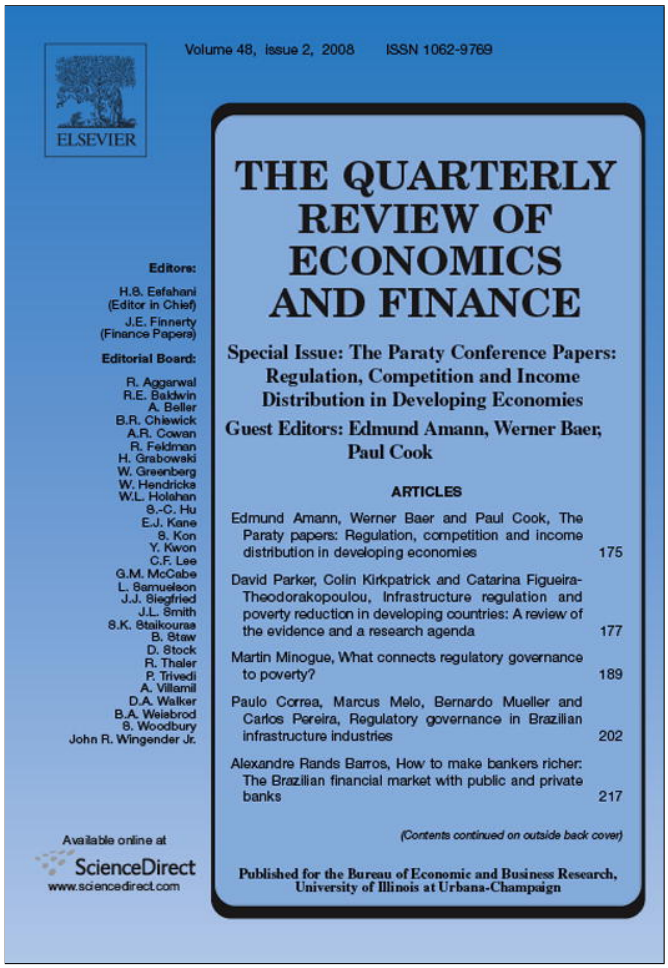

ELSEVIER

The Quarterly Review of Economics and Finance
48 (2008) 263–273

The QUARTERLY REVIEW of ECONOMICS and FINANCE

www.elsevier.com/locate/qref

Competition and circulation of economic elites: Theory and application to the case of Peru

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Received 13 December 2006; received in revised form 13 December 2006; accepted 13 December 2006
Available online 25 March 2007

Abstract

This study aims at understanding the behavior of economic elites. To do so, the paper presents a theoretical model of economic elites, which assumes a different behavior of elites for the First World and the First World economies. The paper then examines the empirical data of Peru to see whether they are consistent with the predictions of the theory and, indeed, finds consistency. At this stage of research, the theory of economic elites seems promising for explaining certain facts of the Third World: economic elites do not circulate endogenously; in addition, reforms in the market/state mix of the economy do not induce this circulation. If economic growth depends on the competitiveness of the economy, which in turn depends on more entrepreneurial capitalists, the latter depends, as suggested by the findings of this paper, on the circulation of elites (on the competition in this sphere, a kind of meta-competition).

JEL classification: D23; D30; O12

Keywords: Competition, Elites, Inequality, Social capital, Social exclusion, Walrasian markets, Non-Walrasian markets

1. Introduction

Economic elites constitute the core of the capitalist class. The behavior of economic elites is, however, relatively understudied in the literature. For instance, the topic of social mobility does not include studies about the degree of social mobility towards the top of the income pyramid. Are elites protected against newcomers? Is this protection based on natural barriers or is it constructed by the elites themselves? In general, what do economic elites do in order to maintain their social

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1062-9769/$ – see front matter
doi:10.1016/j.qref.2006.12.016

position? What changes if any has the current processes of globalization and liberalism brought into the circulation of elites and into competition? Such are the questions that this study intends to answer, theoretically and empirically.

In the First World, social mobility should be very significant. In this society, one should expect that individuals do not inherit their position in the income distribution. The transition matrix between generations should show a trend towards equality in the distribution of incomes. The income distribution process should be similar to the biological process that Francis Galton 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 towards equality.

In the First World, however, the actual degree of social mobility is still under debate. Initial empirical studies on intergenerational incomes of children and parents tended to show that, in fact, the correlation between these incomes was very low. Thus, based on studies made 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 detailed study based on a sample of Connecticut (USA) residents, which used the transition matrix approach, challenged that view and showed that children tend to occupy their parents' position in the income distribution (Menchik, 1979). More recent studies for the case of the United States indicate that the correlation between the incomes of children and those of their parents 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. No such studies seem to exist for the Third World. This paper attempts to start filling this gap.

The paper content is as follows. The theory of elites is presented in Section 2. As a first approximation, the empirical predictions of the elite theory are confronted against the Peruvian data. Section 3 presents the main results. The paper ends with a section of conclusions.

2. The theory of economic elites

In the standard literature, elites are defined as those social groups at the top of any rankable social-power scale (Bodley, 1999, p. 596). The rankable scale includes various types of assets, such as economic or social. Elites are important to understand society because they have social power. Social power refers here to *a group of individuals' ability to impose their will upon others*. This is the well-known Weberian definition of social power. In this definition, however, power appears unconstraint.

In the economic process, however, power is subject to constraints. Take the case of the theory of the monopolist. The monopolist acts guided by a motivation – maximization of 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. Actually, given these constraints and given the motivation of profit maximization, the monopolist could use his power to set, say, the highest price, but he will not. The monopolist is compelled to choose what is good for him, according to his motivation. There will be one and only one price that will satisfy his goal of profit maximization. Thus, the price cannot be arbitrarily chosen. If demand or cost conditions change, the monopolist will choose another price. Price is endogenously determined in a monopoly market.

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. Thus, social

power is interpersonal power. In this study, economic 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. Because power has a purpose, the elites are prisoners of their goals, much like the monopolist.

Many years ago, Bottomore (1964) proposed a theoretical hypothesis about the existence of 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.

But, why do elites constitute 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 to the size of the society. Therefore, the proportion of the governing body in relation to the total population will decline as population increases. This relationship implies that the power of political elite will also rise as population increases. Mosca, however, did not explain the reasons (the theory) underlying his empirical hypothesis.

A theoretical proposition that has been largely developed in the literature to explain the smallness of elites 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).[1]

The same principle should apply to economic elites. As we all know, Pareto defined the economic elite by the concentration of economic resources. Therefore, it follows that "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). In sum, the economic elite theory assumes that economic elites must exist in societies and that they must be small groups of individuals that rule 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 & Richard, 1992, p. 8). Similarly, one can establish the proposition that economic elites affect the income of many people because they concentrate so much physical capital and income flows 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 operates through the market system. Thus, unlike other systems, such as slavery or feudalism, economic power under democratic capitalism is impersonal. This is another assumption of the economic elite theory.

An empirical implication of the elite theory, which assumes that elites must exist and must be small, is that the only change that elites can undergo is the change in the membership of the elite. 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 political elite, but the

[1] Granovetter (2005) also puts forward this hypothesis: "Larger groups will have lower network density because people have cognitive, emotional, spatial, and temporal limits on how many ties they can sustain" (p. 34). Another force to have a small elite group is that it is easy to enforce norms against free riding, making collective action more likely to succeed.

statement may also be applicable to study of economic elites. Is the circulation of economic elites endogenous or exogenous? A theoretical answer is developed now.

On the motivations of the economic elites, the assumption proposed here is that members of economic elites seek not only to maximize profits but also to maintain their privileged position in society; moreover, between these two objectives, individuals have lexicographic preferences, by which maintaining the social position is a priority. They prefer more profits than less, but without loosing social position; that is, profits and social position are not substitutes.

What are the mechanisms that reproduce the elites' privileged position? This is done through various mechanisms:

(a) The economic elites invest in projects that have high returns even if they are subject to high risks because these groups have the economic capacity to bear high losses.
(b) They use the insurance market to protect their capital stock against insurable risks.
(c) In addition to profits, they use their access to capital markets to finance their investment.
(d) Influence on government policies.
(e) Social protection against uninsurable risks.

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 any other group. Mechanisms (b) and (c) refer to their privileged access to two basic markets in the process of capital accumulation. The same can be said about the mechanism (d) because politics is all about big money and big connections. Mechanism (e) also comes from the elite's endowment of high social networks.

Social networks, therefore, play a significant role in the reproduction of the economic elites. Social mobility is blocked by the mechanisms of market exclusions, which facilitate the social reproduction of the economic elites. Market exclusions can then be seen as "natural" barriers to social mobility because they are built in the economic process. The political network is an additional mechanism. Social networks also give elites a higher degree of social protection, reducing greatly the risk of an economic disaster, that is, the loss of the privileged position as member of the elite group. A member's firm may go bankrupt, but his elite membership need not. In this manner, economic elites construct additional barriers to social mobility to the top.[2]

In societies where the degree of inequality in the individual endowment of economic and social assets is very high, as is the case in the Third World countries, the competition to reach the position of the economic elites will be weak. In addition to the barriers mentioned above,

[2] A simple illustration of this theory can be presented as a modified model of the monopoly firm's theory. The relevant set of equations can be shown as follows:

$$\begin{aligned} &\text{Maximize} && P_j = P_{bj} Q_{bj} - H(Q_{bj}; V) \\ &\text{Subject to} && P_{bj} = G(Q_{bj}; Z), \quad G_1 < 0 \\ & && Q_{bj} = F(K_j, L_j, N_J), \quad F_i > 0 \end{aligned}$$

The first equation shows the profit equation of the monopoly firm, where P_j represents nominal profits, P_{bj} the nominal price of good B, Q_{bj} the quantity of good B produced, and H is the short run cost function. The firm seeks to maximize profits subject to the function G (the inverse demand function for good B) and the production function F. Output depends upon physical capital K_j, labor L_j and the social network N_J, which the owner of the firm j belongs to. Social network appears as an input in the production process. The larger the quantity of input N (a social network of a larger size and power) the higher is the quantity of output and, for given quantities of capital and labor inputs, the higher the returns of these resources (as high mean and low risk). The terms V and Z represent exogenous variables of the system. Profits depend now upon the social network of the owners of the firm and part of profits can be seeing as returns to social networks.

pronounced inequalities in the endowments of physical capital and of social status (related to the hierarchy between ethnic groups) will give a greater protection to the economic elite; in this type of society, with strong class and race divisions, and social exclusion, it is not certain that "money talks" (Figueroa, 2003).

An empirical hypothesis that can be derived from this simple theoretical model is that circulation of elites would be endogenous in the First World. By contrast, economic elites do not circulate endogenously in the Third World, but only as a result of major upheavals in society.

3. The behavior of economic elites in Peru

The empirical data needed to test the hypotheses presented above for the Third World are unfortunately not available. Some basic data have been constructed for the case of Peru, which will allow us to present some evidence on the behavior of the elite regarding the formation of social networks.

3.1. Empirical definition of the economic elite

Using an ample definition of the elite families, which includes the owners of large firms (with more than 20 workers) and the professionals with university degrees employed by these firms, the estimate one gets is just around 1% of the population (Figueroa, 2001).

The particular sample of elite families drawn for this study comes 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). 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); therefore, the total number of firms studied is only 39 (Figueroa, 2001).

The next step consisted in identifying Peruvians from the set of directors of these 39 firms. Considering 10 different directors per firm, on average, this would imply a set of near 400 people. The group size estimated is, however, only 37 Peruvians. Part of this gap is explained by the 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 most notable reason is the *pronounced overlaps of directors*. The conclusion is unavoidable: given the cut off value in the ranking of firms, the local economic elite is very small in Peru. (Peru's population is around 27 million.)

Within the group of the top 1000 firms in Peru, the top 4% (40 firms) concentrated 36% of total gross sales and 64% of total profits before taxes in the period 1993–1998. 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] Another estimate based on data from the Government Revenue Service (SUNAT) shows that the largest 0.4% of contributors (around 6000 firms) accounted for 92% of total sales tax revenue in 1994 (Durand, 2003, Table 2.3, p. 99).

[3] Regarding the degree of concentration of profits, the mean Gini coefficient within the top 100 firms with positive profits during the period 1997–1999 is 0.88 (!).

3.2. Overlapping corporate board memberships as social networks

What is the economic organization adopted by elite families in Peru? The elite theory presented above is consistent with the view that elite families operate forming 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. The classical work of Leff (1978, 1979) puts forward the hypothesis that in the Third World elite families will operate in the form of economic groups. Leff's theory assumes that this is a rational way to overcome factor-market imperfections that characterize the Third World, in which capital markets and credit markets are either non-existent or under developed.

Elite's social networks will be measured here by the degree of overlapping corporate board memberships, also called the interlocking corporate directorates in the business organization literature (cf. Mizruchi & Linda, 1988). This variable is clearly observable.

Table 1 shows the network of social relations among the elite measured by the interlocking corporate directorates in Peru's largest firms. In Table 1, the same people are presented horizontally and vertically, and thus each entry says whether or not the two persons share the control and ownership of at least one firm; if the cell is marked 1, they do; if it is marked 0, they do not. For instance, person 1 is connected to other 18 Peruvians in the control and ownership of several firms. This information can be read either horizontally or vertically. Person 25 is connected to other five Peruvians. Person 37 is connected to no one, except to itself, and the diagonal is marked 1, and so are all diagonals.

Table 1 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 isolated owners of single firms, with no connections with the rest of the Peruvian elite.

If there were no social networks among individuals, cells with the value of 1 would appear only in the diagonal of Table 1. If all individuals formed one single network, all cells would have the number 1. Thus, a simple index of the degree of density (d) in a social network can be established as follows:

$$d = \frac{m - n}{n^2 - n} \tag{1}$$

The term m is the number of cells in the matrix with number 1, that is, where nodes are present; and the term n is the number of individuals. This index varies from zero (no networks, where $m = n$) to one (all belong to a single network, where $m = n^2$).

For the total 37 Peruvian elite families, the calculation from Table 1 results in $d = 0.20$; for the group of families 1–25, we get $d = 0.43$; for the group of families 1–10, the value is $d = 0.60$. These results suggest that the group 1–10 operates as a very dense economic group; the group 1–25 operates as a less dense economic group; and the total 37 families as a weak economic group.

The last column of Table 1 shows the connections of the Peruvian elite with multinational corporations. Only 8 out of 37 families do not show direct relations with any corporation as member of the board of directors in any firm. But indirect relations do exist, because their Peruvian partners are connected to corporations through the board of directors. Thus, the Peruvian elite are strongly connected to multinational corporations.

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

Table 1
Peru: elites as economic groups

Families		Romero	Graña	Miro Quesada	Moreyra	Fort	De La Puente	Wiese	Onrubia	Brescia	Nicolini	Montero	Picaso	Bentin	Benavid	Bustam ante	Woodm an	Pollit	Raffo	Piazza	Bercke meyer	Losa	Beoutis	Ledesm	Rizo Patron	Montori	Sotoma	Cilloniz	Ferreyro s	Michell	Wong	Batievs ky	Matos	Galsky	Lucioni	Rodrigu ez	Custer	Ikeda	Cogorn	Arias	Multinat ional
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	1	18	19	2	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	36	37	MN
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	1
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	1
Miro	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	1
Moreyra	4	1	0	0	1	1	1	1	1	1	0	1	1	1	0	1	1	1	0	1	0	0	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0	1
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	1
De La	6	1	1	1	1	1	1	1	0	0	0	1	0	0	1	1	0	0	1	0	0	1	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0	1
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	1
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	1
Brescia	9	1	0	0	0	1	0	0	1	1	1	0	0	1	0	0	1	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Nicolini	10	1	0	0	0	1	0	0	1	1	1	0	0	1	0	0	1	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Montero	11	0	1	1	1	0	1	1	0	0	0	1	1	1	0	1	0	0	1	0	0	1	0	0	0	0	1	1	0	0	0	0	0	0	0	0	0	1
Picaso	12	0	0	0	1	1	0	0	0	0	0	1	1	0	0	0	0	0	0	0	0	0	0	0	1	1	0	0	0	0	0	0	0	0	0	0	0	1
Bentin	13	1	0	0	1	1	0	0	1	1	1	0	0	1	0	0	0	0	0	1	1	0	0	0	1	0	1	0	1	0	0	0	0	0	0	0	0	1
Benavides	14	1	1	1	1	0	1	1	0	0	0	0	0	0	1	1	0	0	1	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	1
Bustamante	15	1	1	1	1	1	1	0	1	1	1	0	0	1	1	1	0	0	1	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	1
Woodman	16	1	0	0	0	1	0	0	1	0	1	0	0	1	0	0	1	1	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Raffo	17	1	0	0	1	1	0	0	1	1	1	0	0	1	0	0	1	1	0	0	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Piazza	18	1	1	1	0	1	1	1	0	0	0	0	0	0	1	1	0	0	1	0	0	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	1
Berckemeyer	19	1	0	0	1	0	1	1	1	1	1	0	0	0	0	0	0	1	0	1	0	0	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Losa	20	1	0	0	0	1	0	0	1	0	1	0	0	1	0	0	1	0	1	0	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Beoutis	21	0	1	1	0	1	1	1	0	0	0	1	0	0	0	0	0	0	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1
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	1
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	0	0	0	0	0	0	0	0	0	0	0	0	1
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	0	0	0	0	0	0	0	0	0	0	0	0	1
Cilloniz	25	0	0	0	0	1	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	0	1
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	1
Batievsky	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	1
Matos	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	1
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	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	1
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

Source: Figueroa (2001).

It seems then that the major reason behind the formation of economic groups is the positive social network effect upon uninsurable risks. Social networks are part of a survival strategy of elites in order 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 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 commonly cited in the literature that the mean death rate of large firms is much smaller than the counterpart rate of small firms seems to be the other side of the coin. Economic elites are socially more protected against economic disasters. The majority of the 26 families that Alcorta (1992) identified as the economic elite in 1983 also belong to the core of the economic elite around the year 2000. The members of the economic elite may loose control of a firm or may close a firm, but as economic agents they will hardly disappear.

3.3. Circulation of elites

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 oligarchic families.

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. Intermarriage within the elites was also the norm. The Prado and Aspillaga families disappeared in the 1960s, while the Miro Quesada family runs one of the principal newspapers of Peru up until now. Another finding of Gilbert's study is the identification of almost 30 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 the intermarriage 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.

General Velasco's revolution (1968–1974) marked the end of the old oligarchy, which was largely based on land ownership. The agrarian oligarchy practically disappeared as a result of the agrarian reform. Today's economic elite includes few survivors of those traditional families; it mostly includes new families that emerged after this revolution.

Velasco's revolution also marked the end of a period of an economy with a higher mix of market/state context and initiated a new context with a lower mix. Around 50 large state firms were created, mostly as part of a program of nationalization of foreign capital (Peru, Banco Central, *Memoria 1977*, Table 14, pp. 43–44). Protection was given to the industrial sector. The government of President Fujimori started in 1990 a program of liberal economic reforms to increase the mix of market/state. Most state firms were privatized and acquired mostly by foreign firms again. Today few firms still remain in the hands of the state. The five largest state firms include: PETROPERU, ELECTROPERU, SEDAPAL (water and sewage services) and CENTROMIN (mining) (Peru, Banco Central, *Memoria 2004*, Annex 61, p. 239). State development banks were closed. Land markets were opened. The degree of openness of the economy increased, particularly in the capital markets. Thus, Peru has completed a kind of full cycle in economic reforms since 1950.

Have the neo-liberal reforms had any effect on Peru's economic elites? Not a significant one. The new core of the Peruvian elite that appeared after the Velasco's revolution has been able to survive the neo-liberal reforms. As was shown in table, the strategy was to join the multinational corporations that took over many state firms and open new firms in Peru. The share of the Peruvian elite in capital ownership has possibly declined, but they remain as the domestic elite group and also as a small group.

In Peru, thus, there has been a circulation of the elites due to external shocks – a nationalist military revolution – not due to the process of neo-liberal economic reforms. Economic growth, which was significant in the 1950s and 1960s, did not bring changes in the elites either. This result is in accord with one of the predictions of elite theory in the Third World.

3.4. Economic power and the allocation of profits

The elite families also concentrate profits. They decide on the use of profits, whether to invest locally or abroad. They have economic power in the sense that they impose their will upon others. Hence, they affect the incomes of millions in society. In spite of much globalization and free mobility of capital, private investment in the Third World depends to large extent on domestic profits, that is, on the behavior of the domestic economic elite. Foreign investment takes place basically among First World countries. As Markusen (2002) has shown "Not surprisingly, the developed countries are the major source of [foreign direct investment], but perhaps less known, they are the major recipients as well" (p. 8).

The concentration of capital implies that the economic elite can impose ultimately their power on the government or workers by threatening to reduce investment. This power can be called the *Kaleckian threat*, for this proposition was initially presented by Kalecki (1943). The limited power of elites is also shown in this situation.

The behavior of elite families regarding investment in Peru has not been possible to measure. Information at 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, *Cuentas Nacionales*, Cuadro 5, p. 20). This information is not available for the following 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 (Bennett, Loyza, & Scmidt-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 increasing globalization in the world economy. 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. Streeten (2001) has indeed made a striking 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" (p. 103). It seems that the fraction of domestic profits that flight abroad is somehow compensated by the inflows of foreign direct investment. Hence, the behavior of investment is as if most of it came from domestic profits.

4. Conclusions

Economic elites are placed at the top of all rankable assets. The theory proposed here is that members of the elites act guided by self-interest motivations, which in their particular case include

two objectives that are lexicographically ordered: first, they seek to maintain their privileged position in society and, only when this objective is assured, they seek profit maximization. The predictions of the elite theory depend on the type of the capitalist society: the circulation of elites is endogenous in the mature capitalist societies (the First World), but it is exogenous in developing capitalist societies (the Third World). In a socially heterogeneous society, where social exclusion mechanisms are important, the power of economic elites confronts only weak challenges by non-elite groups.

As a first attempt to confront theory with reality, the empirical side of this study presents the case of Peru. Given the available data, the result is that Peru's economic elite operates in accordance with the predictions of elite theory. For an empirical definition of the elite, using a specific threshold in the ranking of firms, and using overlapping corporate board memberships (also called interlocking corporate directorates) in the largest firms as an indicator of the size of the elite group, the observed economic elite is indeed small, and has remained small and powerful since the beginning of the 1970s in spite of the several reforms on the market/state mix that the Peruvian economy has undergone. The elite have constructed an interlocked business organization in the form of economic groups.

As the theory predicts, some elite circulation has occurred in Peru as a result of major upheavals. The land reform applied by the revolutionary military government during 1969–1974 eliminated the traditional oligarchy. The circulation of elites has not come endogenously from economic growth; it has not come from reforming the market/state mix of the economy either. Finally, the power of the elite appears in their investment decisions. The life of many people depends upon those decisions. In spite of a higher degree of globalization in the world economy, including the liberalization of international capital markets, domestic investment still depends, to a large extent, on the allocation of profits by the domestic economic elite. Foreign direct investment still originates mostly in the First World and goes mostly to the First World as well.

Rapid economic growth requires a competitive economy, which requires the elite to be constituted by a group of Schumpeterian entrepreneurs, which in turn require competition for displacing elite groups. The latter is a kind of meta-competition. The endogenous circulation of elites, the contestable competition for the elite position, is prior to the competition in the markets. Since market/state reforms do not change the composition of the economic elites towards more entrepreneurial agents, the degree of competitiveness of the economy will not increase significantly with those reforms.

Although more empirical work is needed, the policy implications of the theory presented here challenge the conventional views on development. The poor and the wealthy seek to accumulate social networks. But they form different social networks with different economic returns, in relation to mean income and risk reduction. In terms of risk reduction, the poor use social networks as part of their physical survival strategy. The elite group uses it as a device to maintain a social privilege in society and expand capital accumulation.

In the Third World, the economic elites are endowed with larger quantities of economic and social assets, which give them capacity to build the most advantageous social networks. This superiority in social networks generates additional blockages to social mobility and contributes to the reproduction of income inequality. As in the theory of human capital formation in the schools, the "peer effect" in social networks is positive and stronger for the elites. This conclusion is not in accord with the more optimistic view about the potentiality of social network to fight inequality that is found in the literature. For instance, in its *World Development Report of 2001/2002*, the World Bank says, "social networks are key assets in the portfolio of assets [for the poor and the rich], but their relative importance is greater for poor people" (World Bank, 2001, p. 129). This

wrong insight originates, it seems, from the "poverty approach" to development followed by the World Bank; an "inequality approach", as followed in this paper, leads us to different results.

Although statistical tests are still pending, the theory of economic elites seems promising for explaining certain facts of the Third World. Economic elites do not circulate endogenously; that is, reforms in the market/state mix of the economy do not induce this circulation. If economic growth depends on the degree of competitiveness of the economy, which in turn depends upon the elite's entrepreneurial capacity, the latter, as suggested by the findings of this paper, depends upon the circulation of elites—that is, the competition in this sphere of the economy is prior to the competition in other spheres.

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