

# CHAPTER 3

## THE CONCENTRATION OF ECONOMIC AND POLITICAL POWER

- Markets in Latin America tend to be dominated by a small number of giant firms and are characterized by high levels of market power.
- Monopolies contribute to high inequality and low productivity growth by making consumers pay higher prices, allowing firms to forgo more efficient technology and hindering innovation.
- Monopoly power and business political power are two sides of the same coin as monopoly rents translate into political power that, in turn, increases monopoly power, creating a vicious circle.
- Competition policy (also referred to as “antitrust” or “antimonopoly” policy) is one policy lever that countries can use to contain monopoly power. Its existence and effectiveness are not exogenous to business political power.
- Big business political power also distorts policy beyond the market arena. Of particular concern in the context of LAC’s high-inequality low-growth trap are the effects on fiscal policy. A distinctive feature of fiscal systems in the region is their weak redistributive power.
- Workers and, particularly, organized labour also have the power to distort policy in the market arena. However, the effect of labour unions on efficiency and equality in LAC is ambiguous.

### 3.1. Power concentrated in the hands of a few increases inequality and harms productivity growth

One of the most pernicious challenges of high inequality is the way that it concentrates power. The analysis in chapter 2 of a Latinobarómetro perceptions survey conducted for this report shows that an overwhelming majority of people in the region think that their countries are governed by a few powerful groups that act for their own benefit rather than in the interest of the public good.<sup>1</sup> It also shows that, on average, about a quarter of the respondents consider big business to be the most influential powerful group, with this share ranging from 5 percent (Venezuela) to 48 percent (Chile). In countries where big business is perceived as highly influential, the government is considered less powerful (and vice versa).

This chapter explores the channels through which the concentration of power in the market goes on to sustain high inequality and mediocre productivity dynamics in the region. It acknowledges that monopoly power and business political power are two sides of the same coin, in that monopoly rents translate into political power that, in turn, increases monopoly power, thereby creating a vicious circle<sup>2</sup>.

Business political power distorts policy and weakens institutions. This chapter focuses on the way in which it distorts policy within the market sphere, and systems of fiscal redistribution. It does not present an exhaustive revision of all the areas of policy that may be distorted by business political power. Also, it focuses only on a few types of elites in the Latin America and Caribbean region with a particular influence in these areas, highlighting the role of big businesses and labour unions as market actors. However, of course, there are other relevant types of elites with concentrated power that are actively shaping the development trajectory in the region, with implications for growth and equality. For example, military actors have experienced increasing power in many countries.

Taking the role of elites seriously is a necessity if one is to consider feasible escape routes from this trap. This has been said before. World Development Report 2006, which is devoted to explaining the relationship between inequality and growth, points to the capture by elites of economic and political power as the main reason some countries grow at a slower pace.<sup>3</sup> This chapter revisits this idea and argues that the concentration of power in the hands of a few is one of the factors sustaining both high inequality and low growth in the region, that must be addressed to move forward.

<sup>1</sup> See UNDP (2020); Latinobarómetro (dashboard), Corporación Latinobarómetro, Santiago, Chile, <http://www.latinobarometro.org/lat.jsp>.

<sup>2</sup> An in-depth micro-foundational analysis of power can be found in the World Bank (2017) World Development Report 2017: Governance and the Law.

<sup>3</sup> World Bank (2005).

If these deep inequalities of power that are so common in many LAC countries are addressed, the region could support a more inclusive, thriving market economy in which the private sector finds opportunities for entrepreneurship, the state accomplishes the goals of maintaining the rule of law and providing public goods, and citizens have the freedom to pursue lives that they have reason to value.

## 3.2. Big business power: monopoly power and political influence

### Why worry about market power?

In economics, the concept of market power refers to a firm's ability to raise its price above the price that the same firm would have charged if it were in a fully competitive market. In other words, the more market power a firm has, the more freedom it has to increase its price. There is a close relationship between the number of firms in a market and the extent to which these firms can exercise market power. This is because competition controls price increases. While most firms operate with some degree of market power, only unchallenged monopolists holding the highest possible market power –*monopoly power*– and those near them on the market power continuum represent a concern for society.

The literature on industrial organization, a field of study within economics, identifies three channels by which monopolies are welfare-reducing,<sup>4</sup> contributing to high inequality and low productivity growth. First, monopoly power reduces welfare by making consumers pay higher prices for goods and services. It contributes to more unequal societies because it hurts people differently depending on where they stand on the income distribution.<sup>5</sup> Monopoly prices on essential goods and services hurt the poor more than the wealthy, as they take over a larger share of their budget. Also, the more affluent households can often exclude themselves from their local market if it is monopolized and obtain goods and services from foreign more competitive markets. This is not the case for the poorer households. A mirror situation occurs in markets where a single or few buyers enjoy *monopsony* power: it is frequently the poorest input providers or the poorest workers who are hurt most.<sup>6</sup>

Under monopoly pricing, society's welfare loss is the highest possible. But any price

<sup>4</sup> For a complete discussion, see Motta (2004), chapter 2.

<sup>5</sup> For instance, see Busso and Galiani (2019); Rodríguez-Castelán (2015); Urzúa (2013).

<sup>6</sup> Brummund (2013).

above that which would emerge under competition redistributes resources from consumers to firm owners while reducing overall welfare. Relative to monopoly, competition is thus not only welfare increasing, but also better for consumers than for businesses. Businesses always do better if able to charge a higher price. Businesses and consumers may thus find themselves on opposite sides regarding their views on the desirability of competition. Businesses often lobby for policies that result in less competitive pressure, including weak antitrust institutions. The negative effect from monopoly power may be understated if firms that enjoy it divert resources from productive uses towards rent-seeking using their political influence and lobbying power to keep it or increase it, distorting the course of policy for their own benefit.<sup>7</sup> When people in the region identify big business as the most powerful elite in their countries, they are referring to this sort of behaviour. This chapter explores this expression of business power.

Second, there may be an additional welfare cost if under monopoly the firm operates at a higher cost than it would under competition, that is, if the monopolist—or the firms with the greatest market power—chooses not to use the more efficient technology available. The empirical evidence about the extent and frequency to which this occurs is mixed.<sup>8</sup> Yet, this may pose an even higher cost to society through its potential impact on productivity growth.

There are two possible reasons for a firm with monopoly power to choose an inefficient technology. The first has to do with a lower incentive for managerial effort in the absence of competition. Suppose investment decisions are made by managers who do not have the correct incentives to choose the more efficient technologies. In that case, the lack of competitive pressure may result in the wrong choices.<sup>9</sup> The second reason is related to the absence of selection induced by competition. Competition forces less efficient firms to exit the market, while the more efficient survive. In its absence, the former firms survive. Under this reasoning, competition will increase productivity through entry and exit: the larger output share of the more productive firms explains the rise in productivity. A body of empirical work confirms the role of competition in selecting the more efficient firms and increasing productive efficiency.<sup>10</sup>

Third, an uncontested monopolist has less incentives to innovate. However, on the issue of innovation, the literature shows that very high levels of competition may be as undesirable as monopolies. Competition pushes firms to invest and innovate to improve their position against their rivals, and its absence reduces their incentive

<sup>7</sup> Posner (1975).

<sup>8</sup> Scherer and Ross (1990).

<sup>9</sup> Hart (1983); Scharfstein (1988); Hermalin (1992); Horn, Lang, and Lundgren (1994); Maggi (1996).

<sup>10</sup> Baily, Hulten, and Campbell (1992); Olley and Pakes (1996); Foster, Haltiwanger, and Krizan (1998); Barnes and Haskel (2000).

to do so. But too much competition reduces the ability of the firm to profit from its investments, thereby reducing its incentives to invest and innovate. Thus, some degree of market power is desirable to promote investment in innovation and economic growth.

### **LAC markets are characterized by a small number of big businesses and high levels of market power**

The relationship between market power and inequality has received much attention lately. Both economists and policymakers are concerned over the possibility of rising monopoly power in the world economy. A stream of recent work finds that, at a global scale or, at least, in much of the developed world, the share of income and wealth in the hands of the richest individuals has grown, while the labour share of income has declined and market power has increased.<sup>11</sup> The bulk of the research unveiling evidence of positive and rising markups finds that this trend has been driven by a small number of firms.<sup>12</sup> The picture that emerges is one where a few superstar firms have seized an increasingly large share of their respective markets, and most of their additional gains have gone to their shareholders. A growing share of the world's resources has gone to the hands of that small mass of privileged individuals.

Though this description seems to fit the dynamics of inequality, wealth, and market concentration for much of the world, the trend in market power in Latin America appears to be an exception. For the Latin American countries for which there is data available, the dynamics of markups do not show the increasing trends found in other locations. Instead, markups in Latin America have remained essentially unchanged in the last three decades, strikingly at a much higher level than in the rest of the world. The rising trend that is a current concern among economists and policymakers in the United States and Europe seems to have put the rest of the world on a path to convergence with Latin America in market power (box 3.1).

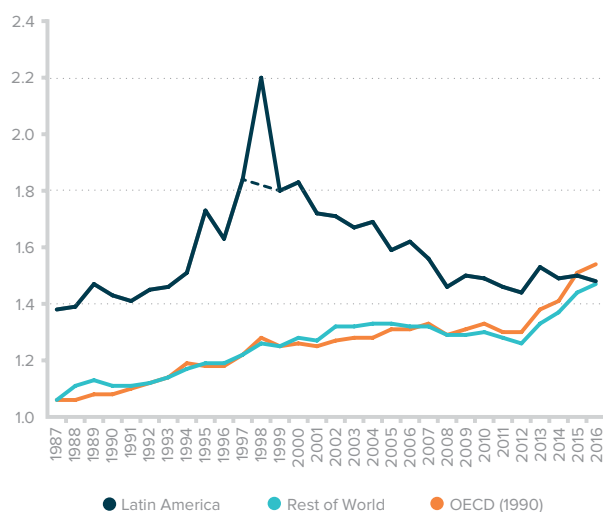
<sup>11</sup> See Karabarbounis and Neiman (2014); Kavoussi (2019); De Loecker, Eeckhout, and Unger (2020).

<sup>12</sup> Autor et al. (2020)

### Box 3.1: Markups in Latin America are higher than in the rest of the world and constant over time

Markups reflect the difference between the cost and the selling price of a product. They may be expressed as a percentage of the selling price or the cost price. Figure B3.1.1 presents the evolution of markups estimated by De Loecker and Eeckhout (2018), expressed as a share of the cost. It distinguishes the evolution of markups in Latin America and the non-Latin American countries of the Organisation for Economic Co-operation and Development (OECD) countries and the rest of the world. Using data from the financial statements of firms in the Worldscope dataset, these authors build a dataset that allows them to follow countries over the same period, including 7 in Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.<sup>a</sup> Figure B3.1.1 shows that the average markup in Latin America does not increase over time. (The peak in 1998 is ignored because it may represent a measurement error and cannot be easily explained otherwise.) Instead, the average is relatively constant and systematically above the averages elsewhere. The increasing markup trend that is a concern in the ongoing public policy debate seems to be putting OECD countries and the rest of the world on a converging path towards the average markup in Latin America.

Figure B3.1.1: Average markups, Latin America, OECD and rest of the world, 1987-2015



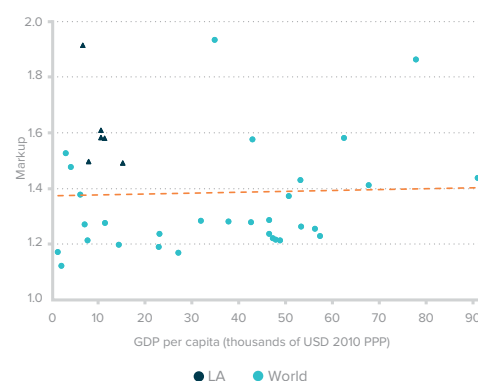
Source: Eslava, Meléndez, and Urdaneta 2021, Background Paper of the UNDP LAC RHDR 2021; De Loecker and Eeckhout 2018.

Note: Average markups by year are estimated as the year fixed effects from a linear regression on the average markup by country, with year and country fixed effects. OECD (1990) corresponds to countries that belonged to the OECD in 1990. Rest of the world corresponds to all countries in the sample that are not part of Latin America.

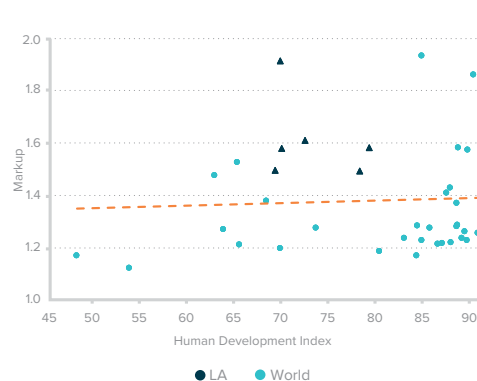
Figure B3.1.2 shows that, globally, there is no systematic relation between market power and a country's development level measured by its gross domestic product (GDP) per capita or its human development index (HDI). High market power appears to be a defining feature of Latin American countries, however. No data are available that are informative on market power in countries falling in the lower development categories in the region.

**Figure B3.1.2: High markups are not a defining feature of a particular development stage**

a. Markup versus GDP per capita



b. Markup versus HDI



Source: UNDP elaboration. Markups from De Loecker and Eeckhout (2018); GDP per capita from World Development Indicators; human development index (HDI) from UNDP.

Note: HDI is the average across 1990-2016.

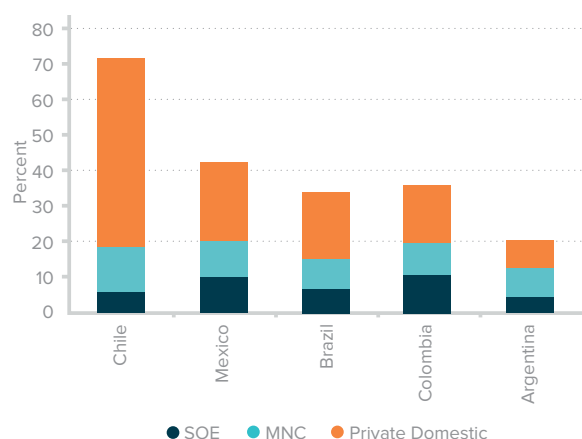
<sup>a</sup> See Worldscope (database), Baker Library, Bloomberg Center, Harvard Business School, Boston, <https://www.library.hbs.edu/find/databases/worldscope>.

Another distinctive feature of Latin America is the prevalence of markets dominated by a small number of giant firms, primarily diversified business groups and multinational corporations. Revenues of the 50 largest firms represented between around 20 percent (Argentina) and about 70 percent of GDP (Chile) in 2019 (figure 3.1). State-owned enterprises (SOEs) have become less widespread since the wave of privatizations in the 1990s. However, their revenues still account for 8 percent (Chile) to 25 percent (Colombia) of the total revenues from this group, and those that remain are giant firms, often in the oil sector. The revenues of multinational corporations represent between 20 percent (Chile) and 43 percent (Argentina) of the total, and the rest are private domestic firms, frequently diversified, family-controlled

business groups.<sup>13</sup> These contribute between 39 percent (Argentina) and 73 percent (Chile) of revenues (figure 3.2). Chile ranks highest on various measures of market concentration and by the presence of huge conglomerates. This probably explains why an overwhelming majority of Chileans see big businesses as the most influential and powerful group in the country (figure 2.14).

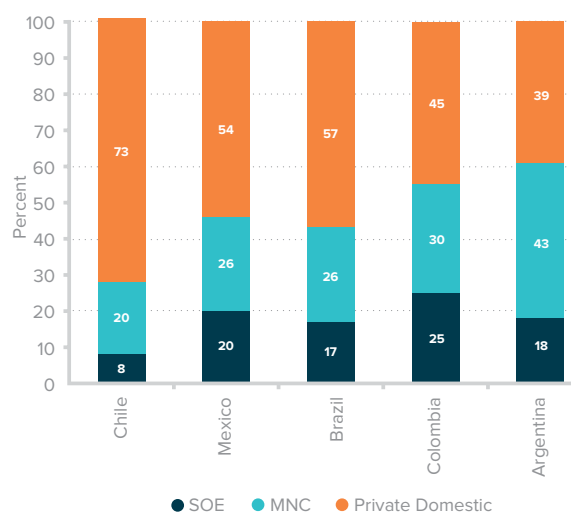
**Figure 3.1: Giant firms dominate Latin American markets**

*Revenues of top 50 firms (as percent of GDP), 2019. Selected countries*



**Figure 3.2: The share of private domestic firms among the largest is highest in Chile**

*Revenues of top 100 firms, by firm type, 2019. Selected countries*



Source: Schneider 2021, Background Paper of the UNDP LAC RHDR 2021; S&P Capital IQ dataset; World Development Indicators. Note: Companies are assigned to a country based on their country of incorporation. State-owned enterprises (SOEs) are those in which a national or subnational government holds a majority share. Multinational corporations (MNCs) are identified by the headquarters of the ultimate corporate parent of the companies. Revenue data are for 2019.

## Some evidence of the effects of market power on productivity and welfare

Because of a lack of good microeconomic data or difficulty in accessing such data, there is little empirical evidence on the impact of market power in LAC countries. There are few industry-specific studies with properly defined relevant markets that tell pieces of the story. Most of the evidence available about damages to consumers, input providers, or workers is from cases handled by competition authorities in the region. Sanctions imposed in the context of cartel investigations are, for example, informative about the damage borne by consumers (box 3.2).

<sup>13</sup> Business groups are large conglomerates, often with subsidiaries in unrelated sectors and mostly family-owned and managed (Khanna and Yafeh (2007); Schneider (2008); Bull, Castellacci, and Kasahara (2014)).



### Box 3.2: The damages caused by cartels

Recent success in Latin America in detecting and punishing cartels, especially in Brazil, Chile, and Mexico, is noteworthy, but not a cause for complacency because authorities are most likely catching only a fraction of the colluders. Cartels transfer resources massively from consumers to business owners. These transfers can be especially damaging to the poor if they target food and essential goods. The damage caused should not be minimized. A worldwide review of more than 700 studies and judicial decisions identified 2,041 cases of overcharging coordinated by hardcore cartels, with a mean estimated overcharge of 49 percent and a median overcharge of 23 percent.<sup>a</sup>

Chilean government regulators uncovered collusive cartel pricing in several mass-market goods, including toilet paper, pharmaceuticals, and fresh chicken. These cartels included both huge domestic business groups and large multinational corporations. It is revealing that colluding firms targeted products with relatively inelastic demand. In the toilet paper case, an iconic firm, CMPC, was found to have conspired from 2000 to 2011 with a much smaller firm, PISA. Together they controlled between 80 and 90 percent of the market and could set prices. Consumer groups estimated the total overcharges at US\$500 million.<sup>b</sup> CMPC agreed to reimburse consumers US\$150 million of its ill-gotten gains.<sup>c</sup>

<sup>a</sup> Connor (2014).

<sup>b</sup> The Economist (2015).

<sup>c</sup> France 24 (2018).

Research has focused mostly on examining the effects of import competition on firm productivity and innovation in Latin America.<sup>14</sup> The studies use the exogenous trade liberalization episodes in the 1980s and 1990s and find positive effects of increased import competition on productivity, product quality, the number of products, innovation, and job rotation.<sup>15</sup> Only a small number of empirical research papers has looked at the impact of enhanced competition on welfare in Latin America. Most notable is research investigating the effect of increased competition caused by the entry of multinational

<sup>14</sup> For a detailed review of this literature, see Shu and Steinwender (2019).

<sup>15</sup> Muendler (2004); Schor (2004); Fernandes (2007); Iacovone (2012); Fernandes and Paunov (2013); Iacovone et al. (2015); Medina (2018).

retail chains in Mexican markets. This research finds that new foreign competition entry resulted in reduced living costs among households, alongside productivity gains among domestic suppliers, higher store exits, lower domestic store profits, and lower incomes among traditional retail sector workers.<sup>16</sup> More generally, the entry of hypermarkets has reduced prices in local markets in Chile, increased local store exits in Uruguay, and reduced prices and improved service quality in markets in Dominican Republic through increased competition.<sup>17</sup> Market power, in contrast, is associated with economywide welfare losses through price increases that mainly affect the incomes of poor households.<sup>18</sup> In urban Mexico, relative welfare losses experienced because of monopoly power in essential goods markets —corn tortillas, processed meats, chickens, eggs, milk, and others— are 19.8 percent greater among the poorest households than among the richest households.<sup>19</sup>

This report offers new analytical insight on the relationship of markups, market concentration, wages, and productivity in selected Latin American countries.<sup>20</sup> The evidence of Eslava, Meléndez, and Urdaneta (2021) confirms the finding of very high and constant average market power in the region's manufacturing sector. It also shows that, in markets defined broadly at the industry level,<sup>21</sup> higher markups are associated with lower labour shares of income. This result points at rents from market power unevenly distributed between workers and business owners in favour of the latter. Redistribution in the opposite direction occurs even though average wages are also higher in markets functioning with higher levels of market power (suggesting some rent-sharing between the firms and their workers). Higher market power is also associated with slightly higher total factor productivity (TFP). Businesses with high market power are also among the largest. The unequal distribution of firm sizes —markets dominated by a few big businesses that coexist with large numbers of tiny ones— is part of the story told by these data: fragmented markets where big businesses are dominant because they face small lower productivity rivals, unable to compete with them. (Chapter 5 revisits this finding from another angle, in the context of examining the incentives from labour market regulations and social protection policy in LAC and their effect on firm size and productivity.)

The evidence also suggests that, if concentration increases in an industry-level market, the increase is driven by the single largest firm in terms of revenue in that market. This finding may not be independent of the fact that big business monopoly rents frequently translate into political power, which perpetuates monopoly rents (see below).

<sup>16</sup> Javorcik, Keller, and Tybout (2008); Iacovone et al. (2015); Atkin, Faber, and Gonzalez-Navarro (2018).

<sup>17</sup> Lira, Rivero, and Vergara (2007); Borraz et al. (2014); Busso and Galiani (2019).

<sup>18</sup> Rodríguez-Castelán (2015).

<sup>19</sup> Urzúa (2013).

<sup>20</sup> Data are only available on Chile, Colombia, Mexico and Uruguay.

<sup>21</sup> Sectors are defined as ISIC 3-digit sectors in Chile, Colombia, Ecuador, and Uruguay (revision 3 for Chile and revision 4 for the other three countries) and as NAICS 4-digit sectors in Mexico.

Another piece of new evidence relates to the effects of market power in the labour market. Using microeconomic labour market data from tax records in Chile, García-Marín (2021) explores the relationship between market concentration and wages. His research shows that labour demand is highly concentrated in Chile, giving firms great power over workers. Concentration has remained high over time, and slightly increased in recent years. The econometric evidence shows that higher employer concentration is associated with lower average wages, and in particular with lower wages among higher-wage workers. Low-wage workers are, in contrast, less affected by employer concentration because their skills are not so occupation-specific, or because they are protected by minimum wage regulations, or both. Consequently, employer concentration reduces wage dispersion by moving all workers' salaries closer to the minimum wage (Thus, wage inequality falls for the wrong reason.)

García-Marín (2021) also shows that the negative effect of labour market concentration on workers' earnings varies with the level of their employer's product market power. Higher product market power lessens the negative impact of labour market concentration on average wages, probably because high markup firms with advantageous hiring positions in concentrated labour markets can pay higher labour costs that they pass on to consumers (sharing some of their rents with their workers).

### **Competition law is an essential policy tool to curb excess market power**

The analysis argues that monopolies with dominant control over markets can potentially foster both inefficiency and inequality. Competition laws (also referred to as antitrust or anti-monopoly laws) are one policy lever that countries can use to break out of this vicious economic cycle by promoting fairer market competition. These laws are aimed at preventing anticompetitive or abusive behaviour by firms with large market power in the economy. This might include curbing practices that harm consumer welfare, such as setting unreasonably high prices when consumers lack access to alternative options, or preventing other firms from competing by setting unreasonably low prices in the short term to drive out competition. Depending on how their design and enforcement shape the de facto power of firms, these laws may have different efficiency and equity implications.

Schneider (2021) contends that, behind the structure of business in the region (and the concentration of power associated with it) is the weakness of competition regulations and agencies. He argues that the Washington Consensus led to too many firms with

market power.<sup>22</sup> This occurred directly through the privatization of public oligopolies and monopolies or indirectly because trade liberalization encouraged mergers to gain the scale needed for international competition. The Washington Consensus also recommended facilitating the entry of multinational corporations, perhaps because it was felt that these corporations would make domestic markets more competitive. This did happen in some instances. In others cases, however, anticompetitive behaviours by multinational corporations came to light later in antitrust investigations. At the time, the countries in LAC were largely unprepared to contain market power because of their nonexistent or weak competition laws and agencies.<sup>23</sup>

Today, 20 LAC countries have adopted competition laws.<sup>24</sup> In the last two decades, eight LAC countries have issued competition laws for the first time.<sup>25</sup> Nine countries have amended their laws.<sup>26</sup> However, most of the activity has taken place in Latin America, where only two countries —Bolivia and Guatemala— do not have a general antitrust regulation. In general, all Latin American regulatory frameworks prohibit both anticompetitive agreements and the abuse of a dominant position. Except for Peru, all countries have issued rules to control mergers. Many countries have reformed their laws and issued regulations in preparation for the implementation of free trade agreements with the United States or the European Union (EU) because these agreements usually have provisions on competition, including obligations to pass a competition law and establish a competition authority. At a supranational level, the Andean Community of Nations issues competition policy regulations for member countries. It has ruled over fines and sanctions, the investigative power of competition authorities, and the burden of proof on damage caused by anticompetitive conduct. It has also provisionally extended its regional framework of competition dispositions to be adopted by Bolivia, in light of the absence of a national competition law there.<sup>27</sup> In the Caribbean, only four countries have competition laws and authorities: Barbados, Guyana, Jamaica, and Trinidad and Tobago. Their absence in other countries is somewhat offset by the CARICOM Competition Commission, a regional antitrust agency.

<sup>22</sup> The Washington Consensus is a term coined in 1989 to refer to a set of 10 economic policy prescriptions considered as the standard reform package promoted at the time among crisis-wracked developing countries by Washington, DC-based institutions, such as the International Monetary Fund (IMF), the World Bank and the United States Department of the Treasury.

<sup>23</sup> It is not just in Latin America where antitrust policies and agencies were new. Before the mid 20th century, only the United States had effective antitrust policies; by the 1960s, several dozen countries joined the United States. The European Union only got serious about antitrust in the 1980s (see Connor (2009)).

<sup>24</sup> Argentina, Barbados, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guyana, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, Trinidad and Tobago, and Venezuela.

<sup>25</sup> Barbados (2000), El Salvador (2004), Honduras (2005), Nicaragua (2006), Trinidad and Tobago (2006), Uruguay (2007), Dominican Republic (2008), and Ecuador (2011).

<sup>26</sup> Brazil (2000 and 2011), Argentina (2001), Chile (2002, 2003 and 2009), Mexico (2006-2011), Panama (2006 and 2007), El Salvador (2007), Peru (2008), Colombia (2009), and Costa Rica (2010).

<sup>27</sup> Decision 608, on the rules for the protection and promotion of competition, was adopted by the Andean Community in 2005.

## Without effective enforcement, even strong competition laws on paper may remain weak in practice

No matter if there are competition laws or how strong they are on paper, they are only as effective as their enforcement. In most countries, the enforcement agency is a national state authority. With few exceptions, competition authorities are part of the executive branch, and the president has the authority to replace the head of the control entity at will.<sup>28</sup> In contexts with close ties between political elites and business elites, factors such as the independence of the enforcement agency or commitment mechanisms that ensure limited discretion in decision-making may be essential for ensuring the efficacy of policies.

Data collected by the OECD show the budgets of competition authorities as a share of GDP in the Americas (including nine Latin American countries, Canada, and the United States). Latin America stands out for its low budgets compared with the OECD threshold and other world regions.<sup>29</sup> Though budget alone is not a perfect measure of the activity of antitrust agencies in the region, it speaks to their capacity and their place in government policy priorities. Perhaps more informative is the fact that, while merger reviews are commonplace across the region, blocked or withdrawn mergers are practically nonexistent, except in Brazil.

Despite progress over the last three decades in creating and improving antitrust enforcement, there is still a long way to go. Agencies often lack the powers required to investigate, for instance, through dawn raids, and are unable to offer attractive leniency agreements to promote whistleblowing among cartel members. They are also unable to contain abuses of market power and cartelization through fines and penalties. Most of them also lack appropriate staffing in numbers and expertise.<sup>30</sup>

In the Executive Opinion Survey, the World Economic Forum asks respondents to rate the effectiveness of policy at ensuring fair competition with a grade between 1 (not effective) to 7 (extremely effective).<sup>31</sup> The average score in Latin America in the 2017-2018 wave of the survey is a mediocre 3.3. On one extreme, Haiti, Venezuela, and Dominican Republic score below 2.5. Haiti does the worst in the world by this measure, ranked last among the 137 countries surveyed. Nicaragua, Paraguay, and Argentina follow closely with scores under 3.0 and also rank in the tail of the distribution. On the other extreme, Chile ranks 35 in 137, with a score of 4.4, followed by Costa Rica, Panama, Jamaica, and Brazil (figure 3.3).

<sup>28</sup> Miranda (2012).

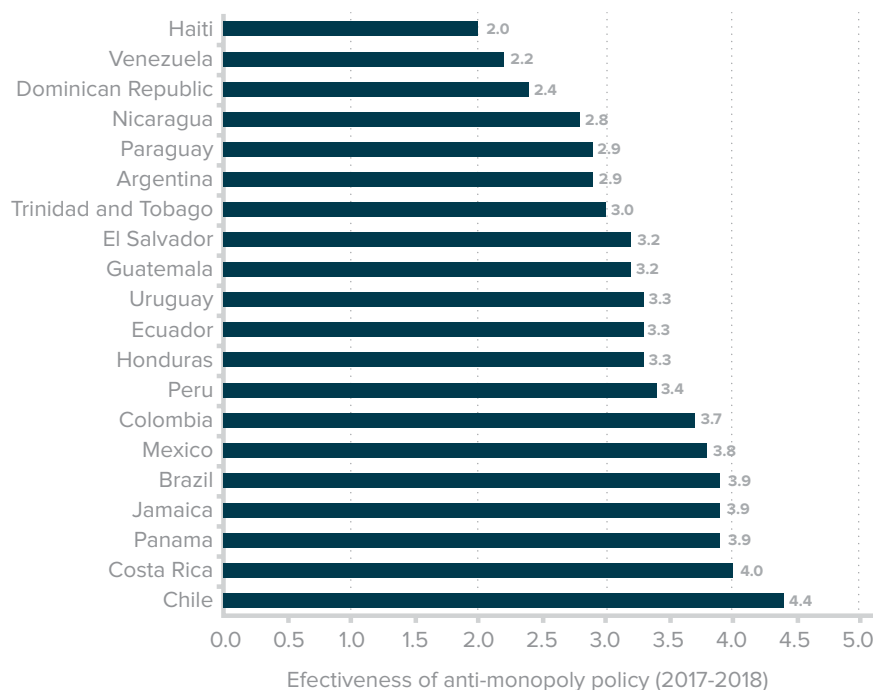
<sup>29</sup> OECD (2021).

<sup>30</sup> See OECD (2021).

<sup>31</sup> See Schwab (2018), appendix B.

**Figure 3.3: Anti-monopoly policies largely fail to ensure fair competition in LAC**

*In your country, how effective are anti-monopoly policies at ensuring fair competition? (1 = not effective at all; 7 = extremely effective), 2017-2018 weighted average*



Source: See Schwab 2018, appendix B.

### Business political power is often responsible for competition policy weakness

The existence and effectiveness of competition laws and agencies are not exogenous to business political power. The history of the communication sector is a powerful example. Thus, concentration and oligopolistic pricing in Mexican telecommunication has been extensively documented.<sup>32</sup> Initially, neither the competition agency nor the sector regulator could inhibit monopoly power. Telmex, alongside other giant firms, belong to what is known in the literature as *poderes fácticos* (factual powers), that is, powerful actors who can dilute or evade government control through lobbying and interference across the three branches of government: congress, the executive, and the judiciary.<sup>33</sup> Members of this elite in telecommunication and the media have lobbied for favourable legislation in Mexico (see box 3.3) and used the judicial system to stymie regulators. As a result, in 2013, the Pacto por México, a political agreement

<sup>32</sup> See Levy and Walton (2009).

<sup>33</sup> Trejo (2013).

among the three largest parties, was designed to regain state control over these de facto powers in the telecommunication sector and elsewhere. While this resulted in substantive changes to the Constitution of Mexico in matters of competition, they have yet to translate into equally substantive changes in the structure of the telecommunication sector, which is still dominated by the same firms.

Big business in some countries has found ways to use courts and other legal provisions to obtain injunctions against the implementation of antitrust measures.<sup>34</sup> For example, the constitutional right of amparo, which is granted to citizens in some countries to stop a policy with potentially harmful effects, has often been used to tie up antitrust rulings in court.<sup>35</sup> The practice was so widespread among firms that consulting businesses emerged specializing in amparos for business.<sup>36</sup> In Brazil, defendants could appeal decisions of the Administrative Council for Economic Defense through up to four layers of appeals courts. In Chile, other courts and the supreme court have often overturned judgments of the national economic prosecutor or achieved reduced penalties.

One may easily forget that trade protection can work in similar ways to cartels by fixing minimum prices. The difference between domestic and international prices constitutes yet another non-market transfer from consumers to firms. The net distributional effect depends on who consumes the product and whether workers in protected firms receive a large part of the transfer. In any case, these transfers merit greater scrutiny.

## Factors that enhance business political power

Business actors exert political influence through deliberate political engagement and their profit-maximizing responses to market signals. Businesspeople's actions in diverse arenas —labour markets, taxes, pricing— have the potential to increase inequality and lower productivity growth, even when this is not what in the abstract they would prefer.

Political scientists and political economists have carefully examined the factors, particular to the region, that may be contributing to enhanced business political power. A first suspect is the electoral rules prevailing in many countries that result in fragmented party systems. Majoritarian presidential elections, combined with proportional representation elections for legislatures, are common in Latin America and rare elsewhere.<sup>37</sup> This combination of electoral rules results in fragmented

<sup>34</sup> The courts often also helped business challenge tax increases. On Guatemala, see Bogliaccini and Madariaga (2019).

<sup>35</sup> Elizondo (2009).

<sup>36</sup> Schneider (2021).

<sup>37</sup> Chaisty, Cheeseman, and Power (2018).



party systems and presidents elected without legislative majorities. Party support in congress through legislative coalitions is built through political transactions. In fragmented party systems, a natural by-product of proportional electoral systems, small groups of legislators extract rents from the executive in return for votes on legislation. This fragmentation opens opportunities for businesses to finance parties or candidates to use these vote negotiations in their favour.<sup>38</sup>

A second suspect is malapportionment, an institutional feature also common in Latin America, whereby sparsely populated, usually rural districts are overrepresented in Congress. Higher malapportionment is associated with lower income taxation and higher inequality in 16 Latin American countries. Economic elites have pressed for malapportionment in moments of institutional reform, to protect their interests. As a result, overrepresentation of conservative rural districts has limited redistributive efforts from representatives of denser, poorer, urban districts.<sup>39</sup>

A third suspect is media concentration. Big business and media in all its forms are closely interwoven, and media ownership is highly concentrated throughout LAC. The dominant media firms are well-known business groups. Some of them started as newspapers or radio businesses in the 20th Century and have become dominant in other media markets (see examples of large and diversified corporate groups in the media in Argentina, Brazil, Chile, Mexico and Peru). Others started in different sectors and moved into media, the case of other groups in Argentina, Chile, Colombia, and countries in Central America.<sup>40</sup> Concentration is high across all media (print, radio, and television) and communication services in the region. The largest four operators control 82 percent of the market, ranging from about two thirds in radio and print media to over 90 percent in television.<sup>41</sup> These firms, at a minimum, are not likely to use their media programming to argue for taxing corporations and their owners or the use of regulation to restrict media concentration.

Moreover, beyond content, media firms also deploy their power in traditional ways. There are many cases of big business using democratic legislatures to pursue their interests. (An example in Mexico is shown in box 3.3).

<sup>38</sup> Schneider (2013).

<sup>39</sup> Ardanaz and Scartascini (2013).

<sup>40</sup> Segovia (2005). Carlos Slim did not buy up major content media in Mexico (possibly because incumbent business groups were unwilling to sell), but he did buy 17 percent of the *New York Times* (Alpert and Beckerman (2015)).

<sup>41</sup> Becerra and Mastrini (2009).



### Box 3.3: The “Ley Televisa” in Mexico

In the early 2000s, the Government of Mexico decided to reform telecommunication regulations. The legislation at the time had been in place since 1960 and was severely outdated. In October 2004, a draft bill establishing the new legislation for regulating the industry was presented. It generated high expectations. The turbulence of an upcoming presidential election, however, led to the dilution of the bill. On 1 December 2005, a completely different bill was proposed. The legislation was approved unanimously by the Chamber of Deputies on 21 March 2006, after 7 minutes of deliberation. It was later approved by the Senate without modification; a minority of senators were opposed.

The new legislation passed in 2006 was deemed a step back in competition in the telecom sector. It was criticized because it benefited large incumbent firms, Televisa and TV Azteca. The new law benefited incumbents against newcomers in several ways. First, it granted control of the radio spectrum concessions to the current radio broadcasters for 20 years, renewable and with priority over third parties. In essence, it guaranteed that current radio broadcasters, such as Televisa, controlled the radio spectrum in perpetuity. Second, it expanded the sphere of action of current broadcasters. Under the new law, incumbents wishing to use radio frequency for additional telecommunication services could do so for free, while newcomers had to bid for the frequency in an auction. The new law made it extremely difficult for newcomers to enter the market. Lack of competition in telecommunication implied lower quality and less trustworthiness in the information being broadcast.

The swift approval of this new legislation without major revision is said to be a result of intense lobbying. Some legislators were critics of the Ley de Televisa. A group of 47 senators demanded the bill. The Supreme Court ruled declaring several articles unconstitutional and automatically repealing them. Despite the Supreme Court’s intervention to counter Televisa’s interference in public policy, the firm has maintained a close relationship with legislators.

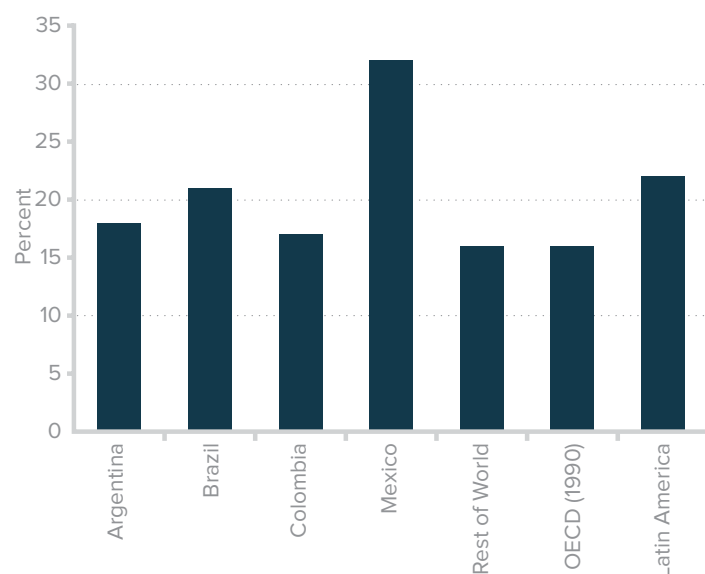
Source: Castañeda and Ruiz (2021), Background Paper of the UNDP LAC RHDR 2021.

A fourth suspect is family-owned firms. There are three hypotheses about the role played by business families in politics. First, relative to paid professional managers, families have a more intense attachment to their firms. They are likely to be more intensely opposed to taxation, regulation, and other measures that adversely affect family patrimony. Second, families have advantages in politics because of their

longer time horizons relative to professional managers.<sup>42</sup> If families agree to support politicians, they can more effectively monitor their performance over time and reward or punish accordingly.<sup>43</sup> Third, families resolve agency problems both in management and politics.<sup>44</sup> Later generations sometimes go into politics giving business families trusted representation within the political elite. The family-ownership factor is not negligible. On average in Latin America, 22 percent of corporations listed in the stock exchange, and 28 percent of large firms (with 100-5,000 employees) are family owned (figures 3.4 and 3.5). Family-owned businesses are among the largest 50 businesses and contribute at least 30 percent of revenues from this group (Brazil) up to more than 90 percent (Mexico). An extreme example of the role played by family-owned businesses, for which there is little quantitative but much anecdotal evidence, is the case of Haiti (box 3.4).

**Figure 3.4: On average in Latin America, 22 percent of corporations listed in the stock exchange are family-owned**

*Fraction of corporations listed in stock markets, from strategic individuals and families, 2019*



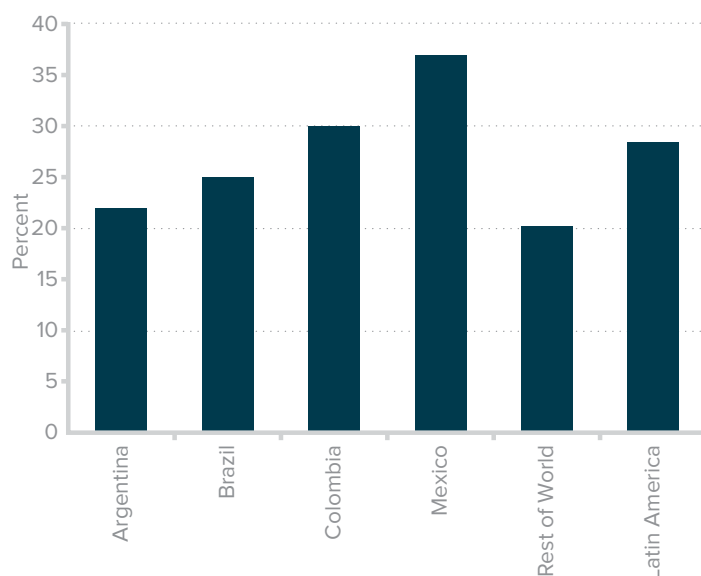
Source: OECD 2019.

Note: Data based on the 10,000 largest listed companies covered by the OECD report. Strategic individuals and families refer to controlling owners or members of a controlling family or block-holders and family offices.

<sup>42</sup> Morck, Wolfenzon, and Yeung (2005).

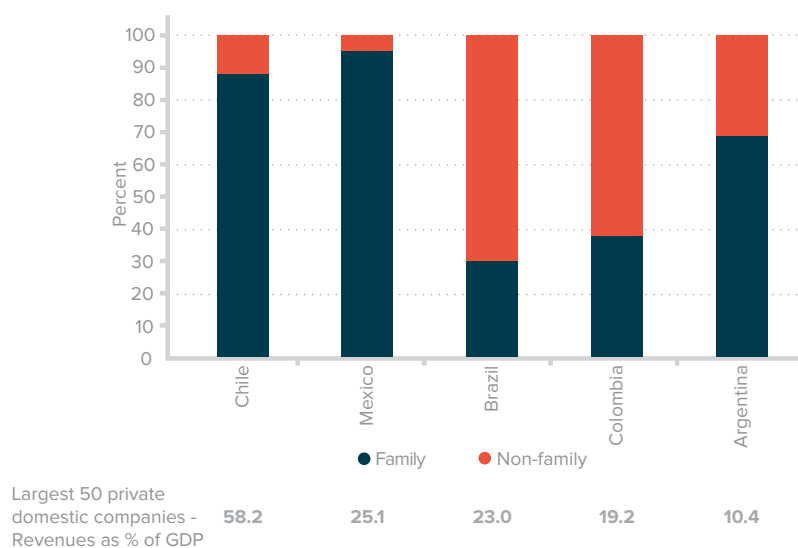
<sup>43</sup> Schneider (2013).

<sup>44</sup> Schneider (2008).

**Figure 3.5: On average in Latin America, 28 percent of large firms are family-owned***Fraction of family-owned firms with 100 to 5,000 employees, 2004-2010*

Source: Bloom et al. 2012.

Note: The firms surveyed are in manufacturing, hospitality, schools, and retail sectors, have 100 to 5,000 employees, and are drawn from national firm databases and company registries.

**Figure 3.6: Family-owned firms are among the largest by revenues***Share of revenues from domestic firms among the 50 largest, by ownership, 2019. Selected countries*

Source: Schneider 2021, Background Paper of the UNDP LAC RHDR 2021; S&amp;P Capital IQ; World Development Indicators.

Note: Companies are assigned to a country based on their place of incorporation.

### Box 3.4: Concentration of power in Haiti

Haiti has a long history of close ties between economic and political elites. For decades, autocratic leaders have traded economic privileges for political support from the wealthiest and most powerful families. The political instability characterizing the country has constantly induced this practice among leaders in need of support. During the second half of the 20th Century, exclusivity and statutory monopolies were granted by presidential decree to a long list of industries, including mining and oil, telecommunication, agriculture, and sesame processing.<sup>a</sup> However, perhaps the most critical exclusivity granted by the government has been in imports. In 1985, 19 families held exclusive rights to import the most widely consumed products.<sup>b</sup> Some of these rights have been legally dismantled, yet informally maintained because of a lack of regulation or enforcement. Haiti imports most of its final products, and, according to the World Bank, 70 percent of total imports in value are highly or moderately concentrated among a small number of importers.<sup>a</sup>

Haiti is a net importer of food. As the main food staple in Haitian households, rice is a good example. Haiti imports over 80 percent of the rice it consumes (mainly from the United States). Although there are 20 firms importing rice in Haiti, six importers are responsible for 70 percent of the rice imports and control the rice market, virtually unchallenged. Importers are also active as wholesalers. In total, 10 major wholesalers serve the country; they tend to indulge in price speculation.<sup>c</sup>

The rice industry illustrates a situation that is similar in various sectors of the economy. Food markets in Haiti are highly concentrated and import dependent. Incumbents do not allow the entry of new competition, and there are no institutions to regulate their conduct. Weak contract enforcement motivates economic actors to operate among friends or family members.<sup>a</sup> Large businesses are family owned, and access to management and ownership is essentially closed to non-family members. Investors perceive that Haiti is the country in the Caribbean with the highest risk of discriminatory policy favouring incumbents, mainly related to price controls and discrimination against foreign firms.<sup>d</sup>

Haiti ranked 138 among 140 countries in 2019 in the global competitiveness index.<sup>e</sup> In 2020, it ranked 179 in the overall ease of doing business, 189 in the ease of starting a business, and 127 in contract enforcement among 190 countries.<sup>f</sup>

<sup>a</sup> Singh and Barton-Dock (2015).

<sup>b</sup> Fass (1990).

<sup>c</sup> Furche (2013). The data here refer to 2010, the latest available year.

<sup>d</sup> On the Economist Intelligence Unit's Operational Risk Model, see EIU (2013).

<sup>e</sup> 2019 data, Ease of Doing Business Index (database), World Bank, Washington, DC, <http://data.worldbank.org/indicator/IC.BUS.EASE.XQ>.

<sup>f</sup> 2019 dataset, GCI (Global Competitiveness Index) (database), World Economic Forum, Geneva, <http://reports.weforum.org/global-competitiveness-index/>.

The menace of capital flight and disinvestment enhances business influence on policy. If the government thinks a tax or spending policy or a regulation to promote redistribution will lead businesses to reduce investment, thereby hurting economic growth and employment generation, it may withdraw the measure. Reactions to business behaviour are often anticipated reactions, whereby governments drop policy proposals over the concern that the proposals may lead to disinvestment even before the proposal is adopted.<sup>45</sup> Business leaders weaponize this power when they claim that certain policies will provoke disinvestment. Governments are more likely to worry about depressing business investments if elections are near and unemployment is high. Most recently, fiscal imbalances resulting from the COVID-19 pandemic have made governments more dependent on private investment to promote economic recovery, enhancing the political power of businesses.

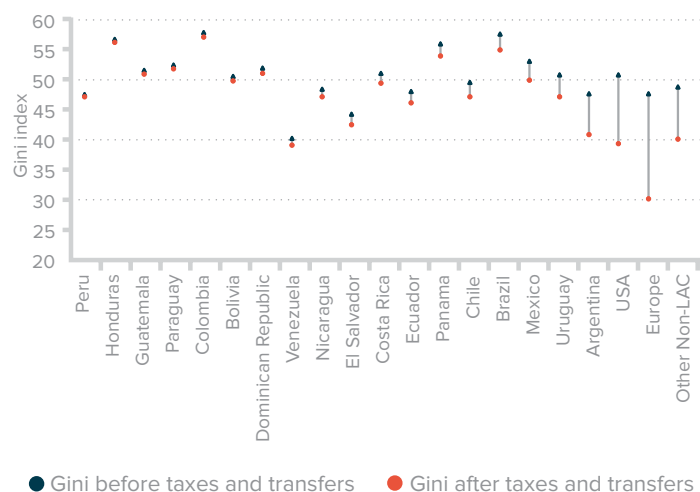
### 3.3. Fiscal redistribution in LAC remains comparatively weak

The concentration of power in the hands of a few not only distorts policy in the market arena. It can also have critical effects on other policy spheres. Of particular concern in the context of the high inequality-low growth trap explored in this report are the effects on taxation and the design of fiscal policy. This section looks at some of the challenges facing the fiscal systems in the region.

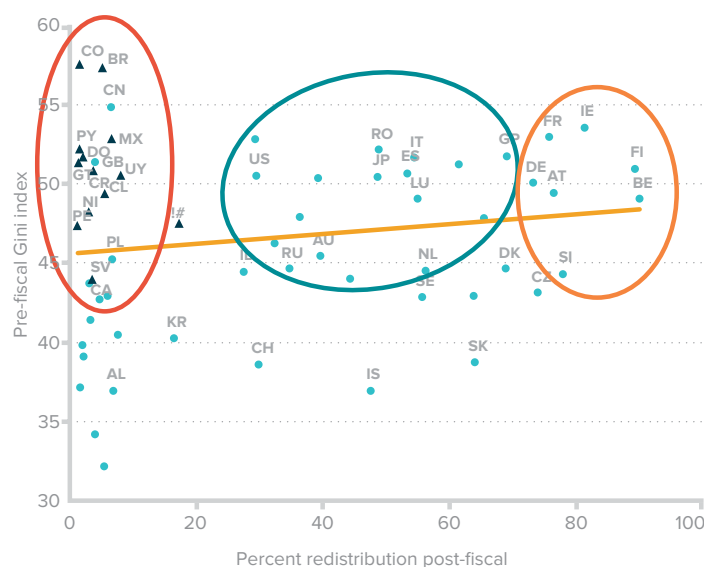
A distinctive feature of fiscal policy in the region is its weak redistributive power. Gini indices in Latin America, with few exceptions, remain essentially unchanged after households pay taxes and receive government transfers (figure 3.7). In Europe, the average Gini index is 47 if redistributive policies are not considered, but 30 if they are considered. In Latin America, the corresponding values are 51 and 49. In Europe, these policies thus reduce the index by 17 points, compared with only 2 points in Latin America.

Although average Gini indices before taxes in the developed world are comparatively low, a closer look at country-level redistributive dynamics shows that many developed countries start at inequality levels similar to those in Latin America. However, these countries manage to transform their income distributions during their transit through the fiscal system (figure 3.8), while most LAC countries do not. After taxes and transfers, inequality falls by 29 points in the United States and 54 points (on average) in Europe, but much less in Latin America: 2 points in Colombia, Dominican Republic, Guatemala, and Paraguay; 4 points in Costa Rica and El Salvador; in the upper extreme, 8 points in Uruguay and 17 points in Argentina. The average redistribution in the 13 countries of Latin America is only 5 points.

<sup>45</sup> Fairfield (2015) offers detailed empirical studies of the Lagos government in Chile in the early 2000s when the Finance Ministry moderated tax increases to avoid a backlash from business.

**Figure 3.7: There is little redistribution through the fiscal system in LAC***Gini indices before and after taxes and transfers, circa 2014*

Source: UNDP elaboration based on OECD Database and CEQ Data Center on Fiscal Redistribution, Commitment to Equity Institute, Tulane University, <https://commitmenttoequity.org/datacenter/>.

**Figure 3.8: LAC countries' fiscal systems are stingy compared with those in the developed world***Pre-fiscal Gini index vs. percent redistribution after taxes and transfers*

Source: Schneider 2021, Background Paper of the UNDP LAC RHDR 2021. Data updated by UNDP using data from OECD and CEQ Data Center on Fiscal Redistribution, Commitment to Equity Institute, Tulane University, <https://commitmenttoequity.org/datacenter/>. Note: OECD calculations exclude indirect taxes and subsidies via the provision of health care or education. To make the numbers comparable, they are compared with the Gini index of market and disposable income of the CEQ Data Center.

In addition, tax systems in the region fail to generate the necessary revenues to invest in development through government provision of quality services and public goods to

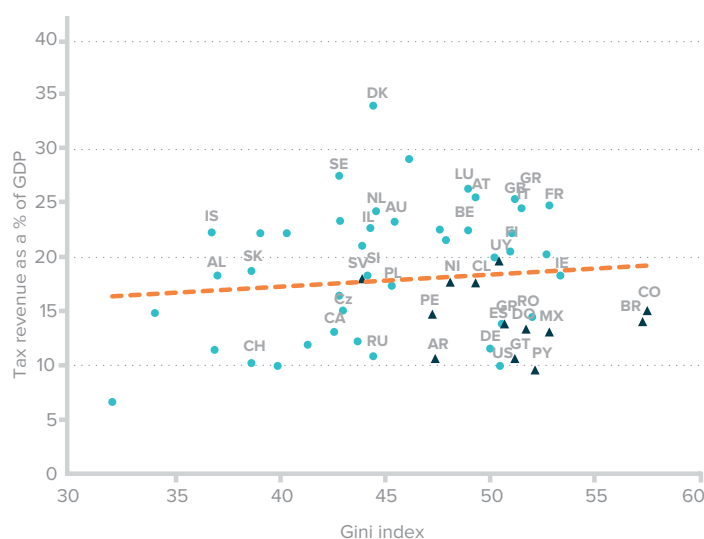
the population. Part of the challenge faced by the region during the COVID-19 pandemic relates to the limited fiscal response capacity of governments. Tax revenue as a share of GDP is less in LAC countries than in other countries at similar levels of development and less than in countries at comparable inequality levels (figures 3.9 and 3.10).

**Figure 3.9: LAC countries collect less taxes as a share of GDP than countries with similar development levels**



Source: UNDP elaboration. Tax as percent of GDP from World Development Indicators (WDI). Human Development Index (HDI) from Human Development Report Office 2020. GDP per capita from World Development Indicators (WDI).

**Figure 3.10: LAC countries collect less taxes as a share of GDP than countries at similar inequality levels**  
*Tax revenue (as percent of GDP) vs. Gini index*

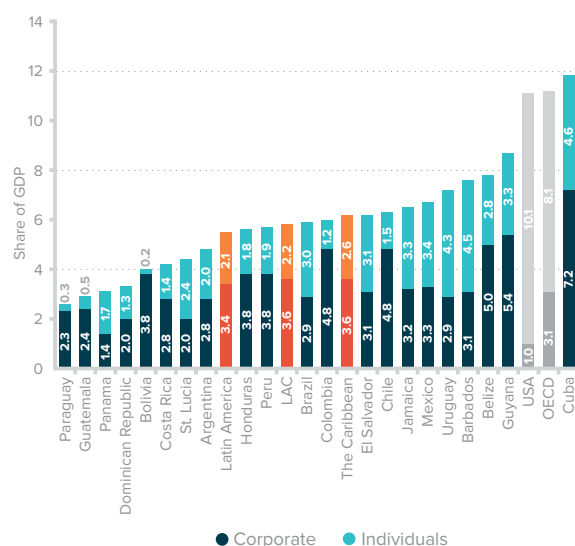


Source: UNDP elaboration. Tax as percent of GDP from World Development Indicators (WDI). Gini indices from OECD Database and Data Center on Fiscal Redistribution, Commitment to Equity Institute, Tulane University, <https://commitmenttoequity.org/datacenter/>.

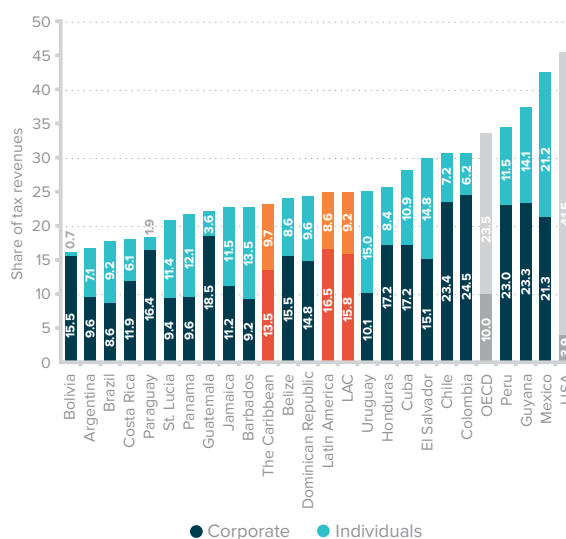
In LAC, personal income taxes and other taxes falling on individuals have historically been low (figure 3.11). At an average of 2.2 percent, these taxes as a share of GDP (panel a) in the region are well below levels in the OECD (8.1 percent) and the United States (10.1 percent). Consequently, tax collections from individuals across LAC countries make up only 9.2 percent of total tax revenues on average, roughly half the share in the OECD and one quarter the share in the United States (panel b). Low personal taxes are explained by low statutory tax rates and tax exemptions. Both statutory and effective tax rates in LAC applied to the highest incomes are well below corresponding rates in Europe and the United States.<sup>46</sup> In contrast, corporate tax revenues as a share of GDP in LAC (3.6 percent) are slightly higher than the OECD average (3.1 percent) and three times the average in the United States (1 percent) (panel a). The contribution of corporate taxes to total tax collection in LAC is approximately 6 percentage points and 12 points higher than the corresponding contributions in the OECD and the United States, respectively.

**Figure 3.11: Tax collection from direct personal taxes is low in LAC countries**

a. Direct taxes on income, profits, and capital gains, % of GDP, 2019



b. Direct taxes on income, profits, and capital gains, % of total tax revenues, 2019



Source: UNDP elaboration based on OECD Database.  
Note: OECD excludes Latin American countries.

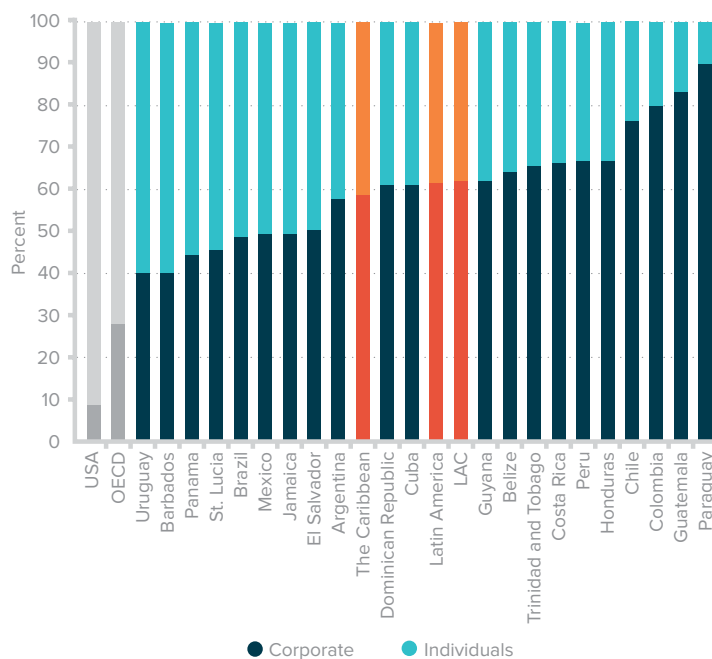
<sup>46</sup> Fairfield (2019).



These data should not give the impression that corporate tax rates in LAC are astronomically high (although, in some countries, that may be the case). They rather highlight different tax structures between LAC countries and developed countries. While developed countries tend to have tax systems in which households and individuals bear the largest share of the direct tax burden, this is not the case in LAC. Instead, they tend to have systems that place a heavier burden on the productive sector (figure 3.12). The relatively small direct tax burden borne by households is partly why direct taxes are less progressive in LAC. Wealthy households and individuals contribute comparatively less.

**Figure 3.12: Taxes to income, profits and capital gains are highly concentrated on the productive sector**

*Tax revenues from direct taxation, percent by type, 2019*



Source: UNDP elaboration based on OECD Database.

Note: OECD excludes Latin American countries.

Placing a heavier relative tax burden on the productive sector than on households has the disadvantage of potentially limiting economic activity and employment, while failing to tax the rich. In a context of concentrated business power, it also implies that the larger, more powerful businesses usually manage to work around statutory tax rates and end up paying lower effective corporate taxes than the smaller businesses as a share of their profits.

While the pattern of low overall taxation levels and the relative scarcity of fiscal revenue from income tax collection is likely the result of many different factors, one relevant factor in the context of this chapter is the way power is concentrated. In particular, the

extent of corporate clout in the political sphere. Indeed, big businesses and business owners in Latin America are partly responsible for maintaining overall effective taxation low and steering fiscal systems away from more progressive taxation through their proximity to political power. This influence is exerted via their interference in tax reforms. The interference ranges from blocking tax increases to compromising tax resources by pushing for exemptions and subsidies to their operations that crowd out redistributive spending. Economic elites also often obstruct expected tax collection through financial maneuvers in tax declarations that shield income from tax obligations.<sup>47</sup>

Business organization strategies to oppose tax increases represent a costly political trade-off for policymakers, especially when these strategies are centralized through coordinated associations (box 3.5).<sup>48</sup> A second and less conspicuous practice relates to business lobbying for tax cuts, exemptions, and deductions. Latin America ranks high on overall tax spending: the 3 percent of GDP in Brazil and 5 percent in Chile exceed the 1 percent in Germany and the 2 percent in the Netherlands (although not as high as in the United States, 6.5 percent).<sup>49</sup> Most of this spending is often associated with exemptions on businesses.<sup>50</sup> Moreover, taxation systems across Latin America are lenient in the private sector in aspects such as the heavy reliance on payroll taxes and the lack of supervision of transfer pricing transactions. The burden of payroll taxes can often be passed on to consumers and workers, in the form of reduced wages in the latter case.<sup>51</sup> Transfer pricing has made enforcing tax regulations on multinational corporations more difficult: their breakdown into subsidiaries and the rise of intrafirm trade among branches have made it easy to shift profits to jurisdictions with lower tax rates.

There are some outliers in the region that have succeeded in raising taxes. Most notably, in 2006, Chile's then presidential candidate Michelle Bachelet campaigned on the proposal of increasing taxes. In her first year in office, she delivered on her campaign promise and implemented a significant increase in taxes (equivalent to 3 percent of GDP), mainly affecting the richest 1 percent. She was backed by previous student protests and her electoral victory and had enough political momentum to implement these changes swiftly. However, consensus on which path is the right one to follow in tax reform in each country remains a highly contested issue, as evidenced by the recent protests that erupted in reaction to Colombia's proposed tax reform in May 2021.

<sup>47</sup> Fairfield and Jorratt (2014).

<sup>48</sup> Castañeda (2017).

<sup>49</sup> Sanhueza and Lobos (2014).

<sup>50</sup> Dutz (2018).

<sup>51</sup> Wibbels and Ahlquist (2011).

### Box 3.5: Private sector associations and the power of economic elites in LAC

This chapter argues that economic elites can play a role in perpetuating inequalities if they promote institutions that allow them to preserve and expand their privilege, while limiting the reach of redistribution through social spending.

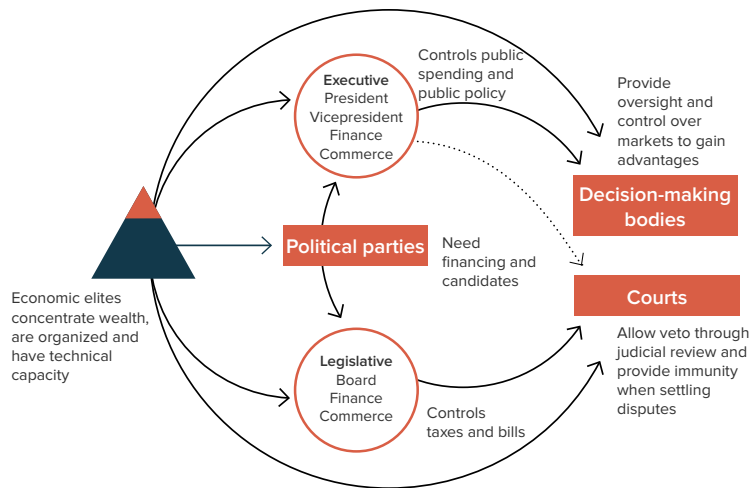
Business organization strategies to oppose tax increases represent a costly political trade-off for policymakers throughout the region, especially when these strategies are centralized through coordinated associations.<sup>a</sup> Despite wide intraregional variations in the degree of organization,<sup>b</sup> overall taxation is lower in countries with strong centralized business associations, such as Chile, Colombia and Guatemala. Over the past three decades, organized associations seeking to secure private interests in LAC have employed a comprehensive set of persuasive practices to influence fiscal policy. One of these practices involves directly blocking corporate tax increases. Government efforts to raise corporate taxes in Argentina and Chile during the 2000s had notably different results.<sup>c</sup> Chile's proposed tax increases in 2003 and 2005 were met by major obstacles from business associations and their political allies. In contrast, Argentina's Government met less opposition from fragmented associations with fewer political connections.

The cases of Guatemala and Honduras provide good examples for understanding the dynamics of elite power in shaping the market and fiscal distribution policies, and the elements underlying them, which are shared by many countries across the region. The paradoxical combination of sustained economic growth and persistent inequality shared by these countries can be at least partially attributed to the disproportionate influence of business elites on democratic outcomes and processes of policy design. This influence has led to selective government responses during the determination of priorities and the orientation of institutional capacity, ultimately limiting investments in development. As a result, fiscal reforms in both countries are rare, and the free trade agreements that opened Central American markets are characterized by low fixed costs for importing equipment and high tariffs on goods aimed at local markets, particularly those in agroindustry.

Umbrella organizations for business associations that protect the interests of a network of families in control of diversified business portfolios, with privileged access to financial services, often benefit from low-complexity, primarily informal, and highly concentrated economies. Depending on their wealth, level of organization, and technical capacity, these organizations contribute to implementing a complex agenda of lobbying strategies to move regulation in favour of businesses and business owners. They produce technical and legal

information through research institutes to persuade policymakers. They finance political parties and campaigns to influence budget and spending decisions and the broad policy agenda. They exert influence on legislation to weigh in on bills related to economic issues, including taxes and trade treaties. They influence courts to veto undesirable policies and settle disputes in their favour. And they directly or indirectly control other decision-making bodies that oversee and control markets (figure B3.5.1).

**Figure B3.5.1: Powerful business elites may exert influence over economic policy through different mechanisms**



Source: Pachón and Brolo 2021, Background Paper of the UNDP LAC RHDR 2021.

This influence is in part possible because of weak democratic contexts that tend to enhance the power of organized interest groups relative to the state.

The layout of political authority often gives the executive branch a prominent role as agenda-setter and policymaker and grants considerable power to the legislature over economic policies via their ability to amend executive bills and budgetary provisions. Business elites sometimes secure seats in key positions in the executive and legislative branches, obtaining enough power to review measures that provide economic incentives, protect their activities from competition, intervene on free trade agreements, or modify the budget to avoid increases in taxation.

As a result of uneven structures of representation, business elites organized through business associations with access to key decision-makers gain a strong voice, while unorganized voters may lose theirs, resulting in policy agendas that end up greatly differing from those mandated by the electorate. These elites have succeeded at centering the debate about tax policy around macroeconomic stability as a priority.<sup>b</sup> In a context of low tax revenues this comes at the expense of constraining government capacity to provide public goods and services, including necessary investments in infrastructure and social policy.

<sup>a</sup> Fairfield and Jorratt (2014).

<sup>b</sup> Schneider (2012); Barrientos and Garita (2015).

<sup>c</sup> Fairfield (2015).

### 3.4. Labour unions can contribute to lowering inequality and boosting economic growth

The economies in the LAC region are characterized by relatively high levels of market concentration. A few local business groups (usually managed and owned by traditional families), alongside multinational corporations, can often extract large rents thanks to their outsized market power. These economic rents frequently allow these actors to buy political power and the capacity to influence policies, taxes, and regulations in a way that contributes to maintaining a status quo that works in their favour. The outcomes of this have been unequal societies with inefficient economies.<sup>52</sup> However it is not only firms that have this power to distort policy in the market arena, but also workers, particularly organized labour.

#### The effect of labour unions on efficiency and equality in LAC is ambiguous

Existing research suggests that the effect of labour unions on efficiency and equality in LAC is ambiguous. The labour unions are neither unequivocally “good” nor “bad” in this regard. On the one hand, there is some evidence suggesting that stronger unions can promote both efficiency and equality. For example, the relative success of the

<sup>52</sup> Schneider (2009).

“Great Banana Strike” organized by labour unions in 1934 against the abuses of power of the United Fruit Company was an important step that contributed to a more equal society in Costa Rica.<sup>53</sup> On the other hand, unions can obstruct policies that improve human capital accumulation among the most vulnerable members of society, such as in public education in Argentina or Mexico, hurting both efficiency and equality, as poor disadvantaged students receive lower quality education than the rest.<sup>54</sup>

These ambiguous effects are perhaps not surprising. As workers in LAC have gone through different historical experiences and operate in diverse political and economic environments, one would expect to see substantial differences in traditions, resources, political affiliations, and objective functions across labour organizations.<sup>55</sup> Moreover, labour unions in the region operate in the context of heterogeneous labour markets. In some countries, informal employment accounts for more than two thirds of the labour force, while, in others, the share is less than a third. Because informal employment is antithetical to the organization of labour unions, the scope of the latter to influence policy one way or the other varies importantly.

In the understanding that there is no single story of labour unions in LAC, this section explores some of the underlying factors that may influence the degree and direction of their impact on efficiency and equality. It considers the characteristics of labour unions in the region (such as their strength and composition), their channels of influence, and the institutional environment in which they operate. It emphasizes the need to go beyond averages to look at the variation in these areas across countries and sectors. Two themes permeate the discussion: whether labour unions are in the public or private sector and, in the case of the latter, whether the firms that employ their affiliates have market power or not.

## The characteristics of labour unions in LAC

Depending on their strength, labour unions may have more or less capacity to affect equality and efficiency outcomes. Evidence across a range of objective and subjective measures of labour union strength, such as labour union density, coverage of collective agreements, share of firms unionized, number of strikes, and whether people consider trade unions to be powerful institutions, suggests that labour unions in LAC are, on average, weak. This is so compared with other institutions in the region (such as government and businesses) and their counterparts in the developed world. There is, however, heterogeneity across countries and sectors. In a few countries, labour

<sup>53</sup> Booth (2008).

<sup>54</sup> Jaume and Willén (2019), Álvarez et al. (2007).

<sup>55</sup> Collier and Collier (2002).

unions are relatively strong; this is the case mainly in Argentina and, to a lesser extent, in Bolivia, Brazil, Costa Rica, Mexico, and Uruguay. In most other countries, labour unions are relatively weak. In a few countries, such as in Guatemala and Haiti, there are no effective labour unions (or they are economically and politically irrelevant).<sup>56</sup> In most cases, labour unions in the region lost power with the abandonment or exhaustion of import substitution industrialization during the 1980s and 1990s, and large informal employment is a deep structural impediment to wide coverage.

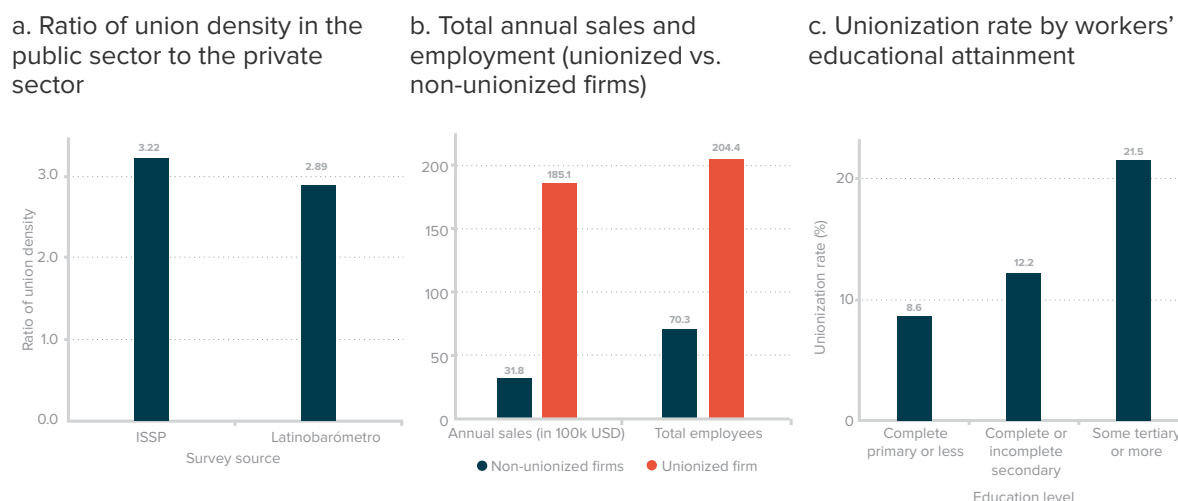
Not only is there large variation in labour union strength across countries, there is also high heterogeneity across sectors and types of workers (figure 3.13). First, across LAC countries, workers in the public sector are more likely to be organized in unions relative to private sector workers (except in activities where unions are legally banned, such as the army and, sometimes, the police). Second, within the private sector, workers are more likely to organize effectively in firms that are larger and enjoy higher rents. Third, in all LAC countries, unionization is more frequent among more educated workers and almost nonexistent among workers that are self-employed or are employed in extremely atomized sectors, such as domestic work or employment in small firms where all workers are relatives. Even though labour unions do not represent informal or unemployed workers, these groups still share the belief with public and private sector employed workers that labour unions are necessary to defend working conditions and wages. Almost 80 percent of people (within all types of employment groups) consider labour unions to be a necessary institution to protect workers from employers' abuses of power.<sup>57</sup> One reason for this may be that labour unions (sometimes) support and collaborate with emerging social movements that partially represent the interests of these outsiders. A good example is Brazil, where a large urban trade union, the Central Única dos Trabalhadores (Unified Workers' Central), has fought alongside the Movimento dos Trabalhadores Rurais Sem Terra (Movement of Landless Rural Workers) to incorporate popular sectors.<sup>58</sup>

<sup>56</sup> Terrell (1993).

<sup>57</sup> 2015 survey data, Latinobarómetro (dashboard), Corporación Latinobarómetro, Santiago, Chile, <http://www.latinobarometro.org/lat.jsp>.

<sup>58</sup> Ramalho (1999); Rossi (2017); Collier (2018).

**Figure 3.13: In LAC, unionization is more common in the public sector, in larger firms, and among more educated workers**



Source: Ronconi 2021, Background Paper of the UNDP LAC RHDR 2021; 2016 data of ISSP (International Social Survey Program) (dashboard), Leibniz Institute for the Social Sciences, Mannheim, Germany, <http://issp.org/data-download/by-year/>; 2007 data of Latinobarómetro. Note: Ratios are simple averages of ratios in LAC countries. (ISSP includes 08 LAC countries and Latinobarómetro 18.)

Source: Ronconi 2021, Background Paper of the UNDP LAC RHDR 2021. Note: Sales are converted to U.S. dollars at the official exchange rate.

Source: Ronconi 2021, Background Paper of the UNDP LAC RHDR 2021. Based on data from ISSP Research Group (2016). Note: Unionization rates are simple averages of rates in LAC countries with available data (includes 8 LAC countries).

## Channels of influence in the market and political arenas

Labour unions use various channels and instruments to affect the rents of big business and, subsequently, economywide efficiency and equality outcomes. Some of these channels operate at the firm or sectoral level in the market arena, while others are in the political arena.

In the market arena, at the firm level, trade union leaders and delegates can bargain with business owners either to share the rents obtained in the product market or not allow employers to exploit the local labour market. Both forces reduce inequality (between capital and labour), and the latter force can also improve efficiency by bringing salaries closer to labour productivity. However, this is only true if union leaders respond to the interests of those they represent and if business owners enjoy rents (that is, they operate in markets that are not perfectly competitive). If labour union leaders are corrupt, they may not share the fruits of their bargaining with workers, and the positive effects on equality and efficiency would recede. In LAC, this is quite a likely scenario; the majority of Latin Americans think that there is substantial corruption in labour unions, and only about one third have some or a lot of trust in labour unions.<sup>59</sup>

<sup>59</sup> 2015 survey data, Latinobarómetro (dashboard), Corporación Latinobarómetro, Santiago, Chile, <http://www.latinobarometro.org/lat.jsp>.



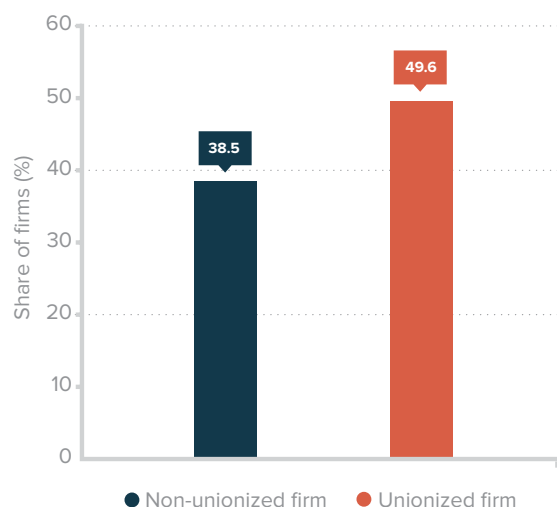
Meanwhile, if labour markets are competitive, labour unions can create inefficiencies by reducing productivity and investment. The reason is this: in the absence of market rents, the level of employment is the efficiency-maximizing one, and higher wages, while clearly beneficial for the workers in those firms, will hurt everybody else as employment is reduced below the optimal. Thus, some form of non-competitive behaviour that results in firm rents is required if unions are to increase equality and efficiency. Furthermore, note that, in these cases, it would be better if, through antitrust policies and other measures to foster competition, those rents were not there. The fact that labour unions bargain with individual firms or a subset of firms in monopolized markets is certainly welcome because at least the rents are not fully captured by firm owners, but are passed on to workers; nonetheless, from the point of view of society, it would be better if there were no rents.

In the political arena, labour unions have three primary instruments to exert their influence. First, they can collude with big business and use their political power to reduce internal and external competition or obtain special tax treatment, subsidies, and privileges, ultimately thereby perpetuating and exacerbating inequality and inefficiency. This channel is still quite common in LAC, though it was even more common during the import substitution industrialization period. Second, labour unions can use their political power to introduce across the board protective regulations for workers (such as minimum wages and severance payments) and lobby the government to devote more resources to enforcement, a crucial concern in a region characterized by the widespread violation of labour and social security regulations.<sup>60</sup> Here, again, however, effects can be mixed because unions may only care about enforcement in large firms where their affiliates are present, leaving the rest of the workforce without protection.<sup>61</sup> Consistent with this hypothesis, data from Enterprise Surveys show that, in LAC, unionized firms are significantly more likely to be inspected than non-unionized firms (figure 3.14).<sup>62</sup> This channel can reduce inequality between firm owners and workers, but exacerbate it across workers. Finally, organized labour can oppose, delegitimize, and destabilize dictatorships or collaborate with them.

<sup>60</sup> Estimates suggest, for example, that half of private sector employees in the region do not receive the benefits to which they are legally entitled, and this problem has not decreased over time (Gasparini and Tornarolli (2009)).

<sup>61</sup> Ronconi (2012); Amengual and Fine (2017).

<sup>62</sup> Note that this also presumably underestimates the relationship because the sample only includes registered firms, and informal firms are rarely inspected (Almeida and Ronconi 2016).

**Figure 3.14: Unionized firms are more likely to undergo inspections than non-unionized firms***Share of firms inspected by labour or social security officers in the previous year*

Source: Ronconi 2021, Background Paper of the UNDP LAC RHDR 2021; data of Enterprise Surveys (dashboard), International Finance Corporation and World Bank, Washington, DC, <https://www.enterprisesurveys.org/>.

Note: LAC countries with inspection data are Brazil, Chile, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guyana, Guatemala, Honduras, Jamaica, Nicaragua, and Peru.

The relationship between labour unions and the minimum wage also deserves attention, particularly in a region where, on the whole, slightly more than half the labour force is informally employed. The effects of minimum wages need to be considered carefully at the individual country level. Even if product markets are competitive, labour markets may not be.<sup>63</sup> Frictions, such as job or worker search costs, can rule out the instantaneous matches between firms and workers required for perfectly competitive labour markets. And these frictions can create rents, which are distributed between firms and workers on the basis of the bargaining power of each party.<sup>64</sup> In this context, minimum wages can change the balance of power in favour of workers. Labour union lobbying for higher minimum wages may thus contribute to a decrease in inequality with minimal impacts on efficiency. However, this result depends on the level at which the minimum wage is set in the overall wage distribution. If it is too high, the outcome can be higher wages among low-wage formal workers, but higher unemployment and informal employment, with lower overall efficiency and contradictory impacts on wage inequality. From this perspective, the participation of labour unions in minimum wage negotiations is welcome. However, considering efficiency and welfare across all workers, not only those in the formal sector, these negotiations need to establish mechanisms to ensure that the interests of non-organized workers in the informal sector, who usually have lower wages than formal workers, and the unemployed are considered as well.

<sup>63</sup> Levy and Cruces (2021).

<sup>64</sup> Flabbi (2021).

## Public-sector unions and the institutional environment

The role of unions in the public sector deserves special attention because the factors determining their influence on efficiency and equality are different. In the private sector, the effects of unions largely depend on firm characteristics (particularly on whether firms have market power) and on the extent of frictions in the labour market that allow space for bargaining. In the public sector, the effects of unions depend more on institutional factors. Public sector labour unions have more room to improve prosperity in contexts where the state is predatory compared with contexts in which the state is already pursuing the general welfare.

Consider, for example, how public sector teachers unions interact with the institutional environment to foster better or worse educational outcomes (a fundamental engine of growth and equality). At times, the strategies pursued by teachers unions can lead to negative consequences—for example, through class days lost because of strikes among teachers or the opposition to or even political manipulation of teacher performance evaluations.<sup>65</sup> These strategies can harm educational quality, with particularly detrimental effects for the most disadvantaged children. Teachers unions, however, also often lobby for higher educational spending, more teaching supplies, and improved school infrastructure maintenance, which certainly contribute to better educational outcomes. In some LAC countries, but particularly in those that lack cohesive bureaucracies, the existence of strong teachers unions could counterbalance the short-term bias of policymakers. All these mixed effects suggest that “the impact of unions on students’ performance depends on the channel and kind of political market in which unions operate, but not on the presence of unions per se.”<sup>66</sup>

Finally, regarding pensions, in many countries in the region public and private sector workers share the same social security regime, and thus there is no advantage to one set of workers versus the other in access to health care or pensions; they are all treated equally. But in other countries, such as Brazil, Jamaica and Mexico, public and private sector workers are under different regimes, sometimes with separate social security institutes. The evidence shows that, in these three countries, public sector workers have more favourable pension regimes: lower contribution rates, shorter contribution periods, or more generous benefits, sometimes substantially so (see chapter 5). Furthermore, it is usually the case that public sector pension schemes, particularly under the pay-as-you-go modality, involve contribution rates that are well below the actuarially fair value of benefits, implying the need for large subsidies from all taxpayers to a reduced subset of workers who, compared with their private sector peers, are clearly more well off. Because the subsidies can be quite large, sometimes equal to two or three percentage points of GDP, the impact on inequality is significant.

<sup>65</sup> Murillo et al. (2005); Hecock (2014); Bruns and Luque (2015); Jaume and Willén (2019).

<sup>66</sup> Murillo et al. (2005, p. 231).

## An open research agenda

The impact of labour unions on equality and efficiency outcomes in the region has been both positive and negative. This finding contrasts with the one on business elites, on which the diagnosis is far from positive. Labour unions have substantially less economic and political power, although this is not always true, and, if they do have power, they can sometimes deploy it to increase equality and efficiency, although this is also not always true. The fact that labour unions have an ambiguous effect on these outcomes in LAC is consistent with the findings from a much larger body of literature on the economic impact of labour unions in North America and Europe.<sup>67</sup> However, it is essential to remember that what is known about this issue in the specific context of the LAC region is still limited because of a combination of factors. The first is conceptual complexity: there is only a partial theoretical understanding of how labour unions affect LAC societies. Second, there is a lack of robust empirical evidence; data are usually limited, and causal inference is particularly challenging. Third is the simple fact that relatively little research has been conducted on labour unions as economic actors in LAC. Understanding the different impacts of labour unions on development outcomes in the region thus remains an open and important research agenda looking forward.

<sup>67</sup> Tzannatos and Aidt (2006).

### Box 3.6: The impact of labour market institutions on price markups and wage markdowns in Uruguay

Using firm-level data for the manufacturing and services sectors in Uruguay between 2002 and 2016, Gandelman and Casacuberta (2021) investigate the impact of labour market institutions, such as wage councils and unions, on the market power of firms in both the product market (through price markups) and the labour market (through wage markdowns). They find that when institutions allow workers to participate in wage negotiations, they are protected from the market power of firms, and wages increase as firms lose bargaining power. However, firms pass on to consumers part of the increase in labour costs through higher prices.

In 1943, Law 10,449 introduced tripartite wage councils in Uruguay for periodic wage negotiations between employer chambers, sectoral trade unions, and government delegates in Uruguay. It established categories of workers by

sector of activity and gave councils the ability to set minimum wages for each category. Between 1992 and 2003, however, the government did not summon these wage councils and withdrew from public negotiations. In 2004, wage negotiations were reinstated. Between 2005 and 2016, councils mandated that wages double. Also, changes in the centralization and coordination of wage bargaining strengthened incentives to unionization, and affiliation to unions increased after 2005.

Gandelman and Casacuberta (2021) find that, in response to these changes, the average wage markdown decreased 50 percent compared with the 2005 value, and the average price markup increased 18 percent. Council-mandated wages account for most of the changes in markups and markdowns. While firms were losing bargaining power in labour markets, they seemed to have been able to pass a sizable part of their increased labour costs on to consumers. Sector unionization had no further effect on markups and a minimal effect on the reduction of markdowns. The impact of unions was channeled through wage negotiations.

Increases in labour productivity did not accompany wage increases in Uruguay, and, as a result, the ratio between average wages and labour productivity increased. As a share of output, labour costs rose. This result contrasts with findings on Europe and the United States, where labour shares have decreased, while markups have increased.

### 3.5. Rebalancing power

This chapter explores how the concentration of power in the hands of a few can distort policy and propel the high-inequality, low-growth trap in LAC. It first looks at the manifestation of this in the market, considering that, in LAC, markets are characterized by a small number of big businesses and high levels of market power. It discusses on how market power in LAC can be costly through its direct effects on productivity and welfare and highlights the fundamental role of effective competition laws in mitigating negative impacts. It presents new evidence showing that greater market power is also associated with higher productivity in LAC. Large firms dominate, at least partly, because their rivals in the market are tiny firms that fail to pose a competitive pressure on account of their relatively low productivity. The chapter also explores the power of workers (through organized labour unions) to shape these outcomes and argues that, while the evidence remains scarce, what is known does suggest that, in certain contexts, unions can do a lot of good. However, they can also be harmful to equality and productivity if they pursue private instead of public interests, which is sometimes

the case. This is more generally true about any kind of power: its impact depends on how it is used and what it is used for.

The chapter critically highlights how monopoly power and market concentration can translate into rent-seeking behaviours and, ultimately, into business political power. In the LAC region, this has led to multiple examples of economic elites interfering in policy design or implementation. Fiscal systems, competition policy, and market regulations have often been shaped to benefit a small group of citizens in response to this interference. Economic elites have seldom used their political power to push for reforms that would put countries on a development path, increasing welfare for all. But they could.

Ultimately, however, sustainably moving out of the high-inequality, low-growth trap will require actions that work to rebalance power. There is no single policy solution for addressing these types of power asymmetries and the distortions they create in both the market arena and the fiscal system. Depending on the context, however, efforts such as regulating campaign financing and lobbying activities, strengthening the power and independence of competition policy and competition agencies, revising market regulations to eliminate those that favour private interests and not the general good, or taking seriously the global conversation about how to tax the super-rich, could all play important roles in moving this agenda forward. The next chapter digs more deeply into the challenges facing the region, considering specifically those posed by violence.

## References

- Almeida, Rita Kullberg, and Lucas Ronconi. 2016. "Labor Inspections in the Developing World: Stylized Facts from the Enterprise Survey". *Industrial Relations*, 55 (3): 468–489.
- Alpert, Lukas I., and Josh Beckerman. 2015. "Carlos Slim Becomes Largest Individual New York Times Shareholder: Mexican Telecom Billionaire Exercises Warrants in Media Company". *Wall Street Journal*, 14 January 2015. <https://www.wsj.com/articles/carlos-slim-exercises-new-york-times-warrants-1421274205>.
- Álvarez, Jesús, Vicente A. García-Moreno, and Harry Anthony Patrinos. 2007. "Institutional Effects as Determinants of Learning Outcomes: Exploring State Variations in Mexico". Policy Research Working Paper, 4286, World Bank, Washington, DC.
- Amengual, Matthew, and Janice R. Fine. 2017. "Co-enforcing Labor Standards: The Unique Contributions of State and Worker Organizations in Argentina and the United States". *Regulation and Governance*, 11 (2): 129–142.
- Ardanaz, Martin, and Carlos Scartascini. 2013. "Inequality and Personal Income Taxation: The Origins and Effects of Legislative Malapportionment". *Comparative Political Studies*, 46 (12): 1636–1663. <https://doi.org/10.1177/0010414013484118>.
- Atkin, David Guy, Benjamin Faber, and Marco Gonzalez-Navarro. 2018. "Retail Globalization and Household Welfare: Evidence from Mexico". *Journal of Political Economy*, 126 (1): 1–73.
- Autor, David H., David Dorn, Lawrence F. Katz, Christina Patterson, and John Van Reenen. 2020. "The Fall of the Labor Share and the Rise of Superstar Firms". *Quarterly Journal of Economics*, 135 (2): 645–709. <https://doi.org/10.1093/qje/qjaa004>.
- Baily, Martin Neil, Charles Hulten, and David Campbell. 1992. "Productivity Dynamics in Manufacturing Plants". *Brookings Papers on Economic Activity*, 23 (1992 Microeconomics): 187–267.
- Barnes, Matthew, and Jonathan Haskel. 2000. "Productivity in the 1990s: Evidence from British Plants". Working paper, Queen Mary College, University of London, London.
- Barrientos, Ricardo, and Mauricio Garita. 2015. "Una Perspectiva Regional sobre la Intervención de las Élités Económicas Centroamericanas en la Política Fiscal". In *Política Fiscal: Expresión del Poder de las Élités Centroamericanas*, edited by Instituto Centroamericano de Estudios Fiscales, 1–24. Guatemala City, Guatemala: F&G Editores.
- Becerra, Martin, and Guillermo Mastrini. 2009. *Los Dueños de la Palabra: Acceso, Estructura y Concentración de los Medios en la América Latina del Siglo XXI*. Buenos Aires: Libros Promoteo.
- Bloom, Nicholas, Christos Genakos, Raffaella Sadun, and John Van Reenen. 2012. "Management Practices across Firms and Countries." NBER Working Paper, 17850 (February), National Bureau of Economic Research, Cambridge, MA.
- Bogliaccini, Juan Ariel, and Aldo Madariaga. 2019. "The Discreet Charm of the Oligarchy: Business Power in Weak Democracies". Working paper, Departamento de Ciencias Sociales y Políticas, Universidad Católica del Uruguay, Montevideo, Uruguay.
- Booth, John. 2008. "Democratic Development in Costa Rica". *Democratization*, 15 (4): 714–732.
- Borraz, Fernando, Juan Dubra, Daniel Ferrés, and Leandro Zipitria. 2014. "Supermarket Entry and the Survival of Small Stores". *Review of Industrial Organization*, 44 (1): 73–79.
- Brummund, Peter William. 2013. "Poverty and Monopsony: Evidence from the Indonesian Labor Market". Paper presented at the 11th International Industrial Organization Conference, Boston, 17–19 May 2013.



- Bruns, Barbara, and Javier Luque. 2015. *Great Teachers: How to Raise Student Learning in Latin America and the Caribbean*. With Soledad De Gregorio, David K. Evans, Marco Fernández, Martin Moreno, Jessica Rodriguez, Guillermo Toral, and Noah Yarrow. Latin American Development Forum Series. Washington, DC: World Bank.
- Bull, Benedicte, Fulvio Castellacci, and Yuri Kasahara. 2014. *Business Groups and Transnational Capitalism in Central America: Economic and Political Strategies*. International Political Economy Series. Basingstoke, UK: Palgrave Macmillan.
- Busso, Matías, and Sebastián Galiani. 2019. "The Causal Effect of Competition on Prices and Quality: Evidence from a Field Experiment". *American Economic Journal: Applied Economics*, 11 (1): 33–56.
- Castañeda, Alejandro, and Daniel Ruiz. 2021. "The Political Economy of the Telecommunications Reform in Mexico". UNDP LAC Working Paper, 8, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, UNDP LAC, New York.
- Castañeda, Néstor. 2017. "Business Coordination and Tax Politics". *Political Studies*, 65 (1): 122–243. <https://doi.org/10.1177/0032321715616287>.
- Chaisty, Paul, Nic Cheeseman, and Timothy Power. 2018. *Coalitional Presidentialism in Comparative Perspective: Minority Presidents in Multiparty Systems*. New York: Cambridge University Press.
- Collier, Ruth Berins. 2018. "Labor Unions in Latin America: Incorporation and Reincorporation under the New Left". In *Reshaping the Political Arena in Latin America: From Resisting Neoliberalism to the Second Incorporation*, edited by Eduardo Silva and Federico M. Rossi, 115–128. Pitt Latin American Series. Pittsburgh: University of Pittsburgh Press.
- Collier, Ruth Berins, and David Collier. 2002. *Shaping the Political Arena: Critical Junctures, the Labor Movement, and Regime Dynamics in Latin America*. Notre Dame, IN: University of Notre Dame Press.
- Connor, John M. 2009. "Cartels and Antitrust Portrayed: Private International Cartels from 1990 to 2008". AAI Working Paper 09-06 (1 September), American Antitrust Institute, Washington, DC.
- Connor John M. 2014. "Cartel Overcharges". In *The Law and Economics of Class Actions*, edited by James Langenfeld, 249–387. Vol. 26 of Research in Law and Economics. Bingley, UK: Emerald Publishing.
- De Loecker, Jan K., and Jan Eeckhout. 2018. "Global Market Power". NBER Working Paper 24768 (June), National Bureau of Economic Research, Cambridge, MA.
- De Loecker, Jan K., Jan Eeckhout, and Gabriel Unger. 2020. "The Rise of Market Power and the Macroeconomic Implications". *Quarterly Journal of Economics*, 135 (2): 561–644. <https://doi.org/10.1093/qje/qjz041>.
- Dutz, Mark A. 2018. *Jobs and Growth: Brazil's Productivity Agenda*. International Development in Focus Series. Washington, DC: World Bank.
- Economist*. 2015. "The Toilet-Paper Tangle: A New Breed of Competition Regulator Takes on the Cartels". *Economist*, 5 December 2015. <https://www.economist.com/the-americas/2015/12/05/the-toilet-paper-tangle>.
- EIU (Economist Intelligence Unit). 2013. "The EIU Methodology". Briefing paper prepared for the Global Assessment Report on Disaster Risk Reduction 2013, EIU, London.
- Elizondo, Carlos. 2009. "Perverse Equilibria: Unsuitable but Durable Institutions". In *No Growth without Equity? Inequality, Interests, and Competition in Mexico*, edited by Santiago Levy and Michael Walton, 157–202. Equity and Development Series. Washington, DC: World Bank; New York: Palgrave Macmillan.
- Empresarios por la Educación. 2015. "Presupuesto Mineduc 2016: ¿Qué Desafíos Presenta para la Agenda Educativa?" Policy Brief (December), Empresarios por la Educación, Guatemala City, Guatemala.



- Eslava, Marcela, Marcela Meléndez, and Nicolás Urdaneta. 2021. “Poder de mercado, desigualdad y productividad en Latinoamérica”. UNDP LAC Working Paper, 11, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, UNDP LAC, New York.
- Fairfield, Tasha. 2015. *Private Wealth and Public Revenue in Latin America: Business Power and Tax Politics*. New York: Cambridge University Press.
- Fairfield, Tasha. 2019. “Taxing Latin American Economic Elites”. In *The Political Economy of Taxation in Latin America*, edited by Gustavo A. Flores-Macías, 172–193. New York: Cambridge University Press.
- Fairfield, Tasha, and Michel Jorratt. 2014. “Top Income Shares, Business Profits, and Effective Tax Rates in Contemporary Chile”. ICTD Working Paper 17 (January), International Center for Tax and Development, Institute of Development Studies, Brighton, UK.
- Fass, Simon M. 1990. *Political Economy in Haiti: The Drama of Survival*. New Brunswick, NJ: Transaction Publishers.
- Fernandes, Ana Margarida. 2007. “Trade Policy, Trade Volumes, and Plant-Level Productivity in Colombian Manufacturing Industries”. *Journal of International Economics*, 71 (1): 52–71.
- Fernandes, Ana Margarida, and Caroline Paunov. 2013. “Does Trade Stimulate Product Quality Upgrading?” *Canadian Journal of Economics*, 46 (4): 1232–1264.
- Flabbi, Luca. 2021. “Implications of Minimum Wages Policies in Labor Markets with High Informality and Frictions”. UNDP LAC Working Paper, 25, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, Bureau for Latin America and the Caribbean, United Nations Development Programme, New York.
- Foster, Lucia, John Haltiwanger, and C. J. Krizan. 1998. “Aggregate Productivity Growth: Lessons from Microeconomic Evidence”. NBER Working Paper, 6803 (November), National Bureau of Economic Research, Cambridge, MA.
- France 24. 2018. “Chilean Consumers to Receive Compensation over Toilet Paper Scandal”. France 24, 2 August 2018. <https://www.france24.com/en/20180801-chilean-consumers-receive-compensation-over-toilet-paper-scandal>.
- Furche, Carlos. 2013. “The Rice Value Chain in Haiti: Policy Proposal”. Oxfam America: Research Backgrounder (9 April), Oxfam America, Boston.
- Gandelman, Nestor, and Carlos Casacuberta. 2021. “The Impact of Labor Market Institutions on Markups and Markdowns: Evidence from Manufacturing and Service Sectors in Uruguay”. UNDP LAC Working Paper, 9, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, UNDP LAC, New York.
- García-Marín. 2021. “Labor-Market Concentration and Earnings: Evidence from Chile”. UNDP LAC Working Paper, 10, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, UNDP LAC, New York.
- Gasparini, Leonardo Carlos, and Leopoldo Tornarolli. 2009. “Labor Informality in Latin America and the Caribbean: Patterns and Trends from Household Survey Microdata”. *Desarrollo y Sociedad*, 63 (September): 13–80.
- Hart, Oliver D. 1983. “The Market Mechanism as an Incentive Scheme”. *Bell Journal of Economics*, 14 (2): 366–382.
- Hecock, R. Douglas. 2014. “Democratization, Education Reform, and the Mexican Teachers’ Union”. *Latin American Research Review*, 49 (1): 62–82.
- Hermalin, Benjamin E. 1992. “The Effects of Competition on Executive Behavior”. *Rand Journal of Economics*, 23 (3): 350–365.
- Horn, Henrik, Harald Lang, and Stefan Lundgren. 1994. “Competition, Long-Run Contracts, and Internal Inefficiencies in Firms”. *European Economic Review*, 38 (2) 213–233.

- Iacovone, Leonardo. 2012. "The Better You Are, the Stronger It Makes You: Evidence on the Asymmetric Impact of Liberalization". *Journal of Development Economics*, 99 (2): 474–485.
- Iacovone, Leonardo, Beata Smarzyska Javorcik, Wolfgang Keller, and James Tybout. 2015. "Supplier Responses to Walmart's Invasion in Mexico". *Journal of International Economics*, 95 (1): 1–15.
- Jaume, David, and Alexander Willén. 2019. "The Long-Run Effects of Teacher Strikes: Evidence from Argentina". *Journal of Labor Economics*, 37 (4): 1097–1139.
- Javorcik, Beata Smarzyska, Wolfgang Keller, and James Tybout. 2008. "Openness and Industrial Response in a Wal-Mart World: A Case Study of Mexican Soaps, Detergents, and Surfactant Producers". *World Economy*, 31 (12): 1558–1580.
- Karabarbounis, Loukas, and Brent Neiman. 2014. "The Global Decline of the Labor Share". *Quarterly Journal of Economics*, 129 (1): 61–103. <https://doi.org/10.1093/qje/qjt032>.
- Kavoussi, Bonnie. 2019. "How Market Power Has Increased U.S. Inequality". May 3, Washington Center for Equitable Growth, Washington, DC.
- Khanna, Tarun, and Yishay Yafeh. 2007. "Business Groups in Emerging Markets: Paragons or Parasites?" *Journal of Economic Literature*, 45 (2): 331–372.
- Levy, Santiago, and Guillermo Cruces. 2021. "Time for a New Course: An Essay on Social Protection and Growth in Latin America". UNDP LAC Working Paper, 24, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, Bureau for Latin America and the Caribbean, United Nations Development Programme, New York.
- Levy, Santiago, and Michael Walton, eds. 2009. *No Growth Without Equity?: Inequality, Interests, and Competition in Mexico*. Equity and Development Series. Washington, DC: World Bank; New York: Palgrave Macmillan.
- Lira, Loreto, Rosario Rivero, and Rodrigo Vergara. 2007. "Entry and Prices: Evidence from the Supermarket Sector". *Review of Industrial Organization*, 31 (4): 237–260.
- Maggi, Giovanni. 1996. "Strategic Trade Policies with Endogenous Mode of Competition". *American Economic Review*, 86 (1): 237–258.
- Medina, Pamela. 2018. "Import Competition, Quality Upgrading, and Exporting: Evidence from the Peruvian Apparel Industry". Working paper, University of Toronto. Toronto.
- Miranda, Alfonso. 2012. "Competition Law in Latin America: Main Trends and Features". April, Centro de Estudios de Derecho de Competencia, Bogotá, Colombia. <https://centrocedec.files.wordpress.com/2010/06/cornell-lacompetition-20123.pdf>.
- Morck, Randall, Daniel Wolfenzon, and Bernard Yeung. 2005. "Corporate Governance, Economic Entrenchment, and Growth". *Journal of Economic Literature*, 43 (3): 655–720. <https://doi.org/10.1257/002205105774431252>.
- Motta, Massimo. 2004. *Competition Policy: Theory and Practice*. New York: Cambridge University Press.
- Muendler, Marc-Andreas. 2004. "Trade, Technology, and Productivity: A Study of Brazilian Manufacturers 1986–1998". CESifo Working Paper 1148 (March), Munich Society for the Promotion of Economic Research, Center for Economic Studies, Ludwig Maximilian University and Ifo Institute for Economic Research, Munich.
- Murillo, María Victoria, Mariano Tommasi, Lucas Ronconi, and Juan Sanguinetti. 2005. "The Economic Effects of Unions in Latin America: Teachers' Unions and Education in Argentina". In *What Difference Do Unions Make? Their Impact on Productivity and Wages in Latin America*, edited by Peter Kuhn and Gustavo Márquez, 197–232. Washington, DC: Inter-American Development Bank.

- OECD (Organisation for Economic Co-operation and Development). 2019. "Owners of the Worlds Listed Companies". OECD Capital Market Series, OECD, Paris.
- OECD (Organisation for Economic Co-operation and Development). 2021. *OECD Competition Trends 2021*. Vol. 1 of *Global Competition Enforcement Update 2015–2019*. Paris: OECD. <http://www.oecd.org/competition/oecd-competition-trends.htm>.
- Olley, G. Steven, and Ariel Pakes. 1996. "The Dynamics of Productivity in the Telecommunications Equipment Industry". *Econometrica*, 64 (6): 1263–1297.
- Pachón, Mónica, and Javier Brolo. 2021. "Lobbying for Inequality? How Business Elites Shape Policy in El Salvador, Honduras, and Guatemala". UNDP LAC Working Paper, 6, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, UNDP LAC, New York.
- Posner, Richard A. 1975. "The Social Costs of Monopoly and Regulation". *Journal of Political Economy*, 83 (4): 807–828.
- Ramalho, José Ricardo. 1999. "Restructuring of Labour and Trade Unions in Brazil". In *Labour Worldwide in the Era of Globalization: Alternative Union Models in the New World Order*, edited by Ronaldo Munck and Peter Waterman, 158–174. International Political Economy Series. London: Palgrave Macmillan.
- Rodríguez-Castelán, Carlos. 2015. "The Poverty Effects of Market Concentration". Policy Research Working Paper, 7515, World Bank, Washington, DC.
- Ronconi, Lucas. 2012. "Globalization, Domestic Institutions, and Enforcement of Labor Law: Evidence from Latin America". *Industrial Relations*, 51 (1): 89–105.
- Ronconi, Lucas. 2021. "How Do Labor Unions Affect Inequality and Efficiency in Latin America and the Caribbean?" UNDP LAC Working Paper, 7, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, UNDP LAC, New York.
- Rossi, Federico M. 2017. *The Poor's Struggle for Political Incorporation: The Piquetero Movement in Argentina*. Cambridge Studies in Contentious Politics Series. New York: Cambridge University Press.
- Sanhueza, Claudia, and Javiera Lobos. 2014. "Sistema Tributario Chileno: Características y Desafíos". In *Tributación en Sociedad: Impuestos y redistribución en el Chile del siglo XXI*, edited by Jorge Atria, 25–52. Santiago, Chile: Uqbar Editores.
- Scharfstein, David. 1988. "Product-Market Competition and Managerial Slack". *Rand Journal of Economics*, 19 (1): 147–155.
- Scherer, Frederic M., and David R. Ross. 1990. *Industrial Market Structure and Economic Performance*. Boston: Houghton-Mifflin.
- Schneider, Aaron. 2012. *State-Building and Tax Regimes in Central America*. New York: Cambridge University Press.
- Schneider, Ben Ross. 2008. "Economic Liberalization and Corporate Governance: The Resilience of Business Groups in Latin America". *Comparative Politics*, 40 (4): 379–397.
- Schneider, Ben Ross. 2009. "Hierarchical Market Economies and Varieties of Capitalism in Latin America". *Journal of Latin American Studies*, 41 (3): 553–575.
- Schneider, Ben Ross. 2013. *Hierarchical Capitalism in Latin America: Business, Labor, and the Challenges of Equitable Development*. Cambridge Studies in Comparative Politics Series. New York: Cambridge University Press.
- Schneider, Ben Ross. 2021. "Big Business and the Inequality Trap in Latin America: Taxes, Collusion, and Undue Influence". UNDP LAC Working Paper, 5, 2021, Background paper for the *Regional Human Development Report for Latin America and the Caribbean 2021*, UNDP LAC, New York.

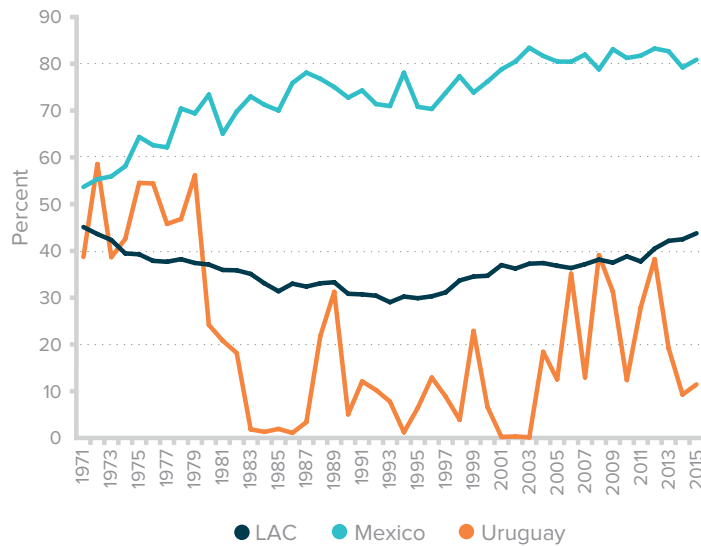
- Schor, Adriana. 2004. "Heterogeneous Productivity Response to Tariff Reduction: Evidence from Brazilian Manufacturing Firms". *Journal of Development Economics*, 75 (2): 373–396.
- Schwab, Klaus, ed. 2018. *Insight Report: The Global Competitiveness Report 2018*. Geneva: World Economic Forum. <http://www3.weforum.org/docs/GCR2018/05FullReport/TheGlobalCompetitivenessReport2018.pdf>.
- Segovia, Alexander. 2005. *Integración Real y Grupos de Poder Económico en América Central: Implicaciones Para el Desarrollo y la Democracia de la Región*. San José, Costa Rica: Fundación Friedrich Ebert.
- Shu, Pian, and Claudia Steinwender. 2019. "The Impact of Trade Liberalization on Firm Productivity and Innovation". *Innovation Policy and the Economy*, 19 (1): 39–68.
- Singh, Raju Jan, and Mary Barton-Dock. 2015. *Haiti: Toward a New Narrative; Systematic Country Diagnostic*. Washington, DC: World Bank.
- Terrell, Katherine. 1993. "Public-Private Wage Differentials in Haiti: Do Public Servants Earn a Rent?" *Journal of Development Economics*, 42 (2): 293–314.
- Trejo, Raúl. 2013. "Poderes fácticos, problemas drásticos". *Revista Mexicana de Ciencias Políticas y Sociales*, 58 (217): 223–232.
- Tzannatos, Zafiris, and Toke S. Aidt. 2006. "Unions and Microeconomic Performance: A Look at What Matters for Economists (and Employers)". *International Labour Review*, 145 (4): 257–278.
- UNDP (United Nations Development Programme). 2020. "Attitudes towards Politics in Latin America: A Review of Regional Perception Data". July, Regional Hub for Latin America and the Caribbean, UNDP, Panama City.
- Urzúa, Carlos M. 2013. "Distributive and Regional Effects of Monopoly Power". *Economía Mexicana Nueva Época*, 22 (2): 279–295.
- Wibbels, Erik, and John S. Ahlquist. 2011. "Development, Trade, and Social Insurance". *International Studies Quarterly*, 55 (1): 125–149. <https://doi.org/10.1111/j.1468-2478.2010.00638.x>.
- World Bank. 2005. *World Development Report 2006: Equity and Development*. Washington, DC: World Bank; New York: Oxford University Press.
- World Bank. 2017. *World Development Report 2017: Governance and the Law*. Washington, DC: World Bank

## THE POWER TO HALT OR ACCELERATE GREENER ENERGY

The transition towards sustainable social and economic progress in LAC depends on reducing emissions from energy production and consumption, particularly electricity, heavily reliant on fossil fuels such as coal, oil, and gas. The LAC region has a substantially higher fraction of hydroelectric production than the rest of the world, but its dependence on fossils remains a challenge. Even after incorporating the social costs of environmental degradation, a green growth path will confront the challenge of substituting fossil fuels with renewable energy under increasing pressure from the economy. Considering that 80 percent of LAC's population lives in cities, the demand for large electrification projects will grow according to the shifting needs of industry, trade, transportation, and households.

This transition faces additional problems in terms of technological change and investment and barriers emerging from political forces –pressure from lobby and private interests– that would suffer from it. Both state and private interests can get in the way in deciding on replacing the region's fossil-dependent energy with renewable sources. Two countries in the region exemplify the possible paths ahead: Mexico and Uruguay. Their energy transitions provide insight into difficulties inherent in the push towards sustainability that can respond to demands from growing economies and the social needs of people.

During the 1970s, both Mexico and Uruguay had per capita electricity consumption of between 500 and 700 kWh. Both countries produced about half of their electricity using fossil fuel sources, while the other half came from hydroelectric projects. According to Organisation for Economic Co-operation and Development (OECD) and International Energy Agency data, Uruguay reached a per capita consumption of 3,000 kWh, above Mexico's consumption of around 2,150 kWh, by the mid-2010s. Likewise, during these four decades, Mexico had increased the use of fossil fuels to 90 percent of its energy consumption, while Uruguay had lowered the share to less than 50 percent. In the same period, Mexico had reduced its electricity production from hydric sources to 10 percent (2015), while Uruguay maintained its share of hydro-based electricity at around 60 percent. The World Bank estimates that the final energy consumption from all renewable sources as a fraction of total final energy increased in Uruguay from 45 percent in 1990 to almost 60 percent in 2015 (figure S6.1). In Mexico, it fell from 15 percent to 9 percent in the same period. Mexico, an oil-producing power, has maintained its fiscal and energy dependence on fossil fuels. In contrast, with similar energy production patterns half a century ago, Uruguay has shifted to much lower fossil fuel dependence.

**Figure S6.1: Electricity production from oil, gas, and coal sources, 1971–2015, % of total**

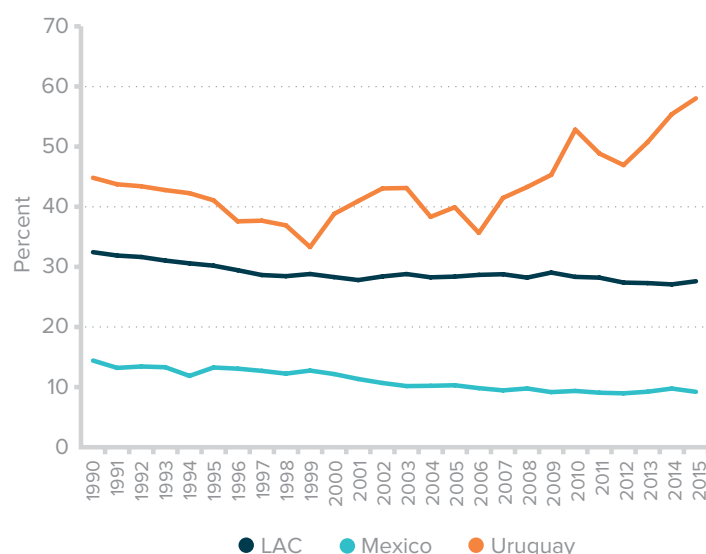
Source: SE4ALL (Sustainable Energy for All) (dashboard), World Bank, Washington, DC, <https://datacatalog.worldbank.org/dataset/sustainable-energy-all>; OECD data; data of International Energy Agency.

Two recent events illustrate how political decisions can shift a country away or closer to a sustainable transition. In March 2021, Mexico’s Senate approved a reform to the law regulating the electric energy sector. This reform privileges electricity production by the state-owned electric power company, Comisión Federal de Electricidad, primarily based on older thermal energy production plants, and weakens the possibility of entry of private producers based on renewables. This recent move will make it more difficult for Mexico to reach its commitment within the Paris Agreement of reducing its greenhouse gas emissions by 22 percent.

Meanwhile, Uruguay has been making some strategic moves towards an energy transition that privileges renewable sources. UNDP has supported its energy transition programme since 2007 with creative mechanisms for incorporating renewable energy production of various scales. Later in 2013, the Los Caracoles wind farm obtained funding from the Clean Development Mechanism under Kyoto, signed between Spain and Uruguay as a debt-for-efficiency swap. This project exchanges debt relief for the country against carbon credits, aiming at a 10 MW production capacity and an equivalent of 180,000 carbon credits during the first seven years of operation. The carbon credits, bought by the Spanish Carbon Fund, reduced US\$10.5 million of Uruguay’s US\$77 million debt with Spain. By 2015, the country had installed 581 MW of wind energy capacity, becoming an example of clean energy (Thwaites 2016). Uruguay is currently focusing on tackling emissions from transportation sources through an e-mobility strategy. The MOVÉS Project—supported by UNDP and the Uruguayan Agency of International Cooperation, funded by the Global Environment Facility, and coordinated in partnership with the Ministry of Industry, Energy and Mining and the Ministry of Housing, Land Use Planning, and Environment—has been crucial to this strategy.

When looking at total energy consumption, of which electricity is a fraction, the divergence between Uruguay and Mexico's energy strategies is evident in the evolution of energy consumption from renewable sources during the past 25 years (figure S6.2).

**Figure S6.2: Renewable energy consumption, % of total final energy consumption**



Source: SE4ALL (Sustainable Energy for All) (dashboard), World Bank, Washington, DC, <https://datacatalog.worldbank.org/dataset/sustainable-energy-all>.

In 2018, a survey was conducted on the geopolitics of renewable energy (FGV and ELKA-KAS 2019), capturing perceptions from close to 700 academics, civic leaders, government representatives, and businesspeople in 10 Latin American countries (Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Panama, and Peru). It found agreement among respondents on the need to transit towards renewable energy in the region. Among respondents, 51 percent considered solar power to be the renewable energy source with the greatest potential in the region, followed by wind (17 percent) and hydro (12 percent). Overall, 92 percent agreed that increasing the share of renewables in the energy mix would positively impact foreign relations across the region. Regarding the inherent risks, 46 percent of respondents saw government bureaucracies as the main threat, followed by social conflicts (27 percent) and legal insecurity (18 percent).

When asked about the possible success of lobbying by sectors opposing the transition to renewable energy, 75 percent and 69 percent of respondents, respectively, found it likely that the transition would be blocked by lobbying by national and foreign oil companies. Similarly, 73 percent considered lobbying by national oil companies to be capable of pressing for the further development of the fossil fuel market, and 74 percent thought the same in the case of foreign oil companies. These answers hint at the concentration of power in the hands of corporations and government agencies,



including major oil companies owned by the national governments in cases like Brazil, Colombia, Ecuador, Mexico and Venezuela, with a potentially significant role in hindering regional drives towards a sustainable energy matrix.

Infrastructure projects to develop renewable energy are not devoid of social conflicts. Many of them require a minimum size to make investments financially viable, given the economies of scale involved. Large hydropower projects during the 1970s and 1980s faced tensions because of their environmental and social impacts and their viability was threatened. Similar concerns have sprung up regarding other renewable energy projects, such as wind and solar farms. These projects require large investments, usually funded by foreign or large domestic economic groups, which struggle to obtain social licenses in areas with high inequality and rapidly emerging grievances.

Furthermore, these projects often locate in peripheral territories with severe drawbacks relative to urban areas. The larger these gaps and the larger the project, the harder it is for such projects to be accepted by local inhabitants. In addition, the 2007 United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP) and its most relevant predecessor in 1989, the Convention 169 of the International Labour Organisation, require projects to obtain free, prior, and informed consent from indigenous or ancestral groups potentially affected by these interventions. Many projects have been rejected because they threaten local cultural or biological diversity.

Achieving energy sustainability in LAC demands that inequalities in the decision-making process be confronted. Political and economic power representing private interests, such as the fossil fuel industry, in alliance with governments that push for legislative changes or hinder the possibility of making the energy mix greener, still constitute significant barriers. However, commitments towards low carbon footprints and the dismantlement of fossil fuel dependence, such as those in Costa Rica and Uruguay, are clear examples of effective leadership contributing to anthropogenic climate change mitigation.

## References

FGV (School of International Relations) and ELKA–KAS (Regional Programme Energy Security and Climate Change in Latin America of the Konrad-Adenauer-Stiftung). 2019. “Geopolitics of Renewable Energies in Latin America: A Survey”. EKLAKAS, São Paulo, Brazil.

Thwaites, Joe. 2016. “How Uruguay Became a Wind Power Powerhouse”. *Commentary* (blog), 7 March. <https://www.wri.org/insights/how-uruguay-became-wind-power-powerhouse>