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## Reputation and Political Legitimacy:

### ITT in Chile, 1920-1972

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### Abstract

The literature on multinational corporations argues that a foreign firm can legitimize their activities, improve its reputation before the domestic society, and reduce the risk of hostile actions by the host government (including expropriation) by approaching and incorporating in its business influential members of the domestic elite. By using the concept of obsolescing political legitimacy, we argue that this legitimating strategy can turn into a source of illegitimacy when there are significant social and institutional changes in the host country. When this type of changes take place the domestic society can perceive the multinational as an actor that benefited from a previously existing social and institutional order increasingly considered as illegitimate. Under these circumstances

the legitimacy of the multinational's operations will be questioned increasing the risk of expropriation. We illustrate our hypothesis with the case of the political strategies of the US multinational International Telephone and Telegraph Company (ITT) in Chile in the twentieth century.

This paper studies the relationship between political legitimacy, corporate reputation, and the risk of expropriation for a multinational corporation. The expropriation of foreign property by local governments witnessed its peak in the 1960s and 1970s, when governments of many less developed countries took over the properties of multinational corporations particularly in the utilities and natural resource sectors.<sup>1</sup> After a pause of almost two decades the early twenty-first century witnessed the return of expropriation in some countries making it imperative to revisit this issue in a historical perspective.

So far, the literature on expropriation of foreign private property by domestic governments has analyzed this phenomenon through two main theoretical approaches. The first one is the so-called obsolescing bargaining power theory, which roughly argues that the more a multinational has invested in a large amount of fixed assets, the easier it is for the local government to change the rules (which can go from higher taxation, royalties, or wages to domestic workers to outright expropriation). With the investment

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<sup>1</sup> KOBRIAN AND WILKINS

already committed the multinational cannot just pack and leave, and therefore is forced to re-negotiate with the government under a weaker position than before.<sup>2</sup> Moreover, the more knowledge and know-how a domestic society has accumulated on how to run the business owned by the multinational, the easier it will be for the domestic government to expropriate.<sup>3</sup> The second approach is informed by the neo-institutional theory and explains the likelihood of expropriation on the domestic country's institutional framework.<sup>4</sup> These scholars argue that in countries where the executive has limited

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<sup>2</sup> Raymond Vernon, *Sovereignty at Bay* (New York, 1971); Louis Wells and David Smith, "Mineral Agreements in Developing Countries: Structure and Substance," *American Journal of International Law*, 69 (1975): 560-590; Louis Wells, "Negotiating with Third World Governments," *Harvard Business Review*, 55 (1977): 52-80; Nathan Fagre and Louis Wells, "Bargaining Power of Multinationals and Host Governments," *Journal of International Business Studies*, 13 (1982): 9-23.

<sup>3</sup> Stephen Kobrin, "Foreign Enterprise and Forced Divestment in LDCs," *International Organization*, 34 (1980): 65-88.

<sup>4</sup> Witold Henisz, "The Institutional Environment for Economic Growth," *Economics and Politics*, 12 (2000): 1-31; Witold Henisz, "Political Institutions and Policy Volatility," *Economics and Politics*, 16 (2004): 1-27; Yi Feng, "Political Freedom, Political Instability, and Policy Uncertainty: A Study of Political Institutions and Private Investment in Developing Countries," *International Studies Quarterly* 45 (2001): 271-94; Nathan Jensen, "Political Risk, Democratic Institutions, and Foreign Direct Investment," *Journal of Politics*, 70 (2008): 1040-1052; Nathan Jensen, "Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment," *International Organization*, 57 (2003): 587-616; Nathan Jensen,

constraints (mainly dictatorial regimes) the risks of expropriation or arbitrary change in the rules regulating foreign investors' operations are higher than in countries where the executive cannot change the rules at his/her will (such as in liberal democracies). They agree with the obsolescing bargaining scholars that some sectors (such as utilities and natural resources) are more vulnerable to expropriation than others (services).

In this paper we contribute to the scholarship on expropriation of foreign property by proposing the concept of *obsolescing political legitimacy*. We define this concept as a foreign firm's gradual loss of legitimacy before the local society resulting from the identification of this firm with a previous social and/or political regime increasingly perceived as illegitimate or archaic. We develop this concept using Daron Acemoglu and James Robinson's conceptual framework as our starting point. According to these scholars, the political status quo in a society results from a history of previous conflicts between different groups or social classes over economic resources. Each of these conflicting groups has an ideal set of political institutions from which they will obtain economic benefit, and by the moment in which the conflict is settled those with greater political power define the final institutional outcome. The political institutions created by the winners determine how the political power and economic resources are distributed.<sup>5</sup> As long as a new institutional framework is consolidated the system preceding it will be

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*Nation States and the Multinational Corporation: A Political Economy of Foreign Direct Investment* (Princeton, 2006).

<sup>5</sup> Daron Acemoglu and James Robinson, *Economic Origins of Dictatorship and Democracy* (Cambridge, 2006); Daron Acemoglu and James Robinson, "On the Economic Origins of Democracy," *Daedalus*, 136 (2007): 160-162.

considered and represented as illegitimate by those benefiting from the newly triumphant system.<sup>6</sup> We maintain that if an organization (a foreign private firm in this case) is increasingly perceived as linked or (even worse) having benefited from the previous institutional order its legitimacy will be increasingly questioned. The less legitimate the firm's operations are perceived, the less protected its property rights will be.

A firm's loss of legitimacy can be sudden or gradual. In countries going through violent revolutions or accelerated processes of decolonization, the operations of a foreign firm can rapidly lose their legitimacy. In countries with dramatic and rapid institutional changes the challenges to the legitimacy of a foreign firm's operations will be fast and radical. On the other hand, many countries experience gradual institutional changes that can be harder to perceive by foreign firms. Sociologist Guillermo O'Donnell argues that gradual political changes that benefit traditionally oppressed groups should allow firms to gradually adapt their strategy to the new environment and not lose legitimacy.<sup>7</sup> However, as we show in this paper gradual and relatively slow changes can lead some firms to remain in a zone of comfort for too long and face challenges to their legitimacy in the long term when it is too late to change. In this paper we focus on a gradual change rather than on a sudden one, which allows us to see a long term process of loss of political legitimacy.

The concept of obsolescing political legitimacy is relevant for the analysis of corporate reputation. We follow other scholars who argue that the concepts of legitimacy

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<sup>6</sup> Guillermo O'Donnell, *El estado burocrático autoritario* (Buenos Aires, 1982).

<sup>7</sup> O'Donnell, *El estado*.

and reputation have a complementary and reciprocal relationship.<sup>8</sup> These scholars argue that changes in the standards in which reputation is based have consequent effects on the firm's legitimacy. In our approach we assume these general changes in standards as resulting from social and institutional changes in the society where the firm is operating.

Some scholars have argued that a multinational can gain political legitimacy, reputation, knowledge of the evolution of domestic politics, and resources from other sectors by creating ties with the local elite (often done by appointing them in their boards).<sup>9</sup> The concept of obsolescing political legitimacy serves us to show the limits of

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<sup>8</sup> Brayden King and David Whetten, "Rethinking the Relationship Between Reputation and Legitimacy: A Social Actor Conceptualization," *Corporate Reputation Review* 11 (2008): 192-207.

<sup>9</sup> Tatiana Kostova and Srilata Zaheer, "Organizational Legitimacy Under Conditions of Complexity: The Case of the Multinational Enterprise," *Academy of Management Review* 24 (1999): 64-81; Tatiana Kostova, Kendall Roth, and Tina Dacin, "Institutional Theory in the Study of Multinational Corporations: A Critique and New Directions," *Academy of Management Review* 33 (2008): 994-1006; Amy Hillman and William Wan, "The Determinants of MNE's Subsidiaries Political Strategies: Evidence of Institutional Duality," *Journal of International Business Studies* 36 (2005): 322-40; Marki Mizruchi, "What do Interlocks do? An Analysis, Critique, and Assessment of Research on Interlocking Directorates," *Annual Review of Sociology* 22 (1996): 271-98; Joel Podolny, "Networks as the Pipes and Prisms of the Market," *American Journal of Sociology* 107 (2001): 33-60; Jean Boddewyn and Thomas Brewer, "International Business-Political Behavior: New Theoretical Directions," *Academy of Management Review* 19 (1994): 119-43; Joel Podolny, "A Status Based Model of Market Competition," *American Journal of Sociology* 98 (1993): 829-72.

this particular strategy. If the host country goes through a series of institutional changes affecting domestic politics but the board composition does not change and remains tied to the previously existing order the legitimacy of the multinational's operations can be questioned by domestic actors. The decision of a firm to keep itself allied to the elite ruling the country prior to the social and institutional changes can respond to two causes. First, and in opposition to what O'Donnell argues, this can be the result of a lack of perception by the firm of the changes taking place in the host country. Or, second, the firm might be trying to legitimize its operations and keep a good reputation before a particular social group, while neglecting others. As Mooweon Rhee and Michael Valdéz have argued corporate reputation has different dimensions and a firm that only focuses on one might be dangerously hurting others.<sup>10</sup> In this paper we show that a firm that focuses on a legitimating strategy consisting on having a board composed by the host country's traditional elite can gain reputation in just one dimension but lose it in another one. By analyzing how a strategy to gain legitimacy and reputation before one social group generated reputational problems before other social groups (eventually ending in expropriation), this paper responds to recent calls to do historical studies on corporate reputation that include the role of different stakeholders.<sup>11</sup>

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<sup>10</sup> Mooweon Rhee and Michael Valdéz, "Contextual Factors Surrounding Reputation Damage with Potential Implications for Reputation Repair," *Academy of Management Review* 34 (2009): 146-168.

<sup>11</sup> Christopher McKenna, Rowena Olegario, and Jonathan Silberstein-Loeb, "Corporate Reputation and Regulation in Historical Perspective," in Michael Barnett and Tim Pollock (eds.), *Handbook of Corporate Reputation* (Oxford, forthcoming).



We illustrate our hypothesis by studying the operations of the US-based telecommunications multinational International Telephone and Telegraph Company (ITT) in Chile between 1927 and 1972. Few multinational corporations have a more negative reputation worldwide as ITT. A recent informal poll among business historians ranked ITT as the fifth most hated corporation in history.<sup>12</sup> ITT owes part of its terrible reputation to its operations in Chile, where in 1972 some ITT's internal documents leaked to the media showed the company conspiring with the CIA to overthrow Chile's left-wing president Salvador Allende. This created an international scandal that tainted ITT's reputation for decades.<sup>13</sup> Unsurprisingly, the literature on ITT in Chile overwhelmingly focuses on the Allende affair.<sup>14</sup> In this paper we show that the Allende affair was just the culmination of a decades-long process of loss of legitimacy and reputation before the

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<sup>12</sup> "History's 13 Most Hated Companies," *The Daily Beast*, June 22 2010 ([www.dailybeast.com](http://www.dailybeast.com) accessed October 7, 2010).

<sup>13</sup> Brent Fisse and John Braithwaite, *The Impact of Publicity on Corporate Offenders* (Albany, 1983), 124-35.

<sup>14</sup> Kristian Gustafson, *Hostile Intent; US Covert Operations in Chile, 1964-1974* (Washington, 2007); Peter Kornbluh, *The Pinochet File* (Washington, 2003); Lubna Qureshi, *Nixon, Kissinger, and Allende: US Involvement in the 1973 Coup in Chile* (Lanham, 2009); Anthony Sampson, *The Sovereign State of ITT* (New York, 1973); Paul Sigmund, *The Overthrow of Allende and the Politics of Chile* (Pittsburgh, 1977); Paul Sigmund, *Multinationals in Latin America: The Politics of Nationalization* (Madison, 1980). For an analysis of the political economy of Chile's telecommunications sector after the 1980s, see Fernando Coloma and Luis Herrera, "Análisis institucional y económico del sector de telecomunicaciones en Chile," *Cuadernos de Economía* 27 (1990): 429-72.

Chilean society resulting from ITT's expensive and poor service and its stubbornness at keeping a board of directors composed by members of the Chilean traditional right even at times when this group had been eclipsed by the rise of more working and middle class oriented political parties. The board composition allowed the firm to have important connections with Chile's corporate elite. However, in a country where the telephone service was considered more and more a necessity, the new political parties attacked the expensive and deficient service provided by ITT and used the multinational's political board composition to portray the firm as a relic of a less equalitarian past and question the legitimacy of its operations. Therefore, during the period we study, the company sought to legitimize itself before a social group that was losing legitimacy harming both the firm's reputation and legitimacy. This facilitated (and legitimized) the eventual expropriation of ITT assets by the Chilean government.

We contribute to the literature on obsolescing bargaining power by including the changing perceived legitimacy of the foreign firms' operations. We agree with this body of scholarship that the more a foreign firm has invested in non-mobile assets the lower its bargaining power vis-à-vis the government will be, but add that the higher (lower) the perception of illegitimacy of the multinational's operations by the domestic society, the lower (higher) the foreign firm's bargaining power will be. We contribute to the literature on the relationship between political regimes and security of foreign investors' property rights, by showing that a more democratic regime can secure foreign firms' property rights more than a more autocratic regime, as long as the multinationals did not benefit from a previous less democratic regime. We also contribute to the literature on corporate reputation by doing a historical analysis of the different dimensions of reputation of a

particular firm. Finally, we contribute to the Latin American historiography by showing how the expropriation of ITT by Allende was the last stage of a long process of loss of legitimacy by ITT.

We analyze the evolution of ITT's board political composition between 1950 and 1970 by researching the political biographies of each of the members of the company's Chilean subsidiary board of directors between 1950 and 1960 plus a network analysis for 1969. Our primary sources include the Chilean congressional debates, ITT and its Chilean subsidiary corporate reports, US Senate hearings on ITT, and declassified documents from the US Central Intelligence Agency (CIA), Chilean government reports, and Chilean and American media.

## Political Environment and Early ITT Investments in Chile

ITT experienced a spectacular growth becoming a major telecommunications multinational in just one decade after its establishment in 1920. By 1929, ITT's entire business was outside the United States and Canada. "No other American (or foreign) corporation had such huge investments abroad in communications [and] no other US corporation had so many employees in foreign lands."<sup>15</sup> During this growth, ITT used as one of its political strategies the appointment of influential people of the local elite in its

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<sup>15</sup> Mira Wilkins, *The Maturing of Multinational Enterprise* (Cambridge, 1974), 130-131.

boards.<sup>16</sup> They started this practice in Spain but later chose to apply in other countries due to the success it had in the Spanish case.<sup>17</sup>

ITT started operations in Chile in 1927, after acquiring the British firm Chili Telephone Company, which controlled 78 percent of the Chilean market and had been criticized for its high rates and bad service.<sup>18</sup> In 1924, the government extended the Chili Telephone's concession subject to a firm's commitment to expand the system and accept government's intervention at determining telephone rates. The government reserved itself the right to expropriate the firm after the end of the fifty-year concession. Dissatisfied with the new contractual terms, the Chili Telephone Company sold its

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<sup>16</sup> Robert Sobel, *ITT: The Management of Opportunity* (New York, 1982): 14-40; Angel Calvo, "State, Firms, and Technology: The Rise of Multinational Telecommunications Companies: ITT and the *Compañía Telefónica Nacional de España, 1924-1945*," *Business History* 50 (2008): 455-59; Antonio Pérez Yustle, "La Compañía Telefónica Nacional de España en la Dictadura de Primo de Rivera, 1923-1930 (Ph.D. Dissertation, Universidad Politécnica de Madrid, 2004): 72-83, 150-174, 271-272; Adoración Alvaro, "Redes empresariales, inversión directa extranjera y monopolio: el caso de Telefónica, 1924-1965," *Revista de Historia Industrial*, 16 (2007), 65-96; Adoración Alvaro, "Inversión directa extranjera y formación de capacidades organizativas locales: un análisis del impacto de Estados Unidos en la empresa española, 1918-1975 (PhD Dissertation, Universidad Complutense de Madrid, 2010), 163-164; Angel Calvo, *Historia de Telefónica, 1924-1975* (Madrid, 2010); Wilkins, *The Maturing*, 71-72.

<sup>17</sup> Gabriela Martínez, *Latin American Telecommunications: Telefónica's Conquest* (New York, 2008), 20.

<sup>18</sup> Covarrubias, *Un cable*, 68.

operations to ITT, which created a new firm under the name of Compañía de Teléfonos de Chile (hereafter, ITT-CTC).<sup>19</sup>

The timing of ITT's arrival to Chile determined its political future. The firm started operations during the semi-autocratic regime of Carlos Ibáñez del Campo, a president who took advantage of a booming economy to embark in an ambitious economic program that included soft loans to manufacturing, government investment in infrastructure and social welfare, and an open door policy to foreign investors.<sup>20</sup> By 1929, US investments in Chile reached \$625 million from just one million in 1900, most of them arriving during the Ibáñez regime.<sup>21</sup>

As a means to encourage investments in telephone infrastructure, Ibáñez reformed the law so that the telephone system would be independent from the restrictions present in the existing electrical services legislation. In 1929, the government controlled senate approved a law permitting fifty-year telephone concessions (which could be extended to ninety years). For the first time the concessions were to be awarded for the whole country (instead of the until then existing regional concessions). Under the new law, the government abandoned its right to nationalize the concessions before fifty years, but had the right to appoint three board members. Phone rates required the president's final

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<sup>19</sup> Carlos Donoso, "De la Compañía Chilena de Teléfonos de Edison a la Compañía de Teléfonos de Chile: Los primeros 50 años de la telefonía nacional, 1880-1930," *Historia* (Santiago), 33 (2000), 101-139.

<sup>20</sup> Mariana Aylwin, Carlos Bascuñán, Sofía Correa, Cristián Gazmuri, Sol Serrano, and Matías Tagle, *Chile en el siglo XX* (Santiago, 1983), 122-2.

<sup>21</sup> Harold Blakemore, "From the War of the Pacific to 1930," in Leslie Bethell (ed.), *Chile Since Independence* (Cambridge, 1993), 82-83.

approval, but would be calculated to guarantee a profit rate of 10 percent of the firm's net investment.<sup>22</sup> In 1930, ITT-CTC signed a thirty-year concession agreement under these terms and committed to modernize and expand the service.<sup>23</sup>

Ibáñez economic plans came to a sudden halt with the Great Depression, which had devastating effects in the Chilean economy.<sup>24</sup> The crisis led to popular unrest, which forced Ibáñez to resign in June 1931. As a result of the crisis, the government could not assure ITT-CTC a fixed profit rate of 10 percent. During the 1931-1958 period the company constantly complained about its incapacity to raise rates and achieve the 10 percent profit rate (see Table 1).<sup>25</sup>

[INSERT TABLE 1 AROUND HERE]

Between 1931 and 1932, Chile went through a period of political turmoil which ended with the election of former president Arturo Alessandri, who won with the support of the center Radical Party and the right-wing Liberal and Conservative parties, which represented the secular and Catholic factions of the Chilean right respectively.<sup>26</sup>

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<sup>22</sup> Covarrubias, *Un cable*, 67-72; Donoso, "De la Compañía."

<sup>23</sup> Donoso, "De la Compañía."

<sup>24</sup> Aníbal Pinto, *Chile, un caso de desarrollo frustrado* (Santiago, 1973), 168; Ricardo Ffrench-Davis and Oscar Muñoz, "Desarrollo económico, inestabilidad y desequilibrios políticos en Chile," *Estudios Cieplan* 28 (1990): 127.

<sup>25</sup> ITT-CTC, *Memoria*, 1950-1958; Covarrubias, *Un cable*, 78.

<sup>26</sup> Michael Monteón, *Chile and the Great Depression: The Politics of Underdevelopment, 1927-1948* (Tempe, 1998), 73-75.

These elections determined Chile's political map for the next decade, with the right represented by the two traditional Liberal and Conservative parties, the center by the middle-class oriented Radical Party, and the left by the rising Socialist and Communist Parties.

### Urbanization, Industrialization, and Political Change

Between 1932 and 1973, Chile became one of the most stable democracies in Latin America. Political stability came together with gradual but deep economic and social transformations. Between the 1930s and 1950s, there was an accepted consensus that economic prosperity could only be achieved by following an economic model based on protectionism, state-led import substitution industrialization (ISI), and government investment in social welfare. These policies increased the size of the urban middle class and the ever more militant organized industrial working class. The political changes resulting from this social transformations sowed the seeds for future challenges to the legitimacy of ITT's operations.

During the 1930s, the ISI was consolidated through an alliance between the government and the private sector and the creation of government agencies in charge of channelling funds to domestic industry.<sup>27</sup> This economic model thrived even during the rule of a center-left coalition known as the Popular Front (1938-1941) led by the Radicals

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<sup>27</sup> Ben Schneider, *Business, Politics, and the State in Twentieth Century Latin America* (Cambridge, 2004), 155.

and supported by the Socialist and Communist parties.<sup>28</sup> During this period, the government purchased 12.5 percent of ITT-CTC shares through CORFO, the government's main development agency. The number of government directors remained in two individuals.<sup>29</sup> After 1941, the Radicals distanced themselves from the left (going to the extreme of outlawing the Communist Party in 1948), but faced serious challenges in the late 1940s, when inflation became a problem. After a rate of 7.7 percent in 1945 inflation jumped to 30 percent in 1946 and 23 percent in 1947.<sup>30</sup> Inflation eventually became one of the most serious challenges the government faced.

A larger middle class urban population meant a higher demand and consumption of telephone service. Between 1925 and 1950 Chile's GDP per-capita increased from \$3,285 to \$3,943,<sup>31</sup> with the number of telephones increasing from 33,249 in 1927 (or 8 telephones per thousand people) to 127,344 (or 20.9 telephones per thousand people) in 1950 (see Graph 1).<sup>32</sup> With this coverage, after 1947 Chile became ITT's world's largest

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<sup>28</sup> Ricardo Ffrench-Davis, Oscar Muñoz, José Miguel Benavente, and Gustavo Crespi, "The Industrialization of Chile, 1940-82," in Enrique Cárdenas, José Antonio Ocampo, and Rosemary Thorp, *An Economic History of Twentieth-Century Latin America*, vol. 3 (New York, 2000), 130-32; Guy Douyon, "Chilean Industrialization Since CORFO" (PhD. Diss. University of California, 1996), 87-89

<sup>29</sup> ITT-CTC, *Memoria*, various years.

<sup>30</sup> Juan Braun, Matías Braun, Ignacio Briones, and José Díaz, *Economía Chilena, 1810-1995* (Santiago, 2000), 336.

<sup>31</sup> Measured in 1995 dollars by purchasing power parity (Braun et al., *Economía*, 310).

<sup>32</sup> Braun, et al., *Economía*, 260.



consumer of telephones.<sup>33</sup> According to the company, Chilean rapid rise in demand could not be satisfied because of increasing costs of materials due to inflation and mandatory wage increases.<sup>34</sup> In 1950, the Chilean government compensated the firm by allowing it to increase telephone rates in 60 percent, which the company considered barely compensated wage increases.<sup>35</sup> This rate hike was highly unpopular and eventually created political problems to the firm.

[INSERT GRAPH 1 AROUND HERE]

ITT-CTC's lack of capacity to satisfy domestic demand led the Chilean elite to consider that government intervention was necessary. In 1946, the government created the National Telecommunications Council to study these deficiencies and in 1956 a group of influential engineers published a study proposing the creation of a state-owned national telephone system. This idea was supported by other major state-owned firms, but rejected by ITT-CTC.<sup>36</sup> Criticisms against low coverage and quality would continue in the years to come.

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<sup>33</sup> Before 1945, the largest market was Argentina, but ITT sold its interests there that year. See, ITT, *Annual Report* (1945), 32; ITT, *Annual Report* (1946), 33; Wilkins, *The Maturing*, 304.

<sup>34</sup> ITT, *Annual Report* (1947), 34; ITT, *Annual Report* (1949), 15.

<sup>35</sup> ITT, *Annual Report* (1950, 1951).

<sup>36</sup> Guillermo Guajardo, "Nacionalismo económico y tecnología internacional: Estados Unidos y la industrialización de México y Chile," in Guillermo Guajardo (ed.), *Ni éxito, ni fracaso: ideas, recursos y actores en las políticas económicas latinoamericanas del siglo XX* (Mexico City, 2005), 104.

## Exhaustion of the ISI Model and New Political Alternatives

During the 1950s, Chile went through several changes relevant for ITT's operations. First, inflation led many to question the existing state-led ISI model. Second, the Radicals fell in decay and were replaced by the Christian Democrats as the main center middle class-oriented political party. And, third, the political left became more powerful.

In 1952, Chile re-elected previous president Ibáñez, who promised to “clean” the country of what he considered the corruption and demagoguery that led to the economic crisis. Although coming to power with a strong support of the left, an inflation of 71 percent in 1954 and 83 percent in 1955 led Ibáñez to follow orthodox recipes to control inflation through cuts in government spending and subsidies while approving higher telephone rates.<sup>37</sup> Ibáñez's austerity program proved extremely unpopular leading the unions to strike and the left to end its support to the president.<sup>38</sup> By the end of his administration, an unpopular Ibáñez desperately re-approached the left by bringing the Communists back to legality and working with the left a new electoral reform that permitted participation in the elections to a larger number of voters and eliminated the possibilities of manipulating voters in the countryside—a strategy that had historically benefited the political right. This reform led to unprecedented increase in popular

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<sup>37</sup> ITT, *Annual Report* (1953), 28; ITT, *Annual Report* (1954), 31; Aylwin, et al., *Chile*, 235; Drake, “Chile,” 125; Braun, et al., *Estadísticas*, 336.

<sup>38</sup> Aylwin, et al., *Chile*, 235.

political participation opening the doors to new political parties.<sup>39</sup> Nevertheless, the economic crisis continued.

Shortly before leaving power in January 1958, the Ibáñez government revised the existing concession he had awarded to ITT-CTC in 1927. Under the new contract, ITT-CTC committed itself to expand coverage in 84,000 more telephones, while the government finally assured the firm a minimum 10 percent return on assets, for which it authorized rate hikes up to 94 percent that year.<sup>40</sup> The company reported this measure, as well as the previous unpopular Ibáñez austerity measures as highly positive and did not complain about low profits again in its reports.<sup>41</sup>

In 1960, Chile suffered a natural disaster that brought political consequences to ITT-CTC. An earthquake in southern Chile destroyed a good part of the telecommunications infrastructure leaving many towns incommunicated. Influential engineers argued that this showed the need for a government-owned telephone company. This reaction came in addition to the frequent complaints by the private industrial sector about the slowness of coverage expansion and rural landowners about high long-distance

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<sup>39</sup> Tomás Moulian, *Fracturas: de Pedro Aguirre Cerda a Salvador Allende, 1938-1973* (Santiago, 2006), 168-69.

<sup>40</sup> “Fórmula para la ampliación del servicio telefónico,” *El Mercurio*, January 3, 1958; “40 millones de dólares serán invertidos en ampliación de servicio telefónico en Chile,” *El Mercurio*, 6 February, 1958.

<sup>41</sup> ITT justified this increase arguing that Chilean rates were still relatively cheap for international standards, see ITT-CTC, *Memoria Anual* (1957), 11; ITT, *Annual Report* (1956), 43; ITT, *Annual Report* (1958), 43-44.

rates. Despite the US embassy and ITT-CTC's opposition to the idea the government went ahead and started studying the feasibility of a state-owned telephone company.<sup>42</sup>

The 1950s economic crisis led to a lack of credibility of the parties holding power until then. The middle class was disappointed with the Radicals while the urban working class (many of them living in the progressively larger shantytowns surrounding Santiago) felt that the existing economic model was not benefiting them. Two political movements capitalized this discontent. The first one was the Christian Democratic Party (hereafter DC, in its Spanish acronym) created in 1957, which sympathized with a new philosophy in the Catholic Church that questioned capitalism and considered a Catholic moral duty to fight against poverty, even through wealth redistribution if necessary.<sup>43</sup> The second one was the Frente de Acción Popular (FRAP), created in 1956 by the Socialist and Communist parties.<sup>44</sup>

The two new political organizations argued that the economic crisis resulted from the exhaustion of the ISI model. For the DC, this model had been too oriented towards big business and needed to be reformed in a way wealth was more equally distributed under government leadership. The party advocated for a redistribution of land in the agrarian sector, the participation of the Chilean government in the foreign-controlled mining sector, and policies of political empowerment of the lower classes. The FRAP

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<sup>42</sup> Covarrubias, *Un cable*, 100-108.

<sup>43</sup> Bernardo Navarrete, "Un centro excéntrico. Cambio y continuidad en la Democracia Cristiana, 1957-2005," *Política* 45 (2005), 117; Luis Moulian and Gloria Guerra, *Eduardo Frei M. Biografía de un estadista utópico* (Santiago, 2000), 47-55.

<sup>44</sup> Alberto Cardemil, *El camino de la utopía: Alessandri, Frei, Allende* (Santiago, 1997), 133.

agreed that ISI had not benefited the lower classes, but proposed as an alternative the expropriation of foreign property and statization of monopolies, banking, and foreign trade. The Liberals and Conservatives also believed that ISI was reaching its limits, but believed the solution consisted on policies of privatization and opening of the economy.<sup>45</sup> These three economic proposals dominated the political debate and affecting the perception of ITT's operations.

### ITT's Link to the Past as Political Liability

In 1958, Chile's political right had the chance to experiment its economic formula after the triumph of their presidential candidate Jorge Alessandri (son of former president Arturo Alessandri). This was a bittersweet victory for the Conservative-Liberal coalition that brought Alessandri to power: Alessandri narrowly won with just 31.6 percent of the votes against 28.5 percent for FRAP's candidate Allende. DC candidate Eduardo Frei Montalva finished third with 20.5 percent replacing the Radicals as the main center political party.<sup>46</sup>

Aware of the decreasing popularity of his Conservative and Liberal backers, Alessandri made big efforts to show himself as a post-partisan technocrat, rather than a

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<sup>45</sup> Luis Corvalán Marquéz, *Del anticapitalismo al neoliberalismo en Chile: izquierda, centro y derecha en la lucha entre los proyectos globales, 1950-2000* (Santiago, 2001), 17-18; Cardemil, *El camino*, 133; Navarrete, "Un centro," 118.

<sup>46</sup> Drake, "Chile," 128; Aylwin et al., *Chile*, 245-47

party ideologue.<sup>47</sup> The DC and left-wing opposition, however, constantly portrayed him as a representative of the oligarchy, foreign interests, and the increasingly unpopular political right. The outcome of Alessandri's policies did not help him. After liberalizing the economy, imports skyrocketed, exports stagnated, and inflation remained high.<sup>48</sup> Lack of confidence and an artificially strong exchange rate encouraged capital flight the president desperately fought against in December 1961 by restricting operations in foreign currency.<sup>49</sup> Unable to keep the currency's value in January 1962 Alessandri devalued the Chilean currency 30 percent,<sup>50</sup> which was interpreted as a signal of a failed economic policy.<sup>51</sup>

The repetitive government approvals to increase telephone rates and the pressures this generated in the budget of a middle class already struggling with the apparently out of control inflation became a political issue. Earlier, in 1957, Federico Duncker, one of the company's lawyers warned that ITT-CTC had to make extra efforts to explain to the public the technical reasons of the constant rate increases in order to avoid political

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<sup>47</sup> Cardemil, *El camino*, 26-29; Drake, "Chile," 142.

<sup>48</sup> French-Davis, et al., "Industrialization," 133.

<sup>49</sup> "Chile Forbids Dollar Payments for Foreign Products Until Jan. 6," *Wall Street Journal*, December 29 (1961), 4.

<sup>50</sup> "Value of Chilean Escudo Drops as Much as 30 Percent After Exchange Ban Ends," *Wall Street Journal*, January 17 (1962), 4.

<sup>51</sup> "Chile's New Dual Rate Foreign Exchange Plan Clouds Trade Picture," *Wall Street Journal*, January 22 (1962), 12.

backlash.<sup>52</sup> In contrast, in most of its post-1958 reports the company expressed its satisfaction with the new government policy.<sup>53</sup> Duncker's words proved prophetic: in July 17 1962, a heated and lengthy debate took place in the Chilean Congress regarding ITT-CTC's operations in which the company was attacked from many fronts.

The 1962 congressional debates on ITT-CTC showed some consensus on what the problems were, but big differences on how to solve them. The consensus shared by the left, center, and right was that ITT-CTC original concession contracts had been too generous for the multinational, that phone rates were expensive, and that the quality of the service was bad. With people of all social backgrounds complaining about these issues, no politician could afford to alienate their constituencies by disagreeing with these basic points. The disagreements, however, were strong. The DC blamed the right for not opposing earlier to a contract granting monopolistic powers to a foreign firm. The company was so corrupt, they argued, that it did not even comply with the already generous contract because it was not extending the telephone lines as required. They added that several commissions had been created in the past to investigate these irregularities, but they never prospered because of the Liberals and Conservatives' systematic opposition. For the Liberals, the main problem was the existence of a monopoly. Jorge Hübner, a Liberal congressman, said that his party opposed "any kind of monopoly, whether it is private or state-owned." He added that things would work better if the directors appointed by the government were controlling the company's

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<sup>52</sup> "Interesantes observaciones en la junta de accionistas de la Compañía Chilena de Teléfonos," *El Mercurio*, April 2, 1957.

<sup>53</sup> ITT-CTC, *Memoria*, various years.

actions, which in his view they apparently did not do. He also defended his party's previous authorizations for telephone rate hikes arguing that the company needed a minimum to survive. The Liberal solution was to open the market to other private firms to compete against ITT. On the other hand, the Communists and Socialists argued that by its very nature, if left alone a multinational corporation would try to abuse its customers, being the only solution a statization of the industry. They added that not only were the company's rates outrageously high, but also ITT-CTC underpaid its workers. For the left, as long as they had a right-wing government, there was not much to do about the company's abuses.<sup>54</sup> The company did not mention the debates in its 1962 or 1963 reports, but emphasized how thanks to the government support they were making big strides to extend telephone coverage as promised.<sup>55</sup> In the meantime, CORFO continued studying the feasibility of a national telecommunications company.<sup>56</sup>

The tone of the debate became more extreme in August 28 1963. This time, the DC openly advocated for outright expropriation of ITT-CTC. In a very dramatic intervention, DC congressman Mario Hamuy defended this proposal arguing that ITT-CTC had repeatedly ignored any plea to stop raising rates. He added that the 10 percent profit on net investments rate assured by the government included loans acquired by the company, meaning the Chilean taxpayers were subsidizing the multinational's loans. Hamuy added that the 39 percent increase in rates in 1962 and the 49 percent already accumulated in 1963 was simply unsustainable for Chilean consumers. Hamuy

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<sup>54</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, July 17 (1962).

<sup>55</sup> ITT-CTC, *Memoria Anual* (1962, 1963).

<sup>56</sup> Guajardo, "Nacionalismo," 105.



emphasized that the problem with ITT-CTC was not an isolated one, but was a reflection of the structural economic problems generated by the pro-big business Alessandri administration. The Socialist congressmen agreed with the DC on the latter point, but added that the structural problems were not just internal but global and ITT represented US imperialism in Chile and its actions needed to be resisted not simply because of a problem of phone rates, but also of sovereignty and exploitation. In this debate, the formerly popular Radicals sided with the Liberals in their opposition to the expropriation proposed by the DC arguing that Chile was a country with rule of law and contracts (no matter how badly they had been written) needed to be honored. The DC and the left counter-argued that because the contract had been signed under a less democratic regime it lacked legitimacy. They had a similar argument to question the validity of the 10 percent secured profit rate.<sup>57</sup>

### Board composition and legitimacy

The first congressional criticisms against ITT-CTC's board composition came in August 28 1963. Communist Congressman Carlos Rosales said that the company's power resided on its board of directors, arguing that ITT-CTC strategically chose people with good political connections. Rosales used as example the company's president, Ernesto Barros Jarpa, former vice-president of the Liberal Party and former Minister of Interior and Foreign Relations. Barros Jarpa also sat on the boards of several of Chile's main corporations in construction, finance, and manufacturing (see Appendix). After

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<sup>57</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, August 28 (1963).

highlighting Barros Jarpa's importance, Rosales proceeded to read the list of ITT-CTC directors showing how most of them belonged to the Liberal and Conservative parties. The government directors, Rosales added, were overtly working for the company and received compensation for this. He concluded that because of this composition and their connections to Alessandri's government the company had been safe in its abusive behavior.<sup>58</sup>

The argument about ITT-CTC's board being dominated by the Liberals and Conservatives was not unsustainable. Although the company's annual reports do not mention the directors' political affiliation, the fact that most of them are prominent members of the society allows us to research the biography of each one of them and determine their affiliation. The Appendix shows the directors' biographies and political affiliations and in Table 2 we display the summary of that information. Between 1950 and 1970, the ITT-CTC board was dominated by individuals belonging to the Liberal and Conservative parties. As some congressmen argued, we show that those belonging to the political right were not even executives of this firm. Moreover, the DC or Radical directors were those appointed by the government.

[INSERT TABLE 2 AROUND HERE]

In order to consider the directors that stayed on the board for a longer period of time (which we assume will be the most influential ones in the company) Table 3 displays the results only for directors sitting on the board for more than four years. It shows that the

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<sup>58</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, August 28 (1963), 3817.

board was very stable with not much rotation (which is also evident in the Appendix), and that the longest-serving directors belonged or sympathized with the Liberal and Conservative parties.

[INSERT TABLE 3 AROUND HERE]

Table 4 shows how during this period, the positions of president or vice-president were held mostly by people who belonged or sympathized with the Liberal and Conservative parties. The individuals for which we did not find any information were either foreigners (mostly American) or government representatives. In short, the three tables show a company that during the period we study remained with a board composed by the traditional right, which explains why it was such an easy target for Christian Democrats, Socialists, and Communists.

[INSERT TABLE 4 AROUND HERE]

The environment was turning against ITT from several fronts. In August 1963, weekly magazine *Vistazo* published a long article showing how the presence of politicians in corporate boards benefited these companies. According to the article, the presence of Barros Jarpa in ITT-CTC's board and in the board of Banco de Crédito e Inversiones made it possible for the company to receive cheap loans.<sup>59</sup> The article also

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<sup>59</sup> "Ocho sociedades con cuñas en diez poderosos bancos," *Vistazo* 569 (1963): 11. The information from the firm's corporate reports do not show a clear benefit in cheap loans from the

pointed the benefits other large corporations such as privately owned oil firm COPEC obtained from these political relations.

A network analysis shows that ITT-CTC's board was even more interconnected with Chile's main corporations than the *Vistazo* article claimed. Graph 2 displays the connections of ITT-CTC's boards with other firms and shows that the company's directors provided links with twenty-one other firms. The bolder the line in the graph the larger the number of shared directors. Although we do not have the information to do network analysis for the pre-1969 period, the fact that the board barely changed during this period allows us to assume that the firm had these strong connections in the previous years.<sup>60</sup> The graph shows a strong connection with a state-owned firm (the Empresa Nacional de Electricidad). However, two of the three directors both firms shared were appointed by the state. ITT-CTC's connections with other influential firms of the Chilean corporate world and the benefits they could bring (such as cheap loans) explains why the company remained with such kind of board despite growing political opposition. Its board composition gave it legitimacy in Chile's corporate world but not in the political sphere.

[INSERT GRAPH 2 AROUND HERE]

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financial sector (see, ITT-CTC, *Memoria*, various years). The *Vistazo* article, however, added more fuel to the questions about the firm's board legitimacy.

<sup>60</sup> Erica Salvaj and Andrea Lluch, "Corporate Networks in Turbulent Environments: A Comparative Study of the Interlocking Directorates of Argentina and Chile (as of 1970)" (Mimeo, Buenos Aires, 2011).

Criticisms in congress against ITT-CTC's board composition continued in November 1963. DC's criticisms were harsher than before when its members said had that ITT-CTC's board was composed by "the most reactionary elements in the country" and was there to go against the workers.<sup>61</sup> DC congressman Luis Musalem said that president Alessandri himself was a former director of several boards composed by some ITT-CTC directors, which created a collusion of interests. For Hamuy, all these showed that the only option was expropriation, something he and his partymen promised would do if their candidate, Eduardo Frei, won the 1964 elections.<sup>62</sup> The Socialists added that according to the original contract, all problems with the company were to be solved at the Supreme Court, which provided ITT-CTC an unfair advantage because one former director of the company (Pedro Silva Fernández) was then the Supreme Court president.<sup>63</sup>

In sum, by 1963 the DC and the FRAP strongly questioned ITT's business in Chile, the role of its board of directors, and what they believed were corrupt links to the traditional political right. What they considered was abusive behavior by the firm was protected by two laws (1930 and 1958) approved in times of restrictions to the political opposition. Because of the perceived illegitimacy of the original contracts, the firm's perceived abusive behavior, and the perception that the company was not even complying with existing legislation, both parties proposed drastic measures that included expropriation and statization of the telephone system.

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<sup>61</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, November 13 (1963), 1330.

<sup>62</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, November 13 (1963).

<sup>63</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, November 13 (1963), 1337.

The DC and FRAP had good reasons to feel emboldened in the debates. In the 1963 municipal elections, the DC became the country's largest political force with 22.7% of the votes, while the Liberals and Conservatives' share fell from 16.5 percent to 13.2 and from 14.7 to 11.4 respectively. FRAP surprised the country by winning with 39.2 percent of the vote in the traditionally conservative region of Curicó. After this humiliating defeat demoralized Liberals and Conservatives decided not to nominate any candidate for the 1964 presidential elections and reluctantly supported DC's Frei.<sup>64</sup>

### ITT's Last Political Strategies Under a New Political Order

The 1964 presidential elections changed the Chilean political landscape. DC's Frei won with 56 percent of the vote, followed by the FRAP's Allende with 38.9 percent, and the Radical candidate with a mere 5 percent.<sup>65</sup> The right-wing Liberal and Conservative parties had clearly lost relevance and the political arena was now dominated by the two hardest critics of ITT-CTC's operations.

Allende's rising popularity panicked the Chilean right, the US government, and ITT. The right-wing parties did not like Frei, a candidate who in 1962 said that "capitalism has being incapable of solving our social and economic problems,"<sup>66</sup> and who in 1964 advocated for a nationalization of the copper industry and redistribution of land

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<sup>64</sup> Aylwin, et al., *Chile*, 255-57.

<sup>65</sup> Aylwin, et al., *Chile*, 258.

<sup>66</sup> Cardemil, *El camino*, 190

among poor peasants, but considered him the “lesser evil” compared to Allende.<sup>67</sup> For Washington, Frei’s movement represented a promising alternative between the reactionary right and Cuba’s Communist model.<sup>68</sup> Worried about an Allende’s potential triumph, the US government gave secret support to Frei’s candidacy and anti-Communist media outlets through \$2.6 million funding channelled by the CIA.<sup>69</sup> Once Frei was in power, the CIA provided funds to the DC candidates for the 1965 congressional elections. During the 1963 campaign, ITT approached the CIA and offered its financial support to operations aiming to assure Frei’s victory, but the offer was rejected by the CIA.<sup>70</sup>

The DC government did not expropriate ITT’s properties in Chile as promised, but it intervened the industry. In 1964, resulting from the post-1960 earthquake CORFO studies the government created Entel, a government-owned long-distance phone company to supply segments of the market neglected by ITT and therefore not originally created to compete against ITT.<sup>71</sup> In 1967, new regulations gave the government the power to

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<sup>67</sup> Mats Lundahl, “El camino a la dictadura: desarrollo político y económico en Chile, 1952-73,” in Roberto García (ed.), *Economía y política durante el gobierno military en Chile, 1973-1987* (Mexico City, 1989), 27-29; Patricio Dooner, *Cambios sociales y conflicto político: el conflicto político nacional durante el gobierno de Eduardo Frei (1964-1970)* (Santiago, 1983), 27; Moulán and Guerra, *Eduardo Frei*, 129-130.

<sup>68</sup> Leonard Gross, *The Last Best Hope: Eduardo Frei and Chilean Democracy* (New York, 1967).

<sup>69</sup> United States Senate, Select Committee to Study Governmental Operations with Respect to Intelligence Activities, *Covert Action in Chile* (Washington, 1975), 9.

<sup>70</sup> US Senate, *Covert Action*, 11-12.

<sup>71</sup> Covarrubias, *Un cable*, 108-110.

control basic telephone network, supply service to poor areas, and for CORFO to purchase up to 49 percent of ITT-CTC shares.<sup>72</sup> Although the latter did not happen under Frei, the new legal framework permitted a gradual transfer of this service to the state. In addition, the new automated technology became available to the Chilean firm allowing it to rapidly expand its services without the need to depend on ITT-CTC.<sup>73</sup>

Frei lost the support of the Chilean right soon after taking power. Higher taxation, political empowerment of the lower classes, and expropriation of land to the traditional rural elite alienated the right who said that Frei was simply “paving the road to Communism in Chile.”<sup>74</sup> His social policies did not gain him the support of the left, either. Allende accused Frei of being the “candidate of imperialism” and promised total opposition from day one.<sup>75</sup> In spite of these challenges, the DC enjoyed an overwhelming 43.6 percent triumph in the 1965 congressional elections. Allende’s FRAP came second with 26.2 percent of the votes, while the Liberals and Conservatives obtained 3.15 and 1.9 percent respectively.<sup>76</sup> Frei changed the constitution modifying the definition of private property, which allowed him to go ahead with the agrarian reform

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<sup>72</sup> Ahmed Galal, “Chile: regulatory specificity, credibility of commitment, and distributional demands,” in Brian Levy and Pablo Spiller (eds.), *Regulations, institutions, and commitment: comparative studies of telecommunications* (Cambridge, UK, 1996), 122-124.

<sup>73</sup> Guajardo, “Nacionalismo,” 106.

<sup>74</sup> Corvalán, *Del anticapitalismo*, 103.

<sup>75</sup> Dooner, *Cambios*, 35-36.

<sup>76</sup> Aylwin et al., *Chile*, 261.



and partial government acquisition of the copper industry.<sup>77</sup> By 1967, the right re-invented itself creating the National Party and continued their opposition to Frei.<sup>78</sup>

Criticisms against ITT-CTC continued in congress after Frei's election. The DC accused ITT-CTC of committing abuses with total impunity and proposed a fixed phone rate for all users to relief families from the ever increasing costs of this service.<sup>79</sup>

Criticisms from the Socialist Party focused on labor abuses and low wages.<sup>80</sup> ITT-CTC responded to these accusations in congress where its representatives argued that a fixed rate would benefit large companies in detriment of families and added that the existing rate system encouraged excessive telephone usage, which forced the firm to invest more than expected.<sup>81</sup> During the whole Frei administration, ITT's board remained dominated by Liberals and Conservatives (see Appendix).

As long as the 1970 presidential elections approached, Chilean politics became increasingly polarized. In 1967, the Socialist Party openly declared the legitimacy of armed struggle and in 1968 a new clandestine left-wing group (the Movimiento de Izquierda Revolucionaria or Revolutionary Left Movement, MIR) aiming to promote a Cuban-style revolution was created.<sup>82</sup> In 1969, radical left-wing groups put bombs in the American Cultural Institute and in *El Mercurio* newspaper and a group of right-wing

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<sup>77</sup> Aylwin, et al., *Chile*, 263-270.

<sup>78</sup> Corvalán, *Del anticapitalismo*, 101;

<sup>79</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, May 11 (1966): 8174.

<sup>80</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, July 12 (1966).

<sup>81</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, May 11 (1966).

<sup>82</sup> Corvalán, *Del anticapitalismo*, 108.

army officers unsuccessfully rebelled against the government. The National Party justified the army rebellion as the inevitable outcome of the chaos generated by the government policies. Internally, the DC faced problems too when in 1969 some of its left-wing members created their own movement known as MAPU and joined the Allende coalition. To make things worse, the right surprised the country with a revival when the National Party obtained 20 percent of the votes in the 1969 congressional elections. The right interpreted this success as a vote of a frustrated population longing for order.<sup>83</sup>

The constitution did not allow Frei to run for a second term, so the DC chose Radomiro Tomic as their presidential candidate. Tomic, a member of the party's left, accepted the nomination under the condition that his party declared itself "anti-capitalist [...] socialist, and revolutionary."<sup>84</sup> Tomic also proposed an alliance with the left, the party rejected.<sup>85</sup> The National Party nominated former president Jorge Alessandri, while the left (now under the umbrella of the Unidad Popular or Popular Unity, UP) nominated Allende.

The US government and ITT did not passively wait for the results. The CIA engaged in a complex scheme to avoid the triumph of Allende in the elections and prevent him from taking power after his electoral victory.<sup>86</sup> The plan included providing

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<sup>83</sup> Aylwin, et al., *Chile*, 276-82.

<sup>84</sup> Aylwin, et al., *Chile*, 280-81.

<sup>85</sup> Corvalán, *Del anticapitalismo*, 78.

<sup>86</sup> United States Senate, Select Committee on Foreign Relations, *The International Telephone and Telegraph Company and Chile, 1970-71* (Washington, 1973); Jack Anderson, *The Anderson Papers* (New York, 1974); Edward Korry, "The USA in Chile, Chile in the USA: A Full

funding to both the DC and National Party campaigns and anti-Allende media outlets worldwide, a coup after the elections if Allende won, and encouraging congressmen to deny Allende's accession to power due to constitutional technicalities. ITT enthusiastically offered its support to conspire against Allende and offered funding for the operation to the CIA. The CIA rejected ITT's money, but advised the company on how to secretly channel money to Alessandri's campaign.<sup>87</sup> Once Allende took power, the CIA sought to undermine his administration through economic warfare, for which it sought an alliance with ITT.<sup>88</sup> There is no evidence, however, that ITT participated in economic warfare.<sup>89</sup>

In 1971, Allende took over part of ITT-CTC's management control. In August 30 1972, in the midst of an economic crisis and fierce opposition from the right, the government proposed a constitutional reform that would allow it to expropriate ITT-CTC's assets. By then, the ITT internal documents showing the company colluding with the CIA to conspire against Allende had been made public by the *Washington Post* and the Chilean government lost no time at capitalizing this scandal in its favor by rapidly translating and publishing the documents into Spanish.<sup>90</sup> Appearing as a foreign

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Retrospective Political and Economic View (1963-1975)," *Estudios Públicos* 72 (1998): 1-48; Kornbluh, *Pinochet*; Qureshi, *Nixon*.

<sup>87</sup> US Senate, *Covert*, 16.

<sup>88</sup> "From Korry to Kissinger and Johnson, 5 October 1970," United States Department of State, CIA Chile Declassification Project Tranche III (1979-1991) (Washington, 1991).

<sup>89</sup> US Senate, *Covert*, 13.

<sup>90</sup> Chile, Secretaría General de Gobierno, *Documentos Secretos de la ITT* (Santiago, 1972); Antonio Vargas MacDonald, *ITT: Documentos de una agresión* (Mexico City, 1973).

conspirator against the Chilean government delegitimized ITT even more making it hard for Allende's opposition to defend it. In fact, despite the hostility against Allende in congress and the openly expropriatory nature of this proposal, there is no record of any congressman defending the company. The DC congressmen said that it was probably better to wait until the concession expired, but gave their approval as well as the radicals. No one argued that a new Chilean firm was incapable of running the industry without the multinational, because by then Entel mastered the new automated technology.<sup>91</sup> In the same session, the Socialists reminded congress of what everybody had agreed before (bad and expensive service) and added the element of violation of national sovereignty. That day, the law permitting the expropriation of ITT's properties in Chile was approved.<sup>92</sup> The worldwide damage of ITT's reputation enworsened later when in December 4 1972, when Allende gave a dramatic speech at the General Assembly of the United Nations accusing ITT and the CIA of conspiring against his government.<sup>93</sup> This happened at a moment in which ITT was already dealing with bribery scandal in the US.<sup>94</sup>

The role of the CIA and ITT in the 1973 coup is still a matter of debate. While some authors argue that both the ITT and CIA played a crucial role at overthrowing

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<sup>91</sup> Guajardo, "Nacionalismo," 106.

<sup>92</sup> Chile, Cámara de Diputados, *Boletín de Sesiones*, August 30 (1972).

<sup>93</sup> Salvador Allende, "Address to the United Nations General Assembly, December 4 1972," in James Cockcroft, *Salvador Allende Reader: Chile's Voice of Democracy* (Melbourne, Australia, 2000), 200-21.

<sup>94</sup> "O'Brien and GOP Clash Over IT&T," *New York Times*, Dec. 14, 1971: 36.

Allende,<sup>95</sup> others claim that even though both wanted Allende out of power the coup was mainly a Chilean internal affair.<sup>96</sup> Regardless of the role ITT played, the leaked documents had a terrible effect in the firm's reputation and left its legitimacy in shambles.

## Conclusion

This paper studies the gradual loss of political legitimacy of a multinational corporation before the host country society as a way to understand hostile actions by domestic governments (which can include expropriation) against foreign firms. In order to achieve this aim we propose the concept of *obsolescing political legitimacy*, which we define as a foreign firm's gradual loss of legitimacy before the local society resulting from the identification of this firm with a previous social and/or political regime increasingly perceived as illegitimate or archaic. Following Brayden King and David Whetten we assume that institutional changes in the host country will also change the legitimacy standards used by the host society eventually affecting the firm's reputation before the same society.<sup>97</sup> The concept of obsolescing political legitimacy allows us to contribute to the extant interpretations on expropriations coming from the literatures of obsolescing

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<sup>95</sup> Kornbluh, *Pinochet*; Qureshi, *Nixon*; Haslam, *The Nixon Administration*; Sampson, *Sovereign State*; Corvalán, *Del anticapitalismo*, 217-33.

<sup>96</sup> Gustafson, *Hostile*, 179-201; Mónica González, *Chile la conjura: los mil y un días del golpe* (Santiago, 2005).

<sup>97</sup> King and Whetten, "Rethinking."

bargaining power and neo-institutional political economy. The first body of scholarship argues that the likelihood of expropriation of a multinational increases the more sunk assets the company has invested in the domestic country. The second school argues that the likelihood of expropriation increases with more authoritarian regimes and decreases with more democratic regimes. By putting the element of perceived legitimacy at the center of the analysis we show that in certain occasions the arrival of a more democratic regime can generate more challenges for a multinational corporation's property rights. If a multinational is perceived by the local society to have benefited in the past from a social and/or political order increasingly considered illegitimate, a government can assume that it does not need to honor any contract signed by that multinational with the previous regime.

We illustrate our point with the case of the US multinational ITT in Chile. Since its arrival the company opted for a legitimization strategy consisting on appointing in its subsidiary's board of directors influential members of the Chilean elite. The problem with this strategy is the dynamic nature of politics. During the period we study Chile went through social and political changes that increased the political and economic power of previously excluded social groups (mainly the middle and the working class) for whom telephone service was not considered a luxury anymore. An increasingly poor reputation due to a deficient and expensive service was capitalized by the new political parties that questioned ITT's corporate power and the very legitimacy of its operations. One of the ways by which they delegitimized ITT was by portraying its board of directors as a relic of Chile's less democratic political past. This argument was used to justify the expropriation of ITT's assets in Chile. When the company was discovered conspiring

against the government it lost what remained of its reputation and legitimacy making the expropriation even easier.

The concept of obsolescing legitimacy can provide us with a new analytical tool to understand the relationship between multinationals and governments. The concept is particularly useful in the presence of institutional changes. These changes can be the result of sudden and violent events (such as military coups, revolutions, or independence wars) or gradual changes. In this paper we focused on gradual institutional changes where a corporation (or any other kind of organization) can adapt by alligning itself to those replacing the groups previously in power. By doing this, the firm can keep its legitimacy before the domestic society. However, if the firm remains allied to those losing political power and representing a gradually disappearing social and political past, the firm can lose legitimacy and risk its property rights.

Other cases of gradual institutional and social changes have shown how the multinationals have successfully adapted. During the 1940s and 1950s, oil companies operating in Venezuela were aware that many democratic politicians and intellectuals considered them allied to the previous dictatorial regimes. The multinationals responded by embracing Venezuelan nationalism and investing heavily in social welfare and in this way legitimize their presence in that country.<sup>98</sup> Adopting a nationalist discourse and showing itself as a domestic firm that improved the lifestyle of the host country's society was particularly useful for Sears when operating in Mexico shortly after the 1938

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<sup>98</sup> Miguel Tinker-Salas, *The Enduring Legacy: Oil, Culture, and Society in Venezuela* (Durham, 2009), 171-203.

expropriation of foreign oil companies.<sup>99</sup> A similar case can be found among some British companies when facing the inevitable decolonization of African territories in the 1960s.<sup>100</sup>

Cases of more rapid institutional changes also provide fertile ground to apply the concept of obsolescing political legitimacy. For example, after the 1959 Cuban revolution the revolutionary government justified the expropriation of foreign assets because of the corporations' alliance with the previous dictatorial or foreign occupation regimes.<sup>101</sup> During the 1960s decolonization of Africa the rulers of these newly created countries considered the operations of many corporations illegitimate because these firms had signed their contracts with a foreign and unelected regime and under legislations that were now foreign. The new African rulers considered that under those circumstances they had no obligation to honor contracts signed under the previous colonial rule.<sup>102</sup> An institutional change can also come without a dramatic change in the political system. In 2008, the Argentinean government expropriated the privately owned pension funds

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<sup>99</sup> Julio Moreno, *Yankee Don't Go Home: Mexican Nationalism, American Business Culture, and the Shaping of Modern Mexico, 1920-1950* (Chapel Hill, 2003)

<sup>100</sup> Stephanie Decker, "Corporate Legitimacy and Advertising: British Companies and the Rhetoric of Development in West Africa, 1950-1970," *Business History Review* 81 (2007): 59-86.

<sup>101</sup> Louis Pérez, *Cuba and the United States: Ties of Singular Intimacy* (Athens, GA, 2003), 242-252.

<sup>102</sup> Leslie Rood, "Nationalization and Indigenization in Africa," *Journal of Modern African Studies* 14 (1976): 427-47; Adeoye Akinsanya, "Host Governments' Responses to Foreign Economic Control: The Experiences of Selected African Countries," *International and Comparative Law Quarterly* 30 (1981): 769-90.



companies arguing that these companies benefited from the previously (and highly delegitimized) free market system ruling that country before the 2001 economic collapse.<sup>103</sup> A domestic democratizing regime change can lead to similar accusations, as happened after the end of Apartheid in South Africa in 1994, when some members of the new ruling African National Congress party (ANC) advocated for the nullification of some contracts signed between multinationals and the pre-1994 government because the illegitimate nature of the Apartheid regime. The negotiated way by which Apartheid ended, however, led the ANC leadership to ignore these calls.<sup>104</sup> A similar sudden loss of legitimacy of multinational corporations resulting from regime change also occurred in 2011 during the pro-democracy popular rebellions taking place in the Middle East and North Africa. The fall of highly unpopular foreign business-friendly dictatorial regimes led some analysts to express concern for the fate of the investments of the multinational corporations that benefited from the crumbling or fallen dictatorships.<sup>105</sup> These concerns were clearly related to the fear that once a business friendly dictator was replaced by a democratic regime, the political legitimacy of the multinationals operating there would be in danger.<sup>106</sup> The fast pace of these political changes led the multinationals to face a sudden problem of reputation and legitimacy. Several of these cases cannot be explained

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<sup>103</sup> “Argentina elimina el sistema privado de pensiones,” *El Mundo* (Spain), 21 October 2008; “Con críticas a las AFJP Cristina Kirchner firmó el proyecto para poner fin a la jubilación privada,” *La Nación* (Argentina), 21 October 2008.

<sup>104</sup> Patrick Bond and Khadija Sharife, “Apartheid Reparations and the Contestation of Corporate Power in Africa,” *Review of African Political Economy*, 36 (2009): 115-137.

<sup>105</sup> “Oil Pressure Rising,” *The Economist*, February 26 (2011), 79-80.

<sup>106</sup> “Arab Unrest Put Their Lobbyists in Uneasy Spot,” *New York Times*, March 2 (2011), A1.

by equating democracy with security of property rights or by the concept of obsolescing bargaining power alone. We hope an analysis focused on the perceived legitimacy of the operations of foreign firms can provide scholars with a tool for deeper understanding of the changing dynamics between multinationals and host societies.

Table 1: ITT-CTC, Profitability on Net Investments, 1950-1958

	Profit rate
1950	1.11
1951	4.63
1952	4.47
1953	4.60
1954	2.93
1955	2.66
1956	3.91
1957	2.91
1958	7.69

Source: ITT-CTC, *Memoria Anual*, various years.

Table 2: ITT-CTC Board of Directors According to Political Affiliation and/or Whether or Not they were ITT Executives, 1950-1970

Political Affiliation	ITT Executive		Total
	No	Yes	
Christian Democrat (or highly likely)	4	0	4
Conservative or Liberal (or highly likely)	16	0	16
No Information	5	11	16
Total	25	11	36

Source: Appendix.

Table 3:

ITT-CTC Board of Directors According to Political Affiliation and Executive Position for Individuals Working for the Company for More Than Four Years, 1950-1970

Political Affiliation	ITT Executive		Total
	No	Yes	
Christian Democrat	1	0	1

Conservative or Liberal	10	0	10
No Information	3	3	6
Total	14	3	17

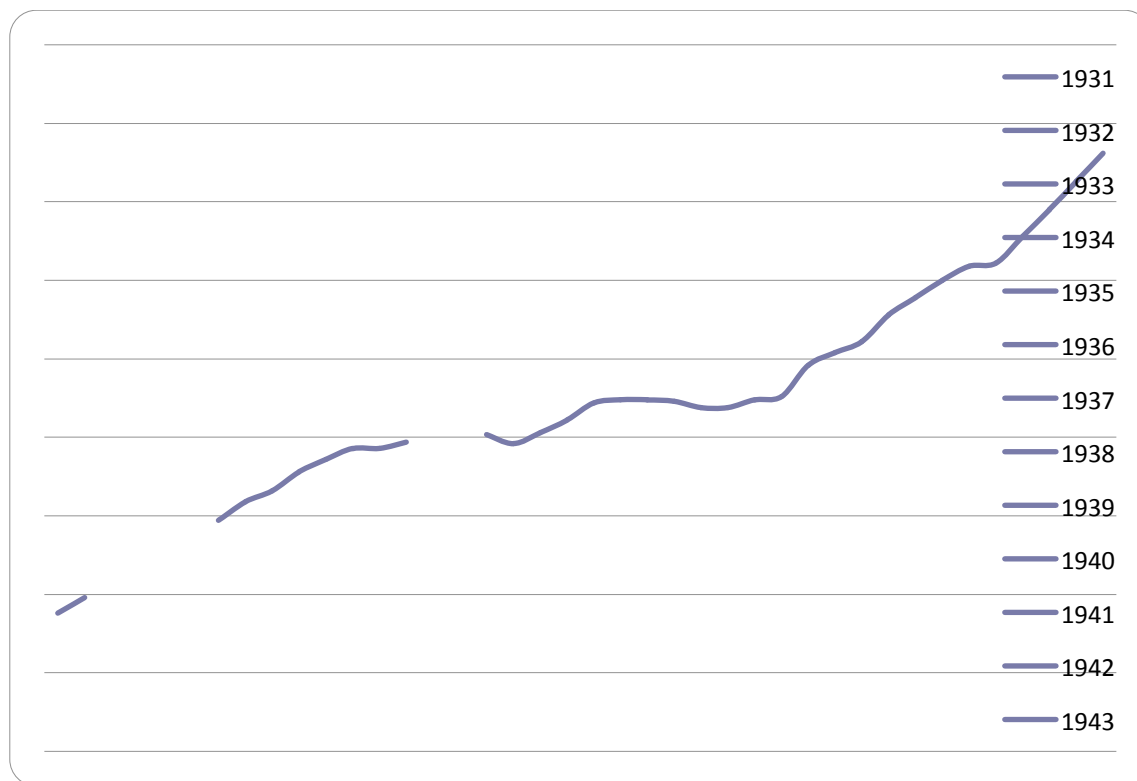
Source: Appendix.

Table 4: ITT-CTC Board of Directors According to Political Affiliation and/or Whether or Not They Were Presidents or Vice-Presidents of the Board, 1950-1970

Political Affiliation	President or Vice-President		Total
	No	Yes	
Christian Democrat (or highly likely)	4	0	4
Liberal or Conservative (or highly likely)	10	6	16
No information	14	2	16
Total	28	8	36

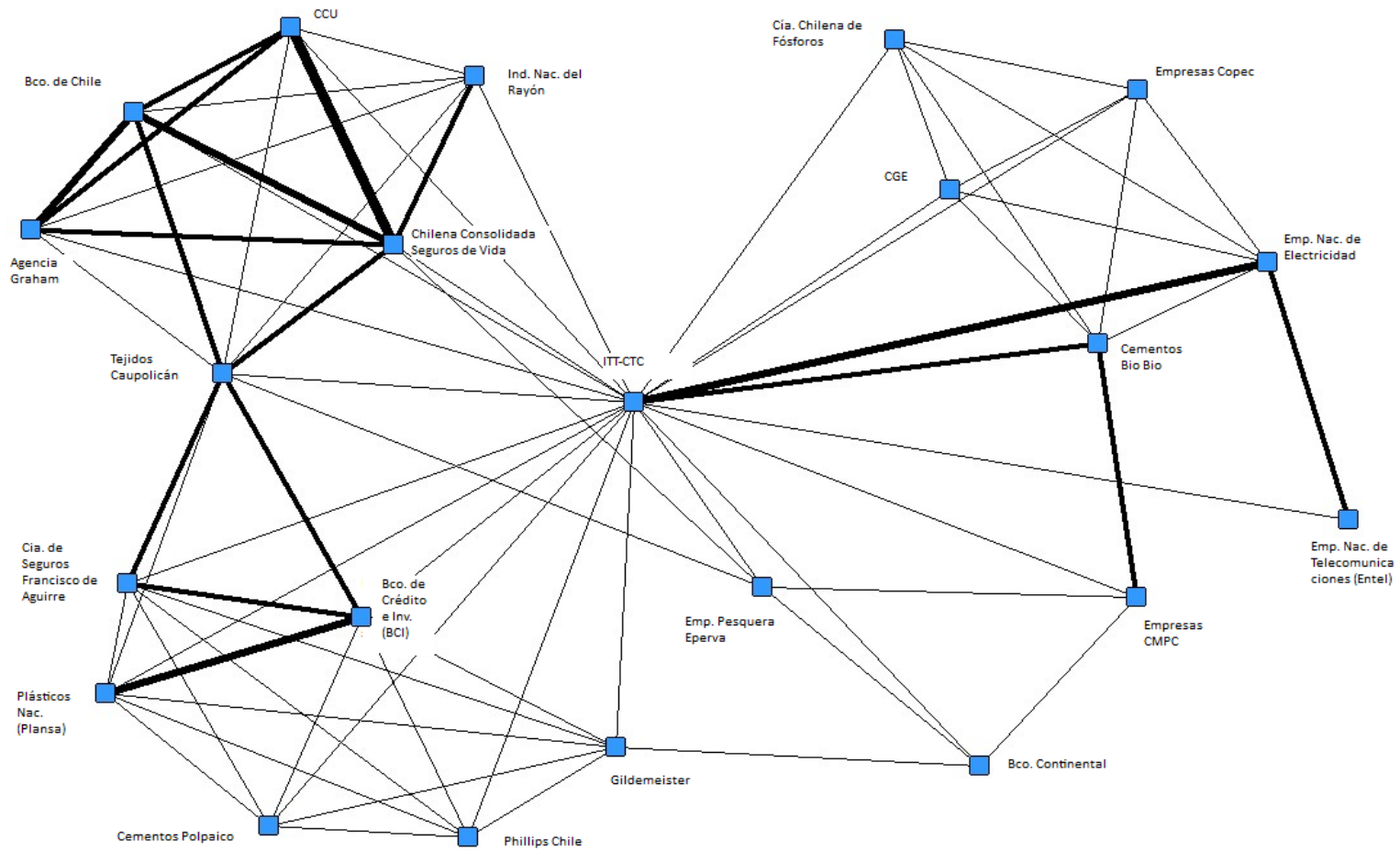
Source: Appendix.

Graph 1. Telephone Coverage in Chile. Number of Telephones per-1000 people.



Source: Calculations with information from the Oxford Latin American Economic History Database (<http://oxlad.qeh.ox.ac.uk/>), accessed February 28, 2011.

Graph 2. ITT-CTC Ego Network (Interlocking directorates 1969).



Appendix: ITT-CTC board of directors (1950-70)

Name	Period	Years on the board	Party affiliation	Biography
Sergio Montt	1959	1	N/A	Chilean diplomat
Jorge Barnard	1950	1	Conservative	Representative for Santiago (Conservative Party) and president of “El Imparcial” newspaper
Guillermo Aviles	1969-1970	1	Likely Liberal or Conservative	Founder of Chile’s Chamber of Building Companies and director in several corporations.



Humberto Duco	1950- 1951	1	N/A	Government representative
Pierre Lehmann	1963	1	Likely Liberal or Conservative	Government representative during Alessandri. Former vice-president of CORFO and president of several major state- owned companies.
Gerhard Adlinger	1967-69	2	N/A	ITT executive formerly employed at McKinsey.
José Manuel Balmaceda	1960- 1962	2	Likely Liberal	Member of a prominent family in the Liberal Party.

Fernando Eguiguren	1968-1970	2	Conservative	Member of the Conservative group “Catholic Action.”
Geoffrey Ogilvie	Vice-president: 1950. Director: 1951-1953	3	N/A	Assigned to Hungary in 1945 to prevent the confiscation of the ITT’s properties.
Ted Westfall	1963-1966	3	N/A	ITT executive. Arrived from Grace Lines to fill the post of Vice-President and area general manager for Latin America
Edgardo Cruz	1966-1969	3	Likely DC	Government representative with several managerial positions in state companies during Frei’s government.

Vicente Izquierdo	1967-1970	3	Likely Liberal	Nephew of president Arturo Alessandri. Founder and president of the National Fishing Society. Participated in CORFO's expansion programs.
Santiago Astraín	1965-69	4	Likely DC or Radical	Government representative during Frei. First general manager of the state owned communications company (ENTEL).
Nicolás Secul	1960-1965	5	Likely Conservative	Director of the national electric service during Jorge Alessandri

Richard Rawlings	Vice-president: 1958-64	6	N/A	US citizen.
Ernesto Concha	1952-58	6	N/A	Government representative.
Pedro Silva	1954- 1962	8	N/A	Law scholar. 1926-30: professor civil Law. President Martial Court (1936). President Appeals Court Santiago (1940). Member Elections Tribunal (1941-44). President Supreme Court (1963-66)
Stephen Larrabee	1958- 1966	8	N/A	ITT executive

Gustavo Lira	1950-59	9	Likely Radical	Government representative.
Luis Subercaseaux	1960-1969	9	Likely Liberal or Conservative	Government representative. Former manager of the Agricultural National Society. Ambassador in Vatican City (1945).
Camilo Saavedra	1952-1962	10	Conservative	Government representative. Campaign advisor of Ibáñez and Jorge Alessandri.
José Ramón Gutierrez	1958-1969	11	Conservative	Conservative congressman (1926-1930). Editor of Conservative newspaper <i>Diario Ilustrado</i> .

Ricardo Letelier	1954-66	12	N/A	CORFO vice-president in 1939. General manager of Banco de Chile (1946-53). Director at the Central Bank. Representative of domestic banks at the Banking Superintendency in the 1950s.
Walter Müller	1950-1957; 1963-1970	14	Likely Conservative or Liberal	President of Chile's manufacturing association, SOFOFA (1934-35). Founder of CORFO. Director and founder of COPEC. Appointed by Jorge Alessandri as ambassador in Washington (1959-62)
Demetrio Rodríguez	1950-1969	19	N/A	ITT-CTC executive.

Fernando Santa Cruz	1950- 1969. Vice- president: 1962	19	Likely Liberal	Son of prominent Liberal politician Vicente Santa Cruz. Landowner.
Guillermo Correa	1950- 1953, 1967. Vice president: 1954- 1966; 1968- 1969	19	Liberal	Congressman for the Liberal Party (1933-37). Vice-president of the Liberal Party. Partner and director at the Agricultural National Society. Minister of Justice during the government of González Videla (1946-7) after González's shift to the right. Director of CORFO (1948) and other firms.

Tomas Rodríguez Briebe	1962. Vice-president: 1950-1970.	20	Likely Conservative	Head of Santiago Stock Exchange. Defender of Church rights in the 1940s.
Ernesto Barros Jarpa	Vice-president: 1950-1954. President: 1955-1970	20	Liberal	Member of Partido Liberal Doctrinario and president in 1932. Minister of Finance. Minister of Foreign Relations (1921-22, 1925). Director in the boards of BCI, Cementos Polpaico, Plásticos Nacionales, ITT Comunicaciones Int, Phillips Chilena, Gildemeister and several insurance companies.
Benjamín Holmes	1950-1969. Vice-	20	Conservative	Chilean ITT executive with connections with the CIA.



	president: 1970			
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Note: Table excludes foreign directors who sat on the board for just one year.

Sources: Bolsa de Santiago, *Anuario Ejecutivo de Sociedades Anónimas, Bancos, Compañías de Seguro y Corredores de la Bolsa de Santiago* 5 (1963); Enrique Bernstein, *Recuerdos de un diplomático: de la Unidad Popular al Gobierno Militar* (Santiago, 1993), 54; Salvatore Bizzarro, *Historical Dictionary of Chile* (New York, 2005); Marcelo Bucheli, “Multinational Corporations, Business Groups, and Economic Nationalism: Standard Oil (New Jersey), Royal Dutch-Shell, and Energy Politics in Chile, 1913-2005,” *Enterprise and Society* 11 (2010): 350-399; Sergio Carrasco, *Cartas del Presidente Jorge Alessandri con los embajadores en la Santa Sede, 1959-1964* (Santiago, 1994); Chile, Biblioteca del Congreso Nacional, “Biografías” (<http://biografias.bcn.cl> accessed October 25, 2010); Chile, *Diario de Sesiones del Senado*; Chile, Ministry of Foreign Affairs ([www.minrel.gov.cl](http://www.minrel.gov.cl) accessed October 25, 2010); Chile, Ministerio de Relaciones Exteriores, *Memoria* (Santiago, 1930); *El Mercurio*; Empresa Periodística de Chile, *Diccionario Biográfico de Chile* (Santiago, 1970); Fitch ([www.fitchratings.com](http://www.fitchratings.com)

accessed October 25, 2010); ITT-CTC, *Memoria Anual* (various years); Korry, "The USA;" *New York Times*; Arturo Olavarría, *Chile entre dos Alessandri* (Santiago, 1962); Augusto Salinas, *Un pastor Santo* (Santiago, 1981), 295; Sobel, *ITT*; Robert Vogeler, *I was Stalin's Prisoner* (New York, 1952), 24, 72; Richard Walter, *Politics and Urban Growth in Santiago, Chile, 1891-1941* (Stanford, 2005), 193; Maurice Zeitlin, Lynda Ewen, and Richard Ratcliff, "'New Princes' for Old? The Large Corporation and the Capitalist Class in Chile," *American Journal of Sociology* 80 (1974): 87-123.