The Role of Globalization in Latin America’s Social Policy Expansion: Evaluating the Linkages of the Compensation Hypothesis in Argentina and Costa Rica

Peter Bruno

March 27, 2017
Advisor: Alfred Montero,
Frank B. Kellogg Professor of Political Science
Carleton College

Abstract: This paper analyzes the relationship between globalization and social policy expansion in two Latin America countries during the 1990s and 2000s for which correlation ostensibly appears to be positive. Deviating from the statistical modeling customary of previous studies, this paper uses recent historical evidence to evaluate the prevalence of three causal linkages inherent to the compensation hypothesis, a theoretical model used to explain the relation between free trade and social spending in OECD countries. It finds that, while the OECD model of the compensation hypothesis does an adequate job at explaining the experience of Argentina, additional theory is needed to explain the pattern of events encountered in Latin America during this period.
During the 1990s Latin America experienced sweeping neoliberal reforms that radically altered the economies and societies of the region. The so-called “losers” of this globalization were thenceforth forced to fight for political change in a liberal world order where protectionism has all but been removed from the government’s policy tool kit (Kingstone and Young 2009). One prominent theory in political economy, led by the work of Dani Rodrik and Geoffrey Garrett using data from OECD economies, suggests a compensation effect in which the governments of nations that are more exposed to foreign markets have tended to turn to social policy as a way of compensating citizens for the added risk and disruption posed by openness to the global economy. The more open an economy is, the higher its expected level of social spending.

As the neoliberal period began to taper at the end of the 1990s, scholars began recognizing the needs of those disaffected by globalization. They began to investigate whether a similar compensation effect was occurring in Latin America. These studies tended to involve large-N statistical regression and led to decidedly mixed results. On one hand, Avelino, Brown, and Hunter (2005), detect a positive correlation between globalization and social spending as a compensation hypothesis would suggest. Kaufman and Segura-Ubiergo (2001) and Wibbels (2006), on the other hand, find a negative relationship between social spending and globalization. What’s more, the models of Brown and Hunter (1995) and Huber, Mustillo, and Stephens (2008) find no significant relationship between these variables in Latin America.

This paper attempts to revisit the relationship between globalization and social spending with added information since Latin America’s ‘Pink Tide’ of the mid-2000s. There are several reasons to do so. First, previous studies did not allow for enough time to properly observe the lagged effect of this hypothesis. Second, the literature on the compensation effect in advanced economies has stressed the role of leftist party success (Ross 2000; Walter 2010). As such, there
is serious need to update the literature on this effect in Latin America to account for the region’s recent wave of left-wing politics. In doing so, this paper hopes to answer the question: to what extent is the compensation effect, as hypothesized for developed nations, able to explain the relationship between globalization and social spending in Latin America following the neoliberal era?

This paper differs from previous studies in its methodological approach. Rather than using statistical models, it descriptively evaluates causal mechanisms of the OECD-centered compensation hypothesis in the cases of Argentina and Costa Rica during the 1990s and 2000s. Utilizing the three microfoundational linkages of compensation theory developed by Stephanie Walter (2010), I evaluate with recent historical evidence whether (1) globalization has led to economic insecurity, (2) economic insecurity molds welfare preferences and demands, and (3) these social preferences result in the election of leftist parties and the expansion of social policies. I find that Argentina’s experience in the 2000s fits the explanation of compensation hypothesis partially in Linkage 1, completely in Linkage 2, and conditionally in Linkage 3. The theory is even less successful when applied to Costa Rica. Thus, I argue that compensation theory, while valuable, does not suffice in explaining the complete story of why and how social policy expands in Latin America.

The findings of this paper are meant to be valuable not only to those who study Latin America, but also to those who are interested in investigating the political economy of trade, welfare, and globalization more generally. While much existing literature on the relationship between globalization and social spending has focused primarily on OECD economies, this paper offers an in-depth perspective from the developing world. By looking exclusively at middle-income Latin American states, this paper evaluates how well a hypothesis constructed for
advanced economies holds up for developing countries. Moreover, this paper hopes to identify which aspects of a compensation hypothesis can be applied to lower and middle income states in future studies. During an increasingly populist and nationalistic era of global history, greater understanding of trade and social compensation across the world remains tremendously important.

Out of all the developing regions that may offer insight into this relationship, Latin America provides an especially interesting story for analysis. Starting in the 1990s, Latin America’s widespread pivot toward neoliberalism became an important natural experiment in global economic history and did not go unnoticed by scholars and economists. By utilizing this context, this paper is able to draw from a wide variety of studies and data on trade and social policy which are not as fruitful in other regions. What makes the Latin American case even more useful to studies on the relationship between globalization and social spending is what occurred during the subsequent decade. After a near region-wide experience with neoliberalism, the 2000s were marked by an almost equally universal trend towards the election of left-wing parties and presidents. This event is commonly referred to as the ‘Pink Tide’. Since we might expect that a left government becomes more likely to use social policy compensation when barred from protectionism, the potential utility of the compensation hypothesis when applied to these cases are considerable.

**The Relationship between Globalization and Social Expenditure**

*The Compensation Hypothesis*

That a nation’s economy benefits overall as a result of free trade has been known to international economists for the past 200 years (Ricardo 1817). What has perhaps been more stimulating for political economists, however, has been the realization that the gains from trade
are not equally shared across a country and that trade will inevitably produce ‘winners’ and ‘losers’. As nations specialize in the sectors for which they have comparative advantage, the workers in less competitive industries become subject to layoffs and unemployment. This unemployment may only be temporary if skills are transferable and work is available in other industries, but often this economic transition has prolonged and systemic effects on displaced workers (Heid and Larch 2016; Galiani, Lamarche, Porto, and Sosa-Escudero 2004). A farmer in a state with an uncompetitive agricultural sector cannot easily sell his or her land and move to where there is manufacturing work, just as a steel plant worker cannot easily take up farming or high-tech manufacturing. Furthermore, exposure to financial contagion and fluctuations in foreign supply and demand pose added risk to the economies of trading partners (Carroll 2016; Suliman 2011). The onus is therefore on governments to assure open trade (pressured by international norms and profit-seeking interests) and compensate the citizenry for any disequalizing effects this trade may cause (as demanded by the so-called ‘losers’ of free trade).

The contemporary literature on which this paper is based is rooted in the works of Dani Rodrik (1998) and Geoffrey Garrett (1998). Rodrik begins by seeking to explain why more open economies in the OECD have bigger governments. He concludes that governments feel pressure to compensate citizens faced with greater economic insecurity as a result of foreign competition. This concept is echoed in Garrett’s scholarship that identifies strong institutions, formidable labor unions, and negotiating ties between the popular groups and the government as key causes of increased social spending when modeled with globalization variables. These works have led to an extensive body of research on the welfare states of developed nations belonging to the OECD (Garen and Trask 2005; Rodrik 1999; Milesi-Ferretti, Perotti, and, Rostagno 2002; Garrett 2001).
Branching out from the pool of states in the OECD, a number of studies also analyzed the relationship between globalization and social expenditure in developing nations. In these states, demands for compensation would likely be caused by labor market inflexibility, increased inequality, or contagion from foreign markets (Lee and Vivarelli 2006). The orientation of this study is to assume a positive and causal relationship between greater trade openness and social policy expansion based on the compensation hypothesis, and then to evaluate whether or not those assumptions were correct.

Efficiency Theory in Developing Nations

In general, there has been far less consensus on the relationship between globalization and social spending in developing countries. Efficiency theory, a prominent alternative to the compensation hypothesis, suggests that global pressures towards fiscal efficiency have led to reductions in social programs and a negative correlation between test variables in developing nations (Sener, Bayrakdar, and Hacioglu 2015; Jeong 2010). Rudra (2002) notes a significant divergence between social spending in the developed world and developing world as globalization has increased. She speculates that concerns over access to foreign lending compels the governments of less developed, open countries to spend pro-cyclically and become especially fiscally minded. Looking specifically at the developing economies of Latin America, Kaufman and Segura-Ubiergo (2001) agree with Rudra’s conclusion and further theorize that a lack of strong institutions and organized labor movements prevent developing states like those in Latin America from transforming demands for compensation into actual policy.

Theories on Scale and Factor Endowments

Other theories on globalization and social expenditure relate to the size and factor endowments of an economy. Katzenstein (1985) argues that the relationship between
globalization and social spending is especially pronounced in small states. Due to their markedly limited resources, these states have little choice but to trade to achieve the same amount of utility and variety of goods as larger nations. Additionally, according to Katzenstein, these smaller nations are also inclined to embrace social democracy and welcome greater levels of social spending (1985). Both of these attributes would suggest that any compensation effect might be more pronounced in a smaller state than a larger one.

Building off the work of Stolper and Samuelson (1941), Rogowski (1987) introduces a useful typography of political cleavages to predict group demographics and prevailing national attitudes on free trade and globalization. He bases these cleavages on factor endowment categories of whether a state has achieved a high or low abundance of capital and whether a state is more abundant in land or labor. As such, Rogowski would predict that highly developed and/or land-abundant states would have the popular labor movements against trade and demand the most compensation, while less developed and/or labor-abundant countries would have more popular labor support for free trade and less demand for compensation. Hiscox (2001) and Beaulieu (2002) expand upon this and further explore the effects of different industry cleavages and factor mobility.

Domestic Explanations for Reform

Still others suggest that any global pattern of social policy change has been moderate and driven primarily by domestic factors, largely unrelated to trade or globalization (Crepaz 1998; Esping-Andersen 1996; Pierson 1996; Garrett and Mitchell 1996). These studies find more significant changes in social spending when observing natural cycles of growth and unemployment. Other domestic explanations for why a state could choose to increase social spending include caring for an aging population and easing labor shifts caused by mass entry of
women into the labor force (Huber and Stephens, 2001). The Latin American-centered studies of Brown and Hunter (1995) and Huber et al. (2008), which find little to no correlation between globalization and social expenditure, might reinforce this hypothesis.

Shortcomings of Statistical Modeling

Before setting up our study it is important to get a better understanding for why previous statistical studies on this subject in Latin America have been so inconsistent in their findings (cf. Brown and Hunter 1995; Kaufman and Segura-Ubiergo 2001; Avelino et al. 2005; Wibbels 2006; Huber et al. 2008). First, these studies all observe a different time range. Huber et al. (2008), Wibbels (2006), and Kaufman and Segura-Ubiergo (2001) all use data ranging from the 1970s to the 1990s. Avelino et al. (2005) and Brown and Hunter (1995) elect to use data from only 1980 to the 1990s. For a region with as dynamic a history as Latin America, these differences should be expected to have a noticeable difference on the relationship being modeled. Since most nations in Latin America were not democracies before the late 1980s, a compensation model that relies on responsive governments should not be expected. Furthermore, the quality of democracy in most Latin American countries has also improved considerably since the periods observed in past studies. To use our case subjects as examples, between 1998 and 2016 Freedom House increased its rating of democracy in Costa Rica by 7 percent and Argentina by nearly 15 percent. More democratic governments are considerably more responsive to the needs of their people on issues of social spending and thus would be more likely to meet its peoples’ demands for trade-related compensation (Lindert 2002). It should be no surprise, then, that the only study to have begun to use data from the 2000s in Latin America, Avelino et al. (2005), found a positive relationship between globalization and social expenditure.
Another limitation faced by statistical models is the inability to understand long-term trends that do not occur on a regular interval. Of all the previous studies mentioned, only Huber et al. (2008) attempts to create a lagged dependent variable to correct for the first-order correlation. For the rest, the models seem to only plot one year’s trade openness value with that same year’s social spending, rather than observing changes in trade-openness or other globalizing factors. Since it is unrealistic to assume that a government would implement salient policy change on a consistent basis (let alone every year), regression models testing for the causes of social policy change are faced with severe limitations. This technic may be sufficient for visualizing a time-series plot of one nation’s data, but it is messy for models using data from up to twelve Latin American states.

By rejecting a statistical regression in favor of two qualitative case studies, this paper is able to avoid these issues and offer a fuller and more descriptive evaluation for how a potential compensation effect operates in these two Latin American countries. As argued by Brady and Collier (2004), a process-tracing and qualitative-comparison approach to social inquiry can be much more illuminating when observing country to country nuances and testing presumptions in a casual process. Rather than provide coefficients and levels of significance, this study hopes to flesh out narratives for how the relationship between globalization and social spending plays out in the politics of a nation, an effort not seen in previous studies.

**Methodology**

Realizing the explanatory limitations of a one-model study, Political Economist Stefanie Walter developed a causal chain of three linkages to summarize the steps of an advanced-economy-centered compensation hypothesis and applied it to the case of Switzerland (2010) [See Figure 1]. This study utilizes those same three linkages and tests their fit when applied
qualitatively to Argentina and Costa Rica, being careful to point out differences with the outcomes seen in advanced economies. I evaluate each linkage independently based on criteria appropriate for the given relationship. In some previous studies, globalization is modeled to include measures of trade openness, FDI, and foreign debt. For the purposes of this paper, globalization is mainly understood as trade openness (trade as a percent of GDP) as well as foreign investment and past development efforts aimed at integrating the government with the world economy. Social policy expansion will be observed in two ways. First, I select the cases of Argentina and Costa Rica because government data shows a clear increase in general government consumption over the observed period (this indicator of social policy spending is preferable because it includes both social security and welfare as well as education and healthcare). Second, I observe social policy expansion as legislation passed that has the potential to directly benefit the livelihoods of those disaffected by globalization.

I will preface my evaluation of the compensation effect with a section outlining a brief background and economic history of Argentina and Costa Rica during the 1990s and 2000s. This will serve to identify who exactly has been the ‘losers’ of globalization in each of these cases. In my evaluation of Linkage 1 (Globalization leads to Economic Insecurity), I will look at changes in unemployment, inequality and poverty during the economic opening of the 1990s. Whereas Walter (2010) and other studies on developed countries contemplate issues of offshoreability, these issues do not seem to be as applicable to nations that are not of high income. My criteria for a case being consistent with compensation theory is the presence of a clear wave of unemployment or inequality that can be directly attributed to globalization, including past neoliberal reform. In order to ascribe the appropriate amount of blame to international trade, I
evaluate previous studies which calculate jobs lost in industries faced with greater import penetration as a percentage of total new unemployment.

In evaluating Linkage 2 (Economic Insecurity leads to Demands for Compensation), I will observe changes in public opinion and civic engagement over the 1990s and 2000s. To better understand specific demands during this period, I will utilize literature on social movements in each country case. This will primarily focus on the *piquetero* movement in Argentina and political discourse surrounding the passage of CAFTA in Costa Rica. I will consider the situation to be consistent with this linkage of the compensation effect if there are explicit demands for welfare, redistribution, or trade-adjustment assistance as a result of the economic insecurity caused by globalization.

In Linkage 3 (Demands for Compensation lead to Preferences for Left Parties), the fit of the compensation hypothesis will be determined by (a) whether a left party was elected and (b) whether social policy reform that improves the livelihoods of those disaffected by globalization was implemented. While I will note difference in the types of social policy executed by a government, any policy aimed at broadening social wellbeing to those disaffected by globalization will be considered consistent with the compensation theory. I will also consider whether Walter’s inclusion of left party success is appropriate in explaining the compensation effect.

After evaluating each link, I will then comment on the explanatory ability of the compensation hypothesis as a whole when applied to Costa Rica and Argentina and discuss how the effect differs both with the developed world and with each other. This will be followed by a discussion on the potential fit of other globalization-welfare state theories. In light of recent shifts in perceptions towards protectionism within the United States and other western
torchbearers of neoliberalism, I will then offer a brief discussion on the future of free trade as it relates to political economy and the compensation hypothesis. This section will contemplate whether protectionism could once again be seen as a viable policy tool. I will end by offering concluding thoughts.

**Figure 1: Flow Chart of Causal Linkages of the Compensation Effect** *Source: Walter (2010).*

I choose Argentina and Costa Rica as case studies for a number of reasons. First and most fundamental, these two nations exemplify a pattern that, at the surface level, seems to fit the narrative of compensation hypothesis. Both nations experienced a large increase in trade openness during the 1990s and subsequently entered a period in the 2000s which was characterized by sizable increases in the size of government. To be specific, trade openness in Argentina and Costa Rica increased by 54 and 28 percent of GDP respectively in the 1990s. Government consumption grew from 12.5 and 13.7 percent of GDP in 2000 to 16.6 and 17.9 percent of GDP in 2010 for Argentina and Costa Rica respectively.

Second, these two countries differ in both size and population density. Argentina is ten times larger than Costa Rica in population and more than fifty times larger in land. This allows us to explore the explanatory capabilities of complementary globalization-welfare theories relating to size and factor endowments, such as those posed by Katzenstein (1985) and Rogowski
(1987). Should we accept Katzenstein’s assertions, then we would expect to see Costa Rica as the smaller nation be more susceptible to trade and welfare spending. If we find merit in Rogowski’s claims, then free trade may benefit more citizens in Costa Rica’s labor-abundant economy and thus may result in less demands for compensation. Thirdly, Argentina and Costa Rica both have relatively high rates of democracy which, theoretically, should heighten government responsiveness to the demands of its people (Lindert 2002). So if a larger number of citizens demand social insurance, we would expect minimal barriers to Linkage 3 if the compensation hypothesis is an appropriate explanation for these cases.

**Who are the Losers of Globalization in Argentina and Costa Rica?**

In order to know which aspects of Argentina’s and Costa Rica’s economies are of interest to this study, I first discuss the origin of the nations’ neoliberal policies and identify which specific groups can be noted as vulnerable to globalization. In many countries in Latin America, liberalization occurred as an attempt to address an economic crisis, which required substantial reform and restructuring of the economy.

When Carlos Menem took office in 1989, Argentina was in the midst of hyperinflation and social and political unrest. Under these circumstances, President Carlos Menem pursued an active reformist agenda. This involved trade liberalization, privatization, and public sector reforms. As a land-abundant nation, agriculture and other land-intensive industries had much to gain from relatively higher world prices for crops, however, these gains were not enough to make up for losses in other areas of Argentina’s economy. Vulnerable sectors mainly consisted of inefficient labor- and capital-intensive manufacturing industries. This included the automotive and petroleum industries which were controlled by the government and accounted for tens of thousands of jobs.
On a similar tale, Costa Rica began the 1980s in deep economic crisis. Elected in 1982 with backing from the U.S. government, National Liberation Party (PLN) President Luís Alberto Monge Álvarez addressed the crisis with a series of austerity and liberalization measures. These neoliberal trends were amplified in the subsequent administration of PLN Oscar Arias and would remain the standard practice for nearly every administration thereafter. The economy during this time shifted away from an array of agricultural cash crops to more FDI-driven industries and tourism. Though many major corporations and banks in Costa Rica remain nationalized, the 1980s and 90s also saw the privatization of some government-administered agribusinesses. For these reasons, Costa Rican farmers have had especially pronounced hardships as a result of liberalization policies, as have some labor-intensive manufacturing which shifted around other Central American markets.

**Linkage 1: Globalization Leads to Economic Insecurity**

The first linkage in our evaluation of the compensation hypothesis is the tie between globalization and economic insecurity. As stated above, globalization is understood as a combination of trade openness, foreign investment, and neoliberal policies. Economic insecurity, in the context of the compensation effect, is defined as an adverse change in unemployment or inequality as well as labor inflexibility. The loss of steel production and low-skilled manufacturing jobs in the American Midwest is one example of how this economic insecurity might manifest itself, but the principle can be applied to any sort of friction caused as an economy reallocates itself to more competitive sectors. As will become apparent shortly, this linkage is partially accurate in the case of Argentina and less so in Costa Rica.

Between 1998 and 2003, Argentina was plagued with a plethora of economic woes. Unemployment had skyrocketed to over 20 percent, income inequality shot up 10 points in its
Gini coefficient and a persistent financial crisis underlined the self-reinforcing nature of a deep and terrible depression. How much of this economic insecurity can be attributed to globalization? According to the literature, a considerable part (Galiani and Sanguinetti 2003; Becker 2012). Galiana and Sanquinetti (2003) show that sectors in which Argentina did not have a competitive advantage, such as automotive, textile, and machinery, suffered tremendously due to greater degrees of import penetration. They also find that, while manufacturing output increased during the 1990s, employment in the manufacturing industry steadily declined. This is because the expansion of the manufacturing sector was led by sectors which tended to hire leaner and more skilled workforces compared to disappearing industries such as the automotive sector. Sectors in Argentina that required the most protection were also the ones that employed greater proportions of unskilled labor and suffered the most during the neoliberal period. The privatization of inefficient, government-owned corporations led to the layoffs of tens of thousands of employees. This included a loss of 45,000 jobs for the former state petroleum corporation, YPF. Furthermore, Damill, Frenkel, and Maurizio (2002) discover that real wages during the neoliberal era increased substantially for skilled laborers, but stagnated for unskilled workers. This contributed to a deepening of inequality.

The opening of Argentina’s capital markets during the end of the neoliberal period can also be blamed for the economic contagion that contributed to the prolonged depression. Market uncertainty during the Mexican Tequila Crisis of 1994-95, the Russian Financial Crisis of 1998 and the Brazilian Financial Crisis of 1999 is believed to be the cause of sudden volatility in capital inflows (Lee and Vivarelli 2006). Argentina’s overreliance on the IMF and foreign investors as a source of budgetary funds further limited policy options and led, initially, to contractionary fiscal policy and austerity measures that stifled recovery.
Although it easy to show the rampant economic instability in Argentina during the late 1990s, it is more difficult to quantify the blame that should be attributed directly to forces of globalization. Argentina’s history of poor macroeconomic management haunted the South American nation’s economy with periodic bouts of inflation and instability for most of its modern history. Combined with policy failures and the inevitable return of a cyclical bust, there were several significant contributors to unemployment and instability in Argentina other than import penetration and exposure to foreign markets. Galiani and Sanguinetti (2003) calculate that every 1 percent increase in import penetration during the 1990s led to a 0.7 percent increase in unemployment among uncompetitive sectors. While this accounts for many thousands of jobs, it represents only 20 percent of total jobs lost during the decade. Other studies have found similar results and concluded that, while trade’s impact on unemployment was significant, other factors such as exchange rate appreciation were also leading culprits (Altramir and Beccaria 1999; Beckerman 2000; Damill et al. 2002; Castro, Olarreaga, and Saslavsky 2007).

Costa Rica’s experience during liberalization is vastly different from that of Argentina. According to Robbins (2003), real and relative wages in Costa Rica both moderately increased as demand for Costa Rican goods met a longtime surplus in supply. Even so, it is fair to say that the benefits of liberalizations did not live up to their stated expectations. The poverty rate decreased by 2 percent in the early 1990s, but then remained troubling high for the rest of the 1990s and 2000s. Inequality also increased by about 7 points in its Gini coefficient after free trade disproportionately benefited skilled labor (Robbins and Gindling 2000). Whereas Argentine society was profoundly affected by the end of the liberalization period, Costa Rica did not encounter the same ordeal. Although unemployment in agriculture increased, overall
unemployment in Costa Rica decreased slightly. We find that Linkage 1 holds partially true for Argentina, but is incomplete in offering an explanation for the experience of Costa Rica.

**Linkage 2: Economic Insecurity Shapes Demand for Compensation**

The second linkage of the compensation hypothesis suggests that economic insecurity stimulates public demand for social policy change. If the compensation hypothesis holds true in these cases, we would expect public sentiment and demands to shift in favor of social policy actions that address economic concerns over globalization. We begin at the individual level and evaluate the policy preferences and demands of an average citizen. According to survey measures on civic engagement by the Latin American Public Opinion Project (LAPOP), levels of participation in protests and contacts with local representatives across Latin America peaked in 2004, around the height of the ‘Pink Tide’. This may signify an influx of disaffected citizens demanding government assistance in the aftermath of the neoliberal era. As evidence of this point, Baker and Green (2011) find modest shifts in Latin American public opinion away from market-oriented reform and towards more leftist policy approaches at the turn of the millennium. However, while these pieces of information offer interesting insight on public opinion, they are insufficient in explaining the causality and specific demands that captivated the policy debate and political discourse of these states that would ultimately lead to welfare expansion.

To further evaluate the perspectives and demands of the public during this period, we can analyze the activity and rhetoric of social movements during the early 2000s. The *piquetero* movement in Argentina and the anti-CAFTA movement in Costa Rica were both horizontally-organized, grass-roots movements that played a large and vocal role in the national discourse of their respective countries during this time. As I will explain later in this section, both of these
movements also consisted of those that felt disaffected by globalization, making them fitting subjects for observing the evolution of the compensation effect from Linkage 1.

The *piquetero* movement began as a group of laid-off petroleum workers in Cutral-Co and General Mosconi, two oil towns in which unemployment had reached 65 percent following privatization. With few options, unemployed workers demonstrated their frustrations by blockading all entrances to their communities, thereby suspending the economies of their towns until the local government was forced to address their concerns. The *piquetero* movement expanded into a “movement of movements” with several loosely connect groups of labor unions and unemployed workers from a wide variety of sectors (Svampa and Pereya 2003, 19). According to Federico M. Rossi, the collection of *piqueteros* became “the main contentious actor in the resistance to the social consequences of neoliberalism and the struggle for reincorporation of the popular sectors following the Washington Consensus Era” (2013, 1). The demands of the *piqueteros* were quite clear, though perhaps open-ended. They demanded *planes trabajar* with specific demands that varied between groups. Typically, this included unemployment subsidies, retraining programs, work assignments, food parcels, welfare payments, and access to social services. Organizing technics often involved blocking major highways, plazas, and intersection.

Opposition movements to the Central American Free Trade Agreement (CAFTA) had more intangible frustrations with globalization. Similar to the *piqueteros*, the anti-CAFTA movement was a broad, decentralized movement of different groups that opposed the free trade deal for a variety of reasons. Some organizers had a long held distrust for government and previous neoliberal efforts. Others were skeptical of the United States and did not want their country to warm up any more to a foreign power. Other environmentalist and indigenous groups were concerned at the possibility that Costa Rica’s natural resources might be exploited or that
people would be forcibly moved off of their land (Craig 2010). Small farmers were a part of these movements, but did not make any specific requests for social policy protections other than to maintain existing agricultural subsidies and nix a proposal to privative waterways (Faure, Le Coq, Vagneron, and Hocde 2012). Although CAFTA was passed and no demands for compensation were explicitly made, Frajman (2012) credits the organizing skills of the anti-CAFTA movement to real efforts by the Costa Rican government to conduct itself with greater transparency and pay attention to the concerns brought up during the national debates. This linkage of the compensation hypothesis is consistent with the Argentine case, but incomplete in its attempt to address the Costa Rican case.

**Linkage 3: Compensation Preferences Lead to the Election of Leftist Parties and Social Policy Expansion**

The final linkage of the compensation hypothesis is the connection between public demands for social policy and the election of leftist parties who expand said policies. The compensation hypothesis relies on the election of leftist parties and the magnitude of new and expanded social policy initiatives they introduce—especially those targeted at aiding the losers of globalization. Left parties emphasize the importance of redistribution and the interests of labor unions and marginalized groups, and position themselves as defenders of the welfare state. While recent literature has questioned whether the left has actually delivered on welfare policy (Pierson 1996; Allan and Scruggs 2004; Klitgaard 2007), demands for welfare in developed nations remain primarily directed at the left (Walter 2010). Furthermore, there is evidence in the developed world that left parties are still more likely to expand social spending quicker than the right (Schniewind, Freitag, and Vatter 2009). Similar principles hold true for Latin American parties, but with added caveats including welfare legacies and political channeling mechanisms.
As with the previous two linkages, this relationship appears more consistent for Argentina than for Costa Rica. After a series of short lived presidents during the Argentine Depression, Eduardo Duhalde of the leftist Partido Justialista (PJ) was appointed by the Argentine congress in 2002. Duhalde, like Menem before him, began to make connections with several factions of the *piqueteros* and found a good deal of success. His endorsement of PJ Néstor Kirchner for president in 2003, undoubtedly helped convince *piqueteros* to join his side. These connections with the *piqueteros* would lead the Kirchner administration to promote a series of welfare programs across the country.

The policy success of the *piquetero* movement does differ from other social movements in the developed world in that rather than demand structural changes in the federal government, most *piquetero* factions worked to establish mutually beneficial relationships with the executive branch for their own gain. With the notable exception of the *Movimientos de Trabajadores Desocupados* (MTD), most groups within the *piquetero* movement embraced Peronist clientelism as a means of incorporation (Ponce 2006). Many of the benefits provided to the *piqueteros* were done locally and specific to a given faction of the movement. Kirchner used these relationships to assert ‘carrots and sticks’ to different *piquetero* groups; providing *Obras Sociales* and unemployment benefits to factions that publicly supported his administration while ignoring the demands of those factions that were against him (Etchemendy and Garay 2010). These actions were temporary, forcing *piqueteros* to renegotiate clientelist relationships once a benefit or subsidy had expired.

Kirchner, however, offered a handful of more sustainable programs. *Jefes y Jefas de Hogar Desocupados* is the largest and most well-established of these programs designed to address emergency unemployment needs. The program offers around 50USD per month to
means-tested, unemployed citizens. In 2003, the program was utilized by 1.4 million beneficiaries. Even for this program, however, funds were not distributed evenly across the country, but were allocated strategically by the Kirchner administration based on political relationships in addition to poverty alleviation needs. This linkage in Argentina therefore appears to be mostly consistent with the established compensation hypothesis, but the clientelist networks that determine where spending is allocated add an extra element that may be unique to Argentina and other Latin American countries with similar political mechanisms. For Argentina, the tradition of clientelism stems from a history of strong unions and strong parties that have resulted in governments that are more responsive to the needs of supporters (Etchemendy and Garay 2010).

The Latin American ‘Pink Tide’ that defined Argentine politics during the 2000s did not take root the same way in Costa Rica. While the Central American country would elect leaders of nominally social democratic parties, presidents all tended to promote a neoliberal development platform that involved opening markets and attracting foreign investment. It was not until the 2014 election of Luis Guillermo Solís that Costa Rica became represented by a leader who expressed skepticism over the neoliberal model. The most fitting example of the compensation hypothesis in Costa Rica is the 2006 election of Oscar Arias, who had served previously in the late 1980s. A member of the center-left Partido Liberacion National (PLN), Arias spent his time in office increasing social spending by 5 percent of GDP, while simultaneously negotiating and ratifying CAFTA. Under Arias, Costa Rica supported 44 anti-poverty programs, generous unemployment benefits and pensions and the highest social expenditure in Latin America as a percentage of GDP (Spalding 2014). However, since many of these policies are universalist in nature (Huber 2010), few are designed specifically to target
those that may have been disaffected by free trade. Since Arias openly ran on supporting CAFTA, it is also difficult to attribute his electoral success to the losers of globalization. Unlike in Argentina, where clientelist networks helped reinforce the rule of Néstor Kirchner and his wife Cristina Fernández for over a decade, Costa Rican presidents are barred from running for an additional consecutive term and thus their policy objects can be cut short, making Costa Rica an even less ideal environment for meeting demands for compensation.

**How Well Does the Compensation Hypothesis Explain Social Policy Expansion in Latin America?**

Overall, we discover that the compensation hypothesis is insufficient in explaining the relationship between globalization and welfare in both cases and especially when applied to Costa Rica. As summarized in Table 1, Argentina is consistent or partially consistent with all of the linkages theorized by compensation hypothesis. However, Argentina is complicated by its history of macroeconomic instability and less traditional avenue of clientelist ties as a means of accessing the government. By contrast, compensation theory fails to adequately explain the case of Costa Rica in all three linkages. For these reasons, we deduce that the compensation hypothesis is somewhat useful at describing the relationship between globalization and social policy expansion in Argentina, but is ultimately unsuccessful at providing a sufficient explanation for the pattern of events that took place in Costa Rica.
Table 1: The Linkages of Compensation Theory Applied to the Cases of Argentina and Costa Rica in the 1990s-2000s

<table>
<thead>
<tr>
<th>Linkage 1: Globalization leads to Economic Insecurity</th>
<th>Argentina</th>
<th>Costa Rica</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privatization leads to tens of thousands of lay-offs. Major depression caused by economic contagion and poor macroeconomic management. Unemployment increased by 12%. Gini coefficient increased from 45 to 54. Partially Consistent with Compensation Hypothesis</td>
<td></td>
<td>Gini coefficient increased from 45 to 51. Modest increase in real and relative wages. Stagnant poverty rate. Compensation Theory Offers Incomplete Explanation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Linkage 2: Economic Insecurity shapes Compensation Demands</th>
<th>Argentina</th>
<th>Costa Rica</th>
</tr>
</thead>
<tbody>
<tr>
<td>Piqueteros: demanded social plans, food parcels, job assignments, unemployment subsidies, and welfare payments. Consistent with Compensation Hypothesis</td>
<td></td>
<td>Anti-CAFTA: demanded more government transparency, appropriate distance from U.S. government, and responsible, local use of natural resources. Compensation Theory Offers Incomplete Explanation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Linkage 3: Compensation Preferences lead to the Election of Left Parties</th>
<th>Argentina</th>
<th>Costa Rica</th>
</tr>
</thead>
<tbody>
<tr>
<td>Néstor Kirchner (PJ) elected in 2003. Clientelist relationships are continually renegotiated with factions of the piqueteros. Jefes y Jefas de Hogar Desocupados expanded. Slightly Modified from Compensation Hypothesis</td>
<td></td>
<td>Oscar Arias (PLN) returns to power in 2006 and substantially expands universalist social programs. Arias is pro-CAFTA and does not specifically target loser of free trade in social policy. Compensation Theory Offers Incomplete Explanation</td>
</tr>
</tbody>
</table>

Alternative Explanations

What explains the large increase in social spending in Argentina and Costa Rica, if not entirely the compensation hypothesis? For Costa Rica, a potential answer to this question lies in the work of Huber (2012) which explains how legacies of a nation’s welfare structure influence that country’s ability to expand social policy. Costa Rica, as a prototypic example of a universalist welfare state, has the politically easiest job at expanding social programs. According to Huber, that is because it is less difficult to convince a country to extend benefits that are already being enjoyed by the more needy citizens in a universalist system than it is to expand
benefits only possessed by the privileged. Thus, even a small presence of a compensation effect may be amplified into greater social spending from welfare legacies due to relative political ease.

Time may have also played a role in the case of Costa Rica. An argument could be made that aspects of the compensation effect took place earlier and/or later than what was observed in this study. Earlier in the sense that President Oscar Arias had begun both liberalization and drastic social policy expansion during his first term in the 1980s, before most other states in the region. This may have reduced the need for Costa Rica to reactively compensate its citizens in the 1990s and 2000s. Other effects may have occurred later in that sense that Costa Rica continued to pursue neoliberal trade policies through the 2007 ratification of CAFTA, up until the 2014 election of an anti-neoliberal president. This mirrors events which many of its Latin American peers experienced a decade earlier in the ‘Pink Tide’. Had this study changed its period of observation for Costa Rica, perhaps it could have found a different era to be more in line with popular iterations of the compensation hypothesis.

To test alternative theories on scale and factor endowment, Becker (2012) explains that unskilled labor in Argentina was neither as abundant a factor as land, nor as scare as capital, and thus should not have been a major winner nor loser of free trade. The massive increase in unemployment, therefore, could not have been explained by the Stolper-Samuelson school of literature that emphasizes the role of factor endowments in the relationship between globalization and social spending. However, Costa Rica, being a smaller, more labor abundant nation, did stand to benefit somewhat from the onshoring of labor-intensive industries and thus may be the reason that a compensation effect did not seem to occur in the same way that it did in Argentina or the developed world, where the disaffected labor population was very vocal, and quite clear about their demands to the government.
Regarding theories on a potential efficiency effect, Rudra (2002) theorized that greater dependence on external debt and foreign investment contributes to a negative correlation between globalization and social spending as developing states are pressured to become more fiscally minded. If Rudra’s theory were correct there should have been no better example than Argentina, where external debt was 115 percent the size of GDP at the turn of the millennium. While President de la Rúa enacted austerity measures for the brief time he was in office, this strategy was hugely unpopular and did not last very long. Rather than cutting spending, Presidents Duhalde and, to a much greater degree, Néstor Kirchner, expanded social welfare programs and subsidies.

One additional policy tool that is absent from the compensation hypothesis is currency controls, which have historically played a large role in Latin America. Albertos (2002) suggests that currency and exchange rate manipulation could reduce the need for social policy compensation because they provide the government with more leeway to address economic woes, repay debts, and enact redistribution. Argentina especially experimented with a large variety of currency controls as a development policy option. Currency controls could be used to depreciate the currency in an effort to support exports or relieve financial stress, as was done under Duhalde, or they could be used to prevent depreciation such as when the Kirchners used them to reduce domestic prices and ease debt repayments. During the period observed in this study, both Argentina and Costa Rica maintained crawling pegs against the dollar. Today, both Costa Rica and Argentina float their currencies, though Costa Rica still enforces a wide currency band in reference to the dollar.
Could Protectionism Return as a Viable Social Policy Tool?

Discussions on the compensation hypothesis have been based on the assumption that states can no longer prevent exposure to globalization though protectionist policies, and thus are forced to turn to social spending in order to soothe economic frictions. In the face of increasing anti-globalization sentiments across the developed world, however, scholars are beginning to question the inevitability of liberal trends. In point of fact, major economies like the United States and United Kingdom, that once led global efforts on liberalization under the Washington Consensus, have found themselves turning inwards (at least in rhetoric), towards nationalism. Thus, as a final component of the compensation hypothesis that this paper will analyses, I will now evaluate whether or not protectionism can once again be seen as a viable policy tool.

Of the two cases observed in this paper, Argentina provides us with the closest glimpse of what a post-Washington Consensus protectionist policy regime may look like. From 2003 to 2015, Presidents Néstor Kirchner and Cristina Fernández increased subsidies, experimented with various capital controls, and implemented a series of price controls and trade restrictions. These actions were subsequently combined with less conventional policies, such as an export tax on soy products and a 1:1 trade policy though which importers of certain final goods were forced to match the value of their imports with the purchase of Argentine exports. In some ways, these were attempts to return to an import-substitution model that signified a golden age for Peronism in Argentina. However, just as in the 1960s, these policies proved unsustainable. While export taxes, high subsidies, and price controls were manageable when exports and growth were high, these police began to fall apart once conditions changed around 2013. It became evident that the effects of the commodity boom would not last forever. As revenue and employment fell, market
distortions became more glaring and Argentina’s macroeconomics once again plagued the nation with low growth, high inflation, and financial troubles.

For small economies like Costa Rica, the negative ramifications for pursuing protectionism can be even greater. Firstly, since small states cannot feasibly produce all of their goods domestically, trade tends to make up a larger share of those nations’ GDP. To increase tariffs or trade restrictions would raise consumer prices quite dramatically. The few concentrated goods that a small state does specialize in will also tend to be heavily reliant on foreign demand (Peretz, Faruqi, Kisanga, and Arthur 2001). Thus, with so little market power, these states have far less leverage if faced with a trade war. Secondly, in some cases, lowering trade barriers can help domestic industries in small states become more competitive. In Costa Rica, for example, one argument in favor of CAFTA was that it would return manufacturing jobs lost to Mexico after NAFTA made their market more attractive to firms seeking to export to the United States.

In sum, from an economic perspective there remains little justification for reversions to protectionism in Latin America. The examples of protectionist models in the region are not especially attractive nor replicable. What’s more, it does not appear that a wave of protectionist policies would even be politically popular in Latin America if proposed today. Thanks no doubt to the commodity boom, public sentiment in favor of free trade has increased by 5-10 percent region-wide in the past decade according to LAPOP. This signals a curious deviation from developed countries where people have lost faith in globalization since the Global Recession. While the compelling economic argument for free trade has not changed in these advanced economies, the political decisions and global ramifications of potential protectionist measures is yet to be known.
Conclusions

The relationship between globalization and social policy expansion varies in important ways between different countries and different stages of development. This study analyzed two Latin American countries and attempted to explain the causal mechanisms of this relationship using qualitative evidence and existing theory designed for developed nations. Investigating this compensation hypothesis warranted the evaluation of three causal linkages. In the first linkage, that globalization yields economic insecurity, we find that exposure to economic contagion and neoliberal policies were partially responsible for the spike in Argentina’s unemployment, as was domestic macroeconomic mismanagement. In Costa Rica, we find a much less harsh impact of globalization that led to moderate increases in real and relative wages. This leads us to declare the compensation hypothesis partially consistent in Linkage 1 for Argentina, but inadequate in explaining the circumstances of Costa Rica. For the second linkage, which suggests that economic insecurity shapes demands for compensation, we find that the piquetero movement in Argentina made several direct demands for unemployment subsidies, food parcels, and jobs. Similar to the piqueteros, the Costa Rican anti-CAFTA movement was broad and decentralized in its opposition to negative aspects of globalization. However, it did not make explicit demands for compensation. Finally, in investigating the third linkage that social policy preferences result in the election of left leaders which implement social policy expansion, we discover that, taking advantage of clientelist networks, the piqueteros succeeded in achieving some level of compensation from the government and keeping left-wing Peronists in power. The increase in social spending under the neoliberal Arias administration in Costa Rica are less directly correlated with globalization. From this we conclude that the compensation hypothesis is somewhat well suited to explain the experience of Argentina during the 90s and 2000s, but is
unsuccessful at explaining the pattern of events encountered by Costa Rica during that same period.

This study provides valuable insight into the impact of globalization on the political economy of Latin American countries. The fact that the compensation hypothesis was able to describe the case of Argentina better than Costa Rica leads us to believe that there is important merit to alternative theories on the relationship between globalization and social policy expansion, specifically fiscal pressures, size of the economy, factor endowments, and capital controls. This may also be due to the fact that, as a large, upper-medium-income country with a relatively scarce labor force, Argentina’s economy simply looks more similar to that of an advanced economy that the hypothesis was designed to explain. The role of strong unions with ties to strong political parties also warrants further investigation.

More generally, this study offers value in that it presents an alternative method through which to observe the relationship between globalization and social policy. Using microfoundational linkages designed by Walter (2010), this study is able to shed large-N modeling in favor for a more qualitative approach that allows us to better understand the logic and narrative behind globalization’s impact on the welfare state. While studies based solely on numbers would be able to observe the positive correlation between globalization and social spending, this study proves that there are important nuances that cannot be understood from statistics alone.
Works Cited:


The World Bank. 2016. World Bank Development Indicators.