CARDOSO, MENEM, AND MACHIAVELLI: POLITICAL TACTICS AND PRIVATIZATION IN LATIN AMERICA

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1 Introduction

In "Implications of Shleifer-Treisman Deals: Lessons from the *Porfiriato*," James Robinson pays Andrei Shleifer and myself the compliment of applying an analytical framework we devised to try to understand economic change in contemporary Russia to the land reforms of Porfirio Díaz in late nineteenth century Mexico. He identifies some interesting parallels. In this note, I repay the compliment by taking a liberty. The twentieth century has also witnessed many attempts at reform in Latin America. Here, I consider the use of political tactics in a couple of more recent cases—the privatization reforms of Carlos Menem in Argentina and Fernando Henrique Cardoso in Brazil.[1]

Both Menem and Cardoso inherited economies with large and inefficient public sectors, which had been built up during the years of populism and military rule. In Argentina, as of the late 1980s state-owned enterprises spent some 15-18 percent of GDP every year (De la Balze 1995, p.89). Many were completely dependent on public subsidies. In 1989, the 13 largest (excluding the defense industry) had an aggregate operating deficit of $3.8 billion, and had accumulated external debt of $11 billion (Alexander and Corti 1993, p.2). In Brazil when Cardoso took office, large state enterprises dominated the utilities, mining, transportation, telecommunications, and gasoline distribution sectors, among others. Government subsidies to railways, ports and highways amounted to $15.5 billion in 1985-95, and those to the electricity sector made up 21 percent of its revenue in 1994 (De Castro 1999; Kawall and Ferreira 1999).

In both countries, previous leaders had struggled to introduce privatizations, with at best limited results. The existing economic structure—though wasteful from a global perspective—

[1] For a related discussion of the politics of macroeconomic stabilization in these countries, see Treisman (2002).

provided a variety of benefits to particular, politically-powerful groups, which had mobilized both overtly and covertly to undermine previous attempts at de-nationalization. Menem and Cardoso found paths around these obstacles. Privatization, in both countries, took off. Under Menem, Argentina privatized some 90 percent of all state enteprises in 1991-4 (IMF 1998, pp.5-6). In Brazil, by 1998 the entire telecommunications and railway sectors, the largest ports, some of the main highways, much of the electricity distribution and generation sectors, and some water and sanitation services had been transferred to private control. In the words of two Brazilian observers, ten years before “not even the most optimistic liberal economist would have dreamed of such an outcome” (Pinheiro and Giambiagi 1999, p.26).

In this paper, I do not attempt to assess the social costs and benefits of these privatization programs. They probably had both, and costs and benefits were certainly distributed unevenly among members of the population. Nor do I make moral judgments about the methods used. Rather, my goal is to illuminate the feat of reform-mongering that these two leaders accomplished. How did Cardoso and Menem succeed in reshaping the economic structure of their countries so profoundly, given the formidable obstacles blocking their way and the repeated failures of their predecessors?

The answer, I suggest, has a lot to do with the particular political strategies these leaders chose. These strategies consisted of a combination of two types of tactics—cooptation and expropriation—which were used selectively to neutralize coalitions of opposition “stakeholders”, actors who had the power and motive to block either the enactment or implementation of reform. Below, I discuss, for each country, the identities of the stakeholders and the collection of tactics that Menem and Cardoso used to break their resistance.

Their strategies were often improvised and sometimes fortuitous. I do not mean to suggest that either politician started out with a detailed masterplan. Their successes also owed something to auspicious circumstances. Menem was lucky to come to power on the heels of a major victory for his Justicialista Party which left it dominant in both houses of parliament and most statehouses. Cardoso benefited from the earlier liberalizations of President Collor.[2] But their achievements also reflected a skillful and unsqueamish use of political tactics. Each leader made a series of correct but risky decisions about which allies to cultivate and which to marginalize, which rivals to coopt and which to attack. Each sensed when to hold out for a larger prize, when to settle for what was quickly attainable. Whether or not they had read him, their actions on these occasions revealed a little of what Machiavelli called *virtù*.[3]

2 Argentina

As Menem assumed the presidency in July 1989, the economy—and state—were in crisis. Inflation that month soared to almost 200 percent a month. In May, food riots had broken out, and rumblings of discontent were coming from the army. To the astonishment of most of his supporters, Menem appointed a cabinet of well-known businessmen and liberal politicians and announced a program of orthodox reforms to open up the economy and reduce government intervention. A key element was privatization of almost all state-owned enterprises.

Menem's predecessor, Raúl Alfonsín, had also attempted to reduce the state's holdings, launching a major privatization program in 1985 (Corrales 1998 p.26). It was emasculated by the policy's opponents. The Peronist-dominated Senate blocked the three privatization bills Alfonsín's government submitted in 1988 (Llanos 2001, p.82). Only four enterprises were actually privatized under Alfonsín, netting the government just $32 million in revenues (Manzetti 1999, p.45) (see Figure 1).

[Figure 1 Here]

[2] However, circumstances beyond their control also *complicated* reforms on several occasions: the 1995 Tequila crisis and the Russian crisis of late 1998 both scared foreign investors away from emerging markets.

[3] One of Menem's close advisors—the future minister responsible for privatization, Roberto Dromi—had read Machiavelli, and cited a famous passage by him to explain Menem's electoral strategy to a visiting American political scientist (Stokes 1999).

Privatization faced a coalition of determined opponents. First, public sector workers feared—correctly—that it would lead to job cuts, and were represented by activist unions. Second, the managers of state enterprises also feared dismissal. Since part of the state industrial sector had been built up by the armed forces, this group included a number of military officers (Manzetti 1999, p.44). Third, privatization would hurt major businesses that supplied state enterprises and received lucrative public contracts; their owners were known in Argentina as the *patria contratista* or the *capitanes de la industria*. Such rent-seeking conglomerates received an estimated $4.7 billion in tax breaks and excess charges in 1989 alone (Corrales 1998, p.34).[4] While overtly supporting free markets, the *capitanes* organized behind the scenes to prevent privatization plans being passed in Congress or implemented in particular cases.[5] Fourth, members of Congress—including leaders of both the Peronist Justicialista Party (PJ) and the oppposition Radicals—feared their prospects would be hurt if privatization proved unpopular with the voters.[6] Finally, provincial governments often stood to lose if major state enterprises in their region cut employment.[7] These various stakeholders in the existing public sector could lobby Congress or the executive to prevent pro-privatization legislation passing and organize

[4] Etchemendy (2001, p.12) claims that the state oil company, YPF, paid subcontractors who extracted oil from its reserves a price many times higher than the international oil price, and then sold the oil to private refiners for lower prices.

[5] According to Corrales (1998, p.29), such *patria contratista* representatives operated furiously in the first months of Menem's administration. They "would barge into cabinet meetings and demand—often hysterically—that the reforms be halted. They threatened to create social unrest by funding strikes, laying off workers, lobbying Congress, holding meetings to vent opposition against aspects of the economic program, spreading rumors of financial collapse, and raising unfounded accusations against government officials".

[6] Menem and his advisors were so sure that privatization would cost them votes that they deliberately dissembled about their plans before the 1989 election (Stokes 1999).

[7] An additional stakeholder, not necessarily opposed to privatization but concerned not to lose out in the process, consisted of the holders of foreign debt issued by the public companies. A hostile reaction from these foreign investors could have been costly to the government's reputation in international markets.

demonstrations or strikes to impede privatization in practice. As a result: “Most of Alfonsín’s privatization deals died in Congress, at the negotiating table, or in the streets” (Ibid, p.36).

Menem set out to “privatize everything that [was] privatizable” (Ibid, p.26). He came close to succeeding. In just a few months, gas and electric companies, the national water and sewage companies, petrochemical firms, iron and steel companies, the post office, port administration, and two public tv channels were all put up for sale. And buyers materialized. As Figure 1 shows, privatization revenues shot up from $32 million in 1985-89 to $5.5 billion in 1992 alone. One hundred and seventeen enterprises were privatized in 1990-94, compared to four in 1983-9 (Manzetti 1999, p.46; Corrales 1997, p.70). By 1995, few major enterprises remained in state hands.

How did he do it? In part, Menem’s success followed from the greater control his party had over the relevant veto points. The PJ controlled the Senate and a majority of state-houses. However, until 1995 it had only a plurality in the Chamber of Deputies, which gave the opposition the option of denying the government the quorum (more than 50 percent of deputies) needed to pass legislation. And the PJ’s dominance of parliament looks rather less of an advantage once one realizes that some of the fiercest opposition to privatization came from within Menem’s own Peronist movement, traditionally an ardent ally of public sector workers and unions. In fact, eight Peronist deputies defected to form a separate bloc in opposition to Menem’s reforms, the *Grupo de los Ocho,* and three more left to form *Afirmación Peronista*. Even if parliamentary dominance explained how privatization legislation got passed, this would not explain the dizzying pace at which it was implemented.

Menem’s tactical challenge was to find a way to break the coalition of the five main anti-privatization stakeholders. He did so by means of a mix of cooptation and attacks.[8] First, public sector workers were bribed with early retirement packages, retraining programs, and shares in the

[8] Corrales (1998), Manzetti (1999), and Etchemendy (2001) are excellent sources for the details of this story.

privatized companies, but vilified and sometimes fired if they went on strike. Unions were coopted by being given subsidies for the union health funds and responsibility for administering employee-owned shares (Murillo 2000, p.157).[9] The oil workers' union received subsidies to enable it to buy part of the oil fleet (Ibid, p.158). A number of moderate unionists were appeased with executive positions: Menem hired Jorge Triaca, the leader of the plastic workers' union, as labor minister and Julio Gullian of the telephone workers as secretary of communications (Manzetti 1999, pp.96-7). Cooperative unionists from enterprises slated for privatization were also invited to participate in the relevant implementing commission (Ibid, p.97). But the stick was as evident as the carrot. When workers in the telephone, railway, and oil industries went on strike, Menem fired many of them, prosecuted ringleaders, and even threatened at one point to call out the military (Corrales 1998, p.26; Manzetti 1999, p.97). Menem also played off unions against each other, threatening the dominant unions with invigorated competition from their rivals—and then offering guarantees of their dominance in return for support on questions of reform. This combination of tactics succeeded in splitting the labor movement and disorganizing the public sector unions' opposition to privatization.

The managers of state enterprises were, for the most part, isolated and expropriated of their power to block privatization. Their leverage had depended on a close alliance with other major businesses that benefited from public ownership. When the resistance of this group was broken, individual public sector managers could do little. The managers were offered voluntary retirement packages, and a role in the commissions that implemented the privatization plans—but little else (Alexander and Corti 1993, p.4). Menem appeased the military by granting an amnesty from prosecution to soldiers accused or convicted of human rights abuses during the military period or of participating in barracks uprisings or planning the Falklands invasion. He also

[9] As a result of the share ownership provisions, about 100,000 employees in telecommunications, oil, gas, and electricity companies became share owners. Those in telecommunications received shares at one sixth of the market price (Manzetti 1999, pp.140, 149).

promised to use some of the revenues from privatization to raise officers' salaries and buy military supplies, although this promise was not kept (Manzetti 1999, p.98).

The greatest challenge Menem faced was outmaneuvering the *capitanes de la industria*. Their covert opposition had been key to the failures of Alfonsín to get privatization moving. Menem's strategy was to win the defection of key members of this group by involving them in privatizations, on highly lucrative terms.[10] Suppliers of public enteprises were given preference in their sale, and the state often assumed some of the enterprise's debt prior to privatization. Monopolistic or oligopolistic conditions were preserved for some years, and buyers of public utilities were guaranteed they could charge high tariffs (Peralta-Ramos 1992, p.110). In addition, the sale prices were often lower than observers had anticipated.[11] In the oil industry, previous private contractors were simply granted 25-year concessions to the oil fields they had previously been mining, at no additional charge. The share of some of the leading Argentine companies in petroleum production increased dramatically (Etchemendy 2001, p.13).[12] These benefits persuaded leading *capitanes* to part with their old contracts and subsidies in return for cheap access to the property of public companies—a trade of current rents for property rights (see Table 1). Once the leading *capitanes* had defected, it was hard for the smaller beneficiaries of state ownership and protection to organize effective opposition (Corrales 1998).

[10] Some of these groups had reportedly been among the largest contributors to Menem's electoral campaign, so there was probably also an element of repayment involved (Manzetti 1999, p.83).

[11] The *Wall Street Journal* (August 31, 1990, quoted in Peralta Ramos 1992, p.117) claimed that the state telephone company Entel and the airline Aerolínias Argentinas were sold "for a fraction of their net worth." The government sold 60 percent of ENTEL in 1990 for $917 million (Ongaro 2000, apendix). In 1988, one of the winning bidders had offered $1 billion for just 40 percent. At that time, the deal was blocked by Congress.

[12] For instance, the share of Pérez Companc rose from 8.9 percent in 1987 to 13.6 percent in 1994; that of ASTRA increased from 1.8 to 5.2 percent in the same period; while that of Bridas grew from 2.8 to 4.3 percent. International oil companies did not do so well. The share of AMOCO fell from 10.0 to 7.0 percent (Etchemendy 2001, p.14).

Table 1: Major Economic Groups Participating in Argentine Privatizations

Economic Groups	Participated in privatizations in following sectors
Pérez Companc	telecommunications, oil, road concession, electricity, gas and oil transportation and distribution, distillery,
Techint	Railways, oil, road concession, telecommunications, electricity, gas and oil transportation, steel
Pescarmona	railways, airlines
Bridas	oil, oil transportation
Bunge & Born	Petrochemicals, gas distribution
Loma Negra	Railways
Acindar	railways, electricity, gas distribution
Benito Roggio	road concessions
ASTRA	Electricity, oil, oil transportation, distillery
Comercial del Plata	tv, electricity, railway, oil, telecommunications, gas transportation and distribution, water services, distillery
Citigroup Argentina	telecommunications, steel, cold storage, hotels, gas transportation
SOCMA	road concessions, sanitation, gas distribution

Source: Bambaci, Saront, and Tommasi (2001), from Gerchunoff y Cánovas (1994).

At the same time, holders of the public companies' foreign debt were bought off with the right to use these debt papers at face value as part of the privatization payment (even though such debt was trading in 1990 at just 14 percent of face value) (Ongaro 2000, p.14; Gerchunoff 1993, p.19). In many of the large privatization deals, the government required that an international bank which could round up such debt papers be one member of the bidding consortium. For instance, Citicorp Venture Capital was a major participant in the group that bought the southern zone of Entel (Petrazzini 1993, p.70). This helped to forge partnerships between domestic and international capital and to align their interests. The involvement of foreign investors also helped stimulate a rapid inflow of foreign direct investment, the stock of which rose from $9 billion in 1990 to $73 billion in 2000 (UNCTAD 2001, p.302). And it eased the negotiations on a Brady deal, signed in 1992, which facilitated Argentina's return to world financial markets.

Overcoming the opposition in Congress that had blocked Alfonsín was yet another challenge. The first major legislation was passed by exploiting the social and political crisis in which Menem assumed office. In order to get him to agree to take over six months early, the Radicals—who still had a plurality in the lower house—pledged not to block Menem's economic legislation in the remaining months of the Congressional term. Under this deal, they allowed passage of the Law of State Reform of 1989, which specifically authorized the privatization of enterprises in a number of sectors—airlines, telephones, media, cultural activities, ecological preservation, underground railways, coal, and petrochemicals—and gave the executive the power to set the details of implementation (Llanos 2001, p.76).

However, in 1990, Congress and various leaders of both main parties reverted to opposing privatization. Subsequent privatization laws were much harder to push through. To win approval, the government relied on two strategies. First, as the government managed to win over or weaken the Congress members' constituencies (in business, the provinces, unions), this helped soften the stance of their representatives. Second, more direct cooptation was used to buy support of the Congress and the necessary party leaders. To bolster his coalition, Menem appealed first to the natural ally of neoliberal reform, the small, conservative Unión del Centro Democrático (UCD), a traditional enemy of Peronism. He also wooed the votes of traditional, regionally-based parties from the country's poor interior with continued pork-barrel projects (Manzetti 1999, p.95). As resistance grew within his own Justicialista Party, Menem brought more of the Peronist heavyweights into government. At the same time, Menem's economy minister, Domingo Cavallo, made a point of involving Congress in all details of the privatization process. From February 1991, he insisted that all privatizations would be submitted to Congress, rather than ordered by presidential decree (Corrales 1998, p.39). A bipartisan commission, with members from both houses, was given the "right to approve the divestiture process, bidding documents, and program terms and conditions" (Alexander and Corti 1993, p.4).

Intense negotiations preceded the passage of most privatization laws. Government representatives met privately with heads of the opposition parties and relevant committees to iron out the deals. While the State Reform Law was passed in one month, subsequent privatization laws took on average 10 months (Llanos 2001, p.85). Menem exploited competition in the Congress, and a number of bills relied for passage on the small regional parties. Often, the government made significant concessions along the way. For instance, in the case of electricity and gas privatization, the government agreed to amendments to restrict exports, with permission to export gas to be granted only so long as "internal supply would not be affected" (Ibid, p.88). The Partido Renovador de Salta, a small, regional ally of the Peronists, had lobbied for this. Congress also intervened to demand subsidies to compensate provinces and the issue of bonds to benefit workers (Ibid, p.89). Although Menem sometimes exercised a partial veto rather than concede too much to the deputies, he almost always moved a considerable way in the parliament's direction. By eroding effective opposition to privatization in their constituencies, and bribing them with direct involvement and concessions, Menem managed to get a sufficient coalition of deputies to pass most of the privatization laws.

Getting privatizations implemented required the acquiescence of local and provincial governments where the firms in question were located. These governments feared a loss of direct revenues and local unemployment. Again, Menem offered a variety of concessions and benefits to coopt them. First, they were given a share of control over the process. Each privatization was implemented by a specially created privatization commission, which included representatives of provincial and local governments, as well as others from the central govenrment, the sectoral policy authority, audit and control bodies, and company management (Alexander and Corti 1993, p.4). Second, they were offered material rewards. The provinces were sometimes given a share of the proceeds, and small ports were transferred to them (Ibid, p.5) The government accepted amendments to the gas privatization bill that provided benefits to the provinces. In order to facilitate the privatization of the oil company YPF, the government transferred rights over hydrocarbons to the provinces and canceled a long-standing debt that the provinces owed to the federal budget for oil and gas royalties (Bambaci et al. 2001).

In sum, Alfonsín's attempts at privatization had mostly fallen victim to a coalition of opponents that included public sector workers, unions, and managers; major domestic businesses; provincial governors; and the Congressional representatives and party leaders that were responsive to these constituencies. Menem split both the public sector unions and domestic businesses by coopting a few of their leaders with positions and benefits in the privatization process. Workers were coopted with retirement benefits and company shares, but summarily fired if they went on strike. Provincial governors and members of Congress were offered detailed involvement in the design and implementation of privatization plans, and allowed to make a variety of amendments that served their—or their constituencies'—interests. Provinces were also offered other benefits and property rights if they acquiesced.

The compromises that Menem made introduced economic inefficiencies at every step. In order to get key *capitanes* to participate, he sold them properties for less than they were probably worth and guaranteed the continuation of monopolies and trade protection.[13] Many of the Congressional amendments which the government accepted reduced the security of property rights in the privatized firms or the flexibility of the labor market. But these inefficiencies need to be seen in context. Without any concessions, the government would not have been able to implement privatization, so the question is whether the government conceded more than necessary and whether the political costs outweigh the resulting efficiency gains from private ownership. I return to this question briefly in the concluding section.

3 Brazil

Brazil's flirtation with privatization had begun in the early 1980s. In July 1981, the military government announced a privatization policy and set up a Special Privatization Commission to implement it. However, by 1984 only 20 companies, with total employment of fewer than 5,000 workers, had been sold, yielding just $190 million in revenues. The World Bank labeled this first attempt at privatization a "classical example of failure" (Pinheiro 2000, p.11).

[13] Corrales (1998) refers to such benefits as "rents-as-bait". For an analysis of how state-created benefits were used to build a political basis for macroeconomic stabilization in Russia in the 1990s, see Treisman (1998) and Shleifer and Treisman (2000).

José Sarney, the first post-authoritarian president, also committed himself to privatization, although without much evident enthusiasm. Yet he, too, did not manage to force the pace. In 1985-9, only 18 companies were privatized, bringing in $533 million in proceeds (see Figure 2). Congress, fearful that the economy might succumb to domination by foreign capital, represented a key obstacle during this period. In 1989, it rejected a government bill (Provisional Measure 26) that would have made almost all state-owned enterprises eligible for privatization (Pinheiro 2000, p.13). The 1988 Constitution, drafted by Congress, restricted privatization, setting up public monopolies in telecommunications, oil, gas distribution.

The government of Sarney's successor, Fernando Collor de Melo, was determined to press ahead. In early 1990, Collor managed to get Congress to adopt as law a new Brazilian Privatization Program. While the governments of Collor and his successor, Itamar Franco, achieved some limited successes, raising $8.6 billion in cash and retiring $3.3 billion in debt papers in 1990-94, they were only able to sell off 33 enterprises. These privatizations greatly decreased the state's role in the steel, petrochemical, and fertilizer sectors, but left untouched its inefficient monopolies in public utilities, oil and gas, and transportation (Pinheiro 2000).

[Figure 2 Here]

This changed under Cardoso, who was elected president in 1994 on the success of the Real Plan he introduced as finance minister, which defeated the country's chronic inflation. In 1995-8, 80 privatizations occurred, raising $60.1 billion and transferring debt worth $13.3 billion from the public sector to the enterprises' buyers. Not only did privatization take off at the federal level, it began and grew rapidly at the state level; of the $72.5 billion raised in 1996-2000, $27 billion came from state privatizations. Foreign investors were allowed to participate, and played an increasing role, which helped to finance the current account deficit and sustain the Real Plan's macroeconomic stabilization.

How did Cardoso break the log jam? Four main groups of stakeholders, similar to those in Argentina, had combined to delay and impede previous privatization efforts. First, public sector workers and their unions, most of which were allied with the left-wing Partido dos Trabalhadores (PT), had fought to defend their jobs and privileges. Second, the public enterprise managers and the central sectoral ministries also stood to lose control over lucrative positions and resource flows (Weyland 2000). Third, public enterprises were often crucial to the health of local economies and employment; provincial governors had reason to fear the political consequences if privatization led to job losses or plant closures. They can also organize protests or simply refuse to cooperate in privatizations.[14] Finally, parliamentary politicians were sensitive to the lobbying of each of these constituencies. In particular, in Brazil's weak party system governors had a great deal of influence over their state delegations.[15]

In order to broaden the scope of privatization, the government needed to get three fifths of the members of both houses of Congress to vote for constitutional amendments that would end the state monopolies in telecommunications, subsoil resources, electricity, coastal shipping, gas distribution, and petroleum. It also hoped to get a constitutional amendment removing discrimination against foreign investors. In the spring of 1995, parliament obliged, passing almost the entire set of amendments that Cardoso demanded.[16] The other stakeholders were crucial to the implementation process. Strikes, protests, law suits, covert obstruction and delaying tactics could have slowed the process to the pace observed under Collor or even Sarney, while scaring away the foreign investors that were key to sustaining Cardoso's main achievement—stabilization.

[14] In a gesture that was extreme although largely theatrical, the governor of Minas Geraís state, former president Itamar Franco, sent units of his state military police to occupy the local federal electric station, Furnas, after discussions took place about its privatization (Altieri 2001).

[15] A fifth possible stakeholder group was the domestic business community (which, as in Argentina, included firms that had benefited from public contracts or cheap state-enterprise-provided inputs). Cardoso appeased business by: granting tariff protection for a variety of products in the automobile and electronic goods sectors; providing soft loans for some; and structuring major privatization deals to ensure involvement of domestic capital (Manzetti 1999, p.198).

[16] The state monopoly in petroleum was "flexibilized" rather than ended (Fleischer 1998, p.123).

Forging a coalition in parliament sufficient to get the constitutional amendments passed, as well as other elements of Cardoso's reform program, required inventive cooptation. First, Cardoso joined forces with the natural allies of privatization. In preparing to run for president in 1994, he opted to ally with the Partido Frente Liberal (PFL), even choosing a PFL vice-president to run on the ticket. This was, in some ways, a bizarre decision for a social democrat who had opposed military rule: the PFL was a conservative party of economic bosses and former supporters of the military regime (Resende-Santos 1997). But it included a faction of liberal ideologues that were more enthusiastic about privatization than Cardoso himself.[17] The party's strength in the less developed, clientelistic North-East, and on Congressional committees, was invaluable in pushing through the necessary legislation. To keep the support of this and other conservative parties, Cardoso backed off from raising the corporate income tax in early 1994 (ibid, p.184). To buy the acquiescence of rural interests, the government also agreed to defer debt payments worth some $1.8-5 billion by landowners to the Banco do Brasil (Mainwaring 1999, p.317) So as not to antagonize the parliamentarians, Cardoso approved a 100 percent increase in legislative and executive pay (Kingstone 1999, p.202). After his landslide victory in the 1994 presidential election, the centrist PMDB also joined Cardoso's coalition.

To disorganize the resistance of public sector workers and their unions, Cardoso employed both carrots and sticks, very much in the manner of Menem. He appeased them with short-term spending and higher salaries, but responded forcefully if they went on strike. Public sector salaries were raised in late 1994, resulting in an increase in federal expenditures on personnel by 22 percent in 1995 and major additional payroll costs for the state governments (Weyland 2000, p.54; IMF 2001, p.155). Cardoso also encouraged workers to participate: by 1999, almost 150,000 employees had become shareholders in privatized companies (Pinheiro and Giambiagi 1999, p.24). However, when the oil workers' union went on strike in May 1995 to

[17] For some hints of Cardoso's hesitance, see Resende-Santos (1997, p.175).

protest planned privatization, Cardoso fired the ringleaders, publicly labeled them "enemies of the people", and sent the army to defend the refineries (Kingstone 1999, p.205). Although various unions and the PT did protest privatizations actively, they were too isolated to have much effect.

The government neutralized the managers of state enterprises by dividing them from their natural allies—the ministries, provincial governments, and their own workers. The key ministries were coopted by giving them a direct say over details of the privatization process. Most decisions were made by the National Privatization Council, which was responsible directly to President Cardoso. This Council had two presidents—the ministers of development and industry and commerce. In addition, it included the finance minister and the minister of budget and management, as well as the minister of the sector to which the enterprise in question belonged (BNDES 2002). Privatizations of road and telecommunications companies were assigned to the sectoral ministries rather than having to go through the National Privatization Council (Baer 2001, p.288).

The state governments were perhaps the trickiest stakeholder group to manage. Privatization would imply the loss of control over major local employers and profit streams. Under Franco, key governors had vigororously opposed public sales (Manzetti 1999, p.196). Yet, as noted, privatization by the states themselves began and grew rapidly under Cardoso, totaling \$28 billion in 1996-2000. One incentive was associated with a major debt bailout that the federal government extended to states in the late 1990s. Conditional on the state governments adopting a fiscal adjustment program and selling their state banks and insolvent state enterprises in electricity, water, sewage, the federal government agreed to assume large state debts. During 1998, the federal government refinanced \$74.5 billion of state debt (Selcher 1998, p.44). One strength of Cardoso in these negotiations was that three of the states with the largest debt—São Paulo, Rio de Janeiro, and Minas Geraís—had governors from his PSDB, who had been elected on Cardoso's coattails in the 1994 election. Their future electoral prospects depended in part on his good will, and in larger part on the continued success of his macroeconomic projects. This made it hard for these states to bargain credibly for better terms, and for other states to organize resistance. At the same time, with other sources of funding shut off because of their dubious finances, states resorted to privatization in order to finance their spending (Pinheiro 2000, p.18; Selcher 1998). States were even permitted to borrow from the Brazilian National Development Bank (BNDES), which doubled as the privatization agency, against future privatization revenue.

Seen as a whole, Cardoso's strategy looks remarkably similar to that of Menem. Public sector workers were offered positive incentives, but attacked ferociously if they went on strike. Public sector managers were split from their natural allies and neutralized. Parliamentarians and ministries were wooed with perks and compromises on the details of legislation, as well as involvement in supervising implementation. In parliament, each leader knitted together an odd coalition of free market ideologues, clientelistic political bosses from poorer provinces with a taste for pork, and the more timid members of his own left-wing or center-left party, elected on their leader's coattails and afraid of falling off. Provincial leaders were bought with a share of the proceeds or of the property rights, other material benefits, or debt refinancing.

The main difference appears to be the extent to which the domestic business community was enticed with government-created benefits. Although I do not attempt to compare systematically, such payoffs were more evident to the naked eye in the Argentine than the Brazilian case. Major businesses in Brazil certainly also benefited from privatization. But, at least according to some close observers, the advantages were less targeted at specific domestic conglomerates than in Argentina (Manzetti 1999, p.303). It is possible that the difference relates to the two countries' struggles against inflation. The major conglomerates in Argentina were suspected of having been directly involved in dumping australs to defeat previous governments' stabilization plans, which may have led to a deliberate attempt by Menem to coopt them individually (Treisman 2002). In Brazil, the currency's numerous previous collapses tended to be seen as the result of a broader set of causes. And at the start of the reform period, Brazil's central bank had far greater international reserves than Argentina's, rendering it less vulnerable to narrow speculative attacks.[18]

4 Concluding Remarks

Under presidents Menem of Argentina and Cardoso of Brazil, privatization advanced rapidly in the 1990s. Unlike their predecessors, whose efforts to get the process started had bogged down, Menem and Cardoso managed to find a set of tactics that would break through political opposition. Their choice of allies was remarkably similar. Each leader built a support coalition that included clientelistic politicians from poorer provinces, free market ideologues, left-wing deputies elected on his coattails, major private businesses, certain provincial governors, and more moderate union leaders and employees.

To build such coalitions, each had to coopt key stakeholders. There were two ways to do this: (1) by negotiating an explicit bargain, or (2) by creating vested interests in reform—that is, by giving the stakeholder an opportunity or asset whose value would increase with reform's success. The disadvantage of explicit bargains is that deals over policy are rarely enforceable, and therefore are not credible. Repeated interactions with relatively low stakes reduces the problem by creating incentives to invest in a reputation for reliability. The executive's dealings with key legislators have this quality, and so "back-room deals", like the ones that eased the path of privatization legislation in both Argentina and Brazil, are common. The second method is self-enforcing, so long as the interest remains "vested". If the stakeholder can sell the asset or opportunity, though, he may "divest" himself and return to his initial opposition.

To coopt allies, governments can use any of three *cooptation currencies*: money, property, or rents. Certain conditions determine which is likely to be preferred. If the stakeholder

[18] At the end of 1994, Brazil's central bank had $38.5 billion in gross international reserves, equal to more than total 1994 imports ($35.5 billion) or the country's entire short-term external debt ($31.4 billion). Argentine gross international reserves at the end of 1989 were only $3.2 billion, compared to imports of $4.2 billion and short-term external debt of $8.5 billion (World Development Indicators, 1999).

is short of cash or constrained from borrowing, and it is possible to write an enforceable contract, money may be effective. For instance, by the mid-1990s, most Brazilian state governments were very short of cash and had been shut out of capital markets by their large accumulated debt and poor fiscal record. Cardoso was able to trade a federal refinancing of their debt for the privatization or closure of state banks (in this case payments could clearly be timed to make the contract credible).

If the reformer needs to create vested interests, this is often easier with property than with money, that most fungible of commodities. By persuading the major domestic business leaders to take stakes in privatized enterprises, Menem increased the odds that they would continue to support privatization—at least until they could resell their stakes. Transferring cash or property is generally less distortionary than resorting to the third currency, government-created market restrictions that yield super-normal profits, or "rents". Yet, for governments with little cash or property to offer, rents are sometimes the only currency available. Since some market restrictions have larger social costs than others, there may be a role for persuading stakeholders to exchange their more destructive rents for less costly alternatives.[19]

Within each group of stakeholders—whether of businesses, provincial governors, or congressional politicians—the appropriate tactic was "divide and rule". If the government could coopt a sufficient kernel of leaders, the others would be unable to organize opposition; many would resign themselves, or even switch to support. Others could be crushed *pour décourager les autres*. Given each president's limited cooptation resources, the art was to judge just how many ringleaders he needed to appease and how much he needed to offer to each. Although Menem and Cardoso were skilled at using cooptation to break opposition coalitions, it is not clear that they always used the cooptation currency that minimized efficiency losses or set the lowest price. In Menem's case, lowering the privatization price more (i.e. transferring property) would have been less distortionary than privatizing firms with monopoly protection or guaranteed minimum tariffs

[19] Corrales (1998) calls this strategy the use of "rents as baits".

(i.e. transferring rents).[20] It is hard to judge from outside, but one wonders whether foreign and domestic businesses might have been willing to settle for slightly less attractive privatization deals. Cardoso could surely have found some way to appease export industry that was not as distortionary as very high import tariffs.

The political economy of privatization in Argentina and Brazil offers an interesting parallel to that in Russia in the early 1990s (see Shleifer and Treisman 2000). In some ways, the strategies of reformers in all three countries overlapped. The coalitions Yeltsin's administration patched together in parliament to promote privatization-related legislation were quite similar to those of Menem and Cardoso—combining economic liberals, opportunistic Yeltsin supporters, and patronage-oriented regional deputies whose votes could be bought with pork and perks. Like Menem in Argentina, Yeltsin bent over backwards to involve the domestic business titans—in Russia, called the "oligarchs"—letting them snap up major oil and minerals enterprises for extremely low prices. This aroused even more scandal in Moscow than in Buenos Aires. Like Menem, Yeltsin probably gave away more in these deals than was necessary to get the oligarchs to participate. A common theme in all three countries was the close relationship between privatization and macroeconomic stabilization. The cooptation of domestic banks with high-rate government bonds and temporary market protections in Brazil was very similar to that in Russia. In all countries, as major exporters acquired privatized firms, they became more interested in currency stability.

A few differences stand out (besides the obvious difference in scale: Russia had to privatize virtually the whole economy). First, the extreme fiscal crisis in Russian forced the government to coopt with shares rather than cash payoffs. Whereas workers in Argentina and Brazil were bribed with voluntary retirement packages, retraining schemes, and sometimes higher wages, in Russia they were coopted with shares in their companies. (Although workers in

[20] However, privatizations with unexpectedly low prices tend to look more "corrupt" than those with guarantees of market power.

Argentina and Brazil did acquire some shares in privatization, the scale was much smaller.) The result was an unusually high level of worker and management share ownership in Russia, which probably did not help corporate governance. Second, Russian unions were relatively weak, and so the privatizers managed to avoid giving them control over employee share packages, as occurred in Argentina. As a result, workers in Russia were generally free to sell their shares individually. Third, unlike in either Argentina or Brazil, the Russian government gave away a proportion of shares (about 29 percent) to the general public by means of a voucher scheme. Ironically, the low value of these vouchers on the secondary market came to be viewed as scandalous, and the exercise backfired on the reformers. The Argentine and Brazilian governments, which gave no shares at all to the general public, did not have this problem.

One similarity between Argentina, Brazil, and Russia in the 1990s—as well as Mexico under the *Porfiriato*—is that wealth and income inequality may well have increased.[21] In his article, James Robinson suggests that such inequality may result from the kind of deal-making that I believe is often necessary in order to get economic reforms implemented. He argues that in Mexico such inequality, combined with resentment engendered by large-scale foreign investment, led to explosive social pressures that culminated in revolution. He concludes, however, that Russia's democratic institutions and its relative unattractiveness to foreign investors may reduce such pressures.

I share Robinson's curiosity about "where the process of … deal making is eventually going," but I do not believe there are general answers to such questions. Deal-making—or political tactics, more broadly—are means that can be applied to different ends. They can be used to secure passage of reforms that decrease inequality as well as those that increase it. Those coopted with income-bearing assets are actors that have some way of impeding reform. But they are not necessarily rich. On the contrary, if the poor are able to protest, sabotage, or vote against the reformers' projects, they will usually have to be coopted, which should reduce inequality. The

[21] I have not seen time series data on this for Argentina or Brazil, but it seems likely.

more revolutionary are the poor, the greater the threat they will pose to reform, and the greater will be the reformers' incentive to coopt them.[22] This also suggests some doubt about the link between inequality and revolution. Even if inequality increases the motive of the poor to revolt, the dead-weight costs of revolution should give both sides an incentive to negotiate a peaceful settlement that both would prefer. Imperfect information or some two-level game could explain why such negotiations fail—but these could have similar effects at low or moderate levels of inequality.

The study of political tactics cannot, in my view, reveal when reforms will be implemented or what their broader consequences will be. But it can illuminate the process by which major changes are made to a country's institutions or policies. It helps to explain the "how" of reform (Shleifer and Treisman 2000). In their different settings, Menem, Cardoso, and Díaz all found ways to institute quite fundamental changes to the systems they inherited. In the language of Machiavelli, each mastered fortune, at least for a while.

[22] Some scholars even contend that the rich will extend democratic rights to the poor to preempt revolution (Acemoglu and Robinson 2000).

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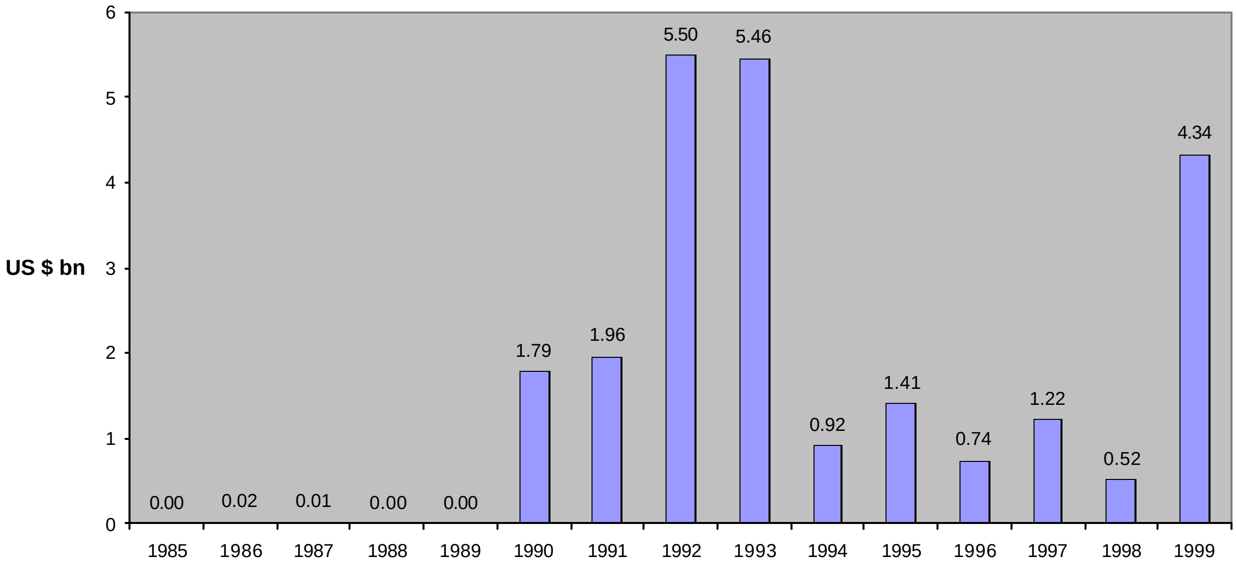
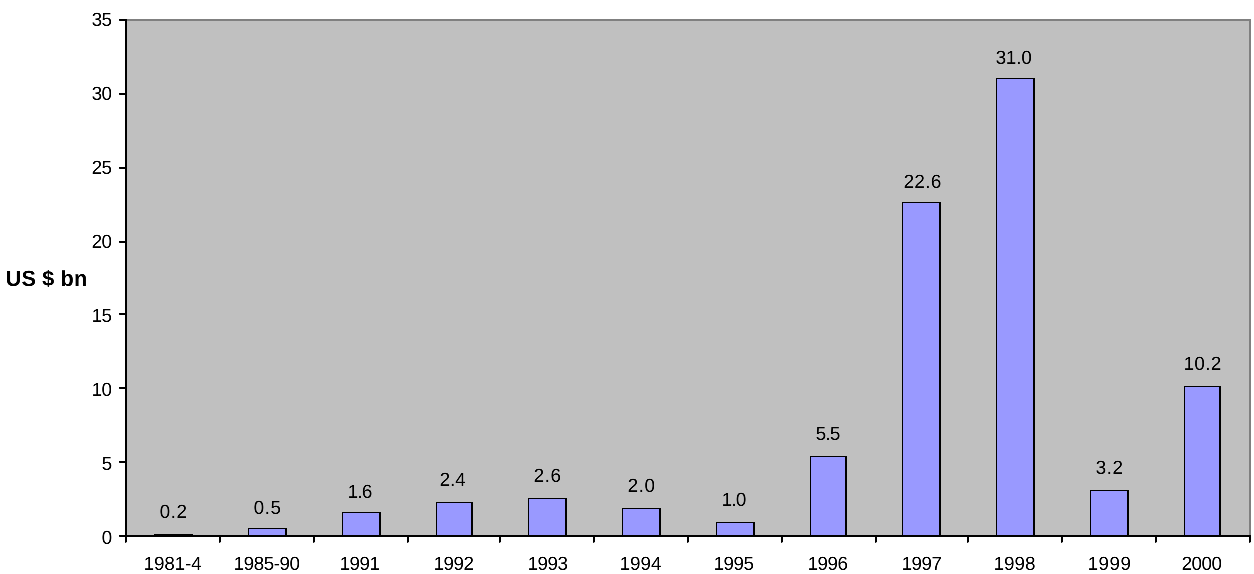
Figure 1: Privatization Proceeds, Argentina 1985-99



Sources: 1985-89, from Manzetti (1999, p.46 and passim); 1990-99, from Ongaro (2000, p.7).

Figure 2: Privatization Proceeds, Brazil 1981-2000



Source: Pinheiro (2000). Total for 2000 is for Jan-Nov.