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RESUMEN

Este estudio busca comprender el comportamiento de las elites económicas en el tercer mundo. Debido a que las elites concentran la propiedad del capital físico en la sociedad, sus acciones tienen influencia en las condiciones de vida de las masas. Sin embargo, la literatura sobre las elites es limitada. Este estudio intenta proponer avances en este tema. El comportamiento que se enfatiza es el de la inversión en capital social. Se propone una teoría sobre la lógica económica de las redes sociales. La teoría predice que la acumulación en capital social depende de los mismos factores que determinan la acumulación en capital físico. Por lo tanto, las elites económicas no circulan de manera endógena. Se examina el caso del Perú y se encuentra consistencia empírica con las predicciones de la teoría. La conclusión del estudio no coincide con el optimismo que se pone usualmente en el capital social como el instrumento que haría posible el desarrollo económico de las masas.

ABSTRACT

This study aims at understanding the behavior of economic elites in the Third World. Because economic elites concentrate the property of physical capital in society, their actions influence the living conditions of the masses. The literature on the elite's behavior is, however, very limited. This study is an attempt to take some steps to fill this gap. The behavior that is emphasized is the investment in social capital. A theory of social networks is thus proposed. A prediction of the theory is that the accumulation of social capital depends on the same set of factors that explain the accumulation of physical capital. Therefore, the economic elites do not circulate endogenously. The case of Peru is examined in the light of this theory. The results show consistency with the predictions of the theory. The conclusion of this study is not in accord with the usual optimism laid down on social capital as the instrument for economic development of the masses.

ECONOMIC ELITES AND SOCIAL CAPITAL [*]

Adolfo Figueroa

Is the degree of social mobility higher in the First World than in the Third World? In order to answer this question one has to establish the social strata under analysis. It is one thing to observe mobility from rural to urban areas, or mobility from white-collar workers to blue-collar workers; it is another to observe mobility from any place in the social pyramid to the top. This study is concerned with the latter process.

Is there a circulation of elites or are they protected against new entrants? Is this protection based on natural barriers or are they constructed by the elites? In general, what do economic elites do in order to maintain their social position? Such are the questions that this study intends to answer.

In order to understand the behavior of economic elites, they must be historically situated. The intention of this study is to analyze the elites' behavior in today's Third World countries. For this purpose, the economic elites will be placed in an abstract society that is socially heterogeneous and hierarchical, and also overpopulated—called the sigma society. This theoretical construction is meant to represent the general case of Third World countries, especially those with a colonial heritage.

Empirical studies on the economic elites of the Third World are very scarce. By contrast, poverty is the theme that dominates the literature on the Third World. As a first approximation, this study analyzes the case of Peru.

The paper content can be summarized as follows. The first four sections deal with theoretical questions. The particular form of functioning of the sigma society is summarized in section 1. Then a theory on the behavior of the elites of a sigma society is discussed in sections 2 to 4. A set of empirical hypotheses is then logically derived from this theory. Section 5 presents

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the empirical confrontation of the hypotheses with the Peruvian experience. The paper ends with a section of conclusions.

1. THE SIGMA SOCIETY[1]

Sigma is an abstract society. It is a heterogeneous and hierarchical society. People participate in the economic process endowed with unequal quantities of economic and social assets. Economic assets include physical capital and human capital. Physical capital is highly concentrated in a small group of individuals, the capitalist class. Human capital is also concentrated in a small group of workers, the middle class.

Social assets include political assets and cultural assets. Political assets refer to citizenship, which gives individuals rights and duties. Due to inequality in the distribution of political assets, a hierarchy of citizens is created in society. There are first-class and second- class citizens. Not all individuals are equal before the law; not all individuals have the same access to public goods supplied by the state.

Sigma is a multiethnic society. Individuals belong to different ethnic groups, which differ in race, language, religion, origin, costumes and so on. Ethnic groups do not have the same social valuation, but they are ranked according to a hierarchy that is historically determined. According to their group of affiliation, this hierarchy gives individuals social assets, which will be called cultural assets. These assets are called cultural because they are based on social beliefs, are learned and transmitted from generation to generation. Inequality in cultural assets implies that some people have social prestige while others suffer social stigma, which leads to discrimination and segregation. People are not like atoms; individuals are socially situated. Children may be born in the wrong families.

In sigma society those individuals who are endowed with larger quantities of physical and human capital are also endowed with more quantities of political and cultural assets. Thus in sigma society there is inequality in the initial distribution of economic and social assets, which implies the existence of groups with different social status in society. Sigma is not only a heterogeneous society, but also a heterogeneous society with a hierarchical structure. The question is whether this initial inequality reproduces itself or changes in the process of economic development.

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[1] This is a summary of the material published in Figueroa (2001).

Sigma society is overpopulated. Therefore, economic equilibrium implies excess labor supply in the labor market, which take the form of unemployment and underemployment. Due to their low human capital endowments, the socially excluded are not part of the labor supply in the labor market. Economic equilibrium also implies income inequality, not only between capitalists and workers but also among workers. Those workers with the lowest endowment of social assets make up the poorest group.

Inequality is reproduced period after period because sigma society operates with economic and social exclusions. Most workers are excluded from the labor, credit and insurance markets. Hence, they cannot accumulate capital, physical or human. Because these three markets play a significant role in the reproduction of inequality, they are called basic markets. In the market system, there is a hierarchy of markets. The poor also face blockages to accumulate human capital via public goods because the system operates with political and cultural exclusions. As a result, the poor are the socially excluded, and the socially excluded are the poor. In other words, the poor are people not only with low incomes but also ethnically different. Poverty has skin color, language, gender, and so on.

As in the case of economic assets, social assets are stocks and can be accumulated. But workers cannot accumulate social assets because the system functions with exclusions. Social mobility will not be the general rule in sigma societies.

As to empirical consistency of sigma theory, Third World countries with a colonial legacy tend to resemble the sigma society. Empirical predictions of sigma theory are particularly consistent with the most notable facts of Latin American countries.

Sigma theory also predicts a very low social mobility in society. But there is no empirical evidence to support this hypothesis; that is, little is known on the intergenerational social mobility in the Third World.

In the First World, surprisingly, our knowledge on the degree of social mobility is still under debate. Theoretically, in a socially homogeneous society (an assumption proposed here to study the First World), social mobility should be very significant. Empirically one should expect that individuals should not inherit their position in the income distribution. The transition matrix between generations should tend to show a random distribution of incomes. The income distribution process should be similar to the biological process that Francis Galton (an English scientist, 1822-1911) studied regarding the relationship between the heights of children and those

of their parents. As we know, Galton showed that with the passage of time "there is regression towards the mean;" that is, over the generations heights tend toward equality.

Initial empirical studies on intergenerational incomes of children and parents tended to show that, in fact, the correlation between these incomes was very low. Based on studies in Europe and the United States, Gary Becker concluded, "Regression to the mean in earnings in rich countries appears to be rapid... In all these countries, low earnings are not strongly transmitted from fathers to sons" (cited in Solon 1992, p. 394).

A study based on a sample of Connecticut (USA) residents, which used the transition matrix approach, showed that generally children assume their parents' position in the income distribution (Menchik 1979). More recent studies for the case of the United States indicate that the correlation is positive and much higher than what previous studies calculated (Solon 1992, Zimmerman 1992). The conclusion of these studies is that intergenerational income mobility in the United States is much weaker than previous estimates had suggested.

But, what can be said about the social mobility in the Third World? In particular, is there social mobility towards the top of the income pyramid in the Third World? On The latter question, sigma theory has much to say, but it needs to be worked out fully. This is done in this paper.

2. ECONOMIC ELITES IN SIGMA SOCIETY

In the standard literature, elites are defined as those social groups at the top of any rankable social-power scale (Bodly 1999, p. 596). The rankable scale may include various types of assets, such as economic, political, or cultural. Elites are important to understand society because they have social power.

Social power refers to a group of individuals' ability to impose their will on others. This is Weber's well-known definition. In this definition, however, power is unconstraint.

In economics, by contrast, social power is not unconstraint. Take the case of the theory of the monopolist. The monopolist acts guided by a motivation—the maximum profits—and has the ability to impose a market price to consumers, but subject to the constraints of demand conditions and cost of production conditions. These conditions are not under the control of the monopolist. Actually, given these constraints and given the motivation of profits maximization, the monopolist

will not set any market price he feels like to choose; he will be compelled to choose what is good for him. There will be one and only one price that will satisfy his goal of profit maximization. If demand or production conditions change, the monopolist will choose another price.

The monopolist case shows that power structure may be exogenous to the economic or political process, but the particular actions taken to exercise that power are endogenous. In this study, social power of the elites will be considered as a constrained power. The Weberian definition will include now the actions and reactions of the people that the elites seek to impose their will upon. Also power has a purpose. The elites are prisoners of their goals.

Bottomore proposed many years ago a theoretical hypothesis about the elites. His assumption was that in every society there is, and there must be, a small group that rules over the rest of society. This group is the elite (Bottomore 1964).

But, why are the elites small groups? In his classic study on political elites, Mosca presented an interesting empirical hypothesis: the size of the political elite does not increase proportionately with the size of the society. Therefore, the proportion of the governing body to the total population will decline as population increases. This relationship implies that the power of the political elite will also rise as population increases. However, Mosca did not explain the reasons behind his empirical hypothesis.

A theoretical proposition that has been advanced in the literature is based on biology and bio-cultural processes. Memory restricts the number of people who can rule. Information management and decision-making are inherently more difficult in large groups. This is summarized as follows: "If members of a decision-making elite must interact with each other face-to-face, we would expect that it never exceed 500 people, regardless of the total size of a society…. Political elites necessarily become a smaller, more powerful proportion of any society as scale increases, just as Mosca predicted" (Bodley 1999, p.596).

The same principle should apply to economic elites, Bodley has argued. As we know, Pareto defined the economic elite by the concentration of economic resources. Therefore, "the Pareto elite will almost invariably be a proportionately smaller and powerful minority as either the scale of society or its wealth increases" (Bodley 1999, p.596).

If elites exist and are small, the implication is that the only change that elites can undergo is the change in membership over time. This is called "the circulation of elites" hypothesis. How

could this happen? "The elite undergoes changes in its membership ordinarily by the recruitment of new individual members from the lower strata of society, sometimes by the incorporation of new social groups, and occasionally by the complete replacement of the established elite by a 'counter elite', as occurs in revolutions" (Bottomore 1964, p.12). Bottomore is referring here to the concept of a political elite, but it can also be applied to economic elites. Accordingly, an economic elite is a small group that rules over the rest of the society in the economic process.

In the political science literature, it is usually proposed that political elites are able to affect political outcomes regularly and substantially (Higley and Gunther 1992, p. 8). Similarly, one could propose that economic elites determine the income of many people because they concentrate so much physical capital and income in the form of profits. The behavior of the economic elites regarding the use they make of profits—consuming, investing abroad, investing domestically—affects the level of incomes of the masses regularly and substantially. In complex and modern societies, the exercise of economic power and its consequences operate through the market system. Thus, economic power under democratic capitalism is impersonal, unlike slavery and feudal systems.

The set of assumptions proposed by Bottomore—the elites exist in every society and are made of small groups—is also part of the assumptions of sigma theory. One needs only to substitute the category of elite by the category capitalist class. Thus, the categories capitalist class and economic elites will be used interchangeably in this study.

Sigma theory predicts the existence of an economic elite, which tends to be small and has economic power. But contrary to Bottomore's theory, sigma theory predicts that the circulation of the elites is not endogenous. In other words, sigma theory would be refuted if we observed the following regularities in capitalist countries:

(a) If elites or capital concentration does not exist;
(b) If elite actions have no consequence for a large segment of the population;
(c) If the size of the elite (once it is empirically defined) increases in proportion, or more than in proportion, to the population increase;
(d) If circulation of the elites occurs over time.

On the motivations of the economic elites, the assumption proposed in sigma theory is that economic elites in capitalist societies seek not only to maximize profits but also to maintain their privileged position in society; moreover, between these two objectives, elites have lexicographic

preferences, where maintaining the social position has priority. They prefer more profits to less profits, but without loosing social position; that is, they are not willing to trade more profits for less social position.

What are the mechanisms that reproduce the elites' privileged position in society? According to sigma theory, this is done through various mechanisms of exclusion:

(a) The economic elites invest in projects that have high returns but high risks because they have the economic capacity to bear high risks.
(b) They use the insurance market to protect their capital stock against insurable risks.
(c) In addition to profits, they can use the capital market to finance investment.

The first mechanism comes from the elites' initial endowments of physical capital. The large size of their wealth gives the elite a significant economic advantage over the other groups. Mechanisms (b) and (c) refer to market exclusion. In particular, credit and insurance markets operate with exclusions. Workers are excluded from these markets because they do not own sufficient capital stock to participate in these market transactions. Hence, the market mechanism helps the wealthy to maintain their relative position. Social mobility is blocked by the mechanisms of market exclusions. Market exclusions facilitate the social reproduction of the economic elites. Market exclusions can then be seeing as "natural" barriers to social mobility because they are built in the economic process.

3. THE ROLE OF SOCIAL NETWORKS

In sigma society, economic elites do not rely on market mechanisms alone. They also engage in social connections. What is the role of social connections or "social capital" in the reproduction of the elites' position?

There is a growing literature on "social capital." However, it is defined in several ways. For instance, Adler and Kwon (2000, Table 5.1) found 17 different definitions. Some of these definitions refer to social capital in terms of social networks. This is the definition that will be utilized here; namely, social capital is a set of personal social relations in the form of social networks that produce an economic return.

Because political and cultural assets are already included in the analysis of sigma society, the type of social relation that seems important to consider now must be the personal relation. Market relations are defined as impersonal social relations, with no additional social ties beyond the exchange of goods. However, in addition to market exchange, people practice sociability, people engage in friendships and connections. Are these activities that are directed to build and maintain social networks part of the economic logic of individuals? Is the homo economicus also investing in these activities? These questions call for a theoretical answer.

In order to construct a theory of social networks, the category social network needs to be transformed into the category of a good; moreover, if it is going to be a capital good, it must satisfy the following properties:

(a) Social network is a stock, the stock of social connections.
(b) It provides an economic return, which can be generated individually or via collective action.
(c) It can be accumulated through investment.
(d) It needs maintenance to avoid depreciation and obsolescence.

Conceptually, therefore, social network can be treated as a capital good. As with any other capital good, people who invest in social networks will have an expectation of economic returns.

The theoretical assumption proposed in this study is that economic elites seek to establish social connections so as to increase business opportunities and reduce uninsurable risks. In this manner, economic elites construct social barriers to social mobility.

In a market economy, why would the individual need a social network? Why would he or she need friends? Only Walrasian and perfect markets—where large number of buyers and sellers participate, all price-takers, supplied with perfect information, and where price is the rationing mechanism—would function without the need of friendship and other forms of social network.

Any theory of social networks would have to assume that there is market failure. This is precisely the case in sigma society: there exist basic markets in the market system. This is the starting point of the theory of social networks.

The theory of social networks assumes that the insurance market is limited to insurable risks only. Risks that are uninsurable in the market—basically the risk of going out of business, the risk

of an economic disaster—need another type of solution. The non-market solution refers to the exchange of favors or reciprocity, which requires a social network. A social network can be seeing as a Rawlsian social contract (Rawls 1971). The individual puts himself on someone else's shoes and thus is willing to exchange favors. The network sets a limit for economic disaster of all its members. Social networks allow people to get social protection through non-market exchange. The theory also assumes exclusion in the credit and labor markets. Under this context, social networks play an important role in the process of production and distribution: business success depends upon social networks.

In sum, social networks can generate economic returns through two mechanisms:

(a) Because one has to be known and trusted to find markets, to obtain supplies, to be granted credit, insurance or a job, social networks reduce transaction costs.
(b) Social networks protect individuals against possible loses arising from uninsurable risks, those that the market cannot insure due to moral hazard and adverse selection problems, including protection against possible major losses, which could conduct individuals to bankruptcy or to any other economic disaster.

Even in cases in which both market and social networks are feasible, elite families will choose social networks by evaluating their relative net benefits. If using the market is more expensive than using the network, they will have incentives to use the latter. Hence, higher transaction costs in market exchange create incentives for the formation of social networks; on the other hand, an underdeveloped insurance market would also create incentives for the formation of social networks.

In socially homogeneous societies the only difference between the rich and the poor is money. In this type of society individuals can choose their friends and social networks, subject to their wealth constraints only. This is so because the poor would like to have friends that are rich, but not vice versa. In sigma societies the constraints to form networks include not only economic assets but also social assets. Peer groups cannot include people from lower social status. In this case, "money does not talk."

In sigma society, therefore, there is a hierarchy in social networks. Some networks are economically superior to others. Networks can then be seeing as social assets, which generate different economic returns. The network generates economic returns for its members. The productivity of their economic resources will increase in terms of higher rates of return and also in

terms of risk reduction. But not all networks generate the same economic benefits. There is a difference in returns between the networks of the elites and those of the socially excluded.

In sigma society, therefore, the blockages to social mobility also come from political and cultural exclusions. These are social assets that are unequally distributed among the population. The poor were born in the wrong family or in the wrong ethnic group. By contrast, in their access to social networks the wealthy have an additional advantage. The economic returns from their social networks are higher compared to the network of the poor. The elite's networks operate as "exclusive clubs". The social network is another mechanism for economic and social protection of the elite. Hence, the risk of an economic disaster of being expelled from the elite is greatly reduced. The social network gives them this security; it also gives them economic advantages in the capital accumulation process. This mechanism reinforces the social reproduction of the elite.

The theory of social networks can thus be stated more precisely as follows: People invest in social connections seeking to maximize economic returns, subject to the constraints given by their initial endowments of economic and social assets. In other words, people invest in social networks with the expectation of economic returns.

The main empirical predictions that can be derived from this simple theory are the following:

(a) For a given endowment of physical capital, the larger the individual's stock of social network the larger his economic benefits.
(b) Elites' circulation is not endogenous, but it is a result of external shocks to society.
(c) Elites are more likely to carry out collective action compared to the case of workers.
(d) Elites' social networks take the form of exclusive clubs.
(e) In the aggregate, social networks are unequally distributed among individuals and contribute to the reproduction of overall inequality.

The first prediction, if corroborated empirically, would show that differences in the rates of return to physical capital own by individuals are due to their differences in the stock of social capital. This is another reason to expect that profits cannot disappear in a competitive market. The last prediction says that social networks do not operate as a mechanism that facilitates social mobility; on the contrary, they block social mobility.

Empirical data to test those empirical hypotheses for the Third World are not available. In the case of Peru, some basic data have been constructed in this study. Hence, the evidence presented here will be based on some pieces of evidence about the behavior of the elite regarding the building of social networks. But before that, a hypothesis on the types of business organizations is presented.

4. ON BUSINESS ORGANIZATIONS

Because economic elites concentrate the stock of capital of society, it is expected that social relations among capitalists in doing business is very important. What are those networks that capitalists seek to construct?

There are various forms of economic organizations of firms. A family of the economic elite may have one or several firms that are owned by the family alone. Several families may own collectively one or several firms. The former is the case of family firms and the latter is the case of economic groups. What are the underlying factors that make elite families decide the form of organization of their firms?

4.1. Family Business

Elites may decide to run family businesses. How do this type of firms operate? In Latin America, a study by Lomnitz and Perez-Lizaur (1987) describes the behavior of an elite Mexican family (the Gomezes). There one can find a chapter devoted to show the relation between the family and their firms. The basic conclusions that can be drawn from this study on the logic of family firms of the elites are the following.

First, family firms have centralized management. The entrepreneur is the owner and manager of the industry. He rules his enterprise much like his own family. His authoritarian control extends not only to his sons and relatives but also to his workers and employees, including technical experts.

Second, most sons have been trained in family firms and work in various positions in them. If an entrepreneur has no sons, he will use other relatives to fill key management positions.

Third, families seek the sole ownership and control of their firms. What is the logic of this? It means total freedom for the owner to withdraw capital for his private use. It also means that he can hand out jobs and positions freely, including not needed jobs for the family, and thus get personal prestige. A fundamental feature of the family enterprise is its degree of integration with family life. The family serves the enterprise and the enterprise serves the family. Family reasons appear to be dominant in terms of business decisions. Kinship interests often overrule the interest of the enterprise.

Fourth, families seek to develop and use social networks for tapping economic resources. In association with politicos, as well as with foreign industrialists and bankers, they are able to break new ground in terms of social contacts that provide financing, contract, permits, markets, and new technology. Social networks, as informal sources of information, are a prime resource when the markets are usually thin and public information is scarce and unreliable. Networks of relatives and friends represent the main source of business intelligence. Family parties and gatherings among the elites are remarkable in that business conversation is quite active.

Social network is built on mutual exchange and mutual dependence, as network participants trade favors and consolidate mutual interests. Such a network is nurtured not only among government and company officials and friends or relatives but also among the entrepreneur's vast social network of acquaintances from school, play (leisure, travel, clubs, sports), and the normal course of business activity.

Fifth, a family firm embodies a basic weakness in that it tends to put loyalty above performance. Social networks can absorb the shocks of a bumpy historical road, but they cannot replace technology or mobilize resources on a scale comparable with large multinational corporations. In other words, family businesses have limitations on their growth. Paternalistic structures adapt poorly to the corporate organization of modern business. Therefore, large corporations will tend to displace family firms.

4.2 Big Business[2]

Technological change has been a major force in the sustained economic growth of the First World. But some studies argue that technology has also influenced the form of the organization of firms.

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[2] This section draws heavily on Chandler et al (1997).

The First Industrial Revolution of the late eighteenth and early nineteenth centuries increased the growth potentials mostly in the textiles and food processing sectors. The Second Industrial Revolution that initiated during the later decades of the nineteenth century included the completion of new transportation and communication systems based on steam power and on electricity. These innovations generated the potential for an unprecedented volume of production and delivery of goods made possible by the new railroads, steamships and telegraphs.

The effective exploitation of those technologies demanded new forms of production, marketing and management, and business organization. They called for much greater investment in physical capital than had earlier industrial technologies. So the resulting industries became more capital-intensive. These new technologies required the creation of industrial enterprises to mobilize the necessary capital and employ the large number of workers and managers needed. It also demanded the corporate structures essential to coordinate the flow of goods through the processes of production and marketing and to monitor the different functional activities involved.

The second industrial revolution implied not only large economies of scale but also economies of scope. At the plant level, the latter mostly came from the cost advantages of producing different end products by using much the same materials and equipment. These properties of the new technology induced the organization of production in the forms of large enterprises and corporations; that is, of big businesses.

The U.S., U.K. and Germany entrepreneurs were the first to exploit the new technology. They soon became a primary source of continuous learning to enhance the productivity of the existing technologies and to commercialize new closely related ones. They also became cores of networks or clusters of essential ancillary and supporting industries and their firms. France, Italy and Spain were followers. Compared to the countries of the first group, therefore these governments played a more active and significant role in the entry of these countries into newer, more capital-intensive industries. This included sate-own enterprises.

In the latecomer countries, the challenge to catch up was confronted with the development of family and corporate groups, networks and alliances, such as <u>zaibatsu</u> and <u>keiretsu</u> in Japan and <u>chaebol</u> in South Korea. The diversified industrial group, called zaibatsu, was owned and controlled by such wealthy families as Mitsui, Iwasaki (Mitsubishi), and Sumitomo. After World War II, many of these prewar groups reemerged as keiretsu in which individual member firms collectively came to control other enterprises of the same group. In Korea, industrialization was the result of the large family-owned diversified group, called chaebol.

In Italy, however, family business acted as the national paradigm, but at the cost of developing organizational capabilities for large firms. Like many German companies, large-scale Italian companies tended to be dominated by single men: Agnelli, Cini, Volpi, Pirelli, Falck, Olivetti, Gardini, Berlusconi.

4.3 Economic Groups

The concept of economic group refers to a group of families who own and control a group of firms and operate as a single economic unit. On this economic behavior of the elite, the classical work of Leff (1978, 1979) put forward the hypothesis that in the Third World these families will operate in the form of economic groups. The theory is that this is a rational way to overcome factor-market imperfections that characterize the Third World. Capital markets, credit markets, markets for managers, and some input markets are non-existent or under developed. (Actually, the term “non-existent or under developed factor markets” should replace the term "market imperfections," which mostly refers to oligopolies or monopolies.) The economic group invests and produces in several sectors that involve vertical integration or other economic and technological complementarities.

Economic groups have economic advantages. First, the groups mobilize capital from wealthy people linked by family or other personal ties. The group possesses their own banks and financial intermediaries. The groups allocate this capital among their diversified activities in a manner that approximates within the firm the functioning of a capital market. Second, the groups move other primary inputs as well as intermediate products within their firms to overcome imperfections in the factor and product markets. Finally, the group’s participation in different activities increases internal information surrounding investment and production decisions.

The economic group is a particular form of industrial organization. It is characterized by the fact that ownership and control have not been separated.

In sum, the form of business organization depends upon technology, the state of market development, and the cost of establishing social networks. Economic elites will follow strategies to adjust to each form of organization. Economic elites will choose some of these forms guided by their logic of maximizing social position and profits. Over time technology changes and markets develop, which generates a tendency for large firms to displace individual family firms, and large corporations to displace local economic groups.

5. THE BEHAVIOR OF ECONOMIC ELITES IN PERU

5.1 Empirical Definition of the Economic Elite

The sample of families studied was drawn from a list of Peruvians who participate in the ownership of the largest firms in Peru. The universe is the set of firms that ranked at the top 40, according to their sales, in any year during the period 1992-1998. This set contains 93 firms. The owners were defined as the members of the directory of each firm as of February 2000. This information is available in the Office of the Public Registry, National Commission for the Supervision of Firms (CONASEV). Because in the period of analysis many firms went into property changes (takeovers and mergers) (8), others were taken over by multinational corporations (11), others were state firms (2) and others lacked information (33), the total number of firms studied is only 39.

The next step consisted in separating Peruvians from the set of directors of these 39 firms. Considering ten directors per firm, on average, this would imply a set of near 400 people. The group size estimated is, however, only 37 people who were Peruvians. Part of this gap is explained by the significant presence of multinational corporations in the economy, which in turn implies the presence of foreigners in the directories; another part is due to the incomplete information of directors per firm. But the conclusion is inescapable: given the cut off value in the ranking of firms, the local economic elite is very small in Peru.

Among the top 1000 firms in Peru, the top 40 firms (4% of firms) concentrated 35% of total gross sales and 52% of total profits before taxes. This is depicted in Table 1. These figures show the high degree of concentration of businesses in Peru, even among the largest firms. Nearly 40 Peruvian families and few multinational corporations concentrate a large magnitude of sales and profits.[3]

5.2 Business Organization as Economic Groups

What is the most common form of business organization adopted by Peru's economic elite? Table 2 shows the network of social relations among the elite regarding the ownership of the largest firms. Do elite families establish social relations—social networks—among them to run firms? In Table 2, the same people are presented horizontally and vertically, and the entry says

whether the two persons share the control and ownership of at least one firm; if the cell is marked 1, they do, and if it is marked 0 they do not. For instance, person 1 is connected to other 18 in the control and ownership of several firms. This information can be read either horizontally or vertically. Person 25 is connected to other 5 people. Person 37 is connected to no one.

Table 2 shows the existence of a group where the network is very dense, the group 1-25. This is a highly interlocked group. The group 29-31 constitutes a separate sub-group (the fishing industry). And the group 32-37 is made of individual owners of single firms, with no connections with the rest. This table suggests that most of the elite families operate as economic groups.

The last column of Table 2 shows the connections of the domestic elite with multinational corporations. Only 8 out of 37 families do not have direct relations with any corporation in any firm. But the indirect relations do exist, because their Peruvian partners are connected to corporations. Thus, the Peruvian elite is connected to multinational corporations.

In relation to the hypotheses put forward above, economic groups—not family firms—is the main form of business organization of the Peruvian economic elite. Hence, families join in establishing a multifamily and multifirm industrial organization.[4]

Although, in the case of Peru, economic groups constitute the principal form of business organization of the economic elite, Leff's hypothesis does not seem to hold true. This theory predicts that an opening of the economy should reduce the significance of the economic groups. This has not happen in Peru. After the liberal reforms initiated in 1990, the economic groups are still under operation, as will be shown below.

It seems then that the major reason behind the formation of economic groups is the positive network effect upon non-insurable risks. Networks are part of a survival strategy of the elite to protect themselves against economic disasters and also as a development strategy, at the same time. In fact, the present Peruvian elite has survived all the vicissitudes of the society, such as the hyperinflation and severe recession of the 1980s, the political violence of the 1980s and first part

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[3] The mean Gini coefficient for the top 100 firms with positive profits during the period 1997-1999 is around 0.88 (!).

[4] It should be noticed that Peruvian legislation uses a different definition of economic group: group of <u>firms</u> that are under the control of a firm or of individuals that operate as a single decision unit. This definition is utilized to set limits to bank credit. The literature on economic groups in Latin America also uses this definition. In this study the economic group refers to group of <u>families</u>, which are the economic agents.

of the 1990s, the liberal reforms of the 1990s, the current recession that started in 1998, and the political crisis of 2000-2001.

The evidence that is commonly found in the literature that the mean death rate of large firms is much smaller than the counterpart of small firms seems to be the other side of the coin, which says that economic elites are socially more protected against economic disasters. The majority of the 26 families that Alcorta identified as the economic elite in 1983 (Alcorta 1992) also belong to the core of the current elite. The members of the economic elite may loose control of a firm or may close a firm, but as economic agents they will rarely disappear.[5]

5.3 The circulation of elites is exogenously determined

Several studies show that in today's Peru family-firms are not as significant as in the past. The work of Thorp and Bertram (1977) presents the general economic history of Peru in the period 1890-1975. The economic history of this period is mainly the history of the oligarchy.

Gilbert (1982) studied three of the most traditional families of the Peruvian economic elite: Prado, Aspillaga and Miro Quesada. He showed that the behavior of family firms had strong social ties with other families of the elite. Intramarriage within the elites was also the norm. The Prado and Aspillaga families disappeared in the sixties, while the Miro Quesada familiy runs one of the principal newspapers of Peru up until now. Another finding of Gilbert's study is the identification of near thirty families as the core of the oligarchic political-economic system of Peru in the 1960s.

A more recent study has been made on the Prado family, one of the most long lasting traditional families in Peru (Portocarrero 1995). This family played a significant role in the Peruvian economy in the period 1890-1970. The economic assets of this family included firms in different sectors, including a bank. The family reproduced itself by following certain rules, such as intramarriage within the Peruvian elite, the allocation of certain family members to particular sectors to have a control of the firms of the empire, and by giving the male who is primogenitor the leadership of the empire.

[5] For the manufacturing sector of Peru, a statistical analysis was applied to find the determinants of death rates of firms. The exercise showed that, in fact, large firms have a lower probability to die compared to small firms. The high death rates of small firms is another reason to explain why it is so difficult for them to get bank credit.

Why does an elite family come to an end? The experience of the Prado family suggests that there is a cycle in the development of an elite family. Mariano Prado Ugarteche was the innovator. His successor Mariano Prado Heudebert was not as good as his father. Mariano Prado Sosa, the last in the dynasty, was known more as a playboy than an entrepreneur.

General Velasco's revolution (1968-1974) marked the end of the old oligarchy, particularly the agrarian oligarchy. Today's economic elite includes few survivors of those traditional families; it mostly includes new families that emerged after this revolution. In addition, few new names have appeared in this core in the nineties (Figueroa 2001a, chapter 2).

Thus, there has been a circulation of the elites due to external shocks—a nationalist military revolution—not due to the process of economic growth. This result is in accord with one of the predictions of the sigma theory.

5.4 Collective Action

Olson's classical theory on collective action predicts that small groups have a higher likelihood to overcome the free rider problem (Olson 1965). The group of economic elites is small and their organizations should therefore be strong. Is this proposition empirically consistent with the behavior of economic elites?

The major organization of firms in Peru is called CONFIEP (Confederación Nacional de Instituciones Empresariales Privadas). There are also associations by economic sectors, 26 in total now. But CONFIEP includes them all; moreover, this is the major confederation of business organizations in Peru.

CONFIEP was founded in 1984. It offers several services to its members. But its basic purpose is to operate as the voice of the economic elite. According to its statues, CONFIEP must change directorate every year. For the period of 1987-2001, the number of total posts to be filled amounts to 1,260. These posts were filled with 361 people. This gap shows that there is concentration in the distribution of posts among the economic elite. The concentration is even higher if one takes into account the fact that 243 businessmen participated in the directorate only once; that is, for one single year only. Thus, only 118 businessmen have been in charge of CONFIEP in 15 years.

Has there been circulation of elites in CONFIEP? As Table 3 shows, 74% of the people that occupied posts in the directorate during the period 1987-2001 did it for certain periods only, either in the first years, the latter years or in the middle. The remaining 26% did it in different periods. This pattern indicates the existence of a limited circulation of the elites in the last decade.

CONFIEP operates as the major pressure group in today's Peruvian society. This organization is in charge of protecting the group interests of the elite from undesirable government interventions and from the pressure of workers. The collective action of the economic elite can be seeing through the behavior of this organization.

Of course, the members of the economic elite also seek individually access to government decision-makers. This relation can take many forms, including corrupt practices, as was made public in 2000-2001, when the population watched on television many videos in which important entrepreneurs appeared making deals with Mr. Montesinos, the powerful advisor to president Fujimori.

5.5 Social networks as "exclusive clubs"

The economic elite together with the upper middle class has created other forms of social networks that operate as exclusive clubs.

Exclusive schools are one of them. It is not rare to find some families who send their children to foreign schools. They send their children even to expensive colleges in the First World. If their children are going to study in Lima, there are around fifteen exclusive schools. These schools offer international diplomas, which allow high school graduates admission to colleges and universities in the First World—and direct admission, without test, to Peruvian private universities as well.[6]

Exclusive social clubs also constitute another form of social network. There is around twelve exclusive social clubs in Lima. These include three country clubs, two golf clubs, one yacht club and three more general social clubs.[7]

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[6] These schools include Alexander von Humboldt (German), Antonio Raymondi (Italian), Franco-Peruano (French), Peruano-británico (British), Markham (British), Newton (British), and nine that are American: Casuarinas, Davy, Guisse, Magister, Pestalozzi, Recoleta, Roosevelt and San Silvestre.

[7] These include: Country Club del Bosque, Rinconada Country Club, Country Club de Villa, Club Encuestre Huachipa, Los Inkas Golf Club, Lima Golf Club, Yacht Club Ancón, Club de la Banca y Comercio, Club Nacional, Club Regatas Lima and Club Internacional.

Residential neighborhoods should also be considered as part of the networks. There are areas in certain districts of Lima (La Molina, Surco, San Isidro and Miraflores) where the wealthy and only the wealthy live. These are areas where free transit of cars and people are not allowed. These areas can be viewed as islands of prosperity in a sea of poverty. As may be expected, these "islands" are highly protected areas, and residents share a more or less common life within these wealthy ghettos. The same structure is found in the rest of large cities in Peru.

The Peruvian economic elite has also constructed international networks. This takes the form of business networks with their foreign counterparts. This is the case of bilateral "chambers of commerce and industry". It also takes the form of more personal business relations with foreign investors in the First World. It is well known that many families from the Peruvian elite own houses in cities like Miami, Los Angeles, and Madrid. They seem to seek entrance to social networks in the First World and thus must own houses in both Peru and abroad.

5.6 Economic Power in Profit Allocation

The economic power of the elite is based on the concentration of physical capital. But in a heterogeneous and hierarchical society, this initial condition creates also concentration in political and cultural assets. As shown here, the social networks that are highly profitable are also concentrated in this group.

The elite families also concentrate profits, the income flow of capital. They decide on the use of profits, whether to invest domestically or abroad. They have economic power in the sense that they impose their will upon others. They decide the incomes of millions in society.

The concentration of capital implies that the economic elite can impose ultimately their power on the government or workers by threatening to reduce investment. Because this proposition was presented initially by Kalecki (1943), it can be called the Kaleckian threat.

The behavior of elite families regarding investment in Peru has not been possible to measure. Information at the family level is unavailable. At the aggregate level, national accounts calculate private investment as a residual of many other calculations. For what they are worth, national accounts show that nearly 75% of total investment was originated in the profits of firms in the period 1960-1974 (Peru, Banco Central 1975, Cuadro 5, p. 20). This information is not available for the later years. In the case of Chile, where information is more complete, 60% of total

investment was originated in the profits of firms in the period 1960-1997 (Benett, Loayza and Schmidt-Hebbel 2002, Cuadro 1, p. 53).

These pieces of information suggest that the behavior of the local elite is critical for investment in the Third World countries. This result is surprising in the face of much talk about globalization. One would expect that, with the liberalization of capital markets since the 1980s in the world economy, domestic investors should be displaced by foreign investment. But this does not seem to be the case. Paul Streeten has indeed made an impressive observation: in the light of globalization "it is a puzzle to find that domestic savings and investment are closer together for most countries than they were before 1914" (Streeten 2001, p. 103).

6. CONCLUSIONS

This paper has developed two related themes. First, the nature of economic elites in a socially heterogeneous and hierarchical society (called the sigma society) has been formulated. The economic elite is a social group at the top of the ranking of capital ownership. The sigma theory assumes that this elite exists; it is small and remains small, and has power to determine the income of the masses. It also assumes that the elite's privileged position in society is reproduced via the exclusion mechanisms.

Second, the theory of social networks has been formulated. In a capitalist economy, people carry out not only market exchange, but also non-market exchange. The latter refers to social connections, also known as "social capital", and defined in this study as social networks. The theoretical proposition is that people invest in social networks seeking to maximize expected economic returns, subject to the constraint given by their endowments in economic and social assets. Economic returns imply higher mean incomes and lower degrees of risk.

In sigma society, people's endowments of economic and social assets determine their social networks. People who are well endowed with these assets will seek social connection with people from the same strata, because the returns will be higher than networking with people from lower strata. Therefore, how much people invest, in what type of networks and with what returns depend upon their initial endowments of economic, political and cultural assets. There will be a hierarchy of social networks, which operate like a system of "clubs", including "exclusive clubs" for the elite.

The empirical side of this research shows that Peru's economic elite operates in accord with the predictions of the sigma theory. For a given ranking threshold, the observed economic elite is small, and has remained so since the beginning of the 1970s. The network is very interlocked in business organization, which takes the form of economic groups. The elites' networks take the form of "exclusive clubs." Collective action is stronger in the elites compared to the case of workers. The circulation of elites has not been continuous over time, but the result of shocks, such as the military revolution of 1968. Finally, the power of the elite appears in their investment decisions. The life of many people depend upon that decision. In spite of the opening of markets, including capital markets, domestic investment still depends to a large extent on the allocation of profits by the domestic economic elite.

The main prediction of sigma theory is that in the Third World there is no endogenous circulation of elites. The economic elites can hardly change. The elites invest in social networks as part of their strategy to maximize profits and to maintain their privileged social position. Social networks reflect the initial inequality in the distribution of physical, human, political and cultural assets and reinforce this inequality. Hence, the initial condition determines the path of capital accumulation (in the form of physical and human capital) between social groups. Consequently, there is path dependence in the degree of inequality. There is no spontaneous circulation of elites; there is no natural social mobility to the top of the income pyramid. There might be social mobility to the middle segment of the income pyramid, but not to the top.

According to sigma theory, social capital contributes to overall inequality and to its persistence. Social capital contributes to preserving the power structure in society. Non-market relations reinforce market relations in the generation of inequality. Social networks play a significant role in the economic process—in the process of production and distribution. Some social networks give more economic advantage to their members than others do. As with any other asset, social capital is a stock that is unequally distributed in society. Its economic returns, therefore, play a role in increasing the overall income inequality.

The economic elite is endowed with larger quantities of economic, political and cultural assets, which give them capacity to build the most advantageous social networks. This superiority in social networks sets additional limits to social mobility and contributes to the reproduction of income inequality. For the elite, the "peer effect" is stronger. This conclusion is not in accord with the more optimistic view of social capital found in the literature, where social capital of the poor is seeing as the missing link between poverty reduction and economic growth.

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Table 1. Peru: Share of top 40 firms in total sales and total profits among top 1000 firms (percentages)

Year	Gross Sales	Profits before taxes
1992	32.0	342.9
1993	32.6	74.0
1994	33.8	56.0
1995	35.3	28.0
1996	36.3	72.7
1997	37.4	63.8
1998	37.5	88.0
Mean (1992-1998)	35.0	52.1

Source: Figueroa (2001[a]), Table 2.1, p.45, and Table 2.3, p.52

Table 2

		Romero	Graña	Miro Quesada	Moreyra	Fort	De La Puente	Wiese	Onrubia	Brescia	Nicolini	Montero	Picaso	Bentin	Benavides	Bustamante	Woodman Pollit	Raffo	Piazza	Berckemeyer	Llosa Barber	Beoutis Ledesma	Rizo Patron	Montori	Sotomayor	Cilloniz	Ferreyros	Michell	Wong Lu	Batievsky Spack	Matos Escalada	Galsky	Lucioni	Rodriguez Rodriguez	Custer	Ikeda	Cogorno	Arias Davila
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37
Romero	1	1	1	1	1	1	1	0	1	1	1	0	0	1	1	1	1	1	1	1	1	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Graña	2	1	1	1	0	1	1	1	0	0	0	1	0	0	1	1	0	0	1	0	0	1	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0
Miro Quesada	3	1	1	1	0	1	1	1	0	0	0	1	0	0	1	1	0	0	1	0	0	1	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0
Moreyra	4	1	0	0	1	1	1	1	1	1	0	1	1	1	0	1	0	1	0	1	0	0	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Fort	5	1	1	1	1	1	1	0	1	1	1	0	1	1	1	1	1	1	1	0	1	1	0	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0
De La Puente	6	1	1	1	1	1	1	1	0	0	0	1	0	0	1	1	0	0	1	1	0	1	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Wiese	7	0	1	1	1	0	1	1	0	0	0	1	0	0	0	0	0	0	0	1	0	1	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Onrubia	8	1	0	0	1	1	0	0	1	1	1	0	0	1	0	0	1	1	0	1	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Brescia	9	1	0	0	1	1	0	0	1	1	0	0	0	1	0	0	0	1	0	1	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Nicolini	10	1	0	0	0	1	0	0	1	0	1	0	0	1	0	0	1	1	0	0	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Montero	11	0	1	1	1	0	1	1	0	0	0	1	1	0	0	1	0	0	0	0	0	1	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0
Picaso	12	0	0	0	1	1	0	0	0	0	0	1	1	0	0	1	0	0	0	0	0	0	0	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0
Bentin	13	1	0	0	1	1	0	0	1	1	1	0	0	1	0	0	1	1	0	1	1	0	0	1	0	0	1	0	1	0	0	0	0	0	0	0	0	0
Benavides	14	1	1	1	0	1	1	0	0	0	0	0	0	0	1	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Bustamante	15	1	1	1	1	1	1	0	0	0	0	1	1	0	1	1	0	0	1	0	0	0	0	1	0	1	1	0	0	0	0	0	0	0	0	0	0	0
Woodman Pollit	16	1	0	0	0	1	0	0	1	0	1	0	0	1	0	0	1	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Raffo	17	1	0	0	1	1	0	0	1	1	1	0	0	1	0	0	1	1	0	1	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Piazza	18	1	1	1	0	1	1	0	0	0	0	0	0	0	1	1	0	0	1	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Berckemeyer	19	1	0	0	1	0	1	1	1	1	0	0	0	1	0	0	0	1	0	1	0	0	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Llosa Barber	20	1	0	0	0	1	0	0	1	0	1	0	0	1	0	0	1	0	1	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Beoutis Ledesma	21	0	1	1	0	1	1	1	0	0	0	1	0	0	0	0	0	0	1	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Rizo Patron	22	1	0	0	1	0	1	1	0	0	1	0	0	0	0	0	0	0	0	1	0	0	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Montori	23	1	0	0	1	0	0	0	1	1	0	0	0	1	0	1	0	1	0	1	0	0	0	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0
Sotomayor	24	0	0	0	1	1	1	1	0	0	0	0	1	0	0	0	0	0	0	1	0	0	1	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0
Cilloniz	25	0	0	0	0	1	0	0	0	0	0	0	1	0	0	1	0	0	0	0	0	0	0	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0
Ferreyros	26	0	0	0	0	0	0	0	0	0	0	1	0	1	0	1	0	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0
Michell	27	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0
Wong Lu	28	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0
Batievsky Spack	29	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1	1	0	0	0	0	0	0
Matos Escalada	30	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	1	0	0	0	0	0	0	0
Galsky	31	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	1	0	0	0	0	0	0
Lucioni	32	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0
Rodriguez Rodríguez	33	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	0
Custer	34	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0
Ikeda	35	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0
Cogorno	36	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0
Arias Davila	37	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1

Table 3. Peru: Directory of CONFIEP by Periods

Periods	Frequency	Percentage	Cumulative
A (1987-91)	102	28.3	28.3
B (1992-96)	77	21.3	49.6
C (1997-01)	88	24.4	74.0
A and B	30	8.3	82.3
A and C	3	0.8	83.1
B and C	39	10.8	93.9
A, B, C	22	6.1	100.0
Total	361	100.0	

Source: CONFIEP, data base constructed by the author