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The Impact of Economic Globalization Welfare States

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Abstract. The literature has yet to draw firm conclusions regarding the effect of economic globalization on government spending in developing countries and Pakistan in particular. This paper tries to overcome this gap in the literature and analyses the impact of globalization and democracy on the aggregate level of Pakistan's social spending from 1972-2018. The methods used include Johansen Cointegration and Vector Error Correction econometric model. The results confirm that globalization is inversely related to social spending, while democracy positively affects social expenditures. The results also demonstrate that debt service and inflation rate harm social spending. In contrast, the more significant economic development and the increased unemployment rate have a positive and meaningful relationship with social expenditure in the long run. Public decision-makers should consider these conclusions to promote economic and social sustainability in Pakistan.

Keywords: Democracy; Econometric models; Globalization, Social Expenditures.

1 Introduction

Over recent decades, the relationship between globalization and the nation-state has become one of the most pressing social science controversies (Heimberger, 2020). The discussion on the effect of economic globalization on the welfare state is far from being established, and the literature suggests contradictory arguments and results about this effect (Rodrik, 1998; Rodden, 2003; Kwon & Pontusson, 2010; Wu & Lin, 2012; Marshall & Fisher, 2015; Heimberger, 2020; Baptista, Pinho & Alves, 2021). The main question is how regimes of various kinds act in response to globalization toward welfare spending.

The issue we propose to address is to understand how the main regimes and their typology react to globalization by relating spending to well-being.
The optimistic assumption predicts a positive correlation between globalization and social spending due to adopting a stimulus-response model. According to this perspective, globalization induces popular demand for compensatory social policies explaining why highly open economies have the most significant welfare states. The pessimistic assumption argues that opening the economy implies greater competitiveness between countries, which creates constraints on the growth of public expenditure (Rudra, 2005). Opening the economy means competing for the attraction of capital, which imposes limitations on the level of tax revenue and therefore depresses public spending (Marshall & Fisher, 2015). Several studies suggest that openness and external shocks were significant determinants of increased welfare commitments in economically advanced countries (Quinn, 1997; Rodrik, 1997, 1998). The reason that explained this importance was that governments had encouragement to increase expenditure due to the enlarged vulnerability and insecurity related to economic openness. The expansion of social spending occurred due to countercyclical Keynesian policies or by intensifying the scope and depth of social insurance (Dos-Santos & Ahmad, 2020).
However, some authors (Franzese & Hayes, 2004; Stephens, Huber, & Stephens, 2002) needed to be more convinced of the benefits of globalization. The literature suggested that increasing trade and investment could constrain public and welfare expenditures. The main reason is that globalization could lead to a greater dependence on exports because of trade liberalization and capital mobility. In this context, firms see taxation as a constraint on competitiveness. The discussion on the association between globalization and social spending produces contrasting expectations for advanced and developing countries. Indeed, the literature on social spending does not adequately describe why the welfare spending trend in LDCs differs in developed countries.
The debate about the interaction between globalization and social spending generates contrasting expectations concerning advanced and developing countries. Concerning social expenditures, the literature does not adequately describe the spending trend with the social welfare trend in LDCs, which differs from developed countries.
The literature on the association between economic globalization and the welfare state suggests different perspectives on the nature of this correlation. Some scholars consider that other socioeconomic processes than globalization influence the welfare state. According to these authors, domestic policies play a more critical role in the welfare state definition than globalization (Iversen, 2001). Other authors consider that globalization has a significant influence on the welfare state. However, they diverge about the direction of this influence which led to the formulation of two theses: the efficiency thesis and the compensation thesis.
The efficiency assumes that high social spending makes international markets less competitive. This effect can transmit through different channels. High social spending can be connected, for example, to higher taxation that results in increased labor costs and decreases the efficiency of exports and domestic production, which are exposed to international competition (Kaufman & Segura, 2001). Second, high fiscal expenditures can decline competitiveness by increasing interest rates, leading to crowding out effects on private investors and increasing the values of the exchange rate (Avelino, Brown,

and Hunter, 2005; Adam et al., 2013). The compensation hypothesis states the opposite effect. It explains that the welfare state counterbalances the risk of globalization by investing more inhuman capital (Kaufman & Segura, 2001). This hypothesis is supported by several studies that make a robust empirical relation between globalization, large public sectors, and social safety net programs (Cameron, 1978). The quantitative research has generated more practical work supporting the compensation thesis as far as developed countries are concerned. As increased economic openness also reinforces welfare spending to strengthen human capital. That is also evident because developed countries usually have large welfare spending budgets to enhance the competitiveness and productivity of the economy in local and international markets (Stephen Ammon, 2002).

Pakistan comprises an appealing and comparatively understudied area for analytical inquiries in social spending. Most of the literature has been carried out to identify globalization's effect on welfare spending in OECD countries (Cameron, 1989; Rodrik, 1998; Hicks & Swank, 1992) and Latin American countries (Avelino, 2002; Kaufman & Segura, 2001). Only some scholars analyzed developing countries, including Pakistan (Rudra, 2005). However, all the previous literature used a multilevel country analysis, and Pakistan (PK) was never analyzed as a country-level study. Therefore, this paper contributes to the literature because it is the first based on time series in Pakistan. The main aim of this paper includes, respectively: 1) Analyze the impact of globalization and democratization on social spending in Pakistan at the aggregate level from 1972-2018. 2) Analyze if the government of PK acted in response to the challenges of globalization with social policy selection that leaned more towards reducing cost or through defensive nation's welfare or compensation.

2 Literature Review

The discussion on the impacts of economic globalization on welfare states is widespread. A protuberant hypothesis is that substantial welfare policies cushion the negative externalities of globalization. New empirical evidence suggests a negative relationship between globalization and public social spending (Busemeyer & Garritzmann, 2017). There are several definitions of globalization. Brady et al. (2005) define economic globalization as strengthening international monetary exchange and the ticket for the contemporary era of global economic integration. Several economic globalization indicators measure trade, financial, and overall economic globalization (Heimberger, 2020). Early "structuralist theories" stated that modernization (economic development) is positively associated with expanding welfare expenditures. This theory claims that the growth of social spending and respective policies represents the state's sense of responsibility toward its citizen "needs." (Flora-Alber, 1981 and Esping-Andersen, 1990).

However, "power resource theorists" declined structuralist arguments. The researchers stated that the power distribution among different political and social groups is the reason for amendments in social policies (Hicks & Swanks, 1992; Cameron, 1987). Several power resource theorists explained that by generating evidence of labor union

strength, considered the most robust forecaster of social and welfare expenditures. Labor wishes to increase welfare expenditures as long as their post-transferer compensation and benefits are likely to increase (Stephens, 1979 and Hicks, 1991).
The discussion on the association between globalization and social spending produces contrasting expectations for advanced and developing countries. Regarding the influence of globalization on social expenditures, several studies suggest that globalization, remarkably increasing openness to trade, has an adversative impact on at least some types of social spending (Kaufman & Segura-Ubiergo, 2001).

3 The efficiency and the Compensation Theory

The literature on the relationship between economic globalization and the welfare state is vast and can be divided into three approaches. The first presents a skeptical attitude towards globalization and its contribution to well-being (Castles, 2004; Iversen, 2001; Iversen & Cusack, 2000; see Taylor-Gooby, 2002)
According to these authors, not globalization leads to social well-being but the socio-economic processes based on technological change that leads to well-being and economic growth. Furthermore, they mention that welfare policies are developed more at the internal policy level than externally at the level of internationalization (Swank, 2002). In this way, the market institutions and the balance of power between internal decision-makers (parties, unions, industry associations, Etc.) condition the impact of the forces of globalization on the formulation of social policies (Swank, BR Starke et al., 2014). However, two other theories agree that globalization significantly affects welfare states. In this context, and as mentioned by Katzenstein (1985), globalization leads to an increase in worker dissatisfaction at an individual level, namely those excluded by globalization. So, they claim compensation through social welfare policies based on increased spending on internal transfers and social support (Garrett, 1998; Rodrik, 1998).
On the contrary, according to the theory of efficiency, which postulates the opposite of the previous ones, globalization limits the use of public expenditures (public expenditures and internal transfers) in general and in welfare in particular. That happens due to the scarce use of public capital at the global level (Genschel, 2002). Given that companies in international markets can threaten to withdraw their money, governments respond by lowering business costs, especially taxes. Thus, decreasing tax revenues reduces public spending and internal transfers, reducing social well-being.

4 Globalization and Expenditures on Welfare

Like the comprehensive policy of internal transfers, investment policies in the social sector also promote
training and capacity building of human capital. That can play an essential role in mitigating the adverse
side effects of economic globalization and, through the multiplier effect, lead to future social and economic well-being and increasing levels of development. Dreher et al.,

2008). Welfare states, institutions, and national policies condition states' reactions to globalization (Campbell, 2005). Most authors agree that since the crisis (oil shock) of 1970, states have reduced expenditure on social support policies (government transfers and public investment in the social sector).
At the same time, in democratic states, where, as a general rule, there are elections every four years, we are witnessing social policies that are interrupted by a new mandate without continuity, on the one hand. On the other hand, procedures with time horizons allow measuring their social gains in terms of competitiveness or social sustainability.
In turn, citizens' expectations also change each time a new government takes office, which may create more or less positive or negative expectations.

5 Democracy and Social Welfare

According to Onaran and Boesch (2014), globalization affects government budgets for social welfare. Despite this, country responses are conditioned by the economic policies of different welfare regimes and their respective institutions. These authors concluded that in Western Europe, globalization has led to increased spending on social policies. However, according to these authors (Onaran & Boesch, 2014)
taxes on dependent employment finance these expenses.
Thus, the compensation hypothesis is verified on the social expenditure side, while there are pressures on efficiency on the tax revenue side.
In this way, these policies are complementary and not competing. Nevertheless, according to Onaran and Boesch (2014), these results occur mainly in conservative regimes.

6 Methodology

Information and data were obtained from secondary sources, namely, the United Nations database (2020) and the World Bank database (2020). The period analyzed included data from 1980 to 2020. The econometric software program includes EVIEWS. The econometric model has the long-run and short-run dynamics between globalization, democracy, controlled variables, and social spending.:

$$S_t = \propto_t + \beta_1 TO_t + \beta_2 FOR_t + \beta_3 Dem_t + +\beta_4 EcodeT_t + \beta_5 URT_t + \beta_6 IRT_t + \beta_7 \; DebtT_t + \varepsilon_t$$

Where: α; βs; ε, and t represent, respectively, the constant; the parameters to be esteemed, the error term, and the years of observation. URT represents the aggregate social expenditures; TO the social expenses; TOt and FORt are the openness of the global economy unemployment rate; and EcodeTt, URTt, IRTTt, and DebTTtt represent inflation rate and financial account.
Dos-Santos and Diz (2018) and Dos-Santos et al. (2012) used a Log-Log model. The heteroscedasticity White test was used, and the values of the t-test were done (0.000). The model was run for 0.10%, 0.005%, and 0.010%.

The degree of fit of the model (R2) is good. The R2 evidence this at 80%, which is a correct fit for the data.

7 Results and Discussion

The model's results are generally in line with those of other authors from developed countries, namely by Dos-Santos and Diz (2018). Thus, in the long term, the opening of emerging economies leads to results that, despite being positive, although these results are dynamic and subject to unpredictability. In addition to opening up the economy, the democratic regime also entails more significant expenditures in terms of internal transfers. The results confirm that the past years of more significant political turbulence in this country led to decreased social expenses. The existence of a higher per capita national income translates into higher social expenditures (control variable). The social problems in this country, namely the increase in the unemployment rate, also conditioned an increase in internal and external transfers. As a problem, the high public debt translates into a sharp decrease in transfers, and this problem worsens in the long term due to instabilities in the interest rate on public debt. In this way, inflation turns out to be an explosive engine with very negative impacts on internal transfers, namely, contributing, in the long term, to a reduction in social support.

8 Conclusion

The results allow us to conclude that, in developing countries, there is an effect and a degree of openness of public policies, an effect of the external environment, which intensely conditions the expenditure on internal transfers. This situation directly impacts a country's social status and its citizens' level of well-being. In this way, developed countries too, namely the G20 and G8 economies, should be alert to the possibility that, with their policies, they have conditioned their countries not only internally but also externally the countries with emerging economies. This contagion can be positive or negative, depending on that country's monetary and fiscal policies. For this reason, internal organizations, such as the International Monetary Fund, will also have to play an essential role in contributing to a better world by defining monetary policies adjusted to realities that are not national but global. Despite this, globalization and open economies continue to be a win-win situation. These transnational supervisory mechanisms must act with a view to the common good.

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