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Regimes, state power, and the effects of external economic
linkages on growth and social equality in the Third World

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The Ohio State University, 1993

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# REGIMES, STATE POWER, AND THE EFFECTS OF EXTERNAL
# ECONOMIC LINKAGES ON GROWTH AND SOCIAL EQUALITY
# IN THE THIRD WORLD

## DISSERTATION

Presented in Partial Fulfillment of the Requirements for the Degree Doctor of Philosophy in
the Graduate School of The Ohio State University

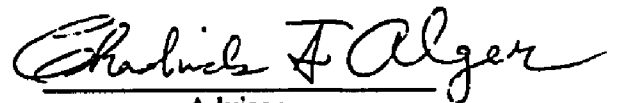By

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# ACKNOWLEDGMENTS

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# Chapter I

# INTRODUCTION

One of the major concerns of scholarly discourse during the last several decades is how the expansion of interdependence or transnational relations affects socio-economic structures in peripheral countries. Most of the answers to this question stem from one of three competing theoretical perspectives: liberal, dependency, and statist. For liberal economists, growing interdependence has beneficial effects on Third World economies due to the diffusion of capital, skills, and technologies, as well as modern value or institutions from advanced industrial countries to less developed countries. In contrast, dependency writers view growing interdependence as increasing foreign penetration or domination of their economies which is the major cause of underdevelopment of peripheral countries. Statist scholars, on the other hand, explain the patterns of development of the Third World as a consequence of the nature of the state and policies taken by state authority.

A number of quantitative studies have been conducted in order to test the propositions provided by these three theoretical perspectives. The following are some of the major findings: (1) foreign direct investment is associated with higher rates of economic growth, at least in the short run; (2) the long term effect of foreign direct investment is a suppression of economic growth; (3) increasing foreign direct investment and aid tends to decrease social equality within peripheral countries. Thus, the findings of previous quantitative studies generally support the dependency perspective rather than the liberal or

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statist approach. Nevertheless, this does not necessarily mean that the dependency perspective is superior to others. Although the forms of external economic relations may affect growth and social equality in the Third World as dependency writers have predicted, the forms of external economic relations itself can be determined by the nature of the state and its actions.

There are some problems in both the above approaches and previous quantitative studies. Theoretically, the dependency and liberal perspectives are critically weak in their disregard for the autonomy of political spheres and the possibility of an independent and autonomous state which has power and objectives distinct from any particular societal force. Although statist writers have corrected this flaw of these two perspectives, they do not tend to distinguish between increasing state power and the direction and/or effectiveness of state actions but instead tend to overemphasize the importance of the strong state in shaping national economic development and bargaining with foreign forces. Strong states may promote growth and social equality, but they can also retard growth and aggravate inequality within Third World countries. In order to account for the direction and effectiveness of state actions, we have to know who controls the state, which may determine the nature of the state. In this respect, regime types may be important factors that determine the effects of external economic linkages (with respect to foreign direct investment, foreign aid, and foreign trade) on the pattern of economic development in the periphery.

If my prediction is correct, there is also a methodological flaw in the previous quantitative studies. Many of those studies use a panel regression method to account for the short term or long term effects of external economic linkages on economic growth. Panel regression analyses however cannot consider the effects of change in regime types that are so prevalent in peripheral countries. In order to evaluate the mediating effects of regime

types between external economic linkages and growth and social equality, it is necessary to adopt a time-series method for the analysis.

From this perspective, the objective of this study is to examine the different impacts that external economic linkages have on growth and social equality across Third World countries. The basic idea investigated is that a regime type is likely to mediate the relations between the forms of external economic linkages and economic growth as well as the social equality in the developing world. By introducing a new classification of regime type for Third World countries, this study will attempt to integrate significant insights of three theoretical approaches.

Chapter two provides an overview and critiques of the three perspectives. Chapter three reviews the results of previous major quantitative studies in terms of the effects of external economic linkages on growth and social equality in Third World countries.

Chapter four explains the theoretical perspective adopted in this study and offers hypotheses concerning the mediating effects of regime type between external economic linkages and growth and equality. A new classification of regimes is introduced which combines the degree of power centralization and infrastructural power. Third World countries can be first divided into three types with respect to the degree of centralization of power in the political system: namely, centralized regimes, fragmented regimes, and moderate pluralistic regimes. The latter includes both democratic and authoritarian regimes which are located somewhere between the centralized and fragmented regimes. Countries can also be divided into two types, strong and weak states, in terms of their infrastructural power as defined by the power of the state to penetrate and centrally coordinate the activities of a civil society. Next, by combining these two dimensions of state strength, Third World countries can be classified into six regime types: centralized regimes with strong states, centralized regimes with weak states, moderate pluralistic regimes with strong states, moderate pluralistic regimes with weak states, fragmented regimes with

strong states, and fragmented regimes with weak states. The effects of external economic linkages are expected to be different across these different types of Third World regimes. I assume that leaders of regimes act to maximize their likelihood of retaining power, and utilize the benefits of external economic relations in order to distribute rewards to their supporters. Because different regime types may present different constraints to political leaders, they are likely to act differently across regimes when utilizing external economic linkages. I expect that the effects of external economic relations are positive only in moderate pluralistic regimes, especially with regards to strong states. Centralized regimes may not be able to check a ruler's abuse of power, while fragmented regimes may not be able to restrict the influence of dominant economic elites pursuing their own economic self interests. Moderate pluralistic regimes may possess a system of checks and balances among political elites and are able to restrain actions taken by powerful domestic groups. Thus, various hypotheses are offered regarding the effects of external economic linkages on growth and social equality in peripheral countries.

Chapter five test hypotheses with respect to the effects of external economic linkages on economic growth. My sample constitutes 24 Third World countries spanning the period of 1973-79. A pooled, cross-section time-series method is employed to analyze data across both time and space. This method not only allows us to employ a large number of observations in parameter estimations, but also enables us to examine the effects of regime types as an intervening variable between external economic linkages and economic growth in peripheral countries. In order to assess different effects of external economic linkages on growth across regimes, I have introduced slope dummy variables. The test results indicate that the effects of external economic linkages are varied across different types of regimes, implying that the regime type weaken or strengthen the relationship between external economic linkages and subsequent economic growth in Third World

countries. As expected, moderate pluralistic regimes with strong states perform better than any other type of regime.

Chapter six tests hypotheses regarding the effects of external economic linkages on social equality in developing countries. A sampling of 23 countries, spanning the period of 1975-79, is utilized. Again, a pooled cross-section time-series approach is employed to test my hypotheses. To this end, I constructed an index of social equality by combining an index developed by Ward, Russett et al, and Hibbs which permits the analysis of time-series data in studying social equality in Third World countries. This index was constructed to overcome the limitation of previous quantitative researches which employed only cross-section analysis because the yearly data of GINI index which are conventionally used as an indicator of inequality within countries were not available for most Third World countries. Although the majority of previous quantitative studies report external economic linkages result in greater inequality within peripheral countries, my test results show that the negative effects of external economic linkages on social equality cannot be generalized in all Third World countries. In moderate pluralistic regimes with strong states, according to my findings, foreign direct investment and debt are likely to contribute to creating a more equal society in the periphery. However, the pattern of residuals shows that there is a serious autocorrelation problem in which the error terms are correlated over time. Thus, my test results are inconclusive, although they strongly support most of my hypotheses regarding the effects of external economic linkages on social equality in developing countries.

In the conclusion, we summarize this study and suggest future research programs.

# Chapter II

# THEORETICAL PERSPECTIVES

With respect to the effects of external economic linkages on Third World economies, three major theoretical approaches have offered completely different predictions. First, for liberal economists, growing interdependence has beneficial effects on Third World economies due to the diffusion of capital, skills, and technologies, as well as values or institutions from advanced industrialized countries to developing countries. Second, dependency writers, in contrast, view growing interdependence as an increasing foreign penetration or domination of their economies which, they argue, is the major cause of underdevelopment of peripheral countries. Third, the statist approach, on the other hand, explains the patterns of development of the Third World as a consequence of the nature of the state and policies taken by political authorities in developing countries.

In this chapter, I will first outline the basic features of these three approaches and the actual mechanisms they propose to explain positive or negative effects of external economic linkages on economic growth and social equality in Third World countries. Then I will discuss the strengths and weaknesses of these approaches, and suggest a possible approach which may integrate insights of these three competing theoretical perspectives.

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**The Liberal Perspective**

The central tenet of liberal economics is that the natural economic process will normally promote economic development if internal barriers inherent in stagnant, traditional societies are removed. For liberals, the development patterns of the West offer a universal model for Third World countries wishing to develop and modernize their economies. Thus, by focusing on the essential factors that promoted the Western Industrial Revolution, modern liberal economists, like Lewis, Rostow, Gerschenkron, Ranis and Fei, have investigated the process by which Third World economies can be transformed into one whose normal condition is sustained growth. Although significant variations can be seen within the liberal tradition, there is a general agreement on the principal changes that characterize this transformation, such as an increase in human skills, a rise in the level of investment and savings, the adoption of more productive technology, and the development of new institutions (Chenery and Strout, 1966). Even though the development of the Third World is viewed as basically their domestic matter, these changes, for liberals, can be accelerated through the integration of their economies into the world market.

Trade is regarded as an "engine of growth", facilitating mutually beneficial relationship between industrialized and developing countries. By using the example of the exchange of English linen for Portuguese wine, Ricard (1933) shows that the world as a whole, as well as each single country, can obtain more goods, at a constant level of factor input, through an international division of labor in which all nations specialize and export only those commodities which relatively have the lowest costs of production. Thus, according to the theory of comparative advantage, Third World countries should specialize in the production of raw material in order to promote growth, if it is more economical to exchange raw materials for manufactured goods than to produce the imported goods domestically.

Eli Heckscher (1919) and Bertil Ohlin (1933) developed the modern version of this theory of comparative advantage. In the classical Recardian model, the comparative advantage is based on the difference in the productivity of labor among countries, resulting from systematic differences such as climate, natural resources, technical know-how, and so forth. These differences lead to different costs of production across nations, so that all countries will benefit as a result of international division of labor and specialization of production. On the other hand, by assuming equal technology, tastes, and factors of production across countries, the Heckscher-Ohlin model isolates the difference in factor endowments as the basic determinant of comparative advantage. According to this model, each country has a comparative advantage in producing commodities that use the nation's relatively abundant and cheap factors intensively. For example, if a country has a relatively good supply of labor compared to its capital, it has a comparative advantage in producing labor-intensive commodities. Therefore, the country should export labor-intensive commodities and import capital intensive goods from countries with relatively ample supplies of capital. In this way, the Heckscher-Ohlin model explains comparative advantages based only on the difference in factor endowments rather than systematic differences across nations. Furthermore, this model notes that free trade not only increases the participants' level of welfare but also equalizes a factor price between countries. As a result, the wage differences between the core and the periphery would be reduced, leading to a more equal international distribution of income.

In essence, the theory of comparative advantage shows that the economy's efficiency will increase through trade, resulting in a higher level of welfare among participants. However, this efficiency is a static, one-time effect which would not provide continued growth. Liberal economists, nevertheless, claim that trade also has indirect dynamic effects on the economic growth of developing countries by stimulating the creation of additional capacity (e.g., Viner, 1953; Haberler, 1959). First, trade increases factor

utilization. By opening the world markets to the products of a country, trade can lead to a fuller use of natural resources and labor previously dormant or only partially employed in the production process. Second, trade increases the factor supply by providing access to resources and products not available domestically, such as new machinery and raw materials, which consequently accelerates growth. Third, trade with more highly advanced countries promotes the transfer of both technical and administrative know-how to less developed countries. Finally, free trade exerts pressure on domestic producers to keep competitive with foreign suppliers. This competition may result in higher efficiency, which then promotes economic growth.

In addition to trade, foreign investment and aid are able to generate economic growth in developing countries. Liberals argue that one of the serious impediments to growth in the LDCs is low investment which is a result of inadequate domestic saving. The theoretical basis of this argument is provided by Every Domar (1957) and Roy Harrod (1948) who show that an economy's rate of growth is a function of its level of savings and output-capital ratio. This Harrod-Domar model considers savings and investment as the central force behind economic growth, and has greatly influenced liberal theories of development in post World War II. For instance, W.A. Lewis notes:

> The central problem in the theory of economic development is to understand the process by which a community which was previously saving and investing 4 or 5 percent of its national income or less, converts itself into an economy where voluntary saving is running at about 12 or 15 percent of national income or more. This is the central problem because the central fact of economic development is rapid accumulation (including knowledge and skills with capital).
>
> (Lewis, 1955, p155)

The problem is how to increase investment at a given level of national income and current volume of consumption (Snider, 1979, p431). Investment equals savings plus imports minus exports, and savings is income minus consumption. Therefore, if

investment is to exceed domestic savings, import must exceed export. In order to finance an import surplus over an extended period, a country needs an autonomous inflow of capital to avoid a balance of payment disequilibrium. This capital may be in the form of investment or aid (grants and loans). Thus, private capital flow and foreign aid represent a transfer of resources to recipient countries which can increase their capital stock without reducing current consumption. Further, foreign investment, like trade, may also bring technology which can increase economic efficiency and growth, while grants have an advantage in transferring capital without requiring further capital inflow or greater net exports of goods and services to cover repayment or servicing charges (Dolan and Tomlin, 1980, p46).

In short, according to the liberal perspective, external economic linkages increase economic growth in Third World countries, ceteris paribus.

The benefits of this external economic linkage with industrial countries may spread within a developing country, decreasing sectoral imbalance and unequal distribution of income over time. According to neoclassical economists, an expansion in any part of the economy tends to have favorable effects on the others. This spillover of growth is partly due to increasing income as a result of exports, which brings new investment opportunities to other sectors. The introduction of foreign investment, even if it is concentrated in the export sector, may result in enlarged employment opportunities and higher wages. Although aid has the same effects as foreign investment, its impact on sectoral balance may be more immediate since aid may go to the more underdeveloped sectors of an economy (Dolan and Tomlin, 1980, pp47-48). Furthermore, increasing the integration of an economy to the world market tends to equalize the distribution of income within the same sector. Increases in exports may raise wages, thus increasing labor's share of income. Foreign investment as well as aid , can also raise labor's share in national income by

creating more jobs and reducing the marginal product of capital (and hence its price) and raising that of labor (and hence wages) (Tomlin and Dollan, 1980, p48).

Thus, according to neoclassical economists, external economic linkages decrease social inequality in Third World countries.

The strength of liberalism is its development of a set of powerful analytical tools and policy prescriptions for the realization of efficiency and maximization of return from society's scarce resources. To this end, liberals emphasize the market and the price mechanism as the most effective means to organize economic relations and to ensure mutual gain and aggregate social benefit. However, in order to facilitate scientific research, liberals, though knowingly, rely on unrealistic assumptions, which often leads them to decrease their ability to predict social and economic phenomena. Besides explicit assumptions for each of their propositions, there are the following implicit assumptions on which liberal theories are based (Lall, 1976). First, liberal economists assume the existence of a fundamental harmony of interests between all members of society. This assumption is the basis of liberal conceptualization of the welfare of society as a whole and the individual welfare of all people in the society. However, if there is a fundamental disharmony of interests (e.g., a disharmony between social classes in capitalist society), welfare should be defined in terms of one group or the other. Furthermore, as shown by the theory of comparative advantage, a fundamental harmony of interests is also assumed to exist between states. This doctrine is, however, based on the "unparalleled expansion of production, population and prosperity" in a particular period (Carr, 1951, p44). Thus, when sustaining conditions break down, disharmony may displace harmony in the inter-state system. Second, liberals assume that it is individual utility (or preference) that should be maximized. For liberals, social groups or classes are not the relevant agent for economic analysis. Based on the combination of the first and second assumptions, liberals emphasize maximizing individual welfare as the sole condition for maximizing social welfare. Third,

the state is viewed as a provider of goods which the market does not offer (e.g., defense, roads, public health, etc.), and as a neutral organization in this process between different groups in society. Welfare economists further assume that the state is a rational actor which knows what the national interest is and tries to achieve it (or ought to). For liberals, since there is no basic conflict of interest in society, and there are no classes in the Marxist sense, the economic structure cannot influence the distribution and exercise of state power. As a result, the government is able to remain the repository of the national interest (Lall, 1976, p186). In practice, however, the state often represents particular interests and uses its power to preserve particular structures of elite dominance and privilege. Even a mild interpretation, which admits a positive and continuous overlap of the economic and political elites and some possibility for conflict of interest, casts grave doubts on the normal forms of analysis and prescriptions in liberal economics (Lall, 1976, p187).

In short, a critical limitation of liberal economics is its tendency to neglect the political framework within which economic development takes place (Gilpin, 1987, p269). The process of economic development is inevitably influenced by political factors (and vice versa), such as the domestic and international configuration of power, and the interests of powerful groups and states. Although it is not necessarily wrong to neglect these elements and focus exclusively on the market, economic factors alone will not explain successes or failures in economic development. In this sense, the liberal theory is incomplete, and cannot serve as a comprehensive approach to economic development in the Third World (Gilpin, 1987).

## The Dependency Perspective

According to the dependency perspective, the liberal theory of economic development is misleading in its implicit assumption that the underdevelopment of the Third World is independent of external forces in the larger world capitalist system. Dependency

writers emphasize the impact of the world capitalist system on internal development, stressing the different roles assumed by nations in the system and the interactions among nations that determine the development within Third World countries (Boli-Bennett, 1980, p81). Therefore, they use the world capitalist system rather than the national society as the starting point of analysis in studying political economies in developing countries.

The central thesis of the dependency approach is that the present underdevelopment of the Third World is mainly a consequence of the development of the world capitalist system in which Southern developing countries constitute the periphery subordinated to the center, Western states. Criticizing the North's development literature which assumes that the present situations of developing countries are similar to past stages of Western nations, dependency writers claim that the past of the now center nations may have been undeveloped, but were never underdeveloped before. Unlike in the past in Western countries, the present situations in the periphery have been shaped by their historical insertion into the world capitalist system, emerged with the wave of European colonization of the world which has rapidly developed a worldwide division of labor. This development of the world capitalist system is viewed as a transnational phenomena in which core capital is internalized within the economy of the periphery by the harmony of interest between external and internal privileges. As a result, the penetration of foreign power into the peripheral economy has had a decisive impact on the economy, class structure, and ultimately the entire social structure of a dependent society. Thus, dependency writers view development and underdevelopment as a partial and interdependent structure of one global system. Sunkel and Paz note:

> Both underdevelopment and development are aspects of the same phenomenon, both are historically simultaneous, both are linked functionally and, therefore, interact and condition each other mutually. This results --- in the division of the world between industrial, advanced or "central" countries, and underdeveloped, backward or "peripheral" countries.
> (Sunkel and Paz, quoted by Valenzuela et al., p499)

Although there is agreement among dependency writers about the above general arguments, a disagreement exists with respect to the effect of external economic linkages on economic growth in the Third World. The "exploitation" school maintains that the periphery is underdeveloped since it has been systematically exploited by the core (Frank, 1969, 1972; Dos Santos, 1970; Amin, 1974; Emmanuel, 1972), while the "dependent" or "associated development" school holds that dependency relations under certain conditions can lead to rapid economic growth (Cardoso, 1973; Cardoso and Falletto, 1979; Evans, 1979). A variant of the world system theory has synthesized these perspectives, predicting that dependency may promote economic growth in the short run, but that it will result in economic stagnation in the long run (Bornschier, 1981; Bornschier and Chase-Dunn, 1985).

According to the "exploitation" school, there are several mechanisms which explain how the incorporation of Third World economies into the world capitalist system results in "the development of underdevelopment" in their economies.

Frank (1969) claims that the "development of underdevelopment" occurs because the world capitalist system is characterized by a metropolis-satellite structure. In this structure, the penetration of the periphery by foreign investment drains surplus from the satellite to the metropolis through the repatriation of profits and interests. As a result, surplus is concentrated in the metropolis, while the satellite is directly impoverished and is cut off from potential investment funds, leading to the slowing down of their economic growth.

Unequal exchange theories note that exploitation is hidden in the prices at which commodities from the Third World are exchanged for commodities from industrialized countries. According to Emmanuel (1972), an unequal exchange arises because of a wide disparity in wage rates throughout the world. Emmanuel views that the prices of commodities are determined by the cost of production rather than supply and demand. The

cost of production consists of wages and constant capital (raw materials, equipment, etc.) needed for producing a particular product. Since it is assumed that the capital costs are roughly uniform, and that profit rates are similar throughout the world, the prices of commodities are basically determined by wage costs, which are, in turn, determined by the cost of producing labor power, i.e., the means of subsistence or standard of living. Because the standard of living in a country changes relatively slowly, wages do not change quickly within a country, resulting in considerably different wage rates from country to country. In this situation, trade leads to an unequal exchange, where surplus value is transferred from low-wage countries to high-wage countries.

A third explanation of the negative effects of foreign penetration on economic growth focuses upon the impact of specialization of raw materials on Third World economies. According to dependency writers, the peripheral countries have been integrated into the world economy as producers of raw materials for export to industrial countries. In this process, Third World countries have often specialized in a single raw material export, either agricultural or mineral. This specialization of raw materials has had detrimental effects on their economies for several reasons. First, according to Prebish (1950), the terms of trade for those commodities tend to decline relative to manufactured goods and capital equipment produced in the core. This is because of the inelasticity of demand for food stuffs and raw materials, as well as different wage rates between the center and the periphery. Second, the prices of raw materials tend to undergo wide fluctuations, which is likely to make economic planning more difficult for the private entrepreneurs and the government planners. Third, an economy specialized in the production of raw materials tends to grow less than one specialized in manufactured production because of their different multiplier effects (Galtung, 1971). A production which involves a high level of processing creates greater demand for related economic activities for the inputs and/or the

output side of production, however these effects are much smaller in a production of raw materials.

Finally, these exploitative relations are supported by the chain of metropolis-satellite relations between and within countries. The integration of peripheral economies into the world capitalist system has created a particular sort of local ruling class which has an interest in perpetuating underdevelopment since their power and interests are based on their connections with core countries. According to Frank,

> This colonial and class structure enables very well defined class interests for the dominant sector of the bourgeoisie. Using government cabinets and other instruments of the state, the bourgeoisie produces a policy of underdevelopment in the economic, social and political life of the "nation" and the people of Latin America.
>
> (Frank, 1972, p13)

In contrast to this "exploitation" school, the "dependent" or "associated development" school maintains that industrialization and hence rapid economic growth can take place even if a country is heavily dependent on advanced industrialized countries (Cardoso, 1973; Cardoso and Falleto, 1979; Evans, 1979). The following three preconditions are expected to be required for the realization of industrialization in the Third World (Clark and Bahry, 1983, p274). First, a country must possess sufficient economic and human resources to support indigenous industrialization. Second, a country must have a strong state that plays a major role in transforming the formerly stagnant non industrial economy by actively participating in developmental activities and by forcing concessions from multinational corporations. Third, there must be some degree of international competition, such as direct competition among foreign corporations with different national bases and/or the growing divergence of interests between Western governments and MNCs. If a country meets these requirements, according to this school, it has a chance to

promote rapid economic growth, regardless of its dependent position in the world capitalist system.

The moving force in this "dependent" or "associated development" is the multinational corporations that conduct industrial productions for the domestic markets of those peripheral countries. To the extent that the interests of these sorts of corporations are compatible with the internal prosperity of the dependent countries, they help rapid economic growth in those peripheral countries. Cardoso notes:

> [T]he growth of multinational corporations necessitates a reformulation of the traditional view of economic imperialism which holds that the basic relationship between a developed capitalist country and an underdeveloped country is one of extractive exploitation that perpetuates stagnation. Today, the massive investment of foreign capital aimed at manufacturing and selling consumer goods to the growing urban middle and upper classes consistent with, and indeed dependent upon, fairly rapid economic growth in at least some crucial sectors of the dependent countries.
> (Cardoso, 1973, p149)

This kind of development, according to this school, is still dependent development since it relies on core controlled multinational corporations with respect to technological, financial, organizational, and market connections that only multinational corporations can assure (Cardoso, 1973, p149).

The world system writers specifically allow for some upward and downward mobility within the world system. According to Wallerstein (1974), the major components in the capitalist world system are three hierarchical ordered tiers of states; the core, the semiperiphery, and the periphery. The core states tend to specialize in manufacturing, while the periphery is relegated to the production of raw materials. The semiperiphery is relatively more developed than the periphery, and is located somewhere between the core and the periphery in the international division of labor. The difference between these countries comes from the degree of the strength of the state machine in different areas which is determined by the original placement of a state in the international division of labor. In this

world system, the strong state is able to avoid the normal operation of the market whenever it does not maximize its profits, while the weak state is not able to resist external market forces and cannot effectively manage its own economy. As a result, "dependent" or "associated development" can take place only in semiperipheral countries with a strong state as well as a large domestic market.

Thus, although the "exploitation" school hypothesizes that external economic linkages are associated with economic stagnation in the Third World, the "dependent" or "associated development" school as well as the world system school holds that external economic linkages promote economic growth in the semiperiphery.

Recently, these different propositions have been explained in a single theoretical framework by Bornschier (1981). Employing Domer's growth model, Bornschier distinguishes between short-term and long-term growth consequences of the dependent industrialization. In the short run, the effect of foreign direct investment on economic growth is positive; the higher the net investment of MNCs in the periphery is, the more rapid economic growth for each country. Nevertheless, according to Bornschier, this effect reverses in the long run. In the periphery, the capital and applied know-how of MNCs are sector-specific, and their interests in investments are tied to specific stages within the product cycle. As a result, MNCs are not likely to move to other sectors or industrial branches within the same country, because other fields of activities do not provide monopolistic advantages or are already occupied by other monopolies. Therefore, in the long run, the threat of overcapacity arises, which leads MNCs to slow down fresh investment in a particular country. As investment declines (or even net capital repatriation takes place), economic growth also declines. This effect is more significant if a country relies its large proportion of investment on MNCs.

From this perspective, Bornschier maintains that although a higher level of foreign investment is positively related to economic growth in the short run, it has negative effects on growth in the long run.

Although dependency writers, in this way, disagree about the effects of external economic linkages upon economic growth in the periphery, there is unanimous agreement that increasing external economic relations are adversely related to social equality in Third World countries.

There are several mechanisms proposed by dependency writers designed to explain the negative effects of external economic linkages on social equality in the periphery. First, long-term external economic relations have formed a special kind of class coalition within integrated segments against the marginalized majority of the population in the periphery. In this situation, increasing dependence leads to more severe inequality, since ruling groups, with power backed up by alliances with the core, can obtain a large share of the national income and prevent income redistribution.

Second, as a result of the integration of Third World economies into the world capitalist system, the periphery has a special sort of economic structure marked by severe internal structural "distortion" (Duval et al. 1981). This includes: (1) uneven development, where development is much greater in some sectors than in others; (2) disarticulation, in which the economy is poorly integrated and the various sectors tend to be poorly connected; (3) sectoral heterogenity, where the returns to factors of production, especially labor, will be much greater in some sectors than others. Under these conditions, a small number of labor elites emerges who work in some sectors (e.g., export or manufacturing) for wages substantially higher than those who work in other sectors.

Third, multinational corporations are also interested in inequality within a peripheral country (Bornschier and Chase-Dunn, 1985). In the core, MNC's are interested in equality among populations because the wealthier masses can afford to purchase MNC-produced

goods. In the periphery, however, MNCs are not interested in income equality because elite demand is thought to be the only effective demand for their products. This view on the part of MNCs is strengthened by the "conspicuous" demand of the wealthy segment in the periphery. Since their frame of reference is the world society, and not a domestic one, they tend to strive after the bourgeois life-style of this reference system. These factors also contribute to a higher income gap and a more intense marginalization in poorer countries (Bornschier, 1983, p13).

Fourth, inequality is also exacerbated by class relations in dependent countries (Rubinson, 1976, p644). The labor force as a whole has less bargaining power in relation to its employers because they face a smaller, more homogeneous set of employers. This is more significant in dependent countries in which the state is relatively weak. Because the weak state cannot escape the control of the dominant class, workers are not able to effectively use the state to apply political leverages in order to meet their demand for higher wages. This also hinders the equalization of income distribution in dependent countries.

For these reasons, the dependency perspective holds that external economic linkages are negatively associated with social equality in Third World countries.

A strength of the dependency perspective is its emphasis on an aspect of domination and exploitation of the periphery by the core in the international system as well as within the political system. Since liberals assume the existence of a fundamental harmony of interests between all members of society and between all states, they tend to separate the economy from politics, accepting the existing sociopolitical framework as a given. As a result, liberals are likely to disregard injustice and inequality as outcomes of economic activities. However, as dependency writers stress, disharmony arises with respect to the distribution of benefits and production as well as power relations, namely, who dominates whom. The convenient fiction of a competitive market price simply does not hold because the bargaining strength influences, to a large extent, the allocation of benefit. Regarding

economic problems at the center of political life, dependency writers sensitize us in a way in which economic relations are transformed into power relations which may shape the distribution of wealth among states and political, social, and economic structures in the periphery.

Nevertheless, the dependency writers have been criticized in many respects, with regard to their lack of conceptual clarity, their use of master concepts (e.g., dependency) to explain everything wrong and undesirable in the periphery, their deterministic nature of their mode of explanation, and their failure to offer specific mechanism through which world capitalist systems distort economic developments in the Third World.

However, the most critical limitation of the dependency perspective, in my view, is that dependency writers, like liberals, basically deny the autonomy of the political spheres and the possibility of an independent and autonomous political leader who has power and objectives distinct from any particular force. Liberals emphasize the maximization of individual choice and free markets in which the government is treated as merely a means or an agency through which individuals achieve their ends. On the other hand, dependency writers (the "exploitation school") view the state as simply another tool used by social classes to increase their power and wealth. The state is regarded as a servant of particular economic interest. The possibility of autonomy of the state in class society has been denied in this conception of the state. Even though they admit relative autonomy of the state (such as the "dependent" or "associated dependent" school), it works only for preserving the general structure of capitalist society.

Nevertheless, state forms and actions are not simply a reflection of the social structure, whether they are conceived in terms of the level of development, class structure, or the level of foreign economic penetration. State authorities may at times utilize their autonomous power in order to mold processes of social and economic change. The pattern of Third World economic development, therefore, reflects not only internal socio-economic

variables and/or external economic linkages, but also actions undertaken by state authorities (Kohli et al., 1984, p303).

## The Statist Perspective

One of the significant characteristics of recent studies of Third World political economies is a convergence on the state as an object of inquiry from different theoretical traditions. This emphasis on the state in current studies is a reflection of the growing recognition of the importance of political, as opposed to economic and social, determinants of social and economic changes in the Third World. Since the state is a point at which political power is concentrated, it is viewed as the most effective mechanism to resist metropolitan pressures and promote development or shape economic and social changes in the periphery. The following two trends can be distinguished which currently lay particular emphasis on the state.

The first trend is a Marxist-inspired political economy which draws heavily on Marxist political and social analysis without sharing its value system nor its assumption of an inevitable revolutionary process (Randall and Theobald, 1985, p172). This includes Philippe Schmitter, Alfred Stepan (1978), Guillermo O'Donnell, Ellen Kay Trimberger (1978), and Theda Skocpol. Since much of this writing has centered in Latin America, the discussions of state have frequently acquired a distinctly authoritarian overtone. Although they rarely state outright approval for authoritarian rule, there is a clear indication that it may be historically necessary (Randall and Theobald, 1985, p172).

The precursor to this authoritarian statism was the interest in state corporatism in the early 1970s, which since then has given way to the concept of bureaucratic authoritarianism. The vogue for this bureaucratic authoritarianism was a response to the emergence of apparently stable and economically 'successful' military regimes in Brazil after 1964, Argentine after 1966, and Chile and Uruguay after 1973. Whereas the approach

based on state corporatism or bureaucratic authoritarianism focuses on the state in their analysis of Third World politics, it did not address the question of what the state is and to what extent it has separate interests of its own (Randall and Theobald, 1985, pp174-75).

The most recent original contribution to answering the above question was given by Skocpol. She defines the state as "a set of administrative, policing and military organizations headed and more or less coordinated by an executive authority" (1979, p29). Any state, according to Skocpol, has its own distinctive functions, namely, to maintain political order and to deal with other states. For these functions, the state fundamentally extracts resources from society and deploys these to create and support coercive and administrative organizations. As a result, the social formation of state power and that of class power do not always overlap. Thus, the state at times may actually hinder the interests of dominant social classes especially in periods of crisis in which the state enforces concessions to the lower classes, or respond to external military pressures or opportunities. As a consequence, Skocpol argues, the state can be potentially autonomous from the entire class structure or mode(s) of production.

Thus, Skocpol challenges the Marxist concepts of the class nature of the state. According to Hamiliton, there are three conceptualization of state autonomy (Hamiliton, 1982, p12). First, state autonomy exists if those who control the state apparatus are able to use it for ends (e.g., to pursue specific state interest) other than those of the dominant class. Second, state autonomy exists if the state acts independently of direct (or indirect) influence or intervention by the dominant class. This conception is called instrumental autonomy. Third, state autonomy exists if the state acts for ends opposed to the actual or perceived interests of the dominant class. This state autonomy is called structural autonomy. The third conceptualization of state autonomy allows the state to transcend structural boundaries, threatening the interests of the dominant class or even eliminating its own existence. The first and second conceptions of state autonomy are not problematic

from the Marxist perspective so long as state interests do not conflict with dominant class interests or the the structural needs of a capitalist system. The third conceptualization of state autonomy, however, contradicts the Marxist perspective which regards only class struggle as the moving force for structural transformation. Skocpol appears to be defending this third conception of state autonomy, suggesting that state autonomy is likely to occur in periods of crisis (internal or external) in which the dominant class is weakened and even the mode of production may be challenged or indetermined.

Marxist-inspired statists claim that this state autonomy (or at least relative autonomy of the state vis-a-vis the dominant class) and strong state capacities to pursue its policies are necessary conditions for effective state intervention in order to promote growth and to redistribute wealth (Rueschemeyer and Evans, 1985, p68).

According to Rueschemeyer and Evans, in order to undertake effective interventions, the state must have a capable bureaucracy with sufficient corporate coherence, which largely determines the capacity of a state to pursue its policies. Furthermore, a certain level of autonomy from the dominant class is necessary to realize policies aimed at capital accumulation and redistribution of wealth since those policies tend to sacrifice the interests of certain segments of the dominant class. This state autonomy may increase when there is a serious division within the dominant class and/or increased pressure from subordinate classes, which may induce the dominant class to grant greater autonomy to the state, or in which subordinate classes acquire sufficient power to undermine monolithic control by the dominant class (Rueschemeyer and Evans, 1985, p64).

Horowits and Trimberger (1976) emphasize a unique mission of the military bureaucrat as an element guaranteeing state autonomy. This is because military elites are more likely than civil bureaucrats to be free of ties to the dominant class, and because they have forces needed to destroy both internal and external class alliances blocking integrated

economic development. From this perspective, liberal parliamentary regimes, Horowits and Trimberger argue, are not appropriate to promote economic development in the Third World. Economic development involves the accumulation of capital and adoption of more effective productive processes, which not only leads often to the demise of landed aristocracy but also tends to threaten the bourgeoisie as well. Because of the risks of national growth and economic calamity, the bourgeoisie find it safer to invest profits in foreign security markets or overseas banks, resulting in the shortage of capital available to an earlier "entrepreneurial" bourgeoisie. A parliamentary regime, according to Horowits and Trimberger, allows this kind of bourgeoisie as well as precapitalist classes tied to external capital to dominate the state apparatus, possibly using the state to oppose development. In this context, the military bureaucracy becomes the necessary pivot of rule by liberating the state from class fetters in order to promote economic development. In this process, however, an autonomous military bureaucracy must contend with existing and emerging class forces, so that the pattern of development is determined by the strength of these classes, and the way the military bureaucrats relate to them (Horowitz and Trimberger, 1976, p229). Thus, from this statist perspective, the relationship between the state and the dominant class is an independent variable determining the type and rate of economic development.

The second trend focusing on the state comes from realist scholars in the field of International Relations, such as Krasner, Gilpin, and Katzenstein. In International Relations, realist writers traditionally view the state as an autonomous actor. The objective sought by the state, for them, is called national interest which cannot be reduced to some summation of private desires (Krasner, 1978a, pp5-6). This conception of the state and national interest significantly differs from that of liberal and Marxist approaches in Political Science. For liberal political scientists, the state is viewed as a referee among competing social groups or at worst a cipher (e.g., Bureaucratic Politics). For Marxists, the policy of

the state is a reflection of either the preferences of the dominant class or the structural needs of a capitalist system (Krasner, 1978a, p5). From this perspective, both liberal and Marxist writers explain state actions in terms of private pressures or needs. Thus, when they explain a particular state action, they focus on the underlying social structure and political mechanism through which particular societal groups determine the state behavior. In this process, the concept of national interest is rejected, since they assume that the state does not have objectives independent of societal preferences (Krasner, 1978a, p5). In contrast, assuming the state as an autonomous actor from any particular societal group, realists explain and describe political phenomena by demonstrating empirically a consistent set of goals sought by political leaders and by defining the conditions under which they can attain their goals within international and domestic constraints (Krasner, 1978a, p6).

Based on this realist paradigm, Krasner (1878a) argues that a central objective pursued by political leaders in the United State since the second World War has been the creation and maintenance of a liberal international economic regime. However, a weak domestic political system in the United States limits central decision makers' ability to extract resources from their society when this goal conflicts with private interests. For Krasner, the fragmentation of power and authority is the central feature of American politics. In this system, public officials were constantly faced with this domestic political constraint because of the high ability of private groups to check state initiatives. As a result, the American political system tends to prevent state autonomy and is likely to decrease the actual power of the state. This is more apparent in the area of foreign commercial policy where decisions involved Congress and executive agencies susceptible to societal pressures. Increasing incoherence in American politics since the 1970s has been a product of this weakness in the US political system.

Thus, for Krasner, the centralization of power in the political system is required in order to increase state autonomy and the actual power of the state vis-a-vis society.

The contribution of the statist perspective is its emphasis on critical roles of the state which may shape patterns of political, social, and economic development in Third World countries. Although liberal economists and dependency writers have disagreed about the effects of external economic linkages on peripheral economies, they have shared one important assumption. They have basically denied the autonomy of political spheres and the possibility of an independent and autonomous state with power and goals distinct from any particular societal force. Unlike liberal or Marxist traditions, the statists view the state as a central actor in all governing coalitions and a critical institution in all-policy networks. Statist writers claim that the state is not merely an arbitrator among competing interests, nor a servant of particular economic groups. For them, it is the state that organizes the society, so that private preference is shaped by public policy. Based on this assumption, scholars taking the statist perspective have maintained that a strong state is an indispensable prerequisite for success in instituting comprehensive political reforms, helping to shaping national economic development, and bargaining with multinational corporations. In this way, the statist perspective offers significant insights for understanding patterns of Third World economic development.

Nevertheless, statist writers tend not to distinguish between increasing state power and the direction and/or effectiveness of state actions. Two aspects of state power appear to be recognized in their literature: infrastructural power and the centralization of power. Infrastructural power refers to power by the state to penetrate and centrally co-ordinate the activities of civil society through its own infrastructure (Mann, 1984, p190). When many statist writers maintain that the weakness of the state is a main cause of poor economic performance in developing countries, they usually have this aspect of state power in mind. Although strong infrastructural power may be a necessary condition for economic development in the Third World, increasing this aspect of state power alone does not tell the direction and/or the effectiveness of the state actions. Strong states may promote

economic growth and equal distribution of wealth, but they may also retard growth and aggravate social inequality in developing countries. In order to account for the direction and effectiveness of state actions, we need to pay attention to those who control the state.

In this respect, the second aspect of state power, the centralization of power in the regime, may be an important determinant of the direction and/or effectiveness of the state actions. The centralization of power is concerned with to what extent a top leader is able to dominate his immediate political environment. A tendency of statist arguments is its emphasis on power centralization as a condition of efficient state intervention in the economy (e.g., Krasner, 1976). A variant of this proposition can be found in the authoritarian model of economic development (e.g., Horowitz and Trimberger, 1976).

However, an increasing centralization of power does not necessarily produce good economic performance of a regime. Without a mechanism for checking the abuse of power, state bureaucrats or political leaders tend to be excessively linked to a small number of economic elite, in which the state's actions might only serve the interest of those elites at the expense of a large number of masses. Since the system is likely to lack the ability to curb the excesses of personal and parochial desires, the politics tend to be characterized by conspiracy, factional politics, clientalism, corruption, and so forth. Furthermore, in regimes with high centralization of power in the hands of a top leader, the information flow is likely to be distorted, which may make it difficult to pursue rational policy making. As a result, there is a tendency to waste a nation's resources extravagantly in extremely centralized regimes.

Thus, although some degree of regime centralization is necessary for effective policy making and implementation, if power is too centralized, negative aspects of centralized regimes may become prevalent. Therefore, the classification of a country by centralized/competitive regimes is not able to account for large differences within centralized regimes. This is also true for the dichotomy of authoritarian/democratic regimes.

Clearly there are different types of authoritarian regimes: some are highly centralized while others allow some dispersion of power or authority. There are also different sorts of democratic regimes: some are very united while others are very fragmented. In order to account for these differences, we need to classify countries by at least three or four regime types.

## The Political Economy Perspective

As discussed above, three major theoretical perspectives have each strengths and weaknesses in explaining the effects of external economic relations of developing countries on their economic growth and social equality. The major task of this study is not to support one approach over the others but to find a way to integrate significant insights of these competing three perspectives. To this end, I will briefly explain the basic features of the new political economy perspective which lay the foundation of my hypotheses that will be tested in the later chapters.

The political economy approach is also called "rational choice" or "public choice" approach, which represents the most distinctive and central development in current "liberal" thinking in explaining patterns of economic development in Third World countries. Although liberals previously focused on private or interest groups, the growing number of liberal scholars now emphasize the strategy of public authority in which public policy is viewed in a problem-solving and public choice context. This shift of emphasis is a product of general development in political science, such as the growing popularity of rational choice models, the introduction of economic concepts, the burgeoning of the fields of public studies, on the one hand, and the sharpening recognition of the "primacy of politics," specifically of state intervention in economic development, on the other (Rundall and Theobald, 1985, pp175-76).

The political economy approach is based on the individual actor who pursues his/her perceived interests. The basic assumption is that man is an egoistic, rational, utility maximizer, and relates means to ends as efficiently as possible. (Staniland, 1985, p36). In other words, "the actor is assumed to have certain specified properties including a set of tastes or preference orderings and a capacity for rational decisions or the ability to choose the most efficient resolution of his choice dilemmas" (Mitchell, 1968, p82). Thus, this approach is based on the fundamental philosophical principles of liberal economics. However, the political economy approach differs from both the purest liberals who expect harmony to result from the general pursuit of self-interest and welfare economists who assume the possibility of identifying and realizing a "general welfare function" (Staniland, 1985, p59).

There are two major actors in this perspectives, namely, interest groups and public officials. Interest groups are formed by individuals seeking specific self-interested goals in order to acquire access to public resources (Olson, 1965). As a member of interest groups, individuals utilize money, expertise, political connections, votes, and other resources to extract benefits, or rents, from government through elections and other direct forms of political involvements, or through the impositions of rewards and sanctions on public officials (Colandar, 1984; Srinivasan, 1985). On the other hand, public officials who are basically concerned with remaining in power (Ames, 1987; Anderson and Hayami, 1986; Alt and Chrystal, 1983) consciously seek to provide benefits to a range of interests they believe will help them retain office. Thus, they systematically favor certain interests over others, maximize their returns from the allocations of public expenditures, goods, services, and state regulation in order to attract and reward supporters (Anderson and Hayami, 1986; Bates, 1981). As a result, politics become the sum total of individuals seeking special advantage through public policy and individual officials seeking to benefits from public office through reelection and rents (Grindle and Thomas, 1991, p25).

One of the best known application of the political economy approach to Third World society is Robert Bates' Markets and States in Tropical Africa. In this book, Bates argues that the crisis of food production in Africa is due to policies which reduce the incentives to smaller producers of both food crops and the exported cash-crops on which the economies and exchequers of many African states depend. In order to promote the short-term political interests of those in power, governments keep food prices artificially low, and use marketing boards to extract large surpluses from cash-crops farmers. At the same time, the governments systematically favor urban and industrial interests as well as some larger farmers, and use agricultural extension services and subsidies as political weapons. In response to these governments' policies, peasants give up growing unprofitable crops, look for better outlets for their produce, or they give up farming and migrate to the town. In other words, peasants "use the market against the state", based on the rational calculation of their individual interests.

In this way, Bates emphasizes the rationality of individual action and incentives for individual initiative to explain policy outcomes in African states. While African governments may be able to keep power by favoring urban interests over those of peasant farmers, in the long run, their policies will create scarcities, force up prices, require food imports, and lead to shortages of foreign exchange - all of which will obviously threaten their popularity among the very groups from whom they curry favor (Staniland, 1985, p59). The pursuit of individual interest may not only lead to conflict but also undermine its longer-term economic and even political interests (Staniland, 1985, p58).

Bates shows that politicians choose policies both to secure social objectives and to protect tighten their hold on power. They tend to treat the market as "an instrument of political control" and their intervention is likely to result in scarcities of some kind, and such scarcities may provide the resources for political patronage and corruption. In other words, they create 'policy-generated rents' which can be selectively allocated to reward

friends and punish enemies. (Staniland, 1985, p59). Thus, politically rational behaviors tend to produce economically irrational ends. However, politicians may come under increasing pressure to extract and spend public resources to maintain the political support of powerful interest groups. Consequently, politicians become trapped in a cycle of flagging support, declining legitimacy, and increased expenditures, but are unable to alter policies because of the political power of the beneficiaries of the status quo. This process may generate increasing economic inefficiencies, extensive political instability, widespred corruption, and successive regime changes (Grindle and Thomas, 1991, p25).

In this way, the political economy perspective offers a coherent and relatively parsimonious explnation for seemingly nonrational decision making by government (Gindle and Thomas, 1991, 25). This approach is able to respond to such questions as "Why should reasonable men adopt public policies that have harmful consequences for the societies they govern?" (Bate, 1981, p3). In order to solve the problem of the state which distort the resource allocation, state activities in the market should be limited (Buchanan, 1980). Thus, the political economy perspective not only provides an explanation for the willingness of public officials to respond to the pressures of various societal forces and for policy choices that are detrimental to society as a whole, but also offer an solution to the problem of the state and the capacity of policy to distort resource allocation (Grindle and Thomas, 1991, p26).

However, the political economy perspective is much less able to explain how some policies and actions of the state can lead to broadly beneficial outcomes. At best, the approach explains why "the public interest" is not often achieved (Grindle and Thomas, 1991, p26).

In the fourth chapter, I will develop a framework that is an attempt to overcome the weakness of this society-centered explanation of policy choice in which policy elites are creatures of vested societal interests. I will use the same basic premise of rational actor

model as the political economy perspective. But I will try to offer an explanation of how policies and actions of some Third World states can lead to broadly beneficial outcomes by using resources extracted through economic linkages with developed countries. External economic linkages through trade, investment, and aid to industrialized countries provide with resources political leaders in developing countries in order to pursue their immediate political interests, namely staying in power, regardless of what their long term objectives are. Thus, external economic linkages to industrialized countries may have negative economic implications in some developing countries. However, the leaders' pursuit of immediate political interests may not necessarily produce harmful effects on their country's economies. This is because the ways of using external resources to pursue immediate political interests are different in different regime types, since they offer different constraints to political leaders. In order to account for the different effects of external economic linkages on Third World countries, I will introduce a new classification of regime types which may affect the direction and effectiveness of state power and mediate the relations between external economic linkages and Third World economies.

Before I explain my framework in more detail, I will review previous major quantitative studies which were conducted over the past two decades in order to test propositions drawn from the liberal, dependency, and statist perspectives.

# Chapter III
## REVIEW OF EARLIER QUANTITATIVE STUDIES

In conjunction with the increasing popularity of dependency theories of national development, a large number of cross-national empirical studies have been conducted by North American and European scholars in order to test some of the propositions provided by the dependency as well as the liberal and statist perspectives. Most of these studies have been conducted to investigate the effects of trade, direct investment, and foreign aid upon the rates of economic growth and inequality in peripheral countries. Although they are a limited range of themes discussed by each theoretical perspective, this narrow focus has produced a coherent group of studies that can be fruitfully compared. This body of literature shows a process of collective refinement and estimation techniques. Furthermore, since these studies have built upon each other, there has been both a good deal of replication of results and extension of hypotheses that have produced theoretically more meaningful results (Rubinson and Holtzman, 1981, pp86-87).

In this chapter, I will review these studies in order to find out what can be concluded from previous quantitative studies about the relationships between external economic linkages and Third World economies. To this end, I first examine the previous findings about the effects of trade, foreign investment, and aid upon economic growth in the periphery. The second part examines the effects of the same independent variables on equality within peripheral countries. Third, I discuss major studies which attempt to assess

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the effects of state power on growth and equality in the dependency contexts. Finally, I point out the problems of previous quantitative studies, and suggest a possible research design that may correct those flaws.

## Economic Growth

With respect to the effects of trade on economic growth in the Third World, previous findings show that commodity concentration and trade composition (specialization of raw materials) have negative effects on growth, while trade intensity (the level of trade) and partner concentration have no effects.

All the studies of trade intensity find that the level of trade has no effect on economic growth (Delacroix and Ragin, 1981; Khalaf, 1979; McGowan and Smith, 1978; Ragin and Delacroix, 1979; Rubinson, 1977; Snider and Kick, 1970). However, this may need a qualification. According to Ragin and Delacroix (1979), trade intensity has significant positive effects within the poorest peripheral countries. From these findings, Rubinson and Holtzman (1981) concluded that if "a country has very little resources, any activity is better than none, " but that "the gain from trade disappear once a country has reached a certain level of development" (1981, p93).

The findings of previous quantitative studies on the effects of export partner concentration on economic growth have produced mixed findings. Walleri (1978) and Rubinson (1977) find negative effects, whereas Kaufman (1975) and Ray and Webster (1978) find positive effects. Alschuler (1976) and Khalaf (1979), on the other hand, report no effects. There seems not to be any systematic and significant differences among these studies which can explain this totally mixed set of findings in a meaningful way (Rubinson and Holtzman, 1981, p94).

However, trade commodity concentration seems to have a significant negative effect on economic growth in the periphery. Alschuler (1976), Delacroix and Ragin (1981),

Khalaf (1979), Ragin and Delacroix (1979), and Walleri (1978) find that countries with exports concentrated in a few commodities are likely to have less rapid economic growth than those with a greater diversity of exported commodities. Although there are three studies reporting no effects (Kaufman et al., 1975; McGowan and Smith, 1978; Ray and Webster, 1978), Ray and Webster use unreliable GNP data, and the other two studies employ a questionable time ordering for their measurements. Thus, we may be able to conclude that there is a systematic tendency that countries exporting a limited variety of goods have lower rates of economic growth than countries exporting a great variety of commodities (Rubinson and Holtzman, 1981, p94). This conclusion, nevertheless, seems conditional. Ragin and Delacroix (1978) and Delacroix and Ragin (1981) find that commodity concentration has no effect on growth within the poorest stratum of peripheral countries.

Trade composition also seems to have a significant effect on growth. According to the study by Alschuler (1976), Delacroix and Ragin (1981), Steiber (1979), and Walleri (1978), there is a tendency that countries exporting raw materials, rather than manufactured products, have lower rates of economic growth than countries exporting manufactured products than raw materials. Although there are several contradictory findings (Delacroix, 1977; Delacroix and Ragin, 1978; Ray and Webster, 1978), Ray and Webster (1978) use unreliable data, and Delacroix and Ragin altered their findings in later works (1979, 1981). Thus, we can draw a conclusion that the international division of labor, unlike the liberal prediction, tends to operate unfavorably to many Third World countries exporting raw materials and importing manufactured goods. This conclusion again seems to be conditional on a level of development: within the poorest countries, trade composition has no effect (Ragin and Delacroix, 1979; Delacroix and Ragin, 1981).

With respect to foreign investment and aid, there is nearly an unanimous agreement that they are associated with higher rates of economic growth in the short run. The positive

relationship between the inflow of foreign investment and economic growth is found by Berweger and Hoby (1978, reported by Bornschier et al., 1985), Bornschier (1980, 1981), Dolan and Tomlin (1979), Jackman (1982), Kaufman et al. (1975), Meyer-Fehr (1978, 1979, reported by Bornschier et al., 1985), Papanek (1973), Ray and Webster (1978), Stoneman (1975), and van Puijenbroek (1984, reported by Bornschier et al., 1985). The positive relationship between inflow of foreign aid and economic growth is found by Kaufman et al. (1975), McGowan and Smith (1978), Papanek (1973), Ray and Webster (1978), Stoneman (1975), and Szymanski (1976). The only exceptions are the findings of Griffin and Enos (1970) for aid, and of Stevenson (1972) for investment which show the negative relationship between foreign investment or aid and economic growth. However, Stevenson uses only seven Latin American countries and Griffin and Enos employ only twelve countries as their samples, so their findings may be due to sampling errors (Bornschier et al., 1978, p667). Thus, from these findings, we may conclude that the immediate effect of the inflows of foreign capital is an increase in the rate of economic growth (Bornschier et al., 1978, p667).

In the long run, nevertheless, penetration by foreign capital seems to have a negative effect on economic growth. The majority of studies find that a large accumulated stock of foreign capital depresses subsequent growth (for investment, Alschuler, 1976; Berweger and Hoby, 1978; Bornschier, 1975, 1980, 1981; Bornschier and Ballmer-Cao, 1978; Chase-Dunn, 1975a; Delacroix and Ragin, 1981; Dolan and Tomlin, 1980; Evans, 1972, reported by Bornschier et al., 1985; Gobalet and Diamond, 1979; Jackman, 1982; Meyer-Fehr, 1978, 1979; Rubinson, 1977; Stoneman, 1975; Timberlake and Kenter, 1983; van Puijenbroek, 1984; Weede, 1981a, 1981b; Weede ;and Tienfenbach, 1981b; for foreign aid, Chase-Dunn, 1975; Rubinson, 1977; Stevenson, 1972). However, the positive effects from the stock of foreign investment on economic growth are found by Kaufman et al. (1975), McGown and Smith (1978), Ray and Webster (1978), and

Szymanski (1976). On the other hand, negative but insignificant effects of the stock of foreign investment are found by Jackman (1982), Weede (1981a, 1981b, reported by Bomschier et al., 1985), and by Weede and Tiefenbach (1981b).

Some of the contradictory findings can be reconciled by comparing the results from ordering them in terms of sample composition (Bomschier et al., 1978; Bomschier and Chase-Dunn, 1985). Four studies which found positive associations between the stock of foreign investment and economic growth investigate only countries of a specific geographical region. Kaufman et al., Ray and Webster, and Szymanski study countries in Latin America, and McGowan and Smith study only African countries. All studies unrestricted by geographic region unanimously find negative effects of capital penetration on economic growth. Even in studies of separate geographical regions, there are contradictory findings. Alschuler and Evans use only Latin American countries as their samples and report negative associations. Stoneman, and Dolan and Tomlin present separate results according to geographical subsamples, showing: negative associations in Latin America, positive associations in Africa, and both positive and negative associations in Asia.

There are several problems in previous studies of separate geographical regions. First, some studies use a questionable measurement of foreign direct investment. In the studies of Latin America, Evans, Kaufman et al., Ray and Webster, and Szymanski employ figures for the stock of United States capital as a proxy for the total foreign stock. This is a problematic proxy. Second, there is the problem with small samples in which the magnitude and direction of estimates can be largely affected by minor specification errors in the equation and by the effects of outliers or the exclusion of particular cases (Russett, 1983, p557).

A careful analysis by Bomschier and Chase-Dunn (1985) reports several factors which are partly attributable to inconsistent results of previous studies of separate

geographical regions. The results of studies of African countries (three studies reporting positive association) can be accounted for by the different sizes of the market or levels of development which mediate the relationship between foreign capital penetration and economic growth (the negative effect is strong only in larger peripheral countries). African countries, as well as several Asian countries, are very small with respect to market size and poorest in the world, while Latin American countries have much greater market size and per capita income. When smaller African countries are excluded from the analysis, the results show the same significant association as the results using unrestricted samples (Bornschier and Chase-Dunn, 1985, p101). Furthermore, the contradictory findings of the studies in Asia (one positive and the other negative) can be explained by the possibility that special cases may dilute the pattern. When Bornschier and Chase-Dunn excluded special cases among Third World countries (such as Hong Kong and Singapore which are city-states playing a specialized entrepot role in the world economy; Israel, Jordan and Syria which composed a war zone during the period studied; and Saudi Arabia which intensely specializes in the export of oil), they found that the negative effects on Asia were as strong as for all the peripheral countries (1985, p101).

Although all studies with unrestricted samples report negative associations between foreign capital penetration and economic growth, Jackman (1982), Weede (1981a, 1981b), and Weede and Tiefenbach (1981b) report that it is not statistically significant. According to Jackman, when total population is controlled, the apparent negative relation of foreign investment stocks to growth wash out. He also argues that birth rates should be controlled since unchecked population growth, not MNC penetration, restrains per capital growth. Weede and Tienfenbach (1981b) maintain that the reported findings of the negative effects of penetration on growth lacks robustness and that its effect virtually washes out when one includes the military participation ratio as a control variable. According to Weede and Tiefenbach, this control variable is important since threats from the international

environment and widespread military service may not only enforce social discipline but also provide some incentive for productive and co-operative relations among different classes. Nevertheless, as Bornschier replied, there is a critical problem in the research design of both studies. Both Jackman and Weede and Tiefenbach misspecified the model by using a growth rate(1960-1977) initiated before the investment (1967), in which penetration in 1967 could not have effected growth between 1960 and 1967. Since fresh investment is associated with growth and adds to foreign capital stocks, the inaccurate use of a time dimension suppresses the negative effects of accumulated foreign capital stocks (Bornschier and Chase-Dunn, 1985, p86). Furthermore, Weede and Tiefenbach fail to control for the short-term positive effect of a continuing inflow of investment, while Jackman, on the other hand, does not effectively control the earlier relationship between the level of development and the degree of foreign investment penetration. Since higher levels of development attract greater amounts of foreign investment, if prior levels of economic development are not controlled, the effects of foreign investment on economic development are confounded with the effects of economic development on foreign investment (Rubinson and Holtzman, 1981, pp96-97).

In short, all previous quantitative studies, unrestricted by geographical region, find negative effects of penetration by foreign capital on economic growth, and those which do not reach statistical significance have shortcomings in their test designs (Bornschier and Chase-Dunn, 1985, p88).


## Social Equality

In addition to the effects of external economic linkages on economic growth, a number of scholars has conducted quantitative empirical research on the effects of external economic relations on social equality within a peripheral country.

With respect to the effects of various measures of trade linkages, the results are totally mixed. The positive and significant effects of trade intensity on equality is found by Dolan (1980, for sectoral equality), Stack (1978), Rubinson (1976), but others report it is not statistically significant (Dolan, 1980, for income equality; Chan, 1989; Bornschier and Hartlieb, 1981, reported by Bornschier and Chase-Dunn, 1980). Kaufman et al. (1975), Walleri (1978), and Stack (1982) find that partner concentration increases sectoral inequality (Kaufman, and Walleri) and income inequality (Stack), while Dolan and Tomlin (1980), and Bornschier and Hartlieb (1981) report they are not significant effects. In terms of commodity concentration, Walleri (1978) finds a significant negative effect on sectoral equality, but Dolan and Tomlin (1980), and Kaufman et al.(1975) report it is not significant. Further, Dolan and Tomlin (1980), Stack (1982), and Bornschier and Hartlieb (1981) report that commodity concentration has no significant effect on income inequality. As for the effects of trade composition, Walleri (1978) finds that specialization of raw materials increases sectoral inequality, and Bornschier and Hartlieb (1981) report that it also results in more income inequality within a peripheral country. Weede and Tiefenbach (1981a), however, report that trade composition has no effect on income inequality.

In short, the results on the effects of trade linkages on social equality are inconsistent, and we cannot draw a conclusion that trade linkage has some systematic effect on equality in a peripheral country.

With respect to the relationship between foreign capital penetration (foreign investment and aid) and equality, however, the majority of studies reports the penetration results in greater inequality within a peripheral country. This relationship holds in terms of three different measures of equality: personal income distribution (Ballmer-Cao, 1979, reported by Bornschier et al., 1985; Bornschier, 1978, 1981, 1983b; Bornschier and Ballmer-Cao, 1978, 1979; Chase-Dunn, 1975; Dolan and Tomlin, 1980; Evans and Timberlake, 1980; Rubinson, 1975; Sullivan, 1983), sectoral income distribution

(Bornschier, 1975; Chase-Dunn, 1975a, 1975b; Dolan and Tomlin, 1979; Kaufman et al., 1975), and agricultural land ownership distribution (Bornschier, 1978; Bornschier and Ballmer-Cao, 1979; Kaufman et al., 1975). The negative effect of foreign aid on equality is also found by Chase-Dunn (1975) and Rubinson 1976).

The only exception to the above results is reported by Weede and Tiefenbach (1981a) who find inconsistent and statistically insignificant effects by using three different sources of data on income inequality and by including the military participation ratio as a control variable in the equation. A shortcoming of their research is that they analyze a sample of the whole world, including both developed and underdeveloped countries. Since it is expected that foreign investment has a positive effect on equality in developed countries, this effect cancels out the negative effect of the foreign investment on equality in underdeveloped countries, resulting in no effect in a sample of the whole world (Bornschier, 1981, p283). Using only the most reliable data and a properly specified control variable (a polynominal function of GDP per capita) suggested by Weede and Tiefenbach, Bornschier (1981c) shows that there is a statistically significant negative effect between foreign investment penetration and equality on peripheral countries even when controlling military participation ratio.

There are two studies that also do not support the proposition that foreign investment increases inequality in the Third World. Chase-Dunn (1975) and Dolan and Tomlin (1980) find negative associations between investment penetration and equality but not statistically significant ones. According to Bornschier and Chase-Dunn (1985), there are several factors that can probably explain their discrepant findings. As for the study of Chase-Dunn, he employs only 31 peripheral countries in his sample. This is probably why he fails to reach a statistical significance. Dolan and Tomlin, however, use a larger sample of 48 developing countries, and report that the effect is small and statistically insignificant. Their problem is probably their use of certain incomparable data on income inequality.

Some of their income distribution data are based on studies of the urban and non-agricultural segments only, and not on studies concerning the entire segments of countries. Thus, as Bornschier and Chase-Dunn argue, their discrepant finding is possibly sample specific.

In short, the weight of evidence supports a proposition that increasing foreign direct investment and foreign aid result in more inequality in peripheral countries.

## State Power, Growth, and Equality

Despite the rise of the statist approach, there have been only a few quantitative studies which consider the possible effects of political initiative and state characteristics on the relationships between external economic linkages and Third World economies. In this section, I will review several major studies on this topic in some detail, since these studies are directly related to my hypotheses presented in the next chapter. The research reviewed includes studies by Rubinson (1976, 1977), Delacroix and Ragin (1981), Gobalet and Diamond (1979), Weede and Tiefenback (1981), and Chan (1989).

In an attempt to specify empirically one of the mechanisms of dependent development, Rubinson (1977) tries to show that dependency produces weak states in the periphery, which is in turn positively related to economic growth. The negative effect of dependency on state strength is expected because of the existence of powerful domestic economic elites, international aid and lending agencies (e.g., IBRD, IMF, USAID), and a group of foreign actors within a periphery country. They attempt to use their leverage to maintain a weak state structure in order to avoid the nationalization of foreign industry, the expansion of social services and welfare programs, the promotion of state-sector development, the limits of the operation of foreign firms, and so forth. The positive effect of state strength on economic growth is expected because strong states are effective mechanism for : (1) protecting economic actors from the risks and uncertainties generated

by the world market; (2) securing privileged access to resources and markets, including their own markets; and (3) organizing economic actors to work in concert in the world market. Based on the panel regression analysis, Rubinson finds that there are significant negative effects by export partner concentration and external public debt on state strength (measured by government revenue as a proportion of GNP) in the period spanning 1955-70 in developing countries, while there is no effect of the volume of trade or debits on investment income. With respect to the effect of state strength on economic growth, his findings show that state strength positively affects GNP, especially in poor countries, but with a statistically significance at best at a .20 level. Thus, Rubinson's findings weakly support his hypothesis that dependency weakens the capacity of states to pursue or implement policies which is positively related to economic growth in the periphery.

However, this proposition was challenged by a study of Delacroix and Ragin (1981). In their research, Delacroix and Ragin distinguish between two aspects of state strength (or state efficacy using their term), viability and activism. Instead of using government revenue as an indicator of state strength, they introduce a composite index of state activism based on three highly correlated indicators of state-sponsored infrastructural and institutional transformation: the value of direct taxation per capita, the ratio of secondary school enrollment to secondary school age population, and the value of public investment per capita. The viability of the state is measured in terms of (1) experience of coup d'etat, and of (2) guerilla activity and amputation of territory. The results of their study show that most of the variation in state efficacy results from phenomena other than dependency. On the other hand, the state variables have strong positive effects on GNP per capita and the number of telephone per 1000 population, also reducing to nonsignificance the previously observed negative effects of dependency on aggregate development in the poor periphery. From these findings, Delacroix and Ragin maintain that state action

directed specifically at counteracting negative effects of dependency on development is the key to development in the Third World.

A related empirical finding is reported by Gobalet and Diamond (1979). They hypothesize that foreign investment limits the economic growth of weak states more than that of strong states because a host nation's bargaining power depends on its ability to monitor foreign firms' activities effectively and enforce agreed-upon terms as well as its ability to skillfully negotiate the terms of foreign investment. To test this hypothesis, Gobalet and Diamond compare the effects of foreign investment on economic growth in countries with low and high proportion of government revenue. Weak states (low government revenue countries) exhibit slightly larger negative effects of direct investment on growth, but the difference in slope compared to strong states (high government revenue countries) is small and insignificant. From these findings, they argue, "the effects of investment dependence do not appreciably differ between high and low in the proportion of national income accruing to the government" (1979, p428).

Gobalet and Diamond (1979) also analyze the interactive effect of the degree of centralization of political power. They predict that investment dependence limits the economic growth of nations with competitive regimes (multi-party political systems) more than that of states with centralized regimes (one party political systems). This is because a politically mobilized population is likely to intensify pressure on elites to bargain aggressively for greater national benefits, and mobilized regimes which generate strong popular expectations and demands on foreign investors are frequently one-party states (1979, p417). Contrary to their expectations, however, Gobalet and Diamond find that the more competitive regimes are better able to resist the negative effects of investment dependence. According to their findings, the larger negative effects of investment dependence among politically centralized nations are statistically significant, while the smaller negative effects in competitive regimes are not statistically significant. Based on this

finding, Gobalet and Diamond argue that less competitive regimes may be more easily co-opted by foreign corporations and induced to accept the terms of foreign entry and operations unfavorable to their nations, or that political mobilization may in fact be higher in competitive regimes. However, the difference in slope between the two groups is not significant.

In terms of the effects of state power on equality, Rubinson (1976), within the framework of Wallerstein's world-system theory, has provided a hypothesis claiming that inequality is reduced by economic development and state strength, while increased by direct economic penetration. According to Rubinson, a strong state is able to shift the balance of political and economic forces away from the dominance of small export elites and towards the development of a much larger and diversified manufacturing class resulting in a more equivalent income distribution. Furthermore, in countries with strong states, large and organized work forces can use the state to press for demands in terms of measures of redistribution of, for example, wages and tax policy. The findings of Rubinson's cross-national regression analysis generally support.his hypothesis.

Although the findings of Bornschier and Ballmer-Cao (1979) support Rubinson's proposition, Weede and Tiefenbach (1981) report contradictory findings in their study which includes the military participation ratio and the square of the logarithm of GNP per capita in their equation. They find that government revenue has no significant effect on income inequality, and moreover this holds true even when they exclude the military participation ratio. Although there is a critical problem in the study of Weede and Tiefenbach (their samples consisting of both developed and developing countries), Chan's study which uses only Third World countries in his samples also shows that state strength (measured by the expenditures of the central government as a percentage of GNP) has no influence on income inequality even without controlling for economic development as conducted by Weede. However, according to Chan, state strength can play an important

role when combined with the ideological norms of regimes: strong and rightist regimes tend to raise the income of the top 20 percent highest income group, whereas strong and leftist regimes tend to reduce the income of this same group (1989, p55).

In sum, the evidence for the intervening role of state strength is not conclusive. Apparently, the size of government revenues (or government expenditures) on total national income is merely a necessary, but not sufficient, condition of state strength (Bornschier and Chase-Dunn, 1985, p140). It may capture the resources available for the state to promote economic development by controlling and coordinating the activities of the society, but it does not represent the actual ability of bureaucracy to do so. Furthermore, state strength by itself does not tell us the direction or effectiveness of a strong state's impact on economic growth and equality. Strong states may promote or prevent economic development, and maintain, exacerbate, or ameliorate the negative effects of foreign penetration on growth or equality in peripheral countries. In order to assess these effects of states, we need to consider not only the resources and capabilities of the state, but also the regime types and/or leaders' ideologies or policy preferences.

## Conclusion

In this chapter, I have reviewed major quantitative studies which were conducted to test some of the propositions provided by three theoretical perspectives. Their findings can be summarized as follows:

(1) There are no systematic effects from the level of trade and export partner concentration on the economic growth in the Third World.

(2) Countries exporting a limited variety of goods have lower rates of economic growth than countries exporting a great variety of goods.

(3) Countries exporting raw materials rather than manufactured goods are likely to have lower rates of economic growth than countries exporting manufactured goods rather than raw materials.

(4) In the short run, foreign direct investment and foreign aid are associated with higher rates of economic growth.

(5) In the long run, however, foreign direct investment and foreign aid have negative effects on economic growth.

(6) There are no systematic effects of trade penetration on equality in a peripheral country.

(7) Increasing foreign direct investment and foreign aid tend to result in more inequality in Third World countries.

(8) The effects of state strength (as measured by the level of government revenue or expenditure as a percentage of GNP) on growth or equality are not conclusive.

(9) More competitive regimes are better able to resist the negative effects of investment dependence than politically centralized regimes.

Thus, the findings of previous studies generally support the dependency perspective rather than the liberal or statist approaches.

Nevertheless, these findings alone do not necessarily confirm the superiority of the dependency perspective over others. Although some forms of external economic linkages may affect growth and equality in the way dependency writers predict, forms of external economic linkages may be a result of the nature of the state and its actions, which may also impact basic liberal assumptions on which their theories are based. A weakness of the statist perspective is that it does not offer propositions about the direction and effectiveness of a strong state's impact on Third World economies. In my view, the direction and effectiveness of state power may be greatly influenced by the degree of centralization of power in the hands of political leaders in which state power has a positive impact on the growth and equality only in regimes that have a system of checks and balances among political elites. I also view that regime centralization and state power mediate the relations between external economic linkages and growth or equality in which the negative effect of

external economic linkages is only significant in centralized regimes especially with strong state.

If my prediction is correct, there is the problem of research design in previous quantitative studies. Many of those studies employ a cross-section analysis with a percentage change score used as the dependent variable or a panel regression method in order to account for the short term or long term effect of external economic linkages on economic development. Their analyses do not consider the frequent change in regime types in peripheral countries. In order to assess the mediating effects of regime types between external economic linkages and economic development in the Third World, I will propose (in the fifth chapter) a pooled cross-section time-series method.

Next, in Chapter IV, I plan to describe the framework of my research and offer hypotheses regarding how regime types affect the relations between external economic linkages and economic growth and social equality in Third World countries.

# Chapter IV

# THEORETICAL FRAMEWORK

## Theoretical Framework

In this research, I will attempt to integrate insights from the liberal, dependency, and statist perspectives on the basis of assumptions drawn from the tradition of public choice political economy. In this tradition, individuals are viewed as rational utility maximizers and behave based on their preference subject to specified constraints. In the context of Third World politics, the major concern of political elites can be assumed to be the maximization of their likelihood to retain power. In other words, leaders of a country select policies not so much because of their intrinsic worth, but largely in terms of how they will affect the regime's support, and hence power (Salmore and Salmore, 1978, p103). To this end, they consciously seek to provide benefits for a range of interests, systematically favoring certain groups over others. In this respect, external economic linkages can be viewed as tools to maximize their return as a way of attracting and rewarding supporters of their regime. Based on these assumptions, I propose that different regime types offer different constraints to political elites, which therefore leads them to respond differently in order to stay in power by utilizing opportunities drawn from the incorporation of their economies into the world market. From this perspective, regime types can be thought to mediate the relations between external economic linkages and economic growth and social equality in Third World countries.

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In this study, the state is considered as an analytically separable entity, composed of a civil and military bureaucracy. The state has a legitimate monopoly of the means of coercion, or public force, within a given territory, and also has a financial basis of system support through taxes and state loans. Regimes are regarded as the social interests (parties, elites, and other organizations) that define the collective interests of society and command state policies (Thomas and Meyer, 1980, p139).

Two dimensions of state strength are distinguished: the centralization of power and infrastructural power. The centralization of power concerns the extent to which a top leader is able to dominate his immediate political environment. The infrastructural power refers to power by the state to penetrate and centrally coordinate the activity of civil society through its own infrastructure (Mann, 1984, p190). In order to avoid confusion, I regard only infrastructural power as state power, and classify regimes in terms of the degree of the centralization of power and infrastructural power. With respect to the centralization of power, countries are divided into three groups: centralized regimes, fragmented regimes, and moderate pluralistic regimes (which are located somewhere between centralized and fragmented regimes). I also classify countries in terms of the degree of infrastructural power: strong states and weak states. Thus, six types of regimes are introduced: the centralized regimes with strong states (CS), centralized regimes with weak states (CW), moderate pluralistic regimes with strong states (PS), moderate pluralistic regimes with weak states (PW), fragmented regimes with strong states (FS), fragmented regimes with weak states (FW) (Table 4.1).

Besides top leaders' abilities to dominate their immediate political environment, centralized regimes and pluralistic regimes (including moderate pluralistic regimes and fragmented regimes) differ in the following respects.

Table 4.1: Regime Classification.

| | | Regime Centralization | | |
| | | High | Moderate | Low |
| Infrastructural Power | Weak | CW | PW | FW |
| | Strong | CS | PS | FS |

Political Control

Checks & Balance
Public Preferences
Information Flow

Centralized regimes

Fragmented Regimes
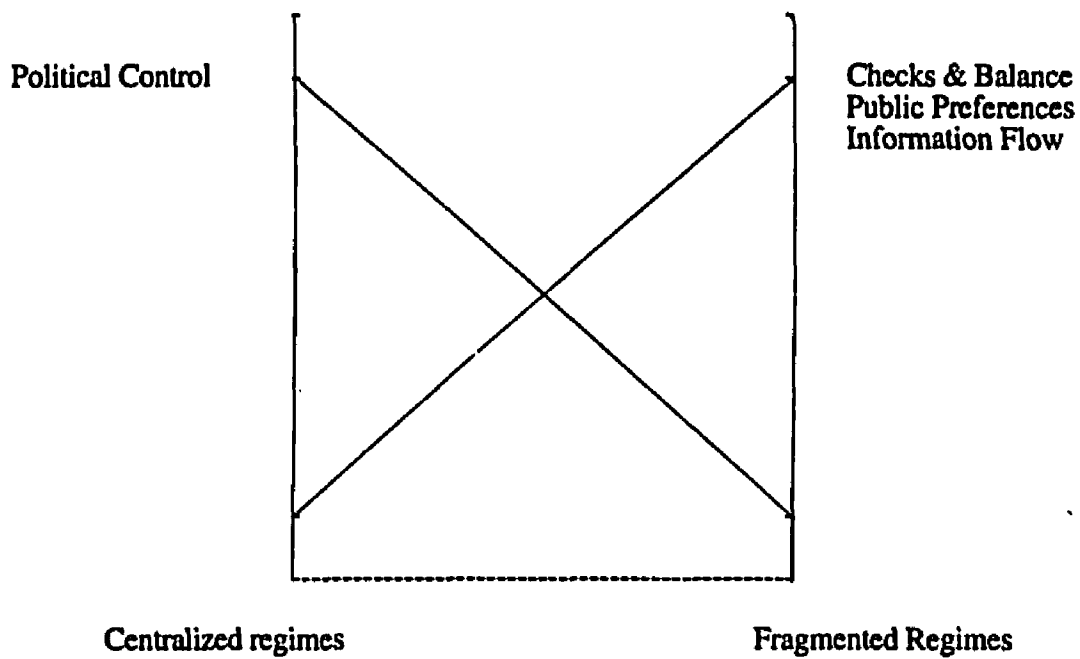
Figure 4.1: Characteristics of Regimes

First, pluralistic regimes decentralize formal responsibility for making decisions to a series of institutions, such as the legislature, the executive and, probably, various forms of "autonomous" agencies, while centralized regimes concentrate such responsibility into the hands of the top rulers. As a result, in pluralistic regimes, responsibilities are diffused away from one identifiable point toward many, thereby acting through an impersonal process. Furthermore, arbitrary action is restricted through accountability mechanisms, "checks and balances", and legal control. (Chalmers and Robinson, 1982, p15).

Second, centralized and pluralistic regimes differ in terms of which views will help to shape policies. In centralized regimes, the decision making process relies on the opinions and desires of only a few (e.g., the military, foreigners, and technocrats), but all with limited access. Furthermore, labor unions, peasant organizations, and a wide variety of cultural and educational institutions are usually not allowed to play an active role through lobbying, agitating, protesting, or otherwise participating in shaping policies. Pluralistic regimes reverse this process, in which there is participation and consultation of more and more diverse interests and groups than under centralized regimes (Chalmer and Robinson, 1982, p23).

The third difference between centralized and pluralistic regimes is the degree of openness to new information. In centralized regimes, the information flow is sharply restricted, especially in its public form, while pluralistic regimes encourage the articulation of many points of view by injecting diverse and conflicting information into the policy process. The decision making process involves not only a competition of interests but also a dialogue or debate in which information plays an important role in the clarification of values and identification of available instruments for action for a thorough exploration of problems for state action. The conscious distortion introduced under centralized regimes restricts this step in the policy process (Chalmers and Robinson, 1982, p27-28).

In sum, there is a trade-off between political leaders' ability to control their immediate political environment and the above three factors involved in the decision making process: the existence of checks and balances, the degree of public preferences shaping policy, and the degree of free information flow. These relationships are indicated in Figure 4.1. Although in centralized regimes top leaders possess a high level of ability to control their immediate political environment, there is a low-level accountability mechanism, an introduction of public preferences, and an information flow in their decision making process. In contrast, fragmented regimes have a high level of checks and balances, free information flow, and a wide variety of public preferences in the policy making process, but with weak political control of their environment in order to pursue the regimes' policies.

## Hypotheses

Contrary to the liberal and dependency perspectives, I expect the effects of external economic linkages on growth and social equality to differ across different types of regimes. As liberals maintain, a major obstacle to the economic development of many Third World countries is their lack of capital, skills, technologies, etc., which are only acquired by integrating their economies into the world market. Nevertheless, increasing the economic linkages to the core tends to produce asymmetrical relationships between the industrial power and peripheral countries. This may provide core states with the means to manipulate small countries in order to achieve their self-interests in the international system. Thus, as for the Third World, there are both opportunities and pitfalls when they participate in the world market. As Tony Smith (1986) argues, one of the important determinant factors which leads dependent countries to have different results may be the ability and behavior of the state when they face the technologically superior force of industrialized countries.

However, state strength alone does not tell the direction or effectiveness of state actions. Strong states may promote economic growth and an egalitarian society, but they may also retard growth and reinforce unequal distribution of wealth. In order to account for the direction and effectiveness of state actions, we need to know who controls the state. In this respect, regime types may be important factors in predicting the results of state strength.

### Effects of External Economic linkages on Growth and Equality

H.1-1 External economic linkages have negative effects on economic growth in centralized regimes.

H.1-2 External economic linkages have negative effects on social equality in centralized regimes.

H.1-3 These tendencies are more significant in centralized regimes with strong states (CS) than centralized regimes with weak states (CW).

A centralized regime tends to produce an elitist political system composed of the privileged and powerful few, and as such politics are likely to be closed to public participation and observation. Therefore, in a centralized regime, the ruler has little fear of public opinion unless he/she is threatened by a coup or revolution. Since the range of opinion holders relevant to his/her calculation is limited, he/she may not know what 'public opinion' is on most issues. Rather his/her main concern is how to control the small number of key figures within the social and economic system (Russett and Monsen, 1975, p5). As a result, this kind of regime tends to produce personal politics, in which the political system favors the ruler and his/her allies and clients whose essential activities involve gaining access to a personal regime's patronage or displacing the ruler and installing another regime (Jackson and Rosberg, 1984, p424).

Since the ruler tends to be preoccupied with his/her survival in a political world of great uncertainty and often turbulence, he/she is more likely to be a conservative system-maintainer rather than a progressive nation-builder. Although the ruler may employ

technocrats and announce national development plans and policies, his/her concrete activities are rarely guided by such impersonal criteria. The real norm that affects political and administrative actions tends to be rooted in friendship, kinship, factional alliances, ethnic fellowships which tend to undermine the rules of state institutions and organizations rather to reinforce or support them (Jackson and Rosberg, 1984, p425). Without accountability mechanisms, such as checks and balances, in the policy making process, this system lacks the ability to curb the excesses of personal and parochial desires, which is characterized by conspiracy, factional politics, clientalism, corruption, purges, rehabilitation, and succession maneuvers. As a result, political considerations may tend to supersede economic criteria in the process of developmental policies.

Thus, even if centralized regimes acquire capital and technology through their external economic linkages, they tend to waste them and are unable to effectively use resources in order to promote growth. Furthermore, this kind of political system is likely to favor a small number of powerful economic elites who have an interest in maintaining the status-quo. As a result, foreign forces which tend to be tied to this privileged group are likely to strengthen this elitist political system in centralized regimes in which personal gain of the privileged few is not conducive to the collective gain of balanced development. Thus, external economic linkages may reinforce the pattern of internal political and economic processes of centralized regimes, and thus may hinder economic growth and reinforce social inequality.

However, it is also conceivable that the ruler in centralized regimes has a strong interest in promoting economic growth in order to maximize his/her likelihood of retaining power. With higher economic growth, the ruler is able to distribute more wealth to his/her supporters in order to attract and reward them, and even to build more arms for the stability of the political system. External economic linkages may be used for this purpose. The existence of a strong state is required in order to pursue this policy effectively, extracting

benefits from the linkages at a minimum cost. In this case, external economic linkages have positive effects on economic growth while they have negative effects on social equality. These tendencies are more significant in strong states than in weak states.

H.2-1 External economic linkages have negative effects on economic growth in fragmented regimes.

H.2-2 External economic linkages have negative effects on social equality in fragmented regimes.

H.2-3 These tendencies are more significant in fragmented regimes with strong states (FS) than fragmented regimes with weak states (FW).

A political system with fragmentation or dispersion of power tends to be completely permeated by pressure groups. In this situation, central decision makers cannot mobilize all of the resources needed for the state's goals because of resistance from domestic groups. In the extreme case, a regime may be threatened by civil disorder and dissolution (Krasner, 1978, p59). As a result, we can expect that such a regime tends to act as unexceptionally as possible, since a fragmented regime has to preserve the fragile support among the mass public and competing governmental factions that keep such a regime in power. In other words, a very fragmented regime will be unwilling to take independent actions from powerful societal forces, which might be a matter of dispute among the parties comprising and supporting the regime.

This kind of political system may create 'distributional coalition' (Olson, 1982) which is likely to retard economic growth and promote an uneven distribution of wealth through its self-seeking behavior to preserve and enlarge its share of society's economic and social resources. In order to redistribute income from society at large to its own members, powerful interest groups such as producer cartels, labor unions, and professional associations, must be enticed to fix prices or wages, limit supply, and restrict competition. As a result, they tend to resist technological change, to impede a different allocation of production factors, and to undermine capital formation. These collusion and

lobbying efforts may reduce economic efficiency, which in the long run results in a heavy price in forgone economic growth. Although Olson argues that distributional coalitions tend to be the most numerous, entrenched, and powerful in the most stable democratic countries, these kinds of coalitions can be thought to be most prevalent in fragmented regimes in which fragile regimes are not able to disrupt, weaken, inhibit, or uproot strong special interests that block socio-economic changes through their ties to state apparatus and foreign interests.

Thus, higher levels of external economic linkages may reinforce the power of a 'distributional coalition', which may in turn help retard economic growth and maintain or increase social inequality in fragmented regimes. This tendency may be more significant in fragmented regimes with strong states than in fragmented regimes with weak states, since these interest groups can use strong states to maintain or increase their wealth and power more effectively.

    H.3-1  External economic linkages have positive effects on economic growth in moderate pluralistic regimes.

    H.3-2  External economic linkages have positive effects on social equality in moderate pluralistic regimes.

    H.3-3  These tendencies are more significant in moderate pluralistic regimes with strong state (PS) than in moderate pluralistic regimes with weak state (PW).

The positive impact of external economic linkages on growth and social equality may be only realized in moderate pluralistic regimes. In order to formulate and implement policies that insulate particularistic interests, a regime needs to concentrate its power, so that it is able to resist pressures from powerful interest groups. However, in a regime where power is too concentrated in the hands of a top leader, the state will be dominated by the one ruler, in which public policies tend to reflect his/her personal preferences. Furthermore, in this kind of regime, there are few checks and balances mechanisms to

restrict a leader's abuse of power, and little information flow in order to conduct effective developmental policies. However, a regime in which there are some divisions within powerful political forces tends to bring constructive compromises among the major contending forces. Since no one leader dominate the regime, particularistic interests tend to be checked by some political groups with different interests. Moreover, the regime is able to have enough information for policy making processes. As a result, a moderate pluralistic regime can use resources acquired from external economic linkages positively and more effectively in order to achieve its policy goals. Moreover, it is able to serve wider segments of the population than a centralized regime or fragmented regime.

Furthermore, the negative influence of foreign interests in the decision making process tends to decrease in moderate pluralistic regimes. Although the basic facts of economic dependency are not likely to change, the capacity of the national communities to shape their own policies within that framework tends to differ across different regimes. Opportunities to exploit positive aspects of the world market emerge from the diversification of dependency, such as the development of new exports, new resources of capital, and new trading partners, as well as the proliferation of multinational corporations and international agencies (Chalmer and Robinson, 1982, p25). The success of these strategies depends not only on an increase in infrastructural power but also the decentralization of power within a regime, since decentralization is likely to make nationalist interests more influential in policy making. Likely, pluralistic regimes create more opportunities for domestic business people to influence economic policy, create more watchdog committees to monitor effectively the activities of multinational corporations, and create more elections to promote the nationalistic definitions of policy problems. Furthermore, in regards to foreign interests, it is more difficult to co-opt political leaders in pluralistic regimes because it is less effective where there exists tighter supervision and more exposure. Since fragmented regimes tend to lead to immobilization, only moderate

pluralistic regimes are able to perform these tasks effectively. Thus, state actions aimed at counteracting dependency-induced obstacles to development may be successful only in moderate pluralistic regimes.

Thus, in a moderate pluralistic regime, the shortcomings of a centralized and fragmented regime can be overcome, so that increasing external economic linkages are expected to have positive effects on economic growth and social equality.

Table 4.2 summarizes our hypotheses with respect to the effects of external economic linkages on economic growth and social equality in each regime.

Table 4.2: The Effects of External Economic Linkages on Growth and Equality in the Third World.

|  |  | Growth | Equality |
| --- | --- | --- | --- |
| Centralized | Weak | - | - |
| Regimes | Strong | - | - |
| Moderate Pluralistic | Weak | + | + |
| Regimes | Strong | + | + |
| Fragmented | Weak | - | - |
| Regimes | Strong | - | - |

## Conclusion

In this chapter, I have outlined a theoretical framework from which I propose to integrate the uncontradictory aspects of the liberal, dependency, and statist approaches. Next, I provided new hypotheses regarding the effects of external economic linkages on

growth and equality in the Third World by means of introducing a new classification of regime types.

The underlying basic idea of my arguments differs in several respects from the three major perspectives. First, I have emphasized the regime type in order to predict the different effects of external economic linkages on growth and equality, while trying to synthesize different propositions that each perspective offers. If my prediction is correct, then the "exploitation" school can well explain the developmental phenomena in centralized regimes and fragmented regimes. Liberals, on the other hand, offer rather accurate predictions about the effects of external economic linkages on growth and equality in moderate pluralistic regimes. Second, I have argued that dependency situations exist not only because the core attempts to dominate the periphery, but also because those political leaders in the periphery are more likely to rely on foreign interests in order to control key figures within their own social and economic systems. Thus, I have emphasized internal determinants of dependency situations. In addition, increasing external economic linkages tend to reinforce the pattern of internal political and economic processes of peripheral countries. Third, although statist writers emphasize a strong state's infrastructural power for effective state intervention, they do not tell the direction or effectiveness of state actions. Strong states may promote economic growth and an egalitarian society, but they may also retard growth and increase the gap between the wealthy and the poor within a country. In order to account for the direction and effectiveness of state actions, it is necessary to know who controls the state. In this respect, I emphasize regime type as an important determinant of the outcomes of state actions. Fourth, my arguments differ from some statist writers who emphasize the centralization of power for effective state intervention. Since their arguments are based on their comparisons between democratic regimes which were often fragmented Third World country regimes in the past, they tend to overemphasize this aspect of state power, ignoring the negative aspects of centralized regimes. Finally, although

statist writers have used state strength as a central concept of their analysis, what they mean by strong or weak states is often unclear. There are many dimensions of state strength, but they tend not to distinguish between the different dimensions of state power. It is my hope that my research can contribute to the theory-building regarding Third World political economies in the above respects.

In the fifth chapter, I will test my hypotheses regarding the effects of state power and external economic linkages on economic growth in Third World countries. Then, in the sixth chapter, I will test my hypothesis with respect to the effects of the same independent variables on social equality in peripheral countries.

# Chapter V

## EFFECTS OF EXTERNAL ECONOMIC LINKAGES
## ON ECONOMIC GROWTH

In this chapter, I will test my hypotheses on the effects of external economic linkages upon economic growth in 24 Third World countries during the period of 1973-79. The year of 1973 marks the beginning of the first oil shock in which the rise in oil prices posed a vital threat to Third World countries. The effect of the 1979 oil increase was also severe. The consequent balance of payment deficit in non-oil-producing countries meant a curtailment of imports crucial for development. A decrease in energy consumption led to a decrease in overall production and consumption, which would certainly stifle economic growth. Furthermore, the slowdown in the developed market economies and subsequent decline in imports from the South had an additional detrimental effect on Third World economies. As a result, many peripheral countries experienced economic stagnation. However, some Third World countries were able to overcome the crisis, although they borrowed heavily from commercial banks in the North. Thus, the years spanning 1973-79 are an appropriate period to test my hypotheses since the different abilities of Third World regimes and states seemed to lead to different consequences in their respective economies. The selection of 24 countries is simply for reasons of data availability.

In order to test my hypotheses, I will analyze data across time and space through the employment of a pooled, cross-section time-series method. This strategy allows us to

employ a large number of observations in parameter estimation. Moreover, incorporating time-series data into the analysis enables us to examine the effects of regime types as intervening variables between external economic linkages and economic growth in Third World countries. This advantage is important to my study since regime types have changed frequently in many peripheral countries in the post World War 2 period.

Before presenting my test results, I will describe my research strategy from which our hypotheses were tested. The procedures taken in this research basically followed thoses taken in a series of quantitative studies, especially by Bornschier and Ballmer-Cao (1978), Bornschier and Chase-Dunn and Rubinson (1978), Chase-Dunn (1975), Rubinson (1977), and Dolan and Tomlin (1980). Except Dolan and Tomlin (1980), the findings of their studies basically supported the dependency perspectives (see Chapter III). Based on the same basic procedure, I will attempt to produce the different results from the above studies by introducing regime types as an intervening variables between external economic linkages and economic growth in developing countries.

## MEASURES

### Measures of Economic Growth

My dependent variable, economic growth (GROWTH), is measured by an annual rate of increase in GDP. I use a series of GDP figures in constant 1980 prices provided by the *International Financial Statistics* (IMF, 1985).

### Measures of External Economic Linkages

In this study, I use two aspects of external economic linkages as independent variables: foreign direct investment, and foreign debt.

Foreign direct investment (PROFIT) is measured by the value of debits on investment income as a percentage of GDP. This value indicates the amount of all profits made by foreign controlled firms in a country. To the extent that internal production within a country is organized and controlled by foreign investment, that country is more subject to the interests of foreign economic actors (Rubinson, 1977, p7). Data are found in the IMF *Balance of Payment Yearbook.*

The use of this indicator considers the dependency tradition which conceptualizes foreign direct investment as the extent to which a country's economy is penetrated and controlled by direct private foreign capital investment (Bornschier et al., 1978, p653). In particular, some view foreign capital control as a structural feature of the position and intensity of links of a penetrated country within a world-economy dominated by transnational corporations (Bornschier and Chase-Dunn, 1985, p71). This conceptualization of foreign investment is ideally measured by a ratio of the value of stock of foreign direct investment to the domestically owned capital stock of the country. This indicator could measure the proportion of capital ownership of a country that is controlled by foreign actors. However, data to construct such a measure are not available for most countries. As a result, many researchers use a ratio of the value of stock of foreign direct investment to the size of a country (as a substitute to the total capital stock), such as the total population or total Gross National Product. Nevertheless, I have not used this measure in my analysis, since yearly estimates of the stock of private foreign direct investment for developing countries are not available.

Foreign debt (DEBT) is measured by the total external debt which is composed of loans to the government and government-guaranteed loans. The more a state is indebted to other states or foreign economic actors, the more leverage and constraints those actors and states have over the economic policies of the country (Rubinson, 1977, p6). This indicator is the conceptual equivalent of stocks of foreign investment, and reflects the dependency

tradition which views foreign aid as a control mechanism through which international or bilateral agencies influence governments in the Third World. Data are from *World Tables* (World Bank, 1976, 1980, 1983).

## Measures of Regime Types and State Power

As discussed in chapter IV, I classify Third World countries in terms of power centralization and infrastructural power. The centralization of power is concerned with to what extent a top leader is able to dominate his immediate political environment. Infrastructural power refers to the capacity of a state to actually penetrate society and implement logistically political decisions throughout the realm. State power is defined with respect to this infrastructural power, and regimes are classified in terms of the degree of centralization of power and infrastructural power.

Power centralization (CENT) is measured by a modified Bank's Aggregate Competition Index score from his *Cross-National Time-Series Data Set*. Bank's index sums score of four variables for each country. These variables include effectiveness of legislature, nominating process, legislative coalitions, and party legitimacy. Each country is scored for each variable as follows:

Effectiveness of Legislature
    (3) Effective
    (2) Partly effective
    (1) Largely ineffective
    (0) No legislature

Nominating Process
    (3) Competitive
    (2) Partly competitive
    (1) Essentially non-competitive
    (0) No legislature

Legislative Coalitions
    (3) More than one party, no coalitions
    (2) More than one party, government coalition, opposition
    (1) More than one party, government coalition, no opposition
    (0) No coalition, no opposition

Party Legitimacy
      (3) No parties excluded
      (2) One or more minor or "extremist" parties excluded
      (1) Significant exclusion of parties (or groups)
      (0) No parties, or all but dominant party and satellites excluded

Since this index reflects the degree of political competition, a country with a legislature which has more than one party and no coalitions is scored higher (3) than a country that has a coalition government (1 or 2). In order to measure the degree of centralization of power rather than political competition, I modified the coding method of the "Legislative Coalitions" variable as follows:

Legislative Coalitions
      (3) More than one party, government coalition, opposition
      (2) More than one party, government coalition, no opposition
      (1) More than one party, no coalition
      (0) No coalition, no opposition

In addition, most countries have the same score with respect to effectiveness of the legislature and nominating process in Bank's data. Since I want to emphasize legislative coalitions and party legitimacy in order to construct an indicator of power centralization, I dropped the legislative nominating process. Thus, my index of power centralization sums the scores of effectiveness of the legislature, party legitimacy, and modified legislative coalition, ranging from 0 to 9 (the higher the score, the more decentralized the nation's political system). I assigned countries with scores from 0 to 2 to be centralized regimes; countries with scores from 3 to 6 as moderate pluralistic regimes; and countries with scores from 7 to 9 as fragmented regimes.

Infrastructural power (TAX) is measured by the percentage of a central government's total revenues obtained from direct taxes on income, profits, and capital

gains. Direct taxes on individuals are much more difficult to collect than indirect taxes, since the former requires more effective bureaucracy. Thus, the greater the proportion of tax revenues that come from direct taxes on individuals, the greater the state's penetration of the society. The countries which have equal to or more than 21.16 percent of this measure (the median point) are assigned to be strong states, while the countries with less than 21.16 percent are assigned to be weak states. Data are from *World Tables*.

According to the above criteria, sample countries were classified as Table 5.1.

Table 5.1: Classification of Third World Countries by Regime Type.

| (CS) | (PS) | (FS) |
|------|------|------|
| Chile 1973-4 | Brazil 1973 | Ecuador 1979 |
| Ecuador 1973-8 | Columbia 1973-9 | Malaysia 1973-9 |
| Ghana 1973,76,78 | El Salvador 1975 | Turkey 1973-9 |
| Honduras 1974-5,78,79 | Indonesia 1973-9 | Venezuela 1973-9 |
| Morocco 1975 | Korea 1973-9 | |
| Peru 1973-5 | Mexico 1973-9 | |
| Philippine 1973-4, 77 | Morocco 1978-9 | |
| Sierra-Leone 1978-9 | Philippine 1978-9 | |
| | Sierra-Leone 1973-6 | |

| (CW) | (PW) | (FW) |
|------|------|------|
| Bolivia 1973-8 | Brazil 1974-9 | Bolivia 1979 |
| Chile 1975-9 | El Salvador 1973-4,76-8 | Sri Lanka 1973-9 |
| El Salvador 1979 | Ghana 1979 | Thailand 1975,79 |
| Ghana 1974-5,77 | Morocco 1977 | |
| Honduras 1973,76,77 | Nicaragua 1973-8 | |
| Morocco 1973-4,76 | Pakistan 1973-6 | |
| Nicaragua 1979 | Paraguay 1973-6 | |
| Pakistan 1977-9 | Peru 1978 | |
| Peru 1976-7,79 | Sierra-Leone 1977 | |
| Philippine 1975-6 | | |
| Thailand 1973-4,76-8 | | |
| Tunisia 1973-9 | | |

Measures of Control Variables

My major concern in this research is to assess the differences in how state power and external economic linkages affect economic growth and social equality in different regimes in the Third World. Thus, my primary purpose in empirically testing our hypotheses is to arrive at good estimates of the parameters of various measures of external economic linkages. To this end, the inclusion of other important variables into our model is essential in order to avoid biasing the coefficients of interest, even if we are not interested in the estimated effects of those variables. In this research, based on the available theories and my experiments, I included five control variables into my model: domestic capital formation, the level of economic growth, the military participation ratio, foreign trade, and state infrastructural power.

Domestic capital formation (SAVE) is measured by the value of local saving as a percentage of GDP. Data are available in *World Tables* (World Bank, 1976, 1980, 1983).

In liberal economic theories, the level of domestic capital is generally regarded as one of the most important determinants of economic growth. For liberal economists, higher domestic savings leads to higher gross domestic investment, which then stimulates economic growth. Furthermore, greater domestic capital may reduce the need for foreign investment, while smaller domestic capital may cause foreign capital to flow in to seize investment opportunities. For these reasons, this variable has been used as a control variable to assess the effects of external economic linkages on economic growth in developing countries (e.g., Chase-Dunn, 1975; Gobalet and Diamond, 1979; Bornschier, 1980c).

The level of economic growth (GDP) is measured by per capita GDP. Because of the extreme right-skewness of the distribution, this measure is converted to a logarithmic

scale to make it suitable for linear regression analysis. The data are from the IMF *International Financial Statistics* (IMF, 1985).

Inclusion of this variable into the model is important in order to sort out the relationship between the level and rate of economic growth. As the World Development Report (World Bank, 1979) suggests, middle income countries may grow faster than both low-income and industrialized countries. Furthermore, because of greater investment opportunities, foreign investment or aid is likely to go to countries with a relatively higher level of economic development. Thus, in order to assess the effects of external economic linkages on economic growth, this initial positive correlation between the level of economic growth and external economic linkages must be controlled.

The military participation ratio (MILIT) is measured by the number of military personnel as a ratio of total population (per ten thousand). The data are from Bank's *Cross-national Time-series Data Set.*

Some researchers, such as Weede and Jogodzinski (1981), Andreski (1968), Kahn (1979), expect better economic performance from societies and states with a somewhat precarious international security situation. This "military sociology approach" hypothesizes that threat from the international environment and wide spread military service may enforce societal discipline and provide some incentive for productive and co-operative relations among classes rather than impoverishing class struggles (Weede and Tiefenbach, 1981, p394). This hypothesis has been supported by previous empirical studies such as those from Garnier and Hazelrigg (1977), Jagodzinski and Weede (1981, reported in Weede and Tiefenbach, 1981), Weede and Jagodzinski (1981), and Weede and Tiefenbach (1981).

State infrastructural power (TAX) is measured by the percentage of a central government's total revenues obtained from direct taxes on income, profits, and capital gains. The countries which have equal to or more than 21.16 percent of this measure (the

median point) are assigned to be strong states, while countries with less than 21.16 percent are assigned to be weak states. Data are from *World Tables*.

The inclusion of this variable into my model considers a proposition offered by some statists and world system writers that state power has a positive effect on economic growth in the Third World. For example, Rubinson (1977) predicts the positive effects of state power on economic growth because strong states are effective mechanisms for: (1) protecting economic actors from the risks and uncertainties generated by the world market; (2) securing privileged access to resources and markets, including their own markets; and (3) organizing economic actors to work in concert in the world market.
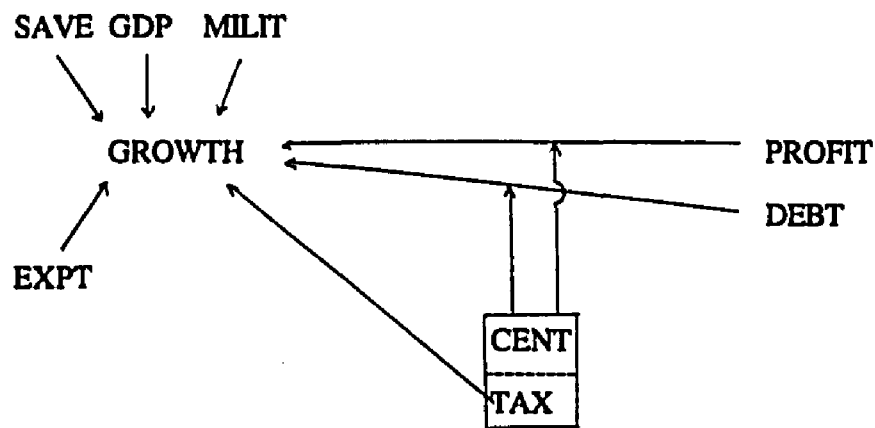


Figure 5.1: Model on the Effects of External Economic Linkages
on Economic Growth in the Third World

The level of export (EXPT) is measured by the value of exports as a percentage of GDP. This indicates to what extent a country depends its economies on exports to the world market. The data are available in the IMF *Direction of Trade*.

The period of 1973-79 was characterized by a slowdown in the developed market economies due to the oil crisis of 1973/74. The subsequent decline in import from the Third World forced many developing countries to decrease their exports drastically, which resulted in severe economic recessions in countries which relied heavily on the exports of their products to developed market economies. Thus, we can expect that higher level of export has negative effects on economic growth during this period.

Figure 5.1 shows the model used to test the mediating effects of regime types between external economic linkage variables (foreign direct investment and foreign debt) and economic growth.

Without considering the mediating effects of regime types, the equation of the model takes the form:

$$\text{GROWTH} = a + b_1\text{SAVE} + b_2\text{GDP} + b_3\text{MILIT} + b_4\text{EXPT} + b_5\text{TAX}$$
$$+ b_6\text{PROFIT} + b_7\text{DEBT} + u \qquad\qquad \text{----- (5-1)}$$

where  $a$ = constant
$b_{1\text{-}7}$ = unstandardized regression coefficients
$u$ = unexplained, or error, term

In order to account for the mediating effects of regime types, I used slope dummy variables in order to test whether or not the effects of foreign direct investment and foreign debt vary across different regimes. To avoid multicollinearity problems, I examined the effects of foreign direct investment and foreign debt on economic growth separately. Thus, in order to assess the different effects of foreign direct investment on growth, equation (5-1) is changed to:

$$\text{GROWTH} = a + b_1\text{SAVE} + b_2\text{GDP} + b_3\text{MILIT} + b_4\text{EXPT} + b_5\text{TAX}$$

$$+ b_6\text{PROFIT} + b_7D_1\text{PROFIT} + b_8D_2\text{PROFIT} + b_9D_3\text{PROFIT}$$

$$+ b_{10}D_4\text{PROFIT} + b_{11}D_5\text{PROFIT} + b_{12}\text{DEBT} + u \quad ----\ (5\text{-}2)$$

$$= a + b_1\text{SAVE} + b_2\text{GDP} + b_3\text{MILIT} + b_4\text{EXPT} + b_5\text{TAX}$$

$$+ (b_6 + b_7D_1 + b_8D_2 + b_9D_3 + b_{10}D_4 + b_{11}D_5)\ \text{PROFIT}$$

$$+ b_{12}\text{DEBT} + u$$

where $D_1$ - $D_5$ = dummy variables for CW, CS, PW, PS, FW regimes, respectively

Providing that $D_1$ is the dummy variable for centralized regimes with weak states (CW), $D_1$ equals one if observation t is a CW regime and zero if t is another regime. Thus, for CW regimes, the estimated coefficient on PROFIT is $b_6 + b_7$, since $D_2$, $D_3$, $D_4$, $D_5 = 0$. For FS regimes, the coefficient for PROFIT is $b_6$, since $D_1$, $D_2$, $D_3$, $D_4$, $D_5 = 0$.

To assess the different effects of foreign debt on growth, equation (5-1) should be changed to:

$$\text{GROWTH} = a + b_1\text{SAVE} + b_2\text{GDP} + b_3\text{MILIT} + b_4\text{EXPT} + b_5\text{TAX}$$

$$+ b_6\text{PROFIT} + b_7\text{DEBT} + b_8D_1\text{DEBT} + b_9D_2\text{DEBT}$$

$$+ b_{10}D_3\text{DEBT} + b_{11}D_4\text{DEBT} + b_{12}D_5\text{DEBT} + u \quad ----\ (5\text{-}3)$$

My expectations regarding the effects of independent variables on economic growth is that in both equations savings (SAVE), military participation ratio (MILIT) and state power (TAX) should be positively associated with economic growth (GROWTH). The level of economic development (GDP) and trade (EXPT), on the other hand, should be negatively associated with the rate of economic growth. More importantly for this study, I expect that in equation (5-2) PROFIT is positively associated with GROWTH in moderate

pluralistic regimes (that is, $b_6 + b_9 > 0$, $b_6 + b_{10} > 0$) and negatively associated with GROWTH in centralized regimes (that is, $b_6 + b_7 < 0$, $b_6 + b_8 < 0$) and fragmented regimes (that is, $b_6 + b_{11} < 0$, $b_6 < 0$). I also expect these effects to be more significant in strong states than in weak states (that is, $|b_6 + b_{10}| > |b_6 + b_9|$, $|b_6 + b_8| > |b_6 + b_7|$, $|b_6| > |b_6 + b_{11}|$ ). Similarly, in equation (5-3), I expect DEBT to be positively associated with GROWTH in moderate pluralistic regimes (that is, $b_7 + b_{10} > 0$, $b_7 + b_{11} > 0$), and negatively associated with GROWTH in both centralized regimes (that is, $b_7 + b_8 < 0$, $b_7 + b_9 < 0$) and fragmented regimes (that is $b_7 + b_{12} < 0$, $b_7 < 0$). These effects are more significant in strong states than in weak states ($|b_7 + b_9| > |b_7 + b_8|$, $|b_7 + b_{11}| > |b_7 + b_{10}|$, $|b_7| > |b_7 + b_{12}|$).

## Method of Analysis

In order to test our hypotheses, I used a pooled, cross-section time-series regression analysis. There are several strengths in using this method compared with conventional methods such as the simple cross-section method, panel regression analysis, or cross-section analysis with a percentage change score used as the dependent variable (e.g., economic growth). First, one of the critical limitations of previous quantitative studies is their small number of samples, due to the scarcity of available data in many developing countries. However, we can overcome this limitation by using both cross-sectional and time-series data, which enables us to get more efficient estimates because we can increase the number of observations. Second, the superiority of cross-sectional or longitudinal analysis may depend on the kind of problem under discussion. Cross-sectional designs may be more useful than longitudinal studies in identifying determinants of the dependent variable if those determinants change very slowly over time. However, if regime types really affect the effects of state power and external economic linkages on Third World

economics, methods used in previous studies are not appropriate since they are not able to evaluate the mediating effects of regime types which have frequently changed in many Third World countries. By incorporating time-series analysis into the cross-sectional method, we can overcome the limitations of the methods used in previous quantitative analyses.

In the pooled data, the cross sectional estimates are incorporated into a time-series model to give it greater predictive power (Stimson, 1985, p918). In this kind of data, the conventional ordinary least square (OLS) technique has serious limitations in obtaining efficient and unbiased estimates of the coefficient parameters. This is because some of the assumptions for BLUE nature of OLS estimators tend to be violated when we use pooled data. First, since the pooled data contain samples with different sizes, the problem of heteroscedasticity is almost inherent in any analysis using stacked pooled data. Second, we expect that there is a serious dependence, or the cases are not independent along the time dimension within units. In these cases, OLS is still unbiased but no longer an efficient estimator. As a result, OLS estimators tend to distort inferences about the true parameters underlying the model. Since the variances of the coefficient parameters are affected by these problems, standard statistical tests will be inaccurate.

Because of these weaknesses of the OLS estimator, the generalized least square (GLS) method was employed in this study. The GLS estimator uses information about the variances and covariances of the error terms in order to correct the above two problems. In the case of heteroskedasticity problems, we give greater weight to those observations whose error terms have smaller variances. When the error terms are correlated (autocorrelation problem), we transform the variances in such a way that the error terms implicit in the transformed variables are uncorrelated (Hanushek and Jackson, 1977, p175).

In order to find whether or not there are heteroschedasticity and/or autocorrelation problems, I first estimated my model, using the OLS method with 168 observations[1]. After I analyzed the residuals, I found that the values of the first-order autocorrelation coefficients (rho) in each cross-sectional unit were very low, which indicated that there was no autocorrelation problem: the error terms are not correlated over time. However, the distribution of residuals revealed that the assumption of homoskedasticity was seriously violated. The pattern of their distributions indicated that the variance of error terms increased as the value of savings increased. This is a serious violation of the assumption of the OLS that the variance of error terms are equal. In order to correct this problem, I inflated each variable by the square root of savings (SAVE). The results of the Breusch-Pagan test[2] indicated that the residuals were homoscedastic.

## Sample of Countries

I took a sample of 24 Third World countries which have no missing data for all the variables in my model during the period of 1973-79. The following are the sample of countries.

Bolivia, Brazil, Chile, Columbia, Ecuador, El Salvador, Honduras, Ghana, Indonesia, Korea Republic, Malaysia, Mexico, Morocco, Nicaragua, Pakistan, Paraguay, Peru, Philippines, Sierra Leone, Sri Lanka, Thailand, Tunisia, Turkey, and Venezuela

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[1] In order to diagnose and correct ill-behavior of error terms and to insure adequate estimates of parameters, I took basically the following steps: (1) Run OLS regression and save the residuals; (2) Look for the first-order autocorrelation coefficients (rho) and their t-ratio in each country; (3) Transform all data using method of first difference in the countries with error terms correlated over time; (4) Run OLS on the original model using data as transformed in step 3 and save the residuals; (5) Examine the residuals if variances of residuals across countries vary drastically, and if this is the case; (6) transform all data in such a way as to give greater weight to those observations whose error terms have smaller variances; (7) Conduct Breusch Pagan test to make sure that there is no heteroscedasticity problem; (8) Reestimate the original model using transformed data from step 6.

[2] I took the steps suggested by Gujarati (1988, p348).

# Results

Before we evaluate my hypotheses, let me examine the data comparing GLS and OLS estimators without considering the effects of regime types as an intervening variable between external economic linkages and economic growth in peripheral countries.

Table 5.2 shows the effects of external economic linkage variables and control variables on economic growth in 24 Third World countries during 1973-79. With respect to external linkages, external public debt (DEBT) has a negative effect on economic growth with statistically significance at a .01 level. Profit made by foreign firms (PROFIT), in contrast, shows a strong positive effect on growth (b = 1.822), and this effect is statistically significant (t = 5.16). This contradicts the results reported by Rubinson (1977) and Chase-Dunn (1975) in which PROFIT has significant negative effects on growth. Thus, our findings do not consistently support either the liberal or dependency perspective: the negative effect of debt on growth supports the hypotheses of the "exploitation" school of the dependency tradition; the positive effect of PROFIT supports the liberal school and the "dependent development" school. With respect to control variables, as predicted, domestic savings (SAVE) and the military participation ratio (MILIT) have positive effects on growth, while trade (EXPT) and gross national product (GDP) have negative effects on the dependent variable. All of these effects are statistically significant at a .01 level. In terms of state power, the effect of direct taxes (TAX) on growth rate is surprisingly negative (b = -.119) with statistically significance at a .01 level (t = 4.12). This negative effect of TAX on GROWTH disconfirms some statist arguments that strong states are an effective mechanism for promoting economic growth in peripheral countries. Rather, the findings strongly support the liberal perspective favoring a small and weak state for economic growth which does not interfere with the economic activities of the private sector.

We see the same pattern in the findings based on the GLS estimator. The only difference is that R-square increases tremendously from .351 to .789. The remaining results show the same pattern. In the remaining sections, I will discuss only the results based on the GLS estimator.

## Effects of Foreign Debt on Economic Growth

Table 5.3 indicates the test results including slope dummy variables which indicate whether or not the effects of external public debt differ across our six regime types: centralized regimes with weak states (CW), centralized regimes with strong states (CS), moderate pluralistic regimes with weak states (PW), moderate pluralistic regimes with strong states (PS), fragmented regimes with weak states (FW), and fragmented regimes with strong states (FS). In FS regimes, foreign debt (DEBT) has a negative effect on the growth rate (b= -.126) and this effect is statistically significant (t = 2.53). CW and FW regimes are not significantly different from FS regimes with respect to the value of both coefficient estimates and t-ratios. However, this does not hold true in three other kinds of regimes (CS, PW, PS regimes). These regimes have smaller effects of foreign debt on growth than FS regimes (b = -.126 + .107 = -.019 for CS regimes; b = -.126 + .102 = -.024 for PW regimes; b = -.126 + .129 = .003 for PS regimes), and these effects are significantly different from those in FS regimes (t = 2.35 for CS regimes; t = 2.10 for PW regimes; t = 3.28 for PS regimes). In PS regimes, the effect of external public debt is even positive although the small value of coefficient estimate indicates that the effect is not substantial. Compared with test results excluding slope dummy variables in Table 5.2, the variance in countries' growth rate explained by the model (R-square) increases from .789 to .832, while the effects of foreign investment and five control variables on the growth rate indicate the same pattern as shown in Table 5.2.

From these findings, we can conclude that although foreign debt has overall negative effects on the growth rate in 24 countries during the period of 1973-79, the negative effects are smaller in moderate pluralistic regimes with weak states as well as centralized regimes with strong states than within the other regimes. Furthermore, the effects are even positive in pluralistic regimes with strong states, whereas the positive effects are not substantial.

**Effects of Foreign Direct Investment on Economic Growth**

Table 5.4 shows the effects of foreign direct investment (PROFIT) on the growth rate in our six types of regime. In FS regimes, PROFIT has a positive effect on the growth rate (b = .760), and this effect is statistically significant (t = 2.72). All weak states do not differ from FS regimes regarding the effects of foreign investment on growth. However, CS regimes have a value of PROFIT coefficient estimate which is twice larger than that for FS regimes (b = 1.558 = .760+.798 for CS), and the difference in this effect is statistically significant at a .05 level. Furthermore, if we look at PS regimes, the difference is much larger both in the value of coefficient estimate and in the level of t-ratio (b for PS = 2.435 = .760 + 1.675; t = 3.35), showing that the positive effect of PROFIT is about three times larger in PS regimes than in FS regimes, and about twice larger in PS regimes than in CS regimes. Compared with test results excluding slope dummy variables in Table 5.2, the variance in countries' growth rate explained by the model increases from .789 to .841.

From this finding, we can conclude that although profit made by foreign firms has a strong positive effect on economic growth in all six types of regime, this positive effect is stronger in CS and especially PS regimes.

## Discussions

The findings reported above indicate that although our hypotheses are only modestly supported, the effects of external economic linkages are varied across different types of regimes. There are several unexpected results which contradict my hypotheses. However, the findings at least offer an evidence strong enough to maintain that regime types either weaken or strengthen the relationship between external economic linkages and subsequent economic growth.

The first unexpected result is that external public debt and foreign direct investment have some systematic effect on economic growth in the periphery in which regime types alone cannot alter the direction of those effects. As for the effects of external public debt (in the 24 Third World countries during the period of 1973-79), there were negative effects on economic growth (except in PS regimes where the positive effect is however negligible) as the exploitation school predicted. This finding is consistent with those of Chase-Dunn and Rubinson. In terms of the effects of foreign investment, our findings show that higher profits made by foreign firms increase the growth rate of 24 countries during the same period. This supports the arguments of liberals as well as the "dependent" or "associated development" school, and contradicts those of the exploitation school, which also contradicts the findings of Chase-Dunn and Rubinson.

With respect to the effects of foreign debt on economic growth, industrialized countries might supress economic growth in the periphery through foreign aid as a control mechanism. When a state is indebted largely to foreign economic actors, foreigners have more leverage and constraints over the economic policies of the stete in order to "exploite" peripheral countries through the repatriation of profits and interests, unequal exchange in the trade, and specialization of export commodities (See Chapter III). However, the negative effects of foreign debt on growth in the Third World do not neccessarily contradict

the liberal perspective. The rise in oil prices in 1973 and 1979 posed a vial threst to developing countries. The balance of paymet deficits ballooned after the oil price hikes of 1973 and 1979. Without access to foreign loans, non-oil-exporting Third World countries would not have found it necessary to curtail their imports and their development sharply. Facing the balance of payment deficits, however, these states have to adopt, at least to some degree, internal adjustment measures to decrease a country's purchases abroad by reducing domestic and foreign expenditures of the state and its residents. In this situation, it may be obvious from the liberal perspective that increasing foreign debt should decrease the rate of economic growth. The real issue may be how effectively the state can control these negative effects of foreign debt on economic growth in the country. In this context, my findings show that regime types will matter in which pluralistic regimes with strong states are the most effective to decrease these negative effects than any other regimes.

With respect to foreign direct investment, my findings indicate that profits made by foreign firms have largely beneficial effects on economic growth in developing countries. My test results can be easily interpreted by the liberal perspective which views the benefits of multinational corporations for host countries as the mobilization and productive use of investment capital (Walters and Blake, 1992, p125). The basic problem of developing countries, for liberals, is the lack of the capital to develop industries that tap natural resources, provide useful products, and generate employment. In this situation, the mobilization of investment capital by multinational corporations accelerates industrialization that cannot teke place without large infusion of capital. The good example is the recent economic history of Singapore, Taiwan, Thailand, Malysia, and South Korea that have used foreign investment and trade policies to achieve industrialization, increased export activity, and a remarkable rise in per capita income. Furthermore, multinational corporations tend to promote the transfer of technology and managerial skills from industrialized countries to host countries, and generate significant amounts of taxable

income, which the state can use for the investment to promote growth (Walters and Blake, 1992, pp126-27).

Another interpretation of my findings can be drawn from the "dependent" or "associate development" school and the world system school. The "dependent" or "associated development" school maintains that industrialization and hence rapid economic growth can take place even if a country is heavily dependent on advanced industrialized countries. The moving force in this "dependent" or "associated development" is the multinational corporations that conduct industrial productions for the domestic markets of Third World countries. To the extent that the interests of mutinational corporations are compatible with the internal prosperity of the dependent countries, they help rapid economic growth in those peripheral countries. The preconditions of this sort of development is the existance of strong states, large economic and human resources to support indigenous industrialization in host countries, and the existance of some degree of international competition among multinational corporations and/or divergence of interests between industrialized states and multinational corporations.

The world system theories go a step further and hold that the effects of direct investment on the rate of economic growth depend on whether the world economy is in a period of relative expansion or contraction. In periods of economic expansion, there is less competition between core states, so that peripheral states have fewer economic and political alternatives than core states and international capitals. As a consequence, there is a relative increase in the bargaining power of the core vis-a-vis the periphery. This may result in the negative effects of foreign direct investment on the rate of economic growth because core states and international capitals possess greater leverage to determine prices and forms of production. From 1950 to 1970, the world economy was in one of its expansionary phases. In the 1970's, however, the world economy entered into a period of economic contraction, shifting the relative bargaining power among countries. In this type of period,

core producers begin to compete more among themselves in order to maintain their share in the relatively reduced world market. As a result, peripheral countries are able to use their relatively advantageous bargaining positions to gain greater control over their national economies and make better deals for the exchange of commodities with core countries. Thus, world system writers predict that foreign direct investment has less negative effects (and even positive for some countries) on the rate of economic growth in periods of economic contraction. Since the period after 1970 has been one of relative economic contraction, my findings do not contradict the previous findings of Chase-Dunn and Rubinson that indicate the negative effects of foreign direct investment on growth on the basis of data before 1970.

The trend in wages in the core countries of the world system can be regarded as another factor in explaining the different effects of foreign investment on economic growth between pre- and post-1970. According to Rubinson, real wages rose at a dramatic rate in almost all core countries from 1950 to 1970. The subsequent pressure on profit margins resulted in a migration by multinational firms which have manufacturing industries (as opposed to the usual extractive industries in peripheral countries) in order to take advantage of lower wage rates. Consequently, the relatively greater expansion and multiplier effects of manufacturing as opposed to extractive industries increases national production in the periphery. In addition, since such industries are located within peripheral countries, they become subject to more political constraints which can be imposed by the state. This may further explain the different effects between foreign investment and external public debt on the rate of economic growth in our findings in which the latter allows less political control of peripheral states than the former.

In sum, as a result of a contraction in the world market and the migration of manufacturing, peripheral countries may gain greater opportunities to control and constrain

the operations of foreign capital within their boundaries than previously capable (Rubinson, 1977).

If this is the case, there is no contradiction between the positive effects of foreign direct investment on growth in my findings and the negative effects in the findings of Chase-Dunn and Rubinson. While my empirical tests rely on the data from the period 1973-79, Chase-Dunn and Rubinson attempt to get an estimate of the effect of foreign investment on growth over the time periods of 1950-70 and 1955-70 respectively. These different time periods might be crucial in explaining the different effects of foreign investment on economic growth in Third World countries.

The difference between my findings and others' might be explained by another factor, that is, the different research designs and methods we adopted to examine the effects of foreign investment on growth in the Third World. First, since I used pooled data of twenty four countries during the period 1973-79, the number of countries included in the samples is much larger than that used in previous studies. While my data consists of 164 observations, Chase-Dunn used only 25 to 28, and Rubinson employed only 37 to 43 observations. The studied based on small samples have a serious problem, since the magnitude and direction of estimates can be largely affected by minor specification errors in the equation and by the effects of outliers or the exclusion of particular cases (Russett, 1983, p557). Second, Chase-Dunn and Rubinson used the panel regression method. In this method, a dependent variable is measured at both the first and second point in time, while the independent variables are measured at an earlier time point. Then the dependent variable at the later point is regressed onto itself at the early time point as well as on other independent variables. As a result, estimates of the effects of the independent variables are obtained which are independent of the variance in the dependent variable at the early time point. Although this method is more appropriate for testing causal propositions than models using only cross-sectional data at the same point in time, this does not overcome the

limitations of a basically cross-sectional design. Cross-sectional correlations and regressions may differ from longitudinal ones, not only in magnitude, but even in sign (Weede, 1981, p257). Extrapolations from cross-sectional findings to cross-time processes may be misleading. In this sense, our findings are probably more reliable than those of previous studies because of our use of pooled data which also account for cross-time processes.

The second unexpected result is that, within centralized regimes, the positive effects of foreign direct investment is larger in strong states than in weak states. Furthermore, external public debt was found to affect growth more negatively in centralized regimes with weak states than in centralized regimes with strong states. Thus, contrary to my prediction, strong states perform better than weak states with respect to the effects of external linkages on economic growth in centralized regimes. In order to explain this phenomena, I need to modify the motivation and strategy of the political ruler in centralized regimes. Although centralized regimes are likely to waste resources extravagantly, the ruler may have a strong interest in promoting economic growth. In order to maximize the likelihood of staying in power, the ruler may want to distribute more wealth to his/her supporters for attracting and rewarding them. To this end, the ruler may seek to acquire more wealth by promoting economic growth in the country. Furthermore, increasing wealth can be used to build strong arms forces to protect the ruler and existing political system. For promoting economic growth, the ruler can exploit the benefits of the links to the world market, which requires a strong state that is able to monitor foreign firms' activities effectively, to enforce the agreed-upon terms, to negotiate skillfully regarding the terms of foreign investment, and to use aid or loans effectively. In this case, it is understandable that strong states perform better than weak states in centralized regimes.

In spite of these unexpected results, my findings do indicate that the effects of external economic linkages on growth rate are varied across different types of regimes.

Especially, as I expected, moderate pluralistic regimes with strong states perform better than any other types of regimes. Although external public debt has negative effects on growth in other regimes, it has a slightly positive effect on growth in moderate pluralistic regimes with strong states. Regarding foreign investment, it has a positive effect in all regimes, but the positive effect is the strongest in moderate pluralistic regimes with strong states. Thus, my findings indicate that regime types affect the effects of external economic linkages in such a way as to weaken or strengthen the direction of the effects of external economic linkages on economic growth. This suggests that the effectiveness of the state to exploit the benefits of external economic linkages and to minimize their costs for promoting economic growth is dependent on the degree of regime centralization and state infrastructural power.

Table 5.2: Effects of External Economic Linkages on Growth

| | (OLS) | | | (GLS) | |
|---|---|---|---|---|---|
| | Estimate | t-ratio | | Estimate | t-ratio |
| INTCPT | .203*** | 5.06 | INTCPT | .169*** | 4.13 |
| SAVE | .0003*** | 5.37 | SAVE | .0003*** | 4.45 |
| GDP | - .022*** | 3.76 | GDP | - .018*** | 2.98 |
| MILIT | .0004*** | 3.89 | MILIT | .0003*** | 4.32 |
| TAX | - .119*** | 4.12 | TAX | - .114*** | 4.41 |
| EXPT | - .158*** | 3.92 | EXPT | - .107*** | 3.31 |
| DEBT | - .083*** | 3.63 | DEBT | - .055*** | 2.70 |
| PROFIT | 1.822*** | 5.16 | PROFIT | 1.485*** | 5.15 |

N = 167
R-square = .351

*** < .001
** < .05
* < .10

N = 162
R-square = .789

*** < .001
**< .05
* < .10

Table 5.3: Effects of Foreign Debt on Growth (GLS)

|  | Estimate | t-ratio |
|---|---|---|
| INTCPT | .105*** | 2.73 |
| SAVE | .0003*** | 5.46 |
| GDP | -.011* | 1.91 |
| MILIT | .0003*** | 3.80 |
| TAX | -.113*** | 3.77 |
| EXPT | -.099*** | 3.36 |
| DEBT | -.126*** | 2.53 |
| x CW | .061 | 1.32 |
| x CS | .107** | 2.35 |
| x PW | .102** | 2.10 |
| x PS | .129*** | 3.28 |
| x FW | .078 | 1.14 |
| PROFIT | 1.822*** | 5.16 |

N = 164
R-square = .832

*** < .001
** < .05
* < .10

Table 5.4: Effects of Foreign Investment on Growth (GLS)

|        | Estimate | t-ratio |
|--------|----------|---------|
| INTCPT | .098**   | 2.46    |
| SAVE   | .0003*** | 6.01    |
| GDP    | - .010   | 1.63    |
| MILIT  | .0004*** | 4.99    |
| TAX    | - .154***| 4.95    |
| EXPT   | - .060** | 1.99    |
| DEBT   | - .045** | 2.32    |
| PROFIT | .760***  | 2.72    |
| x CW   | - .386   | .81     |
| x CS   | .798**   | 2.25    |
| x PW   | .878     | 1.26    |
| x PS   | 1.675*** | 3.35    |
| x FW   | -2.008   | .35     |

N = 164
R-square = .841

*** < .001
** < .05
* < .10

Table 5.5: The Pattern of a First Order Autocorrelated Error in Each Country
(Effects of Foreign Debt on Economic Growth)

| Country Name | Estimate (rho) | T-ratio | PR>T | N | R-square |
|---|---|---|---|---|---|
| Bolivia | .062 | .15 | .888 | 6 | .004 |
| Brazil | -.175 | .44 | .677 | 7 | .031 |
| Chile | .109 | .22 | .838 | 5 | .012 |
| Columbia | .355 | .88 | .410 | 7 | .115 |
| Ecuador | -.591 | 1.14 | .318 | 5 | .245 |
| El Salvador | -.152 | .26 | .809 | 5 | .016 |
| Ghana | .009 | .02 | .983 | 7 | .00008 |
| Honduras | .316 | .87 | .416 | 7 | .113 |
| Indonesia | .026 | .06 | .954 | 7 | .0006 |
| Korea | -.514 | 1.18 | .283 | 7 | .188 |
| Malaysia | -.401 | 1.33 | .234 | 7 | .228 |
| Mexico | .240 | .49 | .641 | 7 | .039 |
| Morocco | -.341 | .96 | .372 | 7 | .134 |
| Nicaragua | .502 | .89 | .406 | 7 | .118 |
| Pakistan | -.103 | 1.03 | .342 | 7 | .151 |
| Paraguay | .333 | .77 | .471 | 7 | .090 |
| Peru | .344 | .95 | .377 | 7 | .132 |
| Philippine | .390 | 1.03 | .343 | 7 | .150 |
| Sierra Leone | -.327 | .98 | .367 | 7 | .137 |
| Sri Lanka | .258 | .59 | .579 | 7 | .054 |
| Thailand | -.011 | .03 | .977 | 7 | .0002 |
| Tunisia | .532 | 1.37 | .219 | 7 | .239 |
| Turkey | .141 | .35 | .742 | 7 | .019 |
| Venezuela | .130 | .28 | .794 | 5 | .019 |

Table 5.6: The Pattern of a First Order Autocorrelated Error in Each Country
(Effects of Foreign Investment on Economic Growth)

| Country Name | Estimate (rho) | T-ratio | PR>T | N | R-square |
|---|---|---|---|---|---|
| Bolivia | -.293 | .68 | .526 | 6 | .085 |
| Brazil | -.089 | .22 | .835 | 7 | .008 |
| Chile | .446 | 1.15 | .293 | 7 | .181 |
| Columbia | .309 | .91 | .399 | 7 | .121 |
| Ecuador | -.256 | .53 | .627 | 5 | .065 |
| El Salvador | .184 | .35 | .747 | 5 | .029 |
| Ghana | .007 | .02 | .987 | 7 | .00005 |
| Honduras | .283 | .75 | .480 | 7 | .086 |
| Indonesia | -.026 | .06 | .955 | 7 | .0006 |
| Korea | -.539 | 1.36 | .223 | 7 | .236 |
| Malaysia | -.282 | .59 | .585 | 5 | .081 |
| Mexico | .263 | .54 | .617 | 5 | .068 |
| Morocco | -.296 | .77 | .468 | 7 | .091 |
| Nicaragua | .626 | 1.05 | .332 | 7 | .156 |
| Pakistan | -.169 | 1.83 | .117 | 7 | .358 |
| Paraguay | .409 | .96 | .372 | 7 | .134 |
| Peru | .387 | 1.19 | .278 | 7 | .191 |
| Philippine | .136 | .33 | .750 | 7 | .018 |
| Sierra Leone | -.346 | .78 | .465 | 7 | .092 |
| Sri Lanka | .356 | .83 | .440 | 7 | .103 |
| Thailand | -.021 | .06 | .956 | 7 | .0005 |
| Tunisia | .528 | 1.32 | .235 | 7 | .225 |
| Turkey | .150 | .35 | .735 | 7 | .021 |
| Venezuela | .354 | 1.03 | .343 | 7 | .150 |

# Chapter VI

# EFFECTS OF EXTERNAL ECONOMIC LINKAGES

# ON SOCIAL EQUALITY

In this chapter, I will test my hypotheses regarding the effects of external economic linkages on social equality in 23 countries during the period of 1975-79. The selection of the countries and time period studied is simply for reasons of data availability, whereas this study covers a special period for the periphery as discussed in the previous chapter. Again a pooled, cross-section time-series method will be employed in order to test my hypotheses. To this end, I constructed an index of social equality which permits us to analyze time-series data in studying social equality in Third World countries. This is important because the yearly data of conventionally used GINI index as an indicator of inequality within a country are not available for most Third World countries. This limitation of data availability has forced researchers to employ cross-section analysis alone in previous quantitative studies. Thus, this study is the first attempt to analyze time-series data in examining the effects of external economic linkages on social equality in peripheral countries. In order to construct a model on the effects of external economic linkages on social equality, I basically followed the major previous works of Chase-Dunn (1975), Rubinson (1976), Dolan and Tomlin (1980), and Weede and Tiefenbach (1981a, 1981b).

# Measures

## Measures of Social Equality

Most researchers have operationalized social equality as personal income equality, that is, the distribution of monetary income across households. This personal income has then been measured by either the GINI Index or the percentage of total income going to the richest five (or twenty) percent of the population, or by the percentage of total income going to each quintile.

However, there are critical limitations in using these measures as an indicator of social equality (Russett et al., 1981, pp759-60). First, income data have been criticized by many authors in light of their accuracy. Household income surveys in most poor countries are often flawed in design or execution. The definition of the unit from which data are compiled may vary among households, income recipients, and the economically active population. And there are always questions about the quality and completeness of coverage. Second, these data are not available for many Third World countries. Even if those data do exist, they are typically available for only one or two points in time. This limitation of data availability has severely restricted the previous empirical studies. Third, in addition to these data problems, there are conceptual limitations to those measures. Even though we can collect complete and accurate income data, they may be misleading because of differences in prices between urban and rural environments, different needs of workers in different situations, and the omission of non monetary income. Especially, income data are not able to capture the inequality in access to goods and services addressing basic needs.

For these reasons, I created a social equality index composed of measures developed by Ward (1978), Russett et al. (1981), and Hibbs (cited by Ward, 1978). The

data of which are available for most countries at points in time occurring over the past twenty years. The way I created each measure and social equality index is as follow:

## Ward Index

The basic idea underlying this index is that social equality within a given social unit is related to both its level of poverty and level of affluence. For example, when the level of affluence is relatively high but the level of basic needs is relatively low, there is probably a maldistribution of income. Thus, in this index, the ratio of poverty to affluence is taken as an indicator of the aggregate level of inequality within countries.

In order to construct this index, I first selected three indicators of poverty and three indicators of affluence which reflect the extent of poverty and affluence in a country respectively. The indicators of poverty include the number of kilo calories per head per day (CALORY), grams of protein per head per day (PROTAIN), and the infant mortality rate (MORTALITY). Each indicator represents one of the most basic human needs, and data are found in *World Tables* (World Bank, 1976, 1980, 1983).

Affluence indicators include the number of passenger vehicles per thousand population (CAR), the number of television set per thousand population (TV), and the number of university students per thousand population (UNIVERSITY). Data are from Bank's *Cross-national Time-series Data Set*. Each measure may reflect very high consumption levels for the rich within Third World countries. I used these affluence indicators rather than those selected by Ward, such as the number of Hilton hotels, the number of universities, and the number of motor vehicle deaths, because my indicators may better reflect changes in the level of affluence over time in developing countries.

The next step is to conduct two factor analyses of these three independent measures of societal affluence and poverty to see if each of these variable is highly correlated. Then,

composite indices of affluence (AFFLUENCE) and poverty (POVERTY) are created by weighting the standardized variables by their factor loading. That is:

$$AFFLUENCE = (.84444CAR + .91705TV + .69839UNIVERSITY)/D \text{ ---- } (6\text{-}1)$$

where D = number of non-missing observations for each case (D>0)
where each variable is standardized.

$$POVERTY = (.91337CALORY + .6213PROTEIN - .66579MORTALITY)/D$$

$$\text{----- } (6\text{-}2)$$

Next, each variable (AFFLUENCE and POVERTY) is standardized, and those cases to the right of -1 standard deviations are coded low (1), between -1 and +1 are coded moderate (2), and the remainder are coded as high (3). Then, each country is classified in terms of the degree of social inequality based on the following assumptions:

1. A society with a low degree of both affluence and poverty is a relatively equal society.

2. A society with a high degree of both affluence and poverty is a highly unequal society.

3. A society with high affluence and low poverty is a more unequal society than a society with low affluence and high poverty.

4. For societies with equal levels of poverty, the one with the greater level of affluence exhibits more inequality.

5. For societies with rough parity between poverty and affluence, the inequality is directly related to the level of both poverty and wealth.

The assumptions 3 and 4 derive from the additional assumption that affluence tends to influence the level of inequality more strongly than does poverty. This assumption is based on the knowledge that the richest segments in societies tend to be relatively smaller in absolute numbers than the poorest segments (Ward, 1978, p28).

From these assumptions, we can deduce the following conceptual map (Table 6.1). Based on this conceptual map and scores assigned to each country, the Ward Index is constructed. We assign to each country a score ranging from 1 to 9: the higher the score a country has, the more inequality the country has.

Table 6.1: Inferring Inequality from Polychotomous Information on Poverty and Affluence in Social Units.

### Inequality Scores

|                       | Extent of Poverty | | |
| --------------------- | ------- | -------- | ----------- |
| Extent of Affluence   | Low (1) | High (2) | Extreme (3) |
| Low (1)               | 1       | 2        | 4           |
| High (2)              | 3       | 6        | 7           |
| Extreme (3)           | 5       | 8        | 9           |

## Russett Index

Another way to estimate social equality in a country from using social indicators has been suggested by Russett et al. (1981). In their recent article, Russett and others have developed the following two estimations of income inequality from health, income, and population patterns.

Income Inequality = 3517.25 - 401.91 Population Density - 93.35 Urban Density

$$+ 139.22 \text{ Average Income} - 2.61 \text{ (Average Income)}^2$$

$$- 412.97 \text{ (Average Income)}^3 \qquad \text{----- (6-3)}$$

Income Inequality = 52.446 + 27.759 Population Growth

+ 50.117 Average Income - .289 (Average Income)$^2$

+ 14.743 Infant Mortality          ----- (6-4)

The equation (6-3) is derived from the Russett and others' model on the determinant of health care. According to Russett and others, an individual's level of health should be a function of geographical closeness to health care facilities, the type of place in which he/she lives (urban or rural area), and income level (in a nonlinear fashion). An individual's geographical distance from health care services is important because the farther a person lives from a doctor, clinic, or hospital, the less able he/she is to obtain the benefits of these various services. Equally important is the consideration that the provision of health care services is concentrated in urban areas rather than rural ones. Finally, an individual's level of health is also dependent on his or her ability to pay for health services. The cost of health services is particularly burdensome for the poor, since even low costs can represent a significant portion of their income. Thus, health is viewed to be inversely related to income in a nonlinear fashion.

Then Russett and others aggregated these factors over all individuals to derive a predicted level of average health as a function of average density, urbanization, average income, and income inequality. In summing the individual income effects over all individuals, linear relations between income and health resulted in a direct relation between average health and average income. Nonlinear effects, when aggregated, yielded a more complex relationship between average health and the income distribution. Average income (INCOME) and an income inequality measure (INEQUALITY) were together assumed to summarize most of the pertinent information about a given country's income distribution. Aggregating the nonlinear income effects and controlling for the effects of population

density (DENSITY) and urban density (URBAN), a model for the determinants of health care can be expressed as:

$$HEALTH = a + b_1 INEQUALITY + b_2 DENSITY + b_3 URBAN$$
$$+ b_4 INCOME + b_5 (INCOME)^2 + b_6 (INCOME)^3 \qquad --- (6-5)$$

After rearranging terms and renaming the regression coefficients (and assuming $b_1 = 0$), equation (6-3) is transformed to:

$$INEQUALITY = a + b_1 DENSITY + b_2 HEALTH + b_3 URBAN$$
$$+ b_4 INCOME + b_5 (INCOME)^2 + b_6 (INCOME)^3 \qquad --- (6-6)$$

In this model of income inequality, the level of health care in a society is used to predict income inequality, while urban density, population density, and income are used to control for other factors which affect the level of health. The results of OLS estimations of this equation are shown in equation (6-3).

The index of health conditions was compiled by averaging the Z-scores (standardized scores with the same mean and standard deviation) of life expectancy and the negative scores of the infant mortality rate. Data on life expectancy, infant mortality rate, and population density are derived from *World Tables*.

Russett and others derive the equation (6-4) from their model on the determinants of fertility. They assume that fertility declines with higher income then begins to rise again. They also expect that fertility varies with infant mortality: the higher the infant mortality, the higher the fertility. After Russett and others aggregated these factors over all households, and manipulated the result algebraically, they arrived at an equation (6-7) indicating a

predicted level of average fertility as a function of average income, average infant mortality, and income inequality.

$$FERTILITY = a + b_1 INEQUALITY + b_2 INCOME + b_3 (INCOME)^2$$
$$+ b_4 MORTALITY \qquad \text{----- (6-7)}$$

Manipulating this equation, and relabeling the coefficients, an equation (6-8) is derived which predicts income inequality.

$$INEQUALITY = a + b_1 FERTILITY + b_2 INCOME + b_3 (INCOME)^2$$
$$+ b_4 MORTALITY \qquad \text{----- (6-8)}$$

However, data on fertility are not widely available, so Russett and others employed population growth instead of fertility as a predictor of income inequality. Based on a definition that the rate of population growth over a period of time equals births minus deaths divided by total population at the beginning of the period, they found the fertility rate as, ceteris paribus, a linear function of population growth and infant mortality. After combining these results with equation (6-6), and relabeling the coefficients, they arrived at the following equation:

$$INEQUALITY = a + b_1 POPULATION\ GROWTH$$
$$+ b_2 INCOME + b_3 (INCOME)^2$$
$$+ b_4 MORTALITY \qquad \text{----- (6-9)}$$

Estimation of this equation yields the result shown in equation (6-4). Data on population and infant mortality are from *World Tables*. Average income can be defined as the level of GDP per capita, and GDP figures are found in the IMF's *International Financial Statistics*.

## Hibbs' Z-Score Index

The calculation of this measure (HIBBS) was nearly identical to the procedure suggested by Hibbs (1973) and adopted by Ward (1976). A small modification is that the literacy rate was used instead of the number of doctors per 1000. This index was calculated as:

$$\text{HIBBS} = (\text{LITERACY} + \text{CALORY} + \text{PROTEIN} + \text{MORTALITY})/D \quad - (6\text{-}10)$$

where D = number of nonmissing observations for each case (D>0)
where each variable is standardized.

The underlying reasoning for using this index is that these particular four values cannot reasonably be held by a small elite portion of the population. Therefore, the summation of these four variables is thought to reflect their distribution. Thus, a high score represents a distribution of great equality, while a low score represents a nonegalitarian distribution (Ward, 1976, p24).

Combining this Hibbs' Z-score index to Ward and two Russett indices, I created a composite index of social equality.

## Social Equality Index

In order to construct a social equality index, I first standardized Ward (WARD), Hibbs (HIBBS), and two Russett indices (RUSSETT1, RUSSETT2), and then conducted a factor analysis of these four measures of social equality. Finally a composite index of

social equality (EQINDEX) was created by weighting the standardized indices by their factor loading. That is:

$$EQINDEX = .69782 \text{ RUSSETT1} + .91124 \text{RUSSETT2}$$
$$+ .56342 \text{WARD} - .5174 \text{HIBBS} \qquad\text{---- (6-11)}$$

To evaluate the validity of this index of social equality, I examined the correlation between this index (for 1973) and the GINI index (for around 1970 taken from Bornschier and Ballmer-Cao, 1979). Even though the years of data collected did not match, the two indices were closely related, with a correlation coefficient $r = .80$ for the nineteen cases (significance $= .001$)[1].

## Measures of External Economic Linkages

As in the fifth chapter, I used two aspects of external economic linkages as independent variables: foreign direct investment and foreign debt. These variables are operationalized in the same way as in the previous chapter.

## Measures of Regime Types

As in the previous chapter, sample countries were classified into six types of regimes according to the degree of power centralization and infrastructural power. First, samples were divided into three groups with respect to their degree of power centralization: centralized regimes, moderate pluralistic regimes, and fragmented regimes. This was conducted in exactly the same way as in Chapter V. Next, countries were classified in

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[1] I first planned to use one of the four index to measure the degree of social equality in developing countries. However, none of the four index alone was not highly correlated to the GINI index. Since an individual index seemed to have an validity problem in my data, I constructed an composite index explained the above.

terms of the degree of infrastructural power. The countries which have equal to or more than 21.40 percent (the median point) for the measure of infrastructural power of the state are assigned to be strong states, while the countries with less than 21.40 percent are assigned to be weak states. The results of the classification are shown in Table 6.2.

Table 6.2: Classification of Third World Countries by Regime Type.

| (CS) | (PS) | (FS) |
|---|---|---|
| Ecuador 1975-8 | Columbia 1975-9 | Ecuador 1979 |
| Ghana 1976,78 | El Salvador 1975 | Malaysia 1975-9 |
| Honduras 1975,78,79 | Indonesia 1975-9 | Turkey 1975-9 |
| Morocco 1975 | Korea 1975-9 | Venezuela 1975-9 |
| Peru 1975 | Mexico 1975-9 | |
| Philippine 1977 | Morocco 1978-9 | |
| Sierra-Leone 1978-9 | Philippine 1978-9 | |
| | Sierra-Leone 1975-6 | |

| (CW) | (PW) | (FW) |
|---|---|---|
| Bolivia 1975-8 | Brazil 1975-9 | Bolivia 1979 |
| Chile 1975-9 | El Salvador 1976-8 | Sri Lanka 1975,76 |
| El Salvador 1979 | Ghana 1979 | Thailand |
| Ghana 1975,77 | Morocco 1977 | |
| Honduras 1976-7 | Nicaragua 1975-8 | |
| Morocco 1976 | Pakistan 1975-6 | |
| Nicaragua 1979 | Paraguay 1975-9 | |
| Pakistan 1977-9 | Peru 1978 | |
| Peru 1976-7,79 | Sierra-Leone 1977 | |
| Philippine 1975-6 | Sri Lanka 1977 | |
| Thailand 1976-8 | | |
| Tunisia 1975-9 | | |

Measures of Control Variables

In order to investigate the effects of external economic linkages on social equality in the Third World, I use the following three control variables.

The level of Economic Growth. A number of liberal economists have suggested that the relationship between growth and inequality is curvilinear rather than liner: equality is likely to worsen in the early stages of development and only later begin to improve again. Kuznet (1955) argues that there are two factors which can explain why growth leads to more inequality at early stage of development. First, the rich tend to save more than the poor, so the rich are likely to accumulate a greater proportion of assets resulting from economic development. Second, industrialization due to economic growth tends to be associated with urbanization, in which urban centers increasingly become the most productive sectors of the economy. Thus, new wealth is likely to be accumulated in industrial and urban areas, thereby also contributing to increasing inequality in the early stages. At a later stage, however, the poor may take more risks in investments for new opportunities than the conservative rich since the incentive to get rich is much greater for the poor than it is for the rich. As a result, the poor tend to increase both their absolute and relative shares of societal products while the rich are likely to stay wealthy in absolute terms, which leads to decreasing levels of inequality at higher levels of development.

This hypothesis of the "inverted-U" has been advanced by other economists for somewhat different reasons. According to Reder (1969), there is little scope for surplus to accrue to one favored group in a primitive society because aggregate output only marginally exceeds the minimum subsistence level for the total population. Nevertheless, as economies become more complex, there is an increase in the equality within that society because of increasing labor differentiations. Kravis (1960) also notes that the labor mass is homogeneous in preindustrial societies, but as the diversity of industries and occupations increases with early industrialization there may be an increasing inequality within the labor force. This is because: (1) protected sectors arise in which unions hold wages above levels that would clear the labor market (Harberger, 1971); (2) labor becomes heterogeneous through on-the-job training as well as formal education: (3) some activities will arise in

which a valuable set of resources must be used by the worker who is paid accordingly (Reder, 1969); and (4) the profit share is greater in modern sectors than in traditional sectors which would rise over time (Lewis, 1954).

According to this "inverted-U" hypothesis, inequality increases as the level of economic growth increases among developing countries. The level of economic growth is measured by GDP per capita, and the data are from IMF *International Financial Statistics* (1985).

Rate of Economic Growth. Many authors have argued that a rapid rate of socio-economic change tends to result in greater inequality (Chan, 1989, p46). Mancur Olson (1963), for example, has observed this tendency while discussing the politically destabilizing effects of rapid economic growth. The results of former empirical studies, however, are rather mixed. Ahluwalia (1974) found that there was no strong pattern which related changes in income distribution to the rates of GNP growth. Nevertheless, Jackman (1975) and Ward (1978), using larger samples and different measures of social equality, have reported that a high level of economic development is conducive to equality, but that a high rate of economic growth is apt to have the opposite effect.

This variable is measured by the annual rate of GDP. Data are from *International Financial Statistics* (IMF, 1985).

The Military Participation Ratio. Weede and Tiefenbach (1981b) argue that the military participation ratio, or the relative size of a country's armed forces, is likely to reduce income inequality. This is because the relative size of a country's armed forces may contribute to the development of human capital, and may also reflect the extent of foreign threat which may encourage the elite to share national wealth with the poor. Empirical support of this hypothesis has been provided by Weede and Tiefenbach (1981a), and Weede (1986a). Dixon and Moon (1986) also reported that the military participation ratio was a positive correlate of a higher physical quality of life.

The military participation ratio is measured by the number of military personnel as a percentage of the total population (per 1,000). The data are found from Bank's *Cross-national Time-series Data Set.*

State infrastructural power is measured by the percentage of the central government's total revenues obtained from direct taxes on income, profits, and capital gains. Data are from *World Tables.*

The inclusion of this state infrastructural power variable into my model is due to the results from Rubinson (1976). According to Rubinson, a strong state is able to shift the balance of political and economic forces away from the dominance of the small export elite and towards the development of a much larger and diversified manufacturing class with the consequence that income distribution is more equal. Furthermore, in a country with a strong state, a large and organized work force can use the state to press for demands in terms of measures of redistribution such as wages and tax policies. The findings of Rubinson's regression cross-national analysis generally support his hypothesis.

The level of trade is measured by the value of exports as a percentage of GDP. This indicates to what extent a country's economy relies on exports to the world market. The data are available in the IMF's *Direction of Trade.*

According to liberal economists, foreign trade enhances social equality in Third World countries, thereby decreasing the sectoral imbalance and unequal distribution of income. Higher exports increase the national income in a country, which then brings new investment opportunities to other sectors. Moreover, increases in exports may raise wages, thus leading to an increase in labor's share of income. In contrast, dependency writers claim that increasing trade will create an export enclave within a peripheral country, in which development is much greater in those export-related sectors (modern sectors) than in others (traditional sectors), and the modern and traditional sectors tend to be poorly connected to each others. Thus, for dependency writers, trade creates internal structural

distortion in the Third World, thus resulting in a higher inequality within a peripheral country.

Figure 6.1 shows the model used to test the mediating effects of regime types between external economic linkages variables (foreign direct investment and foreign debt) and social equality.
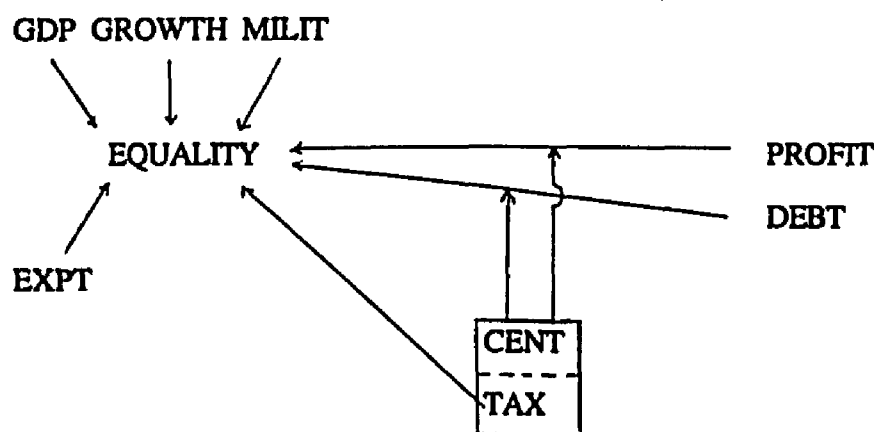


Figure 6.1: Model on the Effects of External Economic Linkages Social Equality in the Third World

## Method of Analysis

In order to test my hypotheses regarding the effects of external economic linkages upon social equality in Third World countries, I used a pooled, cross-section time-series regression analysis[2] . The use of this method gives several strengths to my study compared to previous quantitative studies concerning this topic. First, I could use a larger number of

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[2] For the actual steps taken in this study, see Chapter V.

samples than previous studies by using both cross-sectional and time-series data. Second, since previous studies used the GINI index or the percentage of total income going to each quintile, they were forced to use only a cross-national analysis to test hypotheses because of data availability. My construction of a social equality index enabled me to use pooled cross-sectional time-series data which provided an opportunity to examine, for the first time, across time and space the effects of external economic linkages on social equality in the Third World.

However, the use of pooled cross-sectoral and time-series analysis also produced a serious problem for this study. As discussed in the fifth chapter, with pooled data, the conventionally used ordinary least square (OLS) technique cannot usually be used because this kind of data often creates problems of heteroskedasticity and autocorrelation which violate some of the assumptions for the BLUE nature of an OLS estimator. In order to detect these problems, I first estimated my model, using the OLS method with 115 observations. After analyzing the residuals, I found that the values of many first-order autocorrelation coefficients (rho) in each cross-sectional unit are very high and that these effects are statistically significant, indicating that there was a serious autocorrelation problem: the error terms are correlated over time. Therefore, I transformed all data using a method of the first difference for those countries with high levels of rho in order to obtain independent error terms over time. However, after transforming data several times in this manner, I found that there were still autocorrelation problems, although the results of the Breusch-Pagan test indicated that the assumption of homoskedasticity was not seriously violated. Thus, my test results are not conclusive, although they do strongly support most of my hypotheses regarding the effects of external economic linkages on social equality in developing countries.

## Sample of Countries

I took a sample of 23 Third World countries which are not missing any of the data of all variables in my model during the period of 1975-79. The following are the sample of countries:

Bolivia, Brazil, Columbia, Ecuador, El Salvador, Honduras, Ghana, Indonesia, Korea Republic, Malaysia, Mexico, Morocco, Nicaragua, Pakistan, Paraguay, Peru, Philippines, Sierra Leone, Sri Lanka, Thailand, Tunisia, Turkey, and Venezuela.

## Results

Table 6.3 shows findings using OLS and GLS estimators without considering the effects of regime types as an intervening variable between external economic linkages and social inequality in peripheral countries. In both models, the sign of DEBT and PROFIT coefficients is positive with statistically significant effects. This indicates that higher external public debt and profit made by foreign firms increase social inequality within 23 Third World countries during the period 1975-79. Nevertheless, the effect of EXPT is negative with statistical significance at a .01 level, showing that larger proportions of exports to GDP reduces social inequality. As predicted, the sign of the GDP coefficient is positive and that of the military participation is negative, and those effects are statistically significant. Direct tax shows no effect on social inequality in both of the two models. The only difference between the two models is the effect of economic growth on social inequality. In the OLS model, growth shows a negative effect on social inequality with a statistical significance at the .05 level. In the GLS model, however, the value of the growth coefficient changes from -7.036 to .261, and the t-ratio reduces from 2.12 to .20, indicating that growth does not affect social inequality in the 23 countries of our sample. In

the GLS model, the efficiency of three coefficients (EXPT, DEBT, GDP) increases markedly, and the R-square rises from .368 to .602.

## Effects of Debt on Social Equality

Next, we will examine the differences in the effects of external public debt on social inequality across six types of regime. In the GLS-1 model (Table 6.4), the sign of the debt coefficient is negative in moderate pluralistic regimes with strong states (b = -2.806) with a statistically significant effect at the .05 level (t = 2.27). Although fragmented regimes do not differ significantly in this effect (t -ratio is too small), the rest of the regimes (CW, CS, PW) differ markedly. In CW, CS, and PW regimes, the effects of foreign debt on social inequality are positive, indicating that larger DEBT increases social inequality in these regimes This effect is especially significant in centralized regimes with strong states (CS): the value of the DEBT coefficient is 3.338 (= -2.806 + 6.244), that is, 2.6 times bigger than that for CW regimes (b = 1.322 = -2.806 + 4.128), and 5.7 times bigger than that for PW regimes (b = .599 = -2.806 + 3.405). Thus, these findings support my hypotheses: foreign debt increases social inequality in centralized regimes, in which this effect is more significant in strong states than in weak states; and foreign debt decreases social inequality in moderate pluralistic regimes with strong states. However, the pattern of a first order autocorrelated error is not stationary (see Table 6.5), indicating deterministic errors arising from systematic under- or overprediction rather than stochastic fluctuation around the regression prediction (Stimson, 1985, p939). Therefore, these statistical results are not conclusive, and as such we need to do further studies to get more reliable test results.

**Effects of Foreign Direct Investment on Social Equality**

Table 6.6 indicates the different effects of profits made by foreign firms (PROFIT) on social inequality across six types of regimes using the GLS-1 model. In this model, the effect of PROFIT is negative with a statistical significance at the .01 level in moderate pluralistic regimes with strong states, suggesting that profits made by foreign firms decrease social inequality in this type of regimes. However, the effects of PROFIT on social inequality becomes positive in CW, CS, PW, and FS regimes (b for CW = -72.0 + 120.8 = 48.8; b for CS = -72.0 + 149.8 = 77.8; b for PW = -72.0 + 145,6 = 73.6; b for FS = -72.0 + 89.0 = 17.0). All these effects differ significantly from that in PS regimes (t = 5.49 for CW, 7.95 for CS, 4.98 for PW, 5.51 for FS). Only FW regimes show no difference in the effects of PROFIT on social inequality from PS regimes.

These findings indicate that the effects of profits made by foreign firms on social equality vary across different regimes. Among strong states, as expected, foreign investment increases social equality in moderate pluralistic regimes, and decrease social equality in centralized and fragmented regimes. In centralized regimes, higher profits made by foreign firms increase more inequality in strong states than in weak states. Among moderate pluralistic regimes, profits made by foreign firms decrease social inequality in strong states, while increases it in weak states. In fragmented regimes, profits made by foreign firms increase social inequality in strong states, while in weak states, the effects of foreign firms are not significantly different from those in pluralistic regimes with strong states. However, the pattern of a first order autocorrelated error (see Table 6.7) again shows that the assumption of non-autocorrelation is violated. Thus, these statistical results are not conclusive, and further studies are required in order to test my hypotheses regarding the effects of foreign investment on social equality in developing countries.

# Discussions

As I pointed out above, although the problem of heteroscedasticity does not exist in my data, there is a serious autocorrelation problem, that is, the error terms are not independent along a time dimension within units. This affects the variances of the coefficient parameters, so that standard statistical tests become inaccurate. Thus, I need to do further research to test my hypotheses by correcting the serial dependence of the error terms.

The problem of serial correlation of error terms may stem from my exclusion of an important variable in the models. With respect to the effects of foreign debt on social equality in the OLS model (Table 6.8), I examined the patterns of residuals and found that four countries constituted outliers. Paraguay, Philippines, and Sri Lanka were located highly below the regression line and Sierra Leone was located highly above it. Since the literacy rate is high in Paraguay (.830), Philippines (.854), Sri Lanka (.828), while very low in Sierra Leone (.168), the level of education may be a critical additional determinant of social inequality within a country. A theoretical reasoning to support this point is that a more skilled labor force will produce a shift from lowly paid, unskilled employment to highly paid, skilled employment. This shift may produce higher labor incomes, a reduction in skill differentials, and an increase in the share of wages in total output (Ahluwalia, 1976, p322). This specification error can also be applied to the model for the effects of foreign direct investment on social inequality. In the OLS model (Table 6.9), the above four countries constitute outliers and are located in the same manner, indicating that we should include the level of education into the model. The only difference is the existence of Bolivia as an outlier, located highly above the regression line. The literacy rate of Bolivia is very low (.481), but much higher than that of Sierra Leone, so we may need an additional variable in the model, such as, for example, the level of democracy or socialism.

Table 6.10 and table 6.11 indicate the effect of foreign debt and investment on social inequality, respectively, using Stimson's GLS-ARMA with dummy variables[3] for the above outlier countries. The models increase the efficiency of most of the coefficients, explaining over 85 percent of the variance in social inequality in our samples. In table 6.10, we have more strong evidence than in the GLS-1 model (Table 6.4) which supports my hypotheses. In this case, the sign of the DEBT coefficient is also negative in moderate pluralistic regimes with strong states, but this effect is not statistically significant ($t = 1.53$). However, all other regimes differ markedly in the effects of DEBT on social inequality from PS regimes. In CW, CS, PW, FW, and FS regimes, the effect is positive, indicating that larger DEBT increases social inequality. The differences in these effects from that in PS regimes are all statistically significant. Table 6.11 also provides stronger evidence than the GLS-1 model (table 6.6) for my hypotheses. Here we see basically the same pattern on the effects of profit made by foreign firms on social inequality. However, a simple comparison between the GLS-1 and GLS-2 models is not possible because, in the GLS-2 model, I used different points which distinguish between strong and weak states, that is , the median (21.40 percent) for GLS-1 model, and the mean (26.48 percent) for GLS-2 models. Furthermore, although I am pretty sure that there is no autocorrelation problem in the GLS-2 models, I do not have an computer output regarding the pattern of a first order autocorrelated error in each country for GLS-2 models.

Thus, I must postpone the confirmation of my hypotheses until I obtain more reliable test results. Nevertheless, judging from the findings reported above, it is very likely that (1) external economic linkages have negative effects on equality in centralized regimes; (2) this tendency is more significant in strong states than in weak states; (3) external economic linkages have positive effects on social equality in moderate pluralistic regimes with strong states; and (4) foreign investment increases social inequality in

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[3] For the detail, see Stimson (1985).

fragmented regimes. Thus, my findings cast a doubt about the simple generalization of the results of previous quantitative studies supporting propositions drawn from the dependency perspective.

As discussed in the second chapter, the majority of the previous quantitative studies report that external economic linkages result in greater inequality within a peripheral country. These studies include: Kaufman et al., 1975; Ballmer-Cao, 1979; Bornschier, 1978, 1981, 1983b; Bornschier and Ballmer-Cao, 1979; Evans and Timberlake, 1980; Rubinson, 1976; Sullivan, 1983. Although Weede and Tiefenbach (1981a), Chase-Dunn (1975), and Dolan and Tomlin (1980) offer different findings, there are problems of data or test designs in their studies. Thus, there seems to be an unanimous agreement that increasing foreign direct investment and foreign debt lead to more inequality in peripheral countries.

All regimes but pluralistic regimes with strong states have negative effects of external economic linkages on social equality in the Third World in my findings too. This overall negative effects of foreign debt and foreign direct investment support the dependency perspective that views external economic linkages as the means of foreign penetration in which only industrialized countries and economic elites in the periphery can benefit at the expense of the mass in the Third World. The more a state is indebted to other states or foreign economic actors, the more leverages and constraints those actors and states have over the economic policies of the countries. With respect to foreign direct investment, multinational corporations may distort the economy and the nature of economic development in less developed countries. Local subsidiaries exist as appendages of the metropolitan corporation and as an enclaves in the host economy. Increasing foreign direct investment tends to increase wide gap between the life styles and orientations of better paid and more skilled employees of the multnational corporations and those of their compatriots who are essentially untouched by the international economy. Thus, a small international-

oriented elite coexists with a more backward and more parochial majority of the population. In addition, the technology used in multinational corporations is too advanced, too expensive, and too capital-intensive, so that foreign direct investment does not contribute to increasing employment for a country with large number of enemployed. Furthermore, multinational corporations introduce and agressively market products that are not necessary for the primary tasks involved in national development. Consequently, money is drawn from social, health, and educational necessities, which may aggravate the conditions of poor segments of the society. In this way, the periphery develops in an uneven fashion as foreign direct investment increases (Walters and Blake, 1992, p123).

Although this "associated" or "dependent development" school offers persuasive interpretation of my test results, my findings at least show that the negative effects of foreign direct investment and foreign debt on social equality cannot be generalized in all Third World countries. In centralized regimes and fragmented regimes, although increasing foreign direct investment and foreign debt are likely to decrease social equality, this negative effect may be more significant in strong states than in weak states. With respect to moderate pluralistic regimes with strong states, nevertheless, foreign direct investment and foreign debt are likely to contribute to creating a more equal society in the periphery. Thus, the regime types may affect as an intervening variable between external economic linkages and subsequent social equality.

These different effects of external economic linkages on social equality in the Third World may be explained by different policies pursued by regimes. In terms of foreign debt, states facing serious balance of payment deficits have to take to some extent internal adjustment measures, such as raising interest rates and taxes to reduce the level of spending by business and individuals, as well as reducing government expenditures by curtailing publicly financed programs at home and abroad (Walters and Blake, 1992, p65). These "deflationary" policies attempt to decrease a country's purchases abroad by reducing

domestic and foreign expenditures of individuals, businesses, and government agencies. The issue is where to cut and upon whom the impact of the cut falls, which are political decisions made by regimes, and these decision-makings may be influenced to a great extent by the structures of regimes.

With respect to foreign direct investment, it may be true that multinational corporations are likely to increase wide gap between the wealth and the poor in developing countries at least in the short run. Nevertheless, some developing countries with heavy foreign direct investment, such as Taiwan and South Korea, have a more equitable distribution of income than do those Third World countries that have restricted outside investment. The primary determinants of social equality may be the policies of the regimes of developing countries themselves (Gilpin, 1987, p250). In fact, the governments of the Third World possess various leverages to increase their own benefits from foreign investment. They can impose performance requirements on foreign investments such as greater local participation and more joint ventures, expanded technology transfers, the exporting of locally manufactured goods, increased local content in final products, and restrictions on the reparation of profits. Furthermore, Third World governments can take advantage of the flexibility of multinational corporations to entice them into establishing facilities in depressed areas of a country, and generate employment to a great extent if they give incentives to multinational corporations so that they make more investments in labor-intensive industries. In order to increase their benefits and reduce their costs, a country need a strong state since the specific terms of foreign direct investment are set through bilateral negotiations between corporations and host governments and in accordance with the bargaining skills and relative power of the actors (Gilpin, 1987, p 251).

Whereas my findings, although generally inconclusive, support my hypotheses, there are some unexpected results. In the first place, I expected that external economic linkages would have positive effects on equality in moderate pluralistic regimes. Although

this is the case in strong states, in my findings, larger profits made by foreign firms and foreign debt may decrease social equality in moderate pluralistic regimes with weak states. Therefore, according to my findings, the degree of centralization/fragmentation alone does not determine the direction of the effects of external economic linkages on social equality in the Third World. The positive effects of foreign direct investment and foreign debt require the existence of strong states which can effectively implement a regime's policies toward more equal distribution of wealth. In this sense, the pattern of the effects of external economic linkages on social equality, in moderate pluralistic regimes, may well be explained by some statist writers who advocate the strong state as a necessary condition in order to undertake effective interventions of the state in a society for a more equal distribution of income. However, this is not applicable to centralized and fragmented regimes since strong states might act in such a way as to benefit only political leaders, powerful interest groups and themselves, thus increasing the gap between the wealth and the poor in the countries.

A puzzle of my findings is that pluralistic regimes with strong states are composed of both South Korea and Mexico that is frequently cited as a typical example of "associated" or "dependent development". In South Korea, the beneficial effects of multinational corporations appear to have spilled over into the rest of the economy, while in Mexico, this is said not to have happened. According to "associated" or "dependent development" school, multinational corporations could promote economic growth, but increase social inequality in a semi-peripheral country like Mexico. Contrary to this argument, my findings show that multinational corporations have beneficial effects on both economic growth and social equality in pluralistic regimes with strong states to which Mexico belongs in my regime classification. An interpretation of my results to solve this puzzle is that it is not foreign direct investment but trade and industrial policies taken by the government of Mexico that reduce social equality in these countries. The major difference

between the developmental strategy of Asian NICs (such as South Korea, Taiwan, Singapore, and Hong Kong) and that of Latin American NICs (such as Brazil, Chile, and Mexico) is that the Asian NICs have stressed export-oriented growth while Latin American NICs have emphasized import substitution. A problem of import substitution strategy is that it cannot raise the living standard of the majority of the poor in a country. Even if a country has a large population, most of the people are not able to buy industrial goods if they are very poor. Since the market is small, enterprises cannot expand their production. Thus the problem of unemployment remains, which is further aggravated by the tendency of introducing capital-intensive technologies in this kind of economic strategy. As a result, many people are unemployed or underemployed or have to work in bad work conditions since they do not have bargaining power vis-a-vis their employers because of the existence of many poor people seeking new jobs desperately. On the other hand, the rich who successfully joined the process of industrialization can easily become richer since their business activities tend to be protected by their governments from the competition with foreign enterprises in the name of economic independence. In order to solve this problem, a country should stress export-oriented growth that can provide many better paid jobs in labor-intensive industries on the basis of comparative advantage, thus raising the standard of living of many poor. If this is the case, trade and industrial policies of the state have decisive impact on the degree of social equality in the country. In fact, according to my findings, increasing exports improve social equality in developing countries. Thus, although many scholars maintain that multinational corporations have increased the disparity between the rich and the poor in Latin American NICs, this might not be true. It is their trade and industrial policies that may have worsened already existing maldistribution of wealth in these countries.

In sum, my findings do indicate that the effects of external economic linkages on social equality may not be uniform across Third World countries. One of the crucial factors

which differentiates those effects may be the regime type in the periphery itself which may influence the nature of the state and its policies. If this is true, we need to stress the internal political process of peripheral countries in order to account for the pattern of the effects of external economic linkages on social equality in the Third World.

Table 6.3: Effects of External Economic Linkages on Social Inequality

| | (OLS) | | | (GLS) | |
|---|---|---|---|---|---|
| | Estimate | t-ratio | | Estimate | t-ratio |
| INTCPT | -5.586*** | 3.00 | INTCPT | -7.644*** | 3.18 |
| GDP | 1.017*** | 4.11 | GDP | 1.330*** | 3.70 |
| GROWTH | -7.036*** | 2.12 | GROWTH | .261 | .20 |
| MILIT | -.014*** | 2.95 | MILIT | -.013*** | 2.28 |
| TAX | -.986 | .75 | TAX | -1.368 | 1.10 |
| EXPT | -7.861*** | 4.48 | EXPT | -7.231*** | 5.97 |
| DEBT | 3.587*** | 5.16 | DEBT | 3.203*** | 5.76 |
| PROFIT | 34.834 | 1.81 | PROFIT | 18.304 | 1.68 |

N = 114
R-square = .368

*** < .001
** < .05
* < .10

N = 94
R-square = .602

*** < .001
** < .05
* < .10

Table 6.4: Effects of Foreign Debt on Social Inequality (GLS-1)

| | Estimate | t-ratio |
|---|---|---|
| INTCPT | -4.405*** | 3.11 |
| GDP | .842*** | 4.22 |
| GROWTH | .753 | .59 |
| MILIT | - .003 | .75 |
| TAX | - .681 | .62 |
| EXPT | -5.790*** | 4.60 |
| DEBT | -2.806** | 2.27 |
| x CW | 4.128*** | 3.96 |
| x CS | 6.244*** | 5.83 |
| x PW | 3.405*** | 3.06 |
| x FW | 2.881 | 1.16 |
| x FS | .768 | .50 |
| PROFIT | 16.036 | 1.44 |

N = 97
R-square = .675

*** < .001
** < .05
* < .10

Table 6.5: The Pattern of a First Order Autocorrelated Error in Each Country.
(Effects of Foreign Debt on Social Inequality)

| Country Name | Estimate (rho) | T-ratio | PR>T | N | R-square |
|---|---|---|---|---|---|
| Bolivia | -.089 | .12 | .915 | 3 | .007 |
| Brazil | -.808 | .68 | .620 | 2 | .316 |
| Columbia | .976 | 2.60 | .060 | 5 | .628 |
| Ecuador | -.201 | .28 | .793 | 5 | .019 |
| El Salvador | .388 | .60 | .610 | 3 | .152 |
| Ghana | -.193 | .11 | .933 | 2 | .011 |
| Honduras | .651 | 1.67 | .170 | 5 | .412 |
| Indonesia | -.361 | .44 | .704 | 3 | .088 |
| Korea | -.368 | .23 | .855 | 2 | .051 |
| Malaysia | .651 | 1.46 | .218 | 5 | .348 |
| Mexico | .135 | .25 | .816 | 5 | .015 |
| Morocco | .190 | .27 | .809 | 3 | .036 |
| Nicaragua | .557 | 1.52 | .268 | 3 | .536 |
| Pakistan | -.493 | 1.11 | .330 | 5 | .235 |
| Paraguay | .688 | .87 | .476 | 3 | .274 |
| Peru | .155 | .32 | .763 | 5 | .025 |
| Philippine | .937 | .80 | .570 | 2 | .390 |
| Sierra Leone | -.148 | 1.53 | .369 | 2 | .700 |
| Sri Lanka | .891 | 3.00 | .095 | 3 | .818 |
| Thailand | .670 | 1.87 | .203 | 3 | .636 |
| Tunisia | .564 | 1.36 | .244 | 5 | .318 |
| Turkey | -.899 | .65 | .552 | 5 | .095 |
| Venezuela | -.131 | .31 | .774 | 5 | .023 |

Table 6.6: Effects of Foreign Investment (PROFIT) on Social Inequality (GLS-1)

| | Estimate | t-ratio |
|---|---|---|
| INTCPT | -1.235 | .98 |
| GDP | .379* | 1.90 |
| GROWTH | -1.264 | .92 |
| MILIT | - .023 | 8.81 |
| TAX | 1.771 | 1.61 |
| EXPT | -6.984*** | 5.15 |
| DEBT | 2.488 | 4.15 |
| PROFIT | -72.0** | 4.13 |
| x CW | 120.8*** | 5.49 |
| x CS | 149.8*** | 7.95 |
| x PW | 145.6*** | 4.98 |
| x FW | 55.7 | .37 |
| x FS | 89.0*** | 5.51 |

N = 103
R-square = .818

*** = < .001
** < .05
* < .10

Table 6.7: The Pattern of a First Order Autocorrelated Error in Each Country
(Effects of Foreign Investment on Social Inequality)

| Country Name | Estimate (rho) | T-ratio | PR>T | N | R-square |
|---|---|---|---|---|---|
| Bolivia | -.014 | .02 | .986 | 3 | .0002 |
| Brazil | .576 | 1.26 | .336 | 3 | .441 |
| Columbia | .784 | 1.82 | .143 | 5 | .453 |
| Ecuador | -.163 | .31 | .773 | 5 | .023 |
| El Salvador | .257 | .44 | .705 | 3 | .087 |
| Ghana | -2.539 | .60 | .654 | 2 | .267 |
| Honduras | .757 | 1.79 | .148 | 5 | .446 |
| Indonesia | -.441 | 1.30 | .264 | 5 | .297 |
| Korea | -.244 | .96 | .392 | 5 | .187 |
| Malaysia | .004 | .01 | .995 | 5 | .00001 |
| Mexico | -2.361 | 3.52 | .072 | 3 | .861 |
| Morocco | .397 | 1.04 | .358 | 5 | .212 |
| Nicaragua | .364 | .86 | .439 | 5 | .156 |
| Pakistan | -.033 | .07 | .948 | 5 | .001 |
| Paraguay | -.229 | .37 | .749 | 3 | .063 |
| Peru | .643 | 1.89 | .131 | 5 | .473 |
| Philippine | .251 | .48 | .678 | 3 | .104 |
| Sierra Leone | -.070 | .10 | .929 | 3 | .005 |
| Sri Lanka | .685 | 1.47 | .279 | 3 | .520 |
| Thailand | .844 | 4.04 | .016 | 5 | .803 |
| Tunisia | .268 | .61 | .577 | 5 | .084 |
| Turkey | .140 | .09 | .944 | 2 | .008 |
| Venezuela | .211 | .34 | .753 | 5 | .028 |

Table 6.8: Effects of Foreign Debt on Social Inequality (OLS)

|  | Estimate | t-ratio |
|---|---|---|
| INTCPT | -5.347*** | 3.02 |
| GDP | .923*** | 3.91 |
| GROWTH | -4.722 | 1.51 |
| MILIT | -.014*** | 3.08 |
| TAX | .379 | .25 |
| EXPT | -7.910*** | 4.85 |
| DEBT | 1.650 | .96 |
| x CW | 3.138** | 2.15 |
| x CS | 6.897*** | 4.26 |
| x PW | 1.532 | 1.00 |
| x FW | .881 | .38 |
| x FS | 5.248** | 2.21 |
| PROFIT | 13.178 | .71 |

N = 114
R-square = .496

*** < .001
** < .05
* < .10

Table 6.9: Effects of Foreign Investment (PROFIT) on Social Inequality (OLS)

|  | Estimate | t-ratio |
|---|---|---|
| INTCPT | -3.657* | 1.93 |
| GDP | .605** | 2.18 |
| GROWTH | -6.378*** | 2.13 |
| MILIT | -.015*** | 3.63 |
| TAX | 3.464* | 1.92 |
| EXPT | -9.446*** | 5.58 |
| DEBT | 4.166*** | 3.97 |
| PROFIT | -60.0** | 1.99 |
| x CW | 118.4*** | 3.07 |
| x CS | 180.4*** | 5.38 |
| x PW | 104.0* | 1.95 |
| x FW | 202.2 | .93 |
| x FS | 97.4** | 3.28 |

N = 114
R-square = .515

*** < .001
** < .05
* < .10

Table 6.10: Effects of Foreign Debt on Social Inequality (GLS-2)

|  | Estimate | t-ratio |
|---|---|---|
| INTCPT | -4.112*** | 3.54 |
| PAR | -2.857*** | 7.08 |
| PHI | -2.476*** | 6.58 |
| SIE | 3.581*** | 8.78 |
| SRI | -3.422*** | 6.73 |
| GDP | .804*** | 5.02 |
| GROWTH | 1.806 | 1.06 |
| MILIT | - .021*** | 7.87 |
| TAX | .525 | .54 |
| EXPT | -8.165*** | 7.78 |
| DEBT | -2.017 | 1.53 |
| x CW | 6.657*** | 5.29 |
| x CS | 11.007*** | 4.45 |
| x PW | 5.540*** | 4.20 |
| x FW | 6.682*** | 4.14 |
| x FS | 8.052*** | 2.21 |
| PROFIT | 11.126 | .93 |

N = 114
R-square = .864

\*\*\* < .001
\*\* < .05
\* < .10

Table 6.11: Effects of Foreign Investment (PROFIT) on Social Inequality (GLS-2)

|  | Estimate | t-ratio |
|---|---|---|
| INTCPT | .187 | .16 |
| BOL | 2.375*** | 6.03 |
| PAR | -3.080*** | 8.11 |
| PHI | -2.620*** | 7.95 |
| SIE | 2.438*** | 6.30 |
| SRI | -3.368*** | 7.81 |
| GDP | .122 | .72 |
| GROWTH | -1.683 | 1.12 |
| MILIT | - .017*** | 7.48 |
| TAX | 3.297*** | 3.54 |
| EXPT | -9.132*** | 9.74 |
| DEBT | 2.363*** | 4.20 |
| PROFIT | - 80.3*** | 4.91 |
| x CW | 155.9*** | 8.68 |
| x CS | 220.8*** | 5.53 |
| x PW | 183.2*** | 6.58 |
| x FW | - 38.7 | .35 |
| x FS | 114.7*** | 7.47 |

N = 114
R-square = .897

*** < .001
** < .05
* < .10

# CONCLUSION

The purpose of this study is to examine the variety of Third World countries' response to the expansion of transnational economic linkages in the international system. The basic idea investigated is that the degree of centralization/fragmentation of power in a political system will affect the nature of the state and its actions, which then mediates the relations between various forms of external economic linkages and economic growth and social equality in developing countries. This implies that neither the liberal nor dependency theories can be generalized in order to explain the impact of the world market on peripheral countries. By introducing a new classification of regime types in peripheral countries, I have attempted to integrate the significant insights of three theoretical perspectives: liberal, dependency, and statist.

To this end, I have relied on a basic assumption of the tradition of the political economy perspective. In this perspective, in order to remain in power, political leaders consciously seek to provide benefits to a range of interests, systematically favoring certain groups over others. From extending this logic, I assume that external economic linkages are a tool for political leaders to maximize their return as a way of attracting and rewarding supporters. Thus, this kind of politics tends to generate policies that are distorted in economically and socially irrational ways by self-seeking interest groups and political elites. In this situation, good policies may be pursued only in regimes that have a mechanism of checks and balances among political elites in which the regime has a

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possibility to act as an arbitrator among competing interests. By focusing on the regime types, or government structures, I have also attempted to overcome a weakness of the political economy perspective.

Based on the above basic idea, I have offered hypotheses regarding the effects of external economic linkages on economic growth and social equality, and have tested my hypotheses based on a pooled, cross section-time series analysis using 24 Third World countries during the period of 1973-79. Although the findings do not support all my propositions, they at least confirm my basic stance, indicating the importance of regime types as a mediating factor between the forms of external economic linkages and subsequent economic growth and social equality in peripheral countries.

As for centralized regimes, I hypothesized that external economic linkages have negative effects on economic growth and social equality, and that this tendency is more significant in strong states than in weak states. With respect to social equality, this hypothesis is strongly supported by the test results for 23 countries during the period of 1975-79. Nevertheless, the results are not conclusive because of the violation of a non-autocorrelation assumption in my analysis. In terms of economic growth, my findings show that although foreign debt has a negative effect on economic growth in centralized regimes, this negative effect is smaller in strong states than in weak states. Furthermore, foreign investment is found to have a positive effect on economic growth even in centralized regimes, and this positive effect is more significant in strong states than in weak states. Thus, contrary to my hypothesis, strong states perform better than weak states in centralized regimes with respect to the effects of external economic linkages on economic growth.

In moderate pluralistic regimes, I hypothesized that external economic linkages have positive effects on economic growth and social equality, and that this tendency is more significant in strong states than in weak states. My test results, in general, strongly confirm

this hypothesis. Foreign direct investment is found to have positive effects on economic growth, and this tendency is more significant in strong states than in weak states. Although foreign debt has a small negative effect on growth in weak states, it is found to have a slightly positive effect on growth in strong states. With respect to social equality, higher foreign debt is likely to increase social equality in strong states, while it tends to decrease social equality in weak states. This pattern holds for the effects of foreign direct investment on social equality in moderate pluralistic regimes: larger foreign investment is likely to increase social equality, while it may decrease social equality in weak states. Although the above findings concerning social equality are not conclusive, the weight of the evidence suggests that, in moderate pluralistic regimes with strong states, both foreign direct investment and foreign debt are likely to have positive effects on economic growth and social equality. Except for the effects of foreign investment on growth, however, external economic linkages do not have positive effects on the dependent variables in moderate pluralistic regimes with weak states. If this is true, moderate pluralistic regimes require strong states in order to exploit positive aspects of the world market.

As for fragmented regimes, I hypothesized that external economic linkages have negative effects on both economic growth and social equality in fragmented regimes, and that this tendency is more significant in strong states than in weak states. My findings in general strongly support these hypotheses. According to the findings, foreign debt has negative effects both on economic growth and social equality. Although foreign investment has a positive effect on economic growth, this effect is the smallest among regimes with strong states. Furthermore, increasing foreign direct investment decreases social equality in fragmented regimes with strong states. The test results regarding social equality are again not conclusive, and further studies are required in order to correct autocorrelation problems in my analysis.

From my findings, we might find a new factor which produces the relative autonomy of the state vis-a-vis powerful interest groups. In the traditional Marxist approach, the state is viewed simply as a tool used by dominant classes to increase their power and wealth. Thus, traditional Marxists deny any possibility of an independent and autonomous state that has power and objectives distinct from any particular force. This conceptualization of the state has been challenged by neo-Marxists who view that the state may act independently of direct (or indirect) influence or intervention by the dominant class. Contemporary Marxist-inspired statists, like Skocpol, conceive the state as potentially a more autonomous actor than neo-Marxists in such a way that it can transcend structural boundaries, threatening the interests of a dominant class or even eliminating its own existence.

With respect to the second conceptualization of the state autonomy, neo-Marxists have offered several factors that allow the state to act independently of the interests of particular forces. These factors include: (1) a serious division within the dominant class, which may induce the dominant class to grant greater autonomy to the state, and/or (2) increased pressure from subordinate classes in which subordinate classes acquire power to undermine monolithic control by the dominant class (Rueschemeyer and Evans, 1985, p64).

In addition to these factors, I propose a hypothesis that state autonomy is likely to increase in a regime where there is some division within powerful political elites. In order to formulate and implement policies that insulate particularistic interests, the state need to concentrate power in its political system, so that it is able to resist pressures from powerful interest groups. However, in regimes where power is concentrated too much in the hands of a top leader, the state will be dominated by the one ruler in which public policies tend to reflect his/her personal preferences. In this situation, bureaucratic apparatus cannot achieve their autonomy because bureaucrats are inherently powerless due to their lack of power

base or constituency in their society. As a result, state officials will face significant difficulties in pursuing particular policies which bring conflict with their ruler's interests. Nevertheless, in a regime where there is some division within political elites, no one ruler dominates the regime, which is likely to concede a certain space for autonomous action for the state.

Besides the relative autonomy of the state, regime autonomy may also increase in moderate pluralistic regimes. A regime in which there is some division within powerful political elites tends to bring compromises among the major contending forces in the decision making process. Since no one ruler dominates the regime, particularistic interests which are often tied to some segments of interest groups tend to be checked by some political groups with varying interests. Therefore, when political leaders proposes a policy, they needs some justification for the policy so that the opponents can accept it. In this situation, there is the possibility that the policy may benefit broader segments of the population, at least in the long run. Furthermore, moderate pluralistic regimes may have more leverage to resist the demands of powerful interest groups than any other regimes, because the leader can use the existence of opponents to refuse some demands of particular societal forces without losing their support. Although centralized regimes appear to be able to control any interest group, they lack this kind of leverage probably except in crisis situations so that the ruler tends to be caught by particular interests in the long run. For these reasons, I proposed another hypothesis that a regime can act more independently of powerful interest groups when there is some division among political elites within the regime.

Another theoretical implication drawn from my findings is that the currently most dominant authoritarian model of economic development in the Third World cannot be generalized and needs qualifications. The advocates of this model maintain that, by limiting democratic participation, authoritarian regimes can provide institutional stability, and create

a context favorable to long-term policy making which is conducive to economic growth. In ethnically, religiously, and culturally fragmented societies, authoritarian leaders are able to impose their will on society. As a result, they are able to unite cultural groups into a strong nation state by managing the conflicts between traditional subgroups and those new groups formed by the development process. In short, according to this model, "new states cannot 'afford' democracy because they must place a prior value on economic growth" (Pye, 1966, p72).

My findings show, however, that if power is too concentrated in the hands of one political leader, the effects of external linkages on economic growth will not be larger than in moderate pluralistic regimes. In addition, although the effects of external linkages on social equality in moderate pluralistic regimes with strong states may be positive, those effects in centralized regimes are likely to be negative, which in the long run may lead to political instability. Thus, the positive impact of external economic linkages and the effectiveness of state actions need some extent of decentralization of power within the regime. Furthermore, good economic performance of moderate pluralistic regimes with strong states implies that democracy itself does not hinder rapid economic growth in the Third World. The problem of many Third World countries is that the adoption of democracy may often result in regime fragmentation which is not conducive to economic development. Therefore, the difficult task of leaders of the Third World is how effectively to maintain or create a democracy without bringing about the immobilization of government actions.

Considering these implications of my findings, several studies can be developed in the future. First, my findings show that foreign direct investment has positive effects on economic growth in Third World countries, which is different from the findings of previous studies. As I discussed before, a possible explanation is the difference of time periods used in the analyses between my research and others. Different methods used in the

studies might also generate different outcomes (I used a pooled, cross sectional-time series method while others used panel regression analysis). In order to find the reasons for these differences, we need to do research which compares results prior to and after 1970 using the same methods.

Second, statist writers claim that state strength is a major explanatory variable in explaining the economic performance of peripheral countries. However, state strength itself does not tell us the direction and effectiveness of state actions. Strong states may promote or prevent economic development, and use scarce resources effectively or waste them extravagantly. In my view, the direction and effectiveness of state power may be greatly influenced by the degree of centralization of power in the hands of political leaders. More specifically, state power has positive effects on growth and equality only in regimes that have a mechanism of checks and balances among political elites. In order to examine this hypothesis, the same basic method developed in this study can be used.

Third, in the third chapter, I pointed out that although all previous quantitative studies examined the effect of external economic linkages on growth and/or equality in order to test dependency theories, certain forms of external economic linkages itself may be a result of the nature of the state and its actions. If this is the case, the results of the previous quantitative studies do not reveal anything about whether or not the dependency perspective explains the reality of the Third World political economy. Since my findings indicate that the effects of external economic linkages on growth and social equality in the periphery are different across various political regimes, it is highly possible that the form of external economic linkages may be a matter of choice for political leaders in the Third World. Therefore, an empirical test of this relationship is required.

Fourth, previously I proposed a hypothesis that the autonomy of the state and regime increases in regimes within which there is some division among powerful political elites. However, there is a serious problem in a quantitative study aiming to test this

hypothesis, since it is extremely difficult to operationalize the concept of "autonomy" of the state or regime vis-a-vis dominant interest groups in order to conduct a statistical test. Therefore, in order to avoid this difficulty, detailed case studies testing these hypotheses are required.

Fifth, with respect to the effects of external economic linkages on social equality, I could not correct my autocorrelation problem, so the findings are not conclusive for confirming or rejecting my hypotheses. The examination of outliers reveals that my model excludes an important determinant of social equality, that is, the level of education. This specification error is probably the main cause of serious correlation of residuals over time, which prevented me from correcting the problem by using the conventional method. Therefore, I need to estimate a model including this variable (and probably the degree of democracy or socialism) in order to get more reliable test results of my hypotheses.

Finally, the adoption of a rational actor approach bring about both strengths and weaknesses to this study. Assuming political leaders as rational actors whose main concern is to stay in power with different constraints of regime types, I have attempted to shed some light on the different actions they take, which may lead to different unintended results that countries have in terms of the effects of external economic linkages on economic growth and social equality in the periphery. In so doing, I have tried to contribute to theory-building in the field of political economy, integrating significant insights of major theoretical traditions. However, the choice, goals, or preferences of political leaders not only reflect their immediate concern of staying in power, but also their perceptions of interests which are conditioned by ideology and consensual knowledge. Thus, in reality, the preferences of political elites are not fixed and may change according to shifts in the basic definition of reality, which may result in different actions within the same constraints. Therefore, further studies are required which incorporate regime ideology and elites'

perception into my framework for a more complete explanation concerning the effects of external economic linkages on Third World countries.

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