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**THE POLITICAL ECONOMY OF PRODUCTIVITY:  
ACTORS, ARENAS, AND POLICIES  
A FRAMEWORK OF ANALYSIS**

BY

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## Executive Summary

The evidence suggests that on average Latin American countries are underperforming other developing countries in terms of productivity growth. The productivity of the economy is the outcome of a number of individual and collective decisions undertaken by economic and social actors. These decisions are influenced by the prevailing public policies and institutions of each country, which are themselves endogenous to the actions and interactions of economic and political agents. The purpose of this project is to advance the stock of knowledge on the mechanisms by which countries generate policies that (fail to) enhance productivity.

Insufficient productivity in various Latin American countries is due to a number of policy-related factors, such as policy volatility, insufficient infrastructure, and insufficient human capital, high prices of key inputs such as energy and telecommunications, and social protection systems or credit policies that stimulate allocation of resources towards low-productivity activities. These and other policy-related factors have different degrees of relevance in different countries at different points in time. The purpose of this project is to investigate, at the country level, which are the political processes leading to outcomes that, in each case, affect the productivity of the economy.

Policies are the (equilibrium) outcome of a number of forces operating in the polity. In particular, powerful political actors influence each country's policymaking process in order to induce policies that favor them and or prevent policies that might harm them. This project focuses on explaining the degree of policy influence of various socioeconomic actors, the reasons behind that influence, the way in which demands are articulated in the policymaking process, the nature of the resulting policies, and their impact on productivity.

Public policies that affect the actions of economic agents determining the productivity of the economy are part and parcel of the overall set of economic and social policies of any country. Public policies emerge from a collective decision-making process that involves a multiplicity of political actors who interact in a variety of arenas. We call that process the *policymaking process* (PMP).

In democratic systems such as those in most of Latin America and the Caribbean today, this process plays out on a political stage featuring a variety of political actors (players). Players in this game include official State actors and professional politicians (presidents, party leaders, party activists, legislators, judges, governors, bureaucrats), as well as business groups, unions,

the media, and other members of civil society. These actors interact in different arenas, which may be formal (such as the legislature or the cabinet) or informal (such as the street) and may be more or less transparent.

The PMP can be understood as a process of bargains and exchanges among political actors. Some of these exchanges are consummated instantly, but in many other cases current actions or resources are exchanged for promises of future actions or resources (they are intertemporal transactions). The type of transaction that political actors are able to engage in will depend on the possibilities provided by the institutional environment. Issues of credibility and the capacity to enforce political and policy agreements are crucial for the political actors to be able to engage in intertemporal transactions. The behavior of various political actors in the PMP will depend on their basic incentives (e.g., electoral, power building, job security in the case of state managers, and economic benefits in the case of social actors) as well as on the exchange possibilities provided by institutions such as congress, parties, the judiciary, or the corporatist organization of interests.

The focus of the project will be on a number of country case studies to be undertaken in the context of an Inter-American Development Bank *Red de Centros* Project.<sup>1</sup> The project will draw from a number of existing “cross-sectional” insights on the effects of political institutions and of economic actors’ characteristics and configurations on policymaking and policies. But country focus is a crucial component of any agenda attempting to inform institutional and policy discussion in specific country contexts. Policymaking in each country is the dynamic equilibrium outcome to a number of interactive forces present in each specific country. Only by understanding the forces in operation in each case can one hope to contribute in a relevant way to the country-level discussion.<sup>2</sup>

Following the research strategy put in practice in the project behind Stein et al. (2008) *Policymaking in Latin America: How Politics Shapes Policies*, this project will be a collective and interactive process among various country teams and the coordinators. We will build a number of country studies structured around a common set of questions. The objective of this paper is to put together some theoretical axes as well as a number of guiding questions to serve as background to the country studies, but the overall comparative framework will be jointly

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<sup>1</sup> Call for proposals can be downloaded at <http://www.iadb.org/res/files/proposals/PolEconProductivity.pdf>

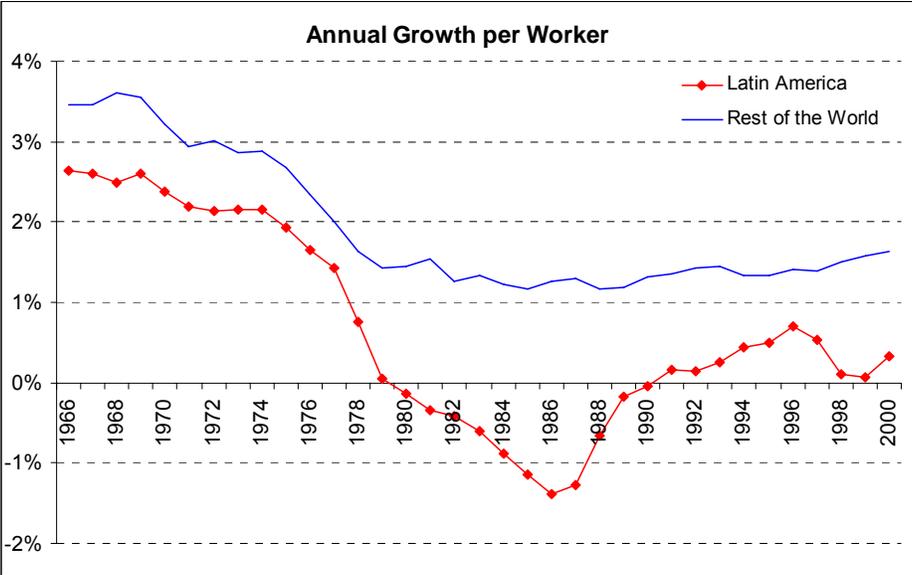
<sup>2</sup> Individual studies could be formulated as comparisons across a few countries of the region or as a comparison with countries outside the region (say, in Asia); but in any case a detailed country level investigation will be necessary.

developed throughout the project with feedback from and cross-fertilization among the country studies.

# 1. Public Policies and Productivity

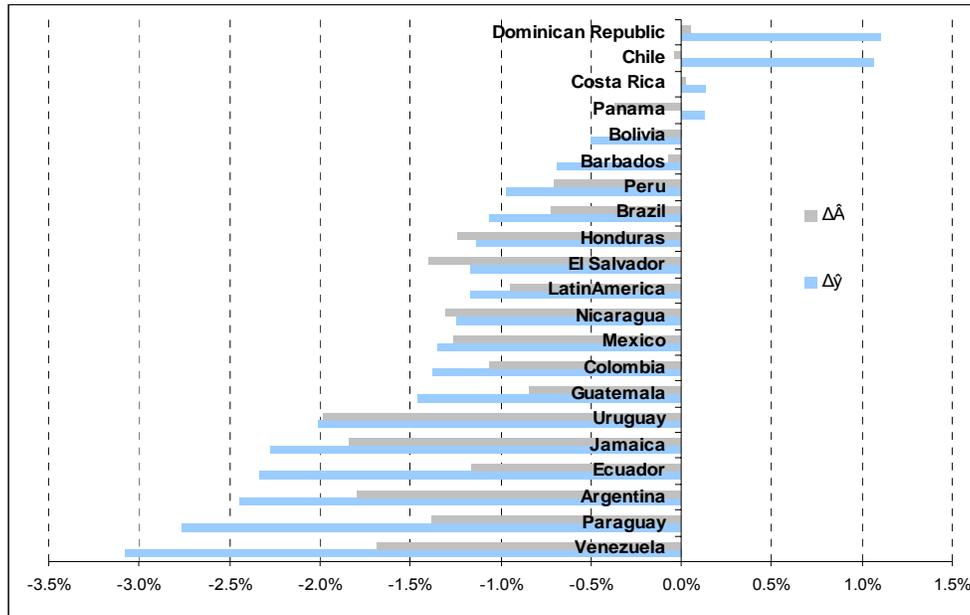
Despite unusually favorable international conditions over the last half decade, Latin America and the Caribbean has lagged behind other regions in economic growth. The evidence suggests that, on average, labor productivity has been the main driver of growth in the region but its growth has been scant (Pagés, Pierre, and Scarpetta, 2008). Consequently, Latin American and Caribbean countries are underperforming other developing countries in terms of productivity growth. Relative to the rest of the world, total factor productivity growth has been consistently slower over time and would explain between 60 and 70 percent of the total growth shortfall (Daude and Fernández-Arias, 2008).

Figure 1. Annual Growth per Worker



Source: Daude and Fernández-Arias (2008)

**Figure 2. Output and TFP Growth Gaps by Country  
Relative to Rest of the World (1995 – 2004)**



Source: Daude and Fernández-Arias (2008)

The productivity of the economy is the outcome of a number of individual and collective decisions undertaken by economic and social actors. Some of the reasons that may prevent productivity gains may be strictly related to the functioning of firms. However, a large part of the decisions may have to do with economic policies, as well as the way they are designed and implemented. First, some economic policies may explicitly or inadvertently favor low-productivity substitution. Second, some policies may shield certain firms from the competition of other firms and reduce firms' incentives to undertake productivity-enhancing investments. Finally, some policies and regulations may prevent certain firms from growing.

Studies looking at the specific impact of policies on productivity are scant given that most of the literature has focused on the impact on growth. Hence, explanations usually include their impact on productivity and their impact on the accumulation of factors. For example, a brief summary of a broad number of studies conducted for Latin America, such as Blyde, Fernández-Arias and Manuelli (2006) and the IDB-led Growth Diagnostics Studies,<sup>3</sup> show that on average, some of the causes for low growth are:

<sup>3</sup> Final drafts of the country documents are available at <http://www.iadb.org/res/files/GDM/GDM-FinalDrafts2008.htm>

- (i) Low investment because returns to investment are low, and access to credit is difficult (or expensive credit). Some of the reasons behind the low returns to investment are low levels of infrastructure, high levels of informality, and low enforcement of property rights. Some of these determinants are explained by interrelated factors, such as fiscal problems in the countries in the region that generate very low physical investments.
- (ii) Scarce levels of innovation because low appropriability of R&D efforts, low levels of infrastructure, and entry and exit barriers (particularly in labor markets)
- (iii) Low levels of exposure to (and competition in) external markets because high macro-policy volatility and (again) low provision of public goods such as infrastructure, regulations, coordination for exporting, etc.

Table 1 shows a summary of the constraints for a group of countries.

**Table 1. Some Stylized Facts on Restrictions for Growth in Latin America**

Argentina	Fiscal sustainability Credit constraints High macro-volatility Scarce public R&D Low enforcement of property rights Rigid labor markets Market barriers	Chisari, Corso, Fanelli, and Romero (2007) Sánchez, and Butler (2007)
Brazil	Distortive tax policy Credit constraints Low infrastructure High informality	Blyde et al. (2007)
Colombia	Low enforcement of property rights Credit constraints Low infrastructure	Melendez and Harker (2007)
Ecuador	Low infrastructure Weak institutional environment Credit constraints High macro-volatility Low enforcement of property rights	Cueva, Albornoz, and Avellan (2007)
El Salvador	Low labor skills Fiscal sustainability Credit constraints Low enforcement of property rights	Zegarra, Rodriguez, and Acevedo (2007)
Guatemala	Low labor skills High informality Low infrastructure Low enforcement of property rights	Artana, Auguste and Cuevas (2007)

**Table 1.,continued**

Nicaragua	High macro-volatility (shocks) Weak institutional environment Low enforcement of property rights Poor provision of public goods (coordination) Credit constraints	Agosín, Bolannos, and Delgado (2007)
Panamá	High macro-volatility (shocks) Tariffs Low infrastructure Low labor skills	Cárdenas and Salazar (2007)
Paraguay	Low return on investment Low infrastructure Poor regulatory environment	Hausmann and Klinger (2007)
Peru	Low rate of discovery Rigid labor markets Low infrastructure Poor regulatory environment Poor provision of public goods (coordination)	Hausmann, and Klinger (2007)
Trinidad and Tobago	High macro-volatility (shocks) High concentration Low labor skills	Artana et al. (2007)

These conditions are similar to those identified by Lewis (2004) for the particular case of productivity-retarding policies in developing economies: restrictions on foreign direct investment (FDI) which limit innovation, distortions in competition in product markets which also limit innovation and the desire to thrive, and the size of the government and the level of informality. Consequently, based on the evidence, and extrapolating according to related work done in the region, insufficient productivity in various Latin American countries is due to a number of policy-related factors, such as policy volatility, insufficient infrastructure, insufficient human capital, high prices of key inputs such as energy and telecommunications, and social protection systems or credit policies that stimulate allocation of resources towards low productivity activities. These and other policy-related factors have different degrees of relevance in different countries at different points in time. For example, Levy and Walton (2007) stress the importance of social security policies on the incentives of workers as a determinant of low productivity growth in Mexico.

Summarizing, the policies that would be the object of study for this project can be grouped into three groups: public goods, rules of the game, and “private” goods. In each of these areas, policies could affect productivity in a negative form either because there is too little or too

much government intervention, or because the intervention is not well designed. For example, in some countries the government may be providing too little of a public good such as infrastructure, or it may be generating highly volatile policies that prevent certain investments and reduce the incentive for innovation. In others, the key explanation may have to do with the existence of very specific policies that help to maintain the market share of less productive firms, such as policies aimed at protecting ailing firms, special tax regimes, subsidized credit, privileged access to capital, and restrictions on land access.

**Table 2. A Brief Outline of Some Policies of Interest (non-exhaustive)**

<b>Public goods</b>	<b>Rules of the game</b>	<b>Private goods</b>
Infrastructure Education Research and Development Coordination	Macro-economic policy (volatility) Tax policy Tariff and non-tariff barriers Labor market regulations Credit and banking regulations Barriers to entry and exit Antitrust policies	Preferred loans Social protection policies Small firm protection and assistance Sector specific productivity policies Subsidies

Given the high level of heterogeneity by country, country studies should identify the situation of productivity in the country and provide some explanation of the main policies that could be affecting productivity. The choice of policies has to take into account the ability to explain them in terms of the political economy framework developed in this document.

Policies are the (equilibrium) outcome of a number of forces operating in the polity. In particular, powerful political actors influence each country's policymaking process in order to induce policies that favor them and/or prevent policies that might harm them. While in every country most socioeconomic actors (business actors at various levels of aggregation, unions, and different types of voters) have policy influence, their demands and the way in which they articulate their demands in the policymaking process are different from country to country. While in some countries those actors' demands do not harm productivity greatly—or across every policy margin—in others, those actors' influence is more harmful to productivity. This

study will try to uncover the links between policies (that hurt productivity) and the underlying policymaking process (PMP) that generates them.

Besides identifying specific policies important for productivity in the specific countries, studies should attempt a general characterization of policymaking in the country and the likelihood that such political economy induces productivity-enhancing policies. Some general characteristics of policymaking and policies, such as volatility, are unlikely to foster long-term productivity. Similarly, as elaborated later in this document, fragmented policymaking environments are unlikely to internalize productivity concerns. To some extent the question is the extent to which the policymaking environment is likely to foster productivity. The rest of the document explores those connections

## **2. Studying the Political Economy of Interests, Institutions and Policies**

The objective of this project is to study the political economy behind the adoption of various policies impacting on productivity. The degree and extent to which different countries have policies deleterious for productivity can be due to a number of factors. For expositional purposes, we arrange some of those factors into four interrelated categories:

- (1) Productivity is not an issue taken into consideration throughout the policymaking process because there is an explicit or implicit predominant view that other issues are of greater priority.
- (2) The productivity effects of various policies in several domains are not well understood by many relevant political actors.
- (3) Some dominant actors use their political power to obtain policies that provide them with rents but have negative effects on productivity by creating incentives leading to economic decisions that lower the productivity of the economy.
- (4) Various political actors (not necessarily dominant) are able to obtain “their policies” in a rather fragmented manner, and these set of policies introduces distortions with negative implications for productivity. This factor can operate within a given moment in time or, more likely, over time.

The IDB's flagship publication on Quality of Life (IDB, 2008) addresses issues related to factor (1), considering factors that make issues more urgent from the point of view of the public and of policymakers. Among other considerations, time horizons and discount rates affect whether the urgent or the important will matter more. As stated in point (2), the impact of a myriad of policy interventions on productivity is not immediately obvious; otherwise extensive research efforts would not be required. Nonetheless, in many cases even the currently available knowledge on the causal effects of policies on productivity growth is clearly not fully incorporated into political decisions. This project will refer to that issue in assessing the articulation of technical knowledge in the policymaking process in the various countries. Policymaking environments could be more or less conducive to having capabilities and incentives to incorporate technical knowledge into the policy process.<sup>4</sup>

This project will focus on attempting to provide an explanation of why outcomes as suggested in (3) and (4) take place in some Latin American countries. As we will explain below, we will complement (3) and (4) with an ancillary perspective that emphasizes the question of why such inefficiencies are not "bargained away" (in a Coasean manner) in political equilibrium.

In order to understand the politics behind economic and other policies, one is led to deal with the interactions of socioeconomic interests as political actors, which take place in a political arena, constituted by State and partisan institutions, which themselves are populated by political actors (politicians, bureaucrats, judges and the like), with their own interests and incentives. Studying these interactions in an integrated manner is at the core of the study of political economy at least since the times of Adam Smith and Karl Marx.

Modern work on political economy provides a variety of angles and perspectives from where to address the role of economic interests and other political actors in policymaking. There are various approaches and interpretations of the way in which state and societal actors interact in the determination of public policies. The approaches vary in their level of aggregation, in their level of abstraction, and also in the relative weight and depth of focus in different actors and institutions.

There is a valuable literature in economics on the interaction between interest groups and political institutions, aptly summarized and developed in Grossman and Helpman (2001),

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<sup>4</sup> See for instance IDB (2005, pages 119-124 and references therein), as well as the Global Development Network's *Bridging Research and Policy Project*.

Persson and Tabellini (2000, Chapter 7) and references therein. Those models provide some general insights, portraying key tensions and conflicts, but do not explore how behavior varies with institutional detail.<sup>5</sup> Also, they take the interest groups as exogenously given and do not study their “industrial organization,” an important factor for explaining which activities are undertaken by which groups in which settings. (Baron, 2002).

Political economic models by economists, for the sake of mathematical tractability, often contain an uneven mixture of rigorous specification and treatment of rational choice and equilibrium in some dimensions combined with ad hoc assumptions on others or dismissal of other problems (Dixit and Romer, 2006). That may be a perfectly reasonable interim research strategy of putting together various analytical building blocks one step at a time, but it needs to be complemented with insights from other less formalized literatures in order to interpret real world cases at the level of detail necessary for this project.<sup>6</sup> One issue that most formalized models tend to brush aside is the temporality of policymaking—policymaking in real time, in the apt expression of Dixit (1996). Issues arise over time, because circumstances change over time and also because the relative power and saliency of various societal and political actors also evolves. Actors strategically bring issues into the table when they believe their position has better chances. When new issues appear on the agenda, actors do not necessarily begin with a clean slate in order to formulate a fully integrated and coherent set of policies. Instead, new proposals are added to (perhaps slightly modified) previous ones.<sup>7</sup> Some actors may not have the power to obtain their desired new legislation, but yet they might be able to block changes updating policy through new demand or forcing neglect of institutional maintenance—what Streeck and Thelen (2005) call “drift.” New elements can be attached to existing institutions gradually changing its status and structure without a formal institutional change (“layering”) or the same institutional environment can be redefined by “displacement” of old relevant

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<sup>5</sup> Some attempts in that direction are provided in Spiller and Liao (2006).

<sup>6</sup> One stream of literature of particular help here is in the field of policy studies, which provides valuable insights on the dynamics of policymaking in some specific policy areas often in the context of the American political system or those of a couple of advanced industrial countries. See, for instance, Sabatier (1999) and Howlett and Ramesh (2003). Other strands of literature in political economy, which have been applied to Latin America, have focused on some specific policy areas (e.g., Murillo, 2008, on public utilities, and Frieden and Stein, 2001, on exchange rate policy) or on some specific moments of broad reform (Fanelli, 2007, on the political economy of reform), as well as the more class-based macropolitical economy which developed around the 1970s and 1980s mostly to explain the more corporatist and democratic policymaking of the times.

<sup>7</sup> Descriptions of such processes abound, for instance, with respect to the evolution of social protection systems in Latin America, a policy domain with important connections to issues of productivity (Levy, 2008). See, for instance, Saavedra and Tommasi (2007) and references therein.

institutions by new ones in the relevant policymaking decisions. Even old policies, rules or institutions can be used for new purposes (“conversion”). All of these forms of policymaking generate unintended consequences because they do not start from a clean slate (Streeck and Thelen, 2005).

Drawing from those various strands of literature, this project will attempt a middle range analysis of the relevant socioeconomic interests, political actors, and institutions and arenas shaping policymaking processes in a number of country studies.

Present-day societies contain a variety of interest groups with some degree of potential influence over policymaking in various policy areas. Given the objectives of this project, we will focus largely on those types of interests and interest groups likely to be active in those spheres (economic, labor regulation, social policy) more directly relevant for productivity. Socioeconomic actors have policy preferences that can be inferred from their economic position and the overall economic structure, and other actors (ethnic or religious) are also driven by distributive expectations both economic and status/value driven. Frieden (2000) provides a nice summary of what he dubs “the Modern Political Economy method,” which consists of identifying actors and their goals, deriving their policy preferences, determining how they group themselves, and “following their interactions with other social institutions.”<sup>8</sup> Section 3 below looks into these issues in more detail.

“Official” political actors such as politicians, bureaucrats and judges care about their careers, which depend on the incentives of the political system and the constraints on making a career in that political systems (politicians need constituencies to represent; bureaucrats need budget for their agencies; judges need political linkages and a law degree, etc.). Those political actors and stage managers operate, then, in the arenas provided by political institutions. Section 4 of the paper summarizes some of the current state of knowledge on the characteristics of those arenas and on the incentives they provide to political actors.

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<sup>8</sup> It is interesting to note that in his chapter Frieden deals almost exclusively with the socioeconomic interests side of the story, giving scant attention to political institutions and professional politicians or state managers. The angle from which “interactions with other social institutions” is referred to is useful, but partial, looking into the optimal strategies of interest groups in terms of what “venues” or points of entry of the political system to utilize. (We will come back to that point later in the paper and in the project, attempting a more articulated perspective). In another excellent chapter in the same collected volume (Frieden, Pastor, and Tomz, 2000), Stephan Haggard summarizes the state of knowledge on the effects of democratic institutions on economic policy (Haggard, 2000). It is noteworthy (but reflective of current state of knowledge) the lack of a chapter integrating these two perspectives.

These political arenas populated by professional political actors are the main places in which socioeconomic interests play their games in order to obtain beneficial policies.<sup>9</sup> This project will pay special attention to the issue of how socioeconomic actors enter into these policymaking arenas. We will emphasize the question of aggregation and articulation of policy bargains over time. Preliminary exploration of the process of policymaking in some countries suggests that one salient feature in many cases is an important fragmentation of policymaking over time and across arenas.

As argued earlier in this section, policies which are bad for productivity could be the result of rent generation for dominant political actors or of a number of inconsistent and distortive policies in different domains, each of which is the conquest of some particular interest groups (see for, instance Mexican examples in Levy and Walton, 2007, and Levy 2008). Either of those explanations begs a hypothetical question of Coasean flavor: why is it that the same redistributions obtained in equilibrium are not instrumented through less distortive policy instruments?<sup>10</sup>

There are many reduced-form models of political interactions in which inefficiencies wash away and redistribution is achieved in efficient ways. Such models include Becker's (1983) *influence function* approach in which competition washes away rents, or Chapter 8 of Grossman and Helpman (2001) on "Competing for Influence" wherein *compensating schedules* in the context of a static game (of common agency) attain no inefficiencies in equilibrium. But, as stated above, reality greatly differs from this ideal, and we need to understand policymaking in real time, in which many idealized efficient political exchanges do not take place due to a variety of transaction costs.

One dimension of that problem that will receive special attention in this project is a fact which we may dub "political substitution across policy domains." Actors who are at the losing end of some policy bargain can substitute away towards another policy domain with a different configuration of actors, and perhaps obtain some benefits there. For instance, workers whose

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<sup>9</sup> At least that is the case in modern day democratic Latin America. Actual practices in some cases still contain several behavioral and organizational carryovers of a more corporatist (and less democratic) past.

<sup>10</sup> In a Coasian argument of idealized trade all actors are sitting simultaneously at the same table and bargaining everything away efficiently, and the final outcome should be efficient (i.e., not bad for productivity). There are good academic works explaining some generic features of policymaking that lead to the so-called "failure of the Political Coase Theorem." (Parisi, 2003; Acemoglu, 2003; Spiller and Tommasi, 2003; and references therein). Those insights are a useful starting point, but the question for this project is more one of comparative politics (why

access to the formal labor market is impeded by a number of regulations which might be favorable to other workers, may not lobby for labor market deregulation as much as move their demands to a social policy arena, where their plea might have better chances. This strategy leads them to redefine their identities and relationship with the political system. That is, they look for the opportunities opened by existing political institutions to increase the effectiveness of their demands. This strategy that we call “issue shopping” is similar to the logic of “venue shopping” identified in the policy literature for advanced countries. “Venue shopping” implies that policy actors seeking to push a particular issue decide strategically on the entry point within the policymaking process more likely to be favorable to the prosecution of their objectives. (See, for instance, Pralle, 2002).<sup>11</sup> In our perspective, “issue shopping” means that actors redefine the issue/policy that would allow them to improve their situation. Shorter time horizons make suboptimal policies more attractive and made this strategy more likely.

In this project, we will try to address these issues in a comparative perspective. The idea is to identify the degree of spatial and temporal fragmentation of the policymaking process, the degree to which institutions (such as political parties, electoral incentives, congressional institutions, the bureaucracy, executive behavior, or corporative structures) facilitate the internalization of concerns for productivity in the various political bargains and stages of the policy process determining public policies. One possible way to think about these issues can be organized in the following three steps:<sup>12</sup>

- (A) Identify the interests that can overcome collective action barriers so as to become relevant political actors (see Section 3 below)
- (B) Define the extent to which those effective interests are “encompassing” or productivity-enhancing: do they care about public goods that enhance productivity, or are they just “narrow” distributive coalitions? If the latter, how “bad” are the rents they are after in terms of incentives and efficiency

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these effects have different intensities across countries), and optimistically one of design (what can be done, given those transactional difficulties to improve outcomes).

<sup>11</sup> Different types of policies have different textures and characteristics that can make them more or less prone to this type of fragmentation. All budget related policies come to a “central arena” that at some level has to take cross effects into considerations. But that effect might weaken under some budget procedures and under some (decentralized) political configurations. “Regulatory” types of policies are potentially more “loose.” Regulatory changes might push substitution towards budget issues (as in our labor laws towards social programs example) and vice hversa.

over time? As summarized by Khan (2000), the rents sought and obtained by various economic actors could be growth reducing or growth enhancing.

(C) Given a distribution of effective interests and the degree of encompassingness and distortiveness of their respective interests, a following step puts these actors in play within a given institutional environment. Now the question becomes a systemic one: to what extent do the institutions and modes of political interaction in the country facilitate the achievement of policies that, while distributing in the direction of the stronger political actors, do so in such a way that internalizes as much as possible the effects on overall productivity?<sup>13</sup>

Answering such questions in a comparative manner is part of the overall objective of the project. In the rest of the section we briefly suggest some considerations/analytical angles that could be considered by the country teams attempting to answer those questions at the country level.

As suggested by point (2) at the beginning of this section, various informational and perceptual considerations should be taken into account in understanding why some actors are able to coalesce with each other around some issues.<sup>14</sup> Socioeconomic interests are not written in stone by God, but they are to some extent a political creation that requires coordination.<sup>15</sup> You only “coalesce” when the thing is very salient to you: one of the reasons why silent majorities do not organize too much.<sup>16</sup> The issue of salience is crucial for less informed actors (the actors with smaller stakes who cannot invest on information). There is a large literature which describes the

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<sup>12</sup> In Section 5 we provide some more specific suggestions for country studies to guide the search for and presentation of information from their cases relevant to addressing these issues.

<sup>13</sup> For a similar logic emphasizing intertemporal transactions see IDB 2005, Spiller and Tommasi (2003), Stein, Tommasi, Scartascini and Spiller, 2008, Scartascini, Stein and Tommasi (2008) and Berkman et al. (2008). This is a way of looking inside the Beckerian black box modeled in part as cooperation in repeated interactions, constrained by the nature of payoffs (depending on the structure of interests) and feasible policy technologies. On the latter, see the application in Post (2007).

<sup>14</sup> See, for instance, IDB (2008) and references there.

<sup>15</sup> James Fearon and David Laitin have produced a number of papers (drawing from ethnographic studies) arguing that even obvious “interest groups” such as ethnic groups are indeed “constructed” in equilibrium (see, for instance, Laitin, 1999, and Fearon, 1999). Herrera (2005) makes the case that economic interests are not given by objective information, but are a function of the interaction between socially held ideas and data, in particular institutional contexts. See also North (2005).

<sup>16</sup> Clearly “productivity” is not the first political demand that comes to the mind of most citizens. Outcomes with more immediate payoffs such as cash transfers and the like are much more likely to bring people in, unless some encompassing and long-sighted organizations are willing and able to put the issue on the table.

mechanisms that increase the salience of various issues, including exogenous shocks and the work of self-interested political entrepreneurs (see, for instance, Baumgartner and Jones, 2005).

From a comparative perspective like the one we will use here, characteristics of the policymaking process and of political institutions of the country could improve or worsen upon these biases. For instance, a good (flexible yet stable) party system should adjust to that topography offering to put together the missing collective action.

In the same vein, relevant interest today could also be the outcome of past state action. For instance Schneider (2004) argues that the fact that business are better organized in Chile, Colombia and Mexico than in Argentina and Brazil is due to the cumulative effect of actions of state officials more than to structural characteristics. Similarly, at a more micro level, Carlos Slim was not a key player of Mexican politics in 1978, but he is in 2008. Bank nationalization gave him an opportunity and the privatization of Telmex consolidated that power.

Keeping with the temporal aspects of policymaking, clearly political equilibria and the resulting policies are moving objects. One important factor to be considered in the studies is the stability of any given set of policies and of the underlying politics. One can imagine situations in which a stable “winning coalition” always obtains its preferred policies, situations in which changing winning coalitions are changing policies frequently, or situations of intertemporal bargaining in which some basic policies are more or less stable in spite of the rotation of political power. Each of these paths of intertemporal politics could have its own impact on productivity. In order to do that, county studies should look not only and the current set of policies, but also at the temporal pattern of policies and politics over the last several administrations.

The next two sections develop in more detail a characterization of socioeconomic interests and of political actors and institutions. The purpose of the sections is to summarize some pre-existing insights that might help country authors in investigating their own cases.

### **3. Interests**

This section provides some suggestive guidelines on the factors likely to affect the degrees and mode of organization for political action of socioeconomic interests, and the types of policy demands they are likely to make. It also suggests the conditions under which the policies they demand are more or less likely to be narrow and distortive, or to incorporate broader concerns and longer horizons. The section draws from insights from previous theoretical or comparative

literature, more as a menu for country authors (in their quest for who are the actors, what makes them so, and how good or bad for productivity are their demands) than as definitive statements of causality in each case.

### ***3.1 Socioeconomic Actors as Political Players***

In the analysis of how socioeconomic actors participate in the policymaking process and affect productivity outcomes, it is important to define both the potential and the actual actors—what Olson (1965) calls “latent” and “organized” groups. Although most of our analysis is based on “organized” groups which can become political players, the type of economic structure is crucial in defining potential players. In turn, this distinction is important for understanding why—given the predictions derived from economic conditions—some actors become crucial players in the PMP and other do not.

In analyzing the **economic structure**, the degree of economic diversification and the relative weight of each sector or industry are crucial for defining potential actors. In particular, the share and type of tradable goods produced in the country should be important for defining preferences and strategies associated to productivity improvement. Tradable producers should be concerned about productivity to remain internationally competitive.<sup>17</sup> Moreover, the degree of asset specificity of both tradable and non-tradable producers should affect their incentives to invest on political influence seeking to foster their preferences (Frieden, 1991). Shafer (1994) suggests that high levels of asset specificity bring state capture for narrow sectoral interests rather than cooperative inter-temporal exchanges. It might be the case, then, that intermediate levels of asset specificity along with tradability might lead to players that seek productivity-improving policies. From there, manufacture rather than mining might be more likely to produce players who are likely to arrive at the inter-temporal agreements necessary for productivity-enhancing policies.<sup>18</sup> Hence, in analyzing the structure of the economy, both the share of tradable

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<sup>17</sup> For instance, in analyzing advanced economies, Cusack, Iversen and Soskice (2007) assume that tradable manufacture producers were crucial in defining collective bargaining levels that enhanced productivity (through investment in skills) using proportional representation in the electoral system as a guarantee for skilled workers about the implicit inter-temporal trade-offs.

<sup>18</sup> There is also a large literature on the problems (e.g., Dutch disease) generated by windfalls on natural resources exports, especially oil and minerals, in terms of time-horizons (see Dunning, 2005). In fact, there are very few effective stabilization funds in the developing world allowing for the appropriate inter-temporal trade-off necessary for productivity enhancement based on mineral resource exports (e.g., Chile, Botswana).

goods and the degree of asset specificity should be important concerns for defining potential players who have a stake on productivity.

Finally, the origin of ownership is important in defining the preferences of producers because foreign owners have a smaller stakes in the whole economy and may be under pressure to disinvest by shareholders if they are public companies and, especially, with a short history in the country. Additionally, foreign companies may have both fewer political connections and a lower level of legitimacy in the country, which reduces their policy influence, or at least it is more likely to be cast in a suspicious light by their opponents (Henisz and Zelner, 2003).

### ***3.2 Political Players and their Policy Preferences***

The characteristics of an economy are useful in defining the potential socioeconomic players in a polity and their preferences. This identification is crucial in assessing the overlapping between their actual policy preferences and political influence and that predicted by the characteristics of the economy. Indeed, the differences between what the economic structure would predict about potential influence and actual policy influence is telling about the working of the PMP. The dynamic evolution into the current situation is crucial as these actors should have shaped their current political economy.<sup>19</sup> Yet, the main goal of case studies is to identify the contemporary situation and the main political players to be included in the analysis of the policymaking process and what political factors explain the lack of overlapping with what the economic characteristics should have predicted.

For the political economy literature, the main socioeconomic players are business and labor, both of which can be divided along traditional sectors (agrarian, mining, industry, services). Size and formality, though, matter in defining their preferences—and their own identity.

**Size** is a crucial feature to define policy preferences and interaction with political institutions, generating differences within the same economic sector. For instance, large businesses (either domestic or transnational) have different stakes, preferences, and capacity than

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<sup>19</sup> For instance, following Hall and Soskice (2001), we may expect that overtime producers' preferences shift the nature of economic production, so countries with a specialization of tradable agrarian and manufacture products investing in productivity enhancing policies may over time became exporters of manufacture as their agrarian exports became less significant as a share of the economy overtime. Yet, the structure of cooperation between firms is what drives productivity enhancing policies and changes in economic structure. In addition, in Kang (2001), productivity enhancing policies facilitated change in economic structure in South Korea. In turn, the new powerful socioeconomic actors were able to drive subsequent policymaking.

small businesses—in the extreme case very small businesses in the informal economy are not so different from informal workers and are in a more precarious situation than formal workers (Itzigsohn, 2000). The time horizons should be shorter for small and medium companies due to their lack of access to financial markets and their dependence on informal mechanisms for credit. Moreover, in Latin America these companies tend to have less skilled labor and therefore have lower incentives to enter inter-temporal exchanges for improving productivity, such as paying more taxes to improve the educational system or establishing a social security system to compensate workers for their investment in skills. Indeed, tax evasion may be a financing mechanism due to the inadequacy of financial markets. The failure to reform the Mexican electricity sector in 2002 brings an example of this logic. When President Fox tried to liberalize the entry of private investors in generation and create a wholesale market for large users, the large business associations, such as Coparmex and Concanaco, supported the reforms whereas the small business association (Canacindra) opposed them. The former represented only 20 percent of consumption and the latter, 30 percent. But the dependence of the latter on state subsidies was larger, to the point of reducing their concern for long-term supply considerations.

Additionally, **size** is crucial in defining the need for collective action. Large companies can be powerful enough to define policy preferences and policy influence, which is likely to be through informal networks, personnel rotation between the public and private sectors, the threat of disinvestment, and financial inducements for electoral campaigns or personal enrichment. In the case of large companies, their diversification as holdings across sectors of the economy or concentration in a single sector, as well as the capital labor ratio and tradability of that sector, shapes their preferences and power.<sup>20</sup> However, their informal networks with political parties and their role in associations aggregating companies should also affect their policy influence.

By contrast, small firms, have a hard time coordinating collective action (even if they agreed on productivity enhancing goals) unless they happen to have some organization capabilities, perhaps as the result of past State action (Schneider, 2005). The effect of size is similar across sectors. In the agrarian sector, for instance, large agrarian producers, small farmers, and subsistence peasants have different preferences to the point that they are usually organized in different associations.

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<sup>20</sup> Although horizontal diversification and vertical integration could be themselves be endogenous to policy and to characteristics of the institutional environment (see Friel, 2008, and references therein).

In Latin America, **formality** is also an important consideration in defining the policy preferences and interactions of socio-economic actors. Workers in the formal and informal sector usually have diverse preferences. Informal workers tend to be less skilled than formal workers. Formal workers' access to social benefits and labor protection along with the ability to organize in labor unions further separates their preferences (and organization) from those of informal workers (e.g., on labor market deregulation or the degree of redistribution of social security).<sup>21</sup> Clearly, formality and informality are to a large extent endogenous to policy, and country studies should pay special attention to these (economic and political) “general equilibrium” considerations. Informal workers, and as well as peasants who have no formal access to the market, tend to organize around other *social* identities that allow them access to state resources—whether regional, local, ethnic, religious, etc. They can be defined as urban poor in clientelistic networks, as coca growers unions or as indigenous groups in order to affect their capacity to affect state distribution of resources.<sup>22</sup>

Which of these potential actors became actual political players—given the same set of economic conditions—changes from country to country and across time. For actors for which economic conditions predict weak political influence, but who have become important political players, it is important to identify the **mechanisms** that produced that “political” effect. For instance, both informal workers and consumers have traditionally been considered as lacking policy influence because they are difficult to organize for collective action given their dispersion (e.g. Portes, Castells and Benton, 1989; Stigler, 1956). However, in post-2000 Argentina, organized informal workers became important political players based on the effect of their protest mechanisms on political stability. These mechanisms involved their interaction with the PMP through political parties—enmeshed in clientelistic networks—and through social mobilization ranging from road blockages to riots (e.g., Auyero 2007, Svampa and Pereira 2003). Similarly, in a context of high electoral competition and public salience produced by the combination of electricity shortages and a contested presidential election, Chilean consumers became influential by inducing political parties to overcome their ideological differences to attract their votes (Murillo and Le Foulon, 2006).

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<sup>21</sup> In analyzing European countries, Mares (2003) argues that skill levels and risk propensity shape the preferences of producers (either employers or employees) regarding the redistribution of social insurance.

The institutionalization of their avenues for political influence is important to assess. Social mobilization evolves in cycles so that leaders cannot rely on the permanent threat of conflict or assume the permanence of competitive elections or exogenous shocks. Hence, even when these actors are “constructed from above” around some contested electoral moments or emerge as a result of a given juncture, it is important to assess whether they continue to be present once that special moment has passed, since there are path dependent dynamics to collective action and organization.

It is important, therefore, that country studies identify the actors who are influential in the PMP, with a special concern to influential political players who are “unexpected” given economic conditions. In so doing, they should identify the mechanisms that generate such influence through their interaction in the PMP. The degree of stability of such political linkages is important to understand their ability to coordinate inter-temporal exchanges. That is, it is different if they are represented by political parties—say on geographic grounds—that if their influence relies on the contingency of an exogenous shock and a contested electoral campaign.

By contrast, the analysis of policy influence by actors whose economic position grants them economic power should include another set of pressure mechanisms, which are likely to rely on a combination of economic and political tools. For instance, labor unions can rely on the power of industrial action—especially during periods of labor shortage or economic boom (Ashenfelter and Johnson, 1969). Yet, alliances with labor-based parties also affect their policy preferences, time horizons and capacity to achieve policy goals (Pizzorno, 1978; Murillo, 2001). For instance, Argentine labor unions accepted policies under President Menem that they had opposed when presented by his non-Peronist predecessor and their influence allowed them to receive concession that they would be able to exploit along with industrial action when labor market conditions improved in the subsequent decade (Murillo, 2001; Etchemendy and Collier, 2007). Similarly, the power of business can be based on their impact on the general economic condition—based on lock outs or disinvestment—or the help of their associations provide to the state for implementing policy (Schneider, 2005). In turn, both labor and business can organize following state initiatives (Schneider, 2005; Collier and Collier, 1991) or they can organize in reaction to state policies. For instance, employer association different from those sponsored by

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<sup>22</sup> For instance, Deborah Yashar (2005) shows how the collapse of corporatist arrangements in Latin America promoted the organization of indigenous groups as societal actors when their peasant identity ceased to allow them access to state resources and recognition of rights in the 1990s.

the state emerged in Mexico in reaction to the 1982 bank nationalization (Frieden, 1991; Heredia, 1993).

The traditional **sectoral divisions** also have an effect regardless of asset specificity because it affects producers' preferences and their capacity to coordinate collective action. In particular, the time horizons of producers in each sector are different in terms of the realization of their investment. Therefore, whether producers are concentrated in a single sector or diversified across sectors may change their policy preferences and time horizons. For instance, the preferences of the domestic holding company CARSO in Mexico regarding telecommunications are clear. Its company Telmex concentrates most of the market in fixed and mobile lines and it seeks to retain its monopolistic rents.<sup>23</sup> The holding, though, is diversified into other sectors, which should increase its capacity to trade favors across regulated sectors with the government (Post, 2007). Indeed, diversification along with its size relative to the economy should facilitate inter-temporal exchanges and because CARSO's value is about half of the Mexican stock exchange its preferences could be encompassing enough to promote productivity-enhancing policies. Yet, this holding has large investments in non-tradable services (finance, retail, telecommunications, etc), which makes its preferences more homogenous but reduces its concern for enhancing productivity. Hence, even if its policy influence is high due to its relative size in the economy, it may not lead to investment in productivity-enhancing policies.

For actors who depend on collective organization for their policy influence, either workers or small and medium business, it is crucial to define the **level of aggregation** of their organizations. Effective peak associations should have the most encompassing set of preferences and should be able to internalize costs that can have deleterious consequences on general productivity (Olson, 1982).<sup>24</sup> By contrast, industry-level associations should be strong enough to impose policy preferences but less likely to internalize costs on other sectors and to care about the consequences of those policies on general productivity levels (Calmfors and Driffill, 1988). They would require political parties or corporatist arrangements to aggregate their views with

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<sup>23</sup> However, in countries where Telmex is not the incumbent players, such as Chile and Argentina, where it tries to compete with Telefonica of Spain, its preferences are for lowering barriers to entry.

<sup>24</sup> It is crucial to define the authority of organization to control the behavior of their members. Golden (1993) shows the importance of union authority regardless of the level of organization. Centralized peak associations like the Mexican CTM have the power to control the behavior of their members because they can affect their collective bargaining process (and during the 1980s set wage ceilings). By contrast, the Argentine CGT did not have power to control the behavior of industrial members who negotiate by themselves and pay union dues indirectly to the

those of other sectors and define a cooperative agreement that increases their time horizons to promote productivity—e.g., see the arguments of Kaufman, Bazdresch and Heredia (1994) on the Mexican Solidarity Pact. Finally, associations grouping very specific sectors are probably weak enough to compensate each other in a competition for rent-seeking that would cancel out, thereby granting leeway to policymakers who prefer productivity-enhancing policies (Becker, 1983)—if the PMP produces incentives for such goals.

Whatever their level of organization, the degree of concentration of the industry and its heterogeneity shape policy preferences and influence when aggregated in organizations at the industry or sector level. Organizations representing a sector that is not concentrated and where firms are very heterogeneous (e.g. some in the formal and some in the informal sector or with ownership divided along diverse origin of capital or regional lines) have more difficulties aggregating common preferences and organizing collective action. As pointed out by Millner (1988), the degree of heterogeneity is crucial in the aggregation of policy preferences. It should also affect the capacity of these firms to define inter-temporal exchanges if they have different degrees of capitalization and are in a competitive environment. The origin of capital (and the diverse costs of financing it entails) should be of especial concern within the same industry as in capital scarce countries, the return to the scarce factor should be higher inducing a stronger competition between domestic and foreign capital. Therefore, direct competition by domestic and foreign producers can make common policy positions—even within the sector—more difficult unless their positions in the productive process are complementary (Pinto and Pinto, 2008).

Socioeconomic players, thus, will vary from case to case. It is the task of country studies to identify who are these actors and how do their preferences regarding productivity enhancing policies relate to their position in the economic structure defined above. In defining these players, it is important to identify if they are organizations or large companies (most other players need prior organization to be influential). Schneider (2005) provides a valuable typology of forms of business participation, which should be taken into consideration in the country studies (see also IDB 2005, pages 92-97).

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confederation (Murillo, 2001). Therefore, an agreement with each of them generates different expectations about the behavior of member unions.

### ***3.3 Policy Influence and Interaction with Policymakers***

Politically influential actors have different mechanisms to voice their concerns in the polity in order to shape the PMP. These mechanisms may vary over time or across country depending on the PMP. Changes in the PMP both across time and across countries shape the choice of policy pressure mechanism by political actors, whether these are organizations or holdings. It is important that country studies identify these mechanisms and their interaction with the PMP, which explains their choice from the repertoire available to socioeconomic and societal actors.

Political parties are traditionally the channels of preference aggregation and representation in the PMP for both socioeconomic and societal actors. However, these actors can rely on larger repertoires of political influence mechanisms. For instance, both business and labor can rely on industrial action—either lockout or disinvestment and strikes, respectively. Business and labor can also use traditional mechanisms of policy influence, such as lobbying legislators and ministers, making explicit political alliances (or making short-term contributions in money or manpower to political parties), or helping the government in policy implementation and coordination.<sup>25</sup> Additionally, actors can rely on less traditional methods of political influence—even if their propensity for using them is not evenly distributed. They can rely on informal networks (e.g., personnel rotation or personal ties), or they can rely on demonstration effects—for example, either through street action or media impact.

An example of the logic just described is the contrast of policy influence tools used by business in Argentina and Chile. In Argentina, large cattle and agricultural producers organized in the Sociedad Rural (SRA) have changed the tools they used for policy pressure. They had supported military coups and used personal networks through personal rotation to achieve policies that either stop redistribution of their income (as when they supported the overthrow of Perón and achieved the end of IAPI -Instituto Argentino de Promoción del Intercambio) or to obtain favorable redistribution (as with the tax policies of the last military regime). After the 1983 democratic transition, they lobbied the Radical administration and protested against taxes on their exports—by means including publicly booing the President during the SRA annual exhibit. Their main policy tool was to stop selling dollars received by their exports, as it happened in 1989 during a period of low reserves in the Treasury. Such a policy tool was less

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<sup>25</sup> See Grossman and Helpman (2001) for an abstract account of the mechanisms used by special interest groups to influence the PMP and hence, policy outcomes.

effective in a period of high reserves in 2008. That year, the SRA joined with smaller producers and started using road blockades and production strikes to protest taxes on exports. The lack of ties with political parties for these large producers explained their strategies regarding the military regime in the pre-1983 period and their extra-institutional strategies in the post 1983 period.

Chilean producers have also used road blockages and hoarding in 1973 and then supported a military coup. After democratization, they chose to foster their ties with right-wing parties, which blocked redistribution through taxation in Congress, but at the same time lobbied the executive and participated in formal consultations on policymaking. The potential veto of right-wing legislators—facilitated by a binominal electoral system—induced the center-left executive to negotiate legislation with large socioeconomic players before sending it to Congress (Siavelis, 2000; Aninat et al., 2008). As a result, it opened the opportunity for a more corporatist participation of business in the political system despite the original lack of ties with the government parties.

The capacity to coordinate these preferences into a cooperative equilibrium leading to productivity enhancing policies depends on some organization of inter-temporal trade-offs either in Congress, a corporatist arrangement including the crucial players or delegation to a third party if enforcement can be trusted. Hence, the impact of these pressure mechanisms depends on the preferences of politicians and their need of support from these actors for their political survival.

The literature on inter-temporal trade-offs by class-based parties emphasizes the coordination of both organizations that aggregate preferences at the adequate level and coincidence with governments by political parties trusted by those organizations. For instance, Alvarez, Garrett and Lange (1991) argue that economic performance in advanced countries was better under two different scenarios. Either labor was organized by an encompassing organization that allowed restraint in return for future employment guaranteed by left-wing predominance in government ,or labor was weak (as collective bargaining was decentralized) and could not press for wage increases in combination with a right-wing government preferring monetary restriction. The combination of labor organization and party in government was crucial to avoid deleterious economic consequences.

In addition to partisan linkages and producers' organization, the electoral geography and the concentration of certain producers—either agrarian or small companies or informal

workers—that makes regional and interest representation converge increase the policy influence of these groups, especially if they are concentrated in marginal districts that have crucial weight in the electoral result (McGillivray, 2003; James, 2001). Federal institutions and overrepresentation of certain regions can also facilitate the policy influence of regionally concentrated actors, as shown by the experience of Northeastern producers in Brazil and the role of legislators representing their interest in Congress (Ames, 2002).

Linkages to the PMP also depend on the structure of political parties. Argentina's Partido Justicialista (PJ) includes regional diversity in its representation, which can generate conflict between elected officials from rural and urban districts. By contrast, the Ecuadorian electoral systems is regionally divided making it more likely to achieve partisan representation of regionally concentrated electoral interest although making it less likely to have the political parties serving as a mechanism for coordination between these interests.

In contrast to the Western European emphasis on parties as mechanisms for preference aggregation, the literature on the Asian developmental states, focus on the interaction between socioeconomic actors (mainly business) and career bureaucrats. This literature emphasizes the nature of bureaucratic incentives and ties to business as bureaucrats retired into business jobs and thereby had incentives to perform well in office while keeping ties to business—generating conditions for what Peter Evans calls “embedded autonomy” (Evans, 1995). Yet, others argue that it was the strength of the state and the business sector and their ability to check on each other regardless of institutional arrangement that produced the success of the Asian Tigers (Kang, 2001). Indeed, state autonomy in this view is related to the national security concerns of the military (Doner, Bryan and Slater 2005), which were absent in Latin America due to its geopolitical location and absence of external threats to national borders.<sup>26</sup>

The diversity of possibilities in terms of the interaction between socioeconomic actors and policymakers—although the literature in Latin America has given us clues for instance on the weakness of bureaucracies as crucial actor (Evans and Rauch, 2000)—should make country studies crucial in identifying the preferences of important socioeconomic players and their mechanisms for policy influence in the PMP. The PMP has a crucial role in defining incentives for these actors to achieve cooperative equilibria where they can make inter-temporal exchanges that allow productivity improvement—for instance, when producers' taxes pay for an

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<sup>26</sup> Centeno (2002) argues that the absence of wars in Latin America explains the weakness of the state.

educational system that will increase the skills of workers and workers make an investment in those skills because they have a safety net in case of unemployment. Such a trade-off requires coordination between employers and between workers in addition to agreements between both parties coordinated by politicians or another third party. According to Cusack, Iversen and Soskice (2007), in Europe businesses' need for skill investment by workers was met because labor received social insurance and an electoral system that facilitated left-wing predominance.

The case studies should identify players, preferences, mechanisms and their interaction with the PMP while assessing the diverse policy outcomes that come out of these equilibria. In particular, they should assess how the mechanisms of preference aggregation by societal actors interact in the PMP, whether through regional, partisan, or other identity, as well as identify the locus of interaction (e.g., Congress, informal corporatist agreements with the executive, etc.). In defining political linkages with politicians, it is important to address the nature of these linkages. That is, whether they involve short-term clientelistic exchanges or long-term distributive expectations based on prior public policies of a more encompassing nature. It is also crucial to assess how the political system shapes the influence of each of these actors and whether there have been agreements that delegate policymaking to institutions with longer-term horizons (as well as the incentives for their personnel to keep those horizons).

#### **4. Political Institutions and Policymaking Arenas**

The country studies to be undertaken in this project should provide a thorough description of the policymaking processes of their respective countries; identifying the roles and incentives of the main political actors. We refer to the country studies in the volume *Policymaking in Latin America: How Politics Shapes Policies* for a number of country studies along these lines,<sup>27</sup> as a starting point. Special attention should be given to the extent to which those arenas and incentives facilitate the choice and implementation of policies that take productivity into account.

Policymaking processes affect the type and content of policies that are adopted, and they also imprint some common characteristics to the public policies of each country. These characteristics by themselves, are likely to have effects on people's behaviors and hence on the outcomes of interest. Policymaking processes can contribute to policy stability or lead to large

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<sup>27</sup> See [http://www.iadb.org/res/network\\_study.cfm?st\\_id=82](http://www.iadb.org/res/network_study.cfm?st_id=82) for additional country studies not included in the book.

policy swings; they may facilitate policy adaptability or lead to excessive rigidity; they can produce policies that promote either the public welfare or private interests; and they can affect the quality of policy implementation and enforcement.<sup>28</sup>

In this section, we summarize some extant knowledge and expectations about the role of key political institutions, actors and arenas in the policymaking process, providing some hints to the way in which they articulate the entry points for relevant socioeconomic interests, their “encompassing” capacities, their horizons, and the potential impact on productivity.<sup>29</sup>

#### ***4.1 Political Parties***

The PMP in a country is strongly influenced by the structure and organization of political parties. Parties could be important vehicles in representing societal and economic interests. They could represent and aggregate those interests in better or worse manners, and could be more or less conducive to the internalization of issues that impinge on the productivity of the economy. The horizons of party leaders, the degree of institutionalization, and the continuity of the coalitions they represent (or the lack thereof), are all factors that could lead to longer-term views and more encompassing political exchanges, or to short-term opportunism. Several aspects of the party system have important indirect effects on other pieces of the institutional environment which are also crucial determinants of whether incentives are towards productivity-enhancing activities or not, such as: the incentives of elected officials to cater to narrower or broader sets of societal interests, the type of relationship between executives and legislatures, the preferences and equilibrium exchanges among presidents and legislators, and the articulation of genuine versus artificial geographical economic interests in the PMP.

Institutionalized and credible parties that represent relevant socioeconomic constituencies could be a natural conduit for the institutionalization of intertemporal compensations necessary to instrument productivity-enhancing policies.<sup>30</sup> On the contrary, party systems that do not aggregate relevant socioeconomic actors well can lead to inefficient modes of interest group

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28 Enforcement might be an important issue in some of the policies we care about in this project, such as the frontier between labor market regulations and social protection, or the regulation of industry, which might provide entry point for some big businesses that could “get their way” through the bureaucracy or the judiciary at the implementation stage.

29 What we highlight here are possible general tendencies which might be more or less operational in different countries, at different points in time, and for particular policy and political junctures.

<sup>30</sup> See for instance the case of Legislative approval of partial accession to Mercosur in Chile, in the appendix of Aninat et al. (2004).

activity (such as road blocks, strikes, and violence), also inducing inefficient policy substitutions and rigidities, as actors cling to whatever favorable policy they can get.

Country studies should provide a brief description of the political party system of the country, including an account of traditionally studied party system characteristics such as fragmentation, discipline, centralization/nationalization, programmatic/clientelistic orientations, as well as type of resulting governments (single party, coalition, minority, majority). This description should be done with an eye on the possible impact of these characteristics on the degree to which these parties are a natural conduit for internalization of productivity issues and on some specific policies in areas of crucial importance for productivity of the country.

#### ***4.2 Legislatures***

Productivity-enhancing policies are more likely to be adopted if legislatures are arenas that facilitate encompassing exchanges and their enforcement over time. Legislatures are the natural arena for political exchanges and representation of various economic and societal interests that are the winners and losers of different economic and social policies. If these representation and articulation functions work well, the legislature could be the place in which those interests can undertake more encompassing and more far-sighted exchanges, providing the possibility of internalizing factors leading to higher overall productivity.

The extent and nature of the role played by legislatures in the PMP varies greatly from country to country. At the more proactive and constructive end of the spectrum, some legislatures are able to develop their own legislative proposals and thus participate along with the executive in directing the policy agenda. This implies some potential fragmentation of policy in decentralized political systems, but also provides a more open and encompassing arena for the intertemporal sustainability of political and policy agreements. Policy-related capabilities of legislatures vary a great deal, and such capabilities are likely to affect the extent to which political exchanges will be informed by sound technical considerations. Legislatures with little technical capabilities and little political weight, which act merely to rubber stamp executive decisions (often after narrow geographical side-payments take place), are unlikely to be the arena that permits a balancing of various sectoral interests with desirable aggregate performance. (Although such objectives might perhaps be attained in other arenas, such as in Executive-led corporatist agreements, the legislature would be a natural arena).

Some legislatures could be subservient to the executive most of the time, not adding institutional value to the intertemporal bargain and implementation of policies. Or they could be merely obstructionist, blocking new legislation independently of its technical merits simply for the political objective of debilitating the executive.

With these and other considerations in mind, country papers will have to identify the type of (and reasons for) influence that the legislature has on PMP and the impact on the relevant characteristics of policies, as various factors affect legislatures' role in the PMP and their impact on the construction of policies that affect productivity. The organization of the legislature will matter for the way it influences policymaking. Some legislatures have important degrees of partisan aggregation and are dominated by "jefes de bancada," some legislatures have strong specialized committees, etc. (see Saiegh, 2008). It may therefore additionally be useful to look into the workings of specific committees dealing with policy areas most relevant for productivity.

Characteristics and incentives of legislators vary across countries. Some legislatures have legislators with profound policy expertise, while in other cases they care only about very narrow projects for their constituencies.

Special attention should be given to whether, and in what way relevant socioeconomic actors channel their "policy demand" activities through the legislature. In what way are socioeconomic actors articulated via the legislature and to what extent the legislature serves as an arena providing for encompassing exchanges or by action or omission fosters fragmentation, venue substitution, short-termism, rigidities, etc. (especially in those policy domains most important for productivity).

### ***4.3 Presidents***

It is well known that Latin American presidents play a preeminent role in policymaking. Even though some features of their behavior are undoubtedly related to personal and leadership qualities, they are also the outcome of their incentives, constraints, and of the selection biases induced by political institutions. Factors such as their constitutional legislative and non-legislative powers, and their partisan powers, along with other features of the political system do imprint different policymaking styles in different countries (Scartascini, 2008; IDB, 2005, pages 57-60.)

Since presidents are elected by a majority or plurality of the national vote, their electoral-based incentives could be more encompassing than those of individual legislators or individual party leaders. Hence, they would be quite likely to be concerned about public goods such as productivity growth. Yet, matters of short term horizon, and of political urgencies with an imperfectly informed public, can lead them in the opposite direction. That is, the presidency could be an institution that facilitates articulation of majoritarian interests at each point in time, but it is not a great arena for intertemporal continuity.

Country studies should explore the extent to which Presidents or other key players within the Executive have the incentives and the empowerment to push for the incorporation of productivity-related concerns into key policy decisions.

#### **4.4 Cabinets**

Even though Cabinets are not supposed to play as crucial a role in policymaking in presidential democracies as they do in parliamentary ones, in practice Cabinet ministers in Latin America tend to play key roles in policymaking. Cabinet ministers and those directly under them provide the knowledge and expertise necessary to formulate policy. The legislature and political parties rarely have at their disposal comparable technical resources for policy discussion, implementation and supervision. Hence, various characteristics of Cabinets are likely to affect the content and qualities of policies. These characteristics include cabinet stability and capacity for coordination, as well as the criteria utilized to select cabinet members. More stable cabinets are likely to induce more stable policies and to permit better policy coordination (lower balkanization), facilitating cooperation with other institutions including the bureaucracy. Some Latin American countries are characterized not only by instability of the individuals in charge of particular *Ministerio*, but even by instability of the *organigrama* itself.

The capabilities and characteristics of cabinet officials as experts in their fields, as managers, and as advocates of government's policies are likely to have an effect on policy outcomes. To the extent that cabinet members are selected purely on the basis of their personal loyalty to the president or because of their political party connections, this may detract from their ability to design sound policies and manage their bureaucratic agencies affectively. (But since policymaking is not purely a technical matter, and political and managerial skills contribute to a

minister's effectiveness, broad criteria of competence rather than narrow training in the policy field may be most suitable.)

It is also important to evaluate whether cabinet instability is the result of the working of political institutions (say party coalition politics) or social pressures on the political system. Cabinet instability can cause suboptimal policies for productivity by making it hard to arrive at inter-temporal exchanges as the ministers do not have any continuity in their tenure. However, it may also be the temporary result of societal pressures on the government—especially extra-institutional pressures—indicating that other factors are behind policy outcomes.

These configurations will also affect the entry points and types of relationships established with socioeconomic actors and interest groups. In some countries, at least at some points in time, the direct appointments of representatives of key interest groups in Cabinet positions could be a way of delegating that policy to the interests of that group (or, on the other side, it could be a way of building credible intertemporal commitments even for policies that hurt those constituencies in the first place—the “Nixon goes to China” effect).

#### ***4.5 Bureaucracies***

Several characteristics of the public administrations or bureaucracies are very important for policymaking in general and for the degree to which policies foster productivity in particular. The characteristics of the bureaucracy are important because they directly affect the quality of implementation, and because the bureaucracy provides an important venue/entry point in which some economic interests could strive for productivity-enhancing or productivity-decreasing policies.<sup>31</sup>

Latin America has traditionally been viewed as a region with large but weak states, and this weakness has been associated with the lack of a stable professional bureaucracy. This weakness, in turn, makes the State easy prey of special interests, impeding effective development policies. This is usually contrasted with the development experience of the Asian Tigers. A strong and autonomous State, supported by a highly professional and meritocratic bureaucracy has been considered a key factor in the success of the Asian Tigers. Even though South Asian countries tend to rank considerably higher than Latin American ones in cross-national indicators of the quality of the bureaucracy, there is substantial variation within each group, and there are

even variations over time and across sector in each country. Country studies should look into the workings of the bureaucracy of their country, paying special attention to its articulation (virtuous or not) with socioeconomic actors and the other actors and arenas of the PMP.<sup>32</sup>

#### ***4.6 Judiciary***

The workings of judicial institutions have direct implications for the feasibility of private contracting, of contracting among private and public actors, and of arrangements among political agents. In each of those spheres, the quality, predictability, and impartiality of judicial decision making is likely to have an impact on the types of economic activities undertaken, in ways that may affect the productivity of the economy. Many sectors which are important for overall productivity, such as infrastructure, are heavily dependent on the quality of long term contracting made feasible by judicial enforcement.

Additionally, the judiciary is a possible entry point of economic interests, both in order to sustain their well deserved rights, as well as to distort enforcement and implementation of laws in their favor. The choice of strategies for interest groups depends on the general workings of the judiciary and of its degree of alignment with executive and legislative power and the cost of access to the judiciary for different societal groups. See Spiller and Liao (2006) for a survey on interest group strategies, and Iaryczower, Spiller and Tommasi (2007) for an application to labor legislation in the case of Argentina.

#### ***4.7 Subnational Actors and Policymaking***

Subnational political actors, such as provincial governments and regional elites are important political players with deep impact in the way policy is made in several Latin American countries (Stein et al., 2008; IDB, 2005, Spiller and Tommasi, 2207). The power of these actors and the particular arenas or political configurations in which they are relevant can lead to policy fragmentation and to productivity-reducing policies. On the other hand, under some conditions local political power can help form clusters of high productivity, facilitating public-private cooperation, with local governments more attuned to the specific needs of producers in their localities (Ferraro and Costamagna, 2000). It is also important to identify the sources of their

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<sup>31</sup> As highlighted in IDB (2005) the characteristic of the bureaucracy could be also a key determinant in encouraging or discouraging inter-temporal agreements, especially through its role in putting such agreements into practice.

influence, whether it is their ability to deliver votes, to generate resources, to represent or control important power players in the country or other power resources. These different sources signal their connection with actors they can represent in the political system.

#### ***4.8 Knowledge in the Policy Process***

In order for productivity concerns to matter when policy decisions are made and implemented, various conditions need to be satisfied. One is that the stock of knowledge available at any point about the combined effects of various policies on productivity must be somewhat incorporated into the policy process. The degree to which that happens will depend on, among other factors, the “industrial organization” of the production of policy knowledge and its articulation into the policy process. Several of the arenas we referred to above, such as parties, congress and the bureaucracy are potential spaces for the accumulation and exchange of technical policy expertise; and there are various other institutions and arenas outside of government, such as think tanks, universities, and the media that are important in the generation and articulation of knowledge.<sup>33</sup>

As we stated earlier in the paper, scientific knowledge about the impact of various policies on productivity is quite incomplete, but even the given currently available knowledge on the causal effects of policies on productivity growth, is clearly not fully incorporated into political decisions in many cases. Policymaking environments could be more or less conducive to having capabilities and incentives to incorporate technical knowledge in its policy process.<sup>34</sup> The way in which knowledge actors are articulated in the policy process varies from country to country, leading to various degrees of trust among elected officials and technical advisors (as well as various qualities of technical advice for given levels of trust).<sup>35</sup>

Furthermore, there are some specific institutions and policy domains which are directly related to issues of productivity, which need to be given special focus. For instance, Colombia has a *Sistema Administrativo Nacional de Productividad*, centered around a *Comisión Nacional*

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<sup>32</sup> See Khan and Jomo (2000), as well as the references therein, for interactions between career bureaucrats and business actors in the Asian cases provided in the previous section on interests.

<sup>33</sup> On the role of the media in the PMP see Hughes (2005) as well as IDB (2005, pages 99-104).

<sup>34</sup> See for instance IDB (2005, pages 119-124, and references therein), as well as the Global Development Network’s *Bridging Research and Policy Project*.

<sup>35</sup> “Allied experts” are trusted more. Chilean politicians trust Concertación experts. Experts in Argentina tend not to be partisan, which makes them seem to be less trustworthy (or they tend to be of lower average quality when they depend mainly on political appointment for their career).

*de Productividad*. Both Brazil and Colombia have “National Productivity Centers” following the experience of some Asian countries, attempting to articulate the private and public sectors around issues of productivity. These types of institutional initiatives should be given special attention to see to what extent they do help internalize productivity concerns in various policy domains.

## **5. Actors at Play in the Policymaking Process**

The last two sections provided a summary of some possible theoretical connections between characteristics of interests and of political institutions and their impact on policies and productivity. Socioeconomic actors such as those characterized in Section 3 pass through arenas such as those mentioned in section 4, which are populated by professional political actors (elected officials, national and local politicians, ministers, bureaucrats, judges). The main task of our project will be to identify the nature of those interactions and the implications for productivity.

Country studies will attempt to explain public policies that affect productivity from a political economy perspective, taking into account the interests, incentives, and constraints of socioeconomic actors and of political actors, and the way they interact over time in the policymaking process of each country.

We take an open-minded approach to the level of disaggregation and style of argument that each team may want to use in each specific case to construct and support their arguments. For instance, some teams may focus on broader configurations of policies and policymaking, while others might decide to focus on a more specific number of policies, which have been identified as crucial for productivity in the country.<sup>36</sup> (Even in the latter case, the explanation of policymaking in that area has to be embedded in the general policymaking process of the country.)

Also, some authors may decide to pick specific “moments” of politics and policymaking if such episodes provide a convenient window to look at the broader issues of the country’s PMP affecting productivity. For instance, one might argue that the current political crisis in Argentina surrounding the increase in taxation of agricultural exports represents one such window.

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<sup>36</sup> In such cases, we suggest, for instance, Chapter 1 of Baron (1999) for a listing of the way in which different types of relevant interests (organized and unorganized) and political actors could be identified.

Additionally, a “country study” could be organized as a paired comparison of a couple of countries within the region or contrast with countries from outside the region, in order to build a comparative argument.

In the rest of this concluding section we suggest some possible guiding questions, which might assist as an organizational device for the country studies and for the later comparisons of the broader project. We suggest organizing some of the relevant information in a multi-dimensional “matrix” including:

- (1) Actors: key socioeconomic interests.
- (2) Mechanisms utilized by socioeconomic actors in their political demands.
- (3) Venues: arenas of the policymaking process, including political institutions.
- (4) Policy domains: policy areas.

For expositional simplicity we will verbalize the suggested questions from an actor-centered perspective, streaming from (1), but the same story can be told from different angles—for instance, from the point of view of a President trying to put together a political coalition in Congress, including some political parties, some socioeconomic actors, and some classes of voters.

Socioeconomic actors who are relevant political actors (and even those who are somewhat ignored in political equilibrium for lack of information or of organization) need to be identified. For each of those actors, some of the things to know include:

- What are their (policy) interests?
- The level of aggregation at which they operate
- Why that is the level of aggregation
- How long have they been around
- With what other actors do they coalesce for specific policy demands
- What makes them relevant political actors (what are their collective action capabilities and political resources)? What are the resources they bring to the table and that enable them to become relevant actors? What is the source of their power?<sup>37</sup>

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<sup>37</sup> For instance Schneider (2005, Section 3) refers to portfolios of business investment in politics, and to the level of aggregation of their collective action, including associations (economy-wide, industrial sector, specific sector),

- Money to support campaigns (+) or to bribe politicians/bureaucrats/judges
- Money to convince voters of things favorable to them
- Economic actions (such as capital flight) that harm the economy and hence the government
- Peaceful demonstrations
- Media campaigns
- Strikes (that hurts government and others)
- Semi-peaceful activities such as *piquetes*
- Violence (could be bought with money)

A related axis will identify which are the entry points of socioeconomic interests and actors into the policymaking process; which are the **venues** in which they play their demands. In order to do that, the main characteristics of these venues and of the PMP process in general have to be identified, along the lines suggested in Section 4 and references therein. In some countries interest groups are closely aligned with political parties and exercise influence through those parties, while in other countries members represent their interest groups by holding offices in government. More generally, these venues include:

- Presidency
- Cabinet (membership or representation among members)
- Congress
- Political party
- Local Government
- Bureaucracy
- Judiciary (non-enforcement of adverse legislation)
- Street
- Public Sympathy

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legislative lobbying, electoral politics, parties and campaign contributions, “old boy” networks, corruption. (See also Spiller and Liao 2006).

In each case, we want to have a factual description of the modes of articulation of each group or sector with the policymaking process, followed by an attempt to explain that articulation.

Finally, it is also necessary to have a description of the relevant policy domains, including their texture and the characteristics of the policy in question, its distributive implications, and its intertemporal properties. Is it a policy that has to be “renewed” politically every period, or does it have status quo biases? Which institutions support its implementation over time? What is the history of the policy and of the actors around it?

Once all the above information is available, one might attempt to organize it in a three dimensional matrix of Actors, Venues, and Policy Domains. In other words, which actors play in what venues (through which instruments) to pursue policies in what policy domain? With that “matrix” in mind, we can then start speculating about the fragmentation or articulation of the policymaking process in various stages, one of the candidate explanations for the characteristics and productivity implication of the policies in question.

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