

RESUMO

Neste trabalho examinamos o impacto da globalização sobre os gastos sociais nos países da América Latina. Para medir o nível de internacionalização das economias latino-americanas, construímos um novo indicador de abertura financeira baseada na codificação proposta por Dennis Quinn (1997). Nossos resultados apontam para duas lógicas sobre a qual os efeitos da globalização se fazem sentir. A abertura comercial tem um impacto negativo sobre o gasto social, enquanto a abertura financeira se relaciona positivamente com o mesmo tipo de gasto. Além disso, governos democráticos tendem a gastar mais em programas sociais. De modo geral, nossa pesquisa conclui que a globalização é um fenômeno complexo, apresentando simultaneamente conseqüências positivas e negativas para o financiamento dos programas sociais na América Latina.

PALAVRAS-CHAVE

Globalização; Internacionalização econômica; Economia política internacional; Política comparada; Comércio internacional; Abertura financeira; Democratização; Políticas públicas; Gasto social; América Latina.

ABSTRACT

We examine the impact globalization and democratization have on social spending in Latin America. To measure globalization we construct a new indicator of financial liberalization for the Latin American cases based on Dennis Quinn's measure of financial openness (Quinn 1997). We find there are two logics upon which globalization operates. Trade openness has a decidedly negative impact on social spending as a percentage of GDP while financial openness has a strong positive correlation with increased spending on social welfare. Politicians operating

under democratic constraints are also more likely to spend on social welfare programs. Our research implies that globalization is a complex process that simultaneously holds both beneficial and deleterious consequences for the provision of social welfare programs in Latin America.

KEY WORDS

Economic Internationalization; International political economy; Comparative politics; International trade; Capital openness; Democratization; Public policies; Social spending; Latin America.

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DEMOCRACY, SOCIAL SPENDING, AND THE TWO LOGICS OF GLOBALIZATION IN LATIN AMERICA, 1980-1999*

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I. INTRODUCTION

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

While globalization has provided some groups in society with new opportunities for social mobility, it has created new sources of inequality and insecurity for others. Most would agree that economic openness puts employers under greater pressure to reduce labor costs, and that individuals who possess the skills, knowledge, and resources associated with internationally competitive sectors benefit more from the new market-oriented system than those who do not.

In this light, questions about how states provide for the welfare of citizens in the contemporary international economic system gain new relevance. How has the international integration of markets for goods, services, and capital affected the

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social policy decisions of Latin American governments? More specifically, have governments become less generous toward citizens in response to the pressures generated by greater economic openness? Or, have they created stronger safety nets and new forms of social assistance in order to meet the new social challenges of globalization?

This paper examines the impact globalization and democracy have on social spending in Latin America. To estimate the impact globalization has on social spending, we introduce a new measure of financial liberalization based on Dennis Quinn's measure of financial openness (Quinn, 1997). We also use the most updated information available on social spending in Latin America compiled by researchers at ECLAC/CEPAL (ECLAC/CEPAL, 2001), which allow us to comprise a longer time series. We use time-series cross-sectional (TSCS) analysis to test whether the empirical patterns observed in previous work are observed in a developing region that has undergone dramatic economic and political change over the last two decades. We build on previous work in several ways. First, we use data on social spending that maximizes cross-country comparability. Second, we test whether our results are sensitive to different measures of globalization and democracy. Finally, since different social programs reach different constituencies, we disaggregate social spending to determine whether the effects of globalization and democracy vary by program.

Several empirical patterns emerge from our analysis. First, confirming previous results from Kaufman and Segura (Kaufman, 2001), we find trade openness has a strong negative impact on the amount of resources devoted to social spending. We also find, however, that the negative correlation between trade openness and social spending depends on how the inflow and outflow of goods and services are measured. Second, we find democracy has a strong positive correlation with social spending. Finally, there is a strong positive relationship between financial openness and social spending, suggesting globalization is not a monolithic process: there are at least two logics associated with economic integration. To understand the causal

links that connect globalization, democracy, and social spending, we break social spending down into several categories. We find that democracy's biggest impact on social spending is through education. Trade openness influences each category in a strongly negative fashion whereas financial openness is associated with higher levels of spending on health and education. The results lend further support to the finding that globalization can hold both positive or negative implications for social spending. This paper's goal is to demonstrate that there are at least two logics of globalization, implying that the results of increased world trade and financial openness are more varied and complex than had previously been thought.

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

II. THEORY

A growing literature addresses the interaction between globalization, domestic politics, and government spending (Cameron 1978; Katzenstein 1985; Hicks and Swank 1992; Pierson 1996; Powers and Kostadinova n.d.; Rodrik 1998, 1999, 2001; Garrett 1998 and 2001; Garrett and Mitchell 1999; Huber 1999; Hurrell and Woods 1999; Garrett and Nickerson 2001; Adsera and Boix forthcoming; Kaufman and Segura (2001); Huber and Stephens forthcoming). Determining whether governments respond to globalization with social policy choices that are oriented more toward cutting costs ("efficiency") or protecting people's welfare ("compensation") lies at the heart of this literature.

Proponents of the efficiency hypothesis argue that governments will reduce taxes and social welfare expenditures that diminish profits, discourage investment, and therefore threaten economic growth and international competitiveness. Social services burden business through the distortion of labor markets and higher taxes. If governments borrow to pay for these services, the higher real interest rates that result further depress investment. In short, the efficiency approach posits economic openness places important constraints on welfare spending, leaving governments little choice but to restrict their social outlays.

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

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

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

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

A number of factors that set Latin America apart from other regions—especially Western Europe—impinge upon the ability and/or inclination of Latin American governments to respond to globalization with robust welfare programs. On the one hand, some of these factors encourage actions in accordance with the efficiency thesis. Others make Latin America more likely to adopt compensatory schemes.

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

The rapid and dramatic process of stabilization and structural adjustment in the wake of the Latin American debt crisis—and the active accompanying role played by the International Monetary Fund—is without parallel in the developed world. IMF prescriptions for attaining fiscal solvency depend on reducing government expenditure on social programs by introducing user fees in health and education,

and by affecting a more efficient distribution of goods and services to the poor.² Governments reluctant to initiate such actions still acknowledge the importance of expressing to the IMF their intent to adopt these economic reforms.

Finally, the comparative weakness of Latin American states exposes welfare programs to the risk of retrenchment. The state in most Latin American countries, while never as strong as in most Western European countries, was weakened further by the economic crisis of the 1980s and 1990s. Governments in the region are notorious for their inability to carry out some of the most essential tasks—tax collection—necessary to maintain generous welfare support (Huber 1999).

Other factors relevant to Latin America provide some reason to expect globalization might promote compensation. Greater trade volatility heightens the insecurity of citizens unless governments take active measures to provide for social protection. Most Latin American countries tend to have relatively specialized patterns of trade compared to their counterparts in the developed world. With higher levels of volatility, the effects of trade exposure may be more severe, inducing a higher level of government spending in relation to total trade. This hypothesized relationship leads us to examine the role played by new democratic regimes.

Noted earlier, most of the previous empirical work focuses on the OECD nations for which comparable and extensive data are available. Understandably, these studies take stable democratic institutions as given. In these models, democracy has only an indirect effect: it works as a channel through which the effects of other relevant variables (such as political parties and union strength) can be analyzed. Although it is important to consider political factors other than regime type, issues relating to regime type and regime transition still deserve attention. At least two reasons justify this claim.

² See Deacon (1999: 222) for a list of the IMF's prescriptions vis-à-vis the social policies of borrowing member countries. See also Grosh (1996) for the theory behind targeting and its practice.

First, we need to know more about the conditions that make democracies work: the conditions that enable them to achieve economic growth, material security, freedom of arbitrary violence, and other widely desirable objectives (Przeworski et al., 1995). Due to the endemic political instability that has characterized developing countries, much of the comparative work on democratization assumes these new regimes were inherently fragile. These works were mostly concerned in constructing etiologies of types of regime change or of emerging democratic regimes. Virtually ignored in this literature is the impact of democracy over public policies.³

The recent political and economic transformations experienced by many developing countries offer a unique opportunity to explore questions about how different political regimes react to external economic shocks (Rodrik, 1999). According to Adserá and Boix (forthcoming), the interaction between democracy and globalization has a strong positive effect on government expenditures. As Latin American countries comprise a significant part of the recent wave of democratization, they provide a great opportunity to analyze the effects of different political regimes over these policy options.

Second, despite the euphoria sparked by the widespread democratization among developing countries, current attitudes toward new democracies are mixed. Although they represent an important change in comparison to previous authoritarian institutions, Latin American democracies have been criticized for not having fulfilled many of the expectations they generated. This growing disenchantment with democracy is particularly acute in the provision of public

³ For a survey of different “types of democracy”, mostly based on institutional characteristics, see Collier and Levitsky (1997). As the ability of the poor to make effective demands depends on the institutional design of democratic regimes, a natural extension of the work done here is to test the impact of different types of democracy over public policies.

services, an area in which democratization was expected to have a tangible impact on the plight of the poor.⁴

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

III. MODEL SPECIFICATION

To test hypotheses on the influence of globalization and democracy on social spending, we examined annual data for 19 Latin American countries between 1980 and 1999.⁵ The data were compiled by researchers at the United Nations

⁴ A recent poll by “Latinobarometro”, published in “The Economist” (2001), attested the decline of the democracy support in Latin America. This disenchantment, however, does not imply in disregarding that changes in democracies are usually moderate and incremental as claimed by many authors (Huntington, 1989; Schmitter and Karl, 1991). In most cases, the disenchantment stems from the perception that new democracies have not represented a shift in government priorities, even an incremental one, toward the interests of the poor.

⁵ The countries are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela. The full data matrix, therefore, comprises a maximum of 380 observations (19 countries x 20 years). Missing data, however, implied that we analyzed smaller data sets, depending on the country and year coverage of variables.

Commission for the Latin American and the Caribbean (ECLAC/CEPAL).⁶ This data set provides a unique opportunity to study the relationship between globalization, democratization, and social spending for two reasons. First, with the exception of Cuba and Haiti, the data include all Latin American countries. Second, the persistent problem of data comparability is minimized by the ECLAC, which conducted studies of each country for the expressed purpose of producing comparable data on social spending.

The data form a Times-Series Cross-Sectional (TSCS) data set in which each country-year represents a single observation. Although pooling the data has the obvious benefit of increasing the number of observations, it can violate at least two of the basic assumptions that underlie Ordinary Least Squares (OLS) estimation. First the temporal structure of the data increases the chance of autocorrelation, violating the OLS assumption that the errors are independent of each other. Second, the cross-sectional structure of the data increases the chance that the variance in the error terms may differ across countries and that there will be spatial processes that affect different panels simultaneously (i.e., a currency crisis in Argentina effects Brazil). The consequence of these violations is that OLS coefficient estimates are still unbiased but inefficient.

In order to deal with these problems we followed Beck and Katz (1995, 1996) and used panel corrected standard errors. To deal with the problem of auto-correlation we included a lagged dependent variable and a set of “n” country and “t” year dummies. The inclusion of a lagged dependent variable is based on two assumptions. First the autocorrelation problem is limited to the first-order correlation, a plausible assumption given the short period covered by the data.

⁶ The data were assembled by two research teams. The first team, which assembled data for the 80s and the beginning of the 90s, yielded two publications: Cominetti and Di Gropello (1994) and Cominetti and Ruiz (1997). The second research team updated and enlarged the first dataset, including not only spending information until 1999 but also countries not covered earlier, such as Jamaica. It has also yielded a publication: Ganuza, León, and Sauma (1999), and it is currently responsible for the information on social spending published yearly in CEPAL’s Social Panorama of Latin America.

Second the autocorrelation is not unit specific; rather, it is assumed to be common across all pooled units.⁷ Finally, but no less important, including a lagged dependent variable allows one to address autocorrelation without transforming the data, which complicates the interpretation of regression coefficients.

The inclusion of a set of “n” country dummies controls for country-specific effects. It assumes that these effects are fixed over time, allowing a different intercept for each country. This statistical technique has two other consequences that are worth mentioning.

First, the combination of these dummy variables may be highly correlated with other independent variables, producing multicollinearity problems within the model and reducing the efficiency of the estimates. Multicollinearity will be particularly acute in relation to variables that are relatively invariant, or fixed, within each country along the 18-year period. This prevents the inclusion of some variables traditionally used in cross-sectional models that explain welfare spending variation in OECD countries: the institutional characteristics of social programs.

Second, the exclusion of relevant variables from the model specification should lead to bias in estimates of the coefficients. From this perspective, the set of dummies summarizes the differences between countries caused by relevant variables that can be considered as fixed over time. The country dummies can also account for the differences caused by unmeasured relevant variables, a very common situation among developing countries for which it is hard to find complete and comparable data. In sum, while the inclusion of country dummies has some disadvantages, it

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

insures that no relevant, and relatively stable, cross-sectional variable is excluded from the model.⁸

Finally, the inclusion of year dummies takes into account time specific effects. For instance, if all countries are subject to a common external shock, the effects of this shock over our dependent variables need to be controlled. This problem is particularly important because of the debt crisis endured by Latin American countries during the end of the last century. Therefore, we will employ the following baseline equation:

$$\begin{aligned} \text{Social Spending}_{i,t} = & \alpha_i + \delta_t + b_1 \text{Social Spending}_{i,t-1} + \\ & + b_2 \text{Pop65} + b_3 \text{Unemployment} + b_4 \text{Level of Development} \\ & + b_5 \text{Growth} + b_6 \text{Urbanization} + b_7 \text{Democracy} \\ & + b_8 \text{Financial Openness} + b_9 \text{Trade Openness} + \varepsilon_{i,t}. \end{aligned}$$

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

Social Spending is the dependent variable.⁹ At first, it will be measured as a percentage of GDP. Results for more disaggregated levels of social spending will be shown later. Although the original data and subsequent updates were produced by CEPAL, updates of Cominetti's original data set show some rather abrupt jumps in the time series within a few of the countries. To make sure that our findings are not driven by these changes, we included a dummy variable in the regression that

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

⁹ The data used in this report is included in the attached disk.

delineates the original data from the updates. The inclusion of this dummy had no impact on the results reported below.

The measure for **democracy** conceives democratization as a distinct process and measures its effects by using a dummy variable for the political regime, coding one for democracies and zero for the residual category of authoritarian regimes. The measure is drawn from Alvarez et al. (1996). Based on Dahl's (1971) minimalist definition of a democratic regime, the authors focus on contestation as the essential institutional feature of democracies.¹⁰ We followed Alvarez et al. in their classification. To check the stability of our results with respect to the measure of democracy, we ran every regression using a continuous variable derived from Gurr's POLITY IV data. We subtracted Gurr's AUTO score from his DEMOC score, producing a more continuous measure that ranges from -10 (most authoritarian) to 10 (the most democratic).

Globalization is measured by two indicators. The first is **trade openness**: the sum of imports and exports as a percentage of the GDP. It is important to note that the inclusion of country dummies in all equations takes into account countries' fixed characteristics (such as the size of the population and the distance from major trade partners) that may influence their exposure to international trade.¹¹ Therefore, we are confident that the coefficient on the trade openness term represents government policy choices.

The second indicator is the degree of **international financial openness**, a measure we constructed using the decision rules outlined by Quinn (1997). Quinn's measure is based on information from the IMF's *Annual Report on Exchange Arrangements*

¹⁰ "Our purpose is to distinguish regimes that allow some, even if limited, regularized competition among conflicting visions and interests from those in which some values or interests enjoy a monopoly buttressed by a threat or the actual use of force." (Alvarez et al., 1996: 4). See Huntington (1991: 266-67) for a similar theoretical point.

¹¹ See Rodrik (1998: 1026), who calls this exogenous component of trade shares as the "natural openness for each country."

and Exchange Restriction. The measure we use, openness, is a quantitative measure of the regulation of international financial transactions both in the capital and current accounts. Quinn's measure is an additive scale that can range from 0-14 with 0 being the most restrictive regime and 14 with the most open.

We also include four control variables traditionally used in the social spending empirical literature. The first is demographic: **pop65** which is defined as the percentage of the population that is 65 years or older. Due to the impact of demographic characteristics over health care and social security, we expect a higher percentage of elderly people in the population to be positively related to social spending. The data for this variable came from the World Development Indicators 2001 (CD ROM).

The second traditional control variable is the **unemployment** rate. Despite the existence of few public unemployment programs in Latin America, we expect this coefficient to be positive: high unemployment rates should be correlated with increased social spending. The data was drawn from various issues of ECLAC's yearly report on the Economic Survey of Latin America.

In addition to these controls, we include the **level of economic development**, defined as the log of Gross Domestic Product per capita and measured in PPP dollars. Including income in the equation takes into account Wagner's Law which states the level of public spending is positively correlated with levels of economic development. The annual **growth** rate of GDP per capita is included to control for the effects of economic volatility on government spending. Data for both variables were drawn from the WDI 2000.

Finally, we also control for **urbanization** since relatively more urban countries depend more on the manufacture and trade of industrial products. A developed industrial sector implies the presence of unions that can strike, protest, and lobby for higher wages, benefits, or social spending. The urban bias Bates observed in

Africa might also be a relevant factor in determining the amount of pressure the population can place on their elected officials (Bates, 1981).

IV. RESULTS – AGGREGATE MEASURES

Table 1 presents the results at the aggregate level. Several patterns can be observed from the estimates. First, the lagged dependent variable in every regression is significant which comes as no surprise. Although there is a strong correlation between the dependent variable and its lag, the coefficient on the lagged dependent term is not close to one, staying fairly close to .73 in all regressions. To make sure that our findings were not generated by the use of a lagged dependent variable on the right-hand side of the equation, we ran the same model using the Prais-Winston correction for AR(1) processes. The results did not depend on the presence of the lagged dependent variable. Second, some of the economic controls are not correlated with social spending. Given the use of both country and year dummy variables in each regression, there is little cross-sectional variance left for the control variables to explain. Third, the coefficient on the democratic dummy variable is statistically significant and positive in every regression. To test the stability of the result with respect to the operationalization of democracy, we substituted in Gurr's POLITY IV measure of democracy. In every regression the Gurr measure score confirmed the results we obtained with Przeworski et al.'s dichotomous operationalization. Finally, the two variables that measure openness are strongly correlated with social spending but in opposite directions. The coefficient for the trade openness variable is significant and negative: as trade openness increases, the resources governments devote to social programs decrease. The coefficient for the financial openness variable is significant and positive: as financial openness increases, the resources governments devote to social programs increase.

Table 1**Regressions with Social Spending (% of GDP) as the Dependent Variable**

	(1)	(2)	(3)	(4)	(5)	(6)
Lagged Dependent Variable	0.736*** (0.046)	0.721*** (0.045)	0.738*** (0.047)	0.735*** (0.046)	0.739*** (0.049)	0.742*** (0.047)
% of Population in Urban Áreas	0.158*** (0.052)	0.165*** (0.048)	0.161*** (0.050)	0.160*** (0.052)	0.157*** (0.055)	0.167*** (0.052)
% of Population aged 65 or Higher	-0.253 (0.303)	-0.253 (0.299)	-0.258 (0.306)	-0.253 (0.300)	-0.263 (0.276)	-0.179 (0.306)
GDP per Capita	-0.000 (0.000)	-0.000 (0.000)	0.000 (0.000)	0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
Growth in GDP per Capita	0.004 (0.013)	-0.000 (0.013)	0.004 (0.013)	0.004 (0.013)	0.006 (0.014)	0.005 (0.014)
Unemployment	0.038 (0.024)	0.043* (0.023)	0.037 (0.024)	0.036 (0.024)	0.036 (0.025)	0.043* (0.024)
Trade Openness	-0.037*** (0.007)	-0.039*** (0.007)	-0.037*** (0.007)	-0.037*** (0.008)	-0.037*** (0.007)	-0.028*** (0.007)
Financial Openness	0.136** (0.058)	0.139** (0.056)	0.131* (0.068)	0.137** (0.058)	0.122* (0.064)	0.229*** (0.063)
Democracy Dummy	0.381** (0.191)	0.370** (0.183)	0.375* (0.195)	0.380** (0.192)	0.374** (0.184)	1.992*** (0.615)
FDI as a % of GDP		0.109*** (0.029)				
Civil War Dummy			-0.087 (0.310)			
Debt Service Ratio				0.003 (0.005)		
Fiscal Deficit as a % of GDP					-0.005 (0.023)	
Trade Openness X Democracy						-0.013 (0.009)
Financial Openness X Democracy						-0.112 (0.077)
Constant	-5.879 (6.173)	-6.529 (5.784)	-6.089 (5.956)	-6.074 (6.145)	-5.384 (6.746)	-8.583 (6.070)
Observations	300	300	300	300	292	300

Panel-Corrected Standard errors in parentheses * significant at 10%; ** significant at 5%; *** significant at 1%. Country and Year dummies are not included in the table for presentation purposes.

The substantive impact of increased trade and democratization is significant. The democracy dummy variable is relatively easy to interpret. The coefficient on the democratic dummy variable indicates that the difference between democratic and authoritarian regimes is roughly .4 percentage points of GDP in the basic model (1) and 2 percentage points of GDP in the model that allows for interactions between democracy, trade openness, and financial openness. Of course, for the larger economies (Brazil, Mexico, and Argentina), a .4 percentage point difference is substantial. In Brazil's 1 trillion dollar economy, for example, .4 percentage points is equivalent to 4 billion dollars.

The impact trade openness has on social spending is substantial as well. To illustrate the constraints trade openness places on social spending among the Latin American countries, we calculated the predicted value of social spending as a percentage of GDP for various levels of openness, holding all other variables constant at their mean values. At one standard deviation below the mean of trade openness, the model predicts that social spending will be roughly 11.5 percent of GDP. At one standard deviation above the mean of trade openness, the model predicts that social spending will be roughly 9.5 percent of GDP: a difference of two percentage points. A two-percentage point change in Brazil's social spending translates roughly into \$20 billion, roughly one-fifth of all social spending in Brazil. In Peru, a two-percentage point change translates roughly into \$2.2 billion: over one-fourth of Peru's outlays for education, health, and social security.

The positive association between financial openness and social spending is substantively significant as well. Holding all other variables constant at their means, moving from one standard deviation below the mean value of Quinn's measure (6.27) to one standard deviation above the mean (10.64) produces a change in spending equivalent to roughly 0.7 percentage points of GDP. Again, in the Brazilian case, liberalizing financial regulations both in the capital and current accounts (moving over the inter-quartile range) is associated with a \$7 billion dollar increase in social spending. In Peru, which in 1998 spent approximately \$7 billion

on education, health, and social security, the model predicts that liberalizing financial regulations over the inter-quartile range would result in an increase of 546 million dollars. A fact that bolsters these findings further, 12 of the 19 countries in our sample witnessed changes in financial openness at least as large as the 4 points that span the inter-quartile range.

The estimates we report withstood a number of tests for stability. First, we tested the stability of the results with respect to our measure of globalization. For instance, Rodrik (1998) argues the most important issue is the “exposure to external risk” brought about by economic internationalization rather than trade shares alone. However, the inclusion of variables that measure “terms of trade risk” or “export concentration” did not cause any noticeable change in our results.¹² We also included in our model a variable for capital liberalization with another variable that measures the net inflows of Foreign Direct Investment (FDI) as a percentage of the GDP. Using the alternative measure based on FDI had no effect on our estimates. Interestingly, increased levels of FDI were associated with higher levels of social spending. The sign on the coefficient was both positive and statistically significant.

Second, we subjected our models to a modified jackknife procedure in which we took each country out, one a time, to see if its absence affected the estimates. This is particularly important given the TSCS nature of the data since influential points are probably clumped together and will not, by themselves, appear to have an effect on the results. We found that the coefficients for the democracy dummy along with the trade openness and financial openness variables kept their sign throughout the procedure.

¹² The first variable is the standard deviation of the first logarithm differences of the terms of trade for each country. Data on terms of trade were drawn from ESDB/IADB, available at the IADB Internet site (www.iadb.org). Export concentration is measured as the summation of the percentage share of the ten most important export products on the total exports for each country. Data from this last variable was collected from ECLAC/CEPAL, Statistical Yearbook of Latin America, various issues.

Also presented in the regression tables is a model that includes an interactive term for democracy and trade openness and an interactive term for democracy and financial openness. The estimates indicate there is no interactive relationship between democracy and openness, either in trade or financial regulation when both interactive terms are included together (see Appendix A). This contrasts with findings by others (Garrett and Nickerson 2001; Adserá and Boix, forthcoming) who find that the interaction between democracy and trade openness has a strong positive impact on social spending.

To summarize our findings with respect to aggregate social spending as a percentage of GDP, we find that democracy has a positive correlation with increased spending. We also find that the globalization process, as measured by trade and financial openness, subjects countries to a complex and even contradictory set of incentives: trade openness is associated negatively with social spending while financial openness is positively correlated with social spending. Our findings imply that globalization operates in a number of different ways and can have differential effects under a variety of contexts.

V. HEALTH, EDUCATION, AND SOCIAL SECURITY

Previous empirical work seeks to establish whether governments respond to globalization by either becoming more efficient (spending less) or by compensating the losers (spending more). However, we might expect that if democratic institutions provide some form of compensation, they would allocate resources to those sectors most affected by increasing competition in the market. Examining whether trade openness, financial openness, and democracy affect all components of social spending equally will help us determine whether changes in spending can be attributed to the compensation or efficiency hypotheses.

Tables 2, 3, and 4 report the results for three components of social spending for both the standard and interactive models. A clear pattern emerges from the estimates. Democracy's positive impact on social spending is channeled through education. The democratic dummy variable has a positive and statistically significant coefficient in all the equations for education.

Table 2**Regressions with Education Spending (% of GDP) as the Dependent Variable**

	(1)	(2)	(3)	(4)
Lagged Dependent Variable	0.679*** (0.047)	0.663*** (0.046)	0.681*** (0.047)	0.667*** (0.047)
% of Population Living in Urban Areas	0.041* (0.022)	0.047** (0.022)	0.044** (0.022)	0.048** (0.022)
% of Population 65 and Over	-0.366*** (0.135)	-0.401*** (0.139)	-0.293** (0.130)	-0.354** (0.141)
GDP per Capitã	0.000** (0.000)	0.000* (0.000)	0.000 (0.000)	0.000 (0.000)
Growth in GDP per Capita	0.002 (0.005)	0.002 (0.005)	0.003 (0.005)	0.002 (0.005)
Unemployment	0.008 (0.008)	0.010 (0.008)	0.012 (0.009)	0.012 (0.008)
Trade Openness	-0.011*** (0.003)	-0.005* (0.003)	-0.010*** (0.003)	-0.005** (0.003)
Financial Openness	0.054** (0.024)	0.065*** (0.023)	0.106*** (0.025)	0.094*** (0.026)
Democracy Dummy	0.278*** (0.076)	0.807*** (0.155)	0.903*** (0.269)	1.089*** (0.284)
Trade Openness X Democracy		-0.010*** (0.003)		-0.009*** (0.003)
Financial Openness X Democracy			-0.072** (0.030)	-0.041 (0.035)
Constant	0.676 (2.752)	0.272 (2.743)	-0.882 (2.603)	-0.560 (2.622)
Observations	301	301	301	301

Panel-Corrected Standard errors in parentheses: * significant at 10%; ** significant at 5%; *** significant at 1%. Country and Year dummies are not included in the table for presentation purposes.

Although the democracy variable maintains its positive coefficient, in the health equation it cannot be distinguished from zero at any acceptable level of confidence.

Table 3

Regressions with Health Spending (% of GDP) as the Dependent Variable

	(1)	(2)	(3)	(4)
Lagged Dependent Variable	0.647*** (0.083)	0.647*** (0.082)	0.644*** (0.083)	0.644*** (0.083)
% of Population in Urban Areas	0.012 (0.013)	0.012 (0.014)	0.012 (0.013)	0.012 (0.014)
% of Population 65 and Over	-0.176* (0.101)	-0.177* (0.101)	-0.192* (0.102)	-0.199* (0.105)
GDP per capita	0.000 (0.000)	0.000 (0.000)	0.000* (0.000)	0.000* (0.000)
Growth in per Capita GDP	-0.001 (0.005)	-0.001 (0.005)	-0.001 (0.005)	-0.002 (0.005)
Unemployment	0.002 (0.008)	0.002 (0.008)	0.001 (0.008)	0.001 (0.008)
Trade Openness	-0.008*** (0.003)	-0.007** (0.003)	-0.008*** (0.003)	-0.007** (0.003)
Financial Openness	0.071*** (0.023)	0.071*** (0.022)	0.060** (0.024)	0.059** (0.024)
Democracy Dummy	0.083 (0.054)	0.118 (0.174)	-0.051 (0.280)	-0.022 (0.296)
Trade Openness X Democracy		-0.001 (0.003)		-0.001 (0.003)
Financial Openness X Democracy			0.016 (0.033)	0.019 (0.033)
Constant	-0.214 (0.742)	-0.243 (0.746)	-0.060 (0.715)	-0.074 (0.714)
Observations	283	283	283	283

Panel-Corrected Standard errors in parentheses * significant at 10%; ** significant at 5%; *** significant at 1%. Country and Year dummies are not included in the table for presentation purposes.

Democracy's association with spending on social security is weak and unstable. Depending on whether an interactive term between democracy and openness is included in the regression, the significance of the democracy dummy variable can become significant at the 10 percent level of confidence. Without the interactive term, the democracy dummy's coefficient is not statistically significant.

Table 4
Regressions with Social Security Spending (% of GDP) as the Dependent Variable

	(1)	(2)	(3)	(4)
Lagged Dependent Variable	0.714*** (0.049)	0.715*** (0.049)	0.720*** (0.049)	0.720*** (0.049)
% of Population in Urban Areas	0.035** (0.016)	0.038** (0.016)	0.038** (0.016)	0.038** (0.016)
% of Population 65 and Over	0.306** (0.149)	0.298* (0.158)	0.402*** (0.150)	0.399** (0.159)
GDP per capitã	0.000 (0.000)	0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
Growth in per Capita GDP	-0.018** (0.009)	-0.019** (0.009)	-0.017* (0.009)	-0.017* (0.009)
Unemployment	0.025* (0.015)	0.024* (0.015)	0.029** (0.015)	0.029* (0.015)
Trade Openness	-0.015*** (0.004)	-0.014** (0.005)	-0.014*** (0.004)	-0.014*** (0.005)
Financial Openness	0.019 (0.022)	0.022 (0.023)	0.087** (0.043)	0.086** (0.042)
Democracy	-0.102 (0.104)	0.053 (0.218)	0.744** (0.351)	0.757* (0.401)
Trade Openness X Democracy		-0.003 (0.005)		-0.000 (0.004)
Financial Openness X Democracy			-0.097** (0.045)	-0.096** (0.041)
Constant	-2.334** (1.083)	-2.381** (1.097)	-3.908*** (1.333)	-3.889*** (1.342)
Observations	281	281	281	281

Panel-Corrected Standard errors in parentheses * significant at 10%; ** significant at 5%; *** significant at 1%. Country and Year dummies are not included in the table for presentation purposes.

The strongest, most consistent pattern in the regressions is the strong and negative association between the trade openness variable and spending. With respect to education, health, and social security, we find trade openness has a strong negative and significant correlation. In terms of the magnitude of the coefficients, in the social security regressions, the trade openness coefficient is nearly double the size of that found in the health regressions; it is also larger when compared to the education regressions. Trade openness, therefore, provides the strongest constraint on social security spending.

Financial openness is most strongly associated with spending on education and health. Its impact on social security is somewhat marginal and unstable depending on the inclusion of an interactive term. Even then, its statistical significance is somewhat weak. Consequently, financial openness is more strongly correlated with the components of social spending that do not necessarily directly tax business and industry.

Along with our findings in the aggregate analysis, the following pattern begins to emerge. Although trade openness is negatively correlated with aggregate social spending, its main effects are found in social security. The positive association between financial openness and social spending is manifested in higher rates of spending on education and health. Democracies, it seems, place their emphasis on education spending.

VI. DISCUSSION

In terms of the compensation versus efficiency hypotheses, the dummy variable term for democracy indicates democratic regimes generally spend more on education, holding the degree of trade and financial openness constant. Trade openness, however, forces governments to cut back on spending in all areas with social security receiving the most cuts. Financial openness, however, has a strong,

positive impact on social spending, particularly in the areas of education and health. Why do more open forms of political representation increase education spending? Moreover, what is driving the two logics of globalization and their contradictory effects on social spending? Without additional data, we can only forward a few plausible explanations.

Democracy's positive impact on social spending can be accounted for in a number of different ways. One possible explanation is that under the constraints of more open forms of political representation, politicians may use social spending as a tool to build electoral support among a wide segment of the electorate (Ames, 1987). Although in some countries they represent very strong political interests, the percentage of the population 65 years and older never reaches more than 15 percent in Latin America (the mean for all Latin American countries is 4.9 percent). In Latin America, funding education may provide the biggest return on each dollar invested. The high political return associated with investment in education is likely to be the result of either the high demand for educational opportunity or through the well-organized teachers unions in the form of increased wages.

More difficult to explain is the negative association between trade openness and social spending. Previous studies on Europe show that there is a strong, positive association between trade openness and the size of government, lending credence to the compensation hypothesis (Cameron 1978; Katzenstein 1985; Hicks and Swank 1992; Pierson 1996; Powers and Kostadinova n.d.; Rodrik 1998, 1999, 2001; Garrett 1998 and 2001; Garrett and Mitchell 1999). Before forwarding any explanation, it is important to note that the negative finding depends on how imports and exports are measured. Although the negative coefficient and the significant t-ratio on the trade openness variable withstood a surprising number of sensitivity tests, measuring exports and imports in terms of purchasing power parities (PPPs) causes the sign on the coefficient to flip while retaining its statistical significance. It turns out that the correlation between the two trade openness variables (one measured using purchasing power parities and the other based on exchange rate conversions)

show a surprising level of divergence: a simple correlation between the two variables is .65. Further work is clearly necessary before rejecting one measure over the other.

Despite the discrepancy, there are reasons to believe that two logics are at work with respect to globalization and social spending. Decomposing the trade variable, we found that the most important component of the sign of the trade openness variable is exports. To the extent that Latin American countries depend on positive trade balances to maintain macroeconomic stability, they may be constrained by keeping prices low on the goods they export. Increasingly dependent on export industries as they liberalize trade, governments may wish to avoid levying taxes on the industries forced to compete in world markets. Consequently, the revenue available from exports may diminish with trade liberalization, forcing governments to spend less on programs that generally depend on revenue collected in the form of taxes on the export sector. The liberalization of financial regulation, however, does two things: 1) it exposes domestic consumers and investors to the vagaries of world financial markets, therefore increasing demands for protection; 2) it can increase the availability of international capital, allowing governments to fund previously underfunded social welfare programs. In other words, governments may compensate domestic actors in the face of increasing financial volatility, or, more open forms of financial regulation provide government with additional capital.

Additional evidence points to the fact that there are two logics of globalization, one based on finance, the other based on trade. Referring back to model (2) in Table 1, we find that FDI as a percentage of GDP enters into the equation with a positive coefficient. As FDI pours into a country, the constraints associated with the current account are relaxed, giving politicians more latitude in their decisions on social spending. What model (2) demonstrates, more importantly, is that the two variables which measure the mobility of international capital are consistent with each other, implying that on the financial side, globalization induces or allows governments to compensate those exposed to the economically integrated world.

A final piece of evidence that is consistent with this explanation resides in the results obtained from the analysis performed on the components of social spending. On the trade side, the large negative impact seems to come mostly through social security. Although trade openness constrains both education and health spending, its biggest impact is on social security. Since social security compensation is funded primarily through payroll taxes which directly affect an employer's wage bill, increased trade openness forces governments to limit spending since taxing business can render export producing industries unable to compete in the global market. Spending on health and education is less directly tied to the costs incurred by the export sector. If trade openness was more strongly associated with cuts in health and education, the connection between export producing industries, taxes on exporting industries, and the constraints on government spending would be more tenuous.

Finally, Adsederá and Boix (forthcoming) argue that countries have followed three possible paths in the relationship between openness and social spending: 1) No opening and no compensation; 2) Opening and compensation, the well-known path followed by OECD countries; and 3) Opening without compensation; a path that usually requires repressive regimes. Yet, Latin American seems to have followed a fourth path: no opening and "compensation". This renders the Latin American countries particularly interesting since some closed countries already have higher than average government sectors, particularly with respect to social spending. In other words, the contradictory effects of internationalization we observe might be the result of previous "compensation" that privileged those other than the poor. Although democratization increases social spending, the impact globalization has on social spending depends on each country's individual history.

VII. CONCLUSION

Using data collected on social spending for the Latin American countries between 1980 and 1999, we set out to test whether the compensation or efficiency hypotheses held for the Latin American continent. As the previous pages revealed, the story is somewhat more complicated than a simple confirmation of one hypothesis over another. Specifically, and in direct contrast to previous work on the OECD countries, we find that trade openness has a negative impact on the allocation of resources to social programs. The strong, negative correlation between trade openness and social spending confirms recent work by Kaufman and Segura (2001). In direct contrast to the negative finding associated with trade openness and social spending, financial openness and social spending are positively related, implying there are two logics of globalization. Moreover, we find in contrast to Kaufman and Segura that democracy has a consistent positive influence on social spending.

Finally, we analyzed the allocation of resources between social spending programs to better understand whether globalization and democracy perform compensating or efficiency functions both in terms of economic investment and politics. Democracies and economies with fairly liberal rules of financial regulation protect spending on programs that reach large segments of the population while trade openness leads to less spending on all components of social spending.

All we have done here is to establish some interesting empirical patterns, more theoretical and empirical work is needed to actually explain this complex set of phenomena. At the very least, we have established there are some heretofore unobserved patterns that deserve further scrutiny. Left unanswered, for example, is why trade openness has a consistently negative correlation with social spending in Latin America when similar models for the OECD nations produce contradictory results. Part of the answer, as we have discovered, may lie in how trade openness is measured. Although more theoretical work is needed to construct the possible mechanisms that lie between trade openness and social spending, additional time

and effort should be spent on refining the trade openness variable. More work is also needed as well to explain why our estimates of democracy's impact on social spending differ from those produced by Kaufman and Segura. Finally, additional efforts are needed to correctly specify a model that interacts globalization with a variety of domestic political institutions. By pursuing these questions in greater depth we can better understand the constraints and opportunities that globalization and democratization afford.

VIII. APPENDIX

Appendix A

Regressions with Social Spending (% of GDP)

as the Dependent Variable

	(1)	(2)	(3)
Lagged Dependent Variable	0.734*** (0.046)	0.747*** (0.047)	0.742*** (0.047)
% of Population in Urban Areas	0.164*** (0.053)	0.164*** (0.052)	0.167*** (0.052)
% of Population 65 and Over	-0.299 (0.317)	-0.094 (0.279)	-0.179 (0.306)
GDP per Capita	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
Growth in per Capita GDP	0.003 (0.013)	0.006 (0.013)	0.005 (0.014)
Unemployment	0.040* (0.024)	0.043* (0.024)	0.043* (0.024)
Trade Openness	-0.027*** (0.007)	-0.036*** (0.007)	-0.028*** (0.007)
Financial Openness	0.152** (0.060)	0.255*** (0.065)	0.229*** (0.063)
Democracy Dummy	1.240*** (0.378)	1.800*** (0.607)	1.992*** (0.615)
Trade Openness X Democracy	-0.017** (0.008)		-0.013 (0.009)
Financial Openness X Democracy		-0.164** (0.067)	-0.112 (0.077)
Constant	-6.342 (6.197)	-9.326 (6.143)	-8.583 (6.070)
Observations	300	300	300

Panel-Corrected Standard errors in parentheses * significant at 10%; ** significant at 5%; *** significant at 1%. Country and Year dummies are not included in the table for presentation purposes.

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