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ABSTRACT OF DISSERTATION

Hanbeom Jeong

The Graduate School
University of Kentucky
2010

GLOBALIZATION AND THE POLITICS OF THE WELFARE STATE

ABSTRACT OF DISSERTATION

A dissertation submitted in partial fulfillment of the requirements for the degree of Doctor of Philosophy in the College of Arts and Sciences at the University of Kentucky

By
Hanbeom Jeong

Lexington, Kentucky

Director: Dr. Horace Bartilow, Professor of Political Science

Lexington, Kentucky

2010

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ABSTRACT OF DISSERTATION

GLOBALIZATION AND THE POLITICS OF THE WELFARE STATE

The theoretical argument of this study is that economic globalization, by default, exerts a downward pressure on the social policies of states largely through the operations of transnational corporations. However, since globalization's effect on social policy is conditional on endogenous political forces such as regime type, democratization, electoral competition and political participation, its proclivity to retrench the welfare state is averted by the preferences of political actors and institutions to expand social spending. This argument found consistent empirical support via a series of cross-section regressions that estimated the interactive effects of economic globalization and various measures of domestic political institutions and affiliations for a sample of 120 countries from 1970 to 2002. Case studies of South Korea, Chile and Spain provided additional qualitative evidence for the study's theoretical argument.

KEY WORDS: Welfare State, Economic Globalization, Compensation, Efficiency

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June 15, 2010

GLOBALIZATION AND THE POLITICS OF THE WELFARE STATE

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June 20, 2010

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To My Parents, Grandparents, Wife and Kids

and

Special Thanks to Dr. Bartilow for his dedicated hard work and assistance in making this project possible

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Part 1

Economic Globalization and the Welfare State: Theoretical and Empirical Approaches

Chapter 1

Globalization and the Welfare State: Existing Theoretical Approaches

1.1. *Introduction*

Economic globalization is commonly referred to as "the increasing internationalization of the production, distribution, and marketing of goods and services" (Harris, 1993, p. 755). Economic globalization in this sense is characterized by the integration of financial and labor markets via trade, foreign investment and capital transfers (Shariff, 2003). Increasing exposure to global integration has resulted in economic dislocations for many countries throughout the world. Much of this dislocation has come in the form of job losses, poverty, income decrease and increasing income inequality even among advanced industrial countries (Lawrence, 1996).

Globalization's negative externalities for the welfare state and questions regarding what the appropriate policy responses should be have sparked passionate debate among policy makers and have grabbed the attention of academic researchers. However, much of the existing academic scholarship is hobbled by theoretical and empirical limitations that conceal more than they reveal about how global economic forces are shaping social policies. The motivation of this research is to elucidate the conditions under which the effects of globalization on social policy are shaped by the nature of countries' domestic political institutions and economic structures.

The question that guides this study is: what explains states' social expenditures when national economies are increasingly integrated into the global economy? In answering this question, a dominant theoretical approach in the extant literature, often referred to as the *Efficiency Theory* of the welfare state, advances the

proposition that globalization produces a 'race to the bottom' effect on social spending. As global market forces dictate national economic decision-making, considerations of greater economic efficiency will lead policy makers to sacrifice the welfare state in order to compete with other states by attracting mobile transnational capital. As national economies become increasingly integrated into the global economy, transnational capital will flow to those countries that provide the lowest levels of social protections for their citizens (Adsera and Boix, 2002, Avelinon et al., 2005, Cameron, 1978, Garrett, 2001, Garrett, 1998, Hicks and Swank, 1992, Huber, 1999, Iversen and Cusack, 2000b, Katzenstein, 1985, Pierson, 2001, Rodrik, 1998, Rudra, 2002, Rudra, 2008, Rudra and Haggard, 2001, Swank, 2002).

While the efficiency theory has in some respects become the intellectual expression of anti-globalization populists on the right and the left (Bhagwati, 2004, pp.21-25), the theory is limited by its inability to clearly identify the primary causal mechanisms through which economic globalization produces the 'race to the bottom' effect on welfare expenditures.

Notwithstanding the limitations of the efficiency theory, other scholars posit what they claim to be an alternative theory – the *Compensation theory* of the welfare state, which advances the proposition that global economic integration may in fact produce an expansionary effect on social spending. It is argued that governments will expand welfare spending to compensate the losers of economic globalization for the purpose of maintaining their political legitimacy (Miller, 1986, O'Connor, 1971). However, as it is currently configured, the compensation theory is nothing more than a statement that global economic integration is correlated with an increase in governments' welfare expenditures. As a result, it is not considered a theory in this analysis but its insights along with those drawn from the efficiency theory are used to

develop an integrated theory of globalization's effects on the welfare state.

In addition to the literature's theoretical limitations, the empirical research of the existing literature has produced evidence that cannot be generalized across a large sample of countries. Some studies have largely analyzed the relationship between economic globalization and welfare spending among OECD (Organization for Economic Cooperation and Development) countries (Cameron, 1978, Garrett, 1998, Hicks and Swank, 1992, Iversen and Cusack, 2000b), while others have based their analyses on developing countries (Avelinon, et al., 2005, Kaufman and Segura-Ubiergo, 2001, Rudra, 2002, Rudra, 2008). Studies whose samples rely on OECD countries suggest that increasing levels of global economic integration increase government welfare expenditures, consistent with the compensation thesis. Meanwhile, studies with samples taken from countries in the developing world suggest that increasing levels of economic globalization significantly reduce government welfare spending as predicted by efficiency theories (Rudra, 2008).

Given these limitations this study contributes to the existing literature in the following ways. First, it draws upon efficiency and compensation approaches and develops an integrated theoretical framework that explains globalization's effects on social spending. Second, the study's theory is systemically tested within the context of a large-N cross-national pooled time-series analysis of 122 countries during the years 1970-2002. To reinforce the statistical analysis, the study also tests the theory via comparative case study analyses of South Korea, Chile and Spain. The methodology that motivated the selection of these countries is discussed in chapter 3. Third, relative to existing studies, a comprehensive measure of economic globalization is utilized that adequately captures the theoretical definition of the concept. Fourth, using principal component analysis, an aggregate indicator that measures the institutional

factors of countries' domestic politics is constructed. Economic globalization interacts with these domestic political factors to empirically predict governments' social spending.

This manuscript is organized in three parts. Part I is comprised of chapters 1, 2 and 3. Chapter 1 reviews the existing literature that features efficiency and compensation approaches to the welfare state. After discussing the theoretical limitations of the existing literature an alternative theoretical framework is advanced that draws upon and integrates efficiency and compensation approaches to explain social policies under conditions of global economic integration. Chapter 2 presents a full discussion of the various components of the study's theoretical argument and affixes hypotheses at the end of each discussion. Chapter 3 presents the study's research design. The outcome variable – welfare spending – and the various explanatory variables are discussed and operationalized. The chapter concludes with a discussion of the estimation procedures, which feature various time-series regressions that are used to analyze the cross-national data as well as a discussion of the methodology that informed the selection of countries used in the case study analysis.

Part II is comprised of chapter 4, 5 and 6. Chapter 4 presents the empirical finding of the interactive effect of economic globalization and national capitalist firms on states' social spending. Chapter 5 presents the empirical findings of the interactive effects of economic globalization and domestic political institutions on states' welfare spending. A number of interactions are examined. The first analyzes the interaction between economic globalization and an index of domestic political institutions on welfare spending. And the analyses that follow examine the interaction between economic globalization and the disaggregated components of political institutions on welfare spending; namely, the interaction between economic globalization and regime

type; the interaction between economic globalization and voter's participation; and the interaction between economic globalization and electoral competition. Chapter 6 shifts the analysis to a discussion of the empirical findings that feature the interactive effects of economic globalization and domestic political affiliation on states' welfare spending. These include the interaction between economic globalization and labor unions and the interaction between economic globalization and the ideology of ruling political parties.

Part III is comprised of Chapters 7, 8, and 9, which presents the case studies of South Korea, Chile and Spain. The case studies illustrate that the effects of global economic integration on welfare policy in emerging economies with authoritarian political histories are conditioned by the variation in the political institutions found in each country. Chapter 10 concludes with a discussion of the theoretical and policy implications that emerge from the research.

1.2. *The Efficiency Theory of Welfare Spending*

The fundamental proposition of the efficiency theory is that high levels of government social spending undermine economic efficiency and the competitiveness of domestic firms in international markets (Avelinon, et al., 2005, Garrett, 2001, Kaufman and Segura-Ubiergo, 2001). It is argued that since social spending is largely funded from corporate taxes, any increase in social expenditures will be accompanied by an equivalent increase in the level of taxes (Song and Hong, 2005). Increased taxes undermine investor confidence and the competitiveness of domestic companies in both domestic and international markets (Garrett, 2001). Increased social spending can also result in increased government debt as the state increases its borrowing to finance its welfare policies. Consequently, increased government borrowing results in

higher interest rates and the devaluation of the currency, both of which increase production costs and discourage companies from making new investments (Garrett, 2001).

High levels of taxes brought about by increases in government welfare policies will ultimately facilitate capital flight, as transnational corporations will begin re-locating their investments to countries that have lower taxes and limited social protections, hence producing a 'race to the bottom' effect on the welfare state (Barnet and Cavanagh, 1994, Barnet and Muller, 1974, Brecher and Costello, 1994). Since economic globalization increases the mobility of transnational capital, it is this threat that forces governments to significantly reduce social expenditures in order to restore investor confidence. In sum, the efficiency theoretical model posits that economic globalization and the level of international competition that emerges from it constrain and limit government welfare spending in order to attract and retain mobile capital.

Recent empirical research seems to confirm the logic of the efficiency theory of welfare spending. One study assessed the impact of economic globalization on the growth of government spending in OECD countries and showed that trade and international financial openness had a negative effect on government spending (Garrett, 2001). Consistent with this finding, recent research using a sample of Latin American countries examined the relationship between economic globalization and welfare spending and found that trade openness had a consistently negative effect on aggregate social spending and social security transfers (Kaufman and Segura-Ubiergo, 2001).

Razin and Sadka (2005) explain the decline of the welfare state in terms of the changing demographic patterns and the global integration of national economies. Under conditions of global economic integration and the growth of an aging

population, governments are caught between a rock and a hard place. On one hand, increasing taxes on capital runs the risk of driving away mobile transnational capital. On the other hand, increasing taxes on a young but increasingly small labor force is both economically and politically unsustainable. Since young people represent an important element of the median voter, they are likely to effectively resist the government's attempt to increase welfare spending. Given this dilemma, government welfare spending is likely to decline (Razin and Sadka, 2005). To the extent that economic globalization exerts a downward 'race to the bottom' effect on social spending, the above discussion serves as this study's theoretical baseline and generates the following hypotheses:

H_E: *Increasing levels of global economic integration are associated with a decrease in welfare spending.*

1.3. *The Compensation Approach*

While recognizing the budgetary constraints of the state under conditions of increased global economic integration, compensation approaches to welfare spending emphasize the social demands for welfare allocation and the political incentives of policy makers to respond to such demands. The welfare system, according to this approach, is a necessary mechanism for offsetting the costs of global economic integration (Cameron, 1978, Kaufman and Segura-Ubiergo, 2001, Quinn, 1997). Scholars in this tradition argue that efficiency theories overlook the political incentive to increase public programs in response to international economic integration (Garrett, 2001). Since policy makers in democracies are primarily motivated by re-election, they are more likely to increase welfare spending to offset negative economic

externalities, such as job losses and increased income inequality that emerge from the competitive nature of the global economy. Hence, knowing that those who are displaced will blame political incumbents for the negative externalities of economic globalization, policy makers are more likely to increase welfare spending to pacify displaced workers. In addition, policy makers will also provide welfare benefits to insure that the negative externalities of global economic integration do not disrupt national financial markets (Avelinon, et al., 2005).

David Cameron's (1978) seminal research provides the first empirical and historical analysis of the growth of the welfare state among Northern European countries. The research was the first quantitative analysis of welfare policy that showed that openness to trade was strongly correlated with what he referred to as the "scope of the public economy," which was measured in terms of the change in total taxes as a percentage of GDP. The research showed that openness to trade was the best predictor of the growth of government revenues. Large nations that were economically less open experienced moderate increases in the scope of the public economy compared to smaller nations with more open economies. While the scope of the public economy among small Western European countries varied with the dominance of left parties in Scandinavian countries or the dominance of centrist or conservative parties in countries like Belgium and Ireland, the best explanation for the expansion of government expenditures is the degree to which national economies had been integrated into the global economy (Cameron, 1978).

In his classic, *Small States in World Markets*, Peter Katzenstein's (1985) analysis is consistent with the compensation approach to welfare policy. By employing a comparative case study analysis of Sweden, Norway, Denmark, the Netherlands and Belgium, Katzenstein demonstrates that global economic integration

is causally related to welfare expenditures as well as to the various state interventions that are designed to increase economic growth and productivity. According to Katzenstein, what distinguishes the small states of Western Europe from larger nations is the ways in which they have combined liberal policies that are designed to leverage greater global economic integration with a policy of domestic compensation through which the country's national economy is protected from the negative consequences of liberal openness (Katzenstein, 1985).

In pursuing an effective industrial policy, the mix of international liberalism and domestic compensation varies widely among small Western European states. Moreover, the development of an industrial policy is not dependent on size but what Katzenstein refers to as democratic corporatism, which is the way in which conflicting economic interests are mediated domestically. Democratic corporatism is characterized by an "ideology of social partnership expressed at the national level; a relatively centralized and concentrated system of interest groups; and voluntary and informal co-ordination of conflicting objectives through continuous political bargaining between interest groups, state bureaucracies, and political parties" (Katzenstein, 1985, 32). It is, therefore, the democratic corporatist nature of small European states that makes it possible to develop an industrial policy that is based on effectively integrating national economies into the global economy, while at the same time developing a robust system of domestic compensation (Katzenstein, 1985).

In building on the work of Cameron (1978) and Katzenstein (1985), Rodrik (1998) developed a cross-national study of the relationship between economic globalization and the size of government. This study was motivated by a simple question: is the relationship between trade and government spending negative as efficiency theory predicts or is the relationship positive as predicted by the

compensation approach? The research shows a positive correlation between countries' exposure to international trade and the size of government. These results are robust to most measures of government spending and the inclusion of a wide range of control indicators as well as various sample selections. According to Rodrik, government spending reduces societal-risk for countries whose economies are increasingly vulnerable to global economic integration, and the relationship between trade openness and the size of government is strongest when the terms-of-trade risk is the highest (Rodrik, 1998).

Other scholars within this research tradition consider the effects of other aspects of economic globalization on government welfare spending. Quinn's (1997) cross-national study of 38 nations estimated the effects of capital mobility on government spending and found that greater capital mobility is associated with higher levels of spending. Other research on the effect of capital mobility on welfare spending has shown that the integration of capital markets has been associated with increases in welfare spending as well as higher corporate taxes (Swank, 1998). A recent empirical treatment of Latin American countries provided additional support for the compensation thesis. Using a measure of financial openness as well as measures of trade openness, Avelinon, Brown and Hunter's research suggests that trade openness has a positive relationship with education and social expenditures, and financial openness does not reduce government expenditures for social programs as predicted by the efficiency theory (Avelinon, et al., 2005).

1.4. *Theoretical Limitations of the Existing Literature*

A significant limitation of efficiency theory's 'race to the bottom' approach to social policy is that the central mechanism through which economic globalization is

said to have a reductive effect on welfare spending is not clearly specified. Different authors in this tradition identify different causal mechanisms. Some identify global corporations as the central mechanism through which economic globalization produces a 'race to the bottom' effect on welfare spending. These scholars argue that since economic globalization increases the mobility of transnational capital, it is the threat of corporate divestment and re-location to other countries that forces governments to slash welfare expenditures in order to reduce costs and restore investor confidence (Barnet and Cavanagh, 1994, Barnet and Muller, 1974). Others point to states as the central mechanism and argue that governments regardless of their ideological orientation are increasingly willing to sacrifice the interests and rights of workers and the poor in order to promote an investor friendly environment (Holman, 1993). And still others point to the structural adjustment policies (SAPs) of the International Monetary Fund (IMF) and the World Bank as the central mechanism and argue that the conditionalities associated with SAPs force governments to retrench welfare expenditures in order to improve economic efficiency by reducing public sector and balance of payments deficits (Bartilow, 1997).

The various mechanisms that scholars identify either directly or indirectly involve the role of corporate capital. As a result, the theoretical discussion in the next chapter draws upon Marxist theories of the welfare state to construct the conditions under which the integration of national capitalist firms into the global production process establishes the causal mechanism through which globalization exerts a downward pressure on states' welfare policies.

A significant limitation of the compensation thesis is that it is based on the assumption that the welfare state is a necessary mechanism for offsetting the negative externalities of economic globalization (Cameron, 1978, Kaufman and Segura-

Ubiergo, 2001, Quinn, 1997). In fact, the Keynesian welfare state is not a creature of global capitalism but was created to stabilize the economic contradictions of capitalism in its national form. In many respects the Keynesian welfare state, as discussed in chapter 2, is naturally incongruent with the logic of global capitalism (Teeple, 1995). Therefore, if it is observed that the welfare state offsets globalization's negative externalities, then this outcome is not natural to the operations of the Keynesian welfare state (Miliband, 1969); but is a function of the ways in which endogenous political institutions, which are absent from the compensation perspective, averts globalization's natural tendencies to retrench the welfare state.

The compensation thesis, as it is currently configured, is less theory and more an observation that the global integration of national economies is correlated with an increase in governments' welfare expenditures. The conditions under which this correlation takes place are never specified. As a result, the compensation thesis is not considered a theory because it fails to specify the necessary endogenous political factors that offset globalization's negative externalities.

On this note, empirical studies in the existing literature have largely overlooked the importance of how economic globalization's effect on states' welfare spending is conditional on the nature of domestic political institutions. It is only in the past few years where a handful of scholars have attempted to address this deficit. In their research, Boix (1998) and Garrette (1998) demonstrate that the impact of global economic integration on governments' welfare expenditures is conditional on the nature of partisan politics. Domestic political variables also feature prominently in the research of Asera and Boix (2002). They argue that the relationship between the openness of national economies and the size of the public sector's welfare spending is heavily conditional on the nature of the political regime. They contend that

governments strategically provide welfare compensation to build domestic political coalitions that support free trade, and democratic governments relative to authoritarian regimes are more likely to use welfare spending to compensate the losers of economic globalization.

While recent studies have attempted to bring greater theoretical precision by identifying the mechanisms through which globalization operates in determining social policies, the mechanisms that are tested in such studies are limited to partisan politics and political regimes. These studies do not provide a comprehensive analysis of how the interactions of economic globalization and other domestic political variables affect states' welfare spending.

This study argues that government welfare spending is a function of the ways in which the pressures of economic globalization is conditioned by domestic politics. Domestic politics consists of political affiliation and political institutional factors that refer respectively to the *willingness* and *capacity* of political systems to initiate changes in public policy (Glatzer and Rueshemeyer, 2005). Political institutional factors, which include the characteristics of political regimes and the levels of electoral competition and political participation, determine the political environment that shapes the incentives and preferences of government officials who make welfare policy. Political affiliation factors, which include organized labor and political parties, determine how government resources - specifically welfare expenditures - are distributed. This study, therefore, builds on the existing literature by examining the ways in which economic globalization's effect on welfare policy is conditional on the domestic political environment that shapes welfare policy and the political affiliations of domestic political actors who distribute social benefits.

1.5. *Towards an Integrated Theory of the Welfare State*

The theoretical limitations of the extant literature present an opportunity to construct a robust theoretical framework that integrates efficiency and compensation approaches to the welfare state. While the existing literature treats these approaches as competing or mutually exclusive 'theories' of the welfare state, they are considered here to be mutually inclusive processes in the development of social policy. Government welfare policy emerges from the tension of globalization's proclivity to retrench social spending and the proclivity of domestic political actors and institutions to compensate. In essence, the construction of social policy, under conditions of global economic integration, is a function of the dialectical pressures for greater economic efficiency and domestic political preferences for greater compensation.

It is postulated that in a world absent of domestic political institutions and where transnational corporations completely dominate countries' political economy, by default, economic globalization will exert a downward pressure on social spending. However, in the presence of domestic politics, globalization's natural proclivity for welfare retrenchment will be averted since its effect on social spending is conditional on the nature of political institutions and the political preferences of labor unions and political parties that set a floor against further retrenchment. The dialectical tension between globalization's tendency to retrench the welfare state and the tendency of domestic political institutions to resist retrenchment is fully developed and empirically tested in the chapters that follow.

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Chapter 2

Globalization's Effect on the Welfare State: Economic Efficiency by Default but Compensation by Design

In the previous chapter it was argued that, by default, economic globalization exerts a downward pressure on welfare expenditures through the operations of transnational corporations. However, since globalization's effect on social policy is conditional on the nature of endogenous political forces, its proclivity to retrench welfare expenditures is averted by the preferences of domestic institutions and political actors to compensate. In developing this integrated theoretical explanation of welfare policy, this chapter asks the following questions: under what structural conditions of corporate capitalism will economic globalization produce a 'race to the bottom' effect on states' social spending? And under what domestic political conditions will institutions and political actors avert globalization's 'race to the bottom' effect on social spending? In answering these questions, the discussion that follows draws upon Marxist and political democratic theories of the welfare state.

Transnational Corporations and the Race to the Bottom

2.1. *Marxist theory of the Welfare State*

Marxist scholars have consistently argued that the dynamics of the modern welfare state cannot be understood apart from the historical development of capitalism. For Marxists, the productive relations of national capitalism depended on the welfare state. State intervention was endemic to the birth of capitalism, guided its early development and has been crucial to the history of capital accumulation, even in the U.S., a country that prides itself as exceptionally and fiercely committed to rugged

individualism and *laissez faire* (Manley, 2008, Miliband, 1969, 9). The intervention of the welfare state was promoted by corporate capital when labor markets were constrained by national boundaries and capital was largely immobile due to the fact that national economies were relatively closed before the 1970s. Corporate capital's promotion of state intervention emerged from the desire to socialize the costs of the business cycle whose economic booms and busts created uncertainty, social disruption and political instability. In addition, corporate capital's promotion of the welfare state represented an attempt to diminish the growing interest in socialism that emerged as a result of the 1930s' depression. The desire to socialize the costs of capital accumulation has historically led countries to introduce old age pensions, hospital insurance and public education. While industrial accident insurance schemes were partly won by labor unions, they largely emerged from the efforts of corporations to create a system that would limit corporate liability for industrial accidents as well as socialize the costs via industry-wide insurance premiums (Teeple, 1995, 13-14).

Marxist scholars argue that the intervention of the welfare state was necessary to the very survival of national capitalism. State intervention helped to mitigate class conflict and managed the internal contradictions of capital accumulation, which given the business cycle produces massive unemployment and economic dislocations for which capitalism in itself has no mechanism to accommodate. In the attempt to rationalize capitalism the welfare state subsidizes the costs of capital accumulation by reproducing the working class, by intervening into labor markets to offset the dominant leverage that capital has over labor, and by intervening into the production process. The state's provision of health care, education, subsidized childcare, child and family allowances, and food stamps has always been associated with attempts to propagate the working class and prepare them for the national labor market. The

regulation of minimum wage and the enactment of child labor laws, education and job training, pensions and unemployment assistance have always been associated with attempts to bring equity in national labor markets. In addition, for Marxists, the welfare state's provision of collective bargaining is nothing more than an institutional framework that manages class conflict between workers and the owners of capital (Milward, 2003, 106-110, Teeple, 1995, 15). The scale and scope of the welfare state's intervention, for Marxists scholars, underscores the fact that capitalism in its national form:

"Depends to an ever-greater extent on the bounties and direct support of the state, and can only preserve its 'private' character on the basis of such public help. State intervention in economic life in fact largely means intervention for the purpose of helping capitalist enterprises. In no field has the notion of the 'welfare state' had a more precise and apposite meaning than here: there are no more persistent and successful applications for public assistance than the proud giants of the private enterprise system" (Miliband, 1969, 78).

While corporate capital in its national form depended on the welfare state, Marxists scholars argue that under conditions of global economic integration the welfare state is increasingly at variance with the logic of capital accumulation. Essentially, the conditions that gave rise to the welfare state have been eroded by the integration of global markets. As capital became increasingly internationalized and was no longer limited to the national labor market, it no longer required the welfare state's intervention to facilitate political compromise with the national working class. The growth of the global labor market undermined national labor markets and thereby undermined the state's *raison d'être* to provide welfare benefits and collective bargaining for the working class. Furthermore, since labor unions are unable to accompany capital into the global labor market, they have now become anachronistic relics of an earlier era of capitalism. National jurisdictions have now become less important in corporate decision-making since transnational corporations can now

secure greater tax concessions from states who increasingly compete for corporate investment in a never-ending race to the bottom where state revenues dwindle and the priorities of the welfare state are abandoned (Milward, 2003, 112-115, Teeple, 1995, 69-74). To the extent that Marxist scholars claim that globalization's 'race to the bottom' effect on social spending is conditional on changes in the structure of corporate capitalism, Marxist theory, in this respect, is a variant of efficiency theories and as such the above discussion generates the following hypothesis:

H_{E1}: *Increasing levels of global economic integration are associated with a decrease in welfare spending when the structure of corporate capital is transnational.*

Institutions and the Politics of Compensation

2.2. *Democratic Regimes and Social Generosity*

The authority characteristics of political regimes simultaneously influence both the pace at which national economies are integrated into the global economy and the scale of government welfare spending. Relative to authoritarian regimes, democratic governments who face public pressure have a strong incentive to compensate economic dislocations that arise from global integration (Garrett, 2001). Several scholars have examined how political regimes affect social spending and argue that political regimes play a crucial role when governments decide social welfare policies under the conditions of increasing economic globalization (Adsera and Boix, 2002, Avelinon, et al., 2005, Hicks and Swank, 1992, Kaufman and Segura-Ubiergo, 2001). Since policy makers in democracies are subject to pressures from elections and interest groups, they are more likely to allocate a larger portion of their budgets for social welfare spending than those in authoritarian regimes. Research on

Latin America demonstrates that in the face of trade expansion, democratic governments are more likely to provide social welfare programs than non-democratic regimes (Avelinon, et al., 2005, Kaufman and Segura-Ubiergo, 2001).

Other researchers, however, caution that democracies do not affect all types of social spending equally. Segura-Ubiergo (2007) argues that lower income groups in Latin America are likely to pressure governments to increase social spending only to the extent that they are the direct beneficiaries of such spending. Results from his research have shown that democracies in Latin America tend to be negatively associated with social security expenditures but positively associated with health and education expenditures (Segura-Ubiergo, 2007, 169). These results reflect the fact that social security beneficiaries in Latin America must be legally employed in the formal sector, and since lower incomes groups who are largely unemployed have no access to these benefits, they have no incentive to press their governments to receive them. Health and education expenditures reach a much larger segment of the population and lower income groups are more likely to press government to increase such expenditures (Segura-Ubiergo, 2007). To the extent that economic globalization's effect on welfare spending is conditional on the authority characteristics of political regimes, the above discussion generates the following hypotheses:

H_2: *Increasing levels of global economic integration are associated with an increase in welfare spending when political regimes are democratic.*

2.3. *Competitive Elections and Social Spending*

Political democratic theories emphasize the effect that political competition among political parties has on government welfare policies (Hicks and Swank, 1992,

Kite, 2004). Given the clientelistic nature of competitive electoral politics in many countries throughout the world, political parties are more likely to propose generous welfare allotments such as pensions, unemployment insurance, job training, health care, and social security in order to secure votes. As the global economic integration of national economies increases, the clientelistic nature of competitive electoral politics is also expected to increase since parties increasingly seek to provide welfare benefits for constituent voting districts adversely affected by economic globalization (Cammack et al., 1988). This discussion generates the following hypothesis:

H_3: *Increasing levels of global economic integration are associated with an increase in welfare spending when the level of electoral competition is high.*

2.4. *Political Participation and Welfare Expansion*

Political democratic theories argue that the level of political participation also affects government welfare expenditures (Hicks and Swank, 1992, Kite, 2004). High voter turnout is reflective of the political entrance of first time and working class voters who will most likely to terminate the political careers of incumbents that they hold responsible for the negative externalities of global economic integration. And since re-election matters to incumbents, they are more likely to promise increasing welfare expenditures to appease the wrath of the voters. To the extent that economic globalization’s effect on welfare spending is conditional on the level of political participation, the above discussion generates the following hypothesis:

H_4: *Increasing levels of global economic integration are associated with an increase in welfare spending when the level of political participation is high.*

2.5. *Democratization and Welfare Expansion*

The above discussions considered the interactive effect of economic globalization and the institutional factors of domestic politics on states' welfare spending. However, because the domestic political system is more than the sum of its parts, it is also important to consider the interaction between economic globalization and the aggregate effect of political institutions (which is an index that is comprised of indicators that measure regime type, the level of electoral competition and political participation) on states' welfare spending. When regimes are democratic and the level of electoral competition and political participation is high, then *democratization* defines the nature of political institutions (Vanhanen, 1984, Vanhanen, 1990, Vanhanen, 1997).

To fully account for the cross-national variation in states' welfare spending it is also necessary to estimate the interactive effect of global economic integration and the aggregate and disaggregate political environmental factors that shape states' welfare spending. In estimating the aggregate effect of institutions an index is constructed via principal components analysis. This discussion generates the following hypotheses:

H_5: *Increasing levels of global economic integration are associated with an increase in welfare spending when democratization of political institutions is high.*

Political Affiliations and the Politics of Compensation

2.6. *Labor Unions and Welfare Expansion*

Social democratic corporatist theories emphasize the ways in which organized labor can directly affect government welfare policies. Although governments in free market economies tend to be more responsive to the preferences of the business sector,

they will also respond to pressure from labor unions that demand the provision of social protection benefits to union members who have been adversely affected by global economic integration. With the threat of strikes, which undermine investor confidence and economic growth, governments are more likely to provide social welfare programs such as pensions, unemployment insurance, job training, health care, and social security under the organized collective power of labor unions (Esping-Anderson, 1990, Garrett, 1998, Hicks, 1999, Kite, 2004, Rodrik, 1998).

Organized labor can also exert indirect pressure on governments to increase welfare spending. In recent years, the labor movement has effectively lobbied the World Trade Organization (WTO) to link labor standards to free trade agreements. The *Social Clause*, as it is commonly called, would require trading countries to observe a series of labor standards, which guarantees minimum wages, the right of labor to engage in collective bargaining, and the prevention of child labor. In addition, global institutions like the WTO would be given the authority to impose sanctions against countries that fail to observe these standards (Hughes and Wilkinson, 1998, Wachtel, 1998, Wet, 1995, Wilkinson and Hughes, 2000).

International agreement on the *Social Clause* would potentially force governments to implement labor standards, which would increase the negotiation power of unions to elicit further concessions from governments to increase welfare spending. Therefore, to the extent that economic globalization's effect on welfare spending is conditional on the strength of organized labor, the above discussion generates the following hypothesis:

H_6: *Increasing levels of global economic integration are associated with an increase in welfare spending when labor unions are strong.*

Other scholars argue that globalization has weakened organized labor and therefore challenge the notion of labor unions' influence in shaping states' welfare policies. Charles Lindblom's *Politics and Markets* is a classic treatise on this issue. Lindblom argues that corporate capital, relative to labor unions, occupies a privileged position in government. Since economic recession and high inflation can topple governments, the legitimacy of governments largely depends on private corporations' providing jobs, generating economic growth and increasing living standards. Consequently, public policy is always geared towards supporting corporate priorities and not those of organized labor (Lindblom, 1977, 172-173). Increasing levels of global economic integration only serve to deepen organized labor's inferior position in government and significantly weaken its political influence to extract welfare allocations from the state.

Case study research about the politics of the labor movement in emerging economies has corroborated Lindblom's basic thesis. Since the 1950s the labor movements in many of these countries have been transformed from being militant organizations that pressed for the rights of working people, to being increasingly co-opted into the free market priorities of transnational capitalism. Given the fact that unions in emerging economies increasingly see themselves as a responsible partner to government and capital they are less likely to press governments to increase welfare allocations (Gray, 2008, Gray, 2007).

Recent empirical research also shows that with increasing global economic integration labor unions in the less developed countries (LDCs) have been unable to prevent the decline of the welfare state. Collective action problems of labor unions in countries with large pools of low-skilled workers tend to weaken the political bargaining power of labor unions vis-à-vis the state and transnational corporations.

Therefore, global economic integration is expected to decrease government welfare spending because labor unions in developing countries are politically too weak to effectively engage the state to provide societal safety nets against the negative externalities of economic globalization (Rudra, 2002).

Still other scholars are quick to remind us that the phenomenon of weak labor unions in LDCs is also taking place in advanced industrial economies, albeit for different reasons. Teeple (1995) argues that global economic integration has significantly reduced government welfare spending in advanced industrial economies largely because governments have consistently enacted legislation intended to curb the political power that labor unions had progressively won since the late nineteenth century. Since the 1980s, advanced industrial countries have enacted legislation that has limited the rights and security of labor unions and consequently has reduced their legal status, and restricted the ways in which labor unions are financed. All these factors make it increasingly difficult for unions to organize and lobby the state in defense of welfare allocations (Teeple, 1995). Therefore, to the extent that increasing global economic integration has weakened the ability of organized labor to extract welfare expenditures from the state, the discussion generates the following hypothesis:

H_7: *Increasing levels of global economic integration are not associated with an increase in welfare spending regardless of the strength of labor unions.*

2.7. *Political Parties and Social Policy*

Social democratic corporatist theories also focus on the power of the political left; namely, leftist parties in shaping the welfare policies of the state (Hicks and

Swank, 1992, Katzenstein, 1985, Kite, 2004). The core theoretical proposition of this perspective is that the political orientation of leftist parties and their supporters affects the ways in which the governments respond to economic globalization. It is argued that the effect of global economic integration on states' welfare spending is conditional on the nature of party politics. Governments led by left or centrist political parties (labor, social democratic, or Christian democratic parties) are more likely to support robust welfare policies than governments led by parties to the political right (Huber and Stephens, 2001, Stephens, 2005). Kite (2004) argues that in countries where social democratic parties are strong the public is less tolerant of economic inequality and holds government accountable for providing welfare benefits. This discussion generates the following hypotheses:

H_8: *Increasing levels of global economic integration are associated with an increase in welfare spending when ruling political parties are on the left.*

2.8. *The Null Effect on Social Spending*

Some scholars argue that the extent of countries' integration into the global economy is exaggerated. It is argued that the great expansion of international trade is grossly exaggerated since world trade, as a percentage of countries' gross domestic product, is roughly the same today as it was before World War 1 (Serrano, 2002). International trade is not a global phenomenon but largely confined to geographical regions, and the foreign investments of transnational corporations are not dispersed globally but largely flow to a few countries. Moreover, since developing countries' participation in the global economy is limited by civil war and mounting debt, the extent of their economic integration and its supposed effect on government welfare

spending should be minuscule (Hirst, 1997, Hirst and Thompson, 1996, Jones, 1995, Scarpf, 1991, Wade, 1996).

Another reason why economic globalization does not affect the welfare state is that states still maintain considerable control over their economies and frequently use government expenditures to provide collective goods (social stability and infrastructure) that are under-supplied by the market but are nevertheless vital to the process of capital accumulation (Friden and Rogowski, 1996, Garrett, 1999, Kurzer, 1993, Vernon, 1971). This discussion generates the following hypothesis:

H_9: *Increasing levels of global economic integration has no effect on states' welfare spending.*

The previous discussions presented an integrated theoretical explanation of globalization's effects on social policy that is informed by efficiency and compensation perspectives. Drawing on Marxist theory, it was shown that the natural tendency of economic globalization, as it operates through transnational corporations, is to exert a downward pressure on social spending. However, given the preferences and interests of domestic institutions and political actors, globalization's proclivity to retrench the welfare state is resisted and averted as it operates through the forces of domestic politics. The study's integrated theory treats the efficiency and compensation perspectives as mutually inclusive processes that determine welfare expenditures under conditions of economic globalization. The subsequent chapter discusses the study's design and data estimation procedures used to empirically test the hypotheses that emerge from the study's theory.

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Chapter 3

Research Design and Methodology

The Empirical Determinants of Welfare Spending[1]

3.1. *Measuring the Dependent Variable*

The existing literature has defined and measured governments' welfare expenditures in terms of countries' social spending as a percentage of GDP, countries' per-capita social spending, or total government spending as a percentage of GDP (Hicks and Swank, 1992, Rudra, 2002). Much of the research on the relationship between economic globalization and government welfare spending has used total central government spending or total government revenues as the dependent variable (Cameron, 1978, Garrett, 2001, Iversen and Cusack, 2000a, Quinn, 1997, Rodrik, 1998). However, measuring the dependent variable in these ways could produce measurement error. This is because central government spending or total government revenues contain numerous items that are not related to welfare spending but include spending for national security, various government subsidies and government employment spending. Total central government spending or revenues can increase without expanding welfare spending. Some governments, in response to globalization's negative externalities, may choose to provide subsidies to domestic corporations (Drunberg, 1998). Others may choose to increase spending on national security in order to put down public riots and protests against global economic integration (Looney, 1993). Therefore, operationalizing the dependent variable in terms of total central government spending or revenues incorrectly conflates welfare spending with other spending priorities of the state (Rudra, 2002).

[1] A full description of the data sources and the operationalization of the variables used in this study are found in this chapter's data appendix.

To correct this type of measurement error, the dependent variable that is used in this study is measured in terms of governments' social spending as a percentage of total government spending (Kaufman and Segura-Ubiergo, 2001, Nooruddin and Simmons, 2009, Rudra, 2002, Rudra, 2008). The dependent variable is calculated from data adopted from the United Nations Statistics Division (UNSD) of *National Account Official Country Data*.[2] Government welfare spending is calculated via the formulae:

$$\frac{\textit{Social Protection Expenditure} + \textit{Education Expenditure} + \textit{Health Expenditure}}{\textit{Total Government Expenditure}}$$[3]

Social protection expenditure includes social security and welfare affairs services. Social security is composed of income transfers and in-cash benefits for the elderly, death survivors, sickness and maternity, work injury, unemployment and family allowances. Welfare affairs and services are defined as assistance delivered to clients or groups of clients with special needs, such as the young, the old, and the disabled (Rudra, 2002). This measurement of the dependent variable eliminates other types of non-governmental welfare spending that is so often conflated into aggregate measures of government expenditures. Moreover, this measurement reflects where governments place their allocative priorities within the national economy (Kaufman and Segura-Ubiergo, 2001).[4]

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[2] This UNSD data is available from 1970 for most countries in the world.

[3] Government welfare spending (Social Protection Expenditure + Education Expenditure + Health Expenditure) is also calculated as a percentage of countries' GDP and used as an alternative measure to check the robustness of the study's results.

[4] The adoption of GDP measure follows the research tradition in this literature. However, it should be acknowledged that this measure is not without limitations. For one thing the growth in a country's GDP may result in more resources being available for welfare expenditures even if the rate of extraction for social benefits does not change. It is not clear from the

3.2. *Measuring the Primary Explanatory Variables*

For the empirical test of the study's theory, which integrates efficiency and compensation approaches to social policy, the central explanatory variables are operationalized as follows. The first, which captures Marxist theory of globalization's 'race to the bottom' effect on social spending, is an interaction between the structure of corporate capital within countries' political and economic systems and the extent to which they are integrated into global economy. The second, which captures the tendency of domestic political forces to resist globalization's downward pressures on social spending, is an interaction between countries' domestic politics (which includes disaggregate measures of political institutions and political affiliations) and their level of integration into the global economy. In addition, principal component analysis is used to generate an aggregate index - *Domestic Political Institutions* - that is comprised of indicators that measure regime type, the level of electoral competition and political participation. *Domestic Political Institutions* also interacts with the level of countries' integration into the global economy. Further details regarding the construction of this index appear in the appendix.

As a constituent element of the interactive term - economic globalization is an index that measures actual financial flows into countries and government reactions to such flows (Dreher, 2006). Actual financial flows include trade as a percentage of GDP, foreign direct investment as a percentage of GDP, portfolio investment as of percentage of GDP, and income payments to foreign nationals as a percentage of GDP. Government restrictions of these flows are composed of hidden import barriers, the mean tariff rate, taxes on international trade as a percentage of current revenue, and

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existing theories if globalization is expected to alter the amount of resources available for welfare or the portion of a nation's productivity that goes towards such policies.

capital account restrictions. Larger numbers in the index indicate higher levels of integration into the global economy (Dreher, 2006, Dreher et al., 2008).

The Empirical Determinant of the Race to the Bottom

3.3. *Marxist Measures of Corporate Power*

In Marxist theory, human society is composed of two parts: the substructure and the superstructure. In capitalist societies the substructure corresponds to the structure of corporate capitalism that gives rise to society's superstructure, which is the political structure of the state with its corresponding laws that define and regulate the economics of the market. While the structure of corporate capital (the substructure) exerts a predominant influence over the state and the nature of the market (the superstructure), the ideas and policies that are produced by the superstructure also influence the substructure and are reinforced in its operations (Marx and Stone, 1904).

Since Marxist theory suggests that the structure of corporate capital determines the political superstructure of the state as well as the economic superstructure of markets (Miliband, 1982, Miliband, 1983, Miliband, 1969), the *power of corporate capital* is calculated in terms of:

$$\frac{\text{The Openness of Political Institutions x The Level of Economic Freedom}}{\text{The Market Capitalization of Domestic Corporation as a \% of GDP}}$$

The relative openness of political institutions and the level of economic freedom, which define the regulatory mechanism of the market, capture the political and economic superstructure. Measures of the openness of countries' political institutions and economic freedom are taken, respectively, from the Polity IV index

and the Economic Freedom of the World index (EFW). The Polity IV index measures the political characteristics of governments, capturing the nature of a country's political superstructure.[5] The EFW index measures the degree of economic freedom that is present in five major areas of a country's economic superstructure: the size of government; legal structures and the security of property rights; access to sound money; freedom to trade internationally; and the regulation of credit markets, labor, and business.[6] The denominator represents the substructure of corporate capital. It is captured by the capitalization or the market value (as a percentage of GDP) of domestically incorporated corporations listed on countries' stock exchanges.

The more open countries' political institutions are and the greater the level of economic freedom, the more likely it is that the interest and influence of the corporate substructure will be firmly reflected in the political superstructure of the state as well as in the economic superstructure of the market (Lindblom, 1977, Mills, 1956). Countries with open political institutions, as discussed in the previous chapter, and by extension those with greater economic freedoms are more likely to increase welfare spending. However, when a larger share of a country's GDP comes under the control of corporate capital, open political institutions and economic freedom will affect welfare spending only through its substructure, which is the level of corporate capitalization of the domestic economy.[7]

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[5] Details regarding the construction of the Polity IV index are provided in the next section that discusses the measurement of Regime Type.

[6] Gwartney, James and Robert Lawson with Herbert Grubel, Jakob de Haan, Jan-Egbert Stur m, and Eelco Zandberg (2009). Economic Freedom of the World: 2009 Annual Report. Vanc ouver, BC: The Fraser Institute. Data retrieved from www.freetheworld.com

[7] Diagnostic test were performed to test whether the underlying theoretical assumptions that guided the calculation of this variable are correct. The test results are reported in Table 3.2 in the data appendix. Consistent with Marxist theory, the openness of political institutions (POLITY) and economic freedom – the superstructure - has no independent effect on welfare spending but only indirectly through the substructure – the corporate capitalization of the domestic economy.

Measuring Political Institutions

3.4. *Political Regime Type*

The data for countries' political regime type is adopted from the Polity IV data set, which measures the institutional authority characteristics of governments. The measure includes the recruitment of the executive, the constraints on executive authority, and political competition. The Polity IV data is an index that ranges from -10 (autocratic regimes) to 10 (democratic regimes). The indicator is categorized as follows: consolidated autocracies range from -10 to -6, anocracies, which are regimes with weakly constituted political authority range from -5 to +5, and consolidated democracies that range from +6 to +10 (Marshall and Jaggers, 2000).

3.5. *Electoral Competition*

The variable that measures the level of countries' electoral competition is adopted from Vanhanen's democratization database. Electoral competition is measured by the portion of votes received by smaller parties in presidential or parliamentary elections, or both. The variable is calculated by subtracting the percentage of votes received by the largest party from 100. If the largest party's portion is 45%, the electoral competition value is 55 (= 100-45). Calculating the distribution of seats in parliament is used to generate the variable when vote percentages are not available. And in cases where the composition of the government is not based on popular elections, then electoral competition is zero (Vanhanen, 1990).

3.6. *Political Participation*

The variable that measures countries political participation is adopted from the International Institute for Democracy and Electoral Assistance. The level of political

participation is measured by the percentage of the voting age population who actually voted in Parliamentary and Presidential Elections. Theoretically, the value can range from 0 (no participation) to 100 (full participation).[8]

Measuring Political Affiliations

3.7. *The Strength of Labor Unions*

Some studies measure the strength of organized labor in terms of the level of unionization. However, unionization is not comparable across countries. In some developing countries, like China, unionization rates are high because labor laws make union membership compulsory. And yet, unions in these countries have little power to represent the interest of their members (Chan and Senser, 1997). In this sense, unionization rates in developing countries "exaggerate labor's independent political strength" (Rudra, 2002, 425), which weakens its ability to adequately capture the strength of unions in the developing world (Banuri and Amadeo, 1991, McGuire, 1997, Valenzuela, 1989, 449). Rudra (2002) resolves this problem by creating the *Potential Labor Power* (PLP) indicator that measures unions' strength as the ratio of skilled labor to unskilled labor divided by the level of surplus workers as a percentage of the work force. This study adopts the PLP to measure the strength of labor unions for all the countries in the data set.[9]

[8] The database can be accessed at http://www.idea.int/vt/index.cfm

[9] PLP decreases as surplus labor expands and the number of low-skilled workers increases relative to skilled workers. To the extent that the surplus labor pool shrinks and labor markets become tighter, PLP increasingly depends on the ratio of skilled to low-skilled workers. This assessment of PLP is limited to the manufacturing sector, since data are not available for most countries outside this sector. See Rudra, Nita. (2002) Globalization and the Decline of the Welfare State in Less-Developed Countries. *International Organization* 56:411-45.

3.8. *The Ideology of Political Parties*

In measuring the ideology of political parties, the primary focus is on the ideology of the ruling party in government. And as such, the operational definition of party ideology follows Castes and Mair's (1984) typology as leftist, centrist, or rightist parties. If the ruling party's ideology is left, then party ideology is coded 1. If the ruling party's ideology is centre, then party ideology is coded 0. And if the ruling party ideology is right, then party ideology is coded -1 (Castles and Mair, 1984).

3.9. *Confounding Variables*

A survey of the literature shows that a set of important variables affects states' welfare spending. These variables are summarized in Table 1. They include a lagged endogenous variable to control for serial correlation (Baltagi, 2005),[10] logged GDP per capita, GDP growth rate, the number of dependents in countries, the level of urbanization, logged inflation, logged population and decade dummy variables that are used to account for important international conditions; namely the oil crisis of the 1970s and the economic recession and debt crisis of the 1980s, that could affect welfare spending rather than economic globalization.

Following Wagner's law GDP per capita, which proxies countries' economic development, is expected to have a positive effect on welfare spending (Adsera and Boix, 2002, Avelinon, et al., 2005, Cameron, 1978, Garrett, 2001, Kaufman and Segura-Ubiergo, 2001, Rodrik, 1998, Rudra, 2002). German economist Adolph Wagner (1835-1917) postulated that the development of an industrial economy is accompanied by an increased share of government expenditure in countries' GDP

[10] Students of welfare policy traditionally include a lagged endogenous variable in their econometric models to control for serial correlation. In this analysis, I do not break with this tradition nor challenge the logic for the use of the lagged endogenous variable.

(Halicio, 2003, Youseif and Abizadeh, 1992). However, the growth rate of countries' GDP is expected to have a negative effect on welfare spending as economic expansion reduces the need for social spending (Avelinon, et al., 2005, Cameron, 1978, Garrett, 2001, Rudra, 2002).

The dependency ratio (sum of young and old in the total population) is expected to have a positive effect on welfare spending. However, since this variable is featured in only one study and was reported not to have a statistically significant effect on welfare spending (Garrett, 2001), it is used in this study to test the robustness of the empirical results.

Urbanization captures the concentration of the working class and poor and is expected to have a positive effect on welfare spending. In countries with urban industrial cities the high concentration of poor and the working class people increases demand for welfare spending (Avelinon, et al., 2005, Garrett, 2001, Rodrik, 1998, Rudra, 2002). The level of inflation is expected to have a negative effect on welfare spending. As inflation increases governments are pressured to cut public spending, especially social welfare. However, the reported direction of the coefficient is not consistent in existing research. Some researchers report that inflation has a negative effect on welfare spending (Avelinon, et al., 2005), while others report a positive effect (Hicks and Swank, 1992). This study also control for population size although a survey of the literature has shown that the variable is used in only one study and its reported effect on welfare spending is zero (Garrett, 2001).

Following Kaufman and Segura-Ubiergo (2001), two-decade dummy variables are incorporated into the analysis to control for international systemic forces that may impact states' welfare expenditures that are independent from economic globalization. One variable captures the oil crisis years from 1970 to 1981. By the late 1960s world

petroleum production peaked and subsequent production entered into a severe decline. And as the world's demand for petroleum remained high, the steep shortfall in production led to sharp increases in oil prices, which led to extreme price inflation. In 1973, petroleum prices experienced further increases as a result of OPEC's oil embargo against the West. And in 1979, oil prices again increased as a result of the Iranian revolution that severely damaged Iran's oil fields, which further reduced oil supplies (Spero, 1981, Chapter 8). The oil crisis of the 1970s, which produced high levels of inflation, exploded government's energy expenditures and deteriorated countries' balance of payments, is expected to have a negative effect on welfare spending (Kaufman and Segura-Ubiergo, 2001).

The other decade variable captures the global recession and debt crisis years from 1982 to 1990, which is often referred to as Latin America's lost decade. As a consequence of the oil price shocks and inflation of the 1970s, the world economy, by the early 1980s, went into recession whereby the GDP growth rates of the developed and developing world plummeted. For most developing countries the recession created a breaking point as many experienced a liquidity crisis. Petroleum exporting countries flush with petrodollars invested their money in international banks, which 'recycled' a major portion of the capital as loans to developing countries, especially to governments in Latin America. As interest rates increased in the U.S. and in Europe in 1979, debt payments also increased making it harder for borrowing countries to pay back their debts, which ultimately precipitated the debt crisis of the 1980s (Lomax, 1988, Nunnenkamp, 1986). The global recession and the Third World's debt crisis of the 1980s are also expected to have a negative effect on welfare spending.

3.10. *The Data Estimation Procedures*

To empirically test the hypotheses of this study, seven regression models are employed. Model one features the interactive effect of economic globalization and corporate capital on governments' social spending. Model two features the interactive effect of economic globalization and the index of political institutions on governments' social spending. Models three through five feature the interactive effects of economic globalization and regime type, electoral competition and voter participation on governments' social spending. The interactive effects of economic globalization and labor unions and the ideology of the ruling political party on governments' social spending are featured in models six through seven. The pooled time-series cross-sectional regressions are expressed as:

Model 1: Economic Globalization and Corporate Capital

$W = \alpha + \beta 1W_1 + \beta 2G + \beta 3CC + \beta 4G*CC + \beta 5CV + ... + \varepsilon$

Model 2: Economic Globalization and Political Institutions

$W = \alpha + \beta 1W_1 + \beta 2G + \beta 3PI + \beta 4G*PI + \beta 5CV + ... + \varepsilon$

Model 3: Economic Globalization and Political Regime

$W = \alpha + \beta 1W_1 + \beta 2G + \beta 3R + \beta 4G*R + \beta 5CV + ... + \varepsilon$

Model 4: Economic Globalization and Electoral Competition

$W = \alpha + \beta 1W_1 + \beta 2G + \beta 3E + \beta 4G*E + \beta 5CV + ... + \varepsilon$

Model 5: Economic Globalization and Voter Participation

$W = \alpha + \beta 1W_1 + \beta 2G + \beta 3V + \beta 4G*V + \beta 5CV + ... + \varepsilon$

Model 6: Economic Globalization and Labor Unions

$W = \alpha + \beta 1W_1 + \beta 2G + \beta 3L + \beta 4G*L + \beta 5CV + ... + \varepsilon$

Model 7: Economic Globalization and Political Parties

$W = \alpha + \beta 1W_1 + \beta 2G + \beta 3P + \beta 4G*P + \beta 5CV + ... + \varepsilon$

Where *W*, represents governments' social spending; *W_1*, represents a one year lag of governments' social spending; *G*, represents economic globalization; *CC,* represents Corporate Capital*; G*CC,* represents the interactive term for economic globalization and corporate capital; *PI*, represents the index of Political Institutions; *G*PI*, represents the interactive term for economic globalization and the index of Political Institutions; *R*, represents political regime type; *G*R*, represents the interactive term for economic globalization and political regime type; *E*, represents the level of electoral competition; *G*E*, represents the interactive term for economic globalization and the level of electoral competition; *V* represents the level of voter participation; *G*V*, represents the interactive term for economic globalization and the level of voter participation; *P*, represents the ideology of the ruling political party; *G*P*, represents the interactive term for economic globalization and the ideology of the ruling political party; *L,* represents the strength of labor unions; *G*L*, represents the interactive term for economic globalization and labor unions' strength; and *CV*, represents the control variables that are included in the study.

3.11. *Case Study Selection Method*

A comparative case study design is also utilized to further test the study's integrated theory. There are two advantages of case study research designs over large N-statistical analyses. First, case study designs allow for detailed examination of the causal mechanisms through which government social policy is generated by the interactions between economic globalization and the various domestic political and economic variables. Although statistical analyses allow for greater theoretical generalization, they are limited in their ability to describe the ways in which variables of theoretical interest interact under specific political conditions. The case study

component of this research will uncover the specific causal processes through which the interaction of domestic political factors with economic globalization produces social welfare policies. Second, case studies allow us to see how the causal relationships between the independent and dependent variables change over time. Although large N-statistical analyses allow us to generate theoretical generalizations about these relationships, they may not explain social welfare outcomes in specific countries.

The methodology that informs the selection of cases in this research is based on the most similar systems design. Cases are selected that have similar values for the confounding variables, while having different values for the central explanatory variables (King et al., 1994). Following this method, case studies of South Korea, Chile and Spain are used to test the hypotheses that welfare spending is conditional on the ways in which countries' domestic politics and institutions interact with global economic integration. All three countries transitioned from authoritarian regimes and therefore share a similar political history. All three countries are similar in terms of their per-capita wealth. Both Spain and South Korea are high-income OECD member countries and Chile is classified as an upper-middle income country.[11] The age-dependency ratios in all three countries are also similar. In 2005, the age-dependence ratios in South Korea, Spain and Chile were respectively 40, 45, and 49 dependents for every 100 working age persons.[12] In addition, all three countries are non-oil producers and were similarly affected by the oil price shocks of the 1970s.

However, in these countries there are significant variations in the key explanatory

[11] The country classifications are based on the World Bank's Data. The data base can be accessed at http://web.worldbank.org

[12] This data can be accessed at http://www.nationmaster.com/graph/peo_age_dep_rat_dep_to_wor_pop-dependency-ratio-dependents-working-population

indicators. In all three countries there has been significant variation in the nature of their external trade policies and regime type. As Table 3.3 shows, these variations can be sorted into four categories: statist protectionism under military authoritarianism (South Korea under Park Chung-hee and Spain under Franco); statist protectionism under democracy (Chile under the socialist government of Salvador Allende); economic liberalism under military authoritarianism (Chile under the Pinochet regime); and economic liberalism under democracy (South Korea under Kim Dae-jung, Chile under the Concertación coalition government and Spain under the socialist government of Manuel Chaves González). In addition, case studies of these countries allow for greater cross-regional variation, which also provides a strong robust test of the study’s hypotheses. A full discussion of these cases is provided in chapters seven, eight and nine.

3.12. *Tables*

Table 3.1: Control Variables of Welfare Spending

Variable	Hypothesized Theoretical Direction	Reported Direction
Lagged Endogenous Variable	positive	
Rudra 2002		positive
Avelino Brown, and Hunter 2005		positive
Kaufman and Segura-Ubiergo 2001		positive
Logged Per Capita GDP	positive	
Rudra 2002		positive
Cameron 1978		zero
Avelino Brown, and Hunter 2005		zero
Kaufman and Segura-Ubiergo 2001		zero
Adsera and Boix 2002		positive
Rodrik 1998		zero
Garrett 2001		zero
GDP Growth Rate	negative	
Avelino Brown, and Hunter 2005		negative
Cameron 1978		negative
Garrett and Mitchell 2001		negative
Rudra 200		zero
Dependents	positive	
Garrett and Mitchell 2001		positive
Garrett 2001		zero
Urbanization	positive	
Rudra 2002		zero
Avelino, Brown, and Hunter 2005		positive
Rodrik 1998		negative
Garrett 2001		zero
Logged Inflation	negative	
Hicks and Swank 1992		positive
Avelino, Brown, and Hunter 2005		negative
Population	Not Determined	
Garrett 2001		zero
Dummy Decade 1970-1981 (Oil crisis Years)	negative	
Kaufman and Segura-Ubiergo 2001		negative
Dummy Decade 1982-1990 (Economic Recession-Debt Crisis Years)	negative	
Kaufman and Segura-Ubiergo 2001		negative

Table 3.2: Corporate Market Capitalization and Welfare Spending

Variable	Coefficient
Lagged Welfare Spending	0.937* (0.026)
POLITY	0.003 (0.005)
Index of Economic Freedom	0.002 (0.009)
Market Capitalization % GDP	11334427.769* (4277302.936)
POLITY*Market Capitalization	0.009 (0.005)
Index of Economic Freedom* Market Capitalization % GDP	-0.002 (0.006)
POLITY*Index of Economic Freedom	-0.000 (0.001)
Corporate Power	-378279.352** (156,283.603)
Economic Globalization	-0.000 (0.000)
Urbanization	-0.000 (0.000)
Dependency	0.006 (0.020)
Growth	0.001 (0.001)
Ln GDP per capita	0.012** (0.006)
Ln population	-0.001 (0.001)
Ln inflation	0.001 (0.002)

Table 3.2: Corporate Market Capitalization and Welfare Spending (continued)

Growth	0.001
	(0.001)
Ln GDP per capita	0.012**
	(0.006)
Ln population	-0.001
	(0.001)
Ln inflation	0.001
	(0.002)
Oil shock (70's)	0.000
	(0.000)
Debt crisis (80's)	-0.004
	(0.004)
Constant	-0.087
	(0.061)
Observations	296
R-squared	0.96

Panel correct standard errors in parentheses ** significant at 1%; *significant at 5%

Table 3.3: Case Study Selection

	Economic Liberalization	Statist Protectionism
Military Authoritarian Regimes	Park Chung-hee (Korea) 1961-1979 Chun Doo-hwan 1980-1988 Franco (Spain) 1939-1975	Pinochet (Chile) 1973-1990
Democratic Regimes	Allende (Chile) 1971-1973	Kim Dae-jung (Korea) 1988-2003 Concertación (Chile) 1990-present Manuel Chaves González (Spain) 1982-1996

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Part II

Empirical Finding

Chapter 4

The Race to the Bottom: Globalization, Transnational Capital and Social Policy

4.1. *Corporate Capital and Social Spending*

Marxist theories of the welfare state argue that capitalism in its national form depends on a robust welfare state to socialize the cost of capital accumulation and manage class conflict between the owners of capital and the owners of labor. However, as capital became increasingly internationalized and was no longer limited to the national labor market, it no longer required the welfare state's intervention to facilitate political compromise with the working class. Under conditions of global economic integration, transnational corporations can now secure greater tax concessions from states that increasingly compete for corporate investments in a never-ending race to the bottom, where state revenues dwindle and the priorities of the welfare state are abandoned (Manley, 2008, Miliband, 1969, Teeple, 1995). To the extent that Marxist theory provides the causal mechanism through which economic globalization exerts a downward pressure on social spending, it is a variant of efficiency theory and as such generated hypothesis H_{E1}, which stated: *Increasing levels of global economic integration are associated with a decrease in welfare spending when the structure of corporate capital is transnational.*

Table 4 presents estimates of the control variables as well as the economic globalization variable to assess the stability of the empirical platform on which the study's welfare expenditure models are built. Model 4a presents estimates for the main control variables without the variable for economic globalization. Model 4b presents estimates for economic globalization along with the controls.

The direction of the coefficients for most of the control variables is consistent with the theoretical predictions and the reported findings of previous empirical research. In both models, prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending. And consistent with Wagner's Law, higher levels of economic development is positively associated with welfare spending. Economic growth, urbanization, population (model 4a only), inflation and the debt crisis of the 1980s are all negatively associated with welfare spending. The oil shocks of the 1970s and dependency fails to reach statistical significance. Economic globalization is positively associated with welfare spending in model 4b.

[Table 4 about here]

Table 4.1 presents the findings of the effect on welfare spending from the interaction between corporate capital and economic globalization. Model 4.1a presents the results with the main explanatory variables - corporate capital and economic globalization – without the interaction term. Model 4.1b presents the main results with the interaction term.

[Table 4.1 about here]

In models 4.1a and 4.1b, prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending. While higher levels of economic development are positively associated with welfare spending, all other control variables fail to reach statistical significance. In model 4.1a,

corporate capital (the constitutive element of the interaction term) is positively associated with welfare spending. However, since the coefficient on the interaction term – Corporate Capital*Globalization - is negative, this positive effect diminishes as corporate capital integrates into the global economy as predicted by Marxist theory. In figure 4.1, the sloping line indicates the marginal effect of corporate capital on welfare spending for meaningful changes in countries' integration into the global economy. The 95% confidence intervals around the line show the conditions under which corporate capital has a statistically significant effect on welfare spending – and it has a statistically significant effect whenever the upper and lower bounds of the confidence interval are both above (or below) the zero line. It can be observed from figure 4.1 that corporate capital's influence on countries' political economy has a significant positive effect on welfare spending when its integration into the global economy is low. However, this positive effect diminishes as its integration into the global economy increases. Once global economic integration exceeds a score of 50 on the KOF index, then corporate capital's influence on countries' political economy no longer has a significant positive effect on welfare spending.

[Figure 4.1 about here]

4.2. *Robustness Checks: Alternate Measures of Globalization and Social Spending*

Alternative measures of social spending and economic globalization, as featured in the research of other scholars, are used to provide additional empirical test for hypothesis H_{E1}. These scholars measure welfare spending as a percentage of countries' GDP and use trade openness and openness to foreign direct investment (FDI) as proxies for economic globalization (Kaufman and Segura-Ubiergo, 2001,

Rudra, 2002, Segura-Ubiergo, 2007). Table 4.2 presents the findings of the effect on welfare spending from the interaction between corporate capital and openness to trade and FDI. Model 4.2a presents the results with the main explanatory variables – trade, FDI and corporate capital – without the interaction terms. Model 4.2b presents the main results with the interaction terms.

[Table 4.2 about here]

Models 4.2a and 4.2b show that prior levels of welfare spending (the lagged dependent variable) are again positively associated with current levels of welfare spending. Urbanization, economic growth, economic development (only in model 4.2a) and the debt crisis of the 1980s are all positively related to welfare spending. Population and inflation are negatively associated with welfare spending. In Model 4.2a, while corporate capital fails to reach statistical significance, trade openness is negatively associated with welfare spending. In Model 4.2b, FDI (the constitutive element of the interaction term) is positively associated with welfare spending. However, since the coefficient on the interaction term – FDI*Corporate Capital - is negative, this positive effect diminishes, a finding that is again consistent with Marxist theory.

Figures 4.2 and 4.3 examine these issues from an alternate vantage point. In Figure 4.2, the sloping line indicates the marginal effect of FDI on welfare spending for meaningful changes in corporate capital. And 95% confidence intervals around the line show the conditions under which FDI has a statistically significant effect on welfare spending. It can be observed that once corporate capital's influence within countries' political economy is greater than 13%, then openness to FDI no longer has

a significant positive effect on welfare spending.

[Figure 4.2 about here]

In Model 4.2b, openness to trade (the constitutive element of the interaction term) is negatively associated with welfare spending. However, since the coefficient on the interaction term – Trade*Corporate Capital - is positive, this reductive effect diminishes, a finding that is not consistent with Marxist theory. In figures 4.3, the sloping line indicates the marginal effect of trade openness on welfare spending for meaningful changes in corporate capital. And 95% confidence intervals around the line show the conditions under which trade openness has a statistically significant effect on welfare spending. It can be observed that trade openness has a significant reductive effect on welfare spending at low levels of corporate capital. However, once corporate capital's influence within countries' political economy is greater than 15%, then openness to international trade no longer has a significant reductive effect on welfare spending.

[Figure 4.3 about here]

4.3. *Summation*

The findings presented in this chapter suggest that economic globalization, as measured by the comprehensive KOF index, will produce a "race to the bottom effect' on welfare expenditures as it interacts with corporate capital. When the structure of corporate capital is national, economic globalization has a positive effect on welfare spending. However, when corporate capital is integrated into the global economy,

economic globalization has a negative effect on welfare spending, as predicted by Marxist theory. This finding received additional confirmation when FDI was used as a proxy for economic globalization. When corporate capital is integrated into the global economy, openness to FDI has a negative effect on welfare spending, which is also consistent with the Marxist variant of efficiency theory.

However, when corporate capital is integrated into the global trading system, openness to trade has a positive effect on welfare spending, a finding that is inconsistent with the Marxist variant of the ‘race to the bottom’ theory. The fact that trade flows produce the opposite effect suggests that there are other forces at play in determining social policy and that global economic integration does not have to run rough shod over the welfare state. It is possible that policy makers could offset economic globalization’s ‘race to the boom’ effect by carefully choosing how their countries are integrated into the global economy as well as carefully negotiating the terms of their countries integration. Negotiating the terms of economic integration will invariably introduce domestic political forces into global processes that are driven by market forces. The empirical findings that are presented in the next chapter suggest that domestic political institutions and political actors play an important role in averting globalization’s proclivity to retrench the welfare state.

4.4. *Tables and Figures*

Table 4: Economic Globalization and Welfare Spending

	Base Model 4a Without Economic Globalization	Base Model 4b with Economic Globalization
Lagged Welfare Spending	0.002* (0.001)	0.002* (0.001)
Economic Globalization		0.002** (0.000)
Urbanization	-0.001* (0.000)	-0.001* (0.000)
Dependency	0.078 (0.051)	0.095 (0.055)
Growth	-0.004** (0.002)	-0.005** (0.002)
Ln GDP per capita	0.095** (0.010)	0.071** (0.013)
Ln population	-0.007** (0.002)	-0.001 (0.003)
Ln inflation	-0.016** (0.004)	-0.009* (0.004)
Oil shock (70's)	0.000 (0.000)	0.000 (0.000)
Debt crisis (80's)	-0.020** (0.003)	-0.006* (0.004)
Constant	-0316** (0.108)	-0.294* (0.120)
Observations	451	451
R-Squared	0.42	0.46

Panel-corrected standard errors are in parentheses. ** significant at 1%; *significant at 5%

Table 4.1: Economic Globalization, Corporate Capital and Welfare Spending

	Model 4.1a Without Interaction	Model 4.1b With Interaction
Lagged Welfare Spending	0.953** (0.023)	0.958** (0.023)
Economic Globalization	-0.000 (0.000)	0.000 (0.000)
Corporate Capital	0.001 (0.000)	0.002* (0.021)
Globalization * Corporate Capital		-0.00004* (0.000)
Urbanization	-0.000 (0.000)	-0.000 (0.000)
Dependency	-0.007 (0.020)	0.003 (0.019)
Growth	0.001 (0.001)	0.000 (0.001)
Ln GDP per capita	0.009* (0.004)	0.009* (0.004)
Ln population	0.001 (0.001)	0.000 (0.001)
Ln inflation	-0.001 (0.002)	-0.000 (0.002)
Oil shock (70's)	0.000 (0.000)	0.000 (0.000)
Debt crisis (80's)	0.000 (0.004)	0.001 (0.004)
Constant	-0.069 (0.036)	-0.066 (0.035)
Observations	296	296
R-Squared	0.96	0.96

Panel-corrected standard errors are in parentheses. ** significant at 1%; *significant at 5%

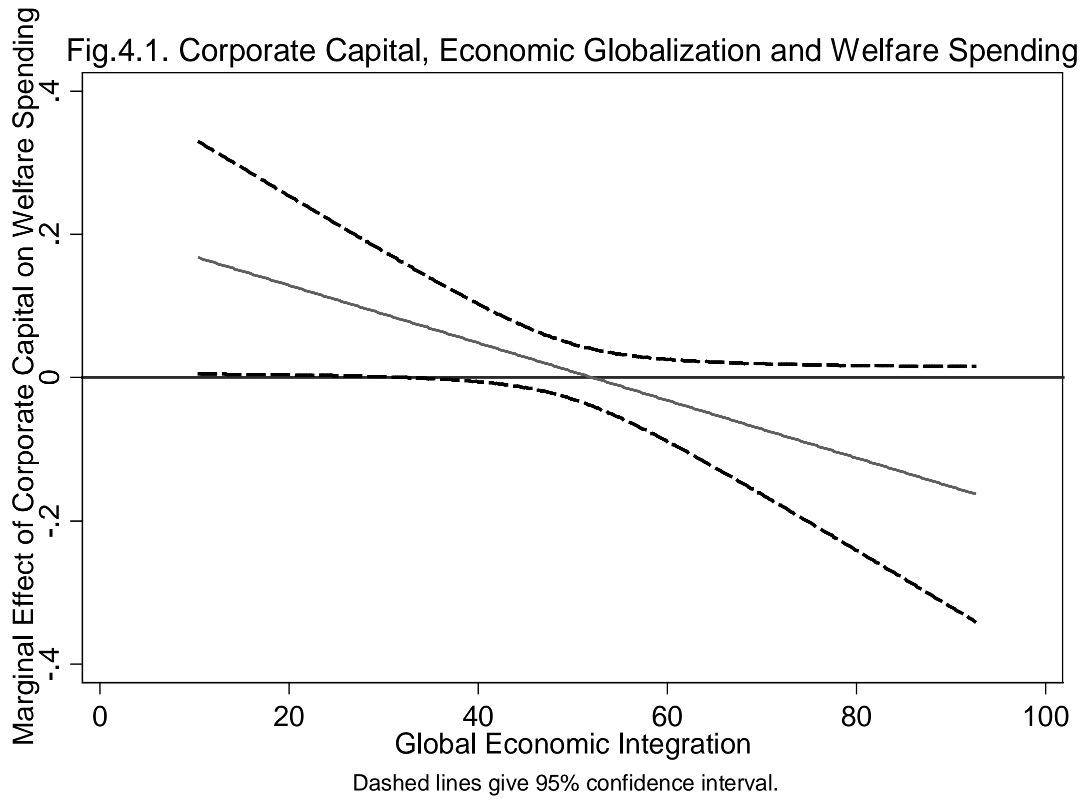


Fig.4.1. Corporate Capital, Economic Globalization and Welfare Spending
Marginal Effect of Corporate Capital on Welfare Spending
.4
.2
0
-.2
-.4
0
20
40
60
80
100
Global Economic Integration
Dashed lines give 95% confidence interval.

Table 4.2: Trade, FDI, Corporate Capital and Welfare Spending

	Model 4.2a Without Interaction	Model 4.2b with Interaction
Lagged Welfare Spending	0.435** (0.109)	0.468** (0.098)
Trade	-0.0002** (0.000)	-0.0004** (0.000)
FDI	-0.001 (0.001)	0.003** (0.001)
Corporate Capital	0.000 (0.000)	-0.002** (0.000)
Corporate Capital*Trade		0.00008** (0.000)
Corporate Capital*FDI		-0.002** (0.000)
Urbanization	0.0003** (0.000)	0.0003** (0.000)
Dependency	0.024 (0.016)	0.030* (0.015)
Growth	0.001** (0.000)	0.001* (0.000)
Ln GDP per capita	0.008** (0.004)	0.005 (0.004)
Ln population	-0.005** (0.001)	-0.005** (0.001)
Ln inflation	-0.003** (0.002)	0.003** (0.001)
Oil shock (70's)	0.000 (0.000)	0.000 (0.000)
Debt crisis (80's)	0.006** (0.003)	0.006** (0.003)
Constant	-0.001 (0.035)	0.021 (0.040)
Observations	338	338
R-Squared	0.60	0.63

Panel-corrected standard errors are in parentheses. ** significant at 1%; *significant at 5%

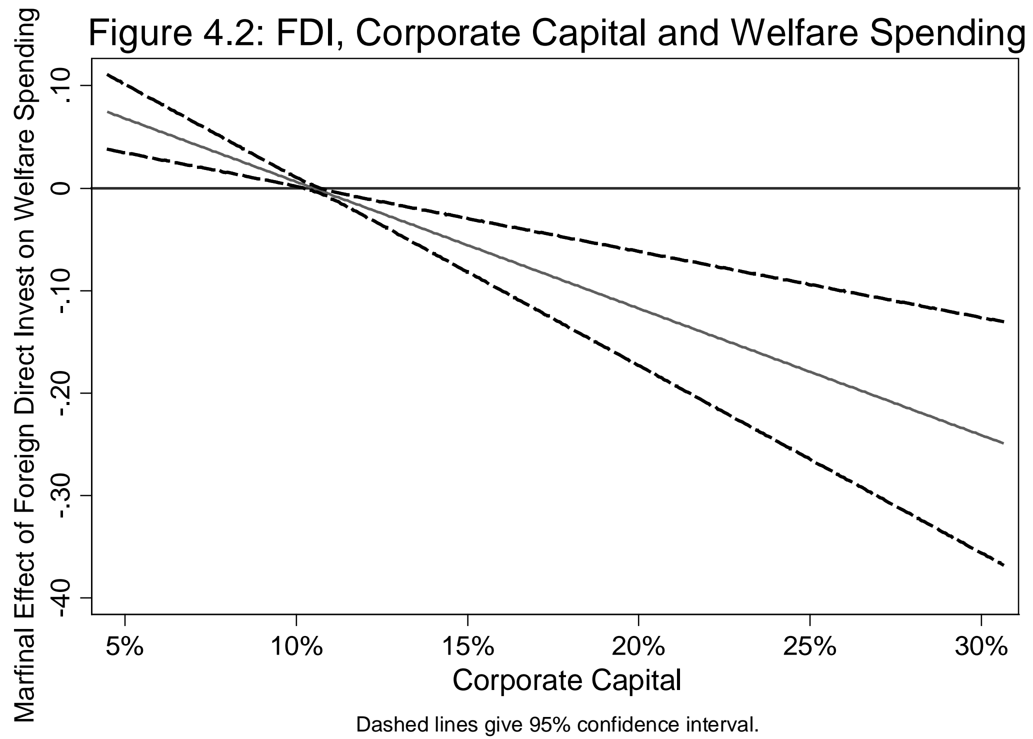
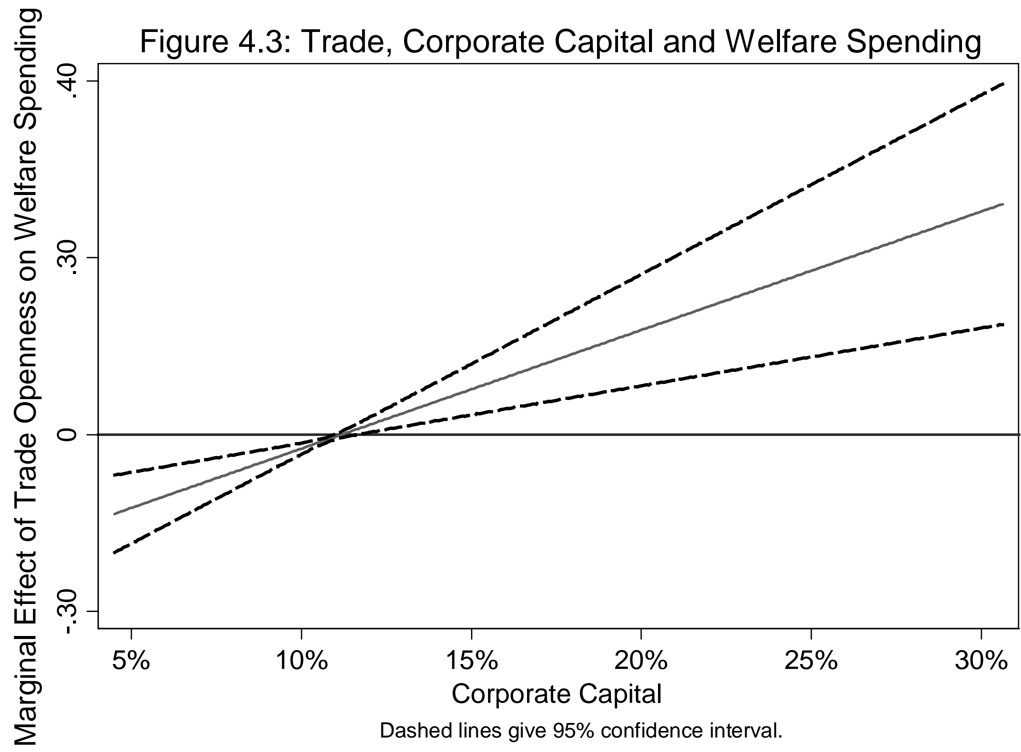


Figure 4.2: FDI, Corporate Capital and Welfare Spending
Marfinal Effect of Foreign Direct Invest on Welfare Spending
.10
0
-.10
-.20
-.30
-40
5%
10%
15%
20%
25%
30%
Corporate Capital
Dashed lines give 95% confidence interval.



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Chapter 5

The Political Environment of Welfare Compensation: Globalization, Institutions and Social Policy

The evidence that was presented in the previous chapter lends support to the argument that economic globalization exerts a downward pressure on welfare expenditures through the operations of transnational corporations. While the use of alternate measures of social spending and globalization, specifically openness to FDI, confirms the predictions of efficiency theory, openness to trade does not. And it was suggested that endogenous political forces might also be at work negotiating the terms of countries' integration into the global economy and in the process avert globalization's proclivity to retrench the welfare state. This chapter presents the findings that lend empirical support to this argument.

5.1. *The Social Generosity of Democratic Governments*

It was argued in chapter 2 that the authority characteristics of political regimes simultaneously affect the pace at which national economies are integrated into the global economy and the scale of social spending. Since policy makers in democracies are subject to pressures from elections and interest groups, they are more likely to allocate a larger portion of their budgets for social welfare spending than those in authoritarian regimes. And to the extent that economic globalization's effect on welfare spending is conditional on the authority characteristics of political regimes, the argument generated hypothesis 2, which stated: *Increasing levels of global economic integration are associated with an increase in welfare spending when political regimes are democratic.*

Table 5.1 presents the findings of the interactive effect of economic globalization and political regime type on welfare spending. Model 5.1a presents the results with the main explanatory variables – economic globalization and political regime type – without the interaction term. And Model 5.1b presents the main results with the interaction term.

[Table 5.1 about here]

The direction of the coefficients for most of the control variables in models 5.1a and 5.1b are also consistent with the theoretical predictions and the reported findings of previous empirical research. Prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending in both models. Urbanization is negatively associated with welfare spending in both models. Increasing levels in the ratio of countries' young and old dependents are positively associated with welfare spending in both models. Economic growth is negatively associated with welfare spending in both models. And consistent with Wagner's Law, higher levels of economic development is positively associated with welfare spending in both models. Inflation is negatively associated with welfare spending in both models. While the oil shocks of the 1970s fail to reach statistical significance, the debt crisis of the 1980s is negatively associated with welfare spending in model 5.1a but fails to reach statistical significance in model 5.1b. And while population size fails to reach statistical significance in model 5.1a, it is negatively associated with welfare spending in model 5.1b. Economic globalization and political regime type are both positively associated with welfare spending in model 5.1a.

Model 5.1b shows that the interactive effect of economic globalization and political regime type is positively associated with welfare spending. The sloping line in figure 5.1 indicates the marginal effect of economic globalization on welfare spending for meaningful changes in the authority characteristics of political regimes. And 95% confidence intervals around the line show the conditions under which economic globalization has a statistically significant effect on welfare spending. It can be observed from figure 5.1 that economic globalization has a reductive effect on welfare spending when political regimes are autocratic. However, this reductive effect declines as the authority characteristics of regimes become more democratic. When the polity score of political regimes is greater than -3, then economic globalization no longer has a reductive effect on welfare spending. Hypothesis 2 is supported by the data.

[Figure 5.1 about here]

While this finding shows that the marginal effect of economic globalization on welfare spending is greater among democracies relative to autocracies and is therefore lends support to hypothesis 2, additional observations are in order. It is interesting to note that autocracies whose economies are integrated into the global economy also provide welfare benefits to their citizens, although at much lower levels than democracies. Table 5.1a, shows the average welfare spending and the average level of economic globalization from 1971 to 2004 for several regimes with autocratic polities. These regimes have high levels of welfare spending and they are also all highly integrated into the global economy. One common characteristic among most of these regimes is that they are all one party leftist or former Soviet Republic regimes that have traditionally provided generous welfare benefits to their citizens. Algeria's National Liberation Front (FNL), the revolutionary organization that directed its war of independence against France that ended in 1962 (Fanon, 1965), ruled the country for four decades and during these years developed Algeria's welfare state. Azerbaijan, Kazakhstan and Kyrgyzstan are all former Soviet Republic states with a Marxist tradition for expansive welfare subsidies, which have been eroded in recent years.

[Table 5.1A about here]

Throughout the 1970s, Bolivia was ruled by a military regime headed by left leaning generals Alfredo Ovando and his successor Juan José Torres. During this period the Bolivian military regime promoted welfare reforms that were aimed at changing the deplorable living conditions for the vast majority of Bolivians. The regime also nationalized the Bolivian operations of the U.S.-based Gulf Oil Corporation (Klein, 2003). Throughout the early 1970s to the late 1980s, Panama was also ruled by populist military regimes. While the regime led by General Omar Torrijoss was corrupt, the regime expanded welfare programs and its nationalist foreign policy appealed to the rural and urban constituencies that were traditionally ignored by the economic elite. After Torrijoss's death in 1981 the populist direction of military government was continued under general Manuel Noriega (Robert C. Harding II, 2001).

While the above regimes were autocratic and presided over economies that were heavily integrated into the global economy, what motivated their extensive welfare allocations was not the pressure from democratic elections but a socialist or populist ideological ethos, which defined and shaped the priorities of public policy.

5.2. *Tight Elections and Welfare Expansion*

With the attempt to increase countries' integration into the global economy the clientelistic nature of competitive electoral politics is expected to increase as political parties will increasingly seek to provide welfare benefits to constituent voting districts adversely affected by economic globalization. In chapter 2, this argument generated hypothesis 3, which stated: *Increasing levels of global economic integration are associated with an increase in welfare spending when the level of electoral competition is high.* Table 5.2 presents the findings of the interactive effect of economic globalization and electoral competition on welfare spending. Model 5.1a presents the results with the main explanatory variables - economic globalization and electoral competition – without the interaction term. And model 5.2b presents the main results with the interaction term.

[Table 5.2 about here]

Similar to Table 5.1, the direction of the coefficients for most of the control variables in models 5.2a and 5.2b are consistent with the theoretical predictions and the reported findings of previous empirical research. Prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending in both models. Urbanization failed to rise to the level of statistical significance in both models. Economic growth, population size, the ratio of countries' young and old dependents, and inflation are all negatively associated with welfare spending. Higher levels of economic development are positively associated with welfare spending in both models. While the oil shocks of the 1970s fail to reach statistical significance, the debt crisis of the 1980s is negatively associated with welfare spending. And while economic globalization fails to reach statistical significance in model 5.2a, electoral competition is positively associated with welfare spending.

Model 5.2b shows the interactive effect of economic globalization and electoral competition. Economic globalization (the constitutive element of the interaction term) is negatively associated with welfare spending. However, since the coefficient on the interaction term – Economic Globalization*Electoral Competition - is positive, this reductive effect diminishes. In figure 5.2, the sloping line indicates the marginal effect of economic globalization on welfare spending for meaningful changes in the level of countries' electoral competition. And 95% confidence intervals around the line show the conditions under which economic globalization has a statistically significant effect on welfare spending. As predicted, it can be observed from figure 5.2 that economic globalization has a significant reductive effect on welfare spending when electoral competition is low. However, this reductive effect diminishes as electoral competition increases. Once the percentage of votes gained by smaller parties in parliamentary and or presidential elections is greater than 29%, then economic globalization no longer has a significant reductive effect on welfare spending. Hypothesis 3 is supported by the data.

[Figure 5.2 about here]

5.3. *Voter Turnout and Social Generosity*

It was argued that high voter turnout is reflective of the political entrance of first time and working class voters who hold political incumbents responsible for the negative externalities of global economic integration. And since incumbent politicians are largely motivated by re-election, they are more likely to expand welfare expenditures to appease the wrath of voters. In chapter 2 this argument led to hypothesis 4, which stated: *Increasing levels of global economic integration are associated with an increase in welfare spending when the level of political participation is high.*

In testing this hypothesis, table 5.3 presents ordinary least square estimates (OLS), which assume that political participation - the percentage of the voting age population who actually voted in parliamentary and presidential elections - is exogenous of welfare spending. However, some scholars argue that political participation and welfare spending are endogenous and therefore including the variable in equations that predict welfare spending will generate biased estimates (Segura-Ubiergo, 2007). It is argued that in the

attempt to prevent conflict and increase social cohesion, governments in some countries may actually increase welfare spending when political participation is low. In conflict prone countries like Colombia and Guatemala where voter turnout rarely exceeds 35% to 45%, governments in these countries have a stronger incentive to increase welfare spending than governments in Uruguay and Costa Rica, where voter turnout is over 80% of the voting age population (Segura-Ubiergo, 2007, pp. 121-123).

Given this argument, Tables 5.3.1 and 5.3.2 present estimates from a two-stage-least-squares instrumental variable model (IV), which assumes that political participation and welfare spending are endogenous. The IV estimates utilize variables that instrument for political participation. These include indicators that measure the number of legislative chambers in countries as well as indicators that measure whether elections are governed by proportional representation. Theoretically, these variables are considered important determinants of voter turnout. It is argued that an increase in the number of legislative chambers slows legislation, which in turn reduces turnout because citizens are more likely to perceive their votes to be less decisive (Jackman, 1987). This indicator is a dichotomous variable that measures the number of legislative chambers in each country. The variable is coded 1 if countries' legislative structure is bicameral and 0 otherwise (Johnson and Wallack, 2006). Moreover, it is argued that elections that are governed by proportional representation will increase voter turnout since votes are not wasted and political parties have a greater incentive to mobilize voters even when their electoral base is weak (Jackman, 1987, Lijphart, 1994). This variable is coded 0 for majoritarian electoral systems; 1 for mixed-member majority systems; and 2 for closed-list proportional representative systems (Gerring and Thacker, 2008, Gerring et al., 2005).

Table 5.3 presents OLS estimates of the interactive effect of economic globalization and voter turnout on welfare spending. Model 5.3a presents the results with the main explanatory variables - economic globalization and voter turnout – without the interaction term. And model 5.3b presents the main results with the interaction term.

[Table 5.3 about here]

The direction of the coefficients for most of the control variables in models 5.3a

and 5.3b are again consistent with the theoretical predictions and findings that are reported in previous empirical research. Prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending in both models. Urbanization and the ratio of countries' young and old dependents fail to rise to the level of statistical significance in both models. Economic growth, population size and inflation are all negatively associated with welfare spending. Higher levels of economic development are positively associated with welfare spending in both models. The oil shocks of the 1970s are negatively associated with welfare spending in model 5.3a, but fail to reach statistical significance in model 5.3b. And the debt crisis of the 1980s is negatively associated with welfare spending in both models. Both economic globalization and voter turnout are positively associated with welfare spending in model 5.3a. While these variables fail to reach statistical significance in model 5.3b, the coefficient on the main interaction term – Economic Globalization*Voter Turnout - is positive.

Since the possible endogeneity between political participation and welfare spending could bias OLS estimates, it is necessary to estimate the data via an IV model, which corrects for endogeneity. Table 5.3.2 presents IV estimates of the interactive effect of economic globalization and voter turnout on welfare spending. Model 5.3.2a presents the IV results with the main explanatory variables - economic globalization and voter turnout – without the interaction term. And model 5.3.2b presents the main IV results with the interaction term. However, before discussing these results, it is necessary to examine the first stage regression results, which evaluate the relevance, the strength and the validity of the instruments used in the IV models. More importantly, the discussion of the first stage regression will also provide results from the empirical test for endogeneity and whether OLS estimates in Table 5.3 are inconsistent.

5.3.1. *Voter Turnout: First Stage Regression Results*

Table 5.3.1 presents statistics from the first stage equations to assess the quality of the instrumentation procedure. First, the underidentification test, as reported by the Kleibergen-Paap statistic, is a test of whether the equations are identified. The test checks the relevance of the excluded instruments (the exogenous instrumental variables that are

not included in the second stage regression). The statistic is a measure of the instruments' relevance (i.e. the correlation with the endogenous variable – voter turnout - that cannot be explained by other control variables), so a rejection of the null indicates that the equations are identified and that the instruments are relevant (Maddala, 1992: 383-389). In models 5.3.1a and 5.3.1b the small *p*-values of the Kleibergen-Paap statistic strongly indicates that the equations are identified and that the instruments (bicameralism and proportional representation) are relevant.

[Table. 5.3.1 about here]

Second, the weak identification test, as reported by the Kleibergen-Paap Wald F statistic and Stock-Yogo critical values test, measures the strength of the instruments' correlation with the endogenous variable – voter turnout. Weak identification arises when the instruments are correlated with the endogenous variable, but only weakly. While different instrumental variable estimators are more robust to weak instruments, two-stage least square can perform poorly when instruments are weak (Stock and Yogo, 2002). Instruments are deemed weak if the first-stage *F* statistics is less than ten (Staiger and Stock, 1997). In models 5.3.1a and 5.3.1b the Kleibergen-Paap Wald F statistics suggests that the models do not suffer from weak instrumentation. This is also confirmed by the Stock-Yogo critical values test, which compares the F statistic with the critical values for the nominal bias and size distortion of TSLS. If the F statistic is larger than the critical values, then the instruments are strong. In models 5.3.1a and 5.3.1b the critical values test at 10% nominal bias as well as 10% size distortion is less than the F statistic, confirming that the models do not suffer from weak instruments (Stock and Yogo, 2002).

Third, the overidentification test, as reported by the Hansen J statistic, assesses the validity of the instruments. Specifically, the Hansen J statistic tests whether the instruments are correlated with the equation's error term. The null hypothesis is that the instruments are not correlated with the error term (i.e. that they are correctly excluded from the equations). Rejecting the null hypothesis indicates that the instruments are not valid (Davidson and MacKinnon, 2004: 336-338). In models 5.3.1a and 5.3.1b the large *p*-values of the Hansen J statistic preclude rejecting the null and suggest that the

instruments are indeed valid.

Fourth, a test for endogeneity in a regression estimated via instrumental variables, as reported by the Durbin-Wu-Hausman test, evaluates whether voter turnout is endogenous to welfare spending as suggested by recent research. The null hypothesis states that any endogeneity among the regressors would not have deleterious effects on OLS estimates. A rejection of the null indicates that the endogenous regressors' effects on the estimates are meaningful and instrumental variable techniques are required (Davidson and MacKinnon, 2004: 338-342). In models 5.3.1a and 5.3.1b the small *p*-values of the Durbin-Wu-Hausman test reject the null and clearly indicate that endogeneity exists between voter turnout and welfare spending and that both models are best estimated via TSLS instrumental variable procedure.

5.3.2. *Voter Turnout: Second Stage Regression Results*

Table 5.3.2 presents estimates from the second stage regression. The direction of the coefficients for most of the control variables in models 5.3.2a and 5.3.2b remain consistent with the reported findings of previous empirical research. Prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending in both models. Economic growth is again negatively associated with welfare spending in both models. Higher levels of economic development are positively associated with welfare spending in both models. Urbanization and the ratio of countries' young and old dependents fail to rise to the level of statistical significance in model 5.3.2a but is negatively associated with welfare spending in model 5.3.2b. Population fails to rise to the level of statistical significance in model 5.3.2a but is negatively associated with welfare spending in model 5.3.2b. Inflation is negatively associated with welfare spending in model 5.3.2a but fails to reach statistical significance in model 5.3.2b. The oil shocks of the 1970s fail to reach statistical significance in both models. And the debt crisis of the 1980s is negatively associated with welfare spending in model 5.3.2a but fails to reach statistical significance in model 5.3.2b. Both economic globalization and voter turnout are positively associated with welfare spending in model 5.3.2a.

[Table. 5.3.2 about here]

In model 5.3.2b economic globalization (the constitutive element of the interaction term) is negatively associated with welfare spending. However, since the coefficient on the interaction term – Economic Globalization*Voter Turnout - is positive, this reductive effect diminishes. In figure 5.3, the sloping line indicates the marginal effect of economic globalization on welfare spending for meaningful changes in the level of voter turnout. And 95% confidence intervals around the line show the conditions under which economic globalization has a statistically significant effect on welfare spending. It can be observed from figure 5.3 that economic globalization has a significant reductive effect on welfare spending when voter turnout is low. However, this reductive effect diminishes as voter turnout increases. Once voter turnout is greater than 35% of the voting age population, then economic globalization no longer has a significant reductive effect on welfare spending. Even after correcting for endogeneity, the results from the IV model support hypothesis 4.

[Figure 5.3 about here]

5.4. *Democratization and Higher Social Spending*

Since countries' domestic political systems, as noted in Chapter 2, is more than the sum of their parts, it is also important to consider that globalization's effect on social spending is conditional on the nature of political institutions (which is an index that is comprised of indicators that measure regime type, the level of electoral competition and political participation). When regimes are democratic and the level of electoral competition and political participation is high, then *democratization* defines the nature of political institutions. The discussion generated hypothesis 5, which stated: *Increasing levels of global economic integration are associated with an increase in welfare spending when democratization of political institutions is high.*

Table 5.4 presents the findings of the aggregate interactive effect of economic globalization and political institutions on welfare spending. Model 5.4a presents the results with the main explanatory variables - economic globalization and political

institution – without the interaction term. And model 5.4b presents the main results with the interaction term.

[Table 5.4 about here]

In both models the direction of the coefficients for most of the control variables are consistent with the theoretical predictions and the reported findings of previous empirical research. Prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending. Higher levels of economic development are positively associated with welfare spending. Economic growth, inflation and urbanization are all negatively associated with welfare spending. While population is negatively associated with welfare spending in model 5.4a, it is positively associated with welfare spending in model 5.4b. The ratio of countries' young and old dependents is positively associated with welfare spending in both models. The oil shocks of the 1970s and the debt crisis of the 1980s fail to reach statistical significance in both models.

Economic globalization and political institutions are both positively associated with welfare spending in model 5.4a. In model 5.4b, the interactive effect of economic globalization and political institutions is positively associated with welfare spending and supports hypothesis 5. The solid sloping line in figure 5.4 indicates the marginal effect of economic globalization on welfare spending for meaningful changes in the democratization of countries' political institutions. 95% confidence intervals around the line allow us to determine the conditions under which economic globalization has a statistically significant effect on welfare spending. It is easy to see that economic globalization has a reductive effect on welfare spending when the democratization of political institutions is low. However, this reductive effect declines as the democratization of political institutions increases. When the democratization score of countries' political institutions is greater than 6, then economic globalization no longer has a reductive effect on welfare spending.

[Figure 5.4 about here]

5.5. *Robustness Checks: Alternate Measures of Globalization and Social Spending*

As in the previous chapter, alternate measures of welfare spending and economic globalization are used to estimate the effect of economic globalization on welfare spending when conditional on the authority characteristics of political regimes. Model 5.5a of Table 5.5 presents results for the interactive effect of the alternate measures of economic globalization and political regimes on welfare spending. Previous welfare spending is positively associated with current welfare spending. While all other control variables fail to rise to the level of statistical significance, urbanization is positively associated with welfare spending in model 5.5b. And while FDI is positively associated with welfare spending in model 5.5a, its constitutive element and its interaction with political regime fail to rise to the level of statistical significance in model 5.5b. Trade openness (the constitutive element of the interaction term) is negatively associated with welfare spending in model 5.5b. However, since the coefficient on the interaction term – Trade*Political Regime - is positive, this reductive effect diminishes.
In figure 5.5, the sloping line indicates the marginal effect of trade openness on welfare spending for meaningful changes in the authority characteristics of political regimes. And 95% confidence intervals around the line allow us to determine the conditions under which openness to trade has a statistically significant effect on welfare spending. It can be observed from figure 5.5 that openness to trade has a reductive effect on welfare spending when political regimes are autocratic. However, this reductive effect declines as the authority characteristics of regimes become more democratic. When the polity score of political regimes is greater than 4, then openness to trade no longer has a reductive effect on welfare spending. Hypothesis 2 is also supported by the alternate measures of welfare spending and economic globalization.

Model 5.6b of Table 5.6 presents results for the interactive effect of the alternate measures of economic globalization and the level of countries' electoral competition on welfare spending. Previous welfare spending is positively associated with current welfare spending. All other control variables fail to rise to the level of statistical significance. FDI and its interaction with electoral competition have no statistical significant effect on welfare spending. However, trade openness (the constitutive element of the interaction term) is again negatively associated with welfare spending. However, since the

coefficient on the interaction term – Trade*Electoral Competition - is positive, this reductive effect diminishes.

In figure 5.6, the sloping line indicates the marginal effect of trade openness on welfare spending for meaningful changes in the level of countries' electoral competition. And 95% confidence intervals around the line show the conditions under which economic globalization has a statistically significant effect on welfare spending. It can be observed from figure 5.6 that openness to trade has a significant reductive effect on welfare spending when electoral competition is low. However, this reductive effect diminishes as electoral competition increases. Once the percentage of votes gained by smaller parties in parliamentary and or presidential elections is greater than 34%, then openness to trade no longer has a significant reductive effect on welfare spending. Hypothesis 3 is supported by the alternate measures for welfare spending and the economic globalization.

Model 5.7b of Table 5.7 presents results for the interactive effect of the alternate measures of economic globalization and political participation on welfare spending. Previous welfare spending is positively associated with current welfare spending. And again, all other control variables fail to rise to the level of statistical significance. FDI and its interaction with voter turnout have no statistically significant effect on welfare spending. However, in model 5.7b, trade openness (the constitutive element of the interaction term) is negatively associated with welfare spending. However, since the coefficient on the interaction term – Trade*Voter Turnout - is positive, this reductive effect diminishes.

In figure 5.7, the sloping line indicates the marginal effect of trade openness on welfare spending for meaningful changes in the level of voter turnout. And the 95% confidence intervals around the line show the conditions under which openness to trade has a statistically significant effect on welfare spending. It can be observed from figure 5.7 that openness to trade has a significant reductive effect on welfare spending when voter turnout is low. However, this reductive effect diminishes as voter turnout increases. Once voter turnout is greater than 15% of the voting age population, then openness to trade no longer has a significant reductive effect on welfare spending. Hypothesis 4 is supported by the alternate measures for economic globalization and welfare spending. Model 5.8b of Table 5.8 presents results for the interactive effect of the alternate

measures of economic globalization and the index of political institutions on welfare spending. Previous welfare spending is positively associated with current welfare spending. In model 5.8a, both FDI and population are negatively associated with welfare spending, while all other variables fail to rise to the level of statistical significance. Urbanization fails to reach statistical significance in model 5.8a but is positively related to welfare spending in model 5.8b. In model 5.8b, FDI and its interaction with domestic political institution have no statistical significant effect on welfare spending. Trade openness (the constitutive element of the interaction term) is negatively associated with welfare spending. However, since the coefficient on the interaction term – Trade*Domestic Political Institutions – is positive, this reductive effect diminishes.

In figure 5.8, the sloping line indicates the marginal effect of trade openness on welfare spending for meaningful changes in the democratization of countries' political institutions. 95% confidence intervals around the line allow us to determine the conditions under which openness to trade has a statistically significant effect on welfare spending. It is easy to see that openness to trade has a reductive effect on welfare spending when the democratization of political institutions is low. However, this reductive effect declines as the democratization of political institutions increases. When the democratization score of countries' political institutions is greater than 11, then openness to trade no longer has a reductive effect on welfare spending. Hypothesis 5 is supported by the alternate measures of welfare spending and economic globalization.

5.6. *Summation*

The results presented in this chapter strongly suggest that domestic political forces avert globalization's 'race to the bottom' effect on social policy. The effect on social spending from global economic integration is largely conditional on the nature of domestic institutions that shape the political environment in which welfare policy is made. When democratization of political institutions is low, economic globalization has a consistently negative effect on welfare spending, an outcome that is consistent with the predictions by efficiency theories. However, when democratization of political institutions is high, domestic political forces will most likely avert globalization's proclivity to retrench the welfare state by expanding social spending.

5.7. *Tables and Figures*

Table 5.1: Economic Globalization, Political Regimes and Welfare Spending

	Model 5.1a Without Interaction	Model 5.1b With Interaction
Lagged Welfare Spending	0.003**	0.003**
	(0.001)	(0.001)
Economic Globalization	0.002**	0.001**
	(0.000)	(0.000)
Political Regime	0.004**	-0.002
	(0.001)	(0.002)
Globalization *Political Regime		0.00014**
		(0.000)
Urbanization	-0.001**	-0.001**
	(0.001)	(0.000)
Dependency	0.102**	0.093*
	(0.037)	(0.038)
Growth	-0.004**	-0.004**
	(0.001)	(0.001)
Ln GDP per capita	0.033**	0.033**
	(0.007)	(0.007)
Ln population	-0.005	-0.006*
	(0.002)	(0.002)
Ln inflation	-0.022**	-0.022**
	(0.004)	(0.004)
Oil shock (70's)	-0.003	0.001
	(0.005)	(0.005)
Debt crisis (80's)	-0.009*	-0.007
	(0.005)	(0.005)
Constant	0.091	0.135
	(0.079)	(0.072)
Observations	801	801
R-Squared	0.32	0.33

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

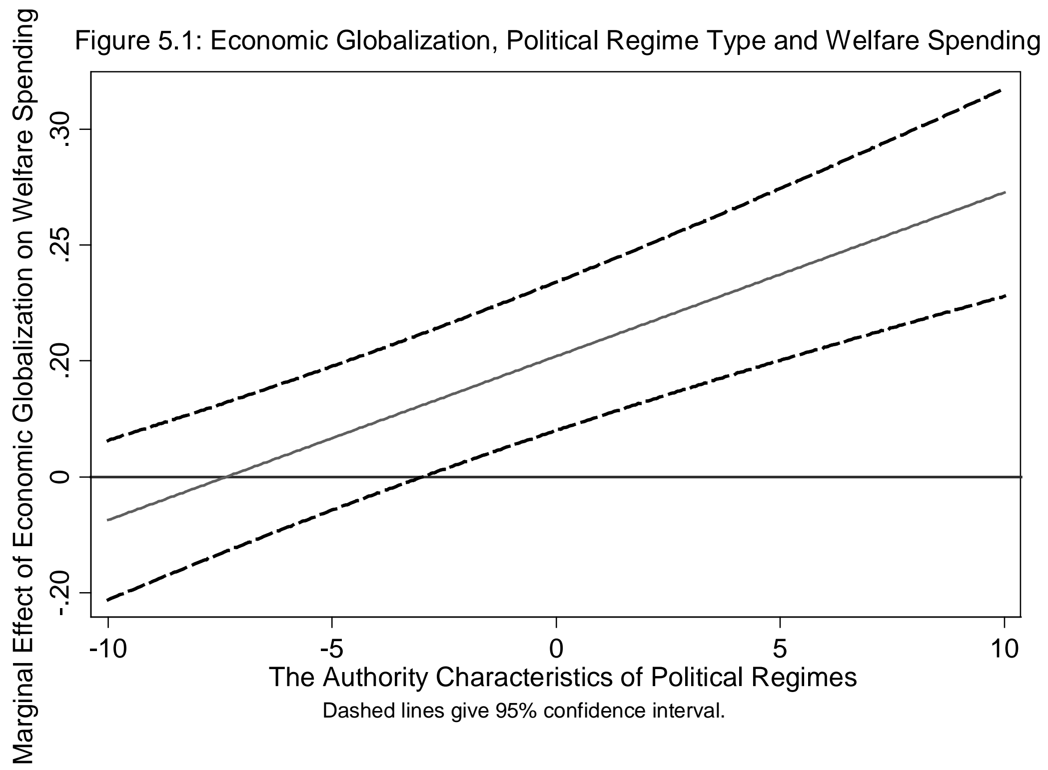


Figure 5.1: Economic Globalization, Political Regime Type and Welfare Spending
Marginal Effect of Economic Globalization on Welfare Spending
.30
.25
.20
0
-.20
-10
-5
0
5
10
The Authority Characteristics of Political Regimes
Dashed lines give 95% confidence interval.

Table 5.1A

Country	Years	Polity Score	Average Welfare Spending % Total Government Spending	Average Level of Economic Globalization
Algeria	1973-1976	-9	0.45	30.00
Azerbaijan	1991-1994	-3	0.42	45.40
Azerbaijan	1995-1997	-6	0.46	50.00
Azerbaijan	1998-2004	-7	0.58	61.03
Bolivia	1971-1977	-7	0.40	44.02
Bolivia	1978-1979	-4	0.45	44.50
Kazakhstan	1991-1994	-3	0.53	60.10
Kazakhstan	1995-2001	-4	0.50	64.20
Kyrgyzstan	1991-2004	-3	0.43	60.15
Panama	1969-1977	-7	0.51	68.54
Panama	1982-1983	-5	0.45	69.00
Panama	1987-1988	-8	0.53	59.82

Table 5.2: Economic Globalization, Electoral Competition and Welfare Spending

	Model 5.2a Without Interaction	Model 5.2b With Interaction
Lagged Welfare Spending	0.002**	0.002**
	(0.001)	(0.001)
Economic Globalization	0.001	-0.005**
	(0.000)	(0.001)
Electoral Competition	0.028**	-0.013
	(0.008)	(0.011)
Globalization*Electoral Competition		0.001**
		(0.000)
Urbanization	-0.000	-0.000
	(0.000)	(0.000)
Dependency	-0.108**	-0.107**
	(0.024)	(0.024)
Growth	-0.003**	-0.003**
	(0.001)	(0.001)
Ln GDP per capita	0.042**	0.045**
	(0.009)	(0.008)
Ln population	-0.010**	-0.010**
	(0.003)	(0.003)
Ln inflation	-0.021**	-0.021**
	(0.004)	(0.004)
Oil shock (70's)	-0.008	-0.007
	(0.005)	(0.005)
Debt crisis (80's)	-0.018**	-0.017**
	(0.004)	(0.004)
Constant	0.137	0.285**
	(0.072)	(0.075)
Observations	708	708
R-Squared	0.42	0.42

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

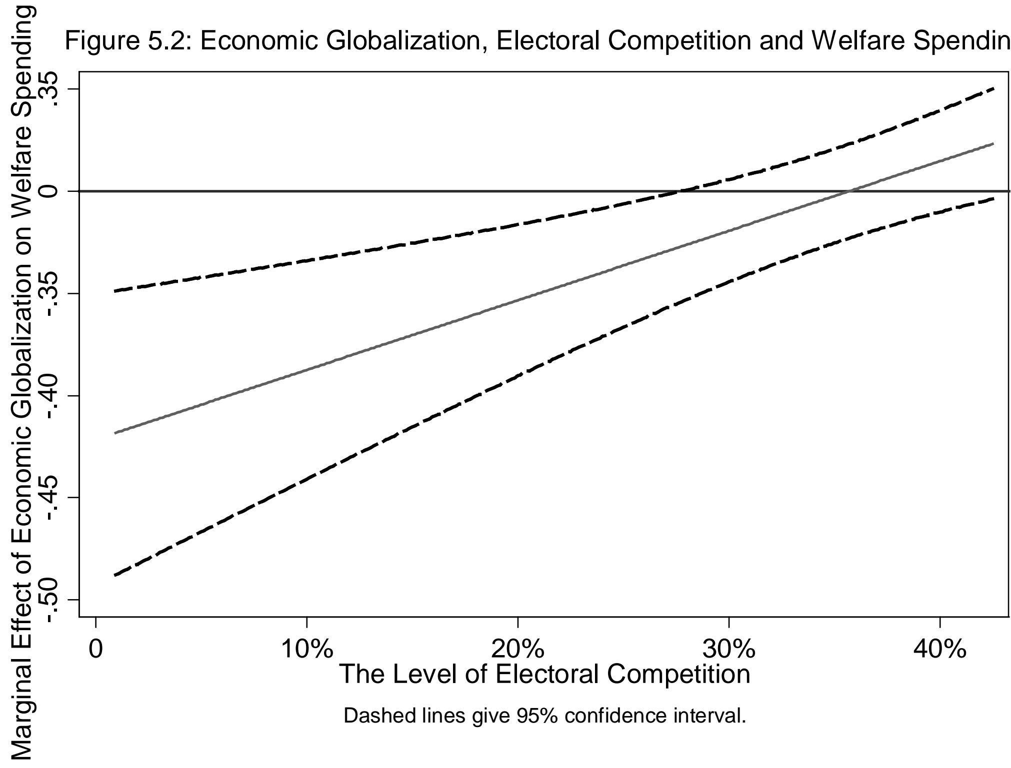


Figure 5.2: Economic Globalization, Electoral Competition and Welfare Spending

Dashed lines give 95% confidence interval.

Table 5.3: Economic Globalization, Voter Turnout and Welfare Spending

	OLS Model 5.3a Without Interaction	OLS Model 5.3b With Interaction
Lagged Welfare Spending	0.002**	0.002**
	(0.001)	(0.001)
Economic Globalization	0.001*	-0.001
	(0.000)	(0.001)
Voter Turnout	0.160**	-0.008
	(0.027)	(0.071)
Globalization*Voter Turnout		0.003*
		(0.001)
Urbanization	-0.000	-0.000
	(0.000)	(0.000)
Dependency	-0.015	-0.005
	(0.039)	(0.041)
Growth	-0.004**	-0.004**
	(0.001)	(0.001)
Ln GDP per capita	0.047**	0.047**
	(0.008)	(0.007)
Ln population	-0.007*	-0.008**
	(0.003)	(0.003)
Ln inflation	-0.021**	-0.021**
	(0.004)	(0.005)
Oil shock (70's)	-0.015*	-0.013
	(0.007)	(0.007)
Debt crisis (80's)	-0.020**	-0.019**
	(0.004)	(0.004)
Constant	-0.019	0.122
	(0.085)	(0.099)
Observations	699	699
R-Squared	0.42	0.43

Panel-corrected standard errors are in parentheses. **significant at 1%;*significant at 5%

Table 5.3.1: Economic Globalization, Voter Turnout and Welfare Spending
Results from the First Stage IV Regression

	IV Model 5.3.1a Without Interaction	IV Model 5.3.1b With Interaction
Underidentification test:		
Kleibergen-Paap rk LM statistic	67.48	15.01
p-value	0.00	0.00
Weak identification test:		
Kleibergen-Paap rk Wald F statistic	40.71	37.23
Stock-Yogi weak ID critical values test:		
TSLS size of nominal bias 10%	34.62	36.36
Maximal IV size distortion 10%	19.93	19.93
Overidentification test of all instruments:		
Hansen J statistic	1.59	0.31
p-value	0.21	0.58
Test for Endogeneity:		
Durbin-Wu-Hausman Test	10.16	5.12
p-value	0.00	0.02

Table 5.3.2: Economic Globalization, Voter Turnout and Welfare Spending

	IV Model 5.3.2a Without Interaction	IV Model 5.3.2b With Interaction
Lagged Welfare Spending	0.002**	0.002**
	(0.001)	(0.001)
Economic Globalization	0.001**	-0.026*
	(0.000)	(0.013)
Voter Turnout	0.349**	-2.113
	(0.099)	(1.115)
Globalization*Voter Turnout		0.038*
		(0.019)
Urbanization	-0.000	-0.001**
	(0.000)	(0.000)
Dependency	0.122	-0.421*
	(0.105)	(0.218)
Growth	-0.005**	-0.004*
	(0.002)	(0.002)
Ln GDP per capita	0.063**	0.089**
	(0.015)	(0.023)
Ln population	0.000	-0.021*
	(0.004)	(0.008)
Ln inflation	-0.017**	-0.003
	(0.006)	(0.007)
Oil shock (70's)	-0.026	-0.004
	(0.024)	(0.031)
Debt crisis (80's)	-0.031**	-0.018
	(0.011)	(0.013)
Constant	-0.404	1.589
	(0.220)	(0.865)
Observations	546	546
R-Squared	0.44	0.24

Robust standard errors are in parentheses. **significant at 1%;*significant at 5%

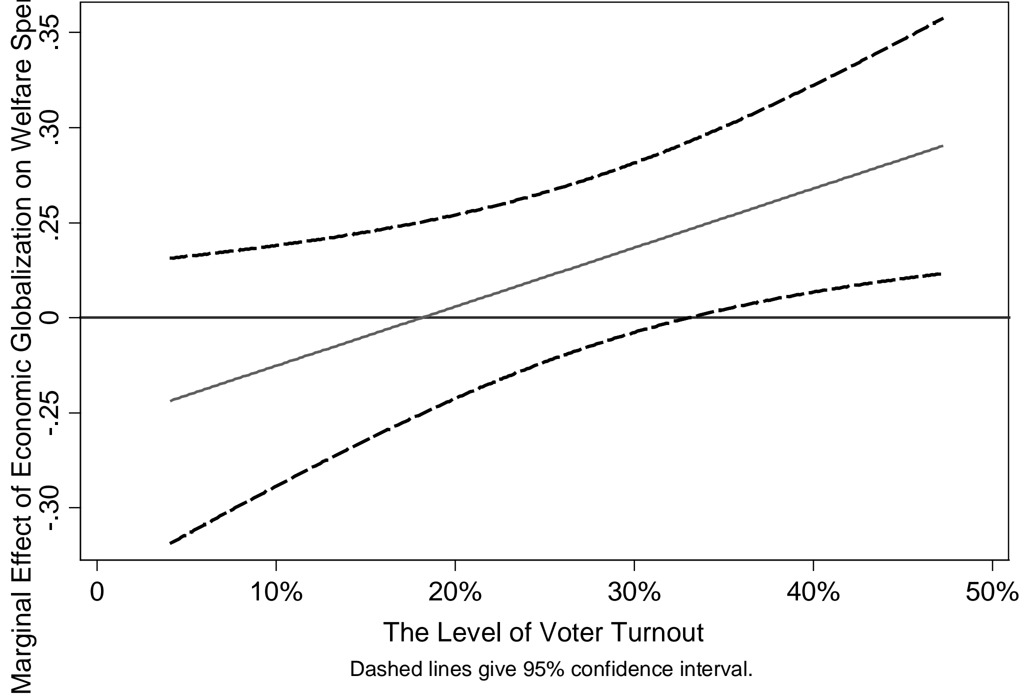


Figure 5.3: Economic Globalization, Voter Turnout and Welfare Spending
Marginal Effect of Economic Globalization on Welfare Spending
-.30
-.25
0
.25
.30
.35
0
10%
20%
30%
40%
50%
The Level of Voter Turnout
Dashed lines give 95% confidence interval.

Table 5.4: Economic Globalization, Political Institutions and Welfare Spending

	Model 5.4a Without Interaction	Model 5.4b With Interaction
Lagged Welfare Spending	0.003**	0.003**
	(0.001)	(0.001)
Economic Globalization	0.002**	0.001**
	(0.000)	(0.000)
Domestic Political Institution	0.037**	-0.005
	(0.007)	(0.013)
Globalization *Political Institution		0.001**
		(0.000)
Urbanization	-0.001**	-0.001**
	(0.000)	(0.000)
Dependency	0.132**	0.112**
	(0.041)	(0.042)
Growth	-0.004**	-0.004**
	(0.001)	(0.001)
Ln GDP per capita	0.034**	0.035**
	(0.007)	(0.007)
Ln population	-0.005*	0.007**
	(0.002)	(0.002)
Ln inflation	-0.022**	-0.021**
	(0.004)	(0.004)
Oil shock (70's)	-0.002	-0.000
	(0.006)	(0.005)
Debt crisis (80's)	-0.010	-0.008
	(0.005)	(0.005)
Constant	0.077	0.116
	(0.082)	(0.074)
Observations	801	801
R-Squared	0.33	0.34

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

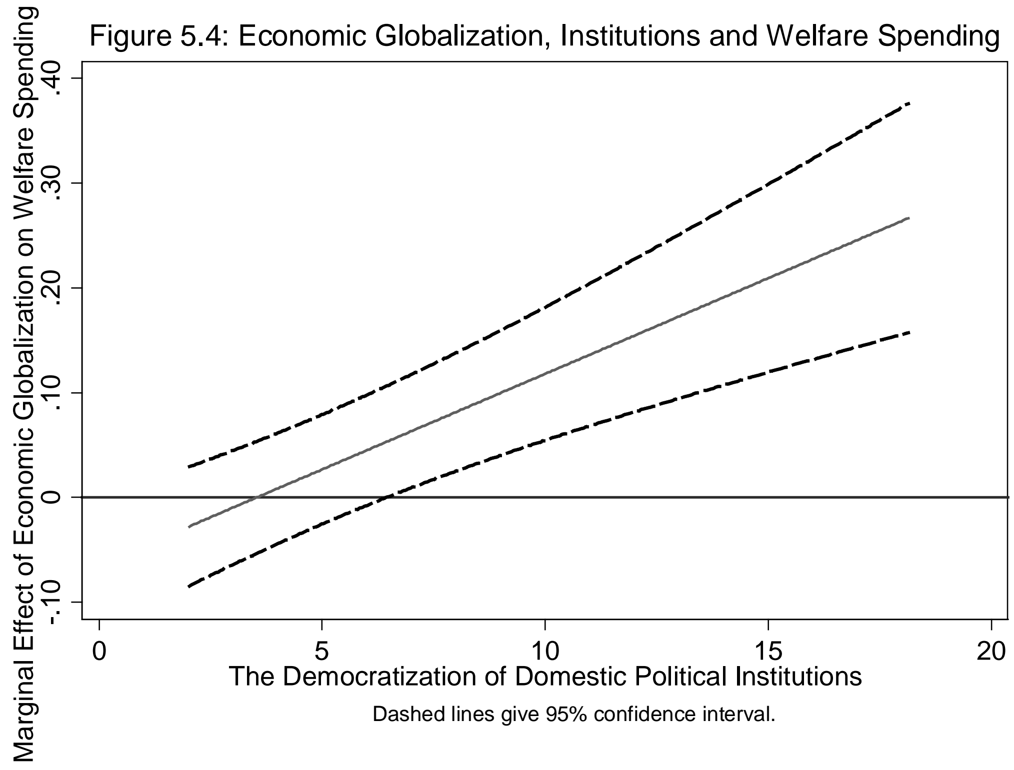


Figure 5.4: Economic Globalization, Institutions and Welfare Spending
Marginal Effect of Economic Globalization on Welfare Spending
-.10
0
.10
.20
.30
.40
0
5
10
15
20
The Democratization of Domestic Political Institutions
Dashed lines give 95% confidence interval.

Table 5.5: Trade, FDI, Political Regime and Welfare Spending

	Model 5.5a Without Interaction	Model 5.5b With Interaction
Lagged Welfare Spending	0.786** (0.082)	0.772** (0.081)
Trade	-0.000 (0.000)	-3.34e-06* (0.000)
FDI	-2.15e-06* (0.000)	-0.000 (0.000)
Political Regime	0.000 (0.000)	-0.001 (0.001)
Trade*Political Regime		5.40e-07** (0.000)
FDI*Political Regime		0.000 (0.000)
Urbanization	0.000 (0.000)	0.0002* (0.000)
Dependency	0.011 (0.012)	0.015 (0.013)
Growth	0.000 (0.000)	0.000 (0.000)
Ln GDP per capita	0.003 (0.003)	0.003 (0.003)
Ln population	-0.002* (0.001)	-0.001 (0.001)
Ln inflation	-0.000 (0.001)	-0.001 (0.001)
Oil shock (70's)	0.001 (0.003)	0.003 (0.003)
Debt crisis (80's)	0.001 (0.002)	0.002 (0.002)
Constant	-0.002 (0.037)	-0.010 (0.039)
Observations	923	923
R-Squared	0.69	0.70

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

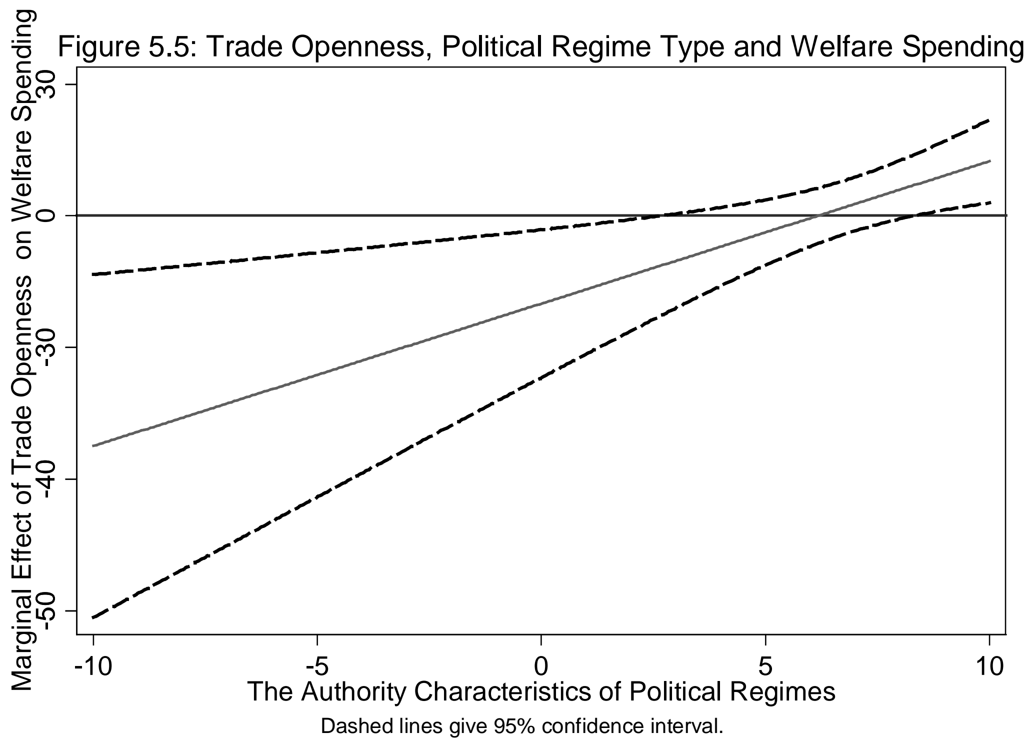


Figure 5.5: Trade Openness, Political Regime Type and Welfare Spending
Marginal Effect of Trade Openness on Welfare Spending
30
0
-30
-40
-50
-10
-5
0
5
10
The Authority Characteristics of Political Regimes
Dashed lines give 95% confidence interval.

Table 5.6: Trade, FDI, Electoral Competition and Welfare Spending

	Model 5.6a Without Interaction	Model 5.6b With Interaction
Lagged Welfare Spending	0.812**	0.804**
	(0.075)	(0.074)
Trade	-0.000	-5.93e-06**
	(0.000)	(0.000)
FDI	-0.000	-0.000
	(0.000)	(0.000)
Electoral Competition	0.000	-0.000
	(0.000)	(0.000)
Trade*Electoral Competition		1.26e-07**
		(0.000)
FDI*Electoral Competition		0.000
		(0.000)
Urbanization	0.000	0.000
	(0.000)	(0.000)
Dependency	0.011	0.014
	(0.013)	(0.014)
Growth	0.000	0.000
	(0.000)	(0.000)
Ln GDP per capita	0.003	0.003
	(0.003)	(0.003)
Ln population	-0.001	-0.000
	(0.001)	(0.001)
Ln inflation	-0.001	-0.001
	(0.001)	(0.001)
Oil shock (70's)	0.002	0.003
	(0.003)	(0.003)
Debt crisis (80's)	0.002	0.002
	(0.002)	(0.002)
Constant	-0.018	-0.015
	(0.036)	(0.035)
Observations	946	946
R-Squared	0.70	0.70

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

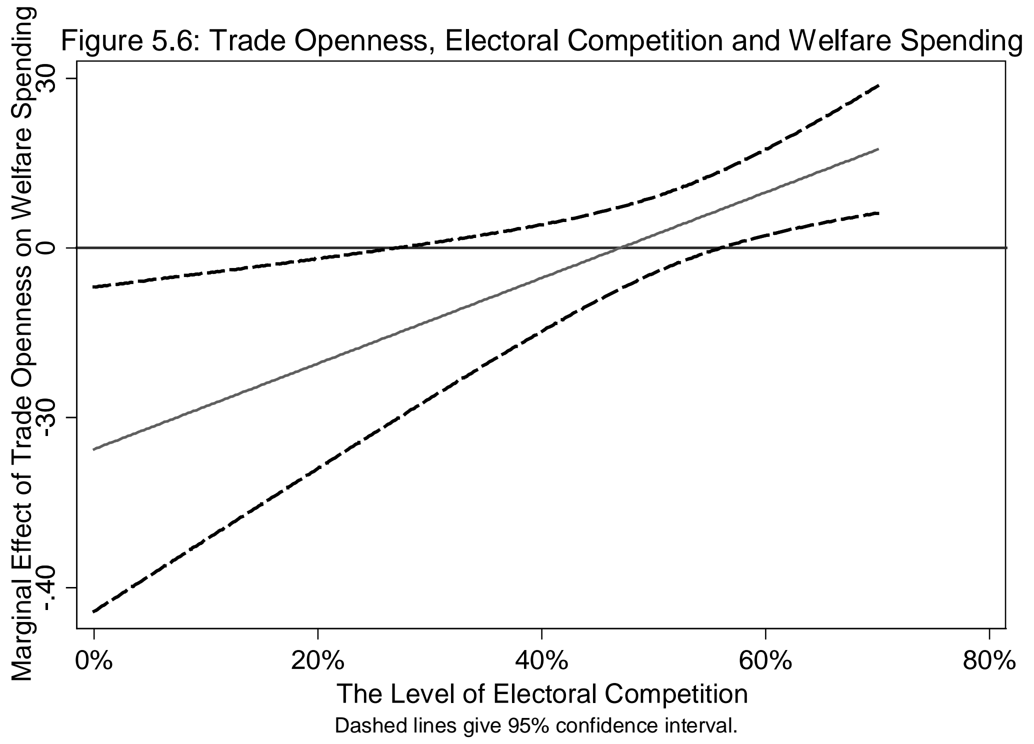


Figure 5.6: Trade Openness, Electoral Competition and Welfare Spending
Marginal Effect of Trade Openness on Welfare Spending
30
0
-30
-.40
0%
20%
40%
60%
80%
The Level of Electoral Competition
Dashed lines give 95% confidence interval.

Table 5.7: Trade, FDI, Voter Turnout and Welfare Spending

	Model 5.7a Without Interaction	Model 5.7b With Interaction
Lagged Welfare Spending	0.809**	0.802**
	(0.076)	(0.076)
Trade	-0.000	-4.13e-06**
	(0.000)	(0.000)
FDI	-0.000	-0.000
	(0.000)	(0.000)
Voter Turnout	0.000	-0.000
	(0.000)	(0.000)
Trade*Voter Turnout		1.04e-07*
		(0.000)
FDI*Voter Turnout		0.000
		(0.000)
Urbanization	0.000	0.000
	(0.000)	(0.000)
Dependency	0.015	0.017
	(0.014)	(0.015)
Growth	0.000	0.000
	(0.000)	(0.000)
Ln GDP per capita	0.003	0.003
	(0.003)	(0.003)
Ln population	-0.001	-0.000
	(0.001)	(0.001)
Ln inflation	-0.000	-0.001
	(0.001)	(0.001)
Oil shock (70's)	0.002	0.003
	(0.003)	(0.003)
Debt crisis (80's)	0.002	0.002
	(0.002)	(0.002)
Constant	-0.022	-0.021
	(0.036)	(0.036)
Observations	946	946
R-Squared	0.70	0.70

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

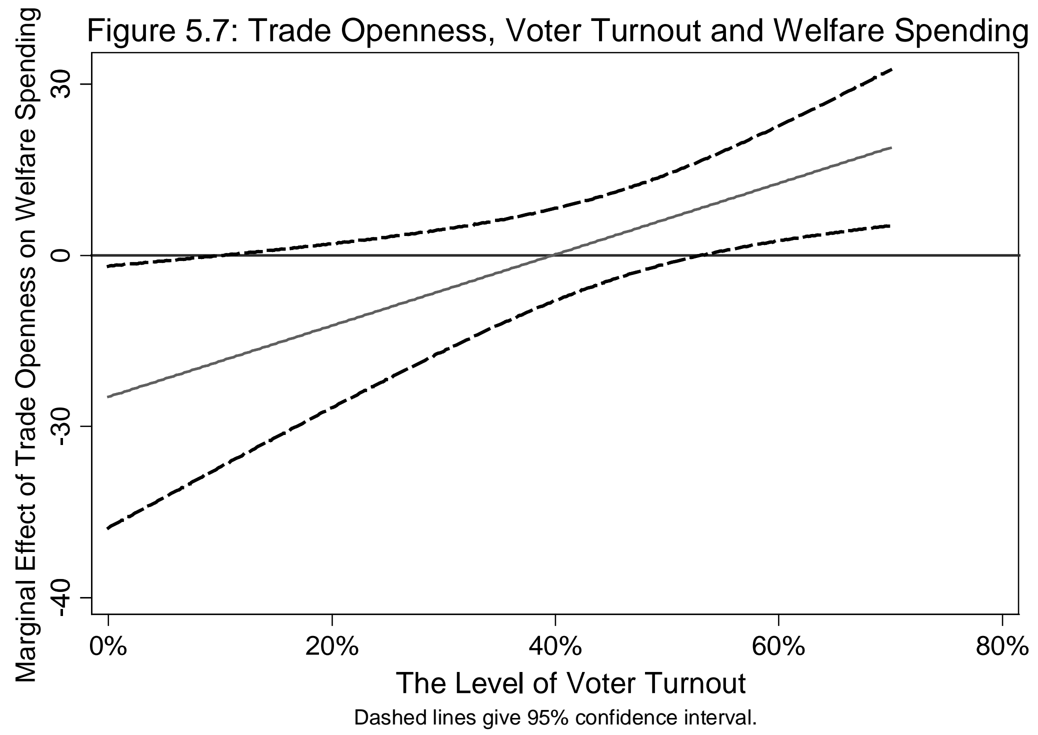
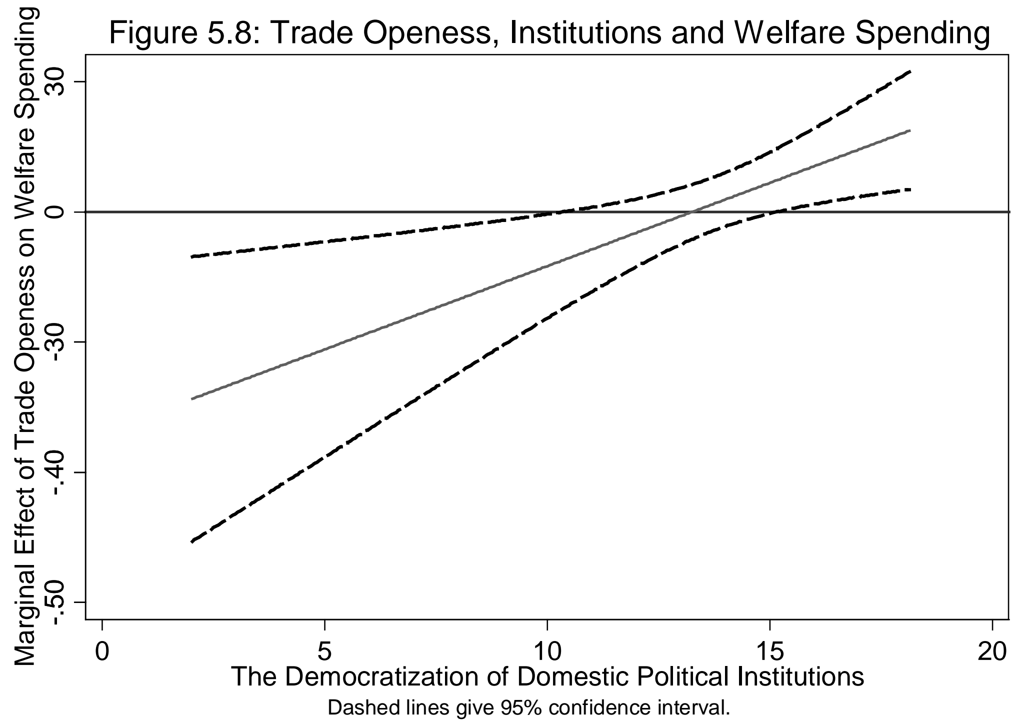


Figure 5.7: Trade Openness, Voter Turnout and Welfare Spending
Marginal Effect of Trade Openness on Welfare Spending
30
0
-30
-40
0%
20%
40%
60%
80%
The Level of Voter Turnout
Dashed lines give 95% confidence interval.

Table 5.8: Trade, FDI, Domestic Political Institutions and Welfare Spending

	Model 5.8a Without Interaction	Model 5.8b With Interaction
Lagged Welfare Spending	0.786**	0.775**
	(0.082)	(0.135)
Trade	-0.000	-2.08e-06*
	(0.000)	(0.000)
FDI	-2.14e-06*	-0.000
	(0.000)	(0.000)
Domestic Political Institution	0.001	-0.006
	(0.002)	(0.004)
Trade*Domestic Political Institution		3.20e-06**
		(0.000)
FDI*Domestic Political Institution		-0.000
		(0.000)
Urbanization	0.000	0.00014*
	(0.000)	(0.000)
Dependency	0.013	0.015
	(0.012)	(0.013)
Growth	0.000	0.000
	(0.000)	(0.000)
Ln GDP per capita	0.003	0.003
	(0.003)	(0.003)
Ln population	-0.002**	-0.000
	(0.001)	(0.001)
Ln inflation	-0.001	-0.001
	(0.001)	(0.001)
Oil shock (70's)	0.001	0.002
	(0.003)	(0.003)
Debt crisis (80's)	0.001	0.001
	(0.002)	(0.002)
Constant	-0.002	-0.012
	(0.037)	(0.040)
Observations	923	923
R-Squared	0.70	0.70

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%



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Chapter 6

The Distribution of Welfare Compensation: Globalization, Political Affiliation and Social Policy

The previous chapter presented evidence that the political institutional environment that shapes the incentives and preferences of policy makers who make social policy averts globalization's natural proclivity to retrench the welfare state. Domestic political actors such as labor unions and political parties shape the distribution of states' social policy. Do the political and ideological preferences of these actors also apply the brakes to globalization's 'race to the bottom' effect on social spending? The discussion that follows addresses this question.

6.1. *Labor Unions and Social Generosity*

Recent scholarship contends that globalization's effect on states' social spending is conditional on the relative strength of organized labor. It is argued that the power of organized labor is displayed when it exerts pressure on governments to increase welfare spending by effectively lobbying the WTO to link labor standards to free trade agreements (Hughes and Wilkinson, 1998, Wachtel, 1998, Wet, 1995, Wilkinson and Hughes, 2000). The discussion in chapter 2 generated hypothesis 6, which stated: *Increasing levels of global economic integration are associated with an increase in welfare spending when labor unions are strong.*

Yet, as discussed in chapter 2, other scholars challenge this notion arguing instead that global economic integration has weakened the power of organized labor to influence states' welfare policies. Organized labor's weakened position is a function of the fact that the labor movements in many countries have been transformed from being militant organizations that once pressed for the rights of the working class, to being co-opted into the free market priorities of transnational capitalism and increasingly see themselves as partners to corporate capital no longer willing to press the state for welfare benefits (Gray, 2008, Gray, 2007). These counter-arguments generated hypothesis 7, which stated: *Increasing levels of global economic integration is not associated with an increase in welfare spending regardless of the strength of labor unions.*

Table 6.1 presents the findings of the interactive effect of economic globalization and labor unions on welfare spending. Model 6.1a presents the results with the main explanatory variables - economic globalization and labor unions – without the interaction term. And model 6.1b presents the main results with the interaction term.

[Table 6.1 about here]

The direction of the coefficients for most of the control variables in models 6.1a and 6.1b are consistent with theoretical predictions that are reported in the findings of previous research. Prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending. Urbanization, economic growth, population, inflation and the debt crisis of the 1980s are all negatively associated with welfare spending. Higher levels of economic development are positively associated with welfare spending. The ratio of countries' young and old dependents and the oil shocks of the 1970s fail to reach statistical significance.

In model 6.1a, economic globalization and organized labor are positively associated with welfare spending. While model 6.1b shows that both economic globalization and organized labor (the constitutive elements of the interaction term) are positively associated with welfare spending, the coefficient on the interaction term – Economic Globalization*Labor Power – has no statistically significant effect on welfare spending, which support hypothesis 7. In other words, this suggest that organized labor's effect on states' welfare spending is not through the forces of global economic integration. This finding lends support to the argument that economic globalization may have weakened and co-opted labor to support the priorities of transnational capital.

6.2. *Party Ideology and Social Generosity*

Social democratic theories contend that economic globalization's effect on social spending is conditional on the nature of party politics. Governments led by leftist or centrist political parties are more likely to support robust welfare policies than governments led by parties to the political right (Huber and Stephens, 2001, Stephens, 2005). In chapter 2, these arguments generated hypothesis 8, which stated: *Increasing*

levels of global economic integration are associated with an increase in welfare spending when ruling political parties are on the left.

Table 6.2 presents the findings of the interactive effect of economic globalization and the ideology of ruling parties on welfare spending. Model 6.2a presents the results with the main explanatory variables - economic globalization and the ideology of the ruling party – without the interaction term. And model 6.2b presents the main results with the interaction term.

[Table 6.2 about here]

The direction of the coefficients for most of the control variables in models 6.2a and 6.2b are consistent with the theoretical predictions that are reported in the findings of previous research. Prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending. Urbanization, economic growth, population, inflation, the oil shock of the 1970s (in model 6.2a only) and the debt crisis of the 1980s are all negatively associated with welfare spending. Higher levels of economic development are positively associated with welfare spending. The ratio of countries' young and old dependents and the oil shocks of the 1970s (in model 6.2b only) fail to reach statistical significance.

Economic globalization is positively associated with welfare spending in models 6.2a and 6.2b. The ideology of the ruling political party is positively associated with welfare spending in model 6.2a, but fails to reach statistical significance in model 6.2b. The coefficient on the interaction term – Economic Globalization*Ruling Party Ideology - is positive. In figure 6.2, the sloping line indicates the marginal effect of economic globalization on welfare spending for meaningful changes in the ideology of ruling political parties. And 95% confidence intervals around the line show the conditions under which economic globalization has a statistically significant effect on welfare spending. Figure 6.2 shows that global economic integration increases welfare spending regardless of political parties. While welfare expenditures are not significantly reduced under right parties, left parties tend to be more generous in the provision of welfare benefits. From this perspective, since social democratic theory predicted that right parties

are more likely to slash states' welfare spending, while left parties are expected to significantly increase spending, hypotheses 8 is partially confirmed by the finding. A clearer picture emerges when considering this issue from a different vantage point. In figure 6.2a, the sloping line indicates the marginal effect of the ideology of ruling parties on welfare spending for meaningful changes in countries' integration into the global economy. From this perspective, right parties have a reductive effect on welfare spending at low levels of global economic integration. However, once left of center parties govern and countries' integration into the global economy exceeds a score of 45 on the KOF index, then an ideological movement from the right to the left increases welfare spending.

6.3. *Robustness Checks: Alternate Measures of Globalization and Social Spending.*

As was done in the previous empirical chapters, alternate measures of social spending and economic globalization are used to provide additional empirical test for the study's hypotheses. Table 6.3 presents the findings of the interactive effect of labor unions and openness to trade and FDI on welfare spending. Model 6.3a presents the results with the main explanatory variables - labor unions and openness to trade and FDI – without the interaction terms. And model 6.3b presents the main results with the interaction terms.

[Table 6.3 about here]

The direction of the coefficients for most of the control variables in models 6.3a and 6.3b are also consistent with theoretical predictions that have been reported in previous research. Prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending. Urbanization, economic growth, population, inflation, the oil shock of the 1970s and the debt crisis of the 1980s are all negatively associated with welfare spending. Consistent with Wagner's Law, higher levels of economic development is positively associated with welfare spending. And the ratio of countries' young and old dependents fails to reach statistical significance.

The power of organized labor has a positive effect on welfare spending in model 6.3a, but interestingly becomes negative in model 6.3b. Openness to trade is negatively

associated with welfare spending, in models 6.3a and 6.3b. However, since the coefficient on the interaction term – Labor Power*Trade – is positive, this reductive effect diminishes, a finding that is consistent with hypothesis 6. In figures 6.3, the sloping line indicates the marginal effect of trade openness on welfare spending for meaningful changes in the Potential Labor Power index (PLP). And 95% confidence intervals around the line show the conditions under which trade openness has a statistically significant effect on welfare spending. It can be observed from figure 6.3 that trade openness has a significant reductive effect on welfare spending when the power of organized labor on the PLP index low. However, this reductive effect diminishes as the power of organized labor increases. Once labor power is greater than 10 percentage points on the PLP index then openness to international trade no longer has a significant reductive effect on welfare spending.

While this analysis has shown that the effects on the welfare state that come from global economic integration, measured in terms of the KOF globalization index - are not conditional on the strength of organized labor, the effects on welfare spending that come from openness to international trade are conditional on the power of the labor movement. This finding seems to support the argument that organized labor can affect welfare policy by attaching labor standards to free trade agreements, which bind governments into making concessions for increased welfare benefits.

Table 6.4 presents the findings of the interactive effect of party ideology and openness to trade and FDI on welfare spending. Model 6.4a presents the results with the main explanatory variables – party ideology and openness to trade and FDI – without the interaction terms. And model 6.4b presents the main results with the interaction terms.

[Table. 6.4 about here]

The directions of the coefficients for most of the control variables in models 6.4a and 6.4b are consistent with the theoretical predictions that are reported in the findings of previous research. Again, prior levels of welfare spending (the lagged dependent variable) are positively associated with current levels of welfare spending. Urbanization, economic growth, population, inflation, the oil shock of the 1970s and the debt crisis of

the 1980s are all negatively associated with welfare spending. Higher levels of economic development and the level of urbanization are positively associated with welfare spending. The ratio of countries' young and old dependents and FDI all fail to reach statistical significance. While openness to trade is negatively associated with welfare spending in models 6.4a and 6.4b, party ideology fails to reach statistical significance. And the interactive terms Party Ideology*Trade and Party Ideology*FDI also fail to reach statistical significance, suggesting that these alternative measures of economic globalization do not affect states' welfare spending via the ideology of political parties. However, the finding presented in Table 6.2 does show that economic globalization, broadly defined and measured by the KOF index, positively affect welfare spending through party ideology.

6.4. *Summation*

The results presented in this chapter suggest that political and ideological preferences of labor unions and political parties avert globalization's downward pressure on social policy. When organized labor is politically strong, economic globalization, measured in terms of openness to trade, will have a positive effect on states' welfare spending. Economic globalization will increase welfare spending regardless of the ideology of ruling political parties, although relative to right parties, left parties provide more generous welfare benefits. The study's cross-national empirical findings have shown that globalization's effect on the welfare state is conditional on the nature of domestic political institutions and political actors. In the chapters that follow these findings are confirmed via the comparative case studies of globalization's effects on the welfare state in South Korea, Chile and Spain.

6.5. *Tables and Figures*

Table 6.1: Economic Globalization, Organized Labor and Welfare Spending

	Model 6.1a Without Interaction	Model 6.1b With Interaction
Lagged Welfare Spending	0.003*	0.003**
	(0.001)	(0.001)
Economic Globalization	0.001**	0.002**
	(0.000)	(0.000)
Labor Power	0.001**	0.002**
	(0.000)	(0.000)
Economic Globalization* Labor Power		-0.000
		(0.000)
Urbanization	-0.001**	-0.001**
	(0.000)	(0.000)
Dependency	-0.002	0.001
	(0.024)	(0.024)
Growth	-0.005**	-0.005**
	(0.001)	(0.001)
Ln GDP per capita	0.030**	0.029**
	(0.006)	(0.006)
Ln population	-0.006**	-0.006**
	(0.002)	(0.002)
Ln inflation	-0.018**	-0.018**
	(0.005)	(0.003)
Oil shock (70's)	-0.013	-0.014
	(0.007)	(0.007)
Debt crisis (80's)	-0.013*	-0.014*
	(0.006)	(0.007)
Constant	0.249**	0.244**
	(0.080)	(0.079)
Observations	737	737
R-Squared	0.31	0.31

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

Table 6.2: Economic Globalization, Party Ideology and Welfare Spending

	Model 6.2a Without Interaction	Model 6.2b With Interaction
Lagged Welfare Spending	0.002**	0.002**
	(0.001)	(0.001)
Economic Globalization	0.002**	0.002**
	(0.000)	(0.000)
Ruling Party Ideology	0.012**	-0.024
	(0.004)	(0.013)
Globalization*Ruling Party Ideology		0.001**
		(0.000)
Urbanization	-0.0005*	-0.0005*
	(0.000)	(0.000)
Dependency	-0.017	-0.013
	(0.031)	(0.032)
Growth	-0.004**	-0.004**
	(0.001)	(0.001)
Ln GDP per capita	0.037**	0.033**
	(0.008)	(0.008)
Ln population	-0.008**	-0.007**
	(0.002)	(0.002)
Ln inflation	-0.015**	-0.015**
	(0.004)	(0.004)
Oil shock (70's)	-0.013*	-0.011
	(0.006)	(0.006)
Debt crisis (80's)	-0.017**	-0.014**
	(0.004)	(0.004)
Constant	0.173	0.194**
	(0.089)	(0.090)
Observations	717	717
R-Squared	0.34	0.35

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

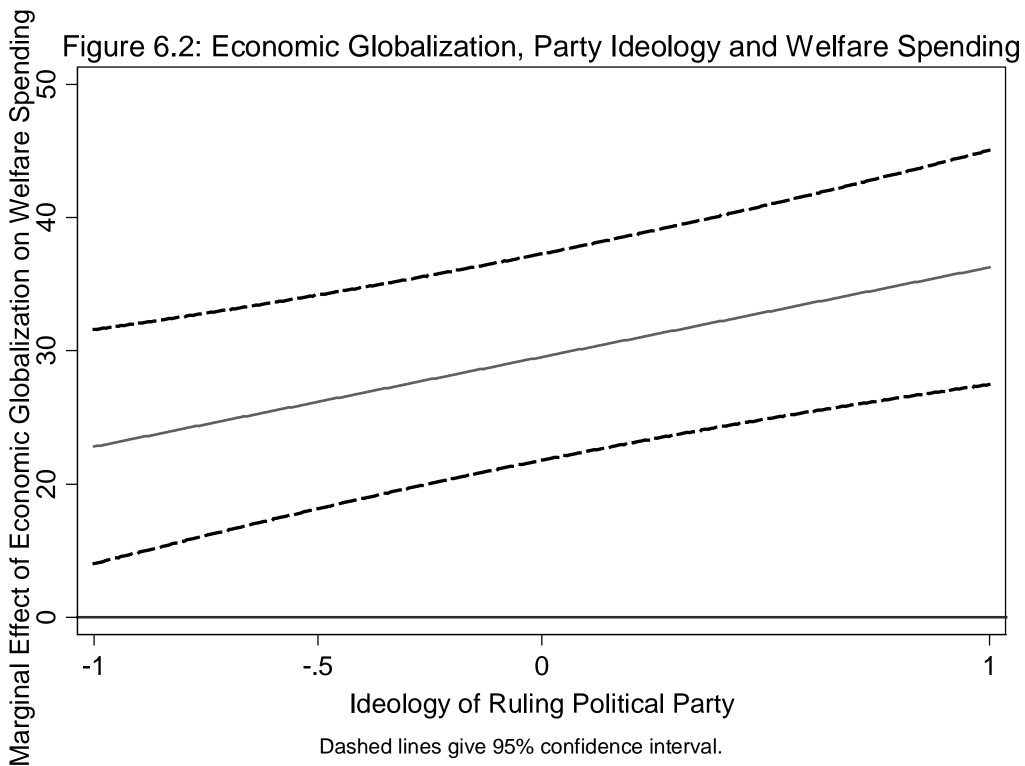
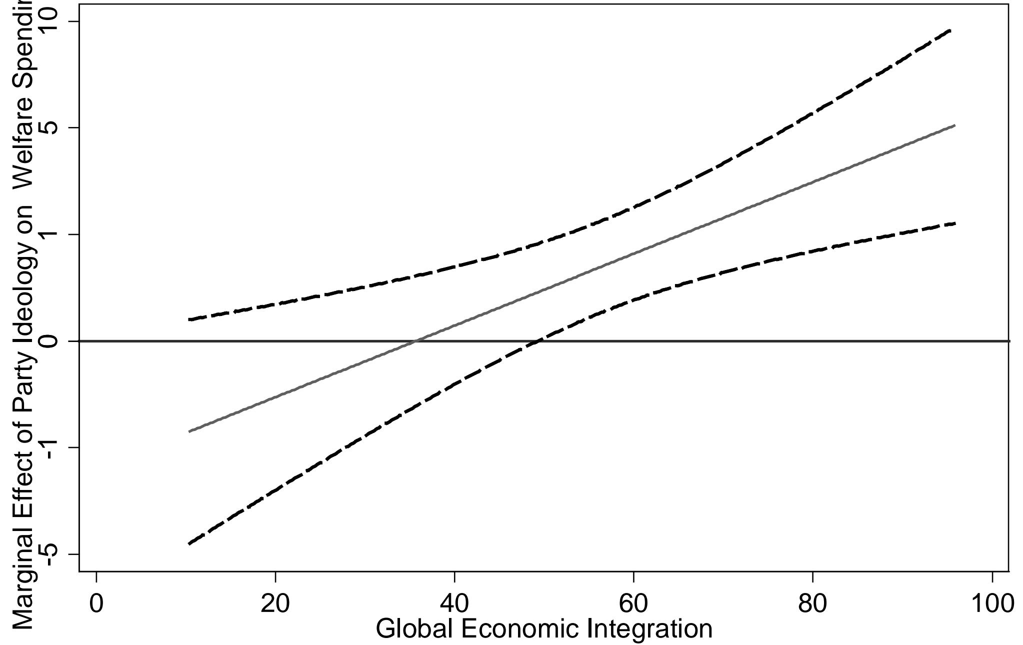


Figure 6.2: Economic Globalization, Party Ideology and Welfare Spending
Marginal Effect of Economic Globalization on Welfare Spending
0
20
30
40
50
-1
-.5
0
1
Ideology of Ruling Political Party
Dashed lines give 95% confidence interval.

Figure 6.2a: Party Ideology, Economic Globalization and Welfare Spending



Dashed lines give 95% confidence interval.

Table 6.3: Trade, FDI, Organized Labor and Welfare Spending

	Model 10.a Without Interaction	Model 10.b With Interaction
Lagged Welfare Spending	0.003**	0.003**
	(0.001)	(0.001)
Trade	-0.0005**	-0.001**
	(0.000)	(0.000)
FDI	0.001	0.002
	(0.002)	(0.002)
Labor Power	0.001**	-0.003**
	(0.000)	(0.000)
Labor Power*Trade		0.00009**
		(0.000)
Labor Power*FDI		-0.000
		(0.000)
Urbanization	-0.001**	-0.001**
	(0.000)	(0.000)
Dependency	-0.005	0.014
	(0.028)	(0.029)
Growth	-0.004**	-0.005**
	(0.001)	(0.001)
Ln GDP per capita	0.052**	0.063**
	(0.007)	(0.008)
Ln population	-0.014**	-0.009**
	(0.003)	(0.003)
Ln inflation	-0.023**	-0.025**
	(0.005)	(0.005)
Oil shock (70's)	-0.022**	-0.022*
	(0.009)	(0.009)
Debt crisis (80's)	-0.022*	-0.023**
	(0.098)	(0.111)
Constant	0.244**	0.129
	(0.098)	(0.111)
Observations	709	709
R-Squared	0.31	0.33

Panel-corrected standard errors are in parentheses. **significant at 1%; *significant at 5%

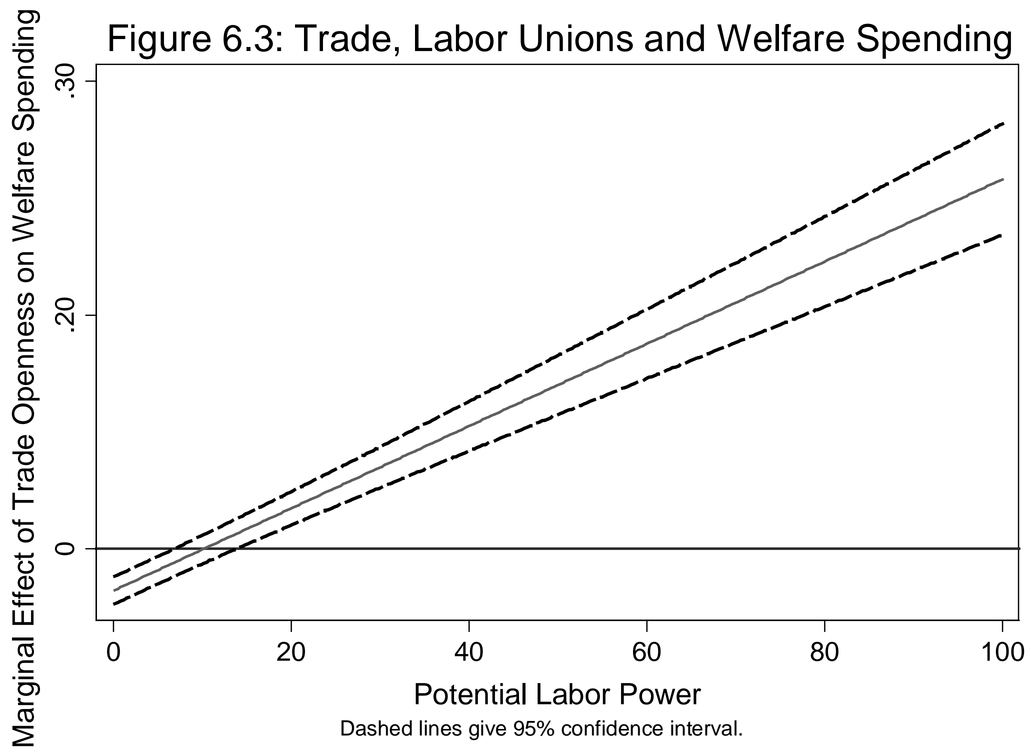


Figure 6.3: Trade, Labor Unions and Welfare Spending
Marginal Effect of Trade Openness on Welfare Spending
.30
.20
0
0
20
40
60
80
100
Potential Labor Power
Dashed lines give 95% confidence interval.

Table 6.4: Party Ideology, Trade, FDI and Welfare Spending

	Model 6.4a Without Interaction	Model 6.4b With Interaction
Lagged Welfare Spending	0.003*	0.003*
	(0.010)	(0.001)
Trade	-0.0005**	-0.0005**
	(0.000)	(0.000)
FDI	0.000	0.001
	(0.002)	(0.002)
Ruling Party Ideology	0.008	0.007
	(0.004)	(0.008)
Party Ideology*Trade		0.000
		(0.000)
Party Ideology*FDI		-0.005
		(0.000)
Urbanization	-0.0005*	-0.0004*
	(0.000)	(0.000)
Dependency	-0.022	0.026
	(0.030)	(0.030)
Growth	-0.004**	-0.004**
	(0.001)	(0.001)
Ln GDP per capita	0.053**	0.051**
	(0.007)	(0.007)
Ln population	-0.018**	-0.018**
	(0.001)	(0.002)
Ln inflation	-0.024**	-0.024**
	(0.004)	(0.004)
Oil shock (70's)	-0.023**	-0.022**
	(0.005)	(0.005)
Debt crisis (80's)	-0.029**	-0.029**
	(0.004)	(0.005)
Constant	0.266**	0.281**
	(0.087)	(0.087)
Observations	757	757
R-Squared	0.31	0.31

Panel-corrected standard errors are in parentheses. **significant at 5%; *significant at 1%

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Part III

Economic Globalization and the Welfare State in Emerging Economies with Authoritarian Political Histories

Chapter 7

Globalization and the Welfare State in South Korea

7.1. *Introduction*

The South Korean welfare state has grown over the past forty years from a system with limited benefits into a system that is relatively comprehensive. What explains this dynamic is the interplay between the variation of South Korea's global economic integration and variation in the nature of its political institutions, which was characterized by a transition from authoritarian military rule to democratic governance.

South Korea's military regimes used social welfare as an instrument to promote economic growth and industrialization. The welfare state under South Korea's military regimes was an ideal portrayal of the developmental use of social policy. The essential components of the corporatist consensus of South Korea's developmental welfare state included: trade policies that protected corporate capital from foreign competition; corporate capital's provision of full employment and private welfare benefits to industry workers; and labor unions acceptance of limited welfare benefits from the state in exchange for full employment of its members (Goodman and White, 1998, p. 17, Wade, 1990, White, 1988, Woo-Cumings, 1999). This chapter presents a discussion of how the pressures of global economic integration and political democratization unraveled this consensus making social policy in South Korea increasingly consistent with compensatory approaches of the welfare state.

Many intricacies are associated with the dynamics of South Korea's welfare state making it desirable to present an historical overview of its evolution from authoritarianism to democracy. This will comprise the content of the next section, to be followed by a discussion of the corporatist consensus of South Korea's developmental welfare state. This is followed by a discussion of the various welfare programs under the military regimes and the ways in which these programs were limited in coverage and were subordinated to the priorities of industrial development. The next sections discuss how the process of economic globalization and democratic governance unraveled the consensus of the developmental welfare state and significantly transformed welfare policy in South Korea. The chapter concludes with a discussion of the future challenges

and the limitations of South Korea's welfare state in an increasingly integrated global economy.

7.2. *Historical Overview*

In 1961 a military coup d'état led by Major General Park Chung-hee effectively ended the democratic government in South Korea's Second Republic. After the assassination of Park Chung-hee in 1979, popular protest against the military regime emerged. These protests reached a climax with the coup d'état led by Chun Doo-hwan and the establishment of martial law. In 1980, millions of people protested the military regime's massacre of Gwangju, which killed 207 democratic protesters. As a result of these protests, the regime made political concessions for the transition to democracy. When the first democratic presidential election was held in 1987, Kim Young-sam and Kim Dae-jung, former critics of South Korea's military regimes, ran against each other and split the opposition vote, enabling former general Roh Tae-woo to win the election. In 1991, Kim Young-sam's Unification Democracy Party merged with Roh's ruling Democratic Justice Party. And as the candidate of the ruling conservative political party he defeated Kim Dae-jung in the 1992 presidential election. The Asian financial crisis in 1997 and the subsequent collapse of the South Korean economy eroded the electoral credibility of the ruling conservative government and in that year ushered into office the liberal government of Kim Dae-jung.

7.3. *The Corporatist Consensus of the Developmental Welfare State*

South Korea's military regimes induced agreements on economic and social policy among labor unions and corporate capital. There was consensus on the importance of protecting the domestic market from international competition. Trade policies advantaged domestic firms by encouraging exports and restricting imports. In return, domestic firms provided full employment and private welfare benefits to workers in the industrial sector (Robinson, 2002, 257, Wiarda, 1997). Labor unions accepted limited welfare benefits from the state in exchange for economic growth and stable employment (Park, 2008, Song and Hong, 2005).

Since an expansive welfare state was seen as an obstacle to economic

development, social spending was restricted and subordinated to the priorities of industrial development. The state's expenditure on education and job training were considered as investments in industrial development rather than social welfare (Goodman and Peng, 1996, Holliday, 2000, Jones, 1993, Kwon, 2007, Kwon and Holliday, 2007). Consequently, expenditures for education and job training accounted for 85-90% of all social spending, while expenditures on health and social protection remained at 1% of total government spending throughout the 1970s and 1980s (United Nations, 2007). Expenditure on education was seen as providing a foundation for transforming South Korea from a low-skilled labor-intensive economy to one that produced high value-added technologies for export markets. In this regard, welfare benefits were limited to workers in the public and industrial sectors that were critical to economic development. The state provided generous tax-cuts and investment subsidies to encourage private firms to provide health care and social protection benefits to their workers.[13] With the exception of public pensions for workers in the public sector, private firms and the contributions of their workers funded all the social insurance and pension programs (Kwon, 2007, Kwon, 1999, Kwon et al., 2009). In short, since welfare policy was subordinated to the priorities of South Korea's industrial development, the essential logic of the developmental welfare state was largely consistent with efficiency theoretical explanations of states' welfare policies.

7.4. *The Social Policies of the Military Regimes*

The welfare policies of South Korea's developmental welfare state can be categorized into three programs. These include social insurance, which included industrial accident insurance, national health insurance, and employment insurance; public pensions; and public assistance (Kim, 2007, Kwon, 2007).

In 1963, the Park Chung-hee regime introduced the industrial accident insurance program to promote economic development by facilitating corporate investments in hard industry like construction, shipbuilding, and the machine industry. The coverage of the

[13] The state also drew upon South Korea's Confusion culture where the provision of welfare was the responsibility of the family. See Song, Ho Keun, and Kyung Zoon Hong. (2005) Globalization and Social Policy in South Korea. In *Globalization and the Future of the Welfare State*, edited by Miguel Glatzer and Dietrich Rueschemeyer. Pittsburgh: University of Pittsburgh Press.

program was funded by the corporate sector and was restricted to firms that had more than 500 employees (Kwon, 2007). Two years later, the government introduced health insurance that only provided coverage for workers in the public sector, private schools and those employed in the corporate sector of the economy. The state's financial contribution to health insurance was negligible and limited to funding the cost of administering the program. However, since the funding for health insurance came from the financial contributions of workers and their employers, coverage was unaffordable for the self-employed, small businesses, and rural farmers – the most vulnerable in South Korean society (Kim, 2007, Kwon, 2007). Similarly, the government's unemployment insurance program, which provided benefits to workers displaced by temporary unemployment was only available to workers in the private sector who were critical to the country's economic development (Kwon, 2007, Kwon, 1999).

While the social insurance program was used to promote economic development, public pensions were designed to consolidate the political support of the military regime and consequently was only available to government and military personnel (Song and Hong, 2005). By 1988 the military government introduced a national pension program (Kim, 2007, Kwon, 2007). And similar to the national health insurance, the national pension program was only available to those workers that were critical to South Korea's industrial development (Kwon, 2007, Kwon, 1999). The national pension program was also financed by the contributions of industrial workers and private firms (Kim, 2007).

Public assistance is the only social protection program that was fully funded by the military regime. The program provided small amounts of food, condiments, clothing, monetary allowance or "consolation money" and subsidized heating costs for the aged. However, the program was not universal and was restricted to the elderly whose family members were not of a working age (Song and Hong, 2005).

7.5. *Political Democratization and Economic Liberalization*

The national protest against the Chun Doo-hwan military regime during the 1980s forced the government to make several concessions for the transition to democracy. These included the amendment of the constitution, the promotion of basic human rights and greater freedoms to political parties, the restoration of presidential elections, the

introduction of local autonomy, the promotion of free speech and the extension of amnesty to pro-democracy leader, Kim Dae-jung (Han-Gyo-Rae, 1987). In December 1987, presidential election was restored, and with the election of the conservative government led by Kim Young Sam, the first civilian regime in 1993, the government embarked on a number of political reforms. The political power of the state was decentralized by giving regional jurisdictions more autonomy. The electoral system was restructured to increase voter participation in national elections.

Political democratization was followed by international demands to liberalize South Korea's economy. Major trading partners, like the U.S., pressed the government to liberalize South Korea's trade and investment policies that protected domestic firms from foreign competition. In response, the government liberalized its trade policy, which effectively ended the protectionist practices of the previous military regimes. Policies that protected the domestic market from foreign capital flows were also abandoned, while the government's membership to the World Trade Organization (WTO) in 1993 and the Organization for Economic Cooperation and Development (OECD) in 1996 strengthened domestic economic reform and deepened South Korea's integration into the global economy (Yang and Moon, 2005). As a result, trade expansion accounted for over 50% of South Korea's GDP throughout the 1990s. Capital flows into South Korea accounted for US$538 million in 1986 and increased to US$1,473 million in 1987. These increases continued throughout the 1990s, exceeding US$10,200 million in 1997 (Song and Hong, 2005).

7.6. *The Crisis of the Developmental Welfare State*

The liberalization of the South Korean economy was an abrogation of the corporatist consensus of the developmental welfare state that was based on trade protection. Domestic firms could no longer rely on the state to protect them from foreign competition. In addition, facing increasing competition from foreign multinationals, they could no longer afford to provide full employment or private welfare for the industrial work force. Foreign competition, especially in labor-intensive industries, increased production costs and forced many firms into bankruptcy, which increased unemployment. With rising unemployment, labor unions would increasingly look to the state to provide a

social safety-net (Song and Hong, 2005, Yang and Moon, 2005).[14]

The response of the Kim Young Sam government was to reform the existing developmental welfare system by incrementally expanding the government's role in the system. The government provided funding for job training, job security grants and unemployment compensation through the Employment Insurance Program. Unemployed workers from the industrial sector were eligible for unemployment benefits and job security grants were given to domestic firms to discourage them from cutting their payrolls. The Employment Insurance Program covered unemployed workers in the private sectors and private school teachers. And similar to the welfare policies of the previous military regimes, the program was financed by the contributions of workers and their employers (Kwon, 2007). The government also expanded the National Pension Program to the self-employed and established several task force committees to study reforming social insurance, pensions, health, housing, education, public protection and employment. The committees included the Welfare Policy Committee for the Disabled and the Medical Care Reform Committee, and the Committee for Social Security Policy, which was responsible for drafting the Five-Year Welfare Development Plan (Song and Hong, 2005).

While the previous military regimes viewed welfare policy as an instrument for industrial development, Kim Young Sam's conservative democratic government viewed it as a mechanism to improve the quality of life as well as an instrument to facilitate development (Song and Hong, 2005). However, welfare reform by the Kim Young Sam government was never comprehensive or universal in scope. The role of the state in welfare reform was restricted to being an organizer of the system, still passing the financial burden of welfare to private companies, social and religious organizations and individual workers (Koh, 1998). In this respect, the welfare policies of Kim Young Sam's conservative government were fundamentally on the same line with those of the previous military regimes.

7.7. *The Asian Financial Crisis, the Democratic Left and the IMF*

Attempts at welfare reform collapsed in face of the Asian financial crisis in 1997.

[14] Rising unemployment also undermined South Korea's family welfare system since the unemployed could not provide for the needs of the family.

The crisis started in Thailand with the financial collapse of the Thai baht, which was driven in part by the financial overextension in the real estate market and the country's rising foreign debt. As the crisis spread, most of Southeast Asia saw slumping currencies, devalued stock markets and a steep rise in private debt. The financial contagion also spread to Northeast Asian countries like South Korea. Indonesia, Thailand and South Korea were the countries the most affected by the crisis. The South Korean economy experienced negative growth rates of 6.7 percent, unemployment rose to 7 percent in 1998, then climbing to 8.6 percent in early 1999, and real income plummeted to 9.3% (Song and Hong, 2005, Yang and Moon, 2005).

South Korea's electorate blamed the conservative government of Kim Young Sam for the financial crisis and in the presidential elections in 1997 replaced the government with the liberal government of Kim Dae-jung. The new government inherited an economy with high levels of debt and depleted foreign exchange reserves. To restore the financial stability of the economy the government accepted a short-term stabilization loan from the International Monetary Fund (IMF). The economic reforms demanded by the IMF included the further liberalization of trade, the privatization of public enterprises, the tightening of monetary policy to arrest the depreciation of the currency, increases in the interest rate to control inflation, and banking reforms to promote greater transparency, all of which furthered the process of liberalizing the South Korean economy (Yang and Moon, 2005). Higher interest rates, in the short-term, coupled with the further liberalization of the economy undermined domestic investment, increased corporate bankruptcies, unemployment, and poverty. The urban poverty rate in South Korea surged from 7 percent in 1997 to 21 percent in 1998 (National Statistics Office, 1999, Song and Hong, 2005).

7.8. *Social Democratic Corporatism and Comprehensive Welfare Reform*

The management of the economic crisis provided the liberal government with the opportunity to fundamentally transform welfare policy from one that was largely selective and based on industrial development to one that was more universal. In pursuing welfare reform, the government attempted to navigate the implementation of two conflicting policies: neoliberal economic reform to resolve the financial crisis and social

reforms to provide adequate safety-nets to those displaced by the financial crisis. Neoliberal economic reform threatened to impede the development of social reform, the policy preference of labor unions and the lower classes – the main supporters of the liberal government (Song and Hong, 2005). On the other hand, the neoliberal economic policies of the IMF were important to stabilize the market to facilitate economic growth.

In resolving this dilemma, the government forged a social democratic corporatist consensus among labor, capital and government regarding the importance of continuing the process of integrating South Korea into the global economy, while developing a comprehensive welfare system (Katzenstein, 1984, Katzenstein, 1985). The creation of the Tripartite Commission in 1998, which included representatives from the government, labor unions and private industry were charged with the task developing a viable compromise to economic and social reforms (Song and Hong, 2005, Yang and Moon, 2005). Members of the commission agreed to introduce economic policies that would facilitate the process of economic liberalization as well as introduce policies that would establish a comprehensive social safety-net to compensate those who are displaced by the process of global economic integration (See Table 7.1). Coupled with the political preference of the liberal government, the financial crisis expedited the pace of economic liberalization and facilitated the transformation of South Korea's welfare system (Song and Hong, 2005). The liberal government, relative to its predecessors, not only structurally reformed South Korea's social policy but also expanded the country's social welfare programs, as indicated in Table 7.2.

The liberal government extended the coverage of the Employment Insurance Program. The program was expanded in four stages. First, to companies with ten or more workers in January 1998; then to companies with more than five workers in march 1998; and then to all the companies in October 1998; and finally to all the employees including temporary workers, part-time workers, and day workers in September 2000 (Gazier and Herrera, 2000, Yang and Moon, 2005). The duration of unemployment benefit was also extended from 60 to 120 days (Kwon, 2007).

In 1999, the government significantly expanded the National Pension Program to cover the entire population. Farmers, the self-employed and temporary workers were excluded from the program in the past because it was difficult to ascertain their income.

The reform of the National Pension Program made it possible to determine their income by calculating the amount that they would contribute to the program based on the value of their homes and cars. (Song and Hong, 2005, Yang and Moon, 2005).

Coverage under the Industrial Accident Insurance Program was also expanded. In the early 1960s, the injury insurance program covered companies with more than 500 employees. Before the reform, the insurance covered 7.5 million employees in companies with more than five workers. Small companies were excluded from the program. However, as a result of the reform, the program covered an additional 1.6 million employees in small companies with four or fewer workers in 2000. At present, enrollment in the program is compulsory for any company with at least one employee. (Yang and Moon, 2005).

A comprehensive National Health Insurance program did not exist in South Korea. Different insurance programs administered health insurance. The Industrial Workers' Health Insurance covered 38 percent of the population, the Public Employee Health Insurance covered 11 percent of the population, and the Regional Health Insurance Program covered 51 percent of the population (Song and Hong, 2005). However, since having separate programs administer health insurance proved to be financially inefficient, the government successfully integrated these programs into a National Health Insurance program with universal coverage (Yang and Moon, 2005).

In addition to reforming the various social insurance programs, the government redesigned the public assistance program and expanded its coverage. With the passage of the National Basic Livelihood Security Law in 1998, the government introduced a generous and comprehensive public assistance program because the existing program only covered people who did not have family members of working age. Consequently, many people in poverty were not eligible to receive the benefits. The new program allowed for benefits to be extended to the poor without regard to any of the eligibility requirements that governed the old program.[15] In addition, the new public assistance program provided cash benefits to the poor and the disabled (Kim, 2007, Kwon, 2007).

[15] The previous assistance program excluded people between the age of 18 to 64 and those who have family members of working age. However, the new program only required that beneficiaries take part in programs such as job training, public work projects or community services if they were of working age (Kwon 2007).

7.9. *Limitations and Future Challenges of the Welfare State*

The South Korean welfare system was fundamentally transformed from a system with limited benefits to one where benefits have increasingly become universal. For example, during 1997 to 2002, social welfare spending increased by 78 percent, health care expenditures increased by 120 percent, education expenditures increased by 60 percent, and social protection expenditures increased by 49 percent (United Nations, 2007). Thus, the South Korean case lends support to the argument that states' welfare policy is the outcome of the conditional relationship between economic globalization and the process of political democratization.

However, despite its transformation, South Korea's welfare policy is not without limitations. For example, the unemployment insurance program does not cover school and college graduates because it is limited to the workers who have been employed for a minimum of six months. The National Pension Program is a voluntary rather than a mandatory system. In addition, by making the program voluntary the government intended to appease the self-employed who saw their contributions to the program as a type of quasi-tax. To date, approximately half of these workers have not registered for the program (Kim, 2000, pp. 10-11, Lee, 2001, p. 6, Yang and Moon, 2005).

South Korea's aging population is a major challenge to the future financial sustainability of the welfare state. Demographic aging will increase the demand for social protection benefits. While demographic aging is also occurring in other OECD countries, the speed and scale of aging is faster in South Korea than other OECD countries. The speed of demographic aging in South Korea is also faster than in Japan where for the last two decades welfare policies have been adjusted to serve the social needs of the elderly. South Korea's demographic aging is also faster than in France and the United States (see Table 7.3). Given this phenomenon, the number of pensioners in the future will increase significantly and over burden the pension fund. Similarly, government health care expenditures will increase as the number of elderly utilizing health care services increases and the quality of medical care that they demand will also become increasingly expensive (Kwon, 2007, pp. 8-10).

The welfare reforms that were initiated by the liberal government during the late 1990s were based on the principle that South Korea's welfare policies should be

socially inclusive, economically developmental and democratically shaped. However, the demographic aging of the South Korean society poses the greatest challenge to the future financial sustainability of a welfare system that is based on these principles. Will the pressures of demographic aging coupled with the pressures of economic globalization unravel a welfare system that is socially inclusive and once again place greater emphasis on the developmental importance of social policy? This question highlights the continuing complexity in studying the dynamics of the welfare state in South Korea.

7.10. *Tables*

Table 7.1: Key Contents of the Tripartite Commission's "Social Compromise to Overcome the Economic Crisis"

Management transparency and corporate restructuring	Improvement of the corporate financial structure More responsible and more transparent corporate governance Promotion of business competitiveness
Enhancing labor market flexibility	Permission for employers to dismiss workers in cases of managerial need Permission for the establishment of temporary work agencies
Policies to promote employment stability and combat unemployment	Expansion and improvement of employment insurance Livelihood support for the unemployed Expansion and improvement of the public employment service Expansion of vocational training Job creation through public works and business start-up subsidies Consultation and re-hiring requirements in case of redundancy dismissals
Enhancing labor rights	Permission for public servants to form workplace associations Permission for teachers to join trade unions Permission for trade unions to engage in political activities Right of dismissed and unemployed workers to join trade unions
Extension and consolidation of the social security system	Integration of social partners in social security steering committees Wage guarantee in bankruptcy cases Extension of social insurance coverage to non-regular workers

Source: Organization for Economic Cooperation and Development (2000:49) in Yang and Moon (2005: 81)

Table 7.2: Globalization and Social Spending

Year	Welfare Expenditure (% of GDP)		
	Social Insurance	Welfare Service	Social Expenditure
Chun Doo-hwan Military Government			
1980	0.50	--	--
1981	0.50	--	--
1982	0.50	--	--
1983	0.50	--	--
1984	0.80	0.1	--
1985	0.20	0.1	--
1986	0.20	0.1	2.6
1987	0.20	0.1	2.6
Roh Tae-woo Transitional Government			
1988	0.20	0.1	3.2
1989	0.30	0.1	3.6
1990	0.80	0.1	3.9
1991	0.90	0.1	3.8
1992	1.00	0.1	4.2
Kim Young-sam Democratic Government			
1993	0.90	0.2	4.4
1994	0.90	0.2	4.7
1995	0.80	0.2	5.1
1996	0.90	0.2	5.3
1997	0.90	0.2	6.8
Kim Dae-jung Democratic Government			
1998	1.02	0.2	6.9
1999	1.19	0.4	7.2
2000	1.60	0.5	10.2
2001	2.00	0.7	n/a
2002	2.00	0.6	n/a

Source: National Statistical Office in Song and Hong (2005:183)

Table 7.3: The Speed of Demographic Aging

	Years that the rate of elderly population reach to			Number of years when elderly increase from 7% to 14% of the population	Number of years when elderly increase from 14% to 20% of the population
	7%	14%	20%		
Korea	2000	2019	2026	19	7
Japan	1970	1994	2006	24	12
France	1864	1979	2020	115	41
USA	1942	2013	2028	71	15

Source: National Statistical Office (2001) in H.J. Kwon (2007)

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Chapter 8

Globalization and the Welfare State in Chile

8.1. *Introduction*

The welfare state in Chile was transformed from a system with comprehensive benefits that was heavily funded by government revenues into one where benefits were significantly limited and regulated by market forces. Welfare policy has recently evolved into a quasi-comprehensive system in which state subsidies and benefits have been expanded but guided by the logic of the private market. Like South Korea, these dynamics are largely the result of the interplay between the variation of Chile's integration into the global economy and variation in the nature of its domestic political system, which witnessed a transition from democratic governance to authoritarianism and then the resumption of democratic practices after sixteen years of military rule.

This chapter begins with an historical overview and then highlights the ways in which Chile's democratic regimes, while pursuing an industrial strategy that featured import-substitution industry (ISI), trade protection and the nationalization of key industries, developed a comprehensive welfare state. The chapter then discusses how the economic and political crisis of the ISI induced welfare state led to the military coup d'état in 1973. The chapter then examines how the economic stabilization and trade liberalization policies of the military junta globally integrated the economy and in the process replaced Chile's traditional welfare state with one that featured significantly limited benefits that were regulated by the free market. This is followed by a discussion of the restoration of democracy in Chile and the creation of a quasi-comprehensive welfare state under conditions of greater global economic integration and the political dominance of the Concertación regime, which is composed of a ruling coalition of centre-left political parties. The chapter concludes with a discussion of the future challenges to Chile's welfare state.

8.2. *Historical Overview*

Chile achieved independence from Spain in 1811 and by 1932 established an electoral democracy that ended in 1973. Throughout much of this period, various

governments attempted to reform Chile’s social and economic system by pursuing ISI, trade protectionism, expanding the welfare state and statist policies that sought to nationalize key industries. These statist policies were instituted following the election of Eduardo Frei of the Christian Democratic Party (PDC) in 1964. The government acquired majority ownership of the copper industry, redistributed land, and expanded access to education. Despite these changes Chile’s political left pressed for more radical reforms, which in 1970 culminated with the election of Salvador Allende of the Popular Unity party. The Allende government accelerated the reforms of the Frei administration by fully nationalizing the copper and telecommunication industries and expanded land reform and the welfare state. The PDC allied with Chile’s parties on the right to block the legislative initiatives of Allende’s Popular Unity government. The ideological gridlock prevented the government from addressing the economic depression. Unemployment and inflation increased, while international capital flows to Chile plummeted. And as the economy continued to deteriorate along with the indecisive outcome of the 1973 Legislative elections, the military intervened on September 11 (Collier and Sater, 1996).

The Chilean military, led by General Augusto Pinochet, deposed the Allende government in a violent coup and terminated democratic practices and civil liberties and regarded the organized left as an internal enemy of the state. In 1978, General Pinochet won a tightly controlled referendum, which institutionalized the junta’s rule. The military regime implemented a series of neo-liberal economic reforms that liberalized trade and investment, privatized state holdings in the economy, and dismantled the comprehensive welfare state. In 1980, General Pinochet won another referendum that approved the new Constitution, which called for a plebiscite in 1988. Chileans were given the opportunity to reelect Pinochet to another 8-year term or reject him in favor of contested democratic elections. The collapse of the economy in 1982 sparked a nationwide protest against the military junta, which helped to galvanize opposition to Pinochet’s reelection among Chile’s political parties. In the ensuing plebiscite, 55% of the Chilean people rejected 8 more years of military rule and called for democratic elections in 1989 (Constable and Valenzuela, 1993, Falcoff, 1989).

Two major coalitions of parties emerged to contest the 1989 elections. These included the center-left Coalition of Parties for Democracy, or Concertación, and the

center-right Democracy and Progress coalition. Patricio Aylwin, a Christian Democrat and the candidate of the Concertación, won the presidency with 55% of the vote and the Concertación won majorities in the Chamber of Deputies and among the elected members of the Senate. The Concertación coalition has governed Chile continuously since the transition to democracy. Eduardo Frei Ruiz-Tagle was elected president in 1993, followed by Ricardo Lagos in 1999, and recently Michelle Bachelet in 2005. While the Concertación coalition governments maintained the neo-liberal economic policies of the Pinochet regime, they have also implemented social programs, although at much reduced levels than the Allende era, to reduce poverty and expand access to education and health care (Rector, 2005).

8.3. *Import-Substitution and the Welfare State*

From the 1930's to the mid-1970s, Chile's import substitution model of industrial development, which was promoted by the United Nations Economic Commission for Latin America (ECLA) and at that time was adopted by governments throughout Latin America, involved the use of discriminatory tariffs, exchange rate controls and tax policies to help establish national industries and protect them from overseas competition. During this period, Chile's ISI strategy was intimately connected with its Bismarkian social interventions to provide a comprehensive welfare state.

The logic of ISI was that since developing countries faced a declining terms of trade with advanced industrial countries and the infancy of their industries placed them at a competitive disadvantage vis-à-vis Western transnational firms, Latin American countries should reduce their dependence on the global economy by encouraging the local production of industrial goods. Protectionist trade policies were, therefore, used to help strengthen national firms to the point where they could compete with foreign producers (Prebisch, 1959, Prebisch, 1950).

Chile's import-competing industries supported trade protection since such policies limited foreign competition and produce economic rents for national firms. Since 1838, the Sociedad National de Agricultura (SNA), which represented the interests of Chile's landowning agricultural producers, secured legislation that imposed tariffs on agricultural imports. And by 1897, the political clout of the Sociedad de Fomento Fabril (SFF), that

represented the interests of Chile's industrial manufacturers was instrumental to the passage of Law 980, which raised tariffs on imported textiles and other manufacturing goods (Edwards and Lederman, 1998, pp. 31-32). Labor unions supported trade protection since it stabilized the national labor market by allowing domestic firms to provide full employment, which in turn strengthens the labor union's collective bargaining power (Barrera and Valenzuela, 1986). At the end of the Allende administration, Chile's import tariffs averaged 105 percent and were highly dispersed across a range of imported products where some products were subjected to nominal tariffs of more than 700 percent. Moreover, trade was severely constrained by a battery of quantitative restrictions. Some of these restrictions included import prohibitions of certain products and the maintenance of a multiple exchange rate system, which further discouraged imports (Edwards and Lederman, 1998, p. 3).

The ISI strategy also involved the nationalization of industries, especially foreign companies that the state considered crucial to national development. Protectionist trade policies were re-enforced by the successive nationalization policies of the Christian Democratic and Socialist governments of Edurdo Frei and Salvador Allende. In his state-of-the-nation address in May 21, 1969, President Frei unveiled plans for the "Chileanization" or part ownership of Chile's copper industry, which culminated in an agreement with Anaconda – the American copper company – for the "negotiated and progressive" nationalization of the company's major mines throughout the country. A similar agreement was also negotiated with the American owned Kennecott Copper Corporation that allowed the government's share of the companies' profits to increase from 72.6 percent to 91.8 percent (Sobel, 1974, p. 22-24). In explaining his economic policies in the months prior to his Presidential inauguration, Allende noted:

"We must recover our basic resources that are in the hands of foreign capital, especially American – copper, iron ore, nitrates, which are in your hands, the hands of American monopolies. Then we must nationalize the monopolies that influence the social and economic development of the country. To this we must add a serious wide-ranging profound agrarian reform, the nationalization of banking and state control over foreign trade" (Sobel, 1974, p. 33).

And in the first year of Allende's presidency, the Chilean Congress unanimously

approved a constitutional amendment that authorized the president to fully nationalize the copper companies of Anaconda, Kennecott and Cerro. All 158 senators and deputies who represented every major political party in Chile voted in favor of the reform. Although 60 percent of Chile's private banking system had already been nationalized by previous administrations, the Allende government accelerated this trend by nationalizing the subsidiaries of the Bank of America, the Bank of London and Citibank of New York. The government also nationalized the U.S-owned International Telephone & Telegraph Corporation (ITT), RCA Victor - the U.S-owned electronic corporation and the assembly plants of General Motors Corporation (Sobel, 1974, pp. 50-51; pp. 56-57; p. 79). In 1973, at the end of the Allende administration, the state controlled 80 percent of Chile's industrial production, 400 corporate enterprises and approximately 60 percent of the country's GNP (Collier and Sater, 1996, p. 342).

ISI was also an integral component of Chile's welfare state. The Allende government's expanded control over the country's industrial output was correlated with a massive increase in social spending. During the period of Chile's largest nationalization initiatives, social spending on health care, education, housing and social assistance, for each year form 1970-1973, more than doubled the annual average of the previous four years (See Table. 8.1).

In the 1940's, White Collar workers from the financial and manufacturing industries established their own health care system – the National Medical Services for Employees (SERMENA) that established a private provider system with private doctors. A limited public health care system was established in 1952, with the creation of the National Health Care Service (SNS), which only provided prenatal care and family planning. However, by 1971, the Allende government unified the health care systems into the *Servicio Unico de Salud* – a national health care system. The state built a network of hospitals and clinics in working class neighborhoods on the outskirts of major cities and provided care for every 44,000 inhabitants. The government also established the National Milk Plan that provided 3,470,000 persons with a ½ liter of milk a day to reduce malnutrition, which affected 50% of Chile' children in 1970. Spending on education increased primary and secondary school enrollments. Primary school enrollment increased from an annual average of 34% during the period 1960-70 to 65% in 1971 to

1972. Secondary school enrollment also grew at a rate of 18.2% during 1971-72 (Isreal, 1989, pp. 35-36). While Chile's state-run Social Security system – the *Servicio de Seguro Social* (SSS) was designed to serve the needs of miners, urban blue-collar and service workers, the Allende government extended coverage to informal workers and peasants and effectively transformed the social security system into a universal entitlement system (Hudson, 1994, Illanes and Riesco, 2007).

The nationalization initiatives of the state were also used to provide the working classes with employment and salary increases as well as empower the labor unions. In 1970, the Allende government signed an agreement with one of the country's largest unions, the Central Workers Union, which provided for the participation of workers in the planning and the administration of state-owned and mixed corporate enterprises, the reduction of unemployment by the provision of 180, 000 jobs and the creation of a Central Committee on Wages and Salaries to formulate new wage and salary policies. In negotiations with the government in 1971 for a new contract, Workers at the Chuquicamata copper mines were given a 21.8% pay increase plus a commitment by the Allende government to spend $3.7 million dollars during 1972 on social programs for the town of Chuquicamata (Sobel, 1974, p. 38; p. 71).

8.4. *The Economic and Political Crisis of the Welfare State*

By the early 1970's, there was growing evidence that Chile's ISI strategy and the welfare state that it supported was financially unsustainable. Social spending per person, between 1920 and 1970, increased by 38%, while GNP per capita increased by only 2.3% (Arellano, 1985, p. 414). Trade protectionism provided no incentive for domestic firms to become efficient, but merely encouraged rent seeking behavior. In addition, the small size of the domestic market never allowed domestic firms to reach economies of scale to be able to compete in export markets. Consequently, overall industrial production fell even among the nationalized industries. And the state's social policies that increased employment and the purchasing power of the working class coupled with the decline in industrial production gave rise to black market activities, shortages and inflationary pressures, which surpassed 200 percent by 1972. In addition, the falling prices for copper (Chile's main export) and the tripling price for imported oil plunged the balance of

payments into deficit, which forced the devaluation of the official exchange rate from 48 Chilean escudos to the U.S. dollar to 85 escudos to the dollar. And on the black market the currency fell from 150 to 300 escudos to the dollar (Collier and Sater, 1996, pp. 345-346, Hudson, 1994, Isreal, 1989, Sobel, 1974, p. 85).

The crisis in the macro economy led to a significant decline in tax revenues, which severely eroded the state's ability to finance its increasingly costly social programs. As a result of the Allende government's expansion of the social security system, there were 35 different pension funds and more than 150 social security programs for different occupational groups. Since the newly incorporated participants of the program secured by law new benefits that were denied to original participants (even when the programs of the new participants were added to existing pension funds), the social security system became inherently unequal and was in financial crisis by 1972. The state's support for the national health care program also became financially unsustainable given the fact that it was tied to the social security system (Hudson, 1994, Mesa-Lago, 1989).

Chile's economic crisis triggered a political crisis within Allende's coalition government. The Socialist being the largest party within the coalition continued to press Allende to accelerate the economic and social policies in Chile's transition to socialism. The PDC members of the coalition gradually shifted to the right and became the most important opposition to the Allende government and they actively promoted legislation that attempted to reverse the expansive growth of the state's acquisition of private capital. Given the fact that the Allende government expropriated the holding of American corporations, opposition also came from the U.S. government. The Nixon administration pursued a two-track policy towards Allende's government. Overtly, the administration cut U.S. aid to Chile and blocked Chile's request for financial assistance from the World Bank at a time when Allende's government needed it the most. Covertly, the Nixon administration worked to help destabilize the government by increasing aid to Chile's military and opposition political groups. With the growing economic crisis and political polarization within the Allende government, the military junta staged a coup d'état on September 11, 1973 (Isreal, 1989, pp. 263-269, Sobel, 1974, pp. 90-91).

8.5. *Economic Liberalization and the Retrenched Welfare State*

In formulating an economic strategy to arrest the economic crisis the junta relied heavily on the advise of the Chicago Boys, a group of Chilean neo-liberal economists who were trained at the University of Chicago under Milton Friedman and Arnold Harberger. The economic policies that were advocated by the Chicago Boys ended decades of ISI development in Chile and the comprehensive welfare state that it induced. The junta's Minister of Finance, in October 1973, stated that Chile's "best prospects for growth are in the opening to international competition" (Méndez, 1979, p. 63-64). The junta's economic policy was based on three objectives: the stabilization of the economy; the liberalization of trade; and the privatization of state holdings (Laban and Larrain, 1995, p. 116, Silva, 1993).

The stabilization policy involved a two-part strategy. Often referred to as 'shock treatment', the first part of the stabilization policy sought to eliminate inflationary pressures by cutting the fiscal deficit by 25% within the first six months of the military dictatorship.[16] The reduction of the fiscal deficit involved the retrenchment of public sector jobs and across the board cuts in the social programs of the welfare state (Friedman, 1975). Second, the stabilization policy also concentrated on arresting the balance of payments crisis by securing external financing from international creditors. By January 1974, the International Monetary Fund (IMF) approved a stand-by arrangement that allowed Chile to borrow U.S$94.8 million over 12 months to overcome the foreign exchange deficit of its balance of payments. The Inter-American Development Bank, in April of that year, approved a U.S$73.3 million loan to Chile, which was denied to the Allende government in 1972. In addition, a syndicate of international commercial banks that included Bankers Trust, Irving Trust, and First National City Bank and several Canadian banks opened a U.S$170 million line of credit to Chile. In addition, just two months after the coup d'état, Manufactures Hanover Trust Co. of New York extended a U.S$44 million loan to Chile's Central Bank and a combination of other American and Canadian commercial banks offered Chile additional loans that totaled U.S$150 million. For its part, the U.S. government also extended loans totaling U.S$52 million to finance Chile's imports of American corn and wheat (Sobel, 1974, p. 161; p. 173).

[16] During this time the junta also replaced the escudo with the peso, with 1 peso = 10, 000 escudos.

The junta's liberalization policy dismantled the Allende government's differentiated tariff structure of rates between 10% and 35%. The objective was to reduce tariffs to a uniform rate of 10% by 1979 (Edwards and Lederman, 1998, p. 4). In fact, as shown in Table 8.2, the junta successfully implemented its trade reforms by significantly reducing tariffs from their 1973 levels to 10% by 1979. However, this pattern was temporarily suspended in 1982-83, when Chile experienced its worst economic crisis since the 1930s. Table 8.5 shows that during these years the economy recorded negative growth rates of -10.3% and -3.8% respectively. In addition to tariff reductions, the junta also gradually reduced and eventually eliminated import prohibitions and import licenses, which served as non-tariff barriers to trade (see Table 8.3). While trade liberalization was incongruent with the rent seeking interests of Chile's import competing firms, trade reforms found strong political support among export-oriented industries that were unable to realize economies of scale under ISI. Exporting firms in Chile's mining and wine industries gained from trade liberalization and the export promotion policies of the junta. Since trade liberalization lowered the price of imported inputs of production, the reform also benefited firms in the construction and transportation industry which participated in several industrial strikes against the Allende government that temporarily paralyzed the domestic economy during 1970-73 (Campero, 1991, Edwards and Lederman, 1998, p. 33).

Three months after the coup d'état the junta implemented its privatization policy by announcing that 115 nationalized companies, including 12 that were owned by foreign capital would be returned to their former owners. The first of these companies were 4 U.S-owned motion pictures distributors, the U.S-owned General Tire International and Dow Chemical. Chile's State Development Corporation announced that another 88 business and industries would also be returned to their former owners because they were illegally expropriated by Allende's Popular Unity government. The junta also signed an agreement with General Motor Corporation that effectively returned ownership of the nationalized assembly plants back to the company (Sobel, 1974, p. 162; p. 173). On December 1974, the junta passed a decree that prohibited the state ownership of commercial banks (Edwards and Lederman, 1998, p. 38).

The junta's privatization policies, which also liberalized the capital markets, were

reinforced by the repression of labor unions that aligned themselves with the Allende government and implemented measures that severely weakened the labor movement. On September 18, 1973, the junta issued a decree that banned the presentation of union demands and suspended the right of union leaders to use paid working hours to address union issues. Other decrees were issued that made it easier for private firms to fire workers, including the firing of workers who lead, in what the junta considered an illegal strike. The junta implemented measures that suspended previous agreements with unions regarding salary increases, benefits and other remunerations to their members. The junta's anti-labor diktat also suspended unions' rights for collective bargaining and the automatic adjustment of pensions to compensate for inflation (Arellano, 1985, p. 415, Barrera and Valenzuela, 1986, p. 235-236). Consequently, union membership drastically declined from 65% of Chile's total wage earners in 1973, the last year of the Allende government, to less than 20% on average for the entire 1980s (Cortázar, 1997, p. 240).

As shown in Table 8.4, the neo-liberal stabilization policies that slashed the fiscal deficit achieved their objective by drastically reducing inflation from a high of 605.9% in 1973 to 21% in 1989, the last year of military rule in Chile. Controlling inflation and the stabilization of prices allowed Chile's industry to achieve greater economies of scale as they benefited from the privatization of capital markets and trade liberalization, which effectively integrated Chile into the global economy. As a result, Chile's annual growth rates during the years of military rule, with the exception of 1982-83, exceeded the growth rates of the previous democratic governments as well as its Latin American neighbors and established the economic conditions that have sustained growth into the transitional years under democratic rule (see Table 8.5).

The success of the junta's neo-liberal policies in resurrecting the economy came at the expense of Chile's welfare state and ended five decades of continuous social spending that was financed by public revenues. As a consequence of the junta's stabilization policies to reduce inflation, social spending as a proportion of GNP was reduced from 20% in the second half of the 1960s to 14% by the start of the 1980s (See Table 8.6). Combined with the junta's privatization policies, the allocation of education, housing and social security was largely determined by market forces with increased participation by the private sector.

In terms of education reform, the junta drastically reduced expenditures on public schools and placed the burden of administering and supporting the education system on local municipalities and parents. Between 1980 to1990, government spending on education was cut by 27%. Schools that were located in affluent municipalities were able to compensate for the shortfall in government funding but schools in poor districts had no alternative source of funding (Delannoy, 2000). Instead, in 1981, the junta introduced a nationwide school voucher program that gave parents the choice between sending their children to private or public schools. The program created a dynamic market for education with more than a thousand private schools entering the market for profit, which increased private enrollment rate from 20% to 40% by 1988 and exceeded 50% in Chile's urban areas. However, the market forces that were unleashed by the voucher program did not improve education outcomes. Results from the international test scores in math and science (TIMSS) in which Chile participated in 1970 and 1999 showed that Chile's ranking, relative to the other 12 countries that participated in those years, worsened (Hsieh and Urquiola, 2002). Higher education was also market driven. Under the Allende government university tuition had traditionally been free. However, with the reform of higher education students were required to pay an enrollment fee. In addition, the level of state's funding to the universities was based on the proportion of students who entered universities with the highest scores on the national aptitude test. Universities were forced to compete for state funding in their effort to recruit the most qualified students. The reform of higher education significantly reduced access to students from working class families who could not afford university fees or whose test scores were not competitive to be recruited by Chile's financially strapped universities (Arellano, 1985, pp. 114-116).

The Allende government established, *Servicio Unico de Salud*, a national health care system by merging SERMENA – the private health care system for white-collar workers with SNS – the public system for blue-collar workers. The junta's reform of health care gave participants the option of switching to private health care institutions. Eight percent of the participants that switched took with them 40% of the revenues of the public health care. While privatization increased the quality of health care for the affluent that switched, the access to quality health care service among the remaining low-income groups suffered from a sharp decline in state funding (Collier and Sater, 1996, pp. 373-

374, Laban and Larrain, 1995, 123).

From the 1950s, the state played a major role in Chile's low-cost housing development and built 60% of the houses between 1960 and 1972. The junta drastically slashed public spending on housing to less than half of its 1970 levels, which increased Chile's housing deficit. In addition, the junta also reduced subsidies on housing loans and increased the participation of the private sector in the development of new homes and municipal buildings. Housing was also allocated to income groups that met certain savings goals, which effectively reduced poor families' access to housing since they could not meet the junta's savings criteria (Hudson, 1994).

The military junta closed the previously unfunded *pay-as-you-go* state run pension system in which benefits were paid directly from taxes and social security contributions. The *pay-as-you-go* system was replaced by funded personal retirement accounts that were administered by private Pension Fund Managing Corporations, often referred to as Administradores de Fondos de Pensiones (AFPs) (Soto, 2007). Initially, the state supervised the pension system and required that assets were deposited in the government debt or bank deposits. However, by the mid to late 1980s, pension fund assets have increasingly been deposited in private domestic securities and mutual funds (Borzutzky, 2003, DuPont, 1996, Kritzer, 1996, Mitchell, 1998). The reform of the pension system removed the share of the employer's contribution to the pension system by terminating the social security tax and established a mandatory contribution rate of 10% of employee's monthly wages (Borzutzky, 2001, Borzutzky, 2003, Castiglioni, 2001). The privatization of the pension system also provided for two separate poverty safety nets. First, workers who contributed to their personal accounts for at least 20 years and who did not accumulate sufficient funds in their accounts to maintain a minimum standard of living upon retirement were entitled to a government-financed "top up" benefit called the minimum pension guarantee. Second, elders who either fail to contribute for 20 years or were never in the system at all were entitled to a PASIS, which was a small noncontributory means-tested benefit that was worth half the minimum pension (Borzutzky, 2003, Kritzer, 1996, Mitchell, 1998).

While Chile's privatized pension system has been hailed as a success and a model for pension reform, the new system was limited in its coverage. Before the junta's

privatization, the coverage of the public pension system accounted for 72 percent of the population, while the private pension system covered just 60 percent by 2000. The problem of coverage is rooted in the structure of Chile's labor market, which is characterized by high levels of self-employment and an informal labor force. Among the self-employed, who account for 28 percent of Chile's labor force, only 4 percent were engaged in the new pension system in 2000. Approximately, 1.5 million self-employed workers were not enrolled in the system (Borzutzky, 2003, Mideplan, 2000). The 10% mandatory employee contribution coupled with the nature of Chile's labor market reduces the incentive for low-wage workers to contribute to the privatized pension system. As a result, only a minority from Chile's labor force makes regular contributions to the pension system, which reduces the likelihood that participants will accumulate sufficient funds in their personal accounts to maintain a minimum standard of living upon retirement. In 2006, projections that were based on the history of worker contributions demonstrated that a large share of the pension system's participants would indeed face financial hardship upon retirement. And 45% of participants would also have pensions below the minimum pension guarantee threshold and would not have met the level of contribution required to qualify for the subsidized government benefit (Solange et al., 2006). An additional problem with the privatized pension reforms is that the high administrative costs, which reduce retirement benefits, also had a negative effect on the level of participation in the system. Administrative cost that is paid to pension fund managers reduce the rate of benefits from 12.7 percent before the reforms to 7.4 percent after their implementation (Kay, 1997).

8.6. *Democratic Transition and the Welfare State: Continuity and Change*

In the 1988 plebiscite the Chilean people voted to reject 8 more years of military rule in favor of democratic elections in 1989 that brought the Concertación coalition government, led by Patricio Aylwin, to office. The new government continued the neo-liberalization economic policies of the junta and went even further in the process of integrating Chile into the global economy. Immediately upon taking office, the Aylwin government reduced the uniform tariff from 15% to 11% in 1991. Unilaterally reduced, even further, the uniform tariff from 11% to 6% from 1999 to 2003 (Bravo-Ortega, 2006,

p. 11; p. 13). And from 1997 to 2009, various Concertación administrations have also extended trade liberalization by negotiating a series of bilateral and multilateral free trade agreements. Currently, Chile has signed 13 Free Trade Agreements, two Free Trade association agreements with MERCOSUR and the European Union and five Economic Complementation Agreements[17] (See Table 8.7).

However, while continuing and in some respects deepening the free market policies inherited from the military junta, the Aylwin government also implemented changes in Chile's social welfare policies. In terms of education the government expanded spending for elementary, secondary and post-secondary schools. Table 8.8 shows that public expenditure on education increased from U.S $940.3 million in 1990 to U.S $3017.7 million in 2001. Moreover, pubic spending per student in primary, secondary and post-secondary schools almost tripled the amounts spent from 1990 to 2002. Consequently, relative to the years under military rule, working class children have greater access to public education. The dropout rate among children from low income families have been reduced from 4%, for the first half of the 1990s, to 2% in 1997 (Cox, 2004, p. 5). There was also a marked improvement in the learning performance among schools with different systems (municipal schools or government subsidized private schools) and these improvements were not biased in favor of private schools. The improvement in learning performance, access and retention rates among low-income children were also a result of the expansion and improved forms of social assistance. The expansion in government funded social assistance included food, health care, school-materials supply and grant programs. The main support for primary education came in the form of school meals and health care. In 2003, 867,589 primary students received school lunches, while another 100,415 received eyeglasses and hearing aids (Cox, 2004, p. 7; pp. 12-17).

In terms of housing, the government continued the practices of the junta by allowing private sector participation in the construction of new homes but increased public spending on housing by 50%. The government also changed the eligibility requirements for public housing programs to benefit low-income families and provided

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[17] These are agreement to establish a framework for negotiations leading to the creation of free tra de.

subsidies to poor neighborhoods to fund utilities. And while the government maintained the structure of privatized heath care, it increased funding for the public health care portions of the system that largely served the poor, especially primary care services. The government increased the salaries of health workers in the public sector and gave more authority to local and regional governments over the distribution of equipment and health-care resources and provisions (Hudson, 1994).

The privatized structure of Chile's pension system was maintained by various Concertación administrations. The Aylwin government, however, increased the minimum pension that was paid of what remained of the state-run *pay-as-you-go* system by 30% (Hudson, 1994). In 2006, the Concertación government led by Michelle Bachelet moved to reform the private pension system to address the problems of coverage and the low participation among low income and the self-employed members of the labor force. Referred to as the "reform of the reform" became law in 2008 and sought to strengthen Chile's private pension system. The latest reforms created a new and more generous non-contributory "solidarity pension" that replaces both the means-tested PASIS benefit and the minimum pension guarantee that was established by the military junta. In 2012 when the reform is fully phased in, elders with family incomes of less than 60% of the national average will be eligible for a full solidarity pension provided that they have no contributory pension benefit. Under the pension system that was created by the junta, low-income workers had little incentive to contribute once they qualified for the minimum pension guarantee. Under the new system, every additional income that is contributed to the personal accounts will earn an extra return. The reform includes other measures that are designed to increase participation in the system. The reforms make participation by the self-employed mandatory. This requirement will be phased in over a seven-year period. The reforms also seek to boost the participation of young low-income workers by paying subsidies to their employers who offer them formal-sector jobs. The personal retirement accounts for women will also be supplemented to compensate for time spent as non-contributors, while providing child care at home. In addition, the new reforms include measures that will reduce the administrative fees that are charged by pension fund managers plus measures that will improve competition among AFPs (Jackson et al., 2009, pp. 32-33) .

8.7. *Future Challenges of the Welfare State*

There is tension between the Concertación government's social welfare initiatives and its commitment to deepen Chile's integration into the global economy. This tension will become more pronounced as Chile's aging population increasingly demand greater outlays in social assistance. In addition, since Chile's economy is deeply integrated into the global market, price fluctuations for copper and a prolonged recession in global capital markets could undermine the financial viability of public expenditures in education, housing and health care as well as threaten pension funds that are increasingly invested in overseas capital markets (OECD, 1998, pp. 17-18). While the Concertación government, in the context of maintaining its domestic economic neo-liberal agenda, has benefited from the sustained growth of the global economy over the last two decades to fund Chile's social programs, the recent collapse of global financial system and the subsequent recession in major industrial economies will most likely force the government to retrench the quasi nature of the welfare state.

8.8. *Tables*

Table 8.1: Social Spending During the Allende Government (millions U.S. dollar)

	1965-69*	1970	1971	1972	1973
Health	139.4	154.2	211.6	247.8	237.2
Education	281.9	362.0	473.2	524.2	354.9
Housing	133.7	108.6	229.0	228.3	220.9
Child Assistance	0.3	0.7	0.6	0.8	0.7
Social Assistance	6.9	7.8	8.4	10.6	5.3
Social Subsistence	0.8	1.9	1.5	0.8	0.3
TOTAL	562.8	635.2	924.2	1012.6	828.5
% of total Expenditure+	32.2	28.9	33.5	34.3	21.6

*Average
+Excluding debt service expenses
Source: World Bank, Chile, An Economy in Transition (Washington, D.C., 1980), p. 165.

Table 8.2: Itinerary of Import Tariff Reductions, 1973-1991

Date	Maximum Tariff	% of Items Subject to Tariff	Tariff Mode	% of Items	Average Tariff
December 31, 1973	220	8.0	90	12.4	94.0
March 1, 1974	200	8.2	80	12.3	90.0
March 27, 1974	160	17.1	70	13.0	80.0
June 5, 1974	149	14.4	60	13.0	67.0
January 16, 1975	120	8.2	55	13.0	52.0
August 13, 1975	90	1.6	40	20.3	44.0
February 9, 1976	80	0.5	35	24.0	38.0
June 7, 1976	65	0.5	30	21.2	33.0
December 23, 1976	65	0.5	20	26.2	27.0
January 8, 1977	55	0.5	20	24.7	24.0
May 2, 1977	45	0.6	20	25.8	22.4
August 29, 1977	35	1.6	20	26.3	19.8
December 3, 1977	25	22.9	15	37.0	15.7
June 1, 1978	25	21.6	10	51.6	13.9
June 1, 1979	10	99.5	10	99.5	10.1
March 23, 1983	20	99.5	20	99.5	20.0
February 9, 1984	35	99.5	35	99.5	35.0
March 1, 1985	30	99.5	30	99.5	30.0
June 29, 1985	20	99.5	20	99.5	22.0
January 5, 1988	15	99.5	15	99.5	15.0
June 1, 1991	11	99.5	11	99.5	11.0

Source: Ffrench-Davis, Ricardo. (1987) Import Liberalization: The Chilean Experience, 1973-1982. In *Military Rule in Chile: Dictatorship and Oppositions*, edited by J.S Valenzuela and A. Valenzuela. Baltimore and London: The Johns Hopkins University Press.

Table 8.3: The Elimination of Non-Tariff Barriers (NTB's)

Instruments	The Situation in 1973: The Number of Product Categories Affected	Dates when Relaxed and Eliminated
Import Prohibitions	187	August 1976: Down to 6 products April 1978: Down to 5 products August 1981: All eliminated
Prior Deposits*	2,872	January 1974: Wavers granted August 1976: Eliminated
Import Licenses**	2,278	January 1974: Eliminated

Source: Sebastian Edwards, and Daniel Lederman. (1998) The Political Economy of Unilateral Trade Liberalization: The Case of Chile. In *NBER Working Paper Series*. Cambridge, MA: National Bureau of Economic Research, p. 60.
*Required a 90-day non-interest bearing deposit at the Central Bank, which was equivalent to 10% of the value of the imported item.
**Government approval was required prior to importation.

Table 8.4: Chile's Inflation, 1973-89 (% change)

Year	% change
1973	605.9
1974	369.2
1975	343.2
1976	197.9
1977	84.2
1978	37.2
1979	38.0
1980	31.2
1981	9.9
1982	20.7
1983	23.1
1984	23.0
1985	26.4
1986	17.4
1987	21.5
1988	12.7
1989	21.4

Source: Sebastain Edwards and Alejandra Cox Edwards, Monetarism and Liberalism: The Chilean Experiment (University of Chicago Press, 1991), pp. 28; p. 213)

Table 8.5: Chile vs. Latin America: Average Annual Growth Rates (percentages), 1965 – 2008 (Alessandri, Frei, Allende, Pinochet and Concertación Administrations)

Year	Chile	Latin America
	The Alessandri Years	
1961	4.8	4.3
1962	4.7	3.5
1963	6.3	7.3
1964	2.2	5.1
	The Frei Years	
1965	0.8	4.7
1966	11.2	4.5
1967	3.2	6.0
1968	3.6	7.1
1969	3.7	6.8
1970	2.1	6.7
	The Allende Years	
1971	9.0	6.8
1972	-1.2	7.0
1973	-5.6	8.3
	The Pinochet Years	
1974	1.0	7.0
1975	-12.9	3.8
1976	3.5	5.4
1977	9.9	4.8
1978	8.2	5.1
1979	8.3	6.5
1980	7.5	5.9
1981	5.3	1.7
1982	-10.3	-1.4
1983	-3.8	-2.5
1984	8.0	3.7
1985	7.1	2.6
1986	5.6	4.1
1987	6.6	3.4
1988	7.3	0.5
1989	10.6	0.9
	The Concertación Years	
	Patricio Aylwin Govt.	
1990	3.7	0.3
1991	8.0	4.6
1992	12.3	3.9
1993	7.0	3.7

Table 8.5: Chile vs. Latin America: Average Annual Growth Rates (percentages), 1965 – 2008 (Alessandri, Frei, Allende, Pinochet and Concertación Administrations), (continued)

	Chile	Latin America
	The Concertación Years	
	Eduardo Frei Ruiz-Tagle Govt.	
Year		
1994	5.7	4.7
1995	10.6	0.6
1996	7.4	3.5
1997	6.6	5.5
1998	3.2	2.4
1999	-0.8	0.2
	Ricardo Lagos Govt.	
2000	4.5	3.9
2001	3.4	0.3
2002	2.2	-0.5
2003	3.9	2.2
2004	6.0	6.1
2005	5.6	4.9
	Michelle Bachelet Govt.	
2006	4.6	5.6
2007	4.7	5.8
2008	3.2	4.4

Source: Data for the years 1961-1981 was adapted from Jorge Rodriguez Grossi, ed, Perspectivas Economicas Para La Democracia: Balance y lecciones Para La Experiencia Chilena (Santiago: Instituto Chileno de Estudios Humanisticos, 1984), p. 32. Data for the years 1982-2008 was adapted from the World Bank's World Development Indicators, 2009.

Table 8.6: Government Social Spending, 1961-1981 (% GDP)

Year	% GDP
Alessandri Years	
1961	17.0
1963	16.3
Frei Years	
1965	20.0
1967	20.1
1969	18.7
Allende Years	
1970	19.9
1971	25.2
1972	25.8
Pinochet Years	
1974	17.6
1975	18.3
1977	17.4
1979	15.4
1981	14.3

Source: Adopted from, Arellano, José-Pablo. (1985) Social Policies in Chile: An Historic al Review. *Journal of Latin American Studies* 17:397-418.

Table 8.7: Chile: Trade Agreements of the Concertación Government

Bilateral Free Trade Agreements	Free Trade Associations	Economic Complementation[+] Agreements
1997 - Canada	1996 - MERCOSUR	1993 - Bolivia
1998 - Mexico	2003 - European Union	1993 - Venezuela
1999 - Central America		1994 - Colombia
2002 - Costa Rica		1995 - Ecuador
2002 - El Salvador		1995 - Peru
2004 - EFTA[#]		
2004 - U.S		
2004 - South Korea		
2006 - Panama		
2006 - China		
2007 - India[*]		
2007 - Japan		
2009 - Australia		

[*] Trade agreement comes with safe guards.
[#]EFTA countries include: Iceland, Liechtenstein, Norway and Switzerland.
Source: Adopted from McGill University's Preferential Trade Agreement Database, which can be accessed at http://ptas.mcgill.ca
[+]Economic Complementation is an agreement to establish a framework for negotiations leading to the creation of free trade. Information on these agreements were adopted from, Tim Martyn, *Complete Guide to Regional Trade Agreements of the Asia-Pacific*. The Australian APEC Study Center, 2001.

Table 8.8: Public Expenditure on Education by various Concertación Administrations; Spending per Student, by Level, 1990-2002

	Public Expenditure on Education ($US Million 2001)	Ministry of education, spending per student Each year, by educational level (US$ Million 2001)		
Year		Primary	Secondary	Post-secondary
1990	940.3	231.8	213.8	823.3
1991	1035.5	244.8	216.5	1109.3
1992	1176.4	270.1	270.7	1111.9
1993	1328.5	302.8	296.3	1097.4
1994	1461.3	325.5	324.5	1148.0
1995	1620.2	371.0	396.3	1180.0
1996	1840.6	402.3	441.1	1240.1
1997	2017.8	443.4	494.3	1319.5
1998	2214.7	480.5	546.0	1333.0
1999	2412.3	518.7	550.0	1417.1
2000	2617.8	539.5	609.6	1374.0
2001	2788.8	582.8	623.5	1360.5
2002	3017.7	N/A	N/A	N/A
%Growth in per student spending		151.4	191.7	63.5

Source: Cristián Cox. 2004. Innovation and reform to improve the quality of primary education: Chile (EFA Education for All Global Monitoring Report 2005, The Quality Imperative), p. 34.

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Chapter 9

Globalization and the Welfare State in Spain

9.1. *Introduction*

From the autocratic regime of Francisco Franco, which pursued an ISI industrial strategy that featured protectionist trade policies and where social benefits were developmental in nature and limited to workers in the industrial sector, to the Socialist government (PSOE) of Manuel Chaves González where social benefits were universal in nature but commensurate with the government's neo-liberal economic strategy, the changing nature of Spain's welfare state is largely correlated with variations in the interaction between the country's integration into the global economy and changes within its domestic political system.

This chapter begins with a brief overview of Spain's political history and then highlights the ways in which the ISI industrial strategy of Franco's dictatorship, unlike Chile's military regime but similar to South Korea's military rulers, established a developmental welfare state with limited social benefits. The chapter then discusses how Franco's ISI developmental strategy undermined economic growth and precipitated the crisis of Spain's developmental welfare state. The chapter then examines how the Stabilization Plan that was adopted by Franco's regime and continued by the transitional government to arrest the country's economic crisis gradually liberalized the economy, while facilitating reforms in Spain's social welfare policies. This is followed by a discussion of how the restoration of democracy, especially during the leadership of the PSOE government, deepened Spain's integration into the global economy, significantly expanded the country's social welfare policies but increasingly tied this expansion to the growth of the market economy. The chapter concludes with a discussion of how Spain's aging population challenges the future sustainability of the country's social policies.

9.2. *Historical Overview*

Franco and the military participated in a failed coup d'état against the Popular Front government, which led to the Spanish civil war from 1936 to 1939. During this conflict, Franco emerged as the leader of the Nationalists against the Popular Front

government. After winning the civil war with assistance from Hitler's Germany and Mussolini's Italy, Franco dissolved the Spanish Parliament and established an autocratic regime from 1939 until his death in 1975. And during World War II Franco permitted Spanish volunteers – the Blue Division – to join the Nazis in the fight against the Soviet Bolsheviks on the Eastern Front as re-payment for Germany's support during the civil war. In 1946, the United Nations (UN) imposed diplomatic sanctions against the Franco regime for its support of the Axis powers and considered using economic sanctions to promote democratization in Spain (Baklanoff, 1978, Harrison, 1985). The post-war diplomatic isolation and the threat of economic sanctions strengthened economic nationalism as the Franco regime's control of foreign trade and the adoption of an ISI development strategy induced the establishment of a developmental welfare state (Anderson, 1970).

Before his death, Franco declared that Juan Carlos would be his successor as King. With this declaration a constitutional monarchy was established in 1977, which oversaw the formation of a political confederation by several centrist political parties that led to the creation of the Union of the Democratic Centre (UCD). In the elections of June 15, 1977 the UCD received 34.4% of the vote taking 166 of the 350 seats in the Congress of Deputies. After 38 years of dictatorship, the transitional UCD led government governed in a coalition with rightist and leftist parties in the Congress. The UCD ruled the country until its defeat to the PSOE in the 1982 general election in which it received only 6.7% of the vote and 11 seats. The party's conservative electoral base defected and gave their support to the newly created alliance between the Democratic Popular Party (PDP) and the Popular Alliance (AP). During its tenure in office the PSOE implemented a number of neo-liberal economic reforms that set the stage for Spain's entrance into the European Economic Community (EEC). The alliance between the PDP and AP eventually led to the establishment of the Peoples Party (PP) - the principal conservative political opposition that defeated the PSOE in the 1996 general election.

9.3. *Import-Substitution and the Developmental Welfare State*

Spain's post-war diplomatic isolation and the threat of economic sanctions against the Franco regime reinforced the protectionist tradition that characterized Spain's trade

policy since the late 1800s (Oliver-Alonso and Valles, 2005, World Bank, 1963). The threat of economic sanctions gave impetus to economic nationalism, which created the conditions in which the ISI developmental strategy was adopted (Pittsburgh Post-Gazette, 1947). The Franco regime established the National Institute of Industry (INI) to give incentives to domestic firms to manufacture products that would substitute for imports (Anderson, 1970). In addition to high tariffs, import licenses and quotas were frequently used to strengthen national firms by restricting competition from foreign importers (Anderson, 1970, Baklanoff, 1978).

Franco's trade policy was consistent with the logic of ISI development. Technological inputs used in domestic industry were imported from behind high trade barriers. The regime's trade policies consisted of a system of multiple exchange rates, the importation of industrial inputs, quotas and state-monopolized trade agreements. The system of multiple exchange rates not only restricted trade but also severely discouraged foreign investment (World Bank, 1963). Imports were limited to technological inputs such as raw materials, semi-finished products, machinery and various chemical inputs that were critical for domestic industrial production. Thirty-eight percent of Spain's imports between 1960 to 1961 consisted of industrial inputs and sixty-two percent consisted of quotas and state-monopolized trade (Baklanoff, 1978). The composition of trade from the 1950s to the 1970s, as shown in Table 9.1, largely reflected the economic autarchy of the Franco regime, which would prove unsustainable with the onset of the near collapse of the economy by the early to mid-1950s.

Given the developmental nature of Franco's welfare state, social benefits were limited to workers in the industrial sectors (Cousins, 1995, Gibbons, 1999). To encourage the worker productivity, the regime introduced compulsory insurance for retirement and health care for workers in the industrial sector (See, Table 9.2). In 1942, the regime provided Health Insurance for low-income industrial workers and their dependants. In 1947, the Old Age and Invalid Insurance Program was introduced, which provided old age subsidies for disabled and low-income industrial workers who were respectively over the age of 60 and 65 years. Private sector firms' contribution to the program was based on a pay-as-you-go system, while public sector firms made contributions via the *Regimen de Clases Pasivas* (RCP). In 1946, health care benefits covered just 30% of population

(Cousins, 1995).

9.4. *Economic Crisis, Liberalism and the Reform of the Developmental Welfare State*

As a result of the adverse residual effects of the civil war and the failure of Franco's ISI development strategy, Spain was far more economically retarded in 1940s than in the previous decade. By the early 1950s, the ISI model proved inadequate to generate economic growth. Spain's per capita GDP was barely 40 percent of the average for Western Europe countries. The country experienced high levels of inflation, the tripling of consumer prices and negative growth rates in some years. The ISI-induced economic crisis, like Allende's Chile, led to the growth of the black market and rationing (Solsten and Meditz, 1988). Moreover, the protectionist trade policies of ISI undermined Spain's technological development and depleted the country's foreign exchange reserves. Such reserves, which were US$58 million in 1958, dropped to US$6 million by mid-1959. And given the growing demands of the emerging middle class for imported food and luxury items coupled with the regime's restraints on foreign trade, exports collapsed and the value of the Spanish peseta fell on the black market, all of which increased the country's balance of payments deficits (Oliver-Alonso and Valles, 2005, 184, Solsten and Meditz, 1988).

To pull Spain form the economic crisis, the Franco regime adopted the recommendations for liberal economic reforms that were advocated by a group of developmental technocrats that included bankers, industrial executives, some academic economists and members of the semi-secret Roman Catholic lay organization - Opus Dei (Giner, 1986, Moreno, 2001). An important aspect of these reforms called for an overhaul of the tax collection system, which increased tax revenues, and coupled with a program of monetary and fiscal restraints the public sector, by 1958, were no longer experiencing deficits but reported a surplus. In addition, Spain joined the International Monetary Fund (IMF), the World Bank, the Organization for Economic Development and Cooperation (OECD) and the General Agreement on Tariffs and Trade (GATT). These institutions brought about significant reforms to Spain's trade policies through a series of initiatives, which included the introduction of a single exchange rate regime and the liberalization of price controls and trade restrictions (Solsten and Meditz, 1988). In implementing these

reforms, tariff rates (both nominal and effective) were significantly reduced. The average level of tariffs declined by 21 percent from 18.7 percent in 1961 to 15.5 percent in 1970 (Baklanoff, 1978, Heston et al., 2006).

The liberal economic reforms allowed the Franco regime to avoid the possibility of suspending its debt payments to foreign banks that held Spanish currency, and by the end of 1959 Spain's balance payments showed a US$100-million surplus. The reforms, moreover, facilitated a steep increase in foreign direct investment between 1960 and 1974 that amounted to US$7.6 billion, which later contributed to the growth of the economy by an impressive 7 percent from 1962 to 1974 (Oliver-Alonso and Valles, 2005, Solsten and Meditz, 1988).

However, the initial effect of these reforms was deflationary and recessionary as they significantly deteriorated real incomes and raised unemployment in the first years of their implementation. The rise in unemployment and reduced wages led to the emigration of approximately 500,000 Spanish workers to other West European countries in search for employment. In a country where social policies were limited the negative effects of the reforms on the Spanish working class induced a crisis in the developmental welfare state. In addition, although the Franco regime outlawed collective bargaining and organized labor unions, the frequency of strikes among industrial sector workers drastically increased, which in turn triggered the growth of various social movements that called for greater democratization and an expansion of the welfare state (Hipsher, 1996, Hooper, 1986, Mangen, 2001, Ramon, 1985, Solsten and Meditz, 1988).

In response to the growing dissatisfaction among the industrial working class, the Franco regime sought to modernize Spain's social policies in an attempt to appease striking workers as well as to increase the efficiency of existing social programs. There were no attempts to transform Spain's limited developmental welfare state into one that provided universal access to social benefits, which was the standard for most countries in Western Europe (Rodriguez, 1993). As shown in Table 9.2, the regime introduced unemployment and illness insurance and social security programs that largely targeted workers in Spain's industrial sectors. The provision of social security benefits were based on the occupational category of workers and the level of contributions provided by the affiliated private and public sector firms (Cousins, 1995, Lieberman, 1982, Rodriguez,

1993). In addition, the regime created temporary work programs that were designed to provide employment relief from the recessionary effects of the liberal economic reforms (Lieberman, 1982, Mangen, 2001). Even with the attempts to modernize social policy, welfare spending in Spain remained at 4 percent of GDP throughout the 1960s, which was far below the standard of Western European countries (Mangen, 2001).

9.5. *The Oil Crisis, the Transitional Centrist and the Developmental Welfare State*

The return to democracy in Spain correlated with the quadrupling of imported oil prices. And given the fact the Spain imported 70% of its energy, the oil price shocks of the 1970s produced an inflationary effect on economic output. However, since the political capital of the centrist government of Adolfo Suarez Gonzalez was largely spent on drafting the new constitution and negotiating the terms for the transition to democracy, the government failed to implement the necessary economic policies that would help the country adjust to the inflationary pressures of the global economy. Consequently, industrial productivity plummeted, which was followed by a sharp increase in wages and consumer prices. As the economy contracted, Spain experienced a reversal in its migration trends due to the economic recession throughout Western Europe as well as an increased outflow of labor from the rural areas that sought diminishing job prospects in the cities. Together, these factors contributed to the sharp increase in the country's unemployment. The recessionary effects of the oil price shocks and government inaction resulted in job losses for 1.5 million workers and by 1982 – the last year of transitional government - unemployment stood at 17 percent (Harrison, 1985, Mangen, 2001, Solsten and Meditz, 1988).

The negotiations between the Suarez government and the political opposition produced the - *Pactos de la Moncloa* (The Moncloa Pacts) in October 1977, which was a series of agreements that defined the process of democratization. These agreements guaranteed a free press, the right of labor unions to organize, the legalization of political parties, the submission of the military to civilian authority, the establishment of local government through open elections, and immunity for members of Franco's regime for actions taken during the dictatorship. The creation of a new constitution via a referendum

in December 1978 formalized Spain's transition to democracy (Oliver-Alonso and Valles, 2005).

The Moncloa Pacts also established the basic structure of Spain's limited welfare state during the transitional period. In terms of welfare reform, the Suarez government was similar to the Franco regime in that it sought to improve the efficiency and the quality of social services under the existing welfare system by restructuring the fragmentary and duplicative ways in which agencies delivered welfare benefits (Mangen, 2001). But more importantly, the Moncloa Pacts created a framework that guided the government's use of social policy to compensate the industrial working class during the economic crisis. In this regard, the government expanded unemployment benefits for industrial workers by extending unemployment entitlements from 12 to 18 months (McMillion, 1981, OECD, 1984). Health care coverage was also extended to self-employed professionals and government subsidies were given to private firms as an incentive to create industrial jobs (Baklanoff, 1978). However, the Moncloa Pacts between the Suarez government and the political opposition made no provision for a comprehensive reform of Franco's developmental welfare state. Such reforms would later emerge under conditions of greater political democratization and the deepening of Spain's economic integration into the European community.

9.6. *Neo-Liberal Socialists, European Integration and Comprehensive Welfare Reform*

When the PSOE took office in October 1982, the socialist government inherited an economy where inflation was running at an annual rate of 16%, the trade deficit stood at US$4 billion, the public sector experienced large deficits, and Spain's foreign exchange reserves were nearly depleted. But having secured an absolute majority in both houses of the Spanish parliament, the socialist government combined its agenda for comprehensive social reform with a neoliberal economic strategy and was able to implement unpopular economic adjustment measures that brought the economy back into balance (Magone, 2004, Solsten and Meditz, 1988).

To reduce the public sector deficit, the government brought the debt-ridden social security system into better balance. The government passed its pension reform legislation in 1985, which involved substantial cuts in benefits and saved US$600 million (Beremo

and Gacia-Duran, 1994, p.109). And through a series of privatization initiatives the socialist government sought to expand the role of the private sector in the economy. These initiatives included the closing of state-run corporations that were unprofitable and privatizing others that belonged to the state holding company INT (National Industry Institute). In other instances, the government downsized state-owned companies in the coal, iron and steel industries. PSOE also passed legislation that ended the state's monopoly of the telecommunications industry and liberalized the energy sector by allowing the pipeline network of Repsol – the state owned Oil Company – to be used by private competitors. In addition, PSOE slashed corporate taxes by 8 percent to improve the competitiveness and profitability of Spanish firms (Polavieja and Richards, 2001, Richards, 1999, pp. 167-168). The government also moved quickly to deregulate the labor market in order to encourage private investment and make the economy more competitive. The uniform structure of wages in an inflationary economy undermined corporate investment since the existing rigidity of the labor market restricted the ability of private firms to reduce their indebtedness (Beremo and Gacia-Duran, 1994, p. 108).

The neoliberal economic strategy of the socialist government also included the liberalization of trade, which was largely driven by Spain's entry into the European Economic Community (EEC) (Heston, et al., 2006). The PSOE signed the Treaty of Accession to the EEC in 1986, which reduced tariffs to zero for imports coming from member countries of the EEC (Ferrera, 2005). The "Europeanization" of Spain was finalized when the socialist government signed the Maastricht Treaty, which established Spain's membership in the European Monetary Union (Oliver-Alonso and Valles, 2005).

The neoliberal adjustment measures of the PSOE reduced the budget deficit to 5 percent in 1985. Inflation was reduced to 4.5% in 1987 and the deregulation of the labor market contained the growth of real wages below the rate of inflation. Spain's industrial output grew at a rate of 5.2% in 1987 and its real GDP registered a growth rate of 5.5 percent, which was the largest rate of expansion among OECD countries during that year (Solsten and Meditz, 1988).

While the stabilization and growth of the economy provided the PSOE with the financial basis to pursue welfare reform, European integration, which required the comprehensive expansion of Spain's social policies to meet European standards, provided

the government with an external political motive to extend universal health, education and social protection benefits (Guillen and Alvarez, 2001). The passage of the General Health Act universalized health care services for all citizens and foreign residents in Spain. Health care coverage increased to 99.8 percent of the population in 1991(Almeda and Sarasa, 1996). The government also expanded unemployment benefits to 50 percent of the unemployed, and social benefits to primary and secondary public education was expanded to cover students between 4 and 15 years old. At the university level, the provision of government funded scholarships allowed low-income families to have greater access to higher education (Moreno and Arriba, 1998).

The 'Europeanization' of Spain brought the country's social policies closer to the European standard (Oliver-Alonso and Valles, 2005). During its tenure in office (1980-1996), the socialist government's welfare reform expanded overall social spending from 25 percent of GDP in 1975 to 40 percent in 1996. Social protection spending increased from 15.6 percent GDP in 1980 to 20.7 percent in 1990 (Guillen and Alvarez, 2001). The government's spending on pensions also increased from 8.5 percent of GDP in 1982 to 10.5 percent in 1995 (OECD, 1999), and as Table 9.3 shows, aggregate per capita social spending on education, social security and health care increased from US$1,311 in 1975 to $US2,625 in 1996.

The Spanish case shows that the transformation of the country's social policies was a function of the interactive and mutually reinforcing process of the political transformation of the state and the economic integration into the European community. In response to the economic crisis of the 1950s and 1970s, Spain abandoned economic nationalism as well as the developmental nature of its social policies and embraced economic liberalization and democracy, while constructing a universal welfare state. Notwithstanding the attempts by the Franco regime to liberalize the economy during the 1960s and the 1970s, further liberalization was largely a product of Spain's membership in the EEC, which required not only the consolidation of democracy but also the comprehensive reform of the welfare state.

9.7. *The Future Challenge to the Welfare State*

Like most countries in the European Union, Spain's aging population poses the

greatest threat to the future financial viability of the welfare state, especially the pension system. Given the fact that the country's fertility rate is 1.2, which is the lowest in the European community, and that 20 percent of the population in 2020 will be over sixty-five years old, Spain faces a future of extreme demographic aging and soaring retirement costs (European Commission, 1998, Moreno, 2001). It is estimated that in countries like Spain, Italy, Germany and France the total burden of pension expenditures (if the current unfunded pay-as-you-go pension system is left unchanged) is expected to rise to approximately 90% of GDP from 2000 to 2050 (Rother et al., 2004). However, with fewer workers to cover the rising costs of pensions, Spain's future pension debt is estimated to be 244 percent of GDP by 2050. This is significantly larger than its current debt, which is 49.7 percent of GDP that is owed to creditors (Thomas, 2010, p.1).[18]

A major overall of the pension system is vital to the financial sustainability of Spain's welfare state. Such reform may entail a combination of various options such as establishing private pension accounts, increasing the retirement age or increasing taxes. These options, however, will be politically costly for Spain's policy makers. However, if governments lack the political courage to reform how the current pension system is funded, then Spain's mounting pension deficits will decrease future governments' ability to finance social policies because the high interest payments that are accrued from such debt will crowd out spending priorities on health care, education and social protection programs.

[18] It must be noted that the rise in immigration flows to Spain has merely delayed the impending debt crisis of Spain's pension system. In the short term, since immigrants tend to be young they help finance pensions by adding to the ranks of working-age contributors. However, in the long term immigrants also grow old, and therefore add to the ranks of retired beneficiaries.

9.8. *Tables*

Table 9.1: Spain: Composition of Foreign Trade, by Product Categories, 1959 and 1973 (percentage)

	Imports		Exports	
	1959	1973	1959	1973
Food product	7.5	14.1	57.2	29.3
Raw materials (a)			9.9	3.7
Semi-Finished Products (b)	(a+b) 68.	(a+b) 50.2	21.9	23.1
Capital Goods	19.3	27.0	3.0	23.2
Consumer manufactures	4.9	8.7	9.0	20.7
Total	100.0	100.0	100.0	100.0

Source: Banco Central, *Estudio economico* (1974:118-19) tables IV-12-13; Banco de Bilbao, *Informe economico* (1973:157) in Baklanoff (1978:69)

Table 9.2: Social Policy of the Developmental Welfare State in Spain: The Franco Regime 1939-1975

1939-1959	**The Period of Import Substitution Industrialization and Economic Decline**
1939	Old age subsidy for low income workers over 65 years or for those with disabilities over 60 years – consolidated in 1947 as Old Age and Invalidity Insurance Program
1942	Health insurance for low income workers and their dependants (coverage 30% of population in 1946 rising to 44% by 1960)
Mid-1940s	Mutual Aid Associations (providing benefits for retirement, disability, long illness, widows and orphans and hence duplicating the insurance programs)
1960-1974	**The Period of Liberal Economic Reforms and Economic Growth**
1961	Unemployment insurance for affiliates of retirements and illness insurance schemes
1963	Basic Law of Social Security – a Bismarckian scheme along occupational lines and based on contributions of the affiliates – benefits linked to professional and occupational categories
1963	Non contributive pensions
1972	Reform of social security – members contributions began to be linked to real incomes
1970	Reform of education system – mandatory and free of charge 6 to 14 years, now 16 years

Source: Gullien (1992) and Cousins (1995)

Table 9.3: Spain's Social Spending Per Capita from 1972 and in 1997 (in constant US $)

Year	Education	Social Security	Health	Total
1972	152.3	877.2	17.3	1046.8
1973	160.7	962.3	16.5	1139.5
1974	159.9	1041.2	18.2	1219.3
1975	170.3	1121.7	20.0	1311.9
1976	182.9	1147.0	17.4	1347.2
1977	214.5	1315.5	18.5	1548.5
1978	236.1	1487.2	19.1	1742.4
1979	224.7	1604.3	23.5	1852.5
1980	235.5	1728.0	19.9	1983.4
1981	229.2	1748.0	19.4	1996.6
1982	217.7	2138.2	18.2	2374.1
1983	195.5	2195.1	18.9	2409.5
1984	218.3	1694.3	463.5	2376.1
1985	214.4	1523.1	490.9	2228.4
1986	n.a.	n.a.	n.a.	n.a.
1987	212.0	1513.3	519.8	2245.1
1988	242.4	1596.7	551.6	2390.7
1989	259.0	1697.8	630.0	2586.8
1990	250.1	1834.3	331.8	2416.2
1991	233.9	1909.1	304.1	2447.1
1992	229.7	2027.4	324.7	2581.7
1993	235.2	2218.6	344.4	2798.2
1994	226.0	2166.8	328.1	2720.9
1995	227.5	2140.4	303.4	2671.3
1996	201.3	2115.9	308.4	2625.5
1997	192.9	2166.0	319.9	2678.8

Source: IMF, *Government Finance Statistics and International Finance Statistics*, various years.

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Chapter 10

Globalization and the Welfare State: Theoretical and Policy Implications

10.1. *Summary of the Main Findings*

The theoretical argument of this study is that economic globalization, by default, exerts a downward pressure on the social policies of states largely through the operations of transnational corporations. However, since globalization's effect on social policy is conditional on endogenous political forces such as regime type, democratization, electoral competition and political participation, its proclivity to retrench the welfare state is averted by the preferences of political actors and institutions to expand social spending. This argument found consistent empirical support via a series of cross-sectional regressions that estimated the interactive effects of economic globalization and various measures of domestic political institutions and affiliations for a sample of 120 countries from 1970 to 2002.

The study's theoretical argument was also demonstrated in the case study analyses of South Korea, Chile and Spain, which are summarized in table 10.1. The extent to which the social benefits of the welfare state were limited or comprehensive was conditional on the interaction between countries' external trade policies and the political authority characteristics of their governments. The comparative analyses of seven regimes in these countries showed that greater democratization, combined with trade and financial liberalization in South Korea (under Kim Dae-jung), Chile (under the Concertación government) and Spain (under the PSOE), produced welfare policies with relatively comprehensive social benefits. Among the democratic regimes only Allende's socialist government in Chile established a comprehensive welfare system that was not associated with economic liberalization. Among the three military dictatorships only Spain (under Franco) and South Korea (under Park Chung-hee) adopted protectionist trade policies that were associated with a limited welfare system. Chile (under Augusto Pinochet) being the only exception among the military rulers whose retrenchment of the welfare state was associated with greater economic liberalization.

Theoretical Implications

10.2. *Implications for Recent Research*

The findings of this study speak to a larger theoretical debate within the comparative public policy literature on economic globalization's effect on the welfare state. Recent empirical research has provided additional support for the efficiency theory showing that economic globalization has retrenched the welfare state in developing countries by drastically cutting social benefits to the middle classes (Rudra, 2008). Other studies have found little evidence of globalization's retrenchment of the welfare state in developed countries like Great Britain, the U.S., Germany and Sweden, despite the best efforts of conservative governments led by Ronald Reagan and Margaret Thatcher (Pierson, 1996, Pierson, 2001). Still other studies have found no evidence of the supposedly shrinking welfare state in terms of program design, coverage and government funding for maternity leave benefits and child care programs among EU and North American welfare states (Henderson and White, 2004).

The empirical findings of these studies are likely to be artifacts of the limited sample size, making it impossible to develop a generalizable theory of the welfare state. A major theoretical contribution of this research is that since the empirical support of its theory is derived from analyses of 120 developed and developing countries, there is greater confidence in the generalizability of this study's theory of the welfare state. However, beyond questions of sample size, the empirical findings of this study may also help to make sense of the evidence of recent scholarship.

The fact that recent research has shown that economic globalization exerts a downward pressure on social spending in developing countries should come without surprise (Rudra, 2008). Harold Wilensky developed one of the earliest theories of the welfare state in which he associated the expansion of the welfare state with industrial economic development, suggesting that industrial economies produce strong welfare states (Wilensky, 1975). Theoretical insights from the 'new institutionalism" in political science arrive at a similar conclusion. Institutionalists argue that since developed countries, far more than those in the developing world, have extensive administrative and financial resources to implement social policy, they are more likely to develop expansive welfare systems (Heclo, 1974). Not only do these arguments explain the broad social

policy differences between rich and poor countries, but they also contextualize why globalization's 'race to the bottom effect' on social spending would be more acute among less affluent countries.

In light of the findings of this research, globalization's retrenchment of the welfare state in developing countries is also explained by the fact that high levels of democratization, electoral competition and political participation – variables that mediate globalization's effect on social spending – are weakly constituted into the political landscape of countries in the developing world. Consequently, in the absence of effective political institutions, globalization's proclivity to retrench the welfare state will not be averted.

Moreover, democratization of political institutions in developed countries have traditionally reflected and protected the interests of the middle class. In these countries, high levels of political participation and electoral competition have largely been driven by middle class voters' concerns about government policies that affect home ownership, social security, taxes, health care and the education of their children. It is not surprising that in developing countries globalization's downward pressure on social policy will largely disadvantage the middle class because political institutions are not sufficiently consolidated to effectively protect their interest.

Policy Implications

10.3. *The Future Direction of Social Policy*

While this research has argued that reports of the welfare state's demise at the hand of economic globalization have been greatly exaggerated, the impending crisis of the social security system may fundamentally change the design of an important component of social policy. For most countries the problems of demographic aging pose a serious threat to the financial viability of the social security system, one of the most expensive and expansive components of the modern welfare state. Most countries administer a pension system that is unfunded. Unfunded pensions are called *pay-as-you-go* because current employees pay pension contributions that are not invested on financial markets but are immediately disbursed to the current generation of retirees. The *pay-as-*

you-go systems can begin paying benefits and expand benefits if the population or productivity grows quickly. However, if the size of the contributing population shrinks, which is the case with demographic aging, or if productivity declines, which was the case with the global financial crisis in 2008, then the system veers into crisis. According to recent projections for the U.S by the Social Security board of trustees, the system in 2016 will begin disbursing more money than it collects, and by 2038 the trust fund will go bankrupt (Devroye, 2003, p. 316).

In an attempt to 'save' social security and provide pension benefits for an aging population, many countries have made significant changes in the design of the program and have replaced their unfunded *pay-as-you-go* systems with fully funded pension systems. With funded systems the pension contributions of the current generation are invested in financial markets until the accumulated capital is withdrawn after retirement and used as retirement income. Following Chile's example, Bolivia, El Salvador, and Mexico have embraced pension systems where contributions are fully invested in capital markets. Other Latin American countries like Colombia, Costa Rica, Peru and Argentina all have mixed systems that feature funded and unfunded pension accounts (Jackson, et al., 2009, p. 21). In the U.S., even after the financial crisis in 2008, state governments have increasingly invested their pension funds in commodity futures, junk bonds, foreign stocks, deeply discounted mortgage-backed securities and margin investing (Williams, 2010). Given the increasing privatization of social security will increasing global economic integration with the potential risk of market failure threaten the future stability of social policy? Or will potential financial gains from greater exposure to the market compensate for market failure during economic downturns and hence strengthen the future financial viability of the welfare state? These questions will be answered as the global economy emerges from the current recession.

10.4 *Table*

Table 10.1: Economic Globalization, Regime Type and Welfare Systems

External Trade Policy	Regime Type	Limited System	Comprehensive System
Protectionism	Authoritarianism	Park Chung-hee (Korea) Franco (Spain)	
	Democracy		Allende (Chile)
Economic Liberalization	Authoritarianism	Pinochet (Chile)	
	Democracy		Kim Dae-jung (Korea) Concertacion (Chile) Socialist (Spain)

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Appendix 1: Generating Political Institution Index

The primary purpose of principal components analysis is to detect the main structure in the relationships among variables covered with the complex dataset and to express the patterns in the structure by emphasizing their similarities and differences (Smith, 2002). However, the most important contribution of principal component analysis is that this analysis allows us to compress the information in the dataset by reducing the number of dimensions of the structure without losing much information on political system, once we find the patterns of the structure in the dataset (STATA). Principal component analysis finds the underlying factors, which shape the variations in the diverse political variables.[19]

TABLE 1. Unrotated Principal Component Factors of Political Institutions

Factor	Eigenvalues	Difference	Proportion	Cumulative
Factor1	2.36528	1.85239	0.7884	0.7884
Factor2	0.51290	0.39107	0.1710	0.9594
Factor3	0.12182	.	0.0406	1.0000

Political Institution Factor: The first factor principal component analysis detects represents the democratization level, which is the best summary of the linear relationship among the variables: as we can see in table 1, political institution factor explains

[19] The correlation between two variables can be showed in a scatterplot. A regression line can represent the simplest summary of the linear relationship between the variables. This means that the regression line reduced the two variables to one factor, which is actually a linear combination of the two component variables. When we extend the two-variable case to a multiple-variable case, the basic principles are the same even though the calculation becomes more complicated. In a multiple-variable case, we can present the relationship as defining a space similar to using a plane in a two-variable example. In a three- variable case, a three-dimensional scatterplot can be used, and we could fit a regression line through the data. If the variable number is more than three, we are unable to illustrate the data in a real space; however, the logic of linear relationship and rotation of the axes to the regression line to maximize the variance of the detected factor remains the same.

approximately 79% of the variation in the domestic institutional variables. If we could define a variable, which would approximate the institution factor, then the variable would capture the most significant pattern among the political institution variables. As Table 1 shows, political institution variables have only one significant factor accepting the Kaiser's Criterion[20] and Cattell's scree plot graph (Figure 1).

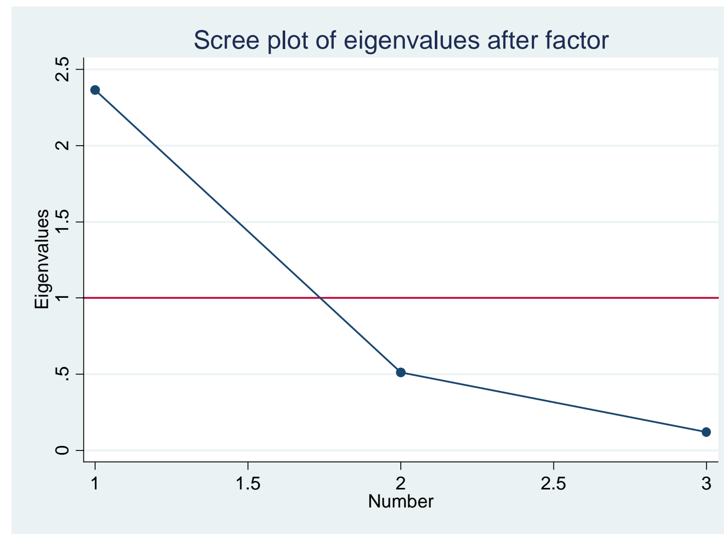

FIGURE: Scree Plot of Eigenvalues after Principal Component Factors of Political Institutions

[20] According to the Kaiser criterion, researchers can retain only factors with eigenvalues greater than 1. This means we keep factors which extracts at least as much as the equivalent of one original variable (Kaiser 1960). It is the one most widely used.

Appendix 2: Data Sources, Measurements and Definitions

A. Government Welfare Spending
Measurement:
Welfare expenditures as a percentage of central government spending
Welfare expenditures as a percentage of GDP
Definition:
Welfare expenditures include social spending on education, health, and social security from 1970 to 2002. The data is government final consumption expenditure by function at current prices. (Source: National Accounts Official Country Data[21] by United Nations Statistics Division)

B. Economic Globalization
Measurement:
Actual flows of trade and investments, and restrictions on trade and capital such as tariff rates
Definition:
Economic globalization is defined as the long distance flows of goods, capital and services as well as information and perceptions that accompany market exchanges. (Dreher 2006; Dreher et al 2008) Economic globalization index ranges between 0 and 100, where higher values indicate a higher degree of globalization. (Source: KOF Index of Globalization)

C. Political Regime Type
Measurement:
The polity represents the regime authority by scoring the authority spectrum on a 21-point scale from consolidated autocracies (-10) to consolidated democracy (+10).
Definition:
Polity IV represents "concomitant qualities of democratic and autocratic authority in governing institutions, rather than discreet and mutually exclusive forms of governance." This score expresses a spectrum of domestic regime that spans from fully institutionalized autocracies through mixed, or incoherent, authority regimes (termed anocracies) to fully institutionalized democracies.

D. Electoral Competition
Measurement:
The percentage of votes gained by the smaller parties in parliamentary and/or presidential elections, The values Ranges from 0 to 100.
Definition:
Electoral competition represents the electoral votes shared by smaller parties. This is calculated by subtracting from 100 the percentage of votes shared by the largest party in parliamentary elections or by the party of the candidate who won in presidential elections.

[21] The database includes details of official national accounts statistics in national currencies as provided by the National Statistical Offices. Data is available for most of the countries, and for the majority of countries data is available from 1970 up to the year t-1.

Theoretically, the value may range from 0 (only one party received 100 % of votes) to 100 (each voter cast a vote for a distinct party). (Source: Vanhanen Index of Democratization)

E. Voter Turnout

Measurement:

The percentage of the voters out of the voting age population

Both Parliamentary and Presidential Elections

Definition:

The percentage of the voting age population who actually voted in the election. Theoretically, the value may range from 0 (no participation) to 100 (full participation). Parliamentary and presidential election data are combined. If both elections occur in the same year, then parliamentary data is used. Election data in the previous year is used for years without elections. (Original Source: International Institute for Democracy and Electoral Assistant)

F. Corporate Capital

Measurement:

$$\text{Power of Corporate Capital} = \frac{\text{Institutional Openness*Economic Freedom}}{\text{Corporate Market Capitalization \% GDP}}$$

Definition:

The denominator measures the capitalization or the market values (as a percentage of GDP) of domestically incorporated companies listed on countries' stock exchanges. The numerators' institutional political freedom is taken from the POLITY index and institutional economic freedom is taken from the economic freedom of the world index (EFW). The EFW index measures the consistency of countries institutions and policies with economic freedom. The index measures the degree of economic freedom that is present in five major areas:

1. Size of Government: Expenditures, Taxes, and Enterprises.
2. Legal Structure and Security of Property Rights.
3. Access to Sound Money.
4. Freedom to Trade Internationally.
5. Regulation of Credit, Labor, and Business.

The POLITY and EFW indices represent the political and economic environment that corporations operate. By themselves greater political and economic freedoms may have a positive effect on welfare spending. However, it is expected that the effect that these freedoms have on welfare spending is diminished as a greater share of countries GDP comes under the control of corporate capital as it is increasingly integrated into the global economy.

G. Labor Strength

Measurement:

Potential Labor Power

Definition:

PLP = (Number of skilled workers/number of low skilled workers) x (1/surplus labor as % of working-age population) (Source: Rudra, Potential Labor Power, 2002)

H. Ruling Party Ideology
Measurement:
Chief executive member's party ideology: right (-1), center oriented (0), and left (1).
Definition:
Right parties: conservative, Christian democratic, or rightwing.
Left parties: communist, socialist, social democratic, or left wing.
Center parties: centrist or when party position is best described as centrist (e.g. the party advocates strengthening private enterprise in a social-liberal context). (Source: the primary source of this measure is the party's name in Wikipedia).

I. Legislative Ideology
Measurement:
The largest legislative party ideology: right (-1), center oriented (0), and left (1).
Definition:
Right parties: conservative, Christian democratic, or right wing.
Left parties: communist, socialist, social democratic, or left wing.
Center parties: centrist or when party position is best described as centrist (e.g. the party advocates strengthening private enterprise in a social-liberal context). (Source: the primary source of this measure is the party's name in Wikipedia)

J. Urbanization
Measurement:
Urban population as a ratio of total population
Definition:
Urbanization is the percentage of population of areas defined as urban in each state out of total population. (Source: Index of Power Resources, Vanhanen 2003)

K. Dependency
Measurement:
Age-dependency ratio
Definition:
"Age-dependency ratio is the number of persons over 60 years old divided by number of persons aged 20-59. (Source: Rudra 2002)

L. Growth
Measurement:
Growth Rate of Real GDP
The growth rate of GDP at constant prices, in percent
Definition:
The difference in real GDP compared to last year, divided by the real GDP last year, multiplied by 100. (Source: United Nations Statistics Divisions).

M. GDP per capita
Measurement:
Logged GDP per capita
Definition:

This is the estimate of real GDP per Capita in constant US dollars at base year 2000. (Source: Gleditsch-Expanded Trade and GDP Data)

N. Population
Measurement:
Logged size of population
Definition:
Population, thousand (Source: Penn World Table)

O. Inflation
Measurement:
Logged Inflation
Definition:
Inflation as measured by the annual growth rate of the GDP implicit deflator shows the rate of price change in the economy as a whole. The GDP implicit deflator is the ratio of GDP in current local currency to GDP in constant local currency. (Source: World Development Indicators)

P. Oil Shock
Measurement:
Dummy 1970s
Definition:
1970s dummy represents world economic crisis due to the oil shocks

Q. Debt Crisis
Measurement:
Dummy 1980s
Definition:
1980s dummy envisions world economic crisis caused by world debt crisis in 1980s.

R. Proportional Representation
Measurement:
The coding for the PR
(0) Majoritarian or Preferential-vote
(1) Mixed-member majority or Block vote
(2) Closed-list-PR
Definition:
Following centripetal theory of democratic governance, this variable measures three features of an electoral system: (a) district magnitude (M), (b) seat allocation rules (majoritarian or proportional), and (c) candidate selection rules. The centripetal ideal type is defined by M>1, proportional seat allocation rules, and party-controlled candidate selection. This is the closed-list-PR electoral system. Other systems are ranked lower in this coding according to their deviation from this ideal type. (Source: Gerring, Thacker, and Moreno, Gerring et al 2005)

S. Bicameralism
Measurement:
Dummy Bicameralism
“0” if not bicameralism
“1” if bicameralism
Definition:
This variable measures the number of chamber of each country. (Source: Johnson & Wallack 2006 , and Comparative Welfare States Data Set, Huber et al. 2004)

T. Trade Openness
Measurement:
Exports + Imports
GDP
Definition:
This variable measures what percent of a country’s GDP comes from trade. The larger the percent, the more open the country’s economy is to international trade. (Source: this indicator is adopted from the World Bank’s database World Development Indicators, 2008).

U. FDI
Measurement:
Net Inflows of foreign direct investment that is recorded in the balance of payments financial account
Definition:
This variable captures inward investment that includes equity capital, reinvestment of earnings, other long-term capital, and short-term capital. Data are in percent of GDP. (Source: this indicator is adopted from the World Bank’s database World Development Indicators, 2008).

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- Senior researcher (at Cyberpoll Survey-Research Co., Ltd)

CONFERENCE PAPERS

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- Superintendent's Award (a testimonial on students' day), 1989, Gyonggi Province Board of Education, Korea

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