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Democracy, Social Spending and Poverty

Marcus André Melo

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UNRISD, Palais des Nations
1211 Geneva 10, Switzerland

Tel: +41 (0)22 9173020
Fax: +41 (0)22 9170650
info@unrisd.org
www.unrisd.org

Overview

In this paper I discuss the impact of two recent broad processes that has changed profoundly welfare provision in the developing world in the last three decades, namely, democratization and globalization. I provide a review of the existing literatures on the effects of both democratization and globalization on social spending, poverty levels, and social welfare, more generally. In this review, I evaluate the strengths and weaknesses of current contributions and highlight the similarities and divergences in the findings of this rapidly expanding area of research. Issues relative to data availability and reliability are also briefly reviewed. The focus in this analytical exercise in on the quantitative analysis available in large N studies, which adopt a cross-national perspective. The paper also provides an updated discussion of global trends in democratization, social spending and poverty, by further exploring recently available data.

The various scholarly attempts at exploring this theme have tried to disentangle the effects of democratization and democracy and to isolate the influence of other global trends and factors. Most authors find evidence against the link established in received wisdom for OECD countries that globalization is expected to affect positively social spending. In this group of countries, trade openness has been found to be positively associated with welfare provision because greater exposure to international markets increases vulnerability to economic fluctuations, leading to higher pressures by actors such trade unions and labor-based political parties for compensatory mechanisms. On the contrary, the studies on developing countries show that trade openness is related to a downward trend on social spending due to the: a) effects of competitive pressures on expenditure cuts, fiscal balance and the corresponding "the race to the bottom" among states; and b) of the changes in labour markets (due to a decline in formal employment and in the manufacturing sector) and weakening of institutions associated with labour interests, in particular, trade unions and political parties.

Most studies concur that trade integration has a consistently negative effect on aggregate social spending. In the Latin American case growing levels of trade integration had a substantial negative effect on aggregate social expenditures, with the effect being driven entirely by the social security category. In addition, there is significant evidence that education and health are relatively immune from such pressures and in some regions expenditures in these areas have expanded. While these effects are found to be global trends, the impact of globalization is not uniform across the developing world. Rather, there is robust evidence that different regions have divergent patterns which result from their distinct institutional legacies from the pre-globalization period (particularly in the social security system), their different fiscal vulnerabilities of countries and their growth rates.

Some recent studies dispute these findings and argue that that trade openness does not constrain government outlays for social programs, and that democracy has a strong positive association with social spending, particularly on items that bolster human capital formation. Nevertheless, the disagreement is rooted in different methodologies for measuring openness, and more significantly, the regional coverage in this specific strand of the literature is limited to Latin America, and cannot be generalized.

The effects of globalization on welfare spending are no less controversial than the effects of democratization on social policies. Political economy models predict that democracies will favour redistribution and social spending because democracy brings more people with below-average incomes to the polls, and they collectively press the government to redistribute income downwards. This literature also predicts that the effects of democracy is not uniform across the social sectors and that programs with large constituencies – in areas such as primary education or primary health care – are expected to expand under democracy because this would bring government's policy closer to the median voter's preference. By contrast, programs which small and concentrated constituencies, such as special pensions, which caters for the interest of groups such as civil servants and formal sector employees, will experience spending cuts.

There is robust econometric evidence from various studies that as countries turn into democracies they will increase their welfare spending. Holding trade openness constant, these studies show that democracy expands social spending in education and health, while keeping social security outlays unaffected or in some cases smaller. Also, repressive authoritarian regimes retrench spending on health and education, but not on social security. Contrary to OECD countries, however, partisanship has no explanatory power in this relationship. There is research support for the effect of regime in specific regions. In Africa, the need to obtain an electoral majority prompted governments to prioritize primary schools over universities within the education budget. In turn, in East Asia, a country that experiences a permanent move to democratic rule sees its average share of social security spending to GDP increase significantly. In Latin America, the evidence of an influence of regime on spending is less clear cut and the findings on the causality are inconclusive. However, there is also considerable support for a positive relationship.

There is also evidence that not only do democracies spend more in social welfare, they also associated with better welfare outcomes. Democracies are argued to do a better job than non-democracies of improving the welfare of the poor and promoting growth. However, this increased spending may not result in more favorable results for the poor because they may favor disproportionably middle income groups and specific clienteles. This explains research findings that, when flaws resulting from the fact that most cross-national studies omit from their samples nondemocratic states with good social records are corrected, non-democracies outperforms democracies in key social indicators such as mortality rates.

A number of relatively robust conclusions come to the fore in the review. The first is that although democracies spend more than non-democracies, the available econometric evidence suggests that they do not perform better in terms of actual outcomes. Second, when disaggregated, current large N research suggests that democracy is associated with higher spending and better education and health care. The contradictory findings in the literature on Latin America may actually result from issues of disaggregation and methodology. In two econometric tests, I found mixed evidence for the role of democracy on social safety nets and on health and education spending. While the effect of democracy on social safety nets was established, its influence on health and education was not, a result that may have arisen because of missing data for the most recent period. Finally, it is increasingly clear that there is strong interregional variation in terms of the behaviour of the main variables of interest. Therefore, one can hardly speak of one model of welfare state in the developing world.

Introduction

The strong wave of democratization that has swept most regions of the world has attracted a lot of scholarly attention to the evaluation of the causal links between democracy, social spending and poverty. In a similar vein, the process of globalization of trade and financial markets has prompted many studies aimed at investigating the impact, if any, of enhanced capital mobility and increased trade openness on the welfare of the poor and middle sectors in the developing world. While these literatures have accumulated, there is a pressing need to evaluate their findings and assessing the state of the art in this area. This paper is designed as a contribution to help filling this gap. The paper provides a review of the quantitative literature on democracy, social spending and poverty, assessing the contributions made to our knowledge of these relationships. This review evaluates the strengths and weaknesses of current contributions and highlights the similarities and divergences in the findings of this rapidly expanding area of research. Issues relative to data availability and reliability are also briefly reviewed.

The review is focused and circumscribed to the large N studies, which adopt a cross-national perspective. These studies are grouped, for expository purposes, into two large categories: those that focus on the impact of globalization on social spending and those that scrutinize the influence of democratic transitions and consolidation on welfare regimes. In addition to this review, the paper provides an updated discussion of global trends in democratization, social spending and poverty, by examining recently available data. The paper is organized as follows. In the first section, I review a selection of contributions to the quantitative literature on welfare in developing countries. This section is subdivided into two sub sections on globalization and democratization. The third section focuses on issues of data availability and reliability whereas the fourth section discusses some global trends and explores some further issues drawing on the available data. The final section concludes.

Literature review of quantitative analyses on democracy, social spending and poverty

What is the effect of globalization and democratization on social spending and poverty in the developing world? [1]The various scholarly attempts at exploring this theme have tried to disentangle the two factors and to isolate the influence of other global trends and factors, such as the noticeable improvements in social indicators, which reflect exogenous factors unrelated to either of these.[2] Indeed globalization and democratization have gone hand in hand over the last two decades in distinct parts of the globe and they are intertwined. Careful attention has to be paid to hold constant globalization indicators – including trade openness or restrictions on capital accounts – while examining the effects of democracy on the outcomes of interest. Conversely, democracy – measured by whatever indicators that are widely used, from Freedom House to Polity IV scores, among others – have to be isolated from the effects of financial liberalization and importance of trade in GDP. [3]

<u>Globalization and social spending</u>

Globalization is expected to affect positively social spending because trade openness has been found to have played that role in the OECD countries in the formative years of the welfare state. Several contributors have argued that historically the welfare state was primarily a response to the pressures of losers of international-market competition.[4] Greater exposure to international markets is associated to greater

[1] See among others Deacon (2000), Cornia et al (2004), and Kauffman and Haggard (forthcoming).

[2] Irrespective of the effects of globalization and democratization on welfare effort, changes in medical technology have led to improvements in health care indicators. Technological change has also meant cheaper medicines and vaccines. These factors have to be taken into account in evaluations of the welfare effects of trade integration or democracy.

[3] Other research strategies involve controlling for the heterogeneity of countries and for country specific factors.

[4] 30% of the variance in social spending is explained by trade integration in bivariate partial correlation for the period 1973-2003 (Segura-Urbiego 2007, 93).

vulnerability to economic fluctuations, leading to higher pressures by actors such trade unions and labor-based political parties for compensatory mechanisms. Economic insecurity then prompted social actors to engage in social bargaining, which usually were associated to corporatist mechanisms of macro-concertation involving employers' peak associations and labor associations. This was the pattern found in the so called corporatist countries, which were small and more integrated in the world markets. [5]

Recent scholarship has challenged this approach putting forward that the sources of vulnerability are primarily located in national markets and are associated with technological change.[6] Moreover, in OECD countries the association between openness and welfare spending has been reversed in recent years. In fact, since 1997 openness and welfare spending have behaved in opposite directions: when openness increases welfare plummets and vice versa (Segura-Urbiego 2007, 91). Wibbels (2006) provides an argument that domestic and external forces combine: while it is true that tradables, unions, and the like in the developing world have less power or interests divergent to those in the OECD—interests that militate against social spending, developed and developing nations have distinct patterns of integration into global markets. This author argues that while income shocks associated with international markets play an insignificant role in the OECD, they are profound in developing nations. In the developed world, governments can respond to those shocks by borrowing on capital markets and spending counter-cyclically on social programs. No such opportunity exists for most governments in the developing countries, most of which have limited access to capital markets during crisis, bigger incentives to balance budgets, and as a result cut social