestic equity market enlargement in Brazil; rather, the major shift took place during the center-left administrations of the Workers' Party (2003-2016). Between 2003 and 2014, Brazilian corporations raised US$244 billion *domestically* either by launching initial public offerings (IPOs) or through follow-on transactions (secondary offerings).[520] To put this figure in perspective, the amount of capital raised by Brazilian firms in the domestic equity market roughly equals the entire GDP of Chile, three quarters of Colombia's, 1.5 times the GDP of Peru, and 44 percent of Argentina's.[521] During that period, record numbers of new issuances were registered in the São Paulo Stock Exchange in multiple years: 87 in 2007, 104 in 2009, 103 in 2010, and 103 again in 2012. Even in 2013, after over a year of sluggish economic growth, a US$5.7 billion equity issuance in Brazil became the largest global IPO, surpassing those of corporate giants like Twitter or Hilton.[522]

The reshaping of the national financial system during the last decade has had significant consequences for the country's firms. All of my top-level interviewees in the Brazilian corporate world coincide in stressing that the image of an economy dominated by enormous business groups that exclusively depend on retained earnings or foreign markets to finance their large-scale investment projects is highly outdated.[523] In contemporary Brazil, CFOs no longer prefer intra-firm or intra-group sources of finance exclusively, which hardly ever suffice to meet their ambitious long-term investment plans. In a country where the domestic market is so important for large firms—Brazil's population reached 200 million people—and with a long history of exchange rate volatility, solely relying on foreign credit markets is rarely an option: concentrating debt in foreign currency when revenues are mostly denominated in Brazilian Reais

[517] Santana (2008: 5). Also see data in Claessens, Klingebiel, and Lubrano (2000: 45-7).
[518] Santana (2008: 6-7).
[519] Coutinho and Rabelo (2003: 57-8).
[520] My calculations based on data from SDC Platinum (Thomson Reuters) and the World Bank. The figure is adjusted for inflation.
[521] My calculations based on 2011 GDP data from the World Bank.
[522] "Latin America IPOs: Record Year," *Latinvex*, January 15, 2014.
[523] Author's interviews with José Filippo, Executive Vice President & CFO of Embraer, São Paulo, April 1, 2014; Wilson Masao Kuzuhara, CFO of Grupo Votorantim (1986-1995) and CEO of Banco Votorantim (1996-2011), São Paulo, April 7, 2014; Roberto Giannetti Da Fonseca, CEO of Kaduna Consulting Group, former top leader at the Federation of Industry of the State of São Paulo (FIESP), São Paulo, March 25, 2014. Not-for-attribution interviews with: senior executive in top consulting firm; and with former CFO of top Brazilian business group, 2014.

is too risky.[524] Moreover, even the CFOs of export-oriented companies nowadays choose to tap domestic sources of finance.

"It is true that up to the mid-1990s our group only used its own resources to finance investments," said to me the former CFO of Grupo Votorantim—one of the largest industrial conglomerates operating, among others, in the cement, steel, pulp and paper, and energy sectors with annual sales of over US$11 billion[525]—; he added: "at the time Brazil did not have a domestic capital market and economic growth was sluggish; but nowadays, for large groups like Votorantim their own resources are not enough to finance the investments they need to make… obtaining funds from outside the firm is essential."[526] Votorantim has recently looked to raise US$5.4 billion in an initial public offering to fund acquisitions and expansion outside of Brazil, as well as to add more products domestically.[527] Similarly, other Brazilian corporate giants—such as Camargo Corrêa, Odebrecht, and Gerdau—either have recently resorted to the domestic stock market to raise capital for investment or are seriously considering doing so. Although Odebrecht and Camargo Corrêa are exemplars of groups that remain privately held—probably due to their reluctance to disclose information about the government contracts associated with their business in civil engineering and construction—in 2004 and 2007, respectively, these *grupos* still decided to take advantage of the newly developed equity market to launch IPOs for some of their subsidiaries.[528] The steel giant Gerdau, for its part, raised about US$5 billion by issuing equity in 2008 and 2011 to finance its expansion.[529]

Companies that are partially owned by the state, such as Vale and Petrobras, actively take advantage of the domestic capital market as a source of investment finance. Petrobras, the Brazilian semi-public oil company, in the 1980s, at a time when the domestic stock market was remarkably small, was experiencing severe credit shortages after failing in several strategies to raise funding.[530] In 2010, Petrobras carried out the largest sale share in history, raising US$70 billion to invest in the development of offshore fields known locally as the *Pré-Sal*.

But the enlarged Brazilian domestic stock market did not have implications just for corporate giants: it has also had consequences for an important segment of medium-sized companies. A recent study has shown that, in contrast to the older huge business groups, an important number of younger and smaller firms have voluntarily chosen to take advantage of the existence of new segments of the domestic stock market that have stricter corporate governance requirements—known as *Nível 2* and *Novo Mercado*—as a strategy to signal their good corporate practices and thus enhance their reputation in the eyes of investors.[531] Among many

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[524] On this point, which can be extended to most Latin American countries, see Coutinho and Rabelo (2003: 62).

[525] Data from: *América Economía*, Top-500 Latin American Firms 2014 Ranking.

[526] Author's interview with Wilson Masao Kuzuhara, CFO of Grupo Votorantim (1986-1995) and CEO of Banco Votorantim (1996-2011), São Paulo, April 7, 2014

[527] "Brazil's Set for Another Blockbuster IPO with Votorantim Cimentos," *Wall Street Journal*, March 31, 2013; "Votorantim Cimentos Pushes Brazil IPO Plans to $12.7 Billion," *Bloomberg*, April 17, 2013.

[528] "The success of Braskem's IPO exceeds expectations," *Odebrecht Informa Online*, November-December 2004. See also: "Abertura de capital é possível para todas subsidiárias, diz Odebrecht," *Valor Econômico*, September 28, 2012.

[529] My calculations based on unpublished data from Dealogic and Ernst & Young Research. See also: "Oferta da Gerdau deve movimentar R$ 4,4 bilhões," *Valor Econômico*, April 24, 2008; "Gerdau capta R$ 4,5 bilhões," *Valor Econômico*, April 13, 2011.

[530] Lavelle (2004: 97).

[531] Finchelstein (2010: 87-90).

others, firms like Natura (cosmetics manufacturing), Marcopolo (manufacturer of buses), the airlines GOL and TAM, and WEG (electric engineering, power, and automation) have recently raised capital—and improved their future capacity to access credit—by listing their shares in these new, stricter corporate governance segments of the domestic stock market.

As anticipated in Chapters 1 and 2 of this study, I do not claim that the empirical analysis presented in this chapter explains *fully* the impressive enlargement of the domestic stock market in contemporary Brazil. I do claim that we cannot understand the origins of this newly structured national financial system without paying attention to the politics that determined a new mode of state involvement in capital markets during the Workers' Party four consecutive administrations (2003-2016). Specifically, the micropolitics within the executive branch—quite peculiar, by comparative standards—led giant SOE pension funds to become major players investing in the domestic stock market, pushing formal rules, as well as informal practices, that fostered further market expansion. In contrast to Chile—examined in Chapter 6—in Brazil it was pension funds directly associated with the state, instead of privatized ones, which became important players in the equity market. Pension funds' behavior as institutional investors in Brazil—critically underpinned by the causal beliefs of the political *técnicos* who headed them—was different than in Chile: the former, but not the latter, became highly proactive in expanding private equity investments and in contributing with enhancing corporate governance practices, two factors that fuel capital market development. After the consolidation of a neo-developmental coalition of political *técnicos* aligning the preferences of the Ministry of Finance and the Brazilian Development Bank (BNDES) (Chapter 3), the market-creating effects of this mode of pension regulation in Brazil were strengthened by the surge of the BNDES as a major domestic institutional investor. To my knowledge, this is the first study that connects the dots between politics and market outcomes in contemporary Brazil in this particular way. I hereby bring together under a single analytical and empirical umbrella major political economy processes that tend to be studied separately and without sufficient attention to policy choices that, while lower in salience than macroeconomic management, have important market-creating effects in the long run.

If macroeconomic stability in and of itself explained the new structure of domestic markets in contemporary Brazil—as mainstream economists typically underscore—we should have seen the enlargement of the domestic stock market occurring long *before* the Workers' Party administrations, not *during* them. After all, the market-oriented reforms championed by Finance Minister and then President Fernando Henrique Cardoso (1993-1994 and 1995-2003, respectively) were successful in taming Brazil's historically high levels of inflation, curbing fiscal deficit, and stabilizing the exchange rate. Clearly, market friendliness does not explain it all, since Cardoso had more valued credentials in the business world than his successor President Lula Da Silva (2003-2010).

Utilizing a similar logic, others may underscore the dominance of orthodox *técnicos* in Lula's first cabinet as the major driving force of the restructuring of the national financial system in Brazil. Domestic capital market enlargement as an automatic consequence of effective market-friendliness signaling, many would argue. However, as I have shown in Chapter 3, orthodox political *técnicos* were only powerful for roughly three years: by 2006 their leverage within the executive branch in Brasília was in rapid decline; by 2007, neo-developmental political *técnicos* had secured their dominance. If such conventional wisdom were to hold, we should have seen a rapid enlargement of the domestic stock market while the orthodox economists were in control of the Ministry of Finance and a rapid or gradual decline after neo-developmental elite officials

secured their leverage. The figures show just the opposite: the Brazilian equity market increased the pace of its expansion *after* the orthodox economists had been displaced by the *neo-desenvolvimentistas*.

Others—scholars and practitioners alike—often attribute the enlargement of the Brazilian domestic equity market to the corporate governance "revolution" that took place with the creation of the *Novo Mercado* or New Market in 2000—that is, *before* the drivers I highlight started to exert causal leverage. Since I do not neglect the impact of corporate governance reform on the restructuring of the Brazilian financial system, I dedicate a specific section towards the end of this chapter to deal with this complementary—rather than alternative—hypothesis. Differing from one the propositions laid out in the framework of this study, the evidence I present in Section 2 indicates that the creation of the Novo Mercado was primarily driven by the action of private actors, and not by political *técnicos* holding elite positions within the state. However, throughout this chapter I present new evidence that suggests that the market-creating effects that this change in the *formal rules* of corporate governance has had owed a lot to the posterior behavior of *state actors*—crucially, the giant SOE pension funds and the BNDES—who decisively used their great market power to induce Brazilian corporations to play by those new rules. In explaining the enlargement of the Brazilian stock market, I argue, the *players*—as well as their informal practices not codified in written legislation—may be as important as the *rules*.[532]

This chapter is organized as follows. Section 1 is dedicated to tracing the process that originated and consolidated a new mode of state involvement in capital markets in Brazil during the four consecutive administrations of the Workers' Party (2003-2016). It has two subsections. The first one tracks down the politics of pension regulation with a focus on the steering of the giant pension funds of SOEs towards capital markets. This subsection proceeds in four steps: (i) the formation and consolidation of a coalition of political *técnicos* with a locus of action in the pensions policy arena and with a particular set of causal beliefs that connected neo-developmental goals with financial market expansion; (ii) the orientation of the large SOE pension funds to become aggressive players in the Brazilian stock market; (iii) the surge of these funds as the main domestic institutional investors fueling Brazil's new private equity and venture capital industries; and (iv) the leading role that these SOE pension funds acquired to push for better corporate governance standards from within Brazilian corporate giants. The second subsection of this chapter shows that this new mode of state involvement in capital markets was strengthened when the neo-developmental coalition of policy entrepreneurs secured its dominance within the Brazilian executive branch in the mid- and late-2000s (a process examined in depth in Chapter 3). The subsection focuses on the process that led the Brazilian Development Bank (BNDES) to have a significantly larger intervention in the domestic equity market.

Section 2 of this chapter specifies the role of business in the process under study. The section shows that the state-centered explanation needs to be complemented with a focus on the role of a specific set of financial-sector actors in setting in motion a corporate governance reform that became a facilitating condition of the behavior of state actors studied in Section 1. Finally, Section 3 examines in greater depth the two main contending explanations: the first alternative hypothesis emphasizes the president's preferences, strategies, and agency, while the second

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[532] On the analytic perils of overemphasizing the study of the *rules of the game* and the importance of avoiding the neglect of the *players* in comparative political economy, see Schneider (2014: 21). I go back to this issue in Chapter 7.

contending explanation emphasizes business pressure as a primary, originating driver of the policy process that has reshaped the stock market in twenty-first-century Brazil.

1. State Involvement in Capital Markets During the Workers' Party Administrations, 2003-2016

State involvement in capital markets changed markedly in Brazil with the arrival of the Workers' Party (Partido dos Trabalhadores or PT) to the presidency in 2003. Contrary to what conventional wisdom would have predicted, this labor-based, left wing party appointed several key political *técnicos* who were intensely motivated in enlarging and improving the functioning of the Brazilian capital market. Interestingly, however, these policy entrepreneurs pushing for capital market development did *not* belong to the coalition of orthodox officials who had a stronghold in the Finance Ministry (studied in detail in Chapter 3); instead, they had a neo-developmental leaning and several of them had close ties with the left and with the labor unions.

This new mode has its origins in the steering of the largest pension funds towards higher involvement in capital markets. During the PT administrations these *fundos de pensão* came to have a coherent and coordinated strategy to invest aggressively in the domestic equity market and became key advocates of reform in opaque regulatory arenas, including corporate governance and the institutional architecture underpinning venture capital and private equity. The leading role played in the domestic capital market by the giant pension funds of state-owned enterprises (SOEs)—*de jure* independent but *de facto* subordinated to the federal executive branch of government—starting in 2003 was later reinforced with the consolidation of the neo-developmental coalition of policy entrepreneurs studied in Chapter 3.

Crucially, the pension funds of SOEs and the Brazilian Development Bank (BNDES) over time came to be partners in a within-state coalition in favor of capital market enlargement. Together, these two state actors were the most important domestic institutional investors; as such, they had great capacity to steer massive resources to the equity market and to actively pursue other market-enlarging activities. In order to simplify the exposition of these complex developments, I will treat in turn each of these two executive branch-associated actors and their involvement in capital markets.

1.I. SOE Pension Funds

Brazil has supplemental pension funds linked to individual companies—both private and state-owned—that provide additional pension benefits on top of the state-run PAYG pension system.[533] These "closed" pension funds (*entidades fechadas de previdência complementar*) pool the savings of the employees of individual companies. Since the mid-1990s these funds acquired significant size: in 1990 pension funds' assets represented 3 percent of GDP; by 2007 they had jumped to 17 percent.[534] Brazil's supplemental pension assets are the largest among developing countries, totaling roughly US$295 billion in 2012.[535] A study comparing the largest pension markets in the world—with a 13-country sample that included the United States, Britain, Canada,

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[533] All the analysis in this chapter refers to the supplemental segment of the pension system. For excellent political economy explanations of the continuity of the Brazilian state-run, pay-as-you-go pension system, see: Brooks (2009) and Madrid (2003: 138-164).
[534] Data from ABRAPP (2001, 2013).
[535] Datz (2013: 116-7).

Japan, and Australia, among others—found that Brazilian pension funds were the ones that grew the fastest between 2000 and 2010.[536]

Although there are over 360 supplemental pension funds in Brazil, both savings and investments are highly concentrated in a relatively small number of actors. The pension funds that manage the savings of the workers of three corporations controlled by the Brazilian government—Previ (pension fund of the workers of Banco do Brasil, banking sector), Petros (workers of Petrobras, oil sector), and Funcef (Caixa Econômica Federal, banking sector)—concentrate 44 percent of the system's total investments.[537] If adding smaller actors, the pension funds of workers of federal government-owned companies comprise 56 percent of the pension system's total investments (PREVIC 2013a: 6).

The economic power of the largest three pension funds is impressive: by 2010, Previ, Petros, and Funcef managed an aggregate investment portfolio that equaled 55 percent of the reserve holdings of the Brazilian Central Bank.[538] To put this in comparative perspective, by 2010 the combined assets of the largest three pension funds of Brazilian SOEs equaled to three quarters of the total assets managed that year by the giant California Public Employees' Retirement System (CalPERS).[539] As the former chief regulator of the complementary pension system told me, the scale of these SOE-linked pension funds—in particular, that of Previ, the largest pension fund in Latin America, which came to have a portfolio of US$92 billion[540]—makes them leaders within the pension fund industry: "if Previ decides to venture into an X type of new investments, many pension funds are likely to behave as followers," reorienting their investment strategies accordingly.[541]

While the giant pension funds of SOEs are formally autonomous entities dedicated to the administration of workers' savings, through a long-standing informal practice the executive branch *de facto* appoints the funds' leadership. More precisely, the federal executive branch appoints the CEOs of the largest SOEs, whom in turn control the nomination process of the presidents of their respective pension funds.[542] This informal institution has led other scholars to label the large pension funds of SOEs as "quasi-state actors."[543]

Triangulating the work of Brazilian economic sociologists[544] with my own archival research and interviews, I identified the key actors that formed a coalition of neo-developmental entrepreneurs that crossed the boundaries of several state or state-related institutions. The core of this group was composed of three leaders who combined political and technical credentials, each coming to lead one of the three major SOE-linked pension funds (Sérgio Rosa, Wagner Pinheiro,

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[536] Towers Watson (2011: 12-4).
[537] My calculations based on data from ABRAPP (2013).
[538] My calculations based on data from the International Monetary Fund (dataset: International Reserves Template; concept: Official Reserve Assets, Foreign Currency Reserves in Convertible Foreign Currencies) and ABRAPP (2010).
[539] My calculations based on ABRAPP (2010) data and *CalPERS for California Annual Report 2010*. CalPERS assets amounted to US$200.5 billion in June 30, 2010.
[540] Author's calculations based on ABRAPP (2010) data.
[541] Author's interview with Adacir Reis, Secretary of Complementary Pensions (2003-2006), Brasília, August 6, 2014.
[542] Multiple interviews cited below, including: Ricardo Berzoini, Pensions Minister (2003), Labor Minister (2004), Brasília, August 7, 2014. Also see: Datz (2013: 120) and Jardim (2007: chapters VI-VII, IX).
[543] Musacchio and Lazzarini (2014: 20).
[544] See: Grün (2009, 2013), Jardim (2007, 2013), Soria e Silva (2011).

and Guilherme Lacerda). In addition, two PT politicians—Ricardo Berzoini and Luiz Gushiken, who had historically had strong links with the SOE-related *fundos de pensão* and had developed technical knowledge on pension funds and finance—during their terms as ministers of the Lula Da Silva administrations served as a source of cohesion for this new coalition of entrepreneurial political *técnicos*, as well as a nexus between the technical and opaque agendas of the pension fund leaders and high-level decision making within the executive branch in Brasília.[545]

All five members of this group had a shared past as labor union leaders. Four of them—all except for Lacerda—were linked with the bankers' unions of São Paulo, and all five were associated with the Unified Central of Workers (Central Única dos Trabalhadores or CUT).[546] Together they formed what Brazilian economic sociologists have called the "*nova elite sindical de fundos de pensão*" (new pension funds' labor-union elite), a very small group of PT-affiliated actors with expertise on this issue and intensely motivated in extending the reach of complementary pension funds to new segments of the working force and connecting pension fund investments with the productive sector.[547] Anticipating the ideas they would carry into office, in 2002, some months before Lula Da Silva initiated his first term, three members of this union-based pension fund elite participated in a small group that drafted, along with representatives of the São Paulo Stock Exchange, a document entitled "*O mercado de capitais como instrumento do desenvolvimento econômico*" ("The Capital Market as an Instrument of Economic Development").[548]

Sérgio Rosa obtained his BA at the University of São Paulo (USP), one of Brazil's most prestigious academic institutions. In contrast to the other two major leaders of SOE-linked pension funds, he did not have formal training in economics: at the USP he majored in journalism. However, as it is widely recognized in the financial industry, Rosa would later on develop impressive technical skills as an asset manager during his long career at Previ; the origins of this skillset can be traced back at least to 1999—four years before being appointed as the pension fund's president—when Rosa became Previ's Director of Shareholdings.[549] Once a journalist asked him what academic theory had had the most impact on him; Rosa replied that it was Professor of Management Peter Drucker's.[550] Rosa had been the president of the national

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[545] See Jardim (2007: 252-5). Following the characterization I proposed in Chapter 2, Berzoini and Gushiken could hardly be classified as political *técnicos* since they clearly evolved to be electorally driven politicians in the elite of the Workers' Party. This notwithstanding, both of them had technical credentials, which may partly explain their active involvement in the technical arena of pension fund regulation: Berzoini is an engineer (FEI, São Bernardo do Campo) and Gushiken had a BA in business administration from the Fundação Getúlio Vargas (FGV), one of the elite universities in Brazil (Jardim 2013: 199-201). Berzoini and Gushiken were entrepreneurial both in high salience political issues and in technical policy agendas. Fitting the characterization that I propose in Chapter 2, during the 1990s Luiz Gushiken, before being appointed in the executive branch of government, set up a consulting firm, Gushiken e Associados (later renamed as Globalprev Consultores Associados) with expertise on pension fund regulation (see Jardim 2007: 58-9, 252, 265). Gushiken's influence over President Lula Da Silva on issues regarding pension fund regulation made it to the press; see, for instance: "Lula reafirma intenção de estimular criação de fundos de pensão," *Valor Econômico*, May 28, 2003.

[546] "Sérgio Rosa e o mundo dos fundos," *Piauí*, August, 2009.

[547] See Jardim (2007: 58, 234-5) and Soria e Silva (2011: 234-8).

[548] "Leia íntegra do documento PT-BOVESPA para o mercado de capitais," *Folha de S. Paulo*, October 17, 2002.

[549] See, for instance, "O ex-sindicalista que redesenhou a Previ," *Valor Econômico*, March 11, 2010.

[550] "O ex-sindicalista que redesenhou a Previ," *Valor Econômico*, March 11, 2010.

union of banking workers (Confederação Nacional dos Bancários) between 1994 and 2000. In line with this study's characterization of elite political *técnicos*, Sérgio Rosa's later career was *not* limited to the political world. Upon leaving the presidency of Brazil's largest pension fund, Rosa was asked whether he would like to pursue a career in electoral politics; he replied that he was not interested in that path: he preferred working as a manager in the corporate world.[551] After stepping down as chairman of Previ in 2010, Rosa focused on his role as board member of major corporations such as Brasil Foods and transportation and logistics company América Latina Logística. Although the PT continued to be in power for another six years—and, hence, political opportunities abounded—Rosa did refrain from pursuing a career within the executive branch or looking to run for elected positions.

Wagner Pinheiro de Oliveira graduated as an economist from the heterodox bastion State University of Campinas (Unicamp). He developed his career as an economist in the back then state-owned bank Banespa; in the late 1990s, Pinheiro joined the PT-affiliated bank workers' union (Federação dos Bancários da CUT de São Paulo) to fight against the privatization of Banespa. This dual profile of professional economist with union activism led him to work for the bank's pension fund Banesprev, where he became director of investments.[552] In 2002 Pinheiro participated in the Lula campaign team as an advisor on capital market development;[553] he was the president of Petros, the second largest pension fund in Brazil, throughout the 2003-2011 period.

Guilherme Lacerda was also trained at the heterodox State University of Campinas, where he received a PhD in economics. During the 1990s he developed a career in academia and as an economic advisor at the subnational level of government, working for the development bank and the planning secretary of the state of Espírito Santo. He developed strong ties with the PT through his affiliation with the labor unions,[554] and surged as the CEO of Funcef, Brazil's third largest pension fund. He chaired that *fundo de pensão* between 2003 and 2011. When his term at Funcef was about to finish, Lacerda attempted to launch an electoral career and ran for congress in 2010[555]—but he failed. Tellingly in terms of the interconnection between pension funds and the neo-developmental coalition studied in Chapter 3, Lacerda, after losing his electoral bid, was appointed to another elite-level yet technical position: in 2012 he started working as managing director of the BNDES, a job he retained until 2015.

Ricardo Berzoini, who was the first Pensions Minister of the Lula administrations, explained to me that, in choosing whom to favor in the appointment of the CEOs of Previ, Petros, and Funcef pension funds, a key factor was that Rosa, Pinheiro, and Lacerda had close ties with the PT and were "technically solid."[556] In subsequent interviews, both Pinheiro and Lacerda acknowledged that these were key factors explaining their accession to lead the pension funds of SOEs.[557] Berzoini and Gushiken politically maneuvered within the executive branch to

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[551] "O ex-sindicalista que redesenhou a Previ," *Valor Econômico*, March 11, 2010.
[552] Interview with Wagner Pinheiro, *Museu da Pessoa*. Accessed on February 5, 2016.
[553] Jardim (2007: 259).
[554] Jardim (2007: 153, 254).
[555] "Lacerda: muito dinheiro, pouco voto," *Veja*, October 4, 2010.
[556] Author's interview with Ricardo Berzoini, Pensions Minister (2003), Labor Minister (2004), Brasília, August 7, 2014.
[557] Author's interviews with Guilherme Lacerda, President of Funcef pension fund (2003-2011), Rio de Janeiro, August 21, 2014, and Wagner Pinheiro, President of Petros pension fund (2003-2010), Brasília, August 12, 2014.

secure the appointment of Rosa, Pinheiro, and Lacerda.[558] Once in office as chairmen of the three giant pension funds, these three political *técnicos* proactively championed multiple decisions that shifted the nature of state involvement in capital markets.

The Secretary of Complementary Pensions who served during most of Lula's first administration explained to me that Rosa, Lacerda and Pinheiro, as political *técnicos*, "were important leaders because they had a systemic vision that went beyond their own pension funds, they had access to power [within the executive branch], and they had a very fluid dialogue with the pension funds' contributors and with unions… these were leaders with a great capacity to dialogue, on top of being technically well trained."[559] In a published piece, the same official described one of these three policy entrepreneurs as follows: "[Wagner Pinheiro's] deep technical training did not deviate him from political sensitivity. On the contrary, […] he was able to reconcile his solid professional credentials, developed in finance and economics courses at [the universities of] Unicamp, USP, and FGV with a great real-world experience in the understanding of conflicts."[560]

In line with the framework of this study, the neo-developmental political *técnicos* steering the pension funds towards higher involvement in capital markets in post-2003 Brazil, though formally appointed, did not act simply as agents: they were agenda-setters and relatively unconstrained promoters of a new orientation of pension fund behavior in domestic financial markets. These political *técnicos* were not simple agents of the labor unions or top executive-branch leaders.

Santana (2012: 65, 67) showed that Berzoini, through the Secretary of Complementary Pensions (*Secretaria de Previdência Complementar*) that depended on him, actively worked to "disseminate the new 'culture of pension funds'" among labor unions and workers; in the early years of the Workers' Party administrations, a number of seminars were organized and informative publications were published with this goal of educating workers/pension fund contributors.[561] Two top informants—a former president and a director of Previ pension fund—explained to me that the workers whose savings they administered were typically not knowledgeable enough about the technicalities of pension fund investment;[562] if anything, they had prejudices against a larger investment in capital markets. Pressure from below does not explain the shift in the orientation of large pension funds:

> *It was a shift pushed from above… from the leadership of the pension funds. Workers didn't have as much clarity on issues of finance and investment. On some occasions we*

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[558] See: "Sérgio Rosa e o mundo dos fundos," *Piauí*, August, 2009. As the veteran president of a pension fund that ranks top-ten by its assets told me, Brazilian presidents do not choose SOE-linked pension fund CEOs themselves since "*presidents have bigger and more pressing things to deal with*" [Author's interview with Jarbas de Biagi, President of Banesprev (1996-2014), São Paulo, April 1, 2014]; rather, presidents appoint high-level officials whom in turn exert influence over the appointment of the CEOs of large, SOE-linked *fundos de pensão*.

[559] Author's interview with Adacir Reis, Secretary of Complementary Pensions (2003-2006), Brasília, August 6, 2014.

[560] Reis (2011: 12).

[561] See, for instance, the 2003 document *Previdência Complementar: Plano de Instituidor* (Ministério da Previdência Social 2003).

[562] Author's interviews with José Sasseron, leader at the union of banking workers and Director of Previ pension fund, São Paulo, March 26, 2014, and Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.

as pension fund presidents even received criticisms from workers… for focusing too much on investing in the equity market.[563]

Soria e Silva's (2011: 296, 298) in-depth study found that the presidents of Previ, Petros, and Funcef routinely had the capacity to impose their preferences on the pension funds' boards where unions are represented; on multiple occasions these leaders resorted to the "*voto de Minerva*," a special prerogative that allowed them to untie votes in the making of decisions on which they faced workers' resistance. Typically, pension fund leaders, in their discussions with workers at pension funds' board meetings, invoked their technical expertise on the complex domains of finance and investments as a source of authority.[564]

Likewise, on multiple occasions these political *técnicos* were the protagonists in the drafting of new regulation that allowed the pension funds to increase their involvement in the domestic capital market. The politicians occupying the pinnacle positions in the executive branch of government were receptive to these new agendas but not the originating driver of regulatory reform. The president of Previ pension fund provided me with an illustrative example of pension funds' entrepreneurial role:

In 2009, the Conselho Monetário Nacional (CMN) [the National Monetary Council chaired by the Minister of Finance] raised the proportion that pension funds were allowed to allocate to variable-income financial products… the new permitted ceiling was set at 70 percent. It was us pension funds who advocated for that ceiling to be raised and it took us a good deal of convincing… for the government this wasn't a top priority. [565]

Similarly, the political *técnicos* chairing the SOE pension funds, in their drive to channel massive resources to a newly developing private equity and venture capital industry, were highly entrepreneurial in designing and advocating for regulatory changes (see Section 1.I.ii of this chapter for an in-depth treatment of this issue). When I asked the former president of Funcef—in charge of a portfolio of US$26 billion[566]—why his fund had come to invest so aggressively in private equity through Brazilian Participation Funds—*Fundos de Investimento em Participações* or FIPs—he explained to me that one of the reasons for channeling investment through FIPs was that this speeded up investment decisions without having to get previous approval from the Ministry of Finance.[567] More specifically, purchasing corporate stock required the approval of the SOE to which the pension fund is linked, which in turn demanded the authorization of the Ministry of Finance—a process deemed as "all too bureaucratic"—whereas the pension fund need not obtain authorization to channel resources to private equity vehicles. This change in its orientation as an institutional investor made Funcef pension fund push for the Brazilian

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[563] Author's interview with Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.
[564] These findings on pension fund presidents' capacity to impose their preferences coincide with the assessment of Jardim (2007: 220-2).
[565] Author's interview with Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.
[566] Figures on the portfolios of Petros and Funcef are the author's calculations based on ABRAPP (2010) data.
[567] Author's interview with Guilherme Lacerda, President of Funcef pension fund (2003-2011), Rio de Janeiro, August 21, 2014.

Securities and Exchange Commission (*Comissão de Valores Mobiliários*, CVM) to adapt and improve existing regulation to "favor this new investor profile" and to boost the development of private equity in Brazil.[568]

The political *técnicos* that worked to reorient the giant pension funds had a neo-developmental ideational underpinning that is probably unique in the context of Latin America. They held the belief that the pension funds could be key players in fostering *long-term* investment in the real economy.[569] In contrast with advocates of developmentalism without the "neo" prefix—i.e. the *desenvolvimentistas*, historically so strong in Brazil—these neo-developmental leaders that came to dominate the technical politics of SOE-linked pension funds believed that this push towards higher levels of long-term investment in the real economy—including the industrial sector and infrastructure development—could be done *through markets*. Specifically, these entrepreneurs within state-linked pension funds considered that it was key to coordinate a base of well-capitalized institutional investors that could participate aggressively in the domestic equity market and behave in markets with a long-term horizon rather than being oriented to speculative short-term gains. This would imply a shift from over-investment in safe government bonds paying high interest rates towards a new orientation that prioritized riskier—but potentially more prone to value-creation—investment in corporate stock.[570] A particular feature of Brazilian political *técnicos*' approach was that they believed that pension funds' investment in infrastructure should be carried out not through the typical fixed-income assets but through the purchase of equity in open companies. They believed that when the pension funds entered in private equity deals they had to induce the target companies to launch an IPO at a later stage.

A document these political *técnicos* co-authored in 2002, before being appointed as SOE pension fund presidents, provides further evidence on these causal beliefs and priorities. The document draws connections between pension funds, domestic capital market expansion, and developmental goals:

> *It is necessary that the Brazilian capital market play a strategic role in [... fostering] economic growth. Efforts need to be made so that voluntary saving schemes including those in pension funds [...] can grow, mobilizing resources for private investment, taking into account that the best international benchmarks place this type of savings as contributing between 15 and 20 percent of gross domestic capital formation.*
> *The [developmental] contribution of the domestic capital market [...] takes place when it creates proper financial conditions to carry out investments, including infrastructure projects, and channels resources to the most productive projects, accelerating economic growth and job creation; [... and] when it offers investment options [...] that are attractive for multiple economic agents, especially for private-capitalization pension funds.*

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568 Author's interview with Guilherme Lacerda, President of Funcef pension fund (2003-2011), Rio de Janeiro, August 21, 2014.

569 Author's interviews with Ricardo Berzoini, Pensions Minister (2003), Labor Minister (2004), Brasília, August 7, 2014; Guilherme Lacerda, President of Funcef pension fund (2003-2011), Rio de Janeiro, August 21, 2014; Wagner Pinheiro, President of Petros pension fund (2003-2010), Brasília, August 12, 2014; and Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.

570 Author's interview with Wagner Pinheiro, President of Petros pension fund (2003-2010), Brasília, August 12, 2014.

[…] The regulation of the complementary pension system, having as its priority to protect the interest of its savers, should increase the freedom and [strengthen] the incentive [for pension funds] to allocate resources in the Brazilian capital market.[571]

As succinctly reflected in such document, these political *técnicos* believed that these developmental goals through markets were not incompatible with the obligation, written in the formal legislation, of taking care of workers' savings, maximizing their value so that pension funds could pay good benefits to future retirees. In this mindset, these two goals were easily reconcilable—or, even more, mutually reinforcing. Contributing to generate a larger equity market, with more firms going public and with the firms already operating there issuing new equities and respecting the interest of pension funds as minority shareholders, was thought as an effective way of maximizing the value of future pension benefits.[572]

The work of Brazilian economic sociologists sheds more light on the peculiar ideational support of these entrepreneurial actors in the pensions arena. These political *técnicos* strongly endorsed one of the core tenets of new developmentalism: that which holds, in stark opposition with Washington Consensus orthodoxy, that economic growth should primarily resort to domestic rather than foreign sources of savings.[573] Jardim's (2007: 234-5) ethnographic and archival research found that labor union leaders that came to form what she calls an "*elite sindical de fundos de pensão*" (pension funds' labor-union elite) shared the idea that, since growing financialization could be interpreted as unavoidable in the post-market-oriented reforms period, pension funds should contribute to push finance away from speculative practices and towards productive investment, job creation, and long-term development.[574] The importance that pension fund leaders with labor-union ties attributed to pushing for better corporate governance standards, Jardim (2007: 238) argues, was associated with the goal of "disciplining" employers' behavior. Very much in line with this characterization, a former Secretary of Complementary Pensions explained to me that "democratizing financial capital was a core idea" that oriented this group of pension fund leaders.[575] As I will show later on (Section 1.I.iii), my field research

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571 "*O mercado de capitais como instrumento do desenvolvimento econômico*" ("The Capital Market as an Instrument of Economic Development").

572 Author's interviews with Guilherme Lacerda, President of Funcef pension fund (2003-2011), Rio de Janeiro, August 21, 2014; Wagner Pinheiro, President of Petros pension fund (2003-2010), Brasília, August 12, 2014; and Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.

573 For an in-depth analysis of new developmentalism in general and for the role of domestic savings in this approach, see Bresser-Pereira (2011: 108, 115-6). Luciano Coutinho, a political *técnico* whose ideas and behavior I study in Chapter 3 and in Section 1.II of this chapter, co-authored a piece well before reaching the presidency of the BNDES in which he argued that the "dependence on foreign funds for the financing of the Brazilian private sector" observed during the 1990s was problematic because "this is a very volatile source, whose cost and terms depend on perceived country risks, the behavior of international interest rates and international capital flows. The [1997] Asian crisis and Brazil's internal currency problems, for example, have increased spreads paid by Brazilian issuers of debt and shortened the term of these securities" (Rabelo and Coutinho 2001: 31).

574 One of the political *técnicos* on whom I focus, published an article making this perspective explicit: Wagner Pinheiro, "Os fundos de pensão e os investimentos em infraestrutura," *Revista de Previdência*, October 2005.

575 Author's interview with Adacir Reis, Secretary of Complementary Pensions (2003-2006), Brasília, August 6, 2014. On this point, see also: Soria e Silva (2011: 240-2).

indicates that a key ideational tenet was that improved corporate governance would push firms to focus on long-term investment rather than short-term value-extraction. This causal belief was well aligned with both neo-developmental goals and pension funds' actuarial needs.

In an interview to the press, the former president of Previ pension fund reflected on the funds' role as institutional investors:

> *My goal is to deal only with heavyweights, with big partners, big corporations, big investors [but] not by being a traditional capitalist [myself]… I am there [at the pension fund leadership] managing wealth that belongs to a lot of people and that has a social purpose [*tem um destino social*]. I can't behave like a tycoon [*magnata*]. I understand that we are capitalists of a new type […], the executives of pension funds have a different logic to manage capital than that of a tycoon.*[576]

1.I.i. SOE Pension Funds in the Domestic Equity Market

The new mode of regulating pension funds during the four consecutive administrations of the Workers' Party (2003-2016) made them key institutional investors in the Brazilian equity market. "The shift in the leadership of the three largest pension funds was key because it created a much more cohesive and powerful bloc of investors," the former president of Petros pension fund told me.[577] Since 2003, the president of Previ pension fund explained to me, a key change was that "a new synergy among the three largest pension funds" was forged.[578]

In 1991, pension funds invested US$5 billion in equity; by 2012, pension funds invested over US$87 billion in equity—a 17-fold increase in twenty years.[579] Figure 5.1 uses a different metric and data source to track down the massive injection of pension funds' capital into variable-income securities.

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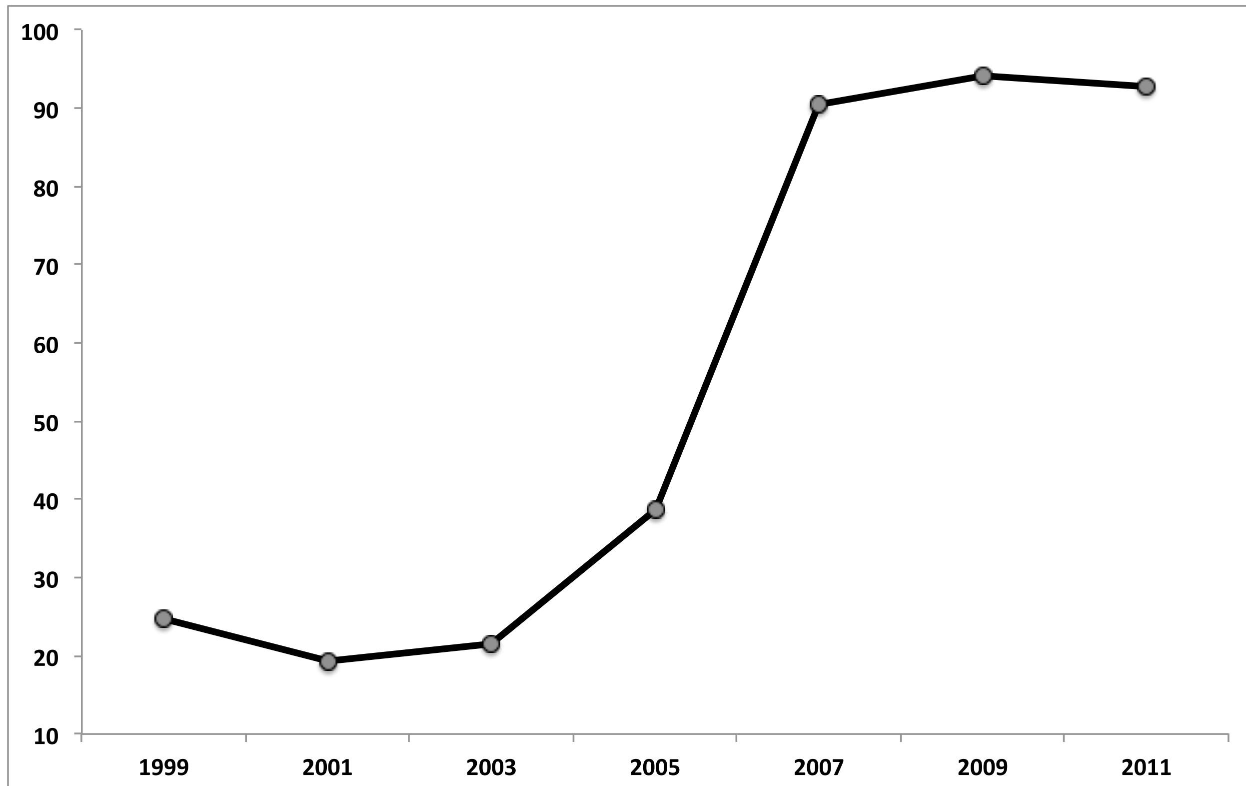
[576] "O ex-sindicalista que redesenhou a Previ," *Valor Econômico*, March 11, 2010.

[577] Author's interview with Wagner Pinheiro, President of Petros pension fund (2003-2010), Brasília, August 12, 2014.

[578] Author's interview with Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.

[579] Author's calculations based on data from ABRAPP (1997) and PREVIC (2013b).

Figure 5.1. Brazil. Pension Funds' Investment in Variable-Income Assets (US$ Billions), 1999-2011.



Source: Author's calculations based on data from ABRAPP (2005, 2013) and IMF's historical exchange rate data.
Notes: Data points are for December of each year. Pension funds' holdings on variable-income assets are calculated by adding the two categories that the Brazilian Association of Private Pension Funds (ABRAPP) classifies as *Renda Variável*: corporate stock (*Ações*) and variable-income securities of investment funds (*Fundos de investimentos – RV*).

The proactivity of SOE-linked pension funds in the domestic equity market is hard to overstate. This becomes clearer when, going beyond the aggregate data for the entire industry captured in Figure 5.1, one analyzes the pension funds' annual investment reports and compares them with pension fund behavior in other Latin American countries and even in developed economies. Previ, the largest SOE pension fund, came to allocate well above 60 percent of its portfolio to variable-income securities; Petros channeled between 30 and 40 percent of its portfolio to this type of assets, depending on the specific year of observation, while Funcef, for its part, came to allocate roughly 36 percent of its portfolio on variable-income securities.[580] As a point of comparison, pension funds in G-7 countries and in a sample of five other Latin American countries allocated on average 20 percent of their portfolios to corporate equity; in another sample of advanced countries—composed of Australia, Finland, Israel, New Zealand,

[580] Data of "Demonstrativo de Investimentos – Renda Variável" taken from: Previ, *Relatório Anual 2007*; Previ, *Relatório Anual 2010*; Petros, *Relatório Anual 2007*; Petros, *Relatório Anual 2010*; Funcef, *Relatório Anual de Atividades 2007*; Funcef, *Relatório Anual de Atividades 2010*.

Norway, Spain, and Sweden—pension funds channeled on average 16 percent of their portfolios to corporate stock.[581]

The steering of long-term pension savings to the domestic stock market championed by Previ, Petros, and Funcef also had demonstration effects on the pension funds of private corporations. The behavior of Fundação CESP, a private pension fund that manages the savings of workers in the energy sector of the State of São Paulo and hence was not directly linked to a SOE, could be seen as an illustration of how private pension funds followed the new pattern of investment set by the large three SOE-linked funds. Fundação CESP—Brazil's fourth pension fund with a portfolio of US$11 billion[582]—came to hold on average 25 percent of its portfolio in corporate stock. In an interview, its CEO told me that during the boom of IPOs of the 2000s,

> *Us pension funds could not buy all the equity we wanted: our demand even surpassed the supply of new corporate stock.*[583]

Another telling illustration of this trend was Petros's decision to buy corporate stock even outside its typical domain of action in companies of the industrial and infrastructure sectors. In late 2010, Petros purchased a US$1.6 billion equity holding in the commercial bank Itaú-Unibanco,[584] which at the time was the eighth bank in the world.[585] This operation granted pension fund Petros 11 percent of the voting shares of the bank, a proportion that would rise up to 15 percent with subsequent purchases of equity in the following years.[586] "This was an important stake in one of Brazil's major banks," Petros's CEO explained to me; "these shares allowed us to get a seat at Itau's board [*conselho de administração*]—such kind of opportunity does not emerge so often and we wanted to take advantage of it."[587]

The aggressiveness of the pension funds of SOEs in buying equity was such that it motivated a change in the legislation regulating pension funds' investments. The political *técnicos* chairing the leading pension funds started exercising pressure over the executive branch higher officials to change a major regulation: raising the proportion that pension funds were allowed to allocate to corporate equity. My interview evidence shows that the leader of such demand was Previ, backed by Petros and Funcef. As a result of pension funds' pressure, in 2009 the government raised the maximum permitted level of investment in variable-income equity from 50 percent of pension funds' portfolios to 70 percent (Resolution 3,792 of the National Monetary Council, CMN).[588] Former Pensions Minister Berzoini explained to me that this regulatory reform was brought to the CMN by the group of state actors associated with the

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[581] The comparative data come from the World Bank (2012: 52).
[582] My calculations based on data from ABRAPP (2010).
[583] Author's interview with Martin Glogowsky, CEO of Fundação CESP (2005-2014), São Paulo, April 2, 2014.
[584] "Petros compra fatia da Camargo Corrêa na Itaúsa por US$ 1,6 bilhão," *Estado de S. Paulo*, 25 November, 2010.
[585] "Brazil dazzles global finance," *Financial Times*, 28 September, 2010.
[586] "Petros atinge fatia de 15% em ações ordinárias da Itaúsa," *Valor Econômico*, January 13, 2014.
[587] Author's interview with Wagner Pinheiro, President of Petros pension fund (2003-2010), Brasília, August 12, 2014.
[588] The *Conselho Monetário Nacional* (CMN) is composed by the Finance Minister, the Planning Minister, and the Central Bank President.

pension funds rather than the other way around;[589] he added that "raising the limit of pension fund investment in equity pursued the goal of getting pension funds to invest in longer terms […] so as to move away from the old tradition of over-investing in government debt."[590]

Analyzing company reports, Santana (2011: 148) found that during the 2000s the giant SOE-linked pension funds came to be important shareholders in the industries of energy, transportation, telecommunications, mining, paper and cellulose, capital goods, steel, petrochemicals, and airplane manufacturing. Previ, Petros, and Funcef, through the purchase of stock, thus decisively contributed to the financing of long-term investment projects of the main Brazilian firms in each of these sectors.

An important illustration of this was the key role played by pension funds in the process of merging the two giants Sadia and Perdigão to create a single national champion[591]—Brasil Foods, which by 2012 had become the largest food company in Latin America.[592] Previ came to hold 15 percent of Brasil Foods' shares, which turned it into the major individual shareholder;[593] the pension funds as a group of shareholders held 27 percent of the company.[594] In Embraer, one of the world's leading airplane manufacturers, Previ came to hold up to 16 percent of the company's shares.[595] Similarly, Funcef and Petros decided to invest in one of Brazil's corporate flagships, JBS,[596] the largest food processing company in the world.

The steering of pension fund assets towards the equity market was also evident in the domain of infrastructure, a key agenda championed by neo-developmental policy entrepreneurs (see Chapter 3). In an article published at the beginning of this new focus on infrastructure investment, the president of Petros pension fund justified this shift arguing that "the international experience shows that infrastructure investments, which are always made with a long-term time horizon, can produce excellent returns, well above pension funds' actuarial targets."[597] Interestingly, because of the capital-market-creating effects this has, a significant part of this infrastructure investment was carried out not through the typical fixed-income assets but through the purchase of equity in open companies. The case of the infrastructure firm Invepar is both illustrative and critical: by 2009, through subsequent injections of capital, Previ, Petros and Funcef came to jointly control a US$-1.4-billion company that is in charge of some of Brazil's

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[589] The same account emerged in my interview with Wagner Pinheiro, President of Petros pension fund (2003-2010), Brasília, August 12, 2014.

[590] Author's interview with Ricardo Berzoini, Pensions Minister (2003), Labor Minister (2004), Brasília, August 7, 2014. On this regulatory change, see as well: "Fundos de pensão poderão correr mais risco," *Folha de S. Paulo*, September 25, 2009. In line with the connection I draw in this chapter between SOE-associated pension funds and corporate governance improvements, CMN Resolution 3,792 stated that pension funds could concentrate up to 70 percent of their portfolios in corporate stock *as long as* those companies were listed in the Novo Mercado, the segment of São Paulo Stock Exchange with the strictest corporate governance standards.

[591] For the process leading to the merger, see *ISTOÉ Dinheiro*, February 11, 2009.

[592] *América Economía*, Ránking 500 Mayores Empresas de América Latina, Sector Alimentos.

[593] "Sérgio Rosa e o mundo dos fundos," *Piauí*, August, 2009.

[594] Santana (2014: 15).

[595] IFC-OECD (2005: 36).

[596] Author's interview with Guilherme Lacerda, President of Funcef pension fund (2003-2011), Rio de Janeiro, August 21, 2014.

[597] Wagner Pinheiro, "Os fundos de pensão e os investimentos em infraestrutura," *Revista de Previdência*, October 2005.

most important airport, highways, and other transport-related projects.[598] As a result of several of this type of financial operations, by 2010 Previ's high level of infrastructure investment *through the equity market* had made it an outlier in an OECD survey of Latin American and European private pension funds: that year Previ allocated US$12 billion or 13.5 percent of its portfolio to this purpose (Della Croce 2012).

One of the microfoundations of this aggregate behavior in favor of equity market development emerged in the interview evidence I collected in Brasília, São Paulo, and Rio de Janeiro. Several interlocutors emphasized that the largest SOE pension funds were concerned with their capacity to pay pension benefits in the distant future. In need of ensuring higher returns, and because they needed to gradually sell part of their corporate stock holdings as the mass of retirees grew, large SOE pension funds advocated for larger liquidity in the São Paulo Stock Exchange. Therefore, on multiple occasions pension fund representatives in company boards requested such firms to issue new equity, expanding the proportion of the company that was traded in the market. To put it in the own words of the president of the largest pension fund in Brazil,

> *We encouraged companies to open their capital, to launch IPOs... It was part of our strategy to generate value and liquidity.*[599]

1.I.ii. Private Equity and Venture Capital: SOE Pension Funds as the Key Domestic Institutional Investors

The new mode of state involvement in capital markets that emerged during the Workers' Party administrations cannot be fully understood without looking at the new connection between SOE-linked pension funds and the private equity and venture capital (PEVC) industries. During the 2000s and 2010s the three giant, SOE-related pension funds were the primary domestic drivers of the growth of Brazil's PEVC. Though small in every country, this segment of the financial sector has important implications: since PEVC investments typically look for exit options through IPOs, they contribute to the enlargement of equity markets.

The importance of this orientation towards private equity for the long-term enlargement of the domestic equity market is hard to overstate. As Gonçalves (2008: 198) has remarked, pension funds' new focus on private equity looked for companies with a high potential for growth and ready to launch IPOs. Pension funds' investments in private equity has prioritized young companies that needed capital to accelerate their expansion and well-established firms that were restructuring to increase their competitiveness, as well mergers in economic sectors seen as having great potential.

Brazil is the region's success story in PEVC development (Musalem and Baer 2010: 42); between 2005 and 2008 the annual growth rate of committed capital was 50 percent, reaching a total of US$27 billion in 2008 (FGV 2008: 3). Pension funds' shift towards these financial vehicles was remarkable: in just five years they went from providing almost no funds to channeling 24 percent of the PEVC industry's total committed capital, becoming the largest domestic source of capital for this segment (FGV 2008: 3; ABDI 2012: 129, 141-2). Figure 5.2 shows that pension funds stand out by far as the largest *domestic* investors in private equity and

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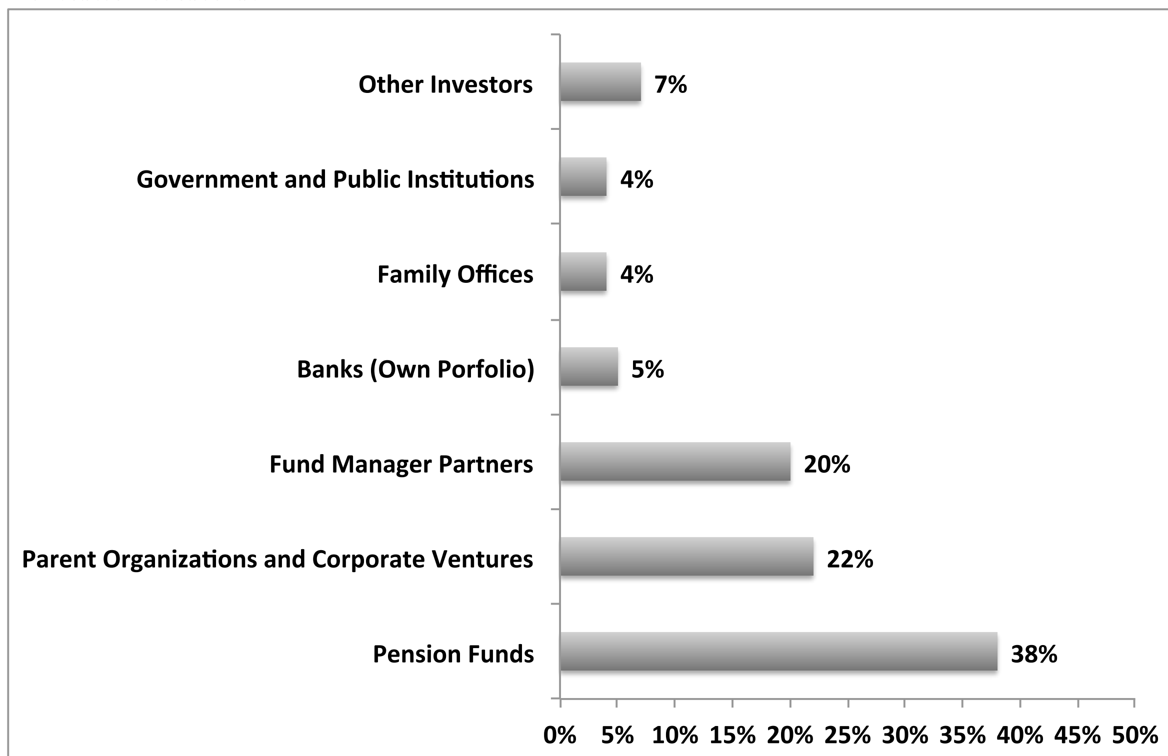
[598] BBVA (2011), Datz (2013), and Invepar's website.

[599] Author's interview with Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.

venture capital: together they are in charge of 38 percent of investments, almost doubling the funds channeled by other investor types such as parent organizations or fund manager partners; pension funds' contribution to PEVC is eight times higher than that of domestic banks.

Figure 5.2. Brazil. Who Invests in Private Equity and Venture Capital? Breakdown by Type of Domestic Investors.



Source: Author's elaboration based on data from GVcepe Database – Getulio Vargas Foundation (ABDI 2012: 142).

Typically, when the pension funds enter in private equity deals they "explicitly induce the companies to launch an IPO at a later stage," the president of Petros pension fund told me.[600] When I asked him specifically how this pressure over firms was exerted, he said: "Normally what we do is to write a clause at the time of structuring the investment that establishes that a condition for us to enter the deal is that the company launches an initial public offering at a later stage."[601] Since SOE pension fund focus on private equity is recent and because the full cycle of these deals is on average between eight and ten years,[602] this new mode of state involvement is likely to have a relevant market-creating effect in the near future, by pushing comparatively small firms—*ceteris paribus*, less likely to enter capital markets—towards floating their equity in the domestic stock market.

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[600] Author's interview with Wagner Pinheiro, President of Petros pension fund (2003-2010), Brasília, August 12, 2014.
[601] On this point, also see: Pinheiro de Oliveira (2011: 102-3).
[602] Pinheiro de Oliveira (2011: 105-6).

Most pension fund investments in private equity have concentrated in what are known in Brazil as "participation funds" (*Fundos de Investimento em Participações* or FIPs).[603] FIPs are closed-end investment funds that can acquire shares and other financial assets of any Brazilian publicly or privately traded company.[604] Echoing previous findings made by Santana (2012: 94-5, 97), the former director of equity investments at Previ pension fund recalled the origins of FIPs as a financial instrument:

> *At the pension funds we were working on ways to avoid the bad investments that had been so typical in the 1990s. It was then that we created FIPs, for which pension funds hire highly qualified managers that screen good business opportunities; in FIPs the pension funds have power because they participate in the board that decides on investments [*comité de investimentos*]... The shift towards investing in FIPs was initiated by the three large pension funds, along with the BNDES...*[605]

The massive growth of pension fund investment in private equity was immediately preceded by a change in the regulation (Instruction 391/03 of the Brazilian Securities and Exchange Commission),[606] whose major modernizing effect was that it enabled institutional investors to orient resources to firms of varying degrees of maturity.[607] The pension funds themselves advocated for this reform and worked with the regulator in its design.[608]

1.I.iii. Corporate Governance Beyond Formal Rules: SOE Pension Funds New Activism Within Brazilian Corporate Giants and the Likely Future Enlargement of the Domestic Equity Market

"O olho do dono engorda o gado."
["The eye of the master fattens the cattle"]
SOE Pension Fund CEO talking about pension
funds' growing activism as minority
shareholders in major Brazilian corporations[609]

In Chapter 1 of this study I synthesized a core point raised by the new conventional wisdom on the Latin American variety of capitalism (Schneider 2013: 47): the region's large domestic corporations, including those in Brazil, are characterized by their ownership concentration and family control. In contrast with liberal market economies (LMEs), in Latin America's hierarchical market economies (HMEs) corporate ownership is not atomized and there are no vibrant markets for corporate control: almost all listed firms have a controlling shareholder. In hierarchical capitalism, the conventional wisdom goes on, institutional investors

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[603] Gonçalves (2008: 198).
[604] Citibank (2011).
[605] Author's interview with Joílson Ferreira, Director of Equity Investment and corporate governance expert of Previ pension fund (2008-2010), Rio de Janeiro, August 22, 2014.
[606] Instrução CVM No. 391/03.
[607] Gonçalves (2008: 198).
[608] Author's interview with Guilherme Lacerda, President of Funcef pension fund (2003-2011), Rio de Janeiro, August 21, 2014.
[609] Pinheiro de Oliveira (2011: 109).

such as pension funds do not have "much if any influence over large firms"; in big Latin American business groups opportunities abound for controlling blocs to expropriate minority, outside investors (Schneider 2013: 45, 52).

In this section I partially challenge this conventional wisdom arguing that it is somewhat outdated for the case of Brazil. The HME Framework was accurate for Brazil up to the late 1990s but in the 2000s and 2010s corporate governance standards improved significantly, enhancing the protection of minority shareholders within Brazilian corporate giants. As Chapter 6 shows for the case of Chile—though the actors and the process there were of a very different nature—in Brazil a significant improvement in the protection of minority shareholders has occurred *despite* the continuity of blockholding. In other words, better corporate governance standards need *not* come hand in hand with the atomization of corporate ownership.

A slow-moving erosion of the patterns stylized in the HME Framework is likely to be under way in contemporary Brazil, and a lot of this erosion may be attributed to the shifting behavior of large SOE pension funds. Schneider (2013: 172) himself, in a chapter about twenty-first century national "escape trajectories" from hierarchical capitalism, acknowledged that a change could be happening in this regard in Brazil due to the joint action of pension funds of SOEs and the BNDES: "[a]lthough almost no firms sold enough shares to dilute ownership control [in the last decade]," he argued, "managers in many listed firms became, as in LMEs, more attentive to minority shareholders." However, Schneider dedicated less than a page to this point and proceeded no further.

Zooming into the micropolitics of changing corporate governance in Brazil is important insofar as this factor, if the mainstream corporate finance literature is right,[610] is likely to partially drive new rounds of equity market enlargement in the future. As I will show in Section 2 below, it was business actors—in particular, financial-sector firms—who acted as the primary driver of the most important change in the *formal rules* of corporate governance standards in Brazil: the creation of new segments within the São Paulo Stock Exchange (Level 1, Level 2, and *Novo Mercado* or New Market) that have stricter corporate governance requirements, including transparency, disclosure, and accountability procedures that enhance the protection of minority shareholders.

Yet in this section I argue that our understanding of the important transformation of corporate governance in Brazil that is likely to underpin further expansion of the domestic equity market is, to say the least, incomplete if we do not connect it to the new mode of state involvement in capital markets that emerged during the 2000s with the shift in the orientation of SOE-linked pension funds. The large *fundos de pensão*, I will show, are changing corporate governance practices *from within* Brazilian corporate giants, partially—but not exclusively—by taking advantage of the existence of Novo Mercado and Level 2. While pension funds cannot be credited for the origins of Novo Mercado, the entrepreneurial role of political *técnicos* chairing these funds during the Workers' Party administrations of the 2000s was critical for the enlargement of Novo Mercado once it was in place.

My evidence shows that the pension funds of SOEs exert their newly acquired market power to push corporations to comply with stricter standards. While other minority shareholders such as foreign portfolio investors most often do *not* play an active role in the governance of Brazilian firms, pension funds' relevance in bringing about changes in the patterns identified in

[610] La Porta et al. (1997, 2000).

the HME Framework is hard to overstate.[611] The longer run market-creating effects of this pension fund behavior are probably higher than we can observe today because this new minority shareholder activism may be operating as a signal for other public and private corporations where pension funds are *not* invested.[612] This section, hence, goes beyond the formal rules to account for the more complex dynamics of corporate governance in the ground.

There is strong evidence indicating that, during the last decade, SOE-associated pension funds have become increasingly active members in the company boards where they participate, pushing for better corporate governance practices and defending the long-term prospects of their investments, frequently battling with other stakeholders who are focused on short-term returns or attempting to exploit minority shareholders. When asked to identify the main change between SOE-linked pension funds' behavior in the 1990s and that of the post-2003 period, multiple of my interviewees in both the private and the public sectors spontaneously responded that the most important change was that the new pension fund leadership was committed to and technically capable of exerting a tight control over investments.[613] I will first uncover the microfoundations of this behavior and then present evidence substantiating the claim.

"Since 2003, at the leadership of the main pension funds we prioritized gaining control over pension funds' investments [in corporations]," told me Sérgio Rosa, Previ's president during the period that started and then consolidated the shift in pension funds involvement in capital markets. When I asked him about the main reasons leading pension funds to adopt a more active role in the firms where they held equity, Rosa replied concisely: "(1) securing the value of pension funds' equity holdings; (2) ensuring the liquidity of those investments; and (3) advocating for firms where we invested to have a long-term vision of investment."[614]

According to a top executive of the Brazilian Association of Private Pension Funds,[615] who has a more general view of the changing role of these institutional investors, "pension funds now see themselves as partners in business… it's not about coming in and coming out rapidly [*entrar e sair*]; pension funds' representatives in corporate boards have a long-term vision because the pension fund needs to deliver benefits in the long run. This long-term perspective contrasts with that of other types of minority shareholders… for instance, the representatives of banks in corporate boards typically want to get in and get out soon, they want to sell their holdings in the short-term."[616] A corporate executive, who during the last decade was the CFO at two major Brazilian corporations where pension funds held equity, told me, "pension funds have come to participate very intensely in corporate boards, they really care for corporate governance practices, taking care that other shareholders in the company do not make decisions that benefit themselves but not the company… pension funds like Previ are pushing for the highest possible

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[611] On foreign portfolio investors' passive role in Brazilian corporations see Coutinho and Rabelo (2003: 37).

[612] This is not a mere theoretical speculation; the presidents of SOE-linked pension funds themselves have stated that they purposely looked to generate "inducements" for other market players, "spreading better [corporate governance] practices" (Pinheiro de Oliveira 2011: 99).

[613] Multiple interviews, Brasília, São Paulo, and Rio de Janeiro, 2014.

[614] Author's interview with Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.

[615] *Associação Brasileira das Entidades Fechadas de Previdência Complementar* (ABRAPP).

[616] Author's interview with Devanir Silva, Superintendent General, Brazilian Association of Private Pension Funds (ABRAPP), São Paulo, March 24, 2014.

corporate governance standards."[617] My interlocutors agree that Previ was the initiator of this shift and that the other SOE pension funds followed it.[618]

The former director of equity investments at Previ, who has a long trajectory working on issues of corporate governance, explained to me that for the pension fund's leadership "corporate governance meant mainly two things: achieving greater transparency and, in pension funds' capacity of capital owners, participating in the management of firms." He traced the origins of this new perspective to an assessment made at Previ's top leadership about the evolution of pension fund behavior in the United States. Previ's leadership assessed that American pension funds had historically played a passive role in corporate boards, traditionally just buying securities and waiting for returns; however, those returns had for a long time been disappointing and the interest of minority shareholders was typically harmed by managers' decisions. In my interlocutor's depiction, a turning point occurred when American pension funds started to be active shareholders, reclaiming control over their investments in corporations. With this understanding of the changing role of American pension funds in issues of corporate governance, Previ started to increasingly prioritize and invest resources to play an active role within Brazilian corporations. Because of the peculiarity of big corporations in Brazil, my informant underlined, pension funds like Previ, in contrast with American pension funds, needed to focus on preventing value-extraction maneuvers by the controlling shareholder or bloc of shareholders, rather than by the managers. "The new premise at our pension fund was that it wasn't enough to just buy equity and wait for future returns," he said.[619]

Just six months after being appointed as the new presidents of SOE pension funds, in June 2003, political t*écnicos* Sérgio Rosa (Previ), Wagner Pinheiro (Petros), and Guilherme Lacerda (Funcef) organized a seminar on pension funds in Rio de Janeiro, which foreshadowed the strategy they would pursue during the following decade.[620] On that occasion, Brazilian SOE *fundos de pensão* invited the president of California Public Employees' Retirement System (CalPERS), a pension fund globally known for its shareholder activism. The specialized press reported that during the seminar the presidents of the largest three Brazilian pension funds discussed the idea of avoiding too diversified investments in equity in the future so as to pool a larger amount of financial resources that could be invested in "firms willing to share or relinquish control in exchange for new capital." A board member of Funcef was quoted as saying, "We would make these joint investments to give us control of companies or make us members of their control blocs so we could become key players determining how those companies are run."[621]

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[617] Author's interview with José Filippo, Executive Vice President & CFO (2012-2014) of Embraer, CFO of CPFL (2004-2009), São Paulo, April 1, 2014.

[618] Author's interviews with Joílson Ferreira, Director of Equity Investment and corporate governance expert of Previ pension fund (2008-2010), Rio de Janeiro, August 22, 2014, and Guilherme Lacerda, President of Funcef pension fund (2003-2011), Rio de Janeiro, August 21, 2014.

[619] Author's interview with Joílson Ferreira, Director of Equity Investment and corporate governance expert of Previ pension fund (2008-2010), Rio de Janeiro, August 22, 2014.

[620] "I Seminário Internacional de Fundos de Pensão começa na terça-feira em Copacabana," *Agência Brasil*, May 25, 2003.

[621] "Harrigan, Brazilian fund heads discuss potential for strategic partnership," *Pensions & Investments*, June 9, 2003.

By 2010, Previ had a team of 180 directors (*conselheiros*) who represented the pension fund in 131 firm boards.[622] In some of these cases, where Previ's stock holdings are very small, the pension fund, at the moment of deciding to invest in the company, put the condition of being allowed to appoint members for the management board (*conselho de administração*).[623] Moreover, due to SOE pension fund pressure, the Brazilian Securities and Exchange Commission started to a enforce a rule that entitled minority shareholders with relatively little equity holdings to appoint members to firms' *conselhos fiscais*, a board that audits the management board.[624] The pension fund leadership pursued several strategies to strengthen the capacity of board members to actively push for the funds' interests within the companies where they held equity. In 2004 and 2008 Previ published two documents aimed at instructing its *conselheiros* about how to push for better corporate governance practices and how to behave in shareholder meetings.[625] Moreover, Previ and Petros have set up training camps specially dedicated to improving the corporate governance skills of the individuals that represent pension funds in firm boards.[626]

Securing the value of pension funds' equity holdings and ensuring the liquidity of those investments so as to be able to sell those stocks in order to pay pension benefits in the future are mutually reinforcing goals. When SOE-linked pension fund leaders pursued these goals during the 2000s and 2010s they induced large Brazilian corporations to improve their corporate governance practices both directly—in companies where the *fundos de pensão* held equity—and indirectly—in other large companies where pension funds did not hold stock and where the protection of minority shareholders continued to be poor. The indirect effect is rooted in the fact that these companies came to face a tougher competition since the cost of outside capital became cheaper for the competitors that did start to better protect minority shareholders.[627] In an article published after stepping down as the CEO of the third largest Brazilian pension fund, which administers the savings of the workers of the state-owned bank Caixa Econômica Federal, Guilherme Lacerda retrospectively reflected on these issues:

> *Brazilian pension funds, as institutional investors, do not act in the market with a frenetic drive for buying and selling. They have greatly contributed to […] the strengthening of healthy patterns of [corporate] governance. […] These enhancements have increased the value of the companies, as it is recognized by the business leaders directly involved in partnerships with pension funds.*

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[622] "O ex-sindicalista que redesenhou a Previ," *Valor Econômico*, March 11, 2010.
[623] Author's interview with Joílson Ferreira, Director of Equity Investment and corporate governance expert of Previ pension fund (2008-2010), Rio de Janeiro, August 22, 2014.
[624] "O ex-sindicalista que redesenhou a Previ," *Valor Econômico*, March 11, 2010.
[625] Da Silva (2011: 2).
[626] Souza Lima (2013: 36), Da Silva (2011: 20).
[627] In a speculative concluding section that deals with Latin American countries at large, Schneider (2008: 390) makes a similar point: if the firms that are adopting new ownership structures and corporate practices that depart from those that characterize the prototypical family-owned, diversified Latin American business group—which include the expropriation of minority shareholders—grow and multiply, these firms may start to edge aside or displace *grupos* and their corporate governance practices. The plausibility of this sort of dynamic leads him to hypothesize that corporate governance changes in Latin America seem "more likely to come gradually and incrementally—through processes like institutional displacement and layering—rather than as an abrupt transformation."

> *Many domestic companies understood the value of moving to the* Novo Mercado *and indeed established serious and modern governance; other companies are more resistant [to change]. But it is beyond doubt that good governance has value. Let's see: the IGC Index […] measures the performance of a portfolio of corporate stock with good levels of corporate governance […] traded in Novo Mercado or categorized in Level 1 or Level 2. […] Since 2001 the IGC Index has recorded a profit of 660 percent, vis-à-vis the 380 percent profit of [companies listed in the conventional segment of the São Paulo Stock Exchange].*
> *In sum, good [corporate] governance practices add value […]. Unfortunately, there are still corporate executives that are resistant [to adapt] to this new era and they act as if firms just needed to maximize short-term results […].*[628]

In 2004, Petros was in fact the first pension fund to include a specific paragraph in one of its new funds stating that "investments must be oriented [*deverá direcionar*] to acquire stock in companies where the partners or controlling shareholders commit themselves to improving corporate governance standards, embracing the rules set in Level 2 – Novo Mercado of the São Paulo stock market."[629]

The case of Embraer, one of the leading airplane manufacturers in the world, is a perfect illustration of how pension fund activism contributed to improving corporate governance practices *within* the company, which in turn has likely had an indirect, macro-level effect over the rest of domestic big business. Up to 2006, Embraer was, in this regard, a prototype of a Brazilian large company: it had a controlling bloc of shareholders.[630] At that point, Previ pension fund, which was part of that bloc and was looking to ensure the future liquidity of its holdings in Embraer as well as maximizing value, advocated for the dilution of the controlling bloc of shareholders and in favor of Embraer issuing new equity at the Novo Mercado.[631] Partly as a result of this pressure from within, in 2006 Embraer diluted its controlling block of shareholders and became Brazil's largest company with atomized ownership.[632]

Although Embraer is a flagship case of pension fund activist shareholding and capital-market-enlarging corporate governance improvements, there are other important illustrations of this broader trend. Previ and Petros, along with other pension funds, were the key members of the bloc of shareholders that controlled Perdigão, one of the largest food producers in the world. A Brazilian analyst denominated Perdigão as "*uma* corporation *de fundos de pensão brasileiros*" because this was a rare case in which pension funds were the *only* members of the controlling bloc of shareholders.[633] This peculiarity strengthens my inference that some major corporate-governance-improving processes can actually be traced to SOE pension fund action. In 2005 and 2006, the SOE pension funds, looking to make their investments more liquid and improve corporate governance standards, decided to dissolve Perdigão's controlling bloc,[634] moving the

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[628] "Governança nas empresas brasileiras globais," *Valor Econômico*, April 8, 2011.
[629] Martins (2008: 182).
[630] IFC-OECD (2005: 34, 36).
[631] Author's interview with Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014. This account was checked in a not-for-attribution interview, 2014.
[632] IFC-OECD (2005: 35).
[633] Martins (2008: 176).
[634] Author's interview with Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014. This account was checked in a not-for-attribution interview, 2014. See as well the coincident published account provided by Petros's former president: Pinheiro de Oliveira (2011: 109-10).

company to the Novo Mercado, and thus turning this giant firm into a case of shareholder diffusion. As Martins (2008: 176) underlines, by taking these steps, the SOE pension funds that were part of the blockholding calculated that it was in their long-term advantage to cede the short-term benefit of cashing their "control premium" (*prêmio de controle*)[635] and instead benefit from the likely higher future value of their stock holdings in a company with higher-than-average corporate governance practices and diffused ownership.

"In all the companies where we hold equity, we push for a vision of investment that prioritizes the long-term," Previ's former president told me; he then unpacked SOE pension funds' rationale:

> *We needed to have power within companies so as to stage effective opposition to managerial decisions prioritizing the short-term, such as attempts geared at over-indebting the firms or focused on paying dividends. That's why we always seek to have the same rights as any other shareholder in the companies in which we choose to invest. This is always a disputed matter in a country like Brazil, where most firms have concentrated ownership… it's a tense issue even in firms that have gone public.*[636]

1.II. The BNDES in Capital Markets[637]

> *"I would love for Brazil to have 'Apples,' a Silicon Valley. We will induce this. If it doesn't occur, it will not be due to lack of capital. The BNDES will be there to finance this strategy."*
> Julio Ramundo, BNDES Managing Director (2011-present) in charge of the bank's Capital Markets Unit[638]

The new mode of state involvement in capital markets that started in the early 2000s through the channel of giant SOE pension funds strengthened when the neo-developmental coalition of policy entrepreneurs secured its dominance within the Brazilian executive branch in the mid- and late-2000s (a process examined in depth in Chapter 3). Starting in 2007, the National Bank for Economic and Social Development (BNDES) came to have a strategy that gave this state-owned development bank a significantly larger intervention in the domestic equity market. This shift in the Bank's strategy was, as I will show, both an end in itself and a means to attain newly set industrial policy goals.

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[635] As opposed to minority shareholders that do not belong to the controlling bloc of shareholders or shareholders of companies where such bloc does not exist, controlling shareholders usually get a price premium when selling their equity.

[636] Author's interview with Sérgio Rosa, President of Previ pension fund (2003-2010), São Paulo, March 31, 2014.

[637] I recommend reading this section in tandem with Chapter 3. In order to avoid repetitions, in this section I do not go back to addressing the origins, goals, and implications of the neo-developmental coalition of policy entrepreneurs that became dominant around 2007; however, such evidence provides important contextual facts to the process hereby analyzed.

[638] Cited by Sierra (2016: 19).

As I study in Chapter 3, around 2007 a "perfect alignment" of developmentalist leaders emerged across state agencies that matter the most in defining the mode of state involvement in markets in Brazil: the Ministry of Finance, the BNDES presidency and board, and the President's Chief of Staff. While this shift, at least in absolute monetary terms, had bigger implications for the scale of state involvement in *credit markets* rather than in *capital markets*, the impact over the latter is significant and, consequently, worth studying in the context of this chapter.

Starting in 2007, at a time when state involvement through the pension funds of SOEs had already become very large, the BNDES moved to be a major institutional investor in the Brazilian stock market. The institutional vehicle for this shift was *BNDES Participações* (BNDES Shareholdings or BNDESPar, for its Portuguese acronym). The statute of BNDESPar establishes, as one of its five goals, that this BNDES subsidiary will seek to "contribute to the strengthening of [Brazilian] capital market by increasing the supply of securities and by democratizing capital ownership in [the country's] corporations."[639] There was, however, a policy change that turned this general goal in the formal writing of the BNDES rules into a major shift in the scale and mode of state involvement in the equity market: the launching of state promotion of the internationalization of Brazilian corporations.

Since the Workers' Party took power in 2003, isolated political *técnicos* had been advocating for the need of the Brazilian state to take a decisive step in supporting the internationalization of some of the country's firms. These ideas only took off with significant strength once neo-developmental leaders managed to defeat orthodox political *técnicos* who had had a stronghold in the Ministry of Finance. As Schneider (2013: 171) has noted,

> *Support for internationalization came largely from the BNDES, with strong backing from other top ministries. BNDES funding for international acquisitions grew after 2005 and especially after [Luciano] Coutinho was appointed [BNDES] president in 2007.*

In Chapter 3, I drew attention to evidence indicating that Coutinho had been a key advocate of state promotion of corporate internationalization not just before being appointed to the presidency of the BNDES in 2007 but even well before the Workers' Party succeeded in winning the 2002 presidential race. Sierra (2015: 71-5) carefully studied the evolution of Coutinho's causal beliefs; the idea that the state should play a key role in the internationalization of Brazilian business and that supporting the emergence of large-scale domestic multinational corporations would contribute to the country's long-term development can be traced back to his time as a doctoral student at Cornell University. His dissertation, completed in 1974 and titled *The Internationalization of Oligopoly Capital*, pursued a comparative historical study of this phenomenon in the United States, Europe, and South Korea. During most of his career, Coutinho was a professor at the heterodox department of economics of the State University of Campinas.

As Sierra (2015: 73-4) remarks, Coutinho's long-dated intellectual partner had been João Carlos Ferraz, whom Coutinho would appoint as his vice-president at the BNDES. Ferraz completed a Ph.D. in Innovation Economy and Public Policies at University of Sussex, England,

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[639] *Estatuto Social da BNDES Participações S.A. – BNDESPAR* (Decisão no. Dir. 149/2002-BNDES and modified by 19 BNDES board Decisões between 2002 and 2015). The original text in Portuguese is: "*Art. 4º A BNDESPAR tem por objeto social […] IV. contribuir para o fortalecimento do mercado de capitais, por intermédio do acréscimo de oferta de valores mobiliários e da democratização da propriedade do capital de empresas.*"

in 1984, and would later become a professor in the heterodox department of economics of the Federal University of Rio de Janeiro (UFRJ). He spent five years as a visiting professor at the University of Tsukuba, Japan, where he studied the internationalization of Japanese firms. During the early 1990s Coutinho and Ferraz were the leading authors of *Estudo da Competitividade da Indústria Brasileira* (Study of the Competitiveness of Brazilian Industry), a highly influential book where they made the case that the Brazilian state should step in to support an expansion of the scale and the international presence of Brazilian firms.

In 2002, Luciano Coutinho participated at a series of meetings called Panels of Brazilian Development (*Painéis do Desenvolvimento Brasileiro*). These were highly technical events bringing together professors of economics and policy practitioners with strong academic credentials. Participants were asked to present policy papers, normative in their nature, or serve as discussants about several issues related to economic policymaking and development. Coutinho expressed his views in front of a close group of colleagues five years before he came to preside the BNDES.

On that occasion, Coutinho argue that the required "industrial policy must support the capitalization and internationalization of Brazilian firms. [...] The overcoming of Brazil's deficiencies in competiveness cannot be accomplished without a set of national champions. […] It is therefore urgent to have a strategy to form 'competitive national champions' […] that can project themselves as global actors" (Coutinho 2002: 200, 204). He went on to say: "As of today we have few global players […]. We can and we should develop world-class large firms in the sectors of steel, pulp and paper, petrochemicals and agribusiness. We should aspire to have strong firms in segments of the industry of ITs" (Coutinho 2002: 205).

These ideas were reflected in the Productive Development Policy (*Política de Desenvolvimento Produtivo* or PDP) adopted in 2008 upon the consolidation of the neo-developmental coalition of political *técnicos*. One of the four main goals of the PDP (*metas-país*) was to increase Brazil's share in world exports markets. The document identified two "strongly related" mechanisms of "corporate internationalization" to achieve such goal: increasing firms' exporting capacity and increasing Brazilian firms' direct investment in commercial and productive units based in foreign countries.[640] Both mechanisms entailed massive injections of capital in existing Brazilian companies. The Productive Development Policy identified seven industries/sectors—considered as internationally competitive and with capacity to extend their reach in world markets—that would be targeted to receive capital so as to boost their potential for internationalization: airplane manufacturing; oil, natural gas, and petrochemicals; bioethanol; mining; steel; cellulose; and meat.[641]

While the PDP was formally presented as an inter-ministerial initiative, several top government officials who asked for anonymity argued that the policy was actually crafted in-house by the BNDES, critically building on the industrial policy orientation that Luciano Coutinho had been developing well before he reached the BNDES presidency.[642] The BNDES thus played the role of championing its industrial policy perspective and then led the coordination and later policy adoption with neo-developmental entrepreneurs at the Ministry of Finance and the Ministry of Development. The BNDES was not only included as one of the three

[640] ABDI-BNDES-MF-MDIC (2008: 20).
[641] ABDI-BNDES-MF-MDIC (2008: 31).
[642] Not-for-attribution interviews with top government officials, 2014.

members of the Executive Secretariat of the Productive Development Policy but also given the role of Coordinator of the programs of state support of corporate internationalization.[643]

What is key for the purposes of this study is that an important part of state promotion of Brazilian MNCs, which could have been pursued with tools that did *not* channel resources through the domestic stock market, did in fact privilege such market as an avenue for state intervention. The decision to use that specific channel to boost investment finance of firms with potential for internationalization is likely associated with the fact that, defying simplistic characterizations of state-led development paradigms, the political *técnicos* that designed and later implemented this industrial policy had been for a long time strong advocates of capital market development. Far from believing in the dichotomy of state-owned development banks vs. capital markets or the orthodox tenet that holds that state-supported finance crowds out private investment, these political *técnicos* had for a long time seen the potential for a positive-sum relationship between large development bank lending *and* domestic capital market enlargement. Higher state proactivity and larger markets were not seen as competing forces but, quite to the opposite, as complements. According to this set of ideas, supporting the internationalization of Brazilian corporations *interacted* with expanding the breadth of the domestic equity market as two desirable goals for Brazil's long-term development. The two goals could be pursued in conjunction.

A sample of evidence on those ideas can be found in a co-authored policy paper that Coutinho wrote over six years prior to reaching the BNDES presidency.[644] After praising two works by Ross Levine on the connection between financial development and economic growth (see Chapter 1 of this study, where I review this literature), Coutinho and his co-author wrote back in 2001:

> *Local stock markets could be particularly important when it comes to providing capital to indigenous emerging firms and to technology-based enterprises […]. Knowledge and expertise about the potential of these firms certainly requires the existence of local financial institutions and a national capital market that are able to perceive and support such opportunities. The experience of Silicon Valley in the U.S. shows that capital markets could be instrumental to fostering [this] type of firms. Initial risk capital is provided by venture capital funds in the hope of realizing large profits in the event of an initial public offering. One of the major difficulties of private equity and venture capital funds in Latin America is precisely the exit problem, since the absence of well developed capital markets does not make an IPO very feasible or attractive […]. The lack of an efficient stock market may hinder Brazil's ability to grasp opportunities linked to the new technologies.*[645]

In another passage of that 2001 paper, Coutinho discussed whether *foreign* capital markets could substitute for a capital market based in Brazil. In line with the neo-developmental

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[643] ABDI-BNDES-MF-MDIC (2008: 37).

[644] For evidence on these ideas expressed once the neo-developmental policy *técnicos* secured their dominance in government, see, for instance: "Coutinho assume e promete empenho na execução do PAC," BNDES Press Release, May 2, 2007; "Para BNDES, momento é bom para aquisições no exterior," *Valor Econômico*, November 5, 2009; "Cabe ao governo eleito pelo povo fixar as prioridades," *Valor Econômico*, October 22, 2014.

[645] Rabelo and Coutinho (2001: 44). The OECD eventually published the final version of this paper as Coutinho and Rabelo (2003).

tenet—reviewed earlier in this chapter—that holds that long-term growth in contemporary Latin America should be based on domestic savings as a source of investment finance for the region's corporations, Coutinho dismissed the possibility of relying on foreign capital markets to substitute for domestic ones:

> *One might posit that the growing use of foreign stock markets by Brazilian firms [during the 1990s] could eventually replace the need for a local stock market. In fact, many Brazilian firms are issuing ADRs in the New York Stock Exchange, and recently the Madrid Stock Exchange has allowed Brazilian firms to list their shares directly (without the use of depositary receipts), which makes the process less expensive. […] But there are two caveats here. One is that informational asymmetries will certainly restrict access to foreign stock markets to a limited number of Brazilian firms; new ventures will have difficulty tapping equity finance in foreign stock exchanges. The other is the question of how much a country without a convertible currency and subject to speculative crisis can depend on foreign sources of finance. These sources are quite volatile, as was clearly shown by the effects of the Mexican, Asian and Russian crises [during the 1990s] on international financial flows to Brazil.*[646]

Coutinho's causal beliefs early on connected pension regulation, corporate governance, domestic capital market expansion, the internationalization of Brazilian firms, and long-term development:

> *A local stock market is also necessary to facilitate the growth of the private pensions industry. Even in countries where pension funds are allowed to invest in foreign assets, the great majority of investments are made in the local market. […] [E]ffective mechanisms for the protection of the rights of outside investors […] are also a sine qua non condition for the expansion of the supply of long-term savings and therefore for the development of capital markets. It is basically through its influence on financial development that improved corporate governance will enhance the competitiveness of Brazilian firms.*[647]

In sum, the consolidation of a strong, ideationally coherent, and well-coordinated neo-developmental coalition of political *técnicos* by 2007, whose strongholds were the Ministry of Finance and the BNDES, had important implications for the mode of state involvement in capital markets.[648] This coalition pursued the goal of increasing state support for the internationalization of Brazilian firms partly through the domestic equity market; its entrepreneurial behavior triggered a major shift in the strategy of BNDES Shareholdings (BNDESPar) as an institutional investor. As synthesized by Sierra (2016: 9) in her study on state support of Brazilian multinationals, during the Workers' Party administrations (2003-2016) the BNDES came to promote firms' internationalization through three tools: loans, capitalization via the purchase of publicly traded company shares, and incentives for mergers and acquisitions among domestic companies. The last two tools have the implication that the state, through the BNDES, injected a massive amount of resources in the domestic equity market.[649]

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[646] Rabelo and Coutinho (2001: 44-5).
[647] Rabelo and Coutinho (2001: 45).
[648] For a longer, in-depth treatment of the origins of this coalition, see Chapter 3.
[649] The micropolitics of state involvement in capital markets through the action of BNDESPar illustrate the point made in the framework of this study about the importance of the formation of coherent

Figure 5.3 tracks down the meteoric growth of the scale of BNDESPar holdings associated with the industrial policy choices reviewed in this section.

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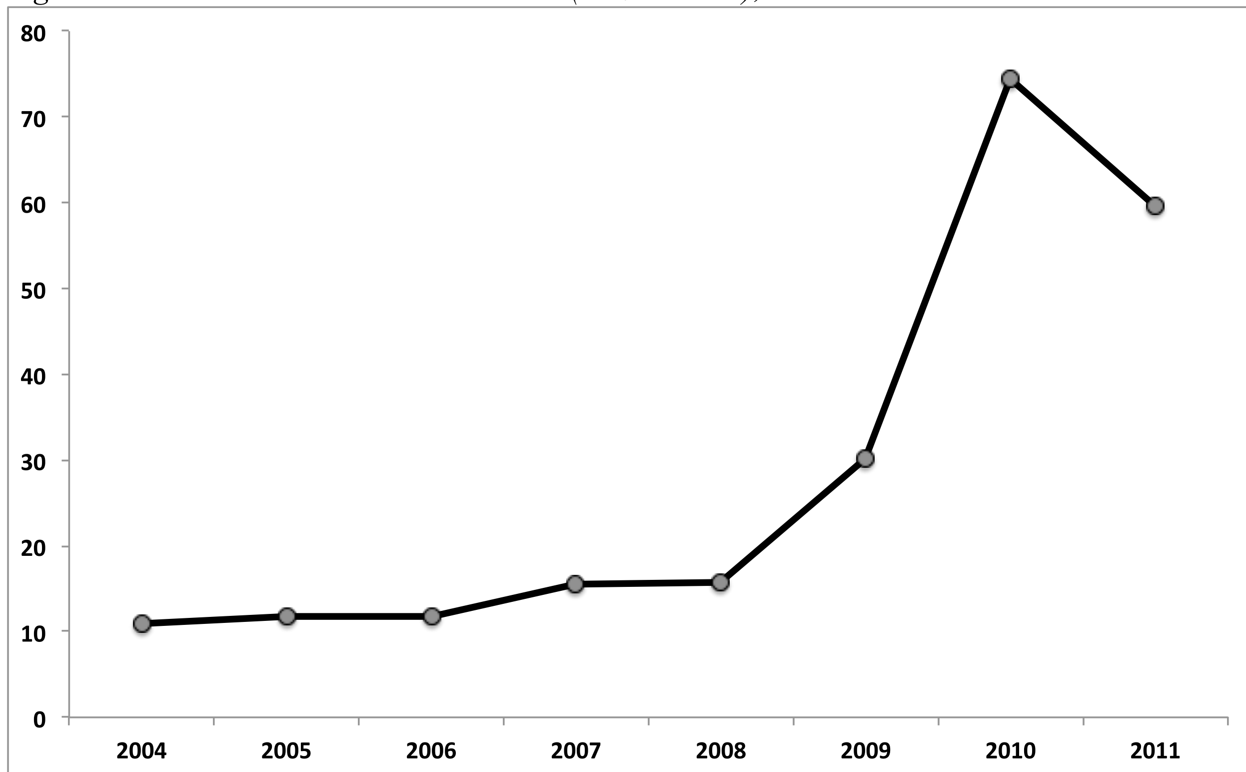
coalitions of political *técnicos* across state agencies and the relevance of ideas as coalitional glues. Between 2003 and 2004, the first years of the Workers' Party in government, the BNDES president was Carlos Lessa (see Chapter 3 for an in-depth study of his profile and action while in office). As I have shown in Chapter 3, at that time the neo-developmental political *técnicos* were struggling for dominance within the executive branch, a task that was difficult not just because an orthodox coalition of political *técnicos* had a stronghold in the Ministry of Finance but also because neo-developmental officials themselves still did not constitute an ideationally coherent and well-coordinated group. Evidence of this tension can be found in the disagreements existing at the time among neo-developmental political *técnicos* with regard to the role of the BNDES in promoting the enlargement of the stock market. As Sierra (2015: 67, 71, 75-7) carefully showed, BNDES President Lessa was a very strong proponent of supporting firm internationalization, which he saw as a desirable instrument of economic statecraft. However, my own field research suggests that Lessa did *not* agree with the idea that other neo-developmental officials like Luciano Coutinho and Guido Mantega had held for a long time (on Mantega, see Chapter 3): namely, that state proactivity through the BNDES should be combined with state support for the enlargement of the domestic capital market. As a matter of fact, Lessa acted to put his ideas in motion: in not-for-attribution interviews (2014) I found that within the BNDES Lessa proactively disempowered the units associated with the promotion of capital markets and the management of BNDES's equity holdings. The dismissal of Lessa as BNDES President contributed to strengthening the ideational coherence among neo-developmental political *técnicos*; by the time Luciano Coutinho was appointed BNDES President in 2007, the debate within this group of officials was settled: supporting the internationalization of large-scale Brazilian firms *and* strengthening the BNDESPar role in the domestic equity market would from then on be pursued in tandem, with the understanding that economic statecraft *and* capital market enlargement were both highly desirable goals to achieve long-term development.

Figure 5.3. Brazil. BNDESPar Total Assets (US$ Billions), 2004-2011.



Source: Author's calculations based on data from annual BNDESPar financial statements and IMF's historical exchange rate data.
Note: Data points are for December of each year.

Coinciding with the process traced in this section and in Chapter 3, the industrial policy shifts championed by neo-developmental political *técnicos*—which centrally included supporting the internationalization of large-scale Brazilian firms—generated a major increase in the provision of capital by BNDES Shareholdings: it went from a baseline of US$7.3 billion in the era that preceded the Workers' Party taking office (1999)[650] to US$10.8 billion in 2004, and it reached US$74.4 billion in 2010.[651] By 2008, when state support for Brazilian multinationals was still taking off, BNDESPar had already come to own stock in 50 percent of the most internationalized firms.[652] By 2011, through BNDESPar, the Brazilian Development Bank was a shareholder in 154 companies.[653]

Sierra's (2016: 10-8) case study on BNDES support of the emergence of JBS as an agribusiness global champion illustrates these broader trends. The BNDES *técnicos* perceived that the domestic agribusiness industry was affected by its fragmentation and diagnosed that concentration would be desirable to achieve gains of scale and avoid foreign takeovers.

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[650] Rabelo and Coutinho (2001: 29).
[651] My calculations based on data from annual BNDESPar financial statements. Da Silva and Zorman (2012: 5) estimate that, by 2011, corporate stock constituted roughly 90 percent of BNDESPar total assets.
[652] Finchelstein (2010: 80).
[653] Data from Da Silva and Zorman (2012: 5). Note that these authors' sample is much more exhaustive than that of Musacchio and Lazzarini (2014: 98).

Furthermore, according to BNDES's assessment, key shortcomings of the Brazilian agribusiness industry were its difficulty of accessing the markets of advanced economies—due to their protectionist policies—and its lag in innovation, both of which relegated Brazilian corporations to a marginal role in global supply chains. The BNDES *técnicos* came to the assessment that these bottlenecks would only be sorted out if the state stepped in to invest in a few companies that could achieve "the necessary scale and relevance to affect the full supply chain and in, turn, modify the industry's international competitiveness."[654] JBS, a Brazilian firm founded in 1953 and dedicated to the production, processing and commercialization of meat products, until the 2000s had been a fully private corporation without any history of state ownership. In the late 2000s it became a flagship case of BNDES-supported corporate internationalization: JBS became the largest Brazilian MNC. In an interview with Sierra (2016: 12), JBS Chief Investor Relations Officer told her, "We would not have obtained so much BNDES funding if we had not shown interest in internationalizing. This is the BNDES strategy: Take Brazil abroad by taking its corporations abroad. This is their strategy and we were part of it."

In 2007, reflecting BNDES President Luciano Coutinho's drive to simultaneously pursue the internationalization of Brazilian firms and contributing to the enlargement of the domestic stock market, the BNDES encouraged JBS to launch an IPO in the São Paulo Stock Exchange.[655] JBS was the first South American agribusiness firm to publicly trade; in that IPO operation BNDESPar acquired a 12.9-percent stake in JBS and obtained seats on the firm's board.[656] After raising capital through the IPO, JBS purchased American giant Swift & Co, outbidding major American corporations Tyson Foods and Cargill. This acquisition was possible thanks to an additional injection of capital by BNDESPar in the amount of US$750 million. Between 2010 and 2011, BNDESPar went on to increase its shareholdings in JBS, coming to own 31 percent of this now global agribusiness champion. Between 2008 and 2015, JBS acquired or participated in new joint ventures in the United States, Italy, Belgium, and Australia, among other countries. [657] This strategy allowed JBS to not only access new markets but also significantly boosted its innovation capacities, as evidenced by its multiple new investments and achievements in R&D.[658]

Finchelstein (2010: 80-1) showed that the patterns observed in the case of JBS resemble BNDESPar action in multiple industries, including steel, textile, railway logistics, cellulose and paper, and oil and gas. Sierra (2016: 18-25), for her part, found that the surge of domestically owned TOTVS as an information technology global champion cannot be understood without looking at the major role the BNDES played in injecting much-needed capital for successful internationalization. Thanks to BNDES support, including BNDESPar acquiring up to 17 percent of the firm in the mid-2000s, by 2015 TOTVS became the world's sixth largest provider of enterprise resource planning (ERP) software to small- and medium-sized enterprises, with subsidiaries in Argentina, Germany, and the United States, as well as R&D centers in the Mexico, United States, and Taiwan.[659]

[654] Sierra (2016: 11).
[655] Author's interview with Julio Ramundo, BNDES Board Director (2011-14) and top official at several units (1992-2011), Rio de Janeiro, August 25, 2014.
[656] Sierra (2016: 13).
[657] Sierra (2016: 13-5).
[658] Sierra (2016: 16-8).
[659] ERP software allows companies to manage information through cloud storage systems and big data processing.

2. Specifying the Role of Business: Financial-Sector Business Actors as Drivers of a Capital-Market Enlarging Reform

This chapter has made the case that the emerge of a new mode of state involvement in capital markets during the Workers' Party administrations (2003-2016) was a critical factor contributing to the enlargement of the Brazilian stock market and the inherent reconfiguration of the national financial system. In line with the propositions laid out in the framework of this study, I have shown that political *técnicos* in the relatively opaque arenas of pension regulation and industrial policy were key agents pushing the Brazilian state to play a very active role investing in the domestic equity market and in advocating for low-salience regulatory changes that further enlarged such market. I have provided abundant evidence indicating that part of the relevant action of state actors in markets was exerting pressure as minority shareholders so that Brazilian corporations embraced stricter corporate governance standards. During the period under study, SOE pension funds and BNDES Shareholdings have consistently induced large Brazilian corporations to improve their corporate governance practices directly, in companies where they held equity. But SOE pension funds' and BNDES Shareholdings' behavior also affected, indirectly, other large companies in which these institutional investors did not hold equity: since the cost of outside capital became cheaper for these companies' competitors—as a result of embracing stricter corporate governance standards—these large firms had to somehow adjust to the new scenario.

While I have put state actors at the center of my argument, I dedicate this section to showing that an important capital-market enlarging reform—adopted in 2000 and *primarily driven by private-sector actors*—laid the ground for and facilitated the action of the state actors during the 2000s. Although not all the activist behavior of SOE pension funds and BNDESPar in favor of enhancing minority shareholder protections was dependent on the prior existence of the Novo Mercado, part of such action did depend on the prior existence of those formal rules. This merits some attention here since it somewhat departs from the expectations of Chapter 2 and it suggests that the action of political *técnicos*, though it may not always be the primary driver of policy design and adoption, can critically contribute to the success of rules that already exist.

In 2000, new segments were created within the São Paulo Stock Exchange (Level 1, Level 2, and *Novo Mercado* or New Market) with stricter corporate governance requirements, including transparency, disclosure, and accountability procedures that enhance the protection of minority shareholders. With the new rules in place, firms already issuing equity or considering doing so could voluntarily choose to list their stock in the new segments instead of relying on the traditional market. For these corporations the incentives for voluntarily listing in the Novo Mercado—as a way of signaling that they adhered to good corporate governance practices—would be lowering the cost and improving the conditions for accessing capital, as well as increasing the value of their shares.[660]

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[660] The former president of Vale—one of the largest Brazilian companies, which was encouraged by pension funds and the BNDES to enter the New Market—once said to the financial press: "*Being in the Novo Mercado is like having a medal that you can wear*." (Cited by Kenyon 2006: 21). Also see Kenyon (2006: 27-8) for a more generalized treatment of the motivations of private firms to enter the New Market.

The São Paulo Stock Exchange (BOVESPA) itself championed the design and set up of this New Market with the goal of at least partially addressing the poor investor rights that characterized Brazil by the end of the 1990s;[661] reducing agency and information risks was deemed as an effective way of attracting new investors and new equity issuers to the domestic market.[662] The Novo Mercado rules did not allow firms entering that market to have nonvoting or "preferred" shares (known locally as *preferenciais nominativas* or simply "PN"), a type of stock that characterizes the capital structure of the vast majority of the country's firms. The Brazilian legislation allowed publicly held companies to issue up to two-thirds of their capital in the form of nonvoting shares, which enabled holders of voting shares to control companies by owning as little as 17 percent of the firm's total stock.[663] These rules gave controlling blocs of shareholders ample opportunities to expropriate minority, outside investors.[664] Among the most important rules constraining firms willing to list in the New Market were the obligation to issue only voting shares and to grant tag-along rights to all shareholders,[665] as well as several mechanisms that strengthened the companies' boards, enhancing the capacity of minority shareholders to hold the controlling bloc of shareholders accountable.

The BOVESPA-championed design and adoption of the new rules of the Novo Mercado—a low-salience and highly technical arena—generated conflict. In such process we can identify at least two deviations from the propositions laid out in the framework of this study: first, some business actors were highly cognizant of the effects that the new rules could have; second, state actors did not call the shots in this case.[666]

BOVESPA, a firm itself, was the most intensely interested actor in the creation of the Novo Mercado and it became the main driver of reform. As no other firm in Brazil, BOVESPA's business depends on the enlargement of the São Paulo Stock Exchange and thus had strong incentives to push for any reform that would contribute with such market expansion. However, as an intense reform proponent as BOVESPA may have been, the firm has little power compared to that of big Brazilian business. On issues affecting their capacity to exert tight control of their business groups, these large *grupos* are not cognitively handicapped, they have well-formed preferences, and are likely to use instrumental power to protect them.

A Korn Ferry and McKinsey & Company report of the situation of large Brazilian corporations by the late 1990s found that the heads of controlling blocs of shareholders saw the advancement of minority shareholder protections as a threat to their capacity to manage their business groups. In the part of the study that collected evidence on subjective views, a top executive-owner was quoted as saying, "for as long as I continue to be the owner of this company, I don't want any board annoying me."[667] An anonymous board member of a company

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[661] Coutinho and Rabelo (2003: 36, 55).
[662] Didier and Schmukler (2014: 60).
[663] Santana (2008: 9).
[664] Kenyon (2006: 18) notes that by 2000 the control premium—i.e. the difference between the price of voting and nonvoting shares—was higher in Brazil than in any other of 13 countries surveyed in a comparative study.
[665] Tag-along rights protect the interest of minority shareholders, ensuring that they will receive the same price per share than that paid to the controlling block of shareholders should the latter decide to sell their stockholdings.
[666] Finchelstein (2010: 60) makes the same inference about the primary role of private rather than public actors in the inception of Novo Mercado.
[667] The original Portuguese quote was: "*Enquanto eu for dono desta companhia, eu não quero nenhum conselho me chateando*."

said to Korn Ferry and McKinsey & Company that by the late 1990s, "Brazilian corporate governance still ha[d] a strong authoritarian leaning." A third informant, a board member as well, explained: "family members and insider board members [related to the owners of the company] do not want to lose or cede control of their companies."[668]

By 2000, BOVESPA had fresh evidence on big business cognitive capacity and willingness to resort to instrumental power: a reform that would have strengthened minority shareholder protections had recently failed in Congress, precisely because of the successful lobby of large business groups that felt threatened by that bill.[669] The former head of listings and issuer relations of the São Paulo Stock Exchange (BOVESPA), whom top executives identify as the *técnica* within BOVESPA who played the critical leading role in the design of the Novo Mercado rules,[670] recalled the opposition they faced during the design of this new segment in the stock market:

> *Novo Mercado was viewed with some trepidation by some issuers and intermediaries. Some large companies with a commanding presence in Brazil's concentrated securities market saw very little upside. Executives and owners of such companies seemed to fear that investors would pressure them to migrate to Novo Mercado, or else punish them for not doing so. Since these blue chip firms already had privileged access to the markets due to their size and history, Novo Mercado merely presented to them the possibility of being cajoled into limiting their flexibility (especially with respect to issuance of non-voting shares). If they did not join, they risked being criticized for sub-optimal governance.*[671]

The weakness of BOVESPA vis-à-vis non-financial business groups with an intense interest in blocking the adoption of new rules that would better safeguard minority shareholders led it to seek support from other actors. The official endorsements that BOVESPA received at the time of launching the Novo Mercado were as few as six: three of them were organizations linked to the International Finance Corporation (IFC-World Bank), an asset management firm based in Brazil, and, tellingly in light of the evidence that constitutes the core of this chapter, the SOE pension fund Petros and the BNDES. One of these six official supporters of Novo Mercado, the Private Sector Advisory Group (PSAG)—a World Bank-affiliated institution that brings together international leaders of the private sector—resorted to the international press to publicize its support for the Novo Mercado and the benefits for investors in Brazilian firms.[672]

"Naturally, BOVESPA could not ignore the concerns (some of them legitimate) of its existing issuers," wrote a former top executive of the São Paulo Stock Exchange in a document where she revisited the process of pushing for the creation of the Novo Mercado in the face of resistance exerted by major domestic business groups.[673] As a way out of this tension within the Brazilian big business community, there was a compromise. In addition to the Novo Mercado, BOVESPA created two segments: Corporate Governance Level 1 and Level 2 (*Nível 1* and *Nível*

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[668] The study is summarized in Gorga (2004: 318-9).
[669] On how business interests first blocked and then watered down the bill that was ultimately passed as Law 10,303/2001, see Gorga (2004: 310-5) and Rodrigues da Cunha (2008: ix). On the failure of the congressional route to improve corporate governance regulations, also see Finchelstein (2010: 84).
[670] Rodrigues da Cunha (2008: x).
[671] Santana (2008: 12).
[672] Santana (2008: 20).
[673] Santana (2008: 13).

2). Level 2 requires issuing companies to comply with all the strict rules of the Novo Mercado, with some important exceptions that include retaining the right to maintain existing preferred shares and issue new ones, as well as the benefit of having to guarantee tag-along rights that are not as favorable for minority shareholders as those in the Novo Mercado. Level 1 relaxes the requirements further, basically replicating the rules of the traditional segment of the market with some additions that focus on higher standards of disclosure. Minority shareholders in companies listing their shares in Level 1 are significantly less protected than those who hold stock in firms listed in the Novo Mercado. The BOVESPA former top executive recalled,

> *The creation of Level 2 satisfied the concerns of companies whose principal objection to Novo Mercado was that it did not permit companies with an existing stock of preferred shares to demonstrate their commitment to good governance. The quite modest requirements of Level 1 […] provided firms with an opportunity to signal at least some commitment to good corporate governance, without fundamentally limiting their flexibility to organize their capital structure or exposing them to another legal forum for settlement of shareholder disputes.*[674]

Conventional wisdom in mainstream economics has long ago shown that rules that improve corporate governance practices, protecting the interests of minority shareholders within firms, constitute an explanatory factor of the deepening of domestic capital markets.[675] In this section I have argued that the action of *business* rather than *state actors* was the primary driver of the adoption of such type of rules in the case of Brazil. More specifically, the São Paulo Stock Exchange, itself a company, along with other financial-sector actors, were the main proponents of reform, succeeding to partially impose their preferences on large, mostly non-financial business groups, and reaching a compromise that significantly improved the formal regulation that serves as the architecture of the São Paulo equity market. Yet I claim that this is only part of the relevant story: it focuses just on the *formal rules*, forgetting that the action of some *players* in subsequent rounds of the game—that is, in the post-adoption phase—may be as important as the rules themselves. The players critically affect whether the new rules will have a significant effect on markets, especially in contexts, as that of Brazil, where the largest corporate incumbents are resistant to change. For this reason, I treat the empirical material in this chapter as evidencing the *complementarity of these hypotheses*: we should not adjudicate between rules or players as *rival explanations*—both factors matter.

The evidence in the previous sections of this chapter strongly suggests that the behavior of state actors that became the most important domestic institutional investors—i.e. SOE pension funds and BNDES Shareholdings—was an important factor contributing to the expansion of the Novo Mercado.[676] In other words, the market-creating effects that this change in the *formal rules* of corporate governance has had hinged significantly on the posterior behavior of these state actors, whom decisively used their great market power to induce Brazilian corporations to play by those new rules. Through a pattern of shareholder activism that was particularly prone to exploiting the advantages of the new rules, the giant SOE pension funds and BNDESPar fulfilled

[674] Santana (2008: 13).
[675] Prominently, La Porta et al. (1997, 2000).
[676] For the role of the BNDES in pushing for better corporate governance, see, for instance: BNDES (2014), Da Silva and Zorman (2012), Santana (2008: 20).

a role that no other player was likely to play. Such activism within corporations contrasts, in particular, with the relative passiveness of foreign portfolio investors.

The abundant empirical material I presented on this shareholder activism on behalf of state actors, which has probably had a positive effect on the enlargement of the Brazilian stock market, is just the tip of the iceberg: this behavior is also likely to have had indirect effects that are much harder to track down empirically. Due to the decision of these state players to induce firms to play by the new rules, in a relatively short period of time, multiple firms where these state actors did *not* hold equity came to face a scenario where their competitors, by complying with higher corporate governance standards, were having access to cheaper finance. It seems reasonable to speculate, therefore, that this new scenario is changing the incentive structure of the firms outside the Novo Mercado—or even outside the stock market altogether—and is likely to trigger a change in the behavior of these firms, as well as further rounds of corporate governance improvements and equity market enlargement in the medium and longer term.

3. Final Remarks

This chapter has traced the process by which, during the last decade, the Brazilian state moved from low to high levels of involvement in capital markets. This was a critical factor reconfiguring the national financial system: Brazil evolved from having a small domestic equity market to one of the most dynamic in the developing world. Moreover, Brazil became the success story in Latin America in the development of domestic private equity and venture capital industries.

As anticipated in Chapters 1 and 2 of this study, I do not claim that the empirical analysis presented in this chapter explains *fully* the impressive enlargement of the domestic stock market in twenty-first-century Brazil. I do claim that we cannot understand the origins of this newly structured national financial system without paying attention to the politics that determined a new mode of state involvement in capital markets during the Workers' Party four consecutive administrations (2003-2016). Specifically, incremental micropolitical changes within the executive branch led giant SOE pension funds to become major players investing in the domestic stock market, pushing formal rules, as well as informal practices, that fostered further market expansion; after the consolidation of a neo-developmental coalition of political *técnicos* aligning the preferences of the Ministry of Finance and the Brazilian Development Bank (BNDES) (Chapter 3), the market-creating effects of this mode of pension regulation was strengthened by the surge of the BNDES as a major domestic institutional investor.

Conventional explanations of the enlargement of the Brazilian stock market and the inherent reconfiguration of the national financial system would limit themselves to emphasizing the driving force of macroeconomic stability. Or, if they were somewhat more sensitive to the politics of market development, mainstream approaches would also include a focus on the rule-making role of market liberals in government. Yet the process-tracing analysis of this chapter indicates that these factors are not sufficient to explain the trajectory of the domestic equity market in twenty-first-century Brazil.

If macroeconomic stability in and of itself explained the enlargement of the domestic stock market, the latter should have occurred long *before* the Workers' Party administrations, not *during* them. After all, Finance Minister and later President Fernando Henrique Cardoso's reforms in the 1990s successfully reduced the country's historically high levels of inflation,

curbed fiscal deficit, and stabilized the exchange rate. Market friendliness cannot explain it all, since Cardoso's pedigree was more valued in the business community than that of his successor, President Lula Da Silva (2003-2010). While other observers may underscore the important role of orthodox *técnicos* in Lula's first cabinet in spurring the growth of the domestic stock market, such explanation is not convincing either. As I have shown in Chapter 3, orthodox political *técnicos* were only powerful for roughly three years: by 2007, their leverage had been reduced and neo-developmental political *técnicos* had secured their dominance. If such conventional wisdom were to hold, we should have seen a rapid enlargement of the domestic stock market while the orthodox economists were in control of the Ministry of Finance and a rapid or gradual decline after neo-developmental elite officials secured their leverage. The data presented in this chapter show, instead, that the Brazilian equity market increased the pace of its expansion *after* the influence of orthodox economists had been curtailed.

The new mode of state involvement in capital markets that underlies the reconfiguration of the national financial system in twenty-first-century Brazil, a developmental project in itself, was formed incrementally. Its key designers and executors were a group of highly entrepreneurial political *técnicos*—who combine strong expert knowledge with brokering skills—in the relatively opaque arenas of pension regulation and industrial policy. They pushed the Brazilian state to play a very active role investing in the domestic equity market and advocating for low-salience regulatory changes that further enlarged the market. Neo-developmental political *técnicos*' policy orientation finally became dominant within the Brazilian executive branch around 2007, when these elite officials eventually succeeded in articulating a well-coordinated and ideationally coherent coalition.

The political *técnicos* that came to dominate the policy process in the arenas of pension fund regulation and industrial policy held an elaborate set of principled and causal beliefs, a neo-developmental ideational underpinning of policy that is probably unique in the context of Latin America. In contrast with advocates of developmentalism without the "neo" prefix, the neo-developmental leaders that worked to redirect the giant SOE pension funds believed that pension funds' push towards higher levels of long-term investment in the real economy could be done *through markets*. Specifically, these entrepreneurs within state-linked pension funds considered that it was key to coordinate a base of well-capitalized institutional investors that could actively participate, with a long-term horizon, in the domestic stock market. This would imply shifting from over-investment in safe government bonds to riskier investment in corporate stock. In this mindset, contributing to develop the equity market and maximizing the value of future pension benefits were seen as mutually reinforcing goals.

For their part, the neo-developmental political *técnicos* in the arena of industrial policy, who secured a stronghold in the National Development Bank in the late 2000s—the empirical focus of Chapter 3—held the belief that new industrial policies should channel resources through the domestic stock market. Far from believing in the dichotomy of state-owned development banks vs. capital markets or the orthodox tenet that holds that state-supported finance crowds out private investment, these political *técnicos* had for a long time seen the potential for a positive-sum relationship between large development bank lending *and* domestic capital market enlargement. While these political *técnicos* designed new policy instruments to deliver long-term bank credit for firms on a massive scale (Chapter 3), they also saw domestic capital markets as an irreplaceable vehicle to fulfill a number of goals. These included promoting the internationalization of Brazilian firms, better insulating Brazilian companies from the negative effects of international financial crises, and providing an exit option for private equity and

venture capital investments that could in turn fuel the growth of new technology-based enterprises.

We could certainly bring up several additional explanatory factors and alternative hypotheses to account for the policy process that has reshaped the stock market in twenty-first-century Brazil. Each of the two most prominent contending hypotheses would stress a different primary driver of variation: on the one hand, the president's preferences, strategies, and agency; on the other hand, business pressure.

The first of these alternative hypotheses would claim that the argument presented in this chapter downplays President Lula's actual agency. Such approach would argue that Lula had a clear sense of what he would get when the heads of SOE pension funds and the BNDES were named; it would assume that the president fully understood the developmentalism-through-the-stock-market approach that these appointees would bring to their work. I recognize that it is important to consider these points. Yet they provide, to say the least, incomplete explanations (if not inaccurate altogether). None of these factors are sufficient to explain the highly complex, intricate and incremental policy process I have examined in this chapter, which took place in nonlegislative arenas where electoral calculations do not shape state actors' behavior.

I recognize that the broad contours of the agenda were of course aligned with Lula's goals. Nevertheless, since so much of this new mode of state involvement in capital markets was rooted in technical decisions that established means-ends relationships to set neo-developmental ideas in motion, we do not gain much analytical leverage by merely acknowledging the good fit between Lula's preferences and the broad contours of neo-developmentalism.

Moreover, this contending hypothesis has a number of problems. First, it neglects the fact that, as this chapter showed, President Lula was not directly involved in the appointment of all the key political *técnicos*. Some of them were appointees of Lula's appointees. So, it seems unreasonable to assume that the behavior of neo-developmental political *técnicos* in the arenas of pension fund regulation and industrial policy could be predicted based on their appointments *alone*. I suggested that it is more accurate to assume that these state actors received what my framework calls incomplete mandates and that they, though formally appointed, did not simply act as the president's agents: they were agenda-setters and relatively unconstrained promoters of a new orientation of pension fund and BNDES behavior in the domestic stock market.

Second, such alternative hypothesis assumes that President Lula had the technical and political capacity to predict how his appointment decisions would lead, at least four years down the road, to the constitution of a new mode of state involvement in capital markets. While appointment decisions made by President Lula and his top appointees certainly enabled the surge of this neo-developmental coalition of elite officials, the process-tracing work of this chapter suggests that this new mode of high state involvement in the stock market via giant SOE pension funds and BNDES Shareholdings was not predetermined from the outset and could hardly be forecasted: rather, it resulted from an incremental process in which contingent events and unintended effects of presidential decisions played a very important role.[677]

This chapter has provided abundant evidence that it is at odds with a hypothesis that puts most of the causal leverage on President Lula's agency and deduces the case trajectory from the president's appointment decisions alone. The like-minded neo-developmental elite officials' capacity to act collectively across state agencies could not simply be assumed, as evidenced by the fact that, during the first years of the PT in government, there were important technical disputes among them. At the time, these political *técnicos* shared the belief that state-led

[677] This is examined in detail in Chapter 3.

development was desirable—yet they did not agree on the convenience of utilizing the stock market as a vehicle for attaining those developmental goals.[678] Appointees' causal beliefs, ultimately articulated into technical proposals while Lula's presidency was well underway, seemed to have influenced the president and set the agenda from the bottom up rather than the other way around. I have shown, for instance, that on multiple occasions these political *técnicos* were the protagonists in the drafting of new regulation that allowed pension funds to increase their involvement in the domestic capital market. The politicians occupying the pinnacle positions in the executive branch of government were receptive to these new agendas—not the originating driver of regulatory reform. Likewise, the state's drive to foster, via SOE pension funds and the BNDES, the private equity and venture capital industries as well as the expansion of the Novo Mercado in São Paulo—all factors closely associated with the fate of domestic stock market development—cannot be attributed to the president. Even if one were willing to assume that President Lula had the resources—expertise and time—to devise a course of action on these issues, it seems highly unlikely that the president's agency would have, in and of itself, produced such outcomes in the absence of political *técnicos*' entrepreneurial and coordinated action, guided by elaborate causal beliefs on the links between financial markets and developmental goals.

Finally, this contending hypothesis neglects the fact that much of the market-creating effects of the new mode of state involvement in capital markets that I studied in this chapter is rooted in institutional shifts that take place in non-legislative arenas. Change in the informal rules underpinning corporate behavior in Brazil matter a lot and the loci of decision making over those rules is far away from the office where the president signs his or her decrees. This chapter showed that some of the action that has reshaped Brazilian markets took place within the boards of multiple companies. No party politician was seated at those tables. Such discussions were not about the type of formal rules to which voters pay attention but rather about the low-salience change of long-standing informal corporate practices. While in very few cases—notably, that of mining giant Vale—the president's agency is likely to have driven these corporate discussions, it is highly unlikely that the president micromanaged this highly technical agenda in the large number of smaller firms where pension funds and the BNDES hold equity—or that he was the architect of a comprehensive strategy for the state to push for better corporate governance standards.

The second contending hypothesis would argue that business pressure was a primary driver of the policy process that in twenty-first-century Brazil constituted a new mode of state involvement in capital markets. No one would reasonably argue that Brazilian business—not just the very largest but also medium-sized enterprises—did not benefit from major state institutions' decisions to channel substantial savings and fiscal resources to the stock market. However, the findings in this chapter suggest that business power cannot explain why, how, and when this new mode of state involvement in capital markets was initiated in the first place.

A business-driven explanation would emphasize that during the last decade the state's injection of capital via SOE pension funds and BNDES Shareholdings benefitted several large business incumbents. It is undeniable that a number of big domestic firms did enjoy state-fueled expansion of investment capital. Yet such argument downplays important pieces of evidence that severely call into question its explanatory power.

First, the timing of key observed events does not fit well with such narrative. Close attention to temporal sequences, as mainstream qualitative methodology underscores, is a critical

[678] See section 1.II. of this chapter.

part of causal inference.[679] An observable implication of a business-centered theory would be that, under conditions of high business leverage over the government, large Brazilian industrialists will be more likely to get the state step in to expand the institutional investor base in domestic capital markets. Throughout the 1990s business actors demanded the state to increase financial support for corporate investment in general and for the internationalization of large Brazilian firms in particular.[680] However, even though big industrialists were core allies of the Cardoso administration, the state did not step in during that period—in the 1990s, state involvement in capital markets was modest vis-à-vis the late 2000s. Neither did state's channeling of capital to the stock market grow at such rapid pace during the first years of the PT administrations, when the new center-left government arguably most needed to court business actors.

Second, had pressure from powerful business incumbents been a main driver of the process analyzed in this chapter, the injection of capital by the Brazilian state during the last decade should have been focused almost exclusively on this segment of the business community, sidelining less powerful groups of firms. Yet this is not what actually happened. Quite to the contrary, an important number of medium-sized enterprises with high growth potential received a substantial part of the funds that state institutions channeled to the capital market. That is, these policies were by no means focused on big industrialists. It thus seems unreasonable to argue that this was a business-driven outcome: these smaller firms simply did not have the necessary leverage over government leaders to induce the flow of resources that we have observed. Had big business dominated the policy process, they would not have allowed funds to be diverted away from them and to favor some of their smaller challengers. A similar point can be made about the state-fueled expansion of the venture capital and private equity industries examined in this chapter. Smaller, innovative firms, rather than big industrial incumbents, emerged as the main winners of the development of these new financial channels.

Finally, a business-driven explanation that challenges my state-centric approach should be able to not just trace empirically but also provide a *logical* account for why business pressure would have an effect on domestic stock market expansion. Yet this is a particularly difficult analytical task. While non-financial corporations can undoubtedly benefit from a substantially expanded and more liquid domestic stock market, it is unlikely that firms, at the individual level, will have strong enough incentives and/or the required cognitive skills to seek to trigger the process of market development. Beyond individual firms, moreover, the standard barriers to collective action are likely to apply: the group of potential beneficiaries from stock market development is very large—especially in an economy as big and complex as the Brazilian—and the expected benefits for individual firms are likely to be perceived as small, outweighed by the costs of mobilization on this issue.

Effective and well-organized business action in favor of policies that trigger domestic stock market development is particularly unlikely in a country as Brazil, which lacks strong multisectoral business associations that could bring coherence—eroding divisions across industries and sectors—as well as coordinate business interlocution with government.[681] While this chapter showed that some business proactivity in favor of market development might occur

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[679] On sequences in process-tracing analysis see, Bennett (2010: 207-8); Collier (2011: 823-4, 828); Seawright and Collier (2010: 343).

[680] Kingstone (1999: 214, 229, 234-5); Mancuso (2007: 28, 65, 67, 173-4, 178-9, 184); Sierra (2015: 60-2).

[681] On the weakness of business associations in Brazil, see Chapter 3.

at the sectoral level, the evidence I presented strongly suggests that the reconfiguration of the national financial system in twenty-first-century Brazil would have been highly unlikely in the absence of political *técnicos* with both elaborate causal beliefs on the links between pension fund regulation, industrial policy, and financial market development, and the brokering skills needed to set in motion and incrementally develop a new mode of high state involvement in capital markets.

Chapter 6. The Politics of State Involvement in Capital Markets in Chile

1. Introduction

In 1980 Chile's domestic capital markets were virtually nonexistent; for the country's firms—even for the largest ones—obtaining finance through the issuance of equity or corporate bonds was not common practice.[682] Chile, a country of 17.5 million people whose economy ranked 54th in 1985 out of 160 countries and had a GDP per capita of US$1,400,[683] by the mid-2010s stands out in Latin America for having domestic capital markets of unparalleled breadth. In 2013, the Chilean stock and corporate bond markets equaled 109 and 36 percent of GDP, respectively.[684] Chile's capital markets are impressively sophisticated for a country of its tiny size that is situated in the periphery of the world economy.[685] This makes it very interesting as a case and worth studying.

In the process from small to large capital market breadth, Chile went through at least two important waves during which multiple of the country's firms decided to issue stock domestically to raise finance for investment. In the 1990s Chile surged well ahead its much bigger and economically powerful neighbors Argentina and Brazil in terms of initial public offerings (IPOs) and secondary or follow-on transactions (measured in absolute terms, not controlling for economy size); the capital raised through these operations was fairly large for Chilean standards.[686] In the early 2010s the number of IPOs and follow-on transactions of Chilean firms in the domestic equity market continued to be roughly ten times higher than in Argentina and represented over a third of those in Brazil, which by then had undergone a period of significant equity market expansion (Chapter 5).[687] These developments are well captured by an indicator that the World Bank uses to compare the structure of national financial systems: during the 2000s, Chile had on average over 1,400 publically listed companies per ten thousand people, that is, over 5.5 times the ratio in Argentina and Brazil.[688]

During the 2000s, Chile came to have a remarkably developed corporate debt market, even vis-à-vis those in high-income countries—both because of its depth and the uncommonly long maturity of the corporate bonds traded therein.[689] Over 90 percent of the bonds issued in

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[682] See Celis and Maturana (1998: 11) and Corbo and Schmidt-Hebbel (2003: 175).

[683] In 1985, Brazil was the 14th largest economy in the world (GDP per capita of US$1,600), Mexico was the 15th (GDP per capita of US$2,400), and Argentina ranked 21st, with GDP per capita of US$2,900; as a point of comparison, the 1985 GDP per capita was US$18,300 for the United States and US$11,500 for Japan (World Development Indicators, World Bank).

[684] World Bank's Financial Structure Database (September 2015 update).

[685] See Hernández and Parro (2004) for additional historical and comparative evidence.

[686] Agosin and Pastén (2003: 97).

[687] IPO and FO figures are my calculations based on data from SDC Platinum (Thomson Reuters) and the World Bank. The annual averages of the sum of IPOs and follow on transactions for the 2010-2014 period was 28.2 for Chile, 80.8 for Brazil, and 3.6 for Argentina.

[688] My calculations based on data from the World Bank's Financial Structure Dataset. Argentina and Brazil had, respectively, 270 and 216 publically listed companies per ten thousand people (mean of the annual records between 2000 and 2010). As a point of comparison, the United States had 1,846; the United Kingdom, 3,917; and Germany, 840.

[689] Braun and Briones (2008: 151-2; 177, 181).

Chile had maturity above five years; the average maturity was 16 years, much longer than anywhere else, including developed countries, where corporate-issued debt maturities average seven years.[690] The amount of capital raised by Chilean corporations in this market is very large, as evidenced by the fact that in 2005, 2009, and 2013 the volume of newly issued corporate bonds each of these years equaled 3 percent of the Chilean GDP; in seven of the years between 2003 and 2013 this amount represented over 10 percent of the country's gross fixed capital formation.[691]

The new conventional wisdom on Latin American political economy has downplayed the importance of these developments reshaping domestic financial systems, an analytical bias that is particularly problematic in the case of Chile. The newly dominant literature on the Latin American "hierarchical" variety of capitalism (Schneider 2013: 7) has fruitfully underscored that a core defining feature of capitalism in Latin America, including Chile, is that very large business groups diversified across multiple economic sectors are one of the two main types of private agents mobilizing large-scale capital for investment. Schneider (2013: 45) remarks that by the 2000s the twenty largest firms in Chile produced half of GDP. In this perspective, the finding that such enormous business groups dominate the economies of Latin America is then used to make a bold statement: in countries like Chile, domestic capital markets are underdeveloped because they have not transitioned to an US-like financial system, with atomized corporate ownership and a vibrant market for corporate control. An evidence of this underdevelopment, this perspective holds, is that the Chilean stock market is comparatively not as liquid and it has low turnover.[692]

I contend, however, that the new conventional wisdom misses the target when it assesses capital market development in Chile through the lenses of the prototypical Liberal Market Economies (LME) of the United States and Britain—two outliers even in the developed world precisely because they have evolved to have markets for corporate control. The figures cited in the opening paragraphs of this chapter clearly indicate that Chile today has a large capital market—the absence of a market for corporate control notwithstanding—in neat contrast with its own past and with regional neighbors of similar development level. The existence of larger capital markets has very important real-world consequences for Chilean firms.

My interviews with senior executives of some of the largest Chilean groups and investment banks[693] consistently indicated that the country's biggest firms have grown so much since the 1990s that they simply cannot rely any more on their own resources to finance the large-scale investments that they carry out nowadays—the domestic equity and corporate bond markets, they argued, have become essential sources of investment finance. These interlocutors highlighted that large Chilean firms issue debt and equity domestically for several reasons. First, nowadays using the domestic capital markets comes with lower transaction costs than those arising from foreign capital markets. Second, many groups have a significant amount, if not most, of their revenue in Chilean pesos; hence, they prefer domestic capital markets so as to minimize the exchange rate risks associated with issuing debt abroad. Third, all large firms—even those that receive most of their revenue in foreign currency—diversify investment finance sources so as to protect themselves from credit crunches such as the one that followed the 2008

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[690] Borensztein et al. (2008: 5, 151). The authors of World Bank (2012: 41) make the same remark, with slightly different figures: bond maturity averages 15 years in Chile and ten years in developed countries.
[691] My calculations based on data from the World Bank's Global Financial Development Dataset.
[692] Schneider (2013: 45).
[693] See the section Author's Interviews at the end of this study.

world financial crisis;[694] in turn, foreign buyers of Chilean firms' debt value the fact that the latter will be able to repay their debts by using the domestic capital markets in the event that international markets dry up.

An additional way of gauging the significant implications that the enlargement of the domestic capital markets has had for Chilean firms is to look at one of the most important recent changes of Chilean capitalism: the emergence and growth of a group of firms with capacity to become multinational corporations. Finchelstein's seminal study on this topic concluded that most Chilean firms raise funds from the domestic capital market in their expansion abroad.[695] Several prominent cases illustrate this general trend.[696] CMPC (Grupo Matte), whose annual revenues reached US$3 billion, became an important regional player in the forestry industry and opened factories in Argentina, Chile, Colombia, Mexico, Peru, and Uruguay to surge as a leading firm in tissue-paper production. Likewise, Arauco—a wood pulp, engineered wood, and forestry company with an annual revenue of US$3.7 billion—has recently resorted intensively to the domestic corporate bond market as a way to raise funds to consolidate its internationalization process—earlier started in Argentina and Brazil—by acquiring eight plants in the United States and Canada; as a result, Arauco became the leading panel producer in the Americas.[697] The shipping company Compañía Sudamericana de Vapores (CSAV), with US$4.9 billion in total annual revenues, is another prime example of successful internationalization. The giant Chilean retail company Cencosud—US$9.7 billion in annual revenues—expanded to Argentina, Mexico and Peru, and came to have more than half of its sales outside Chile. Calderón (2006: 164) has noted more generally that corporate giants with ambitious investment plans in the vibrant Chilean retail industry have required "complex financial engineering to meet the financial requirements of this process [of expansion] by combining equity, bank credits, bonds and new share issues."

What explains Chile's shift from its small domestic capital market in the 1980s to having large equity and long-term corporate bond markets by the mid-2010s? The conventional wisdom basically portrays these developments as a natural byproduct of the so-called Chilean economic "miracle."[698] This perspective underscores factors that make Chile an outlier in the context of Latin America: the strong protection of property rights—or, as it is often stated, the country's "strong institutions"—and a stable trajectory of high growth, low inflation, and balanced government budgets. In Chile—this perspective implies—in contrast to other Latin American countries, there has not been crowding out and an important part of private investment came to be channeled through the domestic capital market.

I do not challenge that these are important variables in accounting for the enlargement of capital markets that unfolded over the last three decades in Chile. However, this conventional

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[694] The giant pulp maker Celulosa Arauco offers a prime example. With its sales concentrated in foreign currency, during the 1990s and 2000s it had continuously used international markets to finance its expansion. In 2008, however, Arauco issued bonds domestically for the first time in 17 years, a strategy that the company decided to repeat on several occasions between 2009 and 2014 (Celulosa Arauco company reports filed at the Chilean Securities Commission, SVS; "Chile Celulosa Arauco Issues $202.2M In Local Bonds," *Dow Jones International News*, November 6, 2008).
[695] Finchelstein (2010: 164).
[696] Finchelstein (2010: 122, 124-5, 129-31). Total revenues in this paragraph correspond to 2008.
[697] *Arauco Corporate Presentation 2016*; "Chile's Arauco places around $300 mln in bonds," *Reuters News*, April 10, 2014.
[698] See, for instance, Hernández and Parro (2008).

wisdom, which subsumes capital market development under a general trajectory of macroeconomic stability with high economic growth, fails to observe that domestic financial markets are political constructions. As such, institutional engineering and political economy drivers are critical:[699] the enlargement of the domestic capital market is not a product of the removal of obstacles to market activity; rather, stock and corporate debt markets result from the interaction of political and economic variables—policy choice shapes the evolution of markets, which in turn shapes future policy choices.

I identify a relatively arcane and largely ignored factor—the politics of pension regulation—as a critical variable reshaping Chile's domestic capital markets. This chapter argues that the major variable that distinguishes Chile from the rest of the region is the mode of regulation of the pension system. We simply cannot understand why and how Chile has evolved to have both large equity and corporate bond markets—with incredibly long term maturity structures—without looking at the politics of pension system regulation. When economists do recognize that the peculiar pension system in Chile is an important variable explaining the country's large capital market breadth, they limit themselves to regressing a proxy of pension regulation—e.g. the total size of assets managed by pension funds or the annual mandatory savings flows of the pension system—on a proxy of financial depth, which often aggregates capital markets and assets in the banking system.[700] Economists, therefore, do not unpack what this mode of pension regulation has meant over time, and they do not explain the politics behind it. Their econometric approach is ill-equipped for explaining an outcome that resulted from a slow-moving process and to capture its sequential character as well as the interplay of market and political variables. Econometric models, because they lack important interaction terms—the bread and butter of comparative political economy—are often poorly specified.

The politics of state involvement in capital markets in Chile can be thought as a long sequence in which regulation generates market effects, which then induce further rounds of regulatory reform, which in turn produce new market outcomes. The politics is state-driven, with elite officials in the executive branch playing a proactive role and market actors being responsive to regulatory change. There is, therefore, a political economy of state involvement in capital markets. It is political economy by definition because outcomes result from the interaction of market and political variables. The root variable—or the point in which the process started to unfold—was an eminently *political* decision: the dismantling of the pay-as-you-go (PAYG), state-run pension system and its replacement for a peculiar institutional arrangement that pools individual savings that are "captive" in the short-term and has created a group of up to then inexistent institutional investors with potentially very powerful market-deepening capacity. Politics was the trigger of an early round of market effects, but these evolving markets triggered themselves the political development of a modern institutional architecture that underpins the two segments of the capital market.

This chapter is organized as follows. The next section provides a very brief summary of the three-decade process covered in this chapter so as to ease the reading of the subsequent sections. Section 3 presents my state-centric explanation of the origins in the early 1980s of the mode of pension regulation that would lead to capital market enlargement, starting in the late 1980s and especially in the 1990s and 2000s; the final subsection of Section 3 engages with the

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[699] This is inspired by and builds on Barma's and Vogel's (2008: 1-3) "market-institutional perspective" of political economy.

[700] The landmark econometric study is that of Corbo and Schmidt-Hebbel (2003), though Holzmann (1997: 160-3) was probably the first to run initial quantitative tests of this relation for the case of Chile.

contending societal hypothesis that holds that business power was the main driver explaining the origins of this mode of pension regulation. Section 4 presents the evidence indicating that this mode of pension regulation had significant capital market-enlarging effects. In Section 5 I draw the connection between these market effects of pension regulation with the state-driven politics of capital market-enhancing incremental reforms during the Concertación administrations (1990s-2000s). Section 6 focuses on business power, arguing that during the 1990s and 2000s it became a lock-in factor contributing to the continuity of the mode of pension regulation that favors capital market expansion; business power, however, does not seem a relevant driver of the incremental reforms that enhanced the institutional underpinnings of domestic capital markets.

2. Overview: The Three-Decade Process in a Snapshot

The formative period of the existing mode of pension regulation in Chile was the last decade of Augusto Pinochet's military dictatorship. In 1980 Chile completely dismantled the state-run PAYG system and replaced it with a system based on a number of competing, private-run and for-profit pension fund administrators (AFPs,[701] the Spanish acronym).[702] The primary motivation of the 1980 reform—engineered by the neoliberal Chicago Boys—was to eliminate state delivery of a service that, in the view of regulators, could be more efficiently provided by private, for-profit firms. As the minister and architect behind Pinochet's pension regulation put it, the guiding principle was "to bestow, as much as it was possible and prudent, the function of administering social services provision to the private enterprise."[703]

The fact that Chile became a worldwide-known case of pension reform (Brooks 2009: 3, 323; Madrid 2003: 3-4) is a testament of the profound institutional innovation that such policy choice implied. In creating a private-run pension system from scratch, Chilean reformers not only had to set in place a number of rules at the outset but also paved the way for a sequence of incremental institutional change, part of which would respond to unexpected effects of setting up this peculiar type of pension system.

Although in 1990, with democracy restored, a twenty-year period started during which the executive branch was uninterruptedly occupied by the center-left coalition Concertación, the goal guiding executive branch's mode of pension regulation continued to be keeping the state withdrawn from the direct provision of pensions. This policy orientation was constant during the Concertación's four consecutive administrations (1990-2010), locked in both by the within-state dominance of a group of entrepreneurial and well-coordinated political *técnicos*—whose stronghold was the Ministry of Finance (*Ministerio de Hacienda*)—and by the strength of the Chilean business community.

By the late 1990s and early 2000s, Chilean presidents had become concerned about growing voter discontent with the incapacity of the private-run pension system to deliver the promise of paying good pension benefits upon retirement. In that context, the Finance Ministry political *técnicos* took advantage of contingently emerging corporate scandals in firms where pension funds held equity to advocate for the adoption of highly technical reforms to improve the institutional underpinnings of Chilean capital markets, including corporate governance

[701] Administradoras de Fondos de Pensiones.

[702] Since then, with few exceptions, all Chilean workers are deducted 10 percent of their wages. This monthly flow has to be saved in an AFP, which in turn charges a fee for managing those resources.

[703] Labor Minister José Piñera, cited by Castiglioni (2001: 46).

regulations. These executive-branch experts, in line with their educational background, held the causal belief that fixing market imperfections was instrumental to promoting investment and growth. Finance Ministry political *técnicos* succeeded in advancing corporate governance and other capital market-enhancing reforms partly because they managed to establish a convincing link between their technical agenda and the high-order political concern of avoiding an erosion of the legitimacy of the entire pension system—an issue to which the president had to pay attention so as to avoid voter backlash.

Since the new rules adopted in the 1990s and 2000s sought to prevent future minority shareholder exploitation in Chilean firms, ensuring a stronger protection of pension funds' investments in the Santiago stock market, an alternative hypothesis would hold that private pension funds' lobby may have been a primary driver of reforms. Yet my process-tracing analysis shows that it was not: the key to understanding this technical policymaking lies within the Chilean state, rather than in the action of interest groups—which were either passive or in straightforward opposition. Executive-branch political *técnicos* not only were more important than potentially intense policy demanders at the sectoral level—i.e. private pension funds—but also succeeded to advance this capital market-enhancing agenda despite the anti-reform resistance exerted by some of Chile's powerful business groups.

In short, this chapter argues that, during the last thirty years, the Chilean state became highly involved in capital markets primarily through its action in regulating the pension system and the incremental capital market-enhancing reforms that such mode of pension regulation motivated. Technocrats within the state with a neoliberal ideational background were the key driving force during the formative moments of this policy path (1980s), while the interaction of policy entrepreneurship by Ministry of Finance technocrats and business power explains why the macro-features of this mode of pension regulation were reproduced over time (1990s-2010s). I acknowledge that other factors contribute to explaining Chile's large capital market breadth, but I stress that we cannot understand that outcome without looking at the political story presented in this chapter. To my knowledge, this is the first study of its kind.

3. The Origins of the Mode of Pension Regulation that Led to Capital Market Enlargement

3. I. The Micropolitics of the 1980 Pension Privatization

In contrast with other bureaucratic-authoritarian regimes in Latin America, Chile's stands out because of the capacity of the technocratic elite to expand its influence way beyond the arena of economic policymaking, reaching policy areas such as health, education, and social security (Silva 2008: 143). While the military dictatorship had been in power for over seven years and a neoliberal adjustment program was well under way by 1980 (see Chapter 4), the adoption of a highly innovative pension reform was not an obvious consequence of earlier choices made along the same path. Instead, it was the result of intense political struggles within the state, with clearly identifiable proponents within the entrepreneurial Chicagoan coalition of political *técnicos* and leaders of the armed forces who were reluctant to set up a private-run pension system.

The neoliberal coalition of policy entrepreneurs working at the State Planning Agency (*Oficina de Planificación Nacional* or ODEPLAN) had drafted a proposal to radically reform the social security system as early as in 1974.[704] But, as my framework highlighted, ideas need carriers who want to invest politically to get them inscribed in new policies, maneuvering within

[704] Huneeus (2000b: 489).

the state to build a coalition of support and overcome opposition. While senior Chicago Boys focused their energies on macroeconomic policymaking, thirty-year-old José Piñera, appointed as Labor Minister (*Ministro de Trabajo*) in 1978, became a hyperactive advocate of pension privatization. Based on the ODEPLAN project, Piñera quickly drafted the pension reform; his energetic action was instrumental in overcoming the suspicions of the military leaders and solving the highly complex technical problems that it involved.[705] In somewhat over a year Piñera managed to defeat the social security reform proposed by Air Force General Nicanor Díaz Estrada, which preserved the solidarity principle of the then existing public pension system.[706] In the decades that followed the Chilean pension privatization, Piñera built an internationally recognized reputation as expert in pension privatization reforms, becoming a consultant of multiple governments and the co-chairman of the Project on Social Security Choice at the American libertarian think tank Cato.

A graduate of the department of economics at the Catholic University in Santiago—which at the time was strongly influenced by the University of Chicago[707]—Piñera went on to pursue his Ph.D. in economics at Harvard University. As I will show next, Piñera was a true market liberal. Soon after returning to Chile, he delivered a conference at the Catholic University whose gist was that Chile had already overcome the stage of economic stabilization and that it was time to move on to a strategy of economic development based on the market model. The director of the State Planning Agency, in the audience that day, invited Piñera to give the same talk in front of the top leadership of the armed forces. According to journalistic accounts, Piñera positively impressed the generals present at the meeting because he was a rare case of a Chicago Boy linking market-oriented reforms with an opportunity for development.[708] A few months after this talk, Piñera was appointed as Labor Minister.

In the drafting of the bill that would replace the pay-as-you-go public pension system for a system based on private capitalization accounts, Piñera worked shoulder to shoulder with Martín Costabal and Hernán Büchi, two fellow thirty-year-old Chicago Boys.[709] Costabal and Büchi had become junior economic advisors of the Pinochet administration immediately after completing, respectively, their MBAs at the University of Chicago and Columbia University.[710] Their role in the preparation of the new pensions bill certainly helped them strengthen their reputation in their road to occupying the maximum authority in the Pinochet cabinet: Büchi would become Finance Minister in 1985, while Costabal reached that position in 1989.

Piñera's 1980 speech introducing the pension reform bill had a libertarian spirit. As he would say in an interview with the weekly magazine *Qué pasa*, the goal was to "carry out a true libertarian revolution [*hacer una verdadera revolución libertaria*], […] grabbing the power from the state and devolving it to the individuals; [… thus] setting the foundations of a new political,

[705] Huneeus (2000b: 489).
[706] Vergara (1985: 224).
[707] Valdés (1995).
[708] This paragraph is based on the narrative presented by Fontaine (1988: 130).
[709] Fontaine (1988: 137).
[710] As Silva (2008: 154), among others, has argued, the label "Chicago Boy" applies more broadly to the members of this network of technocrats that pursued graduate studies in the United States, endorsed the Chicago approach, and were active members of the economic team during the Pinochet years. Büchi is one prominent case of a non-Chicago-trained Chicago Boy, but multiple examples abound, including Columbia-educated Jorge Cauas, and Carlos Cáceres, who received his MBA from Cornell University.

economic, and social reality."[711] Piñera criticized the existing state-run, PAYG system for allowing the government to make choices about people's savings that would be best to leave to individual choice. With the adoption of the new private-run pension system, Piñera argued, workers would enjoy freedom to choose a private pension fund to manage their savings and later on shift to a competing pension fund if they pleased; from then on, they would be free to decide whether to top off mandatory savings with voluntary deposits in their funds so as to improve their pensions upon retirement. The private-run pension system he championed, Piñera explained, would reverse the injustices of the existing pay-as-you-go public pension system insofar as private capitalization would link each worker's individual effort during his working life with the pension benefits to be received after retiring.[712]

In his 1980 address, Piñera emphasized his distrust in the capacity of the state to administer the pension system and his confidence in ceding pension management to for-profit private pension fund administrators subject to market competition and government regulation:

> *The absence of a linkage between pension savings and benefits, as well as the capacity of the political establishment [*la facultad del poder político*] to choose who benefitted and the amount of benefits, have been a source of discretionary power and have opened the way to demagoguery and injustice. What government […], with the eyes in the upcoming elections, would be able to resist the demands of groups with great pressure power? […] [The new private administrators of pension funds], subject to market competition and to an adequate structure of incentives, will provide the service with higher degrees of efficiency and quality.*[713]

A close analysis of the within-state micropolitics that drove the approval of the pension reform bill drafted by the Piñera-led team of technocrats suggests that this major policy change had to be fought for. The action of these elite, Chicagoan officials was instrumental in circumventing pressures against this reform path within the state. The Chicago Boys faced intense resistance from top military officials who pushed for a corporatist rather than a market-oriented model.

The Statute of the Junta enacted after the 1973 coup granted the Air Force with the power to rule over social policy. The Air Force leadership in charge of analyzing pension reform up to the arrival of Piñera was particularly reluctant to move towards a radical dismantling of the state-run, PAYG pension system; in particular, General Gustavo Leigh, the Air Force representative in the Junta, was a staunch opponent of market-oriented solutions in the social policy arena. The State Planning Agency (ODEPLAN) Director Roberto Kelly recalled, "Leigh was totally statist, like all aviators [air force officers] and many uniformed people."[714] In an interview, Leigh himself referred to this tension: "I argued with the Chicago Boys […] because I did not accept this purely economic system of action that disregards social problems."[715]

The State Planning Agency Director recollected how these disputes with the statist group of elite officials paralyzed the Chicago Boys' first attempt to privatize the pension system:

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[711] Fontaine (1988: 140); Vergara (1985: 229).
[712] Unless otherwise specified, the information in this paragraph is based on the archival work carried out by Vergara (1985: 223).
[713] Vergara (1985: 223-4).
[714] Castiglioni (2002: 37).
[715] Castiglioni (2002: 37).

Our first social security presentation [...] was probably in February or March 1974. And when we argued that pension funds were going to be administered by the private sector, Leigh almost jumped over the desk. He asserted that was a crazy idea [...]. So Leigh said, well we have to study this issue in depth, and this, and that, and there was no bill, nothing at all.[716]

In 1975 this battle within the state was reflected in a draft of social security reform that was a rather incoherent compromise between the two competing coalitions. While the Chicago Boys succeeded in incorporating private capitalization to the proposal, the military officials led by then Labor Minister General Nicanor Díaz Estrada managed to secure that the system retained a mixed character, with the state managing an important part of it, and to reject the idea that the managers of private capitalization funds could be for-profit corporations.[717] The reform proposal died because of the stalemate between the two groups of elite officials; the tension would persist and would mark Piñera's time in office as Labor Minister. In an autobiographical book, he recalled,

In Chile there has always been a so-called traditional right in favor of state paternalism and afraid of the concept of minimal state. The idea of adopting a market-oriented [liberal] pension reform as the one we were drafting broke with the [traditional right's] worldview. [...] The last source of resistance [against our reform proposal] wore military uniforms. The Committee of Advisors to the President, as a matter of fact, at the time was composed by a group of generals with statist convictions.[718]

During the drafting of the pension reform, the Committee of Advisors to the Junta called into question Piñera's plan, arguing that its adoption would deprive the state from a hefty flow of funds. On one occasion a member of that Committee, a military officer himself, asked Minister Piñera whether he "[was] aware that this project [of pension privatization] implies transferring the control over an enormous amount of funds from the state to private actors, and this, consequently, means that this government will be surrendering the administration and control of resources that all governments in the last fifty years have relied on."[719] In Piñera's own recollection of the episode, the general officer went on to say, "Are you aware of the fact that this government, if one day it faces more adverse political circumstances, may need the power that we would be relinquishing [if your reform is approved]? Don't you think that on this issue your liberalism [*el liberalismo suyo*] is taking us too far?"[720]

The resistance to adopt this libertarian pension reform was so strong that in August 1980 President Pinochet asked Piñera to stop the initiative.[721] Two features of the framework presented in Chapter 2 help us to account for the eventual adoption of the Piñera-championed

[716] Castiglioni (2002: 37-8).
[717] Huneeus (2000a: 456).
[718] Piñera (1991). On the statist profile of the Committee of Advisors to the Junta (*Comité Asesor de la Junta de Gobierno* or COAJ), see Chapter 4.
[719] Fontaine (1988: 138).
[720] Piñera (1991).
[721] Piñera (1991). Even when the reform was eventually passed, the armed forces, against the will of the Chicago Boys, managed to secure the continuity of their own pension scheme, eschewing to enter private capitalization. This is further evidence about within-state tensions around the Piñera reform.

reform in November 1980. The neoliberal political *técnicos* were able to impose their preference (a) when they succeeded in associating their policy proposal with political goals of higher order for the government leaders who had appointed them and (b) once the relative salience of this issue had declined.

While battling within the state, the Chicago technocratic elite at the Ministry of Labor gradually raised the persuasiveness of the proposed pension reform by connecting it with the military leaders' high-priority goal of reducing the likelihood of left wing and/or labor-based political "extremism" in the future. As Vergara (1985: 228) has argued, the Piñera-led reform promised to have deep depoliticizing effects: by making future pension benefits proportional to the individual worker's capacity to save in his or her own private capitalization account, the new pension system converted this welfare policy into an individual concern that has little to do with the state or with the political arena. This, in turn, would reduce the incentives for workers to organize and engage in collective action.

Piñera referred to the depoliticizing effects of his reform on several occasions. In November 1980 he said that the privatization of the pension system would have "profound political consequences" because it reduced "an enormous source of discretionary state power, which unavoidably generates demagoguery and politicization."[722] In his autobiographical account of this process of persuasion within the state, Piñera recalled,

> *The military officials did in fact have a strong aversion against professional politicians. For many years [the military] had witnessed the slow but persistent destructive capacity of demagoguery and [the politicians'] desire to control ever-larger portions of power. The larger the discretionary power in the hands of the state, the larger the ability of the opportunistic politician to grant benefits to his cronies and to his electoral clientele. It was the identification of this mechanic that eventually united military officers and economists under a common goal. Since the military government was temporary and political power would eventually be handed in to civilians, an effective way of avoiding the start of a new cycle of statism and demagoguery was, precisely, to dismantle the state's excessive economic power.*[723]

During the negotiation within the executive branch, Piñera purposefully pushed for the draft to be discussed with the smallest circle possible—i.e. the Government Junta—avoiding other advisory bodies where he anticipated conflict; moreover, Piñera managed to prevent the tensions within government around his proposed reform to be brought to the public debate (Huneeus 2000a: 457-8).

The relative salience of the issue of pension reform declined drastically by the end of 1980, a factor that was skillfully exploited by the Chicago Boys working at the Labor Ministry. In September of that year Chileans went to the polls to vote in a referendum on a new constitution drafted by the military government. Since the constitution enabled Pinochet to remain as chief of the executive power for another eight years, the plebiscite would be a source of legitimation for the authoritarian regime and for Pinochet himself. Though complaints about fraud were widespread, the military leadership interpreted the official vote count—67 percent in favor of the new constitution—as an ample inflow of legitimacy.[724]

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[722] Vergara (1985: 228).
[723] Piñera (1991).
[724] On the use of non-competitive elections as a source of legitimacy of Pinochet's authoritarian regime and the particular case of the 1980 referendum, see Huneeus (2000a: 148-153).

It seems reasonable to argue that in this context, in which both the authoritarian political elite and the mass public focused their attention on a black-or-white issue of maximum political relevance—regime continuity or change—sectoral policy issues that may have been salient in less dramatic circumstances got blurred and moved off the radar of the mass public. In addition, building on Pierson (1996: 176), we can argue that situations in which "electoral slack" suddenly goes up reduce executive-branch leaders' trepidations about adopting policy that under "normal" circumstances they perceive as likely to generate unnecessary and risky public discontent. This logic may hold even under authoritarian regimes as long as they do have such electoral "thermometer," however sporadic and irregular elections may be. In the post-1980-plebiscite Chilean scenario, these two conditions—relative decline of the salience of pension reform and electoral slack—seemed to have been present, probably facilitating the adoption of pension privatization two months after the election. In his memoirs, Piñera narrates that he had a meeting with President Pinochet the day after the plebiscite and that on that day Pinochet himself decided to end with the stalemate in which the pension reform had fallen (Piñera 1991).

The landmark Decree Law 3,500 was signed in November 1980, radically retrenching the Chilean publicly administered, PAYG, defined-benefit pension system, and setting up an individual savings scheme with defined contributions and privately managed by for-profit pension fund administrators (AFPs, the Spanish acronym). Under the new pension system—which was compulsory for new workers as of 1983 and, though optional, heavily incentivized for those already in the workforce—10 percent of workers' monthly salary is transferred to an AFP; the private pension fund in turn charges a commission fee, part of which is dedicated to paying a disability and survivors' insurance.[725] By 1983, 77 percent of all formal civilian workers no longer belonged to the state-run pension system: their future pension benefits had come to depend on the returns of the mandatory savings managed by the AFPs.[726]

Before moving on to the incremental rule changes that followed the adoption of pension privatization in Chile, let us take a step back from the argument I have hereby proposed. There are several ambitious theories on the adoption of pension privatization that seek to address a large number of cases in Latin America, including Chile, and beyond. Brooks's (2009) is a particularly accomplished one.[727] Perhaps paradoxically, her theory seems to have a remarkably higher explanatory power for accounting for structural pension reforms in the countries that were subject to the diffusion effect of the Chilean model than for studying the Chile case itself.

The first component of Brooks's argument holds that globalization generates a set of incentives and constraints that affect whether government elites adopt pension privatization or not (Brooks 2009: 69-85). The observable implication would be that in the case of Chile the incentives prevailed over the constraints, facilitating pension reformers' quest to adopt this radical policy change. However, the incentives that Brooks identifies as operating in contexts of high global financial integration seem to be significantly more powerful as causal mechanisms in the case of Chile's emulators than in 1980 Chile itself. Episodes of major outflows of highly volatile foreign capital, she argues, enhance the appeal of pension privatization in capital-importing nations; pension privatization is conceived as a way to boost domestic savings and

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[725] Acuña and Iglesias (2000: 442-51); Ewig and Kay (2011: 76).

[726] Acuña and Iglesias (2000: 450); for other technicalities, see pp. 442-51 in such book chapter.

[727] In another major work on pension privatization, Madrid (2003: 5, 40-4, 59) explicitly argues that the salience of the Chilean model is a primary determinant of the pension privatization outcomes he analyzes in other countries. I treat this as an indication that Madrid, as opposed to Brooks, does not claim his theory should be able to explain the Chilean case itself.

hence reduce long-term macroeconomic vulnerability. As Brooks (2009: 77-8) herself acknowledges, however, this type of incentive only came to be very strong in the 1980s and 1990s, first with the advent of the debt crisis and then with the surge of short-term portfolio investment as the main source of capital inflows to the developing world. That is, this globalization-rooted incentive to privatize pension systems only became strong and stable *after* Chile had adopted its structural pension reform. Moreover, the link between private capitalization pension systems and higher domestic savings and growth was developed by academics and promoted by the World Bank only several years after the Chilean government chose to privatize the public pension system (Brooks 2009: 79-80). The fact that later pension privatizers such as neighboring Argentina were particularly influenced by the strength of this new causal belief (see Madrid 2003: 110-6) should not lead us to retrospectively overemphasize this factor as a primary driver of Chile's original reform.

The second and third components of Brooks's argument, for their part, focus on the need of reformist governments to persuade the mass public of the benefits of pension privatization and to pass these reforms through elected legislatures.[728] This analytical focus, while critical to understand the dynamic of pension privatization in democratic settings, seems less helpful to zero in on the key factors shaping privatization processes in highly repressive authoritarian regimes like that of Chile. In particular, this approach leaves un-theorized the fact that in non-democratic settings the main challenge for pro-privatization technocrats may be to obtain consent not from society but rather from anti-reform officials within the state itself.[729] In the case of Chile, the fate of the reform depended more on reformers' capacity to "sell"—to use Brooks's (2009: 11) term—the bill to the military officers in government rather than to sell it to a population that could not vote or to groups representing the popular sectors that were suffering severe state repression.[730]

The units of analysis of the most influential theories on the political economy of pension reform in Latin America (Brooks 2009; Madrid 2003) are major reform laws, as the one studied in this section. When we move towards the realm of incremental regulatory changes like those examined in the following sections, the utility of these arguments declines. In contrast to the process of enacting major reforms that such scholarship has analyzed, the incremental regulatory changes I examine next either do not go through Congress or, when they do, tend not to be salient; in all cases, these incremental reforms on the financial side of the pension system do not have the redistributive effects that are the core motivation of welfare state scholarly agendas. In line with Chapter 2, the difference in the type of policies studied by welfare state scholars and

[728] See Brooks (2009: 93-113). The emphasis on these causal mechanisms is not surprising given that Brooks chooses the scholarship on welfare state reform in Western democracies as her main theoretical interlocutor.

[729] Madrid (2003: 203) argues that authoritarian regimes may be less likely to privatize the pension system than democratic ones because military office-holders are often reluctant to dismantle their own privileged pension schemes.

[730] Madrid (2003: 55-6, 203, 205) notes that authoritarian regimes have typically ignored or suppressed the opponents of pension privatization. Even if I highlight the power shifts within the executive branch and the Chicagoan technocrats' capacity to persuade Pinochet as having the primary leverage to account for the process that led to pension privatization in Chile, I concur with Brooks that even in the case of Chile the observed outcome partially hinged on the government's decision to add some material benefits to the legislation so as to diminish the salience of the loss (see Brooks 2009: 109).

those that I study next are significant—hence, the politics driving policymaking in these arenas is different too.

3.II. The Micropolitics of Incremental Reform in Pension Regulation During the 1980s

Five years after the private pension system was created, the executive branch passed Law 18,398, a landmark shift in regulation that changed pension funds' time horizon as institutional investors. This 1985 law for the first time allowed AFPs to allocate up to 10 percent of their portfolios to purchasing stock of domestic firms, while the maximum allocation of AFP funds to government debt instruments was lowered from 100 percent of their portfolios to 50 percent. Just as important was the fact that the 1985 law created a state-led risk evaluation committee and required this *clasificadora de riesgo* to grade the equity and corporate bonds under AFP consideration. This was a milestone in the process of sophistication of Chilean capital markets.

In 1982 Chile experienced a major banking system collapse amidst a major economic depression, with a 14-percent GDP retraction. In that context, the market-oriented technocrats at the Ministry of Labor and the pensions regulatory body prepared a proposal for an incremental reform to Decree Law 3,500. The draft raised the concern that the private-run pension system was not diversifying risks appropriately; it was necessary, the text argued, to avoid "an exaggerate concentration of [pension fund] investments in few [types of] assets or few issuers."[731] By the end of 1983, 45 percent of AFP investments were concentrated in a single issuer—i.e. the state—and 51 percent was allocated to the same type of asset—i.e. mortgage loans. "This creates incentives for an excess of debt in the economy since the main saver (the pension funds) are only allowed to lend money and not to develop new projects as shareholders," the report argued. "To give but one example, pension funds should not be limited to lend money to develop hydroelectric projects; instead, they should be partial owners of those projects. [This] must be understood as a need for the long term: we need to create today the conditions for the development of a healthy stock market, so that it can effectively safeguard workers' savings."[732]

Juan Artiztía, a University of Chicago MBA that was the chief regulator of the pension system (*Superintendente de AFPs*) between 1981 and 1990, recalls:

> *In the immediate aftermath of the privatization of the pension system the problem we identified within the government was the following: what type of assets should the new AFPs be investing in? Our take was that if AFPs' portfolios were mostly allocated to government-issued bonds we would have reached a ridiculous outcome: after all, why had we created a privately managed pension system? We did not create it for private actors to lend that money to the state once again.*[733]

The interview evidence coincides with the report that the neoliberal political *técnicos* prepared for the Junta. The decision to allow pension funds to invest in corporate stock was justified in tandem with the need to reduce the maximum amount of savings that AFPs were permitted to allocate to government-issued bonds. The concentration of funds in this type of assets, the draft argued, "threatens the very essence of the [private-run pension] system because in the long run the state would be again the one paying pensions; moreover, [this concentration

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[731] *Historia de la Ley Nº 18.398*, Biblioteca del Congreso Nacional de Chile, p. 45.
[732] *Historia de la Ley Nº 18.398*, Biblioteca del Congreso Nacional de Chile, p. 46.
[733] Author's interview with Juan Ariztía, Superintendent of Pensions (1981-1990), Santiago, June 4, 2014.

of investment in government bonds] unnecessarily exposes pension funds to the contingent risks of politics […].”[734]

The Superintendent reconstructs the decision-making process, identifying the actors in favor and against this incremental reform:

> *In that context, General Pinochet told the Labor Minister that he was very concerned about potential conflicts with workers because AFPs concentrated too much of their portfolios in bank deposits—Chile had just underwent a major banking crisis. So I met Pinochet and explained to him that the only way out was to create an industry of risk assessment so as to allow AFPs to invest in equity. This project generated strong opposition from bankers, who threatened that publishing the risk assessments of banks would generate a bank run. The Superintendence of Banks was captured by the industry and thus was against the project too. Non-financial business actors thought that the idea of using pension savings to buy equity was too risky, while the AFPs themselves were passive in the discussion. Under intense pressure from the bank-sector, the Labor Minister and I went to see Pinochet, who said, "The bank run is an excuse of bankers—go ahead and implement the project."*[735]

In addition to increasing the diversification of pension funds' risk, the Chicagoan political *técnicos* skillfully framed this highly technical reform as offering a solution for another high-order political goal. Pinochet was fully committed to launching an ambitious privatization program that would go well beyond that envisioned in the 1973-1977 period, now selling several profitable and "strategic" SOEs, including sectors such as chemicals, steel, electricity, and the national phone company (Kurtz 1999: 421). In the post-1982-crisis scenario, the private business groups did not have enough capital to take over these profitable SOEs on their own; hence, elite officials within the state pushed for what at the time was seen as an innovative solution: changing the pension regulation so as to allow pension funds to invest part of the capital they managed in purchasing equity of companies being privatized.[736]

The evidence from the interview with Pensions Superintendent Ariztía about the micropolitics of the 1985 regulatory reform matches the narrative that Huneeus (2000a: 467-70) built with secondary sources. Though the private sector was in favor of the privatization of SOEs (Silva 1996: 195), there is strong evidence indicating that Ariztía did not exaggerate in the interview with regard to the opposition business actors expressed with regard to the regulatory change being drafted to allow pension funds to invest in equity.

Business actors rejected this proposal arguing that it would trigger risky speculative practices (Huneeus 2000a: 467). Several representatives of the AFP industry talked to the press against the project being drafted by the neoliberal technocrats in government. The president of the association that represented the private pension fund administrators opposed the proposal arguing that there was neither a developed stock market nor good supervision that could guarantee "a minimum level of profitability if the management of these firms ends up being inefficient."[737] These voices of opposition among private-sector actors vis-à-vis the incremental

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[734] *Historia de la Ley Nº 18.398*, Biblioteca del Congreso Nacional de Chile, p. 50.
[735] Author's interview with Juan Ariztía, Superintendent of Pensions (1981-1990), Santiago, June 4, 2014.
[736] As shown in a study by Hachette and Lüders (1992: 86)—cited by Huneeus (2000a: 439)—with 25 percent of the stock of former SOEs acquired by the AFPs, the pension system was the most important source of finance in the post-1985 privatizations.
[737] Huneeus (2000a: 467).

reform of Decree Law 3,500, in a broader context where the business friendliness of the Pinochet administration cannot be disputed, suggests that the entrepreneurial activity of political *técnicos* was a key driver in getting this reform passed. In particular, it seems that what was instrumental was the elite officials' capacity to link this technical reform with the privatization plan, a higher-order goal for Pinochet himself.

Incremental reforms during the last years of the dictatorship further deepened this critical regulatory turning point. Laws 18,646 and 18,798 of 1987 and 1989, respectively, granted AFPs more flexibility to invest in stock of companies whose property is concentrated—a particularly important factor due to the high ownership concentration that characterizes Chilean big corporations—and raised the limit of pension fund investment in equity from 10 to 30 percent.

3.III. The Role of Business Actors in the Politics of Pension Regulation During the Dictatorship

In Section 3 of Chapter 4 I dealt in much greater depth than I will do here with coalitional/societal/business power explanations of the policies that shape modes of state involvement in markets during Chile's authoritarian period. In this subsection I will engage with the same set of hypotheses focusing specifically on the pensions regulatory arena; however, the defense of the state-centric explanation I have presented in the previous sections of this chapter cannot be fully understood without referring to the broader insights on business-government relations during the Pinochet dictatorship presented in Section 3 of Chapter 4. I recommend, therefore, reading this subsection alongside with that one.

Some of the most compelling political economy accounts of the Chilean market-oriented reforms—Silva (1993, 1996), Schamis (1999), and Etchemendy (2011)—provide a less state-centric explanation of the politics of policy adoption than I am presenting in this chapter. While none of them deals specifically with pension regulation, this literature needs to be addressed here to supplement my findings and put them in broader perspective. Though these three authors do not use these terms, very synthetically, what they claim is that a specific segment of the business community enjoyed high levels of instrumental power that allowed these corporate leaders to virtually capture multiple policy making arenas during the "radical neoliberal" (1975-1982) and "pragmatic neoliberal" (1983-1988) phases of the Pinochet dictatorship.[738] More specifically, as Schamis (1999: 245) argued, the core constituency of the military government "rested on a coalition of a handful of diversified economic conglomerates whose main firms were in export activities (mining, fishing, agriculture), manufacturing in internationally competitive industries (food processing, paper), and liquid-asset sectors (finance, insurance, real estate)." This strand of the literature explains policy choices in that period emphasizing that the upper echelons of those conglomerates—especially those with capacity to tap international financial flows to grow their business domestically—had strong instrumental power mainly through recruitment into government.

While the links between these large business actors and Chicago Boys in government were evident—in the particular case of Piñera, he was hired by the Cruzat-Larraín group upon finishing his Ph.D. in the US[739]—I claim that such a materialistic explanation misses a lot of the complexity of policy adoption. Establishing a correlational argument based on the overlapping of material interests between interest groups and policy entrepreneurs in government takes us only halfway, leaving unexplained both the *specific content* policy acquired, the process by which a

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[738] These are the labels and periodization of Silva (1993, 1996).
[739] Fontaine (1988: 128, 130).

policy proposal manages to overcome the resistance of opposing groups within the state, and the *timing* of policy adoption.

In instances such as the privatization of the pension system and its incremental reform to allow pension funds to invest in equity in the 1980s in Chile, whether policy is actually adopted or the status quo prevails depends on the presence of skillful brokers within the state that, first, succeed in putting together an innovative policy package and, second, persuade executive-branch political leaders that these technical proposals are well attuned to other higher-order political goals. This brokering role is not pre-determined and cannot be inferred from interest group pressures; policy adoption significantly depends on the success of this brokering, which in turn shapes the nature of the policy.[740] Absent this entrepreneurial activity within the state, the policy status quo is more likely to prevail—and that was in fact the case with pension reform in Chile, which was postponed for over seven years despite the fact that the cited business groups had been increasing their power.

Furthermore, invoking business power is simply not enough to explain policy choice because elite officials care about their personal professional reputations and are thus unlikely to jeopardize the future performance of the policies they design just to grant material benefits to their business friends. Let me illustrate this point. During the design of the 1980 pension privatization bill, Labor Minister Piñera received pressures from the Association of Bankers to be allowed to participate in the new business of pension fund administration.[741] Yet the political *técnicos* in government disregarded these pressures because they believed that allowing banks to manage pension savings would generate conflicts of interests and put the performance of the new pension system in danger. BHC and Cruzat-Larraín, two of the most powerful conglomerates at the time, owned large banks (Silva 1996: 144) that would have benefitted from being allowed to participate in the new business of pension management—still, the Piñera-led team rejected that option. An explanation of policy choice only based on business instrumental power fails to account for these sorts of contradictions. If business recruitment into government determined policy choice and this were a story of state capture by financial-sector interests, why would the Chicago Boys have cared to exclude bankers from the new industry of pension funds administration?

Business power explanations applied to the arena of pension system regulation more or less implicitly make the following causal connection: the power of economic groups explains the replacement of the state-run pension system because private capitalization would be able to fuel the privatization process, which would in turn benefit the conglomerates. On top of neglecting the importance of within-state politics and missing the complexity of policy processes, this type of claims assumes that business groups have tremendously high cognitive capacities to forecast with great precision the market outcomes of policy choices and how the adoption of one policy—i.e. pension reform—will determine the adoption of another policy far down the road—i.e. privatization of SOEs. In countries so vulnerable to economic volatility as those in Latin America—Chile in the 1970s and 1980s was no exception—inputting such high cognitive capacities to economically powerful business groups seems a stretch. Moreover, such causal argument faces some important empirical "anomalies": if pension privatization in 1980 was ultimately driven by business groups' need to have pension funds as partners in their quest to purchase SOEs, why did it take the government over three years to pass a reform of the pension

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[740] An illustration of that brokering role is that the Chicagoan technocrats had to rewrite their proposal to ensure that the armed forces would continue to have their preexisting public pension scheme.
[741] Piñera (1991).

legislation that enabled pension funds to invest in corporate equity? This time lag between Decree Law 3,500 (1980) and Law 18,398 (1985) seems hard to explain if only relying on a business power explanation.

Let me unpack other simplifications of the business power thesis that can be overcome by having a closer look at within-state politics. I have argued that the 1985 incremental change to pension regulation that allowed pension funds to invest in corporate equity cannot be understood without observing that it was critical in ensuring the feasibility of government's plan of privatizing major SOEs. The launch of this new privatization program, in turn, can be interpreted as an attempt by the Pinochet administration to obtain support from business actors, which had been waning, especially since the 1982 economic crisis (Kurtz 1999: 421). My point is that in understanding this complex policy process it is key to observe that government leaders were not merely reflecting interests from the business sector but, rather, were proactively trying to court these societal actors to strengthen their hold on political power.[742] For the privatization plan to be launched intense political battles within the state had to be fought in order to sideline parts of the armed forces who were strongly reluctant to cede state control over companies deemed as "strategic" (see Chapter 4). Moreover, the action of technocratic elite officials that managed to link this high-order political goal of the Pinochet administration with the change in pension regulation that allowed pension savings to be channeled to the acquisition of SOEs was instrumental in setting the conditions for the privatization plan. While it is undeniable that financial-sector actors benefitted in the years after the 1985 incremental pension regulatory change (Law 18,398)—both because this deepened the equity market and it helped launch a privatization program in which they would profitably participate—it does not seem plausible to argue that these actors were the drivers of such incremental regulatory change in the pensions arena: as Kurtz (1999: 421) pointed, the powerful financial conglomerates—the key actors in the business power thesis (Silva 1993, 1996; Schamis 1999)—by then had collapsed along with the bulk of the banking system.

In short, an explanation of pension regulation in authoritarian Chile stressing business' strong instrumental power sheds additional light to my account—but it does not replace it. The business power perspective reminds us that policy entrepreneurship within the state does not occur in a sociological and economic vacuum—rather, shared networks of business people and policymakers and the economic power of business actors do matter, making some policy paths more likely and others highly unlikely. Furthermore, it is undeniable that some of these conglomerates—though they were not allowed to participate in the new industry of pension fund administration through the banks they owned, which would have been the most profitable option—did benefit economically from the pension reform (e.g. by setting up pension fund administrators of their own). But arguing that coalitional drivers explain the origins of the policy process is an oversimplification that misses the most important, state-centric causal forces. This notwithstanding, as Section 6 will show, strong business power did operate as a causal mechanism of path reproduction in the 1990s and 2000s, contributing to lock in the privatized nature of the pension system.

4. The Capital Market-Enlarging Effects of Pension Regulation

[742] As Kurtz (1999: 419-20) shows, in that juncture the very stability of the military rule was under threat in a situation marked by a 14-percent collapse in GDP, mass unemployment, and the outburst of large opposition protests.

The macro-features of the mode of pension regulation originated during the dictatorship remained unchanged throughout the over three decades that followed the landmark 1980 pension reform.[743] This section will delve into the significant capital market-enlarging effects of this mode of pension regulation throughout since the late 1980s and up to the present.

The fact that, as I will show below, this peculiar type of pension system was the primary driving force behind capital market development, and that later pension reformers elsewhere in Latin America invoked financial system deepening as one strong reason in favor of emulating the Chilean model,[744] may lead to erroneous conclusions about this process. As Section 3 has shown, Chile's pension privatizers were motivated by the goal of severely retrenching the public pension system—that is, developing the capital market was *not* the guiding goal behind the reform; rather, it was a byproduct. A major piece of evidence in this regard is that there was a five-year time lag between the moment in which the original pension privatization law was adopted and the subsequent reforms that enabled pension funds to invest in equity and corporate bond markets. During the first years of existence of this system, the newly created pension funds were *de facto* obliged to invest in non-capital market assets—namely, government-issued bonds and bank deposits.[745]

Keeping the state withdrawn entailed ensuring that the private system performed its function at least moderately well, for which it was instrumental to maximize the returns of private capitalization accounts and to minimize the system's risks. Two features in the regulation were critical to attain these goals: first, the creation of a strong state agency so as to effectively oversee the market of pension funds and secure law enforcement; second, and relatedly, the regulatory-induced emergence of a peculiar type of actor to manage pension savings.

Regarding the first element contributing to optimize the performance of the pension system, the regulators set up a Superintendence of Pensions[746] that is widely considered as an example of institutional strength and bureaucratic capacity, an "activist supervisory agency,"[747] in a country characterized more broadly as having high institutional stability and high enforcement (Levitsky and Murillo 2009). In a comparative assessment prepared for the OECD, Santiso and Whitehead (2006: 39) stated that the Chilean pensions regulatory body "is one of the most credible, technically prestigious and highly esteemed institutions in the country, making it a strong institutional mast":

> *The institution, created and developed with the private pension fund system, is nowadays recognised as one of the major cognitive institutions in its field in Latin America. […] In 2005 it had a total of 147 permanent staff and an annual budget of $6.5 million. [… A] large portion of these resources is devoted to the [… Superintendence's] research department, the División de Estudios. This unit is considered as strategic and acts as a provider of data, analysis and ideas related to the pension system. […] [T]his technical capacity—without comparison in Latin America as other regulatory agencies lack this technical unit—plays a pivotal role and the institution acts as an institutional mast boosting the technical dimension of the political*

[743] See Castiglioni (2002: Chapter 5), Maillet (2013: 96-101), and Section 5 in this chapter.
[744] On the latter point, see Madrid (2003).
[745] See Acuña and Iglesias (2000: 446).
[746] *Superintendencia de Pensiones* (formerly, *Superintendencia de Administradoras de Fondos de Pensiones*).
[747] Agosin and Pastén (2003: 78).

debate on the reform of the system. The division has in total 9 economists (3 of them hold PhDs and four others MBAs or Masters degrees in economics).[748]

The regulatory agency's administrative capacity not only allowed it to monitor and directly punish AFP behavior but also file solid cases in the courts so as to make market practices comply with the law.[749] In a recent example of this institutional strength, the Superintendence won in the Supreme Court a dispute against one of the AFPs, which had challenged a regulation instructing pension funds to sell several billion dollars they had in excess investments allocated to variable income securities; in this case the Superintendence had the capacity to prove that the AFPs had not surpassed the limits due to unusually high stock yields—as one of the pension fund administrators argued—but, rather, that the limits had been surpassed through deliberate investment decisions.[750]

Regarding the second element, the regulatory framework shaped a peculiar type of actor to manage pension savings, characterized by the following attributes:

- As the regulation demanded the fund administrators to comply with a minimum profitability target—a benchmark set endogenously in accordance with the investment performance of the AFP system—the top AFPs *de facto* set the investment patterns of the whole industry, generating a herd behavior.
- AFPs' fees were neither tied to their investment performance nor to the stock of savings they administered; as a result, their optimal microeconomic strategy was to choose an investment portfolio whose returns sufficed to meet the benchmark and whose assets minimized risk and the costs associated with asset management.[751]
- In order to contain principal-agent problems, the regulatory framework made the point that it was critical for a private-run pension system whose benefits would be paid in the distant future to be based on standalone financial actors (*giro único*) that had to be completely detached from other business actors with more short-term-focused strategies. For those AFPs that were somehow related to other companies, the regulation stipulated strong "Chinese Walls" separating the AFPs from the rest of the business group—as well as concrete measures to erect and control them. Consequently, while the number of AFPs in the system, the origin of their capital, and their connections with other business actors varied, an important continuity across the over three decades since the pension system was created was that AFPs—forced by the stringent enforcement of this regulatory approach—behaved as standalone entities focused on the pensions industry. Critically, Chile's AFPs were clearly separated from the banking industry despite the fact that bankers recurrently staged fierce legislative battles to be allowed to participate in the profitable industry of pensions management.[752] Multiple of my interviewees from both the private and

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[748] Santiso and Whitehead (2006: 37-8).

[749] Author's interview with Francisco Margozzini, General Manager of the Association of Private Pension Funds (AAFP) (1989-2014), Santiago, November 27, 2014.

[750] "Supreme court blasts AFP Habitat's case," *BNAmericas*, April 23, 2008.

[751] Complying with the minimum profitability target was important so as to avoid the expensive economic punishments the regulator imposed on the AFPs that did not meet the benchmark.

[752] In the mid 1990s, the Banks Association (ABIF) defended this position in Congress and was defeated by a narrow margin; in 2007, the Association repeated this attempt, with the same result (see *Historia de la Ley Nº 20.255*, Biblioteca del Congreso Nacional de Chile, pp. 1264-7).

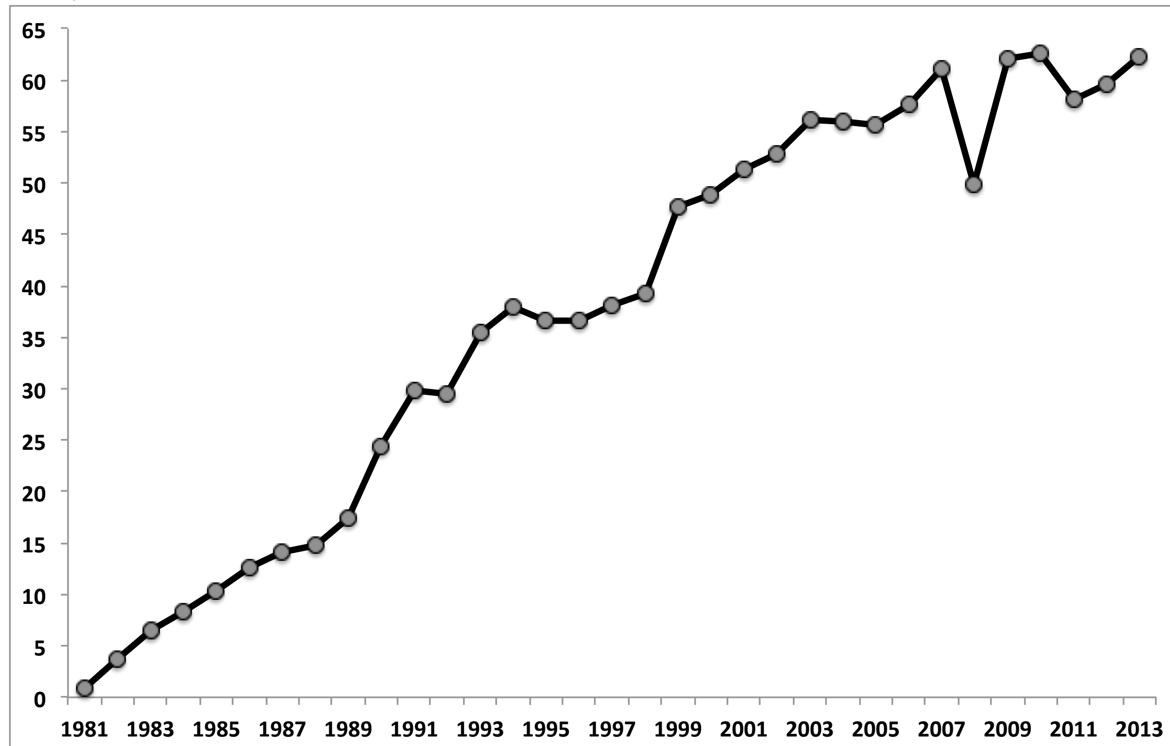
the public sector stressed that, had this provision been absent or removed, the AFPs would certainly have diverted resources away from long-term financial assets to favor banks' short-term business strategy and/or rescue them during periods of banking crisis. The comparative record reinforces such assessment: where the Chinese Walls between private-run pension funds and the banking industry are weakly enforced, as in Argentina in the 1990s and 2000s, it is unlikely that the former operate as institutional investors with long-term horizons.[753]

In line with and expanding on an early but still immature scholarship that had related the pension system and the enlargement of the equity and corporate bond markets[754] and the existing econometric analyses,[755] my in-depth, process-tracing examination strongly suggests that the type of financial actor that this mode of pension regulation engenders was a key factor providing an initial boost to develop the domestic equity and corporate bond markets in the post-reform period.

At the time the PAYG, state-run pension system was replaced by private capitalization Chile's stock market was virtually nonexistent (Magendzo and Titelman 2008: 302). A few years after pension system privatization, a significant stock of long-term savings had already accumulated in the AFPs—by 1990, pension fund assets under AFP management represented 23.3 percent of the Chilean GDP.[756] This amount continued to grow and surpassed 50 percent by 2001 (Figure 6.1), a remarkably high figure considering that at the time pension fund assets averaged 30 percent of GDP in the most developed G-7 countries, 15 percent in comparable emerging economies from Asia—Indonesia, Malaysia, the Philippines, and Thailand—and less than 5 percent in Eastern European countries.[757]

[753] See Bril-Mascarenhas (2014).
[754] Acuña and Iglesias (2000: 478).
[755] The landmark econometric study is that of Corbo and Schmidt-Hebbel (2003), though Holzmann (1997: 160-3) was probably the first to run initial quantitative tests of this relation for the case of Chile. Corbo and Schmidt-Hebbel, testing multiple model specifications, conclude that there is "a long-term relation between financial development" and the mandatory saving variable that serves as proxy to capture the impact of the private-run pension system; "[t]he estimated parameter for the contribution of pension savings flows on financial development is quite strong" (Corbo and Schmidt-Hebbel 2003: 283). Interestingly, these authors recognize the limitations of the econometric approach to test this causal relation: "This exercise carries the enormous difficulty of quantifying reform effects such as the improvement in corporate governance and the development of the risk-rating industry. To do so, we concentrate on a variable of financial depth that aggregates the most important financial instruments of the Chilean capital market, although we recognize that this measurement leaves aside many […] effects" (Corbo and Schmidt-Hebbel 2003: 278). I attempt to address some of these limitations in this section through a non-statistical methodological approach.
[756] Arenas de Mesa et al. (2008: 32).
[757] Data from Didier and Schmukler (2014: 73).

Figure 6.1. Chile. Assets Under Private-Run Pension Fund Management as a Percentage of GDP, 1981-2013.



Source: Author's elaboration based on data from Arenas de Mesa et al. (2008: 32) for the 1981-1989 period and from the World Bank's Global Financial Development Dataset for data points between 1990 and 2013.

Note: For the years for which I have the two sources of data the figures were almost equal, suggesting that, in the absence of better options, it seems safe to merge the two datasets.

With the reforms allowing pension funds to invest in the stock market and creating a risk evaluation industry that could help institutional investors to better assess corporate debt (Section 3.II), this new pool of rapidly growing financial assets became available to flow to the domestic capital market.

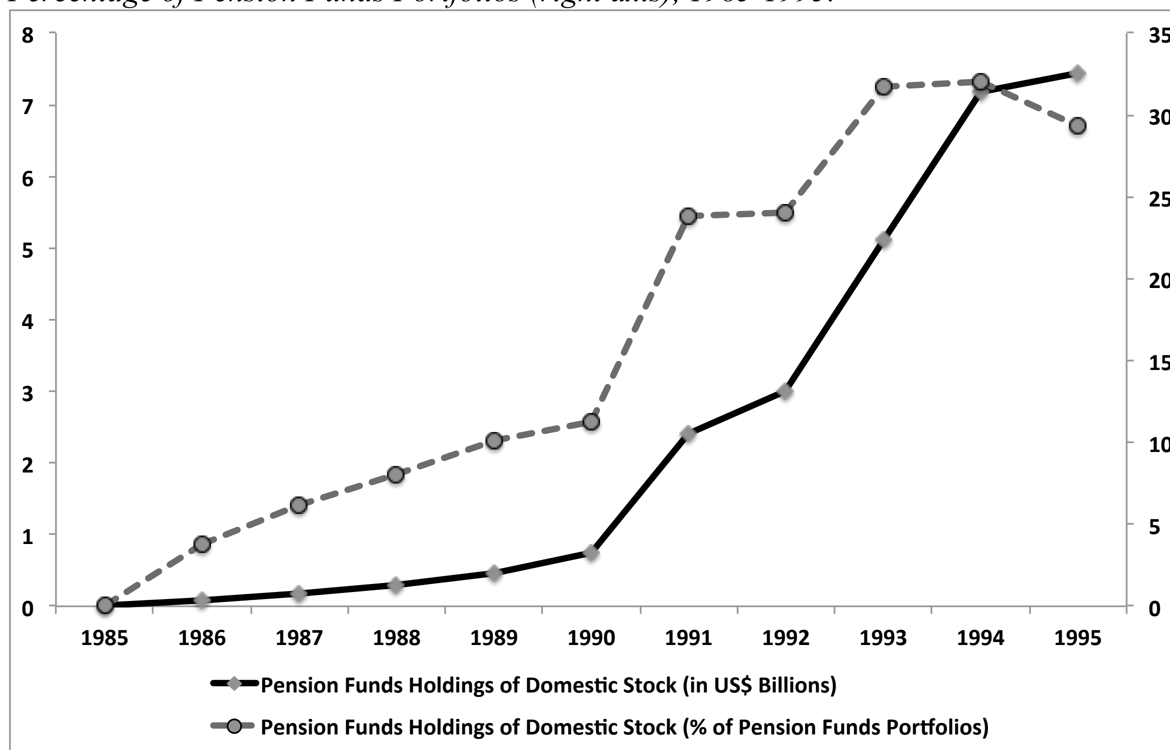
The AFPs were highly responsive to regulation, changing their investment behavior. In the domestic equity market pension funds quickly became aggressive players: while in the period between 1981 and 1984 they were not allowed to invest in stock, between 1985 and 1994 their purchases of equity grew monotonically. They peaked in 1994, coming to comprise 32 percent of pension fund portfolios (Figure 6.2). During this period in which AFPs were not yet allowed to allocate significant resources to *foreign* equity markets, investing in *domestic* stock was instrumental for pension funds to be able to comply with the regulatory pressure in favor of assuring high returns for future pensioners.

As Figure 6.2 shows, the pension funds changing investment behavior represented an injection of US$7 billion in Chile's domestic equity market[758] in the five-year period between 1990 and 1994 (adjusting for inflation, the equivalent to roughly US$10 billion of 2013). This was a significant source of fresh capital for the equity market of a small country that was undergoing its takeoff period. By the mid-1990s the Chilean equity market was already deep—it

[758] My calculations based on data from the Central Bank and the Superintendence of Pensions, Chile.

reached 102 percent of the GDP in 1995[759]—well larger than that of any other Latin American country (controlling for the size of the economy).

Figure 6.2. Chile. Pension Funds Holdings of Domestic Stock in US$ Billions (left axis) and as a Percentage of Pension Funds Portfolios (right axis), 1985-1995.



Source: Author's elaboration based on data from the Central Bank and the Superintendence of Pensions, Chile.
Note: Figures are expressed in nominal terms.

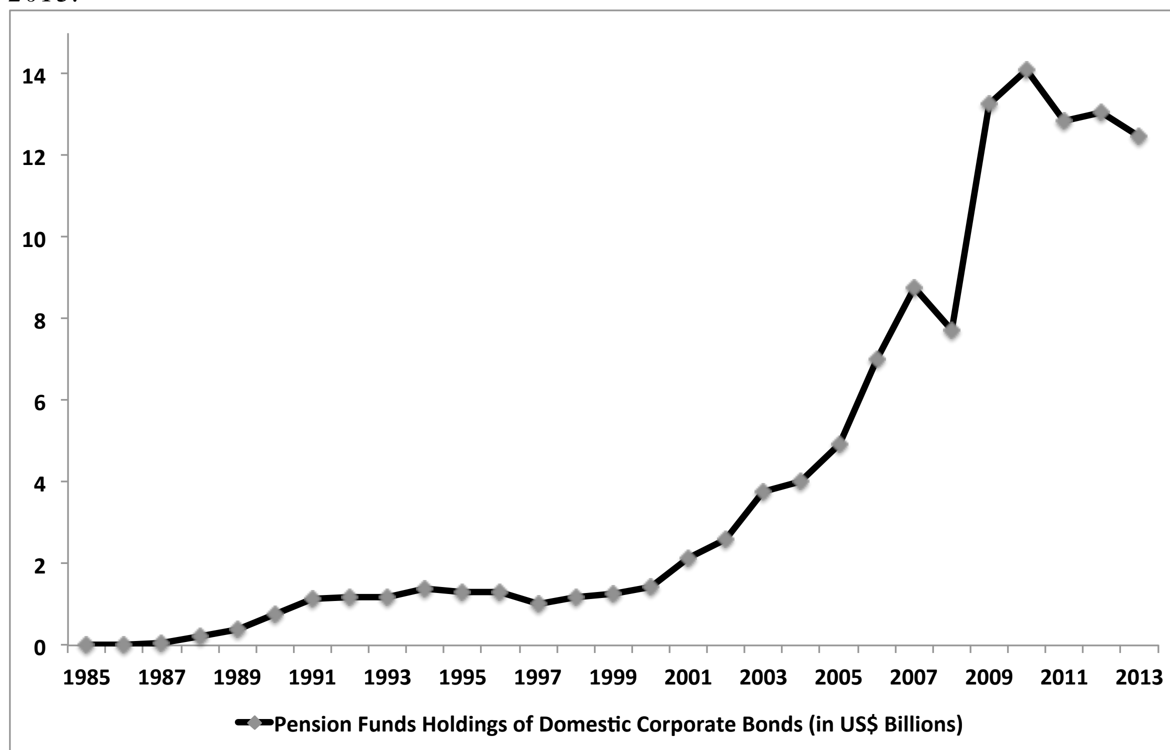
While from the late 1990s onwards, pension funds started to be somewhat less aggressive in the domestic equity markets—which, still, did not prevent them from continuing to allocate roughly US$20 billion to the local stock market by 2010-12—the important point is that the pension system was a *key catalyzer* during the *origins* of the Chilean stock market. A similar point had been made by Acuña and Iglesias (2000: 478):

> *[The evidence seems to suggest that] the growing demand for financial assets from the pension funds and the life insurance companies [associated with the operation of pension funds] may have stimulated the expansion in the volume of trading and the deepening of the market, the reduction in trading costs, the increase in the supply of long-term funds, and the reduction in the cost of company capital. [… The] strongest impacts of the creation of the new pension system may be the increased supply of long-term funds and the deepening of the stock market.*

[759] My calculations based on data from the World Federation of Exchanges and the World Bank.

As for the corporate bond market, pensions funds went from investing 0.6 percent of their portfolios in 1981-2 to allocating 11 percent of their total holdings by 1991,[760] partly as a response to the new government-engineered industry of risk evaluation. This initial shift notwithstanding, the major market-creating effects emanating from pension fund behavior started in the 2000s (Figure 6.3). During that decade Chile came to have an impressively developed corporate debt market, even vis-à-vis those in high-income countries—both because of its depth and the uncommonly long maturity of the corporate bonds traded therein (Braun and Briones 2008: 151-2; 177, 181). The size of Chile's corporate bond market grew from 13 percent of GDP during the 1990s to 21 percent in the 2000s,[761] and over 90 percent of the bonds issued had maturity above 5 years (Borensztein et al. 2008: 5).[762] The amount of capital raised by Chilean corporations in this market is very large, as evidenced by the fact that in 2005, 2009, and 2013 the volume of newly issued corporate bonds each of these years equaled 3 percent of the Chilean GDP; in most years in the series this amounted to over 10 percent of the country's gross fixed capital formation (Table 6.1). The average number of corporations issuing bonds domestically in any given year grew from 8 in the 1990s to 23 in the 2000s,[763] a very important hike considering the small size of the Chilean economy.

Figure 6.3. Chile. Pension Funds Holdings of Domestic Corporate Bonds in US$ Billions, 1985-2013.



Source: Author's elaboration based on data from the Central Bank and the Superintendence of Pensions, Chile.

[760] My calculations based on data from the Superintendence of Pensions, Chile.
[761] World Bank (2012: 41).
[762] The average maturity of the corporate bonds issued in Santiago was 16 years, much longer than anywhere else, including developed countries, where it averages 7 years (Braun and Briones 2008: 151).
[763] Didier and Schmukler (2014: 57).

Note: Figures are expressed in nominal terms.

Table 6.1. Chile. Corporate Bond Issuance Volume in US$ Billions and as a Proportion of GDP and Gross Fixed Capital Formation (GFCP), 2000-2013.

	2000-2002	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*
In US$ Billions	1.1	2.1	2.1	3.5	2.3	1.3	2.2	5.2	4.0	6.2	6.8	8.9
As % of GDP	1.47	2.7	2.1	2.8	1.5	0.8	1.2	3.0	1.8	2.5	2.6	3.2
As % of GFCP	7.1	13.3	10.8	13.4	7.9	3.9	4.9	13.8	8.8	11.0	10.7	13.4

Source: My calculations based on data from the World Bank's Global Financial Development Dataset. The indicator measures the total volume of newly issued corporate bonds by private entities in industries other than finance, holding companies and insurance.
Notes: Figures for 2000-2002 average the data corresponding to 2000, 2001, and 2002. Figures are expressed in nominal terms.

The influential work by economists Braun and Briones (2008: 174-182), attributes this development of the Chilean corporate bond market to a rapid growth in the supply of bonds and to what they call "the natural growth of the assets managed by [the domestic institutional investors]"—among which pension funds are by far the largest. Between 1995 and 2006 Chile's AFPs purchased on average roughly half of all the corporate bonds in the market (Berstein et al. 2009: 114).[764] By 2010-12, pension system's allocations to the Santiago corporate debt market reached US$13 billion,[765] still representing virtually half of the total demand.[766] This massive channeling of pension savings to the corporate bond market starting in the 2000s was partly a response to changes in capital market regulations—examined in Section 5—that granted pension funds more flexibility in their investment decisions (World Bank 2012: 41).

What Braun's and Briones's (2008) econometric exercise fails to identify is that there are key causal mechanisms connecting the accumulation of a large volume of long-term capital in a now mature private capitalization pension system and the emergence of a large, long-term-oriented domestic corporate bond market. My interview evidence suggests that the peculiar type of pension regulation in Chile generates pension funds that, for two reasons, are particularly eager to invest in corporate bonds. First, pension funds are such relevant institutional investors in Chile that they can get corporations to tailor the maturity of their bond issuances to the actuarial targets with which AFPs have to comply (typically, between five and seven years).[767] Second, in

[764] Of the remaining half, most corporate bonds are bought by life insurance companies whose business are a byproduct of the pension privatization reform (Lefort and González 2008: 29) and are currently tightly linked with the functioning of the private pension system (Acuña and Iglesias 2000: 443-4). All other investors in the corporate bond market are only trivial in comparison (Zervos 2004: 8).
[765] My calculations based on data from the Central Bank and the Superintendence of Pensions, Chile.
[766] World Bank (2012: 41); Park (2012: 13).
[767] Author's interview with Alejandro Ferreiro, Superintendent of Pensions (2000-2003), Superintendent of Securities (2003-2006), Economy Minister (2006-2008), Santiago, May 26, 2014. Zervos (2004: 8) makes the same point: pension funds, along with insurance companies, "dominate the demand side for corporate debt […]; [a]s a result, companies in Chile are heavily swayed by the wishes of this concentrated investor base […]. The dominance of these firms has shaped the nature of both the primary

neat contrast with Brazilian pension funds, Chile's AFPs—whenever supply is available—will prefer corporate bonds over equity insofar as bondholders are less likely to be blamed for corporate mismanagement than shareholders. Since AFPs manage the savings of millions of Chilean voters, they prefer, ceteris paribus, to buy corporate assets that do *not* entitle them to exert voice within companies: holding bonds rather than equity improves pension funds' chances of staying insulated from public blame in the event that corporate governance scandals emerge.

5. The State-Driven Politics of Capital Market-Enhancing Incremental Reforms During the Concertación Administrations, 1990s-2000s

Throughout the contemporary democratic period (1990-present), orthodox political *técnicos* in the executive branch were the key actors driving both the continuity of the macro-features defining the private-run pension system and the incremental reforms that, closely related with the pensions policy arena, were undertaken in capital market regulation. As I will specify in Section 6 below, business power was a lock-in factor contributing to the continuity of the private-run pension scheme devised by the Chicago Boys under authoritarianism, but it was state actors who *primarily* drove the process of incremental reforms during the democratic period. The core of this section is, therefore, the state-driven politics of reform through layering in the 1990s and 2000s.[768]

As was early on recognized by Teichman (2001: 84), in the post-1990 democratic period the Finance Ministry "remain[ed] hegemonic within the state"—its "priorities rule[d] public policy development." In Chapter 4 I showed that this dominant position characterized the four consecutive administrations of the center-left Concertación (1990-2010). This rested on the strong human-resource base in the Ministry of Finance—and the relative lack thereof in the other ministries and agencies—and on long-standing informal practices that are not affected by changes in who seats at the President's office—prominently, the involvement of the Finance Ministry's team of economic advisors in the design of all sorts of policies, including those that do not formally fall under its jurisdiction. In that same chapter I provided evidence about the highly technocratic profile and the ideational background of the elite officials that staffed the Finance Ministry. The vast majority of them received economics PhDs at American universities and were true believers in the benefits of market arrangements; they were highly skeptical about the desirability of having the state play any role larger than acting as a strong regulator. Consistent with that ideational background, the elite of Concertación's political *técnicos* at the Finance Ministry was highly optimistic about the importance that larger domestic capital markets could have on fueling investment and economic growth.

Throughout the 1990s and 2000s pension regulation and capital market-enhancing policies—directly or indirectly related to the performance of the pension system—fell under such virtual monopoly of policy design exercised by the Finance Ministry. In these incremental reforms, elite officials at the Ministry worked in tandem with top officials of the

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and secondary markets. […] [T]he liability duration of AFPs is roughly 8 years, and that of insurance companies is about 18-20 years, so that any corporate wishing to place large amounts of paper typically has to issue two tranches in these maturities."

[768] In contrast to the examples provided by the canonical work on layering (Streeck and Thelen 2005: 22-24), Chilean technocrats in the 1990s and 2000s were not after a path-altering change. Rather, they looked to preserve the original goal that had guided pension reformers in the 1980s.

Superintendence of Pensions and the Superintendence of Securities.[769] Although other non-financial aspects of pension regulation did become publically salient during this period,[770] the reforms that I examine in this chapter fit the characterization made in my framework. Technically very opaque, these policy arenas became the domain of elite-level *funcionarios*, who deployed their technical resources to intensely seek policy change in areas of regulation that presidents—and, more generally, party politicians—did not have the will and the capacity to micromanage. This general dynamic is illustrated by the following quote, in which a former elite official at the Finance Ministry recalled the drafting of an important reform to the legal infrastructure of capital markets:

> *The members of the team of advisors got along very well with each other, a quite messianic group, I would say. They worked together with the Pensions Superintendence, which was particularly active, creative, and technocratic—they wanted to do things [*querían hacer cosas*].*[771]

Pribble (2008: 113-4, 172-4, 252-4) demonstrated that during the Concertación administrations of the 1990s and 2000s the Ministry of Finance was the key actor within the executive branch in the process of reforming the Chilean welfare state. She showed that the dominant position occupied by the Finance Ministry's technocracy in the design of healthcare and education policies was instrumental for explaining why the Chilean welfare state reformers in the post-authoritarian period prioritized macroeconomic stability and fiscal discipline, relatively sidelining the goal of enhancing equity.

In the pensions side of the Chilean welfare state, market-oriented perspectives prevailed too. As Castiglioni (2002: 164) has described,

> *During this period within the Concertación there has been an acceptance of the basic ideological framework behind [the] social policy system, particularly in the areas of pensions and healthcare. As a result, all new social policies programs and measures have been introduced from* within *the existing market-oriented system. In pensions, the Concertación governments endorsed the existing individual capitalization model, based on the belief that "the State is a bad administrator, because the funds managed by the State end up being captured by interest groups" [Author's interview with Ignacio Walker, former Concertación Senator]. During this period no major initiative was introduced to fundamentally transform or to reverse the system inherited from military rule. As the former Labor Minister, René Cortázar explains, within the [Concertación] coalition nobody has suggested to replace the existing model with a pay-as-you-go system... This does not mean that the idea is not to introduce some adjustments to the system, but [adjustments are introduced] within the individual capitalization system. From the government's point o f view, the [pension] scheme has*

[769] Respectively, the *Superintendencia de Pensiones* (formerly, *Superintendencia de Administradoras de Fondos de Pensiones*) and the *Superintendencia de Valores y Seguros*. On the role of the Superintendence of Pensions, see Santiso and Whitehead (2006: 37-8).

[770] See Ewig and Kay (2011: 78, 85).

[771] Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014.

to retain capitalization, this will not be reformed [Author's interview with René Cortázar, Labor Minister (1990-1994)[772]*].*

Pensions were not "just another" part of the Chilean welfare state. In the pensions regulatory arena the Finance Ministry political *técnicos* enjoyed enormous leverage not just because any reform would have fiscal implications—as was the case in healthcare and education—but also due to the fact that by the time the Concertación took power in 1990—and increasingly so since then—investment finance—and, indirectly, investment levels and economic growth—were so tightly linked to the maintenance of the macro-features of the pension system adopted in the early 1980s by the Chicagoan officials. While one could think that a center-left coalition might have attempted to somehow reverse pension system privatization—as it happened in Argentina, as well as in Eastern Europe[773]—thus diminishing the pool of capital managed by private-run pension funds, the option of fully or partially reestablishing a state-run, PAYG system did not enter the policy agenda in contemporary Chile.

As my framework highlights, there are intrinsic features of policies that make them resilient in and on themselves—that is, without much need of agency. In the Chilean case, when the Concertación took power in 1990, the private-run pension system managed financial assets that had come to equal 23 percent of GDP, and it had become an important underpinning of the domestic banking system.[774] By 2000, that ratio had climbed up to 50 percent and in subsequent years it continued to grow. Changing the fundamental structure of the pension system therefore would have had significant impacts on the economic cycle.[775]

During the 1980s the Chicagoan technocrats, by modifying the original pension privatization law, set in place the regulation that established the initial connection between the pension system and the domestic capital markets. The dominance of market-oriented political *técnicos* within the Concertación administrations in turn explains the focus of incremental reforms during the 1990s and 2000s. Orthodox elite officials, whose stronghold was the Finance Ministry, sought to expand the already large domestic capital market and to improve its functioning. This was conceived as a means to both secure the performance of the private capitalization pension system—protecting pension funds from the multiple risks associated with investing in corporate equity and debt—and to boost domestic investment.[776] Starting in the 1990s and throughout the 2000s pension and financial system regulation became inseparable policy arenas.

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[772] Though not a member of the Finance Ministry himself, Cortázar shared the educational background of that Ministry's technocracy as he had obtained his Ph.D. in Economics from MIT.

[773] Datz and Dancsi (2013); Naczyk and Domonkos (2016).

[774] A third of the aggregate portfolio of pension funds was invested in financial institutions. Data comes from Arenas de Mesa et al. (2008: 32-3).

[775] Ewig and Kay (2011: 87) make a similar point.

[776] A former elite official at the Finance Ministry told me, "*In Chile, every time we want to do supply-side economics [to increase investment in capital] we focus our efforts on improving the regulation underpinning capital markets*" [Not-for-attribution interview with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), Santiago, 2014]. A former Economy Minister and veteran politician of the Concertación in his memoirs referred with critical terms to this ideational background of the Finance Ministry's technocrats: "*[The Ministry's] energies have been [...] strongly devoted to the development of capital markets, under the questionable assumption that through that channel we will end up expanding [the country's] productive capacities*" (Ominami 2011: 100).

The politics of state involvement in capital markets in contemporary Chile can be thought as a long sequence in which regulation generated market effects, which then induced further rounds of regulatory reform, which in turn produced new market outcomes. As I showed in Section 4, a major reform in an area only indirectly related to financial markets—the privatization of the pension system—had two sequential effects. First, it induced the emergence of a group of private-run pension funds that became institutional investors pooling a significant amount of long-term capital. Second, through a process of incremental institutional change these institutional investors started to inject ever-larger amounts of funds in the up to the then virtually nonexistent equity and corporate debt markets.

In a seminal assessment of the Chilean private-run pension system two decades after its creation, Acuña and Iglesias (2000) hinted about the causal connection between the over-time evolution of the pension system and the regulatory reforms aimed at enhancing the domestic capital market. These authors do not present evidence nor do they delve deep into their claims, but the big picture they portray is consistent with the causal argument I articulate in this section:

> *[T]he simultaneity of the growth of pension funds and the institutional reforms of capital markets suggests that the latter would be a direct consequence of the [1980] pension reform. In fact, […] the evidence clearly supports this causal relation because the [capital market] reforms were justified by the need to ensure that there was an adequate [legal] framework for pension funds' investments […]. The continuous process of legal changes in Chile […] can be interpreted as evidence of a tight relation between the accumulation of [pension] funds and the institutional transformation of capital markets […].*[777]

The framework chapter of this study argued that new policies affecting the mode of state involvement in capital markets are more likely to be adopted when entrepreneurial political *técnicos* can successfully make the case that low-salience, highly technical policy changes are linked with higher order political concerns in the president's agenda. This dynamic was observed in the case of contemporary, post-authoritarian Chile.

My field research indicates that even when private actors manage the private capitalization accounts, top government leaders are strongly concerned by the capacity of such private pension system to actually deliver the promised public good. In the words of Ewig and Kay, although the administration and investment of pension funds was mostly left to the private sector, the state "maintained a regulatory role […] and remained (whether de facto or de jure) *the ultimate guarantor of pensions*" (2011: 76, my emphasis). While having private administrators of pension funds does open some opportunities for strategies of blame avoidance if the system generate big failures—e.g. poor investment decisions leading to major losses for future retirees—my interviews with multiple top regulators suggest that Chilean government leaders have perceived a strong need to ensure a relatively good performance of the private-run pension system.

During the 1990s and 2000s, elite technocratic officials, most of them advisors at the Finance Ministry, linked the high-order political goal of ensuring the good performance of the pension system—basically, maximizing the future value of pension savings while minimizing the risks of pension funds' investments—with the opaque and low-salient agenda of improving the regulation of the domestic capital markets. The fact that such a large part of Chile's pension

[777] Acuña and Iglesias (2000: 477).

savings had been gradually channeled to the domestic capital market gave strong leverage to the Finance Ministry technocrats advocating to improve market regulation. When the pension funds invest up to 30 percent of their portfolios in the stock market and around 10 percent in bonds issued by corporations, it becomes easier to make the case that the provision of the public good of pension benefits upon retirement—which affects large swaths of the Chilean electorate—is tightly dependent on the functioning of the capital market.

Technocratic proactivity was very significant from the very early 1990s. During the first Concertación administration, Eduardo Bitrán, a Boston University Ph.D. in Economics who served as a senior advisor at the Finance Ministry authored a draft for improving the regulation of the capital markets.[778] Bitrán's description is a good illustration of how policies were designed in this process of incremental reforms through layering: "I spent some time studying this issue, I decided to bring to Chile a team of foreign experts, I teamed up with [local] academics..."[779] Another senior official who served at the Finance Ministry during the 1990s told me, "politicians have always had enormous respect for what us *técnicos* thought regarding new capital market regulations; let me make clear that politicians know very little about these issues, we met with them, we explained to them what we were thinking about new reforms… in this policy agenda, politicians had to rely on us."[780] Five interviewees explained to me that the capital market-enhancing incremental reforms adopted in the 1990s and 2000s were all initiated by the Finance Ministry technocracy, which then invited business associations representing the financial sector—such as the Association of Private Pension Funds (AAFP)—as well as the superintendents of pensions and securities to provide their technical input.[781] The Finance Ministry has always been the first mover and the key driving force of policy design. "The Finance Ministry staff listens to several sectors, they consult with the private sector, but they have a lot of power and end up proposing the version of the bill that they want," said a private-sector representative who participated in multiple of those meetings.[782]

In January 1993, upon the completion of this political *técnico*-driven process of policy design, the executive branch sent to Congress a bill that became widely known as the first "capital markets law" ("*ley de mercado de capitales*"), and eventually passed as Law 19,301 (1994). When in 1994 Finance Minister Alejandro Foxley participated in the congressional discussion of the bill he made an explicit link between the growth of institutional investors—among which pension funds are the largest by far—and the need to modernize the legal architecture of capital markets:

[778] Silva (2008: 187).
[779] Author's interview with Eduardo Bitrán, Advisor at the Finance Ministry (1990-1994), Santiago, November 24, 2014.
[780] Not-for-attribution interview with top-level official at the Ministry of Finance (1990s) (Finance Ministry Interviewee #4), Santiago, 2014.
[781] Author's interviews with Enrique Marshall, Banking Superintendent (2000-2005), Central Bank General Manager and Board Member (1991-1993; 2005-2014), Santiago, November 25, 2014; Francisco Margozzini, General Manager of the Association of Private Pension Funds (AAFP) (1989-2014), Santiago, November 27, 2014; Not-for-attribution interviews with top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #3), and top-level official at the Ministry of Finance (1990s) (Finance Ministry Interviewee #4), Santiago, 2014.
[782] Author's interview with Francisco Margozzini, General Manager of the Association of Private Pension Funds (AAFP) (1989-2014), Santiago, November 27, 2014.

In the case of Chile, the development of the domestic market for the intermediation of publically offered assets is more important than in other countries of similar development levels. This is due to the preponderant role that institutional investors play as demanders of assets for investment.[783]

In its introductory message to the bill, the executive branch stated,

The limits set by the existing regulation seriously restrict pension funds' investment options. The rapid growth of these pension funds has created a situation in which the availability of investment instruments is much smaller than investors demand. This situation has undesirable consequences, both for the pension system and the capital markets, which must be fixed shortly so as to avoid that they impact negatively in the amount of workers' future pensions.[784]

The 1994 law was a very technical piece of legislation centrally aimed at expanding the type of assets to which institutional investors were allowed to allocate their resources. In particular, the law enabled institutional investors to buy stock from firms with heavily concentrated ownership structures and from firms doing an initial public offering (IPO). In the early legislation regulating the pension system these assets were deemed as potentially risky, threatening to affect the value of future pension benefits.[785] By the early 1990s, the Finance Ministry's political *técnicos* had gained confidence that this was a risk worth taking. The law purposely looked to generate incentives for pension funds to diversify their equity portfolio beyond the type of firms on which they had focused during the 1980s—i.e. formerly state-owned enterprises in areas such as energy and infrastructure.[786] Starting with this 1994 law, state regulators explicitly attempted to allow pension fund investment to flow to sectors—such as mining and forestry—whose firms had not, until then, participated in the stock market.[787]

An elite official who, at the time the first capital markets law was passed, was the executive officer of a Capital Markets Committee created within the Finance Ministry, recalls the motivations leading to the reform:

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783 *Historia de la Ley Nº 19.301*, Biblioteca del Congreso Nacional de Chile, p. 355.

784 *Historia de la Ley Nº 19.301*, Biblioteca del Congreso Nacional de Chile, p. 11.

785 As Celis and Maturana note (1998: 12), until the passage of this reform, "the available investor base for IPOs was still narrow," partly because the regulation in force prevented pension funds—the largest institutional investors—from buying these issues during the first trading days.

786 See Agosin and Pastén (2003: 97).

787 Scholars have remarked that one of the key capital market-enhancing contributions of the 1994 law was the creation of a private industry dedicated to the rating of equity and corporate bonds (Corbo and Schmidt-Hebbel 2003: 274). In Section 3.II I noted that the 1985 reform had created a state-run *clasificadora de riesgo* that graded the equity and corporate bonds under AFP consideration. However, a top advisor at the Finance Ministry who worked in the drafting of the 1994 bill explained to me that this state-run scheme for evaluating risk was not sophisticated enough for the growing Chilean capital markets; with this in mind, the Finance Ministry officials used the bill to allow the development of a private-run risk-rating industry so as to remove this obstacle to further capital market expansion [Author's interview with Eduardo Bitrán, Advisor at the Finance Ministry (1990-1994), Santiago, November 24, 2014]. The law had a rapid effect in this regard: by 1996, 125 risk classifications were registered in the stock market, and the number had risen to 252 by 2002 (Corbo and Schmidt-Hebbel 2003: 274).

These initiatives [to improve the institutional underpinnings of capital markets] were originated by the time when the AFPs had accumulated a lot of funds. The rules that until then regulated how the pension funds should invest [the savings they administered] were very rudimentary—there was no adequate relation between the agents that managed those pensions assets and the firms demanding those resources. In the early 1990s, this was still an underdeveloped capital market in terms of its regulations. It was then that the Finance Ministry creates a Capital Markets Committee […]. The existing regulation was too rigid with regard to institutional investors because they were still shaped by the fear left by the 1982-1983 financial crisis. Therefore, by 1994 we moved towards […] new, more liberal regulations [… which included] having more flexible rules regulating pension fund [investments].[788]

Both qualitative and quantitative data indicate that the goals that executive branch political *técnicos* pursued in advancing this legislation did have effects in the continued development of Chile's domestic capital markets. Celis and Maturana (1998: 11) referred to these changes from the perspective of non-financial firms: with the growing presence of large pension funds and other equity investors, "local companies realized that equity financing was a feasible opportunity; [f]urthermore, the country's sustained economic growth exerted pressure on the companies for new financing sources in order to meet their investment plans." As Agosin and Pastén (2003: 97) noted, during this period IPOs were launched by a wide array of companies in multiple sectors, including pharmaceutical retailers, department stores, supermarkets, footwear producers, consumer goods, mining, and fisheries.

The Chief Investment Officer of LarraínVial, one of the leading financial firms in Chile, describes how business preferences shifted as the equity market expanded: in the past, large parts of the business community had been reluctant to launch IPOs, whereas by the 1990s they faced strong incentives to enter the equity market:

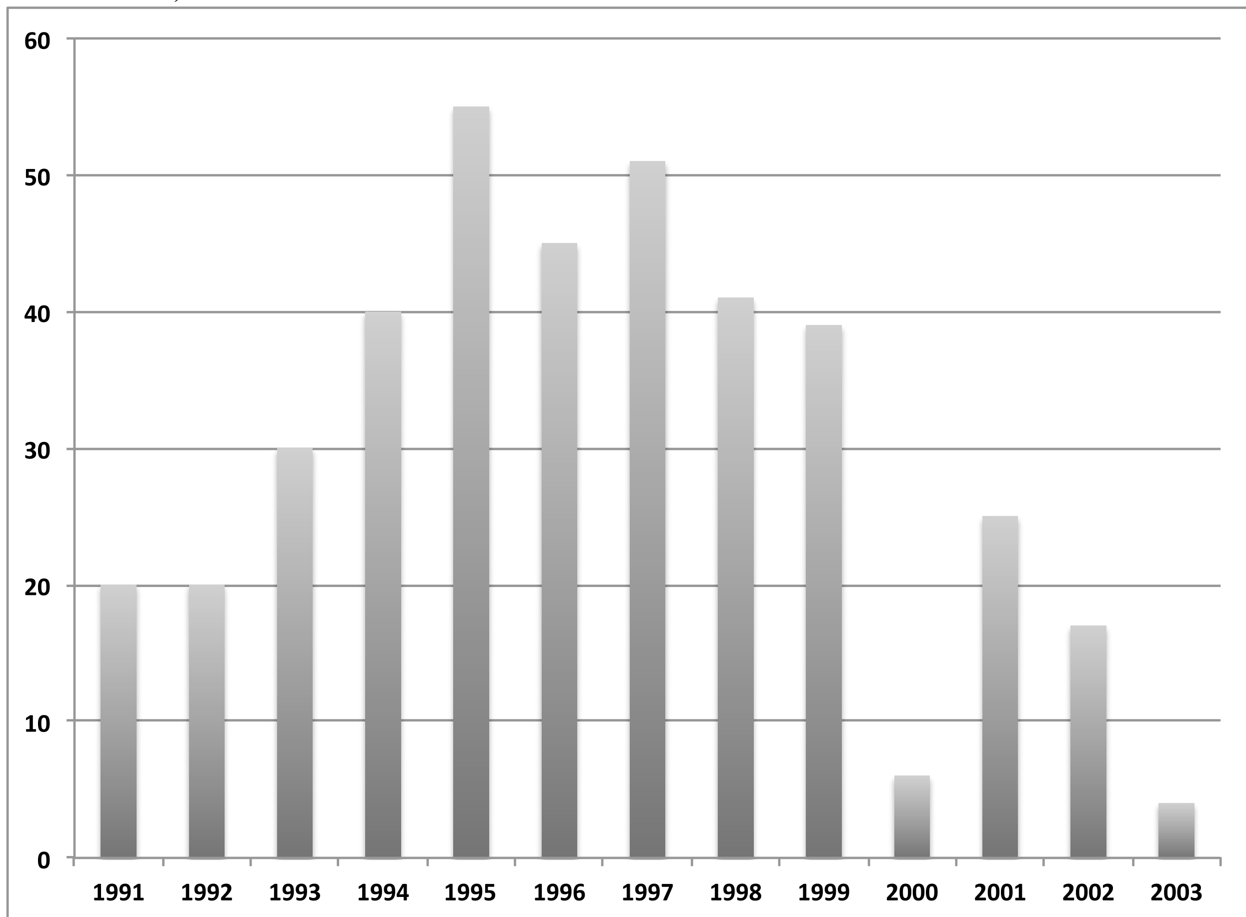
In the early 1980s the price-utility ratio was not high in Chile's stock market; but between 1985 and 1995 there was a boom that turned the Chilean stock market into one of the most profitable in the world. The price of equity in the Chilean stock market had grown a lot as a consequence of pension funds' demand.
As we know, in Latin America the word 'profit' is often a taboo: as firms didn't want to release information about how much money they were making, they were not used to launching IPOs. However, when the domestic stock market starts to be so attractive, as was the case in Chile [beginning in the 1990s], the businessman starts to question his reluctance to launch an IPO because he can earn a lot by selling part of his firm's equity.
The following example illustrates what happened in Chile more generally. In the 1990s I worked at Citicorp's IPO division. At the time, the retail sector was completely excluded from the stock market. One day we met with the family that owned a middle-sized firm in the retail sector... and the owner told us, "I've come to realize that if I

[788] Author's interview with Álvaro Clarke, Executive Secretary of the Capital Markets Group and Advisor of Ministry of Finance (1994-2000), Superintendent of Securities (2000-2003), Member of the Commission for Pension Reform (2006) and of the Technical Advisory Committee on Pension Fund Investments (2008), Santiago, November 19, 2014.

don't do an IPO my competitors will do it, and they will receive so much capital that they will end up buying me or liquidating me."[789]

Quantitative evidence points in the same direction. Law 19,301 was passed in March 1994. Data on initial and secondary public offerings suggests that Chilean corporations did respond to the new pool of capital that became available for investment (Figure 6.3). Not only was 1995 the year with the largest number of IPOs and follow-on transactions in a decade but also the amount of capital raised in the stock market through these new issues was substantial—9.4 percent of Chile's GDP.[790] Agosin and Pastén (2003: 103) show that in the mid-1980s share issues represented less than 2 percent of Chilean corporations' total funds, by 1990 that source of investment finance had only grown up to 5.7 percent, but in 1994 the proportion was significantly higher, reaching 16 percent.

Figure 6.3. Chile. Annual Number of Initial and Secondary Public Offerings in the Domestic Stock Market, 1991-2003.



Source: Author's elaboration based on data from SDC Platinum (Thomson Reuters) and the World Bank.

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[789] Author's interview with José Manuel Silva, Chief Investment Officer, LarraínVial (1997-2014), Santiago, May 27, 2014.

[790] My calculations based on data from SDC Platinum (Thomson Reuters) and the World Bank.

The sequence of political *técnico*-driven incremental reforms continued during the 2000s. In the late 1990s, Nicolás Eyzaguirre, in his capacity as advisor of the Capital Markets Committee within the Finance Ministry, had been working on the making of a bill to adapt capital market regulation to the new context marked by the financial opening of the Chilean economy. In 2000, Eyzaguirre, recently appointed as Finance Minister, moved forward with the draft he had been working on for several years. Using the great leverage that ministry grants in the policymaking process, Eyzaguirre took this as one of his priorities[791] and, in just six months, got the bill passed as Law 19,768 (2001)—widely known in Chile as "MK1," denoting that this was the first of a series of capital markets laws.[792]

Centrally, the MK1 resorted to tax exemptions as a way to attract new inflows of capital to Chile's capital markets and to generate new incentives for closed companies to launch IPOs. Among the most relevant changes that Law 19,768 introduced was the abolition of the capital gains tax for (a) shares with high trading volume in the stock market, and (b) for the sale of stock of emerging companies launching IPOs—a benefit extended for a period of three years after the company had gone public and aimed at offering an exit strategy for investors looking for higher risk alternatives.

5.I. The State-Driven Politics of Corporate Governance Reform

In this chapter I have emphasized that the politics of state involvement in capital markets in Chile is rooted in a major reform of the pension system that then, due to intrinsic features in the policy and the market effects it generated, opened a sequence of incremental capital market-enhancing reforms. Corporate governance regulation is a subset within those incremental reforms adopted in the 1990s and 2000s. I treat corporate governance separately in this section so as to simplify the exposition. In contemporary Chile, probably more than in most other settings, pension regulation and corporate governance reforms are part of the same story. It must be noted at the outset, however, that corporate governance reforms come later in the sequence of capital market development. That is, pension-fund-driven capital market deepening comes first, and then, at a later stage this market outcome becomes a key trigger of corporate governance-improving initiatives.

A highly influential body of literature (prominently, La Porta et al. 1997, 2000) underlines that improvement in corporate governance standards is a key driver of capital market development. As Schneider (2008, 2013) has convincingly argued, a core, defining attribute of capitalism in Latin America—across the countries of this study and very especially in the case of Chile—is the omnipresence of diversified business groups whose ownership structure is heavily concentrated. Most large Latin American firms have a controlling bloc of shareholders, often members of the same family.[793] Under such circumstances, there is one feature of corporate governance that is particularly key in contributing to the deepening of the domestic equity market: the presence of regulation that protects the interests of minority shareholders. While scholars of corporate governance in the United States tend to focus on the principal-agent

[791] Author's interview with Enrique Marshall, Banking Superintendent (2000-2005), Central Bank General Manager and Board Member (1991-1993; 2005-2014), Santiago, November 25, 2014; Not-for-attribution interview with top-level official at the Ministry of Finance (1990s) (Finance Ministry Interviewee #4), Santiago, 2014.

[792] Other less relevant pieces of legislation in this sequence were Law 20,190 (2007)—known as "MK2"—and Law 20,448 (2010)—or "MK3."

[793] See: Lefort and Walker (2000); Lefort and Urzúa (2008).

problem that emerges in companies whose ownership is atomized—and therefore, on the issue of managers extracting value from shareholders—in countries like Chile the key issue is whether regulation prevents controlling blocs of shareholders from exploiting minority shareholders.

In regions like Latin America, with a history marked by poor corporate governance standards and a vast majority of large firms not going public and therefore avoiding the transparency requirements inherent to floating equity, there are few actors who would have an interest and the necessary political leverage for pushing for an agenda of corporate governance reform. The two largest business actors in Latin American countries—diversified business groups and multinational corporations (MNCs)—are typically indifferent or against corporate governance reform. In the case of *grupos*, improving protections for minority shareholders goes against the ability of the controlling block of shareholders to continue to concentrate managerial decisions, a key feature driving their economic success.[794] Big domestic business dominate encompassing business associations where they are relevant, such as in Chile,[795] making them an unlikely candidate for pushing regulatory change in corporate governance. Foreign investors clearly have an interest in this agenda, but it is unlikely that they have enough influence over domestic policy makers and/or that they will be willing to invest their political capital to unravel the process of reform on this particular issue.

At least potentially, private pension funds are among the most intense groups demanding policy reform.[796] Be it for the purposes of diversifying the risk of their portfolios and/or because regulation allows them to hold only a relatively small fraction of equity in a single company, pension funds everywhere tend to be minority shareholders. The more pension funds invest in stock—vis-à-vis other type of assets—the stronger their need to ensure that they are not subject to value-extraction operations by "exploitative" blockholding shareholders. As for politicians, Culpepper (2011) predicts that elected officials will only become involved in this policy arena when the issue of corporate governance reform moves—typically, due to contingent factors—from its default location in the quadrant of "quiet politics"—that is, issues to which voters do not pay attention—to the quadrant of high salience politics.

In Chile, all these observable implications derived from existing theory do in fact match the empirical record. In line with the expectations laid out in the framework chapter, elite officials with technical background were the key actors in the process of reforming corporate governance standards. These policy entrepreneurs at the Finance Ministry exploited the contingent outburst of corporate scandals to connect the high-order political goal of containing public discontent regarding the private-run pension system with the technically very opaque agenda of corporate governance regulation.

For roughly two decades private-run pension funds, although they acquired a growing amount of corporate stock, were not vocal in favor of corporate governance reform. A series of corporate scandals starting in the late 1990s in companies where pension funds were minority shareholders contingently put pension fund administrators under public scrutiny; they were thus pressured to abandon their up to then rather passive stance towards corporate practices and governance. For their part, the Concertación technocrats in the executive branch—for whom, in line with their educational background, fixing market imperfections was considered instrumental

[794] On this latter point, see Schneider (2008).
[795] See Section 4.I in Chapter 4.
[796] Gillan and Starks (1998, 2000), who study developed countries, identify the incentives that led pension funds to pose growing pressure in favor of better corporate governance in the companies where they invested.

in promoting investment and growth—took advantage of those contingent events to advocate for reforms that would prevent future minority shareholder exploitation on behalf of controlling shareholders.

The salience of such technically opaque corporate governance reform was not high in and of itself; rather, it indirectly gained salience because the Finance Ministry's technocrats skillfully connected it with a non-opaque goal that could easily be traceable to government action: the need to improve the pension system's capacity to deliver the promise of having good pension benefits in the future. Two surveys conducted in the early 2000s help substantiate this claim. The first one revealed that only 10 percent of the roughly 10,000 AFP affiliates surveyed knew how the pension funds were invested;[797] since the survey was conducted after a series of corporate scandals widely covered in the media and the question posed was cognitively less taxing for respondents than the issue of corporate governance, it seems safe to say that public knowledge on corporate governance was very minimal. The second survey showed that half of the workers belonging to pension funds stated that the system was "bad" or "very bad,"[798] which indicates that the performance of the system was a salient, political concern. As Brooks (2009: 324-5) has argued, even in Chile, once considered the poster child of successful pension privatization, the private-run system had failed to create its own social foundations: over time, citizens had come to be disenchanted about its efficacy in providing social protection.

Building on my theoretical framework (Chapter 2), we can speculate counterfactually that capital market-enhancing corporate governance reforms in Chile might not have gone as far had this link, between the *experts*-driven low-salience agenda and the high-order *political* concern of avoiding an erosion of the legitimacy of the entire pension system, not been established. The elite officials at the Finance Ministry tied an agenda that is particularly appealing for market-oriented technocrats anywhere but one on which few politicians would invest much political capital—i.e. improving minority shareholder protection so as to prevent value-extraction operations—with a political issue that ranked high in the public eyes in that particular juncture.

Despite the fact that the new proposed regulation affected the interest of the controlling shareholders of big corporations, and even though Chile is characterized by its comparatively very high levels of business power (see Section 4.I in Chapter 4), as Culpepper's (2011) theory predicts, under high salience even powerful business actors directed affected by regulation tend to lose. As a result, in 2000 the executive branch managed to pass a major piece of legislation improving corporate governance standards—Law 19,705, widely known as the "*Ley de OPAs*" or the public tender offerings (PTOs) law.[799] Next I unpack this process and present evidence to support my characterization of it.

In 1997, the Spanish company Endesa bought Chile's largest company in the electricity sector, Enersis.[800] The AFPs held a significant amount of Enersis stock; however, their power within the holding was minimal because those shares did not grant voting rights. Endesa made a public tender offer that heavily benefited the controllers of Enersis to the detriment of minority

[797] Arenas de Mesa et al. (2008: 44).

[798] Ewig and Kay (2011: 78).

[799] As corporate governance experts Lefort and González (2008: 21) argue, while the original legislation regulating the functioning of Chilean corporations dates back from 1981 (*Leyes del Mercado de Valores y de Sociedades Anónimas*), the first reform specifically designed to improve corporate governance standards in Chile came about with Law 19,705 (2000).

[800] The data in this paragraph comes from the case study of the Chispas Case by Agosin and Pastén (2003).

shareholders, including pension funds—i.e. the offer included paying controllers' shares at a price eight hundred times higher than the price for non-controlling shares. In practice, this implied that future retirees, whose savings were managed by the AFPs, would lose from this takeover bid. Ultimately, even though the pension funds managed to void the tender offer in courts, the "*Caso Chispas*"—as this corporate scandal was labeled in the media debate—became a highly visible testament of the underdevelopment of corporate governance regulation in Chile and how weak protections for minority shareholders could—via shareholder oppression—affect the returns of a pension system heavily invested in the equity market.

In contrast with countries that have a PAYG, state-run pension system or one of the multiple types of hybrid public-private pension schemes, in Chile a vast majority of the population is entirely dependent on the private-run system's capacity to maximize the returns of savings. As a result, voter sensitivity to corporate scandals affecting AFP investments in the stock market is comparatively much higher in Chile than in most other settings. The Enersis/Chispas case focused public opinion on how vulnerable the millions of future pensioners could be in instances of value-extraction staged by the controlling shareholders of the country's largest corporations.

Because of the peculiar nature of AFPs described above (Section 4)—in particular, the herd behavior that the regulation generates and the fact that their profit comes from monthly fees and not from the pension funds' financial performance—they are not necessarily as concerned by episodes that diminish the return of the portfolios they manage, such as those emerged from badly performing equity holdings. However, the *Caso Chispas* in the late 1990s did put pressure on AFPs to show themselves concerned about corporate governance standards. The source of that newly emerged concern was not so much guaranteeing a good performance of the portfolios AFPs administered but, instead, that the legitimacy of the pension system itself came to be called into question by the public opinion. In order to be perceived as respectable and trustworthy agents of their principals (i.e. the millions of voters that would become pensioners in the future), the AFPs had to stage a public opinion campaign portraying themselves as fierce defenders of the interests of minority shareholders within large corporations. Thus, the *Caso Chispas* was a turning point in the *political* strategy of the industry of private pension funds: it was the first move towards a stable strategy of publicly showing a strong will to defend the interest of future pensioners in their capacity as minority shareholders. During the 2000s subsequent corporate scandals in firms where the pension funds held equity—such as the "*Caso La Polar*" and the "*Caso Cascada*"— reinforced this growing AFP concern about corporate governance issues.

A top executive with over three decades of experience in the Chilean financial industry explained to me,

> *Roughly during the first two decades of existence of the private-run pension system, the AFPs did not actively push in favor of improving corporate governance standards. A change occurred when the entire pension system started to be questioned politically; at that point, the pension fund administrators strategically decided to start showing themselves as very concerned "for our affiliates," for transparency. This change of attitude on behalf of AFPs is rooted in their need to improve their public image… the pension fund administrators have recently been very active in pushing for good corporate governance standards, and they do so because they perceive that the continuity of the entire private pension system is at risk.*[801]

[801] Not-for-attribution interview, Santiago, 2014.

The General Manager of the Association of AFPs, who has held this position since 1989, described to me the process leading to the passage of the *Ley de OPAs.* His characterization reinforces the inference that the industry of pension funds was an active supporter of an overhaul of the corporate governance system but that this support was a strategic adaptation to a changed context marked by widespread social discontent.

> *The OPAs Law was born as consequence of the* Caso Chispas *(...), a company where the AFPs, as minority shareholders, were offered a very low price for their shares (...). We, the AFPs, are very peculiar minority shareholders: we have the capacity to conduct research, to lobby, to make ourselves heard; we represent millions of pension contributors. We have resorted to these advantages in the case of many firms in which the controlling shareholders were attempting to obtain too much of the pie or where there were conflict of interests.*
> *With all this said, in the case of the OPAs Law, we, as the Association of AFPs, didn't have to lobby too hard because the social discontent [with the Chispas corporate scandal] was so strong that there was a quite significant political consensus in favor of passing the law. (...) Our role in the passage of the* Ley de OPAs *was not as decisive.*[802]

In the view of Alejandro Ferreiro, Superintendent of Pensions (2000-2003) and later Superintendent of Securities,

> *The AFPs were a key driver in the reform of corporate governance regulation. The AFPs have a very peculiar attribute: they are big minority shareholders that have all the Chilean people behind them. Therefore, they pushed strongly in favor of the regulation aimed at preventing controlling blocs of shareholders from extracting value from minority shareholders. The* Ley de OPAs *was the most important piece of such type of legislation.*[803]

The main source of opposition to this corporate governance reform was big business, as the OPAs Law would deprive controlling shareholders from the usual practice of receiving an overprice whenever they sold their stock.[804] Alvaro Clarke is often identified as the key policy entrepreneur within the executive branch in the process leading to the passage of the *Ley de OPAs*;[805] when the bill was submitted to Congress he was the deputy secretary of finance; during the discussion of the bill he was appointed Superintendent of Securities. In both capacities Clarke participated actively in the congressional discussions. When I interviewed him, he recalled:

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[802] Author's interview with Francisco Margozzini, General Manager of the Association of Private Pension Funds (AAFP) (1989-2014), Santiago, November 27, 2014.
[803] Author's interview with Alejandro Ferreiro, Superintendent of Pensions (2000-2003), Superintendent of Securities (2003-2006), Economy Minister (2006-2008), Santiago, May 26, 2014.
[804] Author's interview with Enrique Marshall, Banking Superintendent (2000-2005), Central Bank General Manager and Board Member (1991-1993; 2005-2014), Santiago, November 25, 2014.
[805] Author's interviews with Axel Buchheister, Senior Advisor, Libertad y Desarrollo think tank (1997-2009), Santiago, November 25, 2014; Hugo Lavados, Superintendent of Securities (1990-1994), Economy Minister (2008-2010), President AFP Curprum (2014), Santiago, May 28, 2014.

It was very hard to pass the OPAs Law because business groups were against it. Their controlling shareholders were used to selling their equity well above the price of that stock in the market; Enersis was an extreme case of overvaluation of the stock held by the controlling group of shareholders. Big business exerted resistance against this reform everywhere: in negotiations with the executive branch of government, in Congress, in the public debate…[806]

A former president of the national, multi-sectoral business association CPC, supported this assessment of the role of big business:

Business associations were not primary demanders of corporate governance reform. Rather, corporations had to adapt themselves to those changes [más bien se tuvieron que adaptar a estos cambios].[807]

Matching the expectations of the framework of this study, in contemporary Chile the politics of capital market-enhancing corporate governance reform was state- rather than society-driven. Ambitious elite officials with a locus of power and coordination at the Finance Ministry took advantage of the contingent emergence of corporate scandals—and the president's concerns about public opinion backlashes rooted in discontent with the pension system—to advance an opaque policy agenda that reflected their conviction about the importance of having the state step in to fix capital market imperfections. The executive branch political *técnicos* stressed the "urgency" of improving the up to then very backward standards of Chile's corporate governance vis-à-vis developed countries, framing the urgency with arguments such as tying capital market development with economic growth, and the need to attract foreign portfolio investors—which, the political *técnicos* argued, were increasingly concerned with corporate governance in the aftermath of the late-1990s Asian crisis.[808] The experts dominating the policy process within the executive branch successfully connected their technical preferences with high-order political goals; this was probably determining in the decision to move forward with a reform package that antagonized parts of the business community at a time when business power scored high (see Section 4.I in Chapter 4). The Association of AFPs—a close ally of both business associations and the political right (see Section 6 below)—had little choice but to bandwagon with the executive branch, providing the Concertación with a helpful—and otherwise unlikely—partner in the debate.

Eventually, in 2000, Law 19,705 was passed. This was the first legislation regulating takeover operations, enhancing transparency and disclosure requirements, and establishing

[806] Author's interview with Álvaro Clarke, Executive Secretary of the Capital Markets Group and Advisor of Ministry of Finance (1994-2000), Superintendent of Securities (2000-2003), Member of the Commission for Pension Reform (2006) and of the Technical Advisory Committee on Pension Fund Investments (2008), Santiago, November 19, 2014. In order to get the bill passed, the executive branch eventually introduced a temporary clause in the law that allowed controlling shareholders to op out for a period of three years from the mandatory tender offer to sell their controlling stocks. On the opt-out provision, see Agosin and Pastén (2003: 88-9).

[807] Author's interview with José Antonio Guzmán, CPC President (1990-1996), President of AFP Habitat (2006-2014), Santiago, May 26, 2014.

[808] *Historia de la Ley Nº 19.705*, Biblioteca del Congreso Nacional de Chile, pp. 15, 50, 532-3.

several procedures to check the discretion of controlling shareholders.[809] Overall, the OPAs Law was a landmark step towards ensuring minority shareholder protection in a country with a growing domestic equity market and in which blockholding is likely to continue to characterize large companies. As noted by Braun and Briones (2008: 157), after these reforms, Chile came to perform comparatively well in terms of protecting minority investors: according to the World Bank Doing Business Database (2006), Chile ranked 18th out of 174 countries, well above the Asian economies and similar to the average OECD standard.

6. Final Remarks. Business Power: Specifying its Causal Status and Leverage to Account for Macro-Continuity and Incremental Reforms

This chapter's in-depth examination of Chile, in line with the propositions of Chapter 2, showed that state, rather than business, actors were the first movers and primary drivers at the *origins* of the current mode of state involvement in capital markets. In contrast to what an alternative, business-driven explanation would argue, I found no strong evidence suggesting that business pressure was the primary factor explaining those original policy choices. Section 3 above made the point that, in the case of Chile, the change in the balance of power within the executive branch was the key factor explaining the decision to dismantle the public pension system and to put in its place a system of private capitalization run by for-profit pension fund administrators. In other words, the drivers of policy adoption in the early 1980s were statist rather than societal.

Yet the framework chapter of this study also argues that business actors are highly likely to become critical factors explaining policy *continuity*. Policies adopted at time 0 generate incentives and resources for business actors because they create new markets. By time [1,...,n], business actors are likely to have learned about the advantages of operating in those markets. Non-financial corporations, for instance, may adapt their corporate finance strategies so as to tap newly available sources of funding such as growing equity markets; these firms thereby become invested in the maintenance of the policies that underpin those capital markets. The framework chapter makes the point that for financial-sector actors—some of which might not have existed at the time of policy adoption—what is at stake is even more important than for firms in the productive sector; therefore, financial-sector actors are likely to become "intense" groups defending policy continuity.

In this chapter I have shown that societal mechanisms of reproduction did in fact play a role in Chile in the post-adoption phase of the 1990s and 2000s, with business power becoming a lock-in factor. Since business power has scored so high during the democratic administrations of the center-left Concertación (see Section 4.I in Chapter 4), it is easy to fall into the temptation of overstating the explanatory leverage of this variable. In this final section I will present the evidence and the logic to specify the causal status of business power in the process that followed pension privatization in Chile; when, how, and why it mattered—and the circumstances under which business was not a relevant actor in the policy process.

At the broadest level, as it is widely documented, the powerful business community adhered to the small-state model implemented during the Pinochet dictatorship; the multi-

[809] More specifically, the law regulated public tender offerings (PTOs), requiring that they be made *pro rata* to all shareholders, and it severely limited the kinds of self-dealing that lead to rent extractions by controlling interests (Agosin and Pastén 2003: 79).

sectoral business association CPC has had the role of acting as a "watchdog" in defense of that model.[810] Over the years, the pension privatization reform, which gained multiple emulators across Latin America and the postcommunist countries,[811] came to be seen by the Chilean business as a signature policy of the market model. But business defense of the model has not been merely ideational: it has had material bases too. Fitting with the stylized account presented in Chapter 2, many of the largest Chilean firms—whose preferences dominate within the powerful business associations (see Chapter 4)—in the 1990s and 2000s came to be increasingly (if indirectly) invested in the maintenance of a pension system that was a critical irrigation source for the equity and corporate bond markets where these large firms obtained part of their finance. As shown earlier in this chapter, AFPs are the most important institutional investors, reflected by the fact that when Chilean firms issue equity and bonds in the domestic capital market they discuss with pension fund representatives important terms, such as bonds maturity structures.[812] Moreover, pension funds' continuous demand for these assets has pushed prices up.

In that context—which, I insist, was not foreseen at the time of pension privatization but was, instead, configured over the years—the Concertación policymakers perceived that pension system re-reforms could only be done on the margins, in favor of "continuity rather than reinvention" (Ewig and Kay 2011: 85), or otherwise face intense business opposition. Therefore, in contemporary Chile business power at the cross-sectoral level, through the anticipated reactions it generates on policymakers, can safely be identified as a factor contributing to the locking in of the macro-features of the private-run pension system—or contributing to removing the renationalization of the private capitalization system from the policy agenda.

But strong business power across the board does not seem to be the only relevant business-driven mechanism of path reproduction. In accordance with the propositions of my framework for empirical analysis (Chapter 2), while multiple Chilean firms would be affected by any policy change that shrunk the demand for the equity and bonds in domestic capital markets, their business depends less intensively on the continuity of private capitalization than it does in the case of the firms that operate in the pensions industry itself as AFPs. In other words, large non-financial Chilean firms could potentially replace the funds obtained in the domestic capital market for other sources of investment finance—e.g. foreign markets[813]—but, in contrast, a drastic change in the pension system would hit at the core of the firms running pension funds. The continuity of such system concentrates benefits more strongly in private pension fund administrators, which do not face the collective action problems that do affect large non-financial firms in this policy arena. Furthermore, the fact that, as I will show, the AFPs have managed to impose their preferences even on issues on which there was no business consensus at the cross-sectoral level is an additional reason to infer that, in order to exhaustively assess the mechanisms that reproduced this mode of pension regulation, we should go beyond the conventional argument holding that the Chilean business is powerful tout court and consider industry-specific business power as well.

In Chile, the previously inexistent industry of private pension funds became instrumentally powerful in and of itself. In a typical "policy creates politics" dynamic, pension reform induced the creation of an association representing private pension funds, which has

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[810] On this point, see the literature cited by Fairfield (2010: 77).
[811] See Madrid (2003: 3-4).
[812] In the case of the equity market, pension funds are contacted prior to new stock issuances as a way to "read" the market and estimate final demand (Celis and Maturana 1998: 13).
[813] See Agosin and Pastén (2003: 99); Zervos (2004).

grown powerful over time. The AAFP, as the association is known in Chile, has had huge stakes in the continuity of the privatized pension system and has successfully acted as an intense policy demander throughout the four administrations of the Concertación. While in Section 5 above I showed that the wave of capital market-enhancing incremental reforms of the 1990s and 2000s has to be attributed to state actors and that evidence indicates that business actors were either in opposition or only reactively adherent to them, it seems accurate to argue that the continuity of the pension system itself can partly be attributed to the strong instrumental power of the pension funds industry. That is, although I have found no evidence suggesting that the sequence of capital market-enhancing reforms was driven by business, from this chapter's evidence we can infer that the strength of the corporations running pension funds was important in leaving off the policy agenda any attempts to introduce *major* changes in the pension system, including partial or full pension renationalization.

In Chile, private-run pension administrators have been powerful as an industry because they have historically been tightly linked with Chile's right-wing parties. An observable evidence of this linkage is that the vast majority of the leadership of the AFP association, as well as the top managerial positions in AFPs and the board members that AFPs appoint to represent them in the corporations in which they are minority shareholders, were either directly affiliated with the partisan right or had strong personal ties with it. Since during most of the 1990s right-wing parties controlled the Senate—thanks to its overrepresentation rooted in the electoral system and the senators that Pinochet appointed before stepping down in 1990—the AFP industry was in a good position to block laws that could affect its interests.

The prime evidence of the strong power of the pension fund industry is that, in defending its preferences, it managed to twist the arms of another highly powerful industry—the private banks represented by the Association of Banks (ABIF), itself a member of the multi-sectoral business association CPC. During the over three decades since their creation, Chile's AFPs have been clearly separated from the banking industry (see Section 4). Bankers recurrently staged fierce legislative battles to challenge the policy status quo and be allowed to participate in the profitable industry of pensions management. The AFPs, for their part, defended the policy status quo calculating that, if private banks were allowed to participate in the pensions industry, bankers, benefiting from economies of scale, would outcompete them. In the mid-1990s, the Association of Banks defended this position in Congress and was defeated by a narrow margin. In 2007, the Association repeated this attempt, with the same result: right-wing political parties in the Senate sided with the pension fund industry against bankers and voted against changing the policy status quo.[814] When I asked a business leader, who chaired the banking association at the time in which this reform was discussed, why bankers had lost—and the pension industry had won—this legislative battle, he told me: "We lost because the right-wing Senate members were

[814] See *Historia de la Ley Nº 20.255*, Biblioteca del Congreso Nacional de Chile, pp. 1264-7; 2591-4. As Ewig and Kay (2011: 86-7) noted, the debate around Article 81 of the proposed bill, which would have allowed private banks to participate in the pensions industry, was mixed with an institutional debate about whether the passage of the bill demanded a simple or a *calificado* quorum. I concur with their conclusion: the root cause explaining the continuity of the status quo on this issue was the power of this interest group rather than institutional design. "[I]nstitutional rules were not the cause […]; rather, they were leveraged by […]" interest groups empowered earlier by the pension privatization reform (Ewig and Kay 2011: 87).

in favor of the AFPs… the lobby that pension fund administrators did was spectacular and ultimately it was more effective than the bankers' lobby."[815]

Acknowledging the ties between the industry of pension fund administrators and the partisan right overrepresented in Congress should not lead us to overstate the causal leverage of this factor in accounting for the continuity of this mode of state involvement in capital markets in twenty-first-century Chile. As Fairfield (2010: 81) claimed, the right's veto power eroded after 1998, when the terms of Pinochet's designated senators ended; by the time Michelle Bachelet took office in 2006, the Concertación enjoyed a congressional majority. As Ewig and Kay (2011: 79) note, the pension fund industry lost battles against some proposed reforms which were eventually passed, such as the provision aimed at increasing intra-industry competition by mandating that cohorts of new workers would be assigned to the pension fund with the lowest commission fee. Interestingly, however, we can speculate that the recent decline in the instrumental power of the pension fund industry might have been "canceled out" by a new development that seems to have increased its structural power: during the past two decades, through a process of acquisitions, foreign investors came to dominate the AFP industry; hence, since then, drastically altering pension regulation would imply affecting the interests of major, global corporate players of American and European origin.

In short, in contemporary post-authoritarian Chile business power at the cross-sectoral and the industry-specific levels can safely be considered a lock-in factor contributing to the continuity of the basic structure of the private-run pension system and, hence, the mode of state involvement in capital markets that is associated with it. This chapter specified the causal status of business power, providing a logic and evidence that suggests that it was *not* a main driver at the formative moments of this path, but it did become a societal mechanism of reproduction in the subsequent decades.

Finally, in this chapter I showed that, although the Chilean powerful big business played a role in the maintenance of the broad contours of pension regulation, it was the action of state—rather than business—actors that primarily drove the adoption of a series of incremental, highly technical reforms that enhanced the functioning of those markets in the 1990s and 2000s. As the process-tracing analysis indicated, elite technocrats with a locus of power and coordination at the Finance Ministry were the key designers and proponents of reforms, which antagonized parts of the business community at a time when business power scored high. The Concertación political *técnicos* in the executive branch—for whom, in line with their educational background, fixing market imperfections was considered instrumental in promoting investment and growth—took advantage of the contingent emergence of corporate scandals to advocate for reforms that would prevent future minority shareholder exploitation on behalf of controlling shareholders.

These technical policy changes in Chile had significant capital-market enlarging effects: strengthening minority shareholder protections can trigger new inflows of capital to the domestic market not just by domestic financiers but also by foreign portfolio investors. Private pension funds—the main domestic institutional investors in Chile, managing assets that at the time the capital market reforms were passed amounted to as much as 45 percent of the country's GDP—could have potentially been an intense policy demander in favor of improving corporate governance regulations. My empirical analysis showed, however, that they were *not*. Again,

[815] Author's interview with Hernán Somerville, President of the Association of Banks (1993-2011), President of the CPC encompassing business association (2004-2006), Santiago, November 20, 2014. Also, see: "Somerville insistirá en AFP de bancos si el gobierno propone agente estatal," *Economía y Negocios*, March 21, 2008.

timing and sequencing were central to accurately trace the process: a triangulation of primary and secondary sources indicated that private-run pension funds in Chile actually started to be increasingly vocal in favor of minority shareholder protections *after* reforms were passed—their pressure was not a primary factor originating the new regulation itself.

While financial-sector actors, such as privately run pension funds, were passive in the capital-market enhancing reforms of the recent decades, big non-financial corporations, this chapter showed, were in straightforward opposition because the new rules would deprive controlling shareholders from the informally institutionalized practice of receiving an overprice whenever they sold their stock. Just as in the period of policy formation (1980s), in accounting for the politics of policymaking behind the incremental reforms of the 1990s and 2000s, a state-centric argument has stronger explanatory power than alternative hypotheses stressing business power.

Chapter 7. Implications

What broader implications can we draw from this study's political explanation of the puzzling contrasts among Latin American national financial systems? This final chapter formulates a set of implications with the goal of pointing to what we still do not know and explaining why addressing these gaps would be fruitful both for academics and for practitioners in the real world of business, politics, and policymaking. The implications are organized in three sections: political science; comparative political economy; and Latin American political economy.

1. Political Science

1.I. The State

One of the main implications of this study is that any research on the evolution of markets in world regions where such markets did not exist requires unpacking "*the* state," gaining texture in our observations of the conflicts within. Unpacking the state is an essential task to sharpen our theories relating to other important policy processes, well beyond the policy arenas that shape markets.

Fine books on advanced political economies have compellingly moved away from monolithic conceptions of "*the* bureaucracy" to build knowledge of how different organizations within states exercise autonomy vis-à-vis societal interests to drive policy change.[816] When traveling to less developed world regions where state structures are less "Weberian," however, my study suggests that unpacking the state critically entails focusing on *people* within the state at least as much as on its *organizational structures*. In particular, I focus on coalitions of elite officials across different areas of the state. To borrow the language of one of those landmark books,[817] in contexts like that of Latin America we may need to do more to better understand how groups of appointed elite officials—rather than state agencies—forge their autonomy so as to advance their policy preferences. Unpacking the state in this sense implies gaining a better understanding of the contending policy orientations on technical issues within the executive branch, and looking at the changing balances of power between groups of elite officials in nonlegislative arenas, where electoral calculations do not seem to shape much of the observed behavior.[818]

There are important ramifications for the analytical foundations of the state laid out in this study. Future scholarship drawing on the policy-centered approach that holds that policies are major causes of political outcomes[819] can be substantially enriched by complementing existing explanations based on partisan politics and interest groups' influence with a more

[816] See Carpenter (2001) and Vogel (1996).
[817] Carpenter (2001).
[818] The literature on technocracy is obviously a place to start. "Classical" Latin American political economy paid technocrats a lot of attention—see Collier's (1979) review of the bureaucratic-authoritarian model—, a focus that was fortunately revitalized in recent works, including Murillo's (2009) and Dargent's (2015).
[819] See, for instance, Pierson (1993, 1996), Hacker and Pierson (2014).

careful appreciation of the impact of political *técnicos*' preferences in the policy process. In particular, if specific features of policy design are so important that they can even reconfigure the political context in the long run,[820] political science should take elite officials' influence over the content of policies, in the phases of policy formulation and adoption, more seriously than it currently does. Future political science work should be more open than it currently is to observing that there may be important interaction effects between prominent macro variables, such as partisanship and business power, and the micropolitical factors underscored in this study.

This state-centric micropolitical approach seems particularly promising for future endeavors to explain the policy process in areas like public support for innovation and industrial policies that seek to reconfigure the sectoral profile of developing economies. These important policy arenas, at least in developing countries, often lack powerful business incumbents—policies are typically designed before industries have really come into being as such—and tend not to affect presidents' electoral calculations. In this type of policy arenas, political *técnicos* are likely to have the strongest influence on policy. But closer attention to changes in the balance of power between competing groups of elite officials with different policy orientations can also sharpen our future understanding of the content and timing of adoption of other major policies, such as those relating to the welfare state. We could certainly improve our future explanations of the expansion or retrenchment of social policies like old-age pensions, income-support policies, or broad-based consumer subsidies by ensuring that our empirical agendas do not limit themselves to societal independent variables or presidential electoral calculations, but also pay attention to the fact that political *técnicos* are often agenda setters themselves. Much of the observed variation in the configuration of welfare states—within countries over time and across countries—is unexplained if we fail to open the black box of the state along these lines.

My study suggests that political scientists could refine their explanations of policy processes in areas like those mentioned above by inquiring into the drivers of variation in the balance of power between fiscally orthodox finance ministries and executive-branch agencies that are not directly involved in fiscal policymaking. My dissertation shows that these power shifts within the state happen frequently, even in the absence of change in government's partisanship; it suggests as well that these power shifts cannot simply be attributed to signaling strategies in world markets or to the influence of interest groups. We thus need more sophisticated approaches that include other potential drivers, such as elite officials' capacity to develop reputations of technical competence. These new theory-building efforts should also advance our current understanding of how contingent factors such as the emergence of corruption scandals or exogenous international crises discredit some policy orientations and empower others—and how that, in turn, generates power shifts within the executive branch of government.

Contemporary political science has developed sophisticated theories of presidential behavior and its influence over policy, while it has left most theorizing on chief executives' appointees to the principal-agent approach. Yet if the arguments made in this study are right, we will need better microfoundations of the behavior of the executive branch of government than we presently have. That is, if it is true that we cannot predict the behavior of officials appointed to the top tiers of the executive branch based on their appointment *alone*, we will need to take new steps towards understanding these elite officials' preferences, sources of power, and strategies for acting collectively across state agencies. In short, if appointed officials who combine strong expert knowledge with brokering skills are not simply agents, but rather agenda-setters and

[820] See Garay (2007).

relatively unconstrained designers and executors of policy, our explanations of the policy process in developing regions like Latin America will have to be more sensitive to these within-state dynamics.

1.II. Public Salience of Policy Issues

Political science still has only a limited understanding of the full complexity of one key variable in policymaking processes: the public *salience* of policy issues. Though variation in issue salience has received substantial attention in American public policy literature,[821] comparative politics scholars are still taking their first steps to incorporate this independent variable and/or causal mechanism into their theories.[822] We now have neater formulations than we did just a short time ago. Different sorts of policies generate different sorts of politics, partly because the salience of policies varies.[823] Moreover, we know that public salience not only varies across policy issues but also within policy issues over time.[824]

According to my framework, the leverage of political *técnicos* in driving technical policies that ultimately shape domestic markets is associated with the fact that chief executives tend not to pay high levels of attention to these issues at the time of policy design and adoption. But why are some presidents more inclined than others to attempt to micromanage these policy choices? Why may even the same president, holding office over long periods of time, choose to micromanage those decisions on some occasions and not on others? Under what conditions will presidents become actively involved in the decision-making of technical policy choices to which the mass public does not pay attention? Answering these questions would help refine the framework presented in Chapter 2 of this study. Yet the importance of such analytical gaps goes well beyond the immediate interests of my study: future research will certainly need to have a much more sophisticated understanding of how and why issue salience varies.

Comparative politics still thinks rather dichotomously about public salience: is policy issue X of high or low salience? This goes against the analytical potential that comes with thinking of salience as a matter of degree and in specific contexts: policy issue X is of lower or higher political salience *relative* to policy issues Y and Z. Thinking relatively may help scholars to understand why the same policy issue may change its salience over time in seemingly unpredictable ways: often, the issue under study is the same, but the larger pool of issues that "compete" for the attention of the mass public changes over time. In other words, the relative salience of an issue may go up simply because other issues that were until then competing for the attention of the mass public move off of the public's radar. Likewise, the salience of that same issue may go down because other issues start to overload the cognitive capacity of the mass public. Take, for instance, environmental protection. It seems that when economies are growing, it becomes a salient issue. When economies stagnate or enter recession, jobs and growth capture the agenda, and environmental policy recedes from view.

Contextualizing salience, looking at the broader set of issues that compete for the attention of the mass public in each setting, sheds light on why chief executives may not care much about apparently salient policy decisions in contexts in which the salience of issue X is blurred or trumped by the salience of issues Y or Z. The complexity of issue salience as a

[821] Notably, Jones and Baumgartner (2005).
[822] The works of Murillo (2009) and Culpepper (2011) are major contributions bringing issue salience to the core of new political economy theories of policymaking.
[823] Culpepper (2011: 180).
[824] Murillo (2009: 249).

variable, it should be noted, may be even higher in the volatile political and economic environments of developing countries.

In addition, refining our theories may entail thinking of issue salience not just as a causal mechanism but also as an object of political manipulation. Issue salience can indeed be a politically-shaped dependent variable in and of itself. How political actors maneuver to purposely manipulate an issue's degree of salience and/or delay their entrepreneurial activity until the salience of an issue wanes, should therefore become a focus of our attention in new research agendas.[825]

Future political science research could gain analytical leverage by building on these insights into the public salience of policy issues. For instance, the study of the adoption and implementation of austerity measures, a hot topic in Euro-Crisis-hit Europe and in post-commodity-boom Latin America, could be enriched by tracking down more effectively chief executives' and technocrats' strategies to manipulate issue salience. Political scientists could come up with sharper explanations of the fate of the economic reforms underway in the aftermath of the Great Recession by systematically analyzing how political actors strategically manage different pools of issues that compete for the mass public's limited cognitive capacity in different contexts and points in time, and how these strategies might, in turn, have shaped the contrasting observed outcomes.

These insights on policy salience may also inform future work on the interaction between political calculations shaped by the electoral calendar and government spending decisions. For instance, our future analysis of topics such as the politics of patronage spending or public works programs should consider more carefully politicians' predictions of the over-time variation of the salience of these budgetary expansions. We can probably learn much more about the timing of adoption and the nature of policy design in such arenas of policymaking if we study the interaction effects between the formal institutions that regulate the electoral cycle and political incumbents' proactive strategies to over-burden or unburden voters' cognitive capacity so as to improve their own chances of reelection.

2. Comparative Political Economy

2.I. The Political Construction of Markets

The Polanyian tenet that markets are political constructions is at the core of comparative political economy (CPE). The point is not that states "create the conditions for" market development or fix market imperfections; rather, state action is a critical factor in the *creation* and later *shaping* of domestic markets. The artistry required for effective market governance, Vogel (2016: 6-7) has argued, is a core government function comparable to statecraft. My study starts with this premise—i.e. the "how" part of its title, *How States Shape Markets*, assumes that they do—and engages both analytically and empirically with the Polanyian perspective in CPE. I now take a step back in order to draw broader implications from my study for this tradition of political economy and to hint at some potentially fruitful avenues for future research.

The empirical material presented in this dissertation suggests that up to here there has been a "Northian bias" in our study of the political construction of markets in certain developing regions like Latin America. This bias is likely to have had multiple negative effects on academic endeavors, the most important of which may be the concealing of important research agendas

[825] See Capoccia (2016: 1097, 1112-4).

and the ill-definition of those that did emerge as focuses of inquiry. A Polanyian approach could be ready to travel much further and better to new empirical cases than it has so far once we manage to compensate for the Northian bias in political economy—and, for that matter, in political science.

In light of the findings of this dissertation, I claim that the full potential of the "*markets as institutions*" perspective[826] for the study of Latin America—and quite likely beyond—is yet to be exploited. Such scholarly underdevelopment may be traced to the dominant impact of Douglass North[827] on our understanding of institutions and the research agendas that are crafted upon it: as Ben Ross Schneider insightfully argued, in the Northian view, "if we get the institutions—the rules of the game—right, then individuals and organizations, such as firms, will behave; so, better to study the rules than the players. Yet we neglect the players, these mammoth players [like big business], at our analytic peril."[828]

Throughout this study I have shown that the *players*—as well as their informal practices—may be as important as the *formal rules* in accounting for the different trajectories of national financial systems in Latin America. These players include big business and, critically—as I have shown—*state actors*. In particular, it is essential to foster analytical curiosity regarding how states act as players in domestic markets. This inevitably calls new scholarship to bring into view a large range of state actors that are typically not studied in the political economy of domestic markets, such as pension funds of state-owned enterprises (SOEs).

By bridging the venerable Polanyian tradition in CPE with this critical diagnosis of the current bias in institutional analysis, in order to rebalance the attention we give to players vis-à-vis the rules of the game, we can draw important implications for future research from the empirics uncovered in this study. These implications are likely to have the strongest appeal for scholars working in countries or areas characterized by *institutional weakness*—an up-and-coming research agenda in and of itself—in which formal rules are comparatively unstable and/or weakly enforced.[829] In those contexts, I speculate, a closer attention to the players in the construction of markets, rather than just on the politics behind the formal rules that are the focus of mainstream research, should pay particularly high scholarly dividends.

Let me illustrate the type of implications that can result from reorienting empirical research in this direction. My study of Chile has shown that the privatization of the pension system and the incremental reforms that unfolded over roughly three decades shaped a new private-sector actor with strong incentives to become a very active player in the domestic capital market. The evidence I presented indicates that we cannot understand the initial phases of enlargement of both the equity and the long-term corporate debt markets in Chile without looking at the behavior of pension funds as the major domestic institutional investors. While foreign portfolio investors can later become major drivers of domestic capital market enlargement, their volatile behavior and their lack of attachment to the long-term "fate" of the country where they operate makes them unlikely drivers of expansion during the formative stages of markets.

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[826] Barma and Vogel (2008); Vogel (2016, especially chapter 1).
[827] North (1990).
[828] Schneider (2014: 21). Also see Post (2014a: 219-21). Economic sociology seems to have been better immunized than political science against this type of analytical bias, as evidenced in some of its recent classics, published long before Schneider's warnings (see Fligstein 2001, especially pp. 27-44).
[829] See Levitsky and Murillo (2009, 2014).

The evidence in this study also suggests that differences in the nature of pension funds, which by design pool large volumes of capital and have long-term liabilities, have varying effects on domestic capital markets. In Chile, private-run pension funds' optimal microeconomic strategy was to choose an investment portfolio whose returns sufficed to meet the minimum profitability target—so as to avoid penalties from the regulator—and whose assets minimized risk and the costs associated with asset management. Hence, Chilean pension funds, in contrast to those in Brazil, were inclined to allocate massive resources in the corporate bond market, and were less attracted to the option to inject funds into the venture capital and private equity industries; the latter strategy would have increased the costs of asset management and thus shrunk the profits of pension fund administrators. In Brazil, the largest pension funds sought simultaneously to prioritize their actuarial targets *and* their involvement in the private ventures where they invested; therefore, they were less attracted to channeling resources to the corporate debt market—since bonds are a type of asset that minimizes pension funds' voice in corporations—and much more inclined to inject capital in the stock market; and impressively entrepreneurial in the development of the domestic venture capital and private equity industries.

An important finding of the in-depth case studies I conducted is that the effective improvement of corporate governance standards, which in turn deepens domestic capital markets, may depend on the interaction between state actors and specific groups within the private sector. In contemporary Brazil, which deviates from some of the propositions laid out in the framework of this study, the action of *business* rather than *state actors* was the primary driver of the *adoption* of such type of rules. More specifically, financial-sector actors were able partially to impose their preferences on large non-financial business groups that were reluctant to accept changes; and eventually these two sets of business actors reached a compromise that significantly improved the formal regulation that serves as the architecture of the São Paulo equity market.

However, I claimed that this is only part of the relevant story: it focuses only on the *formal rules*, and ignores the fact that the action of some *players* in subsequent rounds of the game—that is, in the post-adoption phase—may be as important as the rules themselves. The players critically affect whether the new rules will have significant effects on markets, especially in contexts, as that of Brazil, where the largest corporate incumbents are resistant to change. The evidence presented in Chapter 5 strongly suggests that the state actors that became the most important domestic institutional investors—SOE pension funds and BNDES Shareholdings—contributed greatly to the expansion of a new segment within the domestic stock market that had significantly stricter corporate governance requirements. In other words, the market-creating effects that this change in the *formal rules* of corporate governance has had owed a lot to the posterior behavior of these state actors, who decisively used their great market power to induce Brazilian corporations to play by those new rules. Through a pattern of shareholder activism that was particularly prone to exploiting the advantages of the new rules, the giant SOE pension funds and BNDES Shareholdings fulfilled a role that no other player was likely to play. Such activism within corporations contrasts, in particular, with the relative passiveness of foreign portfolio investors.

These findings can trigger new rounds of theory building to push forward a vibrant strand of literature that has greatly deepened our knowledge on how *types of business actors* affect important political economy outcomes in the developing world.[830] The extension of the Varieties

[830] Latin America's "classical" political economy, it must be noted, produced remarkably insightful knowledge on these issues, including the masterpieces of Cardoso and Faletto (1979) and O'Donnell

of Capitalism approach to Latin America and to East Central Europe has refined our thinking about big domestic business—specifically, diversified groups—and multinational corporations (MNCs), by better identifying their preferences and sources of power.[831] Yet those studies, in their quest to outline the macro-logic of capitalism in peripheral regions, have remained at too abstract a level to understand how different types of firms and corporate structures—including MNCs and diversified business groups—shape institutional and market outcomes of interest.

In contrast, Alison Post's work, by looking at actors in the public utilities sector and by enriching the sometimes too deductive political economy approach with economic sociology, represents a leap forward in uncovering the different microfoundations of foreign and domestic investors. Post (2014a: 24-9, 219-21; 2014b: 112-5) brought our attention to two attributes that define "types of investors," their preferences, and strategies: structure and embeddedness. Domestic firms that are diversified across sectors, she argues, tend to prefer financing their investment in domestic currency and are likely to have longer time horizons than MNCs in their negotiations with governments; they tend to see their relationship with the state as ongoing, and are therefore more willing than MNCs to suffer short-term losses in contexts of high economic volatility.

In future research, these insights can help scholars to lay the microfoundations of the behavior of different actors that play a role in the political construction of financial markets. Actors' time horizons and degrees of embeddedness—and, hence, their likelihood to sustain a long-term participation in markets—as my study has hinted, seem to matter a lot in explaining whether, to what extent, and which domestic markets expand (or fail to do so). After all, varying degrees of investor patience is a key driver of variation across market structures. We need to improve our theories of the sources of variation in investors' time horizons. As another illustration of how to move forward, in laying out sharper microfoundations it may be important to incorporate actors' degrees of "cultural embeddedness" (Post 2014a: 28-9; 2014b: 113); these sociological variables are likely to affect the capacity of different types of actors to assess financial risks and make investment decisions.

The findings in my study motivate future scholarship to draw inspiration from and contribute to this new literature, by working rigorously on identifying the microfoundations of different types of firms' behavior in markets. These analytical endeavors should cover a broad set of actors: since in many developing regions the boundaries between private and public actors are blurrier than their labels suggest,[832] we also need to ask ourselves how these new thoughts on the microfoundations of investors' strategies travel, in order to develop theories of the behavior of quasi-state actors, such as SOE pension funds or state-supported institutional investors. Just as we have recently gained a lot by deepening our knowledge about different types of firms within the set of indisputably pure private actors, we could gain understanding in the future by extending such lines of inquiry to market players that are public/private-hybrids.

2.II. Capital and Credit Markets

A takeaway point of this dissertation is that it may be worth refining the conventional wisdom about the alleged trade-off between capital and credit markets. Over three decades ago, John Zysman wrote what would then become the main reference in the CPE of national financial

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(1973, 1978). However, as Luna, Murillo, and Schrank (2014: 3, 5-6) argued, such tradition of Latin American political economy declined and ultimately vanished just "when we need it most."

[831] See, especially, Schneider (2013) and Nölke and Vliegenthart (2009).

[832] See Musacchio and Lazzarini (2014).

systems.[833] In this perspective, credit and capital markets were alternative, rather than complementary, sources of finance for a country's firms. Subsequent work—notably Hall and Soskice (2001)—erected the bank-based/capital market-based dichotomy as a core foundation of the mainstream approach to comparative capitalism.[834] Yet the findings in my study suggest that it is important to spell out the scope conditions of the trade-off intrinsic to such dichotomous CPE framing: in the early twenty-first century, in developing regions like Latin America the expansion of both long-term credit markets *and* capital markets may occur simultaneously. Therefore, under certain conditions, these two domestic markets are better conceived as complements rather than substitutes.

Why does the most common CPE presumption about the structure of national financial systems not hold in regions like Latin America? How can my findings in this study inform future CPE research on this apparent dichotomy between credit and capital markets? The in-depth study of Brazil (Chapters 3 and 5) suggests that in countries that are significantly far from their financial development benchmark (see Chapter 1), as was Brazil in the early 2000s, a massive expansion of the capacity to deliver long-term bank credit for firms can come along with a substantial enlargement of the domestic capital market. That is, in contexts in which the financial system is shallow at a baseline time period, there is ample room for large-scale expansion of both types of markets. The case of Brazil shows that, when this kind of financial development occurs, not only will it be likely that the largest firms tap both credit and capital markets but also, and more surprisingly, that even medium-sized firms do so. In the real-world markets of Latin American countries, the dichotomous bank-based/capital market-based understanding of national financial systems therefore presents a false trade-off.

Yet the findings in this study have another implication: while in late financial system developers credit and capital markets are not substitutes, whether these two markets actually develop simultaneously will depend on agency. That is, the structure allows for credit and capital markets to develop in tandem—but this happens only if there are agents who act upon such structural opportunities: there is nothing spontaneous or automatic in the expansion of the scale of markets.[835] Government actors make choices, and these choices have consequences for financial development: in regions like Latin America, state actors can reproduce the bank-based/capital market-based dichotomy or they can assume that in their context this is a false dichotomy and push for policy that seeks the expansion of both markets at the same time.

In Chapter 5 I showed that when the elite officials that dominate the financial system-shaping policy process believe that real-world credit and capital markets are complements, we are more likely to see both markets expand in tandem. During the last decade, Brazilian political *técnicos* that pushed for a significant increase in the scale of long-term credit provided by the state-owned National Development Bank have also been strong advocates of capital market development. Far from believing in the dichotomy of strong development banks vs. robust capital markets, or the orthodox tenet that holds that state-supported finance crowds out private investment, these political *técnicos* had for a long time seen the potential for a positive-sum relationship between large development bank lending and domestic capital market enlargement.

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[833] Zysman (1983).

[834] See Hardie et al. (2013) for a critique of this dichotomous approach to the CPE of national financial systems in the context of advanced industrial countries.

[835] See Vogel (2016: 3-4) for a general characterization of how "the visible hand of the government" is behind the expansion of markets.

Defying simplistic characterizations of state-led development paradigms, I showed that these elite officials with strong academic credentials held elaborate causal beliefs on the non-dichotomous opportunities for national financial system development in contexts like that of twenty-first-century Brazil (Chapter 5). They were highly entrepreneurial in making the case that it was essential to substantially increase the scale and lengthen the maturity structure of bank credit in Brazil, making long-term loans available to the full range of Brazilian firms, from giant national champions to small firms in peripheral regions which until then did not have access to credit. At the same time that these political *técnicos* were designing new policy instruments to deliver long-term bank credit for firms on a massive scale, they actively advocated for the development of domestic equity and corporate bond markets. These Brazilian neo-developmental technocrats—who secured a stronghold in the National Development Bank in the late 2000s—saw domestic capital markets as an irreplaceable vehicle to fulfill a number of goals, including better insulation of Brazilian companies from the negative effects of international financial crises, and provision of an exit option for private equity and venture capital investments that could in turn fuel the growth of new technology-based enterprises.

Brazilian elite officials' causal beliefs thus combined the desirability of state-led development on the credit side of the financial system and the need to venture into making new rules—along the lines of what Steve Vogel calls market development and "*marketcraft*"[836]—as a means to expand the scale and scope of the local equity and corporate debt markets, as well as to improve their functioning. In contrast, in Chile (Chapters 4 and 6) the technocrats that dominated the policy process that has shaped domestic markets, whose stronghold was the finance ministry, held causal beliefs that saw credit and capital markets as substitutes rather than complements. Therefore, the structural opportunity of expanding both segments of the financial system at once was not exploited in Chile: while strong market development and marketcraft efforts had substantial effects on both the stock and the corporate debt markets, on the credit side of the financial system the state remained passive even after it became evident that the development of a long-term loan market that could finance firms other than the giant business groups was lagging behind.

In short, in real-world markets like Latin America's there is no trade-off between bank-based and capital market-based finance. These markets are complementary, as indicated by the case of Brazil, where both the stock and long-term loan markets expanded in tandem. But the case of Brazil offers a final additional implication that gives back some leverage, even in the developing world, to the conventional dichotomous framing in the CPE of national financial systems. While it is true that loan and equity markets are complements, it seems that the massive expansion of long-term bank credit has contributed to hindering the development of a large long-term corporate bond market in Brazil. This suggests that in regions like Latin America the dichotomy that matters is not that between bank-based and capital market-based finance, but rather that between long-term credit markets and long-term corporate bond markets. If I am right, future policy debates about marketcraft and investment finance in the developing world should leave aside the classical formulation of the dichotomy and explore the new opportunities that arise by acknowledging that some real-world markets may in fact be substitutes, while others are complementary.

[836] Vogel (2016, especially pp. 7-8, 20-1).

3. Latin American Political Economy

3.I. State Capacities

An important implication of my study is that the new configurations of national financial systems in twenty-first century Latin America influence governments' capacity to guide the economy, as well as the specific repertoires of policy options at their disposal. This builds on one of Zysman's (1983) major—but somewhat neglected—contributions: showing that the structure of the national financial system affects the national executive's goals and strategies for managing the economy and the state's capacity to exert industrial leadership.[837]

Just as Zysman (1983) noted that different structures of domestic financial systems in developed countries—credit-based in France and Japan; capital-market-based in Britain and the United States—affected the capacity of national political executives to intervene in the economy, in contemporary Latin America national financial systems set key parameters that affect governments' strategies. Key actors who design growth-promoting policies, like executive-branch technocrats, face different realities across Latin American countries. Due to increasingly distinctive national market structures, nowadays it is simply not the same to be a development-concerned executive-branch leader in Argentina, Brazil, Chile, Colombia, Mexico, or Peru.

The case of Argentina in the late 2000s and early 2010s is a perfect illustration of how market structures influence government capabilities to guide the economy using financial channels. By the late 2000s, Argentina had a remarkably small domestic equity market for a country that the World Bank categorizes as high-income. In 2008, the center-left government of Peronist President Cristina Kirchner unexpectedly decided to nationalize the private pension system, creating a new system based on a single, state-run pension fund (the FGS, for its Spanish acronym). Hence, the government came to administer the equity holdings that formerly private pension funds had had in their portfolios. Had such radical change in pension regulation occurred in a country with a medium-sized or large domestic stock market, the government would have come to enjoy multiple new policy options to manage the economy. Had Argentina had a different national financial system, the 2008 pension system renationalization would have significantly boosted the state leverage over firms: by controlling the flow of pension financial funds to listed companies, the government would have greatly increased its capacity to implement a new state-led industrial strategy.

However, even after such radical pension reform, the Argentine government's capacity to manage the economy was not substantially strengthened. This incapacity was certainly not rooted in Kirchner administration's lack of appetite for enhancing government control over the economy—it undoubtedly coveted such power—but the domestic stock market was so small at the time of pension system renationalization that the Argentine state could only use this newly acquired financial tool to influence a very minor part of the country's firms. Between 2008 and 2015 the Argentine government was only able to exert some voice in the relatively few firms in which the FGS state-run pension fund is a minority shareholder. With no companies launching initial public offerings in the tiny Buenos Aires stock market, the Kirchner administration could not expand its shareholdings, either.

In Chile, the configuration of the national financial system sets parameters that critically shape governments' growth-promoting strategies, albeit in a very different way than in Argentina. By 2016 Chile had accumulated two consecutive years of sluggish economic growth

[837] Zysman (1983, especially pp. 16, 56-7, 68-9, 72-80).

and the Central Bank projected that that trend would continue for at least another year.[838] In that context, the finance and economy ministers of the center-left administration of President Michelle Bachelet expressed their disappointment and launched a set of initiatives aimed at increasing productivity and fueling long-term economic growth.[839] The "22 Measures" were presented as part of an agenda that the Bachelet administration labels "2016: The Year of Productivity." What the ambitious rhetoric concealed was the fact that, as a result of the process traced in the previous chapters of this study, the Chilean state had severely undermined its capacity to trigger a process of deep economic transformation. Since the Chilean state has given away its tools, in 2016 the executive branch leaders, even if they were willing to do so, could not launch any seriously ambitious industrial policy.

While in the March 2016 press conference the Chilean finance and economy ministers talked about the need to foster higher value-added sectors with greater propensity to generate economic growth, a close analysis of the 22 Measures reveals the incapacity of the Chilean state to guide a process of industrial transformation. The selective allocation of industrial finance is the key tool for any government willing to exert some degree of industrial leadership (Zysman 1983: 16, 76). However, despite the government officials' rhetoric about industrial upgrading, only two of the 22 measures announced on that occasion in Santiago de Chile would enhance state-run schemes of selective credit allocation. The new capital to be injected through CORFO credit lines is as little as 0.27 percent of the country's GDP.[840] Seven of the 22 measures have the goal of streamlining bureaucratic procedures—all issues quite unlikely to trigger deep economic transformation—while four of the measures introduced minor reforms to the tax rules affecting export-oriented firms. All in all, half of the proposed agenda is focused on simply removing bureaucratic obstacles to markets.

The policy processes examined in Chapters 4 and 6 have reconfigured the structure of the Chilean national financial system in a way that strongly constrains what the government can do in 2016 when it faces a situation marked by two consecutive years of sluggish economic growth and over-dependence on commodities. In such a setting, the success or failure of the new executive branch's agenda "2016: The Year of Productivity" will depend on whether private-sector financial actors respond positively to the new incentives that the reforms would lay out. More specifically, meeting the target contained in the 22 Measures to raise investment finance for Chilean companies by US$8 billion—i.e. 3 percent of GDP, not a hugely ambitious plan in any case[841]—will strongly depend on whether the new incentives set for major private institutional investors end up being effective.[842]

Because Chile's national financial system has such a large capital market, the government's 2016 productivity-enhancing agenda places a strong bet on successfully incentivizing the private-run pension funds to reorient their portfolios, channeling funds to long-term investments in infrastructure. But there are good reasons to expect that, even though Chile has an unparalleled pool of patient capital in its pension system, this strategy will not suffice to

[838] The rate of GDP growth in Chile was 1.9 percent in 2014 and 2.1 percent in 2015 ("Base de Datos Estadísticos," Central Bank of Chile).
[839] "Gobierno anuncia medidas para expandir el financiamiento, promover la exportación de servicios y simplificar trámites," Chilean Economy Ministry Press Release, March 30, 2016.
[840] My calculations based on adding the funds associated with Measures 4 and 5.
[841] My calculations based on data from the Chilean Economy Ministry Press Release, March 30, 2016.
[842] See: Measures 1, 2, and 7, as well as Presidential Message No. 55-364 (submitted to the Chilean Congress on May 6, 2016).

spur a process of industrial upgrading. In contrast with the Brazilian executive branch's success in steering pension savings to infrastructure projects during the last decade (Chapter 5), the Chilean executive branch adopts an arm's-length approach to pension regulation that prevents the state from selectively orienting pension fund investment. In the 2000s Chilean governments have relied on this strategy in their attempt to develop an industry of venture capital and private equity that could improve the country's poor innovative performance.[843] The disappointing results of those attempts[844] suggest that it is unlikely that the same approach—this time, with the goal of inducing pension funds to inject long-term capital in the infrastructure sector—will succeed now.

While the structure of the national financial system severely constrains Chilean governments' capacity to set long-term developmental goals and attain the few and humble objectives that they do pursue, the situation is quite different in Brazil. The short-run impact of corruption scandals, changes in the government's partisan identity, and the volatility of economic variables such as international oil prices, should not distract us from giving full attention to the structural features of the Brazilian political economy and their likely effects in the longer run. The new configuration of the Brazilian financial system (Chapters 3 and 5) seems to have recently influenced the government's goals themselves—that is, the new structure of domestic markets has opened opportunities for the government to pursue new objectives and strengthened its capacity to attain them.[845]

The importance of the bank credit segment of the financial system in twenty-first-century Brazil has enabled the government to utilize selective schemes to exert influence over domestic firms to move to new sectors and to boost their innovative capacities.[846] Since the mid-2000s, the Brazilian government has supported the development of breakthrough technology by funding basic R&D as well as providing seed-capital to sectors like new materials, environment, electronics, and chemicals.[847] The Brazilian Development Bank's (BNDES) targeting of pharmaceutical companies is the key factor that explains why R&D expenditures in that industry almost tripled during the 2000s.[848] In the early 2010s, the BNDES approved over US$4.2 billion in renewable energy financing, targeting biofuels, solar, and wind energy.[849]

Moreover, the range of policy options for the Brazilian state expanded on top of those related to the credit-side of the financial system. During the last decade the Brazilian government took advantage of the new opportunities that accompany the country's larger and more vibrant stock market at home. The following example illustrates this: in November 2007 the Brazilian federal government announced the discovery of huge new petroleum reserves in the "pre-salt" region off the coastline of Rio de Janeiro. It was the world's second-biggest strike in two decades; the first field found was estimated to contain petroleum equal to all of Norway's reserves.[850] Extracting the oil from the new fields—which are over 4 miles deep, including a 1.2-

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[843] See: *Historia de la Ley Nº 20.190*, Biblioteca del Congreso Nacional de Chile. The bill was passed in 2007.
[844] See: Musalem and Baer (2010: 45-6); Sevil Esteban (2012: 47-50).
[845] These case-specific observations are inspired in the more general logic laid out by Zysman (1983: 79).
[846] For a general characterization of state support for innovation during the last decade in Brazil, see: Hochstetler and Montero (2013: 1494-6).
[847] Mazzucato and Penna (2015: 23-4, 28); Mazzucato (2015: 205).
[848] Mazzucato and Penna (2015: 23, 28).
[849] Mazzucato (2015: 131); Mazzucato and Penna (2015: 27).
[850] "All this and oil too: God may indeed be Brazilian after all," *The Economist*, November 15, 2007.

mile layer of salt—is a capital-intensive endeavor demanding innovative technologies. Since the government gave the state-controlled oil company, Petrobras, the protagonist role in the development of the pre-salt reserves,[851] in mid-2010 the firm's board decided to approve a US$224 billion investment plan for the following five years.[852] In pursuing this plan, the Brazilian government took a path that would have been foreclosed in a country like Argentina, despite the fact that the Cristina Kirchner administration was as strongly attracted to state-led development as the Workers' Party chief executives in Brazil, and similarly pressed to capitalize the renationalized Argentine oil company YPF. At the end of 2010, the state-controlled Brazilian oil giant Petrobras issued new equity in the São Paulo Stock Exchange, raising US$70 billion. The sales script used to court potential investors during the roadshow had explicitly made the point that the equity sale would go straight into developing the pre-salt reserves.[853] This massive equity issuance set a world record and suggests that Brazilian government leaders have adapted their strategies to a new reality marked by the newly structured domestic markets.

3.II. Typologies of Latin American Political Economies

"Financial deregulation could be the string that unravels coordinated market economies…"
Concluding pages of Introduction to *Varieties of Capitalism*[854]

"Expanding stock markets have the potential to change fundamental features of hierarchical capitalism, and to do so much more quickly than changes on other dimensions..."
Schneider (2013: 63).

"I've come to realize that if I don't do an IPO [initial public offering] my competitors will do it, and they will receive so much capital that they will end up buying me or liquidating me."
Owner of a middle-sized Chilean firm talking with an institutional investor[855]

"Large Brazilian groups [nowadays] don't like to work too much with their own cash flow—they very much prefer working with other people's money…"
Former CFO of top Brazilian business group[856]

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[851] Hochstetler (2011: 364).
[852] Musacchio and Lazzarini (2014: 190).
[853] For an extended description of the operation, see: "How Petrobras struck $70 billion," *Euromoney*, March 2011.
[854] Hall and Soskice (2001: 64).
[855] Author's interview with José Manuel Silva, Chief Investment Officer, LarraínVial (1997-2014), Santiago, May 27, 2014.
[856] Not-for-attribution interview, São Paulo, 2014.

The classical endeavor to compare national models of capitalism has fortunately returned to the center of political science.[857] Its resurgence can be attributed to the publication of *Varieties of Capitalism* (Hall and Soskice 2001). With over 9,000 Google Scholar citations in a decade and a half—and an impressive 66 percent increase in citation counts in just the last three years—[858] VoC is undoubtedly at the center of the discipline, generating as much inspiration as frustration, and uncountable followers and detractors. The vast majority of roads lead to VoC for anyone engaging with the debate on comparative capitalism. My study has important implications for those interested in drawing—either partially or exhaustively—on VoC's analytical toolkit to study the nature of contemporary capitalism in regions outside those that motivated the original agenda. I do not attempt to engage with the VoC approach as a whole, nor does my study have implications for all of the spheres of coordination that are central to VoC's theorization, such as vocational training and education. I do claim, however, that the findings of this study should be taken seriously in future attempts to draw inspiration from VoC to study developing regions like Latin America.

Finance is at the very core of the VoC approach. More precisely, the prevailing mode of corporate finance—or the means firms utilize to raise funds for investment—critically flavors each of the two varieties—liberal market economies (LMEs) and coordinated market economies (CMEs).[859] In the quote that serves as an epigraph to this section, Hall and Soskice (2001: 64) mention in passing what could actually become the source of the demise of VoC's intellectual hegemony in the comparative study of capitalism: the two key equilibria—LME and CME—hinge on national models of investment finance. That is, ongoing changes affecting corporate finance in CMEs may be "the string that unravels" one of the two "optimal" models of capitalism. (And if we end up with a single successful variety instead of two *varieties*, the sexiness of the approach itself could start to gradually decline.)[860]

More recent work on VoC added precision, shedding more light on the centrality that corporate finance had on the original agenda. Hardie et al. (2013: 693) remarked that the alleged presence of credit-based systems and patient capital is so closely associated with other core elements of CMEs that the "continued viability of institutional diversity" across advanced capitalist economies would hinge on this feature of the national financial system. Nölke and Vliegenthart (2009), for their part, in skillfully extending the reach of the VoC research program to East Central European countries—the Czech Republic, Hungary, Poland, and the Slovak Republic—formed the concept of dependent market economy (DME). The "D" in DME highlights an attribute that pertains to the financial sphere: the primary characteristic of DMEs is their dependence on foreign capital. More specifically, the core distinctive feature of political economies of this variety is that the primary means of raising investments is through foreign

[857] This tradition in comparative political economy dates back at least to Shonfield (1965) and has Zysman (1983) as its main classic in the specific sub-literature on comparative national financial systems.
[858] My calculations based on Google Scholar data, accessed in May 2013 and May 2016. To put VoC's 9,000 citations in perspective it is helpful to note that Barrington Moore's *Social Origins of Dictatorship and Democracy* and Robert Dahl's *Polyarchy* had, respectively, 7,586 and 8,668 counts (May 25, 2016).
[859] On a subtler level, it can be noted that finance enters the VoC agenda through a narrow window: the focus is on how it affects the concentration or dispersion of share ownership of firms, and on how that in turn shapes the incentives of the major stakeholders in a corporation. A similar critique is made in Hardie et al. (2013: 692-3).
[860] This point notwithstanding, Hall and Soskice do not predict convergence but continued divergence.

direct investments and foreign-owned banks. East Central European economies are thus fundamentally dependent on investment decisions by transnational corporations.[861]

The adaptation of VoC to Latin America (Schneider 2013) has laid out a new conventional wisdom that we could label the HME Framework. In this perspective, the largest and most advanced Latin American countries all fit under a single model of hierarchical market economy (HME). One of the four elements that characterize HMEs is the central role that multinational corporations (MNCs) play in this economy; in this regard, as Schneider himself points out (2013: 75), Latin America resembles DMEs, with all the implications this feature has for the mode of financing investments. What makes HMEs distinctive, Schneider insightfully remarks, is that this region's economies—as opposed to those in Eastern Europe—have large *domestic* firms: "[a]ny attempt to characterize capitalism in Latin America has to devote considerable attention to business groups."[862] Furthermore, he fruitfully underscores that these very large domestic business groups (or *grupos*) are key agents mobilizing large-scale capital for investment.[863]

Where I part company with the HME Framework is on its downplaying of recent changes in how firms finance investments in Latin America. The findings in my study have strong implications in this regard, not just because of what we are already observing in the field but also, and perhaps more importantly, because of the gradual institutional change that may be under way in the region. While hierarchy itself seems likely to continue to define big domestic business in the region—and we should applaud Ben Ross Schneider for coming up with this invaluable heuristic device—the HME Framework, as it is formulated nowadays, may not be sufficiently well-prepared to capture the changing modes in which big Latin American firms finance their large-scale investments. However fascinating institutional complementarities may be as an analytical tool, if this side of the framework is pushed too far, we end up obscuring some new important empirical realities, as my study has shown and will further elaborate below. This type of equilibrium analysis does not capture gradual institutional change through displacement and layering in the domain of corporate finance.

With regard to investment finance in domestic corporations, the HME Framework depicts Latin American economies as dominated by enormous business groups that exclusively depend on retained earnings or foreign markets to finance their large-scale investment projects. Disregarding sources of *domestic* finance that are *external* to firms—which, incidentally, fits nicely with the purpose of stressing hierarchy as Latin America's defining mechanism of allocation—may have been an accurate stylized depiction of companies in the region through the late 1990s or early 2000s. However, the findings in my study that suggest that big domestic firms—and even medium-sized enterprises in countries like Brazil—no longer exclusively rely on internal sources of finance or foreign debt, imply that the mode of corporate finance as

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[861] Nölke and Vliegenthart (2009: 676-7, 679-80). On a side note, it must be made clear that this attribute of dependence does *not* imply that the DME equilibrium is a suboptimal one in the terms of the original VoC agenda. To the contrary, the authors quite persuasively argue that DMEs have a set of specific comparative advantages—vis-à-vis both LMEs and CMEs—and a superior economic performance over comparable, but less pure, socioeconomic systems; DMEs have comparative advantages in the assembly and production of relatively complex and durable consumer goods (Nölke and Vliegenthart 2009: 672, 676).

[862] Schneider (2013: 46).

[863] Schneider (2013: 7).

depicted in the HME Framework may have been eroding gradually. Continuing to assume its pertinence can thus be analytically misleading and bias future efforts in data collection.

Since domestic corporations are the crucial actors in VoC's firm-centered political economy, and because finance is at the core of this approach, in applying this framework to Latin America we need to be particularly attentive to changes affecting how the region's firms raise the funds for financing their investments. Being sensitive to those shifts is quite challenging because they are not likely to come in the form of radical institutional change.

Jorge Schvarzer—one of the founding fathers of the study of the self-financing giant domestic business groups that are central to the HME Framework—built on research he had conducted in the 1970s and 1980s to provide important microfoundations of the behavior of this peculiar corporate creature.[864] A key defining feature of these *grupos* is their reluctance to disclose accurate information on their operations. In his study of the top 100 Argentine firms in the early 1990s, Schvarzer (1995: 200-1) emphasized that closed corporations enjoyed a high degree of "secrecy" and that it was virtually impossible for anyone outside the firms to access reliable information about them. For their part, listed firms typically released balance sheets that misrepresented the actual situation of their business activities. Schvarzer (1995: 200-1, 208) argued that several motives explained large firms' reluctance to disclose accurate information, including advancing the controlling shareholder's short-term goals, concealing illegal parts of the business, evading taxes, and facilitating capital flight.

The goal of maximizing secrecy in the operation of the firm is hard to reconcile with a strategy of corporate finance that seeks external funds. Such logic at least partially explains why the classical Latin American *grupo* relied so strongly on retained earnings. The former president of a leading institutional investor in Argentina illustrated this tension by telling me,

> *On one occasion several representatives of institutional investors, including myself, met with a major domestic business group. The owner of the firm wanted to issue a corporate bond as a way of raising capital. At one point in the meeting we started posing tougher and tougher questions to this corporate owner; the guy started to feel annoyed, he was nervous about us asking so many questions about his firm… and he eventually decided not to deal with outside investors. This is the prototypical behavior of big business in Argentina… many of these meetings between institutional investors and corporate representatives do not end well.*[865]

Similarly, Carlos Lessa, president of the Brazilian Development Bank (BNDES) in 2003-2004—the period that preceded the massive expansion of state involvement in credit markets (Chapter 3)—explained to me the difficulty he encountered during his meetings with corporate representatives due to their reluctance to disclose information on their operations:

> *Development banks have a chronic challenge: when a businessman brings an investment project for our consideration he is obliged to do a striptease, the bank needs to know everything about this firm, but this generates tension because the majority of firms do not want to provide information. For the businessman what's key is to dominate the markets where his firm operates; therefore, he won't want to provide*

[864] Schvarzer (1995: 200-2, 208).

[865] Not-for-attribution interview with a former president of a leading Argentine institutional investor, Buenos Aires, 2013.

detailed information that would be really valuable for his competitors… what type of plant he will build, how he deals with suppliers, and so on.[866]

The business strategies that these quotes illustrate were useful for stylizing the behavior of domestic firms in Latin America until the late 1990s. Under those circumstances, the HME Framework portrayal of domestic business as almost exclusively relying on retained earnings as a source of investment finance was fully accurate. In the book that first crafted the HME Framework, the piece of evidence that most directly attempted to substantiate the relative irrelevance of external financing in Latin American capitalism was the following: "By one estimate, even companies listed on the Brazilian stock exchange relied on retained earnings for around 75 percent of their financing needs."[867]

However, two problems potentially affect the quality of the inference that the HME Framework put forward. First, the cited data on Brazil corresponds to the 1994-1998 period,[868] that is, long before both the enlargement of the Brazilian equity market and the expansion of the scale of BNDES long-term credit for corporations that I have examined in Chapters 3 and 5. Second, in that text we lack a comparative perspective to assess properly the cited data on Brazil; this is important because when we use this type of indicator a difference of a few percentage points has a disproportionate impact on how we assess country cases. We should thus note that firms' primary reliance on retained earnings for financing investments is *not* a peculiarity of Latin America. Although we do not have reliable cross-national data for any single point in time (let alone panel data), some observations from the World Bank's Enterprise Surveys suffice to substantiate my assertion. The proportion of investment financed with retained earnings was large across countries: 51 percent in Germany (2005), 61 percent in Turkey (2013), 60 percent in Spain (2005), 68 percent in South Africa (2007), 74 percent in Poland (2013), 64 percent in Israel (2013), 65 percent in South Korea, and 76 percent in Sweden (2014). At more aggregate levels, for the group of high-income OECD members included in the sample, 67 percent of corporate investment was financed internally, while this proportion amounted to 73 percent for the surveyed countries in Eastern Europe and Central Asia.[869] If anything, in line with the findings of my study and diverging from the way the HME Framework portrays firms, the proportion of investment financed with retained earnings, after the changes in the domestic credit and capital markets studied in the preceding chapters, was comparatively low in Brazil—55 percent (2009)—and Chile—56 percent (2010).[870]

The findings in my study, as well as the reconsideration of the data presented above, indicate that, although the HME Framework is right in remarking that the omnipresence of giant domestic business groups gives Latin American capitalism its peculiar flavor, we need to acknowledge the growing importance of alternative forms of corporate finance, especially for larger firms. We cannot simply assume that the sort of intra-group self-financing that characterized the business groups studied by the original literature on Latin American *grupos* is still the best way to stylize real-world business strategies in the twenty-first century.

[866] Author's interview with Carlos Lessa, BNDES President (2003-2004), Rio de Janeiro, August 22, 2014.
[867] Schneider (2013: 43-4).
[868] The cited estimate comes originally from Claessens et al. (2000: 11-2).
[869] All data from Enterprise Surveys, World Bank.
[870] The World Bank's dataset does not have observations for the 1990s, which would allow us to improve our characterization of variation over time within Latin American countries.

In the preceding chapters I have presented abundant evidence that serves as a starting point to better characterize strategies of corporate finance in the region by the mid-2010s. My evidence seems to indicate, for instance, that in contemporary Brazil CFOs no longer prefer intra-firm or intra-group sources of finance exclusively, which hardly ever suffice to meet their ambitious long-term investment plans. Furthermore, in a country in which the domestic market is so important for large firms, and where there is a long history of exchange rate volatility, solely relying on foreign credit markets is rarely an option: concentrating debt in foreign currency when revenues are mostly denominated in Brazilian Reais is too risky.[871] This marks a big shift in Brazil compared to the late 1990s, a time for which the HME Framework seems to have been a better fit.[872] After the major reconfiguration of the Brazilian financial system in the 2000s and 2010s, even the CFOs of export-oriented companies, which are far less exposed to exchange rate risks than firms that sell domestically, nowadays choose to tap domestic sources of finance, both in the equity and long-term credit markets.

Chile shares with Brazil the presence of a large domestic equity market, but it differs in that during the 2000s and 2010s Chile came to have an impressively large market of corporate debt in which firms can raise extremely long-term finance—at 16 years, the average maturity of the Santiago corporate bond market surpasses that of advanced political economies (see Chapter 6). Meanwhile, the Chilean state, in contrast to the Brazilian, has retreated from the long-term credit market (Chapter 4). The evidence presented in this study indicates that the country's largest firms have grown so much since the 1990s that they simply cannot rely any more on their own resources to finance the large-scale investments that they carry out. The domestic equity and corporate bond markets have thus become essential sources of investment finance.

Chilean firms issue debt and equity domestically for several reasons. First, nowadays using the domestic capital markets comes with lower transaction costs than those encountered in foreign capital markets. Second, many groups have a significant share of their revenue in Chilean pesos; hence, they prefer domestic capital markets so as to minimize the exchange rate risks associated with issuing debt abroad. Third, all large firms—even those that receive most of their revenue in foreign currency—diversify investment finance sources so as to protect themselves from credit crunches such as the one that followed the 2008 world financial crisis; in turn, foreign buyers of Chilean firms' debt value the fact that the latter will be able to repay their debts by using the domestic capital markets in the event that international markets dry up.

In Chapters 5 and 6 I presented evidence about a recent development in Latin American capitalism that further calls into question the financial-side of the HME Framework: the emergence and growth of domestic firms with capacity to become multinational corporations.[873] The impressively successful internationalization of a large set of Chilean and Brazilian firms

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[871] On this point, which can be extended to most Latin American countries, see Coutinho and Rabelo (2003: 62). Post's (2014a: 24-5; 2014b: 112) study on cross-sector diversified domestic business groups with assets in the sector of public utilities makes the same point about these *grupos*' preference to finance investment locally, refraining from contracting debt in foreign currency; my findings differ from hers, though, in that this preference does not imply that firms will only resort to retained earnings.

[872] In the early 2000s, after a decade of market-oriented reforms, observers stressed the fact that large Brazilian firms had become increasingly dependent on obtaining finance in foreign stock exchanges, with virtually no funds being raised domestically. See: Claessens et al. (2000: 45-7); Coutinho and Rabelo (2003: 57-8); Santana (2008: 5-7).

[873] In gathering evidence, I strongly relied on the pioneering works of Finchelstein (2010) and Sierra (2015), which are entirely dedicated to studying the process of Latin American firms' internationalization.

could not have been accomplished had these domestic corporations relied exclusively on retained earnings or foreign sources of finance. Becoming global or regional players with the capacity to conquer multiple new markets is a daunting task for firms that basically start the process with roots in only one Latin American economy. In the process of becoming MNCs, these Chilean and Brazilian firms strongly relied on *domestic* sources of finance: newly structured credit and capital markets were a critical necessary condition for international expansion. Retained earnings are simply not enough for the large-scale investments that successful internationalization demands, while foreign finance is too scarce, too volatile, too risky, or too costly—or a combination of several of these attributes. In this study I have thus claimed that this important new trend in Latin American capitalism is practically impossible to explain if the domestic financial markets were actually as they are stylized in the HME Framework. The negative case of Argentina strengthens this proposition: even as late as the mid-2010s, both its capital and credit markets fit perfectly with the depiction of Latin American financial markets in the HME Framework; partly as a result of that, Argentina's performance in terms of the internationalization of its firms has been remarkably poor.

Moreover, this study has argued that the changing structure of national financial systems in Latin America has implications for more than just the corporate giants around which the HME Framework is organized: at least in the case of Brazil, it has also had consequences for an important segment of medium-sized companies whose future growth may undermine the hierarchical nature of Brazilian capitalism altogether. In contrast to many older, enormous business groups, an important number of younger and smaller firms have voluntarily chosen to take advantage of the Novo Mercado and Level 2—two new segments within the São Paulo Stock Exchange with stricter corporate governance requirements—as a signaling strategy to enhance their reputation in the eyes of investors. Multiple medium-sized, technology-based firms, in industries such as electric engineering, power, and automation; engines; capital goods; and information technology; have recently raised capital domestically to finance their expansion.[874]

These developments, highlighted across the chapters of this study, depart quite starkly from the mainstream way of engaging, from Latin America, with the dominant framework of comparative capitalism. They demand refining the logic in the HME Framework and call for new empirical research. The findings in this dissertation push me to formulate some preliminary propositions that look to move the discussion forward, while admitting up front that they are speculative in nature.

The ongoing changes in the structure of national financial systems in Latin American countries studied in this dissertation seem to have partially altered the incentive structure of the region's corporate world. The tension between two conflicting goals for Latin American firms may be increasing as a result of the reconfiguration of domestic financial markets. On the one hand, as the founding fathers of the study of Latin American *grupos* underscored decades ago, the region's firms are particularly inclined to prioritize keeping their activity away from public scrutiny—the state and business competitors alike—which increases their incentives to look inwards and to try to finance their investments with retained earnings. On the other hand, firms face a new incentive structure whereby an increasing number of their *domestic* competitors are

[874] Schneider (2013: 169) notes that these medium-sized enterprises "in sophisticated manufacturing and some services" compose "a sort of [newly emerged] Brazilian Mittelstand." In a footnote, Schneider (2013: 169) briefly mentions the same point I am making here: "[t]he emergence of these dynamic middle sized firms is related in part to the expansion of credit and equity markets."

accessing finance in domestic credit and capital markets with lower costs and better terms. If upstart competitors continue to reduce their costs, the advantage of incumbent firms' continued reliance on retained earnings so as to avoid disclosure requirements is likely to put them in danger.[875] At a theoretical level, there might be a tipping point at which, in the quest for survival, firms that currently almost exclusively self-finance may recalculate and start looking to tap outside—but domestic—sources of investment finance.

While theorizing any further or measuring this currently unfolding process is beyond the scope of this study, I do want to suggest that the best theoretical compass with which to address the slow-moving change of capitalism in large Latin American economies is that of comparative historical institutionalism. In particular, we should start with the scholarship on gradual institutional change, which is already mature for the analysis of advanced capitalism, but is still struggling to find its way in the analysis of developing areas like Latin America.[876]

The findings of my study suggest that the likely erosion of a core feature highlighted in the HME Framework—i.e. the large domestic business group that mobilizes large-scale investment without tapping domestic sources of finance external to the firm, and the shallowness of domestic financial markets with which this corporate behavior is associated—might be a slow-moving process that combines attributes of two modes of gradual institutional change: displacement and layering.[877]

Since defection is a critical mechanism of institutional change through displacement, new scholarship on comparative capitalism in Latin America will have to assess to what extent the emerging market configurations and "associated behavioral logics" I have identified in this study actually suffice to push to the side the traditional practices of incumbent business groups underscored by the HME Framework. Will a sufficiently large number of domestic firms "cultivate" a new form of raising investment capital that is more reliant on domestic financial markets? That is, will the current and future "defection" from traditional corporate practices be enough to edge them aside?[878] This study has provided abundant evidence of piecemeal rule changes that, fitting with the layering dynamics typified in the scholarship on institutional change, may have been small at the time but could accumulate and lead to substantial change over the long run.[879]

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[875] For political economy scholars pursuing this line of thought in the future it may be convenient to start with economic sociology, which seems to be a step ahead than political science and economics in this regard (see, for instance, Fligstein 2001, especially pp. 70-86).

[876] In the concluding paragraphs of two of his works, Ben Ross Schneider speculated about the need to look for gradual sources of institutional change to understand potential future transformations of Latin American capitalism (Schneider 2008: 390; 2013: 196-7). This path, though, remains to be explored.

[877] Gradual change through displacement occurs when new institutions—formal or informal—are introduced and directly compete with an older set of rules that had patterned actions until then (Mahoney and Thelen 2010: 8, 16). Displacement happens "as new models emerge and diffuse which call into question existing, previously taken-for-granted organizational forms and practices" (Streeck and Thelen 2005: 19). Layering differs from displacement in that it generates change by affecting how the original rules structure behavior; in processes of change through layering, instead of wholly new institutions being introduced, new rules are attached on top of or alongside old ones (Mahoney and Thelen 2010: 16-7).

[878] I use the quotation marks to identify where I am directly borrowing on the language of Streeck and Thelen (2005: 20).

[879] These incremental changes range from the rules that originally enabled Chilean pension funds to invest in the domestic equity market (Chapter 6) to those that affected the sources of finance of the Brazilian

In sum, core attributes of Latin American HMEs may be gradually eroding. Yet these processes of gradual institutional change vary from country to country. Thus, a major takeaway point of this study is that not distinguishing different political economy models makes us lose more than what we gain in inquiring into the nature of contemporary Latin American capitalism. Some countries have recently developed large domestic markets where firms can raise long-term investment capital, albeit through very different channels. In some countries the key source is the credit market supported by state-owned banking institutions, while in other countries stock or corporate bond markets are the central mechanism for channeling savings into productive investment. In some Latin American countries firms virtually have no means to raise long-term investment capital at home and are in fact forced to rely on retained earnings and foreign loans.

These new varying configurations of national financial systems are powerfully shaping real-world growth strategies in Latin America. They have huge implications for issues as important as whether a country's medium-sized firms will obtain the necessary funds to increase expenditures on innovation activities or whether large firms will be able to finance their internationalization. These reconfigured financial institutions are even likely to underlie different national models of adjustment to the end of the boom in commodity prices. Since the HME Framework's tendency to lump together diverse economies fails to represent the current situation, we will ultimately want to develop new typologies that capture the diversity of political economy models in twenty-first-century Latin America.

Development Bank (Chapter 3), as well as the rules that expanded Brazilian pension funds' opportunities to channel investment to the private equity industry (Chapter 5).

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Argentina *(all interviews conducted in Buenos Aires)*

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Bleger, Leonardo. President Previsol AFJP; Chief Economist, Banco Credicoop (1994-2006). August 21, 2013.
Campos, Jaime. President, Asociación Empresaria Argentina (Argentine Business Association). September 2, 2013.
Cedrola, Luis. Former CFO of Arcor. December 10, 2013.
Franck, Carlos. Financial Director, Techint. December 4, 2013.
Galván, Sergio. Former Director of Investment and Finance of Orígenes AFJP. November 28, 2013.
Helman, Héctor. Director, National Securities Commission (CNV) (2006-2013). August 12, 2013.
Katz, Sebastián. Chief Economic Researcher, Argentine Central Bank. Deputy Secretary, Ministry of Economy (2004-6). August 9, 2013.
Lavagna, Roberto. Economy Minister (2002-2005). March 12, 2014.
Marx, Daniel. Secretary of Finance (1999-2001). President, Quantum Finanzas (2003-present). September 6 and 9, 2013.
Olivieri, Carlos. Former CFO, Grupo Bemberg. December 18, 2013.
Otermin, Marcelo. Investment Manager, Prorenta AFJP (1994-2008). December 6, 2013.
Peguet, Carlos. Former President, Consolidar AFJP (1996-2008). December 5, 2013.
Rofman, Rafael. Former Vice-President, Nación AFJP. Lead Social Protection Specialist, World Bank (2006-2015). November 27 and December 11, 2013.
Saumell, Jorge. President, Arauca Bit AFJP (1996-2008). Vice-President, Association of Pension Funds (Unión de AFJPs) (2003-2008). November 29, 2013.

Not-for-attribution interviews
Former official at the Fondo de Garantía de Sustentabilidad-ANSES. December 12, 2013.
Former AFJP top executive, 2013.
Former official at the National Securities Commission (CNV). December 20, 2013.
Former official at Superintendence of Pension Fund Administrators (SAFJP). December 5, 2013.
President of a leading Argentine institutional investor (2000s), 2013.

Brazil

Brasília
Arbache, Jorge. Senior Economic Advisor to the President, Brazilian National Development Bank (BNDES) (2009-2014). August 5, 2014.

Arcuri, Reginaldo Braga. President, Brazilian Agency of Industrial Development (ABDI) (2007-10). Secretary of Production Development, Ministry of Development (MDIC) (1999-2002). August 7, 2014.

Barral, Welber. Secretary of Foreign Trade (2007-2011), Ministry of Development (MDIC). Board member, Federation of Industry of the State of São Paulo (FIESP) (2011-2013). August 11, 2014.

Berzoini, Ricardo. Pensions Minister (2003). Labor Minister (2004). Former president of the Workers' Party. Former member of the Chamber of Deputies. August 7, 2014.

Cascaldi Garcia, Danilo. Policy and Industry Analyst, National Confederation of Industry (CNI) (2009-2014). August 14, 2014.

Castelo Branco, Flávio Pinheiro de. Executive Manager of Economic Policy, National Confederation of Industry (CNI). August 14, 2014.

Comin, Alexandre. Deputy Secretary, Ministry of Development (MDIC). Senior Analyst, National Confederation of Industry (CNI) (2008-2010). August 15, 2014.

Leal, Maria Luisa Campos Machado. Director, Brazilian Agency of Industrial Development (ABDI) (2008-14). Chief Advisor, Secretary of Institutional Relations (2007-8). Top official, Ministry of Development (2000-2). August 13, 2014.

Neves, Mário das. Top official at the Ministry of Planning (2000-2010). August 15, 2014.

Oliveira, Dyogo Henrique de. Deputy Executive Secretary (2011-2014), Deputy Secretary of Economic Policy (2008-11), General Coordinator of Sectoral Analysis (2006-7), Ministry of Finance. August 6, 2014.

Pinheiro, Wagner. President, Petros pension fund (2003-2010). August 12, 2014.

Pires, Manoel de Castro. Director, Executive Secretary of the Ministry of Finance (2011-4). General Coordinator of Fiscal Policy, Ministry of Finance (2008-10). Research Associate in fiscal policy, IPEA (2004-8). August 8, 2014.

Reis, Adacir. Secretary of Complementary Pensions (2003-2006). August 6, 2014.

Schaefer, Ricardo. Executive Secretary (2013-5) and Deputy Executive Secretary (2011-3), Ministry of Development (MDIC). Executive Secretary, National Council of Industrial Development (CNDI) (2005-6). August 12, 2014.

Rio de Janeiro

Alves Junior, Antonio José. Advisor to the BNDES President. Chief, BNDES Department of Relations with Government (2009-20013). Chief, Special Advisory Board of the President's Chief of Staff (2005-2009). August 20, 2014.

Augusto, Jose. Director of Policies and Strategy, National Confederation of Industry (CNI). September 1, 2014.

Coutinho, Luciano. President, Brazilian National Development Bank (BNDES) (2007-2016). August 25, 2014.

Dias, Luciana. Superintendent of Capital Market Development, Director, National Securities Commission (CVM) (2008-2011; 2011-2014). September 1, 2014.

Ferreira, Joílson. Director of Equity Investment and corporate governance expert of Previ pension fund (2008-2010). August 22, 2014.

Fiocca, Demian. Vice-President (2004-6) and President (2006), Brazilian National Development Bank (BNDES). Executive Director, Vale (2007-9). August 21, 2014.

Lacerda, Guilherme. President of Funcef pension fund (2003-2011), August 21, 2014.

Lessa, Carlos. President, Brazilian National Development Bank (BNDES) (2003-4). August 22, 2014.
Ramundo, Julio. Managing Director in charge of the bank's Capital Markets Unit, Brazilian National Development Bank (BNDES) (2011-2016). Top official at several units, BNDES (1992-2011). August 25, 2014.

São Paulo
Aguiar, Luiz Carlos. Former CFO of Embraer and former CFO of Previ pension fund. March 27, 2014.
Biagi, Jarbas de. President, Banesprev (top-ten Brazilian pension fund) (1996-2014). April 1, 2014.
Filippo, José. Executive Vice President & CFO (2012-2014) of Embraer, CFO of CPFL (2004-2009). April 1, 2014.
Furlan, Luiz Fernando. Minister of Development, Industry and Foreign Trade (2003-2007). March 28, 2014.
Giannetti Da Fonseca, Roberto, CEO of Kaduna Consulting Group; former Executive Director of International Affairs and Foreign Trade, Federation of Industry of the State of São Paulo (FIESP). March 25, 2014.
Glogowsky, Martin. CEO, Fundação CESP (Brazil's fourth largest pension fund) (2005-present). April 2, 2014.
Masao Kuzuhara, Wilson. CFO, Grupo Votorantim (1986-1995), and CEO, Banco Votorantim (1996-2011). April 7, 2014.
Rosa, Sérgio. President of Previ pension fund (2003-2010). March 31, 2014.
Sasseron, José. Leader at the union of banking workers and Director of Previ pension fund. March 26, 2014.
Sennes, Ricardo. Managing Partner, consultancy firm Prospectiva (2001-present). March 27, 2014.
Silva, Devanir. Superintendent General, Brazilian Association of Private Pension Funds (ABRAPP). March 24, 2014.
Ukon, Masao. Partner & Managing Director, The Boston Consulting Group. April 3, 2014.
Zanotto, Thomaz. Director, Federation of Industry of the State of São Paulo (FIESP). March 31, 2014.

Over Skype
Santana, Maria Helena. Advisor and Head of Listings and Issuer Relations of the Sao Paulo Stock Exchange BOVESPA (1994-2006). Chairwoman, National Securities Exchange Commission CVM (2007-2012). December 12, 2014.

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Former top official at the Ministry of Finance, 2014.
Senior executive in top consulting firm, 2014.

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Alvear, Fernando. General Manager, CPC encompassing business association (2010-2014). May 27, 2014.

Ariztía, Juan. Superintendent of Pensions (1981-1990). June 4, 2014.

Berstein, Solange. Superintendent of Pensions (2003-2014). May 29, 2014.

Bitrán, Eduardo. Advisor at the Finance Ministry (1990-1994). Senior Executive (late 1990s) and CEO (2014-2015), CORFO. November 24, 2014.

Buchheister, Axel. Senior Advisor, Libertad y Desarrollo think tank (1997-2009). November 25, 2014.

Clarke, Álvaro. Executive Secretary of the Capital Markets Group and Advisor of Ministry of Finance (1994-2000). Superintendent of Securities (2000-2003). Member of the Commission for Pension Reform (2006) and of the Technical Advisory Committee on Pension Fund Investments (2008). November 19, 2014.

Díaz, Álvaro. Deputy Secretary (2000-2005), top official (1996-1999), Economy Ministry. November 28, 2014.

Ferreiro, Alejandro. Superintendent of Pensions (2000-2003). Superintendent of Securities (2003-2006). Economy Minister (2006-2008). May 26, 2014.

González Dale, Alejandro. CFO Grupo Falabella (2006-2014), CFO Endesa (2002-2006). December 2, 2014.

Guzmán, José Antonio. President, CPC encompassing business association (1990-1996), President AFP Habitat (2006-2014). May 26, 2014.

Lagos, Ricardo. President of Chile (2000-2006). December 2, 2014.

Larraín, Felipe. Finance Minister (2010-2014). May 30, 2014.

Larraín, Guillermo. Coordinator of Policy, Ministry of Finance (1997-2000). Superintendent of Pensions (2003-2006). Superintendent of Securities (2007-2010). Vice-President, BancoEstado (2014-2015). June 2, 2014.

Lavados, Hugo. Superintendent of Securities (1990-1994), Economy Minister (2008-2010), President AFP Curprum (2014-). May 28, 2014.

Margozzini, Francisco. Chief of Research and General Manager (1984-1988; 1989-2014), Association of Private Pension Funds (AAFP). November 27, 2014.

Marshall, Enrique. General Manager, Board Member, and Vice-President, Central Bank of Chile (1991-1993; 2005-2014; 2014). Superintendent of Banks (2000-2005). November 25, 2014.

Mena Valencia, José Manuel. CEO, BancoEstado (1995-2007). May 29, 2014.

Ominami, Carlos. Economy Minister (1990-1992). Concertación Senator (1993-2010). December 3, 2014.

Rivas, Gonzalo. CORFO CEO (1997-2003). June 3, 2014.

Sandoval, Felipe. CORFO CEO (1994-1997). June 6, 2014.

Silva, José Manuel. Chief Investment Officer, Larraín Vial (1997-2014). May 27, 2014.

Somerville, Hernán. President, Association of Banks (ABIF) (1993-2011). President, CPC encompassing business association (2004-2006). Director, Central Bank of Chile (1983-1988). November 20, 2014.

Valdés, Rodrigo. Finance Minister (2015-present). President, BancoEstado (2014-2015). Top official, International Monetary Fund (2009-2013). Chief Economist (2002-2008),

Central Bank. Chief of Economic Advisors, Ministry of Finance (2000-2002). Senior Economist (1996-2000), Central Bank. December 1, 2014.
Velasco, Andrés. Finance Minister (2006-2010). November 28, 2014.
Wagner, María Eugenia. Advisor to the Finance Minister (1994-2000). Deputy Secretary of Finance (2000-2006). November 19, 2014
Walker, Eduardo. Member of the Technical Advisory Committee on Pension Fund Investments (2008-present). Head of Research Department, AFP Habitat (1992-1996). May 23, 2014.
Zahler, Roberto. President, Central Bank of Chile (1991-1996). June 3, 2014.

Not-for-attribution interviews
CFO of top Chilean business group, 2014.
Top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #1), 2014.
Top-level official at the Ministry of Finance (2000s and 2010s) (Finance Ministry Interviewee #2), 2014.
Top-level official at the Ministry of Finance (1990s and 2000s) (Finance Ministry Interviewee #3), 2014.
Top-level official at the Ministry of Finance (1990s) (Finance Ministry Interviewee #4), 2014.
Top-level official at CORFO (1990s and 2000s) (CORFO Interviewee #1), 2014.
Former top-level official at CORFO (CORFO Interviewee #2), 2014.
Former top-level official at CORFO (CORFO Interviewee #3), 2014.
Top-level official at the Economy Ministry (1990s and 2000s), 2014
Senior executive with over three decades of experience in the Chilean financial industry, 2014.
Top business leader, 2014.

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