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# Beyond the Washington Consensus Promoting Economic Growth and Minimizing the Threat of Violence in Latin America through Social Development



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**NAVAL  
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**MONTEREY, CALIFORNIA**

**THESIS**

**BEYOND THE WASHINGTON CONSENSUS:  
PROMOTING ECONOMIC GROWTH AND MINIMIZING  
THE THREAT OF VIOLENCE IN LATIN AMERICA  
THROUGH SOCIAL DEVELOPMENT**

by

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March 2012

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GROWTH AND MINIMIZING THE THREAT OF VIOLENCE IN LATIN AMERICA  
THROUGH SOCIAL DEVELOPMENT**

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## **ABSTRACT**

In this thesis, I examine the role social development plays in the successes and failures of Washington Consensus–type neoliberal economic growth strategies throughout Latin America, as well as the effects of growth on levels of political violence in the region. I also analyze the role of targeted social spending in legitimizing the implementation of structural adjustment programs across all regime types. Finally, I use a discriminate analysis to divide the countries of Latin America and the Caribbean into two distinct geographic and economic subregions where separate development strategies can be optimized.

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## TABLE OF CONTENTS

I.	BACKGROUND ON POST WASHINGTON CONSENSUS ECONOMIC DEVELOPMENT IN LATIN AMERICA AND THE CARRIBEAN.....	1
A.	MAJOR RESEARCH QUESTION .....	1
B.	IMPORTANCE .....	2
C.	PROBLEMS AND HYPOTHESES .....	3
D.	LITERATURE REVIEW.....	5
E.	METHODS AND SOURCES .....	13
F.	THESIS OVERVIEW .....	14
II.	FACTOR ANALYSIS ON KEY CONSTRAINTS ON GROWTH IN LATIN AMERICA .....	15
A.	INTRODUCTION .....	15
B.	POTENTIAL GROWTH CONSTRAINTS .....	15
C.	DATA AND METHODOLOGY .....	24
1.	Data.....	24
2.	Hypothesis <sub>1</sub> .....	25
3.	Methodology .....	25
D.	RESULTS AND ANALYSIS .....	26
E.	CONCLUSION .....	31
III.	THE INFLUENCE OF NEGOTIATION AND TARGETED SOCIAL SPENDING ON NEOLIBERAL STRUCTURAL ADJUSTMENT PROGRAMS IN LATIN AMERICA (1970–2000).....	33
A.	INTRODUCTION .....	33
B.	LITERATURE REVIEW.....	35
C.	DATA, HYPOTHESIS, AND METHODOLOGY .....	39
1.	Data.....	39
2.	Hypothesis <sub>2</sub> .....	42
3.	General Model .....	42
4.	Methodology .....	43
D.	RESULTS AND ANALYSIS .....	43
E.	CONCLUSION .....	50
IV.	ECONOMIC DEVELOPMENT AND INCREASED POLITICAL VIOLENCE IN LATIN AMERICA (1996–2008).....	53
A.	INTRODUCTION .....	53
B.	EXPLANATIONS FOR CAUSES OF POLITICAL VIOLENCE: A BRIEF LITERATURE REVIEW .....	55
C.	POLITICAL VIOLENCE IN LATIN AMERICA .....	61
D.	MODELS, DATA, AND METHODS.....	62
1.	Models .....	62
2.	Hypothesis <sub>3</sub> .....	63
3.	Data and Methodology .....	63
E.	RESULTS AND ANALYSIS .....	67

F.	CONCLUSION .....	71
V.	GETTING THE CLASSIFICATION RIGHT: DISCRIMINATE ANALYSIS ON THE COUNTRIES OF LATIN AMERICA AND THE CARIBBEAN .....	75
A.	INTRODUCTION .....	75
B.	DATA, HYPOTHESIS, AND METHODOLOGY .....	79
1.	Data.....	79
2.	Hypotheses .....	79
3.	Methodology .....	79
C.	RESULTS AND ANALYSIS.....	81
D.	CONCLUSION .....	86
VI.	CONCLUSIONS, RECCOMENDATIONS, AND POLICY IMPLICATIONS ..	89
A.	CONCLUSIONS.....	89
B.	RECOMMENDATIONS .....	91
1.	Database Updates.....	91
2.	Further Study .....	93
C.	POLICY IMPLICATIONS .....	94
1.	Implications for the United States and other Wealthy Countries.....	94
2.	Implications for Latin America .....	95
	LIST OF REFERENCES.....	99
	INITIAL DISTRIBUTION LIST .....	109

## LIST OF FIGURES

Figure 1.	Latin America and the Caribbean by Subregion .....	18
Figure 2.	World Economic Forum Twelve Pillars of Competitiveness in Latin America Subregion I and Subregion II.....	19
Figure 3.	Heritage Foundation Index of Economic Freedom in Latin American Subregion I and Subregion II.....	20
Figure 4.	World Bank Worldwide Governance Indicators in Latin American Subregion I and Subregion II.....	21
Figure 5.	Legatum Prosperity Index in Latin American Subregion I and Subregion II .....	23
Figure 6.	Snapshot of Liberalization vs. Inequality in Latin America.....	73
Figure 7.	GDP per capita by Purchasing Power Parity in Current U.S. Dollars (2011) .....	76
Figure 8.	World Economic Forum Stage of Development (2011) .....	77
Figure 9.	Legatum Prosperity Index Overall Prosperity Score (2011).....	78
Figure 10.	UN Human Development Index (2011).....	78
Figure 11.	Latin America and the Caribbean by Subregion Based on a Discriminate Analysis of the Combined Factor Scores .....	87

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## LIST OF TABLES

Table 1.	Economic First Principles .....	6
Table 2.	Washington Consensus.....	7
Table 3.	Latin American Countries at Various Stages of Development (Actual Stage in Parentheses).....	17
Table 4.	Factor Analysis – Total Sample of Countries (loadings on principal dimensions).....	27
Table 5.	Factor Analysis – Stage 1 - 2 Countries (loadings on principal dimension).....	28
Table 6.	Factor Analysis – Stage 2.5 - 3 Countries (loadings on principal dimensions).....	29
Table 7.	Regressions of Neoliberal Reform (Simple Average) on Hypothesized Determinates (1970–2000) .....	45
Table 8.	Regressions of Neoliberal Reform (Weighted Factors) on Hypothesized Determinates (1970–2000) .....	46
Table 9.	Regressions of Neoliberal Reform (Dropped Variables) on Hypothesized Determinates (1970–2000) .....	47
Table 10.	Regressions of Political Violence in Latin America on Hypothesized Determinates (1996–2008).....	67
Table 11.	Discriminate Analysis on Various Indices of Economic, Political, and Social Development.....	81
Table 12.	Factor Analysis (Dimension Reduction) on Latin American and Caribbean Countries.....	82

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## LIST OF ACRONYMS AND ABBREVIATIONS

BA	Bureaucratic Authoritarian
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
FDI	Foreign Direct Investment
HDI	Human Development Index
IEF	Index of Economic Freedom
IMF	International Monetary Fund
KOF	<i>Konjunkturforschungsstelle</i> (Business Cycle Research Institute)
LPI	Legatum Prosperity Index
OLS	Ordinary Least Square
PRI	<i>Partido Revolucionario Institucional</i> (Institutional Revolutionary Party)
PPP	Purchasing Power Parity
UN	United Nations
WEF	World Economic Forum
WGI	Worldwide Governance Indicators



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## ACKNOWLEDGMENTS

This project began as a three-country comparative analysis of growth strategies in Chile, Argentina, and Uruguay, but quickly expanded to include all of Latin America as the initial results led me in a direction that I had not been expecting. The role of social development became central to my findings and argument, and I felt that I could not do the topic justice without expanding the scope to include the rest of Latin America. I would like to thank Professor Arturo Sotomayor for patiently listening to my initial findings and allowing me the freedom to expand the project to its present form. Without his guidance and expertise in the region, this thesis would be much less interesting and the findings much more limited.

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Even with all of this help, the findings and arguments presented in this thesis are mine alone, and I take full responsibility for any errors that may remain.

On a more personal note, I would like to thank my parents for raising me to question everything, and my wife, Jennifer, for her enduring patience and understanding as I worked on this project. Finally, I dedicate this thesis to my beautiful daughters, Ally and Ava.

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# **I. BACKGROUND ON POST WASHINGTON CONSENSUS ECONOMIC DEVELOPMENT IN LATIN AMERICA AND THE CARRIBEAN**

## **A. MAJOR RESEARCH QUESTION**

Latin America and the Caribbean is one of six geographical areas included in the World Bank's list of developing regions.<sup>1</sup> Unfortunately, lumping all of the diverse countries of Latin America and the Caribbean together for the purposes of development has led to development strategies that may have been correct for some countries, but were proclaimed the answer to the development question in all. This was particularly the case under the guise of the "Washington Consensus" during the late 1980s and through the 1990s. The neoliberal approach of the Washington Consensus argued that social spending has a negative impact on economic growth and that a country must minimize social expenditures to remain competitive in a globalized economy. In Latin America, the poster child for Washington Consensus growth strategies was Chile and the rapid growth experienced there during the authoritarian regime of President Augusto Pinochet. The influence of the Chilean growth model on strategies implemented elsewhere in Latin America cannot be overstated, but in many cases, the neoliberal model failed to achieve the desired results. Why was this so? Why did the orthodox neoliberal model have success in some parts of Latin America, why it has been a dismal failure in others, and what role did social development play in these successes and failures?

This question is very straightforward and yet it raises additional questions that need to be addressed in order to answer it fully and place it within the proper context. First, what role did social spending play in allowing both democratic and authoritarian governments to successfully implement economic reforms? Were the economic policies implemented by the various regime types all orthodox

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<sup>1</sup> The other World Bank Developing Regions are: Africa, East Asia and the Pacific, Europe and Central Asia, Middle East and North Africa, and South Asia.

reforms, or was there variation in the policy enactment that could account for the variation in the popular response? What influence did external factors have on internal strategies for reform implementation? Second, what were the unintended consequences of orthodox neoliberal reform strategies and what role did economic growth combined with decreased social spending play in increased inequality and violence in Latin America? Third, what role can social development play in building post–Washington Consensus pro-growth strategies that promote growth within a country’s current stage of development and establish the necessary prerequisites to move a country to the next stage? Finally, can Latin America and the Caribbean be geographically and economically separated into subregions that produce better development policy recommendations to maximize the growth potential of individual countries—moving beyond a one-size fits all Washington Consensus type approach?

## **B. IMPORTANCE**

Dani Rodrik’s recent and highly influential book, *One Economics – Many Recipes*, seems to challenge the neoliberal free market ideals that have been pervasive in the realm of development economics since John Williamson coined the phrase “Washington Consensus” in 1990.<sup>2</sup> Rodrik primarily uses the rampant successes of the Asian Tigers to demonstrate how the functions that good institutions perform do not necessarily require a specific form of those institutions to work. In other words, as long as the institutions are able to accomplish their goals, it doesn’t really matter what shape they take or how they are implemented. Rodrik’s approach is incomplete however, as he tends to focus on cases where there was growth without the Washington Consensus (as in Asia) and overlook cases where the Washington Consensus has worked—especially in some Latin American countries. Additionally, Rodrik disregards positive cases where there was growth in Latin America without a strict adherence to Washington

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<sup>2</sup> John Williamson and Institute for International Economics (U.S.), *Latin American Adjustment: How Much has Happened?* (Washington, D.C.: Institute for International Economics, 1990).

Consensus principles.<sup>3</sup> Finally, Rodrik fails to analyze the role of social spending and social development in both promoting economic growth and facilitating structural adjustment programs.

A better understanding of which portions of orthodox neoliberal development strategies are most necessary for growth is vital if scarce government funds are to be spent in the most efficient way for promoting growth and development. Further, different growth strategies may be more effective depending on where a country lies on their growth trajectory. For example, poorer countries may receive a higher return on their investment by focusing on particular areas such as infrastructure building than a wealthier country would. Additionally, challenging the neoliberal assumption that social spending has a negative impact on economic growth is vital to fully appreciating the complexities of the Latin American case. Finally, a non-U.S.-centric repackaging of the strategy is required to make growth initiatives more desirable for developing economies. Specifically, the term “Washington Consensus” has done little to promote its use, as the developing world has been resistant to adopt strategies seen as dictated by the “imperialist north.”<sup>4</sup> However, before a restructuring of development packages can be accomplished, the vital portions of what is already in place and the role of social development in promoting economic growth, easing the implementation of structural adjustment programs, and minimizing the threat of violence must be determined and evaluated.

### **C. PROBLEMS AND HYPOTHESES**

The Washington Consensus has not been nearly as successful at promoting economic development and growth as was originally promised to countries of Latin America and the Caribbean. As these states have become more democratic, the political costs of implementing a full Washington

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<sup>3</sup> Dani Rodrik, *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth* (Princeton: Princeton University Press, 2007).

<sup>4</sup> Josef Joffe, *Uberpower: The Imperial Temptation of America* (New York: W.W. Norton & Co., 2006).

Consensus regime has become nearly untenable for domestic leadership, and many have turned to alternate growth strategies that are not as politically unpopular. Without a reassessment and restructuring of the prescribed growth policies espoused by Washington and most international development organizations, the West potentially stands to lose desired influence in the developing states. In an increasingly globalized world, it is in the interest of all states to promote growth and development, and while this does not mean a complete abandonment of neoliberal economic policies, it does mean a return to economic first principles and a pragmatic approach to growth strategy implementation with a renewed focus on social development.

I define social development or social change as moving in the direction of achieving the goals of the United Nations' Declaration on Social Progress and Development of 1969.<sup>5</sup> This differs from economic development in that economic development considers growth but does not consider distribution of the fruits of that growth. Social development then is progress towards the elimination of poverty through methods that ensure greater equity and rights throughout the population. I also focus on the use of targeted social spending, which I define as any social spending that is not broad based in its application. For example, education and health programs that are targeted to those most in need and are not broadly applied to the entire population would be considered targeted social spending.

**Hypothesis<sub>1</sub>:** Targeted social spending and social development has played a central role in both the implementation and success of orthodox neoliberal reforms throughout Latin America and the Caribbean. Social spending eased the political costs of structural adjustment and separately played a central role in actually achieving growth.

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<sup>5</sup> *Declaration on Social Progress and Development*, UN Resolution 2542 (11 Dec. 1969): 1–27.

**Hypothesis<sub>2</sub>:** All governments, regardless of regime type, had to make concessions to their populations during periods of economic reform, but democratic regimes were better able to negotiate and thus implemented more orthodox type reforms.

**Hypothesis<sub>3</sub>:** In Latin America, controlling for sudden economic shocks, levels of democracy, population levels, globalization, and democratization—there is an increase in incidence of political violence during periods of economic growth, high unemployment, greater income inequality, and low levels of voice and accountability for the majority of the population.

**Hypothesis<sub>4</sub>:** Although a focus on targeted social spending and social development will help all countries of Latin America and the Caribbean, other areas of focus will help countries more or less depending on their current level of development.

**Hypothesis<sub>5</sub>:** The countries of Latin America and the Caribbean can be divided into two distinct geographic and economic subregions, and separate development strategies can be optimized to promote the most growth for each subregion at the lowest cost to the government.

#### **D. LITERATURE REVIEW**

Building on the inductive approach of Hirschman, Gerschenkron, and Rostow<sup>6</sup>, Dani Rodrik finds that what matters most when it comes to economic growth and development is function not form, namely a return to economic first principles. For Rodrik the most important thing to help foster economic development is to find ways to build on economic first principles no matter what form those implementations take. Rodrik examines the strong development and growth in Asia over the last several decades and finds that they were able to

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<sup>6</sup> Albert O. Hirschman, *The Strategy of Economic Development* (New Haven: Yale University Press, 1958); Alexander Gerschenkron, *Economic Backwardness in Historical Perspective, a Book of Essays* (Cambridge: Belknap Press of Harvard University Press, 1962); W. W. Rostow, *The Stages of Economic Growth, a Non-Communist Manifesto* (Cambridge England: University Press, 1960).



achieve rapid growth without using the usually prescribed methods of the Washington Consensus. Table 1 lists Rodrik’s economic first principles.

1. Protection of Property Rights	4. Appropriate Incentives
2. Contract Enforcement	5. Sound Money
3. Market-based Competition	6. Debt Sustainability

Table 1. Economic First Principles<sup>7</sup>

Rodrik argues that an individualized country-specific approach to development is required to ensure success, and many others have followed in this line of thinking.<sup>8</sup> The problem for Rodrik is that his analysis seems to neglect places where the Washington Consensus has worked and place too heavy of an emphasis on the East Asian development model. By ignoring other growth strategies, many of which have been rejected because of their long-term viability (such as Import Substitution Industrialization), Rodrik leaves out a breadth of strategies that have also been shown to work in the past, at least for getting industrialization and growth started in the first place.

John Williamson’s original Washington Consensus identifies ten policy instruments about which there is a reasonable consensus in Washington. Williamson’s Washington is both the political Washington of Congress and the technocratic Washington of international financial institutions, the Federal Reserve, and the think tanks.<sup>9</sup> The left side of Table 2 lays out these ten policy recommendations as originally proposed by Williamson and the right side includes the ten additional policy recommendations integrated into Rodrik’s “Augmented” Washington Consensus. Even with these twenty policy

<sup>7</sup> Rodrik, *One Economics, Many Recipes*, 15.

<sup>8</sup> José Antonio Ocampo, “Beyond the Washington Consensus: What do we Mean?” *Journal of Post Keynesian Economics* 27, no. 2 (Winter 2004): 293–314; Daniel Kaufmann et al., “Growth without Governance [with Comments],” *Economía* 3, no. 1 (Fall 2002): 169–229; John Williamson, “The Washington Consensus and Beyond,” *Economic and Political Weekly* 38, no. 15 (Apr. 2003): 1475–1481; Joseph E. Stiglitz and Lyn Squire, “International Development: Is it Possible?” *Foreign Policy*, no. 110, Special Edition: Frontiers of Knowledge (Spring 1998): 138–151.

<sup>9</sup> Williamson and Institute for International Economics (U.S.), *Latin American Adjustment: How Much has Happened?*, 2.

recommendations, several key determinants of economic growth are unaddressed and require further exploration.

<i>Original Washington Consensus</i> <sup>10</sup>	<i>“Augmented Washington Consensus”</i> <sup>11</sup>
1. Fiscal discipline	11. Corporate governance
2. Reorientation of public expenditures	12. Anticorruption
3. Tax reform	13. Flexible labor markets
4. Interest rate liberalization	14. Adherence to WTO disciplines
5. Competitive exchange rates	15. Adherence to international financial codes and standards
6. Trade liberalization	16. Prudent capital-account opening
7. Openness to direct foreign investment	17. Nonintermediate exchange rate regimes
8. Privatization	18. Independent central banks/inflation targeting
9. Deregulation	19. Social safety nets
10. Secure property rights	20. Targeted poverty reduction

Table 2. Washington Consensus

Determinants of Gross Domestic Product (GDP) growth are continuously a source of debate within the literature, but a general consensus exists as to which key determinates to examine to add to the depth of knowledge on this topic. Neoclassical economists tend to focus on labor and capital and the factors which impact their availability and productivity, Keynesians look at government and private spending and investment, and Monetarists concentrate on the money supply and inflation. Somewhere within this conglomeration of ideas most likely lies the answers, but debate will continue for the foreseeable future. Regardless of their impact in the positive or negative direction, the review that follows highlights why these factors are at least worth examination with regards to Washington Consensus effectiveness.

Degregorio finds foreign direct investment (FDI) to have a positive impact on GDP growth and on output itself due to the increased availability of capital, particularly when labor is underutilized.<sup>12</sup> Kosack, on the other hand, finds FDI to

<sup>10</sup> Ibid., 20.

<sup>11</sup> Rodrik, *One Economics, Many Recipes*, 17.

<sup>12</sup> José De Gregorio, “Economic Growth in Latin America,” *Journal of Development Economics* 39, no. 1 (Jul. 1992): 59–84.

have a negligible if not slightly negative impact on GDP growth and a negligible impact on GDP. The negative influence is found to come from the crowding out of local public and private investment with FDI.<sup>13</sup> In Latin America, labor has been historically underutilized, and local public and private investment could have been crowded out especially during times of fiscal limitation based on the debt restructuring.

Fisher and Lucas find that the rate of inflation also has a real impact on growth and output.<sup>14</sup> However, there is also a consensus that it is actually the expectation of inflation that impacts growth.<sup>15</sup> Further, Fatas finds that output stability is affected by the reputation of the central bank in fighting inflation.<sup>16</sup> Thus, expectations are found to be just as important if not more important than the inflation itself. The Southern Cone has seen periods of hyperinflation during the last thirty years and each state has chosen its own methods for dealing with inflation, thus inflation and inflation expectations could play a significant role in any variation in growth strategies.

Labor and capital productivity are also found to positively affect growth and real output. Mankiw finds the importance of capital productivity using a

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<sup>13</sup> Stephen Kosack and Jennifer Tobin, "Funding Self-Sustaining Development: The Role of Aid, FDI and Government in Economic Success," *International Organization* 60, no. 1 (Winter 2006): 205–243.

<sup>14</sup> Stanley Fischer, "The Role of Macroeconomic Factors in Growth," *Journal of Monetary Economics* 32, no. 3 (Dec. 1993): 485–512; Robert E. Lucas Jr., "Inflation and Welfare," *Econometrica* 68, no. 2 (Mar. 2000): 247–274.

<sup>15</sup> Sami Alpanda and Adam Honig, "The Impact of Central Bank Independence on Political Monetary Cycles in Advanced and Developing Nations," *Journal of Money, Credit and Banking* 41, no. 7 (Oct. 2009): 1365–1389; William Bernhard, J. Lawrence Broz and William Roberts Clark, "The Political Economy of Monetary Institutions," *International Organization* 56, no. 4, The Political Economy of Monetary Institutions (Autumn 2002): 693–723; Andreas Freytag, "The Credibility of Monetary Reform: New Evidence," *Public Choice* 124, no. 3/4 (Sep. 2005): 391–409; Klaus Schmidt-Hebbel et al., "Inflation Targeting in Brazil, Chile, and Mexico: Performance, Credibility, and the Exchange Rate [with Comments]," *Economía* 2, no. 2 (Spring 2002): 31–89; Leo Svensson, "Inflation Targeting as a Monetary Policy Rule," *Journal of Monetary Economics* 43, no. 3 (Jun. 1999): 607–654.

<sup>16</sup> Antonio Fatás, Ilian Mihov and Andrew K. Rose, "Quantitative Goals for Monetary Policy," *Journal of Money, Credit and Banking* 39, no. 5 (Aug. 2007): 1163–1176.

Solow growth model<sup>17</sup> and Gregorio confirms the influence on labor productivity on real growth and output.<sup>18</sup> Unemployment is a measure of a labor pool that is underutilized, and Milton Friedman finds that tightening measures aimed at controlling inflation can lead to higher unemployment,<sup>19</sup> thus there should be some overlap between low inflation and lower labor productivity on a per capita basis. There is little question that productivity influences growth, but how much output during a given year is due to that change in productivity is still a matter of some question.

Outside of the purely economic realm, Hojman and Weyland find a positive correlation between the level of democracy in a country and its level of output and rate of growth.<sup>20</sup> Kurtz agrees with this assessment, but finds that as level of democracy goes up GDP per capita may go down and income inequality certainly rises.<sup>21</sup> Liberal democracies are often associated with open market financial systems and liberal trade policies; these are thought to be the intervening factors leading to output growth, and thus there may be co-variation with some of the components of the Washington Consensus.

Just as important as the policies themselves, is why states choose to implement these policies in the first place. The political economy literature offers several insights into the policy making process, but there is certainly a consensus that governments of all forms, but especially representative democracies, must

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<sup>17</sup> N. Gregory Mankiw, David Romer and David N. Weil, "A Contribution to the Empirics of Economic Growth," *The Quarterly Journal of Economics* 107, no. 2 (May 1992): 407–437.

<sup>18</sup> José De Gregorio, *Productivity Growth and Disinflation in Chile* National Bureau of Economic Research, [2004].

<sup>19</sup> Milton Friedman, "Monetary Policy: Theory and Practice," *Journal of Money, Credit and Banking* 14, no. 1 (Feb. 1982): 98–118.

<sup>20</sup> David E. Hojman, "Poverty and Inequality in Chile: Are Democratic Politics and Neoliberal Economics Good for You?" *Journal of Interamerican Studies and World Affairs* 38, no. 2/3, Special Double Issue: Poverty and Inequality in Latin America (Summer - Autumn 1996): 73–96; Kurt Weyland, "Economic Policy in Chile's New Democracy," *Journal of Interamerican Studies and World Affairs* 41, no. 3 (Autumn 1999): 67–96.

<sup>21</sup> Marcus J. Kurtz, "Understanding the Third World Welfare State after Neoliberalism: The Politics of Social Provision in Chile and Mexico," *Comparative Politics* 34, no. 3 (Apr. 2002): 293–313.

pay social and political costs in order to implement reform plans.<sup>22</sup> Additionally, even if the new plan would be pareto superior to the current circumstances, there are transition costs and distributional effects that may lead those with vested interests to resist the changes.<sup>23</sup> Przeworski finds that the best strategy for democratic governments is to immediately implement a radical program instead of a gradual one, regardless of popular preferences in the first place. Even if the programs must be moderated later, the political costs for the politicians are smaller, and more reforms are implemented under this strategy.<sup>24</sup> Further, despite traditional neoliberal thinking, Tandler finds that the state must play a central role in reform adoption for the strategies to be successful. By conducting public information campaigns, taking over some bureaucratic tasks previously assigned to municipal governments, and encouraging and assisting in the formation of civic associations, the central government influences good civil society. Good civil society then leads to good government and the cycle perpetuates itself.<sup>25</sup> This means that identical states could implement the same strategy, but because of the form or quality of the government, the reforms may be less effective or even end up reversed under pressure.

This difference in results based on the form of government in place could potentially be helpful in explaining some of the variation in program success across Latin America and the Caribbean. Fortunately, Haggard and Kaufman find that there are strategies that can be implemented to offset some of the difficulties democratic governments (especially unconsolidated democratic governments) face when installing a reform plan.<sup>26</sup> Nevertheless, the transition

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<sup>22</sup> Stephan Haggard and Robert R. Kaufman, *The Political Economy of Democratic Transitions* (Princeton, N.J.: Princeton University Press, 1995), 9; Adam Przeworski and Group on East-South Systems Transformations, *Sustainable Democracy* (Cambridge [England]; New York: Cambridge University Press, 1995), 70.

<sup>23</sup> Adam Przeworski, *Democracy and the Market: Political and Economic Reforms in Eastern Europe and Latin America* (Cambridge; New York: Cambridge University Press, 1991), 160.

<sup>24</sup> *Ibid.*, 174.

<sup>25</sup> Judith Tandler, *Good Government in the Tropics* (Baltimore: Johns Hopkins University Press, 1997), 16.

<sup>26</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 376–377.

to democracy occurred throughout the region during the period of study, and this may help explain why the reform plans implemented took different forms throughout the region.

Another potential explanation comes from the literature on policy diffusion. Weyland finds that policy diffusion occurs in a specific geographic proximity, proceeds in waves in an S-shaped pattern, and entails the adoption of the same policy framework in each of the states.<sup>27</sup> Under policy diffusion, the development program would have started in one state, and through the heuristics of availability, representativeness, and anchoring, spread throughout the region. The availability heuristic would imply that the rampant successes of the economic development strategies in the initial state (in this case Chile) would cause the neighboring states to overrate this strategy because its effects are seen as immediate and relevant. The representative heuristic then would cause the next state to overvalue the sample size as relevant for the entire region—ignoring specific characteristics of the initial case not present in the subsequent cases. Finally, the anchoring heuristic sets the initial value from which to deviate at the level of the first state.<sup>28</sup> This means that the original development strategy implemented by the first state is used as the basis for all other strategies nearby. Because of these heuristics, the reforms implemented by the follow-on states may not have been the ideal development strategies, and they would have eventually been changed when the political cost became too high or the strategies were seen as failing.

The final, and perhaps most contentious, potential determinate of GDP growth is social development. Segura-Ubierno expands on earlier work by Haggard and Kauffman and details the paths taken by welfare states in Latin

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<sup>27</sup> Kurt Weyland, "Theories of Policy Diffusion: Lessons from Latin American Pension Reform," *World Politics* 57, no. 2 (Jan. 2005): 265.

<sup>28</sup> *Ibid.*, 284–285.

America.<sup>29</sup> Segura-Ubiergo uses social spending as the dependent variable however, and as such does not examine the impact of social spending on economic growth.<sup>30</sup> For preliminary analyses of social development as a dependent variable, we must return to the economic literature.

During the neoliberal zenith, it was argued by Martin Feldstein (and others) that high levels of social spending were fueling overconsumption, preventing societal saving, and thus lowering levels of investment to promote growth.<sup>31</sup> Further arguments promoted the idea that social spending provided a disincentive to work by providing too high of an income for the unemployed.<sup>32</sup> On the other side of the spectrum, Midgely and others have argued that social spending on “productivist” social programs can promote economic growth.<sup>33</sup> These programs generally focus on education and health as a means of improving worker productivity while simultaneously improving quality of life.<sup>34</sup> Despite the theoretical underpinnings on both sides of the argument, little quantitative research has resolved the debate—and even less research has been done concerning social spending and growth in Latin America. Although the

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<sup>29</sup> For Haggard and Kauffman’s original argument see: Robert R. Kaufman and Alex Segura-Ubiergo, “Globalization, Domestic Politics, and Social Spending in Latin America A Time-Series Cross-Section Analysis, 1973–97,” *World Politics* 53, no. 4 (Jul. 2001): 553–587; and Stephan Haggard and Robert R. Kaufman, *Development, Democracy, and Welfare States: Latin America, East Asia, and Eastern Europe* (Princeton: Princeton University Press, 2008).

<sup>30</sup> Segura-Ubiergo does take a preliminary look at the effectiveness of social spending on lowering inequality, but does not address pro-growth components of social development. See: Alex Segura-Ubiergo, *The Political Economy of the Welfare State in Latin America : Globalization, Democracy, and Development* (Cambridge; New York: Cambridge University Press, 2007), 276–280.

<sup>31</sup> Martin Feldstein, “Social Security, Induced Retirement, and Aggregate Capital Accumulation,” *Journal of Political Economy* 82, no. 5 (Sep. - Oct. 1974): 905–926; Robert William Bacon and Walter Eltis, *Britain’s Economic Problem: Too Few Producers*, 2d ed. (London: Macmillan, 1978).

<sup>32</sup> Charles A. Murray, *Losing Ground: American Social Policy, 1950–1980* (New York: Basic Books, 1984).

<sup>33</sup> For a succinct overview of Midgley’s work on this topic see: James Midgley and Kwong-leung Tang, “Introduction: Social Policy, Economic Growth and Developmental Welfare,” *International Journal of Social Welfare* 10, no. 4 (2001): 244–252.

<sup>34</sup> See also: George Psacharopoulos, “Education and Development: A Review,” *The World Bank Research Observer* 3, no. 1 (Jan. 1988): pp. 99–116; Gary S. Becker, “Investment in Human Capital: A Theoretical Analysis,” *Journal of Political Economy* 70, no. 5, Part 2: Investment in Human Beings (Oct. 1962): 9–49.

results of this thesis are far from definitive, the findings should at least facilitate much discussion and encourage future studies.

## E. METHODS AND SOURCES

This study begins with a factor analysis on key growth constraints across the universe of cases. Indices reflecting the ten components of the original Washington Consensus and the ten components of the “Augmented” Washington Consensus as described by Rodrik are included as well as measures meant to reflect the other growth constraints discussed in the literature review. This approach allows preexisting, fully developed, academically scrutinized, and reliable indices to be used and provides a consistent approach for country scoring across the cases. The factor analysis shows which components of the following indices are most closely aligned with growth potential across the universe of cases.

Thus:

$$GrowthPotential = f(WEF_{GCI} + HF_{IEF} + WB_{WGI} + LPI + UN_{HDI}) \quad (\text{Eqn. 1.1})$$

where:

$WEF_{GCI}$	= World Economic Forum Global Competitiveness Index
$HF_{IEF}$	= Heritage Foundation Index of Economic Freedom
$WB_{WGI}$	= World Bank Worldwide Governance Indicators
$LPI$	= Legatum Prosperity Index
$UN_{HDI}$	= United Nations Human Development Index

The Global Competitiveness Index (GCI) data come from the World Economic Forum (WEF), The Index of Economic Freedom (IEF) data come from a joint project of the Heritage Foundation and the Wall Street Journal, Worldwide Governance Indicators (WGI) come from the World Bank, the Legatum Prosperity Index (LPI) is an annual product of the Legatum Institute in London, and the Human Development Index (HDI) is a product of the United Nations (UN). I provide a full explanation of the development of the combined datasets in Chapter II as well as an explanation as to their coverage of all potential explanatory variables discussed so far.



Once factor analysis is complete using Eqn. 1 on the universe of cases, I divide the cases into two subgroupings based on the WEF Stage of Development.<sup>35</sup> A factor analysis is performed on each of these subgroupings to determine what potential growth constraints are most closely aligned with growth potential in each of them. The results of this factor analysis provide insight into potential differences in growth strategies that would be most effective in each subgrouping.

## **F. THESIS OVERVIEW**

Six chapters comprise this thesis. This chapter provided an overview of the major research question posed by this thesis as well as a discussion of my general approach. Chapter II includes the results of the factor analyses on both the universe of data as well as the two country subgroupings. Chapter III provides a quantitative analysis of the role democratic negotiation and targeted social spending played in the implementation of neoliberal structural adjustment strategies across Latin America and the Caribbean from 1970 to 2000. Chapter IV provides a quantitative analysis of the affects growth and associated inequality had on levels of violence. Chapter V reexamines the assumptions of Chapter II and performs a discriminate analysis on the countries in Latin America and the Caribbean to determine the proper subgrouping of each. This ensures the policy recommendations for each country is appropriate according to where they are currently located along the growth spectrum. Chapter VI provides a conclusion as well as recommendations for future research and some policy prescriptions grounded in my findings.

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<sup>35</sup> A full explanation of the division point chosen is provided in Chapter II.

## **II. FACTOR ANALYSIS ON KEY CONSTRAINTS ON GROWTH IN LATIN AMERICA**

### **A. INTRODUCTION**

This chapter addresses my first puzzle identified in the introduction; namely, why has the orthodox neoliberal model had success in some parts in Latin America, and why has it been a dismal failure in others. The answer to this question is somewhat surprising and has a profound impact on potential growth strategies for the region. I begin with an overview of the potential growth constraints in Latin America and a framework with which to divide the region into two subregions of growth potential. Next, I use a factor analysis on the universe of cases to show which growth constraints are more closely aligned with growth potential in each subregion. Finally, I discuss the implications of these findings for generating targeted growth strategies that look very different in each subregion.

For the purposes of this chapter, I assume that the World Economic Forum (WEF) has correctly identified the stage of growth for each of the countries of the world and specifically for each country in Latin America and the Caribbean. This assumption is necessary for the performance of the factor analysis, and is justified considering large number of cases under study. It is important to note here that I do not make the same assumption in Chapter V, and there I perform a discriminate analysis to determine the classification of each country in Latin America and the Caribbean properly. Thus, I report the Latin American subregions here as the WEF Stages of Development would divide them, but I adjust the subregions in Chapter V to better reflect the actual status of the Latin American and Caribbean countries.

### **B. POTENTIAL GROWTH CONSTRAINTS**

For more than three decades, the WEF has published their annual Global Competitive Index (GCI), ranking the countries of the world along twelve pillars of

competitiveness. The WEF's GCI has become the international standard for determining a country's growth potential within the world economy and is thus a good place to start for examining potential constraints on growth. The WEF defines competitiveness as, "the set of institutions, policies, and factors that determine the level of productivity of a country."<sup>36</sup> By extension, the level of productivity also determines growth potential in the medium to long run as well as a country's ability to obtain and sustain a high level of income.

The WEF breaks down the factors that influence competitiveness and productivity into twelve pillars that are then combined into a weighted factor average to come up with a final GCI score for each country. For the purposes of this chapter, the final GCI score is called the "growth potential." The twelve pillars that make up the growth potential are: Institutions, Infrastructure, Macroeconomic Environment, Health and Primary Education, Higher Education and Training, Goods Market Efficiency, Labor Market Efficiency, Financial Market Development, Technological Readiness, Market Size, Business Sophistication, and Innovation.<sup>37</sup> The Market Size pillar has been removed from the models used in this chapter due to statistical insignificance and complete independence from the other factors. In other words, Market Size fell out of all models as an independent and statistically insignificant variable.

The WEF uses the weighted index to sort the countries of the world into 3 distinct stages of development. These are: Stage 1 (factor driven economies), Stage 2 (efficiency driven economies), and Stage 3 (innovation driven economies).<sup>38</sup> In between each of these stages are countries in transition from one stage to the next. For simplicity, I place the transition countries into their own stages that I call Stage 1.5 (for countries transitioning between Stage 1 and Stage 2) and Stage 2.5 (for countries transitioning between Stage 2 and 3). In

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<sup>36</sup> Klaus Schwab, *The Global Competitiveness Report 2010–2011* (Geneva, Switzerland: World Economic Forum, [2010]).

<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

Latin America, no country has yet reached Stage 3 although several are very close. In fact, an examination of the groupings of Latin American countries yields two independent subregions that are incredibly different from one another. I call these Subregions I and II. Table 3 lists each country by subregion, and Figure 1 and Figure 2 show geographically and quantitatively (according to WEF pillar scores) just how different these two subregions are.<sup>39</sup>

<b>Subregion I (Stages 1–2)</b>	<b>Subregion II (Stages 2.5–3)</b>
The Andes and Central America	The Southern Cone
Bolivia (1.0)	Argentina (2.5)
Nicaragua (1.0)	Brazil (2.5)
Guatemala (1.5)	Chile (2.5)
Honduras (1.5)	Mexico (2.5)
Jamaica (1.5)	Uruguay (2.5)
Paraguay (1.5)	
Venezuela (1.5)	
Belize (2.0)	
Colombia (2.0)	
Costa Rica (2.0)	
Dominican Republic (2.0)	
Ecuador (2.0)	
El Salvador (2.0)	
Panama (2.0)	
Peru (2.0)	

Source: World Economic Forum

Table 3. Latin American Countries at Various Stages of Development (Actual Stage in Parentheses)

<sup>39</sup> Figures 2 to 5 are radar plots of the various indices intended to show the variation across the two Latin American subregions. Each axis represents one component of the respective index and the two star plots represent the scores on each component by each subregion. Displaying the data on a radar plot allows for a rapid comparison across multiple dimensions of each subregion, and I attempt to use them to show major disparities between the two subregions across a multitude of indices.



Figure 1. Latin America and the Caribbean by Subregion

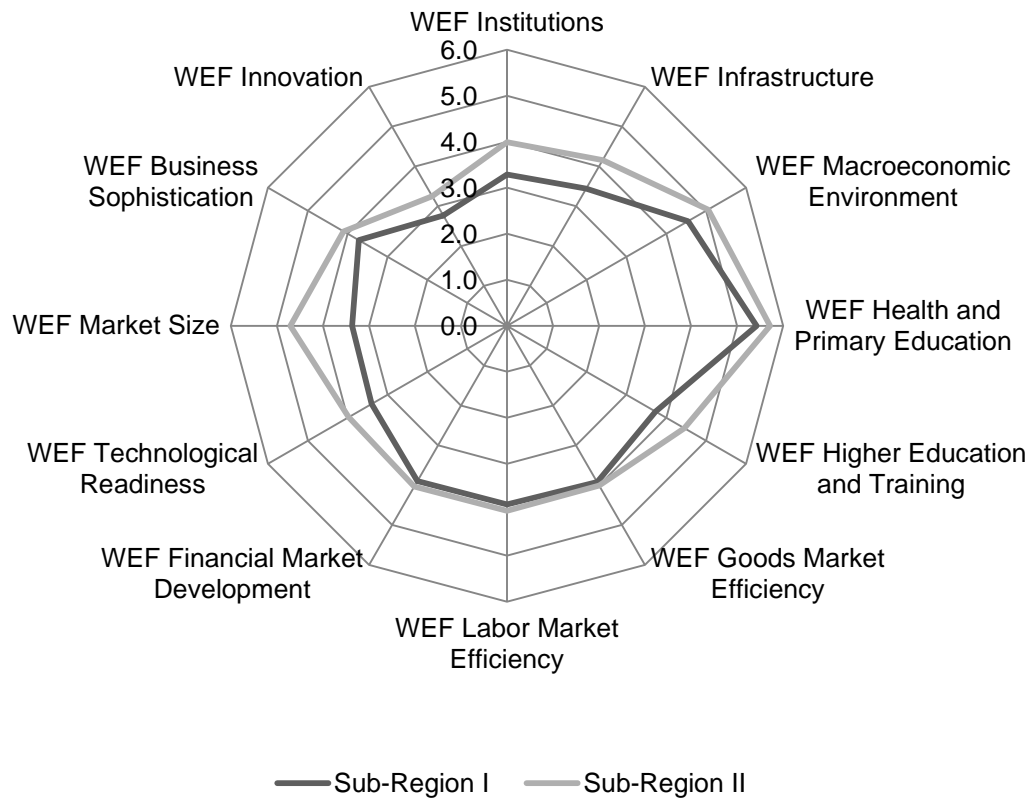


Figure 2. World Economic Forum Twelve Pillars of Competitiveness in Latin America Subregion I and Subregion II

Additional constraints on growth may come from areas not well captured by the World Economic Forum’s Twelve Pillars of Competitiveness. The Heritage Foundation and the Wall Street Journal publish an annual *Index of Economic Freedom* (IEF) that may capture additional growth constraints. The ten factors measured by the IEF parallel the core principles of the original Washington Consensus and include: Business Freedom, Trade Freedom, Fiscal Freedom, Government Spending, Monetary Freedom, Investment Freedom, Financial Freedom, Property Rights, Freedom from Corruption, and Labor Freedom.<sup>40</sup> Although the IEF is operating on the principle that more government

<sup>40</sup> Terry Miller and Kim R. Holmes, *2011 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, 2011).

spending is a normative bad<sup>41</sup>, the data and index are useful nonetheless, and when combined together with the other indexes can help to illustrate how appropriate levels of government spending can be used most effectively to promote growth. Latin American Subregions I and II also rank out quite differently in the IEF scores. Figure 3 shows a comparison.

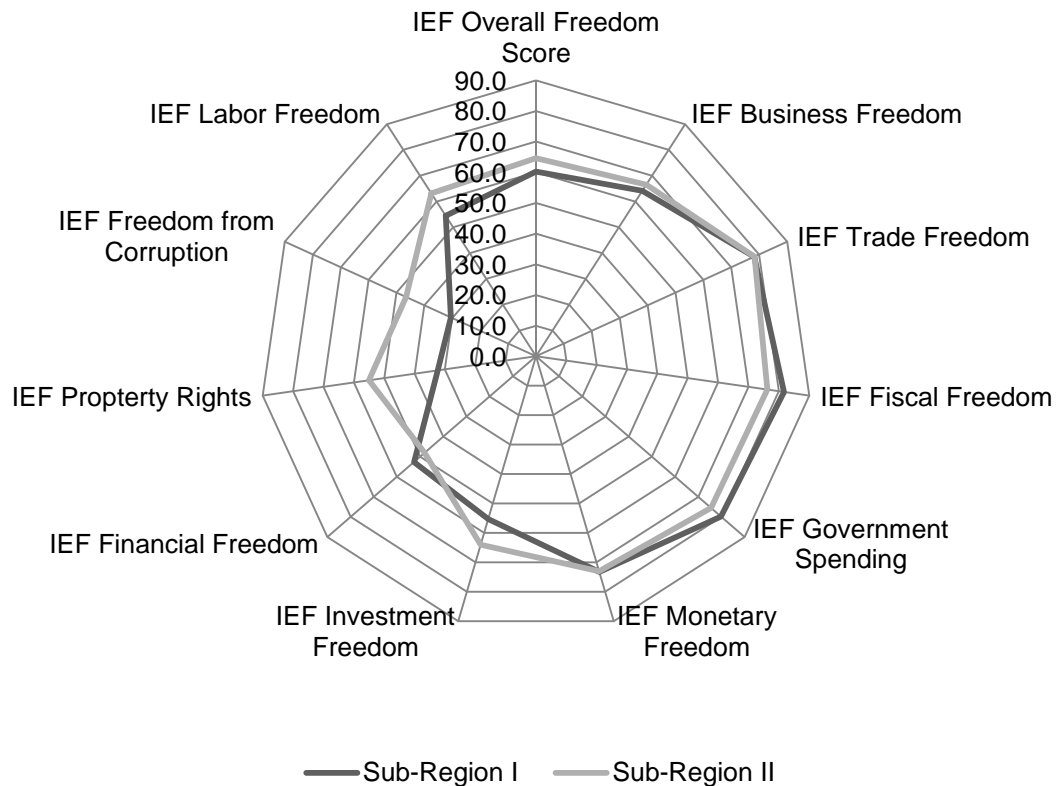


Figure 3. Heritage Foundation Index of Economic Freedom in Latin American Subregion I and Subregion II

Although the GCI and IEF are each intended to capture some measures of good government they are not complete and there is a better index available from the World Bank to measure governance and anti-corruption in a more

<sup>41</sup> For IEF scoring purposes, higher levels of government per capita spending results in lower scores in both the Government Spending and Fiscal Freedom categories. This explains why the Subregion II countries' scores in those categories are "inside" the Subregion I scores.

accurate and comprehensive manner. The World Bank has been publishing their Worldwide Governance Indicators (WGI) since 1996, and they are recognized as the most thorough and accurate reflection of general governance within a country. The World Bank has divided the overall governance scores into six independent categories for scoring governance and anti-corruption. They are: Voice and Accountability, Political Stability and Lack of Violence, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption.<sup>42</sup> The variation between Latin American Subregion I and Subregion II is striking in these categories. Subregion II scores significantly higher than Subregion I in every governance category. Figure 4 shows these differences.

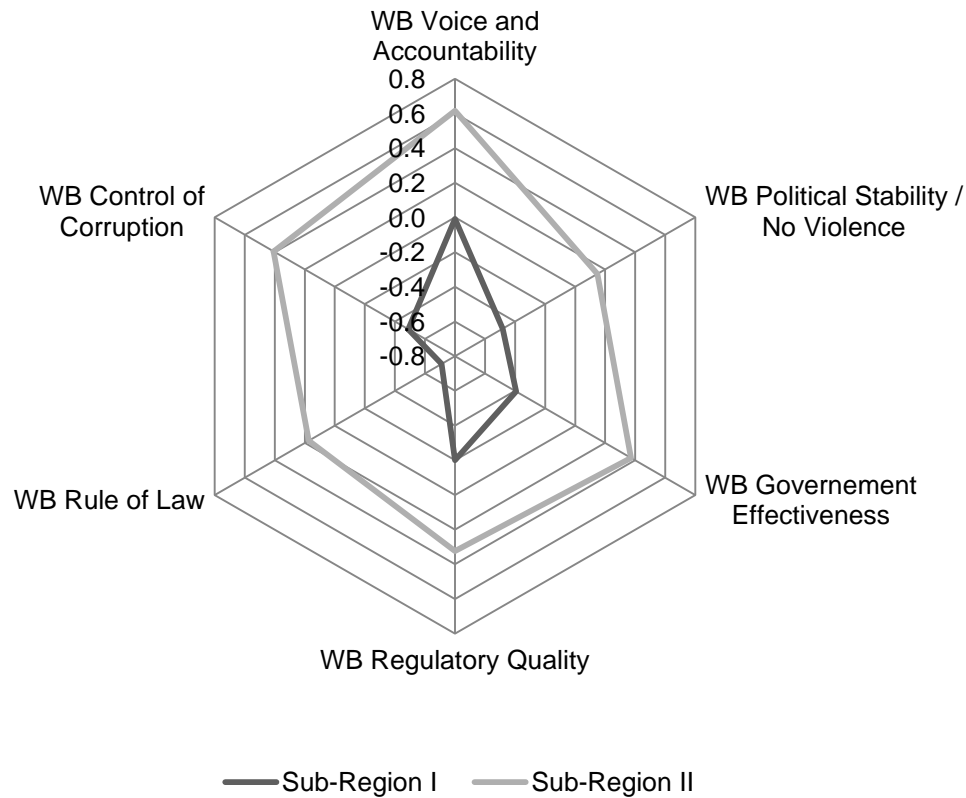


Figure 4. World Bank Worldwide Governance Indicators in Latin American Subregion I and Subregion II

<sup>42</sup> The World Bank, *Worldwide Governance Indicators* (Washington, DC: The World Bank, [2011]).



Although the GCI captures some forms of social spending with the Health and Primary Education and Higher Education and Training pillars, there are significant categories of social spending that this index does not capture. Further, no index introduced thus far fully captures the potential constraints placed on country growth due to entrepreneurship. The GCI Innovation pillar may capture the “spirit” of entrepreneurship well, but there are several functions of entrepreneurs (e.g., small-business owners, job creators, and improving on efficiency to maximize profits) within an economy other than innovation. The Legatum Institute’s Legatum Prosperity Index (LPI) is comprised of six key determinates of a country’s overall prosperity. These include: Economy, Entrepreneurship and Opportunity, Governance, Education, Health, Safety and Security, Personal Freedom, and Social Capital. The Safety and Security index includes both physical security and measures of social protection such as social security and basic welfare. The Social Capital index also adds a measure of a country’s interpersonal networks and overall level of trust.<sup>43</sup> Thus, the inclusion of the LPI adds additional measures of social development, entrepreneurship, and social capital, to those measures already introduced as potential growth constraints. As was the case for the three indices already introduced, the LPI average scores for Latin American countries in Subregion I were significantly lower than the average scores for the countries in Subregion II. The radar plot in Figure 5 shows just how much variation exists between the two subregions.

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<sup>43</sup> Legatum Institute, *The 2011 Legatum Prosperity Index* (London, United Kingdom: Legatum Institute, 2011).

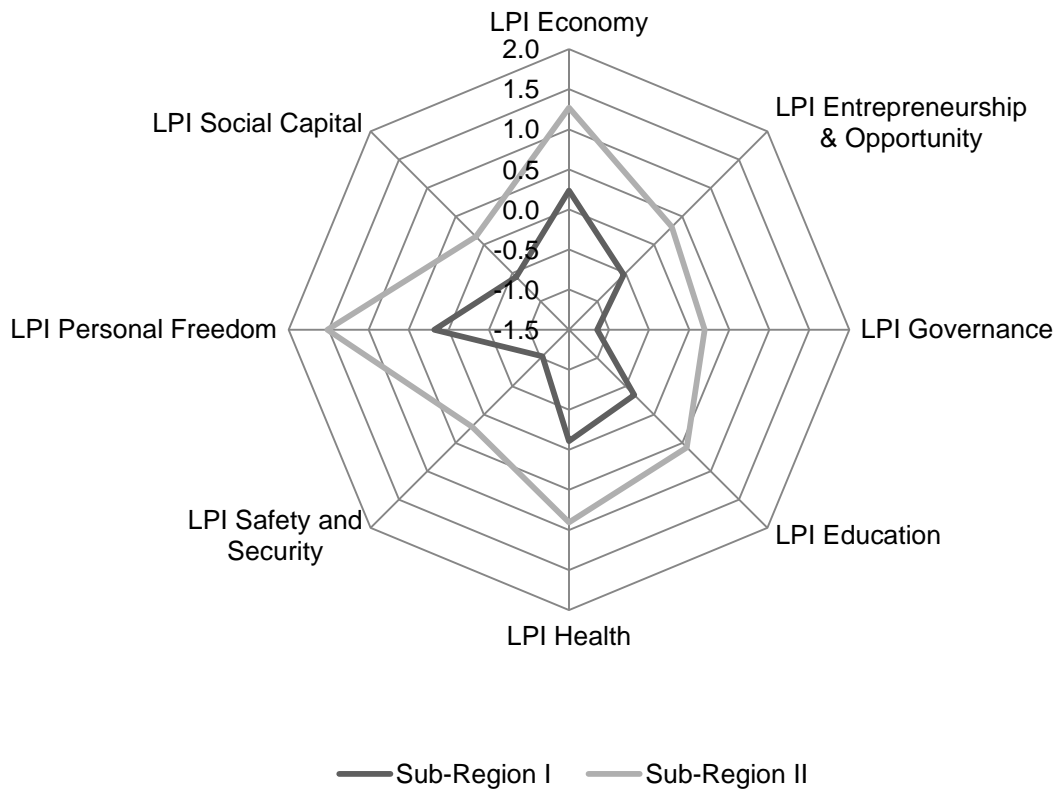


Figure 5. Legatum Prosperity Index in Latin American Subregion I and Subregion II

The United Nations (UN) also generates a yearly index that is designed to capture potential growth limitations in the form of health, education, and living standards. Combined together, the UN Human Development Index (HDI) is meant to capture the quality of an individual’s life rather than just their income or social wellbeing individually.<sup>44</sup> The HDI has become the standard in international growth measurements and its inclusion in the combined dataset is intended to ensure all potential measures of constraints on development are captured. The HDI is a score between zero and one with one being the highest level of human development that can be achieved and zero being the lowest. The HDI average

<sup>44</sup> United Nations Development Programme, *Human Development Report 2011* (New York, NY: Palgrave Macmillan, 2011).

of Latin American Subregion I is 0.687 and the average of Subregion II is 0.775. Thus, the minimal variation within each subregion is paltry compared to the scale of the differences between Subregion I and Subregion II.

## **C. DATA AND METHODOLOGY**

### **1. Data**

The CGI, IEF, WGI, LPI, and HDI indices were first pooled together into a combined dataset on potential growth constraints for the universe of cases. The most limiting index case wise is the LPI, which contains 110 countries, however the other five indices are similar in scope and magnitude. All data come from 2011 and are the most current available for each country.<sup>45</sup> The worldwide excluded countries include troubled hot spots such as Afghanistan and Iraq, as well as failed states such as Somalia. In Latin America and the Caribbean, the excluded countries include Cuba, which is notoriously elusive when it comes to providing economic data for international consumption, and Haiti, which has been in a near failed state status since the catastrophic earthquake there in 2010. Also excluded from the combined dataset are Suriname, Guyana, and French Guiana. These countries are often not included as part of the Latin American region, they are small, and economic data is particularly sparse and difficult to obtain. With the exclusion of these five countries from Latin America, the overall dataset still includes 20 countries as shown in Table 3 and Figure 1. Additionally, despite the lack of data available, it is clear that all five excluded countries fall within the Subregion I category and the results obtained below apply here as well.

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<sup>45</sup> The World Economic Forum has since released the 2012 Global Competitive Index, but it was unavailable during the conduct of this research.

## 2. Hypothesis<sub>1</sub>

Targeted social spending and social development has played a central role in both the implementation and success of orthodox neoliberal reforms throughout Latin America and the Caribbean. Social spending eased the political costs of structural adjustment and separately played a central role in actually achieving growth.

## 3. Methodology

The methodology follows a similar path as was undertaken by Robert Looney in his paper on entrepreneurship in Pakistan,<sup>46</sup> but the focus here has been broadened from a single country to Latin America as a region within the context of a world economy. In addition, the importance of social development as constraining or aiding economic development is understudied. Thus, the inclusion of the entire LPI and the UN HDI<sup>47</sup> in my combined dataset will help to illuminate just where social development indicators fall within the key dimensions of growth potential. I perform a factor analysis on this combined data set to determine how many distinct phenomena exist within the 39 potential growth constraints outlined above. I also examine where Growth Potential fits in relation to these distinct phenomena to elucidate those phenomenon most associated with Growth Potential. Finally, I re-perform the factor analysis on the two subsets of the data divided along the stages of growth. The first subset is for countries within Stages 1 through 2, and the second subset includes countries in Stages 2.5 and 3 (These parallel Latin American Subregion I and Subregion II as shown in Table 3 and Figure 1). A comparison between the results of these two factor analyses can then shed some light on why growth strategies within one

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<sup>46</sup> Robert E. Looney, *Entrepreneurship and the Process of Development: A Framework for Applied Expeditionary Economics in Pakistan* (Kansas City, Kansas: Kauffman Foundation, 2011).

<sup>47</sup> These indices were not included in Looney's work.

subregion of Latin America are not necessarily well suited for countries that are not in the same subregion. Table 3 reports the results of the initial factor analysis on the universe of cases.

#### **D. RESULTS AND ANALYSIS**

For the total sample of countries, growth potential is most closely aligned with Factor 1, the Competitiveness and Governance dimension, specifically WEF's innovation, institutions, business sophistication, market efficiencies and technological readiness along the competitiveness dimension and measures of governance from every available index. However, growth potential is also closely aligned with Factor 2, the Social Development and Entrepreneurship dimension, which includes measures of health, education, human development, and entrepreneurship. Thus, an analysis of the results of the factor analysis on the total sample of countries provides us with little helpful information, except to say that growth potential is not as closely aligned with the Economic Freedom, Fiscal Policy, and Labor Market dimensions as is frequently reported in the literature.

Looking a little more closely at the results in Table 4, it becomes clear that the linkages between growth potential and entrepreneurship and social development when examined as the universe of cases are likely blurred by the wide variation in the intra-country environments. In other words, as outlined in the discussion of the variation between Subregions I and II across the various indices used in this chapter, the division of the countries into two subgroups is both useful and necessary in order to glean any specific implications for Subregions I and II. Thus, by re-performing the factor analyses on the two subgroupings, the variations within the subgroupings are reduced and more useful results can be obtained. Table 5 presents the results for the factor analysis on countries in Stages 1 through 2, and Table 6 presents the results for the factor analysis on countries in Stages 2.5 and 3.

Key Indicators	Main Dimensions				
	Factor 1 Competitive- ness & Governance	Factor 2 Social Development & Entrepre- neurship	Factor 3 Economic Freedom	Factor 4 Fiscal Policy	Factor 5 Labor Market
WEF Innovation	0.786	0.351	0.156	0.308	0.064
WEF Institutions	0.781	0.269	0.188	0.226	0.364
WEF Business Sophistication	0.775	0.393	0.223	0.200	-0.021
WEF Goods Market Efficiency	0.772	0.255	0.334	0.020	0.326
WEF Financial Market Development	0.770	0.116	0.285	-0.002	0.208
<b>WEF Growth Potential</b>	<b>0.732</b>	<b>0.579</b>	<b>0.218</b>	<b>0.137</b>	<b>0.178</b>
IEF Freedom from Corruption	0.627	0.399	0.395	0.389	0.285
LPI Governance	0.624	0.397	0.463	0.346	0.256
WB Government Effectiveness	0.606	0.498	0.430	0.333	0.193
WB Control of Corruption	0.603	0.382	0.430	0.377	0.288
IEF Property Rights	0.602	0.338	0.488	0.368	0.241
WEF Technological Readiness	0.572	0.554	0.381	0.375	0.127
WB Rule of Law	0.569	0.440	0.458	0.394	0.234
LPI Social Capital	0.520	0.390	0.210	0.359	0.185
IEF Business Freedom	0.441	0.396	0.406	0.227	0.213
WEF Health and Primary Education	0.280	0.862	0.210	0.164	0.055
LPI Education	0.198	0.849	0.271	0.304	0.096
Human Development Index	0.262	0.835	0.321	0.239	0.081
LPI Health	0.269	0.828	0.314	0.265	0.038
WEF Higher Education and Training	0.467	0.706	0.274	0.347	0.139
LPI Entrepreneurship & Opportunity	0.484	0.640	0.399	0.340	0.176
WEF Infrastructure	0.577	0.640	0.291	0.213	0.129
LPI Economy	0.571	0.607	0.387	-0.114	-0.045
LPI Safety and Security	0.288	0.534	0.480	0.401	0.272
WEF Macroeconomic Environment	0.448	0.487	0.017	-0.357	0.082
IEF Trade Freedom	0.107	0.312	0.822	0.137	0.184
IEF Investment Freedom	0.300	0.111	0.791	0.262	0.129
IEF Monetary Freedom	0.266	0.178	0.771	-0.192	-0.066
IEF Tariff Rate	-0.112	-0.366	-0.765	-0.120	-0.117
IEF Financial Freedom	0.362	0.193	0.716	0.215	0.165
WB Regulatory Quality	0.505	0.395	0.636	0.294	0.187
WB Voice and Accountability	0.260	0.264	0.628	0.568	0.032
WB Political Stability / No Violence	0.227	0.349	0.465	0.382	0.427
IEF Government Spending	-0.025	-0.294	-0.035	-0.851	-0.052
IEF Tax Burden % of GDP	0.153	0.321	0.253	0.798	-0.005
IEF Fiscal Freedom	-0.466	-0.018	-0.080	-0.693	0.291
LPI Personal Freedom	0.343	0.193	0.454	0.485	0.182
IEF Labor Freedom	0.278	0.041	0.132	-0.122	0.794
WEF Labor Market Efficiency	0.552	0.151	0.272	0.076	0.649

Notes: Extraction Method: IBM SPSS 20.0 Principle Component Analysis. Rotation Method Variamax with Kaiser Normalization. Rotation converged in 7 iterations. WEF = World Economic Forum Dataset, IEF = Heritage Foundation Index of Economic Freedom Dataset, WB = World Bank Governance Dataset, LPI = Legatum Prosperity Index Dataset, Human Development Index: United Nations Human Development Index 2011

Table 4. Factor Analysis – Total Sample of Countries (loadings on principal dimensions)

Key Indicators	Main Dimensions							
	Factor 1 Social Development & Entrepreneurship	Factor 2 Governance	Factor 3 Competitiveness	Factor 4 Economic Freedom	Factor 5 Fiscal Policy	Factor 6 Democracy	Factor 7 Labor Market	Factor 8 Fiscal Freedom
LPI Education	0.942	0.088	0.052	0.065	-0.072	0.071	0.100	-0.019
Human Development Index	0.921	0.150	0.057	0.091	-0.015	0.041	-0.042	-0.125
LPI Health	0.914	0.161	-0.012	0.126	0.053	-0.028	-0.098	-0.077
WEF Health and Primary Education	0.900	0.053	0.081	-0.067	0.106	-0.039	0.030	-0.041
WEF Higher Education and Training	0.805	0.153	0.423	0.074	-0.160	0.037	0.049	0.134
LPI Entrepreneurship & Opportunity	0.754	0.371	0.241	0.311	-0.048	0.117	0.021	0.035
WEF Infrastructure	0.659	0.373	0.476	0.081	0.055	-0.167	0.115	0.134
WEF Technological Readiness	0.648	0.266	0.518	0.264	-0.022	0.070	0.029	0.025
<b>WEF Growth Potential</b>	<b>0.625</b>	<b>0.313</b>	<b>0.578</b>	<b>-0.036</b>	<b>0.187</b>	<b>-0.144</b>	<b>0.262</b>	<b>0.125</b>
WEF Macroeconomic Environment	0.485	0.129	0.027	-0.105	0.435	-0.246	0.343	0.318
LPI Safety and Security	0.447	0.372	-0.222	0.261	0.010	0.346	0.358	0.084
WB Control of Corruption	0.174	0.842	0.172	0.101	0.010	0.209	0.232	-0.010
WB Rule of Law	0.272	0.821	0.260	0.110	0.060	0.129	0.217	0.067
IEF Freedom from Corruption	0.217	0.753	0.350	0.147	-0.084	0.169	0.221	0.035
IEF Property Rights	0.050	0.746	0.316	0.318	0.011	0.071	0.036	-0.107
WB Government Effectiveness	0.405	0.724	0.360	0.072	0.114	0.127	0.104	0.110
LPI Governance	0.267	0.684	0.377	0.165	0.188	0.294	0.238	-0.003
IEF Business Freedom	0.218	0.670	-0.053	0.254	0.017	-0.332	-0.038	-0.009
WB Regulatory Quality	0.240	0.650	0.274	0.528	0.059	0.202	0.037	0.002
WEF Institutions	0.050	0.610	0.557	-0.210	0.034	-0.144	0.392	0.026
WEF Business Sophistication	0.350	0.202	0.861	0.069	0.185	-0.039	-0.024	-0.007
WEF Financial Market Development	0.070	0.278	0.846	0.151	0.032	0.143	0.054	-0.051
WEF Innovation	0.176	0.211	0.807	-0.138	0.082	0.018	0.211	0.238
WEF Goods Market Efficiency	0.093	0.403	0.749	0.150	0.190	-0.095	0.263	-0.041
IEF Trade Freedom	0.169	0.155	-0.060	0.839	0.063	0.109	0.252	-0.001
IEF Tariff Rate	-0.217	-0.044	-0.038	-0.784	-0.090	-0.131	-0.223	-0.058
IEF Financial Freedom	0.033	0.319	0.185	0.746	0.021	0.226	0.026	-0.074
IEF Investment Freedom	-0.112	0.459	0.112	0.638	0.034	0.290	-0.055	-0.284
IEF Government Spending	-0.093	-0.030	0.249	0.125	0.867	0.086	-0.047	-0.006
IEF Tax Burden % of GDP	0.153	0.092	-0.102	0.182	-0.696	0.245	0.161	0.414
LPI Economy	0.585	0.176	0.152	0.172	0.680	-0.012	0.052	0.118
IEF Monetary Freedom	0.058	0.273	-0.108	0.543	0.610	0.082	0.085	0.035
LPI Personal Freedom	-0.035	0.078	0.034	0.203	0.039	0.839	0.081	0.028
WB Voice and Accountability	0.033	0.310	-0.039	0.393	-0.106	0.727	-0.173	0.036
WEF Labor Market Efficiency	-0.065	0.148	0.385	0.268	-0.002	0.026	0.749	0.009
IEF Labor Freedom	-0.005	0.284	0.206	0.140	-0.013	-0.098	0.637	-0.146
WB Political Stability / No Violence	0.188	0.347	-0.029	0.228	-0.160	0.430	0.586	0.112
IEF Fiscal Freedom	0.397	-0.003	-0.082	0.263	0.073	-0.195	0.131	-0.715

Notes: Extraction Method: IBM SPSS 20.0 Principle Component Analysis. Rotation Method Variamax with Kaiser Normalization. Rotation converged in 12 iterations. WEF = World Economic Forum Dataset, IEF = Heritage Foundation Index of Economic Freedom Dataset, WB = World Bank Governance Dataset, LPI = Legatum Prosperity Index Dataset, Human Development Index: United Nations Human Development Index 2011

Table 5. Factor Analysis – Stage 1 - 2 Countries (loadings on principal dimension)

Key Indicators	Main Dimensions					
	Factor 1 Innovation, Competitiveness, & Social Development	Factor 2 Security & Governance	Factor 3 Economic Freedom	Factor 4 Fiscal Policy	Factor 5 Labor Market	Factor 6 Macroeconomic Environment
WEF Innovation	0.868	0.146	0.113	0.270	0.107	0.024
WEF Business Sophistication	0.851	0.048	0.143	0.259	0.033	0.069
<b>WEF Growth Potential</b>	<b>0.837</b>	<b>0.288</b>	<b>0.211</b>	<b>0.109</b>	<b>0.296</b>	<b>0.181</b>
LPI Economy	0.758	0.300	0.109	0.027	0.161	0.330
WEF Infrastructure	0.757	0.384	0.223	0.063	0.057	-0.022
WEF Technological Readiness	0.686	0.454	0.334	0.268	0.147	0.058
LPI Entrepreneurship & Opportunity	0.655	0.539	0.208	0.268	0.304	0.049
WEF Goods Market Efficiency	0.650	0.265	0.472	-0.129	0.379	0.092
WEF Higher Education and Training	0.643	0.493	0.195	0.310	0.296	0.001
WEF Institutions	0.617	0.490	0.340	0.059	0.301	0.254
WB Government Effectiveness	0.614	0.499	0.461	0.194	0.258	0.149
WEF Financial Market Development	0.600	0.097	0.371	-0.076	0.361	0.400
LPI Health	0.590	0.524	0.130	0.426	0.086	-0.198
Human Development Index	0.574	0.525	0.253	0.307	0.215	-0.134
WEF Health and Primary Education	0.558	0.494	0.273	0.209	0.194	-0.244
IEF Property Rights	0.520	0.484	0.466	0.222	0.308	0.206
IEF Business Freedom	0.475	0.444	0.389	0.182	0.255	-0.042
LPI Safety and Security	0.283	0.866	0.296	0.130	0.049	-0.063
WB Political Stability / No Violence	0.179	0.818	0.322	0.051	-0.020	0.090
LPI Personal Freedom	0.239	0.725	0.030	0.335	0.219	0.312
WB Control of Corruption	0.532	0.614	0.373	0.146	0.262	0.240
IEF Freedom from Corruption	0.576	0.592	0.360	0.144	0.292	0.181
WB Rule of Law	0.501	0.555	0.481	0.301	0.251	0.111
LPI Social Capital	0.443	0.549	0.034	0.370	0.442	0.201
LPI Governance	0.534	0.541	0.408	0.270	0.322	0.193
IEF Trade Freedom	0.119	0.260	0.895	0.042	0.036	-0.047
IEF Tariff Rate	-0.158	-0.262	-0.837	-0.059	0.029	0.147
IEF Investment Freedom	0.128	0.121	0.771	0.263	0.212	0.239
WB Regulatory Quality	0.472	0.331	0.660	0.221	0.341	0.168
IEF Monetary Freedom	0.489	0.092	0.600	0.013	0.034	-0.016
IEF Financial Freedom	0.284	0.039	0.574	0.285	0.480	0.146
IEF Tax Burden % of GDP	0.101	0.159	0.106	0.903	-0.087	-0.021
IEF Fiscal Freedom	-0.338	-0.110	-0.055	-0.852	0.124	-0.156
IEF Government Spending	-0.075	-0.163	-0.160	-0.832	0.081	0.275
WB Voice and Accountability	0.098	0.474	0.431	0.655	0.115	0.158
LPI Education	0.241	0.555	0.035	0.559	0.248	-0.175
IEF Labor Freedom	0.210	0.175	0.117	-0.282	0.788	-0.022
WEF Labor Market Efficiency	0.540	0.321	0.248	-0.118	0.636	0.023
WEF Macroeconomic Environment	0.470	0.212	0.054	-0.335	-0.004	0.595

Notes: Extraction Method: IBM SPSS 20.0 Principle Component Analysis. Rotation Method Variamax with Kaiser Normalization. Rotation converged in 9 iterations. WEF = World Economic Forum Dataset, IEF = Heritage Foundation Index of Economic Freedom Dataset, WB = World Bank Governance Dataset, LPI = Legatum Prosperity Index Dataset, Human Development Index: United Nations Human Development Index 2011

Table 6. Factor Analysis – Stage 2.5 - 3 Countries (loadings on principal dimensions)



For countries in Latin American Subregion I, the results of the factor analysis in Table 5 show growth potential is most closely aligned with the Social Development and Entrepreneurship dimension followed by the Competitiveness dimension. For countries in Subregion I, the implications of these results is that growth potential can be increased by focusing energy and resources in the direction of Social Development and Entrepreneurship first. This runs counter to the general Washington Consensus ideas that less government spending is better and that decreasing a country's fiscal obligations is the only way to get growth started. In the case of the countries in Subregion I, this appears not to be the case. In fact, by properly targeting government resources (even increasing spending) in the direction of social development and entrepreneurship, the countries in Subregion I can increase their growth potential, holding all else equal. In other words, even without implementing other market reforms.

For the more developed countries in Latin American Subregion II, the results of the factor analysis in Table 6 show that growth potential is most closely aligned with the Innovation, Competitiveness, and Social Development dimension. Although Social development indicators are still aligned with growth potential in Subregion II, they are less closely aligned then they were in the Subregion I results. Entrepreneurship, and the related Innovation and Technological readiness, plays a much larger role in supporting growth potential in Subregion II countries. Although Social Development is still important for the Subregion II countries, targeted spending to improve entrepreneurship and innovation will make a greater impact in the Subregion II countries. Further, training programs that both increase the level of entrepreneurship and improve levels of higher education would provide stimulus along several dimensions that are closely related with growth potential and may provide the most influence for the money spent.

## **E. CONCLUSION**

Latin America and the Caribbean is not a uniform region full of countries that are in need of the same growth strategies as dictated by the International Monetary Fund or the World Bank. By looking at each individual country and placing them within the proper subregion, targeted pro-growth programs can be generated that focus on the areas that are most closely aligned with growth potential given the country's current stage of development. For countries that are located within geographic and developmental Subregion I, strategies most closely aligned with increasing a country's growth potential focus on improving measures of social development first and basic entrepreneurship second. For countries in Subregion II, strategies that focus on improving measures of entrepreneurship, competitiveness, and innovation first have the greatest impact on increasing growth potential. Programs aimed at increasing levels of social development also greatly benefit countries in Subregion II, and may lower the overall political cost of reform implementation as will be shown in the next chapter. Programs that include targeted entrepreneurship education to both improve social development scores in the education factors and improve scores along the entrepreneurship and innovation dimensions, may provide the greatest influence on growth potential in Subregion II countries for the least amount of money spent.

Many of the potential constraints on growth that are frequently touted as the only way to achieve lasting development have been shown here to have little correlation to growth potential across the universe of cases and specifically in Latin American Subregions I and II. For example, Market openness, economic freedoms, labor markets, and fiscal policy were shown to be less closely aligned with growth potential than all other possible factors. Although other research has shown close linkages between these factors and economic growth, this chapter demonstrates that targeting less politically unpopular constraints on growth can have a greater impact than previously thought. In both Subregions I and II, the findings of this chapter indicate that there are politically viable alternatives to

market reforms that provide a greater linkage to improving growth potential than the market reforms themselves do. This does not imply that free-market ideals are undesirable in the Latin American context, but it does indicate that there are better, less politically contentious ways, to get the process started. While this chapter has shown the close alignment between targeted social spending and growth potential in both Latin American subregions, Chapter II will examine the central role social spending played in the initial adoption of neoliberal reforms throughout the region.

### III. THE INFLUENCE OF NEGOTIATION AND TARGETED SOCIAL SPENDING ON NEOLIBERAL STRUCTURAL ADJUSTMENT PROGRAMS IN LATIN AMERICA (1970–2000)

#### A. INTRODUCTION

It is a common assumption that bureaucratic authoritarian regimes in Latin America have been better able to absorb the political costs of implementing neoliberal economic reforms than their democratic counterparts.<sup>48</sup> Despite this assumption, it is clear that several democracies have implemented neoliberal reforms, and several (for example: Argentina, Peru, and Brazil) have done so with popular support (at least initially in Brazil).<sup>49</sup> The Venezuelan government, on the other hand, attempted to implement orthodox reforms and was met with massive street protests, and the policies were eventually reversed.<sup>50</sup> In the case of Chile, the military dictatorship was capable of repressing any resistance to the economic reforms among the lower classes, and there was strong popular support among the middle sectors for implementation of a neoliberal program. Nevertheless, the Pinochet government had to make several concessions in program implementation in response to public backlash.<sup>51</sup> What factors allowed for both democratic and authoritarian governments to successfully implement reform programs? Were the economic policies implemented by the various regime types all orthodox, “Washington Consensus” type reforms, or was there variation in the policy enactment that could account for the variation in the

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<sup>48</sup> For examples of this line of thinking see: David Pion-Berlin, “Political Repression and Economic Doctrines,” *Comparative Political Studies* 16, no. 1 (Apr. 1983): 37–66; John Sheahan, *Patterns of Development in Latin America: Poverty, Repression, and Economic Strategy* (Princeton, N.J: Princeton University Press, 1987); Glen Biglaiser and Helen Kellogg Institute for International Studies, *Guardians of the Nation? : Economists, Generals, and Economic Reform in Latin America* (Notre Dame, Ind: University of Notre Dame Press, 2002).

<sup>49</sup> Kurt Weyland, *The Politics of Market Reform in Fragile Democracies: Argentina, Brazil, Peru, and Venezuela* (Princeton, N.J; Woodstock: Princeton University Press, 2004), 1–2.

<sup>50</sup> Kurt Weyland, “The Rise of Latin America’s Two Lefts: Insights from Rentier State Theory,” *Comparative Politics* 41, no. 2 (Jan. 2009): 149.

<sup>51</sup> Marcus Kurtz, “State Developmentalism without a Developmental State: The Public Foundations of the “Free Market Miracle” in Chile,” *Latin American Politics and Society* 43, no. 2 (Summer 2001): 1–3.

popular response? Finally, what influence did external factors, such as systemic economic shocks and International Monetary Fund (IMF) program prescriptions, have on internal strategies for reform implementation?

First, I argue that bureaucratic authoritarian (BA) regimes also had to make concessions to their populations when enacting reforms, and the process led to package implementation that was much less orthodox than is typically assumed. I follow O'Donnell and define BA regimes as “systems that are excluding and emphatically non-democratic.”<sup>52</sup> Also, following O'Donnell, I characterize the system as comprised of high-level technocrats and the military who work in conjunction with foreign capital to maximize industrialization.<sup>53</sup> Examples of prototypical BA regimes are Chile, Argentina, and Uruguay during the military regimes and Mexico during the technocratic period of rule by the *Partido Revolucionario Institucional* (PRI).<sup>54</sup> Second, I argue that through negotiations or concessions, democracies in Latin America were actually better able to implement reform programs than their authoritarian counterparts. The key policy tool used by both regime types to ease the political costs of reform implementation was targeted social spending to counteract the negative externalities generated by the reforms—this is the central finding of this chapter. In other words, both democratic and authoritarian regimes used targeted social spending to overcome popular resistance to the reform programs, and this targeted social spending was crucial to ensuring the policies were not reversed.

I also argue that where natural resource wealth is abundant, governments can more easily roll back reform programs, especially when met with strong

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<sup>52</sup> David Collier, “Overview of the Bureaucratic-Authoritarian Model,” in *The New Authoritarianism in Latin America*, eds. David Collier, Fernando Henrique Cardoso and Joint Committee on Latin American Studies (Princeton, N.J.: Princeton University Press, 1979), 24–25. For BA in the original context see: Guillermo A. O'Donnell, *Modernization and Bureaucratic-Authoritarianism; Studies in South American Politics* (Berkeley: Institute of International Studies, University of California, 1973).

<sup>53</sup> Collier, *Overview of the Bureaucratic-Authoritarian Model*, 24.

<sup>54</sup> PRI rule does not nicely fit the BA model in that the role of the military differed in Mexico than in Chile, Argentina, or Uruguay. Nevertheless, the behaviors exuded by the PRI seem to closely follow those undertaken by the more prototypical BA regimes.

popular resistance. In other words, natural resource wealth allows governments to bypass the negotiation routes undertaken by the other countries. This was particularly true in the case of oil producing countries, as other forms of natural resource wealth were found to be statistically insignificant. I also rule out other potential internal explanations for reform acceptance, such as high inflation, unemployment, or levels of violence. Finally, I find that the IMF and the United States did not play a significant role in the development strategies undertaken by these countries, despite common assumptions to the contrary. Moreover, external economic shocks that could affect internal reform strategies were also not statistically significant.

## **B. LITERATURE REVIEW**

Before looking at potential answers found by other scholars concerning the questions asked in this chapter it is important to remember what neoliberal reforms are in the first place. In Chapter I, I provided a thorough description of neoliberal reforms in the form of John Williamson's "Washington Consensus"<sup>55</sup> and Dani Rodrik's "Augmented Washington Consensus."<sup>56</sup> For determination as to whether a reform package was orthodox or not, I am primarily concerned with the original Washington Consensus here, however, Rodrik's inclusion of targeted social spending as a primary component in his Augmented Washington Consensus provides the impetus for its inclusion as a key determinate in this chapter.

The common assumption among early scholarly work on the process of economic reform implementation in Latin America is that political repression is necessary to implement orthodox reforms. Pion-Berlin argues that business elites and politicians form alliances with international institutions like the IMF to repress the population to facilitate the implementation of reforms.<sup>57</sup> Pion-Berlin's

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<sup>55</sup> Williamson and Institute for International Economics (U.S.), *Latin American Adjustment*.

<sup>56</sup> Rodrik, *One Economics, Many Recipes*, 17.

<sup>57</sup> Pion-Berlin, *Political Repression and Economic Doctrines*, 37–66.

study is limited in scope, however, to Argentina over a 23 year period and may lack applicability to the rest of the region. Further, Pion-Berlin tends to discount the staying power of reforms during the periods when Argentina was a democracy.

Along this same line, John Sheahan presents a logic based argument and offers significant evidence that repressive regimes should have an easier time implementing reforms.<sup>58</sup> However, Sheahan tends to over-weight the case of Chile, while under-weighting the cases of neoliberal policy reforms in democracies. Further, as Glen Biglaiser shows, there was wide variation in the capabilities of military regimes to implement orthodox reforms, and many countries were worse off in varying ways after the reforms were implemented.<sup>59</sup> Because Sheahan wrote contemporaneously with many Latin American countries' implementation of neoliberal reforms in democracies, he is most likely missing several cases that would have altered his argument.

In democracies, Kurt Weyland details the negotiations that take place between the population and the government when reform programs are implemented.<sup>60</sup> Weyland relies on a synthesis of psychological and political economy arguments, but does not examine how bureaucratic authoritarian regimes also have to make concessions to the people to remain legitimate. Additionally, Weyland tends to lump all reforms together as orthodox, and there was actually quite a large variation among the reform policies implemented throughout the region.

Fear and uncertainty can also play an important role in the acceptance of painful economic policy implementation by the general population, and several authors have explored various factors that can lead to fear and uncertainty and thus a greater propensity to accept neoliberalism. Cristina Rojas shows that

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<sup>58</sup> Sheahan, *Patterns of Development in Latin America*.

<sup>59</sup> Biglaiser and Helen Kellogg Institute for International Studies, *Guardians of the Nation?*

<sup>60</sup> Weyland, *The Politics of Market Reform in Fragile Democracies*.

neoliberalism in Colombia was implemented in an attempt to modify structural conditions that were influencing the civil war there.<sup>61</sup> Although she was specifically writing about Colombia, similar arguments could be made about other countries with insurgencies (Peru for example). In situations where the populace fears for their safety they may be more willing to accept the externalities from an orthodox reform strategy than they would be otherwise. Thus, the influence of political violence preceding structural reforms should be controlled for.

Kurt Weyland adds that in addition to the physical fear of political violence, economic fear and uncertainty can influence a population's willingness to accept economic liberalization.<sup>62</sup> This is particularly true for periods of wide swings in unemployment and inflation which can lead to fear and uncertainty, especially during periods of hyperinflation such as those that were pervasive throughout the region. Unfortunately, Weyland's evaluations are limited to a few countries and he ignores periods of military rule. This chapter fills in this gap by examining policy implementation in 17 Latin American countries, and by including both democracies and authoritarian governments.

Another contribution from Weyland leads us to understand that natural resource endowments matter.<sup>63</sup> He argues that oil wealth influenced the type of leftist regime that appeared in response to the neoliberal reforms that preceded them; however, he does not specifically address the ability of states to implement reforms in the first place. Weyland's argument also suggests that natural resource wealth matters when it comes to the ability of the state to tax their people in order to sustain painful orthodox reforms. Weyland looks specifically at oil wealth, but in Latin America there is a wide variety of natural resource wealth

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<sup>61</sup> Cristina Rojas, "Colombia's Neoliberal Regime of Governance: Securitization by Dispossession," in *Post-Neoliberalism in the Americas*, eds. Laura Macdonald and Anne Ruckert (New York: Palgrave Macmillan, 2009), 233.

<sup>62</sup> Kurt Weyland, "Swallowing the Bitter Pill: Sources of Popular Support for Neoliberal Reform in Latin America," *Comparative Political Studies* 31, no. 5 (Oct. 1998): 539–568; Weyland, *The Politics of Market Reform in Fragile Democracies*.

<sup>63</sup> Weyland, *The Rise of Latin America's Two Lefts*, 145–164.



endowments, thus it is necessary to test for both primary commodities exports generally and oil exports specifically to weigh the influence of each as a possible independent variable.

Contrary to popular arguments about the influence of the United States and the IMF in the adaption of neoliberal reforms, Javier Corrales finds that internal politics played a much more central role in policy choices.<sup>64</sup> Miguel Centeno also minimizes the influence of external actors on neoliberal policy choices in Mexico.<sup>65</sup> For example, Centeno emphasizes that Mexico “enjoyed a surprising degree of sovereignty in dealing with its internal challenges.”<sup>66</sup> Nevertheless, Mexico under Salinas actually moved much closer to the United States, regardless of the reasons behind it. Thus, it is important not to completely neglect external influences, and IMF loans will serve as an independent variable to control for the potential influence of external actors. This is based on the assumption that countries receiving IMF loans would be more likely to implement IMF and U.S. policy prescriptions.

Much of the current work in Latin America ignores the question of how the policies were implemented and instead focuses on the positive and negative effects of these policies.<sup>67</sup> The unexpected “left-turn” in Latin America has redirected the focus of scholars studying the region from looking at how programs are implemented to examining the effects of the reforms after the

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<sup>64</sup> Javier Corrales, “Market Reforms,” in *Constructing Democratic Governance in Latin America*, eds. Jorge I. Domínguez and Michael Shifter, 2nd ed. (Baltimore: Johns Hopkins University Press, 2003).

<sup>65</sup> Miguel Angel Centeno, *Democracy within Reason: Technocratic Revolution in Mexico* (Pennsylvania State University Press, 1994).

<sup>66</sup> *Ibid.*, 71.

<sup>67</sup> For example see: Kurt Weyland, “Assessing Latin American Neoliberalism: Introduction to a Debate,” *Latin American Research Review* 39, no. 3 (2004): 143–149; Evelyne Huber and Fred Solt, “Successes and Failures of Neoliberalism,” *Latin American Research Review* 39, no. 3 (2004): 150–164; Michael Walton, “Neoliberalism in Latin America: Good, Bad, or Incomplete?” *Latin American Research Review* 39, no. 3 (2004): 165–183; Moises Arce and Paul Bellinger, “Low-Intensity Democracy Revisited: The Effects of Economic Liberalization on Political Activity in Latin America,” *World Politics* 60, no. 1 (2007): 97–121.

fact.<sup>68</sup> While the effects of neoliberalism are important, understanding the means to which they are implemented is also crucial. This aspect has been neglected in recent scholarship in light of the severe political and electoral backlash, and this chapter seeks to reverse this trend.

## C. DATA, HYPOTHESIS, AND METHODOLOGY

### 1. Data

Economic data, including Gross Domestic Product (GDP) per capita growth, inflation (GDP deflator), unemployment (percent of unemployed adults), the use of IMF credit, and resource dependence (commodity exports and oil rents as a percentage of GDP) come from the World Bank. By using a standardized source the economic data, continuity of methodology is assured. Although much of this data is also available from the IMF, the World Bank data set is larger and covers the entire period of the study, 1970–2000.<sup>69</sup>

Democratization and durability scores come from the Polity IV dataset.<sup>70</sup> Polity IV has created some contentiousness over their methodology and consistency. The alternative measure, the Freedom House index has also received similar scrutiny.<sup>71</sup> Nevertheless, Polity IV is commonly used throughout political science literature. Along with the actual Polity IV score, I also create a dummy variable for democratization with a score of one meaning democracy and a zero meaning authoritarian government. This dummy variable is generated for three alternative cutoff points prevalent in the literature. They are: Polity IV greater than zero, Polity IV greater than or equal to seven, and Polity IV greater than or equal to eight. This cutoff point is of significant concern given this data

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<sup>68</sup> See, for example: Weyland, *The Rise of Latin America's Two Lefts*, 145–164.

<sup>69</sup> The World Bank, *World Development Indicators (1960–2010)* (Washington, D.C.: The World Bank, 2011).

<sup>70</sup> Monty G. Marshall, Keith Jagers and Ted Robert Gurr, *Polity IV Project: Political Regime Characteristics and Transitions, 1800–2010* (Vienna, VA: Center for Systemic Peace, 2011).

<sup>71</sup> Gerardo L. Munck and Jay Verkuilen, "Conceptualizing and Measuring Democracy: Evaluating Alternative Indices," *Comparative Political Studies* 35, no. 1 (Feb. 2002): 5–34.

set. There are 87 data points where the Polity IV score is greater than zero but less than eight, and there are 55 data points where the Polity IV score is either a seven or an eight.

Data on liberalization come from the dataset generated by Hubert Escaith and Igor Paunovic that is an expansion of an earlier dataset generated by Samuel Morley et al.<sup>72</sup> This dataset is widely used by Latin American scholars to explore the levels of neoliberal reforms implemented at various times and places.<sup>73</sup> Unfortunately, this dataset is limited to the time period 1970–2000 and to 17 Latin American and Caribbean countries. The time period is acceptable because the vast majority of neoliberal reforms were implemented during this period, and I am focused on initial implementation and not the backlash. The 17 countries included in the dataset include all of the largest economies, but exclude countries that have had economic difficulties during the period of the study such as Cuba and Haiti. The exclusion of these countries may skew the data somewhat, but all of the largest economies are included and is deemed to be sufficient. Further, there is limited data available on the excluded countries, and unfortunately they most likely would have had to have been excluded anyway. The liberalization dataset has indices for commercial and capital account liberalization, as well as indices for privatization and tax reform. Escaith and Paunovic combine the scores together for a total liberalization score that is either a simple average of the other scores, or a combination of a weighted factor analysis of the other scores. These scores have a range from zero to one and are measured out two decimal places. I run the regressions on both.

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<sup>72</sup> Hubert Escaith and Igor Paunovic, *Reformas Estructurales En América Latina y El Caribe Enel Período 1970–2000: Índices y Notas Metodológicas* (Santiago, Chile: Economic Commission for Latin America and the Caribbean, 2004); Samuel A. Morley, Roberto Machado and Stefano Pettinato, *Indexes of Structural Reform in Latin America* (Santiago, Chile: Economic Commission for Latin America and the Caribbean, 1999).

<sup>73</sup> For example see: Arce and Bellinger, *Low-Intensity Democracy Revisited*, 102.

Missing unemployment data from the World Bank is filled in by a recent IMF Working Paper on unemployment rates in the region.<sup>74</sup> The methodologies used by this study mirror the approaches taken by the World Bank and are thus a valid substitute for the missing data. Unfortunately, there would have been too many missing data points to make the regression analysis useful without including this additional dataset.

Data on violence come from the University of Maryland's Center for International Development and Conflict Management's "Global Terrorism Database." Despite its name, this expansive database contains all incidence of intrastate violence. This database is widely used in the conflict and terrorism literature and is supported and maintained by academics using a consistent approach that does not vary over time. This database does not include incidents that are deemed to have been perpetrated by state actors; nevertheless, a close examination of the data has determined that trends in violence by all actors have tended to move together. In other words, the number of violent incidents occurring during a given year can serve as a useful proxy for overall levels of violence in a country.<sup>75</sup>

Finally, data on social spending as a percentage of GDP come from the Evelyn Huber et al. database on politics and social spending in Latin America. This data is a combination of government spending on Health, Education, Social Security, and various other social welfare programs within a country. Although their database is a compilation of data from various sources across time, it is the

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<sup>74</sup> Laurence Ball, Nicolás De Roux and Marc Hofstetter, *IMF Working Paper 11/252: Unemployment in Latin America and the Caribbean* (Washington, DC: International Monetary Fund, [2011]).

<sup>75</sup> National Consortium for the Study of Terrorism and Responses to Terrorism (START), *Global Terrorism Database [Data File: Globalterrorismdb\_0611dist.xlsx]* (College Park, Maryland: University of Maryland, 2011).

most complete dataset regarding social spending in Latin America, and without it the regressions performed here (and the subsequent findings) would not have been possible.<sup>76</sup>

## 2. Hypothesis<sub>2</sub>

All governments, regardless of regime type, had to make concessions to their populations during periods of economic reform, but democratic regimes were better able to negotiate and thus implemented more orthodox type reforms.

## 3. General Model

$$\begin{aligned} NeoRef = & Pol4 + Pol4Dur + \pi + \pi_{t-1} + Un + Un_{t-1} \\ & + Soc + Vio + GDP + IMF + COM + OIL + C_i \end{aligned} \quad (\text{Eqn. 3.1})$$

where:

- NeoRef = Neoliberal Reform (Simple Average or Weighted Factor Score)<sup>77</sup>
- Pol4 = Dummy variable for Democratization based on Polity IV score<sup>78</sup>
- Pol4Dur = The Polity IV score durability in years
- $\pi$  = Inflation
- $\pi_{t-1}$  = Inflation during the previous period
- Un = Unemployment Rate
- $Un_{t-1}$  = Unemployment Rate during the previous period
- Soc = The level of targeted social spending as a percentage of GDP
- Vio = The number of incidences of violence occurring during the year
- GDP = Real growth in GDP per capita
- IMF = Amount of IMF funding received during the year
- COM = Commodities exports as a percentage of GDP
- OIL = Oil rents as a percentage of GDP
- $C_i$  = Constant

<sup>76</sup> Evelyne Huber et al., *Social Policy in Latin America and the Caribbean Dataset, 1960–2006* (Chapel Hill, North Carolina: University of North Carolina, 2008).

<sup>77</sup> The simple average of the Escaith and Paunovic scores are used for models Simple Average 1–6, and the weighted factor scores are used for models Weighted Factors 1–6.

<sup>78</sup> When denoted as (P4 Score) the actual Polity IV numeric score is used in the model. Similarly, (P4>0), (P4≥7), and (P4≥8) are used to denote the models where dummy variables are used to test for the effects of varying levels of democratization.

The model is deductively determined based on the internal and external independent variables seen as important in the literature. As the primary purpose of this chapter is to test for the influence of regime type on structural reform implementation, the model provides a means to test Hypothesis<sub>2</sub> while controlling for all other variables seen as significant, thus providing for results that show the independent influence of regime type on reform implementation and acceptance.

#### **4. Methodology**

The model is tested for all variables using Minitab16 software to perform ordinary least square (OLS) regressions. Regressions are performed first using a simple average of the Escaith and Paunovic liberalization scores as the dependent variables, then the regressions are run again using a weighted factor analysis of the Escaith and Paunovic scores that takes into account variances in the importance in each factor with regards to generating economic growth (weighted factors). For each set of regressions the various cutoff points for measuring democracy via Polity IV scores is substituted into each subsequent model. This results in a set of four models and four regressions run, thus covering every possible combination. The results of the OLS regressions for the simple average and weighted factors are reported in Tables 5 and 6, respectively. Finally, independent variables that were determined to be statistically insignificant in Tables 2 and 3 are dropped and the regressions ran again without them. The results of the final four models and regressions are reported in Table 7.

#### **D. RESULTS AND ANALYSIS**

As Tables 7 to 9 show, there was a high statistical significance (at the 99 percent level) that democracies were able to implement neoliberal reforms that were closer to the orthodox model than authoritarian regimes. This held regardless of the cutoff point chosen to determine whether a regime was democratic or not, and the sign on the coefficient was positive in all cases. The

coefficient on the Polity IV score variable for models *Simple Average 1* and *Weighted Factors 1* is particularly enlightening in this regard. For example, in the *Weighted Factors 1* model, for every 1 point increase in the Polity IV score (range -10 to 10) the ability of a regime to implement neoliberal reforms would rise by .01 points or one percent of the maximum value—holding all else constant. For the models using dummy variables to measure democracy the interpretation of the results are even straighter forward and more powerful. As an example, in the model *Weighted Factors 2 (P4>0)* there is a .14 point increase in the ability of a country to implement reforms when that country is a democracy. These results clearly show that Weyland's findings on market reforms in democracies<sup>79</sup> hold throughout all of Latin America, and democratization actually aids in neoliberal reform implementation contrary to earlier pro-authoritarianism arguments.<sup>80</sup> Finally, although not statistically significant in all of the simple average models, the Polity IV durability score was highly statistically significant (at the 99 percent level) in all of the weighted factors models and the sign on the coefficient was positive but small. It appears from these results that the longevity of regime type also matters when it comes to reform implementation, but due to the low values on the coefficients and variation in statistical significance across the models, these results are tentative at best.

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<sup>79</sup> Weyland, *The Politics of Market Reform in Fragile Democracies*.

<sup>80</sup> This is also consistent with the findings of Centeno on Mexico but extended to the entire region: Centeno, *Democracy within Reason*.

<i>Variable</i>	<i>Simple Avg. 1 (P4 Score)</i>	<i>Simple Avg. 2 (P4&gt;0)</i>	<i>Simple Avg. 3 (P4≥7)</i>	<i>Simple Avg. 4 (P4≥8)</i>
Constant	0.53781*** (16.19)	0.53781*** (16.19)	0.55871*** (16.82)	0.56819*** (15.97)
Polity IV Score	0.008379*** (6.15)	0.11666*** (5.96)	0.10860*** (5.76)	0.04122** (2.06)
Polity IV Durability	-0.0010358** (-2.10)	-0.0008042 (-1.65)	-0.0011389** (-2.27)	-0.0006363 (-1.21)
Inflation	-0.00000774 (-0.29)	-0.00001000 (-0.38)	-0.00001619 (-0.60)	0.00000735 (0.26)
Inflation (t-1)	-0.00000826 (-0.79)	-0.00000738 (-0.71)	-0.00000809 (-0.77)	-0.00000576 (-0.52)
Unemployment	0.003361 (0.73)	0.002986 (0.65)	0.000553 (0.12)	0.003513 (0.72)
Unemployment (t-1)	-0.001997 (-0.44)	-0.001875 (-0.41)	-0.000308 (-0.07)	-0.001629 (-0.34)
Social Spending	0.003394* (1.83)	0.004069** (2.18)	0.002948* (1.57)	0.002639 (1.30)
Violence	-0.00015300** (-2.03)	-0.00015911** (-2.10)	-0.00014548* (-1.92)	-0.00008114 (-1.02)
GDP Growth	0.002627 (1.24)	0.002814 (1.32)	0.002129 (0.99)	0.003335 (1.48)
Use of IMF Credit	-0.03318* (-1.69)	-0.02287 (-1.17)	-0.01680 (-0.86)	-0.01652 (-0.80)
Exports (%GDP)	0.0021042** (2.12)	0.0021531** (2.16)	0.0029034*** (2.98)	0.003191*** (3.02)
Oil Rents	-0.007768*** (-6.54)	-0.007061** (-6.03)	-0.007617*** (-6.38)	-0.006793*** (-5.34)
Adjusted R <sup>2</sup>	27.0%	26.4%	25.8%	17.5%

\*p<.10, \*\*p<.05, \*\*\*p<.01

Table 7. Regressions of Neoliberal Reform (Simple Average) on Hypothesized Determinates (1970–2000)



<i>Variable</i>	<i>Weighted Factors 1 (P4 Score)</i>	<i>Weighted Factors 2 (P4&gt;0)</i>	<i>Weighted Factors 3 (P4≥7)</i>	<i>Weighted Factors 4 (P4≥8)</i>
Constant	0.41446*** (10.36)	0.33049*** (8.19)	0.35272*** (8.86)	0.37550*** (8.62)
Polity IV Score	0.011149*** (7.84)	0.14424*** (6.93)	0.14460*** (7.34)	0.07757*** (3.59)
Polity IV Durability	0.003375*** (3.21)	0.003612*** (3.36)	0.003120*** (2.92)	0.003472*** (3.00)
Inflation	0.00000038 (0.01)	-0.00000083 (-0.03)	-0.00001064 (-0.38)	0.00001685 (0.56)
Inflation (t-1)	-0.00000512 (-0.47)	-0.00000343 (-0.31)	-0.00000504 (-0.46)	-0.00000322 (-0.27)
Unemployment	0.000615 (0.13)	0.000150 (0.03)	-0.003078 (-0.61)	0.000791 (0.15)
Unemployment (t-1)	0.000643 (0.13)	0.000688 (0.14)	-0.002952 (-0.60)	0.001333 (0.25)
Social Spending	0.007118*** (3.57)	0.007998*** (3.91)	0.006346*** (3.13)	0.005329** (2.37)
Violence	-0.0002362*** (2.98)	-0.0002334*** (-2.87)	-0.0002248*** (-2.80)	-0.00013228 (-1.54)
GDP Growth	0.000893 (0.39)	0.001362 (0.58)	0.000169 (0.07)	0.001613 (0.64)
Use of IMF Credit	0.01882 (0.93)	0.03269 (1.42)	0.04037* (1.77)	0.03727 (1.51)
Exports (%GDP)	0.005768*** (4.59)	0.005830*** (4.50)	0.006915*** (5.53)	0.006908*** (5.00)
Oil Rents	-0.008279*** (-6.63)	-0.007181*** (-5.72)	-0.008111*** (-6.42)	-0.007369*** (-5.33)
Adjusted R <sup>2</sup>	41.8%	38.9%	40.1%	29.8%

\*p<.1, \*\*p<.05, \*\*\*p<.01

Table 8. Regressions of Neoliberal Reform (Weighted Factors) on Hypothesized Determinates (1970–2000)

Interestingly, the following variables were shown in prior literature to be significant influences in neoliberal reform implementation but were not found to be statistically significant here. Variables influencing an individual's level of economic fear were not statistically significant in any of the models. These include inflation and unemployment rates in the current and preceding year, as well as the overall economic situation facing an economy in the form of real GDP per capita growth. Also statistically insignificant in nearly all models<sup>81</sup> were external factors incentivizing countries to implement neoliberal reforms such as

<sup>81</sup> In two models, there appeared to be some statistical significance at the 90 percent level, but the coefficients were incredibly low and contributed little to the models overall.

IMF funds. It appears from these results that internal factors, such as levels of democratic representation, played a much larger role in influencing governments to undertake reforms than encouragement from external entities like the IMF or United States.

Looking at the models in Tables 7 and 8, it becomes clear that there is a significant drop in R-squared values between the models that used a Polity IV score less than or equal to seven and the models that used a Polity IV score less than or equal to eight. Statistical significance of the explanatory variables does not change when choosing either cutoff point, but it seems that seven is the cutoff point that provides the highest overall explanatory power for the models. Table 9 shows results for the final four models which drop the statistically insignificant variables and use Polity IV scores of greater than or equal to seven as the cutoff point for the dummy variables. Also carried forward to the Table 9 models is the violence variable.

<i>Variable</i>	<i>Simple Avg. 5 (P4 Score)</i>	<i>Simple Avg. 6 (P4≥7)</i>	<i>Weighted Factors 5 (P4 Score)</i>	<i>Weighted Factors 6 (P4≥7)</i>
Constant	0.52586*** (23.32)	0.49099*** (23.47)	0.37166*** (13.02)	0.32130*** (12.18)
Polity IV Score	0.007724*** (6.82)	0.13495*** (8.98)	0.011364*** (8.82)	0.19174*** (11.53)
Polity IV Durability	-0.0003534 (-0.84)	-0.008461** (-2.05)	0.0028282*** (3.72)	0.0018338** (2.56)
Social Spending	0.007941*** (4.99)	0.006018*** (3.85)	0.01593*** (8.26)	0.012158*** (6.93)
Violence	-0.00006990 (-1.21)	-0.00007262 (-1.31)	-0.00010959* (-1.68)	-0.00011131* (-1.83)
Exports (%GDP)	0.0012591 (1.59)	0.0020756*** (2.83)	0.0029130*** (2.96)	0.0009031*** (4.84)
Oil Rents	-0.004588*** (-4.47)	-0.005833*** (-5.78)	-0.004359*** (-3.75)	-0.006111*** (-5.46)
Adjusted R <sup>2</sup>	24.1%	30.0%	36.6%	44.2%

\*p<.1, \*\*p<.05, \*\*\*p<.01

Table 9. Regressions of Neoliberal Reform (Dropped Variables) on Hypothesized Determinates (1970–2000)

The results for the violence variable were particularly confusing and cannot be easily explained away. First, levels of violence were shown to be statistically significant in six of the eight initial models and the sign on the coefficient was negative. This poses a challenge to the literature that finds fear from violence will allow a regime to implement reforms more easily. Looking a little closer however and the insignificance of the coefficient values is somewhat more apparent. The coefficient values may have been negative, but they are very small, meaning that for an increase in the level of violence by one event the ability to implement reforms would decrease by an order of magnitude in the 10,000ths range. This is very small compared to the other significant factors. Put another way, you would need 1000 violent events to occur during a year just to decrease the ability of a government to implement reforms by one percent. Perhaps in extremely violent situations governments become unable to focus on reforms programs and instead must focus on dealing with the violence. This could account for the unexpected results, but without further evidence, this is only speculative at best. Due to the statistical significance in the first eight models, levels of violence data are included in the final four models, and the final results are only statistically significant in two of the models and only then at the 90 percent level. Thus, the significance of levels of violence influencing neoliberal reforms is highly questionable.

Exports of commodities were found to be statistically significant with a positive sign on the coefficient, but a relatively small value. This is interesting considering that oil rents were also found to be highly statistically significant but with a negative sign on the coefficient. It would appear that Weyland's assessment of oil wealth's impact on reform implementation<sup>82</sup> is accurate and can be more broadly applied in this case. Further, the positive sign on the general commodities exports variable is consistent with the Latin American context. Despite a large dependency on primary product exports (not including oil), most Latin American countries' exports are relatively diverse, with no single

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<sup>82</sup> Weyland, *The Rise of Latin America's Two Lefts*, 145–164.

commodity making up more than ten percent of GDP. A couple of possible exceptions are Chilean copper that comes in at 10.1 percent of GDP and at times comprised over 80 percent of the country's exports, and Mexican oil that comprised nearly 80 percent of exports in the 1980s.<sup>83</sup> Further, in the oil exporting countries, oil rents make up a significantly large percentage of the country's GDP. For example, oil rents made up nearly 50 percent of Venezuela's GDP in 1979. This was down to 25 percent by 2000, but clearly oil rents play a significant role in Venezuela's economy and sales of fuel in general still account for nearly 90 percent of Venezuela's exports.<sup>84</sup> Thus, where there was significant oil wealth, countries were less prone to implement orthodox reform agendas—holding all else equal.

Finally, and most importantly, targeted social spending was clearly used to allow countries to implement more orthodox neoliberal reforms than they would have otherwise been able to impose. This shows that in both authoritarian and democratic regimes reforms that are more orthodox were implemented simply by compensating for some of the negative externalities generated by the reform programs. This is in spite of (or in addition to) any normative value intrinsic to increased social spending. In Latin America, social spending was used to compensate or co-opt the masses into accepting the reform packages. Social spending remained targeted and was not broad-based, thus the reforms were still neoliberal in the "Augmented Washington Consensus" sense, and Rodrik's inclusion of targeted social spending<sup>85</sup> certainly makes the implementation of the rest of the reforms easier.

The magnitude of the influence of targeted social spending on reform acceptance was also substantial—the tradeoff is nearly one for one. For

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<sup>83</sup> The World Bank, *World Development Indicators (1960–2010)*.

<sup>84</sup> *Ibid.*

<sup>85</sup> Rodrik, *One Economics, Many Recipes*, 17.

example, using the *Weighted Factor 6* model,<sup>86</sup> for an increase in social spending by one percent of GDP liberalization is able to rise by over .01. Remembering that .01 is one percent of the possible maximum value of the liberalization index and the influence of social spending on liberalization becomes apparent. This is a significant finding for a region like Latin America because there is vast room for improvement with regards to social spending levels. For example, of the countries examined in this study, only Chile, Costa Rica, Uruguay, and at times Brazil, Jamaica, and Bolivia had social spending levels greater than ten percent of GDP.<sup>87</sup> This is paltry compared to the social spending in the highly successful social democracies of Northern Europe, such as Sweden with spending levels over 30 percent of GDP during this same time period.<sup>88</sup> Interestingly, with the highest levels of social spending in the region, Chile's spending actually rose to just over twenty percent of GDP during the second half of the military regime<sup>89</sup> lending additional evidence to my argument that even authoritarian regimes had to compensate for the negative externalities generated by the reforms with social spending.

## E. CONCLUSION

Despite the common assumption that authoritarian regimes would have an easier time implementing neoliberal reforms in Latin America, this chapter has shown that neither regime type was able to fully implement the reforms they desired without making some concessions—thus, even authoritarian regimes need some degree of legitimacy. Neoliberal policy reforms implemented in Latin America were not uniform in level or duration, but varied in intensity due to the situation in the country where they were to be imposed. Popular support for reforms was won through two separate but equally important means: negotiation

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<sup>86</sup> This is probably the best model; every factor is statistically significant and it explains over 44 percent of the variation in the dependent variable.

<sup>87</sup> Huber et al., *Social Policy in Latin America and the Caribbean Dataset, 1960–2006*.

<sup>88</sup> William Adema, *Net Social Expenditure (2nd Edition, OECD Labour Market and Social Policy Occasional Paper. no. 52* (Paris, France: OECD Publishing, 2001).

<sup>89</sup> Huber et al., *Social Policy in Latin America and the Caribbean Dataset, 1960–2006*.

and compensation or co-option. Both authoritarian regimes and democracies were forced to moderate their reform goals in response to popular resistance and either decreased the levels of reforms implemented or compensated certain sectors for structural adjustments with targeted social spending. Further, other potential influences on reform implementation seen in the literature, including economic and political fears and external influences from the IMF and United States, were found to be unimportant and statistically insignificant.

The most salient finding of this chapter is that the inclusion of targeted social spending and the expansion of social safety nets in the “Augmented Washington Consensus” provide a broader set of policy tools to ease the political costs of neoliberal reform implementation. This chapter has shown just how large a role social spending can play in easing the political costs of structural reforms. Social spending, along with anti-corruption and good governance reforms, can lessen the blow to the people while simultaneously improving levels of democratic representation and social equality. The implementation of reforms is as much about the ability of a government to bring along the people as it is about getting the reforms right in the first place.

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## **IV. ECONOMIC DEVELOPMENT AND INCREASED POLITICAL VIOLENCE IN LATIN AMERICA (1996–2008)**

### **A. INTRODUCTION**

American journalists, diplomats, and leaders across the political spectrum have frequently commented on the association between a lack of development and political violence, especially in the aftermath of September 11, 2001.<sup>90</sup> This somewhat simplistic argument appeals to the Western capitalistic ideals of wealth attainment and can be restated as: political violence (in this case terrorism) happens because people are frustrated with their inability to provide for the basic needs of their families, and high unemployment gives them the free time to participate in the violence. This is by no means a new argument. During the Cold War, development was seen as a way to fend off the threat of communist revolution, and after the Cold War, a more nuanced approach argued that development would eliminate one of the major causes of civil war and ethnic conflict. It thus appears on the surface that the popular arguments for development programs have shifted with the political climate and the headlines that run contemporaneously with them. Despite this appearance, there is a common theme amongst these arguments: a lack of development (poverty) leads to political violence in one form or another. But, what about the other way around? Does economic growth, and the associated increase in inequality seen in Latin America, lead to increases in political violence?

Most recent scholarly work finds little to no evidence of a link between poverty and political violence. However, in an effort to provide universal theories for the causes of violence, most of the scholarly work has looked at the data

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<sup>90</sup> For examples from both sides of the political spectrum in the United States see: George W. Bush, "Statement by the President of the United States of America at the International Conference on Financing for Development; Monterrey, Mexico; 22 Mar. 2002," <http://www.un.org/ffd/statements/usaE.htm> (accessed 10 Aug. 2011); Hillary Clinton, "Statement by the Secretary of State on Development in the 21st Century; Washington, D.C; 6 January 2010," Remarks to the Center for Global Development, <http://www.state.gov/secretary/rm/2010/01/134838.htm> (accessed 10 Aug. 2011).



through a global lens. This has tended to completely eliminate regional variation in the statistical models. Because of this, much of the statistical work has provided little explanatory value to scholars. Many explanations for the causes of political violence that will be explored in the literature review have been eliminated through the “universe of data,” and very few potential causes have gotten past the regression analysis. This chapter seeks to reverse this trend. By focusing on a single region for the statistical analysis, data skewing due to regional variation can be reduced and nearly eliminated.

Latin America provides the ideal location to begin this re-examination of the data. The region is relatively large geographically, provides for adequate variation across the hemisphere, and has had numerous examples of political violence during the period of study. Controlling for education level, population size, good governance, and even democratization, incidence of political violence actually increase in Latin America as Gross Domestic Product (GDP) per capita increases. The data also show that this is made all the more significant when there is a simultaneous rise in unemployment and income distribution becomes more skewed. Thus, I argue that development programs can inadvertently create a perfect trifecta of economic causes of political violence when they are implemented in such a way that income increases per capita overall, but unemployment in the sectors hurt by the development program increases, and the economic gains are focused in a higher concentration among the rich. It should be noted up front that the models presented in this chapter are not robust and have relatively low R-squared values, but the factors just outlined are all statistically significant at the 95 percent level at a minimum. To put it plainly—contrary to popular arguments, economic development in Latin America has actually led to a higher incidence of political violence because the economic gains have not been shared evenly, and there have not been adequate social safety nets to help those who have been negatively affected by the development programs.

## B. EXPLANATIONS FOR CAUSES OF POLITICAL VIOLENCE: A BRIEF LITERATURE REVIEW

The explanations for the causes of all political violence can be roughly grouped into four categories: economy, good governance (democracy, voice and accountability, lack of corruption), education, and population variation (ethnicity, religion, culture). Nicholas Sambanis examines the similarities and differences between terrorism and civil war and finds that the same mechanisms underlie the phenomena we call terrorism and civil war and thus these phenomena are not causally distinct.<sup>91</sup> Along these lines, civil war and terrorism are often analyzed separately in the literature because of limitations in the datasets available, and the arguments here are similarly limited by the available datasets. Nevertheless, I repeat the regressions using both terrorism and civil war data sets with similar results. Thus, Sambanis's findings appear to hold for Latin America. Much research into political violence however, does not make effort to test their findings in multiple contexts. Therefore, where possible, the findings of others are reported in their original context, but the implications of the findings are assumed to hold for all forms of political violence unless shown otherwise.

Ethnicity and religion, as causes of political violence, have been studied extensively since September 11, 2001, but most of the academic work has found little link between variations in ethnicity and religion and political violence. Fearon and Laitin find that the causes of civil war depend on whether the conditions on the ground support an insurgency and are not due to ethnic or religious diversity. Further, their work eliminates the end of the Cold War as a potential cause of civil war and political violence.<sup>92</sup> They seek a global explanation for political violence in the form of civil war and may be missing some regional variation as a result. Paul Collier goes a step further and finds that

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<sup>91</sup> Nicholas Sambanis, "Terrorism and Civil War," in *Terrorism, Economic Development, and Political Openness*, eds. Philip Keefer and Norman Loayza (Cambridge University Press, 2008), 174–206.

<sup>92</sup> James D. Fearon and David D. Laitin, "Ethnicity, Insurgency, and Civil War," *The American Political Science Review* 97, no. 1 (Feb. 2003): 75–90.

ethnic and religious diversity actually reduces the risk of civil conflict.<sup>93</sup> In spite of Fearon, Laitin, and Colliers findings, it is extremely difficult to independently test for ethnic diversity as a potential cause (in and of itself) for political violence in Latin America, because the population in the region is predominately divided along economic and social lines that run parallel to the individual's ethnic or cultural identity. Thus, the influence of inequality as an independent variable cannot be seen as independent to ethnic or cultural causes of violence in Latin America.

Arguments that low levels of education lead to political violence initially followed the same lines as property crime theory. Under these arguments, lower levels of education are associated with lower levels of wages and thus an economic propensity to commit property crime.<sup>94</sup> The academic leap from property crime to political violence has been virtually impossible, but arguments in the popular press have persisted espousing the supposed link. Krueger and Maleckova find no correlation between level of education and terrorism when performing a study using the universe of incidents of terrorism.<sup>95</sup> A more nuanced approach is taken by Cragin and Chalk from the RAND Corporation. They find that social development policies, including a focus on improving education opportunities can weaken local support for terrorist activities. Cragin and Chalk also perform their analysis based on a global dataset and do not delve into regional variation in the data.<sup>96</sup>

Perhaps the best supported set of arguments for causes of political violence comes from research into good governance, democracy, voice and

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<sup>93</sup> Paul Collier, "The Market for Civil War," *Foreign Policy*, no. 136 (May–Jun. 2003): 38–45.

<sup>94</sup> Isaac Ehrlich, "Participation in Illegitimate Activities: A Theoretical and Empirical Investigation," *Journal of Political Economy* 81, no. 3 (May–Jun. 1973): 521–565; Richard B. Freeman, "Why do so Many Young American Men Commit Crimes and what might we do about it?" *The Journal of Economic Perspectives* 10, no. 1 (Winter 1996): 25–42.

<sup>95</sup> Alan B. Krueger and Jitka Malečková, "Education, Poverty and Terrorism: Is there a Causal Connection?" *The Journal of Economic Perspectives* 17, no. 4 (Autumn 2003): 119–144.

<sup>96</sup> Kim Cragin and Peter Chalk, *Terrorism and Development* (Santa Monica, CA: RAND, 2003).

accountability, and political corruption. Under this set of theories, there will be a higher incidence of political violence when voice and accountability is low, where there are high levels of political corruption, and where levels of good governance are low. Democracy comes into play because those who would choose to use political violence take into account the likelihood the state would respond with repression. In a non-democracy environment, repression is more likely; therefore, an individual would be less likely to partake in political violence. In a democracy, there would be a lower likelihood of significant repression—thus a lower opportunity cost to the person considering political violence.<sup>97</sup> Recent scholarship focuses on democracies in transition and finds that significant shifts in the type or quality of the state can lead to a significant increase in political violence as the status quo is shifting,<sup>98</sup> and Fearon and Laitin find no direct causal link between democracy and political violence, but do find that political instability can lead to conditions that favor insurgency.<sup>99</sup>

Economic arguments for the causes of political violence in its various forms have been the most pervasive in the literature.<sup>100</sup> Collier and Sambanis find that recession increases the risk of political violence, and Blomberg and Hess find that development leads to a decrease in political violence once development is stabilized.<sup>101</sup> Interestingly, in another chapter in the same volume, Blomberg and Hess find that economic growth is actually associated

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<sup>97</sup> Håvard Hegre et al., "Toward a Democratic Civil Peace? Democracy, Political Change, and Civil War, 1816–1992," *The American Political Science Review* 95, no. 1 (Mar. 2001): 33–48; Mark Irving Lichbach, "Deterrence Or Escalation? The Puzzle of Aggregate Studies of Repression and Dissent," *The Journal of Conflict Resolution* 31, no. 2 (Jun. 1987): 266–297.

<sup>98</sup> Will H. Moore, "Repression and Dissent: Substitution, Context, and Timing," *American Journal of Political Science* 42, no. 3 (Jul. 1998): 851–873.

<sup>99</sup> Fearon and Laitin, *Ethnicity, Insurgency, and Civil War*, 75–90.

<sup>100</sup> For a thorough review of the Economic Theories of Civil War see: Nicholas Sambanis, "A Review of Recent Advances and Future Directions in the Quantitative Literature on Civil War," *Defence & Peace Economics* 13, no. 3 (Jun. 2002): 215–243.

<sup>101</sup> Paul Collier and Nicholas Sambanis, "Understanding Civil War: A New Agenda," *The Journal of Conflict Resolution* 46, no. 1 (Feb. 2002): 3–12; S. Brock Blomberg and Gregory D. Hess, "The Lexus and the Olive Branch: Globalization, Democratization, and Terrorism," in *Terrorism, Economic Development, and Political Openness*, eds. Philip Keefer and Norman Loayza (Cambridge, MA: Cambridge University Press, 2008), 116–147.

with higher incidences of terrorism (particularly in states with higher relative incomes).<sup>102</sup> Blomberg and Hess do not disaggregate income distribution from economic growth here, but there have been few (if any) cases of rapid economic growth since the cold war that has occurred in such a way as to improve income distribution at the same time. If income distribution is separated out from economic growth then Martha Crenshaw's argument may hold true that a small portion of the "elite take it upon themselves to act on behalf of a majority unaware of its plight, unwilling to take action to remedy grievances, or unable to express discontent."<sup>103</sup> In other words, taken together, Crenshaw and Blomberg and Hess can be seen as an argument that increasing income disparity caused by an increase in economic growth can lead to an increase in political violence. This runs counter to the classic arguments made by Paul Collier and others at the World Bank that economic development leads to greater stability and less political violence.<sup>104</sup>

Other economic arguments about the causes of political violence include unemployment and economic shocks. The unemployment argument is pretty straight forward. An individual has no productive work to do, has free time, is poor due to a lack of income, and thus will commit violence in an effort to improve his or her situation. Djankov and Reynal-Querol find no correlation between poverty or unemployment and civil war, and both Crenshaw and Pape find no correlation between unemployment and various forms of terrorism.<sup>105</sup> On

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<sup>102</sup> S. Brock Blomberg and Gregory D. Hess, "From (no) Butter to Guns? Understanding the Economic Role in Transnational Terrorism," in *Terrorism, Economic Development, and Political Openness*, eds. Philip Keefer and Norman Loayza (Cambridge, MA: Cambridge University Press, 2008), 83–115.

<sup>103</sup> Martha Crenshaw, "The Causes of Terrorism," *Comparative Politics* 13, no. 4 (Jul. 1981): 396.

<sup>104</sup> Paul Collier and David Dollar, "Development Effectiveness: What have we Learnt?" *The Economic Journal* 114, no. 496, Features (Jun. 2004): F244-F271.

<sup>105</sup> Simeon Djankov and Marta Reynal-Querol, *Poverty and Civil War: Revisiting the Evidence. CEPR Discussion Paper no. 6980* (London: Center for Economic Policy Research, [2008]); Crenshaw, *The Causes of Terrorism*, 379–399; Robert A. Pape, "The Strategic Logic of Suicide Terrorism," *The American Political Science Review* 97, no. 3 (Aug. 2003): 343–361.

the other hand, Cragin and Chalk find that decreasing unemployment through development programs can lead to a decrease in political violence in all forms.<sup>106</sup> All of these studies however, were global in nature and could have missed important regional variation leading to one result or another. Miguel et al. argue that it is not unemployment or lack of opportunity that leads to an increase in political violence, but rapid shocks to the status quo. They use an ingenuous method of looking for economic shocks through weather patterns in economies heavily dependent on agriculture and find that it is these shocks to the economy and status quo that lead to a propensity for political violence.<sup>107</sup> Similarly, though with a less complex research method, Cragin and Chalk find that terrorism increases when development policies are implemented in such a way as to shock the system without providing for safety nets for those adversely affected by the programs.<sup>108</sup>

In perhaps the worst-case scenario of political violence and lack of economic development, James Piazza examines failed states and their propensity for political violence. Piazza finds a strong link between failed states and civil war, but finds no correlation between failed states and terrorism.<sup>109</sup> Stewart Patrick comes to a similar conclusion, and emphasizes the distinction between the internal and external threat caused by failed states. For Patrick, “failed states are mainly a threat to their own inhabitants.” Patrick goes on to argue that despite (or because of) this, foreign aid should still be provided to encourage development.<sup>110</sup> Patrick does not take into consideration the links between economic growth and further increases in political violence, however,

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<sup>106</sup> Cragin and Chalk, *Terrorism and Development*, 1–42.

<sup>107</sup> Edward Miguel, Shanker Satyanath and Ernest Sergenti, “Economic Shocks and Civil Conflict: An Instrumental Variables Approach,” *Journal of Political Economy* 112, no. 4 (Aug. 2004): 725–753.

<sup>108</sup> Cragin and Chalk, *Terrorism and Development*, 1–42.

<sup>109</sup> James A. Piazza, “Incubators of Terror: Do Failed and Failing States Promote Transnational Terrorism?” *International Studies Quarterly* 52, no. 3 (Sep. 2008): 469–488.

<sup>110</sup> Stewart Patrick, “Failed States are mainly a Threat to their Own Inhabitants. We should Help them Anyway,” *Foreign Policy*, no. 187 (Jul. 2011): 55–57.

and his argument for continued aid rings hollow without adequate provisions for social safety nets to lower the impact of economic growth on those who are harmed by the programs.

The earliest arguments for a link between development and increased political violence came from Samuel Huntington in his *Political Order in Changing Societies*. Originally published in 1968, Huntington argues that development can destabilize society by disrupting traditional social groupings,<sup>111</sup> by causing increases in inequality,<sup>112</sup> and by rapid modernization breeding inefficiencies and the potential for corruption.<sup>113</sup> Huntington's arguments may have been groundbreaking at the time, but parts are severely overstated. For example, Huntington also argues that in the long-run inequality will eventually be lowered by growth.<sup>114</sup> This has clearly not yet been the case in the developing countries as a whole. Most notably, Serge Lang has also challenged Huntington's methodology. Lang argues that Huntington's mathematical models<sup>115</sup> are inadequate at best and meaningless at worst.<sup>116</sup> Thus, parts of the arguments in this chapter may parallel Huntington's work, but all of my assertions are empirically tested. Further, Huntington does not take into account any of the positives gained by globalization, considers greater trade only from a growth standpoint, and thus only considers the negatives associated with international interconnectivity.

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<sup>111</sup> Samuel P. Huntington and Harvard University and Center for International Affairs, *Political Order in Changing Societies* (Yale University Press, 2006), 57.

<sup>112</sup> *Ibid.*, 56.

<sup>113</sup> *Ibid.*, 59–71.

<sup>114</sup> *Ibid.*, 57.

<sup>115</sup> Huntington's models were not meant to be taken as a mathematical representation of reality but were intended as a theoretical framework through which to examine the case studies. Nevertheless, Huntington reports decimal values of his ratios for comparison across cases, and as such, mathematicians such as Lang challenge the validity of the results.

<sup>116</sup> Serge Lang, *Challenges* (New York: Springer, 1998), 39–43.

### C. POLITICAL VIOLENCE IN LATIN AMERICA

Since the end of the civil war in Guatemala in 1996, there have been 2962 individual recorded incidences of political violence in Latin America, not counting the constant suffering in Haiti or the ongoing civil wars in Colombia or Peru.<sup>117</sup> Much of the academic research into the causes of political violence has been conducted using the universe of data and has not focused on a region specific approach. Latin America has highly diverse economies, from Chile—a poster child for neoliberal economic growth policies, to Haiti—a failed state, so economic analysis for the causes of political violence could be beneficial. Perhaps the best theory for political violence that actually fits the situation on the ground in Latin America comes from Blomberg and Hess.<sup>118</sup> They argue simply, that economic development can cause political violence. Latin America makes a good region in which to test their argument. Latin America is geographically large; it has a wide cross-state variation of levels of economic growth; and it is lacking the ethnic and religious diversity seen in other regions. Blomberg and Hess may be missing some of the intervening variables here however. This chapter looks to show that it is not merely an increase in income that leads to greater political violence, but that there are several important intervening variables that Blomberg and Hess do not adequately test for, namely: income inequality, unemployment, and access to other outlets to air political grievances.

Increases in income inequality and unemployment frequently go together with economic development, particularly when neoliberal economic growth strategies are implemented. Greater income inequality leads to social pressures as those who are left behind during the period of economic growth become frustrated with their situation. There are always winners and losers whenever a new economic development strategy is implemented, and without adequate social safety nets (frequently a deficiency in developing states) there is no means

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<sup>117</sup> These numbers come from a compilation of the data included in the University of Maryland's Global Terrorism Database.

<sup>118</sup> Blomberg and Hess, *From (no) Butter to Guns?*, 83–115.



to provide protection for those who come out on the losing end of the development strategy. These individuals feel they were comparatively better off before the strategy was implemented, they may have lost their jobs as a result, and they may turn to political violence when there is no suitable alternative to better their situation. In an environment where the individual feels that their grievance either cannot, or will not, be addressed by the state, the individual may turn to political violence as an alternative method to air their grievances and improve their situation.

#### D. MODELS, DATA, AND METHODS

Using the initial framework provided by Blomberg and Hess, but adding variables to test for the deductive factors outlined above, and providing additional variables to control for those factors deemed most important in the literature, the following models are used to test the subsequent hypothesis:

##### 1. Models

$$\begin{aligned} \text{Violence1} = & \beta_1(\ln(\text{GDP})) + \beta_2(\Delta\text{GDP}) + \beta_3(\text{Gini}) \\ & + \beta_4(\text{Pol4}) + \beta_5(\text{PolDur}) + \beta_6(\text{KOF}) + \beta_7(\text{Pop}) \\ & + \beta_8(\text{LR}) + \beta_9(\text{UR}) + \beta_{10}(\text{Voice}) \end{aligned} \quad (\text{Eqn. 4.1})$$

$$\begin{aligned} \text{Violence2} = & \beta_1(\ln(\text{GDP})) + \beta_3(\text{Gini}) + \beta_5(\text{PolDur}) \\ & + \beta_6(\text{KOF}) + \beta_9(\text{UR}) + \beta_{10}(\text{Voice}) \end{aligned} \quad (\text{Eqn. 4.2})$$

where:

- $\ln(\text{GDP})$  = The natural log of PPP GDP per capita in 2005\$
- $\Delta\text{GDP}$  = The delta of current GDP per capita and the three year running average
- Gini = The Gini coefficient
- Pol4 = The Polity IV score
- PolDur = The Polity IV score durability (in years)
- KOF = The KOF Index of Globalization
- Pop = Population
- LR = Literacy Rate
- UR = Unemployment Rate
- Voice = World Bank Voice and Accountability score

## **2. Hypothesis<sub>3</sub>**

In Latin America, controlling for sudden economic shocks, levels of democracy, population levels, globalization, and democratization—there is an increase in incidence of political violence during periods of economic growth, high unemployment, greater income inequality, and low levels of voice and accountability for the majority of the population.

## **3. Data and Methodology**

The models provide a means of testing the hypothesis in the way the data is available. Data for terrorism events is used as a proxy for incidence of political violence occurring during a given year. Data on events of civil war is also available and was used to verify the validity of choosing the terrorism data, and the findings were similar. Model Violence<sub>1</sub> combines all relevant variables included in the literature (and deduced in the preceding sections) and provides for as robust a testing of the hypothesis as possible. Model Violence<sub>2</sub> was inductively generated after the initial round of regressions, and eliminates those variables that were not shown to be statistically significant during the first round of testing.

Data for terrorism events come from the University of Maryland's "Global Terrorism Database."<sup>119</sup> The database is widely used by researchers and scholars and is professionally maintained by academics. The dataset has reliable data after World War II, but data on other variables are only available after 1996. This may seem like a hindrance to accurate hypothesis testing, but by selecting 1996 as the start date for the study in this chapter, influence from other potential causes of, and restraints on, political violence can be eliminated. Specifically, by 1996, much of the global reverberations from the end of the Cold War were dampened, and the civil war in Guatemala was just coming to an end. Further,

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<sup>119</sup> National Consortium for the Study of Terrorism and Responses to Terrorism (START), *Global Terrorism Database [Data File: Globalterrorismdb\_0611dist.xlsx]*.

there are adequate incidence of terrorism (2962 coded events) between 1996 and 2008 (when the dataset ends) to sufficiently test the hypothesis using regression analysis.

All economic data, including Gross Domestic Product (GDP) per capita, unemployment, and Gini coefficient, come from the World Bank.<sup>120</sup> GDP per capita data were chosen in 2005 purchasing power parity United States dollars for consistency purposes and to account for any fluctuations in exchange rates that may skew the data. The natural log of GDP per capita is used for the regressions because the numbers are very large and the natural log gives for a more meaningful data point for computational purposes. Data for the difference between GDP per capita and a three-year running average of GDP per capita were manually calculated using data from the World Bank. This additional variable provides a means for testing for variations in levels of political violence associated with sudden shifts in levels of economic growth. In other words,  $\Delta$ GDP represents the signed magnitude of any economic shock. Additional demographic data also come from the World Bank including both population size and literacy rate. Literacy rate was selected as a proxy for levels of educational attainment. Limitations of the World Bank dataset also led to the elimination of both Cuba and Haiti from the dataset. Economic data for both states is nonexistent, inconsistent, or unreliable during the period of study and regrettably they had to be removed from the dataset. This omission could potentially skew the results of the regression since both states have limited or negative economic growth during the period of study but also experienced several incidences of political violence.

Levels of democratization are controlled for by using scores from the Polity IV database. Additionally, to control for rapid changes in levels of governance, the Polity IV Durability score is used. The Polity IV database contains scores on a 21-point scale for each state during the period of study.

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<sup>120</sup> The World Bank, *World Development Indicators (1960–2010)*.

These scores range from a -10 (hereditary monarchy) to a +10 (consolidated democracy).<sup>121</sup> The Polity IV database has received some criticism that the scores tend to favor leftist regimes over more conservative ones, but the other database for measuring democracy, the Freedom House Index, is missing several years of data for a few of the states included in the region.<sup>122</sup> Therefore, to ensure robust testing, the Polity IV database was used.

To control for an individual's ability to find an alternate means to address their political grievances other than political violence, the World Bank's Worldwide Governance Indicators are used.<sup>123</sup> The World Bank ranks Voice and Accountability on a scale of +2.5 to -2.5, and the more positive the score, the better the state does at providing a public voice to their population and ensuring the government is accountable to the populace in the form of free and fair elections and legal accountability for corruption. The World Bank has five additional categories it tracks with relation to good governance, but Voice and Accountability captures those elements that are shown in the literature to be most vital to providing an individual a means to redress their grievances.

The final data come from the Swiss Federal Institute of Technology's KOF<sup>124</sup> Index of Globalization.<sup>125</sup> This index ranks a state's globalization along the three categories of social, economic, and political globalization. These three categories are then combined together to create the KOF score with a ranking between 1 and 100, with a higher score indicating greater levels of globalization. If higher levels of globalization provide an additional means for individuals to air their political grievances then we should see a negative coefficient in the

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<sup>121</sup> Marshall, Jagers and Gurr, *Polity IV Project*.

<sup>122</sup> Munck and Verkuilen, *Conceptualizing and Measuring Democracy*, 5–34.

<sup>123</sup> The World Bank, *Worldwide Governance Indicators*.

<sup>124</sup> KOF is a German acronym for *Konjunkturforschungsstelle*, meaning Business Cycle Research Institute.

<sup>125</sup> Original: Axel Dreher, "Does Globalization Affect Growth? Evidence from a New Index of Globalization," *Applied Economics* 38, no. 10 (Jun. 2006): 1091–1110; updated: Axel Dreher, Noel Gaston and Willem Jozef Meine Martens, *Measuring Globalization: Gauging its Consequences*, 1st ed. (New York: Springer, 2008).

regression. Remember that the KOF Index includes social and political globalization as well as economic, so typical arguments that economic globalization may lead to greater incidence of political violence cannot be separated from the social arguments that outlets for airing frustrations will reduce political violence. The inclusion of the KOF Index allows for separating the positive aspects of globalization (means to air grievances, etc.) from the negative aspects directly associated with growth.

The hypothesis is tested using the data, as presented above, inserted into the two models for political violence. The tests are performed using Minitab16 statistical software, and results are calculated using Ordinary Least Square (OLS) Regression Analysis. Any missing data points are interpolated linearly unless they are at the endpoint, in which case they are duplicated from the data point immediately to the other side temporally. The results are presented in Table 3 with the coefficient scores presented in the main columns and the T-Statistic presented in parenthesis just under the coefficient. Adjusted  $R^2$  scores are presented in the bottom of each column for each model, and individual coefficient statistical significance is represented by using a coded star (\*) system. One star represents a p-value of less than 0.10 and thus a statistical significance at the 90 percent level; two stars represents a p-value of less than 0.05 and thus a statistical significance at the 95 percent level; and three stars represents a p-value of less than 0.01 and thus a statistical significance at the 99 percent level.

## E. RESULTS AND ANALYSIS

<i>Variable</i>	<i>Violence1</i>	<i>Violence2</i>
Constant	-315.0*** (-3.09)	-296.32*** (-3.72)
Log of GDP per capita (ln(GDP))	32.91** (2.20)	26.766*** (3.10)
3 Year $\Delta$ GDP per capita ( $\Delta$ GDP)	0.00213 (0.17)	
Gini Coefficient (Gini)	2.5391*** (2.90)	2.2863*** (0.003)
Polity Four Score (Pol4)	-0.0456 (-0.09)	
Polity Score Durability (PolDur)	0.6988*** (4.15)	0.6906*** (4.19)
KOF Index of Globalization (KOF)	-1.3404* (-1.79)	-1.2444* (-1.75)
Population (Pop)	-0.00000003 (-0.30)	
Literacy Rate (LR)	-0.4788 (-0.62)	
Unemployment (UN)	1.8352** (2.30)	1.7914** (2.46)
Voice and Accountability (Voice)	-29.845*** (-3.50)	-30.278* (-3.65)
Adjusted R <sup>2</sup>	15.0%	16.2%

\*p<.10, \*\*p<.05, \*\*\*p<.01

Table 10. Regressions of Political Violence in Latin America on Hypothesized Determinates (1996–2008)

Results of the regressions for the Violence1 model determined that shocks to the economy, as captured by the  $\Delta$ GDP variable, were statistically insignificant at predicting either an event of political violence in Latin America. This runs counter to the arguments presented by Miguel et al., but perhaps a better proxy for economic shock could have been used to perform the test. Miguel et al.'s approach was unique in that they used weather shocks as a proxy for economic shocks in states that are highly dependent on agriculture. Their methodology would not have had universal applicability throughout Latin America, but my construct of the  $\Delta$ GDP variable did contain significant data points of economic shocks during the period of study; however, the regressions still showed no statistical correlation to political violence. Economic shocks can thus not be considered a significant contributor to political violence in Latin America.

Levels of democratization were also not found to be statistically significant correlates with political violence. The Polity IV scores were not statistically significant in the Violence1 model tests and were thus eliminated from the second run model. Interestingly, the Polity IV Durability score was statistically significant at the 99 percent level in the model and has a positive sign on the coefficient. The regression shows that in Latin America, for every additional year a regime type is in place, the number of incidence of violence is likely to go down by 0.69. That means that for every two years a stable model of governance (no matter the form) manages to stay in place there will be (on average) one less event of violence. This implies that although economic shocks were shown to not significantly contribute to political violence, political shocks are likely to have an influence.

Additional factors that were eliminated from the first model, were population size and literacy rate. You will recall that literacy rate was used as a proxy for the level of education of the public, and that population size was used to control for the influence of population growth on political stability. Neither was shown to be statistically significant. Population growth was not significant during the 12-year duration of this study and its statistical insignificance was not all that surprising. However, it was surprising that levels of education would have no influence on levels of political violence. Perhaps a better proxy could have been found for level of education of the population, but literacy rates were the only data available for all states during the entire period of study, and even then some data had to be interpolated. Based on this, the influence of levels of education on political violence cannot be ruled out conclusively.

With change in GDP per capita, the Polity IV score, population level, and literacy rate eliminated as likely correlates with political violence, a regression was then performed using the Violence2 model that leaves them out. Results for this regression does show a slight improvement in the Adjusted  $R^2$ , but it is clear that there is still much missing from these models for robust predicting of political violence. With this in mind, it is important to note that Adjusted  $R^2$  values this low

are not unusual for this type of modeling and testing, especially when there is no way to control for individual psychological effects.

In both the Violence2 model, the natural log of GDP per capita, the Gini coefficient, the unemployment rate, the Polity IV Durability score and the World Bank Voice and Accountability score are all statistically significant at the 95 percent level at a minimum, and most of the variables are significant at the 99 percent level. The KOF Index of Globalization score is also statistically significant at the 90 percent level. The Polity IV Durability score was discussed earlier as a control variable, and its significance should not be neglected, but political stability is not the major focus of this chapter.

The independent variables that seem to go together should be discussed first before turning to the intervening variables. The natural log of GDP per capita, the Gini coefficient for income inequality, and the level of unemployment go together, and the results of the regressions are in accordance with the arguments presented earlier. The coefficient on the natural log of GDP per capita is positive in the Violence2 model, meaning that as GDP per capita increases there is an increase in the likelihood of political violence occurring during the year. The Gini coefficient is a decimal score between 0 and 1 so the interpretation of the coefficient in this category is particularly difficult. However, a quick calculation shows that for every decimal level change in the Gini coefficient, the likelihood of a terrorism event occurring during any given year goes up by .22. Thus, the larger the income inequality the greater the likelihood of a terrorism event occurring. Interpretation of the coefficient on the level of unemployment is more straightforward.

The coefficient on the unemployment independent variable is positive in the Violence2 model. The data for unemployment was inputted in whole number percentages instead of as decimal, so the data interpretation is very clear. For each percentage increase in the rate of unemployment, there would be an increase in incidents of political violence of 1.79. Individual instances of political



violence should not cause a significant increase in the unemployment rate, so the results of the Violence2 model can be taken as causal in the case of unemployment.

The final two statistically significant variables appear to be intervening variables that work to counter the influence of the economic forces on political violence. The World Bank Voice and Accountability score has a negative coefficient in the Violence2 model. Remember that the World Bank Voice and Accountability score varies between +2.5 and -2.5. This makes the interpretation of the coefficients on Voice and Accountability that much more powerful. For a one point increase in the Voice and Accountability score there would be decrease in the occurrence of events of political violence by 30 in a year. This is with all other variables held constant. It is clear that an outlet for political frustrations and grievance addressing provides a powerful alternative to political violence.

Also statistically significant, but not nearly as powerful, the coefficient on the KOF Index of Globalization score is also negative. For every one-point change in the KOF score, there would be one less incidence of political violence occurring in the country during a given year. Remembering that the scale for the KOF score is 0 to 100, it becomes clear that globalization (particularly social and political globalization) provide some form of meaningful outlet to air political grievances and to seek redress for those on the losing side of economic globalization. Remember however, that causation could run in the opposite direction here in that a decrease in the level of political violence could lead to an increase in globalization as foreign capitalists look to move into markets that would now be seen as more stable. The globalization findings are at least partly counter to Huntington's argument that increased connectivity would lead to greater instability (at least initially).

## **F. CONCLUSION**

Economic growth accompanied by an increase in income inequality (as measured by the Gini Index) and unemployment have been shown in this chapter to lead to a greater incidence of political violence in Latin America. Significantly, and somewhat ironically, the influence of these economic factors can be countered by increases in globalization and improvements in the political voice of the people and the accountability of government to them. This chapter goes a step further than the work by Blomberg and Hess as it captures the additional influence of income inequality and the countervailing forces of globalization. By focusing on one region, much of the generalizability may have been lost; however, the explanatory power of the model for Latin America is much greater than the models that have come from the more globally focused work. The performance of similar studies in other regions would help to confirm the suitability of this approach.

The findings also confirm many of Huntington's assertions about the destabilization effects that can be associated with rapid growth. Unlike Huntington, however, I systematically and econometrically test all of the variables and the prognosis is thus not as dire. Huntington does not consider the positive influences of globalization as potentially offsetting some of the negative implications associated with rapid growth. Further, Huntington provides no solution to the problem, offers very few independent variables that can counter the negative influences of growth, and is thus an incomplete picture of what is really going on in developing countries. This chapter shows how increasing measures that provide for political outlets for dealing with the negative externalities can work to (at least partially) offset some of these externalities. Finally, Huntington completely ignores social spending as a means to minimize the negative influences of growth (increasing inequality), and he thus is missing a major tool that can act to lower levels of political violence. This is perhaps the most salient finding of this chapter.

The implication of the findings in this chapter is also significant for those in the policy world. To minimize the influence of economic growth on political violence, development strategies must be crafted in such a way as to adequately compensate those who are negatively impacted by the new strategies. This includes investment in the necessary tax collection infrastructure to extract some of the profits from those significantly helped by the development strategies and investment in the infrastructure required to provide adequate social safety nets for those who are impacted negatively. The findings on globalization and voice also suggest that focused aid in the areas of good governance and improvements in the level of civil society may help to offset some of the risk associated with economic growth. Remember that the globalization scores include social and political globalization as well as economic—and the participation of NGOs and good mentoring by consolidated democracies could be of benefit here.

According to projections from the World Bank's Center for Poverty Reduction and Equity, 11.5 percent of Latin America will still be living on less than two dollars a day by 2015.<sup>126</sup> The intent of this chapter is not to argue that aid programs and development assistance should be reduced or eliminated to prevent the associated increase in political violence, in fact quite the opposite. This chapter has shown how responsible aid packages and development programs can help to alleviate some of the social pressures that lead to the increases in political violence seen in the data during periods of economic growth. Much work remains to be done regarding poverty in the region, but by promoting a balanced approach and ensuring the windfalls of development are distributed more evenly amongst the population; poverty can be reduced while minimizing the risk of political violence.

By analyzing inequality and growth in this chapter as independent variables, it is thus impossible to also prove causation in the direction from

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<sup>126</sup> The World Bank, *Global Economic Prospects - 2009* (Washington, D.C.: The International Bank for Reconstruction and Development / The World Bank, 2009), 47.

growth to inequality, and more significantly, it is extremely difficult to show a direct link from the development strategy implemented to an increase in inequality. This presents an interesting topic for future research. It is often assumed (as in this thesis) that growth (specifically through liberalization) increases inequality, but the nonexistence of a complete time-series dataset of Gini or some other measure of inequality prevents thorough quantitative verification of this causal relationship. Figure 6 provides some preliminary evidence that there is a link between liberalization and increased inequality. The graph is a snapshot of current levels of liberalization in a country (approximated by IEF country score) vs. the most recently performed calculation of Gini from the World Bank.

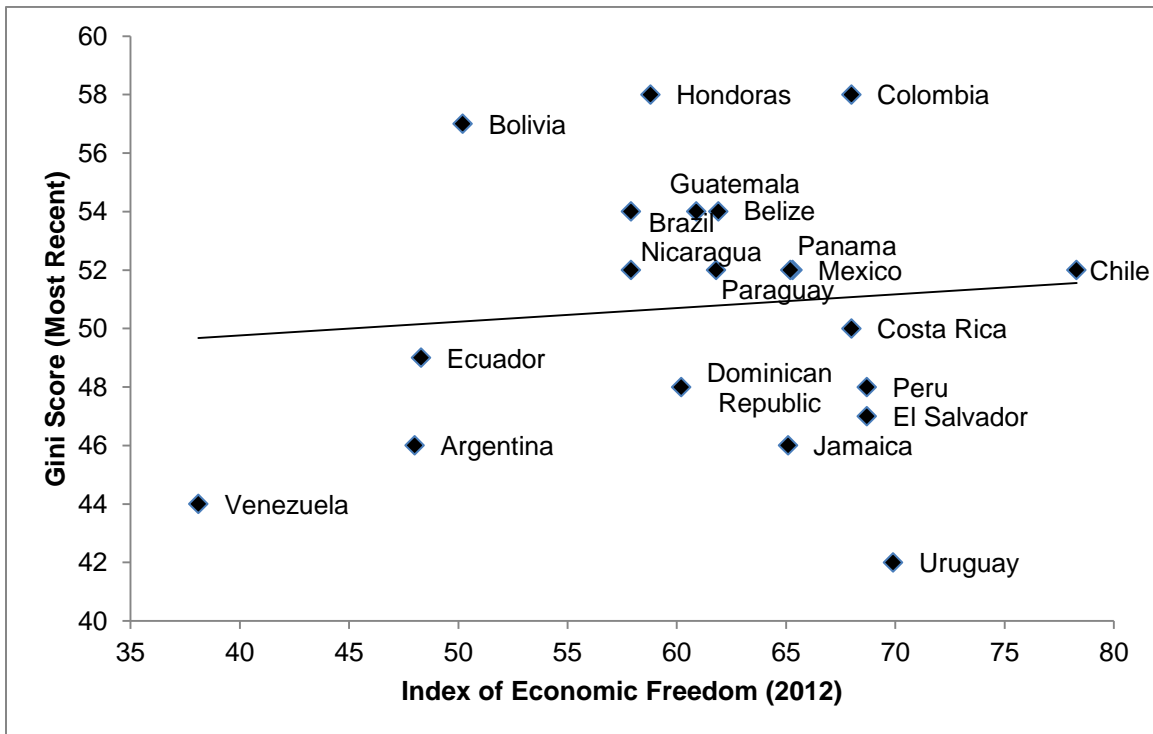


Figure 6. Snapshot of Liberalization vs. Inequality in Latin America

It is clear from Figure 6 that there is a strong positive relationship between the level of liberalization in a country and the level of inequality. Nevertheless, and the reason I suggest more research in this area, it is clear that there is much

more going on in every case. For example, Uruguay has a high score on the IEF in 2012 at 69.9 and yet the lowest level of Gini in Latin America at 42 percent. Similarly, Colombia has a high score on the IEF at 68 and yet their Gini is among the highest in Latin America at 58%. Thus, although a generalization could be made that higher levels of liberalization are associated with higher levels of inequality in Latin America, there are many countries where this pattern does not hold true.

## **V. GETTING THE CLASSIFICATION RIGHT: DISCRIMINATE ANALYSIS ON THE COUNTRIES OF LATIN AMERICA AND THE CARIBBEAN**

### **A. INTRODUCTION**

While Chapter IV demonstrated the importance of social development in minimizing the adverse effects of externalities created by economic development strategies (particularly liberalization), and Chapter III focused on the role targeted social spending had in the implementation of reforms in the first place, this chapter brings us back to the recommendations inherent in the findings of Chapter II—namely that Latin America can be separated into two subregions that will both benefit from a focus on targeted social spending to promote growth, but where the other focuses of development programs will look drastically different to maximize growth potential. You will recall that Chapter II made a very basic assumption that the World Economic Forum's (WEF) stages of growth are fundamentally correct for Latin America and the Caribbean, and thus the WEF stages can be used to divide the region into the two subregions for devising pro-growth strategies. Recall also, that the universe of cases was required, rather than a Latin American specific approach during the factor analysis in order to obtain a large enough N to successfully perform the factor analysis. This chapter drops the assumptions of Chapter II, and looks directly at the countries of Latin America and the Caribbean to evaluate each country's current stage of development and thus ensure that the prescriptions of Chapter II are appropriately applied.

Successfully dividing a region as diverse as Latin America and the Caribbean into two subregions according to level of development is not a simple task—if you want those subregions to actually be useful and not merely conjecture. The complications are inherent in the definition of development one chooses to use. For example, if you choose to define development in a purely economic sense using gross domestic product per capita on a purchasing power

parity basis—as many economists do—then you end up viewing the countries much as is shown in Figure 7. You will notice immediately that viewing the region in this light would rank Costa Rica, Panama, and Venezuela above economic and political powerhouse Brazil. This is already very different from the country stages based on global competitiveness from the WEF that were used in Chapter II. Figure 8 serves as a reminder of where the countries rank out according to the WEF stages of development.

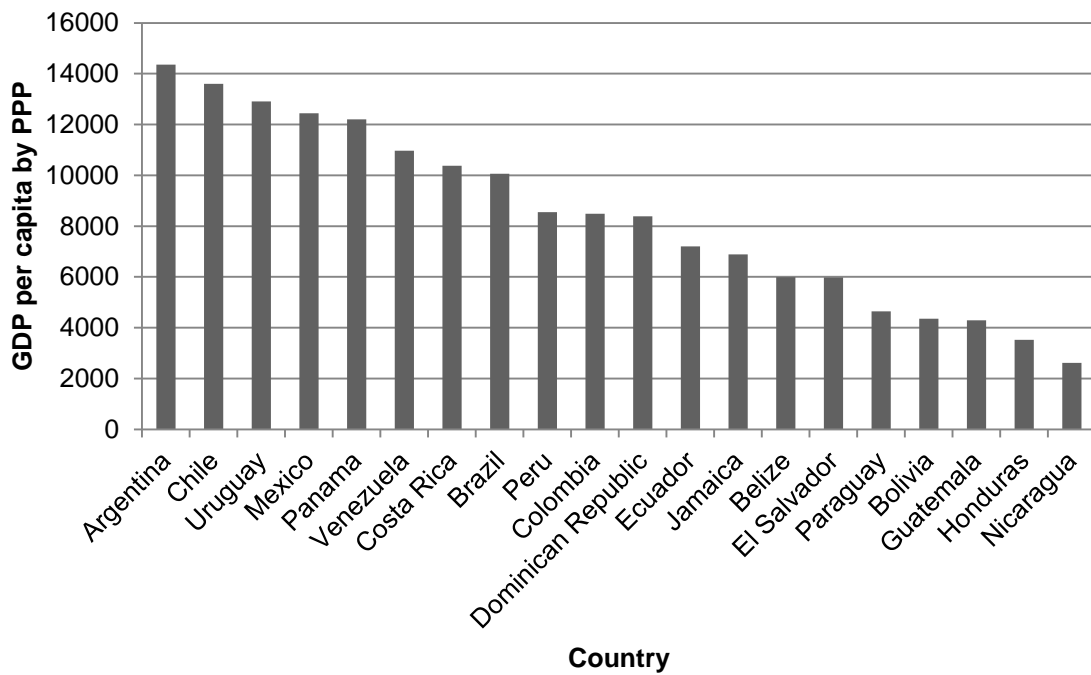


Figure 7. GDP per capita by Purchasing Power Parity in Current U.S. Dollars (2011)

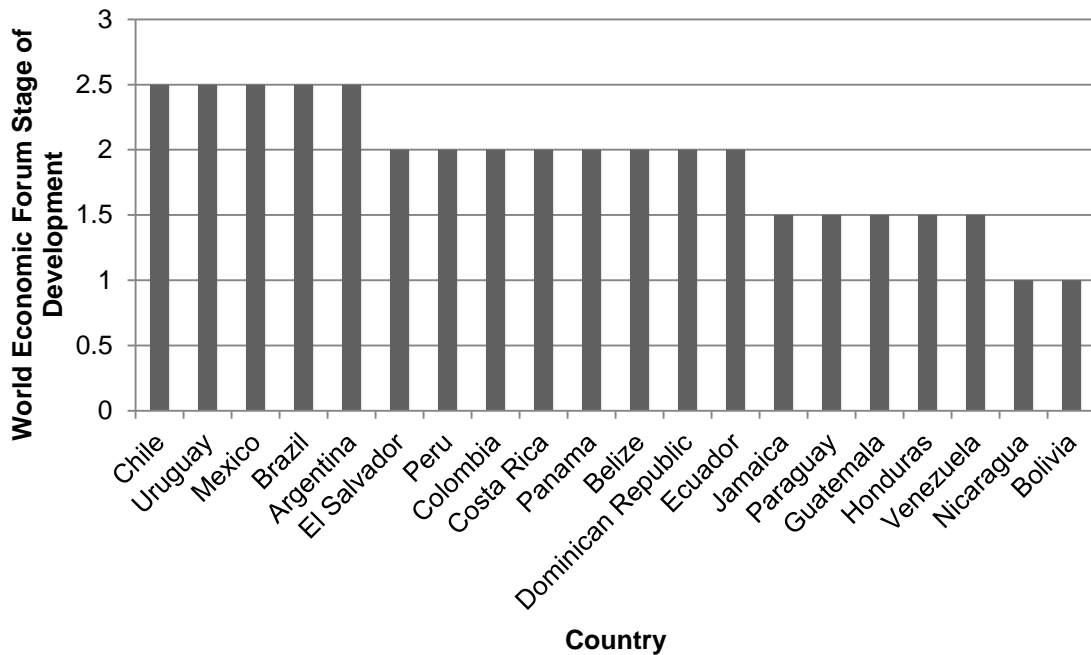


Figure 8. World Economic Forum Stage of Development (2011)

Other potential measures of development only provide added confusion to the matter. Legatum Prosperity Index (LPI)<sup>127</sup> and the UN Human Development Index (HDI) capture measures of social development well. However, as Figures 9 and 10 show, some countries that are doing well economically, such as Venezuela, Mexico, and Brazil, do not fare nearly as well when social development is factored in.<sup>128</sup> This leads to the central question of this chapter—is there a better way to rank and sort the countries of Latin America that is both illustrative and useful for improving development programs?

<sup>127</sup> LPI also captures measure of entrepreneurship as described in Chapter II.

<sup>128</sup> Venezuela and Mexico perform poorly when comparing their LPI score to their level of economic development, and Venezuela and Brazil perform poorly when comparing their HDI score to their level of economic development.



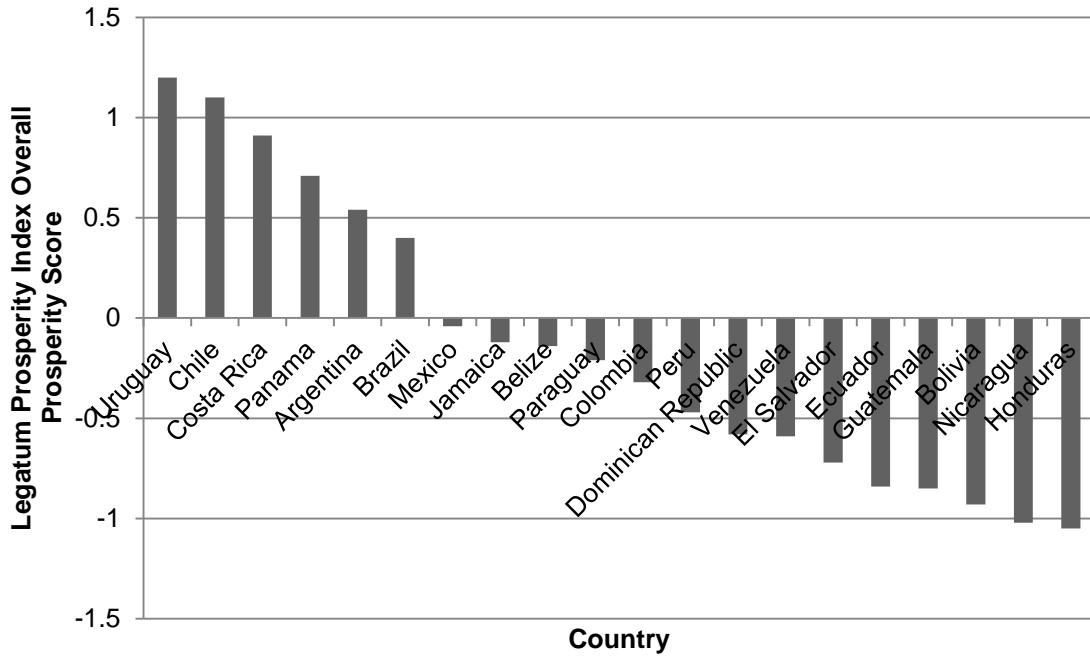


Figure 9. Legatum Prosperity Index Overall Prosperity Score (2011)

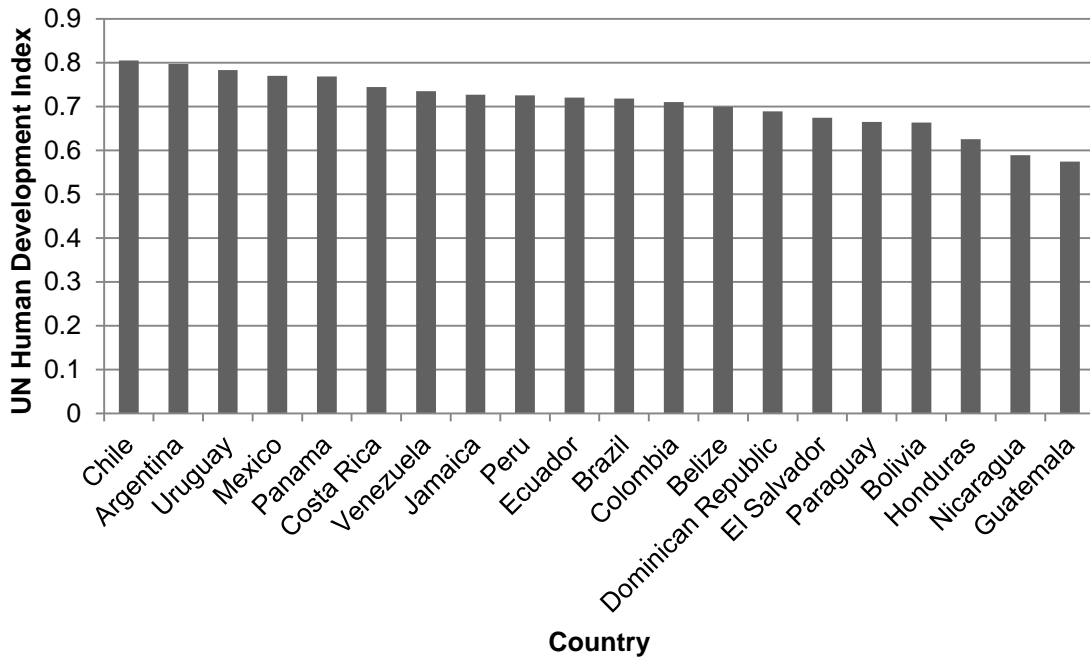


Figure 10. UN Human Development Index (2011)

## B. DATA, HYPOTHESIS, AND METHODOLOGY

### 1. Data

As in previous chapters, the data used come from highly established and transparent indices of development and growth potential. I measure levels of economic, political, and social development using The World Economic Forum's Global Competitiveness Index (GCI),<sup>129</sup> Heritage Foundation's Index of Economic Freedom (IEF),<sup>130</sup> The World Bank's Worldwide Governance Indicators (WGI),<sup>131</sup> the Legatum Prosperity Index (LPI),<sup>132</sup> and the UN Human Development Index (HDI).<sup>133</sup> Finally, all economic data come from the World Bank.<sup>134</sup>

### 2. Hypotheses

**Hypothesis<sub>4</sub>:** Although a focus on targeted social spending and social development will help all countries of Latin America and the Caribbean, other areas of focus will help countries more or less depending on their current level of development.

**Hypothesis<sub>5</sub>:** The countries of Latin America and the Caribbean can be divided into two distinct geographic and economic subregions, and separate development strategies can be optimized to promote the most growth for each subregion at the lowest cost to the government.

### 3. Methodology

I begin with the WEF country stages as a point of departure for study and run a discriminate analysis on the Latin American dataset for each of the indices

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<sup>129</sup> Schwab, *The Global Competitiveness Report 2010–2011*.

<sup>130</sup> Miller and Holmes, *2011 Index of Economic Freedom*.

<sup>131</sup> The World Bank, *Worldwide Governance Indicators*.

<sup>132</sup> Legatum Institute, *The 2011 Legatum Prosperity Index*.

<sup>133</sup> United Nations Development Programme, *Human Development Report 2011*.

<sup>134</sup> The World Bank, *World Development Indicators (1960–2010)*.

of development and growth potential. This produces two separate sub-categories of countries for each index as well as a probability score that the country is ranked correctly. Next, I re-perform the factor analysis as described in Chapter II, but this time on the Latin American data only. The sample size is too small to then run the factor analysis on subgroupings of the data (hence the approach taken using the universe of data in Chapter II), but reducing the variables into factors decreases the number of observations enough to make a final discriminate analysis possible on the factor scored combination of all the indices. This final discriminate analysis considers economic, political, and social development scores for a final ranking of the countries based on the totality of the data. Table 11 shows the results of the discriminate analysis, and Table 12 lists the results of the factor analysis used to generate the variables for the final discriminate analysis.

## C. RESULTS AND ANALYSIS

Country	WEF		IEF		WB WGI		LPI		HDI		GDP per capita		Rotated Factor Analysis	
	Group	Prob.	Group	Prob.	Group	Prob.	Group	Prob.	Group	Prob.	Group	Prob.	Group	Prob.
Argentina	II	0.976	II	0.903	II	0.636	II	0.972	II	0.893	II	0.977	II	0.906
Belize	I	1.000	I	0.999	I	0.883	I	0.893	I	0.735	I	0.959	I	0.896
Bolivia	I	1.000	I	1.000	I	0.749	I	0.996	I	0.898	I	0.989	I	0.949
Brazil	II	1.000	II	0.997	II	0.627	II	0.831	I	0.602	II	0.549	II	0.765
Chile	II	1.000	II	0.996	II	0.997	II	0.974	II	0.915	II	0.957	II	0.988
Colombia	I	0.999	I	0.604	I	0.514	I	0.859	I	0.661	I	0.749	I	0.593
Costa Rica	I	1.000	I	0.658	II	0.814	II	0.848	II	0.604	II	0.613	II	0.935
Dominican Rep.	I	1.000	I	0.982	I	0.970	I	0.999	I	0.793	I	0.764	I	0.974
Ecuador	I	0.998	I	0.674	I	0.772	I	0.994	I	0.586	I	0.896	I	0.847
El Salvador	I	1.000	I	1.000	I	0.878	I	0.971	I	0.861	I	0.959	I	0.974
Guatemala	I	1.000	I	0.898	I	0.986	I	0.996	I	0.994	I	0.990	I	0.987
Honduras	I	1.000	I	0.989	I	0.940	I	0.996	I	0.968	I	0.994	I	0.988
Jamaica	I	1.000	I	0.984	I	0.780	I	0.999	I	0.531	I	0.918	I	0.937
Mexico	II	1.000	II	0.953	I	0.675	II	0.914	II	0.778	II	0.896	II	0.503
Nicaragua	I	1.000	I	1.000	I	0.976	I	0.993	I	0.990	I	0.997	I	0.997
Panama	I	1.000	I	0.986	I	0.585	II	0.589	II	0.767	II	0.877	II	0.753
Paraguay	I	1.000	I	1.000	I	0.995	II	0.541	I	0.892	I	0.986	I	0.994
Peru	I	1.000	I	0.804	I	0.971	I	0.978	I	0.547	I	0.739	I	0.899
Uruguay	II	1.000	II	0.999	II	0.988	II	0.997	II	0.842	II	0.927	II	0.987
Venezuela	I	1.000	I	0.993	I	0.881	I	0.721	II	0.533	II	0.721	I	0.826

Notes: Grouping Method: IBM SPSS 20.0 Discriminate Analysis. Results reported are predicted group membership and probability of group membership. Rotated factors for final column were determined via IBM SPSS 20.0 Principle Component Analysis with Varimax Rotation and Kaiser Normalization on Latin American cases only (rotation converged in 12 iterations). WEF = World Economic Forum Global Competitiveness Index, IEF = Heritage Foundation Index of Economic Freedom, WB = World Bank Worldwide Governance Indicators, LPI = Legatum Prosperity Index, HDI = United Nations Human Development Index 2011

Table 11. Discriminate Analysis on Various Indices of Economic, Political, and Social Development

Key Indicators	Main Dimensions					
	Factor 1 Governance & Rights	Factor 2 Economic Freedom	Factor 3 Innovation & Infrastructure	Factor 4 Social Development & Entrepreneurship	Factor 5 Labor Freedom	Factor 6 Macroeconomic Environment
WB Political Stability / No Violence	.898	.091	.094	-.009	-.057	-.021
WB Control of Corruption	.849	.207	.270	.074	.261	.223
WB Voice and Accountability	.832	.190	.192	.300	.204	.049
LPI Personal Freedom	.807	-.143	.196	.255	-.053	.044
IEF Freedom from Corruption	.805	.218	.355	.038	.219	.248
LPI Safety and Security	.804	.126	-.002	.286	-.298	-.038
WB Rule of Law	.797	.251	.359	.205	.240	.162
LPI Governance	.787	.293	.349	.205	.240	.125
WEF Institutions	.763	.307	.410	.048	.201	.172
IEF Property Rights	.619	.456	.392	.203	.331	.164
WB Government Effectiveness	.608	.226	.498	.278	.346	.248
WEF Health and Primary Education	.530	-.271	.084	.319	.227	.414
IEF Monetary Freedom	.113	.881	.051	-.068	.200	.015
WEF Goods Market Efficiency	.339	.842	.342	.040	.079	.044
IEF Financial Freedom	-.136	.827	.238	-.006	.166	.080
IEF Investment Freedom	.389	.780	.170	.238	.202	-.180
IEF Trade Freedom	.354	.728	-.060	-.385	-.016	.224
IEF Government Spending	.035	.719	-.193	.162	-.210	.177
WB Regulatory Quality	.453	.676	.451	.130	.281	.078
WEF Labor Market Efficiency	.370	.595	.306	.040	.487	-.111
LPI Education	.397	-.579	.223	.409	-.055	.413
IEF Fiscal Freedom	.085	.568	-.560	-.112	-.404	.103
WEF Business Sophistication	.246	.313	.844	.139	.063	.109
WEF Innovation	.446	-.066	.793	.140	.061	.159
WEF Technological Readiness	.440	.151	.697	.414	-.092	.105
WEF Financial Market Development	.082	.660	.669	.078	.003	-.087
WEF Infrastructure	.410	.272	.657	.217	.113	.243
WEF Higher Education and Training	.495	-.342	.593	.318	.117	.287
LPI Social Capital	.194	.072	.177	.806	-.030	-.118
LPI Health	.475	-.042	.173	.697	.121	-.006
LPI Entrepreneurship & Opportunity	.449	.019	.530	.622	.137	.029
Human Development Index	.437	-.245	.275	.614	.098	.364
IEF Business Freedom	-.169	.432	.098	.586	.526	.087
IEF Labor Freedom	.374	.212	.028	.077	.855	-.046
WEF Macroeconomic Environment	.096	.157	.106	-.180	-.007	.923
LPI Economy	.298	.150	.413	.274	-.140	.581

Notes: Extraction Method: IBM SPSS 20.0 Principle Component Analysis. Rotation Method Varimax with Kaiser Normalization. Rotation converged in 12 iterations. WEF = World Economic Forum Data Set, IEF = Heritage Foundation Index of Economic Freedom Data Set, WB = World Bank Governance Data Set, LPI = Legatum Prosperity Index Data Set, Human Development Index: United Nations Human Development Index 2011

Table 12. Factor Analysis (Dimension Reduction) on Latin American and Caribbean Countries

Discriminate analysis on WEF GCI gives the expected results as shown in Table 11. The countries divide out into two subregions as originally described based upon their WEF stage of development and as was the central assumption in Chapter II. The probabilities that the countries are correctly classified are greater than 97 percent in every case, and most cases have a 100 percent probability of being correct. This follows the original assumption of using the WEF stage of development to sub-divide Latin America and the Caribbean. Further, when only Heritage Foundation IEF scores are considered, the countries break out into similar groupings, although Colombia, Costa Rica, and Ecuador have relatively low probabilities of correct classification according to IEF scores and can nearly be grouped with the more developed countries in Subregion II.

Based solely on WB WGI scores, Costa Rica moves up into Subregion II, and Mexico shifts down to Subregion I. Further, Panama and Colombia appear to be very close to shifting into Subregion II based on the low probability of their correct classification in this category. The limitation of the WB WGI scores to looking solely at measures of good governance provides a much focused area for these countries to improve to aid in shifting to the next stage of development.

Recalling that the LPI includes more measures of social development and entrepreneurship than the other indices, and the results of the discriminate analysis on this index are particularly illustrative. Costa Rica, Panama, and Paraguay move into Subregion II based on the results of the discriminate analysis, although Panama and Paraguay have relatively low probabilities of correct classification, and thus still have work to do along these dimensions. The fact that Paraguay is on the verge of breaking through is the most surprising of the results based on the LPI discriminate analysis. Paraguay has one of the lowest GDP per capita among the countries of Latin America and the Caribbean, and has been plagued with chronic underperformance. It appears as though Paraguay's scores on Personal Freedom, Social Capital, and Health are providing enough offset for their negative scores in Education, Entrepreneurship, and Governance to place them just barely in Subregion II. Based upon their

highly negative scores in these other areas however, it is clear Paraguay has much more work to do to move into the next stage of development.

Interestingly, taking only into account the social development factors included in the UN HDI and Brazil falls out of inclusion with the most developed countries. Further, as would be expected based upon their relatively high levels of social spending, Venezuela, Costa Rica, and Panama move up into Subregion II. These countries still have much work to do as well, and Venezuela and Costa Rica have relatively low probabilities of proper classification. In fact, with a probability of proper classification at 53.3 percent, Venezuela is nearly just as likely to be classified with the Subregion I countries. Further, these results show that although Brazil is an economic powerhouse, they are underperforming their regional economic peers when it comes to social development.

One of the arguments against using all of these complicated indices to measure development and growth potential is that oftentimes GDP per capita is highly correlated with the results. This would imply that simply using readily available GDP per capita data could provide nearly as much information and predictive power as the indices do. A comparison of the results of the discriminate analysis on the GDP per capita (PPP) data with the results from the other indices illustrates why more than economic data is needed. First, using GDP per capita for the discriminate analysis places Venezuela into Subregion II again. This is contrary to every other possible way of measuring development and growth potential with the slight exception of the HDI discussed above. Further, a large country like Brazil loses any influence due to market size and efficiencies of scale and has a very low probability of being classified correctly in Subregion II. Clearly, solely using economic data such as GDP per capita can provide an incomplete picture of a country's state of development and growth potential.

What do all of the contradictory results of the discriminate analysis on the individual indices really tell us? First, they tell us that something more is needed to provide the larger picture when considering where a country is actually located

along the development spectrum. Second, comparisons between the results of the separate indices can shed some light on which areas individual countries need to focus on apart from those areas prescribed in Chapter II. Finally, the results remind us to always take into account the particular focus of a given groups' index and to look deeper to ensure their prescriptions are placed within the proper context.

The results of the discriminate analysis on the variables generated through the factor analysis reported in Table 12 may provide, or at least point us in the general direction of, the “something more” than can answer all of the concerns raised about the results of the individual index discriminate analyses. Through the factor analysis of my Latin American combined dataset, I reduce the various scores across the multitude of indices included down to just six independent factors that capture the variation within and across the indices. The results of the discriminate analysis on these factors provide us with a useful division of the countries into subregions that takes into account all of the dimensions included in the combined dataset.

Not surprisingly, Costa Rica and Panama move up to Subregion II under the final discriminate analysis. This follows the results of the individual discriminate analysis on the LPI, and HDI for Panama, and the LPI, HDI, and World Bank WGI for Costa Rica. Panama and Costa Rica both have the advantage of the large market associated with free trade agreements with the United States,<sup>135</sup> and clearly Costa Rica has among the best governance in the region. Panama still has work to do concerning governance, but they have made great progress recently in social development,<sup>136</sup> and this appears to provide the impetus for moving them into Subregion II.

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<sup>135</sup> Costa Rica is covered by CAFTA-DR: *Dominican Republic-Central America-United States Free Trade Agreement Implementation Act*, Public Law 109–53, (2005). Panama is covered by the Panama Trade Promotion Agreement: *United States-Panama Trade Promotion Agreement Implementation Act*, Public Law 112–43 (2011).

<sup>136</sup> Legatum Institute, *The 2011 Legatum Prosperity Index*; United Nations Development Programme, *Human Development Report 2011*.



Mexico provides the greatest surprise in results of the final discriminate analysis, but as in the case of Panama and Costa Rica, the individual discriminate analyses can provide specific targets for improvement. Mexico is still ranked as a Subregion II country, but their probability of correct placement is very low at 50.3 percent. Thus, statistically, Mexico is barely less likely to be classified as a Subregion I country than as a Subregion II country. The results of the individual discriminate analysis on WB WGI points to specific areas for Mexico to address, such as control of corruption, political stability, and general rule of law. Mexico may be teetering on the brink of sliding to a Subregion I country, but recent reforms in the political arena are heading in the right direction, and the likely shift away from the war on drugs after the upcoming elections may help with the control of corruption and the rule of law as it applies to citizen's rights.

#### **D. CONCLUSION**

It is important to point out that the countries as divided into subregions and shown in Figure 11 only differ slightly from the original division according to the WEF stage of development seen in Figure 1 of Chapter II (Panama and Costa Rica). It is also significant that the vast majority of countries were ranked within the same subregion across all of the discriminate analyses.<sup>137</sup> In the cases where the country's subregion was correctly identified consistently, then the policy prescriptions of Chapter II can provide a great deal of insight into where countries can best target development programs. However, the results of the individual discriminate analyses can also provide additional guidance—particularly when a country's probability of being divided correctly is relatively low. In other words, Chapter II shows areas most closely aligned with growth

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<sup>137</sup> Specifically, Argentina, Chile, and Uruguay were consistently ranked in Subregion II, and Belize, Bolivia, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Jamaica, Nicaragua, and Peru were consistently ranked in Subregion I.

within a subregion, and this chapter illuminates areas to focus on for moving from Subregion I to Subregion II (or areas where improvement is needed to prevent sliding into the lower subregion).



Figure 11. Latin America and the Caribbean by Subregion Based on a Discriminate Analysis of the Combined Factor Scores

Interestingly, and central to the arguments made in the rest of this thesis, social development appears to have played a dominant role in moving Panama and Costa Rica into Subregion II. Their high scores in the LPI and HDI (both heavily weighted in measures of social development) played a dominant role in allowing Panama and Costa Rica to move up into the group of most developed countries in Latin America (Subregion II). Thus, social development is shown to not only play a role in development within a subregion as in Chapter II, but is also shown to help a country move from one stage of development to the next.

## **VI. CONCLUSIONS, RECCOMENDATIONS, AND POLICY IMPLICATIONS**

### **A. CONCLUSIONS**

The central argument of this thesis has been that Social Development and targeted social spending played an active role in the implementation and acceptances of economic reforms in the past, but they also promote growth by increasing the productive capacity of the population. Further, social development can act to offset the proclivity of development to increase instability and levels of political violence. This ability of social development to promote stability and growth and also encourage the acceptance of structural adjustment programs demonstrates the fallacy of the Washington Consensus demand that a country must lower their fiscal burden for growth to happen.

Chapter I provided a basic overview of the Washington Consensus and its proponents, while Chapter II performed a varimax rotated factor analysis to determine those factors that are most closely aligned with growth potential in both Latin American subregions. For the countries of Subregion I, the results show the pro-growth benefits of a strategy that focuses on social development through targeted social spending on education and health programs—thus increasing worker productivity. On the other hand, the countries of Subregion II achieve pro-growth benefits by focusing on strategies that improve entrepreneurship first and higher levels of social development (such as higher education and specialized training) second. There are of course other areas that are closely aligned with growth potential, but these factors are the most closely aligned and also happen to be the least politically contentious.

Chapter III found that both democracies and authoritarian governments used targeted social spending in the past to reduce the political costs of structural adjustment programs, and democracies were better able to negotiate with their populations and thus enacted farther-reaching reforms. The most important finding of Chapter III was that targeted social spending and an increase

in social safety nets can serve to ease the implementation of economic reforms and work to strengthen democratic negotiation and governance.

Chapter IV found a strong correlation between economic development and levels of political violence in Latin America, but also found a potential solution in social development. Where levels of inequality rose there was a corresponding increase in political violence, but programs that focus on social development can work to counter the potential for increased violence. I also find a positive role for globalization as a means for the airing of political grievances to minimize the risk of political violence. This finding runs counter to the arguments that globalization in and of itself is destabilizing. Political violence and instability are clearly normative negatives, but growth and development are required for a society to maximize its potential and improve the lives of its citizens. Social development works to mitigate the risks of political violence and instability by compensating those who do not receive the maximum benefit of development or are harmed by it. Governments must possess adequate capacity to tax those who benefit the most from growth to provide the social safety nets and social development programs required to mitigate the risk of increased political violence, and where that capacity does not exist it must be built.

Finally, Chapter V challenged the country stage of growth classifications of the World Economic Forum and performed a discriminate analysis to determine the appropriate subregion membership for each Latin American country. The results of this analysis provided targeted strategies for borderline countries to move to the next stage of growth and reclassified Panama and Costa Rica as Subregion II countries. Social development played a role here as well, as the countries that were able to transition to the higher subregion did so primarily through increased levels of social development. The other important factor for encouraging transition to the next stage of growth appears to be improving internal levels of governance. All the infrastructure and markets in the world are useless unless there is adequate governance to manage them effectively.

Scholars have understudied the role of social development, social safety nets, and social spending in promoting growth, and the Washington Consensus misinterpreted it as a waste of government resources. This thesis challenges this core assumption of the original Washington Consensus, not on political grounds as is usual, but on purely economic grounds. This thesis has shown that social development lessens the risk of political violence and eases the political costs of structural adjustment policies. Further, I have demonstrated through rigorous statistical analysis the pro-growth influence social development can have in building a stronger and more competitive workforce. Finally, social development plays a role in not only promoting growth based on a country's current stage of growth, but it also aids in putting the conditions in place necessary to move into the next stage of growth altogether.

## **B. RECOMMENDATIONS**

### **1. Database Updates**

Several of the databases used in this thesis are out of date and will require updating to remain relevant. For example, the Escaith and Paunovic database on liberalization, vital to the time series analysis performed in Chapter III, only has valid data through 2000. Escaith and Paunovic's database was an update on an earlier database by Morley et al., and it is time for an update to take the database through at least 2010. The methodology provided by Morley et al., and improved by Escaith and Paunovic, is sound, and an update to the database would allow for additional hypothesis testing using liberalization as both an independent and dependent variable.

Other databases used in this thesis are not necessarily out of date but neglect certain countries whose inclusion would provide for more robust hypothesis testing. For example, nearly every database excludes Cuba and Haiti. Cuba is excluded due to the lack of reporting of key economic statistics and the unreliability of the numbers they do report, and Haiti has been excluded recently due to the lack of infrastructure available to collect and disseminate data

after the political turmoil of 2004 and the subsequent earthquake of 2010. Nevertheless, for Haiti, it is vital to have a good set of data with which to base recommendations for reestablishing growth and stability. The World Bank has the resources and expertise to help measure the indicators, and the United Nations should make accurate economic data gathering a major component of their mission. Until the breadth of the problem is fully understood, adequate solutions are unlikely to emerge.

Cuba, on the other hand, has the resources and expertise to measure and manage their own economic data, but hostile economic policies from the United States make the release of accurate data untenable for the near future. The lessening of restrictions on the travel ban in 2011, and a renewed focus on cultural exchange between the two countries are steps in the right direction. The Cuban people should benefit greatly from increased access to the world market, but accurate economic data and some kind of guarantee against nationalization will likely be required before foreign direct investment (FDI) will return in droves. Cuba no longer represents any real threat to the United States militarily, and unilateral action on the part of the United States to normalize relations with Cuba would put the onus on them to open the national books and reenter the international economy.

Another database in need of updating is the World Bank Worldwide Governance Indicators (WGI). This dataset is highly useful in quantitative research and has been updated regularly since its creation in 1996. Unfortunately, the World Bank has not opted to look back at the years prior to 1996 and release data for those years. This would be a difficult and time-consuming undertaking, nevertheless, the value to quantitative research on periods before 1996 would be enormous. The World Bank publicizes their methodology; and even if they do not have the resources to gather the data for the years preceding 1996, independent researchers should be able to follow their approach and produce a viable database.

Finally, and most important, there is currently no single database of income inequality that can be utilized for time-series research. The Gini Index data from the World Bank is good when it is available, but it is very inconsistent in the choice of years where the data was gathered and calculations performed. The results are snapshots of data that do not overlap across countries and time. This leads to an overall inability to perform viable quantitative studies using income inequality as either an independent or dependent variable. The workarounds to the currently available data include interpolation and estimation—each with their own drawbacks. Inequality is too important and politically sensitive of a topic for unreliable and incomplete data to be used as the basis of debate.

## **2. Further Study**

The conclusion of Chapter IV provided the outline for a future research project into the effect of liberalization on income inequality in Latin America. I just outlined the problems with inequality data in general, but a qualitative longitudinal study of the process of liberalization and the impact on income inequality should be possible to construct using currently available data and in country research. This qualitative research could then be backed up and second checked by snapshot quantitative analysis on the inequality and liberalization data when it is available. The combination of the two methodologies should allow for a more complete answer to the liberalization and inequality question than is currently available.

In addition to a need for supplementary inequality research, the findings of this thesis should prompt a similar systematic approach to other developing regions. For example, Africa is another region where a one-size-fits-all approach to development has been tried with varying levels of success and where a geographic division of growth stage has emerged (coastal vs. non-coastal). The factor analysis approach of Chapter II and the discriminate analysis approach of Chapter V should provide a good foundation for research on improving



development programs there. This is not to argue that the potential solutions would be identical (they likely differ significantly), but the methodologies employed in this thesis should be valid regardless of the region in which they are applied.

Finally, the development suggestions derived from Chapters II and V are only as good as the present data. That means a process of reevaluation and revision will be necessary to ensure the policy recommendations remain current and valid. The effects of each new program will likely alter the data and the subsequent results, but the methodology allows for a reappraisal of the situation and policy adjustment as necessary. This becomes even more important as a country nears the next stage of growth. Managing the transition to the next stage can be extremely difficult for any country, but using the framework provided in this thesis to evaluate the options can help streamline the process.

## **C. POLICY IMPLICATIONS**

### **1. Implications for the United States and other Wealthy Countries**

The United States, in particular, has a vital interest in promoting development and minimizing instability in Latin America. In the current globalized world, instability (especially in the Western Hemisphere) undermines markets and threatens economic prosperity. Chapter IV outlined the link between economic growth and political violence, and it demonstrated how minimizing income inequality and unemployment could help to mitigate the threat. Thus, the United States and the rest of the world are placed in the situation of trying to determine how to encourage development while discouraging the associated increase in political violence. It becomes clear that the encouragement of low government spending associated with the original Washington Consensus is counterproductive, and targeted social spending can be used to address many of these issues.

Additionally, the United States and international development organizations have done little to encourage acceptance of recommendations by

packaging them as a one-size-fits-all approach and forcing them on developing countries. Calling the approach the “Washington Consensus” further damages the credibility of the programs in a region where the imperial intentions of the north are always in question. The United States and our wealthy international partners need to empower the developing countries by building a partnership approach to development that provides recommendations not impositions. Listening to the genuine political concerns of the developing countries will allow for a realistic approach to policy implementation, and utilizing the recommendations of Chapters II and V should provide a basis from which to build development strategies that are less contentious in the first place.

Apart from the multitude of other reasons why democracy is a normative good for Latin America, the findings of Chapter III reiterate the fact that democracies also are better able to implement economic reforms when needed. For the United States and the United Nations, this means that support of pro-democracy initiatives should continue to be encouraged in Latin America, and countries that have recently transitioned, or are in the process of transitioning, should be encouraged and aided in the process by the international community where possible. As Chapter II implies, democracies in transition are less stable than any other type of regime that has been in place for a significant period, but the ability of democratic regimes to negotiate through economic reforms cannot be understated. Thus, continued democratization and democracy should be encouraged where possible.

## **2. Implications for Latin America**

Social spending on education and health care build the productive base of a society and over time erode the factors leading to increases in income inequality. Additionally, Chapter III showed how social spending can be used to offset some of the negative externalities associated with a structural adjustment program. Latin American countries should only undertake in development programs after assessing the negative externalities associated with them and

building in a program to address those externalities. Countries should not undertake development programs just for development's sake but with a real purpose to improve the lives of the people.

For the least developed countries of Latin America and the Caribbean (those countries in Subregion I), the results of Chapter II imply a focus on social development first then entrepreneurship. This runs counter to the general Washington Consensus ideas that less government spending is better and that decreasing a country's fiscal obligations is the only way to get growth started. In the case of the countries in Subregion I, this appears not to be the case. For the more developed countries in Latin American Subregion II on the other hand, growth potential is most closely aligned with innovation and competitiveness first, then higher levels of social development. Training programs that both increase the level of entrepreneurship and higher education of the population would provide stimulus along several dimensions that are closely related with growth potential and may provide the most influence for the money spent.

Countries that are ready to transition to the next stage of development have additional areas of improvement to focus on before the transition can occur. Chapter V illustrates where the countries in transition should focus, but a few examples illustrate the point. Mexico needs to focus on governance reforms to solidify its place as a Subregion II country, and Colombia must concentrate on governance reforms in order to begin the transition to the next stage of growth. Panama and Costa Rica meet the prerequisites to transition to the next stage, and despite the improper classification by the WEF, both countries will benefit from a concentration on the items prescribed for Subregion II.

The final recommendation for the countries of Latin America is to learn from the lessons of the past, but not to use past failures as an excuse either. The Washington Consensus did not sustainably meet its stated purpose, but that does not mean that the United States, the IMF, and the World Bank recommended it with malicious intent. The developed world still has much to offer in terms of resources and aid to support growth in Latin America. Refusing

help because of past failures would dramatically limit the strategy options available. This thesis has shown that there are several potential strategies for growth that are less politically contentious than the Washington Consensus and would lead to lower income inequality over the long run. The countries of Latin America should insist on bilateral development strategies, but not reject offers of help just because of whom they come from.

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