

Globalization, Democracy and Social Spending in Latin America, 1980 – 1997

Autoria: George Avelino Filho

Abstract

This paper examines the impact globalization and democratization have on social spending in Latin America. To measure globalization it introduces a new indicator of financial liberalization for the Latin American cases based on Dennis Quinn's measure of financial openness (Quinn 1997). The findings indicate that there are two logics upon which globalization operates. Trade openness has a decidedly negative impact on social spending as a percentage of GDP while financial openness has a strong positive correlation with increased spending on social welfare. Politicians operating under democratic constraints are also more likely to spend on social welfare programs. This research implies that globalization is a complex process that simultaneously holds both beneficial and deleterious consequences for the provision of social welfare programs in Latin America.

INTRODUCTION

The globalization of markets for capital, goods, services, and information that has taken place in the past fifteen or so years is without historical parallel. Against a wider context of international integration, Latin America has experienced the most dramatic change in its economic policy orientation since World War II. Latin American governments have instituted a broad array of reforms aimed at integrating their economies into global markets. While many other regions have made changes in a similar direction, few have undergone as rapid and thorough a transformation as Latin America.

While globalization has provided some segments of society with new opportunities for social mobility, it has also no doubt created new sources of inequality and introduced or heightened economic insecurities among other groups. Few would dispute the basic fact that economic openness puts employers under greater pressure to reduce labor costs and related restrictions and individuals, who possess the skills, knowledge, and resources associated with internationally competitive sectors benefit more from the new market-oriented system than those who do not.

In this light, questions about how states provide for the welfare of citizens in the contemporary international economic system gain new relevance. How has the international integration of markets for goods, services, and capital affected the social policy decisions of Latin American governments? More specifically, have governments become less generous toward citizens in response to the pressures generated by greater economic openness? Or, have they created stronger safety nets and new forms of social assistance in order to meet the new social challenges of globalization?

This paper examines the impact of globalization and democracy on social spending in Latin America between 1980 and 1997. We use time-series cross-sectional (TSCS) analysis to test whether the empirical patterns observed in the OECD nations are observed in a developing region that has undergone dramatic economic and political change over the last two decades. We build on previous work in several ways. First, we use data on social spending data that maximizes cross-country comparability. Second, we test whether our

results are sensitive to different measures of globalization and democracy. Finally, since different social programs reach various constituencies, we disaggregate social spending to determine whether individual programs are affected differently by globalization and democracy.

Several empirical patterns emerge from our analysis. First, confirming previous results from Kaufman and Segura (2001), we find trade openness has a very strong negative impact on the amount of resources devoted to social spending both in terms of social spending as a percentage of GDP and as expressed in dollars per capita. Second, we find democracy has a strong and positive correlation with social spending both as a percentage of GDP and in per capita terms. To understand the mechanisms that connect globalization, democracy, and social spending, we break social spending down into several categories. We find that democracy's biggest impact on social spending is through education while trade openness has its largest negative impact on health spending. We also find that increased trade openness has a redistributive impact on the allocation of resources to social security, education, health, and housing: countries that trade a relatively high percentage of their GDP protect education and health while adding significantly to housing and other programs.

The paper proceeds as follows. Section one introduces the theory and previous empirical work that relates globalization to government spending. Section two describes our data and the model we use to test the hypotheses derived from the previous section. Section three presents the results. Section four provides some preliminary and tentative explanations. Section five concludes the paper by discussing the implications of our findings as well as identifying some questions that remain unanswered.

THEORY

A growing literature addresses these and related concerns (Cameron 1978; Katzenstein 1985; Hicks and Swank 1992; Pierson 1996; Rodrik 1998, 1999, 2001; Garrett 1998 and 2001; Garrett and Mitchell 1999; Huber 1996; Garrett and Nickerson 2001; Adsera and Boix 2002; Kaufman and Segura 2001; Huber and Stephens 2001). The question at the core of this literature involves whether governments respond to the challenges of globalization with social policy choices that are oriented more toward cutting costs ("efficiency") or protecting people's welfare ("compensation").

The central notion of the efficiency approach is that governments will reduce taxes and social welfare expenditures that diminish profits, discourage investment, and therefore threaten economic growth and international competitiveness. Social services burden business through the distortion of labor markets and higher taxes. If governments borrow to pay for these services, the higher real interest rates that result further depress investment. In short, the efficiency approach envisions economic openness as pitting efficiency harshly against welfare, and leaving governments little choice but to restrict their social outlays.

The compensation perspective recognizes the constraints imposed by economic integration on the social policy options of governments, yet accords weight to the countervailing demands imposed by citizens seeking protection from the state. It stresses the perception among top elected officials and bureaucrats that the social instability and political discontent engendered by internationalization could ultimately endanger the model of economic openness as well as their careers. The core contention of the compensation thesis is that government officials use the latitude they have to strengthen social insurance mechanisms and cushion citizens from the vagaries of the international economy.

The findings of the various works devoted to the efficiency vs. compensation question are far from conclusive. This article builds upon the existing debate by examining the effects

of economic integration on social spending for 19 Latin American countries between 1980 and 1997. In addition to investigating how globalization as a composite measure has affected social expenditures as a whole, we investigate whether all facets of openness (e.g. trade as well as capital mobility) have had similar results; whether internationalization has affected all categories of social services similarly; and whether the relative political openness of governments (i.e. regime type) has been significant in shaping social spending patterns. By disaggregating the concept of globalization as well as social spending, we provide for the possibility that economic change may affect social services in complex and differentiated ways.

Social expenditures are a clear general measure of the extent to which governments contract or expand their commitments to citizens.¹ Rises or falls in spending can provide clues about the constraints facing public officials, their latitude for responding to those constraints, and the relative weight they place on competing priorities. The quantitative dimension inherent in studies of expenditures is conducive to clarity and comparability across countries. Yet because welfare states may change in *kind* as well as in *quantity* (similar amounts of money may fund very different types of programs and constituencies), case studies and small-N comparisons that examine the transformation of social programs in detail are hence necessary complements to large N-analysis.

Latin America constitutes an interesting and relatively understudied region for the analytical questions at hand. The majority of studies aimed at understanding globalization's effects on social protection focus on OECD countries (e.g. Cameron 1989, Garrett 1998; Garrett and Mitchell 1999; Katzenstein 1985; Pierson 1996; Rodrik 1998; Hicks and Swank 1992). This literature grew in part out of a concern that social welfare states in industrialized democracies would undergo severe erosion as increased trade with low wage economies put downward pressure on wages and benefits, and the increased mobility of capital induced business people to go abroad to seek higher returns on their investments. Some authors pay special attention to the developing world (e.g. Garrett and Nickerson 2001; Rodrik 1999), but only one major quantitative study (Kaufman and Segura 2001) focuses specifically on Latin America.

A number of factors that set Latin America apart from other regions -- especially Western Europe -- impinge upon the ability and/or inclination of Latin American governments to respond to globalization with robust welfare programs. On the one hand, some of these are in accordance with the efficiency thesis. Others lend credence to the compensation hypothesis.

The relative weakness of unions and paucity of Social Democratic parties, a historical support base for universalistic and solidaristic social protection policies in Western Europe deprives Latin American citizens of two key organizational means to defend social services against budgetary cuts. Thus, while Cameron (1978) finds that trade openness in Western Europe resulted in the provision of greater public resources for social protection; such an outcome is not automatically generalizable to Latin America.

The rapid and dramatic process of economic adjustment and restructuring in the wake of the Latin American debt crisis -- and the active accompanying role played by the International Monetary Fund -- is without parallel for the developed world. IMF prescriptions for attaining fiscal solvency have rested in part on reducing social expenditures through the introduction of such measures as user fees in health and education, and the targeting of services toward the truly needy in place of subsidies whose beneficiaries include middle and

upper class individuals. Even governments reluctant to initiate such actions acknowledge the importance of signaling to the IMF their seriousness about economic reform.

Finally, the comparative weakness of Latin American states exposes welfare programs to particular risk of retrenchment. The state in most Latin American countries, while never as strong as most Western European states, was weakened further by the economic crisis of the 1980s and '90s. Governments in the region are notorious for their inability to carry out some of the most essential tasks -- such as the collection of tax revenues -- for supporting generous welfare states (Huber 1996).

On the other hand, other factors relevant to Latin America provide some reason to expect that governments in the region may be taking actions compatible with the notion of compensation. Greater trade volatility heightens the insecurity of citizens unless governments take active measures to provide for social protection in times of downturn. Most Latin American countries -- like most of their developing world counterparts -- tend to have more specialized patterns of trade than OECD countries. If governments in the region are attentive to the negative implications for social welfare that such patterns of trade can sometimes have, social expenditures should figure high in relation to total trade. This last aspect leads us to attempt for the role played by new democratic regimes.

Most of former studies focus on OECD countries, for which comparable and extensive data was available. Understandably, these studies take stable democratic institutions as given. In these models, democracy has only an indirect effect: it works as a channel through which the effects of other relevant variables (such as political parties and union strength) can be analyzed.

Although we agree that it is important to consider political factors other than regime type, we believe issues relating to regime type and regime transition still deserve attention from comparative students. At least two reasons justify our claim.

First, we need to know more about the conditions that make democracies work -- that is the conditions that enable them to achieve economic growth, material security, freedom of arbitrary violence, and other widely desirable objectives. (Przeworski et al, 1995) Due to the endemic political instability that has characterized developing countries, much of the comparative work on democratization departed from an assumption that these regimes were inherently fragile. These works were mostly concerned in constructing etiologies of types of regime change or of emerging democratic regimes, rather than with the impact of democracy over public policies.²

The recent political and economic transformations experienced by many developing countries offer a rich opportunity to explore questions about the capabilities of different types of political regimes to react to external economic shocks by implementing policies necessary for economic recovery (Rodrik, 1999). According to Adserá and Boix (forthcoming), the interaction between democracies and economic opening has a strong positive effect on government expenditures.

In sum, the issue seems to oppose political versus economic costs of internationalization, where political incentives to expand social spending in response to internationalization, often overlooked by efficiency perspective, may change along with the type of political regime. As Latin American countries comprise a significant part of the recent wave of democratization, they provide a great opportunity to analyze the effects of different political regimes over these policy options.

Second, despite the euphoria sparked by the widespread democratization among developing countries, current feelings toward new democracies are mixed. Although they

represent an important change in comparison to previous authoritarian institutions, Latin American democracies have been criticized for not having fulfilled many of expectations they generated. This democratic disenchantment is particularly acute in the social area, where democratization was expected to make a tangible effect on the welfare of the poor.³

As the empirical literature makes clear, democracies alone are unlikely to reverse deeply entrenched patterns of poverty and social inequality. Nevertheless, the prevalence of new democracies headed by governments with a presumed interest in maintaining social stability and winning re-election would seem to auger well for social welfare programs. The social dislocations produced by restructuring an economy toward competition in the international marketplace affect middle class as well as poorer segments of the population. Middle class individuals not only vote in higher numbers than their lower class counterparts but also are also crucial to public opinion formation. Rebellion among indigenous peasant producers in southern Mexico, food riots in Argentina, and strikes by public sector workers in a number of countries are among the expressions of protest that have emerged in the last decade. The widespread institution of social emergency programs, such as PRONASOL in Mexico and FONCODES in Peru, suggests that governments in the region are not unaware of the need to secure support for themselves and for their economic reforms.

METHODOLOGY: MODEL SPECIFICATION AND VARIABLES DEFINITION

To test the hypotheses about the influence of democratization over social spending, we examined annual data for the 19 Latin American countries between 1980 and 1997.⁴ The data was compiled by a team of researchers assembled by the United Nations Commission for the Latin American and the Caribbean (ECLAC/CEPAL).⁵ This data set provides a unique opportunity to study the relationship between globalization, democracy, and social spending for two reasons. First, with the exception of Cuba, and Haiti, the set includes all Latin American countries. Second the recurrent problem of data comparability is minimized by the effort made by the ECLAC, which led country studies project to produce comparable data on social spending across Latin America.⁶

The data form a Times-Series Cross-Sectional (TSCS) data set in which each country-year represents a single observation. Although pooling the data has the obvious benefit of increasing the number of observations, it can violate at least two of the basic assumptions that underlie Ordinary Least Squares (OLS) estimation. First the temporal structure of the data increases the chance of autocorrelation of the error terms along the periods of each country, which would violate the OLS assumption that the errors are independent of each other. Second the cross-sectional structure of the data increases the chance that the variance in the error terms may differ across countries, due to country-specific factors, which would violate the OLS assumption that error terms have a constant variance. That is, errors' variance would not be homoscedastic. The consequence of these violations is that OLS coefficient estimates are still unbiased but inefficient.

In order to deal with these problems we followed Beck and Katz (1995, 1996) and used panel corrected standard errors. Also, we included a lagged dependent variable and a set of "n" country and "t" year dummies. The inclusion of a lagged dependent variable is based on two assumptions. First the autocorrelation problem is limited to the first-order correlation, a plausible assumption given the short period covered by the data. Second the autocorrelation is not unit specific; rather it is assumed to be common across all pooled units.⁷ Finally, but not less important, including a lagged dependent variable allows one to address autocorrelation without transforming the data, which may complicate the interpretation of regression coefficients.

The inclusion of a set of “n” country dummies addresses the heteroscedasticity problem by controlling for country-specific effects. It assumes that these effects are fixed during the covered period, allowing a different intercept for each country. This statistical technique has two other consequences that are worth mentioning.

On one side, the combination of these dummy variables may be highly correlated with other independent variables, enhancing multicollinearity problems within the model and reducing the efficiency of the coefficient estimates. Multicollinearity problems will be particularly acute in relation to variables that can be regarded as relatively invariant, or fixed, within each country along the 18-year period covered by the data. This prevents the inclusion of some variables traditionally used in cross-sectional models aiming to explain welfare spending variation in OECD countries, such as the institutional characteristics of social programs.

On the other side, the exclusion of relevant variables from the model specification should lead to bias in the coefficient estimators. From this perspective, the set of dummies summarizes the differences between countries caused by relevant variables that can be considered as fixed over the period. It accounts even for the differences caused by unmeasured relevant variables, a very common situation among developing countries, for which it is hard to find comparable data.

In sum, while the inclusion of country dummies has the disadvantage of preventing inference about fixed cross-sectional characteristics, it has the advantage of assuring that no relevant, and relatively stable, cross-sectional variable is excluded from the model.⁸

Finally, the inclusion of “n” year dummies takes into account time specific effects. For instance, if all countries are subject to a common external shock, the effects of this shock over our dependent variables need to be controlled. This aspect is particular important for Latin American countries during the end of the last century, which seems to share a common story with impact of the Debt Crisis.

Therefore, we will employ the following baseline equation:

$$\text{Social Spending}_{i,t} = \alpha_i + \delta_t + b_1 \text{Social Spending}_{i,t-1} + b_2 \text{Pop65}^+_{i,t} + b_3 \text{Unemployment}_{i,t} + b_4 \text{Level of Development}_{i,t} + b_5 \text{Growth}_{i,t} + b_6 \text{Democracy}_{i,t} + b_7 \text{Financial Liberalization}_{i,t} + b_8 \text{Trade Openness}_{i,t} + \varepsilon_{i,t}.$$

In this equation, terms α and δ represent the country and year dummies, the b 's are the parameter estimates, ε represents the error term, and, finally, the subscripts i and t represent the country and year of observations respectively.

More specifically, **Social Spending** is the dependent variable, measured in two ways: as a percentage of GDP and in 1990 per capita dollars. At first, it will be, measured as a percentage of GDP, and in 1990's per capita dollars. Results for more disaggregate levels of social spending and for changes in the composition of the social budget will be shown later.

The measure for **democracy** conceives democratization as a clear-cut process and measures its effects by using a dummy variable for the political regime, which codes one for democracies and zero for the residual category of authoritarian regimes. This measure is drawn from Alvarez et al (1996). Based on Dahl's (1971) minimalist definition of a democratic regime, the authors focus on contestation as the essential institutional feature of democracies.⁹ We followed Alvarez et al (1996) in their classification; moreover, as the authors' codification ends in 1990, we completed the codification for the period between 1991 and 1997 using the same operational rules and information from the comparative literature on Latin American politics.

The internationalization of national economies is measured by two indicators. The first is the **trade openness**, which is measured, following the traditional way in the literature, as the sum of imports and exports as a percentage of the GDP. It is important to notice that, the inclusion of country dummies in all equations takes into account countries' fixed characteristics (such as the size of the population and the distance from major trade partners) that may influence their exposure to international trade.¹⁰ Therefore, we are confident that our coefficient on the trade openness variable represents government policy choices.

The second indicator is the degree of **international financial liberalization**, drawn from Morley, Machado, and Pettinato (1999), and defined as "the average of four components which reflects the sectoral control of foreign investment, limits on profit and interest repatriation, controls on external credits by national borrowers and capital outflows." The index, is based on information from IMF's *Annual Report on Exchange Arrangements and Exchange Restriction*, and it is normalized between zero and one, with one being the country observation with the smallest legal restrictions on capital flows.¹¹

In addition, we employ four control variables traditionally used in the social spending empirical literature. The first is the demographic structure, **pop65**, which defined as the percentage of the population that is 65 years or older. Due to the impact of demographic characteristics over health care and social security, we expect a higher percentage of elderly people in the population to be positively related to social spending. The data for this variable came from the World Bank's data set "World Development Indicators" (WDI) 2001.

The second traditional control variable is the **unemployment** rate. As in the case of the demographic structure, and despite the existence of few public unemployment programs, this coefficient has an expected positive sign; therefore, the greater the unemployment rate is in a country the greater are the demands on governmental social spending. The data was drawn from various issues of ECLAC's yearly report on the "Economic Survey of Latin America."

We added two other control variables. The first is the **level of economic development**, defined as the log of the GDP per capita and measured in PPP dollars, takes into account a "Wagner's Law" effect, which expects public spending to rise with income. The second control variable is the annual **growth** rate of the GDP per capita, which takes into account the effects of economic volatility during the period. Data for both variables were drawn from WDI 2001.

RESULTS

Aggregate Measures

Table 1 shows the correlation between regime type, globalization and social spending at the aggregate level. Several patterns can be observed from the estimates. First, the lagged dependent variable in every regression is significant which comes as no surprise, due to the stickiness of social spending. Although there is a strong correlation between the dependent variable and its lag, the coefficient on the lagged dependent term is not extremely close to one, ranging from .72 to .76. Consequently, the unit root problem is not a concern.

Second, none of the economic controls are correlated with social spending. Given the use of both country and year dummy variables in each regression, there is little cross-sectional variance left for the control variables to explain.

Third, the coefficient on the democratic dummy variable is strongly positive in every regression. To test the stability of the result with respect to the operationalization of democracy, we substituted Gurr's POLITY IV measure of Democracy – Autocracy. In every

regression the Democracy – Autocracy score¹² confirmed the results we obtained with Alvarez et al (1996) dichotomous measure. Finally, the coefficient for the trade openness variable is significant and negative: as a country's trade as a percentage of GDP increases, the amount of resources governments spend on social programs decreases.

TABLE 1 ABOUT HERE

The substantive impact of the trade and democracy variables is significant. The coefficient for the democracy dummy variable is relatively easy to interpret: it indicates that the difference between democratic and authoritarian regimes is roughly .8 percentage points of GDP per capita. Of course, for the larger economies (Brazil, Mexico, and Argentina), a .8 percentage point difference is substantial. In Brazil's 1 trillion dollar economy, for example, .8 percentage points is equivalent to 800 million dollars. We find the same pattern when we substitute per capita social spending in the regression. There, the substantive significance is easier to grasp. The coefficient on the democratic dummy variable ranges from \$35 dollars per capita to \$45 dollars per capita. Given that the total social spending in some countries was less than \$45 dollars (Paraguay, Bolivia, and Peru), the difference between democratic and authoritarian regimes is substantial. Even among the bigger spenders (Chile, Costa Rica, Brazil), between \$400 and \$500 per capita, the \$35 to \$45 difference amounts to roughly 20 percent of all social spending. Regressions for the per capita spending figures can be found in Appendix 1

The impact trade openness has on social spending is substantial as well. Holding all other variables constant at their means, varying trade openness from 30% to 60% results in a change in social spending of -1.73 percentage points (95% confidence interval from -2.6 to -.88). In per capita terms, more open traders (at the 75% percentile) will spend approximately \$71 less than their more closed counterparts (95% confidence interval is -115.03 to -25.50). Although the differences at first seem staggering, it is important that the ability for countries to move up and down the trade openness scale is somewhat circumscribed. For example, the difference between Brazil's highest and lowest trade openness figure is roughly 8 percentage points.

Before continuing, let us describe the precautions we have taken to gauge the stability of our estimates. First, we tested for different specification of our internationalization variables. For instance, Rodrik (1998) argues the most important issue is the "exposure to external risk" brought about by economic internationalization rather than trade shares alone. However, the inclusion of variables that proxy either for "terms of trade risk" or "export concentration", along with a respective interaction term with trade openness, as suggested by Rodrik (pp. 1014-19), did not cause any noticeable change in our results.¹³ We also try to substitute our variable for capital liberalization for another measuring the net inflows of Foreign Direct Investment as a percentage of the GDP, drawn from WDI; but, as in the case above, we could not find any significant change in any coefficient.

Second, we subjected our models to bootstrapping sample: taking each country out, one at a time, to see if its absence affects the estimates. This is particularly important given the TSCS nature of the data since single influential points are probably clumped together and will not, by themselves, have an effect on the results. We found that the democracy dummy variable and trade openness remained significant regardless of what country was removed from the sample.

Implied in the previous empirical work is the notion that governments respond to globalization by either becoming more efficient (spending less) or by compensating the losers (spending more). However, as Kaufman and Segura note, the number of constituencies that benefit from social spending varies dramatically. Consequently, we would expect that if

democratic institutions serve as a compensating mechanism, they would allocate resources to those sectors most affected by increasing competition in the market. Examining whether trade openness and democracy affect all components of social spending help determine whether changes in spending can be attributed to the compensation or efficiency hypotheses.

Health, Education, and Social Security

Health, education, and social security are the main components of social spending yet serve very diverse segments of the population. As Kaufman and Segura note, social security outlays may be most susceptible to globalization since they comprise an important part of the wage bill (Kaufman and Segura, 2001). Health and education, however, are not as directly tied to the costs born by employers. There may be important differences between health and education as well. Although there are certainly important societal effects of an increasing supply of educational opportunity, the direct beneficiaries of increasing access to education are the young students themselves along with their parents. Those benefiting from health expenditures represent a wider segment of the population. Since those below the age of 18 do not have the right to vote in most Latin American countries, a considerable segment of the population does not have the ability to press their demands through the ballot box. Since the demographic groups that benefit directly from spending on health, education, and social security vary, we estimated the previous models using the amount spent on health, education, and social security.

Table 2 reports the results for the three important components of social spending for a standard model and then one with interactions. A clear pattern emerges from the estimates reported in the table: Democracy's positive impact on social spending is channeled through education. The democratic dummy variable has a positive and statistically significant coefficient in both equations for education.

TABLE 2 ABOUT HERE

Although the democracy variable maintains its positive coefficient, in the health equation it cannot be distinguished from zero at any acceptable level of confidence. The consistent pattern in the health regressions is the strong and negative association between the trade openness variable and spending. With respect to social security, we find that only the interactive term between democracy and trade openness exhibits a strong negative correlation with spending.

Along with our findings in the aggregate analysis, the following pattern begins to emerge. Although trade openness is negatively correlated with aggregate social spending, its main effects are found in health spending and education spending. Democracy's positive association with social spending is manifested in higher rates of spending on education. The interaction between democracy and trade openness is always negative and significant. Democracies, it seems, are much quicker to cut social spending as larger segments of the economy are exposed to trade. But, as we saw in Figure 2, a large number of democracies (democracies with relatively low levels of trade to GDP) actually spend more than authoritarian regimes (roughly 60 percent of our cases). The picture, consequently, is somewhat murky. In terms of the compensation versus efficiency hypothesis, the dummy variable term for democracy indicates democratic regimes compensate exposure to trade by increasing social spending particularly in education. Trade openness, however, forces governments to cut back on spending particularly in health and education. What we can say is that among countries in which trade makes up a small percentage (i.e. Brazil, Argentina, Mexico, Colombia, Peru, Venezuela), democracies spend more than authoritarian regimes. In countries with relatively high levels of trade (i.e. Costa Rica, Panama, Jamaica, Nicaragua, Paraguay), democracies spend less than their authoritarian counterparts. In fact when we

eliminate the largest economies (those with trade representing 30 percent or less of GDP), the interactive term between democracy and trade openness becomes insignificant while the democracy dummy variable still maintains its strong positive coefficient.

Although disaggregating social spending into health, education, and social security reveals some interesting patterns, some important questions remain unanswered. We don't know, for example, whether democracies spend more on education by taking from health or social security. We know that trade openness does not seem to affect the overall size of social security, what we don't know is whether maintaining the levels of social security comes at the cost of health and education. According to the estimates from the regressions reported in Table 2, the answer would be yes. However, the regression analysis used heretofore cannot answer these questions.

CONCLUSION

Using data collected on social spending for the Latin American countries between 1980 and 1997, we set out to test whether the compensation or efficiency hypotheses held for the Latin American continent. As the previous pages revealed, the story is somewhat more complicated than a simple confirmation of one or the other hypothesis. Specifically, and in direct contrast to previous work by on the OECD countries, we find that trade openness has a negative impact on the allocation of resources to social programs. The strong, negative correlation between trade openness and social spending confirms recent work by Kaufman and Segura (2001). We find, however, in contrast to Kaufman and Segura, that democracy has a consistent positive influence on social spending. Interacting democracy and trade openness produced a very contradictory result, implying that democracies do not compensate the losers as trade openness increases, accelerating the efficient allocation of resources away from social spending. Further investigation, however, showed that negative coefficient on the interactive term was largely the result of large democratic economies that outspent their democratic counterparts. Finally, analyzed the allocation of resources among social spending programs to better understand whether globalization and democracy perform compensating or efficiency functions both in terms of economic investment and politics. Democracies protect spending on programs that reach large segments of the population while globalization leads to a more efficient allocation of resources among different spending programs.

All we have done here is establish some interesting empirical patterns, more theoretical and empirical work are needed to better understand a complex set of phenomena. At the very least, we have established there are some heretofore unobserved patterns that deserve further scrutiny. Left unanswered, for example, is why trade openness has a consistently negative correlation with social spending in Latin America when similar models for the OECD nations come to the opposite conclusion. More work is needed as well to account for the different effects we find for democracy in direct contrast to work by Kaufman and Segura. Finally, more work is needed on correctly specifying a model that interacts globalization with domestic political institutions. By pursuing these questions in greater depth and with greater understanding, we can better understand the political and economic constraints and opportunities that globalization and democracy afford.

TABLE 1
Social Spending as a Percentage of GDP Regressed on Control
Variables, Democracy, Capital Liberalization, and Trade Openness.

	(1)	(2)	(3)	(4)	(5)	(6)
	SPGDP	SPGDP	SPGDP	SPGDP	SPGDP	SPGDP
Social Spending/GDP _{t-1}	0.759*** (0.052)	0.767*** (0.054)	0.760*** (0.053)	0.756*** (0.059)	0.759*** (0.052)	0.726*** (0.055)
GDP/capita _t	-1.342 (1.343)	-1.333 (1.338)	-1.321 (1.389)	-0.384 (1.424)	-1.399 (1.378)	-0.850 (1.276)
Economic Growth _t	-0.346 (1.103)	-0.207 (1.068)	-0.360 (1.127)	-1.228 (1.201)	-0.427 (1.093)	-0.739 (1.122)
Unemployment _t	0.066* (0.037)	0.067* (0.040)	0.066* (0.037)	0.065 (0.041)	0.065* (0.037)	0.057 (0.036)
% of Pop. over 65 _t	-1.160 (0.797)	-1.332 (1.002)	-1.158 (0.797)	-1.122 (0.794)	-1.161 (0.800)	-0.831 (0.780)
Democracy Dummy _t	0.774*** (0.235)	0.827*** (0.255)	0.755*** (0.264)	0.586*** (0.189)	0.761*** (0.240)	2.955*** (0.440)
Trade Openness _t	-0.043*** (0.010)	-0.046*** (0.012)	-0.043*** (0.010)	-0.045*** (0.010)	-0.044*** (0.010)	-0.027*** (0.010)
Capital Liberalization _t	-0.893 (0.753)	-0.899 (0.731)	-0.920 (0.725)	-0.616 (0.820)	-0.891 (0.753)	0.339 (0.919)
Fiscal Decific _t		0.013 (0.022)				
Civil War _t			-0.061 (0.181)			
Debt Service Ratio _t				0.027*** (0.006)		
Inflation _t					0.000 (0.000)	
Trade Openness X Democracy Dummy						-0.044*** (0.008)
Capital Liberalization X Democracy Dummy						-0.882 (0.910)
Observations	214	208	214	214	214	214

Standard errors in parentheses* significant at 10%; ** significant at 5%; *** significant at 1%

TABLE 2
Regression for Education, Health, and Social Security

	(1)	(2)	(3)	(4)	(5)	(6)
	Education	Education	Health	Health	Social Security	Social Security
Lagged Dependent Variable	0.751 (29.40)**	0.695 (16.98)**	0.549 (16.37)**	0.563 (17.00)**	0.826 (8.52)**	0.812 (8.93)**
Unemployment	0.461 (2.21)*	0.330 (1.66)	0.803 (4.86)**	0.657 (3.53)**	1.205 (1.20)	0.611 (0.66)
GDP/capita (log)	18.118 (1.50)	33.638 (2.89)**	39.705 (4.04)**	45.237 (4.26)**	11.533 (0.72)	17.655 (1.05)
Economic Growth	-1.111 (0.10)	-15.287 (1.35)	1.404 (0.09)	-3.056 (0.19)	-17.260 (0.72)	-37.484 (1.52)
Population 65 and Above	-11.316 (1.29)	-6.979 (0.79)	0.051 (0.02)	0.245 (0.07)	25.743 (2.28)*	22.550 (1.88)
Democracy Dummy 1=Democracy	11.730 (5.45)**	58.212 (5.25)**	0.805 (0.39)	10.250 (1.23)	14.632 (1.72)	23.987 (0.78)
Trade Openness	-0.300 (2.51)*	-0.028 (0.27)	-0.257 (3.80)**	-0.166 (2.43)*	-0.011 (0.06)	0.260 (1.22)
Capital Liberalization	-1.788 (0.32)	26.317 (1.77)	16.748 (3.04)**	16.746 (1.48)	-5.986 (0.22)	-34.987 (0.82)
Democracy X Capital Lib.		-21.766 (0.91)		3.777 (0.32)		48.739 (0.91)
Democracy X Trade Openness		-0.853 (7.30)**		-0.311 (3.98)**		-1.022 (2.76)**
Constant	-60.109 (0.70)	-212.090 (2.93)**	-269.675 (3.55)**	-315.371 (3.92)**	-201.810 (2.06)*	-203.189 (1.93)
Observations	200	200	183	183	177	177

Panel-corrected z-statistics in parentheses: * significant at 5% level; ** significant at 1% level

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¹ While summary figures do not address the distributional impact of social spending, there is some evidence that they exert a positive impact on the poorer sectors of the population in Latin America. (Petrei, 1996; Mostajo 2000).

² For a survey of different "types of democracy", mostly based on institutional characteristics, see Collier and Levitsky (1997). As the ability of the poor to make effective demands depends on the institutional design of democratic regimes, a natural extension of the work done here is to test the impact of different types of democracy over public policies.

³ A recent pool by "Latinobarometro", published in "The Economist" (2001), attested the decline of the democracy support in Latin America. This disenchantment, however, does not imply in disregarding that changes in democracies are usually moderate and incremental as claimed by many authors (Huntington, 1989; Schmitter and Karl, 1991). In most cases, the disenchantment stems from the perception that new democracies have not represented a shift in government priorities, even an incremental one, toward the interests of the poor.

⁴ Countries are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela. The full data matrix, therefore, comprises a maximum of 342 observations (19 countries x 18 years). Missing data, however, implied that we analyzed smaller data sets, depending on the country and year coverage of variables.

⁵ ECLAC/CEPAL "Base de Datos de Gasto Social - División de Desarrollo Social de la Cepal, actualizada hasta fines de 1998."

⁶ This project has yielded two publications: Cominetti and Di Gropello (1994) and Cominetti and Ruiz (1997).

⁷ As argued by Beck and Katz, (1995: 638), "The assumption of unit-specific serial correlations also seems odd at a theoretical level. Time-series cross-section analysis assume that the 'interesting' parameters of the model, β , do not vary across units; this assumption of pooling is at the heart of TSCS analysis. Why not should we expect the 'nuisance' ρ to not show similar pooling? ρ can be interpreted as how long it takes for prior shocks to be removed from the system. Why should this 'memory' be the only model parameter that varies from unit to unit?" See also, Beck and Katz (1996).

⁸ As stressed by Stimson (1985), the estimated dummy coefficients are not explanation, but rather summary measures of our ignorance about the causes of between-units differences. Following Przeworski and Teune (1970), one would say that the dummies represent our inability to "substitute the name of variables for the names of social systems." (p.8)

⁹ "Our purpose is to distinguish regimes that allow some, even if limited, regularized competition among conflicting visions and interests from those in which some values or interests enjoy a monopoly buttressed by a threat or the actual use of force." (Alvarez et al, 1996: 4). See Huntington (1991: 266-67) for a similar theoretical point.

¹⁰ See Rodrik (1998: 1026), who calls this exogenous component of trade shares as the “natural openness for each country.”

¹¹ The difference between each country absolute index and the least liberalized country year observation is expressed as a percentage of the difference between the maximum and minimum absolute indexes for all countries over the entire period.

¹² This is an updated version of former Polity I, II, and III data sets. For a more detailed discussion of the indicators, see Gurr, Jagers and Moore (1991), and Jagers and Gurr (1995). The data can be downloaded at the following website:

<http://www.cidcm.umd.edu/inscr/polity/>. The democracy score is not dichotomous, since it ranges from -10 to 10.

¹³ The first variable is the standard deviation of the first logarithm differences of the terms of trade for each country. Data on terms of trade were drawn from ESDB/IADB, available at the IADB Internet site (www.iadb.org). Export concentration is measured as the summation of the percentage share of the ten most important export products on the total exports for each country. Data from this last variable was collected from ECLAC/CEPAL, Statistical Yearbook of Latin America, various issues.