Explaining Institutional Innovation
Contents

Preface

Comparative Perspectives on Institutional Origins and Evolution  7
Eric Hershberg

Chapter One
Introduction: Explaining Institutional Innovation  9
Richard F. Doner

Chapter Two
The Office of the Historian of Havana: Notes on a Case of Institutional Upgrading  19
Pedro Monreal

Chapter Three
The Association of Caribbean States: The Political Limits of Intergovernmental Institutions  37
Andrés Serbin

Chapter Four
Creating Institutions for Development: Conflict and Accommodation at the University of Puerto Rico  45
Emilio Pantojas García
Chapter Five

Crises and Institutional Origins: Business Associations in Latin America 57
Ben Ross Schneider

Chapter Six

The State and Capital in Chile: Social Construction of Institutions for Economic Policymaking 69
Eduardo Silva

Chapter Seven

The Formal Origins and Consequences of Adaptive Informal Institutions: Insights from Private Sector Development in China 83
Kellee S. Tsai

Chapter Eight

Explaining Divergence in Sugar: The Philippines and Brazil 107
Richard F. Doner and Ansil Ramsay

List of Contributors 127
Institutions, whether economic, political, or cultural in nature, emerge and evolve as a product of social interactions. At times, institutions are the result of deliberate initiatives, whereas on other occasions they arise more or less by accident, unintended byproducts of behaviors that become routinized over time. While social scientists agree that institutions are crucial determinants of outcomes across a variety of societal domains, perspectives differ as to when to anticipate institutional innovation and how to predict the performance of particular institutions over time. Analysis of institutions is especially important in circumstances characterized by instability rather than continuity: both the direction and the consolidation of change reflect the characteristics of institutions and their relationships to various stakeholders.

To explore these issues in depth, the Social Science Research Council (SSRC) and the Cátedra del Caribe at the University of Havana convened a June 2006 workshop in Havana involving roughly thirty researchers with common interests in the roles of institutions in shaping social, economic, and cultural life in the contemporary world. In addition to Cuba specialists, the meeting included experts on other parts of the Caribbean as well as on Latin America and East Asia. Two-thirds of the participants were from Cuba, where an array of new institutional mechanisms has arisen during the years following the disappearance of the Soviet Union, which, as is well known, amounted to a radical external shock to the island’s communist economy. Indeed, it was in large measure because of the pace and significance of institutional change on the island that the Council and the University deemed such a gathering especially timely.
This volume consists of revised versions of several of the written contributions prepared for the Havana workshop. Encompassing instances of institutional innovation across geographic settings and historical periods, the essays highlight the ways in which institutions emerge in contexts where key actors perceive gaps that cannot be filled adequately through existing mechanisms. External shocks were identified as one but by no means the only factor that motivates the establishment of new institutions or the reconfiguration of existing arrangements. Yet the apparent need for institutions, however urgent, does not inevitably lead to their persistence over time, nor does it ensure that whatever institutions do emerge will manage to resolve the problems that brought them about. Moreover, just as change can trigger efforts to forge new institutions, the latter can set in motion processes unforeseen by those who set out to create them in the first place.

These findings are of great importance to observers of contemporary Cuba, where both political and economic arrangements are in considerable flux, and where the development of new institutional forms is essential in order to preserve the social gains of the Revolution that triumphed over fifty years ago. It is hoped that the publication of this volume will contribute to debates in Cuba concerning the sorts of institutional arrangements that could promote social and economic advancement amid radically changing circumstances. Engineering such institutions—and orienting them effectively toward achieving sustainable development—represents a crucial challenge for Cuban practitioners and policymakers. Absent “good institutions,” “good development” is likely to prove elusive.

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Note
1 Among those in attendance, in addition to authors of chapters in this volume, particularly important contributions to the discussions were made by Jorge Nuñez, Digna Castañeda, Omar Everleny Pérez, Milagro Martinez, María Zabala, Lazaro Peña, and Isarelis Pérez. Special thanks are in order to Sarah Doty of the SSRC, who organized the meeting splendidly, and to the Christopher Reynolds Foundation, which made the event possible through a generous grant to the Council.
Introduction

Most scholars and policymakers now recognize that economic development cannot be explained solely by levels of investment, by education, by culture, by policies, or by type of government. There is, instead, a growing consensus that economic development is primarily a function of institutions that help societies to reap potential gains from interactions among independent actors (Hoff and Stiglitz 2001). This conclusion is not surprising: institutions—the norms, rules, and organizations that “govern” transactions—are the mechanisms for mitigating the collective-action problems (among sectors, among workers, among firms, between firms and workers, between firms and officials) that lie at the heart of economic development. Recognition that institutions are key to economic growth and to the distribution of resources is reflected not only in scholarly analyses of arrangements such as property rights, microfinance, business associations, and public agencies but also in the advice of development agencies that practitioners focus less on urging states to avoid intervening in markets and more on constructing pro-market institutions.1

But claims that “institutions matter” often beg two important questions: (1) What kinds of institutions contribute to what kinds of development? (2) Where do “good” institutions—that is, those that facilitate efficient and equitable outcomes—come from, and why do they evolve the way they do? Contributors to the present volume focus on the second question: institutional origins and evolution.2 They were asked to explain the emergence or evolution of an institution or set of institutions. And they were asked to do so in light of the argument that institutional innovation requires “tough times”
during which leaders see themselves as highly vulnerable to internal pressures and external threats but lacking the means to address such pressures.

The following chapters generally support this “systemic vulnerability” argument in the sense that various types of crises precede and stimulate the institutional changes in question. But the analyses also indicate the need to qualify and enrich the vulnerability argument in several ways. This chapter reviews the book’s contributions as follows: the following section describes the vulnerability argument and locates it within various categories of explanations for institutional origins. The next section reviews the empirical puzzles addressed in this book’s chapters and evaluates the authors’ conclusions in light of the vulnerability argument. The final section summarizes some of the key lessons to be drawn and identifies directions for further research.

**Approaches to Institutional Origins and Evolution**

Explaining institutional variation in the industrialized world has become a major scholarly focus, especially as analysts seek to understand why developed market economies vary in their organization and whether national diversity is possible in the face of globalization forces. The issue is equally if not more important in the developing world, where market failures are pervasive and institutional innovation is all the more essential and where less institutionalized states face pressures for convergence at least as strong as those in the industrialized world. We do, in fact, find numerous and puzzling instances of institutional strength and innovation in developing countries. For example, unlike most of Africa, Botswana’s property rights and public agencies helped the country attain some of the highest growth rates in the world (Acemoglu, Johnson, and Robinson 2003). In Southeast Asia, Indonesia’s strong macroeconomic and agricultural logistics agencies helped the country attain healthy growth rates and self-sufficiency in rice production from the late 1960s through the 1980s, but Indonesia “grew into trouble” in the late 1990s (Temple 2003). And in Latin America, the Fundación Chile, a public-private institution, has been highly successful as a source of technology transfer, innovation, and new firm incubation in Chilean agribusiness, marine resources, and forestry (Tiffin and Carmona 2004).

How might we explain such variation? The contributors to this volume were asked to confront an explanation that begins from two assumptions: (1) institutions are largely a function of actions by political leaders, and (2) it is
thus necessary to specify the pressures and opportunities facing such leaders. The strict version of this systemic vulnerability argument is that the creation or evolution of efficient institutions only occurs when political leaders confront popular discontent and external threats but lack resources to address these problems (Doner, Ritchie, and Slater 2005). Under these conditions, institutional innovation helps to generate required resources.

This argument combines elements of two of the more prominent accounts of institutional origins and change: functionalist-efficiency and power-distributional approaches (Thelen 2001). In the functionalist account, institutions emerge to solve collective-action problems. They are mechanisms through which interdependent parties achieve efficient outcomes. This is consistent with the vulnerability position, which views institutional innovation as an efficiency-based response to tough times. Yet the vulnerability argument also highlights the fact that political leaders promote institutions to shore up their own, threatened positions. In this sense, the argument is consistent with a power perspective, according to which institutions are inherently distributional and forged out of political struggles. The vulnerability argument draws from these two perspectives by postulating the conditions under which efficiency makes sense in terms of power. Put differently, the argument highlights the conditions under which “good economics makes good politics.” The vulnerability argument is, however, silent with regard to two other sets of explanations. One stresses the impact of cultural variables, such as norms and networks. The other emphasizes more historical, path-dependent dynamics—the idea that once an institution has been established, the costs of changing it are high.5 There are, furthermore, variants of path dependency to account for processes that “channel but do not preclude” institutional change (Thelen 2001, 221).

What then do the contributions to this volume say about the utility of the vulnerability approach? To what extent do these analyses suggest a modified version of this approach, one that takes into consideration cultural and historical factors?

Assessing the Arguments

By emphasizing the impact of crises on institutional innovation, the contributions by Ben Ross Schneider, Eduardo Silva, and Ansil Ramsay and myself provide significant support for the vulnerability argument while also
suggesting some useful qualifications. Schneider seeks to understand the conditions under which strong (that is, institutionalized and encompassing) business associations emerged in some Latin American countries and not in others and finds that the proximate cause of associational strength is state support. But in pushing the causal chain one step further, he finds that this state support is itself a function of economic and political crisis. By demonstrating the vulnerability of state actors, crises pushed these leaders to strengthen and rely on associations for key functions. But Schneider also suggests the basis for a more nuanced understanding of vulnerability’s impact. He highlights the importance of examining the consequences of partial or segmented crises. He explores a range of ways in which state actors promote business associations. And he demonstrates path dependence mechanisms by showing how associations, once established, can persist not by inertia but by being converted to serve new functions.

Eduardo Silva explores important shifts in Chilean policy and business-state relations during the 1980s. The policy shift involved a move from a set of radical, neoliberal economic policies emphasizing stabilization, liberalization, and deregulation to a more pragmatic model that included, for example, sectoral policies, export promotion, and more reflationary monetary policies. This policy shift had an important institutional corollary, namely, a move from the state acting as a relatively autonomous, personalistic, and closed actor to the emergence of a more inclusive process in which broader sectors of business had access to policymaking. This more institutionalized system of capital-state relations, similar to Peter Evans’s (1995) concept of “embedded autonomy,” emerged as part of the Pinochet regime’s reaction to economic crisis in the early 1980s. Silva’s analysis, with his emphasis on the increasing role of business associations, conforms to the dynamic described by Schneider. But Silva’s emphasis on domestic coalitions highlights the importance of political mechanisms in ways that are consistent with but better specified than in the vulnerability argument. Specifically, Silva describes the ways in which the debt crisis of the early 1980s not only “ripped apart the capitalist coalition” that supported the earlier policies but also spawned mass, popular mobilization and the growth of a broader business coalition led by associations.

Ansil Ramsay and I seek to explain the striking contrast between the sugar industries of Brazil and the Philippines. How did the Philippines’ industry descend into stagnation from its status as one of the world’s most
technologically advanced and efficient producers of sugar? How did Brazil, on the other hand, rise to become one of the world’s largest and most efficient producers of sugar as well as ethanol? At one level, the answer lies in the institutional arrangements of each industry. Whereas inefficient clientelism, indeed cronyism, ruled in the Philippines, Brazil’s sugar industry grew under an efficient, quasi-corporatist set of arrangements. These contrasting institutions in turn reflected very different sets of pressures on authoritarian leaders in each country. Put most simply, long-standing economic and security ties to the United States, along with localized popular pressure, reduced pressures on Philippine elites, especially President Ferdinand Marcos, to promote greater efficiency in sugar production and distribution. In contrast, the Brazilian military confronted a number of threats to the economic growth so central to their own legitimacy. The most important of these threats were oil price hikes in the 1970s. Upgrading the sugar industry, including ethanol production, constituted an important mechanism for reducing petroleum dependence and earning needed foreign exchange. It is worth noting, however, that Brazil’s institutional strengths in sugar were not necessarily characteristic of other industries in Brazil. Indeed, if this chapter provides support for the vulnerability hypothesis, it also highlights the potential for more sector-specific variants within national systems.

Kellee Tsai’s analysis of private sector development in China moves us further away from an emphasis on discrete vulnerability factors toward an appreciation of dynamics only hinted at in the other chapters. One is the importance of “bottom-up” initiatives. Whereas the vulnerability argument emphasizes the role of national leaders, Tsai describes a three-step, bottom-up process in which: (1) privately managed and owned businesses emerged disguised as collective enterprises, (2) these businesses attracted Chinese Communist Party members into entrepreneurial activities and encouraged the formal integration of capitalists into the Party, and (3) this influx of business members paved the way for revisions in the Chinese constitution that recognized the existence and role of the private sector. Another important feature of Tsai’s analysis is her emphasis on the ways in which informal arrangements—“coping strategies” to avoid formal restrictions—motivated political leaders to modify original, formal institutions. In this sense, Tsai’s analysis is consistent with a variant of path dependency in which existing arrangements evolve by being converted to new functions or by adopting new layers
of functions. Still a third important feature of Tsai’s analysis is her explanation of the informal arrangements themselves. Rather than primordial institutions, they are relatively functional responses to local problems. But there is a clear political-distributional theme in Tsai’s arguments as well. These efficient, informal arrangements emerge only under particular sets of political conditions: in the presence of incoherence among formal arrangements and of overlapping interests between citizens and local officials. Finally, Tsai returns to the core vulnerability argument by raising the “high politics” question of when and whether political leaders will help translate local, adaptive informal institutions into more formal institutional reform.

The chapters by Pedro Monreal, Emilio Pantojas García, and Andrés Serbin move away from strictly economic institutions, such as firms, business associations, and business-government relations, to the realms of urban development, education, and regional cooperation. Yet each also echoes themes running through other chapters. Monreal’s focus is Cuba’s most successful effort in local development: the transformation of the historic center of Old Havana. At one level, Monreal describes the institutional mechanisms—including new, dense networks of innovative planners and local inhabitants—through which the development has occurred. He then seeks to explain this success and raise the question of whether the experience can be reproduced elsewhere in Cuba. Monreal’s explanation for the initiative and its success reflects vulnerability conditions—namely, a series of problems, the most serious of which was the country’s deep crisis of the early 1990s following the disappearance of the Soviet Union. But this is far from a simple “crisis-response” story. Rather, Monreal echoes Tsai’s emphasis on institutional “layering” by describing the ways in which the innovation of the 1990s built on prior changes. He also confirms the importance of both local initiatives and links between local interests and key nonlocal actors, in this case the Council of State. But Monreal’s analysis departs from Tsai’s in one crucial area: whereas local, informal initiatives were adopted and institutionalized by elites at the national level in China, Monreal is profoundly skeptical as to the possibility of reproducing the Old Havana “model” elsewhere in Cuba.

In Pantojas García’s discussion of the establishment and evolution of the University of Puerto Rico (UPR), power and culture loom much larger than vulnerability. Put most directly, Pantojas García argues that UPR initially emerged out of a “cultural project of Americanization.” His account is
especially helpful in highlighting the ambiguously conflictual nature of this project. Although UPR was clearly designed to further U.S. colonial goals of cultural assimilation, its technocratic component also met the Puerto Rican elite’s aspirations for higher education. The result was the local elite’s “participation, albeit in a conflictive manner.” But while it is true that vulnerability, in the sense of rising threats and weak resources, is not evident in the prewar story of UPR, it is the very absence of such conditions that helps to account for the prevalence of a cultural assimilationist project. Indeed, Pantojas García also identifies more efficiency-based pressures accounting for UPR’s post–World War II evolution. With the United States’ rising interest in self-rule for Puerto Rico, away from sugar production and toward export-led industrialization, UPR was reorganized to include the Social Science Research Center and the School of Public Administration. This technocratic turn also included the establishment of the Puerto Rico Industrial Development Company (Fomento). In sum, Pantojas García describes a process of institutional development characterized initially by a politically influenced cultural project and subsequently by greater attention to the efficiency concerns of an imperial power confronted with decolonization pressures.

Finally, Andrés Serbin’s analysis of the Association of Caribbean States (ACS) highlights the collective-action challenges in creating an institution under relatively permissive conditions. Established in 1994, the ACS aimed to maximize intra-regional trade, improve the region’s bargaining power, and forge a regional identity through deeper cooperation. These were bold goals; indeed, their very breadth and ambition can reflect the permissive context in which they were adopted. The Cold War had ended, and globalization seemed to be pushing countries in the region to agreement on the need for greater interdependence and bargaining leverage vis-à-vis the rest of the world. But pressure to meet these goals, never that great in the first place, actually lessened over the next decade. The member countries found themselves pulled apart not simply by turf fights, weak organizational structures, and conflicting views on the role of the United States but also by external opportunities and constraints. Factors such as free-trade agreements, bilateral ties, and oil-based opportunities for leadership by Venezuela pushed the organization to focus on more narrowly functionalist issues, such as natural disasters and tourism. But progress on even these issues has been modest in the presence of external options, even if these options carry their own risks.
Conclusions

This book’s analyses provide strong evidence that vulnerability, in the form of crises perceived by political leaders, is a necessary condition for explaining the emergence of, or movement toward, institutional strengths. But the analyses also demonstrate the need to qualify the strict version of the vulnerability argument. First, vulnerability is often a matter of degree; crises, as Schneider notes, may be partial or segmented. Second, and related, vulnerability may result in sector-specific changes, as in Brazil’s sugar industry, or in place-specific reforms, as in Old Havana. Third, the functional and distributional logics of vulnerability pressures may not be sufficient to account for institutional evolution. Crises can result not in the creation of new institutions but in the conversion of old functions or the layering of new functions onto existing arrangements. Fourth, although the support of top leaders is necessary for institutional change, it is often not sufficient; as seen in Tsai’s analyses of Chinese reforms, change can emerge out of bottom-up efforts to navigate formal constraints through the creation of informal arrangements.

The chapters also leave open at least two important questions for further research. One is whether similar vulnerabilities result in similar institutional innovations. For example, did all Latin American leaders facing crises respond by promoting business associations, and in the same ways? To the extent that they did not, did variation in responses reflect more proximate political constraints, such as the number of “veto players,” that is, actors with the authority and desire to block policy change (Tsebelis 2002)? Or, as suggested by the work of Judith Tendler (1997) on Northeast Brazil and Gerry McDermott (2007) on Argentina’s wine industry, did such variation reflect the ways in which inter-elite political competition “sensitized” different political leaders to crises? A second and related question has to do with the potential for diffusion of institutional innovation: What specific sets of conditions influence, for example, whether the successful renewal of Old Havana can be replicated elsewhere in Cuba? Why did the institutional innovations in Brazilian sugar not spread to the country’s coffee industry? Why, on the other hand, did Chinese leaders adopt and diffuse informal adaptations from the local level?

Answering these and related questions requires comparative research. The importance of such analysis is growing. In terms of theory, scholars are beginning to grapple with the surprising variation in institutional arrangements and capacities across the developing world. In terms of policy, countries are facing growing pressures—from rivals and consumers in more competitive,
external economic environments and from domestic interests pressing for reform—for institutional innovation.

Notes
2 On the first question, of “goodness of fit” between institutions and different levels of development, see Doner (2009) and Pritchett and Woolcock (2004).
4 See for example Weiss (2003).
5 This definition is drawn from Levi (1997).
6 For an initial discussion of this issue, see Schneider (2004, 30–31).

References


Local development that is decentralized and partially autonomous is a relatively untested concept in Cuba. Experimentation has been limited, heterogeneous, and generally disappointing. Economic and social decline in some localities (sugar zones, for instance) or the ascendance of others (for example, the new tourist development “poles”) have been more the result of exogenous forces, such as global dynamics or centralized state decisions, than the action of local institutions. In the midst of this relative lack of autochthonous, viable, successful local development, there is one notable exception: the historic center of Old Havana.

Although there is insufficient information for rigorous comparison with other recent cases of local development in Cuba, the evidence suggests that the historic center of Old Havana, which has a population of approximately 70,000 occupying 2.14 square kilometers, is the only instance of a high-density urban area that has been able to “reinvent” itself successfully after the severe economic crisis of the early 1990s triggered by the disappearance of communism (Office of the Historian 1998). The renewal of the historic center has been multidimensional, encompassing the recovery of cultural heritage (both tangible and intangible), improvement of living conditions, renovation of urban infrastructure, expansion of social and community services, creation of new jobs and income sources, establishment of high-level local technical and administrative capacities, active public participation in the social processes of the region, and consolidation of a regional identity based on values and traditions that fundamentally reflect self-recognition of the progress in recent transformations.
This is not to imply in any way that the historic center has been free of problems. The transformation is ongoing, successes coexist with difficulties and insufficiencies, and there is still a long way to go in terms of development. Local living conditions remain inadequate, and although the process of physical and social renewal is advancing, it faces the constant challenges inherent in the oldest urban area of the country, which had been neglected for decades. Old Havana was traditionally inhabited by a low-income population and harbored pockets of social marginality. Nevertheless, the relatively rapid progress of the historic center is quite noteworthy compared both to its own previous situation and to that of other areas that have not progressed, or have declined, despite enjoying relatively better initial conditions fifteen years earlier.

The case of Havana’s historic center is the largest and most successful experiment in local development in contemporary Cuba, going well beyond simple restoration of cultural heritage. In fact, the capital’s historic center is now at the forefront of the country’s drive toward development. The historic center is currently one of the local spaces in Cuba with the most favorable conditions for consolidating economic support for activities that are dynamic, diversified, and mutually reinforcing based on intensive knowledge exploitation (Monreal and Carranza 2003).

At least two questions arise from this success. First, what explains the exceptional success of this autochthonous, decentralized local development? And, second, could this experience be reproduced in other areas of the country?

The following analysis of these issues emphasizes institutional factors. Although these factors have been acknowledged in work on the transformational experience of the historic center, they merit deeper analysis. This chapter puts forth four basic premises: first, that the institutional framework offered by the Office of the Historian (its organizations, norms, and rules, both for its own operations and those that it generates) has been the most important factor in the successful local development of the historic center; second, that in the mid-1990s, local institutional development promoted by the Office of the Historian reached a qualitatively superior level with the Master Plan for Comprehensive Renewal of Old Havana, which created decentralized institutional support for development specific to the area; third, that this institutional development principally resulted from factors arising from the local society of the historic center, even though nonlocal actors were also
involved; and fourth, that the institutional development achieved—which has proved to be appropriate for the challenges faced—did not emerge from a preconceived vision “from above” but rather was the product of deliberative actions, largely initiated by local actors who were somewhat motivated by strategic visions but who were, above all, responding to situations of crisis.

Since little research has been done on the historic center from an institutional perspective, this analysis is based primarily on the author’s practical experience as a collaborator, since 1995, on the Master Plan for Comprehensive Renewal of Old Havana. This analysis does not attempt to provide definitive conclusions; rather it is hoped that it will suggest hypotheses for further investigation.

The chapter is divided into three sections. The first part is a general overview of the origins and the process of institutional transformation experienced by the Office of the Historian, with emphasis on the changes that, beginning in the early 1980s, progressively modified its functions, character, and structure into an institutional network specialized in local development. The second section examines the work of the Office of the Historian, especially through the role of the Master Plan for Comprehensive Renewal of Old Havana, in restructuring local society. Lastly, the work analyzes the impact of crises on institutional transformations and considers the potential for replicating the institutional model in order to promote development in other areas of the country.

**The Office of the Historian of Havana:**
**From Cultural Sponsorship to Local Sustainable Development**

Over time, the Office of the Historian of Havana has become in practice the most powerful local public corporation in Cuba. In fact, it is the only important local corporation in the country. It was not always that way, and paradoxically, that is not even its current legal status.

It was founded in 1938 as an autonomous municipal entity that would carry on the work of the historian of the city (a public position created in 1925) of safeguarding Cuba’s, and especially Havana’s, heritage. Its mission statement is to “promote Havana’s culture and international connections (Office of the Historian 1998, I:9).

During most of its institutional history (1938 to 1993), the Office of the Historian of Havana primarily carried out preservation functions (investment
and legislation for preserving monuments and buildings with historic or artistic value) and supported related scientific and cultural activities (research, dissemination, event organizing, formation of cultural societies, museums, and recovery of popular traditions, among others). Although the office was always interested in engaging in economic and social development alongside cultural preservation, real possibilities to do so were relatively limited. This was the case even after 1981, when the Cuban State provided the office with funding to invest in the restoration of the historic center.

The office’s critical change, from a legal and practical perspective, occurred in 1993 with Decree-Law No. 143, which mandated the office to promote sustainable development in a specific area designated a “Priority Preservation Zone,” encompassing the historic center of Old Havana, which occupies approximately half the area within the municipality of Old Havana, one of fifteen municipalities in the city of Havana. Decree-Law No. 143 also changed the legal status of the Office of the Historian, making it directly subordinate to the Council of State rather than to the Provincial Government of the City of Havana (Office of the Historian 1998, I:9–10).

This radical transformation of the Office of the Historian took place over a relatively prolonged time period, which was marked by two distinct phases:

2. Institutional Upgrading (1993–2007): Transformation of the office into a complex institutional network responsible for the promotion of sustainable local development

From an institutional perspective, the two relevant axes of the transformation of the Office of the Historian were the scope of its functions and the availability of resources for financing its objectives.

During the first phase, the office continued to primarily carry out cultural sponsorship (heritage preservation), but there was a radical change in the availability and the origin of resources. There was a substantial increase in financing available for architectural preservation, and the funding came from the Council of State, an institution directly related to the national executive. Thus, although during this first phase the Office of the Historian formally reported to the Provincial Government of the City of Havana, as a practical
matter it was in a position of dual institutional subordination, with the Council of State as the most important relationship. In 1982, UNESCO declared Old Havana and its fortifications a World Heritage site. This recognition was crucial as it notably raised the visibility and prestige of the office on a national and international level and consequently increased the leverage of the office vis-à-vis other national and foreign institutions.

The restoration plans were grouped by five-year periods: in the 1981–85 period, the state allocated 11.7 million pesos for twenty-five projects; for the 1986–90 period, thirty million pesos were allocated for thirty-six projects (Office of the Historian 2007c). This situation contrasted very favorably with the twenty previous years (1961–80), during which the office sponsored only nine restoration projects in the historic center (Office of the Historian 2007d).

In hindsight, it is clear that during the first phase, allocation of investment facilities, a gradual institutional change took place, which became increasingly necessary since large-scale restoration required a comprehensive social plan at the local level. At the same time, thanks to its special relationship to the Council of State, the Office of the Historian became a better endowed entity with greater influence on legislation and mobilization of international assistance compared to the two government bodies that it formally reported to: the Municipal Government of Old Havana and the Provincial Government of the City of Havana.

From this perspective, it was only a matter of time before the second phase, institutional upgrading, came about, but the new phase did not occur automatically, nor did it simply emerge from a perceived logical necessity for change; rather, it was principally the result of the deep economic crisis of the early 1990s triggered by the disappearance of the Soviet Union. The inevitable budgetary impact on the country created intense pressure to find new sources of funding to continue the preservation of the historic center. In addition, the severity of the crisis in one of the most impoverished areas of the country gave more relevance to the notion of “comprehensive renewal,” which would address the cultural heritage, economic, social, institutional, and spiritual aspects of restoring the city’s historic center. Without a doubt, a nonlocal actor—the Council of State—played a crucial role in the institutional upgrading that took place in the Office of the Historian beginning in 1993. This executive body adopted exceptional policies that changed the focus of the office’s operations.
toward local sustainable development and shaped the regulatory environment so that the office could obtain the resources necessary to fulfill its mandate.

Nevertheless, the office’s own actions were crucial in getting the Cuban government within a few months to grant it an extraordinary set of legal instruments such that it became the first local public corporation specifically established to promote sustainable development in an urban area in a comprehensive and decentralized manner. This capacity for influence was clearly related to the office’s leadership, especially the exceptional qualities of its principal director, Dr. Eusebio Leal. Also critical were the concrete successes and effective dissemination of the results obtained during the first phase of the allocation of financing facilities. Even more important was the fact that, during those years, the Office of the Historian created a competent professional team that forged a close relationship with the local population, enabling the office to develop effective strategies for public participation in local development (Valcarcel and García 1995).

The institutional upgrading of the Office of the Historian was a complex process in which agencies already existing within the office (such as the Director of Architectural Preservation) were expanded and strengthened, new agencies were established (such as the Master Plan for Comprehensive Renewal of Old Havana and the enterprise Habaguanex), legal instruments were adopted at a national level (Agreement No. 2951 of the Executive Committee of the Council of Ministers, establishing the Zone of High Significance for Tourism, and Resolution No. 1/94 of the Minister of Finances and Prices, decreeing the obligation of entities located within the historic center to contribute to the financing of the office’s programs, among others), and the office was able to apply its own norms (such as the Urban Regulations for the Prioritized Conservation and High Significance for Tourism zones).

However, in our view, the institutional upgrading of the Office of the Historian beginning in 1993 had two essential pillars: Decree-Law No. 143, which expanded the mandate of the office for the first time beyond cultural stewardship by granting it authority for local sustainable development, and the Master Plan for Comprehensive Renewal of Old Havana (1994), which provided the fundamental basis for the Office of the Historian to undertake its new role of promoting sustainable development.

The Master Plan for Comprehensive Renewal of Old Havana, an agency of the Office of the Historian, is responsible for all aspects of urban renewal
in the historic center. Its mandate is defined as “management of methodology and information, supervision, and coordination in establishing the guidelines for comprehensive development of the historic center; consultancy and information services in the fields of physical and socioeconomic renewal; and convening the actors involved in developing the Plan” (Office of the Historian 1998, IV:2). Its work is multidisciplinary and encompasses public participation in the area's organizations as an instrument for effective management of local development plans and programs.

The following are the principal functions of the Master Plan:

- Produce the Comprehensive Development Plan
- Study the issues facing the historic center at various levels
- Describe, analyze, and structure the territory
- Recommend policies for preservation and development and for improving the living conditions of inhabitants
- Establish the most appropriate strategies and actions for recovery and development of the historic center
- Adopt legislative authority within the designated territory of the office
- Supervise construction and utilization activities
- Coordinate the investment process among various development programs
- Provide information, consulting, and assistance
- Oversee restoration work
- Implement socioeconomic projects
- Convene internal and external participants in the socioeconomic and urban work

(Office of the Historian 2007a)

The first step for the Master Plan, the Comprehensive Development Plan, provides policies and strategies as well as regulatory instruments that enable the physical, economic, and social renewal of Old Havana. The Comprehensive Development Plan is informed by four basic principles that, although they do reflect national interests, primarily entail clearly articulated local interests that are well supported by the institutional framework put in place:

1. Protect cultural heritage, restoring the area through a comprehensive and ongoing plan that addresses the challenges it faces and that harmonizes preservation of cultural values with the needs of socioeconomic development
2. Preserve the residential character of the historic center, assuring the permanence of the resident population according to the appropriate parameters of habitability, densities, and quality of life
3. Provide the area with technical and service infrastructure that will function according to contemporary needs
4. Achieve self-financed comprehensive development that provides for productive investment in heritage renewal, leading to a local economy that guarantees sustainable development

(Office of the Historian 2007b)

The institutional framework created by the Office of the Historian during the institutional upgrade phase includes three agency groups:

1. Entities dedicated to physical renewal (Master Plan, Department of Architectural Heritage, Department of Projects, Department of Housing, Office of Archaeology, Agency for Monument Restoration, Carenas Construction Agency)
2. Entities dedicated to sociocultural programming (Department of Cultural Heritage, Master Plan, Office of Humanitarian Affairs, Melchor Gaspar de Jovellanos Institute, Employment Agency)
3. Entities dedicated to administration and generation of financial resources (Department of Economics, Department of Cultural Heritage, Economic Organization of the Museum of the City, Negotiation Group, Habaganex, San Cristóbal Travel Agency, Fénix Real Estate, Aurea Real Estate)

(Office of the Historian 1998, III:2–4)

The continued formal independent status of the Office of the Historian—as an agency of the Council of State—allows it and the institutional framework that has developed within it since 1993 to operate as an organization that plans and promotes local development that is rooted in the dynamic of a local society.

The Master Plan for Comprehensive Renewal of Old Havana: Reinventing Local Society
It is impossible to exaggerate the exceptional nature, within the Cuban context, of the local development process undertaken in Old Havana. Probably one of its most extraordinary characteristics has been the way in which
location as a unit of planning analysis and management has become central to the development process. In this approach, location is understood not only as a physical space but also as a “social location,” a versatile nexus of enterprises, productive activities, and general social activity capable of generating sustainable economic and social development on its own.

Unlike predominant approaches in Cuba—both then and now—the Master Plan did not conceive of local development in terms of a sector or sectors (such as tourism, retail, or real estate) located in a geographic area. The “geographic area” was not analyzed as a manifestation of sectors, nor was it dismissed as a residual and subordinate result of sectoral dynamics; rather, it was valued for the determining role it plays in the development of the local social web and the means for making it function appropriately. The Master Plan assumes that local well-being does not depend fundamentally on “development factors” (of supply) that exist in a given area; it looks instead at the possibility of favoring and reinforcing capacities for economic, technological, social, and institutional innovation that emerge from the complex local interactions between supply and demand factors.

The institutional upgrading phase of the Office of the Historian, beginning in 1993, occurred at a time when international tourism was identified as the major sector in which the country should invest for future development. This was the golden moment of international tourism, which was officially designated as the driver for national development, resulting in centralized identification of areas that would benefit from the expansion of this new sector. Most of these were coastal areas that were transformed into “tourism poles” since the tourism was largely of the sun and beach variety. Old Havana was one of the few non-beach areas of the country that benefited from the expansion of international tourism due to locally based supply factors, such as the historic architecture, that created a potential tourist attraction capable of generating significant income. Thus, in its new phase of institutional upgrading, the Office of the Historian adopted the premises of the appreciable tourism potential of the historic center and the potential for channeling resources generated by tourism into the comprehensive renewal of the area (Office of the Historian 1998, IV:2).

In contrast to other areas of the country, beginning in the mid-1990s management of local development in the historic center was based on an essentially instrumental approach to the expansion of tourism in the area. In
other words, tourism would become large and important in Old Havana, but it would not be the only aspect, or even the most significant aspect, of local development. Tourists and foreign capital would be welcome, but they would never become vigorous actors in local development; the fundamental objective was local development of the area (the historic center), while the sector (tourism) would simply be one of the means of achieving that end.

Income generated by tourism and related activities—such as gastronomy, retail, and cultural industries—did transform the economic profile of the area and provided the resources necessary to initiate and assure the sustainability of what to date continues to be the most significant experiment in decentralized local development undertaken in Cuba. The immensity of the local transformation that has been achieved relies heavily on the establishment of a new sector (tourism). What transpired in the historic center amounts to a reinvention on a grand scale of its local society since development activities have led to changes across a broad spectrum of the life and work conditions of the local population and have had repercussions in the quality of the interactions among the actors who make up this local society. This is especially evident with respect to dynamics of participation that are singular in the country, at least on the scale occurring in the historic center.

In 1996, there was a significant housing restoration in San Isidro, one of the neighborhoods that presented an especially critical situation in both its physical and social conditions. Located in the historic center, somewhat removed from its principal tourist attractions, the neighborhood was chosen by the Master Plan and the Municipal Government of Old Havana for an experiment that required the active participation of the residents occupying fourteen blocks in an area of 8.5 hectares. The Master Plan assigned approximately one million dollars to the project, in addition to support from enterprises connected to the area, to repair 120 buildings (46 percent of the total in the neighborhood) at the same time that other facilities were created to establish and expand social services specifically designed for the community. That experience played an important role in the subsequent work of the Master Plan and would be extended to other neighborhoods in the historic center (Office of the Historian 2007a).

In addition to the housing programs, the Comprehensive Development Plan also fostered social activities as far-ranging as a medical center specializing in pediatric rehabilitation, trade schools, a maternity hospital, a geriatric
The Office of the Historian of Havana

clinic, educational centers, museums, amusement parks, libraries, concert halls, retirement homes, cultural centers, and classrooms in museums for students enrolled in local schools, among others.

The available data for the 1994–2004 period indicate the sustainable character and the social content of the local development experience in the historic center: 60 percent of the 250 million dollars earned by the business arm of the office was dedicated to projects that continued to generate financial benefits for the renewal process, and the remaining 40 percent was directly applied to social projects. 3

The “New” Office of the Historian as a Specific Solution to a General Crisis: A Case of Systemic Vulnerability?

The institutional transformation of the Office of the Historian, which eventually led to the establishment of a new entity specializing in local sustainable development (the Master Plan for Comprehensive Renewal of Old Havana), was, as noted above, a gradual process that took place over several years and was determined in large part by the adoption of actions meant to overcome various and diverse crises.

The process of institutional change was not the result of a single crisis. The first phase, allocation of investment facilities (1981–93), was an attempt to overcome a crisis limited to the specific cultural preservation obligations of the Office of the Historian. As noted above, in the preceding twenty years (1961–80) there were only nine restoration interventions in the historic center (Office of the Historian 2007d), an ostensibly insufficient rate. It was then understood that the institution did not have the resources or the authority required to avoid what was justifiably viewed as an imminent danger of physical collapse of the greatest part of the historic architecture in the country’s historic center. The response was a substantial increase in financial resources—allocated directly by the Council of State—and a strengthening of the office’s relative position through the establishment of a special relationship with the Council of State. This linkage gave the Office of the Historian a margin for negotiation and influence within the Cuban State apparatus that was much greater than what it enjoyed under its formal status as an agency of the Provincial Government of the City of Havana.

Through the two plans for restoration of the historic center undertaken in this first phase—the first from 1981 to 1985 and the second from 1986
to 1990—it became clear that the problem was not limited to a crisis in the architecture's physical integrity, but that in fact there were multiple crises that encompassed the economic and social conditions and the values of the local population. This perception of the simultaneous presence of multiple crises and the need to address all their dimensions contributed positively to creating favorable conditions for the institutional leap that took place beginning in 1993. Particularly important here was the appreciation that local structures and mechanisms would be required for the strategic planning as well as the daily management of local development in Old Havana.

Nevertheless, the real catalyst of the second phase, institutional upgrading (beginning in 1993), was another crisis—one of a nature, complexity, depth, and consequence much greater than the previous ones. In the early 1990s, the entire country was subsumed by the most serious peacetime economic crisis in its history: GDP contracted 35 percent in only four years, economic activity almost collapsed, and the standard of living took a heavy blow. The effects of this general predicament were felt unevenly across the country, and Old Havana was one of the urban areas that was hit particularly hard.

The 1995 census data on population and housing in the historic center—from the first census since 1981—painted a disturbing picture of the local standard of living. Of all living spaces, 49.4 percent were a precarious type of housing unit called habitación en cuartería. Of the total housing stock, 43.4 percent had structural defects in the roofs and 42 percent had cracked or crumbling walls; 39.6 percent did not have running water. There were evacuation plans due to danger of collapse for 18.3 percent of all dwellings (Master Plan for Comprehensive Renewal of Old Havana 1995, V:9–10).

An opinion survey that year of historic center residents indicated that 66 percent thought that repairing the housing infrastructure was the most important problem facing the community. At the same time, in spite of everything, 80.7 percent of respondents thought Old Havana was an attractive place to live, 84.3 percent expressed willingness to participate in solving the historic center's problems, and 76.6 percent were willing to join housing restoration projects (Office of the Historian 1998, V:17).

The survey also revealed crucial information about the residents' assessment of the restoration work carried out up to that point in the historic center. Although 85 percent of respondents described the changes as positive, 47 percent did not feel that they had benefited from the work. Specialists
working with the Master Plan interpreted this data to mean that “independent of the reasons each individual values something that does not confer a direct benefit, this is an indication of a basis for strengthening participation, and as a result, the physical and social transformation of the historic center” (Office of the Historian 1998, V:18).

These data were formally published by the Master Plan in 1995, but clearly the situation was well known and had been studied and documented for some time by the specialists and management of the Office of the Historian (Valcarcel and García 1995). It appears that during the most difficult years of the economic crisis (1990–94), there was a renewed commitment of mutual support between the Office of the Historian and the local population. This process would play a fundamental role in the institutional upgrading of the office as well as contribute to an improved definition of the dynamics among the actors who would become the principal agents of the new phase: the office and the local population.

During the economic crisis of the early 1990s, the Office of the Historian became increasingly involved in local problems that went well beyond its formal mandate (historic preservation) at the same time that the local population, deeply dissatisfied with their standard of living, perceived the Office of the Historian as the institution that was best situated to address concrete problems, especially improvements in housing conditions. The office was a visible, prestigious, effective, well-connected, influential institution with coherent social advocacy that focused on the local community.

If the Office of the Historian sought to broaden its functions—as a matter of principle as well as necessity—toward sustainable local development, it inevitably had to forge a coalition with the local community. Unlike other processes, local development would not be viable without popular political support, which was highly dependent on accomplishing consensually determined goals. And it would also not be achieved without relying on one of the greatest potential assets that the office had for its work: the active participation of the population in addressing local problems. There was popular pressure that could be channeled in an informal, yet tangible, political commitment between the local residents and the Office of the Historian, the institution that had the greatest will and credibility to outline an agenda to address local issues.5

The convergence of interests between the office and the local population also extended to the perception of the existence of a significant “external
threat”: the possibility that nonlocal entities could control the assets of the historic center, appropriating income from tourism. The perception of threat was reasonable in a context in which powerful national tourist corporations were being created, whose vision of tourist expansion was fundamentally sectoral and oriented toward “business.”6

Both the Office of the Historian and the resident population of the historic center were fully aware that there were no easy solutions to the community’s problems since the area did not possess assets that were capable of producing income immediately. The principal potential asset was the historic architecture, which was in a precarious state that necessitated considerable investment as well as the establishment of a complex network of agencies that would make it possible to use it. This is a very important point: most attention has been paid to the office’s redistributive role during the institutional upgrading phase—the transfer of resources from its companies into social programs—but the truly significant aspect of its management was the creation of value in the network of institutions it established. The “transformative,” rather than simply redistributive, nature of the office required the creation of strong institutional support, with professional staff trained in obtaining and processing specialized information and possessing the political capacity to negotiate the accommodation of competing demands that could facilitate the rapid expansion of competitive economic activities with the necessary value added.

The office’s institutional upgrading included the adoption of legal instruments that allowed it to “generate its own sources of financing,” “enter into agreements,” “grant or deny authorizations for work and uses of urban space in the priority preservation zone,” and impose taxes on “entities in the priority preservation zone that are not dependent on the Office of the Historian” (Council of State of the Republic of Cuba 1993). In economic terms, this represented at least four things: (1) the establishment of a quasi monopoly over the disposition of historic assets in the historic center; (2) the possibility of directly converting these assets into income-generating “tourist attractions” without substantial interventions from other agencies; (3) the capacity for direct appropriation of a large part of the income generated in the area by expansion activities such as tourism, gastronomy, and retail; and (4) the possibility of establishing a self-sustaining process of local development with relative ease.
The concurrence of the three factors mentioned above—popular pressure, perception of external threat, and scarce resources—is a modified version of the systemic vulnerability identified by authors such as Richard Doner, Dan Slater, and Bryan Ritchie (2005) to explain institutional strengthening in the context of development processes. In the case examined here, the systemic vulnerability would correspond to the scale of challenges facing local development processes.

The institutional transformation of the Office of the Historian represented, in practice, the creation of a new institution. The differences from the office prior to 1993 are not limited to the scale of its operations. Rather, the institutional web surrounding the current office is incomparably greater. It has become an entirely different institution, one that is now engaged in sustainable local development.

What is now the largest local public corporation in Cuba did not emerge as an inevitable necessity but was the result of deliberate actions by the leadership of the Office of the Historian with the support of the Council of State, which was gained through the moral authority acquired from previous outcomes. The Council of State was very important in launching the new phase of institutional upgrading and continued to play an important role, although after the initiation of the new phase the institutional web created evolved through the interactions of the two local actors: the office and the local population.

The Office of the Historian is currently a mature and effective institution. Its success is based on its nature as a value-creating agency. Using the principal available resource of historic architecture, the business arm of the office has proved especially capable of carrying out the arduous income-producing activities required, and the institutional structure that supports this capability has been very advantageous. The office's institutional strength is based on the establishment of a vast system of delivery of social and individual benefits to the local population, fundamentally in the form of “public goods,” which include the strengthening of local capacities to create new value, with a transparent system open to negotiation with the citizens in the area.

Replicating the institutional experience of the Office of the Historian is more probable in the management of historic centers than in local development in other regions of Cuba (Office of the Historian 2006). As stated by a senior UNESCO official, “There are aspects of the case of the renewal of Old
Havana that can be applied in Latin America and other parts of the world. This model may not be transplanted, but it is possible to learn from it.”

Nevertheless, the possibilities for reproducing the institutional model of the Office of the Historian within the local development processes of Cuba—assuming that in the future experiments with decentralized local development programs are preferred—are practically nil. One of the greatest lessons of the historic center experience is that the relatively autonomous and sustainable local development that took place was the result of institutional upgrading—the daring and radical transformation of a unique institution in Cuba. A complex set of specific circumstances, in a particular time and place, enabled the office to be transformed into a powerful local public corporation for the promotion of community development. The available information indicates that there is no other area that currently has the type of institution capable of undergoing a similar self-transformation.

But the experience of the Office of the Historian illustrates not only that relatively autonomous decentralized local development is viable in a centralized economy like Cuba’s but also that local society is capable of generating—under certain conditions—the type of local institutions that can lead to more effective local development than that available “from above” (institutions designed and implemented by nonlocal actors). At this stage, this is only a hypothesis that needs to be confirmed through the study of a greater number of cases, but it could be useful to consider for any debate on potential development models in Cuba.

Notes

1 There are other cases of relatively autonomous local development in Cuba, but they are almost all in rural zones with small populations and limited institutional density. The community of Las Terrazas, located west of Havana in the Sierra del Rosario, is a representative example of this type of development.

2 Local public corporation is understood here as a state institution (or network of institutions) in which the local dimension means two things: (1) a spatial dimension at the municipal or submunicipal level as the framework for the entity’s activities; and (2) the
significant predominance of territorial interests in the internal logic of the entity, in its actions, and in its relations with other institutional actors.

3 Statements of architect Patricia Rodríguez, Director of the Master Plan (Matos 2006).

4 A *habitación en cuartería* is a small single room in a larger building containing many of these units (typically housing crowded families). Construction and hygiene conditions are generally poor.

5 The rest of the important local institutions, principally the Municipal Government of Old Havana and the Municipal Committee of the Cuban Communist Party, were also actively involved in seeking solutions to problems in the historic center, but at that time under those particular conditions, the Office of the Historian proved to be more effective in resolving concrete problems and was therefore more highly regarded by the local population.

6 Earnings generated by the tourist corporations were redistributed in a centralized manner by the Cuban State, with a substantial portion dedicated to financing social programs. The point here is that these state corporations operated to maximize benefits, which created interests that could diverge from, and even be antagonistic to, the interests of other institutions in the country. For example, the tourism corporations might demand use of historic center buildings that could conflict with the uses contemplated by the Master Plan.

7 Statement of Herman van Hooff, director of UNESCO’s Regional Bureau for Culture in Latin America and the Caribbean (Matos 2006).

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When the Association of Caribbean States (ACS) was formally established in July of 1994, the many expectations of governmental, intergovernmental, and nongovernmental actors for the creation and consolidation of a region with its own geopolitical, cultural, and economic characteristics appeared to be satisfied. Born in an auspicious international context—the end of the Cold War, with the resulting decline in strategic importance of the region for the United States, and a process of globalization that activated and accelerated regional integration processes—the creation of a regional intergovernmental institution that brought together all the states and territories of the Greater Caribbean addressed a long-standing aspiration of many groups and sectors in the region (Serbin 2002).

Nevertheless, well over a decade after its inception, the attempt to establish an efficient, functional regional institution that represents the interests of the region—especially by addressing the environmental, social, and political issues that afflict the Caribbean—appears to have been shipwrecked. The following analysis explores how the combination of variables arising from the international conjunctures and the responses to them, in terms of political will and commitment from the member countries, has affected the evolution, consistence, and influence of an intergovernmental institution and introduced significant changes in its agenda and the scope of its work.

Gestation and Birth: Vicissitudes of Political Will in a Difficult Birth and Foundational Institutional Weaknesses

The establishment of the ACS on July 24, 1994, in Cartagena, Colombia, by agreement of thirty-seven states and territories of the Greater Caribbean,
marked the culmination of a multiphase process arising from different initiatives by a series of governments and regional institutions at the beginning of the 1990s. The favorable international context, with the end of the Cold War and the growing impact of globalization processes, facilitated, perhaps for the first time, a convergence among regional actors without intervention or pressure from outside interests.

In this context, beginning with the presentation of the report *Time for Action*, prepared by the West Indian Commission in 1992, which stressed the need to “deepen and broaden” regional integration, Caribbean Community (CARICOM) member countries of that era—as well as the Group of Three (Colombia, Mexico, and Venezuela), Cuba, and, to a lesser extent, the Central American countries—expressed their political will to support the creation and consolidation of a regional institution that would fulfill two objectives. First, it would give prominence to the common interests of Caribbean nations, understood as all countries connected to the Caribbean Sea, regardless of size, colonial heritage, language, or political system. Secondly, it would contribute to the elimination of barriers inherited from the colonial past that separated countries of the region (Serbin 1994).

In this stage, the ACS sought collectively to pursue three objectives: (1) to maximize regional trade and those economies of scale needed to achieve insertion into the international economic system through trade liberalization; (2) to optimize the region’s bargaining power with third parties (given its post–Cold War decline in geopolitical importance) through the forging of strategic regional alliances based on identification of common interests; and (3) to move toward various forms of cooperation and eventual integration, through establishment of consensus on matters of common interest and the consolidation of a regional identity, based on a common cultural and social fabric, that will overcome existing divisions and heterogeneity and benefit the population of the entire region (Serbin 1994).

From the very beginning, these objectives encountered a series of obstacles, despite the manifest political will of the CARICOM countries (especially Trinidad and Tobago) and Venezuela and Cuba to launch the initial development of the institution. Three factors merit emphasis.

First, the political will of the initiating countries corresponded to their specific political situations. Trinidad and Tobago sought regional leadership in the Caribbean, while the converging interests of Venezuela and Trinidad
led them to host the headquarters and the secretariat, respectively. Cuba, meanwhile, aspired to strengthen regional linkages within the framework of an organization that would exclude the United States. These motivations did not always enjoy an effective commitment and appropriate support from the other countries. This was especially evident for the Central American countries, which perceived the idea of the Greater Caribbean as far removed from their immediate interests, and for Mexico, which conceived the region as a function of a larger hemispheric or global strategic game.

Second, the institutional structure established by the ACS was inspired by the organizational structure of the Latin American Economic System (LAES), which was already showing significant signs of exhaustion and exhibited similar defects, including very strict subordination of the secretary general’s decisions for approval by the Council of Ministers of the member countries. At the same time, there was no provision for guaranteed sustainable funding flows to the organization. Added to this situation was the election of the first secretary general of the ACS, the Venezuelan Simón Molina Duarte, which occurred in the midst of political transition in Venezuela. Venezuelan President Carlos Andrés Pérez, the principal advocate of the ACS, was facing impeachment, and an interim president was put in place until the election, for the second time, of Rafael Caldera, who was very jealous of the ties that Pérez had established with the governments of the Caribbean. Thus, the capacity of the new secretariat to create a more autonomous institutional structure was undermined due to, among other reasons, the lack of effective political support from its host country. Additionally, the secretariat was unable to promote a regional agenda that was not hemmed in by the national interests of each member state.

Third, from the beginning, a series of exogenous factors weakened the support the ACS might have acquired. Negotiations around European Community (EC) banana quotas generated tensions and splits among the CARICOM member countries; those linked to the EC through the Lomé Accord (which was due for renegotiation), along with the ACP (Africa, Caribbean, and Pacific Group of States) countries, were at odds with the Central American contingent. Furthermore, in December of 1994, six months after the creation of the ACS, the Free Trade Area of the Americas (FTAA) was launched. This dealt a deathblow to the initial objective of developing a framework for economic integration and free trade within the Greater Caribbean region and

**Survival and Transition: Functional Cooperation**

From its foundation, these circumstances limited the ACS in its capacity to promote the initial objectives of regional integration and stronger regional capacity for alliances with third parties. The organization was forced to reorient its priorities toward a somewhat different objective—functional cooperation. It did so, with uneven results, in four areas: regional trade, transportation, sustainable tourism, and natural disasters. The new secretary general of the ACS, the Jamaican professor Norman Girvan, elected in 2000, obtained the approval of the governments (subsequently endorsed at the Margarita Summit, in December 2001) for a work plan focused on those four themes within the framework of promoting the Greater Caribbean as a “cooperation zone.” This represented a new vision of the organization’s mission that would complement the work of CARICOM and SIECA (Central American Secretariat for Economic Integration) (Girvan 2004). Curiously, Girvan’s initial aspiration as secretary general to promote a more political objective of converting the region into a “peace zone” (Serbin 1989) did not garner the political support (or the consensus) necessary from the member governments, despite strong support from the CARICOM countries.

At this stage, some notable achievements included signing the Convention for Sustainable Tourism of the Caribbean in December 2001 and progress toward enacting an agreement on air transportation, along with some actions in disaster prevention. These actions took place at a time when the actors with the most weight in the association were increasingly concentrating their efforts elsewhere: negotiating free-trade agreements with the United States (involving the Central American countries and the Dominican Republic), strengthening bilateral ties between Mexico and the United States through NAFTA, managing the crisis and political transition in Venezuela with the emergence of Hugo Chávez, and refocusing on domestic subregional dynamics (involving the CARICOM countries). These trends significantly weakened the original idea of the ACS as an integrating mechanism for the Greater Caribbean with a secretary general capable of convening political will and commitment.
From an institutional perspective, the “parochialization” of the ACS that took place during this stage, with its strong emphasis on the engagement of CARICOM and the insular Caribbean countries, did not lead to the development nor the continuity of an effective and sustainable institutionality; rather, it basically led to addressing a series of technical issues within some of the four priority objectives for functional cooperation. A noteworthy outcome is that trade among the Greater Caribbean countries did not increase significantly, barely making up 8 percent of trade flows.

The Tenth Anniversary and Its Prospects

The March 2004 designation of the new secretary general of the ACS, the Dominican professor Rubén Silié, took place in a new regional conjuncture that altered the challenges facing this intergovernmental institution as it sought to survive and establish its capacity to perform effectively. The Dominican Republic–Central America Free Trade Agreement (CAFTA) with the United States has practically broken off this subregion from the Greater Caribbean, bringing it closer to North America. Additionally, the CARICOM countries, in light of the disappearance of the advantages conferred by the Caribbean Basin Initiative, have reactivated the process of negotiating a free-trade accord with the United States. And Venezuela, with the presidency of Hugo Chávez and high petroleum revenues, has initiated a diplomatic offensive in the region, and in the hemisphere more broadly, supporting a program of low-cost energy supply with soft conditions through PetroCaribe, which benefits CARICOM (except Trinidad and Tobago and Barbados), as well as Cuba, the Dominican Republic, and Haiti. Furthermore, by promoting the Bolivarian Alliance for the Peoples of Our America (ALBA) as an alternative to the FTAA, Venezuela has contributed to new fragmentations and polarizations in the region.

As the new secretary general recognized, the ACS had lost political strength (Silié 2004). The declining interest of governments was evidenced by the increasingly limited attendance of ministers and chief executives at ACS meetings and the absence of sustained funding flows for its maintenance through the payments of country quotas. The repeated postponement of the Panama ACS Summit—ultimately held in July of 2005 and marking the tenth anniversary of the organization—was highly revealing. Several key leaders, such as Fidel Castro and Hugo Chávez, did not attend, although their
governments sent high-level delegations. The argument of a lack of security for the two leaders does not seem sufficiently solid to justify their nonattendance, especially for the latter. The absence of several Central American leaders was also conspicuous.

But beyond the absences, which denoted the weakened political will for driving the organization's evolution, the summit's agenda itself revealed a significant change in emphasis. There was a new accent on development and the fight against poverty and exclusion, in tandem with a growing connection to the United Nations and identification with its millennium development goals, and a renewed interest in energy cooperation in the region resulting from the diplomatic offensive of the Chávez government at the regional and global level (Serbin 2006). Additionally, there was a clear reordering of priorities within the four central cooperation objectives of the ACS agenda: most important, there was growing attention to the need to address the region's vulnerability to natural disasters through international, and especially regional, cooperation; secondly, there was renewed interest in regional integration with special reference to the impact of WTO negotiations; and finally, tourism and transportation were displaced to lesser importance, in contrast to the technical priorities established in the preceding decade (ACS 2005).

Pressing issues for the organization's agenda included the social and environmental vulnerabilities of the region and the need to salvage political interest in the association from its member states given the historical moment of growing regional fragmentation, divergence, and atomization, in contrast to the conjuncture in which the organization came into being a decade before. Thus, the new secretary general was making an effort to reintroduce issues that go beyond technical concerns to address relevant political issues, such as migration and regional security, that were traditionally excluded from the agenda. Notably, this incipient recognition of the political vulnerabilities of the region was occurring at a time of increasing confrontation between Venezuela and the United States. Absent from the agenda were crisis and conflict prevention, even though those were emerging as significant issues in light of the Haitian crisis and the new profile of the Organization of American States (OAS) in the region (Silié 2004). Furthermore, within this political initiative there was a need to promote multilateralism and respect for international law in order to create a sphere of common interests for the countries and territories of the Greater Caribbean with the ACS.  

2
Conclusions

This summary review of the origins and development of the Association of Caribbean States provides for some preliminary conclusions about its institutional development and its effectiveness at implementing the mission assigned to it by the member governments.

First, the institutional weakness and fragility of the ACS is due to two elements: the changing political will of the government actors that initiated the organization, resulting from regional as well as global transformations, and an institutional structure that was highly dependent on that will, with little capacity for political and financial autonomy for pursuing issues of a supranational nature in a regional agenda.

Second, these two factors—the overwhelmingly political dimension as well as the specific nature of the concomitant institutional debility—have not only contributed to the difficulty of addressing the two primary objectives originally outlined for the ACS (regional integration and development of alliances in multilateral forums and in negotiations with external actors); they also have hampered effective cooperation around vulnerabilities specific to the Greater Caribbean, such as the impact of natural disasters, as well as social and political challenges.

Third, a redefinition of the institution’s mission along the lines of the proposal for greater emphasis on political issues and common interests that surpass mere functional cooperation again faces the constraints of institutional weaknesses, limited autonomy, and political-legal structure that inhibit supranational initiatives. It also comes up against the lack of political will of the members of an intergovernmental institution that tends to serve the specific interests of the individual governments rather than those of the region as a whole.

Notes

1 The opinions expressed here are solely the author’s and do not represent the views of the Regional Coordinator of Economic and Social Research (Coordinadora Regional de Investigaciones Económicas y Sociales — CRIES).

2 Personal interview with Dr. Rubén Silié, Santo Domingo, June 2006.
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Preliminary Propositions

The objective of this essay is to reflect on issues of “institutional transformation in response to vulnerability” in the context of the challenges of institutional development in small island economies in the Caribbean, such as Puerto Rico’s. This was the task that we were assigned for the workshop that led to this volume. Before entering into the substance of institutional transformation in small island economies and societies, we need to examine some assumptions underlying the theme of institutional transformation and vulnerability.

First, the notion of institutional transformation and creation is a product of modernity. That is, the conscious attempt at “routinization” and structuring of human endeavor (the institutionalization of social and cultural practices) with the purpose of achieving predefined goals (development, democracy, social and/or economic equality) is rooted in the Enlightenment view that society is an organic entity that is susceptible to exogenous intervention. This notion is thus a fully modern and functionalist proposition. In reality, successful and resilient institutions do not necessarily respond to “functional” notions of need and efficiency. Successful institutions are also those that are able to adapt and fulfill symbolic needs. I would venture to assert that such are the cases of the Catholic Church or the English monarchy, whose functional value can be questioned but whose symbolic value (symbolic capital in postmodern terms) ensures continuity. Of course, adaptation (symbolic and functional adaptation) is the key to the resiliency of these types of “anachronistic” institutions. Hence, the defenders of the English monarchy argue that it promotes tourism (an economic function) and affirms the cultural and political identity of the United Kingdom (a symbolic function).
Second, the notion of vulnerability assumes a relationship. Vulnerability to what—external institutional influences? What or who are vulnerable—populations, indigenous institutions? Is openness (economic, political, social) the same as vulnerability? What is the difference between receptiveness to institutional transformation (institutional flexibility) and institutional vulnerability? It can be argued that the underlying assumption of a phrase that associates institutional transformation and vulnerability is that all institutional transformations that are good are endogenous and all institutional transformations with potentially negative implications are exogenous. This is, of course, an artificial dichotomy, but it is important that we bring it to the surface in order to avoid falling into such a conceptual trap.

When we talk about vulnerability, in the Caribbean at least, we are assuming that the economic, political, and social asymmetries between the small countries of the region and their former or present imperial centers (the United States, France, the Netherlands, England) place the region at a disadvantage in “choosing” or “charting” the road to institutional transformation and development. Hence, vulnerability may be taken to mean the lack of power to resist certain types of exogenous influences that result in negative or unwanted institutional transformations.¹

My central argument in this essay is that institutional transformation results from the dynamics of conflict and accommodation. I shall discuss two critical instances of institutional transformation at the University of Puerto Rico (UPR) to examine the factors that characterize these transformations. The instances examined are: first, the founding of UPR in 1903, linked to the political project of the Americanization of Puerto Rico after the United States took over the island in 1898;² and second, the university reform that began in 1942, linked to the project of modernization advanced by the Popular Democratic Party after its ascent to power in 1940.³

The University of Puerto Rico: Institution Building, Cultural and Technocratic Projects of Transformation

The Project of Americanization
The creation of the University of Puerto Rico in 1903 presents an interesting case of convergence between exogenous and endogenous interests in a colonial context. In 1898, Puerto Rico became a possession of the United States
as a result of the Spanish-Cuban-American War. During the nineteenth century, the Puerto Rican elite had been demanding the creation of a university from the Spanish colonial authorities. Up to the creation of UPR, the local elite and their children had been forced to study in Spain, Cuba (University of Havana), or in other European countries and the United States. The founding of the University of Puerto Rico thus articulated the aspirations of the Puerto Rican elite for an institution of higher education.

UPR was founded in 1903 as a “normal school” for training teachers. This was followed by the establishment of the School of Agriculture and Mechanical Arts in 1904 (Osuna 1923, 254–55). The aim of these schools, or colleges, was to develop a cadre of local (“native”) teachers who would serve in the public school system teaching English and American history and culture along with other disciplines and to provide technicians (chemists, agronomists, engineers) for the island’s sugar plantation economy, which flourished under the aegis of American sugar corporations (see Ayala 1999). The creation of UPR thus articulated the interests of the United States to create an educational institution that would help advance its stated policy goal of Americanizing Puerto Rico and to create a technical cadre for its economic interests.

The control of the institution was put in the hands of American colonial officials. The chancellor and president of the Board of Trustees of UPR was the commissioner of education, an American official appointed by the American governor, who in turn was appointed by the U.S. president with the consent of the U.S. Senate. The board of trustees also included the governor, the attorney general, and the secretary and the treasurer of Puerto Rico, all American officials. The Speaker of the House of Delegates (an elected Puerto Rican) and five other members appointed by the governor completed the membership. This institutional arrangement ensured complete control and coordination of educational policy by the American colonial government while allowing for partial and subordinate participation of members of the Puerto Rican elite. Aida Negrón de Montilla (1971) explains that the main aim of public education between 1900 and 1930 was assimilating Puerto Ricans into American culture, the “Americanization of Puerto Rico.” Thus the medium of education was English, from 1900 until 1934 in grade schools and until 1942 in high schools and the university (Navarro Rivera 2000, 60).

This process of institution building was not without conflict. The convergence of the interests and aspirations of the local elite and the officials of the
new ruling power for higher education was accompanied by contradictory views over the aims and direction of the institution. The imposition of English as the medium of education was the major conflictive issue. Although not anti-American, the local elite favored the use of Spanish, the Puerto Rican vernacular, as the medium of education. (The language issue and its corollary, cultural assimilation, have been conflictive issues between the Puerto Rican elite and the U.S. government from 1898 to the present [see Barreto 2001].) Other policy issues, such as personnel appointments, budgetary allocations, and so forth, added to the wrangling and maneuvering between American administrators and local politicians (Navarro Rivera 2000).

UPR’s institution-building process was characterized by a dynamic of conflict and accommodation. American officials exercised their power and imposed the project of Americanization against resistance from the local elite. Nonetheless, the Puerto Rican elite were allowed to form important cultural space with the creation, for example, of the Department of Hispanic Studies (Departamento de Estudios Hispánicos) in 1927. This department became a leading center of Puerto Rican intellectual activity during the 1930s. The “Fiesta de la Lengua” (Festival of the Language) was first held in 1930 to celebrate the Spanish language and Hispanic culture and became a major annual event of the university. The leading figures in the department, such as José Pedreira and Tomás Blanco, published landmark studies on Puerto Rican Hispanic identity and culture, and their generation of academics is remembered as one of the most important cohorts of Puerto Rican intellectuals, la generación del treinta (the thirties generation) (Manrique Cabrera 1956, 281–84).

It is important to note, however, that the creation and development of the Department of Hispanic Studies was actively sponsored by two North American academics, Professor Josephine W. Holt and Chancellor Thomas E. Benner. They understood that, given Puerto Rico’s Hispanic heritage, UPR should be the leading institution in the field of Hispanic studies within the United States and that Americans interested in studying the Spanish language and Hispanic culture and literature should do so at UPR. Hence, they developed the program to also train American teachers of Spanish and Hispanic culture (Manrique Cabrera 1956).

Thus, the initial stage of institution building at UPR revolved around the converging interests in higher education and the antagonistic views over
language and cultural assimilation of the Puerto Rican elite and the American colonial officials. The American officials exercised power, imposing the project of Americanization against resistance from the local elite. Yet the elite participated in institution building because they gained something from it, namely, the education of their children at home. It was a dynamic of conflict and accommodation, very well described by the subtitle of Pablo Navarro Rivera’s (2000) book *De control político a crisis permanente* (From political control to permanent crisis).

Conflict, however, is inherent to institution building, a fact that is often downplayed in the reconstruction of institutional histories. The constant presence of conflict and the recurrent outbreak of confrontation, however, do not necessarily mean permanent crisis. The question is whether accommodation can be reached by satisfying some of the interests and aspirations of all participants in institutional life. The ability to create these “points of convergence” is what allows institutions to proceed with their development. It is a process of constant adaptation through conflict and accommodation.

Institution building in the case of UPR was anchored on the cultural project of Americanization. Although the local elite opposed cultural assimilation, this project included a technocratic component of higher education that enabled its participation, albeit in a conflictive manner.

**The Project of Modernization**

The consolidation of UPR as a “modern” institution of higher education took place after World War II. At the end of the Great Depression and the beginning of the war, a new colonial mentality was emerging. The Rooseveltian New Deal doctrines and Good Neighbor policy were applied to Puerto Rico. The United States emerged from the war as a superpower. A new world order was also emerging, where colonialism was seen as a hindrance to world peace. The post–World War II period would be guided by a drive to end colonial empires. Decolonization became the buzzword in international relations. In Puerto Rico, this signaled the beginning of what can be termed “enlightened colonialism.”

By the 1930s, the project of Americanization had failed; the cultural assimilation of Puerto Ricans proved impossible. Moreover, the poverty of Puerto Rican peasants and their exploitation by sugar corporations gave way to the emergence of a radical nationalist movement (Scarano 1996).
American colonial policies in Puerto Rico during the Great Depression had to confront not only issues of poverty and social welfare but also the emerging challenge of radical nationalism. The Puerto Rican elite participated willingly as intermediaries in the implementation of New Deal policies on the island (see Mathews 1960). The repression of the Nationalist Party’s leadership and militants during the 1930s tested the sincerity and depth of the political allegiance of the Puerto Rican elite to American rule on the island. In the end, the police officers that repressed the nationalists, and some of the judges and prosecutors that imprisoned them, were Puerto Ricans. Later, the affinity of the local elite for American policies and views on the war against fascism contributed further to the development of a new colonial mentality tolerant of Puerto Rican culture. These developments demonstrated that there was not necessarily a contradiction between being loyal to Puerto Rican culture and Hispanic heritage and being loyal to American rule and economic interests on the island. After all, many of the soldiers in the U.S. Army sent to fight against Germany and Japan were Spanish-speaking full-blooded Puerto Ricans.

The watershed events that fostered the emergence of enlightened colonialism as a new style of colonial rule were: (1) the victory of the Popular Democratic Party (Partido Popular Democrático, or PPD) in the 1940 election, with a platform of social and economic reforms promising to move the island out of the state of poverty and misery created by the sugar economy; and (2) the appointment of the reform-minded “New Dealer” Rexford G. Tugwell as governor of the island in 1941 (Pantojas García 1990; Scarano 1993). In his book Administración de una revolución (Administration of a revolution), Charles T. Goodsell (1967) discusses a series of reforms in public administration prompted by a need to administer the island efficiently during World War II. As Puerto Rico became the fulcrum of the Caribbean front in the war, with German submarines in the Caribbean threatening supply lines with England, the colony had to be administered in a way that would abate both internal (nationalist) and external threats to U.S. naval bases in the eastern Caribbean (including Puerto Rico).

In 1941 and 1942, the PPD-led legislative assembly passed a series of laws ranging from agrarian reform to the reorganization of the local government (Goodsell 1967; Pantojas García 1990). A new law reorganizing university governance and administration was passed as part of this package of reforms. Also in 1942, the first Puerto Rican chancellor was appointed to head UPR
and the dynamics of conflict and accommodation took a new direction (Navarro Rivera 2000).  

The end of World War II caused a realignment of the interests and aspirations of the Puerto Rican elite and those of the U.S. government. The creation of the United Nations to implement decolonization and a new world order that would prevent a third world war prompted, for example, the appointment by President Truman of the first Puerto Rican governor in 1946. The emerging political consensus in Washington moved away from assimilation and toward a degree of self-rule for Puerto Rico. It also moved away from favoring the interests of the sugar corporations (Pantojas García 1990).  

The political project for the restructuring of colonial rule in Puerto Rico implied three major changes: (1) a degree of self-rule, allowing Puerto Ricans to elect their own governor and legislature and to draw up a local constitution; (2) the modernization of social and political institutions as well as the socioeconomic infrastructure; and (3) economic development through the industrialization of the island. The political formula that accommodated the converging political interests of the Puerto Rican elite and the U.S. government became known as the Commonwealth of Puerto Rico (Estado Libre Asociado). The economic complement to that formula was the first export-led industrialization program in the world, known as Operation Bootstrap (see Pantojas García 1990).  

The development of the intellectual infrastructure to achieve the goals of the new political project fell upon the University of Puerto Rico and the Puerto Rico Industrial Development Company (popularly known as Fomento). Following the appointment of a Puerto Rican chancellor, the university was reorganized along modern technocratic lines. In 1943, the College of Liberal Arts and Sciences was eliminated and replaced with the Colleges of Natural Sciences, Social Sciences, and Humanities. Within the College of Social Sciences, four new units were established that would play a key role in the “modernization” of Puerto Rico: the Economics Department, the Social Science Research Center, the School of Public Administration, and the School of Social Work (Roca de Torres, Gaztambide, and Morales Vázquez 2003; Lauria Pericelli 1989). The Middle States Association accredited UPR for the first time in 1946 (Navarro Rivera 2000).  

The Department of Economics, the Social Science Research Center, and the School of Public Administration provided the research and training for
the technocratic cadre that would lead the socioeconomic and administrative restructuring of “modern” Puerto Rico. Among the many visiting professors in the College of Social Sciences were the future Noble Prize economists John Kenneth Galbraith and Wassily Leontief, noted sociologist C. Wright Mills, and the well-known historian and later prime minister of Trinidad and Tobago, Eric Williams (Roca de Torres, Gaztambide, and Morales Vázquez 2003). The Social Science Research Center conducted landmark studies on fertility and population control, as well as on social change (see Lauria Pericelli 1989). The School of Social Work, for its part, provided the cadre of technocrats that would implement the policies of social reform for the welfare state developed to fulfill the promises of the PPD’s populist project (see Pantojas García 1990).

But the role of academics was not limited to teaching at UPR. Fomento’s director, Teodoro Moscoso (the architect of the development strategy that would be known as “industrialization by invitation,” or the maquiladora development model), put together a technocratic structure akin to a think tank. A cadre of young economists was hired by Fomento in the late 1940s and the 1950s to provide technical and intellectual substance for the new economic-development model. Aside from the already mentioned Galbraith and Leontief, Arthur Lewis (another future Nobel Prize winner in economics), prominent planner Harvey S. Perloff from the University of Chicago, and other distinguished economists served in the government of Puerto Rico (Maldonado 1997).

Again, institutional development and change were driven by conflict and accommodation. The transformation of UPR into a modern institution of higher education at the service of a political project of modernization and development under American rule was achieved through a convergence of interests forged out of internal and external political and institutional conflicts. The impossibility of culturally assimilating the Puerto Rican population and elite and the strategic needs imposed by the Great Depression and World War II created the conditions, if not the need, for accommodation. The American colonial officials came to accept that the political loyalty of the Puerto Rican elite was not in contradiction with cultural pride in their Hispanic heritage. Loyalty without assimilation and local self-rule became the points of convergence. Puerto Ricans would run the day-to-day internal affairs of the university and the government of the island, while the U.S. government
would remain in control of the larger strategic affairs: defense, foreign affairs, international trade, customs, and so forth. But in order to arrive at this outcome, the university and the island had to navigate through a series of institutional conflicts and social transformations. Both Puerto Rican and American societies underwent major changes before this outcome could be achieved.

Concluding Thoughts

The most common notions about institutions hold that they emerge and are preserved because they fulfill social needs. This is only partially true and does not explain the durability and renewed relevance of “anachronistic” institutions such as Western monarchies and the Catholic Church. The notion of institution building as a purposeful and deliberate action of groups with power is a strictly modern phenomenon.

The experience of the University of Puerto Rico suggests that successful attempts at institution building result from the articulation of a political project. The concept of a political project in the broadest sense can be defined as a set of social, economic, and political objectives and propositions that articulate the interests, preferences, values, and social aspirations of sociopolitical coalitions.

A sociopolitical coalition is a heterogeneous social force or cluster of groups that converges around a political, social, or economic project. Put another way, a sociopolitical coalition integrates groups with diverse interests in support of a set of programs or a platform for social action that articulates perceived convergences. This implies that differences and contradictions exist and play a role in institution building. A political project articulates the interests and preferences of a sociopolitical coalition, but all the interests and preferences of the members of or participants in the coalition are not articulated equally. Moreover, sociopolitical coalitions are stratified and articulate the interests, preferences, objectives, and aspirations of their components in a differentiated and hierarchical manner. Not all groups want the same things and not all groups get what they want. Institutional success, stability, and development come from balancing conflicting interests and satisfying competing needs. Institutional crises emerge when balancing fails.

In short, successful institutions are those that articulate a political project of a sociopolitical coalition by balancing competing interests and claims against convergent ones while advancing toward a stated objective. The
ability to institutionalize a political project is a function of power struggles and compromises rather than just functionality.

Institutional stability, in turn, is a function precisely of how competing demands and aspirations are managed in order to achieve “equilibrium” or institutional balance. The inability to satisfy and balance competing demands within an institution is what precipitates institutional crises. However, institutional crisis is not to be confused with institutional decline. Crisis is the way in which institutions renew themselves, adapt to change, and develop. Whether an institutional crisis leads to decline or to renewal is a function of how conflict is managed in order to achieve a new accommodation between convergent and divergent institutional interests and demands.

The two critical points in the institutional development of UPR, its founding as a normal school and its postwar role as a modern institution, represent a case of successful institutional development. This success was a function of the ability of institutional actors to achieve accommodation in a context of conflict. That is, it was a function of their success in negotiating and settling competing claims over resources and institutional policies.

It can be argued, then, that the possibility of institutionalizing a political project is a function of institutional compromise and accommodation—that is, of satisfying competing claims fully or partially while mobilizing support for shared interests and views. Hence, institutional functionality does not mean the non-conflictive implantation of a political project. Institutions are not made up of the perfectly fitting pieces of a jigsaw puzzle; rather, institutions are living entities moving in historic and social contexts. As for any living thing with moving parts, dysfunction—conflict—is inherent to institutional functioning. Institution building and institutional development are always contingent on how conflicts are mediated and resolved.

Notes

1 An example of this could be the current struggle to impose Western-style democracy in parts of the Islamic world.

2 A political project can be defined as a set of social, economic, and political objectives and propositions that articulate the interests, preferences, values, and social aspirations of
sociopolitical coalitions. This is a broader definition than the one proposed in Pantojas García (1990). A fuller discussion is found in the conclusion of this essay.

3 Latin American universities historically have played an important role in wider social transformations. The role of universities in Latin America is not limited to abstract research and intellectual endeavors. Rather, these institutions have been important centers for political mobilization and social change. In the Hispanic Caribbean, universities in Cuba, the Dominican Republic, and Puerto Rico follow this historic trend.

4 This was the case, for example, for José Celso Barbosa, the leader of the first political party to favor statehood (annexation by the United States) for Puerto Rico, who studied medicine at the University of Michigan in Ann Arbor, graduating in 1880.

5 This School of Agriculture was eventually separated from the normal school and established in the western town of Mayagüez in 1912.

6 The socially dominant Puerto Rican elite were not monolithic. They were, in fact, deeply politically divided between those who favored U.S. statehood, independence and autonomy, or self-rule under U.S. political sovereignty. The pro-independence and autonomist factions of the elite were the dominant political force between 1905 and 1932, forming the Union Party (Partido Unión de Puerto Rico) (Bayrán Toro 1989).

7 The impoverishment of the island’s population was such that Rexford G. Tugwell, the American governor appointed by Franklin D. Roosevelt, referred to it in his memoirs as “the stricken land” (Tugwell 1947).

8 Governor Tugwell was part of President Roosevelt’s brain trust. He favored New Deal-type policies for Puerto Rico, advocating government intervention in the economy, social welfare, and administrative reforms. In the Caribbean, Tugwell was a proponent of the Good Neighbor policy, arguing that democracy and social welfare were the way to guarantee political stability in the region and thus the security interests of the United States during World War II (Tugwell 1947).

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**Introduction**

In the universe of institutions, encompassing business associations belong to an interesting hybrid category. They lie at the intersection of—and intermediate between—public and private spheres. Historically, strong encompassing associations do not arise spontaneously out of the business community but are rather helped along by state actions. At the same time, they are not completely controlled by government. As institutions, their major accomplishment, and potential for contributing to development, is to solve collective-action problems. Other kinds of institutions can solve numerous other obstacles to development, such as reducing transaction costs, improving transparency, protecting property rights, and enhancing state performance. Business associations can contribute to some of these outcomes, but their major function is to promote collective action, which in turn opens up possibilities for solving coordination problems among members in the broader economy (see Doner and Schneider [2000] for a review). Private sector solutions to coordination problems have become even more important in recent decades as states have reduced their direct participation in the economy. As Peter Hall and David Soskice (2001) put it, the challenge for public policy is not so much to force private actors to change their behavior but rather to induce them to cooperate more effectively with one another.

Where do institutionalized, encompassing associations come from? In the medium and long run, strong business associations depended on state support in the form of privileged access to policy forums or delegated public resources or authority. State support was necessary and sufficient, and the history of
the twentieth century in Latin America is littered with the acronyms of now-defunct associations that collapsed in the absence of such support. What in turn induced states to provide these benefits? In most cases, state support first came when economic and political crises triggered efforts by state actors to enlist business associations in programs to solve short-term problems.

**Crises and Institutional Origins**

The small number of well-institutionalized encompassing associations in Latin America were all born in or tempered by crisis. Economic crisis and vulnerability were fairly constant in twentieth-century Latin America. Take for example the following set of crises. In the late 1920s, the coffee sector in Colombia went into recession because international prices were falling and high-quality Colombian coffees were not fetching the higher prices they deserved. In the 1940s, wartime import rationing severely disrupted Colombia's growing industrial sector. In the early 1940s, Brazil's industrial sector faced shortages of skilled workers. In the late 1930s, the Popular Front government in Chile faced a crisis of confidence with business (and another crisis of confidence emerged in 1983, though between a different private sector and a very different government). In 1987, the Mexican government was struggling to contain an inflation rate over 100 percent and faced the prospect of massive capital flight.

As crises go, there is little at first sight that is particularly remarkable in this list. Other countries and other sectors also suffered a variety of economic shocks. What sets this list apart is the distinct nature of the government response: in all the cases, state actors, usually mid- to top-level bureaucrats in ministries responsible for economic policy, took action to improve dramatically communication between business and government, as well as coordination among businesses, by helping business create or strengthen encompassing business associations. The impetus came through the state, and the peculiarities of the crisis influenced the specific incentives for state actors to organize business. In some cases, state actors called on business to organize in order to substitute for or complement state capacity in implementing policies to overcome crises. In other cases, strong business opposition to government was part of the crisis, or at least its political manifestation, and state actors therefore worked to resolve the political crisis by collaborating with business associations.
In some cases, close business-government collaboration to overcome acute crises was just crisis management, and the collaboration faded along with the crisis conditions. In other cases, though, the collaboration left lasting institutional legacies. The following sections consider three main types of legacies, which are well illustrated by the response of state actors to the specific crises listed at the beginning of this section.

Consultative Mechanisms

In crises where governments turned to business because they lacked information (or the means to collect it) or capacity for short-term policy implementation, state actors created formal mechanisms to channel regular consultation and dialogue over the longer run. Such mechanisms took the form of public-private boards, councils, or forums with varying goals and compositions, but always stipulating formal representation by business associations.\(^5\) Often, formal mechanisms for consultation shifted or broadened their policy focus as the crisis subsided, and they were sometimes replicated to other policy areas.

For example, in the early 1940s Colombian President Alfonso López Pumarejo had regular contact with business people from his rapidly industrializing hometown of Medellín. However, the difficulties of managing rationed imports during the war caused severe bottlenecks in industry so that the president’s friends were always calling him. As the number of individual consultations became unmanageable, López Pumarejo told Medellín industrialists that he could not talk to each of them individually but if they selected a spokesperson he would take his calls (Urrutia 1983). The government initially proposed helping the industrialists organize by imposing compulsory membership and government representation in the association, but the industrialists demurred and instead formed ANDI (National Association for Industry) in order to take advantage of the president’s offer. After 1945, import bottlenecks faded, but the government still relied on ANDI for consultations and gradually appointed ANDI representatives to dozens of public-private boards.

Decades later in Mexico, inflation was spinning out of control and policymakers feared another round of massive capital flight in the run-up to the 1988 presidential elections. So in late 1987, ministers in the economic area proposed tripartite negotiations (also known as pactos) on wages and prices
Explaining Institutional Innovation

in order to bring inflation down quickly and restore communication and confidence with the private sector. Representatives of the encompassing CCE (Business Coordinating Council) negotiated closely and constantly with government (who in turn negotiated with labor) over the pace of price reductions and over compliance monitoring. Inflation dropped from over 100 percent to less than 20 percent in less than a year. Yet even when all parties agreed that inflation was under control, the pacto lived on as the government and the business sector proposed new items for negotiation and consultation. These ongoing discussions gave businesses strong incentives to continue investing in their associations.

In political crises that risk pushing business into opposition, governments can offer opportunities for businesses to have input into policy forums to reduce their distrust of government intentions (or co-opt them, others might argue). In the late 1930s and the 1940s, many governments across the political spectrum adopted the policies and institutions that would comprise the strategy of import-substituting industrialization (ISI) and the Latin American version of the developmental state. However, where left-wing governments were intervening to build the institutions of ISI, these interventions created conflict with business and bred distrust, and policymakers would sometimes build in consultative mechanisms to assuage this distrust. For example, one of the key instruments of the developmental state was a development bank. When the leftist Popular Front government in Chile went to create CORFO (Production Development Corporation) in 1939, they decided it would be good to bring representatives of the private sector on to the board of the corporation. This representation then gave industrialists strong incentives to invest in the industry association SOFOFA (Federation of Chilean Industry) (Silva 1996).

Successful experiences with regularized consultation frequently resulted in replication across other policy spheres through two logics of either state initiative or business demand. If one public-private council works well in solving the vulnerabilities state actors face in one situation, then these officials can turn to councils again when they face new problems or when they move to new positions in the government. Jaime Serra participated in the successful pactos in Mexico, and so later, as the minister in charge of negotiating NAFTA, he established new forms of close consultation with business. In other cases, especially as the number of public-private forums expands, business associations use the
precedent to press the government to include representatives from associations whenever the government creates a new policy entity.

**Delegation**

Crises often reveal to state actors the limits of their ability to implement policies, and in some such instances policymakers opt to delegate public authority and/or public funding to organized business. Early in the twentieth century, coffee grew to account for more than half of Colombia's exports. Yet coffee growers could not solve very costly problems that required them to act collectively. There were many small producers and no association to bring them together, and no institution capable of monitoring high- and low-quality exports. As a result, all coffee, even the highest quality, fetched discounted prices in international markets because buyers had no guarantees on the quality of any individual bag. Growers met in annual conferences in the 1920s and regularly created committees charged with establishing a national federation. These committees also regularly failed in this task, except the last interim committee in 1928, which begged the government to solve their dilemma. State actors were well aware of the country's dependence on coffee and on getting coffee to market at the highest price. They were also aware that the state lacked the staff and resources to administer a national program of quality control. So they convinced the growers' committee to accept a government-mandated tax on exports that the new coffee association, Federacafe, would administer for the benefit of the sector. Federacafe was thus born with huge resources and indispensable functions, so that in short order nearly all growers had joined. Federacafe went on to grade coffee exports, guarantee their quality in international markets, and improve the image of Colombian coffee in consuming markets (Juan Valdez is Federacafe's marketing logo), as well as provide infrastructure, transportation, credit, research, and social spending.

In Brazil in the 1930s, as industry grew rapidly, industrialists used the São Paulo federation (what would become FIESP — the Federation of Industries of São Paulo) to voice their concerns about expanding the pool of skilled workers. The government responded with an ambitious program that taxed firms (1 percent of payroll) but then returned the revenue to the industry federations for them to implement the training programs. This model was actually replicated widely across other countries of Latin America, though all
other countries put the payroll tax into a fund controlled by a joint public-private committee (Wolff and Castro 2003). Lastly, for a recent example, many bilateral and multilateral trade agreements stipulate various rules-of-origin requirements. In Chile in the 1990s, the government delegated the task of verifying compliance to the industry association SOFOFA. As in the earlier case of the establishment of CORFO, this new delegation shifted the organization of the association, as SOFOFA collects significant revenues for this verification, but also now offers members a new range of trade-related services.

As in successful experiences with consultative forums, successful delegation occasionally bred institutional replication in other areas. So, for example, the coffee model in Colombia of taxing exports to promote sectoral development was replicated in several sectors, most notably in rice. And officials later carried the training model in Brazilian industry over to commerce and agriculture.

**Strong Encompassing Associations**

This third type of institutional legacy of crisis was the result of the previous two. In my definition, business associations become strong institutions if they have independence from the state, large professional staffs, and a consistent record of reconciling divergent preferences among members. By way of analogy to governments, these associations have sovereignty and strong executive and legislative functions. These dimensions of strength derive from state actions that help business members overcome the usual obstacles to collective action (Olson 1965). So, for example, the creation of consultative mechanisms generated a new selective benefit—members can get access to the information exchanged with the government only if they belong to the association. Moreover, firms have a stronger interest in participating in the associations in order to have input into the selection of association leaders, who in turn determine association representation in government forums. Lastly, consultative forums increase the staff needs of associations, in that association representatives want to come to the table with enough experts and information to match those on the government side.

The delegation of significant public authority and resources to associations was much rarer than creating formal arenas for consultation, but when delegation happened it transformed the associations overnight into institutions that had large memberships, professional staffs, and intense interest in
intermediation and reconciliation. In the dimension of autonomy from government, the act of delegation also created a new vulnerability for the association to government threats to withdraw or curtail the delegation. However, as discussed in the next section, such retractions were rare, and over time the delegation took on an aura of entitlement, thereby raising the costs to the government of retracting the authority delegated. However, some vulnerability remained, and associations with delegated functions were not as critical of the government as less dependent associations.

Institutional Continuity and Institutional Diversion

Over the course of the twentieth century, there was a good deal of continuity in associations and in their institutional connections to the state, though a number of exceptional cases of collapse illustrated how fragile these “institutions” were. Continuity in these three kinds of institutions came partially from positive feedback loops but more fundamentally from active, ongoing political support, especially from state actors. One feedback loop worked through state actors, who, as noted above, were likely to continue and replicate consultation and delegation when they felt that the first experiences had turned out well. This feedback loop was more important in cases where state actors continued for long periods in government; otherwise, this loop was usually cut short by turnover in the cabinet. For association leaders the feedback was more immediate and constant, in that they recognized that retaining members and resources depended on maintaining the benefits of consultation and delegation. However, even in the absence of feedback loops, political support from state actors was necessary and sufficient, and its withdrawal was very damaging to the association.

Within a general pattern of continuity, there were important instances of institutional change. Among the three kinds of institutional legacies, the persistence of institutional arrangements varied in twentieth-century Latin America, with continuity more common in instances of delegation than consultative mechanisms or association strength. In several instances, governments dramatically rescinded or reorganized consultative mechanisms. In the 1970s, for example, the Pinochet dictatorship in Chile almost completely reconfigured the institutional connections between business and government; however, most of the key business associations emerged again, after an initial period of dormancy, stronger than before in part because the government
created new forums for consultation with business. In a democratic context, Fernando Collor in the early 1990s discontinued a number of crucial state agencies as well as consultative bodies. Moreover, policymakers who did not want to tangle with formal reforms could easily reduce the relevance of consultative mechanisms by sending subordinates, withholding information, or creating parallel channels of communication.

For associations that were strengthened by consultation, such shifts in access to policy forums can easily undermine the incentives for members to continue to invest, especially if shifts away from consultation with business associations are accompanied by an opening of alternative avenues, like elections and campaign finance, for political participation by business. The erosion of investment in associations has been notable in several of the strongest all-encompassing associations, such as CPC (Confederation for Production and Commerce) in Chile and CCE in Mexico. These associations were the crucial business interlocutors in the macroeconomic crises of the 1980s and 1990s, as well as the political transition in Chile; but with greater stability and more routinized democracy, all-encompassing associations have become less central and are often eclipsed by the sectoral associations that intermediate in policy areas like trade.

In contrast to consultative bodies, governments rarely abrogated delegation. There are several likely reasons for greater continuity in delegation. First, the bulk of association revenues come, directly or indirectly, from the functions delegated to the association, so that association leaders take as their primary task maintaining the delegated functions. Second, it is difficult for state actors to withdraw delegation informally, as they can with consultation. In the case of consultation, association leaders are less likely to fight for formal continuity because they know the formal arrangements depend on informal commitment, but association leaders do struggle tenaciously to maintain formal delegation. Third, state actors have incentives to maintain delegation in order to keep associations at least partially dependent on the state and therefore less likely to cause political trouble.

Although governments rarely rescind delegation, the functions delegated can, over the longer term, evolve in their impact on associations in a process of institutional conversion or, in most cases, diversion and distortion. The clearest cases are the major associations in Brazil. Associations like the São Paulo industrial federation FIESP in the 1940s and 1950s were the major conduits
for business representation and interest intermediation and they were well represented on major government councils. At the same time, these associations managed huge funds for job training. By the 1960s, the consultative forums had lost relevance, but the training kept up. By the 1980s and 1990s, the management “fees” granted to FIESP for running the training programs amounted to hundreds of millions of dollars, which supported a huge bureaucracy and shifted incentives for would-be leaders to use FIESP, and federations in other states even more so, primarily as trampolines to political office. Federacafe suffered a milder case of institutional diversion when the government allowed it to create a market-stabilization fund that gave the association access to hundreds of millions of dollars, which it went on to invest in a business empire that included at one point a shipping company, an airline, various financial subsidiaries, and dozens of other holdings. Managing this empire displaced representing members as the association’s top priority, at least until Federacafe’s business portfolio turned sour and it was forced to sell off most of its subsidiaries.

These processes of institutional conversion and distortion are important in their own right, but they also have further consequences for the larger world of business representation. When associations control significant delegated resources but cease to intermediate member interests well, the withdrawal of members does not lead to the usual erosion, and the association continues to fill the organizational space that might otherwise be filled by new associational contenders. For instance, Brazilian capitalists have invested large amounts of time and money in alternative associations, but these alternatives have a hard time sticking and competing with well-endowed associations like FIESP. In this vicious cycle, then, delegation ends up in fact undermining the collective representation of business.

**Conclusion**

By way of summary, this analysis has sought to highlight several key features of institutional formation and change in business associations in twentieth-century Latin America. First, the origins of nearly all strong encompassing business associations can be traced back to moments of economic and political crisis. Second, these moments revealed to state actors their vulnerability and limited state capacity to resolve the crises, and state actors in turn offered associations access to policymaking or delegation to them of policy
functions. Third, consultation and delegation solved the major collective-action problems that plague potential associations comprised of many diverse members by creating attractive selective incentives for firms to join. Fourth, consultation and delegation (and their invigorating effects on collective action) continued not due to institutional inertia but rather because of active state support buttressed by ancillary feedback loops. And fifth, in some cases institutional continuity was disrupted abruptly by changes in government or diverted slowly over time by the delegation of massive, distortionary resources to associations.

Notes

1 Essay prepared for the workshop on institutional origins sponsored by the Social Science Research Council and the University of Havana.

2 My focus is on encompassing associations that cover all large firms in the economy or broad sectors like industry or commerce. Associations in narrower sectors with few firms do tend to arise spontaneously and universally. They are typically less complicated analytically and less useful for development.

3 The empirical analysis in this essay comes largely from my book (Schneider 2004).

4 The crises and vulnerabilities considered here were usually partial or segmented compared to the systemic vulnerabilities that figure in explanations of developmental states in East Asia (Woo-Cumings 1999; Doner, Ritchie, and Slater 2005).

5 Normally informal arrangements depend on particular state actors and change when the incumbents do, but some informal arrangements, such as the monthly luncheons between some Mexican associations and government ministers, survived for decades and should be considered along with formal institutions.

6 The pactos, however, ended badly at the end of 1994 when the government allegedly told business representatives of its intention to devalue the exchange rate. The stampede of capital that preceded and followed the devaluation in December created one of Mexico’s worst financial crises (Ortega 2002).

7 Many decades later, one of the first acts of the new left government in Brazil in early 2002 was to create an Economic and Social Council (CES), with seventy representatives each from business, labor, and government. The motivation seemed to be in part to calm business fears and provide them input into the broad government agenda. In the end, though, the council had little real effect.
References


Most studies assume that social groups played no significant role in economic policymaking and institution building during Chile’s military dictatorship (1973–1989), a period in which the military government broke not only with the previous economic development model (import-substituting industrialization) but also with the more participatory policymaking institutions of the preceding democratic period. They argue that, during the dictatorship, technocratic rule backed by a strong state with a high level of autonomy from society sufficed to accomplish Chile’s neoliberal transformation, which became the foundation for sustained economic growth after redemocratization (Frieden 1991; Fontaine 1988; Campero 1984; Foxley 1983). In other words, the dictatorship may have ruled in the general interest of capital, but it did so without participation by capitalists and by repressing organized labor and middle-class social groups. It fell to the democratic governments that followed to craft the institutional mechanisms for social-group participation in policymaking, which became the bedrock for Chile’s widely admired consensual style of policymaking. These included institutions to cultivate harmonious, collaborative relations with capitalists, whose investment—especially in a free-market export-oriented economy like Chile’s—was considered crucial for economic growth and socioeconomic stability.

A closer examination of events, however, shows that arguments concerning the autonomy of the military regime from capitalists (although not labor and middle classes) were exaggerated. Business elites, in addition to technocrats and the strong state, played a significant role in the shift from “radical” to “pragmatic” neoliberal economic policies and in shaping
institutions and practices for policy consultation with capitalists, especially in the period between 1982 and 1986. The system of business-state relations constructed during that period, and which was retained after redemocratization in 1990, closely resembles Peter Evans’s (1995) concept of “embedded state autonomy.”

The point, however, is not that all good things in Chile today had their origins in the military government. Rather, it is that crisis periods open opportunities for societal participation in institution building even in states assumed to be very strong and highly autonomous. Chile, then, is an excellent example of how economic crises shake up the support coalitions of established orders (Gourevitch 1986). Old policies no longer work and social groups cast about for new ones that serve shifting interests better. As social groups raise demands, states help shape the contours of new dominant coalitions by supporting some groups over others. In the process, existing institutions and practices experience modification and new ones are constructed. This is because institutions express power relations, in this case between state and capitalists as well as among capitalists themselves.

**Embedded Autonomy and the Chilean State**

Between 1982 and 1994, Chilean state managers, politicians, and capitalists constructed a system of business-state interaction that approximates Peter Evans’s (1995) concept of embedded state autonomy along with its hypothesized beneficial effects on investment and production. The concept builds on the assumption that the interaction between capitalists and the state is crucial for investment and production because it influences the private sector’s confidence to commit resources. The participation of capitalists in policy formulation and implementation builds confidence that the policies will work. Some structures of business-state interactions, however, are more conducive to long-term stability and growth than others. Embedded autonomy refers to a system of business-state relations in which the state retains a measure of autonomy but is not isolated or unduly insulated from societal preferences. In such arrangements, state institutions and officials, as well as business participants, must have certain characteristics to avoid undue influence by particularistic interests in the policy process. State managers may set overall development goals and policies, yet dense networks of communication with the private sector are encouraged because they provide important information on
what capitalists are likely to find workable and hence stimulate investment (Maxfield and Schneider 1997).

Whether the interaction is personalistic or institutional is key for embedded autonomy. In the Chilean case, a tight hierarchical state structure, staffed by technically proficient personnel, and participation by encompassing business peak associations with well-developed technical departments proved functional for investment-inducing interaction between large-scale capital and policymakers. With access to the policy process, Chilean capitalists since 1984 have felt confident that solutions to national economic problems would not be at the expense of their interests. Policymakers have benefited because they get a much better idea of how capitalists will react to policy. This helped to smooth over potentially conflictive relationships after redemocratization (E. Silva 1996a).

These institutional arrangements did not spring whole-cloth from technocratic planning. They were constructed during periods of economic and political crises, when capitalists made strong demands on a state forced to rebuild its support base among the dominant class. Those pressures induced state managers to build embedded autonomy in Chile during the military dictatorship, at least in a partial form. I say “partial” because it only included business interests and pointedly excluded middle-class groups and labor. Later, the crucible of democratization confronted the political opposition to the military dictatorship with a series of pressures that, in the interest of returning Chile to civilian rule, influenced its calculation to retain that system of business-state relations. The rest of this chapter analyzes the construction of partial embedded autonomy in these two periods.

Constructing Partial Embedded Autonomy: Capitalists, the State, and Pragmatic Neoliberalism, 1983–89

The economic crisis of 1982–83 shook the capitalist coalition that had supported radical neoliberal policies since 1975, a situation that, coupled with the resurgence of mass mobilization and demands for redemocratization, politically weakened the military government. During this period, capitalists demanded a shift to a more pragmatic neoliberal development model and greater, more institutionalized access to policymaking, which laid the foundations of the current structure of partial embedded state autonomy in Chile. A brief account of the radical neoliberal model, its capitalist support base, and
its system of interaction between state and capital sets the stage for the analysis of the change to the more pragmatic model and the institutional structure for business-state relations it generated. The contrast between this earlier system of business-state relations under military rule and the one that followed is instructive.

Between 1975 and 1982, Chile implemented a set of radical neoliberal policies to construct a liberal economy and society (Edwards and Edwards 1987; Foxley 1983). These included “shock therapy” stabilization and the rapid liberalization of capital markets, prices, and trade with little regard for their adverse effects. A fixed exchange rate in 1979 became the centerpiece of a system of automatic economic adjustment. Market logic also guided reform of social, labor, and education policy. The military regime gave radical free market–oriented technocrats—the Chicago boys—a high degree of insulation in policy formulation (Fontaine 1988). However, a narrow group of capitalists with connections to the Chicago boys also participated in the policy process (E. Silva 1996a, 1996b). These were the heads of rising financial-based conglomerates (Dahse 1979; Sanfuentes 1984). These capitalists helped shape policies that emphasized investment for short-term financial gain over investments in production, which contributed to the severity of the economic crisis that erupted in 1982–84. Capitalists associated with firms oriented toward domestic markets or that did not have substantial financial assets, in addition to business organizations, were marginalized from policymaking. Economic policymaking, then, was concentrated in the Ministry of Finance and the Central Bank, headed by free-market technocrats with particularistic ties to the heads of financially based, internationally oriented conglomerates. These business elites used their privileged connection to the Chicago boys (and to international capital markets) to leverage mergers and acquisitions during the first phase of public enterprise privatization. With control over Chile’s financial system and the export-oriented sectors of the economy, these conglomerates soon dominated the Chilean economy and became the core of the capitalist power bloc that supported radical neoliberalism. After a period of adjustment between 1975 and 1978, the rest of Chilean large-scale business became allied factions of that power bloc.²

The international debt crisis of the early 1980s ripped apart the capitalist coalition that had supported radical neoliberalism. In 1982, the debt crisis contributed to the collapse of the Chilean financial system, GDP contracted
by 14 percent, and unemployment soared to somewhere between 25 and 33 percent (Edwards and Edwards 1987). The crisis brought down the core internationalist conglomerates that had participated in formulating radical neoliberal policies (Rozas and Marín 1989). These conglomerates and their particularistic ties to the Chicago boys had also contributed to the economic crisis. On the one hand, those ties gave them access to financial sector and trade liberalization policymaking, as well as to discussions of privatization policy, making it possible for them to build their economic empires in a frenzy of mergers and acquisitions. On the other hand, these business elites owed their economic power to a massive debt buildup (facilitated by the design of financial sector liberalization, disguised by an intricate network of holding companies and shell corporations) (Dahse 1979). As long as high international liquidity and cheap interest rates prevailed, all was well. When those conditions changed in the early 1980s, the conglomerates used their economic power to soak up available credit at the expense of the rest of the economy (de la Cuadra and Valdés 1992). They bet on their political connections and their stranglehold over the economy to avoid state intervention and stall changes to the radical neoliberal economic development model.

While the core conglomerates fought for survival, business peak associations, under the auspices of the Confederation for Production and Commerce (Confederación de la Producción y Comercio — CPC)—Chile’s encompassing business peak association—began to develop an alternative economic model: pragmatic neoliberalism (Campero 1984; E. Silva 1996b). They took this action because, with the exception of devaluation in mid-1982, the military government initially refused to consider more aggressive state action to combat the economic depression with reflationary policies. Capitalists outside the ring of the core conglomerates believed that a more united front behind a comprehensive policy package might sway the military government. By mid-1983, all six of the business and landowning associations affiliated with the CPC—which effectively represented large-scale business in Chile—had formed a cohesive coalition behind an economic recovery program. Policy recommendations included high real exchange rates, low across-the-board tariffs with protection against unfair competition, a reflationary monetary policy, low interest rates, debt relief, sectoral policies (such as export promotion, construction projects, and agricultural development), and \textit{a more inclusive, institutionalized policymaking process}. In addition to these demands,
each of the sectoral business organizations (industry, agriculture, commerce, construction, mining, and finance) hammered out detailed policy proposals to stimulate investment in their sector over a three-year period.

Relying on the concentration of power in the state under military rule, General Augusto Pinochet largely ignored the policy demands of the pragmatic neoliberal capitalist coalition for most of 1983 (Campero 1984, 1995). However, escalating mass mobilization that year by middle classes, organized labor, and shantytown dwellers and the resurgence of banned political parties posed a political crisis for Pinochet as well. By the end of 1983, the largest opposition grouping had formed the Democratic Alliance (Alianza Democrática — AD), a coalition of centrist and center-left political parties dominated by Christian Democrats. Beginning in May 1983 they staged monthly protests, emphasizing negotiation with the military (primarily the air force and police) and conservatives—but not Pinochet—to effect a transition to democracy.\(^3\)

AD also attempted to win over members of the pragmatic coalition, especially industrialists producing for domestic markets (E. Silva 1996b). It stressed respect for private property, a mixed economy with ample room for private enterprise, and industrialization. The idea was to build a broad multi-class coalition against Pinochet’s rule and the Chicago boys.

The strategy almost worked. Frustrated by the military government’s lack of response to their policy proposals, both the CPC and the industrialists’ peak association issued veiled threats that capitalists might join AD. Replicating the rhetoric they used to destabilize Salvador Allende, they pointedly stated that the private sector only rose up against governments that posed a threat to private enterprise. The economic crisis and the dictatorship’s unwillingness to enact reflationary policies constituted as grim a threat as any possible mismanagement of the economy by the moderate opposition.

In May 1984, Pinochet responded with tactics calculated to recapture the undivided loyalty of large-scale capitalists and landowners. In the first year of his initiative, business elites exercised their greatest degree of direct influence, and although that diminished in 1985, the policy recommendations of the pragmatic coalition and a new institutional structure for business-state relations endured. Moreover, they became the foundation for economic management in democracy (E. Silva 1996b).

What were those policies and institutions, which Chileans dubbed pragmatic neoliberalism, and under which Chile enjoyed sustained economic growth?
Under pragmatic neoliberalism, policymakers in the financial institutions still preferred neutral policy instruments. However, they also agreed that the state had a more direct role to play in economic management, especially in the stabilizing of prices and boosting of production, albeit with the most market-friendly instruments available (E. Silva 1996b). Consequently, the state kept real exchange rates high, ensured interest rates were reasonable, and protected agriculture with price floors and manufacturers from unfair import competition, as well as giving the latter export incentives. Yet, the state also kept price supports and other sectoral policies at levels that only provided the minimum of protection to keep businesses from succumbing to international competition. In other words, Chile’s basically liberal economy set relatively high performance standards for industry because competition remained fierce despite some protection.

The system of business-state relations that emerged emphasized an investment-inducing measure of state autonomy with clear channels of communication with capitalists. Capitalist inclusion in the policymaking process enhanced the credibility of proposed policies, and close capitalist interaction with government officials buoyed confidence in the nation’s economic future. State autonomy and a clear line of authority among line ministries ensured policy cohesion, supplemented by the fact that general private-sector policy recommendations emerged from consensus-building negotiations among peak associations that were members of the CPC (E. Silva 1996a). In the words of a CPC president during this period (repeated by many other high-ranking business representatives): “Hammering out a consensus within the CPC was a difficult process. But once completed we knew that these policies would stimulate production instead of the financial speculation of the past. Once the authorities began to listen to us, our hope in the future rekindled. Although we don’t get everything we want, we can trust the rules of the game that emerge. As long as they remain stable they encourage us to invest.”

High rates of investment (25 percent of GDP) and sustained economic growth averaging about 8 percent per year to 1988 followed. In sharp contrast to the radical neoliberal period, much of post-1983 investment went to productive firms in agro-exports and internationally competitive industry. Moreover, after the financial sector recovered it did not overshadow other economic activities as it had before the economic crisis (E. Silva 1996a, 311;
Explaining Institutional Innovation

Rozas and Marín 1989). This trend continued in the democratic period that followed (Fazio 1997).

On the state side, the enduring system of interaction that emerged from the 1982–83 economic and political crisis featured a mixture of experienced, well-trained career bureaucrats in the financial agencies that stood at the top of the hierarchy of economic ministries (E. Silva 1996a). True, between 1984 and 1985 Pinochet appointed capitalists who represented the most critical sectors of large-scale business to the top positions in the financial and economic ministries. But this was largely a political move to recover the loyalty of business elites and to keep industrialists from joining the moderate opposition. After Chile’s economy and politics stabilized in 1985, the top economic policymakers of the principal economic agencies were drawn almost exclusively from the ranks of experienced, technocratic, flexible, civil service officers. As in the previous policy period, they set general policy that emphasized economic liberalism. Under them, however, prominent capitalists headed sectoral ministries (Economy for Industry and Commerce, Agriculture, Mining, and Public Works).

On the private sector side, the ministers maintained fluid channels of communication with cohesive and highly representative business peak associations at two levels (E. Silva 1996a). First, the umbrella organization, the CPC, routinely discussed interest rates and general monetary policy with the minister of finance and central bankers. Second, sector-specific peak associations participated in the formulation and implementation stages of the policy process in close contact with the ministries in charge of their sectors. At both the general and sector-specific levels, the state and capitalists negotiated policy on the basis of technical criteria instead of personal favors, clientelism, or political threats. This necessitated the expansion of the technical departments of the sectoral peak associations.

Business-State Relations in Democratic Chile

After redemocratization in 1990, economic policy and the system of interaction between capital and the state closely followed the model of pragmatic neoliberalism, a direct result of explicit and implicit negotiations over democratization between the military government and the private sector. The center-left Concert of Parties for Democracy (Concertación de Partidos por la Democracia — CPD), which took over political power in March 1990, had long pledged its
The State and Capital in Chile

commitment to the development of a liberal economy and society during the transition to democracy. It explicitly promised not to tamper with the general economic model of pragmatic neoliberalism. However, because it had opposed the dictatorship, the CPD faced the problem of convincing investors—who after 1985 once again enthusiastically supported Pinochet—that it was sincere. The problem was how to maintain investor confidence and avoid an antagonistic relationship with capitalists (E. Silva 1996a, 311).5

The CPD solved the problem by establishing a system of close consultation with business peak associations whenever it sought changes to the pragmatic neoliberalism that had existed under Pinochet. During the administration of Patricio Aylwin (1990–94), this applied largely to tax and labor-code policy, although it also included discussions of more sector-specific issues as they arose. Thus, top policymakers regularly consulted and negotiated with the leadership of business peak associations on major economic policy issues, from the policy formulation stage on down. Top policymakers set an agenda for incremental change and their technical commissions drafted legislative bills. These bills were circulated to the appropriate business peak associations, which formed their own technical commissions to study the proposals and make observations. Policymakers and capitalists then negotiated on the basis of those reports (E. Silva 1996a, 311–12).

The fact that to a significant degree negotiations involved organized business, as opposed to the interests of individual capitalists, facilitated the process. On issues that affected the general interests of the business community, the CPC took the lead. It ensured that negotiations focused only on key issues on which the different sectoral peak associations had formed a consensus. On sector-specific matters policymakers dealt directly with the relevant business association (E. Silva 1996a, 313).

While this system of consultation with capitalists exhibited little significant change from that of pragmatic neoliberalism under Pinochet, some of the characteristics of top policymakers did. The top ranks no longer contained primarily a mixture of career bureaucrats and businesspeople. Instead, most were highly trained economists from think tanks linked to the major political parties now in government (P. Silva 1991). Thus, having businesspeople in the cabinet was not absolutely essential for investor confidence. However, according to capitalists and CPD government officials alike, a commitment to building a liberal economy and society coupled with technical
capability was crucial, as was flexibility after feedback on policy proposals (E. Silva 1996a, 313).

With relatively minor alterations, and with ebbs and flows in tension, this system of business-state relations persists (Schneider 2004). For example, President Eduardo Frei Ruiz-Tagle (1994–2000) twice convoked a National Production Forum (in 1994 and 1996). The second one even included representation by organized labor, albeit in a firmly subordinate position to the state and business. His administration later institutionalized this form of collaboration by forming a permanent commission under the auspices of the Ministry of Economy and the CPC. Main policy issues included technology, taxation, exchange rates, regional economic integration, labor, and education, among other themes. The aim of the forums and the permanent commission was to fine-tune policy changes in the interest of efficient business performance. As before, the structure of interaction involved focus on meetings between business association leaders and state policymakers to define a policy agenda. Once the policy agenda was set, the research departments of the business associations and of the relevant state agency hammered out policy details on the basis of technical criteria (E. Silva 1998).

After a rocky start over labor-code reforms under President Ricardo Lagos, the basic pattern of business-state interaction continued unabated (E. Silva 2002). One major difference, however, was a heavier emphasis on regional integration issues, either regional or bilateral with the United States. Moreover, the CPC’s role in business-state relations began to wane as that of the Society for Industrial Development (SFF) waxed stronger, in part due to continued institutional development, especially in its international trade department (Schneider 2004).

**Conclusion**

Even in political systems with strong states that enjoy high levels of autonomy from social forces, crisis periods open opportunities for such forces to press the state for policy and institutional changes that later become routine and are seemingly divorced from their social origins. These are lessons one can draw from the Chilean case, beyond the usual arguments about which policies and what policy sequences perform best for sustained economic growth or whether Chile had achieved economic growth with equity. Which social forces
matter the most depends on the conjuncture; from 1975 to 1989, only capitalists had any significant influence; but after that period, middle classes—and, to a far lesser degree, labor—could be added (Oppenheim 2006; Borzutzky 2002, 2006).

During the radical neoliberal policy period (1975–82), centralization of military rule coupled with high international liquidity made it possible for a narrow group of business interests, organized around financially based conglomerates, to play an important policymaking role to the exclusion of other capitalists. They offered Pinochet the material basis for reconstructing Chile (investment) and destroying the economic system that had spawned socialism—along with unconditional support for his personal rule (E. Silva 1996b). Along with the involvement of the Chicago boys, these relationships between capital and the state built a personalistic, closed, inflexible system of business-state relations that proved unstable (E. Silva 1996a).

An international debt crisis that devastated the Chilean economy between 1982 and 1984 enabled a broader pragmatic neoliberal capitalist coalition dominated by fixed-asset (as opposed to liquid-asset) holders producing for international markets in alliance with producers for domestic markets. They helped to shape macroeconomic and sectoral policies that emphasized recovery and investment in industrial, extractive, and agricultural sectors, thus bolstering employment (E. Silva 1996b). In the context of a growing political crisis they forged a new, more institutionalized system of capital-state relations as Pinochet accommodated their concrete policy demands as well as their desire for more routine participation in the policymaking process (E. Silva 1996a). With this tactic, Pinochet retained undisputed political control of Chile.

Democratic governments after 1990 largely retained the policy orientation and system of capital-state relations that capitalists helped build in the dictatorship’s pragmatic neoliberal policy period. Again, this outcome was, at least in part, the result of political confrontation and negotiation between the opposition to the dictatorship and capitalists from 1983 to 1989. In order to secure broad-based political support, AD and then CPD systematically declared a commitment to pragmatic neoliberalism and to maintaining open channels of communication with the private sector. Once in control of political power, the CPD followed through on these promises (E. Silva 1996a, 1996b; Oppenheim 2006).
Notes

1 Max Weber (1978) first drew attention to this distinction and its consequences when he developed the ideal types of patrimonial and legal-rational bureaucracies.

2 For this conceptualization of power blocs, see Poulantzas (1973).

3 For an overview of Chile’s transition to democracy see Drake and Jaksic (1995).

4 Author interviews with Jorge Fontaine (CPC), April 6, 1989; Humberto Prieto, National Chamber of Commerce (CNC), January 19, 1989; Pedro Lizana, Society for Industrial Development (SFF), October 25, 1988; and Raúl García, National Agricultural Society (SNA), January 23, 1989.

5 In an author interview on August 29, 1988, in Santiago, Chile, Alejandro Foxley, a high-ranking member of the CPD and minister of finance under Aylwin, supported this interpretation.

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The evolution of formal institutions governing China’s private sector raises a fundamental puzzle: even though China’s private entrepreneurs are not mobilizing politically, major reforms in China’s formal institutions have enhanced the private sector’s political legitimacy and economic security. In a complete reversal of their founding principles, the Chinese Communist Party (CCP) now welcomes capitalists, and at least on paper, the state constitution of the People’s Republic of China (PRC) protects private property rights. How can this be explained?

I argue that the emergence of adaptive informal institutions provides opportunities for substantial transformations in official governing institutions— even in the absence of external intervention, crisis conditions, or political mobilization. Specifically, the case of private sector development in reform-era China demonstrates that informal interactions between various state and non-state actors at the local level may contribute to the flexibility of formal institutions at the national level. Without denying the proximate causal role of elite politics and decisions, this chapter contends that under certain circumstances the etiology of formal institutional change lies in the informal coping strategies devised by local actors to evade the restrictions of formal institutions. The argument starts from the premise that formal institutions comprise a myriad of constraints and opportunities, which may motivate everyday actors to devise novel operating arrangements that are not officially sanctioned. With repetition and diffusion, these informal coping strategies may take on an institutional reality of their own. In contrast to deep-rooted, “primordial” informal institutions, which tend to resist change, I call the resulting norms and practices “adaptive informal institutions” since
they represent creative responses to formal institutional environments that actors find too constraining. Widespread use of adaptive informal institutions may then motivate political elites to reform the original formal institutions. Examining the life cycle of adaptive informal institutions can thus demonstrate how some formal institutions manage to undergo significant transformations in the absence of exogenous shocks, societal demands, or complete institutional breakdown.

To illustrate this iterative logic, this chapter examines the dynamics of private sector development in China since the late 1970s by focusing on three institutional spaces in which major changes have occurred: first, the official policy adjustments that sanctioned the revival of China's private sector; second, the incorporation of capitalists into the CCP; and as a complementary institutional effect of the first two changes, third, the amendments to the PRC constitution that formally recognized and protected private property. Taken together, these three cases represent dramatic transformations in the most important formal institutions in the country—namely, economic policy orientation, the party, and the state. They also show that even in nondemocratic contexts, the etiology of and political justification for formal institutional change may lie in the informal coping strategies devised by local actors to evade the restrictions of formal institutions. To be sure, reform-oriented elites in Beijing were instrumental in making the official decisions to reform the Communist Party and PRC constitution. But this chapter proposes that the accumulation of informal interactions between local state and economic actors provided both the impetus and the legitimizing basis for these key reforms. When viewed from this perspective, the remarkable institutional changes promoting private sector development become less puzzling. Ultimately, both the designers and enforcers of China's formal institutions have proven to be flexible, and even responsive, to the actors driving the country's economic growth: private entrepreneurs.

The chapter proceeds as follows: the first section proposes that the emergence and incorporation of adaptive informal institutions are key processes in a broader sequence of endogenous institutional change. The chapter then examines three empirical cases to show how adaptive informal institutions underlying private sector development have stimulated sequential changes in China's formal institutions. The conclusion reflects upon the theoretical implications of the argument developed in this chapter.
The Role of Adaptive Informal Institutions in Explaining Endogenous Institutional Change

Theoretically, this chapter makes two complementary suggestions for furthering our understanding of institutional development—first, adaptive informal institutions may play an analytically meaningful role in explaining endogenous institutional change; and second, the causal process underlying endogenous institutional change is relational, meaning that it derives from interactions among various grassroots actors. Empirically, the case of China demonstrates that even in nondemocratic settings where formal institutions appear to be imposed top-down rather than subject to popular suffrage, everyday actors may quietly appropriate formal institutions to serve their own ends. This is most likely to occur when there is a gap between the original intentions of formal institutions and the perceived needs and interests of local actors. At the same time, local state agents may collaborate with ordinary people by intentionally misinterpreting the formal institutions that they are supposed to uphold. Such bureaucratic deviance is more likely to be found in situations where different formal institutions have conflicting mandates, which facilitates ignoring one set of rules to comply with another, and where local officials have convergent interests with local citizens in a particular policy area (promoting local economic growth, hiding revenues from higher levels of government, protecting local industry, bending rules to attract external investment, and so forth). In turn, these collaborative interactions may generate adaptive informal institutions that provide a powerful demonstration effect and prompt policy elites to transform key attributes of the official political and economic orders. Institutions depend on human interaction for their survival and transformation. They are not simply imposed and enforced by state agents and other proprietors of formal institutions. The analytical basis and implications of these claims are clarified below.

The Formal Origins of Adaptive Informal Institutions

The cliché that rules are meant to be broken may indulge latent rebellious sensibilities, but this argument starts with the assumption that rules are meant to be observed, enforced, and followed. This view of formal institutions resonates with that of sociological institutionalism, which views them as being behaviorally prescriptive and normative: institutions tell actors how they should or should not act (Powell and DiMaggio 1991). Formal institutions are intended
to provide a certain element of predictability and stability in human interactions. Given this assumption, certain outcomes predictably follow from certain institutions. Even complex multilayered institutional environments can be modeled elegantly to yield convincing explanations for why counterintuitive behaviors or policy choices occur (Tsebelis 1990). However, formal institutions do not always function as intended. Unintended consequences can flow from formal institutions, and cases of institutional failure abound throughout the world, which has thus inspired entire research agendas devoted to explaining the gap between intended and unintended institutional outcomes.

It is in this context that institutionalists have paid greater attention to “softer variables,” such as ideas, norms, and culture (Bates 1988; Berman 2001; Blyth 1997)—or what others might call informal institutions. The underlying rationale for turning to less formal variables is relatively straightforward. If formal institutions are expected to produce X outcome, but Y occurs instead, then the noise must stem from exogenous informal variables. The analytic shortcoming of this is that informal institutions effectively become residual variables that are expected to bear the explanatory slack whenever formal institutions can no longer account for the variation in outcomes. And more typically, informal institutions are blamed for inhibiting the normal functioning of formal institutions. Cultural explanations for why certain countries are neither more developed nor more democratic are often cited as cogent examples of how informal institutions may undermine formal ones (see, for example, Harrison and Huntington 2000). As Douglass North (1990, 91) explains, in certain contexts “the formal rules change, but the informal constraints do not. In consequence, there develops an ongoing tension between informal constraints and the new formal rules,” which may be attributed to “the deep-seated cultural inheritance that underlies many informal constraints.”

This observation leaves us with the analytic conflation of informal constraints, informal institutions, and cultural inheritance—and the vague impression that all three compromise the intended functions of formal institutions. The tendency for explanations to privilege informal institutions only when formal ones have failed at their prescribed tasks ironically demonstrates the normative power that scholars reflexively ascribe to formal institutions. Formal institutions implicitly represent the baseline from which we evaluate the desirability of various outcomes. More recently, however, efforts have
been made to theorize directly about the causal impact of informal institutions. Gretchen Helmke and Steven Levitsky (2004), in particular, have proposed a typology for classifying the relationship between formal and informal institutions, such that they may be complementary, accommodating, competing, or substitutive. The typology represents a helpful first step in clarifying the nature and function of informal institutions relative to formal ones, but it does not develop a theory about the processes of informal institutional emergence and change, or the formalization of informal institutions. And indeed, a large part of the challenge in inserting informal institutions into causal explanations is where to place them temporally, given that almost no society is completely devoid of some semblance of formal institutions.

For the purposes of capturing the causal effects of informal institutions at a more manageable intermediate stage, this paper thus brackets the “deep-seated cultural inheritance” underlying informal institutions and starts with the blank slate of formal institutions, which I define as rules, regulations, policies, and procedures that are promulgated and meant to be enforced by entities and agents generally recognized as being official. As in my earlier work, this study regards formal institutions as being both constraining and enabling. On the one hand, formal institutions limit the range of officially permissible behavior. On the other hand, multilayered institutional environments offer transformative possibilities; in particular, formal institutional contexts with overlapping jurisdictions and inconsistent or unrealistic mandates provide opportunities for actors to adjust, ignore, or evade discrete portions of formal institutions. Initially, many of these adaptive responses may appear to be idiosyncratic or isolated. However, over time they may evolve into adaptive informal institutions, which I define as regularized patterns of interaction that emerge as adaptive responses to the constraints and opportunities of formal institutions, violate or transcend the scope of formal institutions, and are widely practiced. In order for this intermediate stage of institutional adaptation to develop, at least the base-level guardians of formal institutions need to be complicit in allowing the institutional distortions to occur, over and over again. Adaptive informal institutions are more likely to arise and thrive in localities where the enforcers of formal institutions and the creators of informal adaptations have convergent interests. This is the first part of my argument in a longer sequence explaining endogenous institutional development.
Explaining Institutional Innovation

The second part concerns what happens after adaptive informal institutions emerge. At the most basic level, the proliferation of adaptive informal institutions may undermine the legitimacy of formal institutions. The relevance of institutions, whether formal or informal, depends on their capacity to guide human perceptions and practices. But do the enforcers of formal institutions ignore, incorporate, or discipline the actors sustaining adaptive informal institutions? The answer to this question is historically and nationally contingent. In the case of China, crackdowns on adaptive informal institutions are most likely to occur during political campaigns against economic crimes and corruption and other periods when there is heightened political sensitivity to local deviations from national mandates. But if the law enforcers themselves are party to the offending activities, then efforts to curb them are unlikely to be sustainable beyond those priority moments.

Beyond China, we may expect that when adaptive informal institutions constitute flagrant forms of criminal activity, they will elicit the attention of law-enforcement entities. Yet even the definition of “flagrant” criminal behavior is contextually variable. In some cases, embezzlement of state assets would constitute flagrant criminal activity, but under other circumstances asset stripping of a public enterprise by its managers and workers might be so common that it fails to trigger strong official reactions. For the present purposes, I will simply define flagrant forms of criminal activity as illegal practices that are readily discernable and have immediate social costs that would be difficult to cover up. An example of this would be Ponzi schemes, which usually involve large numbers of enraged people by the time they collapse. Another example would be violation of food and drug safety standards, which endangers lives and motivates regulatory development (Tam and Yang 2005).

In contrast, adaptive informal institutions that merely stretch the limits of formal institutions—or create new patterns of interaction not explicitly governed by formal institutions—may endure and even thrive unencumbered for some length of time. The adaptive practices discussed in this paper fall into these quasi-legal and extralegal gray areas. They are adaptive informal institutions that arise in a context where some local political and economic actors face incentives to promote private sector development but formal institutions at the national level lag in adjusting to new businesses and their associated externalities.
This focus on the origins and effects of adaptive informal institutions resonates with the logics of non-reinforcing event sequences and structural friction among multiple institutional layers in historical institutionalism and American political development (Lieberman 2002; Mahoney 2000). When adaptive informal institutions arise in response to the dissonance between existing formal institutions and the operational preferences of actors, adaptive informal institutions start to redirect and undermine the previously self-enforcing formal institutions (see Greif and Laitin 2004). In this narrative, the use of preexisting formal institutions as the analytical baseline against which actors devise coping strategies is important. Indeed, the formal-informal-formal sequence represents the core of the argument. The next section presents three instances of major institutional changes relating to private sector development in China to illustrate this contention more concretely.

**The Political Economy of Adaptive Informal Institutions in Reform-Era China**

As historical institutionalists have pointed out, most institutions do not exist in isolation from one another. Instead, instances of “institutional coupling” may be observed among clusters of institutions that are mutually dependent (Pierson 2004, 224–27). The following cases of institutional changes relating to private sector development in China should be viewed in this light. Certain changes in formal institutions may be traced to particular informal practices and adaptive informal institutions. In turn, the resulting changes in formal institutions facilitate complementary adjustments in other formal institutions. Specifically, the examples below show how informal practices at the ground level paved the way for legalization of the private sector, which attracted the participation of party members in entrepreneurial activities. The rise of “red capitalists” then influenced the formal incorporation of capitalists into the CCP. In turn, the preceding adaptive informal institutions enabled reform-oriented elites to justify revisions to the PRC constitution that recognize the existence and contribution of the private economy.

**Red Hat Disguises and Private Sector Development**

In contemporary China, “wearing a red hat” (dai hongmaozi) refers to the practice of registering a business as a collective enterprise when it is really privately managed and owned. A related disguise is paying a state-owned enterprise for use of its name in running a private business; those are called
“hang-on” enterprises (guahu qiye) because they are registered as appendages to established government operations. Red hat operations emerged as an adaptive informal institution during the first decade of economic reform, when private enterprises with more than eight employees (siying qiye) were not legally permitted.\(^5\) Therefore, until 1988, China’s private sector technically only consisted of “individual households” (getihu) with fewer than eight employees.\(^6\) Yet in reality, many of the collective enterprises were larger private businesses wearing red hats (Naughton 1994). One entrepreneur that I interviewed in Huizhou, Guangdong, for instance, explained that he was able to open a sizable piglet store as early as 1978 because he ran it under the auspices of the local township’s communal supply shop (Interview No. 191).\(^7\) Another entrepreneur in Nanjing, Jiangsu, proudly recounted that in 1982 she was able to run a large and lucrative clothing business as a collective enterprise, while running the same business as a private one would have been “impossible” (Interview No. 166). By the time that private enterprises were permitted, an estimated half-million businesses were already using the red hat disguise. And in certain localities, it was commonly known that between 90 and 95 percent of registered collective enterprises wore red hats (Parris 1993).

After the 1988 regulations permitting private enterprises—and the politically rooted economic downturn of 1989–92 following the Tiananmen Square crisis—private sector growth boomed. Between 1990 and 2000, the average annual growth rate in the number of registered private businesses was 32.8 percent, the number of people employed in the private sector grew at an annual average rate of 29.2 percent, their registered capitalization grew at 65.1 percent, their value added to GDP grew at 58.7 percent, and their volume of retail sales grew at a rate of 70.2 percent (Zhongguo tongji nianjian, various years). In the interim, a network of formal institutions governing the private sector had developed throughout the country.

On the most superficial level, it is tempting to attribute China’s remarkable private sector development to official policies and institutions regulating the non-state economy. I would argue, however, that China’s formal institutions have presented local state and economic actors with more of a constraining rather than a permissive environment for private capital accumulation—and key to our purposes here, local actors have exercised agency in manipulating formal institutions to their advantage.
Throughout the 1980s and most of the 1990s, private entrepreneurs experienced not only a social stigma for being profit oriented but also political persecution. There was considerable political uncertainty about the trajectory of economic reform, and private entrepreneurs were publicly criticized during the national campaigns against “spiritual pollution” in 1983–84 and against “bourgeois liberalization” in 1987. At the local level, entrepreneurs were subjected to arbitrary treatment by tax collectors and harassment by other bureaucrats. In contrast, state and collective enterprises received favorable treatment relative to private ones in terms of tax breaks, bank loans, and use of land. Those were the operating realities that business owners faced beneath the impressive statistics.

Why, then, were entrepreneurs willing to enter into and stay in business? As suggested above, one way for entrepreneurs to avoid social and political ostracism was to wear a red hat. This adaptive strategy was so widespread that “wearing a red hat” became (and remains) common terminology in everyday discourse. The practice became institutionalized as a standard, albeit informal, operating practice for private entrepreneurs. Yet the actual process through which this occurred was not simply the case of entrepreneurs deceiving local bureaucrats; instead, the actions of agents were collaborative and reflexively strategic. Most local cadres knew exactly what they were doing when they accepted, or perhaps extracted, a registration fee from a local entrepreneur to run a collective enterprise. Hundreds of thousands of both state and non-state actors were complicit agents in popularizing the red hat phenomenon. Meanwhile, China’s collective sector boomed and represented the basis of rapid rural industrialization (Oi 1999).

In the spirit of Deng Xiaoping’s dictum to focus on practical results rather than ideology, when central-level elites realized that many collectives were really private enterprises, it was futile—and indeed, impractical—to insist on limiting the private economy to household producing units with less than eight employees. Although conservative, or “leftist,” political elites would have preferred to restrict the non-state sector, both the popularity and the economic effectiveness of wearing a red hat gave reformers concrete evidence and thus political support for expanding the scope of China’s nascent private economy. Influential scholars, such as Yu Guangyuan and Xue Muqiao from the Chinese Academy of Social Sciences, drew on their observations of local empirical realities to help reformist leaders develop consensus about the
appropriate next steps in China’s reform process. During a pivotal academic and policy meeting held in Beijing in 1986, they reasoned that, given that China was still in the initial stage of socialism, first, it would be impossible to avoid developing the private economy; second, the advantages of developing the private economy would outweigh the disadvantages; and third, under a socialist system the private sector could still be subject to state guidance and control (*Beijing Review* 1987).

Broad-based agreement on these key points about China’s “initial stage of socialism” paved the way for shifts in the official guiding principles and policies of the party-state. On the party side, at the Thirteenth National Congress of the CCP in 1987, Premier Zhao Ziyang announced, “Cooperative, individual and private sectors of the economy in both urban and rural areas should all be encouraged to expand…. [And] we must formulate policies and enact laws governing the private sector as soon as possible, in order to protect its legitimate interest” (*Beijing Review* 1988). Following the party’s lead, on the state side the National People’s Congress (NPC) passed a constitutional amendment accepting Zhao’s proposal in April 1988, and two months later the PRC State Council issued regulations governing “private enterprises” with eight or more employees. In an acknowledgement that these regulations were really post hoc sanctioning of ground-level realities, official publications disclosed that by then China already had 225,000 private enterprises employing 3.6 million employees, with an average of sixteen employees per business—that is, twice the number of workers that individual private businesses were permitted to employ (*Zhongguo siyingjingji nianjian*, various years).

In sum, the practice of wearing a red hat is an example of how an adaptive informal institution contributed to the institutional conversion of a formal regulation: the collective registration status. Camouflaging the true ownership structure of a business rendered the formal distinction in nomenclature between collective and private enterprises virtually meaningless. By the same token, as an adaptive informal institution, the red hat practice also became an increasingly prominent institutional layer in China’s once-limited field of corporate organizational types. Instead of displacing the collective sector, red hat enterprises represented an additional form of collective enterprise; this innovative layer not only expanded the institutional space for private businesses to operate in but also created a politically acceptable rationale for devising
a more transparent registration status for larger private enterprises. In this case, the impetus for institutional change stemmed from friction between preexisting institutions that privileged the collective sector and policies that sanctioned limited development of the private sector. Both state and economic actors coped with the friction by popularizing the adaptive informal institution of wearing a red hat. The economic success and widespread use of this adaptive informal institution then provided reformers with the requisite evidence that expanding the scope of the private sector would enhance China’s productive forces during the initial stage of socialism. As we will see below, ultimately the adaptive informal institution of wearing a red hat not only influenced the legalization of private enterprises with more than eight employees but also provided the basis for subsequent institutional changes in the CCP and state constitution.

The Chinese Communist Party’s Incorporation of Capitalists

The first generation of profit-oriented business operators in post-Mao China generally came from two different backgrounds. The “individual entrepreneurs” (getihu) consisted of street peddlers, itinerant vendors, and small retail business owners who subsisted on the fringes of the socialist-era economy and did not have the benefits of state employment. The popular perception of getihu was that they were criminals and social outcasts who lacked alternative employment options; hence, they experienced considerable political and social discrimination. In reality, however, most were simply underemployed farmers who no longer had to work in collectives.

At the other extreme, the other strata of society active in commerce were “cadre entrepreneurs” and “red capitalists” who used their privileged political status to run businesses indirectly or help others run red hat operations. Even though CCP members were not allowed to operate private businesses, it was apparent throughout the 1980s and 1990s that many were active participants in the non-state sector. Indeed, official surveys reveal an increasing proportion of self-identified CCP members among private entrepreneurs over time, such that only 7 percent of business owners admitted to being party members in 1991, but by 2003 over one-third admitted to being private entrepreneurs (Zhongguo siyingjingji nianjian, various years). It is reasonable to assume that the earlier official figures underestimate the true proportion of party members in the private sector due to the politico-ideological sensitivity concerning the appropriate relationship between the CCP and “market socialism
with Chinese characteristics.” For many years, the uneasy coexistence between China’s official socialist ideology and the reality of private sector development accounts for the simultaneous growth of business owners among party members and the underreporting of party members in official surveys of private entrepreneurs.

On the CCP’s eightieth anniversary on July 1, 2001, however, General Secretary Jiang Zemin gave a landmark speech widely interpreted as inviting private entrepreneurs to join the party. The rationale was weaved into Jiang Zemin’s “Theory of the Three Represents,” which is supposed to represent the theoretical extension of Marxism-Leninism, Mao Zedong Thought, and Deng Xiaoping Theory but actually made the controversial recommendation that the party should represent “the most advanced forces of production, the most advanced cultural forces, and the interests of the overwhelming majority of people.” The CCP had launched a mass media campaign publicizing the Three Represents leading up to the anniversary, but it was the July 1 speech, followed by the Sixteenth Party Congress in late 2002, that clarified the implication of the “theory”—that is, that the CCP should not discriminate against private entrepreneurs and should in fact embrace them because they are contributing (the most) to China’s economic development. A number of the party’s old guard disapproved of the sharp ideological turn that Jiang and his supporters were advocating. Even online chat rooms and message boards filled with colorful, passionately argued objections to the selling out of the CCP.10

As such, it is remarkable that the CCP agreed to change—and indeed, reverse—its former ideological depiction of capitalists as exploitative “class enemies.” Bruce Dickson (2003) suggests that allowing private entrepreneurs into the party was a strategic decision to incorporate a growing, and increasingly wealthy, portion of Chinese society. It was an effort to preempt autonomous political organization on the part of private business owners. While this interpretation of the party’s decision makes sense, I would add that the underlying causal mechanisms leading to this decision were rooted in the growing power of the informal rules of the game that had evolved over the first two decades of economic reform. Party members were active in the private sector well before private entrepreneurs were formally permitted to join the party. But how was this possible, given that China remains an authoritarian regime dominated by a Leninist party?
As discussed, the adaptive informal institution of wearing a red hat offered CCP members an ideologically appropriate cover for participating in for-profit activities. This, in turn, led to the adaptive practice of being a “red capitalist” (hong zibenjia). Because private entrepreneurs were explicitly banned from joining the party after 1989, wearing a red hat became a safer way for party members to run large businesses. And local party cadres were willing to look the other way because red capitalists often contributed more to the local economy than ordinary entrepreneurs. For illustrative purposes, consider the experience of a furniture manufacturer in rural Hebei Province (Interview No. 153). After earning his BA from the local Communist Party school, Mr. Hong (pseudonym) worked as a high-ranking manager in a state-owned enterprise for more than a dozen years. By the time he was thirty-six years old in 1991, however, Mr. Hong was ready for a big change. He had harbored dreams of running his own business for a while but knew that it would “look bad” if a party member entered the private sector. As a result, he registered his furniture factory as a collective enterprise. Given that Mr. Hong was well regarded in his locality, he had little difficulty negotiating with the local bureaucracy to wear a red hat. In fact, I met Mr. Hong through local officials, who introduced him as “an upstanding red capitalist.” Besides being an economically successful party member, Mr. Hong serves as a deputy in the local People’s Congress and serves as the vice director of the local Chamber of Commerce. Mr. Hong is hardly representative of the typical business owner, but local government hosts selected him as an interviewee because they were proud of Owner Hong’s local commercial and political stature, even if he was a cadre entrepreneur who wore a red hat.

By the early 2000s, the spread of red capitalists presented the party with the critical dilemma of whether to condemn their economic activities or embrace them. Of entrepreneurs surveyed by official entities in 2000, 19.8 percent indicated that they were already CCP members (Zhongguo tongji nianjian 2005). Should such a large percentage of business owners remain politically marginalized? After consulting with provincial and sub-provincial officials throughout China, the party’s core leadership decided that it was in the interest of continued economic growth, as well as party rejuvenation and survival, to legitimize the existing red capitalists and co-opt other private entrepreneurs. Shortly after the party lifted the ban on cultivating capitalist members, a party theoretician explained, “If our party doesn’t build more
branches [under the circumstances of rapid growth in the non-public eco-
nomic organizations], then other social forces will attract those people. If the 
party doesn’t open up its organizations to [private entrepreneurs], then other 
organizations will hold activities for them” (Yan 2005, 107). The report fur-
ther highlighted the relative underrepresentation of business owners in the 
party: “By the end of 2002 there were 2.1 million party members in non-pub-
lic economic organizations, which accounts for only around 2 percent of the 
total membership, and over 80 percent of foreign-invested enterprises and 
private enterprises do not have party members” (Yan 2005, 108).

Within a remarkably short period of time, the party line shifted from ban-
n ing to welcoming capitalists. Such a reversal in party policy would have been 
difficult to justify in the absence of preexisting grassroots deviations from the 
party line. Wearing a red hat enabled party members to become red capital-
ists, which ended up changing the occupational composition of the party from 
within. As employees of the party-state began running their own businesses, 
albeit disguised as collective ventures, the party’s ban on private entrepre-
eurs became increasingly unrealistic, if not anachronistic. Although Jiang 
Zemin is generally credited (or blamed) for allowing capitalists into the party, 
the decision was not the impulsive act of a dictator. The decision did not occur 
in a societal void, as evidenced by the series of discussions with local officials 
throughout the country. And at a deeper causal level, all the informal coping 
strategies that both state and non-state actors had reproduced in their daily 
interactions took on an institutional reality of their own, thereby challenging 
national leaders to adapt preexisting formal institutions to assimilate these 
hitherto informal practices. The cumulative effects of this dynamic can also 
be seen in revisions to the PRC constitution that have become increasingly 
favorable toward the private sector.

**Private Sector–Friendly Revisions to the PRC Constitution**

Revisions to the PRC constitution have generally lagged behind developments 
in actual practices. Of the various constitutional changes that have occurred 
since 1982, the first two revisions represent reactive formalization of local 
practices and realities. The 2004 revision put forth an ambitious objective that 
was inspired by the two adaptive informal institutions discussed above—wear-
ing a red hat and the proliferation of red capitalists. Of all the institutional 
changes discussed thus far, the following sequence of constitutional revisions
illustrates most organically this chapter’s argument about the causal mechanisms underlying endogenous dynamics of formal institutional change.

First, as introduced earlier, in 1988, the First Session of the Seventh NPC added a paragraph to Article 11 that “permits the private sector of the economy to exist and develop within the limits prescribed by law.” The paragraph also stated: “The private sector of the economy is a complement to the socialist economy.” This new section provided the legal basis for allowing “private enterprises” (siying qiye) with more than eight employees to operate while indicating that the private sector would still be subject to state control, as indicated in the final clause of the paragraph: “The state protects the lawful rights and interests of the private sector of the economy and exercises guidance, supervision, and control over the private sector of the economy.” This formal recognition of larger private businesses trailed ground-level practices, as ambitious entrepreneurs were already scaling up in the guise of collective enterprises; but going forward, legal recognition of private enterprises rendered the adaptive informal institution of red hat disguises less necessary.

Second, in 1999, the Second Session of the Ninth NPC amended the aforementioned paragraph in Article 11 to say: “Individual, private, and other non-public economies that exist within the limits prescribed by law are major components of the socialist market economy.” The 1999 revisions also included a statement indicating, “The People’s Republic of China governs the country according to law and makes it a socialist country ruled by law.” The combination of elevating the non-state sector to a “major component” of the economy and introducing the notion that the country is governed by the rule of law signaled a more legitimate and secure status for the private sector. The reason these amendments may not appear to be groundbreaking is because once again the constitutional revisions followed changes that were already taking place in the Chinese economy. By 1999, spontaneous “privatization” or restructuring (gaizhi) of collective enterprises had already been occurring in rural China for five years. Due to various local innovations in property rights structures, the non-state sector was already a “major component” of the economy by the time the constitution acknowledged it.

Third, in 2004 the Second Session of the Tenth NPC made the more radical revision of encouraging private sector development and protecting private property rights under the constitution. Article 11 was changed again to stipulate:
The state protects the lawful rights and interests of the private sector of the economy, including individual and private businesses. The state encourages, supports, and guides the development of the private sector and exercises supervision and administration over the sector according to law.

And Article 13 introduced, “The lawful private property of citizens shall not be encroached upon.” Meanwhile, the Theory of the Three Represents—which makes the controversial claim that the party represents the “most advanced forces of production” (that is, private entrepreneurs)—was incorporated into state ideology alongside “Marxism, Leninism, Mao Zedong Thought, and the Theories of Deng Xiaoping.” Since the Sixteenth Party Congress in 2002 had incorporated upholding the Three Represents in the CCP’s mission statement, it was not surprising that the state constitution would be similarly amended.

Unlike the first two amendments discussed above, however, the constitutional stipulation that private property rights would be protected should be viewed as an objective rather than a post hoc recognition of ground-level realities. Although certain adaptive informal institutions enable economic actors to engage in contractual exchanges as if they were guaranteed by a formal legal system of private property rights (Oi and Walder 1999), the rise of serious disputes concerning asset ownership demonstrates that such arrangements are not immune from government intervention/expropriation. This is, of course, a risk that all adaptive informal institutions face, but the point here is that because the most recent constitutional revisions have more complex systemic implications for China’s political economy, lags in actual implementation should be expected. Formal protection of private property rights requires strengthening the institutions that support the rule of law (Clark, Murrell, and Whiting 2006). As Yu An, a Tsinghua University law professor who served on the constitution’s drafting committee, commented:

Some revised articles are an acknowledgement of the current situation, while others are new stipulations. That means adjustments should be made to existing laws, or new laws should be implemented…. The Constitution itself can hardly regulate the particular behavior of the government and the people. Without significant adjustment of current common laws, the impact of the constitutional revision may be greatly reduced. (China Business Weekly 2004)

In the interim, various adaptive informal institutions will continue to serve as self-enforcing substitutes for property rights.
Although the series of constitutional revisions relating to the private sector appears to be a linear progression of increasing official recognition and legal protection of its interests, there was nothing automatic or predetermined about the development of various formal institutions to support the private sector. In the context of evolving property rights regimes in rural China, Susan Whiting (2001, 299) observes, “Even dramatic change occurs incrementally. The presence of complementarities among institutions and policies means that singular changes interact to bring about more fundamental changes in the incentives and constraints in the institutional environment.” I would add that in the case of China’s constitutional revisions, the “singular changes” are rooted in the informal adaptive strategies of grassroots actors.

Given the opacity of the Chinese political system, it is challenging to prove with definitive data that the spread of adaptive informal institutions used by private entrepreneurs directly influenced the various constitutional amendments. Based on published sources, as well as field interviews with government officials, elite intellectuals, and private entrepreneurs, however, we may infer the plausibility of the counterfactual to my argument. That is, in the absence of the adaptive informal institutions discussed above, it is unlikely that reform-oriented elites would have found the pro–private sector constitutional amendments either desirable or feasible. Both the economic success of private businesses and the popularity of private entrepreneurship among party members offered reformers evidence (against “leftist,” or conservative, leaders) that enhancing the scope of the private sector would be in the country’s political and economic interests. Indeed, various legal scholars were already pushing for the protection of private property rights during the drafting meetings of the 1999 constitutional revision, but their recommendations were shelved due to opposition by more conservative party members (Xisheng 2004). Only after the party came to terms with red capitalist members in 2002 was it politically possible to revisit the earlier constitutional proposals to protect private property.

While there was still internal debate over the inclusion of private property protection in the consultative processes leading up to the 2004 constitutional revision, by 2003 and early 2004 proponents of private property rights were able to build their case by implying that there was societal support for constitutional revision along those lines. Even though private entrepreneurs themselves never mobilized from below to lobby for constitutional protection
of their assets, reformers strategically solicited input from the official mass association representing private entrepreneurs, the All-China Federation of Industry and Commerce (ACFIC, gongshang lian). In practice, state-sponsored mass associations in Leninist systems usually serve to transmit official policy to constituent members in a state-corporatist fashion, but they are also meant in principle to represent the interests of its members. As such, during the earlier rounds of constitutional revision, ACFIC was charged with convening small-scale forums with entrepreneurs throughout the country to gather their opinions about the upcoming constitutional revisions. Prior to the 2004 revision, however, the official narrative of the process is that ACFIC initiated the consultative discussions with entrepreneurs and that it played an important role in advocating constitutional protection of private property (Interview No. 148). In other words, reformers gave ACFIC credit for representing the voice of private entrepreneurs and pushing for the private property clause in order to create a stronger political case for revising the constitution along the lines that they were hoping for at least five years earlier. In reality, private entrepreneurs themselves were remarkably absent from the actual process, but the cumulative effect of their adaptive informal institutions and the changes that they engendered in formal institutions governing the private sector enabled reformers to justify further protections on their behalf. The causal mechanisms were indirect, informal, and fundamentally political.

Conclusion

In examining the process of endogenous institutional change in reform-era China, this chapter makes two contentions that may inform our understanding of institutional development in other contexts: first, the causal mechanism for institutional change depends on interactions between various state and non-state actors; and second, adaptive informal institutions may play an important role in endogenous accounts of such change. Specifically, adaptive informal institutions may emerge out of the collaborative coping strategies of state and non-state actors when they find formal institutions too constraining. Over time, adaptive informal institutions may facilitate significant changes in formal institutions by providing elites with political support for the introduction of key reforms. This reactive sequence of institutional change may occur even in authoritarian regimes where political institutions are not necessarily expected to be responsive to grassroots interactions.
Yet it is important to point out that this apparent political “responsive-
ness” has occurred through indirect means in the case of China. Private entre-
preneurs as a group have not lobbied directly for protection of their property
rights or for membership in the Chinese Communist Party. Instead, people
from different social backgrounds have entered the private sector as a self-
help strategy to enhance their material welfare and, in the process, have come
to appear to party-state elites as an increasingly important constituency. In
the course of their daily interactions with one another and with local staff of
the party-state, business owners have had a structural impact on the direction
of formal institutional reforms. Therefore, even though the regime has pur-
sued policies that imply a strategy of corporatist inclusion of private capital,
this chapter suggests that the causal mechanism underlying these preemptive
corporatist efforts lies in the cumulative effect of informal interactions at the
local level rather than in purely economic or social considerations.

Ultimately, the ability of the nominally socialist regime to accommodate
private sector development is only one expression of the broader transforma-
tion that has occurred in China’s institutional context. Although the PRC is
still an authoritarian regime, the nature of its political economy has changed
so dramatically that China scholars have felt compelled to qualify its categori-
cal nomenclature with various adjectives to distinguish it from the party-state
of the 1950s and 1960s (Baum and Shevchenko 1999). Rather than worry-
ing about whether contemporary China is now a bureaucratic-authoritarian
regime or a capitalist developmental state, greater attention should be paid
to the causal mechanisms and processes underlying the regime’s remarkable
institutional resilience. Informal interactions and informal institutions may
represent an important, yet typically overlooked, part of the story.

Indeed, beyond the case of China there is comparative analytic value in
viewing adaptive informal institutions as vehicles for change in formal insti-
tutions. Attending to the rise of informal adaptive responses expands the
scope of what we typically deem to be relevant in political analysis. Local
innovations, evasive tactics, and other extra-legal practices often seem distant
from the hallowed ranks of political elites and their associated formal politi-
cal institutions. The concept of adaptive informal institutions brings them a
little closer. Sporadic acts of noncompliance or random criminality are not
cause for concern. But strategic responses that are repeated, widespread, sys-
tematically reproduced, and therefore “institutionalized” through informal
praxis generally elicit official attention in some form or another. Determining when and whether adaptive informal institutions will have such catalytic effects is politically contingent and requires empirical study of both the high politics and the apparently apolitical low politics of grassroots adaptations to formal institutions.

Notes


2 Five types of informal institutions are identified by Hans-Joachim Lauth (2000).

3 This definition draws from Helmke and Levitsky (2004, 727) but also includes public policies because they typically have institutional consequences. Pierson (2004, 165) suggests, “It makes good sense to think of public policies as important institutions. For the individuals and social organizations that make up civil society, public policies are clearly very central rules governing their interactions.”

4 For example, distinct cycles of crackdowns on local financial institutions such as trust and investment companies were apparent and corresponded with the broader policy reform cycles through the late 1990s when Zhu Rongji was Premier. Correspondence with Yi-feng Tao, November 10, 2006.

5 The eight-employee limit has an ideological rationale: in *Das Kapital* (1867), Marx indicated that capitalist producers with more than eight employees were exploitative and surplus accumulating, while those with less than eight workers were non-exploitative household producing units.

6 For more detail, see Young (1995).

7 As part of a larger project, I conducted interviews with over three hundred Chinese entrepreneurs and officials over the course of 2001 to 2005.

8 On local variation in the use of red hat strategies and development of private property rights, see Oi and Walder (1999) and Whiting (2001).

9 By the same token, Whiting (2001, 163–64) points out that local officials and entrepreneurs “shared a common interest in the security of shareholding cooperatives” as legitimate collective enterprises in localities that were dominated by genuine collective
enterprises, as well as in localities that were dominated by private businesses.


These consultations “took place over a period of perhaps two years” (Fewsmith 2002, 3).

As Whiting (2001) points out, privatization of collectives was due to changes in the fiscal system, the cadre evaluation system, and the national political economic environment. Furthermore, by 1999 the selling off of small and medium-sized state-owned enterprises, announced at the Fifteenth Party Congress in 1997, was gaining momentum.

References


Yan, Li. 2005. Qieshijiaqiang fei gongyouzhijingji zhuzhi dangjian gongzuo buduan guangda dang de gongzuo de fugai mian [Work practically to expand continuously and...


Chapter Eight

Explaining Divergence in Sugar: The Philippines and Brazil

Richard F. Doner and Ansil Ramsay

Introduction

In the 1930s, the Philippines was “one of the world’s most efficient and technologically advanced producers of cane sugar” (Billig 1993, 122). By the 1980s, the country’s sugar industry had become a laggard, plagued by old technology and corruption. Conversely, Brazil grew from a mid-level producer, whose exports were less than those of Thailand in 1990–91, to dominate world sugar markets in 2004–5 (Martines-Filho, Burnquist, and Vian 2006). This contrast provides a useful lens into the questions central to this volume: What is the role of institutions in development? How do we explain variations in institutional arrangements and capacities? Through an analysis of the Philippines’ and Brazil’s experiences in sugar, this chapter offers three sets of arguments: First, stagnation in the Philippines and upgrading in Brazil reflect contrasting institutional capacities. Second, these differences are in part a function of differences in the structure of elite competition. Finally, vulnerability pressures on elites constitute the most critical factor explaining differences in both capacities and elite competition.

The chapter proceeds as follows: sections I and II analyze the Philippine and Brazilian cases respectively. Each section begins with an analysis of the developmental challenges or tasks and the respective institutional capacities. It then explores the sources of these cross-national differences. Section III summarizes our findings.
I. The Philippines

Policy Challenges
The most proximate explanation for the Philippines’ disappointing performance in sugar lies in the country’s failure to address at least three policy challenges: property rights, risk socialization, and research and development. We trace these issues from the establishment of modern mills in the 1920s through the early 1970s, and then from Ferdinand Marcos’s establishment of martial law in 1972.

Ownership relations between Philippine sugarcane growers and millers dating back to the early twentieth century have discouraged efforts to improve productivity in both cane production and mills. Unlike Brazil’s integrated system (discussed below), where millers control most of the cane fields, Philippine planters typically retain ownership, reflected in an official coupon, or quedan, of as much as 75 percent of the sugar even after the cane is milled and stored in mill warehouses. Initially, this share-quedan property-rights regime had an important efficiency function — namely, to persuade hacienda owners, who had traditionally milled sugar as well as grown the cane on their farms, to bring their cane to be milled at more modern centrifugal factories.

However, under the quedan system millers have had little incentive to invest in mill modernization since such upgrading would benefit growers as much as, if not more than, the mill operators themselves. By 2003, the average age of sugar mills in the Philippines—described by Billig (2003, 61) as large, “superannuated, highly polluting dinosaurs that continue to use older technology, to depreciate rapidly, and to function at low capacity utilization”—was fifty years, compared to an average of less than twenty for Thai mills. This has translated into rates of sugar extracted from cane that are lower than the average Philippine rates of fifty years ago. For their part, planters have focused on trading ownership shares rather than agricultural productivity. Many industry participants recognized these problems and urged a shift to the “cane-purchase” system (Billig 2003), but as discussed below, distributional differences and institutional fragmentation have blocked such a change.

Also, the Philippines sugar industry has suffered from a more fundamental challenge to property rights after Marcos’s declaration of martial law in 1972. Whereas basic property rights had remained stable in the face
of numerous government shifts, Marcos seized property from uncooperative oligarchs, including from the Lopez family, “the wealthiest of the wealthy sugar families” (Hawes 1987, 96–97). His message was clear: property was no longer power, “since at a stroke of the martial pen it ceased to be property” (Anderson 1988, 22). Another blow to existing rights was Marcos’ decision to replace existing export arrangements with a state-sponsored system, the Philippine Sugar Commission (Philsucom), under the control of a crony, Roberto Benedicto. This firm had both control of the export trade and, more importantly for Filipino producers, exclusive rights to purchase all sugar (that is, all quedans). In essence, Benedicto determined the prices at which he bought raw sugar and paid for milled sugar. His monopoly and monopsony profits allowed Benedicto to purchase refineries and related infrastructure but also undermined other planters’ confidence in the whole marketing system. The result was a level of economic and political insecurity during the martial law years under which existing sugar interests “could not risk new investments or even maximize production.” Thus, “the sharp drop in sugar production in the late 1970s was attributed to the variability and uncertainty of government action” (Hawes 1987, 96–97).

The process of risk socialization was also problematic. Philippine sugar producers enjoyed excessive socialization but faced little risk prior to the 1970s. As “perhaps the nation’s most powerful single lobby” for much of the twentieth century, Philippine planters became the largest customer of the National Bank of the Philippines, which financed the construction of mills and provided other forms of capital to the industry on easy terms (McCoy 1983, 137). Indeed, prior to martial law, sugar interests dominated the banking industry (Hawes 1987). The planters “had easy access to credit, low labor costs, cheap and abundant land, large profits,” and thus little incentive to make improvements in cane yields or mill efficiency (Billig 2003, 49). Further inhibiting the industry’s modernization were guaranteed sugar quotas from the United States, which ensured profits and reassured bankers they would be repaid. According to a U.S. government estimate, in 1967 alone U.S. quotas provided some 97 million dollars in “hidden assistance” to Philippine planters and millers.4

The industry’s risks rose sharply during the martial law period. Part of the problem was the end of preferential access to the protected U.S. market in 1974 and low market prices beginning in 1975, but these shifts were
compounded by Benedicto’s monopoly and monopsony power. In 1974, operating through a state-backed bank, Benedicto held much of the sugar crop rather than exporting it, in the mistaken belief that world sugar prices would rise in 1975. Instead sugar prices fell from 67 cents per pound in 1974 to only 30 cents per pound in 1975. The consequences were dire for planters and millers, and devastating for impoverished workers in the industry. Then, in the 1980s, Benedicto bought sugar at an artificially low domestic price and sold it in world markets at a much higher price, with most of the profits going to Marcos and selected cronies (Billig 2003). These moves severely weakened existing growers and millers. Facing these risks, “[n]either domestic nor foreign investors invested new money in sugar during the martial law years” (Hawes 1987, 96).

Under these conditions, a lack of research and development is not surprising. Government-sponsored research facilities did produce new cane varieties in the 1920s; the Philippine Sugar Association (PSA), established in 1922, functioned as a clearinghouse for private research into field productivity (Larkin 1993); and industry leaders explored new mechanization techniques when faced with market volatility in the mid-1970s (Billig 2003). However, none of these efforts was sustained, and by the 1990s government research and extension functions, under the Sugar Regulatory Administration (SRA), had become disorganized and underfunded (Billig 2003). No new research was being done on new cane varieties, and there was little effort to improve soil quality or water supplies and irrigation. Efforts to have planters associations take over research and development from ineffective state agencies foundered because the associations could not agree on which group would manage the research. The consequence of these failures is that the average cost of sugar production in the Philippines prices it out of world markets.

Institutional Capacities
Michael Billig has summarized the Philippine sugar industry as a case of “technical inefficiency and institutional stasis.” Indeed, the industry has exhibited only sporadic consultation, poor monitoring, and as a result, a consistent sense of mistrust both within the industry and between private and public interests. Until the 1970s, there was little consultation or even need for it. Disputes tended to involve distributive issues, especially fights over quedan allocations, not cane yield or sugar quality. Where public-private exchanges
did occur, they tended to involve particular millers or planters, on the one hand, and individual legislators, some of whom were sugar producers themselves, on the other. This shifted briefly in the mid-1970s when, confronted with market volatility and the loss of preferential access to the U.S. market, Marcos proposed a state-sponsored export organization as a means to improve market and pricing coordination. Growers and millers welcomed the proposal, in part out of mistrust of the private traders traditionally managing exports.

However, after this mechanism (Philsucot) became a rent-generating machine for Marcos and his cronies, consultation was replaced by top-down decisions. In contrast with Thailand’s “competitive clientelism,” Marcos practiced “monopoly clientelism,” which discouraged competition, terminated consultation, made a mockery of credible commitments, and made monitoring impossible. In addition to the direct costs to producers of such practices, the arbitrariness and uncertainty they created deterred new investments. Under martial law, sugar interests kept their heads down and tried, mostly without success, to avoid predation.

Since the end of martial law in 1986, consultation both among sugar interests and between them and state officials has improved but been sporadic. The key government sugar agency, the SRA, is responsible for coordinating R&D, for extension services, for issuing licenses to traders, for managing the quedan system, and for monitoring the industry’s operations. But its capacity for monitoring the large number of actors in areas such as wage-law compliance, quota management, illegal sugar sales, imports, and (most critically) quedan distribution is minimal at best (Billig 2003). Indeed, it is the ongoing and myriad grower-miller conflicts built into the quedan system that occupy and overwhelm the SRA.

This state of affairs reflects weakness and fragmentation within both the public and private sectors. Despite having a staff with many PhDs in agricultural sciences, the SRA exhibits both “institutional bloat” and internal conflict reminiscent of problems in the Thailand Cane and Sugar Board (Billig 2003, 67, 113). The SRA’s problems in turn reflect conflicts within the private sector, exemplified by disputes among umbrella planters’ federations over representation on the SRA’s board. More broadly, conflict within and among sugar associations—what Billig terms “groupism”—has been rampant. This fragmentation reflects not only a tradition of personalistic organizations but also
real distributional differences pitting planters against millers and, increasingly, both against traders (many of whom are ethnic Chinese). With sugar industry meetings “frequently ending in greater disharmony than when they started” (Billig 2003, 231), the industry’s emphasis is on short-term advantages obtained through particularistic lobbying or through the direct exercise of political power. As one official described it, “We solve the lobbying problem here by putting people from our group into Congress to represent our interests directly” (Larkin 1993, 231).

Two other factors have further impeded organizational cohesion in—and commitment to—upgrading by the industry. One is the tendency among large planters to diversify out of sugar into areas such as media and real estate, thus weakening their commitment to the industry overall. The other is the political weakness of perhaps the principal Philippine-based source of pressure for higher cane and sugar quality—namely, the large food processors, including multinationals, such as Del Monte, Kraft, Pepsi, and Coca-Cola, for whom sugar is a key input. In part because they are multinationals in a country sensitive to pressures viewed as neocolonialist, these firms must work behind the scenes, often through domestic food producers, when it comes to pressing for easier sugar imports or improvements in local productivity (Billig 2003). The result of all these factors is a persistent inability to address collective-action problems, including improvement of cane yields and milling efficiency and, most critically, reform of the quedan system. This system has endured, despite significant support for a change on the part of powerful sugar interests and extensive research by the World Bank and others demonstrating the superiority of the cane-purchase alternative (Billig 2003).

Elite Political Competition
This reinforcing public-private institutional fragmentation reflects a broader and persistent pattern of elite relations, in which extra-bureaucratic power dominated what Paul Hutchcroft (1994) has described as a weakly institutionalized state, one “more often plundered than plunderer.” Historically, this state has generated rent not for the bureaucratic elite within the state but for oligarchic forces with a strong base outside the state, who nevertheless rely on particularistic access to state-related political machinery (Hutchcroft 2000). With the exception of the martial law period, these elites have dominated the state through parties that, via the legislature, have functioned largely as channels for particularistic demands on the bureaucracy. As Anderson (1988)
noted, the Philippine political system has been a democracy, but a “cacique democracy” (see also Hutchcroft 2000, 219). Martial law, for its part, represented the consolidation of power by a particular group of interests led by Marcos. This centralization of power involved “a greater degree of purposive rent allocation” but little if any “enforcement of larger performance criteria” (Hutchcroft 2000, 227; see also Doner 1991). The state has been, as a result, swamped by oligarchic demands and incapable of playing a coherent role in economic development (Hutchcroft 1994).

Systemic Pressures
The “technical inefficiency and institutional stasis” of the Philippine sugar industry, as well as of the country’s broader governance context, are the results of the strikingly permissive environment in which elites have operated. External factors have “been an obstacle—not a catalyst—for change” in the Philippines (Hutchcroft 1994, 233). With the exception of World War II, when the Japanese seized control of the Philippines from the United States, Filipino elites have had no real threats to their power and privileges from external forces. Under colonialism, the United States reinforced these privileges, both political and financial, by focusing on the construction of representative institutions through which elites maintained dominance. The Cold War brought guarantees of military assistance, foreign aid, and preferential market access for sugar exports. The overall pattern has been one in which the state, “while plundered internally…is repeatedly rescued externally” (Hutchcroft 1994, 226).

Ties to the United States thus also provided resources that weakened the incentives of political leaders to build broad coalitions of support and strengthen institutions. In general, agricultural resources provided an important basis for growth during much of the twentieth century, with sugar accounting for roughly one-quarter of the country’s total exports from the late 1940s until 1974, when the Philippines’ preferential access to the U.S. market ended (Larkin 1993). The lure of the U.S. market has been particularly pernicious in discouraging institutional strength and focus on upgrading. Larkin demonstrates, for example, that the Philippine Sugar Association’s early technical focus was soon submerged by efforts to ensure continued access to the U.S. market. In the late 1920s to early 1930s, by illustration, the PSA levied an assessment on its members not to support technical improvements but to finance a U.S. office lobbying for market access (Larkin 1993).
Popular discontent, a second dimension of systemic pressures, has not been absent in the Philippines. Organized rural protests were led first by the People's Anti-Japanese Army (Hukbalahap) after World War II and subsequently by the New People's Army (NPA) in the 1970s and 1980s, but these pressures were not threatening to the established political order. The Huks never had a strong impact outside their central Luzon heartland, “especially not in the sugarlands of the western Visayas” (Larkin 1993, 241). While the NPA was active in Negros, the main sugar island of the Visayas, elites responded through small side payments, localized electoral mobilization, localized repression, and simply exiting the countryside for the safer confines of Manila (Kerkvliet 1979).

Productivity improvements were not part of the response. Indeed, the relative weakness of popular pressures has allowed cheap labor to remain the key competitive advantage for Philippine sugar producers and a de facto obstacle to upgrading. An illustrative case in point was the short lifespan of industry and government interest in agro-mechanization in the face of the 1970s market volatility. Overseas study trips and research on mechanization of planting, weeding, loading, and harvesting prompted local entrepreneurs to begin marketing new equipment, but with labor abundant and wages low, the effort was halted, “even reversed” (Billig 2003, 68).

II. Brazil

Policy Tasks
Brazil has been able both to expand sugar production and to operate as one of the world’s most efficient producers (USDA FAS 2003). This performance in turn reflects successes in at least four policy areas, the first of which involves property rights. Although sugar production began in the Northeast Region, over 80 percent of Brazil’s sugar now comes from the central and southern parts of the country, especially the state of São Paulo. In addition to favorable climate, terrain better suited to mechanization, and proximity to major urban markets, this area has benefited from a particular ownership pattern. Unlike in the Philippines, large capital-intensive mills in Brazil own much of the land on which sugarcane is grown, with the rest owned mostly by large-scale sugarcane farmers who displaced small holders. The millers (usinieros) also control much of the entire upstream-downstream production process,
including “supply and manufacture of agricultural and industrial inputs, cane cultivation, and sugar and alcohol refining and marketing” (Nunberg 1986, 63). This has given them strong incentives to expand as well as improve sugar production since profits from these changes go mainly to them rather than having to be shared with planters as in the Philippines.

Risk socialization in Brazil has been more performance oriented than in the Philippines. The military government that took power in 1964 gave high priority to improving agricultural as well as industrial productivity, and sugar was a major focus of this strategy. Government funding was central to the rapid growth of the modern São Paulo sugar complex (Barzelay 1986). The regime’s policies included making it easier for mills to relocate to the central and southern regions, building bulk-loading facilities at ports, and giving mills loans to modernize with negative interest rates and flexible repayment schedules (Nunberg 1986).

These incentives eventually led to overcapacity, especially when world sugar prices collapsed in 1975 and export markets disappeared. The Brazilian strategy was to relieve the problem initially through state-based repression of small farmers and unemployed workers in the Northeast and subsequently by converting surplus cane into alcohol (Nunberg 1986). Driven by foreign-exchange shortages and fears of popular protests (discussed below), President Geisel promulgated the National Alcohol Program (Proálcool) in 1975 with the goal of saving foreign exchange by using alcohol to supplement gasoline supply (Barzelay 1986). Success of this policy required growth of downstream demand for sugar-based alcohol. Such demand emerged when the auto industry, concerned with fuel shortages during the Iran-Iraq War, committed to building engines capable of using alcohol. With the growth of alcohol-powered automobiles, Proálcool became irreversible. This solution to the overproduction crisis created a major alternative to exporting sugar and has continued to give Brazil flexibility in world sugar markets that no other major sugar-exporting nation has. Sugarcane can be diverted to the production of sugar or alcohol depending on relative world prices of sugar and oil.

Brazil has also gone much further than the Philippines in promoting research and development to improve sugarcane yields and the efficiency of converting cane to sugar, as well as ethanol production and related products. In the mid-1960s, Brazilian sugarcane yields were around forty-two tons per hectare (Wilkinson and Sorj 1992), but by 2005 they had risen to
around seventy-two tons per hectare (USDA FAS 2005). Initial programs to improve cane yields and milling efficiency came from the state, especially the São Paulo State government (Martines-Filho, Burnquist, and Vian 2006). By the end of the 1970s, these efforts were dwarfed by the highly successful programs of the Canavieira Technology Center (CTC), a component of the largest private sugar cooperative in the South and Southeast, Copersucar. Since the end of the 1960s, the center has developed new cane varieties, technologies for ethanol production, new products (such as biodegradable plastic), technologies for biomass electricity co-generation, and mechanical innovations (such as modified harvesters). The CTC has also benefited from state (São Paulo) investments in basic research and molecular genetics as well as cane breeding (Martines-Filho, Burnquist, and Vian 2006). Overall, these efforts resulted in rising yields of cane per hectare; increased yields of sugar per ton of sugarcane, with Brazil now a world leader in converting cane to sugar (USDA FAS 2005); and striking progress in ethanol production, with 2006 real ethanol prices at less than a third of 1975 levels (Martines-Filho, Burnquist, and Vian 2006). Ethanol production, which in 2005 consumed over half the total sugarcane produced, has provided the sugar complex “a solid domestic and international market foundation” (Martines-Filho, Burnquist, and Vian 2006, 93).

**Institutional Capacities**

Brazil’s success in upgrading its sugar industry reflected explicit efforts to expand institutional capacities both within and between public and private sectors after 1964. This was, however, part of a longer, uneven process of change in the governance of the sugar industry. In the 1930s the government created a semiautonomous organization, the Sugar and Alcohol Institute (IAA), to coordinate sugar production and marketing and to channel excess sugar into alcohol production for industrial uses. Barbara Nunberg (1986, 44) describes the IAA as initially functioning as a “corporatist” organization through the 1950s but then transforming into a case of “extreme political clientelism” as a result of its commitment to protecting the incomes of Northeast sugar producers.12

As opportunities and pressures for exports grew, and as sugar production migrated to the more fertile central and southern regions, the IAA’s functionality declined (the organization was disbanded in 1990), replaced by a system whose core components were highly organized producers’ cooperatives,
based in São Paulo, and a more centralized state. These cooperatives, especially Copersucar, emerged as “the model for Brazilian agricultural development under the post-1964 military regime” (Nunberg 1986, 63). Copersucar’s initial focus was on marketing and finance, but it gradually expanded its functions to include packaging and distribution of its own brands; processing and distribution of other commodities, including coffee; and as noted above, extensive research and development. By the late 1970s, it represented 86 percent of the millers in São Paulo, and these millers produced over 40 percent of the country’s sugar. In stark contrast to the Philippine case, the cooperative had close ties with local manufacturers of industrial inputs for sugar cultivation, refining, and harvesting (Nunberg 1986).

Not surprisingly, the cooperative had a strong voice in sugar policies, including price controls and, most critically, alcohol production. Indeed, its members became the “new channels of interest intermediation” and, together with the state, constituted “a new centralization of policymaking in sugar” (Nunberg 1986, 78). Copersucar “proposed an enormous expansion of state-controlled alcohol production to help alleviate the balance of payments deficit incurred largely by soaring oil prices” (Nunberg 1986, 65). The result, after extensive consultation, was the Proálcool, established in 1975.

Two particular features of Proálcool merit note: all of its production processes were left in private sector hands, but the expansion of private sector distilleries was “the direct result of an extremely attractive credit programme” based on government financing estimated to constitute a subsidy of up to 75 percent of construction costs (Saint 1982, 227). Adopting this kind of program faced opposition from competing interests in the state, including the Ministry of Agriculture, the state oil company (Petrobras), and the IAA. The coalition that overcame these interests involved large-scale sugar interests, represented by Copersucar; producers of agricultural equipment; the auto industry (concerned about sales decline in the face of rising oil prices); and state financial agencies, including the Central Bank and the Ministry of Finance (which allocated resources to other government agencies, managed price controls, and supervised and managed macroeconomic policies important to agriculture). New channels of interest intermediation, involving personal connections between Copersucar leaders and financial officials, as well as direct access to the president, were important mechanisms of policy development (Helfand 1999; Saint 1982; Barzelay 1986).
Nevertheless, even in the late 1970s after its basic parameters were established, Proalcool suffered from “weak programme vision, vague institutional definition and organizational restrictions” (Saint 1982, 227). In response, the Brazilian president committed the government to “strengthening the institutional basis” of the program by improving coordination, setting priorities, refining credit policies, and “monitoring programme progress and proposing remedial action as necessary” (Saint 1982, 228). Reinforcing these efforts was a broader process of state-led institutional reform in the sugar industry’s governance. As part of what Nunberg calls an “ambitious program of technical modernization” (1986, 73), the government first undertook an administrative reform of the IAA that involved reducing the organization's autonomy, infusing it with technocratic norms, recruiting technocrats into key positions, and placing military personnel in top leadership. In subsequent centralization, many IAA functions were shifted into policymaking bodies of the state itself, but in what corresponds closely to Peter Evans’s (1995) “embedded autonomy,” many of the IAA’s functions were also taken over by the private sector cooperatives (1995), such as Copersucar (Nunberg 1986).

**Elite Political Competition**

Low levels of political competition under military rule facilitated the policy initiatives and institutional reforms central to the upgrading of sugar production in Brazil. Although many parts of the Brazilian bureaucracy were weakly institutionalized, fragmented, corrupt, and staffed with patronage appointments, the state had important strengths. The macroeconomic agencies, especially the Brazilian Development Bank (BNDES), were politically protected and staffed by skilled technocrats with a “developmentalist mentality” and key roles in spending decisions for the agricultural sector (Schneider 1991, 36; Helfand 1999). Additionally, the military regime could use appointments to give the unwieldy bureaucracy “dynamism and structure” (Schneider 1999, 291). This appointive bureaucracy could be used to “structure access and representation for societal groups,” disrupting those the military wanted weakened and facilitating representation for those whose goals meshed with those of the regime (Schneider 1999, 297). The large sugar producers, represented by cooperatives such as Copersucar, were clearly beneficiaries of this system. Smaller, independent cane suppliers, along with workers subject to military repression, were the major losers (Nunberg 1986; Saint 1982).
Why did the Brazilian military not use its public power for private ends, as occurred in the Philippines under Marcos? Part of the reason stems from the fact that the Brazilian regime had more autonomy from producer groups than did the oligarchic Philippine state under martial law. Why then, unlike Marcos, did the Brazilian military also use its autonomy to strengthen the collective capacity of private sugar interests? Indeed, for all its statism, the Brazilian military relied on private actors, whereas Marcos’s crony ruled the industry through a state marketing organization. Part of the answer to this lies in the emergence of large sugar producers in the central and southern regions, to the detriment of Northeast Region producers and smaller central and southern producers as well. Equally, if not more important, groups such as Cooper-sucar constituted both the embodiment of the military regime’s developmental vision of an agro-industrial transformation of Brazilian agriculture and the actual mechanism of this transformation (Barzelay 1986; Nunberg 1986; Schneider 1999). But this still leaves the question of why the Brazilian military, unlike Ferdinand Marcos, was so intent on such a transformation.

Systemic Pressures
The key theme running through accounts of Brazil’s sugar industry is perceived vulnerability. Brazil’s initial and short-lived initiative in sugar-based alcohol production in the 1930s “was formulated as an explicit response to the excessively vulnerable position in which the Brazilian sugar industry found itself in the aftermath of the world market disaster of 1930” (Nunberg 1986, 56). There was little need for an expansion of production or innovative alcohol programs through the 1950s, given low opportunities for exports and the need to maintain an adequate supply of sugar for domestic consumption. New opportunities emerged in the 1960s when Brazil captured a significant share of Cuba’s sugar quota, which had been canceled by the United States. From 1959 to 1968, Brazilian exports to the United States jumped from 12,000 to 615,000 metric tons (Nunberg 1986).

The puzzle is why, unlike the Philippines, which also benefited from a larger U.S. market, Brazil not only expanded exports but also transformed its institutions to upgrade its entire sugar product structure. The answer lies in the ways in which these new opportunities coexisted with, indeed were superseded by, a series of threats to the Brazilian economy, especially to the industrializing project of the country’s military rulers. In the 1960s,
exports of sugar, as well as of other primary commodities, became increasingly important as a source of foreign exchange to finance imported inputs for the military's import-substituting industrialization (ISI) project. At the same time, exports were viewed as a solution to the chronic overproduction crises to which sugar producers were vulnerable (two such crises took place in 1964–65 and 1967). The state thus initiated a major export thrust in sugar, but as Nunberg (1986, 59) notes, “such a policy posed heightened risk of vulnerability and dependence—precisely the conditions that state intervention had sought to mitigate when it first began in the 1930s.” As such, this was not just an export shift. It instead meant that “the entire system of production and administration of the sugar sector would have to be transformed to meet competitive world-market standards…. In consequence, the state undertook a massive modernization program and attempted to alter its long-standing policies of subsidizing noncompetitive producers.”

Concretely, this program of technical modernization included mechanization, better cane varieties and infrastructure, improved financing, and industry (especially mill) rationalization through mergers, relocations, and incorporations. But the government “was burdened with an institutional apparatus that had not kept pace” with the sector's changes and the distributional and information challenges inherent in the modernization program (Nunberg 1986, 57). The state response was the administrative reform process discussed above.

Pressures for upgrading—specifically into alcohol (ethanol)—intensified in the following two decades. At the sectoral level, sugar producers sought alternative outlets for sugar in response to increased export competition from sugar substitutes and European sugar beet producers in the 1970s and early 1980s. The most critical factors were national—the military's growing concern with petroleum dependence and external imbalances, and the potential of sugar-based ethanol to offset petroleum imports.

Ethanol production…was a minor activity in Brazil until the 1970s when the sharp rise in oil prices threatened the military dictatorship's ability to rule. At the time 90% of the gasoline was imported, causing fuel shortages, inflation, current account deficits, and diminished hard currency reserves. By 1975, sugar prices fell sharply in the international market. At the same time, oil importing countries suffered from significant price hikes…Brazilian imports and balance of payments accounts were strongly impacted by this oil price increase, leading the government
to launch the Proalcool program at the end of 1975. (Martines-Filho, Burnquist, and Vian 2006, 93)

The second oil shock of 1979 stimulated an expansion of the program, which had the added potential benefits of raising rural incomes and employment (Saint 1982; Barzelay 1986). The Iran-Iraq War, which began in 1980, further encouraged the program and helped push conflicting ministries and agencies, as well as private sector actors, toward a commitment to the program.

By the late 1980s, the level of state intervention in the sugar industry had declined significantly. Ethanol prices were deregulated; the state “Cane, Sugar, and Ethanol Official Harvest Plan” was discontinued; and a 40 percent tax on sugar exports exceeding a set quota was eliminated (Martines-Filho, Burnquist, and Vian 2006; Sheales et al. 1999). This liberalization was in part because the debt crisis undermined the state’s ability to sustain financial support; because agriculture had declined as a source of foreign exchange, from 81 percent in 1965 to 38 percent in 1985; and because the democratization process, beginning in the late 1970s, undermined the corporatist and sometimes clientelist policy institutions operating under the military (Helfand 1999). But Brazil’s continued success in sugar exports and ethanol production under more liberalized conditions reflected policies and institutions put in place in the face of more challenging conditions in preceding decades.

III. Conclusion

The sugar industries reviewed in this chapter constitute a hierarchy of performance: deterioration in the Philippines and comprehensive upgrading in Brazil. This cross-national variation — as well as longitudinal variation within each country — reflects institutional capacities and underlying systemic pressures. With minor exceptions, sugar production in the Philippines has been governed by fragmented (“groupist”) producers dominating poorly staffed and highly politicized state agencies (Philex, Philsucom, SRA). Under these conditions, particularistic clientelism aimed at securing quota rents, not collective consultation, has been the norm. In Brazil, we have seen a centralized state engaged with organized sugar interests — producer cooperatives — in a deliberate project of agro-industrial transformation.

This cross-national variation reflects important variation in the pressures facing political elites. In the Philippines, localized popular resistance, Cold
War security guarantees and aid, and preferential market access allowed societal elites to plunder the state, a process epitomized by crony use of a state monopoly to weaken an already stagnant sugar industry. Conversely, for the Brazilian military rulers, sugar was a critical source of foreign exchange for ISI-based capital accumulation. Given the competitive pressures in global sugar markets, reliable exports required upgrading of cane varieties and mechanization. The potential of sugar-based ethanol as an alternative to expensive petroleum exports further intensified the pressures for true agro-industrial transformation in sugar.

The importance of systemic pressures can also be seen in “blips and pockets” of institutional strength within countries. In the Philippines, a brief episode of collective consultation and monitoring occurred only in the mid-1970s when the country lost preferential access to U.S. sugar markets. More sustained pressures in Brazil translated into consistent institutional strengthening in sugar. The Brazil sugar case is interesting as a distinct “pocket” of efficiency in an otherwise fragmented set of institutions operating not just at the national level but in agriculture more broadly (Helfand 1999, 8).

Finally, these cases suggest that systemic pressures constitute a more powerful explanation of institutional and sectoral performance than do arguments based on path dependence and on more proximate political factors. One might justifiably argue that the Philippines’ problems stem largely from the “stickiness” of the quedan system. In this view, the norms, interests, and arrangements associated with this system blocked its demise even in the face of clear evidence that cane-purchase arrangements could save the industry from catastrophe (Billig 2003, 144). But in the absence of significantly different pressures on political elites, it is difficult to know how sticky an institution is; and Billig’s own (1993) historical account of the “Death and Rebirth of Entrepreneurism” in the Philippine sugar industry indicates the impact of shifting incentives on even long-standing cultural practices. Similarly, the lack of systemic pressures in the Philippines facilitated a crony-based monopoly operating not through traditional private arrangements but rather through a set of state-backed institutions. Conversely, the Brazilian military’s willingness and capacity to essentially do away with the IAA, an organization central to Brazilian sugar and rooted in powerful agricultural interests, even as the same military opted to support private sugar producer cooperatives as the embodiment and mechanism of agro-industrial upgrading, provides further
evidence for the likelihood of institutional change when political elites face significant threats.

Finally, systemic factors also trump proximate political arrangements, including regime type and electoral competition, as explanations for institutional change and sectoral performance. Authoritarian regimes in both the Philippines and Brazil resulted in distinctly different institutional capacities and sectoral performance. A key source of this difference lies not in some essentialist Brazilian capacity for efficient institutions but rather in pressures on military elites for politically legitimizing efficiency. This is to argue that concentration of authority in the absence of systemic pressures yields few developmental benefits. Political arrangements are often themselves the result of systemic pressures.

Notes
1 This chapter is drawn from chapter 5 of Doner (2009), coauthored with Ansil Ramsay.
2 We are grateful to Michael Billig for comments and corrections on earlier drafts of this section.
3 Mills were originally located on each sugar-growing hacienda and owned by planters. Between 1914 and 1927, some 820 hacienda-based, old-style iron mills were replaced by seventeen highly efficient centrifugal mills that could extract 85 percent of the juice from cane compared to 40 percent for the older hacienda mills. These seventeen new mills, owned by consortia that included Americans, were built in response to the establishment of free trade in sugar between the Philippines and the United States. It is important to note that quota shares to the U.S. market were allocated to individual mills, which in turn allocated the shares to planters in the mills’ districts (Hawes 1987, 86–87; Billig 2003).
4 Philippines sugar entered the United States free of duty from 1913 until 1934, when duties were imposed on Philippines sugar. Duty-free quotas were reestablished in 1946, expanded in 1961 (in part due to the nationalization of Cuban sugar in 1961), and then ended in 1974 (Hawes 1987, 90–94). On quotas and their impact, see also Billig (2003, 54–55; 1993, 125) and McCoy (1983, 141).
5 By the mid-1980s, twenty-two of the forty-one mills “had lost so much money that they were, in effect, controlled by the Philippine National Bank” (Hawes 1987, 96).
This review draws on Billig (2003) and personal communication from Michael Billig, December 20, 2006, for which we are grateful.

Institutional fragmentation within the industry is far from recent. Larkin (1993, 161) describes the inability of the PSA to represent planters, who formed their own association in the 1920s.

Unless noted, this review draws on Hutchcroft (1994, 223–33).

Sugar has been grown in the Northeast since the sixteenth century, when Brazil was a Portuguese colony. The Portuguese used African slaves as workers on large, Portuguese-owned plantations. While this region was still Brazil’s dominant sugar-producing region into the early decades of the twentieth century, it now produces less than 15 percent of Brazil’s sugar. Many mills there are small, use obsolete machinery, and rely on farmers who produce low yields of sugarcane (Nunberg 1986, 57–68). (Unless noted, this review draws on Nunberg.)

The auto industry has since switched to manufacturing flex-fuel engines that can run on either ethanol or gasoline (Barzelay 1986, 198).


The IAA “initially tread[ed] a fine line between cooptation and control of producing elites.”

Unless noted, this account draws on Nunberg (1986), especially page 57.

Billig’s explicit struggle with alternative explanations for the persistence of an inefficient arrangement constitutes a model of intellectual honesty.

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