

Development, Autarky, and Social Insurance

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Abstract

Despite concerted attention to the causes and consequences of government investment in education, little research has sought to systematically explain the roots and developmental consequences of the single largest category of spending in the developing world: social security. This paper establishes a theoretical framework linking autarkic post-World War II economic strategies in the developing world to the emergence of insurance-based social regimes that emphasize spending on programs like social security. In doing so, the paper has three aims: First, to identify structural factors affecting the choice of internally-oriented developmental strategies; second, to link key features of internally-oriented capitalism to the birth and development of social policy regimes; and third, to examine the developmental implications of insurance-based social spending regimes in an era of opening international markets. We argue that a government's choice of development strategy is conditioned by the size of the domestic market, relative abundance of labor, and land inequality in the context of a closed international trading system. The development strategy in turn shapes the fiscal priority governments place on social insurance. We then claim that large investments in inequitable insurance programs left nations poorly prepared for the opening of international markets that began in the early 1980s. Preliminary empirical analysis finds support for our argument. Overall, the results suggest that economic policies in the 1960s and 1970s had important implications for the emergence of social policy and that those early outlines are more important than "globalization" in shaping both contemporary social policy and economic outcomes.

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It is now conventional wisdom in the literature on advanced industrial capitalism that there is an affinity between approaches to organizing production and broad constellations of social policy. Indeed, on this point the otherwise conflicting schools of thought associated with varieties of capitalism (Iversen 2005; Soskice 2001) and power resources (Bradley et al. 2003; Esping-Andersen 1990) agree. In contrast, there is little research on social policy *regimes* in the developing world. Standard accounts hold that redistributive spending in such contexts is *ad hoc* and impervious to generalization. Though some recent research has challenged this notion by showing systematic relationships between year-on-year changes in types of social spending and “globalization”, we know little about how fundamental approaches to capitalism and social policy shape each other in non-OECD contexts. That the case, this paper has three aims: First, to identify structural factors affecting the extent to which governments pursued autarkic developmental strategies in the post-War period; second, to link key features of autarkic development strategies to the development of insurance-based welfare-production regimes; and third, to examine the developmental implications of insurance-based policy regimes in an era of opening international markets.

Several empirical and theoretical considerations motivate our focus on the affinity between internally-oriented development strategies and insurance spending. First, the embryonic comparative literature on social policy in the developing world has focused on how international economic factors have affected overall social spending priorities (Avelino, Brown, and Hunter 2005; Kaufman and Segura-Ubierno 2001; Rudra 2002; Wibbels 2006) and social security reform (Brooks 2002; Brooks 2005). Such research has contributed a great deal to our understanding of the politics of social policy *reform*, but it does not help us understand why nations began the current era of globalization with such wildly different social priorities. Indeed, as we show below the substantial cross-national differences in social security spending priorities that emerge from distinct, post-war economic strategies swamp the effects associated with a globalizing international economy, which heretofore have been the focus of research on social policy in the developing world. Second, while there are literally hundreds of studies on the causes and consequences of education spending,¹ we do not have a systematic explanation for why countries spend

¹ See, for instance, Barro (1997), Ansell (2007), Rudra and Haggard (2005), Lake and Baum (2001).

on social security and welfare. This is surprising because the most recent data shows that governments in the developing world spend, on average, more than twice as much on social security and welfare as on education, and there is five times more cross-national variation in social security and welfare spending than there is in education spending.² That governments place such varied emphasis on such a large spending category with such potentially important distributional implications begs for an explanation. Third and finally, early and extensive spending on insurance programs in the developing world is likely to have important developmental implications. Again, while we know a great deal about the long-term repercussions of prioritizing public education, we know far less about the impact of government commitments to social insurance. We argue below that insurance-heavy spending regimes produce labor markets poorly adapted for international competition, increase inequality, and systematically under-invest in primary and secondary education. Thus, the economic strategies and related social spending regimes pursued decades ago have had important developmental implications in today's world.

Building on recent research on inequality and redistributive politics as well as work on OECD welfare states, we address these issues by presenting an informal theoretical model in which land, labor and capital bargain initially over the outlines of a development strategy, defined here with regards to its internal orientation. Agents' preferences over the development strategy are shaped by four factors: domestic market size, the relative abundance of labor, land inequality, and the openness of the international economy. Once the degree of autarky is chosen, we suggest that one key challenge each nation faces is the organization of a labor force appropriate to their developmental projects. Social policy becomes a tool for the creation of such labor markets. The closedness of the development strategy and ongoing bargaining among factor owners shapes countries' social policy regimes. While autarkic developmental projects required large, densely organized, highly insured industrial workforces aimed at production for domestic markets, export-oriented strategies were premised upon flexible workforces.

² For the 44 developing countries reporting both social security and education spending in 1998, social security and welfare account for an average of 30% of total government spending compared with 13% for education. The standard deviation of social security and welfare spending is 19 while that for education is 5. The biggest social security spender that year was Uruguay (70%) while Lesotho spent the most on education (24%). See the appendix for details on the data.

These dynamics are manifested empirically in divergent priorities for insurance oriented types of social spending. Empirical analysis of data beginning in the 1960s finds support for the model, showing the impact of these factors in shaping development strategies and social insurance spending in the developing world. We also show that insurance-based social spending regimes are associated with poor developmental outcomes over subsequent decades.

The results have theoretical implications for several literatures. First, they help answer ongoing questions about why apparently similar countries chose divergent economic policies over the last 50 years. Second, the findings suggest the extent to which the political and economic logics underpinning the development of social policy regimes shape contemporary social policy in much of the world. Third and finally, the research helps close the gap with the literature on the political economy of the welfare state in advanced industrial democracies by showing an affinity between approaches to developmental capitalism and social policy.

The rest of the paper is organized into five sections. In the following, we briefly review the OECD social policy literature and assess its relevance to the developing world. In doing so, we suggest the need for a theoretical account of the nexus between capitalism and social policy in the developing world that mirrors developments in the OECD literature. We also review recent research on social policy in the developing world, noting the advances made but also emphasizing the limitations of an approach that seeks to explain year-on-year changes without accounting for divergent social spending starting points in anything more than a technical sense.³ In the second section, we describe insurance spending across the developing world as a means to establish our empirical puzzle. In the third section we present our argument and derive hypotheses. In the fourth section we describe our data and methods in addition to presenting our results. The final section concludes with the implications of our findings and suggestions for further research.

1. Capitalism, Development and Social Policies

³ For example, by including fixed effects/country dummies in large panel time series studies

Research examining the welfare states of a handful of wealthy nations dominates the literature on capitalism and social spending. It is a body of work rich in empirical associations (between, for instance, electoral institutions and social spending, trade openness and the size of government, and the strength of left-labor alliances and redistribution), though a serious theoretical divide separates those that emphasize the centrality of class-based (Korpi 1983) as opposed to sector-based (Hall and Soskice 2001; Iversen 2005; Mares 2003) conflicts in the birth and evolution of the welfare state. Both approaches, however, find inspiration in Esping-Andersen's (1990) mapping of general approaches to capitalism onto welfare regimes. Irrespective of whether liberal, Christian democratic or social democratic welfare states are rooted in class conflict or distinctive varieties of capitalism, the close link between modes of capitalist production and redistribution is well established in the literature.

No such unifying theme runs through the truncated literature on the political economy of social spending in the developing world. For starters, while the OECD literature has identified the fundamental ingredients of distinct approaches to capitalism (unionization rates, electoral systems, the level of wage bargaining, etc.), there is no systematic account for why developing countries pursued divergent economic policies in the post-World War II period. Of course, the extensive development literature has emphasized the difference between internally-oriented import substituting strategies and export-oriented, trading strategies, but aside from an abbreviated literature exploring why countries like Brazil and Mexico pursued import substitution industrialization while Korea and Taiwan did not (Gereffi and Wyman 1990), we do not have a systematic account as to why countries varied so extensively on their joint use of tariffs, import licensing, export subsidies, price controls, marketing boards, state-owned enterprises and the like. The post-war quest for improved living standards via industrialization coincided with attempts to develop systematic national social policies. Our poor understanding of the key ingredients in choosing developmental strategies represents a central obstacle to identifying any potential link between economic and social policies. Iversen links "welfare-production regimes" to firms' competitive strategies in the international economy. Our goal is to expand and generalize this notion by linking social policy in the

developing world, particularly insurance programs, with the degree to which countries *protected* their nascent domestic industry from having to compete internationally.

In the absence of a coherent causal explanation for variations in how autarkic development strategies were, it should not be surprising that we lack accounts as to how development strategies might have impacted the emergence and evolution of social policy. Indeed, a common theme in research on the equivalent of the welfare state in the developing world is that social policy in such settings is less coherent, more idiosyncratic and less amenable to theorizing than in the OECD. Such interpretations probably stem from the difficulty in systematically cumulating the findings of numerous case studies on the impact of, e.g., market reforms on social spending or inequality. It is worth noting, however, that this frustration is also voiced by some stymied by the quest for regularities in large-*n* data sets as well (Rodrik 1998). Thus, even where case specific research suggest an affinity between import substituting developmental goals and the emergence of social insurance (Malloy 1979; Mesa-Lago 1978) or between export-oriented industrialization and education spending (Amsden 1992; Woo 1990), the analyses lack the kind of conceptual foundations that might provide for generalization.

A recent spate of research has challenged the notion that social spending in the developing world is impervious to generalization by showing systematic relationships between globalization and year-on-year changes in types of social spending (Avelino, Brown, and Hunter 2005; Kaufman and Segura-Ubiergo 2001; Rudra 2002; Wibbels 2006). A related set of papers (Ahlquist 2006; Mosley 2003; Sobel 1999) documents how developing countries tend to face capital markets that are more “disciplinarian” in approaching poorer countries than richer ones, more rapidly punishing poorer countries for spending and inflation outcomes that investors find undesirable. The emerging consensus is that developmental welfare states are more constrained by trends in the global economy than their counterparts in the OECD but that some areas of social spending are more vulnerable than others.

Though important, such research is limited. Most importantly, the underlying complexion of spending across countries on the eve of market opening has been a black box. To the extent this variation has been addressed, it is only atheoretically via country fixed effects that are almost never reported in

printed tables of regression results. The analysis of annual changes in expenditures tells us little about how fundamental approaches to capitalist development and social spending shape each other. While it is interesting that substantial economic opening has measurable, if modest, effects on social spending, such research does not explain why countries varied so substantially in their social spending priorities before the ongoing wave of market liberalization. More concretely, recent econometric models (Kaufman and Segura-Ubiergo 2001; Wibbels 2006) show that a permanent one percent (of GDP) increase in trade dependence implies a long-term decline in social insurance allocations by about 0.2% government spending. Contrast this marginal finding with the differences in spending priorities between Brazil and Malaysia on the eve of the debt crisis, despite reasonably similar per capita incomes and demographics: social insurance spending accounted for just under 50% of Brazil's expenditure but only 4% in Malaysia. What is remarkable is the extent to which the divergent initial priorities swamp the impact of changes in the global economy. As we will show, these cross-national differences in the commitment to social insurance that pre-date liberalization have a much stronger impact on contemporary social policy than the imperatives of international markets which have been the focus of recent scholarly attention.

Unfortunately, while we can look to the OECD welfare state literature for inspiration, the arguments found there do not travel well. Though large welfare states are associated with small, open, trade dependent economies in the OECD, the opposite holds in the developing world where the highest levels of social spending (and insurance spending, in particular) are associated with large, historically closed economies. Additionally, the contemporary literature on OECD welfare states assumes that struggles over market regulation and the distribution of public spending occur in the context of democratic governance; many social spending regimes in emerging markets developed and/or are currently administered under authoritarian auspices. In this regard, the emergence of social spending in developing nations mirrors the birth of some OECD welfare states. As Esping-Andersen notes of the hypothesis linking democracy to the emergence of welfare states, "the thesis confronts the historical oddity that the first major welfare-state initiatives occurred prior to democracy and were powerfully motivated by the desire to arrest its realization."(1990:13) An important implication of this argument is

that models relying on electoral institutions or the *electoral* strength of the Left are unlikely to provide much traction in explaining the emergence of social spending regimes in the developing world. It also appears that some of the aspects of democratic politics that influence redistribution in the OECD seem not to in the developing world. There is no obvious relationship, for instance, between the proportionality of electoral systems and welfare effort in the developing world, despite a strong positive association in the OECD (Alesina, Glaeser, and Sacerdote 2001).

Finally, it is worth noting that social spending priorities have important implications for developmental trajectories. In the OECD literature, distinct welfare states have impacts on everything from growth to inequality (Alvarez, Garrett, and Lange 1991; Bradley et al. 2003; Iversen 2005). In the developmental context, we know from the standard Barro growth model and more recent work on endogenous growth that human capital accumulation has important implications for developmental outcomes ranging from economic growth to the evolution of inequality (Barro 1997). In the developing world, the current line is that the impressive outcomes in several East Asian countries and developmental failures in sub-Saharan Africa and elsewhere reflect in part these countries successes or failures in making sustained investments in human capital. That the case, we have almost no research on the developmental implications of insurance spending, despite the fact that it consumes more than twice as much of the average public budget as education in the developing world. Nor do we know if heavy spending on insurance programs crowds out government contributions to education. Indeed, even after the developmental advantages of human capital investments became clear, many countries across the developing world have continued to spend extensively on insurance programs.

Here, the literature on redistribution offers contending perspectives, and hence, a puzzle. In the first camp, the mechanisms for redistribution are inefficient; addressing redistributive demands is the source of slower growth in unequal societies, e.g., Meltzer & Richard (1981). In the second camp, markets for something important are incomplete, implying that redistribution can be welfare enhancing *on average* (Benabou 2000; Bourguignon and Verdier 2000). While this literature has looked at redistribution in the social insurance sense *or* in the growth enhancement sense, it has not explained why

governments would emphasize one redistributive strategy over another. In linking such choices to developmental outcomes, we aim to make a broader contribution to the literature on the political economy of redistribution.

To sum up, there are three major shortcomings in current work on development and social spending in the developing world. First, there is no generalizable account as to why apparently similar countries pursued more or less autarkic development strategies in the post-World War II era. Second, there is no compelling theoretical story linking particular modes of developmental capitalism to social spending regimes. What literature does exist on social policy has focused on the relationship between the process of market reforms, international market integration and year-on-year changes in spending categories rather than on the factors shaping fundamental social policy regimes. We provide an explanation both for why countries chose different economic strategies in the period after World War II and how those strategies shaped the emergence of social spending regimes. Third, existing research provides limited insight into the developmental implications of investments in social insurance. We address these shortcomings by laying out an explicit theoretical framework endogenizing the initial choice of development strategy and showing how this choice had important implications for the broad contours of social policy as they emerged across the developing world in the post-World War II era.

2. Social Insurance in the Developing World

Consistent with established thinking in the social policy literature, we consider social insurance to include the pooling of individual resources via contributions to the state so that individuals who experience some change in their work status (unemployment, retirement, etc.) receive financial support. Because it typically depends on contributory transfers, social insurance tends to insure the better off and reiterates existing social hierarchies. Such is particularly the case in the developing world where insurance programs developed to cover a relatively small number of economically and politically strategic sectors, while the costs of such programs were broadly diffused. From Brazil (Malloy 1979) to Peru (Mesa-Lago 1978) to South Africa (Lund 1993), social insurance developed on an occupation-by-occupation basis, with the result being programs that had a relatively narrow range of beneficiaries among

relatively privileged workers in the formal sector. In the developing world, insurance spending is strongly oriented toward old age transfers but can also include unemployment insurance, survivor's benefits, disability, and the like.

Throughout this paper we operationalize social policy regimes using spending data. As a matter of measurement, the IMF aggregates the various insurance programs noted above under the heading "social security and welfare". Figure 1 presents a series of boxplots⁴ each of which depicts the distribution of the shares of government spending for a major spending category. Cases include only in developing countries in the pre- and post-debt crisis periods. The cross-country variation in social security/welfare spending in the South dwarfs that of all other types categories; in some countries, social insurance is clearly the biggest government budget priority while in others little is being spent. In the post-debt-crisis period, cross-country variation in social security spending has *increased* in the developing world.

FIGURE 1 HERE

Figure 2 plots two sets of data.⁵ In the left panel, the two indices of development strategy are juxtaposed while social policy regimes are compared in the right panel. We use the tools of hierarchical cluster analysis⁶ as devised by Fraley and Raftery (2002b) to systematically examine the data for coherent groupings of countries (see appendix).

In the left panel of Figure 2, we identify three clusters of countries: those inwardly focused, those pursuing an export-orientation, and a group of "extreme exporters" that include small Caribbean islands,

⁴ Boxplots, due to Tukey (1977), are convenient ways to display the key distributional features of a variable. The thick bar in the center locates the median while the range of the box shows the interquartile range. The whiskers show the range of the data that extend up to ± 1.5 times the interquartile range. Dots are outliers. The notches in the side of the boxes depict a rough 95% confidence interval around the median; if the notches don't overlap then the hypothesis that the difference between the medians is 0 can be rejected at the 5% level.

⁵ Data are described in more detail below; Definitions, sources, and descriptive statistics are in the appendix.

⁶ All analysis was performed in R 2.4.0 (R Core Development Team 2006). Cluster analysis used the `mcclus` library (Fraley and Raftery 2002a). We emphasize that cluster analysis, particularly as used here, is primarily an exploratory rather than confirmatory or inferential activity. There are many attributes on which to measure similarity and difference across countries and, given some set of attributes, numerous algorithms for identifying clusters. We are simply attempting to establish the existence of an interpretable pattern across developing countries in both their development strategies and the nature of their insurance spending priorities. Below we turn to more traditional regression modeling to establish the relationships between development strategies and social spending and between social spending and outcomes of interest in the developing world.

Middle Eastern oil states, and Asian export processors like Macao. On the right, countries are plotted on the two largest elements of social spending—social insurance and education. The clustering approach makes clear that social security prioritization differentiates countries: there are those that allocate a significant portion of the budget to social insurance and others who do not. Among the non-spenders, there is wide variation in human capital spending which appears along the x -axis.⁷ The members of the three clusters give face-value credence to the argument linking development strategies to social spending priorities. The high social security spenders are all import-substituters in the 1950s-70s.

Figure 2 Here

It is also the case that these spending priorities appear to be very stable through time. We argue that developing countries' social spending priorities are directly implicated in the countries' choices of development strategies. As such, spending should not vary radically from year to year. To examine stability across all countries, we calculate the coefficient of variation in social spending using all available observations prior to 1983. Figure 3 presents plots on the distribution of the coefficients of variation for social security spending variables. All variables show extremely low variation relative to their means for most cases, implying that spending is not volatile as a proportion of the government budget. Further examination of specific cases (not reported here) reinforces the notion that insurance spending is stable and not prone to dramatic shifts.

Figure 3 Here

Given this descriptive data, we now develop a theoretical account to explain why insurance spending represents a highly variable share of national budgets, appears relatively stable through time on the eve of economic liberalization, and seems to be related to post-war development strategies.

3. The Argument

We present our argument in three steps. First we explore how internal macro-level structural conditions impact the internal orientation of development strategies. We develop an informal three factor model in which the preferences of land, labor and capital vis-à-vis development strategies are conditioned

⁷ If the clustering is done in three dimensions by including health and education spending individually rather than as

by the size of the internal market, inequality in rural landholdings, the relative abundance of labor, and the openness of the international economy. Second, we suggest that autarkic development strategies impact the returns to factors and shape the preferences of land, labor and capital with regards to social spending geared toward insurance. The resulting social policy regime fosters the emergence of a labor force (and market) complementing the development strategy. Indeed, we argue that social policy is integral to the development project. Third and finally, we argue that social policy regimes that focus on insurance produce poor development outcomes as measured by the evolution of national income and interpersonal inequality during the current era of globalizing markets. By producing bifurcated labor markets with substantial rigidities, such social regimes slow economic development and contribute to worsening inequality.

We contend that one of the primary post-World War II development challenges is the mobilization of a work force appropriate to capitalist development, given the factor endowments and state of the international economy at the time. We are not the first to emphasize the critical importance of labor markets to capitalism. Despite the centrality of capital accumulation to Gerschenkron's account of development, he also argues that "...the overriding fact to consider is that industrial labor, in the sense of a stable, reliable, and disciplined group that has cut the umbilical cord connecting it with the land and has become suitable for utilization in factories, is not abundant but extremely scarce in a backward country. Creation of an industrial labor force that really deserves its name is a most difficult and protracted process."(Gershenkron 1967:9) Likewise, Weber suggests that the distinctive feature of capitalism as it emerged in what became the advanced industrialized democracies was in the organization of labor markets. He writes that "in modern times the Occident has developed...a very different form of capitalism which has appeared nowhere else: the rational capitalistic organization of (formally) free labour."(Weber 1958:21)⁸ Polanyi (1944) and Esping-Andersen (1990) also emphasize the complementarities among the

a sum, the same solution prevails; differences in social security allocation do all the work.

⁸ He goes on to suggest that "Labour must, on the contrary, be performed as if it were an absolute end in itself, a calling. But such an attitude is by no means a product of nature. It cannot be evoked by low wages or high ones alone, but can only be the product of a long and arduous process of education. To-day, capitalism, once in the

creation, standardization, and regulation of the labor force during the emergence of contemporary capitalism.

In Esping-Andersen's (1990) classic account of welfare regimes in the OECD, modern capitalism requires the presence of workers willing to sell their time, thereby "commodifying" labor. In advanced countries, wage labor markets became the dominant source of income for those not owning capital. Risk-averse workers employed political and industrial tactics to redistribute wealth and risk in an effort to "decommodify" labor. Indeed, it was in large part the demands of "commodified" labor for security against market volatility that underpin both sectoral (varieties of capitalism) and factoral (power resources) accounts of the rise of the welfare state. The challenge of post-World War II development in today's emerging markets reverses this order. In many cases, large pools of un- or weakly-commodified labor persisted well past the middle of the 20th century. In the context of slowly opening international markets, incipient political pressures from both elites and the poor after colonial independence, and the skills required in even basic manufacturing, one of the key challenges for policy makers was stimulating the formation of appropriate wage labor markets. Consistent with case study research on countries as diverse as Korea, South Africa and Brazil, we argue that governments chose social policies as part of the attempt to foster the emergence of a labor force with skills and incentives congruent with their developmental strategies.

3.1 From Endowments to Autarkic Development Strategies

Gereffi defines a development strategy as "sets of government policies that shape a country's relationship to the global economy and that affect the domestic allocation of resources among industries and major social groups." (Gereffi and Wyman 1990:23) Consistent with this definition, the development literature has identified a number of coherent, post-war economic strategies; the defining feature of these strategies was the degree of autarky. While some countries pursued policies explicitly aimed at fostering export capacity in higher value added merchandise, others emphasized the development of heavy industrial production to service domestic demand. In these latter cases, lower value added exports were

saddle, can recruit its labouring force in all industrial countries with comparative ease. In the past this was in every

tightly managed and used to finance import substitution industrialization. Less well-recognized is that the organization and regulation of labor markets was a key element of these strategies. Import substituting economic strategies created relatively privileged working and middle classes that could serve as both the labor input for and the ultimate consumers of domestic industrial production. In such cases, policy makers inflated urban incomes by limiting the arbitrage of urban and rural wages, maintained overvalued exchange rates, and developed social policies that served to protect the position of the emergent working and middle classes. In export-led developers (whether industrial or primary product exporters), on the other hand, policy-makers created much more fluid labor markets, encouraged the equalization of urban and rural wages, and developed social policies emphasizing worker mobility at the expense of protection or insurance. In many such cases, capital and the state actively repressed demands for insurance-oriented spending.

But why did some countries choose autarkic development strategies? Our account begins with a three-factor model inspired by Rogowski's (1987) classic work. In the model, owners of land, labor and capital bargain over the development strategy, defined here with regards to the openness of the domestic economy. We assume the following:

1. Each agent in the economy is owner of only one productive factor;
2. For workers there is a tradeoff between industrial and agricultural production, i.e., a country cannot be both relatively labor and land abundant;⁹
3. Factors are immobile across countries;
4. Agents seek to maximize their incomes;
5. Consistent with the cases and time period we are examining, capital is assumed to be scarce;
6. The international trading and financial system is relatively closed.¹⁰

case an extremely difficult problem" (p.62).

⁹ This is consistent with models in which the workers' reservation wage is the subsistence earnings from abandoning the wage labor force.

¹⁰ We find assumption (6) to be uncontroversial during the period that marks the birth of most development strategies between the end of World War II and the 1970s. Of course, the actual extent of international openness

We posit a highly reduced-form conception of the political process. Development strategy is held to be the result of Nash bargaining between factor owners in which the greater the share of national income directed to a factor the greater the bargaining power accruing to those factor owners. The political process is a mapping from income shares into policy. In the three-way bargaining situation, the Nash concept can be considered as akin to a coalition formation game in which owners of, for example, labor and capital can collude against land owners and implement their preferred development strategy even if land owners receive a greater share of national income than either capital or labor separately.

The relatively closed post-war international economy has two implications for our study. First, it conditions the relative power of land, labor and capital in a society. From the Heckscher-Olin theorem and the Stolper-Samuelson corollary thereof, assumptions (3), (5) and (6) imply that capital will be protectionist and favor internally-oriented development strategies across cases. Similarly, policy-makers initiated development strategies and their concomitant social spending regimes in an era when labor was relatively weak in labor abundant economies and relatively strong in labor scarce economies. As a result, our model predicts that it is the relative abundance of *labor* that will determine the development strategy in many cases. Second, the closed international economy reduces the costs and increases the potential benefits of autarkic, import-substituting policies. This emphasis on the role of international markets in framing foundational distributive fights belies the closed economy assumption in most of the literature on inequality and redistribution. With very few exceptions, the demand for particular types of labor and the resulting nature of social conflicts are strongly influenced by conditions in the international economy. In contrast to classic accounts of economic development in Western Europe which tend to emphasize the importance of domestic factors (though see Pomeranz (2000) for an exception), conditions in the international economy loom large in accounts of post War development, whether among export-led developers (Wade 1990), import substituters (Baer 1972; Hirschman 1968), or primary commodity producers (Bates 1997).

varies during this period, but throughout it is relatively closed when compared with the international economy prior to World War I or what emerges from the third world debt crisis of the 1980s. Among the 60 countries for which

Given our assumptions, we argue that the preferences of land, labor and capital over the orientation of the development strategy are conditioned by three factors: the size of the domestic market, the relative abundance of labor, and inequality in rural landholdings. The size of the domestic market shapes the expected returns of capital, land and labor vis-à-vis inward-oriented policies. Though the underlying coalitional politics inherent in our factor-based approach will vary across cases, market size conditions the potential benefits to all factors from internally-oriented strategies. Insufficient domestic demand makes economies of scale in industrially-produced goods more difficult to achieve, reducing returns to all factors. The larger the market, the more likely a coalition in favor of an internally oriented development strategy will emerge and impose its preferred economic policies.

The relative abundance of labor conditions its social strength and preferences over the development strategy. Where labor is relatively scarce workers benefit from internally oriented development strategies and the protectionism they imply. The relatively closed international economy during the era of interest provided scarce labor with additional bargaining power and hurt the bargaining power of abundant labor. Given that capital is also assumed to be scarce, scarce labor implies a capital-labor coalition in favor of an internally oriented development strategy at the expense of land, which is abundant and opposed autarkic economic policies.

Lastly, rural inequality plays a key role in defining how difficult it is to finance an internally oriented development strategy at the expense of land. As the history of import substitution makes clear, internally oriented development strategies are typically financed through high taxes on agricultural production, state controls over agricultural exports, and/or other means of extracting agricultural surplus. Where land is equitably distributed, it is relatively difficult for a capital/labor coalition to extract rural surplus for several reasons. First, as the scale of farms shrinks and their numbers increase, the political and administrative costs to a protectionist capital-labor coalition of taxing the countryside increases. When landowners are few and large, the task of tax collection (or other form of surplus extraction) becomes easier. Second, small and medium-sized landowners are more sensitive to increased costs than

we have data on the period from 1960 to 2000, average trade dependence went from 46 percent in 1960 to 75

wealthy, large landholders as they are typically closer to the subsistence level and with poorer access to credit. In contrast, when rural holdings are concentrated, they represent an attractive target for urban coalitions. This account is consistent with failed attempts at internally oriented development strategies in a case like Korea, where the equitable distribution of land facilitated a powerful collective rejection of attempts to implement autarkic policies at their expense. Such an experience contrast with cases like Egypt or Pakistan never mind quintessential internally oriented cases like Brazil or Chile where greater inequality made large landholders politically attractive sources for financing internally oriented policies (Mahon 1992).

Internally oriented developmental strategies were typically pursued in societies that had large internal markets, scarce supplies of labor and high levels of land inequality (Diaz Alejandro 1984; Murphy, Shleifer, and Vishny 1989). As a matter of necessity, most countries with such large markets responded to the great depression with a turn inward. As Baer (1972:97) explains “The depression of the Thirties resulted in renewed shortages of imported goods. The fall of foreign exchange receipts from exports forced most countries...to curtail imports. The decline resulted at first in increased use of productive capacity underutilized in the Twenties, and later in the creation of new industrial capacity.” Only in the 1950s and onward, however, did ISI become explicit policy in countries such as Argentina, Brazil, Mexico, Turkey, and South Africa. In these contexts, early, uneven processes of industrialization combined with labor scarcity to produce relatively high urban wages. In most such cases, moreover, high initial levels of land inequality ensured that the prospective returns to any export-promoting policies would benefit the highly concentrated rural elite. Experiments in export promotion proved politically unsustainable, particularly in democratic contexts (Mahon 1992). In these settings, policy-makers confronted a post-war environment in which a large internal market combined with labor scarcity to produce urban wages high enough to support import substitution while high rural inequality made export promotion politically difficult. The policy mix was similar in most such cases: trade protection, the creation and subsidization of infant industries, overvalued exchange rates to promote the importation of

capital goods, and the extraction of surplus from agricultural areas in order to finance the project. The initial result was typically rapid industrial growth oriented toward domestic production. The flip side of autarkic strategies was those that emphasized external competitiveness for economic dynamism. Initially, such strategies commonly included export incentives, generally low trade barriers (though with some exceptions for imports), higher interest rates, and the maintenance of weak exchange rates (Rodrik 1999).

3.2 From Autarkic Development Strategies to Insurance-Based Social Policy Regimes

Once development strategies are chosen, they have important implications for social policy. This relationship results from an ongoing redistributive struggle among the competing factors and the labor market demands of an autarkic development strategy, which social policy becomes a key tool in creating. On the former point, where labor was scarce (and thus empowered in the context of closed international markets), it played an important role in the broad outlines of social policy. It is worth noting that the cases (think Argentina and Chile) with post-war social spending regimes most consistent with what we see in the OECD in terms of social security and labor protections are also cases that saw relatively well organized, protectionist working classes playing a substantial role in the negotiation of insurance-based social policies in the 1950s and 1960s. In contrast, where labor was abundant, the relatively closed international environment served to reduce the bargaining and organizational power of workers. The absence of working class participation in the formulation of social policies is evident in labor abundant cases as diverse as Korea, Pakistan, and Guatemala.

Internally-oriented development strategies had important implications for the interests of capital and labor vis-à-vis the government's commitment to insurance spending. Capitalists in ISI cases have two interests that bear on social spending: first, the creation of an industrial labor force (both white and blue collar); and second, the creation of a consumer base large enough to warrant production. Both of these interests were shaped by the fact that most such cases were labor scarce. In such contexts, generating appropriately skilled labor represented a significant investment and risk for both firms and workers. Social security systems became the social policy of choice in such contexts. They were designed both to generate and maintain particular sets of skills in the labor market as well as to ensure a minimum of

income in order to guarantee a stable level of domestic demand (Mesa-Lago 1978:6). When combined with other, related policies, the resulting insurance-based social spending regimes were characterized by labor market protections and high wages that increased costs, of course, but in doing so ensured the size and stability of the domestic market. Given highly concentrated production markets, moreover, capital was able to pass on the costs of such programs to consumers.¹¹

The interests of capital were complemented by those of labor.¹² Indeed, the relatively closed international economy of the 1950s-1960s created a situation in which urban labor had relatively significant influence on the construction of these policies. In such cases, labor's market power was maximized both as a limited, skilled input into manufacturing production and as a key consumer of the manufactured output (Mallet 1970). Thus, once established, labor in import-substituting sectors was economically and politically privileged. In most such cases, high inequality framed labor's preference for insurance spending as it sought to insure itself against a big drop into the rest of informal or agricultural labor markets. These privileged working classes cooperated with industrial elites to lobby for the creation of social regimes that included labor market rigidities, disability and (in some cases) unemployment insurance, and strong social security systems—what we call insurance-based social regimes. Mesa-Lago (1978:3) captures the common, stratified dynamic well when he writes that “social security...has often been manipulated to gain the electoral support of a particular clientele, to legitimate a spurious political regime, and to satisfy the needs and coopt (sic) powerful pressure groups which threaten the status quo.” The creation and expansion of such systems responded to the underlying demands of capital and labor—capital with its concern for insuring its investment in workers and the stability of domestic demand and labor with its concern for insuring itself from much lower wages outside of the manufacturing and public sectors.

In contrast, outward-oriented development strategies militated against insurance spending. Export-led industrialization (EOI) projects were initiated in societies with lower initial levels of inequality

¹¹ Yet another indirect mode of extracting agricultural surplus.

and labor market stratification. Capital in EOI cases had two central interests: first, the creation of a productive labor force; and second, minimizing labor costs in order to ensure international competitiveness. Insurance spending served neither end, since it limited labor market mobility and increased costs. Likewise, with relatively low levels of inequality, workers had a smaller distance to fall in the income distribution should they lose their jobs thus facing lower risk and requiring less insurance. Given the closed international economy of the 1950s-60s, moreover, labor in these export-led, labor abundant economies was in a weak bargaining position vis-à-vis capital. In most such cases, the state and private capital formulated social policy in a political context characterized by labor's exclusion.

3.3 From Insurance-Based Social Policy Regimes to Developmental Outcomes

Having explored the origins of distinct approaches to social spending regimes, we turn to the developmental implications of these regimes over recent decades as the global economy has become more open. Here we focus on the impact of social spending on the evolution of inequality and per capita income growth. By analyzing the performance of these political economies, we are interested primarily in the capacity of this understudied approach to redistribution to prepare nations for the challenges and opportunities created by the opening of the international economy. Doing so helps redress the imbalance between the abundant research on education and the paucity of research on the insurance aspect of social policy.

We expect insurance-based social policy regimes to detract from economic performance. With liberalization, imports become cheaper and the pace of industrial substitution slows (or the costs of such substitution go up), thereby decreasing the returns to industrial deepening. Irrespective of social spending regime, the result is likely to be a prolonged process of deindustrialization and poor growth as the economic basis of the previously protected and highly insured working and middle classes decline. Insurance-oriented spending is likely to exacerbate these difficulties. First, significant spending on insurance can crowd out commitments to education. To the extent that human capital is a key to long-term

¹² One can imagine labor as maximizing its expected return from current wages and its alternatives in the labor market. Where the alternatives are sufficiently poor (conditions of high inequality), it prefers spending on insurance. When the alternatives are sufficiently good (conditions of low inequality), insurance becomes moot.

growth, insurance spenders will be lacking in a key ingredient for successful adjustment. Second, high insurance spending produces a skill distribution whereby a small share of the working population possess skills valued by manufacturers but a large majority has insufficient skills to take advantage of the increasingly skill-intensive nature of production in the global economy.¹³ Third, To the extent that such spending increases inequality (see below) and inequality has a negative impact on growth in developing nations (Barro 2000), social security and other insurance expenditures have negative implications for developmental outcomes.

Next we consider the distributive implications of insurance-based spending regimes. In cases with autarkic development strategies, most of which are characterized by labor scarcity, Stolper-Samuelson tells us that liberalization will reduce the income of labor. More precisely, the opening serves to limit the income of urban workers and potentially reduce the size of the middle class, while increasing the returns to land. The resulting increase in inequality is likely to be exacerbated by social security systems which are often designed to reiterate existing social hierarchies (Esping-Andersen 1990: 22), particularly in the developing world where they are often regressive (Mesa-Lago 1994). One implication of these protections is that they entrench inequality by limiting the arbitrage between higher urban wages and lower rural ones.¹⁴

Insurance-based spending is likely to exacerbate the link between inequality and liberalization for four reasons. First, as trade opening exposes highly protected domestic firms to competition, it produces deindustrialization and declining formal sector employment. Insurance-based spending regimes will have a negative impact on inequality as ever smaller shares of the population benefit from such spending (informal sector workers neither pay into such systems nor benefit from them). Second, as the formal sector of the economy shrinks, the fiscal burden of such systems will mount as the supported-to-active worker ratio climbs rapidly. Typically, the poor suffer most during such fiscal crises. Third, given the organized constituencies associated with social security systems, the result is likely to be a fiscal

¹³ For detailed arguments bearing on the relationship among skills, inequality and growth, see Feenstra and Hanson (1996) and Kremer and Maskin (2005).

crowding out of social policies such as education and health care that might alleviate inequality (Wibbels 2006). Fourth and finally, because most social security systems are financed by employer contributions and passed on through higher prices for goods and services, the benefits accruing to relatively well-off recipients are shared by the poor who suffer from reduced purchasing power. Such dynamics are likely to swamp any positive income effects associated with increased returns to agriculture in such cases (these cases are land abundant), most of which have sharply maldistributed rural income anyway. In these insurance-based systems, therefore, we are likely to see mounting inequality as exposure to an open international economy increases.

Figure 4

Figure 4 provides an overview of our causal argument and outlines the factors we expect to influence the preferences of land, labor and capital over the internal orientation of development strategies and insurance-based social policies. None of this necessarily abstract discussion is intended to dismiss cross-national differences within or similarities across development strategies. It is clear, for instance, that the Egyptian and Mexican approaches to ISI were quite different in much the same way that some have drawn attention to diverse approaches within the EOI camp.¹⁵ Similarly, what we today call export-led industrializers themselves pursued policies of import substitution in the 1950s, and several of the ISI cases experimented with policy reforms aimed at promoting exports in the 1960s and 70s. Nevertheless, as the data presented below makes clear, the distinctions in development strategies had real implications both for the underlying nature of the economy and the formulation of social policy.

4. Data, Methods and Models

In this section we describe the data we use and then present a series of results from relatively simple regression models.

4.1 Data

¹⁴ Such inequality was often further exacerbated by technological innovations in agriculture during the 60s and 70s and government policies prejudicial to agriculture.

¹⁵ On ISI cases see Waterbury (1993). On the EOI cases see Booth (1997).

The underlying dataset is an (unbalanced) panel time series. There are serious shortcomings in data availability for many countries, particularly prior to 1980, so we are cautious in the claims we draw from the analyses. We analyze the data by breaking the data into discrete time intervals. We then take means of the relevant variables for each country for all available years in the interval and analyze cross-sectional averages. Given the evidence that development strategies and social spending priorities are very stable through time, averages seem unproblematic and serve to maximize the number of cases under analysis. The first interval takes all available data prior to 1983. We choose 1983 as our cut-off point as 1982 was the last year of data before the onset of the debt crisis which drastically altered the macroeconomic environment and fiscal position of many countries. Additionally, the debt crisis provided multilateral lending organizations with improved leverage over debtor nations at the same time that these organizations were strongly emphasizing export competitiveness as the path out of crisis and default (Stallings 1992). We use the average for all available years prior to 1983.

While we have discussed internally-oriented development strategies as discrete choices, the reality is, of course, more nuanced. Countries varied to the extent they pursued autarchic economic policies, and even EOI cases used some levels of import protection. As such, we measure ISI as the proportion of total manufacturing output *not* exported; higher values indicate a more domestically oriented manufacturing sector.¹⁶ Though our notion of developmental strategy has been couched in terms of more or less openness, it is more precise to think of this strategy in regard to openness towards exports, particularly of manufactures. Both ISI and EOI cases maintained significant tariffs and non-tariff import restrictions (Gibson and Ward 1992). Generic measures of openness or deviations from gravity-model trade predictions (Hiscox and Kastner 2006) will be insufficient to differentiate between cases.

We operationalize our notion of an insurance-oriented social policy regime using social spending data. Although there are many components to the government's social policy strategy, spending variables

¹⁶ Note that this ISI variable takes on negative values for some periods. While this is curious, we have two tentative explanations. First, some of the most export-intensive economies may be re-exporting from other countries. Second, and probably more importantly, this value is calculated by combining export data from two sources (see the appendix). This combination may result in a mismatch between total manufacturing output and total manufacturing

have the advantage of obvious cross-national comparability. Other important aspects of welfare regimes include wage policies, labor market regulations and worker training. We have strong priors that these non-quantified aspects of social regimes are likely to be closely related to the spending data that we do have. Union-negotiated wages are most likely in internally-oriented cases. Deregulated labor markets (or those regulated to the employers' advantage) are most likely in export-led cases. Thus, while we cannot test large-scale empirical claims about these crucial other elements of social regimes and are sensitive to Esping-Andersen's (1990:19) suggestion that "expenditures are epiphenomenal to the theoretical substance of the welfare state", we are confident that our spending indicators are representative of the broader social regimes and will allow for a first cut at testing the argument outlined above.

Spending variables appear as both independent and dependent variables in the analysis below. The spending variable of interest is (central) government expenditure on social security/welfare. This standardization emphasizes the importance of governmental priorities rather than overall effort. Data for these variables are taken from the IMF Government Finance Statistics (2005), supplemented with data from CEPAL.¹⁷ Overall spending data are taken from the World Bank's *World Development Indicators* (2006) (henceforth *WDI*).

Having already established longitudinal stability within countries and meaningful variation across them, we now turn to regression analysis to examine the three causal theories outlined above. The first links market size, labor abundance and inequality to the choice of development strategy, the second links development strategies to early social spending patterns while the last links social spending patterns in the pre-debt crisis era with outcomes today.

4.2 *From Endowments to Development Strategies*

As indicated by our theoretical discussion, the key predictor variables are initial market size, labor scarcity and inequality. We measure market size as the log of the product of initial (1960)

exports. In any event, ISI correlates with manufacturing exports at -0.65 for the whole dataset and -0.7 for the pre-1982 period.

¹⁷ CEPAL and IMF data correlate at over 0.65 for all country-years where they overlap. CEPAL data supplement the data for several Latin American countries for which early spending data (pre-1982) from the IMF were unavailable or quite suspect.

population and income levels (logged GDP per capita). Labor abundance is measured in a manner consistent with Leamer (1984) by comparing a country's share of the global endowment of labor with its share of the world gross domestic product. Because inequality in land distribution is key to our argument on the challenge of financing autarkic development strategies, we use Vanhanen's (2003) data on the percent of farms that are owned by smallholders. As the share of family farms falls, land inequality mounts. To these variables we add a control for natural resource production (measured as the sum of fuel and metal exports as a share of merchandise exports). Some have argued that resource endowments can help finance internally oriented industrialization. Against such claims one must consider the de-industrializing impact of real exchange rate appreciation associated with heavy reliance on natural resource exports (Corden 1984). We fit this model using ordinary least squares (OLS). There was no evidence of heteroskedasticity, so we report conventional OLS standard errors.

Table 1 displays the parameter estimates for the ISI model. Findings here are quite supportive of the theoretical model described above; ISI is increasing in domestic market size and rural inequality but decreasing in labor endowment.

Table 1 Here

4.3 From Autarkic Development Strategies to Insurance Spending

Turning to the impact of development strategies on social policy, we operationalize our notion of social spending regimes using social spending data as described above. We fit several models using social security/welfare spending as proportion of the government budget as the response variable. The general form of the models is $\text{Spending} \sim \text{Development Strategy} + \text{Demand} + \text{Institutions}$.

We measure development strategy in several ways. We incorporate the findings above by using the predicted values of ISI from model 1 as covariates. To gauge the robustness of our findings to inclusion of the error terms from model 1, we also fit the models using the actual values of ISI.¹⁸ Finally,

¹⁸ An alternative to this strategy is to fit all the regression models simultaneously as a system. With the highly restricted sample size, however, two- and three-stage least squares algorithms could not invert the transformed covariate matrix.

we include a measure of trade openness¹⁹. There is a long-standing contention in the OECD welfare state literature that insurance spending is more prevalent in smaller countries because they are more exposed to volatile international markets (Katzenstein 1985). Our theory, however, would imply that more open countries in the developing world would spend *less* on insurance to the extent that social insurance and education spending are traded off against one another depending on the labor market requirements of open-vs.-closed developmental strategies.²⁰

The demand variables include measures of the relative size of the young and old populations.²¹ We introduce per capita income to control for the long-standing (but controversial) argument that societal wealth increases the demand for social spending at a faster rate than GDP growth.²² Finally, each country's Polity score (Marshall, Jaggers, and Gurr 2004) controls for the arguments of Lindert (2004), Adserá and Boix (2002), and Brown and Hunter (1999) that regime type mediates the relationship between capitalism and social spending—they all suggest that democracies produce more social spending, though the precise mechanisms vary.²³ As before, all variables are measured at their pre-debt crisis averages. All models are fit using OLS.

Table 2 about here

Table 2 displays the parameter estimates for several models of social security priority. Findings broadly conform to our expectations and have some interesting implications. First, countries pursuing ISI strategies put greater weight on insurance spending in government budgets. All else equal, a country that retains 10% more of its industrial production domestically on average over the pre-debt crisis period will allocate about 7% more of its budget to social security expenditures. This finding is robust to different

¹⁹ (Exports + Imports)/GDP as taken from the Penn World Tables

²⁰ Note that Iversen and Cusack (2000) find the “compensation hypothesis” wanting in the OECD, instead arguing that changes in welfare spending are the result of secular trends in the composition of wealthy nations' economies. In the developing world, Kaufman & Segura-Ubiergo (2001) and Rudra (2002) both find that the compensation hypothesis has little empirical support.

²¹ See Lindert (2004) on demographic effects on social spending

²² Note that the empirical findings in this regard are mixed.

²³ Note that our response variables are spending *priorities*, not intensity. We therefore have no strong expectation regarding the marginal relationship between democracy and spending priorities. Indeed, our argument is strengthened if we find no evidence of a relationship between regime type and spending priorities.

demand variables and whether we use fitted or actual ISI values.²⁴ Turning to the demand variables, we see that a larger young population significantly decreases social security as a spending priority while a larger elderly population has the opposite effect. We note that these results are consistent with the hypothesis that social security spending crowds out education spending. Finally, parameter estimates for the openness variable also lend support to our argument; more open economies spend a significantly *smaller* portion of their budgets on insurance, though this finding is not quite as strong as that for ISI.

4.4 From Early Insurance Spending to Current Policy and Developmental Outcomes

Finally we turn to the impact of insurance spending on economic and social outcomes over the last 20 years of opening international markets. We emphasize that the findings in this section are suggestive and certainly need additional examination with different data, both qualitative and quantitative.

Our first set of models estimates the impact of early developmental strategies and social spending current levels of social insurance spending. Our argument implies that these spending priorities will persist due to the association affinity between insurance regimes and the overall structure of production in inwardly-oriented developing countries.

Table 3 displays parameter estimates for several models of recent-period social security spending. Models 6 and 7 show that an additional 1% of the pre-1983 budget devoted to social security spending implies about 1% more of the recent period budget will be allocated toward insurance spending. If we use pre-1983 ISI as predictor rather than social security spending, we see similar results.²⁵ Remarkably, more inwardly-oriented development strategies in the 60s and 70s show persistent policy effects in the late 80s and 90s.

Our next set of models is a first cut at examining the effects of early developmental strategies and associated insurance policies on recent income inequality and economic growth. Consistent with standard

²⁴ We note that the significance of the fitted ISI values is consistently lower than that for the actual values. This is a sample size effect; there are eight countries for which the full suite of ISI covariates were not available but did have ISI measured. If the models with actual ISI are fit on a restricted sample, results are nearly identical to those with the predicted values.

²⁵ Chile is an unusual case in this regard because it began privatizing its social security system in the mid-1980s, drastically reducing its (government) expenditures. If Chile is excluded from the analysis, all parameter estimates for ISI and prior social security spending increase in magnitude and standard errors shrink; the fitted ISI values achieve significance and the 0.09 level.

practice, we control for initial income inequality, the initial level of per capita income and the extent of democratic governance. We find no evidence for a curvilinear relationship between income and inequality and so leave the squared income term out of the models. Likewise, we find no evidence that trade exposure, oftentimes found to have a negative impact on inequality (Reuveny and Li 2003), has any direct impact beyond its influence on spending regimes.

The results from model 10 suggest that, as expected, high initial levels of social security spending serve to increase subsequent inequality. Each percent increase in the priority given to such spending increases the predicted gini coefficient by 0.14. Comparing Argentina and Malaysia, the difference in the commitment to insurance spending is expected to increase the gini coefficient by more than four points in the former compared to the latter. The actual gini increased by about 5 points in Argentina and went down by about a point in Malaysia.

Turning to growth, the economics literature on growth is fabulously extensive and the debates increasingly focused on important methodological issues (for important recent work see Banerjee and Duflo 2003; Barro 2000; for important recent work see Lindert 2004; Perotti 1996). For simplicity's sake, we estimate panel regressions of the percentage cumulative change in per capita income from the eve of the debt crisis until the most recent data available (typically 2003). The key independent variable is our measure of social security and welfare spending as a share of total spending. Based on the results from table 3, we include the average social security expenditure in the post-1983 period. We expect it to have a negative impact on growth. We introduce a fairly standard body of controls, including initial logged per capita income, government consumption as a share of GDP, regime type (as measured by Polity IV), and the fertility rate. Unless otherwise noted, all independent variables are panel averages for the years from 1983-2003. We note that there is reasonable evidence that the relationship among some of these variables might be non-linear (Banerjee and Duflo 2003) and/or that there is reason to expect indirect effects among variables (Barro 2000). Under current data constraints, we will leave those problems for later and want to be clear that the results are nothing more than suggestive.

Table 4 Here

The results depicted in model 11 in Table 4 show that the greater the share of the budget devoted to social security and welfare, the lower per capita income was over the subsequent two decades. Each percentage increase in such spending reduces per capita income by 1.2 percent twenty years later. For comparison's sake, the model suggests that a country that spent as much on social security as Argentina (58% of government spending) would see per capita income grow 63% less over the 20 years leading up to 2003 than a case like Malaysia that spent 5% percent of its budget on social security.²⁶ The only other variables to achieve significance are initial logged GDP per capita and the fertility rate.

5. Conclusion

This paper has laid out a framework for understanding the dynamics of developmental capitalism over the last 50 years through the lens of social policy. We argue that autarkic development strategies and insurance-based social policies are deeply intertwined. The relative abundance of labor, inequality, and market size all combined in a context of closed international markets in the decades following World War II to condition the extent to which development strategies were internally-oriented. Import substituting strategies are associated with insurance-based social spending regimes and an emphasis on social security expenditures. We provide four lines of preliminary evidence in support of our account. First, we show that countries group on development strategies and insurance spending priority in coherent ways. Second, we show that initial market size, labor abundance and inequality combine to impact the internal orientation of development policy. Third, we show that autarkic development policies are linked with insurance spending priorities. Fourth and finally, we show that pre-debt crisis insurance-based spending regimes have negative implications for important political-economic outcomes in the current era of liberalizing markets. All of our statistical models are simple, but the results are suggestive.

The results have important implications for the literature on social spending in the developing world. While some researchers have focused on the implications of international markets and market transitions for the evolution of social policy over the last twenty years, the underlying complexion of spending across countries on the eve of market opening has been a black box. We have tried to open that

²⁶ The actual difference in per capita income growth is actually somewhat higher than the model predicts.

black box, showing that the priority attached to social insurance differs markedly and systematically. Of course it is the case that cutting, expanding and reorienting of social policies is taking place across the developing world, oftentimes in response to competitive pressures and the evolving strength of various constituencies. That said, the stability in the fundamental outlines of spending regimes is noteworthy. Indeed, if we compare the scale of the effects uncovered here with those in recent cross-national research exploring globalization's impact on social spending in the developing world, what is striking is how much more important early spending regimes are for shaping contemporary social policy. For instance, our findings suggest that a country that looks like Mexico in 1960 is expected to pursue ISI and emphasize insurance spending to the tune of 26 percent of the budget on the eve of its process of market liberalization. If we turn to recent estimates of the impact of global economic forces on these starting points, we can see how small they are. Taking the midpoint for the similar results reported in Kaufman and Segura (2001: 578) and Wibbels (2006: 454-55), for instance, a substantial 10 percent increase in trade dependence over recent decades is predicted to reduce social security to the tune of 0.8 percent of spending in a case like Mexico. In dollar (or peso) terms that is not a trivial amount, but it is dwarfed by the fact that a country like Korea that pursued an export-led strategy in the post-war era begins the 1980s spending less than one-fourth as much on social security as Mexico.

In emphasizing the importance of strategies of capitalist development, we have begun to place research on social policy in the developing world on a theoretical footing more comparable to that on OECD welfare states. That literature began with attempts to explain broad differences across welfare regimes and later moved on to thinking about how dynamics in the global economy might shape the reform of social policies. That ordering has been reversed in work on the developing world. Given the longstanding recognition that the political struggles over the shape of capitalism are intimately tied up in struggles over the distribution and redistribution of capitalism's surplus, it perhaps comes as no surprise that the broad strokes of developmental capitalism that emerge out of the post-war period have important implications for the redistributive aspect of governments' fiscal policies. Nevertheless, in linking the two

we move away from the widespread notion that redistribution in the developing world is idiosyncratic and clientelistic.

Our focus on the link between autarkic development strategies and insurance spending provides two additional benefits—one causally prior to the emergence of social regimes and the other causally consequent. In order to explain the affinity between autarky and insurance, we begin with a causal account of why governments pursue autarky in the first place. In doing so, we make a contribution to a now largely forgotten literature comparing export-led to internally-driven development models. In a rush to debate the economic benefits of trade in the aftermath of widespread market reforms in the 1980s and 1990s, researchers left aside unanswered questions as to why development policies diverged so starkly in the post-war period. That early import-substituters continue to struggle economically twenty years after substantial economic liberalization suggests that our causal account of the births of development strategies might be of something more than historical interest.²⁷ Similarly, in providing evidence that social regimes oriented toward insurance have produced more inequality and grown slowly, we make a contribution to the literature on the policy determinants of development. That literature has focused on everything from financial sector policies to corruption. With regards to government expenditures, the overwhelming focus has been on the benefits of primary and secondary education. The lack of attention to the developmental implications of spending on insurance—the other large component of social spending—is surprising given that it represents a far larger share of the average government budget in the developing world. In unreported findings, moreover, we see very limited impacts of education spending on developmental outcomes which stands in stark contrast to the strong negative impact of insurance spending we find here.²⁸

Finally, our findings suggest a number of directions for future research. First, while we have provided a link between autarkic development policies and insurance spending, it would be interesting to explore the link between outward-oriented development strategies and social policy regimes. Is there, for

²⁷ See Easterly (2001) for evidence that growth did not improve despite “better” policy. He argues that this had much to do with goings on in the global North.

²⁸ Note that there is an important distinction between education *spending* and educational *attainment*.

instance, an affinity between trade openness and investments in human capital at the expense of insurance? Here the task is harder because the collection of countries that eschewed autarky in favor of trade is very heterogeneous—ranging from relatively wealthy manufacturing exporters like Korea to poor agricultural exporters such as Mali. Nevertheless, given the evidence linking human capital to technological learning and international competitiveness, it would be surprising if some forms of economic openness did not foster investments in primary and secondary education. Second, though the vast majority of social security systems in the developing world are regressive, they vary in the extent to which the distribution of beneficiaries is skewed upwards. Here, it would be useful to develop a theoretical account for cross-national variation in the distribution of beneficiaries of social policies. Research on the OECD has identified systematic variation in this regard. While liberal market economies narrowly focus sparse programs on the poorest, Christian democratic economies are characterized by fairly generous policies that reiterate existing hierarchies in labor markets, and social democratic economies widely distribute very generous benefits across most members of society. To date, we know little about the causal factors associated with diverse distributional emphases across social programs in the developing world.

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Appendix 1: Hierarchical Cluster Analysis

Hierarchical cluster analysis is a well-developed branch of applied statistics that attempts to identify groups in data such that objects within groups are as similar as possible while the differences between groups are maximized. Hierarchical methods are distinguished from partitioning methods. In the former, the analyst is attempting to discover some sort of clustering structure in the data; the number of clusters is taken as unknown. In the latter, the analyst decides *a priori* how many clusters there are and attempts to assign observations to clusters in some optimal manner. *K*-means clustering is the most well-known algorithm for partitioning. Traditional clustering algorithms²⁹ use intuitively plausible procedures based on various distance metrics to either merge or divide groups of observations into clusters. In the paper we use more recently developed model-based clustering procedures. This second generation of clustering methods uses mixture models to assign observations to clusters. The most common method is to posit the data as a mixture of multivariate Normal distributions with each component of the mixture corresponding to a different cluster. The challenge, then, is to select the parameterization of the statistical model as well as the appropriate number of clusters. Model-based clustering has the advantage of strong grounding in probability theory. It provides a principled way in which to systematically examine data for structure.

We follow the mixture modeling approach of Fraley and Raftery (2002b). In a mixture approach, the data are assumed to represent a mixture of G k -dimensional multivariate normal distributions. The likelihood of the general (Gaussian) mixture model is expressed as

$$L(\theta_1, \dots, \theta_G; \tau_1, \dots, \tau_G | y) = \prod_{i=1}^n \sum_{j=1}^G \tau_j \phi_j(y_i | \theta_j)$$

Where y is an $n \times k$ matrix of n observations over k variables and G indexes the number of clusters. The parameter τ_j represents the weight placed on the j th component or, equivalently, the probability that an observation is in the j th cluster; ϕ_j is a multivariate normal density with parameters $\theta_j = (\mu_j, \Sigma_j)$. The

²⁹ See Kaufman and Rousseeuw (1990) for an introduction to traditional clustering methods

shape of the clusters is governed by the covariance matrices Σ_j .³⁰ Estimating this model for various values of G and parameterizations of Σ_j admits comparison across non-nested models. We select the optimal clustering solution according to the BIC (Fraley and Raftery 2002b; Raftery 1995).

Appendix 2: Data definitions and sources

GDP per capita: Real GDP per capita in constant \$US 2000, taken from the *WDI*.

Market size: population (MM) * log(GDP per capita). Both population and wealth figures taken from the *WDI*.

Labor endowment: (population / world population) / (GDP / World GDP) following Leamer (1984) and Midford (1993). Population figures taken from the *WDI*. GDP figures are in 2000 real \$US and taken from the *WDI*.

Land equality: Proportion of farmland owned by single families, taken from Vanhanen (2003).

Resource dependence: Sum of fuel and ores & mineral exports as percent of merchandise exports, taken from the *WDI*.

ISI: Manufacturing (%GDP) – Manufacturing exports (%GDP), taken from *WDI*.

Social Security Spending: Social security/welfare spending (% government spending), taken from the IMF *Government Finance Statistics* (2005). Some missing values in Latin America were supplemented with data from CEPAL (n.d.).

Human capital spending: The sum of education and health spending as % of government spending, taken from the IMF *Government Finance Statistics*.

Openness: (Exports + Imports)/GDP, taken from the Penn World Tables.

Gini: “Highest quality” gini coefficients taken from WIID (2005), adjusted as per the conventional wisdom

ΔGini: Change in Gini from its pre-debt crisis average to its average over the 1995-2003 period.

³⁰ One of the advantages of the mixture modeling approach is its flexibility in approaching the “geometry” of the clusters, i.e. spherical, ellipsoidal, of equal or variable volume, etc. In the Fraley-Raftery implementation employed

Fertility:

Polity: Polity IV score scaled from 0-20 (Marshall, Jaggers, and Gurr 2004)

Pop<16 & >64: Taken from the *WDI*

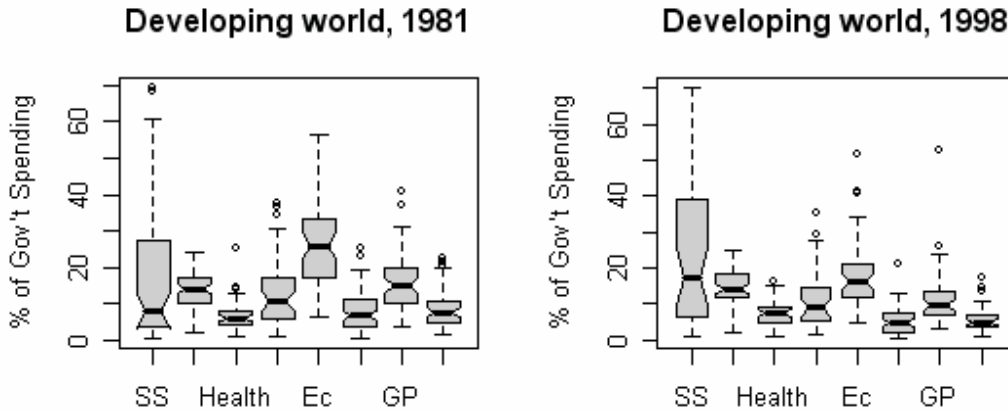
%ΔGDPpc: Total percent change in real per capita GDP from 1982 to the most recent available value between 1995 and 2003.

Urban: population proportion living in urban areas from *WDI*

here, Σ_j is parameterized using eigenvalue decomposition and the likelihood is maximized via EM (Dempster, Laird, and Rubin 1977).

Figure 1: The composition of government expenditures in the developing world pre- and post-debt crisis

Social insurance spending varies dramatically across developing countries. After the debt crisis, variation in social insurance spending increased.

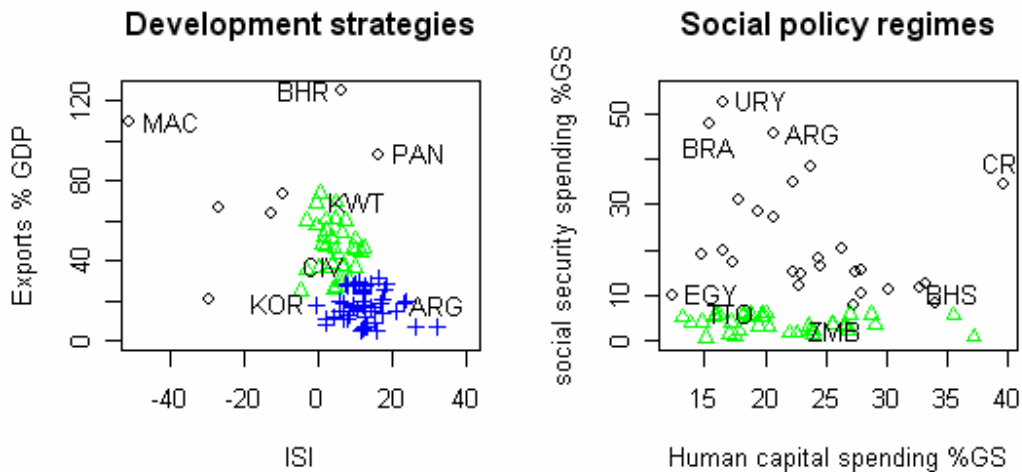


Note: The thick bar in the center locates the median while the range of the box shows the interquartile range. The whiskers show the range of the data that extend up to ± 1.5 times the interquartile range. Dots are outliers. The notches in the side of the boxes depict a rough 95% confidence interval around the median. SS is social security and welfare spending; Ec is “economic affairs and services”. GP is “general public services”. The non-labeled hash marks are, from left to right, education, defense, forestry & fishing, and transportation. Spending data are taken from the IMF *Government Finance Statistics*.

Figure 2: Clustering in the development strategy and social policy data

Countries clearly diverge in their development strategies.

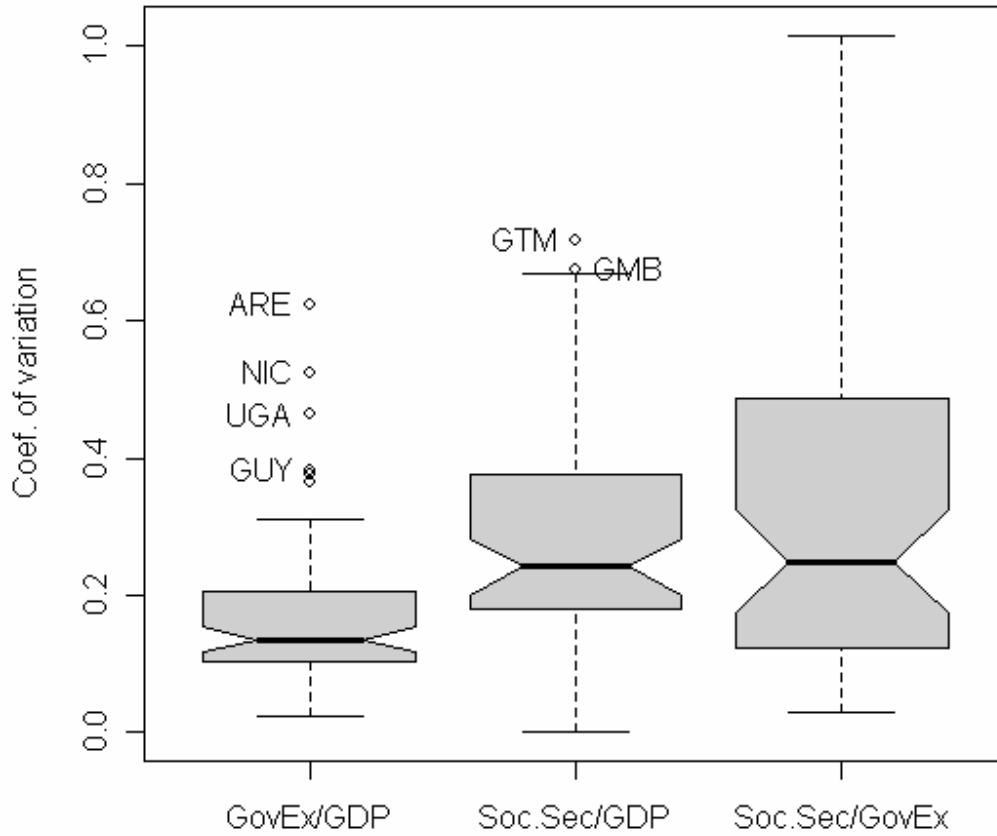
Social spending priorities are divided between those emphasizing insurance and those that do not.



Sources: See data appendix

Figure 3: Distribution of the Coefficients of Variation for Insurance Spending

On average, social insurance spending effort and prioritization are quite stable in the developing world prior to the debt crisis.



Note: The thick bar in the center locates the median while the range of the box shows the interquartile range. The whiskers show the range of the data that extend up to ± 1.5 times the interquartile range. Dots are outliers. The notches in the side of the boxes depict a rough 95% confidence interval around the median. SS is social security and welfare spending. All counties included had at least three observations prior to 1983 for all variables. See appendix for data sources.

Figure 4: Schematic of the Argument

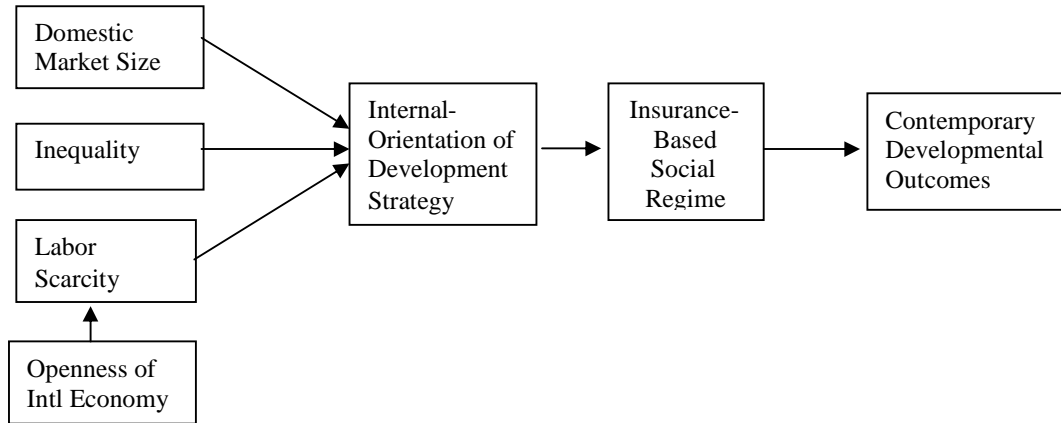


Table 1: OLS model of development strategy on initial conditions

Larger countries scarce in labor and with more unequal land distribution are more likely to follow ISI developmental strategies in the pre-debt crisis era.

ISI		
Model 1		
<i>Covariates</i>	$\hat{\beta}$	$\sigma_{\hat{\beta}}$
Market size	0.33	0.07
Labor endowment	-0.21	0.10
Land equality	-0.14	0.04
Resource dependence	-0.07	0.02
Constant	4.54	3.52
$N =$	60	
Adj. R^2	0.38	
F (df)	10 (4,55)	

Note: All variables are averages over all available observations prior to 1983. Bolded entries are significant at the 0.05 level or better using two-tailed tests.

Table 2: OLS estimation of social security spending on development strategy
Governments pursuing ISI strategies in the pre-debt crisis era prioritize social security spending.

<i>Covariates</i>	Social Security as % Government Spending			
	$\hat{\beta} (\sigma_{\hat{\beta}})$			
	2	3	4	5
ISI	<i>0.91</i>		<i>0.84</i>	
(predicted)	(0.50)		(0.49)	
ISI		0.66		0.71
(actual)		(0.19)		(0.19)
Pop > 64	3.07	2.44		
	(1.22)	(0.90)		
Pop < 16			-1.03	-0.91
			(0.37)	(0.31)
Polity	0.19	0.22	0.18	0.25
	(0.28)	(0.21)	(0.28)	(0.21)
GDPpc	<i>5.23</i>	5.28	5.81	4.67
(log)	(2.95)	(1.59)	(2.82)	(1.61)
Openness	<i>-0.11</i>	-0.05	-0.12	<i>-0.06</i>
	(0.05)	(0.03)	(0.05)	(0.03)
Constant	-43.53	-42.60	9.30	10.32
	(17.36)	(11.08)	(27.13)	(20.57)
<i>N</i> =	44	52	44	52
Resid σ (df)	8.9 (38)	8.5 (46)	8.8 (38)	8.4 (46)
Adj. R^2	0.58	0.58	0.59	0.59
<i>F</i> (df)	12.6 (5,38)	15.3 (5,46)	13.3 (5,38)	15.9 (5,46)

Note: All variables are averages over all available observations prior to 1983. Bolded entries are significant at the 0.05 level or better while italicized entries are significant at the 0.1 level or better using two-tailed tests.

Table 3: OLS estimation of current social insurance spending outcomes
Countries pursuing ISI strategies and/or prioritizing social insurance in the pre-debt crisis era emphasize social insurance more on in more recent budgets

	Soc. Sec. Ex	Soc. Sec. Ex	Soc. Sec. Ex	Soc. Sec. Ex
	$\hat{\beta} (\sigma_{\hat{\beta}})$			
<i>Covariates</i>	6	7	8	9
Soc. Sec.* (predicted)	0.81 (0.35)			
Soc. Sec.* (actual)		0.96 (0.13)		
ISI* (predicted)			1.01 (0.70)	
ISI* (actual)				0.85 (0.30)
Pop > 64	-0.51 (1.22)	-0.78 (0.77)	3.08 (1.56)	1.30 (1.13)
Polity	0.96 (0.40)	0.57 (0.26)	1.10 (0.50)	<i>0.71</i> (0.40)
Log GDPpc	3.50 (2.37)	3.43 (1.19)	1.62 (3.50)	5.39 (1.76)
Openness	-0.04 (0.061)	-0.03 (0.02)	-0.07 (0.06)	-0.04 (0.04)
Constant	-22.88 (12.67)	-19.22 (7.09)	-24.89 16.66	-40.47 (11.16)
<i>N</i> =	46	51	41	51
Resid σ (df)	11.7 (40)	8.0 (45)	13.5 (36)	12.3(45)
Adj. R^2	0.60	0.80	0.49	0.55
<i>F</i> (df)	14 (5,40)	43 (5,45)	9 (5,36)	13 (5,45)

* Denotes variables at or derived from their pre-debt crisis averages.

Note: Predicted social security values taken from model 5. Response variables and non-starred covariates are averages over 1983-2003. Bolded entries are significant at the 0.05 level or better while italicized entries are significant at the 0.1 level or better using two-tailed tests.

Table 4: OLS estimation of current developmental outcomes

In an era of liberalizing trade, developing countries prioritizing social insurance spending in the pre-debt crisis period have worse growth and inequality performance than those that did not.

<i>Covariates</i>	Δ Gini	% Δ GDPpc
	$\hat{\beta} (\sigma_{\hat{\beta}})$	
	10	11
Soc. Sec. (actual)	<i>0.14</i> (0.08)	-1.21 (0.49)
GDPpc	-3.26 (21.01)	-25.50 (8.76)
GDPpc ²	0.07 (1.40)	
Gini; pre-debt	0.65 (0.14)	
Polity	-0.18 (0.22)	1.61 (1.46)
Fertility		-1.57 (0.28)
Openness	0.01 (0.02)	-0.10 (0.22)
Urban	0.01 (0.08)	
Constant	40.21 (77.32)	301.46 (71.26)
<i>N</i> =	29	54
Resid σ (df)	14.5 (21)	44.6 (46)
Adj. R^2	0.66	0.40
<i>F</i> (df)	8.7 (7,21)	6.1 (7,46)

Note: In model 11, social security is measured at its post debt-crisis average; it is at its pre-debt crisis average in model 10. GDPpc is at its 1982 value in model 11 but its post 1995 average in model 12. All other variables are averages over the post 1983 period. Bolded entries are significant at the 0.05 level or better while italicized entries are significant at the 0.1 level or better using two-tailed tests.