The Political Economy of Inequality in Developing Countries : Trajectories from Industrialization to Inequality

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Abstract

This thesis examines the variation in levels of inequality between late-industrialising countries in Latin America and East Asia from the 1960s. Latin American countries have more advanced welfare states, higher social spending, and more abundant left power resources than their East Asian counterparts. Yet, economic inequalities are much greater in the former than in the latter. The differences between these two regions in distributional outcomes are also surprising given their historical and political similarities, such as a long colonial history and authoritarian military rule. In order to answer these ongoing puzzles that cannot be fully explained by existing research, this thesis provides a causal story to explain the discrepancy of inequality in the two regions.

This thesis argues that inward-looking industrialisation versus outward-looking industrialisation make a huge difference in levels of inequality by influencing the characteristics of labour market and welfare policies. The main theoretical claims of this thesis have two parts. Firstly, I argue that authoritarian leaders in both countries faced a set of incentives that shaped the probability of their initial adoption of inward-looking versus outward-looking industrialisation. Contrary to the existing literature which considers the choice of openness and closedness as exogenously given, this research argues that the choice of openness is a rational choice of a dictator, under political and economic impasse such as lack of financial resources and a higher office holding cost, in an effort to fulfil his economic and political interests. By developing a causal theory, this thesis directly theorises the choice of dictators. Secondly, I argue that this choice has a subsequent path-dependent effect on the progressivity of welfare policies and labour market. Inward-looking industrialisation produces social policies that favour small and narrow insider coalitions, which in turn lead to higher levels of inequality, and vice versa for outward-looking industrialisation. By providing clear theoretical mechanisms connecting industrialisation to inequality, this thesis explains the institutional trajectories of different types of industrialisation on inequality.

These claims are tested in an unbalanced pooled time-series cross-sectional analysis of sixteen Latin American and East Asian countries from the 1960s to the 2000s. Using a newly constructed original data set, the findings show that countries that adopted outward-looking industrialisation strategies have more flexible and unregulated labour markets and minimal welfare spending. By contrast, countries with inward-looking industrialisation strategies have more bifurcated and highly regulated labour markets, and generous but highly stratified welfare states. As a result, labour market institutions and welfare policies conditionally affect inequality depending on the types of industrialisation. Whereas labour market institutions and welfare spending exacerbate inequalities in countries with inward-looking industrialisation, they are linked to relatively low levels of inequality in countries with outward-looking industrialisation. The causal mechanisms are also explored in qualitative case studies of Latin American and East Asian countries.

This thesis makes important theoretical and empirical contributions to the comparative studies of inequality. First, this research broadens the theoretical and empirical scope of comparative studies of inequality by incorporating two regions that have been traditionally under-explored. In addition, this thesis calls for a reconsideration of the existing theories on the relationship between openness, social policies, and inequality. Against the Katzensteinian approach positing a positive relationship between openness and the expansion of welfare state, this thesis finds theoretical and empirical evidence that inward-looking industrialisation is related to higher levels of welfare spending and more protective labour market institutions, although this exacerbates inequality because of its regressive nature of welfare states and labour market.

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Chapter 1. Introduction

1.1. The Puzzle

Despite conventional views only focusing on external differences (e.g. land size, the amount of natural resources), Latin America and East Asia, two of the well-known late-industrialising regions, share considerable similarities: A history of rapid growth and industrialisation since World War II, a long period of colonial rule, a period of political instability mostly in the form of authoritarian military rule (O'Donnell 1973), and the resulting unconsolidated democracy for a long time period are the common features that characterize both regions. The two regions also experienced similar economic crises in the 1980s and the 1990s, which led to neoliberal economic reforms in the era of globalisation. However, the two regions show considerable differences with regard to the distributional issues. As Milanovic (2010) reported, Latin America is known to be the most unequal region in the world.[1] Based on available data from the 1960s to the recent decades, the differences of Gini coefficient in Latin America and East Asia are huge, and this trend has not changed significantly up until today. Despite the historical and political similarities of the two regions, the striking dissimilarity in the distributional results in the two regions remains as an enigma in the field of comparative political economy.

Specifically, we need to look at the following two ongoing puzzles that have not been fully explained by existing academic works. Firstly, since World War I and II, Latin American countries have formed the most advanced welfare systems among the group of developing countries, and their social spending levels have been much higher than those of almost all East Asian countries and several advanced democracies. The average social expenditure level of Uruguay, Argentina, Chile, Brazil, and Costa Rica has exceeded even that of Japan (Haggard and Kaufman 2008). However, a substantial number of studies point out that welfare spending

[1] As one of the interesting counter arguments of this, Williamson (2009) argues that the level of inequality in Latin America is not especially high compared to prior Latin America's belle époque.

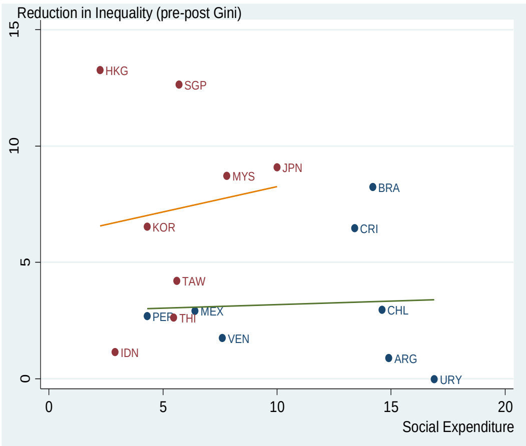
in Latin America did not actually contribute to the decline of inequality (e.g. Rudra 2004). Why, at the outset, did they construct such an extensive welfare system among all developing countries, and why did the higher levels of welfare spending not contribute to a reduction of unequal distribution of wealth? Also, despite its minimal welfare spending and protections for workers, how did East Asian countries maintain such a relatively equal distribution? Secondly, contrasting to the expectation of power resources theory that emphasizes the role of leftist parties and labour power resources on distribution and the expansion of welfare state (Korpi 1980, 1985, 2006; Garrett 1998; Swank 2002; Korpi and Palme 2003), why have Latin American countries become more unequal in spite of their relatively abundant left power resources? Figure 1 clearly illustrates these puzzles.

Figure 1. Welfare Spending and Inequality in the World

(a)

(b)

(c)



* *Social Expenditure* (% of GDP): Average central government expenditures on social security, health, and education during 1970~2000, IMF Government Finance Statistics, OECD Social Expenditure database (SOCX)

* *Post tax and transfer Gini*: in (a) and (b), averaged during 1970~2000, Solt (2016)

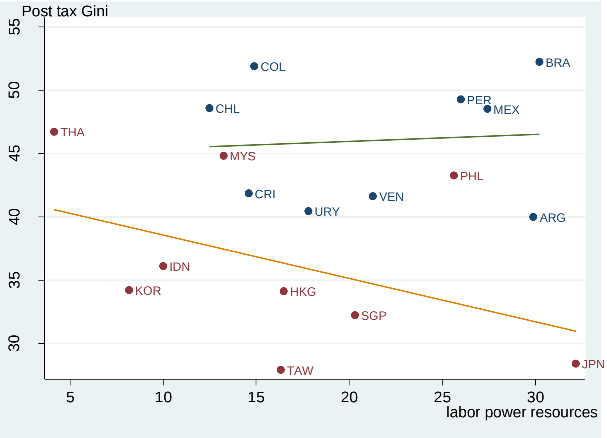
* *Reduction in inequality*: Pre-tax Gini minus Post tax Gini, averaged during 1970~2000, Solt (2016)

In graph (a), among the three groups of countries – advanced economies (green dots), Latin American countries (blue dots), and East Asian countries (red dots) –, advanced economies have the highest levels of social expenditure of all countries, and their levels of inequality are the lowest. The higher the social expenditure, the lower the inequality in advanced economies.

This pattern is shown to be the same in East Asian countries. Most Latin American countries spend mid-levels of social expenditure in comparison with advanced countries and East Asian countries; however, the levels of inequality in Latin American countries are much higher than their East Asian counterparts. If we exclude several under-developed countries in terms of GDP from the sample (i.e. Philippines, Malaysia, Peru, Thailand) and focus more on middle-income countries, the pattern becomes much clearer (see *graph (b)*). A careful examination is needed to explain why the directions of the slopes and the intercepts of the two regions are so different. Against conventional wisdom, we can observe a nearly flat (in graph (a)) and somewhat positive relationship (in graph (b)) between social expenditure and inequality in Latin America. In figure (c), we can also observe that social spending reduces inequality much more effectively in East Asia than in Latin America. It may imply that Graph (c) shows the regressive characteristics of welfare states in Latin America, because the difference between pre-tax Gini and post-tax Gini (namely, the reduction of inequality) depends on the degree to which taxes and welfare policies are progressive and the extent to which government transfers redistribute income to poorer members of society.

Figure 2 below shows the second empirical puzzle between labour power and inequality. As conventional expectations of power resources theorists argued, the positive relationship between greater labour resources and more equal distribution has been regarded as a very natural fact. However, as in *Figure* 2, if we measure labour power by union density –although this is a rough proxy–, we can see a slightly positive slope between labour power and inequality in Latin America that sharply contrasts with the conventional expectations. Most Latin American countries are traditionally known to have relatively stronger labour power than East Asian countries; however, the levels of inequality are much higher in Latin America. Why did the abundant labour power of Latin American countries not contribute to the reduction in inequality?

Figure 2. The Puzzle of Labour Power Resources and Inequality



* *Labour power*: measured by union density, Averaged during 1970~2000: *OECD, ILO, and various sources*

* *Gini coefficient*: *Post tax and transfer Gini, Solt (2016)*

Against conventional views interpreting the expansion of welfare state and labour mobilization naturally contribute to a better distribution of wealth, I will show that the sizable welfare state and strong left labour power resources of Latin America essentially aggravated inequality and explain why. (In addition to this, I also explain how East Asian countries with minimal welfare spending and labour power resources achieved relatively lower levels of inequality.) The explanations are essentially related to the characteristics of labour market and welfare policies formed in the two regions. By providing a causal mechanism that explains distinctive constructions and characteristics of welfare states and labour market, this thesis suggests an answer to the empirical and theoretical puzzles of the discrepancy between the levels of inequality in the two regions, as highlighted above.

1.2. A Theory on Inequality in Middle-Income Countries: Trajectories from Industrialisation to Inequality

This thesis examines the variations in levels of inequality between late-industrialising countries in Latin America and East Asia. Most importantly, it argues that types of industrialisation –

inward-looking industrialisation versus outward-looking industrialisation– make a huge difference in levels of inequality in the two regions by influencing the characteristics of social policy –welfare policies and labour market. In other words, these two types of industrialisation create contrasting welfare state and labour market, and this is one of the main causes of differing levels of inequality in the two regions.

The two types of industrialisation –inward-looking and outward-looking industrialisation– are the development policies that the two regions adopted as base strategies for economic growth and development. The two distinctive development strategies are also known as import-substitution industrialisation (henceforth ISI) and export-oriented industrialisation (henceforth EOI). Since the key difference between the two strategies lies in the trade policy –trade openness or protectionism–, the choice of development strategies is fundamentally the same as the choice of trade orientation.

The core feature of ISI is its heavy reliance on domestic market expansion as a means to ensure continuous economic growth whilst blocking import. A number of Latin American countries and Southeast Asian countries adopted ISI from the 1930s and maintained it mostly until the Debt crisis of Latin America in 1982. The core instruments of the ISI model are protectionist policies including appreciated exchange-rate, extensive use of tariffs and quotas, complex multiple-exchange-rate systems, direct subsidies for firms, and the use of state-owned banks that supported industrialisation (Haggard 1990; Haggard and Kaufman 2008, 61-63). East Asian countries began adopting EOI in the period between the 1950s and the 1960s and maintained it until the 1990s, when the economic liberalization and Asian economic crisis happened.[2] Late comers such as the Philippines, Indonesia, Malaysia, and Thailand adopted EOI in the 1970s and 1980s and still maintain its trade-centred policies.

[2] However, the legacies of EOI are still existent in many East Asian countries and they have continued to pursue export-oriented policies. Chapter 6 illustrates this in detail.

Based on their core differences especially in trade policy orientations and industrial focus, ISI and EOI served as crucial frameworks of economic development, and they have formed lasting legacies in Latin America and East Asia until recently. Accompanying with a set of distinctive industrial policies, ISI pursues the growth of the domestic market through protective industrial policies, and EOI aims at economic growth through higher export based on price competitiveness of light manufacturing. By providing a path dependent argument that connects the types of industrialisation to the levels of inequality, this thesis provides a holistic explanation on the origins and variations of economic inequality in developing economies.

Figure 3. The Process and Changes of Industrial Strategies

Autarky →	Open economy (Latin ~1930, Asia ~1950)	Institutional Consolidation of ISI (1940~) in Latin America or EOI (1960~) in East Asia	After Economic liberalization (End of ISI: after the mid-1980s)

The main theoretical claims of this thesis have two parts. Firstly, I argue that authoritarian leaders faced a set of incentives that shaped the probability of their initial adoption of inward-looking versus outward-looking industrialisation. Contrary to the existing literature which considers the choice of openness and protectionism as simply exogenously given, this thesis directly theorises the choice of dictators and argues that the choice of openness is a rational choice of a dictator, under political and economic impasse such as lack of financial and natural resources, rent income, and public support, in an effort to fulfil his economic and political interests. Compared to dictators who possess enough material resources to repress the public, those who are lacking resources can lower/appease public demand by opening the economy. Secondly, I argue that this choice has a subsequent path-dependent effect on the progressivity of labour market and welfare policies. Inward-looking industrialisation produces labour and social policies that favour small and narrow insider coalitions, which in turn leads to higher levels of inequality. On the contrary, outward-looking industrialisation produces limited but universal labour market and social policies that basically support broad recipients, which in turn leads to relatively lower levels of inequality.[3] In other words, I argue that welfare states and labour markets, which were constructed under protectionism, tend to be more distorted, biased, insider-centric, irrespective of their size or intensity of welfare benefits and labour protection. Therefore, they ultimately have negative impacts on inequality. This is totally different from conventional approaches that the size of the welfare state, the degree of labour market protection or flexibility, and left labour power can explain levels of inequality.

By providing a clear theoretical mechanism connecting industrialisation to inequality, this thesis explains the trajectories of different types of industrialisation to inequality. I contend that this causal mechanism can fill the gap in existing theories and explain a large part of inequality in developing countries, especially wage inequality through different characteristics of labour market institutions, and disposable income inequality through the scope of welfare recipients and beneficiaries of welfare policies.

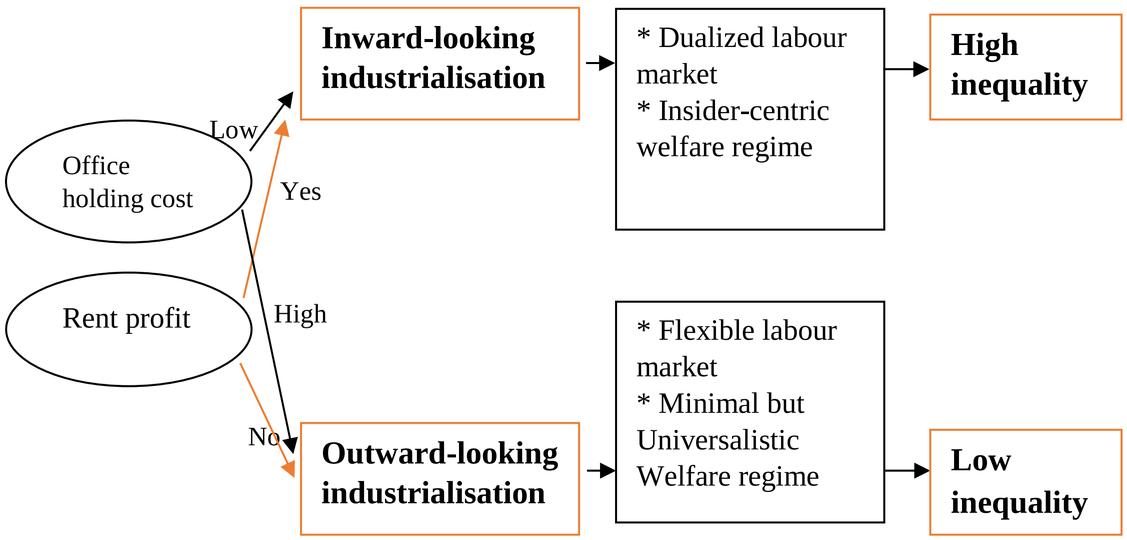
The causal mechanisms are tested in three consecutive analyses, with time-series cross sectional analysis and historical comparative analyses. There are clearly three stages to this argument: 1. The initial choice facing political leaders under authoritarian rule to choose outward or inward policies; 2. How this decision is channelled into welfare and labour market policies; and; 3. How these policies lead to divergent levels of inequality. The theoretical mechanisms will be tested consecutively by qualitative and quantitative methodologies: mainly, historical mini-case studies and time-series cross-sectional analyses are used. Using a newly

[3] Even after the end of government-led industrialisation strategies, the vestiges of the strategies remain and affect the levels of inequality. This will be discussed in Chapter 6.

constructed original data set –an unbalanced pooled time-series cross-sectional analysis of fifteen Latin American and East Asian countries from the 1960s to the 2000s–, the findings show that countries that adopted outward-looking industrialisation strategies have more flexible and unregulated labour markets and minimal welfare spending. By contrast, countries with inward-looking industrialisation strategies have more bifurcated, highly regulated labour markets and generous but highly stratified welfare states. Whereas labour market institutions and welfare policies exacerbate inequalities in countries with inward-looking industrialisation, they are linked to relatively low levels of inequality in countries with outward-looking industrialisation. As a result, the effects of labour market institutions and welfare policies on inequality depend on the type of industrialisation. The causal mechanisms will be further explored in qualitative case studies chapters of Latin American and East Asian countries.

Figure 4 describes the analytic framework of this thesis, clarifying the two different paths from industrialisation to inequality. It consists of three stages. The first stage explains why and under what circumstances a political leader chooses inward-looking or outward-looking industrialisation. A dictator's rent income and office holding cost shape the choice. The second stage illustrates a causal link of how this decision is channelled into different labour market institutions and dissimilar welfare regimes. The third stage then illustrates how these contrasting institutional configurations finally lead to divergent levels of inequality.

Figure 4. Model: From the Choice of Industrialisation to the Inequality



In order to clearly present the core causal arguments of this thesis, I explain these three stages in a sequential order. Each claim will be discussed in detail in subsequent chapters.

1.3. Contribution of this Research

Comparing levels of economic inequality across countries has been a major academic topic in various academic fields since the 1980s. Particularly, in the field of comparative political economy, there have been considerable attempts to explain the variations of inequality in advanced democracies with political and institutional variables such as electoral systems, democracy and partisan politics, social policy and welfare system, as a scholarly effort to unveil remaining enigmas on the politics of distribution. Existing works and theories, however, generally have been focusing on the advanced democratic and early-industrialised countries that are mostly Western European countries and North American countries. A relatively fewer number of studies especially in the field of political economy have concentrated on the political economy of inequality by fully focusing on late-industrialising economies such as Latin America, East and Southeast Asia, or Southern and Eastern Europe (cf. Rudra 2004). Little is known about the origins of variations in economic inequality of the 'third world' and relatively few theoretical explanations on the political economy of inequality regarding the middle-income countries have been accumulated so far. In this sense, this thesis makes important theoretical and empirical contributions to the comparative studies of inequality in newly-industrialising countries. It broadens the empirical scope of comparative studies of inequality by incorporating two regions that have been traditionally under-explored. Theoretically, this thesis explains the construction and characteristics of labour market policies and welfare regime in different middle-income countries. Under these circumstances, this thesis aims to provide a holistic explanation on the origins and variations in economic inequality in developing economies, while focusing on the role of industrialisation.

In addition, this thesis calls for a reconsideration of the existing theories on the relationship between openness, welfare spending and labour market institutions, and inequality. Against the Katzensteinian approach positing a positive relationship between openness and the expansion of welfare state, this thesis finds theoretical and empirical evidence that trade protectionism is related to higher levels of welfare spending and more protective labour market institutions. Ironically, the larger size of welfare state and protectionist labour market policies exacerbate inequality because of their regressive and distorted characteristics that have been developed under protectionism.

In sum, this study supplements existing explanations of the inequality in developing countries while challenging several existing theories including the compensation hypothesis (Cameron 1978; Katzenstein 1985; Garett 1998; Rodrik 1998) and power resources hypothesis (Korpi 1980, 1985). Overall, my argument adds detailed causal mechanisms that are missing in existing literatures and clarifies important institutional differences in examining inequality in late-industrialised countries. Most importantly, this thesis suggests a unified causal mechanism linking types of industrialisation, distinct institutional and policy developments, and their impact on inequality. This is an attempt to provide a convincing explanation on the origins and variations in inequality in the newly developing countries which remains as unexamined.

Firstly, this thesis contests the relationship between openness and welfare state development and its distributional results by focusing on late-industrialising countries. Studies on advanced countries show that openness leads to a higher level of social spending and an expansion of welfare state as a governmental compensation for people who experience higher economic loss and uncertainty because of trade expansion and volatile international competitions (Katzenstein 1985; Garrett 1998). Since this line of research emphasizing the partisan reactions toward increasing risks after opening economy is based on the advanced European democracies with clear partisan differences and consolidated democratic institutions, the argument is not relevant to explaining the distribution and welfare in middle-income economies that have relatively short and unconsolidated history of democracy. In this context, this thesis suggests a completely different story with regard to the relationship among openness, labour market institutions and welfare state expansion, and inequality in developing countries. Why do more internally oriented and protective countries tend to have higher levels of protection, and why do more externally exposed economies tend to have less protection and welfare spending in developing economies? What could explain these contrasting patterns in developing economies compared to advanced economies? The analysis suggests new insights into the meaning of trade openness and outward-looking industrialisation in the developing nations. Contrary to the existing approach that considers trade openness as increasing socioeconomic risks to the poor, I argue that economic openness needs to be considered as more job opportunities and chances for the poor to earn more income in developing, non-democratic economies. The positive relationship between openness and the expansion of welfare spending does not find support in export-oriented non-democratic developing countries aiming for higher exports through competitiveness on low labour cost. This perspective adds a new insight to the relationship between openness and welfare expansion.

Secondly, this study challenges a line of research that emphasizes the positive role of left power resources in the expansion of welfare state and equal distribution (Korpi 1983, 1985, 2006; Korpi and Palme 2003). The core assumption of the power resources approach is that labourers and left parties have shared interests in supporting labours' right and there is no internal division within labour. However, as clearly challenged by Rueda (2007), if the labour is divided into two groups, the insiders in formal sectors with job security and the outsiders in informal sectors, then the two groups do not share same interest and leftist parties are likely to support the interest of insiders, rather than that of outsiders. By providing detailed mechanism of how different industrialisations and the resulting labour market institutions affect the characteristics of left power resources in the two regions, and especially how inward-looking industrialisation distorts the characteristics of labour market institutions in Latin America, I suggest a reverse impact of labour powers on the distribution in the context of Latin America.

Last but not least, unlike existing research which deals with economic openness and protectionism as exogenous, this thesis suggests a theory with regard to the dictator's choice on openness or closedness. This provides an alternative explanation to the traditional historical understanding of inward-looking industrialisation as a nationalistic movement against super powers forcing deepening dependency –simply a political ideological understanding that does not consider the interest of influential actors in the periods of economic and political turmoil.

1.4. Methodology

In order to clearly trace the choice of trade regime (types of industrialisation) and to contrast the impact of different types of industrialisation on inequality via the contrasting development of welfare states and labour market institutions, I explore the two archetype regions –Latin

America and East Asia– by using multi-methods including comparative historical case studies and empirical analyses. For the empirical test, I constructed an unbalanced pooled time-series cross-sectional data set of fifteen[4] Latin American and East Asian countries mostly from the 1960 to the 2000s[5], covering possibly from the beginning of industrialisation, as an effort to secure relevant variations of inward-looking industrialisation and outward-looking industrialisation. Conventional perception understands the mid-1980s or the early 1990s as the beginning of globalisation (and the end of development strategies), which dramatically changed macroeconomic policies of countries forcing them to open their domestic markets and to pursue more export-oriented policies. However, some Southeast Asian countries started their modern industrialisation even after the 1980s or 1990s, complicating the uniform view of globalisation 'starting' in the 1990s. In addition, since the legacies of industrialisation strategies has persisted for a considerable period of time, I have extended the data collection to the 2000s. This relatively wide time span will allow us to fully capture the periods of ISI and EOI in these countries and to trace the influence of industrialisation strategies on inequality.

Considering the limitations of large-N studies, this thesis also provides historical case studies. It explores historical cases and causal mechanisms in more detail that have not been adequately reviewed due to data availability issues in the quantitative large-N chapter. As quantitative analysis limits researchers' interpretation due to the accuracy or the conceptualization of unquantifiable variables and difficulties in understanding the causal paths, this thesis tries to confirm that the main argument and causal mechanisms of this thesis are valid and can be supported in historical evidence through process-tracing method.

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[4] The countries included for the empirical test are, for East Asia: Hong Kong, Indonesia, Japan, Malaysia, the Philippines, South Korea, Taiwan, Thailand; for Latin America: Argentina, Brazil, Chile, Costa Rica, Mexico, Peru, Uruguay, and Venezuela.

[5] One of the major limitations of this data set is that the time span is not long enough to cover all Latin American countries who started their full-scale industrialisation in the early 1930s~1940s. (i.e. Argentina, Mexico, and Brazil)

1.5 Findings

The findings of this thesis are as follows. First, outward-looking industrialisation is linked to the development of more flexible and unregulated labour market institutions (e.g. low levels of union density, labour protections and regulations) and minimum welfare spending (e.g. low levels of social insurance spending, but a relatively universal education and health spending). On the other hand, inward-looking industrialisation is vitally concerned with bifurcated and highly protective labour market institutions (e.g. higher levels of union density, labour protection and regulations), a generous but stratified welfare spending (higher social insurance spending, but a lower education and health spending). Institutions developed under different types of industrialisation have clearly 'dissimilar' characteristics, thus influence inequality quite differently in its direction and impact.

Second, this thesis confirms that labour market institutions (union density, labour market regulations) and welfare policies (social spending, education and health spending) developed under protectionism have negative impact on the distribution of wealth. On the contrary, the same institutions and policies influenced by outward-looking industrialisation are linked to relatively low levels of inequality. For example, union density, one of the major labour market institutions known to be related negatively (-) with inequality, has dissimilar impacts on inequality in Latin America and East Asia. The empirical results show that higher union density is related to low levels of inequality in East Asian countries; however, it is connected to higher levels of inequality in Latin American countries. Against the conventional wisdom expecting the straightforward and equivalent impact of the same institutions and policies on inequality, this result supports my argument that even same institutions and policies have different abilities and characteristics on inequality depending on whether they are influenced by inward-looking industrialisation or outward-looking industrialisation. The impact of institutions on inequality can be differentiated, and sometimes, contradictory, according to the types of industrialisation.

Overall, by focusing on the distinct institutional arrangements and policy outcomes following different trajectories of industrialisation, this thesis contributes to the understanding of inequality and attempts to unearth the mechanism that drives the different patterns of inequality in Latin America and East Asia. Moreover, in addressing theoretical limitations inherent in existing explanations of inequality in developing countries, this study suggests a new explanation on the conditional nature of institutions and policies on inequality and provides a holistic picture in understanding the origins of inequality.

However, this study is not without limitations. The attempt to develop a parsimonious theory that covers both East Asia and Latin America inevitably overlooks some important historical and institutional details of countries. Also, the empirical test of this thesis cannot cover some of the important periods due to the lack of available dataset. In addition, as high levels of inequality can be a cause of expansion of welfare states, this research fundamentally encounters endogeneity problems. Despite the limitations, this research is worth elaborating further. It broadens the theoretical and empirical scope of the comparative studies of inequality by incorporating two regions that have been traditionally unexplored. It is an empirical extension of inequality studies to a broader range of cases. In addition, this is by far the first comprehensive approach to explore the origins and variations of inequality encompassing Latin America and East Asian in the field of comparative political economy. The huge achievement of inequality studies in comparative political economy has not placed much attention on the middle-income and developing countries. By emphasizing the causal linkage from the choice of industrialisation, the cross-regional divergence in labour market institutions and welfare policies, and inequality, I intended to draw a parsimonious model of developmental capitalism.

1.6 Chapter Outlines

This thesis is structured into five chapters. As explained briefly, the main argument of this thesis is divided into three consecutive theoretical chapters. To carefully examine the stages of theoretical mechanisms, each chapter comprises of a detailed theory section dealing with each theoretical stage and an empirical analysis supported either by qualitative case studies or quantitative analyses.

Chapter 2 reviews major works regarding industrialisation in developing countries, the political economy of the development of social policies including labour market and welfare regimes, and the political economy of inequality. It mainly reviews the current development of inequality studies explaining developing countries and finds a missing link to connect industrialisation, labour market and welfare regime, and the levels of inequality.

Chapter 3 examines the first stage of my theoretical mechanism explaining why some countries adopted inward-looking industrialisation while others did not. It focuses on the political leaders' utility calculations over the choice. This chapter provides, in particular, the conditions under which the choice was made and explains the theoretical mechanism. The theoretical claim is supported with a case study, qualitative analysis. The case study examines historical details over the choice which in some countries dates back to the 1920s or the 1930s. It verifies whether the theoretical argument has considerable leverage to explain actual policy choices.

Chapter 4 starts with a theoretical discussion of the second stage of my causal argument: How the inward-looking and outward-looking industrialisations are channelled into different characteristics of labour market policies and welfare regimes. It firstly explains the process of how the initial choice of the types of industrialisation leads to specific political economy coalitions and how they influence the characteristics of welfare regimes and labour market. The argument linking inward-looking/outward-looking development strategies and the characteristics of labour market and welfare states is supported by the evidence gathered from the literature on labour markets and welfare states in individual countries. Especially, this gives special attention to the development of insider-outsider dynamics in labour market and the regressive characteristics of labour market and welfare state regimes in Latin America from the 1940s. Although the lack of comparable data limits quantitative analysis covering from the 1940s, qualitative literature on individual countries provides some evidence, even partially, on the characteristics of labour market and welfare state. Chapter 4 also looks at variation in labour market institutions and welfare policies by focusing on their progressivity and regressivity. The findings confirm that outward-looking policy is linked to more flexible, unregulated labour market institutions and minimum levels of labour protection. On the other hand, inward-looking industrialisation is vitally associated with bifurcated and highly protective labour market institutions and generous but stratified welfare spending patterns. Institutions developed under different types of industrialisation have clearly 'dissimilar' characteristics.

Chapter 5 then provides a detailed theoretical discussion of how these regimes influence the levels of inequality. The focus is to clearly explain how the policies and institutions lead to divergent levels of inequality. In this chapter, first of all, I describe the trend of inequality and inward-looking policies and the relationship between the two variables in Latin America and East Asia. Then I empirically test my argument with a pooled time-series cross-sectional dataset from 1960 to 2000s, covering all available years, as an effort to secure relevant variations of inward-looking industrialisation and outward-looking industrialisation. The analytic models firstly test the impact of the labour market institutions and welfare regimes on inequality and secondly look at the conditional impact of inward-looking orientations on inequality. This is an effort to statistically confirm the leverage of inwardness on inequality. The empirical result confirms that labour market institutions and welfare policies developed under inward-looking orientations have actually aggravated inequality. On the contrary, the institutions and policies influenced by outward-looking industrialisation are linked to relatively lower levels of inequality.

Chapter 6, the concluding chapter, recapitulates the main findings and implications of this research, as well as its limitations and remaining future challenges. Some practical implications regarding the current challenges facing Latin America and East Asia are discussed. It also suggests a provisional theory of explaining inequality after the globalisation and liberal economic reforms.

Chapter 2. Literature Review

2.1. Theoretical Challenges towards Existing Research

Comparing and explaining levels of economic inequality (including wage, income, wealth inequality) across countries has been a major topic in various academic fields since the 1980s. In particular, in the field of political economy, considerable attempts have been made to systematically explain the causes and variations of inequality mainly in advanced democracies. Starting from the median voter theorem of redistribution (Romer 1975; Meltzer and Richard 1981), existing works find that the electoral system, partisan composition, and labour market institutions -such as wage setting institution, centralization of wage bargaining, and union density- are meaningful variables that account for such differences of inequality (Garrett 1998; Scharpf and Schmidt 2000; Huber and Stephens 2001; Iversen and Soskice 2006).[6] Furthermore, Hall and Soskice's (2001) Varieties of Capitalism approach (hereafter VoC) has been an influential framework to explain variations in inequality with systematic institutional differences between LMEs and CMEs. Based on the VoC approach, one of the major works dealing with institutional context and inequality is Rueda and Pontusson (2000). They suggest a theory which explains the diversity of wage inequality with institutional differences of advanced countries. This thesis here takes a cue from this line of work despite it covers different regions. Going beyond the VoC approach, which has been criticized for being structural and functionalistic, this thesis aims to provide a theoretical agent-driven causal story based on the interests of agents influenced by types of industrialisation.

Despite the piqued political economists' interest in inequality, significant challenges remain to the understanding of inequality in developing countries. First, it is not clear to what extent the explanatory variables from existing research focusing on advanced democracies can

[6] For a more detailed review, see Beramendi and Anderson (2008).

be applied to developing countries where mostly non-democratic political backgrounds exist. For instance, the explanatory leverage of partisan composition or electoral rules on inequality tends to be constrained in developing countries that have a relatively short history of consolidated democracy. We therefore need to re-examine the impact of causal factors in the new context of developing countries. Second, what is lacking is an overarching and unified political economy theory of inequality focusing on developing countries. We have observed the most severe fluctuations in inequality in developing countries after WWI and WWII, and many have attempted to account for inequality with macroeconomic and socio-political factors such as economic growth, trade and globalisation, land distribution, foreign direct investment, and colonial history (see Kuznets 1955; Fields 1989; Engerman and Sokoloff 1997; Wood 1997; Bruno *et al*. 1998; Milanovic 1998; 2005; Sylwester 2000; Cornia 2005;). These studies, however, often lack detailed theoretical mechanisms linking macroeconomic and socio-political variables to inequality. This is a major limitation because existing studies of advanced democracies have revealed that socio-economic factors do not ***directly*** influence inequality. Instead, they influence inequality through actors' political preference, economic interests, and existing institutional and policy arrangements. In order to understand the origins and systematic variations of economic inequality in the ‘third world’, we need to examine the concealed theoretical mechanism behind inequality.

This thesis thus aims to fill the existing theoretical gap and provides a holistic theoretical argument that supplements existing works. Above all, this thesis focuses on the different paths from types of industrialisation to the inequality, by examining the divergent development of labour market and welfare regimes. Although diverse patterns of labour market and welfare policies of developing economies have been researched before, the causal mechanisms for the systematic differences have not yet been well-theorized. This work is not the first one to focus on industrialisation and its impact on welfare state; however, this is a study aiming to fill in still-existing missing links.

Most importantly, in contrast to the conventional political economy approach that considers economic openness as exogenously given, this thesis considers economic openness (and the following types of industrialisation) as a political decision. This thesis clearly shows the endogenous nature of the decision by taking key actors' political and material incentives into account. Surprisingly, existing studies have not addressed the possibility that industrialisation strategy (and the following trade policy orientation) is a political choice of decision makers who aim to maximize their political and materialistic goals. This thesis will put forward a clear theoretical mechanism that explains the choice itself thereby providing the missing link of the first stage of theoretical mechanism from the choice of industrialisation to inequality.

In addition, this thesis expands upon existing research by adding one more causal link: the link between types of industrialisation to the levels of inequality. Previous works only connect industrialisation strategies to social policies or welfare state development. This is a partial approach that does not provide a comprehensive understanding of the influence of industrialisation on macroeconomic outcomes. A considerable number of studies have suggested that types of industrialisation may be connected to the diverse levels of distribution and inequality, but there is no research to examine the relationship with a detailed theoretical mechanism and empirical tests. By adding a further link, I intend to provide a coherent theoretical mechanism that connects industrialisation to inequality.

By doing so, this thesis clearly challenges a line of research that emphasizes the positive relationship between left power resources and equal distribution (Korpi 1983, 2006; Korpi and Palme 2003; Huber and Stephens 2012) and provides an alternative explanation for the influence of labour power and labour market institutions on inequality. Against power resource theorists' conventional approach that considers left power resources and labour protection reduces inequality, I argue that this is not always true especially in the context of protectionist economy. While they consider labour market regulations and protections as positive means to improve social conditions for workers, others are concerned about the possible negative effects of employment protection (Pagés and Heckman 2003). Employment protection brings about labour market dualization, and this can cause the aggravation of distribution. In this regard, this thesis suggests and explains a causal route from protectionist industrialisation to the inequality, via labour market dualization and insiderness. It takes into account agents' conflicting political economy interests influenced by protectionist industrialisation and thus explains how the institutional differences in labour market occur *ab initio*. This also helps to understand why the impact of labour market institutions and welfare policies on inequality is quite different from country to country and the underlying mechanism of these phenomena.

This thesis also challenges to the compensation hypothesis (Cameron 1978; Katzenstein 1985; Garett 1998; Rodrik 1998) and contests the relationship between openness and welfare state development and its distributional results by focusing on late-development countries. Studies on advanced countries show that openness leads to a higher level of social spending and an expansion of welfare state as a governmental compensation for people who experience higher economic loss and uncertainty because of trade expansion and volatile international competitions (Katzenstein 1985; Garrett 1998). Since this line of research emphasizing the partisan or democratic governments' reaction toward increasing risks, the argument is not relevant to explaining the distribution and welfare in middle-income economies that have relatively short and unconsolidated history of democracy. In this context, this thesis suggests new insights into the role of trade openness and outward-looking industrialisation in developing nations. Contrary to the existing approach that considers trade openness as increasing socioeconomic risks among the poor, I argue that, in developing non-democratic economies, outward-looking industrialisation based on trade openness creates more job opportunities and chances for the poor to earn more income, while protectionism creates more favourable welfare systems exclusively for labour market insiders. The positive relationship between openness and the expansion of welfare spending does not find support in export-oriented non-democratic developing countries. This perspective adds a new insight to the relationship between openness and welfare expansion.

Below is a brief critical review on the recent advancement of political economic research of inequality in developing countries.

2.2 The Political Economy of Industrialisation

This thesis primarily focuses on economic inequality of developing countries, but the theoretical argument starts from the choice of industrialisation. Recently, more scholarly efforts are dedicated to examining the diverse origins of developing countries in terms of welfare policies, socioeconomic institutions, and various policy outcomes. Amongst of all, a number of new recent approaches that focus on types of industrialisation and the resulting policy/institutional diversity in developing countries can be considered as a second theoretical attempt to develop 'a new Varieties of Capitalism (henceforth VoC)' on developing countries, aiming to undercover the origins of economic and socio-political institutional diversity. As an effort to connect 'production regime' and various institutional and policy outcomes, VoC approach has been successfully functioning as a major theoretical tool to explain different types of capitalism encompassing welfare system, financial and industrial relations in advanced economies (Kitschelt *et al*. 1999; Hall and Soskice 2001). The systematic variation of industrial and financial relations of advanced economies, categorized as coordinated market economies and liberal market economies, has been reported as an effective tool to explain the diversity of advanced industrial countries. In a similar vein, akin to distinctions like SMEs and LMEs, inward-looking industrialisation and outward-looking industrialisation can be understood as two different types of production regimes in developing countries. Academic attempts focusing on industrialisation and development policies of developing countries have made a considerable progress suggesting a new unified theoretical mechanism, departing from conventional 'fragmented' theoretical approaches in explaining the varieties of political economy of developing countries with just one or two historical variables.

The first generation of the political economy of industrialisation mainly explains economic growth with types of industrialisation. The major examples are Deyo (1987), Haggard (1990), and Wade (1990). These works set out to explain the East Asian economic success and the Latin American failure by focusing on the socio-economic conditions, institutional backgrounds of the regions, and the role of the state. They compare various institutional and macroeconomic outcomes in Latin America and East Asia by focusing on the dissimilar developmental strategies and by providing rich historical details and interpretation. One of the major work is Haggard (1990), who compares various institutional and macroeconomic outcomes of Latin America and East Asia, by focusing on the dissimilar developmental industrialisation (mainly known as ISI (Import substitution industrialisation) and EOI (Export oriented industrialisation), or ELI (Export-led industrialisation)). He focuses on the political economy of growth in the newly industrialising Latin American and East Asian countries and traces their successes and failures from industrialisation models to the socioeconomic consequences. By providing rich historical details and theoretical interpretations based on political economy approach, this work provides a valuable insight that types of industrialisation can lead to different macroeconomic and socioeconomic results because of contradictory political and economic interests of actors within the system. This research puts enormous efforts into showing the socioeconomic procedures of ISI and EOI with a huge amount of historical details and carefully explains how industrial policies bring about different levels of economic growth in societies; however, it does not provide a clear theoretical mechanism that connects industrialisation and different economic results. Historical details of his work give us an intuition that the connection between industrialisation and macroeconomic outcomes would be robust and convincing, but without a clear theoretical mechanism with an empirical analysis, in a strict sense, the relationship between industrialisation and the variety of developing capitalism seems tenuous. In a similar vein, a large stack of studies such as Frank *et al*. (1975), Diaz-Alejandro (1976), Behrman (1976), Mesa Lago (1978), focusing on types of industrialization and the outcomes, seem to be vulnerable to the criticism of being merely descriptive research, lacking theoretical rigor. Overall, this line of research has not properly focused on more fundamental issues, such as the initial choice of industrialisation and the theoretical mechanism of how industrialisation affects existing institutions, policies, and the major actors' interests. Existing works have focused more on socioeconomic differences of the two regions, mostly factor endowments, thereby ignoring the possible political conflicts over the choice of industrialisation strategies. Despite their emphasis on the role of state, it is not clearly theorized in terms of political mechanism.

Recognizing this limitation, the second generation of political economy of industrialisation, such as Wibbels and Ahlquist (2007, 2011), Haggard and Kaufman (2008), and Rueda, Wibbels, and Altamirano (2015), shed light on the missing links by providing a clear theoretical mechanism and arguments. This new generation of research puts more effort into developing clearer theories that connect the start of industrialisation to the various institutional arrangements and policy outcomes. They contribute to the development of a more universal theory and do not limiting the scope of research to just a few Latin American countries where ISI was most prominent. While Haggard (1990) examines the discrepancy of ISI and EOI itself and the subsequent socioeconomic differences, Haggard and Kaufman (2008) take one step further and show "*how the development strategies and production strategies of firms are complementary to particular social policies and labour market institutions." (*ibid., 2*)*. This study makes a huge stride compared to previous studies in terms of providing detailed theoretical processes of the welfare state development. This study, however, provides too many complicated theoretical claims that explain nearly every historical details and changes of social policies, thereby lacking a clear unified causal mechanism on the development of social policy. Also, the clustering of countries and their within-cluster differences are not very clear and accurate (Mares and Carnes 2009).

Wibbels and Ahlquist (2007, 2011), by contrast, provide a parsimonious causal mechanism linking industrialisation and social policy outcomes. The core argument is that social insurance and social spending priorities are developed to support the developmental regime of states. By taking two different types of development strategies – the ISI and EOI – as an analytic core, the authors explain two different welfare regimes in the third world: '*social insurance regime*' in Latin America versus '*human resources regime*' in East Asia. This noble argument is, nevertheless, not free from criticism. Firstly, it compares the economic interest of capital and labour under different types of industrialisations with a coherent logic, but it completely ignores the interest of the state (government), especially the political motive of the state to provide social insurance and social spending. Secondly, the authors follow Rogowski (1987) and suggest four factor-based conditions (domestic market size, relative abundance of labour, asset inequality, and the openness to the international economy) as structural factors that influence a country's choice of industrialisation strategy. However, the directions and impacts of the structural factors on the choice of strategy are less clear (Mares and Carnes 2009, 103). For example, the factor-based conditions, –domestic market size, asset inequality, and the levels of openness–, can also be the outcomes of ISI strategies. These structural factors are thus treated as completely exogenous while they are actually endogenous in nature. Another limitation in Rogowski's and Wibbels' account is the assumption on which the interests of major actors rest. The authors consider the interests of capital and labour are based solely on the factor endowment; therefore, their approach lacks political considerations of the key political actors concerning social policy.

With regard to labour market institutions in particular, Rueda *et al.* (2015) provide a causal mechanism that connects inward-looking industrialisation and labour market dualization. The core argument is that ISI and EOI condition –to varying degrees– the interests of labour market participants including employees and employers altogether. Under ISI, labour market dualization is intensified because the interest of labour market insiders coincides with that of the capitalists. In inward-looking countries, the capital's cost of discharging skilled insiders is much greater than in outward-looking countries because of the skill premium of skilled workers on protected industry. Labour market inflexibility and dualization become inevitable results of ISI policies. This work clearly presents the conflicting interests of labour market participants and suggests reliable scenarios about the origins of labour market dualization with a particular emphasis on industrialisation. However, some important questions remain unanswered. First of all, more empirical support for the theoretical claims need to be provided. Moreover, the interests of capital in a closed economy seem a bit unclear and the capital's economic incentive to protect insiders needs to be further elaborated. The authors argue that capitalists want labour peace. However, as the labour market becomes inflexible, the cost of maintaining insiders will be increased accordingly to comply with the insiders' needs. Then, will the returns of maintaining powerful insiders (benefits from maintaining labour peace) be high enough compared to the costs of preserving strong insiders? Even in a closed economy, increasing the production costs would be considerable burden on firms which could lead to a decrease of purchasing power among general citizens and demand for goods. The authors' argument about the shared interest of capital and protected workers in maintaining labour market insiders needs to be elaborated further. This thesis is in line with the work by Rueda *et al*. (2015) in that it focuses on the causal chain from inward-looking industrialisation to labour market dualization.

It differs from them, however, in that my work focuses more extensively on the differences of political coalitions of major actors, and their influence on inequality. By clarifying interest of actors over the choice of industrialisation, this thesis aims to provide a guide to understand inequality in developing world.

2.3 The Political Economy of Welfare State and Labour Market Institutions

To explain the development of the welfare state, a great deal of influential political economy literature argues that trade openness leads to a higher level of social spending and an expansion of the welfare state. The reason is that democratic governments need to compensate people who experience higher economic loss caused by trade expansion and volatile international competition (Katzenstein 1985; Garrett 1998).[7] However, we have seen many contradictory cases in middle-income countries. For example, Latin American inward-looking economies adopted the most advanced welfare systems among the group of developing countries, and most of the outward-looking East Asian countries developed minimalist welfare states. As Rudra (2002, 414) points out, "*systematic explorations of government social spending in LDCs have yet to be undertaken*". More interestingly, there is no clear positive relationship between the size of welfare state and the reduction of inequality in LDCs. Rather, it has been reported that higher social spending actually led to the increase of inequality in LDCs (ibid., 432-435). In a similar vein, power resource theorists' explanation on the expansion of welfare states and the fairer distribution does not have enough leverage in explaining developing regions since

[7] The mechanism that connects globalisation with the expansion of the welfare state can be summarized in three stages. First, "growing exposure to international markets increases economic insecurity and inequality". Second, "vulnerable economic actors will use political channels such as trade unions and political parties to press the governments for compensation". Third, "governments will respond to the pressures by expanding the welfare state" (Segura-Ubiergo 2007, 8-9)

countries with the richest left-labour resources amongst developing countries show the highest levels of inequality. In order to understand this opposite pattern, we need a different story.

One of the major shortcomings of existing works on welfare states development in developing countries would be that they mostly focus on the size of welfare spending, but not on the characteristics of welfare state. Rarely do these studies take into account characteristic differences of the welfare state, including the range of its recipients, and the progressivity and regressivity of the welfare state (One notable exception is Franzoni (2008)). Considering the fact that welfare programs were developed as political rewards to support authoritarian regimes especially in developing countries, the fragmentary interpretation of welfare programs would be dangerous.

The key to understand the characteristics of welfare state would be in the deliberate interpretation of actors' interests who are involved in the process of welfare state development. This makes the interpretation of welfare state quite differently. For instance, power resources theory assumes that labour unions and leftist parties represent the interest of the working class, and leftist parties with the support of organized labour serve the interest of the working class by expanding the size of welfare state and by providing more favourable conditions for labourers (Korpi 1983; Korpi and Palme 2003).[8] In this perspective, what matters for welfare state development and equal distribution is the mobilization of working class. The core assumption of the power resources approach is that labourers and left parties have shared interests in supporting labours' right and there is no internal division within the working class. However, as clearly challenged by Rueda (2007), if labour is divided into two groups, the insiders in formal sectors with job security and the outsiders in informal sectors with no security, then the two groups do not share the same interest and leftist parties are likely to support the

[8] The power resources approach assumes that there is a fundamental cleavage between capitalists and the working class (Segura-Ubiergo 2007, 9)

interest of insiders, rather than those of outsiders. This thesis takes into account the opposing interests within labour and only then can we understand the real characteristics of labour market institutions. In this sense, this thesis is in direct contrast with Huber and Stephens (2012) who assume the straightforward and positive role of left labour resources.

Recent approaches focus more on the characteristics and consequences of labour market regulations, through the dynamics of insider-outsider politics. Recent research reports the possibility that stronger employment protection would rather lead to negative impact on inequality. Djankov and Ramalho (2009) demonstrate that developing countries with rigid employment laws tend to have larger informal sectors and higher unemployment, especially among young workers. Young workers, who are mostly precarious job seekers and outsiders of labour market, experience higher risks than old and protected workers. Especially, Latin American countries with more rigid employment laws have a tendency to maintain the levels of rigidity. As Heckman and Pagés (2002) point out the regressive role of employment protection, it implies a negative impact of dualized protection on labour market. Similarly, Häusermann and Schwander (2012) trace to what extent labour market segmentation translates into actual social cleavages. They argue that the negative consequences of labour dualization can be controlled by existing welfare regimes in advanced countries. However, this may not be the case in some developing countries where existing welfare regimes are not very protective especially for the unemployed or part-time workers. This study also leaves some room for doubt regarding the directions of the causal mechanism.

Despite the important insights of recent works, there still remain some questions about the origins of labour dualization and the origins of rigid labour market institutions. This thesis would contribute to this point by providing a causal story about the origins of labour market rigidity and the development of regressive welfare institutions.

2.4 The Political Economy of Economic Inequality

Although the particular attention of this study will be paid to the income inequality in developing countries, the theoretical insights can be drawn from advanced countries as their implications are applicable in understanding of inequality in developing countries. From the perspectives of comparative political economy, I briefly review the determinants of inequality discussed in the context of advanced countries and their theoretical advancement. Then I review several inequality studies focusing on developing economies including Latin America and East Asia whilst mentioning limitations of existing research. Lastly, the recent development of inequality studies with regard to democratisation and the implications of the research in the context of developing countries are briefly reviewed.

Determinants of Disposable Income Inequality

The political economic explanations of income inequality (post tax and transfer) in advanced countries have revolved around four elements (Beramendi and Anderson 2008, 5). The first explanation is based on the median voter theorem of redistribution (Romer 1975; Meltzer and Richard 1981) and the second explanation focuses on the insurance variable (Moene and Wallerstein 2001; 2003). The third explanation is based on the partisan politics and their impact on policy outcomes and, finally, the fourth explanation is based on the role of political and labour market institutions as constraints on the set of policies available to policymakers (Rueda 2000) The second, third and fourth explanations are basically a kind of counter arguments to the Meltzer-Richard model.

With regard to the first explanation, the classic argument as to the level of inequality and the size of welfare spending stems from Meltzer-Richard hypothesis (Meltzer and Richard, 1981). It assumes a positive relationship between the level of inequality and the social welfare expenditure of government and explains that the distance between median income and mean income will determine the level of public demands toward redistribution. As the wage gap becomes wider, the benefit from government distribution becomes higher; the farther the distance between median income and mean income, the larger the public demand for redistribution. Therefore, the greater the public spending will be. Meltzer-Richard model is based on several basic assumptions in order to formalize reality in a simple way. First of all, all citizens vote for the maximization of their utility (the income) under two party plurality electoral systems with universal suffrage and a flat tax rate. Secondly, the result of the election determines the redistribution policy of government and all voters receive an identical sum of government transfer. Thirdly, voters have single peaked preferences, are well aware of government policy, and are fully informed about the ramifications of their decision. Fourthly, as shown by Hotelling (1929), Downs (1957), and Roberts (1977), the median voter is a decisive voter. Based on these assumptions, the MR model formally demonstrate that the higher the inequality (the farther the distance between median income and mean income), voters below the mean income will vote for redistribution and increase the size of government (Meltzer and Richard, 1981, 916). The MR model shows the mechanism of distribution in democracy in a very clear way and sheds lights on the following long-standing enigma: Under what conditions and to what extent a democratic government distributes to the public. However, contrary to the assumptions of the MR model, in reality, the link between higher public demands for redistribution and government reaction to that demands does not seem all that clear. To what extent does government accede to public demand for redistribution in a society and why are there still differences on the level of government distribution among countries having similar levels of inequality? Without considering the impact of institutions and political factors, it would not be easy to answer all remaining puzzles. Although MR model provides us with a clear intuition and expectation that unequal countries are likely to spend more; however, it is reported that there are considerable empirical counter-examples of this expectation. Iversen and Soskice (2006) refer to this pattern as the “Paradox of Redistribution” and refute the MR model by modifying its assumptions and taking variables of electoral systems into account (Iversen and Soskice 2006). Moreover, although its parsimonious and clear demonstration, the MR model has some limitation to be applied to the explanation of income inequality of developing countries under non-democratic system.

Limitations of the median voter approach have thereafter affected subsequent studies of inequality in various ways. First of all, in order to explain the paradox of redistribution and to provide a modified argument of Meltzer-Richard model, Moene and Wallerstein (2001; 2003) provide an explanation by introducing the social insurance theory. Basically, they believe that even if inequality increases, support for some types of welfare spending may not increase. Based on this intuition, they modify the Meltzer-Richard model and suggest a new hypothesis. That is, government redistributes income and at the same time provides social insurance. Considering the redistributive benefits and insurance benefits simultaneously, higher income inequality increases support for redistribution received by employed workers but reduces support for insurance against income loss (Moene and Wallerstein 2001, 871). In other words, greater inequality in income is associated with less spending on social insurance targeted at unemployment (Ibid., 859). As inequality increases and the income of the median voter decreases (when mean income is constant), Meltzer-Richard hypothesis expects that the welfare spending of government will increase. However, the Moene and Wallerstein model expects that as income inequality increases, the public demand for social insurance targeted to unemployment decreases, and as a result, the welfare spending of government will decrease. Welfare policies can be understood as the public provision of insurance, and self-interested voters support these policies to be protected by the failure of private insurance. If insurance is assumed as normal goods, the demand for insurance will be reduced because of the income loss by the increase of income inequality. The Moene and Wallerstein model supposes that welfare spending is a public provision of insurance, and the reduced demand for insurance will lead to the decrease in welfare spending. In this sense, the Moene and Wallerstein model is in striking contrast to the Meltzer-Richard model in relation to the inequality and the size of welfare spending.

Secondly, the explanation based on partisan politics emphasizes the role of political agency and its impact on inequality. As Beramendi and Anderson (2008, 6) point out that, "*If the median voter in fact rules the democratic game, there is no good reason why policies should exhibit partisan traits",* because parties would just follow the preference of the median voter. In this sense, partisan politics provide us with an alternative argument against the Meltzer-Richard model. The basic argument of the partisan influence on inequality is that leftist parties favour distributive policies or pro-poor policies than rightist parties as the core constituent of left-wing parties are the poor and the working class, therefore left government tends to distribute more than the right government via government taxation and welfare spending. In this sense, less inequality is expected under left government. Government partisanship shapes the politics of distribution through various policy tools such as government taxation and welfare spending. And more directly, government partisanship affects the distribution of market income and wages through minimum-wage policy or other forms of wage policy. Several empirical studies confirm the positive impact of partisanship on welfare spending and distribution (see Garett 1998, Rueda and Pontusson 2000; Rueda, 2008)

Last explanation as to the politics of inequality is based on the importance of institutional factors like electoral systems and labour market institutions such as union density and wage-bargaining centralization. Median voter approaches ignore the importance of institutions as constraints as well as political settings that shape the politics of distribution. Criticizing its ignorance on institutional factors, the institutional explanation provides us with influential arguments regarding the causes and variation of inequality. The basic argument of the institutional approach is that different institutional settings lead to different levels and variations in inequality.

Electoral institutions are systems of representation that translate individual preferences into political outcomes (Beramendi and Anderson 2008, 7). Therefore, distinct electoral rules translate people's preferences in a different way. Contrary to the Meltzer-Richard model assuming a uniform two-party plurality electoral system in their formal model, other scholars argue that different electoral systems can lead to different distributive results because of the differences of the level of representation of public demand. They support this argument by comparing two major electoral systems - the PR and the majoritarian systems- and their impact on distributional politics. For example, Iversen and Soskice (2006) argue that Meltzer-Richard model fails to explain the variance in redistribution across countries of similar level of inequality and content that PR systems redistribute more than majoritarian systems. The empirical test supports their argument (Iversen and Soskice 2006, 165). Although the simple dichotomy of PR and majoritarian electoral system cannot properly explain the inequality of countries with mixed systems, it offers us a helpful intuition to explore the causes of variation in inequality.

In addition to the electoral institutions, labour market institutions can be basically understood as corporatist arrangements of wages and welfare system and are also related with the argument of power resources approach (Korpi 1983). Focusing on the role of labour market institutions or economic institutions in policy outcomes is especially useful to understand the politics of inequality and redistribution (Bradley *et al*. 2003; Pontusson, Rueda and Way 2002; Rueda 2007). To explain, in advanced corporatist countries with a highly centralized wage coordination institution, the negotiation between labour unions, employers and government can compress the wage level to maintain lower levels of inflation and faster economic growth. Less inequality is achieved thanks to the results of such negotiation restricting wages. The government compensates labour for their income loss with insurance and various fiscal policies financed by employers and also provides vocational training for specific skilled labour which is very important in maintaining their industrial structure (Estevez-Abe, Iversen, and Soskice 2001). Through this process, a large public welfare system is developed. In this sense, we can expect that highly centralized wage coordination and the high level of union density will lead to a less unequal distribution of wage. As we have seen from this argument, the institutional explanation focuses on institutional arrangements that are largely overlooked by the simple median voter model (Beramendi and Anderson 2008, 8).

So far, I provided brief explanations on the determinants of inequality mainly focusing on the causal mechanism of inequality. Existing research has contributed to the understanding of deterministic mechanisms of inequality; however, there is one limitation: existing research is mainly based on the observation of advanced democracies.

Inequality studies based on middle-income countries

Economic and socio-demographic explanations

Research on inequality in developing countries primarily focuses on macroeconomic factors (see Fields 1989; Wood 1997; Bruno *et al*. 1998; Milanovic 1998; 2000; 2002; 2003; 2005) and socio-demographic factors (Sylwester 2000; Cornia 2005; Milanovic 1994; Kim *et al*. 2000) including inflation, unemployment, economic growth, land distribution, foreign direct investment, trade dependency, education, health condition, sectoral dualism, and etc. All these factors are known as major determinants of inequality as well as poverty.

The major interest of this thesis is to explain the difference of inequality between Latin America and East Asia. Therefore, I particularly focus on research that explains inequality gaps between the two regions. Unfortunately, except for few works, there are only limited numbers of studies that compare the two regions based on rigorous theoretical assumptions and hypothesis. Thus, I review some works that investigate inequality across the world, highlighting a number of critical works on this topic.

With regard to the macroeconomic factors, existing studies emphasize the importance of economic growth, trade, and globalisation in explaining the difference of world inequality. A huge amount of research expects that different level of economic growth can account for inequality. Based on the seminal work of Kuznets (1955), scholars have tried to explain the differences of inequality using the inverted U-curve theory. When we look at the graph of the world income distribution, where the x-axis represents the level of economic growth and the y-axis refers to the levels of inequality, the inflated part of the inverted U-curve graph represents the Latin American countries with highest Gini coefficient. Furthermore, a few advanced East Asian countries are located in the right side of Latin American countries. Although the inverted U–curve theory provides a parsimonious illustration about the relationship between growth and inequality, empirical studies have not confirmed the relationship because the empirically observed curves are not symmetrical and smooth as Kuznets depicts. According to Milanovic (1994), the relationship between economic growth and inequality is not clear, and the explanatory power of economic growth on inequality is not strong as there is no clear mechanism linking growth and distribution. Basically, the Kuznet curve is considered as a theory about the inequality within country level, not about the cross-national level, thus reveals some limitations in explaining the variation of inequality among countries.

Scholars have sought for answers in the long colonial history of Latin America. Engerman and Sokoloff (1997), as well as Acemoglu and Robinson (2001) argued that the highest inequality in Latin America cannot be fully understood without considering its historical root. Scholars pointed out that one of the major determinants of inequality is the unequal distribution of land (Russett 1964; Frankema 2006). Historically, Latin America showed a higher inequality in the distribution of land, and this asset concentration increased the extraordinarily high inequality compared to other regions (Huber *et al*. 2006). On the contrary, East Asian countries such as Taiwan, Malaysia, South Korea, and the Philippines had achieved successful land reformation and land redistribution after the colonial periods. However, as industrialisation and urbanization proceed and the number of people who reside in rural agricultural area shrinks, it makes the importance of land and historical factors as determinants of inequality less compelling.

In terms of resource endowments, studies suggest that the relatively abundant natural resources of Latin America led to a higher inequality in this region than East Asia. Leamer *et al*. (1999) and Doner *et al*. (2005) argue that the resource abundance in Latin America explains the slow speed of the accumulation of human resources than in East Asia. The abundant natural resources and job opportunities interrupt workers' desires and incentives to accumulate skills. In the end, these factors dampen industrialisation and modernization and, in turn, increase the wage gap between rural and urban workers, supporting this hypothesis.

With respect to socio-economic and demographic factors, a line of studies indicates that the high-quality compulsory education or higher secondary school enrolment rate in East Asian countries contributed to the low inequality compared to that of Latin America (Birdsall *et al*. 1997). The higher economic growth in the 1970s and 1980s led to an increase in real income, and the quality education supported the economic growth by providing industries with relevant skilled workers. However, they fail to explain why only East Asian countries provided a high-quality education and why Latin American countries did not. Regarding this point, Harrison (2000) suggests one explanation: the culture. He argues that the different value system between Latin America and East Asia affect the desires and incentives of government and society to accumulate human resources. This explanation seems interesting, but it fails to provide empirical evidence and clearer logic especially regarding the government incentives of providing education.

Unfortunately, a large number of studies explaining inequality in developing regions reveal considerable limitations. Although they provide us with various interesting stories as to the determinants of inequality, coherent causal mechanisms that associate various variables and inequality are not clearly suggested. Overall, they do not suggest any theoretical mechanisms linking the aforementioned various variables and inequality, thus leave us unanswered questions. Existing research on inequality in developing regions have tested several hypotheses; however, they are just extended lists of various variables with little cohesion in terms of mechanism. In sum, inequality studies exploring developing countries have failed to suggest clear theories on several key questions about inequality.

Political Explanations

The recent development in the study of inequality based on the political economic perspectives underscores the importance of the above-stated political and institutional factors in explaining the inequality in advanced countries. However, the potency of these explanations is limited to advanced democracies. Indeed, upon considering the cases of developing countries, we are unable to ascertain that there are sufficient numbers of empirical studies that support the findings from advanced countries in developing or middle-income countries. There have been only few studies based on the political economic perspectives in exploring inequality in developing countries.

In the recent comparative political economy literature, there have been debates over the causal relationship between inequality and democracy. On the one hand, inequality can lead to democratisation (e.g., Acemoglu and Robinson 2006; Ansell and Samuels 2015; Boix 2003; Houle 2009). Yet, there is no consensus regarding whether lower levels of inequality under autocracy is more conducive to democratisation (Boix 2003), higher levels of inequality are associated with higher likelihood of democratisation (Ansell and Samuels 2015), or middle levels of inequality is related to higher chances of democratisation (Acemoglu and Robinson 2006). On the other hand, studies have argued that inequality is decreased under democracy more than under authoritarian regimes. Most notably, the Meltzer-Richard model also implies that redistribution is greater in democracy than in dictatorship (Meltzer and Richard 1981).

The relationship between political regime and inequality has not been tested in the context of advanced countries, because there is no variation in political regimes in developed democracies. Thus, the scholastic interests on the relation between political regimes and inequality or welfare spending have been mainly focused on middle-income countries especially those amongst Latin America. There are several major studies which test the relationship between democracy and the level of inequality; however, the findings are less coherent and are dependent on time and space. As many scholars argued (Rueschemeyer *2015*, Dahl 2006), there are several good reasons to expect that democracy is conducive to reduce inequality. By providing the right to vote to the poor and the powerless, the underprivileged can get a chance to participate in the political decision-making process and, as a result, can increase their welfare (Huber *et al*. 2006, 949). However, a clear positive relationship between democracy and better distribution has not been confirmed in many empirical studies on developing countries.

Concerning the relationship between democracy and inequality, a lot of studies have failed to uncover a clear mechanism behind. However, according to Muller (1988), the cross-national test regarding the association between democracy and inequality reveals a clear negative relationship. An interesting research, Gradstein *et al*. (2001), provides an empirical evidence regarding the relationship. They provide a hypothesis that "*In societies where equality is highly valued, there is less of a distributional conflict across income groups, hence democratisation* *may have only a negligible effect on inequality. On the contrary, in societies where equality is not valued, democratisation reduces inequality through redistribution as the poor outvote the rich"* (Ibid., 1). Although it is still controversial how to measure citizens' perception on equality in a society, the empirical result from 126 countries support the hypotheses.

In addition, one of the most notable recent studies is Huber *et al*. (2006), and the findings give important intuitions to the scholars of comparative political economy. Their contribution can be divided into two folds: methodological and theoretical. As the first pooled time series analysis in exploring inequality in Latin American and the Caribbean based on the comparative political economy approach, they test the impact of politics and socio-economic variables on inequality. They examine the role of politics by adopting four well-measured political variables: democratic history (accumulated years of democracy), repressive authoritarianism, legislative partisan balance (Left-Right balance of seats in the lower house), and executive partisanship. The empirical test result indicates that democracy is related to lower inequality; however, after including all the political variables, the impact of democracy is not statistically significant anymore. Instead, the interaction term between democracy and social security spending shows a statistically significant coefficient. It means that the effect of social spending on inequality is conditional on the political regime. In brief, "*social security and welfare spending under conditions of sustained democracy is likely to be egalitarian, whereas it is anti-egalitarian where the democratic record is weak*" (Huber *et al*. 2006, 958) This gives us an important implication that the direct positive connection between social spending and equality is not always true especially in developing countries with less solid democratic regime.

However, it has been reported that the association between democracy and a greater redistribution of income and a higher provision of social insurance and services is less clear in East Asia. One of the conventional explanations regarding this fact points out that almost all the East Asian countries have been under strong and coercive military rules by conservativeright parties or under strong monarchs, thus the non-democratic tradition continues to exert a strong legacy that blocks generous distribution of wealth and welfare even after democratisation of these countries. This suggests that the ability of democracy in East Asia is relatively weak than many advanced countries. Considering the relatively short history of democracy, alongside the under-ripened democratic institutional settings characteristic to these countries, the previously mentioned research based on democratic advanced countries, such as M&R or M&W models, may not have enough explanatory power to explain the variations in inequality in developing countries. However, as I previously mentioned, there is still a room for a much lively discussion especially with regard to the role of industrialisation and institutions in the relationship between democracy and inequality, especially when we compare the ability of democracy in reducing inequality in Latin America and East Asia.

Chapter 3. The Choice of Trade Regime

In order to explain the causal link from the choice of development strategy to inequality, as a first step, this chapter focuses on explaining the political economy choice of trade regime. Even though the two archetype development strategies (ISI and EOI) are composed of various industrial policies respectively, their key difference is obviously rooted in its trade orientation – trade openness vs. protectionism. The industrial policies were developed in a way to support each trade regime.

The studies on trade regime have a long tradition in the field of social science including economics and international political economy. Scholars have mostly focused on the economic consequences of trade policies; for example, the impact of trade openness on economic growth (e.g. Greenaway and Nam 1988; Harrison 1996; Yanikkaya 2003; Awokuse 2008) or on the size of welfare states (e.g. Garrett 1998; Iversen and Cusack 2000; Iversen 2001; Swank 2002). Existing research, however, considered trade openness and protectionism as exogenously given; it has rarely studied the politics of trade policy –especially its decision mechanism and the political interests over the choice. Very little is known about why a country decides to open or to close its economy. To fill this theoretical gap, this thesis firstly provides an argument explaining the choice of trade regime. Supporting historical evidence including case studies is provided at the end of this chapter.

The main claim of this chapter is that a trade regime is not exogenously given but the result of political leaders' 'autonomous' choice. Therefore, trade regimes and their introduction timings and changes are subject to political economy interpretations. This theoretical perspective is supported by the observations that trade policies of middle-income countries are not merely path-dependent legacies of the colonial periods or the result of comparative advantages based on resource endowment. Instead, these policies have changed frequently until the 1980s, when the neoliberal structural adjustment program was forced globally and almost all countries had to adopt neo-liberal trade regime to some extent.

This thesis exclusively focuses on Latin American and East Asian middle-income countries in which their deliberate choice of trade regime and industrialisation occurred long before their full democratisation.[9] In this sense, in the argument I present, I consider the utility of a self-interested political leader or a policy maker –a final decision maker on the choice of trade policy. My argument, therefore, is not directly applicable to the trade policy choices of advanced, consolidated democracies.[10]

The remainder of this chapter is organized as follows. I start by presenting a review on the strengths and limitations of existing research on this topic and show how this thesis contributes to the literature by filling important theoretical gaps of current works. Then, I provide a theoretical argument to explain the choice of trade policy. Lastly, case studies and historical evidence are provided to verify the theoretical claim.

3.1 Existing Research on the Choice of Trade Policy

Although many have studied the implications of trade policies, few studies have examined the choice of trade regime itself. Among the small number of studies that have, the theoretical explanations can be divided into three broad categories: economic explanations, resource endowment (or comparative advantage), and foreign influences.

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[9] Even though some countries maintained nominal and partial democracies during some periods, these can hardly be considered consolidated and full democracies. Among the countries I analyse, stable democracies are not observed when the choice on trade regime made, except for Costa Rica.

[10] Although the foremost aim of politicians –office holding– is similar in autocracies and democracies, trade policies in democracies are more likely to be influenced by interest groups, public opinion, and partisan negotiations. Trade deficits may also matter to eliminate budget deficits. In this sense, the argument by Rogowski (1987) seems to be more convincing to explain the choices of trade policy in democratic countries. He argued that levels of openness in advanced democracies depend on the size of domestic market and the conflict between interest groups (i.e. the power struggle between owners of abundant resources and those of scarce resources).

The economic interpretation suggests that the economic situation and shocks from the early 1920s to 1930s increased incentives to adopt protectionism and import-substituting industrialisation for Latin American countries. Due to the economic recession in 1929, especially, many Latin American countries shifted their focus from an export economy of primary goods to protectionist policies (Haggard 1990). Their trade deficits played a large role in this choice, as their exports to developed countries dropped significantly and balance of payment problems aggravated in Latin American countries (Thorp 1992; Cárdenas *et al*. 2000). At the same time, the prices of agricultural products, their main export product, dropped seriously owing to reduced demand from developed countries. This intensified their trade deficit problem because the prices of the consumer goods they imported from developed countries remained high. Some argue that these circumstances created the need for the domestic production of consumer goods and measures to protect domestic manufacturing industries until it became mature enough to compete in international markets. This explanation thus emphasizes trade protectionism in Latin America as a natural response to the economic situation at the time.[11] Economic conditions, however, cannot explain why East Asian countries, which did not struggle with serious balance of payment problems or trade deficits, adopted protectionist industrialisation during the 1950s to 1960s. In fact, the economic explanation would expect the Asian countries to adopt trade openness, as opposed to protectionism, given the economic boom during and after the Korean War. Instead, we see that most East Asian countries pursued protectionism at least until the 1960s. Only Japan adopted and maintained trade openness after opening its harbour in 1853. (The Japanese case will be explained in the following case study chapter.)

[11] The ideological and theoretical basis of protectionist industrialisation in Latin American countries was established after the actual protectionism progressed.

The second group of explanations, as proposed by Rogowski (1987) and, more recently, by Wibbels and Alquist (2008, 2011), emphasizes that trade regimes are structurally determined by the relative abundance of resources of countries. Based on three-factor endowment model of Stolper and Samuelson (1941), Rogowski argued that a country can predict the gains and loss of trade openness or protectionism by comparing the relative abundance of labour, capital, and land. Put simply, owners of abundant resources will benefit more from open markets, whereas owners of scarce resources will have higher profits in protected markets. Following this logic, we can expect that a country with abundant resources (movable resources such as labour and capital) would choose trade openness and vice versa. In other words, the conflict between gainers and losers of international trade would determine the choice of trade regime. (Rogowski 1987) This is a logical expectation based on economic interest of countries and resources owners; however, it does not consider the influence of the political factors and its dynamics since it only takes into account the economic interests of resource holders. More importantly, this explanation cannot explain trade policy changes over time as the relative abundance of resources does not change often. For example, policy makers in Mexico changed their trade regime from openness to protectionism, to mixed regime, and, finally, to openness since the 1930s; however, there is no evidence that their factor endowment changed during the time. Also, there is little report of a conflict between resource owners or between importers and exporters about trade regime in Latin America in the early and mid-20th century, when protectionism was firstly introduced. Land owners were mostly exporters of agricultural goods and the most powerful local elite of that periods, however, there is limited evidence that they resisted against protectionism severely. This could be explained with their weak organization -poorly organized land owners and farmers. Although landed elite owned a large area of land, local farmers were mostly tenant farmers who did not have their own land and say; therefore, government was able to appease landed elite with other types of compensation such as weak land reform and allowed them to use much cheaper workers immigrated from other poorer countries. Otherwise, it is presumed that exporters (mostly, people in farming industry) could not predict the outcome of the protectionist policy in advance.

Finally, International Political Economy scholars argued that the choice of trade policy is highly dependent on foreign pressures, such as the US' enforcement of trade openness or Soviet Unions' trade protectionism. However, it is unclear that foreign pressure has ever influenced the choice of trade regime in middle-income countries against their own economic or political interests. Despite enormous pressure of the United States in particular, several countries managed to maintain protectionism (e.g. Costa Rica, South Korea, Taiwan in the 1960s). For example, although there was heavy pressure from the US to open the Dominican Republic's economy and to abandon protectionist policies from the mid-1920s to the early 1960s, General Rafael Trujillo, president and dictator of the country since 1930, tried to develop ways to circumvent current limitations and to keep protectionism (Pons 1990).

In sum, previous research has clear limitations in understanding the choice of trade regime as it lacks political motivations behind the choice and cannot explain the changes and dynamics of trade regimes.

3.2 Theory – Utility Maximization under the Choice of Trade Regime

Against existing research that considers trade regimes as exogenously given, this thesis argues that the choice and changes of trade regimes in Latin America and East Asia in the early 20th century are closely related to two goals of a political leader: *rent seeking* and *office holding* (political survival). In other words, the choice of a trade regime is based on political leaders' utility calculation between rent maximization and political survival. Political leaders, especially those in countries with abundant resources (e.g. natural resources, national wealth etc.), prefer protectionism since it is more advantageous to collect rent. The larger the amount of expected rent, the more preferred the choice of protectionism and the longer the life of protectionism. However, if the amount of rent from protectionism does not suffice to secure the rulers' economic interest or protectionism threatens seriously the possibility of political survival, political leaders will give up rent-seeking and switch to trade openness. (Put simply, as the costs of maintaining protectionist policies increase considerably, the benefits of protectionism for the political leader will decrease and, as a result, the leader will not be able to maintain protectionism any longer.) For instance, resource depletion or critical public dissatisfaction caused by politicians' excessive rent seeking –as it accompanies serious corruption and slow economic growth due to inefficiency– would be a turning point of protectionism to openness.

Assumptions of main argument

Before discussing the choice of trade regime in Latin American and East Asian countries in the early 20th century, it is worth clarifying the assumptions underlying my argument. First, I assume an autocracy or an unconsolidated democracy in which self-interested political leaders can decide major policies and use their power to steer the decision into their self-interest. This differs from consolidated democracies, where policy preferences are aggregated through democratic process, even if it is also partly influenced by the lobbying activities of interest groups. The countries covered in this thesis were mostly autocracies ruled by dictators or military juntas during their industrialisation periods; therefore, this assumption seems to match the reality. Second, I assume that a political leader in non-democracies has two aims: to maximize economic rent and to maintain office with minimum cost. Rent seeking here means that a political leader uses national wealth or distribute national resources[12] for her own

[12] This includes the possibility of borrowing money on the financial market or selling natural resources.

wellbeing at her discretion. Securing the office means purchasing loyalty from the public and the elites by distributing resources –such as money, goods, and power– or by punishing them for betrayals. This assumption can be found in existing research (see, for example, Wintrobe 2000, Bueno de Mesquita 2005; 2011;). In a similar vein, the idea that a political leader in an autocracy does not want to maximize public support –by injecting additional funds to satisfy the public– seems realistic. If minimum levels of support are enough to maintain office, a political leader will prefer this because it can save operating costs and give her more private rent to spend or to hide in a secured place. In short, the utility function of a political leader can be represented as follows:

Max (U) =Max (rent) +Min (cost of maintaining office) under budget constraints

Since the goals of rent maximization and office holding may conflict due to budget constraints (national budget means revenue income from taxation, sales of natural resources, etc), they cannot easily be pursued simultaneously. A ruler's rent-seeking behaviour can fuel discontent among the public and the elite including political opponents of the ruler who now face a reduction in their share of the national resources, and this will increase the cost of maintaining office. The more political leaders spend on repressing or appeasing the public and the elites, the lower their rent maximization. While political leaders must navigate between these two aims, I assume that they will value office holding over maximizing rent, because the latter is only possible when she is in power. Finally, I presume that a protectionist economy requires higher operating costs than an open economy. In a closed economy, wealth tends to be concentrated on political leaders and their core supporters and elites. This leads to greater dissatisfaction among the public and political rivals, and it increases the likelihood that these actors try to take financial resources from the incumbent through rebellion and riot. Protected economies, therefore, need more financial and military resources to appease or repress the public and political rivals. If a political leader realizes that protectionism cannot be maintained with her budget –operating cost exceeds her rent income plus government budget–, she will consider the transition to openness to reduce public discontent; otherwise, she will rob and flee her country and a new leader will take office. (Here, I do not assume the full rationality that all leaders have the capacity to calculate the costs and benefits correctly. Following Herbert Simon (1957), I assume here the bounded rationality of a political leader that she has a rough idea of the amount of loyalty needed to maintain the regime. Of course, her predictions may be wrong, therefore there can be some (unintended) office changes caused by calculation errors.)

The Benefits of Maintaining Protectionism

It is essential to understand that a political leader has a strong incentive to maintain a closed, protected market economy. It provides her with significantly more economic rent and political discretion which help her to manage and to distribute various resources without being restrained by external economic factors, such as international price competition or external commodity market shocks. By controlling factor prices through protectionist tools such as fixed exchange rates, high tariffs, and import quota, a political leader can generate a huge amount of political and economic rent. This can then be used to satisfy her own interest and purchase political resources such as military power, rewards for their core supporters, punishment of political rivals, and personal protection measures.

In addition, protectionism is a favourable political strategy for political leaders to control the power of the elite (the haves). Protectionism distorts the distribution of wealth in a society by blocking the market allocation of resources, by protecting uncompetitive sectors and industries, and by receiving economic rents and political loyalty from the beneficiaries of protection. Through this process, price controls on resources can be used as an effective tool to punish or reward the existing business elites and the haves. Political leaders can use price controls on resources to benefit the elites[13], who own scarce resources, and maintain their support since protectionism favours the owner of the scarce resources in a society (Heckscher and Ohlin 1991). Conversely, protectionism gives political leaders more discretion to limit the financial capacity of the rival elite through factor price distortion and import and export controls. Of course, political leaders try to maximize and acquire personal rent by establishing rent-seeking firms and nationalizing profitable companies.

In this sense, we can understand that the choice of protectionism and a shift from openness (primary goods export economy) to protectionism[14] are in line with a political leader's effort to maximize rent. Then, why do some political leaders open their economy despite considerable loss of rents generated by protectionism, as we have seen in many East Asian countries? (Wu 2015; Lake 2009)

Dictators' Choice of Openness

To answer this question, my argument emphasizes two conditions: the amount of rent and the costs of office holding. The choice of openness is more likely to happen when *the amount of rent under protectionism is insufficient*. This can occur in various circumstances such as price drop of natural resources (and the resulting decline in exports), bribery reduction from resource

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[13] In a closed economy, existing elites may share considerable interests with political leaders and therefore are likely to prefer protectionism to openness. Most of all, under a closed economy, the current elite enjoys more resources and power than the general public. As economic openness is expected to bring about uncertainty regarding future resource allocations and to lead to an increase in the number of new elites and capitalists, transitioning to openness would reduce the privilege enjoyed by the current elite. If they want to maintain their privileged position, maintaining protectionism would be the preferred option to secure stable profits given the monopolistic economic structure. This holds especially if the domestic market is considerably large. As such, protectionism creates strong ties between the elites in protected industries and a dictator, and their coalition becomes a powerful resource for dictators.

[14] It mostly happened during the early 20_{th} century in Latin America: After maintaining primary goods export economy for quite long periods, these countries adopted protectionism.

exploitation companies, decrease in foreign fund or investment, rising prices of imported raw materials and intermediate goods for domestic production, the slump in domestic sales of state-owned manufacturing companies due to the recession and poor quality. In addition, the transition to openness is more likely to happen when *office holding becomes too costly under protectionism*. These costs can originate from internal economic pressures, as protectionism leads to stagnated growth, distorted prices of goods, overrated exchange rates, and production of poor quality goods in the long term. Politically, inefficient and distorted distribution of resources may wield significant political conflict and, possibly, government changes. An economically closed country can also be confronted by external pressures for free trade from other countries, such as the US, or international organizations, such as the WTO or IMF. These pressures can be accompanied with a reduction in military and financial aid, which makes maintaining protectionism a costly option. In short, when the cost of office holding exceeds rent profit under protectionism, a political leader does not have the financial and political resources to maintain the current system; and she will have to give up rent-seeking and transition to trade openness.

Pursuing rent under protectionism basically requires a sizable domestic market which enables an autarkic economy to grow continuously, or sufficient natural resources to extract profits from it. Political leaders, however, can even obtain considerable profits in resource poor countries, if the country has a continuous source of income, such as foreign aid or foreign investment. In the absence of these potential income/rent sources, politicians cannot seek large amount of rent whilst bearing the cost of maintaining office. Therefore, they must give up a large part of private rent income and move to openness.

Economies with limited financial or natural resources (and with abundant unskilled poor labour) experience harsher political and economic insecurity surrounding limited resources. Due to budget constraints, political leaders cannot purchase the loyalty of the elite which leaves them open to possible betrayal. Moreover, political leaders lack the resources to either provide goods to the public, who needs jobs and income to escape from poverty, or to repress their demands with military force. Trade openness can then be a survival strategy of a political leader to mitigate threats from the public by providing them with more job opportunities and labour income.[15] This should work especially in labour abundant countries with cheap labour and an open climate to foreign investments to attract more entrepreneurs and companies. Opening the economy in low-income countries to international trade can greatly relieve public frustration. In the short run, there could be some repulsion by the existing protected elite; however, in the long run, the economy and the tax revenue could rise due to establishment of various firms, job creation, and economic stimulation. In addition, it is likely that more investment will be brought in from overseas to take advantage of cheap labour, as a result, technological advances can be accelerated through the inflow of technologies and investments by overseas companies. It can also be expected to have a number of other positive effects, such as a rise in consumer utility through imports of foreign goods rather than buying expensive, low-quality domestic industrial products that have been produced in the protection market. To summarize, openness is an attractive option for a political leader in a resource poor country in the long term. Since poor countries lack a stable source of taxation, politicians have a strong incentive to pursue economic growth to create a tax basis for the future (Olson 1993). Growth through openness can benefit political survival by reducing the democratisation pressures from the public who now sees their material demands satisfied with more job opportunities and regular income.[16] By contrast, a political leader with abundant natural resources or knowledge of the existence

[15] As trade benefits the owner of abundant production factor, countries with relatively abundant unskilled and poor labours could benefit from trade openness based on comparative advantage and price competitiveness of their cheap labour (Heckscher and Ohlin 1991).

[16] Regarding the relationship between openness and democratisation, see Milner and Mukherjee (2009). Their findings show that the causal relationship between economic openness and democratisation is weak. It may signify that economic openness is a buffer (a strategy) in order not to be democratized.

of natural resources[17] would prefer to maintain her office without adopting openness, because she can satisfy her core supporters and punish antagonists with the rent in the short term.

So far, I have explained that rent-seeking and political survival are the main factors driving the choice of and transition to a trade regime. Table 1 illustrates this by presenting possible choices of economic openness or protectionism as a combination of the expected amount of rent and the cost of office holding. I use this theoretical framework to select the cases from Latin America and East Asia for case study in the following section.

Table 1: The Choice and Changes of Trade Regime

	Cost of maintaining office	
Amount of (expected) Rent	High	Low
High	Case 1: **Protectionism** (until rent income >cost of office holding) → **Mixed regime** (partial protectionism: Protectionism through coalitions with interest groups	Case 3: **Protectionism**
Low	Case 2: **Openness**	Case 4: **Protectionism** (until rent>cost of office holding)

Most countries covered in this thesis have experienced colonial rule, and during that period, they played a role in exporting a variety of primary products to the ruling country. They maintained a primary goods export economy after achieving independence and transitioned

[17] One important point that is related to the vulnerability of the office holding is whether a challenger knows the source of the resources in maintaining office. If a country owns a lot of natural resources and the source is well-known to the public or the elite, it is likely to increase the number of riots or revolutions by challengers because anyone can gain the material source for the office holding, thereby it is more difficult to maintain office with strong loyalty (see Wintrobe 2000).

later to either trade protectionism or trade openness during their industrialisation periods. (Countries without colonial experience resisted the opening of economy for some time, but under some external military and economic pressure, they moved to trade openness. The exemplary case is Japan in 1840s~1850s.) These decisions were made under some degree of economic crises, although the level of crisis differed across countries. To understand these choices better, let us firstly consider the cases with low costs of office holding. Political leaders in Case 3 (low office costs + high rent income) can maintain protectionism without significant burden since they can earn rent without having to spend much on maintaining office. (Countries with abundant natural/financial resources and few rivals would apply to this case) Case 4 represents the choices of political leaders in countries with scarce natural resources and national wealth but also with low political burden. In these cases, as protectionism guarantees greater power and discretion over the national economy, political leaders would try to maintain protectionism until the cost of office holding encroaches on rent benefit.

Our main interest is on the two cases in which the budgetary burden of office holding exists. Case 2 refers to the countries that choose openness under a high burden of office holding and the low possibility of rent profit. It also applies to the countries that have moved away from protectionism to openness due to rapidly rising office holding costs. These countries include Japan, which faced the threat of opening in the 1840~50s, Latin American countries under severe economic crises in the 1970s, and the post-war Korea and Taiwan suffering from poverty in the 1960s. Under these constraints, authoritarian leaders have no option but to adopt trade openness to lessen discontent and protests from the public, even if this means a considerable loss of political and economic rents. By seeking broad-based public loyalty through economic growth or foreign investment, political leaders can maintain office and secure access to more resources in the future.[18] The situation is different from Case 1, where protectionism is maintained even under severe budgetary constraints of office holding. Historically, this (case 1) was possible by securing the political support of organized groups, such as labour unions, core ethnic groups, beneficiaries of protectionism, or by adopting a mixed strategy between protectionism and openness. The detailed examples will be discussed in the following case study chapter; however, to give a brief account here, if countries provide discriminative benefits to a chosen group and as an exchange gain loyalty from them, the political leaders will be able to maintain protectionism. The exemplary cases are Argentina, Mexico, and Malaysia in the 1970s.

This explanation has considerable historical leverage; history shows that authoritarian countries with ample natural resources rarely adopted an open economy. Countries corresponding to Case 1 would experience more severe political turmoil surrounding abundant rent benefits and political competitions amongst potential political rivals; and the incumbent will try to maintain protectionism to maximize rent profit at least until the cost of office holding becomes too expensive. Relatively rich countries in Latin America would fall in this category. Political leaders in Brazil, for example, maintained protectionism for a long time and later constructed a mixed economy during the 1970s to prolong the life of protectionism.[19] Whoever rules, regardless of types of dictators –a military junta or a tinpot dictator, or a totalitarian leader–, authoritarian politicians in resource rich countries tended to maintain a strictly closed economic system. Case 2 is best observed in many South East Asian countries who opened their economy during the industrialisation periods, and later in Latin American countries who

[18] Again, investing in military power can be a double-edged sword for political leaders' safety, and budget constraints itself limits the empowerment of military.

[19] Of course, this does not guarantee a politically stable office holding of a dictator.

failed to maintain their protectionist economy. The detailed historical comparison will be provided in the next chapter. To recapitulate, my hypotheses are as follows:

H1: The higher the expected amount of rent, the higher the likelihood of adopting and maintaining trade protectionism.

H2: The higher the cost of office holding, the higher the likelihood of adopting trade openness.

H3: Even if the cost of office holding increases and the amount of rent is not sufficient to maintain office, a political leader can extend the life of protectionism by constructing a coalition with an organized group, such as organized labour, ethnic groups, or elites.

3.3 Historical Evidence on the Choice of ISI and EOI

Overview

In this chapter, I examine the causal chain of my argument through historical examples. The first part is a summarized overview that shows a brief history of trade regime during the industrialisation period of Latin American and East Asian countries. The second part is a more detailed case study, which is included to trace specific historical contexts of each country regarding the choices and transitions between inward-looking and outward-looking industrialisation. As scores of countries had shown changing pathways between trade regimes, it is necessary to provide a more detailed explanation regarding their moves based on the theoretical argument previously explained in Table 1. As a result, by looking at contrasting historical cases, this thesis confirms how causally convincing the above-mentioned argument is in explaining the reality.

Many Latin American and East Asian countries became independent in the late 1800s and the early 1900s respectively, from the colonial rule of Britain, Spain, the Netherlands, Japan, etc. Before and right after independence, the countries especially in Latin America were maintaining a primary goods export economy as a legacy of colonial periods. Most colonial countries were serving a role of supporting ruling countries with production of food, raw materials, and primary industrial goods, and it was hardly a result of voluntary policy choice of subjugated countries. Therefore, this thesis traces the post-independence industrialisation periods, in which countries have voluntarily opted for their trade policies with sovereignty. This has been in most cases since the 1900s, mainly since the 1920s in Latin America, and the 1950s in East Asia, except for Japan that opened its port in the mid-19th century.

Most countries covered in this thesis selected their trade regime under the authoritarian rule or in the early stage of democracy, long before democracy was fully consolidated. Since my argument for the choice of trade regime is based on an autocratic political leader's utility function, the choice of a trade policy in a consolidated democratic country is beyond the scope of this thesis. Therefore, some countries that chose their trade policy under consolidated democracy, such as Costa Rica, are excluded from the case analysis of this chapter.[20]

The Historical Background: Prior to the Introduction of ISI / EOI

A number of Latin American and East and Southeast Asian countries were liberated from colonial rules mainly since the 1820s and the 1930s respectively. Although there is a considerable gap between the periods, here I begin with the early 1920s when the full-fledged discussion on industrialisation and modern development started in South America.

In the early 20th century, economically, laissez-faire was dominant, but, politically, various political ideologies such as nationalism, fascism, and communism co-existed. This period was also marked by political confusion before and after World War I, such as the emergence of republican governments or authoritarian regimes, and the outbreak of civil wars based on ethnic

[20] The democracy score of Latin American and East Asian countries in their industrialisation periods were various, but only few exceptional countries achieved full democracy at the time.

and religious conflicts. Prior to independence, resource rich colonies in Latin America and East Asia had served as a resource base to provide various products – crops and raw materials such as copper, nitrates, tin, oil, and minerals– with ruling countries. Colonies with insufficient natural resources had also been engaged in basic-level primary goods production and labour-intensive industries such as raw material processing. As a natural consequence, the volume of trade between the colonies and the ruling countries increased greatly and some degree of modern production facilities was equipped in the colonial region. Considering the colonial exploitation by ruling countries, however, there has been a substantial controversy about whether colonial experience actually helped the modern development of colonies after their independence. In any case, the level of economic openness measured by the amount of import and export was quite high in the two regions until the first era of the post-independence periods.

In the post-independence era, thanks to the commodity export boom of the last decades of the 19th century, Latin American countries reached a significant level of economic growth first. Especially between 1850 and World War I, thanks to the fall in ocean freight rates and transportation costs by constructions of railway networks, many Latin American countries integrated into the global economy mainly by trading with European and North American economies. (Bulmer-Thomas el al. 2006, 3) Until the end of 1920s, a large scale foreign investment was concentrated in Latin America due to its high profitability of investments. To summarize, at least by the end of 1920s, most Latin American countries maintained outward-looking macroeconomic policies with minimal state intervention, and their economic dependence on primary and agricultural goods export was very high.

The Introduction of ISI and EOI

After World War I, Latin America's trade deficit was deepened by the end of war boom, and inflationary financing during the war caused considerable financial imbalances (Ibid., 4). In addition, the Great Depression strengthened protectionist policies in Europe and North America, such as high tariffs and import quota to imported goods, cutting down Latin America's trade profit by reducing the amount of agricultural and primary-goods export. However, the US conversely forced developing countries to eliminate tariffs imposed on foreign goods. The set of trade policies of Dominican Republic during the 1919~1942 is a good example that shows the unfair trade rules forced by the US (Pons 1990).[21] As a consequence, there was a rising controversy regarding the unfair trade rules imposed on developing countries due to the protectionist trade tendency of developed countries.

Along with the global trend of protectionism after the recession, Latin American countries also adopted some protectionist policies such as higher tariffs. By the end of 1920s, however, the trend was not strongly inconsistent with previous liberal outward-looking macroeconomic policies maintained for a long period after their independence, and the policies did not critically block or bother the export of primary and agricultural products. Rather, the protectionist trend became a stimulus to promote domestic light manufacturing industries. (Bulmer-Thomas el al. 2006, 5) It later raised a necessity of full-scale industrialisation that deviated from the dependence on agricultural products, raw materials, and commodity export.

An earnest discussion about industrialisation and competition with developed countries began, and various political, economic, and philosophical debates surrounding comparative advantage, modernization, and dependency argument became widespread.[22] In Latin America, after the Great Depression and the end of war boom, criticisms on higher economic dependence on single crop (e.g. coffee) or single commodity export became widespread due to its higher

[21] However, Dominican Republic tried to circumvent the unfair trade rules by enacting Law 250 in 1925. The law imposed a consumption tax on imported goods so that could supplement the reduced tariff revenue (Pons 1990).
[22] A well-established dependency theory was published in 1949 by Singer and Prebisch; However, the dependency argument itself was being discussed long before its official publication.

riskiness and variability to changing international market condition (Ibid., 6). The agricultural and commodity dependence also blocked the development and investment on skilled industry that may bring about continuous and stable growth of economy.

In the 1930s, a lot of Latin American countries were facing considerable confusion in domestic politics. The main feature of this period can be summarized as the advent of dictators supported by the military and the centralization of their political power. The most representative cases are Brazil, Argentina, and Mexico. During the periods, dictators started to pursue a full-scale industrialisation to gain public support and to acquire popular legitimacy. Although countries adopted protectionist policies in different times, Latin American countries generally started to adopt an inward-looking development strategy since the 1930s. In the case of Argentina, ISI was introduced in the early 1930s, and in Brazil, ISI was introduced in 1937 under the Vargas regime. In Mexico, several protectionist policies were introduced under the Cárdenas regime. He gave up the fixed exchange rate system in 1932 and promoted industrial protection policies and nationalization of foreign oil companies since 1936. The inward-looking protectionist strategy was pursued along with the dictators' success of centralization of power and it later expanded their power of controlling domestic economy. Big countries in Latin America introduced ISI a bit earlier than smaller countries and their overall level of development was higher than most East Asian countries. Although the level of trade deficit increased, their economic conditions were not extremely bad due to the high economic development achieved in previous years and steady returns from agricultural export and commodity export. The resources needed for inward-looking industrialisation were mainly from the export of natural resources (including agricultural products) and foreign investment (mainly from the US in the 1930s) thanks to *'the higher profitability of investments in countries in need of capital' (*Ibid., 3). In short, Latin American countries had a more favourable condition to obtain capital and debt financing than most East Asian countries and these became a financial source to continue the inward-looking industrialisation.

Regarding the introduction of inward-looking industrialisation in Latin America, in the early stage, there was little resistance from existing traditional economic elites, such as traditional agrarian sectors, foreign agriculture companies, large-scale plantation landowners, agricultural companies, and resource mining companies. As ISI policy aimed to foster domestic manufacturing industries through import protection measures such as tariffs and exchange rate appreciation, the protectionist tools had a negative effect on export of agricultural products (e.g. coffee, sugar, bananas, and etc) and natural resources[23]. However, their resistance against protectionism in the early years was not high as they were not well-organized to protect their own interests and they did not have enough political power to block the decision at that time. As incentives of inward-looking industrialisation grew, political leaders in Latin America could ignore the claims of existing economic elites who wanted to maintain outward-looking trade policy focusing on the profit from agrarian and commodity export.

The discussion on full-scale industrialisation began earlier in Latin America than in East Asia, as Latin America was far from the direct damage of the war. East Asian countries, on the other hand, were only able to lay the foundation for industrialisation after a considerable amount of time due to the aftermath of World War II and Korean War. Along with severe colonial exploitation and the destruction of industrial facilities during the wars, their full-fledged industrialisation was delayed further. Except for Japan, which did not have a colonial experience but opened its port (1854) in the wake of the invasion of the Western powers,

[23] Later, the cheap labour immigrated from other poor countries supported the plantation agricultural industries, so that the agrarian elites received some level of compensation. As South American countries are sparsely populated (Labour was a scarce factor of production), "*Immigration was, in some cases, encouraged by official policies, as in Brazil, or occurred spontaneously, as in Argentina and Uruguay*" (Bulmer-Thomas el al. 2006, 3) "*By the end of the war, the industrial lobby in the larger countries had become powerful enough to challenge traditional export interests, and government policy began for the first time to give priority to the needs of secondary over primary products*."(Ibid., 5)

followed by rapid industrialisation, the industrialisation of other East Asian countries such as Korea and Taiwan began in earnest in the late 1950s. Hong Kong, which was already under the British Crown rule from 1841, achieved industrial development earlier than other East Asian countries, and Singapore, which also had a long history of economic openness under the British rule, had a little ahead of the economic opening even after being separated from Malaysia. In other Southeast Asian countries, the struggle for independence was delayed further as civil wars continued and the disruption of domestic politics persisted in the aftermath of the religious, racial and class disputes, their discussion on industrialisation were delayed further.

Most East Asian countries industrialised later than their Latin American counterparts, except for Japan that carried out ambitious outward-looking industrialisation immediately after the opening of a port to foreign trade in 1854. Korea and Taiwan, much poorer countries than most Latin American countries in the early 20th century, adopted inward-looking industrialisation in the 1950s right after their independence, even though it required a considerable capital investment at the initiatory stage. The adoption of ISI began with rebuilding domestic production facilities that were completely destroyed during the Korean War and lost after the evacuation from mainland China to Taiwan (1949) respectively. It is difficult to say that the overall economic conditions of the two countries were good at the time of the introduction of ISI; however, in terms of dictator's rent seeking, it was not that pessimistic. The US wanted to maintain a right-wing government in South Korea and in Taiwan due to the Cold War, thereby offered considerable material and military aids before and after the Korean War. The military aid from the US was used to maintain the security of the regime and the economic aid was used to suppress the complaints about the regime by providing the public with essential goods such as food, clothing, and shelters. Due to the fatal weakness stemming from lack of natural resources and technology, the ISI production facilities in East Asian countries were limited to very basic ones, such as sugar refining and milling industry.

The lack of natural resources and the small domestic market were not enough to benefit the dictators through ISI, but the foreign aid funds given for national reconstruction were being redirected to the dictatorial regimes for their political survival. Namely, the reduced burden of office holding and the opportunities of rent seeking were still favourable conditions for adopting and maintaining protectionism and inward-looking industrialisation in East Asia in the 1950s.

Table 2. The Introduction of ISI

Latin America	ISI: 1930s~early 1940s	ISI: 1950s	ISI: After the 1960s
	Argentina, Brazil, Mexico	Chile, Uruguay, Venezuela, El Salvador	Ecuador, Honduras, Peru, Dominican Republic, Costa Rica
East Asia		ISI: late 1950s	ISI: 1970s
		Taiwan, Korea	Philippines, Thailand, Malaysia

The Shift from ISI to EOI and the prolonged ISI

Then, why did these countries that had adopted protectionist regime switched to openness? Let us start from East Asian countries which switched to openness only after few years of maintaining ISI in the 1960s. (It happened much earlier than most Latin American countries that gave up ISI in the 1970s and 1980s) In the case of South Korea, Taiwan, and Singapore in the early 1960s, the shift to EOI happened after *severe* budget crises. These were largely due to the reduction of foreign aids, the withdrawal of foreign troops, and borrowing restrictions. The reduction of aid not only restricted rent-seeking behaviours of dictators but also resulted in a shortage of basic goods the public needed, which led to national wide complaints and riots. A sharp drop in aid revenues made it difficult to maintain public support any longer. Also, the withdrawal of foreign troops/military support meant a deadly budget shortage and the increase of office holding cost for dictators who should maintain internal and external security against coup d'état and wars. When a regime is threatened by coups and riots, the incumbent government needs to secure stability by purchasing more public loyalty, but the lack of budget makes purchasing loyalty difficult. In this case, dictators have an incentive to overcome the crisis through foreign investment and job creation by opening the economy.

South Korea had maintained ISI in the 1950s, but soon after the US decided to cut military and economic aid, the Rhee Syngman government faced a major economic and political crisis and was later abruptly overshadowed by the aftermath of the illegal election causing sharp drop of popularity and power division of support groups. The next Park Chung-hee military government, which took power via military coup under the tacit approval of the US –which worried about the ruling of communist forces during the Cold War– faced serious financial constraints and negative public sentiment due to the lack of political legitimacy, shortage of foreign aids, and limitations in borrowing from abroad in his initial days in office. Therefore, the government had a strong incentive to solve this problem through economic growth and long-term revenue generation. This was possible by pursuing market-based policies selling labour intensive goods to the international market and creating more jobs since there was no source of income through domestic solutions.

Similarly, in the late 1940s, the KMT was settled in the island of Taiwan after the defeat against the Chinese Communist Party. After the evacuation, the KMT pursued ISI policies thanks to the wealth and national treasures taken from the mainland China. However, the national budget was not enough to maintain the country and the expected amounts of economic rents from the protectionist policies ruling the island were scarce due to the small size of domestic market and lack of resources. At the same time, facing increasing public opposition (intellectuals in particular) to the dictatorship of Chiang Kai-shek, he was tempted to solve this crisis through economic growth. The possible solution was to adopt openness and to produce exportable goods and industries targeting international markets. Also, there was one more thing in common between the two countries. Due to the aftermath of the Chinese Civil War, the

Korean War, and the Cold War, the organized labour in both countries were nearly annihilated as the labour forces and left-wing parties, influenced by communist ideology, were the strongest rivals of the right-wing dictatorship of the two countries. As a result, the dictators of both countries could not consider extending the ISI through solidarity with the labour force.

In the cases of other Southeast Asian countries, such as Malaysia and Singapore, budget constraints (a small rent income) explain their shift to EOI. Due to racial disputes, Singapore's independence from Malaysia caused severe financial and military constraints from the beginning. Singapore originally had a strong legacy of openness because of the long-standing British colonial rule, and after independence, it was exposed to external military threats because of its hostile relationship with Malaysia. Moreover, a lack of natural resources originating from its small territory was a major constraint. Therefore, there was no source of rent income for the dictator, and the survival of the regime itself was threatened critically. The only possible solution was to seek the survival of the regime through the pursuit of intermediary trade based on locational advantage and industrialisation of manufacturing based on outward-looking strategies.

The possible question raised here is how some Latin American countries could continue maintaining ISI in spite of its inefficiency. Despite the economic slowdown and increasing dissatisfaction of the general public, history shows that a political leader could extend the life of ISI through an alliance with public-based opinion groups such as organized labour by providing them selective benefits. This makes them to share the interest of ISI and to support ISI. Brazil, Mexico, and Argentina during the 1960s and 1970s (the last period of ISI) fell into this category. The strategy of José López Portillo, the president of Mexico from 1976 to 1982, who tried to continue the inward-looking industrial approaches by gaining support of labour union, is a prime example. Also, in earlier periods, the Perón regime in Argentina and the

Vargas regime in Brazil created distinctive benefits for organized labour and urban workers and made them support for ISI. However, if a political leader's or ruling party's core support base was a majority ethnic group that accounts for more than half of the population, the government could not sustain the ISI and soon switched to EOI in order for maintaining the popular support. This was shown in Malaysia in 1970 where the economic elite group was overseas Chinese, and their political support was not powerful enough to continue inward-looking policies against native Malaysians' interest. It was practically difficult to mobilize public opinion based on a single minority ethnic group in a situation where ethnic conflict is severe. In most cases, organized labour in Southeast Asian region was extremely shrunk due to the Cold War, so the labour groups that dictators could ally as key supporters of ISI were very weak and limited. (Leftist force was largely shrunk in most East Asian countries due to the Cold War and several right-wing regimes supported by the US). As a result, East Asian countries that did not have a powerful organized labour or ethnic groups ended the ISI period considerably earlier than their Latin American counterparts.

The abolition of ISI

After a short period of high growth in the early days of ISI (economic stimulus led by increased domestic investment), a number of critical problems occurred in Latin America: The poor quality of domestically produced goods and stagnated economic growth as delayed technological advancement and reduced incentives to investing in quality control and human resources development. The problems were further heightened by the failure of inflation control, and this led to an irreversible economic catastrophe.

The continued ISI facilitated rent seeking and corruption; political leaders attempted to maintain the ISI as long as possible to the point where it became too much of a burden to maintain the office. The general public, who was not a direct beneficiary of ISI and mostly poor workers working in rural areas, had to suffer economic losses due to the protectionist policies. They had to buy poor quality, domestically produced goods which were not even cheap and, to make matters worse, also had to bear high inflation. Since the mid-stage of ISI, the national debt and inflation became so high and some countries were successfully democratized (e.g. Uruguay), targeted benefits for maintaining ISI were increasingly unavailable. As a result, facing irreversible budgetary constraints, such as debt crises in the 1980s, the Latin American countries had to abandon ISI and transited to open economy. Some have argued that Latin American countries were forced to abandon ISI and open its economy by severe pressure from the IMF and other creditors. More essentially, however, due to the increase in office holding costs and the decline in rent profits, it is reasonable to interpret that ISI's profits were no longer guaranteed therefore faded away over time.

The choices and transitions of trade regime: individual country cases

Since the trade regime was not fixed in countries and was often shifted from protectionism to openness or vice versa, I will show the choices and transitions of industrialisation strategy each country made more specifically in light of the political economy narratives laid out previously. Each country had contrasting and changing conditions over time in terms of the two explanatory variables: the amount of rent (income) and the cost of office holding. As both variables fluctuate according to political and economic circumstances, this chapter will focus on the changes of each explanatory condition and the resulting changes of trade regime of countries from the perspectives of a political leader’s utility.

Before examining each country’s history of trade regime/industrialisation strategy, it is necessary to briefly explain how the abundance and shortage of rent and the increase or decrease of office holding cost are defined and interpreted in examining detailed historical cases. Above all, I distinguish the shortage of a dictator’s rent from the deficiency of national wealth. For example, even if the GDP per capita is very low and the entire country is suffering from poverty, if a dictator is exclusively able to enjoy affluent goods and services and to secure the armed forces by misappropriating government funds or being supported by a powerful alliance, this cannot be simply interpreted as a case of rent shortage. Similarly, if a dictator monopolizes a great deal of natural resources and can purchase as much loyalty as she/he needs with the financial resources, this is not interpreted as a case of rent deficit. Although the trade balance is in deficit, if borrowing from abroad or treasury bonds as collateral are available or a foreign aid which is needed to maintain the regime exists, I also do not interpret this as dictator's rent deficit. Because she/he can still use foreign funds and aids to privately cultivate her own military/mercenaries and reign over the countries in the long run. Namely, a dictator's rent shortage is defined as a condition under which she cannot fulfil her and core supporters' personal economic and security interests by secretly embezzling nation's financial resources, for instance, providing luxury goods or private armed forces with unauthorized public money.

To summarize, in analysing the historical context on the choice of trade regime:
1) If natural resources exist and there is considerable revenue income from their sales or (natural) resource extraction companies, (even indirectly, economic rents (e.g. bribe) from resource extraction companies can be large) and 2) if there are obtainable external financial resources such as borrowing from abroad or foreign aids (including military aids), these are not interpreted as a case of rent shortage/budget constraint.

On the other hand, situations such as 1) A moratorium on payment or bankruptcy (it results in serious political turmoil that a dictator cannot control) or 2) a critical internal and external military crisis such as large-scale demonstrations and military coups (so that the dictator needs more loyalties from the public), is interpreted as the factors that increase the cost of office holding.

Case Selection rules

Before commencing the analysis in detail, there is a need to briefly mention the case selection rules and criteria. In each cell of the Table 3 below, one country is selected. Due to changes of conditions, however, countries often move within cells, so sometimes one country can represent more than two cases. The selection of cases is based on two criteria. First, the countries which were often dealt with in existing research regarding industrialisation strategy are basically excluded or explained simply. Rather, I focus more on the countries that were not often analyzed in previous research as this thesis aims to rigorously test the core argument with under-researched cases. Second, I focus more on the case showing frequent changes of trade regime. Existing theory and research could not convincingly explain the changes of trade regime of a country as they focus on structural or external factors and conditions (the amount of natural resources, the size of land and domestic market, etc) that do not change often over time. In this context, I challenge previous research by explaining under-analysed cases.

The ensuing case study chapter describes the circumstances under which trade regime was selected and changed. Table 3 summarizes the actual choices and changes of trade regime of Latin American and East Asian countries.

Table 3: The Choices and Changes of Trade Regime

	Cost of maintaining office	
Amount of Rent benefit	High	Low
High	Protectionism	Protectionism
Low	Openness	Protectionism

Table 4: The Historical Trajectories of Trade Regime: Each Country

Trade Regime (after independence)	**Ideal Types**	
Protectionism	North Korea	Maintained protectionism from division of territory until now
Protectionism to Openness	Korea (1950s~1960s) Taiwan (1960s)	Maintained protectionist industrialisation only few years and moved to openness
Openness (or autarky to openness)	Japan (since 1853) Hong Kong Singapore Philippines, Thailand, Malaysia, Indonesia (after 1960s)	Maintained openness after 1853 Under British influence Since independence, 1965 Autarky to openness
Openness (primary goods export phrase) **to Protectionism, and then Openness**	Argentina, Brazil, Mexico, Venezuela, Chile (1930s ~1940s): from openness to protectionism Chile, Uruguay, Venezuela, El Salvador (1960s) : protectionism to openness Argentina, Brazil, Mexico, (1970s ~1980s) : protectionism to openness	Argentina, Brazil, Mexico : Maintained a primary goods export economy for quite a long period of time after independence. Then, moved to protectionism in the 1930s and 1940s and then transited to openness in the 1980s Chile, Uruguay, Venezuela, El Salvador : Maintained protectionism relatively short period compared to other big Latin American countries

Strong and early ISI countries	Middle levels of ISI countries	Weak ISI countries
Argentina, Brazil, Mexico, India (Asia, democracy)	Chile, Uruguay, Venezuela, El Salvador	Ecuador, Honduras, Peru, Dominican Republic, Costa Rica (democracy)
Strong and early EOI countries	Mixed countries	Late EOI countries
Japan, Kora, Taiwan	Hong Kong, Singapore (intermediary traders)	Philippines, Thailand, Malaysia, Indonesia

Case 1: Protectionism since independence and without transition - North Korea

North Korea has maintained protectionism since the partition of Korea at the end of World War II (1945). It has traded with only limited number of countries, including China, Russia, and several non-democratic countries such as Cuba, Syria, Iran and Venezuela. (In recent years, North Korean citizens have been actively operating their own black-market economy (called *Jangmadang*) by smuggling goods from China and South Korea, and the North Korean government has turned a blind eye to trading goods in the market which is officially illegal.)

North Korea's protectionism can be interpreted as a voluntary and rational choice to maximize a dictator's rent income based on the nation's abundant natural resources. Since 1948, it has maintained a closed economy where Kim Il Sung government and his family ruled for over 70 years. By restricting people's contact with the outside world[24] and strengthening mutual monitoring system against coups and revolution, the Kim Il Sung regime and his successors have been able to significantly reduce the operating costs of the regime. North Korea's protectionism after the 1990s, however, was forced by external forces and international sanctions as the number of diplomatic ties with North Korea has plummeted since the economic sanction of the Bush administration.

Basically, North Korea's protectionism is rooted in its ability to maintain rent income based on abundant natural resources.[25] Strategies that have retained the loyalty of the elite by granting exclusive benefits to the core elite –military and party members– have greatly contributed to reducing office holding costs. Until the 1970s, inward-looking industrialisation

[24] This was possible because of the geopolitical location of North Korea: it only neighbours two countries, China and South Korea, and North Korea and South Korea have been in a constant hostile relationship since 1948. China, the most significant political and military ally of North Korea, has been the only external contact point for North Korea ever since the beginning of international economic sanctions against North Korea in the mid-2000s.

[25] North Korea's abundant natural resources, especially minerals, can be estimated through the amount of trade in mineral. There are secondary sources to estimate the amount. For reference, see Mineral Commodity Summaries of various years and USGS Minerals yearbook.

was pursued rapidly, but after that, the economic growth rate slowed, and was outpaced by South Korea. Due to the limitation of the domestic market size and the restriction of external loan (debt), it was not possible to expand the fiscal capacity. Therefore, the problems common in the ISI countries –overly expansionary fiscal policies and inflation– were not frequently observed.

It is reported that its reserves of natural resources are much bigger than those of South Korea, and the remaining reserves are still substantial.[26] The amount of rent income that the regime could manage through the export of natural resources was considerable (high rent income) and thanks to the income, it was possible to develop nuclear weapons and to maintain core elites' support. On the other hand, the office holding cost is considerably low. The political characteristics –such as extremely high levels of public control (censorship, brainwashing, imprisonment in a workhouse, etc) and surveillance system (monitoring neighbours) – played a very effective role in controlling the public complaints. Purging the elite periodically has also contributed to lowering office holding costs. External military threats have remained, but the friendly relationship with China and Russia made a significant contribution to the maintenance of the North Korean regime. After the North Korean famine in the early 1990s (referred to as the Arduous March), there was a view that public coups or elite rebellions are likable, but the mobilization of the public was almost impossible and there was no alternative leader (political competitors) in existence, which ended up with a result of maintaining the incumbent regime.

However, it is unlikely that North Korea can maintain its strict protectionist economic policies in the future. Due to its completion of the development of nuclear weapons and ICBM, the economic sanctions and pressures imposed by the international community have become

[26] Total natural resources rents (% of GDP) in South Korea was 0.2 (World Development Indicators, The World Bank), no data is available for North Korea but upon considering the amount of mineral resources, the natural resources rents of North Korea would be much higher than that of South Korea.

greater, and the direct assistance of China and Russia, the UN member states, has become impossible. As a result, North Korea's economic policy is expected to change. As the recent inter-Korean summit talks and the 2018 North Korea–United States summit imply a significant level of economic aid and economic stimulus in the future in exchange for giving up nuclear weapons, it is expected that some degree of economic opening up will be observed. The pursuit of export-based industries based on low labour costs is expected.

Case 2: Protectionism to Openness (ISI to EOI) – Korea

Existing research has mainly explained the introduction of ISI with a focus on resource endowment and trade deficits, but this view cannot explain why South Korea, which had been totally destroyed during the Korean war, with very low national income and small size of domestic market and trade deficit, introduced ISI. Why did the country adopted ISI, even autarky seems to be difficult to be maintained?

In the mid-1950s, after the Korean War, Korea introduced ISI under the Rhee Syngman regime. In order to rebuild industrial facilities destroyed during the war and to expand domestic production facilities, it would be necessary to implement some sort of inward-looking, protectionist policies (Haggard 1990). Yet, it makes sense to interpret it as the rational choice of the Rhee regime, which was able to secure substantial rent income based on the US military and economic aids. The United States and UN aid funds had been largely redirected to the political funds of the regime in the name of investment for post-war domestic reconstruction of production facilities and for purchasing foreign production machinery.[27] As the UN and the United States' material and food aids had been distributed to the public and used to meet public needs by supplying minimal food and shelter, it contributed greatly to the post-war domestic

[27] Cheng (1990) also pointed out that especially the United States lost control over the operation of the aid fund given to Rhee regime.

political stability. In addition, US military aid, which had been maintained for a considerable period due to the geopolitical importance of South Korea and Taiwan during the Cold War, greatly contributed to lowering office holding costs. Much of the foreign aid funds were used for political funds for the Rhee regime (A significant amount of political funds from the US and UN aid funds has been put into illegal elections) and were used for extending power of the *de facto* dictator Rhee Syngman.

As the amount of military aid and financial aid from the United States gradually decreased, the Rhee government was in a military and economic crisis. The decline in aid supplies led to an increase in dissatisfaction among the people suffering from daily lives, and the reduction of military aid in the face of confrontation with North Korea meant a significant increase in the cost of maintaining the regime. Under such circumstances, the Rhee government was ousted after trying to rig elections to hold on to his power. This was the result of pushing for an unreasonable extension of the regime in a situation where the citizens' dissatisfaction could not be mitigated. The following Park Chung-hee administration, who gained power in the aftermath of the military coup, abandoned the ISI policies and attempted to switch to EOI policies. He had double constraints: a decrease in rent profits (plummeted foreign aids) and an increase in office holding costs (the decrease of US military aids and increasing public discontents over his dictatorship) due to the reduction of the US aid after the announcement of the Nixon Doctrine. The Park regime had inherent limitations of lack of legitimacy and had a restriction on the increase of office holding costs in both political and military aspects. The Park regime earned profit from the war reparations received from Japan, but it was difficult to utilize it as a long-term rent because of the small amount of compensation due to hasty agreement. In the absence of a long-term source of rent profits, the possibility of coups or revolutions due to lack of his legitimacy, and the external threat by North Korea, EOI was a strategy to reduce office holding costs by reducing public dissatisfaction and securing internal support through economic growth and the increase of low wage jobs. The following Jeon Doo-hwan regime maintained the outward-looking industrialisation policy while gradually moving from low-waged manufacturing industries to high-tech heavy industry.

South Korea's ISI policy has been maintained for a considerable period, at least 10 years. At the time of introducing the ISI policies, the organization of the economic elite that can stop or support it was very weak. After the land reform by the US military rule (1949~1950), almost all landed elite lost their power and disappeared. The interests of the landowners who emphasize the export of agricultural products (therefore preferring outward-looking policies) were ignored. The power of economic elite was also minimal due to the aftermath of Korean war. The interest of state led the adoption of ISI policies.

In other words, South Korea (and similarly, Taiwan) maintained protectionism and pursued rent maximization with foreign aid funds, but the decrease of aid and the increase of public discontent greatly increased office holding costs. In the end, South Korea had no choice but to open its economy. These two countries are good examples showing the adoption process of EOI, who adopted openness as a result of difficulties in political survival due to the loss of rent source and the increase in office holding costs. The fact that the organized labour force was eradicated by the Korean War, the right-wing regime, the Cold War, and the US influence was also a factor that made the maintenance of ISI difficult, as labour insiders could not be formed during the later ISI periods.

Case 3: Autarky to Openness or Openness so far (without changes)

Japan

Japan was a monarchy, independent country in most of its history which maintained an autarky economy until the middle of 19th century. The modernization and industrialisation of Japan, however, was the fastest among the other East Asian countries. Japan had a traditional political system represented by the Shogunate (Bakuhu) system and a closed economic structure until the 1850s. Since 1850, however, Japan has consistently been subjected to US' pressure for opening its economy and forming a trading relationship with western powers. In 1854, the Shogunate finally concluded 'Japan and US Treaty of Peace and Amity (the Convention of Kanagawa or Kanagawa Treaty) and the Treaty of Amity and Commerce (1858). Signed under threat of force, these were unequal treaties that Japan could not impose any tariffs on US goods and penalize American criminals, and political and economic turmoil continued. After the opening of ports of Shimoda and Hakodate to American vessels, Japanese products lost competitiveness in price and quality and Japanese raw materials were exported at low prices. The opening of ports was a surrender to external military threats thus it is hard to see it as a voluntary and intentional choice of government. It did not directly lead to full-scale outward-looking industrialisation at that time.

The voluntary economic openness combined with full-fledged outward-looking industrialisation, rather than simply opening few harbours, began after the political turmoil of the Tokugawa shogunate (Edo) period and reformist daimyo took power. In 1863, there was an increase in external threats such as fighting with merchant ships of the United States, France and the Netherlands, and the power struggle within the Tokugawa shogunate still existed. Office holding costs were high in the presence of mixed internal and external threats, while there was no continuous source of rent income. (no special natural resources or exportable goods). The awareness that the maintenance of country may be difficult increased. In 1868, under external conflicts with western powers and internal disputes with the rest of the Shogunate, the reformist daimyo established the Meiji new government and carried out the Meiji Restoration. As a result, they pursued openness and outward-looking industrialisation in order to lay the foundations for faster economic growth and modernization and to expand military resources. In other words, this is an example of securing the political support for the incumbent regime by promoting economic openness and export-oriented industrial policies (financial efforts such as currency reform, bond issuance, etc.) and by securing financial resources to expand military power. (This time, it was a voluntary choice of government under internal and external threats and an inward-looking industrial strategy was not possible given the size of the domestic market and natural resources rent). The Meiji Restoration was committed to fostering unilateral capitalism and strengthening military power by carrying out industrialisation, while suppressing democratisation and human rights movement and promoting the return of the monarchy. The contents of the Meiji Restoration were very similar to the outward-looking industrialisation. In the early days of economic opening, imports of overseas goods surged as a result of the rapid increase of imported foreign goods, thus the trade deficit increased. However, full-fledged industrialisation centred on light manufacturing was achieved only after a short period of time. By acquiring and imitating the skills and technologies of the west, Japan was able to achieve economic gains through export of domestically produced goods and a high level of economic growth. To promote export, several private enterprises such as Mitsubishi, Mitsui, and Sumitomo were supported by the government (it is similar to the governmental support to large companies (*chaebol*) in South Korea). Later it became the origin of government-business collusion.

Case 4: Openness to protectionism and then to Openness

Argentina

From the 1880s to 1920s, Argentina was in the primary product export phrase, and its agricultural export contributed to the achievement of considerable wealth and high economic growth. Between the 1860s and the 1930s, Argentina's economic growth was higher than any other country in the world. However, after the Great Depression and the growth followed by the World War II, trade deficits increased rapidly due to declining crop prices and sluggish export. This resulted in slower economic growth and considerable socio-political turmoil. Undiversified export (agricultural products, mainly meat) and import (coal, oil, and industrial products) and one-sided foreign investment, which mainly depends on the UK, caused problems (Bulmer-Thomas 2003).

The military continually intervened in the political economy of Argentina in the 20th century. The military ousted the first civilian president Hipólito Yrigoyen[28] and transitioned from a raw material export economy into protectionism and implemented early stage ISI policies. The military also supported Yacimientos Petrolíferos Fiscales (YPF, Argentine oil/gas company) and Yacimientos Carboníferos Fiscales (YCF: Argentine coal company) under the banner of pursuing fundamental industrialisation with domestic industry protection. In particular, YPF was the world's first energy company established by the government in 1907 (Solberg 1979; Bulmer-Thomas 2006, 150). The government enacted various regulations and laws to monopolize oil drilling and banned the entry of private enterprises. It also designated wide drilling areas for exclusive mining by the government (Gadano 2010, 2013).[29] It became the military government's rent source. The claimed rationale for the military's policy was to prevent the increase in the trade deficit in the face of falling agricultural prices. However, behind it, it was intended to expand the military's economic influence and the control of agricultural elites, and to exploit enormous rent income gained from resource export. The so-called 'Década Infame' (Infamous Decade) began. Business sectors, the Condordancia (the ruling party coalition), and the opposition party were greatly corrupted, and the military

[28] After the ouster of president Yrigoyen in 1922, the transition towards democracy or democratic elections in Argentina did not take place until the mid-1980s.

[29] Since the establishment of the YPF (1907), various state-run energy companies have been established in many Latin American countries based on their abundant natural resources. Uruguay founded the ANCAP in 1931, Bolivia founded the YPFB in 1936, and President Lázaro Cárdenas of Mexico founded Pemex in 1938, after nationalizing the oil industry. In 1950, Chile founded ENAP. These state-run energy companies were working as 'rent sources' for the government's import substitution industrialisation. Later in the 1970s, the Carlos Andres Pérez government decided to take control of the Venezuelan oil industry and created PDVSA (Gadano 2013).

accepted illegal political funds from the power company CHADE (Companía Hispano Argentina de Electricidad) and tolerated its dismal management. The development of non-agricultural industries was still in its infancy, and agricultural exports accounted for the bulk of the economy as before. Also, there was considerable opposition to the protectionism and inward-looking industrialisation by a small number of landowners with economic and political power, especially those who were in the Argentine agricultural sector. As they had an interest in exporting agricultural products, there was a limit to the pursuit of strict protectionism. In addition, since this was a period that other trading partners, in particular the United Kingdom, adopted protectionism, the discriminatory treatment of the UK on agricultural exports of Argentina led to financial difficulties.

In 1946, Juan Domingo Perón took office as president and pursued a full-fledged ISI policy that combines import substitution industrialisation and protectionism. The economic policies of the Perón government began with nationalization of industries and land reform. Since 1947, a series of industries such as railways, gas, telephones, electricity, and shipbuilding had been nationalized. The earnings accumulated during World War II economic boom was invested in the nationalization. The role and influence of the government greatly increased with the expansion of government intervention and control. At this time, Argentina's economic conditions were not as good as they were in the late 1920s, but there was considerable financial surplus accumulated by the export of agricultural products and the war time procurement, and the performance of the government-owned energy companies was not bad either. In other words, there existed a considerable amount of rent resource. However, there was significant difficulties in terms of office holding, because the political influence of the military was still very strong. Therefore, it was very important to maintain office while avoiding intervention, abuse, and threats by the military and competitors. Although Perón also participated in the military coup in 1943, the Perón administration constantly had to worry about the possibility of being replaced by other military rivals. (high office holding cost). Securing the office required strong public approval. Perón's strategy was to gain support for ISI policies and the government based on the support of organized labour (Levitsky 2003). Serving as Minister of Labour after the military coup in 1943, he maintained a favourable relationship with the union (CGT: Confereración General del Trabajo (the confederation of trade unions)) to legalize labour movements and to improve labour laws.[30] Perón, who was elected as president in 1946 based on the support of labour and the poor, was able to secure continued support for the regime and create a stable ruling base by promoting policies favourable to the unions even after the election. (Prior to the Perón government, a series of labour laws had already been enacted: severance/retirement payments, paid leave, retirement extension and pensions were introduced. These were labour market institutions and policies that lowered labour market flexibility and mainly contributed to the stability of current workers, resulting in limited absorption of surplus labour in rural areas.) In addition, the emerging domestic industrialist forces who favoured protectionism, who wanted to check traditional landed elites and agricultural elites (export-oriented), also supported Perón. (state-capital-labour coalition). Despite the high office holding costs and relatively unfavourable financial conditions, the Perón government was able to pursue a government-led ISI with some degree of financial discretion. This was not possible without the support of organized labour. Perón used a strategy that allocates much of government budget to labour's welfare, redistribution and social welfare, and in return obtains support of labour, labour unions, and the poor. Although opponents criticized that Perón allocated most of the nation's wealth to simple redistribution, the poverty rate fell dramatically since Perón took office and many hospitals and schools were established. Overall, Perón's economic policies were highly labour-friendly and a typical example of ISI, which

[30] In September 1945, the military, who used to check Perón's political influence, arrested Perón but had to release him four days later due to massive campaigns by labour and the public for his release.

characterizes the operation of domestic market-oriented economic policies through forming a coalition between labour and domestic industrial capitalists.

However, after the advent of Perón's government and the full-scale industrialisation of import substitution industrialisation, the energy companies' (e.g.YPF) performance plummeted due to difficulties in attracting new investment and price policies unfavourable to the business (Gadano 2013). Agricultural industry continuously lost its competitiveness in export as prices fluctuated greatly according to the business cycles which put huge strains on the nation's finances. The redistribution policies greatly reduced poverty rates and contributed to forming a large middle class, yet it caused a huge burden on national finance in the long run as Perón could not create a new industry that would produce sustainable national revenues. Still, the Perón government's ISI policy was backed by the earning from agricultural exports.

The Perón government was overthrown by a military coup mainly due to a conflict with the Catholic Church (Gill 2008). The following military governments (Eduardo Lonardi regime, Revolución Libertadora regime, Arturo Frondizi regime, Arturo Illia regime, Revolución Argentina regime) took different approaches to attract foreign investment while essentially maintaining the ISI policies.[31] They either cooperate with the working class by appeasing labour unions or union leaders (the coalition of local capitalists-labour-ISI preferred regimes) or oppress the labour to curb its power (the coalition of agricultural elite-free trade preferred regimes). The former intended to generate rent income through export of raw materials and the latter did to attract foreign investment and loans. In the latter case, however, labour force was strong and did not last long. They were able to survive the military oppression in alliance with other forces. Under the Frondizi government and the following military regime (Revolución

[31] For a reference, labour union friendly governments were: Eduardo Lonardi regime and Arturo Illia regime. Neoliberalist governments were: Arturo Frondizi regime and Revolución Argentina regime. The latter regimes originally tried to coordinate with labour union, but, later, they pursued neo liberalism (openness) in order to avoid another military coup.

Argentina), which took power from 1958 to 62 and 1966 to 1973 respectively, redistribution policy, which was based on social consensus between the labour sector and the domestic industrial capitalists, was not maintained. On the contrary, foreign capital grew into a prominent force under the Frondizi government and Onganía government (1966-70). It actively engaged in industrial investment in oil, automobile and petrochemicals during the periods.) Extreme fluctuations on the role of the labour union --active political participation or repression by the military regime-- were repeated, but they were still the most powerful and organized force in Argentina. They had an important say in the decision of government's economic policy, supporting protectionism and ISI in most cases. Contrary to the continuous and rapid price increases of intermediary or capital goods in international markets, crops and agricultural products that were still an important part of Argentina's export were regularly exposed to the vulnerability of foreign trade, experiencing severe price fluctuations. With the regular balance-of-trade deficit and payment crisis, the government tried to partially introduce liberalism to attract foreign investment while maintaining the ISI. Yet, this kind of mixed approach was not very successful. Domestic industrial sectors suffered from a continuing decline in domestic demand and unemployment due to its low competitiveness, and the increase in competitiveness through wage cuts was not successful due to the strong resistance of the working class and labour union. The instability of the economy was repeated, which in turn led to a turning point in economic policy.

The 1976's military coup of George Rafael Videla and the 1989's hyperinflation gradually led to the end of ISI policies. Videla took control of the military with the connivance of the Catholic Church and strengthened his power through purging the opposition forces (students, journalists, and Perónists) and oppression of labour (*Guerra Sucia* (dirty war)). At the same time, he cut wages in the public sector to ease the government's financial deficit and froze wage increase that was strongly demanded by the Argentine corporate sector. Real wages dropped significantly due to price liberalization and reduced government spending, labour activities were strictly banned, and union leaders lost their political influence. (Later, the union activities resumed after democracy was restored, but this did not prevent labour market deregulation, flexibility, and real wage decline.) In addition, the military government induced the liberalization of domestic financial market by eliminating various regulations and subsidies and inducing foreign investment by rising domestic interest rate higher than the foreign interest rate. Videla's neoliberal approach was greatly different from previous regimes' ISI-based policies combined with nationalism. The reason for this change can be interpreted as a move to find new rent sources caused by the reduction in profits of national energy companies and a decrease in rent income from raw material and exports. In fact, declining domestic demand, plummeted economic growth and exports greatly lowered the government's fiscal discretion, and this led the Videla government to seek foreign investment through market opening and to raise funds for office holding through the sales of state-owned companies (for reference, see Sims 1996). Also, Videla, whose political support base was anti-Perónists and the Catholic church, tried to undermine the power of the 'labour union and industrial capitalists' coalition' (the political economy coalition that supports ISI policies) for political reasons. His political suppression on the existing alliances contributed to the absorption of foreign investors, multinational companies and exporters, particularly the agricultural elite and landed elite, into Videla's new political supporters.

As a result, the coalition of 'state-labour-domestic industries', formed by previous governments to maintain their ISI industrialisation policies, was mostly collapsed, and ISI policies have gradually been replaced by neoliberal policies. Videla's new policies were not a typical EOI industrialisation strategy to increase national income through the promotion of export industries, but rather a short-term economic stimulus package that attracted speculative foreign funds through simple market opening and the increase of domestic interest rate. The hasty governmental investment on the heavy industries also resulted in a significant increase in foreign debts. In fact, Argentina's foreign debt rose from 7 billion dollars in 1976 to 43 billion dollars in 1983.

Since then, the Alfonsín administration, which took power in 1983, had to worry about military coup d'etat and was not free from the surging foreign debt and the pressure to repay it. Although he was elected in the presidential election with a pledge to increase wages and reduce inequality, he was unable to fulfil his pledge due to political and economic conditions, and eventually had to accept the IMF and World Bank restructuring programs to implement economic openness and privatization policies (Stiles 1987). Despite the thirteen strikes by the labour groups, including the General Confederation of Labour (CGT: Confederación General del Trabajo de la República Argentina), the days of ISI policy ended, and Argentina fully transitioned to an open economy. Despite these measures, however, the economic crisis, including the hyperinflation in 1989, could not be prevented. In the 1989 presidential election, Carlos Menem pledged to withdraw neoliberal economic policies, but after the election, he followed the neoliberal restructuring programs and implemented the convertibility plan. This is an example of the incumbent administration's policy shift for the survival of office (by absolute necessity, see Kohli 1993), only considering overcoming the extreme political and economic crisis. To survive, the government had to give up a large number of the existing political/economic supporters and its economic discretion and switch to an open economy. This was a common feature of large Latin American countries, which had maintained ISI for a long time, switching from ISI to openness or EOI in the late 1980s.

Chapter 4. The Consequences of ISI and EOI: The Contrasting Development of Social Policies and Inequality

4.1. Introduction

So far, we have examined the choice on inward-looking and outward-looking industrialisation mainly from the viewpoint of dictators' rent seeking and political survival. Next, I will present a series of mechanisms on how the chosen types of industrialisation lead to the development of characteristically different social policies in the two newly industrialising regions in more details.[32]

The second theoretical claim of this thesis consists of three consecutive arguments: 1) Inward-looking industrialisation and outward-looking industrialisation create two different types of political economy coalition: one is a 'state-capital-insiders' coalition, and the other one is a 'state-capital' coalition 2) Each coalition develops contrasting characteristics of welfare regimes and labour market structure and policies 3) The varieties of labour market and welfare regimes can explain the different levels of inequality in inward-looking and outward-looking economies in Latin America and East Asia.

Under inward-looking system, a **'*State-Business(Capital)-Insiders*'** coalition is created, and this becomes a foundation of a regressive –narrow-based and insider-centred– welfare state and a highly dualized labour market. Under outward-looking system, a **'*State-Business(Capital)*'** coalition is developed, and this is a basis for a minimalist but a broad-based welfare regime and a flexible but a rather repressive labour market. Labour market institutions and welfare regimes developed under protectionist economies are more likely to aggravate

[32] Be aware that this thesis only deals with lately industrialising developing economies in Latin America and East Asia that have a relatively short history of modern institution which is relatively flexible to change. My research is not proper to explain early developed advanced countries as their institutional environment does not follow my general argument.

income inequality owing to its pro-insider, dualistic labour market segmentation, while those developed under outward-looking economies are more likely to ameliorate or at least maintain levels of inequality due to its relatively narrow wage gap within labour market and its strong 'state-capital' incentive to foster universal human resources.[33] Namely, this thesis emphasizes the conditional impact of industrialisation on inequality, via the contrasting development of labour market and welfare regimes in non-democratic developing countries.

In this chapter, I firstly explain how types of industrialisation shape material interests of influential actors and how they create specific types of socio-economic coalition. Then I will provide a more detailed explanation on how each coalition contributes to the development of a 'regressive' or a 'competitive' labour market and welfare regime. By focusing on the point, the causal mechanism linking industrialisation and inequality via the diversification of labour market and welfare policies will be clearly presented. The legacies of inward-looking and outward-looking industrialisation and their diverse impact on labour market and welfare state, and finally on inequality are the key research interests of this thesis. The argument linking divergent development of social policies and inequality will be presented and tested with an in-depth empirical analysis in the next chapter –chapter 5– and here I firstly focus on the divergent development of social policies–welfare regimes and labour market policies in inward-looking and outward-looking economies.

4.2. Types of Industrialisation and the Development of Distinctive Coalitions

I argue that the two types of industrialisation create distinctive coalitions of major actors by influencing their interests and imposing restrictions on them; thereby constraining the ways in

[33] The hegemonic power is of course on the state and capital in both economies, therefore they can extract a large portion of national wealth by using possible means. Natural resource abundant countries can extract more, however, putting this aside, I argue that the main factors influencing income inequality of general public are related to the distinctive characteristics of labour market and welfare state policies.

which the state, capital, and labour make profits. Firstly, I clarify the interests of major actors and the coalitions constructed under different types of industrialisation.

State-Business-Insider coalition vs State-Business coalition

The choice of inward-looking industrialisation creates an '*State-Business(Capital)-Insiders*' coalition that supports continuous protectionism. After the adoption of inward-looking industrialisation, the *state* retains its strong discretion to control and distribute major financial and material resources. This serves as a decisive basis to be able to exert control over capitalists. As inward-looking protectionist industrialisation aims to substitute imported goods with domestically produced goods by reducing import, the *state* selectively chooses and supports few firms and industries (i.e., high-tech heavy industries that need financing and technology) for meeting domestic demand. It includes the nationalization of industries or the direct funding by government to some selective firms due to heavy burden of initial investment. It also accompanies active protectionist measures (at least for some selective industries) blocking import from advanced countries because novice domestic industries need time to grow up and to accumulate technological advancement. In due course, exclusive protection and support for few selective firms generate persistent discrimination against unprotected, traditional sectors. Thanks to the continuous and guaranteed profits from domestic market demand regardless of the intensity of international competitions, c*apitalists(business)* in protected industries have a strong interest to maintain protectionist policies and want to maintain a strong tie with the *state* as exclusion from protection means a significant loss.

Protections for few selective firms and industries also create an unequal system in the labour market and help create and empower labour market insiders. As protected industries are free from international competitions and basically oligopolistic, they gain more profits and security and can offer a higher stability to their employed workers. Under protected, government-controlled industries, the *state* has control over the number of licenses to establish firms; therefore, entry barriers of establishing a new firm are high and job opportunities are always likely to be undersupplied owing to the limited competitions between firms. It limits the creation of new jobs and especially the opportunities for the unemployed to get a good job. The likelihood of an unemployed person to get a good job is much more limited under ISI than EOI, and after she luckily gets a job, her expected cost of job loss is likely to be huge. As a result, under inward-looking system, maintaining job and job security becomes the foremost concern of the employed, and the incentives for protecting their job becomes greater as the income gap between the employed and the unemployed grows. As a natural consequence, it brings the reinforcement of insiderness in the labour market by increasing the incentive of the incumbent workers and the needs of protectionism and labour mobilisation which will be exclusively beneficial for them. To sum up, the state, business, and labour market insiders share a common interest to maintain protectionism, therefore the '*State-Business-Insiders*' coalition is created and reinforced as a political consequence of ISI.

On the contrary, outward-looking industrialisation produces a coercive '*State-Business'* coalition, which is based on the sacrifice of overall labour forces. Outward-looking economy generates profits mainly from export, not from entirely leaning on domestic market sales, therefore creating totally different interests of major actors. After adopting openness, the *state* under rent shortage and severe budget constraints for office holding wants to make profits as soon as possible to collect tax revenue therefore improving its dire economic and political situation. To obtain profits in a relatively short period of time, the state has a strong incentive to support exporters with every possible policy tools (i.e., direct and indirect subsidies for export, basic SOCs provision, various support plans and policies for more export, etc). Supported by governmental initiatives, firms seek to earn more profits by entering international markets, not solely towards domestic market expansion. Under the outward-looking industrialisation strategy, many developing countries start and focus on the development of light, labour intensive industries such as garment manufacturing, shoemaking, assembling of intermediary goods, and their price competitiveness comes from maintaining lowest possible labour costs. In this situation, the *state* and the *capitalists* have a strong, shared interest to suppress labour costs and to maintain a highly flexible labour market institution for more export. As an inevitable consequence, it causes an overall brutal treatment against labour regardless of their employment status. Capitalists especially in labour abundant countries can create huge profits from international markets by maintaining cheap labour wage, and as a reward, incumbent government receives rents (e.g. political funds for maintaining office) from the *capital* for helping them maintain a flexible and repressive labour market. As a result of this shared interest, unionization itself and unions' wage negotiation power become significantly limited by governmental control. The wage negotiation power of skilled labour is also controlled by the shared interest of the '*State-Business*' coalition; in other words, the working class –insiders or outsiders– remains as powerless.[34] Since there are higher job opportunities than in inward-looking economies and the wage level among industries is quite flat due to governmental wage control, in general, workers do not have a strong incentive to secure their current job. Their demand for more wages and better working conditions can be simply ignored by the *state* and *business*, as the labour force is always abundant thus becoming less organized and powerless. Accordingly, the 'state-business' coalition that completely excludes overall labour is created as a result of outward-looking industrialisation.

[34] However, as a compensation for the relatively low-waged skilled and semi-skilled workers and as an effort to prevent labour forces to move to a different company or industry, companies make the best use of internal compensation system such as occupational welfare system, severance pay, and life-long employment. Also, firms try to nurture skilled labour by investing in employment training at the firm level. These benefits are contextually different from the reinforcement of labour insiderness in inward-looking industrialisation.

To recapitulate, inward-looking and outward-looking industrialisations are linked to the formation of distinctive coalitions due to contrasting interests of major actors under each system. Under inward-looking system, the *state*, *capital*, and *labour market insiders* have a strong shared interest to maintain and secure protections; while, under outward-looking system, the *state* and *capital* have a shared interest to maintain low labour costs thus repressing overall labour, so that they can extract more profits through export in competitive international market.

4.3. The Development of Disparate Social Policies: Labour Market and Welfare Regimes

The two coalitions strive to institutionalize and consolidate their favourite types of institutions and policies in existing setting. As power of a coalition strengthens, the coalition's logic of interest maximization is more likely to be reflected in the characteristics of institutions and policies in a way to secure their own benefits and to block the benefits of their counterparts. The ways that the two coalitions try to achieve profits are best observed through labour market institutions and welfare policies: both are directly related to the way profits are transferred, the way powerful actors punish their counterparts to achieve more profits, and the way actors gain income and power resources in the given setup.

As a second causal chain of my argument, I explain two different routes from the political economy coalitions to the development of specific characteristics of labour market and welfare system. One is a development of protectionist labour market institutions that favours labour market insiders and a sizable, but highly regressive welfare regime in inward-looking economies. The other one is a highly flexible labour market institution and a minimalist, but universal welfare regime in outward-looking economies. The next section describes the contrasting development of labour market institutions and welfare regime respectively.

The Development of 'Insider-centred' vs 'Competition-oriented' Labour Market

Under ISI with a strong '*insiders-capital-state*' coalition, labour market institutions are reorganized mainly to meet the needs and interests of labour market insiders. This leads to the reinforcement of employment protection and labour market regulations discriminating labour market outsiders –workers in non-protected industry, part-time and unemployed workers, thereby aggravating wage inequality between insiders and outsiders. This explains the advent of a regressive insider-centred and a highly dualized labour market in many inward-looking economies.

In an inward-looking economy, incumbent workers have a strong incentive to protect and strengthen their job security, because of their high expected costs of job loss and slim employment prospects when they lose their job. This serves as a momentum for the incumbent workers to organize a strong 'insider-centred' labour union and to join it to securely maintain their job status. In this context, labour unions act as institutions mainly for the labour market insiders, not part-time workers or the unemployed. A closed, protected economy generates a strong rivalry between incumbent workers and the outsiders surrounding limited opportunities of getting a job, therefore the unionization of labour market insiders fundamentally prevents the employment of outsiders. As a consequence, incumbent industrial workers have a strong incentive 1) to enact strict labour market regulations for blocking dismissal and strengthening statutory job protections for protecting labour market insiders 2) to organize and join labour unions in order to maintain their job security by enacting unemployment protection laws against involuntary job losses 3) to establish a system that makes hiring and firing difficult. As the wage gap between the industrial formal sector and the traditional rural/informal sector grows, outsiders may attempt to underbid their wages to get a job. However, labour insiders seek to prevent this by using every conceivable means such as enacting labour market regulations against turnover or going on strike.

Then, how do *capital* and the *state* react to this? I argue that both *capital (business)* and the *state* share the same interest with labour insiders thus contributing to the development of inflexible and insider-protective labour market institution. Complementing Rueda *et al*. (2015) and Wibbels and Ahlquist (2011) who argue that *capital*'s interest is in maintaining labour peace and stable domestic demand, (therefore they will support labour market insiders), I suggest a slightly different argument. The scholars insist that labour peace is number one priority of *business* for continuing import substitute industrialisation. Their view is basically a demand side argument thus focusing more on what kind of labour the *capital* and *business* need in inward-looking economies. Instead, my argument is more about the dynamics the influential actors interact with and coordinate their interests. Therefore, I focus more on the major actors' compromise of interest.

To understand *capital(business)*'s decision on whether to maintain the 'expensive' insiders, we need to examine the uncertainties *capital* faces. Considering the expected job training costs and time costs for replacing incumbent workers with new, relatively cheap workers and the turnover costs caused by firing current workers, *capital* faces significant uncertainty about the benefits from hiring new workers and firing insiders. Firms in inward-looking economies basically need more semi-skilled and high-skilled workers with high skill specificity, because their major industrial purpose is to foster technologically advanced manufacturing industries that can substitute imported goods (i.e., cars, electrical appliance). The problem is that labour replacement cost can be very expensive in inward-looking economies. Finding and hiring a new 'skilled, but cheap' worker is quite difficult due to high skill specificity, as ordinary workers cannot easily invest in learning a specific skill if the chances of getting a job in a specific firm or a sector/ industry are very limited. Due to the uncertain supply of skilled labour and the higher wage burden, firm owners may consider hiring cheap and unskilled workers and train them by providing vocational training. Considering the expected skill training costs, however, more uncertainty is expected for the business owners to invest much money in the job training of the new workers, because, after training, the workers will soon become expensive insiders striving to maintain their privilege and wage negotiation power (especially if they join in labour union). In this situation, capitalists and firm owners do not have strong interest to invest money in skill training in order to replace incumbent workers with new workers. As a result, *capital/business* is likely to opt for the easiest option: maintaining insiders. In this situation, even if labour market outsiders desperately want a secure job, their expected benefits to invest in expensive job training and higher education with their own money is unclear. In this context, unemployment is a matter of the intensity of insiderness in the labour market, not a matter of skill-level or education level, as incumbent labour insiders strongly try to protect their job status and *capital(business)* does not have an efficient way to replace them with new workers. As firm owners in protected industry have greater price setting power of goods thanks to the monopolistic industrial structure, the burden of higher wage and protection of labour insiders will be directly shifted on to consumers rather than to the *business* itself: it will be one of the reasons why *capital* and *business* endure the expensive labour insiders.

In terms of the interest of the *state*, similarly, it is more likely to support labour market insiders' interests and the institutionalization of insider protection, due to their relatively strong political and economic power supported by their relatively higher labour wages and job security. Given the fact that the purchasing power of middle-income secured job holders contributes most to the domestic market growth in inward-looking industrial countries, government has no strong incentive to threaten the privileged status of the labour market insiders.

This '*state-capital-insiders*' coalition thus contributes to the development of highly inflexible and regressive 'insider-protective' labour market institutions, thereby aggravating inequality by widening wages and protections between insiders and outsiders.

On the other hand, the '*state-capital' coalition* in export-oriented economies has a strong interest to restrain overall labour power, and this leads to a development of 'competition-oriented (flexible and unprotected)' labour market institutions. This is clearly in line with the coalition's common interest in prioritizing export enhancement. In most developing EOI economies aiming to achieve higher export, the only way to achieve this goal is to export labour-intensive goods by lowering labour costs. For this goal, the *state* and *capital* coordinate labour market to be more flexible and unprotected, therefore maintaining lowest possible labour wages and labour costs and achieving higher export sales through price competitiveness. Meanwhile, they do not have any incentive to provide job protection or protectionist regulations for working classes, because labour market protection and regulations incur costs and increase the price of export goods. In an open economy, it is natural for wages to be formed based on demand-supply of labour and the skill level of workers. The nondemocratic (or unconsolidated democracies) outward-looking economies, however, wants to establish a more oppressive system in favour of the interest of capital for easier supply and replacement of labour. Therefore, no or low levels of minimum wage and labour protection, and relaxed regulations regarding working conditions are the institutional arrangement for the shared interest of *state-capital* coalition. In addition, *capital* and the *state* are less favourable to the labour unions and their mobilization because it can increase the wage bargaining power of unions and labour rights, thus finally increases labour wages and costs. As collective action theorists point out, the abundant labour forces and a great number of small-sized light manufacturing firms make it fundamentally taxing to create a strong labour union with centralized wage bargaining power. The flexible labour market with minimal labour protection legislations and regulations and weak labour unions are the institutional results of this 'state-capital' coalition. The workers in general, even if those in formal sectors and highly-skilled, are basically unprotected and politically powerless due to their low levels of organized power.

In export-oriented economies, the working class is not a powerful actor regardless of labour market insiders or outsiders. They are nearly unable to modify labour market regulations to be more labour protective. One notable point, however, is that labour movements and unionization, if any, are far from exclusive protection for specific groups. The basic characteristics of labour market institutions are not distorted only for some exclusive groups such as labour market insiders.[35] Later, as democratisation proceeds, the awareness of the poor working conditions and the increased industrial accidents empower public voice and legalize labour unions so that more labour protection including guarantee of basic legal rights are made possible. Yet, this is basically a way of gradually improving the labour market problems in a way that does not harm the shared interest of capital and the state. The minimum wage system and the improvement of the working environment were only gradually introduced at the cost of workers' sacrifice and labour disputes. Legally guaranteed labour rights are largely ignored and the large gap between law and practice is observed in many nondemocratic outward-looking economies.[36]

The Development of 'Regressive' vs 'Minimalist' Welfare State

The coalitions following inward-looking and outward-looking industrialisation also influence the characteristics of welfare state thus generating two unique types of welfare state: one is a 'regressive' welfare state, and the other one is a 'minimalist' welfare state. The differences in the characteristics of these welfare states have different impacts on inequality.

I argue that the '*state-capital-insiders'* coalition of inward-looking industrialisation create a 'regressive' welfare state which is exclusively beneficial for the elite and labour market

[35] Of course, workers with specific skills (high tech industrial workers, for example) have more say; however, their wage negotiation power is limited in a firm level, not expanded to industry or national level.
[36] This is because their labour law is often simply copied from that of developed countries.

insiders. Labour market insiders in protected economies can strongly demand more social protection programs and welfare benefits and this is in large part supported by the shared interest of the coalition to maintain protectionism. The greater their expected loss due to dismissal or being laid-off, the more protection they will demand. This leads to the establishment and strengthening of social protection and social insurance benefits mostly for labour insiders. as a result, the narrow and targeted welfare spending aggravates (disposable income) inequality by discriminating outsiders in the labour market. Table 1 features the different characteristics of welfare state under openness and protectionism.

Table 1. The Development of Welfare State under Protectionism and Openness

	Protectionism → Openness	
Higher welfare spending ↑	**Highly regressive/distorted welfare state for labour market insiders**	Compensatory and generous Welfare State
Lower welfare spending	Welfare state for core supporters (military, elites etc)	**Minimal but universal welfare state/ protection**

This claim is fundamentally different from conventional approaches that welfare state is established to assist certain types of production and industrialisation or to compensate for risks caused by economic openness. The welfare state of inward-looking economies is neither a ‘production-supportive’ welfare state (see Wibbels and Ahlquist 2007; Rueda, Wibbels, and Altamirano 2015) for the domestic market development nor a ‘compensatory’ welfare state for the unprotected and the damaged (e.g. Katzenstein 1985; Garett 1998). Compensation hypothesis cannot explain the opposite patterns observed in developing countries covered by this thesis: Inward-looking closed economies tend to spend more on social insurance, and outward-looking open economies are associated with minimal levels of social insurance provision although most of their citizens are exposed to harsher international competition.[37] In addition, the explanation by Wibbels and Ahlquist (2007) has a limitation in understanding the welfare states of developing countries. They argue that welfare state institutions are developed in a way to support industrialisation and to provide a market with relevant labour forces that the type of industrialisation requires. However, it is worth noting that skilled labours that protectionist economies need were actually undersupplied in Latin America and the Caribbean and the public vocational training spending in inward-looking economies were minimal (Pallegrino 2001; Ducci 1991). Against these supply-side approaches, I would rather focus more on a political, demand-side argument by shedding light on the shared interest of and demand of influential actors, especially labour insiders.

Between ISI and EOI, the core factor that brings a big difference in their welfare system is the presence of strong labour insiders. The 'insider-capital-state' coalition and the subsequent consolidation of labour market dualisation in protected economies contribute to the development of regressive welfare state. Based on their superior position in labour market and the common interests of the '*state-capital-insiders*' coalition, labour insiders can ask for greater protection against their risks (i.e., industrial disasters, layoffs or dismissals) and, as a result, social protection and social insurance system have evolved to give labour insiders more exclusive benefits but resulting in the exclusion of outsiders. In brief, protectionism develops a 'regressive' welfare state mainly supporting the interest of labour insiders, while discriminating labour market outsiders. Welfare programs influence inequality by changing the amount of disposable income through government transfers, social service delivery, and social insurance scheme. To understand the influence of welfare on inequality and the progressivity

[37] This is in large part because compensation hypothesis is developed based on the experience of advanced democratic economies. In coordinating the interests of the losers and the winners of economic openness and globalisation, the losers are likely to receive more compensation in democracies than in autocracies.

of welfare spending, we need broad information on the scope of welfare programs, the beneficiaries, and the amount of spending. Therefore, rather than simply looking at the size of welfare spending, examining the characteristics of welfare state becomes much more important.

The interests of major actors matter in construction and arrangement of detailed welfare policies. First of all, the '*state-capital-insiders*' coalition in inward-looking economies helps build a sizable social insurance and social protection system, as labour insiders strategically put their best efforts into the growth of social insurance spending as a safety net in case of job loss. Workers with high skill specificity are not easily transferrable to other firms –especially in oligopoly industrial structure of inward-looking system–, thus they try to protect themselves from industrial risks or dismissal by emphasizing their demand for more social insurance. Business and the state are more likely to accept their request, thanks to the relatively easier transfer of loss to general consumers in the form of price increases. The oligopolistic economic structure gives them much room for negotiation by adjusting the price and supply of domestically manufactured goods. Also, organized labour insiders are important in political sense for maintaining political support for the incumbent regime, therefore it is highly likely that their demand will not be ignored by the state. To the contrary, the '*state-capital*' coalition of outward-looking economies does not have any interest in providing an additional social insurance or social protection programs with their workers because welfare spending is related to the increase of labour costs and, fundamentally, to the decrease of their own profits. As a result, the introduction of social insurance and social protection is delayed and remained at a very minimal level.

Secondly, as to education policies, outward-looking economies are closely related to the attention given to the primary and secondary education due to its concentration on low- and semi-skilled light manufacturing. Trade openness and global competition strengthen both labour's demand and capital/governmental needs to expand education. In a competitive global economy, capital and government have a strong shared interest to invest more in education, in order to reach minimum skill levels and to increase labour competitiveness through education. Even in light manufacturing industries, there is an inherent need to train abundant manufacturing workers at least to a certain proficiency level in reading and writing. From the demand side of education (labour's point of view), acquiring a minimum level of skill is a necessary condition to get a job among many similar competitors. If a worker wants to get a job which offers better working conditions and higher wages, there is no option but to improve her education level and skill level. Higher demand for more education is developed in this context. After achieving some levels of economic growth, growth through light industry is confronted with severe limitation due to strong pursuit of the third-world countries with much lower unit labour costs. In this context, a gradual orientation towards the development of heavy and high-tech industries is required and this will need more skilled workers. Thus, most outward-looking East Asian countries made education and vocational training their highest priority (Asian Development Bank 2007). However, governmental supply of higher education is not necessary in the early stage of outward-looking industrialisation which basically attempts industrialisation through the growth of light industries requiring low- and middle-skilled labour. In the early stage of outward-looking economies, the state rather focuses on the supply of primary and secondary education. Yet, the public demand for higher education to get a better job tends to outstrip the governmental supply of higher education, which in turn results in the rapid provision of private universities and increasing competition for entering universities. Education demand in the open economy is basically higher than that of the closed economy, and with the increase of skill premium, low- and middle-income families hope for a class shift through education, which ultimately enables low-income families to move towards upper classes and this helps reduce inequality. Education works as a ladder that help people climb their way up to higher social positions.[38]

To the contrary, inward-looking industrialisation is basically associated with more focus on higher education that fosters skilled labour for capital-intensive and technology-intensive heavy industries. However, one of the claims of this thesis is that the strong labour insiderness of closed market economies fundamentally hinders the leverage of education on deciding employment status and getting a job; therefore, people's demand for more education would not be very high. The unemployed have lower incentives to spend on education, as unemployment is not entirely a matter of skill level or education level; it is rather a matter of the intensity of insiderness related to entry barriers and regulations on hiring and firing in labour market. The employed have a strong incentive to block the inclusion of outsiders in formal sector, because it will raise the possibility of wage decrease, thereby threatening insiders' wage premium. Insiders do not have any interest in asking for more public education as it will increase the number of possible competitors. Education, under this situation, becomes an exclusive privilege for the elite, the rich, and the privileged middle class in inward-looking economies. As a result, the positive impact of education on lowering inequality cannot be expected in inward-looking economies. In other words, the virtuous cycle in which the poor get better jobs and escape from poverty cannot be easily accomplished with the increase in the provision of public education and, ultimately, the ability of public education to lower inequality will be fairly limited in inward-looking economies. In addition to this, from a supply side, government and *capital* in inward-looking economies also do not have a strong incentive to provide public education especially primary and secondary education, because fostering a large number of general skilled labours is not their primary industrial concern. Instead, it is more likely that

[38] In the long run, however, more than half of job seekers have a college degree due to excessive demand for higher education, and this makes skill and education premium largely disappear in recent years.

they would focus more on the provision of higher education and skill training because it is related to the supply of relevant labourers to the high-tech heavy industries in inward-looking economies. However, monopoly system itself basically does not require abundant skilled workers than the optimal level and labour insiders try to block the hiring of new workers for protecting their wage premium, the provision of skill training will be more likely to be limited. As a consequence, the ability of public education in reducing inequality could be significantly limited or less effective in the context of inwardness because the possibility of class mobility through education is limited due to high entry barriers in the labour market, the need for universal public education is low, and the demand for education is also low.

Lastly, with regard to health-related spending, the *state* and *business* in outward-looking economies have a shared interest in providing a relevant level of general healthcare. This is in line with the *state-business* interest to provide workers with an adequate medical treatment for returning to work after fast recovery. In this context, we can understand that why public health insurance is introduced much earlier than other types of social insurance in outward-looking economies. However, occupational health and safety insurance is not highly progressive or generous enough due to the *state's* and *business'* concern of rising labour costs. There is always a limitation in providing public healthcare owing to the abundance of workers as they are easily replaceable in labour abundant countries. In a similar vein, support for the disabled, children, adolescents, and pregnant women is not a primary concern of government at all. Although the demand for healthcare is always high because of innumerable industrial accidents caused by poor working conditions and low safety standards and the *state* and *business* put their priority on healthcare among other welfare programs, the public health spending was not enough to meet the public needs. To provide a general and universal medical service with lowest possible costs, outward-looking economies adopt a standardized healthcare system relatively earlier. This accompanies a general medical provision system which sets and controls the medical fee by the government. It emphasizes speedy treatment over careful service, and against doctors' resistance, this naturally increases the number of patients to take care of per day thus incurring severe burden to doctors. (This efficiency-oriented medical service provision remains as a structural problem until recently.) To sum up, the ability of government healthcare spending on reducing inequality can be considerably high due to its universal and efficient provision. On the contrary, in inward-looking economies, the elite and labour insiders ask for a privileged healthcare system in case of industrial accidents or severe illness as insurance for themselves. As the size of insider-centric labour market and technology-centred industries is not huge, small number of skilled workers and the elites become beneficiaries of the healthcare system and this keeps the coverage of healthcare limited.

The implications of these key characteristic differences of welfare policies on inequality are somewhat surprising. Influential actors in closed economies did not provide public with general education and healthcare (see Levy 1986; loyd-Sherlock 2000), but only for few privileged people. This implies a distorted welfare structure and explains the higher inequality in inward-looking economies, despite their relatively higher social and welfare spending. Plus, the ability of public education in reducing inequality could be significantly limited or less effective in the context of inwardness because the possibility of class mobility through education is limited due to high entry barriers in the labour market, the need for universal public education is low, and the demand for education is also low. In a similar vein, despite their relatively higher spending on healthcare and health-related social insurance, the health-related spending in inward-looking economies would not actually contribute to the reduction in inequality. This is because of their limited range of patient care –mainly for labour market insiders and the elite. In outward-looking countries, considering their relatively general healthcare programs at the lowest costs, their health-related spending could contribute to the improvement of inequality.

Accordingly, the higher social insurance and social protection spending in import-substitution economies could not contribute to the reduction in inequality. The benefits, including pensions and social insurances, are mainly for labour market insiders to protect the skilled labour forces and to secure their job security by increasing the rigidity of labour market. Similarly, the social insurance and social protection in export-led countries would have nothing to do with inequality because of its minimal spending level.

4.4. The Contrasting Development of Social Policies in Latin America and East Asia

The purpose of this section is to provide evidence on the opposite characteristics of social policies that have been developed under ISI and EOI respectively. Due to data unavailability, there is a considerable constraint on the presentation of comparative evidence on the development of social policies since the 1940s. Instead, I present some evidence based on existing literature.

"*In Latin America, labor laws function to divide, rather than unite, workers. They are not neutral rules of the game that apply equally to all workers in the economy, or that apply in the same way across countries. Rather, their stipulations regarding hiring and firing, working conditions, and the functioning of labor unions make workers' lives highly unequal. They stratify workers and shape their long-term career paths, guaranteeing some individuals secure employment (and even retirement), while relegating others to serial short-term occupation and instability. Still other workers are case outside the world of "legal" employment altogether, in unregistered jobs "off the books" in the informal sector.*"

(Carnes 2014,1-2)

Before the full-scale adoption of ISI and EOI, regardless of Latin America and East Asia, repression was a central feature of the state response to worker organizations and protests (Collier and Collier 2002, 3-6). In conjunction with more frequent political upheavals and industrialisation, this tendency soon changed especially in Latin America. Political leaders began to consider mobilizing workers as a support base (Ibid., 6) and industrialisation accelerated this process with the urban influx of labour force.

The most distinctive feature of the Latin American labour market is strong labour protection, mostly for formal sector incumbent workers (labour insiders). A large number of scholars argue that labour protection in Latin America was provided as a top-down process for political reasons (i.e. for office holding or building a political support basis), rather than a protection demanded by workers (Segura-Ubiergo 2007, 43). "*In the middle of the twentieth century, labor laws were introduced in many countries as a means of co-opting the rising industrial class. The large numbers of workers who were flocking to cities to work in factories were attractive to politicians as a source of electoral support and political mobilization*" (Carnes 2014, 7).

This can be interpreted as a self-reinforcing process of labour protection. Political leaders, who want to maximize rent through pursuing the ISI while maintaining office, needed to establish a sturdy political base. Considering frequent political changes during the mid-1900s, it was important for the political leaders to establish a solid support base for pursuing profits while keeping the office safe. Although the increasing new urban working class have not yet strongly demanded a full-scale protection for themselves, political leaders can build political support by suggesting and providing exclusive benefits and protections for the workers in advance. The beneficiaries of the protection, the incumbent workers, then ask further protection against job-loss or wage decrease, and their demand is more likely to be updated in the labour code. As it is politically difficult to remove or reduce the current level of protection regardless of regime types, labour protection tends to be strengthened rather than decreased. This may lead to the urban-rural and sectoral (formal vs. informal) cleavages in the labour market by creating exclusive benefits for the most organized workers.

In sum, as far as the coalition between labour organization and the state exists, levels of labour protection will be strengthened. The incumbent workers share a common interest with protectionists/protectionism because it prevents foreign workers from entering the labour market thus decreasing the possibility of wage decrease and job loss. In other words, the longer the period of economic protectionism and the stronger the state-labour coalition, the more protective labour market institution will be consolidated. This leads to higher hiring and firing costs, therefore creating a highly rigid labour market. Several scholars have reported on the rigidity of labour markets in Latin America. They are highly rigid by international standards but labour codes in countries have not changed much although there are some variations across countries (Ibid., 3).

One thing to note is that the rigid labour market regulations are linked to the development of social insurance or social protection exclusively beneficial for formal sector workers and secured job holders. Heckman and Pagés (2003, 11) mentioned that "*Labor regulations were one way to distributing the rents from protection among covered workers and employers. Regulations are a low cost way (from the point of government fiscal authorities) of providing social insurance to protect workers*". Latin American countries have developed advance social insurance schemes (and higher social security spending) much earlier than their Asian counterparts. Old age pensions and unemployment insurance were introduced much earlier than their needs in Latin America, and this can be interpreted as a political economy reward from political leaders in return for the support for the incumbent and protectionism.

Table 2. Spending on Social Security, 1960~1990, selected countries

Latin America	Social Security	**Asia**	Social Security
Argentina	8.55	Japan	6.63
Brazil	5.54	S. Korea	0.80
Mexico	1.45	Singapore	0.50

(average, % of GDP)

Welfare systems in Latin America developed in a fragmented way (Segura-Urbiergo 2007, 25) and they were first established for groups such as government officials and the military. Then they extended to the best organized, the working classes, leaving without protection most of labour market outsiders. (Ibid., 25) Until the 1980s, the coverage increased, but not equally between the labour insiders and outsiders especially in the large countries in the region (Mesa-Lago (1986, 1989).

Table 3. Social Spending in Latin America, 1973~2000

Country	Social Spending (% of GDP)	Coverage (1980)
Argentina	14.7	78.9
Chile	13.8	67.3
Uruguay	13.5	68.5
Brazil	12.5	48.0
Costa Rica	10.5	76.0
Venezuela	7.2	45.2
Bolivia	6.5	25.4
Mexico	5.6	53.4
Peru	5.3	17.4
El Salvador	5.1	6.2
Ecuador	4.8	7.9
Dominican Republic	4.3	7.9
Paraguay	4.0	18.2
Guatemala	3.1	14.2

Source: Segura-Ubiergo (2007, 30), Mesa-Lago(1989)

Differences in the organized power of labour unions in Latin America and East Asia are also notable institutional characteristics. The relative strength of organized labour power between

Latin America and East Asia can be inferred through the number of workdays lost due to labour disputes. The clear difference in the power of organized labour union is observed between the ISI countries and EOI countries.

Table 4. The Number of Workdays lost due to Labour Disputes

(average per year per 1,000 labour force members)

	Period	Days lost
Argentina	1974	60
Chile	1980	158
Venezuela	1980	70
India[a]	1980	153
Philippines[b]	1980	61
Bangladesh	1980	28
Indonesia	1980	1
South Korea	1980	2
Malaysia	1980	2.5
Thailand	1980	4

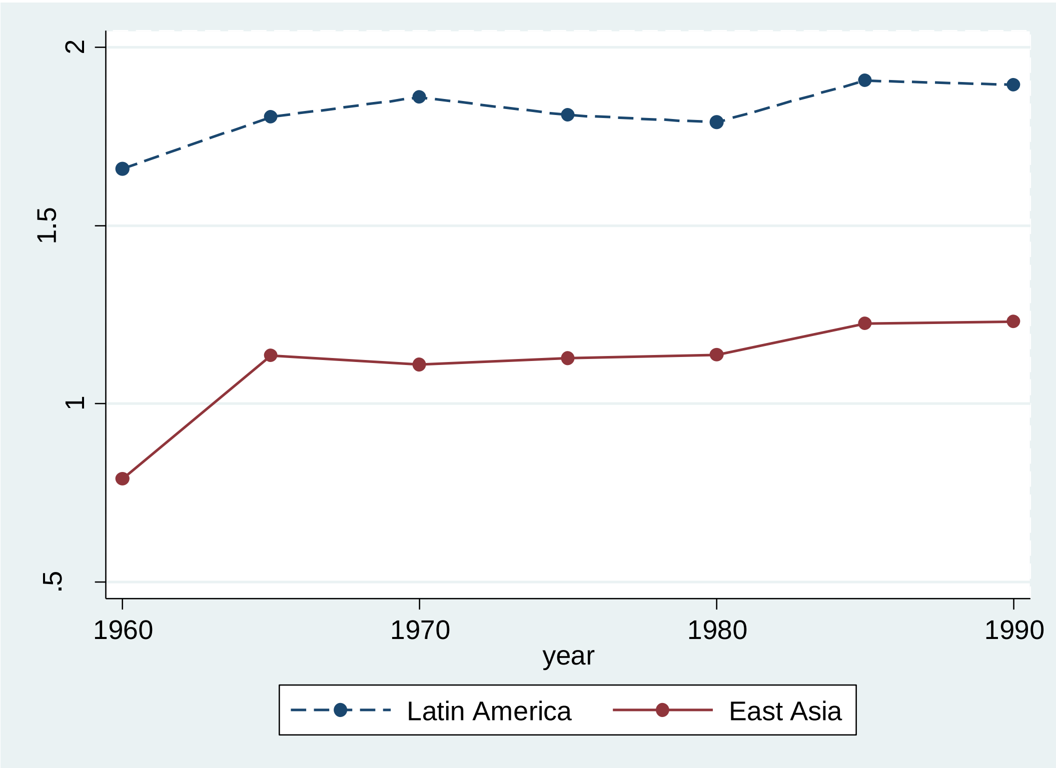
Source: International Labour Statistics, Banuri (1991)

[a] India maintained ISI until the 1970s and Philippines did until the early 1960s

East Asian labour market institutions can be characterized by strong legacies of political economy coalitions between states and businesses since the start of export-oriented industrialisation. Thanks to the high economic growth and labour demand, there was little need for government to adopt active labour market policies against unemployment – at least until the economic downturn. Full employment and growing economy supplemented the lack of labour protection, active labour market policies, and social security in East Asia during the golden days of EOI. At the same time, for more export of manufactured goods, price control was the key. In East Asia, governmental efforts to repress wage - through suppression of labour unionization and sabotaging union membership – were greater before democratisation, and the wage bargaining between the centralized labour union and government and business was highly limited. The levels of centralization of labour union was very low, therefore wage bargaining was mostly limited to the firm level, not extended to the industry or central level.

Also, the levels of employment protection, based on the strictness of layoffs and the use of temporary workers, were much weaker in East Asia than Latin America. The trend of flexible labour market continued. *Figure 1* is a labour market rigidity index measuring the rigidity of employment protection legislation. It depicts the differing levels of employment protection between the Latin American and East Asian countries and shows that the levels of labour market rigidity is much greater in Latin American countries than East Asian countries.

Figure 1. Labour Market Regulation – Strictness of Employment Protection



Source: Campos and Nugent, 2012

Chapter 5. The Influence of Social Policies on Inequality

In the previous chapter, we have reviewed the characteristically different development of social policies following the choice of inward-looking or outward-looking development strategies. And, as a natural consequence, it can explain the variations of inequality in the two regions. This chapter empirically tests the relationship linking development regime, the opposing characteristics of social policies, and the levels of inequality.

To recapitulate briefly, the '*state-capital-insiders*' coalition of inward-looking economies contributes to the development of highly inflexible and regressive 'insider-protective' labour market institutions and regulations, thereby aggravating inequality by widening wages and protections between labour market insiders and outsiders. Contrary to inward-looking economies, the '*state-capital*' coalition of outward-looking economies contributes to the development of weak unionization and labour market regulations, thereby decreasing the inequality level. Although the levels of unionization and labour protection are minimal in Asian regions, the positive role of labour market institutions to reduce inequality are not distorted by discriminating insiders and outsiders.

Similarly, the characteristic differences of welfare states in inward-looking and outward-looking economies have different impacts on inequality. Inward-looking economy develops a regressive welfare state where social benefits and services are mainly concentrated on labour market insiders. On the contrary, outward-looking economies basically develop universal welfare programs focusing on an overall human development. The size of welfare spending, however, is minimal, therefore it can reduce the levels of inequality, but its impact would not be very significant.

As a consequence, these dynamics of labour market and welfare regimes then explain the differences of inequality in Latin America and East Asia.

5.1. Expected Relationship between Social policies and Inequality

So far, this thesis has explained two different paths from inward-looking economies and outward-looking economies to inequality. By providing a causal mechanism linking types of industrialisation to inequality via labour market institutions and welfare policies, we have examined the choice of dictators on economic openness or protectionism, the interests of actors and their coalitions, the characteristics of labour market and welfare policies, and finally, their impact on inequality. By doing so, I have suggested a theoretical mechanism on how labour market and welfare policies are influenced by trade openness and protectionism, on what the impact of the social policies (labour market and welfare policies) on inequality will be, against conventional wisdom emphasizing a straightforward and the same impact (and directionality) of institutions on inequality. The overall argument and the impact of institutions and policies on inequality are summarized in *Table 1*.

Table 1. Two Different Paths: from Industrialisation to Inequality

	Outward-looking Economy	**Inward-looking Economy**
Interest of actors	**State**: to increase export by controlling labour cost / to earn higher rents and taxes from economic growth **Capital**: to increase profits from export by maintaining price competitiveness and by repressing labour costs **Labour**: to earn a decent income from a workplace **Loser**: overall labour	**State**: to maintain their controls over resources through protection **Capital**: to maintain profits through higher protection/ import prohibition for their uncompetitive firms **Insiders**: to maintain job security and to earn higher benefits/income. **Outsiders**: to get a decent job **Loser**: labour market outsiders
Coalition	A 'Government-Capital' coalition	A 'Government-Capital-Insiders' coalition
Institutions and policy outcomes	Highly flexible and unprotected labour market Weak unions Minimalistic welfare spending on Social Insurance/ social protection Relatively higher levels of education spending / minimal but universal health spending	Highly protected 'insider-centric' labour market Severe insider-outsider dualization Strong, but fragmented labour unions Higher levels of social insurance/labour protection Minimal levels of education/health spending
Possible distributional results	Higher inequality between capital and overall labour Low inequality among labourers	Higher inequality between protected capital and unprotected capital Higher inequality between labour market insiders and outsiders

H_1: Labour market institutions (including employment protection, labour market regulations (firing, hiring), and unionization level will increase the levels of inequality in inward-looking economies.

To the contrary, the same labour market institutions developed in outward-looking economies (especially labour market regulations and unionization) will reduce the levels of inequality.

H_2: The ability of public welfare programs (education, health, social security) in reducing inequality would be very limited in inward-looking economies than outward-looking economies.

5.2. Brief Statistics – Trends in Inequality and Inward-looking Industrialisation

Trends in Inequality: Latin America and East Asia

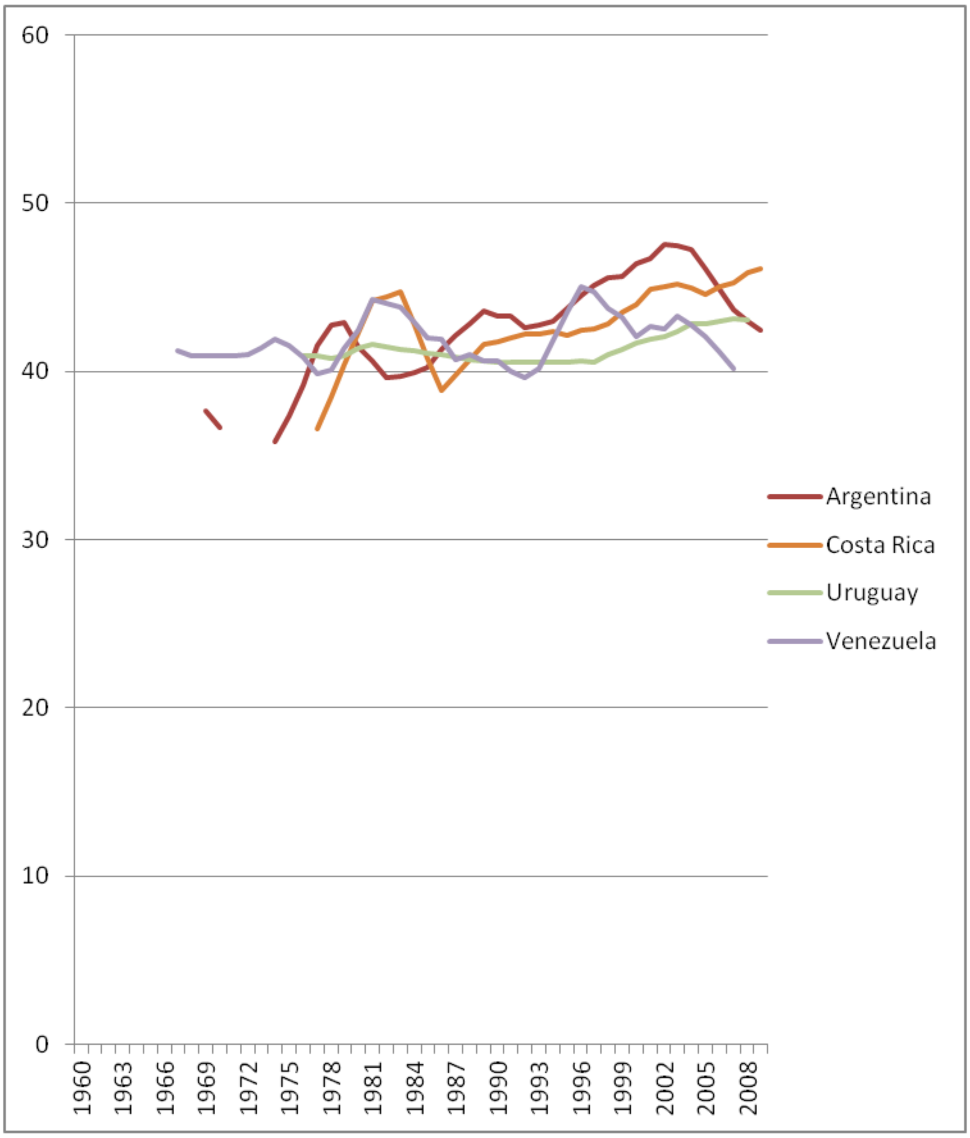
The level of inequality in the modern world has been gradually increasing (Milanovic 1999; Kenworthy and Pontusson 2005; Brandolini and Smeeding 2008). This is a universal trend affecting developed and developing countries alike. Concomitantly with this global trend, there is a growing interest towards the study of inequality across all academic fields, and scholars have developed a continued interest in exploring possible determinants to explain the variation of inequality in advanced countries.

The causes and consequences of inequality have always been a major area of interest for social scientists, regardless of their specialization as political scientists, sociologists, or economists. But inequality research has primarily focused on inequalities within advanced countries, one of the reasons being the relative shortage of reliable comparable data for developing and underdeveloped countries alike. However, recent scholarly efforts to increase the comparability of the measurement of inequality have contributed to the vigorous development of comparative inequality studies.

Thanks to this development, the dependent variable this thesis uses is Gini coefficients collected from 'Standardized World Income Inequality Database (SWIID)'(Solt 2016). By adopting a custom missing-data algorithm based on the data from WIID (World Income Inequality Database), the SWIID produces reliable and comparable Gini indices (Ibid., 1). This data set has many strong points such as its extensive data coverage from 1960 and the maximized comparability. One limitation we must note, however, is that the standard error of the Gini coefficient of Latin America is twice greater than that of Asia; this is because of the relative insufficiency of data collected in Latin America. Moreover, considering the fact that some Latin American countries had started industrialisation in the early 1920s ~ 1940s, the dataset used in this project does not cover such periods; hence this is another limitation of my research.

With regards to the measurement of inequality, the Gini coefficient would be a better measurement to estimate the income inequality of developing countries. Generally, scholars conducting research in advanced countries use the 90/10 ratio or the Gini coefficient as a measure of inequality, and the correlation between the two is extremely high: over 0.9, thus there is hardly any difference between the two. However, if we want to examine income inequality in developing countries, it would be better to use the Gini index instead of the 90/10 ratio. The Gini coefficient is calculated based on household incomes whereas the 90/10 ratio is based on the income of full-time workers. Since the size of informal employment in developing countries is huge, in order to capture the real inequality level in developing countries, it would be better to use the Gini coefficient. Based on the above observations and the acquired data, I briefly look at the trend of inequality in Latin America and East Asia.

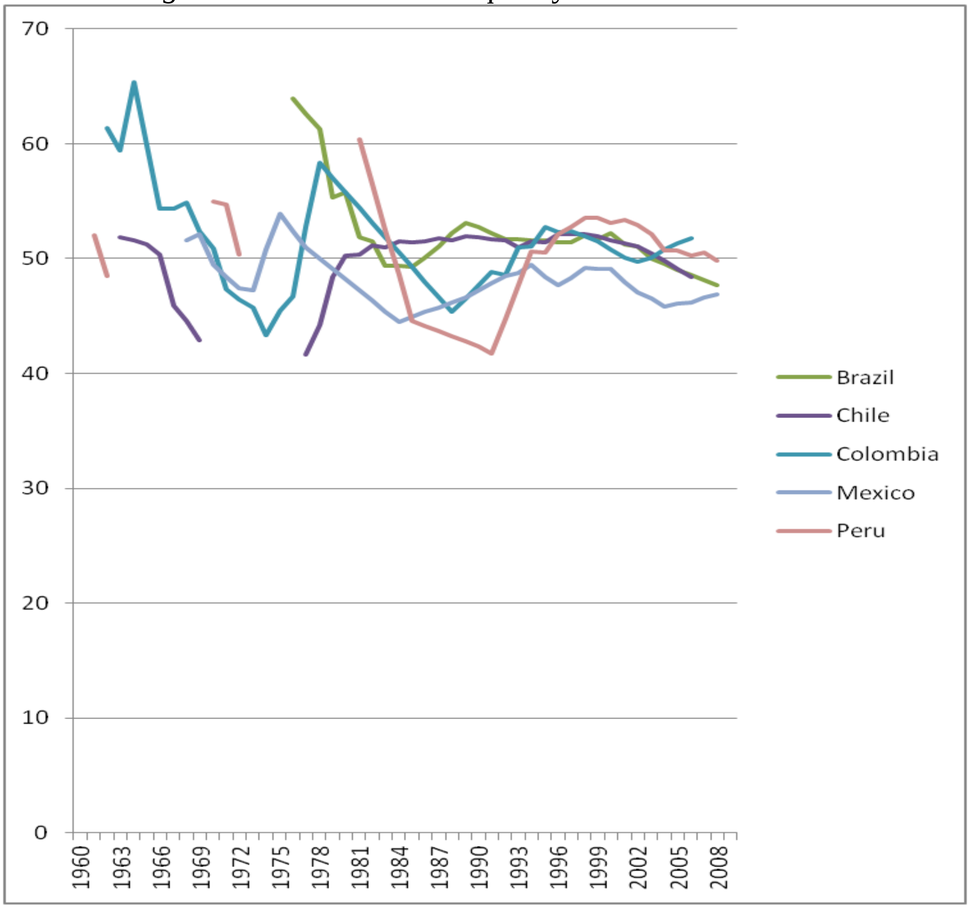
Figure 1. The Trend in Inequality in Latin America: I



(Y-axis: Gini coefficient, X-axis: time)

Figure 1 illustrates the trend of inequality in Argentina, Costa Rica, Uruguay, and Venezuela. The first four Latin American countries show the most stable pattern of inequality in Latin America. In particular, Uruguay, which is known as the most 'equal' country in Latin America, shows a nearly balanced pattern. The average Gini coefficient of Uruguay, until the most recent years, is maintained at 41.07. In a combined comparison among Latin American and Asian countries, as we shall see in *Table 1*, Uruguay has the 7th lowest average Gini coefficient among 18 countries.

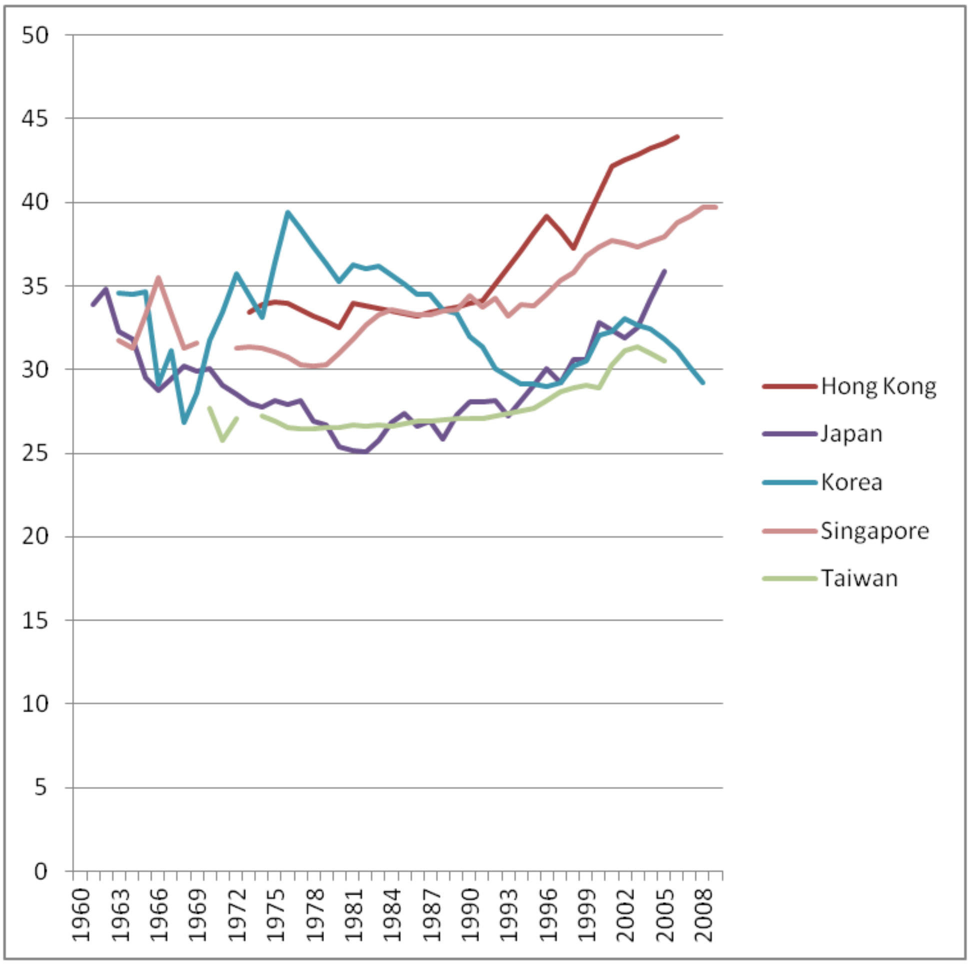
Figure 2. The Trend in Inequality in Latin America: II



(Y-axis: Gini coefficient, X-axis: time)

Figure 2 illustrates the trend of inequality of the remaining five countries in Latin America. Despite severe fluctuations, the more recent overall trend shows a relatively stable pattern. But the average Gini Coefficient of these countries is above 50, showing the most unequal distribution of income in the world.

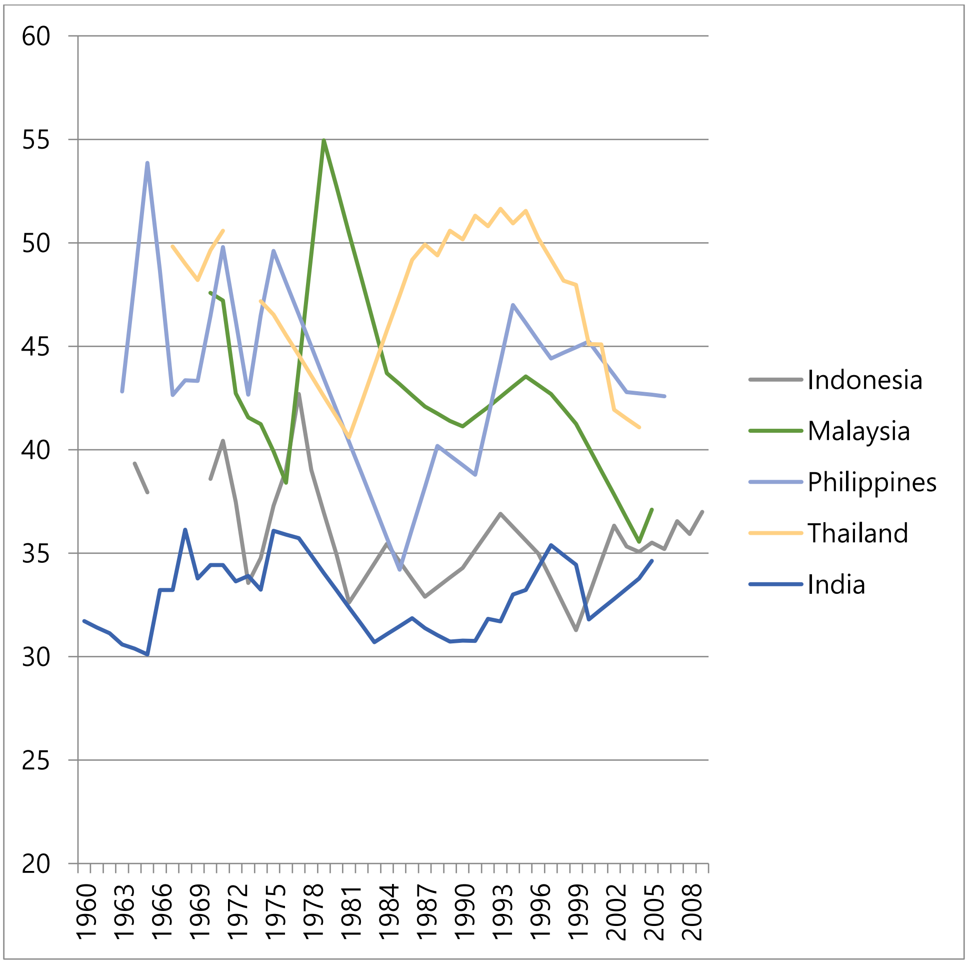
Figure 3. The Trend in Inequality in East Asia: I



(Y-axis: Gini coefficient, X-axis: time)

Figure 3 depicts the trend of inequality of the most advanced countries in East Asia. One of the most noticeable aspects is the highly compressed inequality of the 1960s. Contrasting these countries with the former Latin American countries, we observe a significant difference between the two groups. The average inequality of these East Asian countries is approximately 30 before 1997, but with 1997 as the starting point of the Asian financial crisis, all four countries experienced an increase in inequality. It is said that the rising inequality of Singapore and Hong Kong is due to the recent development of higher sector dualism. In the case of Hong Kong, the increasing Chinese population after the transfer of sovereignty is known as one of the reasons for the rising inequality.

Figure 4. The trend in Inequality in East Asia: II



(Y-axis: Gini coefficient, X-axis: time)

Lastly, *Figure 4* displays the trends of inequality of the five Southeast Asian countries. These countries show a more severe pattern of fluctuations than the East Asian countries. One thing we need to note is that the countries either had maintained traditional agricultural system until the 1980s or adopted inward-looking industrialisation and maintained it until the 1980s, normally before globalisation, and they have adopted export-oriented outward-looking industrialisation after that. This is the major difference from the previous countries who adopted export-oriented industrialisation nearly from the beginning. The average inequality of Indonesia, Malaysia, Thailand, India, and Philippines is approximately 40, and recent trends show a more compressed pattern of inequality among the countries. One interesting point is that, despite the 1997 economic crisis, the four countries' level of inequality actually decreased. India, which had adopted import substitution industrialisation (ISI) after independence and maintained it until the 1980s, shows a relatively stable and lower level of inequality than the other countries.

Table 1. Income Inequality during the 1960s to 2000s

		1960s	1970s	1980s	1990s	2000s	Average
Latin American countries	Argentina	37.96	39.57	41.35	44.27	45.47	42.18
	Brazil	40.19	57.40	51.06	51.76	49.41	51.51
	Chile	48.35	43.38	51.40	51.72	50.03	49.65
	Colombia	56.98	49.89	49.34	51.13	50.63	51.56
	Costa Rica	42.46	41.41	41.97	42.63	45.23	42.87
	Mexico	51.71	49.85	45.96	48.65	46.64	48.20
	Peru	51.84	52.53	47.88	50.04	51.32	50.01
	Uruguay	31.84	40.99	41.05	40.80	42.65	41.07
	Venezuela	41.50	41.14	42.19	42.41	42.09	41.88
	Average	44.76	46.24	45.8	47.05	47.05	46.55
East Asian countries	Hong Kong	39.57	33.48	33.62	37.48	43.03	36.48
	Japan	31.08	27.65	26.50	29.39	33.38	29.18
	Korea (south)	31.39	35.99	34.72	30.02	31.59	32.85
	Singapore	32.57	30.84	33.28	34.88	38.39	34.06
	Taiwan	33.58	26.61	26.84	28.07	30.84	28.35
	Average	33.64	30.91	30.99	31.97	35.45	32.18
Southeast Asian Countries	Indonesia	38.62	37.61	33.88	34.55	35.72	35.66
	Malaysia	46.15	45.20	44.04	42.19	37.23	43.13
	Philippines	46.15	45.97	38.00	44.22	43.13	43.47
	Thailand	48.62	45.26	46.94	49.69	42.40	47.06
	India	32.17	34.62	31.53	33.03	33.10	32.90
	Average	42.34	41.73	38.88	40.74	38.32	40.44

Table 1 briefly illustrates the trends in inequality from the 1960s to the 2000s and compares the level of inequality of each region. This is a rough classification based on regions; however, the type of industrialisation each region had adopted were very similar. Latin American countries had adopted import-substitution industrialisation from the 1920s~1940s, and East Asian countries had chosen export-oriented industrialisation from approximately the 1950s ~ 1970s (South Korea and Taiwan). And Southeast Asian countries had either maintained

agricultural tradition or adopted import-substitution industrialisation from around the 1960s, but then moved to export-oriented orientations after the 1980s. One of the most distinguishable patterns based on this table is that the average Gini coefficient of inward-looking Latin American countries is much higher than the remaining East Asian and Southeast Asian countries, and the cross-country differences in inequality within the East Asian countries is very little. And the levels of inequality in Southeast Asian countries are located in the middle in between the two regions.

Trends and patterns of inward-looking industrialisation

To understand the trend and pattern of inward-looking industrialisation and outward-looking industrialisation in both regions, I provide several graphs illustrating the trends. With regards to the measurement of the trend of inwardness, I used the numerically transformed measurement of ISI following Wibbels and Ahlquist (2007). ISI is measured as the difference between total manufacturing production (% of GDP, value added) and manufacturing export (% of GDP). This measurement describes *the amount of manufacturing products consumed in domestic market*, thus it can capture the strength of inwardness.

There is no single agreed-upon method in measuring ISI. A classic approach by economists can be found in Chenery (1960, 639-44) and Morley and Smith (1970). For them, import substitution occurs "with a decline in the ratio of import to total supply". However, the decline of imports can also occur just because of the changes of price of imported goods or changes in exchange rate, thus it is less accurate to measure the trend of inwardness. In addition, this measurement cannot capture the tendency of EOI which we regard as a discrete choice of ISI. One of the major problems we encounter is that it is not easy to capture a country's 'will' to intentionally grow the size of domestic market (ISI) or export market (EOI). Data on government subsidies for export market/domestic market would be useful, but the lack of available data set does not allow us to consider this. The measurement of ISI by Wibbels and Ahlquist (2007, 2011) is the best available measurement at this moment, but several limitations need to be noted. Firstly, differences in technical skills between countries can influence the level of domestic consumption of domestic manufactured goods. If the manufacturing sector of a country has relatively higher competitiveness and technological skills than other countries, the size of the domestic manufacturing industry is likely to expand. The preference for buying domestically manufactured goods may not be due to intentional inward-looking policies. The current measurement cannot distinguish the differences of domestic market size based on the differences of technological skills or competitiveness of countries. It is necessary to control this impact by adopting some dummy variables that capture the different technological skills of countries. Secondly, the current measurement of ISI reveals some limitations to capture the government's intentional efforts on pursuing inwardness or outwardness. Historical data on tariff levels or government subsidies for export can be good proxies to capture the tendency of ISI and inwardness, but the data availability is extremely limited. Looking for an additional proxy or an alternative measurement would be a future challenge of this thesis.

Before discussing the impact of inwardness, it is worth noting a specificity of this data. The World Bank data on the total manufacturing production (% of GDP) is provided as a form of total value added[39]. As the manufacturing export is calculated as the total output (nominal % of GDP, not a form of value added), the difference between total manufacturing production and manufacturing export sometimes makes negative values. World Bank does not provide the data on manufacturing export as a form of value added or gross manufacturing output, thus, in

[39] Manufacturing refers to industries belonging to ISIC divisions 15-37. Value added is the net output of a sector after adding up all outputs and subtracting intermediate inputs. It is calculated without making deductions for depreciation of fabricated assets or depletion and degradation of natural resources. The origin of value added is determined by the International Standard Industrial Classification (ISIC), revision 3. (World Bank 2013)

some countries especially for export-led countries focusing on intermediary trade (i.e. Hong Kong[40]), negative values are observed.[41] As every country is based on the same data source to measure the size of ISI, there is no comparability problem[42].

Figure 5 describes the trend of the major four import-substitution countries in Latin America. Higher values represent the tendency of ISI and lower values stand for the propensity of EOI.

[40] Hong Kong is well-known for its intermediary trade between Asian and Western countries as well as its high value-added pharmaceutical industry, thus it shows very high levels of manufacturing imports as well as manufacturing exports.
[41] Data source is World Development Indicators (World Bank 2013)
[42] Wibbels and Ahlquist (2007) also mentioned the same problems of their data set.

Figure 5. The Trend in Inwardness in Latin America

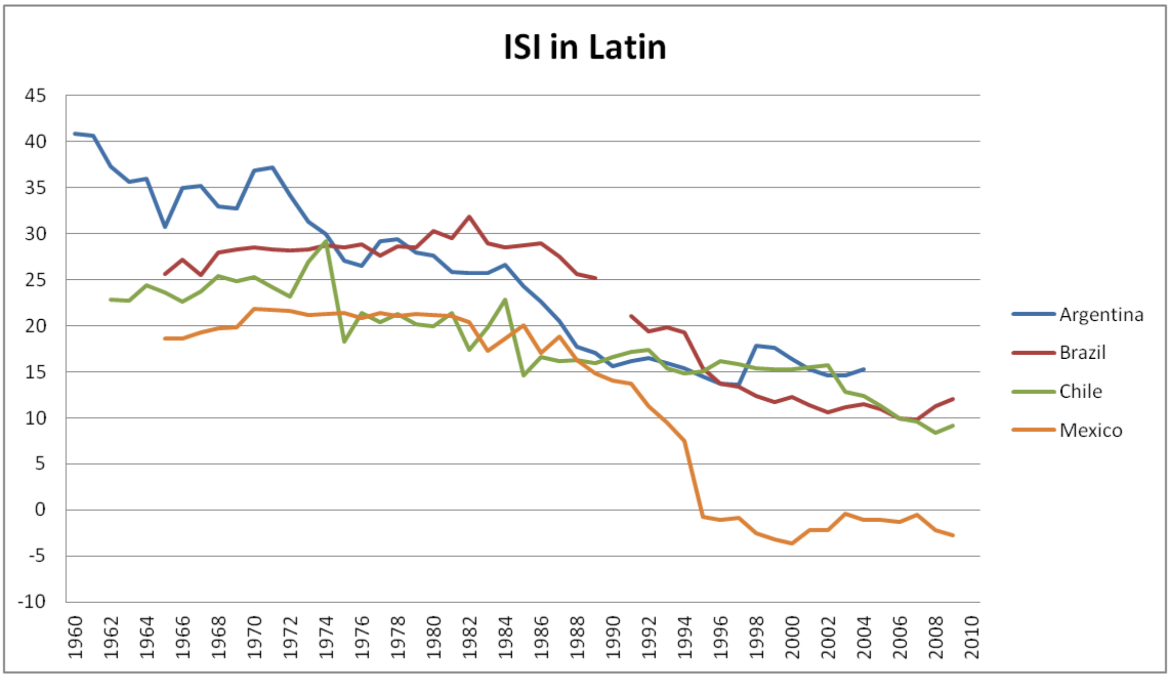


Figure 5 clearly illustrates the decreasing trend of ISI since the debt crisis of 1982 in Latin America. Before 1970, the amount of manufacturing consumption in the domestic market comprises of approximately 20% to 40% of the GDP. However, the most recent observations show that the domestic consumption of manufacturing products has decreased below 15%.

Figure 6. The Trend in Inwardness in East Asia

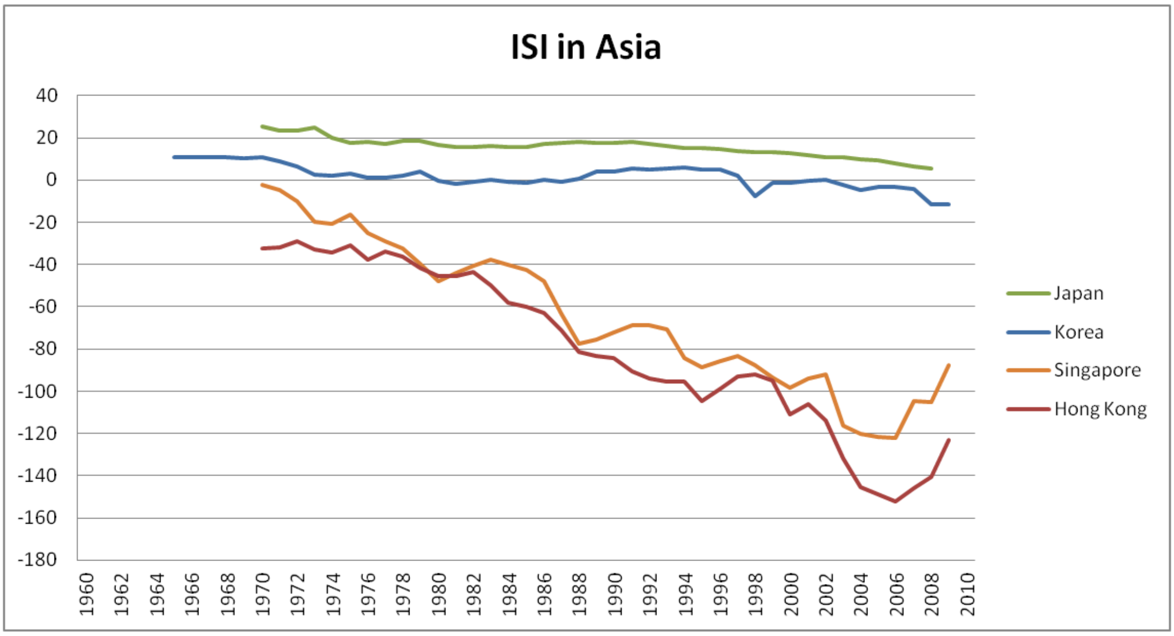


Figure 6 illustrates the trends of inwardness of the major four[43] export-led countries in East Asia. The trends here are markedly different from those observed in Latin America. Before taking a closer look at the chart, it is worth pointing out the lower ISI values in y-axis. Although the data of the 1960s are insufficient for some countries, it is clear that the average values of ISI are much lower than that of the aforementioned Latin American countries. Japan and South Korea have not shown significant changes since the 1960s. In Singapore, a slight increase is observed after 2006. Hong Kong, which is famous for its high tech pharmaceutical industry and intermediary trade, shows the lowest trend in inwardness. The negative value would reflect the higher productivity of added value of the manufactured goods.

[43] Unfortunately, World Bank does not provide data on Taiwan. The data will be updated from alternative data sources.

Figure 7. The Trend of Inwardness in Southeast Asia

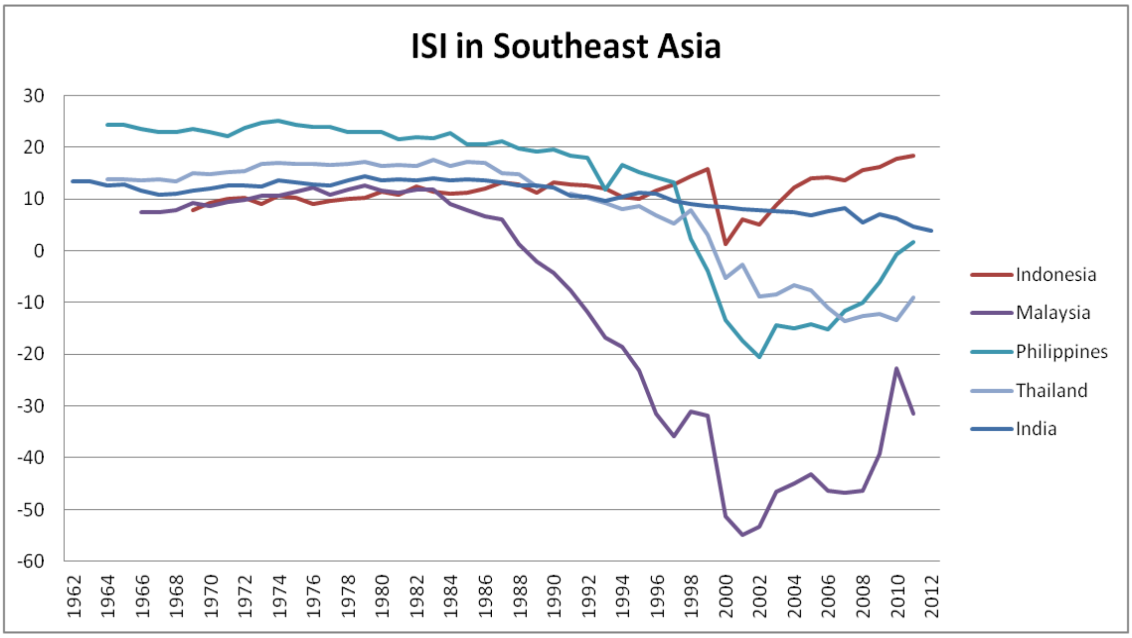


Figure 7 shows the trend of ISI in Southeast Asian countries. The level of inwardness of these five Southeast Asian countries is in between East Asian countries and Latin American countries. Although their starting points of export-oriented industrialisation are quite different to each other, Malaysia, Philippines, and Thailand show a rapid decrease of the ISI in the early 1990s. Particularly, in the early 1980s, we can see that India had suddenly moved to the export-led orientations. However, in the early 2000s, the five countries showed a pattern of increasing inwardness.

Table 2. The Overall Trend in Inwardness (protectionist tendency)

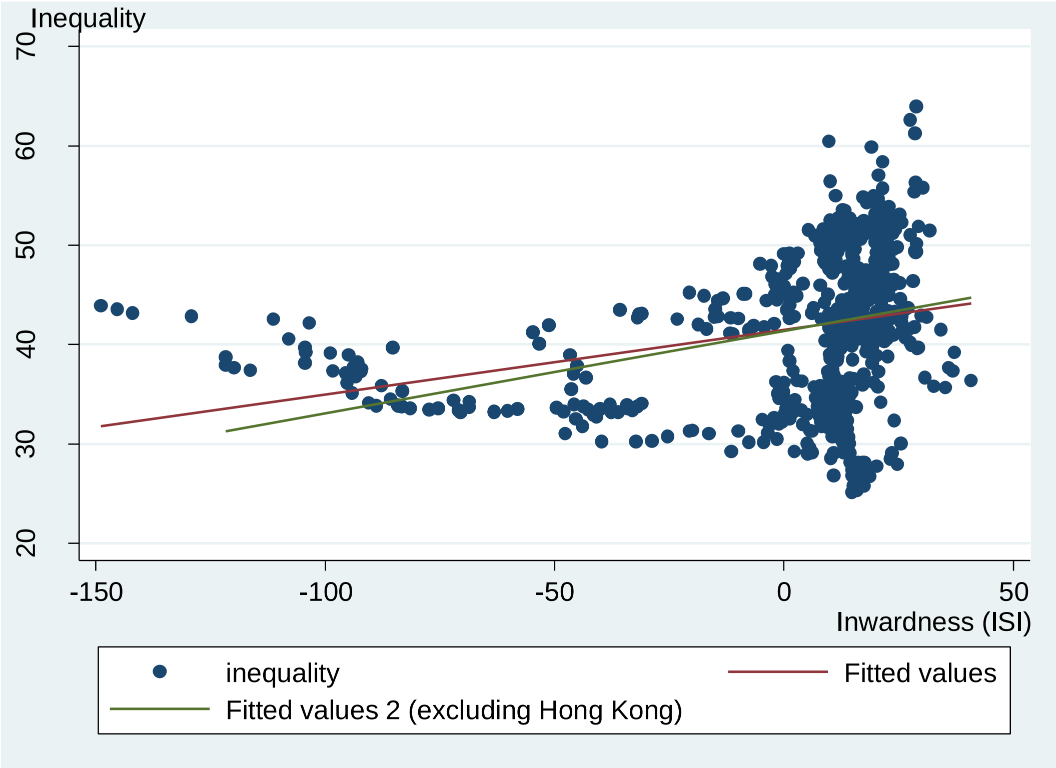
	Argentina	Brazil	Chile	Colombia	Costa R	Mexico	Peru	Uruguay	Venezuela
Avg	25.2	21.8	18.3	16.3	11.2	11.7	17.1	15.4	14.9
60s	36.9	27.2	23.9	18.5	13.6	19.7	17.9	.	15.3
70s	33.2	28.6	22.5	20.9	13.9	21.3	20.5	.	15.8
80s	26.9	28.3	17.8	19.4	17.4	17.8	22.2	21.0	15.6
90s	17.2	15.8	15.8	12.8	10.6	3.0	14.8	14.9	13.9
00s	15.4	11.0	11.6	10.3	0.5	-1.5	12.5	10.8	13.9
	Hong Kong	Indonesia	Japan	Korea	Malaysia	Philippines	Singapore	India	Thailand
Avg	-80.09	11.4	14.0	1.8	-11.4	12.1	-72.1	10.87	7.8
60s	.	9.3	.	10.7	8.6	23.4	.	12.22	14.3
70s	-34.07	10.3	16.7	3.1	11.5	23.5	-31.7	13.01	16.7
80s	-60.13	12.2	16.7	0.3	1.7	20.1	-54.1	13.42	14.6
90s	-94.29	9.9	14.9	2.5	-34.8	1.8	-82.9	10.29	3.2
00s	-131.89	14.5	9.1	-4.5	-40.9	-9.5	-107.0	6.87	-10.5

In sum, *Table 2* presents the trend in ISI of all countries. We can observe a steep decrease in ISI values in Latin American countries and significantly lower values of ISI across the board in Asian countries. Also, newly developing countries such as India, Indonesia, Philippines, and Thailand show clear trends of EOI after the late 1990s.

The Relationship between Protectionism and Inequality

Figure 8 briefly shows the relationship between economic inwardness and inequality.

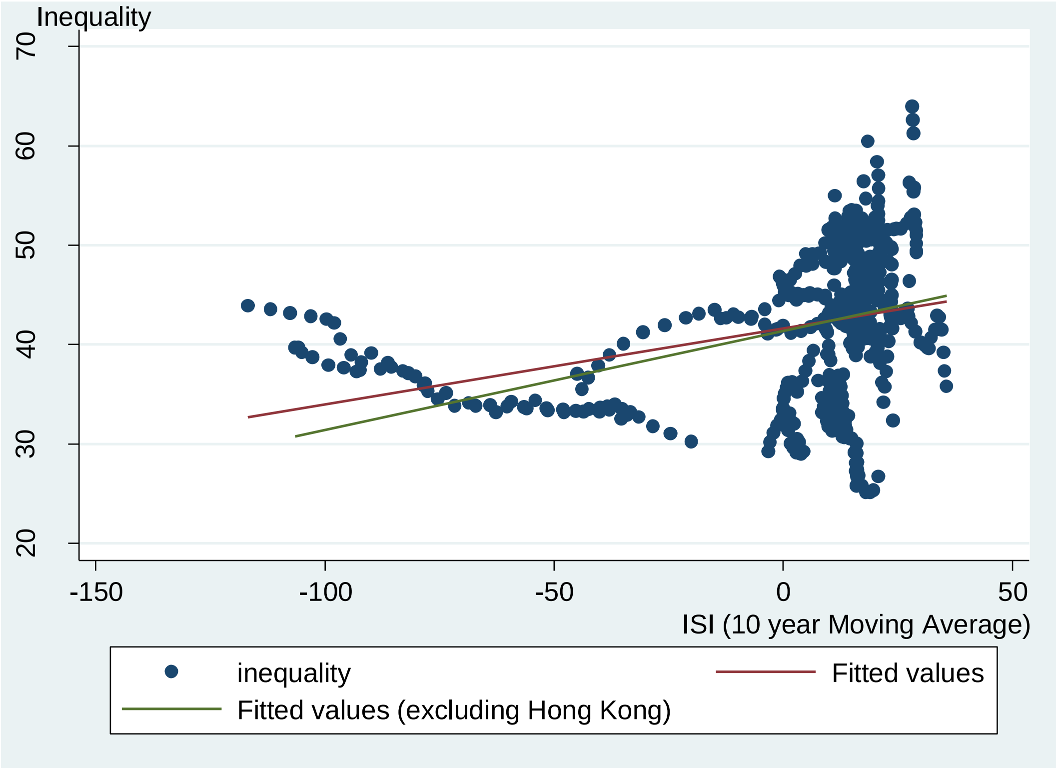
Figure 8. The Relationship between Protectionism and Inequality: every country



(*Based on every year observation)

This is based on every year observations (from 1960~2013), and it shows a positive relationship between inwardness and higher inequality. Even after excluding outliers in the left side (mostly Hong Kong), this relationship clearly remains. The correlation between the two variables is 0.269. Although our major concern is to see the longitudinal relationship of this trend, it is not easily represented with a simple x-y axis graph. Instead, *Figure 9* provides an alternative graph by calculating a moving average of protectionism.

Figure 9. The relationship between Protectionism (moving average) and Inequality



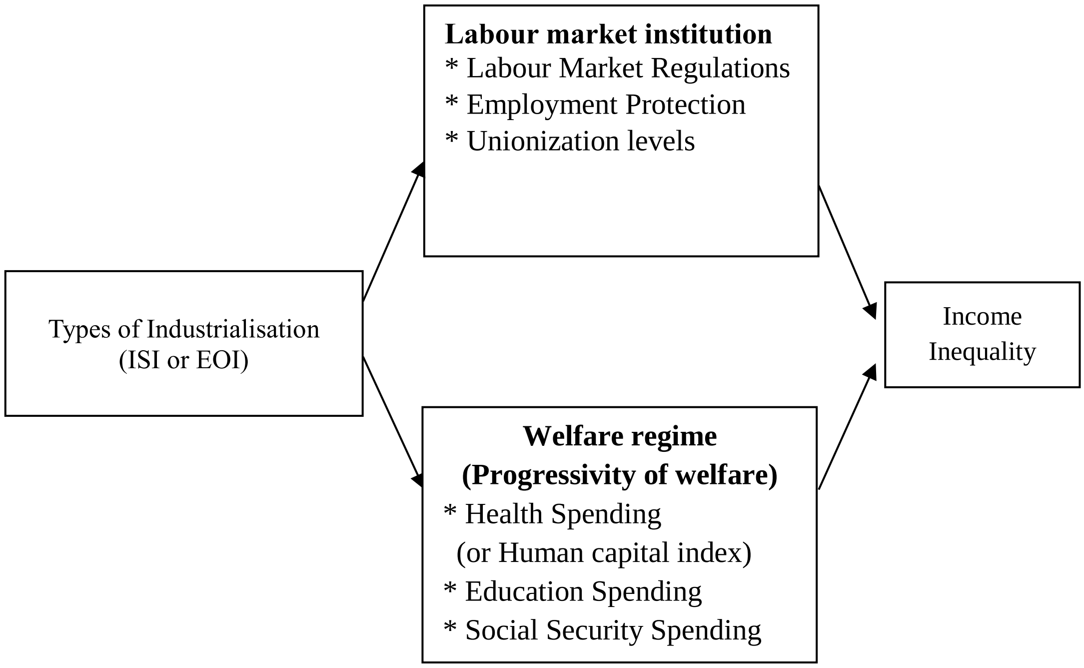
After applying the moving average of ISI, a clear positive relationship between ISI and levels of inequality is observed.

5.3 Time-series Cross-Sectional Analysis

In the previous chapter, I argued that a country's choice of inward-looking or outward-looking industrialisation leads to different characteristics of labour market institutions and welfare regimes. I have equally suggested that the effect of labour market institutions and welfare policies on inequality varies substantially across Latin America and in East Asia.

In this chapter, I empirically test my theoretical argument, focusing on the impact of labour market institutions and welfare programs on the levels of inequality across sixteen major East Asian and Latin American countries from 1960 to 2005. The aim of this longitudinal analysis is to confirm the impact of protectionism/openness on inequality via labour market institutions and welfare policies, as argued in previous chapter. This chapter's analytical procedure is illustrated in *Figure 10* below.

Figure 10. Explanatory Variables and Inequality



Data and Methods

Sample Selection

The countries included in the study are: Argentina, Brazil, Chile, Costa Rica, Colombia, Mexico, Uruguay, and Venezuela in Latin America and Hong Kong, South Korea, Singapore, Taiwan[44], Japan[45], Philippines, Thailand, Malaysia, and Indonesia in East Asia. These countries were selected based on the availability of data on the major independent variables tested in this research, enabling us to build an unbalanced pooled time cross-sectional dataset

44 Major international organizations such as OECE and IMF do not provide data on Taiwan because of sovereignty issue. The data are supplemented with additional sources.

45 Japan is not a middle-income country, but it is known as a typical model of EOI; Thus, I included Japan in my analysis.

spanning from 1960 to 2005. The relatively wide time span allows us to capture the periods of protectionism and export-orientations, normally before the 2000s.

Yet, the pooled dataset presents several limitations that need to be discussed before embarking on the main body of the analysis. *First*, most countries included in this research are not major OECD countries and therefore information on the major economic indicators employed here is not fully available through the statistical services of major institutions such as the IMF, the World Bank, and the OECD. For this reason, I choose to supplement my dataset with available data from third-party institutions and region-specific books and articles. To enhance consistency and to ensure comparability, I double-check all the statistical information acquired through third-party institutions. *Second*, although it would be ideal to cover earlier time periods because most Latin American countries adopted ISI before the 1960s (normally during the 1920s ~1940s), comparable statistical information is mainly available after 1980. This is mainly due to the lack of official statistics in earlier periods. This issue is dealt with various ways including a qualitative case study covering before the 1960s. *Third*, the collected data observations are neither well-balanced nor evenly distributed across the time period. Unfortunately, the number of observations of the 1960s and 1970s is smaller than that of the 1990s and 2000s, while the data coverage is limited for some periods for the Latin American countries which adopted ISI before 1970s. Therefore, because of data availability some countries are better represented than others.

Methodology and Analytic Models

To test my argument in a more rigorous empirical way, the statistical test needs to account for the multi-causal relations implied in the argument as a whole. More specifically, the analysis needs to i) test for the relationship between protectionist industrialisation strategy and labour market institutions/welfare policies and ii) account for the influence of those labour market institutions and welfare policies on inequality.

One way of testing for the multi-stage relationship implied here is by using mediation models, either with the help of causal mediation analysis (Imai, Keele, Tingley 2010) or with structural equations. However, there are many limitations in the use of these methods to the current setting of my thesis. To begin with, meditation analysis is designed to test cross-sectional data, not time-series dataset. Second, the unbalanced dataset in my disposal does not allow us to adopt ideal methodologies because of missing data and time gaps, while third, structural equation modelling is not an appropriate strategy for pooled-time cross sectional datasets. This is because of the problems caused by omitted variables, autocorrelation, heteroskedasticity. For these reasons, I test my hypothesis using a PCSE analysis, by including a conditional term of ISI (the degree/levels of inward-looking industrialisation/protectionism), to see the conditional and indirect impact of ISI on inequality.

The use of pooled time-series cross section analysis has been highlighted in recent studies (Beck and Katz 1995, Federico 2000) and several major advantages associated with this approach have been reported. Pooling cross sectional and time-series data increases the number of observations and it allows us to include more independent variables and to test more complex causal models, even with the ones with limited variances of observation. However, the pooled time-series analysis inherently contains several major limitations, such as autocorrelation, heteroskedasticity, and contemporaneous correlations. It is therefore important to check whether the analytic model employed here presents any of these limitations. The statistical model employed in this analysis is chosen after a series of diagnostic tests is run. These include the Breusch and Pagan's Lagrange Multiplier test, the Hausman test, and the modified Wald test[46]. Based on these processes and test results, I use panel-corrected standard error (PCSE) estimates with the options of panel-specific AR(1)[47] where the parameters are estimated by Prais-Winsten regression. When computing the standard errors and the variance-covariance estimates, PCSE assumes that the disturbances are heteroskedastic and contemporaneously correlated across panels.

Based on this method, the association between the institutions and policies and the levels of inequality is empirically tested below. The baseline analytical models are the following:

$$(1) \quad \mathrm{Y_{it}} = \alpha_\mathrm{i} + \sum_\mathrm{k} \beta_\mathrm{k} \mathrm{X_{kit-1}} + \sum_\mathrm{k} \mathrm{j_k}\,\mathrm{country} + \sum_\mathrm{k} \mathrm{g_k}\,\mathrm{year} + \varepsilon_\mathrm{it}$$

$$(2) \quad \mathrm{Y_{it}} = \mathrm{c_i} + \sum_\mathrm{k} \mathrm{r_k} \mathrm{X_{kit-1}} + \sum_\mathrm{k} \mathrm{j_k}\,\mathrm{country} + \sum_\mathrm{k} \mathrm{g_k}\,\mathrm{year} + \varepsilon_\mathrm{it}$$

$$(*\ comparison\ between\ ISI\ and\ EOI\ countries)$$

$$(3) \quad \mathrm{Y_{it}} = \mathrm{d_i} + \sum_\mathrm{k} \mathrm{l_k} \mathrm{X_{kit-1}} + \sum_\mathrm{k} \mathrm{m_k} \mathrm{X_{kit-1}} * \mathbf{ISI}(\mathbf{inwardness}) + \sum_\mathrm{k} \mathrm{j_k}\,\mathrm{country} + \sum_\mathrm{k} \mathrm{g_k}\,\mathrm{year} + \varepsilon_\mathrm{it}$$

where Y[48] is the dependent variable (the Gini net (post tax and transfer)) and X is the independent variable (labour market institutions, welfare programs, and control variables). All

[46] To briefly explain the process of the model specification, at first, I run the Breusch and Pagan's Lagrange Multiplier (LM) test for the random effects. The null hypothesis is rejected at the 0.05 level, and the Hausman test is used to decide whether to use a fixed effect or random effect model. In most cases I can reject the null hypothesis that the difference in coefficients not systematic, thus a fixed effect model is chosen. To check whether there are any issues of auto-correlations, contemporaneous correlation (cross-sectional correlation), heteroskedasticity, I run a modified Wald test for checking groupwise heteroskedasticity in fixed effect regression model, Pantest2 for serial correlation in residuals (The null hypothesis that rho=0 if residuals are AR(1) is rejected), Modified Wald test (The null hypothesis that sigma(i)^2 = sigma^2 for all I is rejected), and the Breusch-Pagan LM test for a cross-sectional correlation in a fixed effects model.

[47] This approach is different from simply applying the practice of using a lagged dependent to correct for serial autocorrelation. For more detailed argument, see Achen (2000).

[48] Since there are many independent variables that have negative values, I do not apply a natural logarithmic transformation into the dependent and independent variables. (This is just a technical decision). Thus, the interpretation of coefficient is simply 'A one-unit change in independent variable would lead to the b (coefficient) amount of change in dependent variable.'

independent variables are one-year lagged. i refers to a country, t is time, and k is the number of independent variables. α_i, b_i, c_i refer to the intercepts for each country, β and l refer to the slopes of the independent variables, r and m refers to the slopes of the conditional impact of ISI countries and Inwardness (ISI), and ε_{it} is a random error term. In addition, several control variables such as GDP growth and GDP per capita are included to control for the difference of economic conditions across countries. I further add country and year dummies to control for the country specific and year specific effects.

The first model tests the direct impact of labour market institutions and welfare regime on inequality. And the second model additionally examines the impact of labour market institutions and welfare regime on inequality by dividing countries into two groups: ISI countries and EOI countries. As argued in previous chapters, it is expected that the determinants of inequality of the two regions differ significantly because of the dissimilar characteristics of labour market institutions and welfare regimes developed in the two regions. The division would allow us to see how distinct the two groups are. The third model then looks at the conditional effect of inwardness (protectionism) on inequality. This is a test to confirm the indirect influence of protectionism on inequality via labour market institutions and welfare policies.

Measurement and Variables of Interest

Measurement of Inward-looking trade policy orientations

With regards to the measurement of inward-looking industrialisation -the degree of protectionist trade policy orientations-, three different measurements are used to ensure a rigorous test. They are i) ISI (Wibbels and Ahlquist 2011) ii) the Hiscox-Kastner index of trade protectionism and iii) trade openness. Since there is no single agreed-upon method[49] in measuring inward-looking industrialisation and trade policy orientations/distortions, it would be beneficial to report results by applying various measurements of inward-looking protectionist orientations. Conventional approach measures trade protection by examining the level of openness (sum of import and export), trade flows adjusted for country-characteristics, tariffs or non-tariff barriers, or measures based on price outcomes such as real exchange rate. As these are mostly outcome-based measures; they do not directly capture a country's *purposeful intent* to increase the level of trade protection or export orientations. Historical data on tariff levels or government subsidies for export can be good proxies to capture the tendency of ISI and inwardness, but the availability and comparability of relevant datasets for developing countries are extremely limited. (Partial data on this are reported in case study sections.)

Keeping these limitations in mind, and following Wibbels and Ahlquist (2007), I start by using the numerically transformed measurement of ISI. ISI is measured as the difference between total manufacturing production (% of GDP, value added) and manufacturing export (% of GDP). This measurement describes the amount of manufacturing products consumed in a domestic market, thus it captures the strength of inward-looking orientations of a country that substitute imported manufacturing goods into domestically produced ones. Despite its simple calculation method and higher data availability and comparability, several limitations need to be noted. Firstly, differences in the level of technology among countries can influence the demand of domestically manufactured goods. If a manufacturing sector of a country has relatively higher competitiveness and advanced technological skills than other countries, the

[49] A classic approach by economists can be found in Chenery (1960, 639~44) and Morley and Smith (1970). For them, import substitution occurs "with a decline in the ratio of import to total supply". However, the decline of imports can also occur just because of the changes of price of imported goods or changes in exchange rate, thus it is less accurate to measure the trend of inwardness. This measurement cannot also capture the tendency of EOI which we regard as a discrete choice of ISI.

size of the domestic manufacturing industry is likely to expand and the demand for domestic goods naturally increases. This means that the preference for buying domestically manufactured goods may not be up to intentional inward-looking policies. For instance, Japan shows a relatively higher level of ISI compared to other East Asian Countries[50], but the country is actually known as a typical example of export-oriented country. Secondly, before discussing the impact of inwardness on inequality, it is worth noting a specificity of this index. The World Bank data on the total manufacturing production (% of GDP) is provided as a form of total value added. As the manufacturing export is calculated as the total output (nominal % of GDP, not a form of value added), the difference between total manufacturing production and manufacturing export sometimes makes negative values. World Bank does not provide the data on manufacturing export as a form of value added or gross manufacturing output, thus, in some countries especially for export-led countries focusing on intermediary trade (i.e. Hong Kong), negative values of ISI are observed. As every country is based on the same data source to measure the size of ISI, there is no comparability problem. However, since the value added is affected by the kinds of goods (high tech product produces much higher profits), there still remains limitations of comparability.

As a second index of inward-looking orientations, the Hiscox-Kastner index for trade policy orientations is used. This is a cross-national measure of trade policy orientations by using gravity model between 1960 and 2000 (Hiscox and Kastner 2008). It provides a reliable alternative approach to existing methods for simply estimating levels of trade openness. Unfortunately, the data does not cover every country in my sample, thus the empirical analysis of Hong Kong, Singapore, Taiwan, and Malaysia cannot be done.

[50] During 1960~2010, the mean score of ISI in Japan is 15.68, which is much greater than other major East Asian countries (Singapore -64.51, Hong Kong -80.64, South Korea 1.84). Generally speaking, advanced countries have approximately 10~20 mean scores for ISI.

Lastly, because of data availability issues, the traditional measurement of trade openness (the sum of import and export, % of GDP) is also used as a proxy for trade policy orientations. The correlation of the aforementioned three measurements ranges between 34% to 60%.

Variables for Measuring Labour market institutions & Progressivity of Welfare State

In order to measure the characteristics of labour market institutions and welfare spending regimes, the following variables are collected.

*I*n order to capture the characteristics of labour market, the following three variables are used: i) Labour market rigidity and Employment protection legislation Index (Campos and Nugent 2009) ii) labour market regulations (Fraser institute 2014) iii) Unionization (Union density). There is currently no agreed measurement to gauge labour market rigidity and employment protection; Existing works mostly investigate historical changes of labour law or analyze labour market survey. To increase accuracy, I use both type of measurements. *First*, the EPL index by Campos and Nugent is a *de jure* index developed based on Botero *et al*. (2004), and I use this as a proxy of the levels of 'Employment protection for the employed workers', in other words, the level of employment protection for insiders. Higher scores represent more protection for the employed workers, the insiders. It provides comparisons of labour laws across countries over time and covers every country in my sample from 1950 to 2004. (As it is expected that there would be a considerable gap between labour laws and the actual levels of (insider) labour protection, it needs to be supplemented by alternative data on employment protection in the future.) As a *second* measurement, an index of labour market regulations is used. This is extracted from Economic Freedom index by Fraser Institute, a labour market survey covering from 1970. The labour market regulation index is accumulated based on various types of labour regulations including minimum wage, hiring and firing regulations, collective bargaining, working hour regulations, cost of worker dismissal, etc. If labour market regulations are biased more towards labour market insiders and employed workers, they would relate to higher inequality. On the other hand, if labour market regulations are for protecting overall labour forces, then they would associate with less inequality. I previously argued that ISI develops protections exclusively for insiders: If this is true, the impact of labour market regulations would be negative (more inequality). Note that, the correlation between EPL index and Labour market regulations index is 0.6905. Lastly, union density is used as a proxy for reflecting the power of organized labour. Union density is measured as the ratio of wage earners that are trade union members, divided by the total number of salary earners. According to the power resources theory, the mobilization of labour and pro-labour left parties led to the expansion of the welfare state and decomodifying distribution of wealth (Esping-Andersen 1990; Korpi 1983). This argument suggests that the expansion of labour unions and labour movements will lead to more egalitarian redistribution of wealth. However, as argued in the previous chapter, this effect depends on the characteristics of the labour market: if labour unions mainly represent the interests of insiders, instead of outsiders and low wage earners, unions would relate to more inequality. By extension, the positive role of organized labour in reducing inequality would be highly limited in inward-looking economies. Considering the unequal protection between insiders and outsiders in the labour market and the fact that insiders of labour markets mainly constitute the core of unions and labour movements in Latin America (Haggard 1990), the expansion of labour unions and labour power may not increase equality in Latin America. I postulated in previous chapter that higher union density will not be related to the decrease of inequality in inward-looking economies. In doing so, my thesis puts forward a counter-argument that challenges the conventional theoretical expectation of the power resources theory.

In addition, in order to examine the impact of welfare regime (welfare spending programs) on inequality, in an attempt to measure the progressivity of the welfare state, I use i) Public education spending ii) Public health related spending and iii) Public social security spending (% of GDP). There are significant limitations in interpreting these variables as measures of welfare state progressivity as these spending variables lack information about the coverage or major beneficiaries. Given that the lack of comparable information limits empirical analysis, as an alternative way of testing my argument, I focus on the 'directions' of the coefficients in interpreting the impact of these variables on inequality. To be clear, I previously argued that, because of the regressive characteristics of welfare state in inward-looking economies, the ability of welfare spending in reducing inequality would be highly limited. (So, if the coefficient of education spending on inequality is positive (+) in Latin America, I would interpret this as an evidence showing the regressive characteristics of education spending in Latin America) As there are difficulties to directly measure the regressivity of welfare regime, because of lack of comparable dataset and lack of academic consensus, I also consider using some outcome-based measurements such as human capital index, based on years of schooling (Barro and Lee, 2012) and returns to education (Psacharopoulos 1994)[51].

The limitations of measurement issues discussed here are supplemented in the qualitative case study section of this thesis and it will allow us to capture the regressive/progressive characteristics of welfare regimes.

Dependent Variable

The dependent variable this thesis uses is the Gini coefficient collected from the Standardized World Income Inequality Database (SWIID) (Solt 2016). By adopting a custom missing-data algorithm based on the data from WIID (World Income Inequality Database), the SWIID

[51] For more information on the measurement of regressivity of welfare regimes, see Franzoni (2008). If a country has a higher human capital index, this can be interpreted as evidence showing the progressivity of the country's education policy.

produces reliable and comparable Gini indices (Ibid., 1). This data set has many strong points such as its extensive data coverage from 1960 and the maximized comparability. With regards to the measurement of inequality, the Gini coefficient would be a better measurement to estimate the income inequality of developing countries. Generally, scholars conducting research in advanced countries use the 90/10 ratio or the Gini coefficient as a measure of inequality, and the correlation between the two is extremely high: over 0.9, thus there is hardly any difference between the two. However, if we want to examine inequality in developing countries, it would be better to use the Gini index instead of the 90/10 ratio. The Gini coefficient is calculated based on household incomes whereas the 90/10 ratio is based on the income of full-time workers. Since the size of informal employment in developing countries is huge, in order to capture the real inequality level in developing countries, it would be better to use the Gini coefficient. One limitation we must note, however, is that the standard error of the Gini coefficient of Latin America is two times greater than that of Asia; this is because of the relative insufficiency of data collected in Latin America. Moreover, considering the fact that some Latin American countries had started industrialisation in the early 1920s ~ 1940s, the dataset used in this project does not cover such periods; hence this is another limitation of my research.

Control Variables

Two sets of control variables are included in the empirical analysis. The first includes political variables and the second includes economic variables. As political factors, I include i) democracy (dummy variable) and ii) the strength of democratic tradition. Plus, in order to control different economic conditions of countries, I include GDP per capita and GDP growth rate as control variables.

The relationship between political regime and inequality has not been tested in the context of advanced countries, because there is no variation in political regimes in most of advanced democracies. Thus, the scholastic interests on the relation between political regimes and inequality or welfare spending are mainly tested in less developed countries especially those amongst Latin America. There are several major studies which tested the relationship between democracy and the level of inequality; however, the findings are less coherent because they are dependent on time and space. As many scholars argued, there are several good reasons to expect that democracy is conducive to reduce inequality (Rueschemeyer 2015, Dahl 2006). By providing the rights to vote to the poor and the powerless, the underprivileged can get a chance to participate in the political decision-making process and, as a result, can increase their welfare (Huber et al. 2006, 949). However, many empirical studies on developing countries did not confirm this relationship quite clearly. The association between democracy and a greater redistribution of income and the provision of social insurance and services is less clear in East Asia.

In order to control the immediate impact of political regime on inequality, a dummy variable of democracy is used. The data is collected from Cheibub *et al.* (2010). In addition, as a measurement of democratic tradition and its strength, moving averages of 'polity II' score from Polity IV project for the previous 10 years from the observation year are used. This polity score is computed by subtracting the Autocracy score from the Democracy score, and the scale rages from 10 (strongly democratic) to -10 (strongly autocratic). Instead of the simple classification of regime type into democracy or non-democracy, the moving average score may represent the political reality more accurately (see Huber et al. 2006)

The details and expected directions of the coefficients are provided in *Tables* below.

Table 3: The Summary of the Expected Coefficient of Variables
(Dependent variable: net Gini (after tax and transfer))

Variables	Inward-looking Economies	Outward-looking Economies
Labour market institutions		
Employment Protection (EPL) (insider protection)	++	+
Labour market regulations	++	-
Union density	++	-/0
Welfare regimes		
Education spending	+/0	-
Health spending	+/0	-/0
Social Security spending	++	-/0

Table 4: The Summary of the Expected Coefficient of Variables: Interactions

Variables	**DV: net Gini** (after tax & transfer)
Interaction terms	
Inwardness* labour market institutions	
1.Inwardness*EPL (insider protection)	++
2. Inwardness*Labour market regulation	++
3. Inwardness*unionization	++
Inwardness*welfare spending variables	
1.Inwardness*Education spending	+
2.Inwardness*Health spending	+
3.Inwardness*Social Security spending	++

The conditional term between inwardness and labour market institutions/welfare regime will test and confirm the conditional effect of inward-looking orientation on inequality.

Results

Determinants of Inequality: base model

The overall PCSE regression result is described in *Table 5*. The result does not seem to support the conventional argument.

Table 5. The Determinants of Inequality: All Cases, every independent variable

	Model 1	*Model 2*	*Model 3*	*Model 4*
L.EPL	*4.186**** *(0.879)*		*6.292**** *(1.768)*	
L.Labour market regulations		*-0.127* *(0.345)*		*-0.613*** *(0.244)*
L.Union density	*-0.049* *(0.046)*	*-0.071* *(0.053)*	*-0.040* *(0.048)*	*-0.039* *(0.054)*
L.Education spending	*-0.175* *(0.166)*	*-0.850**** *(0.274)*		
L.Human capital index			*0.915* *(3.227)*	*-6.385**** *(1.777)*
L.Health spending	*0.265* *(0.165)*	*1.426**** *(0.325)*	*0.331*** *(0.168)*	*1.303**** *(0.322)*
L.Social security spending	*0.221**** *(0.061)*	*0.665**** *(0.145)*	*0.128** *(0.066)*	*0.462**** *(0.098)*
L.Unemployment	*-0.012* *(0.076)*	*0.022* *(0.113)*	*0.011* *(0.080)*	*0.028* *(0.103)*
L.GDP_per cap	*-0.000*** *(0.000)*	*-0.001**** *(0.000)*	*-0.000* *(0.000)*	*-0.001**** *(0.000)*
L.GDP_per cap_growth	*0.012* *(0.026)*	*0.038* *(0.031)*	*0.013* *(0.028)*	*0.032* *(0.037)*
L.inflation	*-0.000* *(0.000)*	*0.001** *(0.000)*	*-0.000* *(0.000)*	*0.001*** *(0.000)*
L.Democracy_dummy	*-1.358* *(0.843)*	*-2.107** *(1.253)*	*-2.459**** *(0.879)*	*-3.565*** *(1.449)*
Strength of democratic history	*0.047* *(0.182)*	*0.017* *(0.215)*	*0.350* *(0.222)*	*0.768*** *(0.362)*
obs	*209*	*150*	*221*	*162*
groups	*16*	*15*	*16*	*15*
R squared	*0.9842*	*0.9816*	*0.979*	*0.989*

*p-value .01 =***; .05= **; .1= *, Values in parentheses are standard errors*
L. signifies 1 year lagged observation

Firstly, with regard to the impact of labour market institutions and inequality, the EPL and Labour market regulation index are individually tested as they represent similar concept. In Models 1 and 3, the EPL index increases inequality and the impact is quite concrete and statistically significant at the 0.01 level (4.186***~6.292***). Protections for employed workers limit the access of outsiders for regular jobs, and hence could be related to the biased wage distribution. In model 4, however, overall labour market regulations (proxy for labour market rigidity) decrease inequality and this is also statistically significant at the 0.05 level (-0.613**). It remains room for more detailed theoretical interpretation in the next section. With regard to the power of labour, higher union density is associated with less inequality, but it is not statistically significant in all four models. Previous research has continuously stressed the distributive impact of power resources in the sense that unions are conducive to compress wage within industry and favor more egalitarian labour and welfare policies. The overall impact of union density on inequality does not seem to support this line of argument.

In terms of welfare spending, strikingly enough, public health spending (0.331**~1.426***) and social security spending (0.128*~0.665***) all relate to higher inequality. This directly contradicts to the conventional assumption positing the positive role of welfare spending on the reduction of inequality. As Rudra confirmed in her 2004 article, I also confirm the negative impact of welfare spending on the distribution of wealth. On the contrary, spending on education and human capital index (used as an alternative index for measuring the progressivity of public education policy) both reduce inequality and they are both statistically significant (Education spending: -0.850***, Human capital index: -6.385***).

Regarding the remaining control variables, unemployment is expected to be related with higher levels of inequality; however Model 1~4 do not confirm the impact. Inflation mostly relates to higher levels of inequality at the 0.05 level. GDP per capita is associated with higher inequality in most models, the impact of GDP growth on inequality is hard to conclude. As

Milanovic (2008) argues, the relationship between economic growth and inequality is not clear enough. The relationship between economic growth and inequality is still a controversial issue, and researchers have not reached to an agreement yet particularly with regard to Kuznets' inverted U-curve hypothesis. Finally, in regard to political regime, the result shows that democracy is statistically significantly related to lower levels of inequality (-2.107* ~ -3.565**); however, the impact of strength of democratic history does not find support.

Determinants of Inequality*: Latin America vs. East Asia*

One of the major interests of this thesis is to compare the impacts of determinants of inequality in the two regions. Table 6 describes and compares the results. Although most variables of interests are statistically significant, the directions and impacts of the variables on inequality are quite different as argued in previous chapter. First of all, with regard to labour market institutions, labour market regulations increase inequality in Latin America (0.641***~1.131***) but decreases inequality in East Asia (-1.374***~ -2.102***). I hypothesized that only in Latin America higher labour market regulations would be associated with the increase of inequality because of their bias towards protections for labour insiders and difficulties to job entry. On the other hand, it was anticipated that in East Asia, labour market regulations would relate to less inequality because the labour regulations are not biased for exclusive protections for labour market insiders. Statistical evidence supports this argument. This clearly shows that labour market regulations work as positive means to improve social conditions for workers in East Asia, while those regulations fail to serve the positive role in Latin America. Regarding employment protection legislation, it increases inequality in both regions, and the EPL's impact on inequality is much greater in Asia (7.07***~8.97***) than in Latin (2.04*~4.13**). This shows the negative impact of insider protection in the distribution of income in the two regions. As for union density, higher union density is related to less inequality only in Asia (-0.13*~ -0.37***). This result also supports my argument that strong labour unions in Latin America would not be helpful in reducing inequality because of its insider-centric characteristics.

Table 6. The Determinants of Inequality: coefficient compared

	Model 1		Model 2		Model 3		Model 4	
	LA	**EA**	**LA**	**EA**	**LA**	**EA**	**LA**	**EA**
	coef/se	coef/se	coef/se	coef/se	coef/se	coef/se	coef/se	coef/se
L.Labour Market Regulations	1.131*** (0.261)	-2.102*** (0.496)			0.641*** (0.237)	-1.374*** (0.348)		
L.EPL			4.129*** (0.786)	8.972*** (2.955)			2.040* (1.052)	7.075*** (2.729)
L.Union Density	0.014 (0.032)	-0.366*** (0.097)	-0.008 (0.028)	-0.131* (0.069)	-0.018 (0.032)	-0.172*** (0.065)	-0.007 (0.031)	-0.147** (0.068)
L.Education Spending	-0.354 (0.221)	-0.659* (0.387)	0.023 (0.207)	-0.099 (0.239)				
L.Human capital Index					-4.058*** (1.090)	-4.843*** (1.407)	1.379 (1.719)	-6.148*** (1.632)
L.Health Spending	0.651*** (0.212)	-3.175*** (0.799)	0.059 (0.141)	-0.650 (0.682)	0.211 (0.192)	-1.716*** (0.593)	0.178 (0.147)	0.209 (0.639)
L.Social Security Spending	0.092 (0.069)	-0.749** (0.380)	0.064 (0.087)	-1.178*** (0.331)	0.114* (0.067)	0.207 (0.268)	0.237*** (0.087)	-0.631** (0.286)
L.Unemployment	-0.026 (0.069)	0.509** (0.240)	0.046 (0.055)	0.625*** (0.143)	0.137* (0.081)	0.498*** (0.150)	-0.028 (0.058)	0.573*** (0.151)
L.GDP (per cap)	-0.002*** (0.000)	-0.000*** (0.000)	-0.001** (0.000)	-0.000 (0.000)	-0.001*** (0.000)	-0.000*** (0.000)	-0.002*** (0.000)	-0.000 (0.000)
L.GDP (growth)	0.048 (0.029)	-0.010 (0.089)	0.018 (0.023)	-0.000 (0.047)	0.060** (0.026)	-0.067** (0.034)	0.024 (0.024)	-0.029 (0.042)
L.Inflation	0.000 (0.000)	-0.103 (0.198)	-0.000** (0.000)	-0.040 (0.133)	0.000 (0.000)	-0.085 (0.107)	-0.000** (0.000)	-0.206** (0.082)
L.Democracy	0.644 (0.669)	-2.040 (4.968)	0.222 (0.414)	-10.39*** (2.403)	-0.302 (0.623)	-8.832*** (1.990)	0.406 (0.472)	-10.93*** (2.239)
Strength of democracy	-0.060 (0.098)	0.599 (0.479)	-0.242* (0.126)	0.484* (0.267)	0.084 (0.101)	1.081*** (0.201)	-0.362*** (0.119)	0.686*** (0.183)
obs	69	81	146	63	81	81	146	75
group	7	8	9	7	8	7	9	7
R-squred	0.9688	0.9975	0.9769	0.9723	0.9982	0.9809	0.9842	0.9716

*p-value .01 =***; .05= **; .1= *, Values in parentheses are standard errors*

Spending on education, health, and social security also have different impacts on inequality in the two regions. First of all, education spending is associated with lower levels of inequality in East Asia (-0.659*) only in model 1. In Latin America, the empirical results show that education spending does not contribute to the reduction of inequality in all models and this is statistically significant. When we adopt the human capital index as a measure of progressivity of education, instead of using public education spending, and examine its impact on inequality, greater human capital index is associated with lower levels of inequality. And the ability of human capital in reducing inequality is a bit greater in East Asia (-4.848***) than in Latin America (-4.058***). This also supports the theoretical expectations. Health spending relates to higher inequality in Latin America (0.651*** in model 1) and does not find statistical supports in other models. On the contrary, in East Asia, public health spending is related with low levels of inequality (-1.716*** ~ -3.175***). As to social security spending, it reduces inequality in East Asia (-0.631**~ -1.178***), but it increases inequality or does not have statistically significant impacts in Latin America (0.114*~0.237***). This supports my hypothesis that social security in Latin America did not function well in providing benefits for the unprivileged. Regressive characteristics of social security in Latin America seem to be related to this finding.

The empirical result shows that the impacts of labour market institutions and welfare policies on inequality are different in Latin American and East Asia. To see whether the differences in coefficients are statistically significant, I test the coefficients across the groups based on mode 1 and report the result of F-test in *Table 7*. (Gujarati 1988)

Table 7. Tests for Equality for coefficients in Latin America and East Asia: model 1

Variables of interest	***P-values***
Labour Market Regulation	0.013
Union density	0.098
Education spending	0.351
Health spending	0.001
Social Security Spending	0.024
Unemployment	0.521
Inflation	0.462
Democracy (dummy)	0.890
Democracy (moving average 10years)	0.964

Table 7 indicates that the coefficients of the PCSE regression are statistically significantly different except for education spending among major independent variables. It supports the hypothesis that the impacts of various determinants of inequality are significantly different between Latin America and East Asia. Control variables do not show particular differences between Latin America and East Asia.

Conditional Effect: The Conditional Impact of Inwardness on Inequality

For a more accurate test examining the conditional impact of inwardness on inequality, three different measurements of inwardness are used. As mentioned previously, ISI, the Hiscox & Kastner index for trade protection and Trade openness are employed. The correlations between variables are approximately 0.4~0.9. Trade openness is re-coded (multiplied by -1) in order for a convenient interpretation of its coefficient. Namely, the higher score of each measurement signifies greater trade protection and inward-looking orientations. The test result examining the conditional impact of inwardness on inequality via labour market institutions is described in *Table 8*.

Table 8. The conditional effect of Inwardness on Inequality: via Labour Market Institutions

	Model 1-1	Model 1-2	Model 1-3	Model 2-1	Model 2-2	Model 2-3	Model 3-1	Model 3-2	Model 3-3
Measurement of Inwardness	**ISI**	**H&K**	**Trade**	**ISI**	**H&K**	**Trade**	**ISI**	**H&K**	**Trade**
L.Inwardness *Labour Market Regulation	0.013*** (0.004)	-0.016 (0.011)	.003** (0.001)						
L. Labour Market Regulation	0.286 (0.237)	0.679* (0.402)	0.094 (0.231)						
L. Inwardness *EPL				0.038 (0.026)	0.05*** (0.019)	0.017* (0.010)			
L.EPL				4.55*** (0.585)	6.18*** (0.912)	4.49*** (0.779)			
L.Inwardness *Union density							-0.002** (0.001)	.004*** (0.001)	0.000 (0.000)
L.Union Density							-0.049** (0.021)	-.267*** (0.063)	-0.021 (0.025)
L. Inwardness	-0.015 (0.014)	0.102* (0.060)	0.005 (0.005)	0.022 (0.024)	0.10*** (0.033)	0.009 (0.010)	.079*** (0.025)	-0.046 (0.033)	0.017* (0.010)
L.Unemployment	0.001 (0.068)	-0.040 (0.062)	-0.035 (0.070)	0.12*** (0.037)	0.107** (0.043)	.098*** (0.036)	0.068 (0.043)	0.118** (0.058)	0.068 (0.042)
L.GDP growth (per cap)	-0.006 (0.015)	0.014 (0.020)	-0.010 (0.016)	0.007 (0.010)	0.022** (0.011)	0.003 (0.010)	0.014 (0.016)	0.047** (0.022)	0.016 (0.015)
L.GDP (per cap)	-0.00*** (0.000)	-0.0*** (0.000)	-0.00** (0.000)	-0.00*** (0.000)	-0.00*** (0.000)	-0.00** (0.000)	-0.00*** (0.000)	-0.00*** (0.000)	-0.00** (0.000)
L.Inflation	0.000 (0.000)	0.000 (0.000)	0.000 (0.001)	-0.000** (0.000)	-0.00*** (0.000)	-0.000** (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
L.Democracy	0.036 (0.734)	-1.04** (0.475)	-0.053 (0.758)	0.169 (0.348)	-0.045 (0.327)	0.054 (0.336)	0.377 (0.359)	0.418 (0.432)	0.339 (0.348)
Strength of Democratic History	0.078 (0.122)	-0.3*** (0.089)	0.105 (0.138)	-0.42*** (0.068)	-0.56*** (0.066)	-.377*** (0.070)	-.444*** (0.070)	-.586*** (0.083)	-.382*** (0.078)
Obs	261	152	261	449	351	450	341	253	342
group	16	14	16	16	14	16	16	14	16
R-squared	0.9729	0.9805	0.9759	0.9475	0.9346	0.9441	0.9237	0.9462	0.9507

Figures in parentheses are standard errors.
***p<.01; **p<.05; *p<.10
* Trade openness is re-coded (multiplied by -1) for a convenient interpretation of the direction of its coefficient. Namely, the higher score of each measurement of inwardness signifies greater trade protection and inward-looking orientations

Models 1-1, 1-2, and 1-3 illustrate the conditional impact of inwardness and labour market regulation on inequality. Except Model 1-2, which uses the Hiscox & Kastner measurement of inwardness, Models 1-1 and 1-3 support the theoretical claim that under the influence of inward-looking industrialisation and trade protection, the characteristic of labour market regulations are biased for the interest of labour market insiders thus deepening inequality. The positive coefficients of the conditional terms in Inwardness*Labour Market Regulation (0.013***) and Inwardness*trade (0.003**) confirm the conditional impact of inwardness. Model 1-2 also confirm the negative distributional impact of labour market regulation (0.679*) and Inwardness (0.102*, measured by H&K index), but its conditional effect is not statistically significant. Regarding the conditional term of Inwardness and EPL, Models 2-2 (0.05***) and 2-3 (0.017*) find that employment protection has more negative impact under inwardness and the conditional effect is statistically significant. It shows that employment protection aggravates inequality in countries where the higher trade protection exists. Also, the one unit change in the EPL index brings the direct increase of 4.49~6.18 point of Gini index, thereby shows a significant negative impact on inequality. Lastly, as to the conditional effect of inwardness and union density, the effect is only confirmed in model 3-2. In other words, union density increases inequality in places where trade protection is strong. However, this relationship is not supported in model 3-1 and 3-3. Union density itself seems to decrease the levels of inequality as argued in previous research.

Table 9. The conditional effect of Inwardness on Inequality: via Welfare Spending

	Model4-1	Model4-2	Model4-3	Model5-1	model5-2	Model5-3	Model6-1	Model6-2	model6-3
	ISI	H&K	Trade	ISI	H&K	Trade	ISI	H&K	Trade
L.Inwardness *Education	0.001 (0.007)	0.035*** (0.009)	-0.001 (0.001)						
L.Education	-0.050 (0.113)	-1.293*** (0.367)	-0.087 (0.172)						
L.Inwardness* Health spending				0.007* (0.007)	0.007* (0.007)	-0.000 (0.002)			
L.Health spending				-0.045 (0.085)	-0.252 (0.235)	-0.040 (0.156)			
L.Inwardness*Social security spending							-0.001 (0.002)	0.001 (0.003)	-0.001 (0.001)
L. Social security spending							-0.108 (0.071)	-0.138 (0.156)	0.171** (0.078)
L.Inwardness	0.081** (0.036)	-0.085** (0.034)	0.021** (0.009)	0.059*** (0.017)	0.006 (0.017)	0.022*** (0.007)	0.054*** (0.017)	-0.006 (0.024)	0.035*** (0.007)
L.Unemployment	0.074 (0.045)	0.031 (0.061)	0.045 (0.044)	0.064* (0.036)	0.039 (0.041)	0.038 (0.042)	0.103** (0.044)	0.068 (0.057)	0.098** (0.043)
L.GDP growth	-0.002 (0.015)	0.016 (0.019)	-0.003 (0.015)	-0.002 (0.012)	0.012 (0.012)	-0.003 (0.014)	-0.005 (0.013)	-0.000 (0.019)	-0.007 (0.013)
L.GDP (per cap)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000 (0.000)	-0.000*** (0.000)	-0.000 (0.000)	-0.000** (0.000)	-0.000*** (0.000)	-0.000** (0.000)
L.Inflation	-0.000* (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000** (0.000)	-0.000** (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000* (0.000)
L.Democracy	0.443 (0.477)	0.103 (0.434)	0.312 (0.397)	0.702* (0.414)	0.486 (0.435)	0.513 (0.430)	0.406 (0.435)	0.317 (0.493)	0.505 (0.426)
Strength of Democratic History	-0.453*** (0.099)	-0.441*** (0.134)	-0.542*** (0.109)	-0.371*** (0.083)	-0.565*** (0.072)	-0.401*** (0.134)	-0.536*** (0.072)	-0.541*** (0.080)	-0.430*** (0.076)
obs	407	294	407	383	271	383	318	215	318
group	16	14	16	16	14	16	16	14	16
R-squared	0.9563	0.9682	0.9557	0.9534	0.9697	0.9509	0.9818	0.9724	0.9639

Figures in parentheses are standard errors. ***p<.01; **p<.05; *p<.10

Table 9 tests the hypothesis that inward-looking industrialisation has a conditional impact on inequality via welfare spending categories including education, health, and social security spending. The conditional impact of inwardness and education spending on inequality is supported in model 4-2. Education spending individually decreases inequality (-1.293***), but when trade protection is high, education spending increases inequality (0.35***). However, when inwardness is measured as ISI and (inverted) trade openness, the conditional effect of inwardness is not statistically significant. In Model 4-1, 4-2, 4-3, trade protection (the Inwardness variable) broadly increases inequality (0.021**~0.081**). In terms of the conditional term of inwardness and health spending, we can also confirm the conditional effect of inwardness. However, it is statistically significant only at the 0.1 level. Model 5-1, 5-2, and 5-3 also show that health spending does not influence inequality, but Inwardness itself still has considerable negative impact on the increase of inequality (0.022***~0.059***). Lastly, in model 6-1, 6-2, and 6-3, the conditional term of social security spending and inwardness does not show any critical impact, thus my theoretical expectation is not supported by empirical analysis. Only when inwardness is measured as (inverted) trade openness, the negative impact of social security spending on inequality is confirmed. (In fact, most existing works have found the conditional impact of social security spending*trade openness on inequality by using dummy variables of trade openness; if trade openness is greater than 50% of GDP, then researchers coded it as trade openness. Although my thesis does not follow this kind of obscure analysis- it rather uses original data of trade openness- the test results do not support my theoretical expectation. The ISI's individually negative impact on inequality is statistically confirmed (0.035*** ~0.054***).

So far, I have presented empirical evidence which test the hypotheses derived from my main theoretical argument. Despite the fact that the empirical estimation is based on a limited sample because of data availability imitations, the empirical results still offer an important account of the relationship between inward-looking orientations and inequality. Overall, the empirical evidence mostly supports my argument linking inward-looking industrialisation and inequality through various labour market institutions and welfare regimes. To reiterate, after sorting countries into Latin America and East Asia, the test results mostly support the theoretical argument presented earlier. Also, empirical results strongly support the conditional relationship between the ISI and inequality via labour market institutions. Under the higher inward-looking orientations, labour market institutions aggravate inequality. In Latin America, labour market institutions such as EPL and labour market regulations strongly deepen inequality[52], and higher union density does not contribute to the reduction of inequality. On the contrary, in export oriented East Asia, labour market regulations and unionization contribute to the reduction of inequality, and EPL increases inequality as in Latin America. The relationships between labour market institutions and inequality are statistically significant in most of my analysis. Empirical evidence supports the theoretical expectation that the insider-oriented labour market institutions in Latin America is associated with severe aggravation of inequality.

On the contrary, concerning welfare spending regimes, empirical results are partially supportive to the expectations of theoretical argument. After dividing countries into two groups, education, health, social security spending decreases inequality in East Asia, and it increases inequality or has no impact in Latin America. In the examination of conditional terms, higher ISI distorts the positive role of education spending in reducing inequality, but in terms of social security spending, we cannot find enough empirical support. The results therefore do not fully and confidently support my earlier argument postulating that Inward-looking orientations lead

[52] The test result coincides with Heckman and Pagés (2003). They addressed that labour market regulations in Latin America reduces labour market flexibility, employment of vulnerable workers, thus leading to higher levels of inequality.

to the regressive characteristics of social security spending, and therefore relate to the increase of inequality. Last but not least, in all models, the direct negative impact of ISI on inequality is confirmed. This may imply that, as many economists mentioned earlier, ISI directly distorts the allocations of national resources and wealth.

Overall, by examining the trajectories from different types of industrialisation, this thesis contributes to the understanding of inequality and unearths the mechanism that drives divergent levels of inequality in Latin America and East Asia. Although not all of my theoretical expectations on the relationship between inwardness and inequality via labour market/welfare institutions coincide with the empirical testing results, the overall PCSE results supports the hypothesis that the differences of inequality are in large part the result of the inward-looking orientation and its impact on the characteristic reorganization of labour market and welfare institutions.

Chapter 6. Conclusion

6.1 Summary

So far, this thesis has tried to explain the variation in levels of inequality between late-industrialising countries in Latin America and East Asia since their full-scale industrialisation, roughly from the 1940s. Although Latin American countries have more advanced welfare programs, higher social spending, and more abundant left power resources than their East Asian counterparts, the levels of inequality are much greater in Latin America than in East Asia. The differences in distributional outcomes between the two regions are also surprising given their historical and political similarities, such as a long colonial history and authoritarian military rule. To answer these ongoing puzzles that cannot be fully explained by existing research, this thesis has provided a causal and theoretical mechanism linking inward-looking and outward-looking industrialisation, social policies, and the levels of inequality.

This thesis has shown that different types of industrialisation make a huge difference in levels of inequality by influencing the characteristics of labour market and welfare policies. To explain this with a parsimonious theory, three consecutive chapters have been provided. Chapter 3 has suggested a theory on the choice of industrialisation strategies by explaining the incentives of authoritarian leaders. Contrary to existing literature that considers the choice of openness and protectionism as exogenously given, this thesis has argued that the choice of openness and protectionism is a rational choice of a dictator who wants to maximize her rent income while maintaining office under political and economic impasse. By developing a simple theory, this thesis has attempted to directly explain the choice of dictators on trade regime. Secondly, Chapter 4 has argued that this choice has a subsequent path-dependent effect on the progressivity of welfare policies and labour market policies. Historical evidence has been provided that inward-looking industrialisation produces regressive social policies that favour small and narrow insider coalitions, which in turn lead to higher levels of inequality, and outward-looking industrialisation leads to the development of minimal but universal social policies that do not distinguish labour market insiders and outsiders. By providing a clear theoretical mechanism connecting types of industrialisation to inequality, this thesis has explained the institutional trajectories of different types of industrialisation. In addition, the second section of Chapter 4 has reviewed historical evidence on the development of regressive labour market and welfare state in Latin America and of flexible labour market and minimalist welfare state in East Asia. The historical evidence has shown that countries with inward-looking industrialisation strategies have bifurcated and highly regulated labour markets and highly stratified and biased welfare benefits. By contrast, countries that adopted outward-looking industrialisation strategies have more flexible and unregulated labour markets and minimal welfare spending. It clearly shows that inward-looking and outward-looking industrialisation strategies are connected to the development of diverse characteristics of social policies that are important determinants of inequality. Then, Chapter 5 has empirically tested the argument by using an unbalanced pooled time-series cross-sectional analysis of fifteen Latin American and East Asian countries from the 1960s to the 2000s by using a newly constructed original data set. Although not all of my theoretical expectations on the relationship between development strategy (trade orientation), labour market institutions and welfare policies, and the levels of inequality coincide with the empirical testing results, the PCSE result has shown that the impact and directions of labour market institutions and welfare spending on the levels of inequality are entirely dissimilar between Latin America and East Asia. In other words, ISI and EOI have different influences on the same institutions and affect the ability and characteristics of the institutions. To be more specific, based on the empirical test results, the ISI model is positively related to union density, but the higher union density does not have any impact on inequality in Latin America. On the contrary, the impact of union density on inequality is negative (-) and statistically significant in East Asia. This seems to support the idea that the ISI in Latin America limits the incentive of trade unions to compresses wage and support more egalitarian policies due to increasing insider-outsider dualism in labour market. Moreover, this supports the possibility that the differences on levels of inequality are partly the result of the influence of different development strategies on institutional arrangements in both regions. As a result, the test results have shown that labour market institutions and welfare policies conditionally affect levels of inequality depending on the type of industrialisation they have been developed under. Whereas labour market institutions and welfare spending exacerbate inequalities in countries with inward-looking industrialisation, they are linked to relatively low levels of inequality in countries with outward-looking industrialisation.

As a whole, I would like to emphasise the implications and significance of this line of research to which this thesis contributes. First of all, similar to the VoCs framework that clusters countries into groups such as LMEs and SMEs, distinctive development models can be interpreted as a production regime of developing countries. This thesis is in an extension in line with the research stressing the production regime and its institutional outcomes (Hall and Soskice 2001) and there is much room for further research on development regime of developing countries based on the two contrasting models: the ISI and the EOI. Although this thesis only focused on inequality and the empirical test results are not exactly coincide with my theoretical expectation, if we extend the span of research, we could possibly examine and confirm the influence of development regime on various political economy variables such as corruption. Secondly, this thesis reconfirms the possibility that various institutions can guide macroeconomic performances such as inequality. Development regimes or production regimes may influence the characteristics of institutions, which in turn shape the macroeconomic performances of a country. It also suggests that even if countries have similar institutions and policies, the influence and ability of the institutions are not same in every country. The characteristics of institutions can be changed by the influence of development regimes and this may explain the varying impact of institutions on macroeconomic consequences among countries. Thirdly, this thesis implies that existing institutions can limit the ability of political regime and political agencies on reducing inequality. In chapter 5, the empirical test results have shown that the ability of democracy in reducing inequality is much greater in East Asia than in Latin America. It suggests that under the distorted nature of labour market institutions and welfare programs, the ability of democracy in reducing inequality can be also limited. As Rueda (2005) demonstrated, institutions limit and affect the ability and will of political agencies, therefore policies can be distorted by the existing rules and institutions and yield an adverse impact. Similarly, the influence of political variables could be limited by the influence of institutions (Rueda 2008). On the contrary, there is also a possibility that political factors such as strong democratic tradition can interrupt the deterioration of institutions.

For reference, there were some limitations in the process of conducting this research. First of all, this thesis' attempt to develop a parsimonious logic that covers both East Asia and Latin America overlooked some important variations among countries. The aim of this thesis is to compare the two big regions, and this inevitably oversimplifies the differences and variations among countries within the same regional area. Further case studies that take into account such variations among the regional groups will be needed to support and complement my model. Especially, studies that consider the national peculiarities or the varying degrees of how thorough a country adopted a specific development model would be useful.

Secondly, although I tried to provide a causal mechanism linking different development models to macroeconomic performances, the empirical test of this thesis is partially limited. I have shown that there are statistically significant relationships between development models and a lot of variables on labour market and welfare state; however, the independent variables are limited due to comparability issue. The available and comparable variables on labour market institutions and welfare problems cannot be collected thoroughly. Also, a rigorous empirical test demonstrating the causal relationship cannot be conducted due to the limitation of methodology. More control variables should be included in each regression to raise the relevancy of model in future studies. Also, the fact that not all my theoretical expectations were supported by empirical and historical evidence suggests that more careful and rigorous logical inferences are needed in the future research.

Thirdly, the problem of endogeneity and potentially counter causal relationships need to be dealt with more careful analyses. For example, it is possible that Latin America's high level of welfare spending was a response to already existing high levels of inequality. Although I ran a series of Durbin-Wu-Hausman tests to control the endogeneity issue in my model, it was not possible to thoroughly consider every possible instrument variables. These limitations will be complemented in my future research by conducting careful quantitative and qualitative studies to clarify the causal link.

6.2 Future Challenges: Changing Economic Conditions and Explaining Inequality

“Latin America’s economic history took a decisive turn with the 1982 financial and economic crisis and the ensuing transition to democracy throughout the region.”

(Bulmer-Thomas et al. 2006, 1)

Globalisation, Changes in Existing Coalition, and Inequality

In this section, I would like to conclude this thesis by providing a provisional theory on the changes of existing coalitions and inequality under a changing political economy environment – globalisation and neoliberal economic reforms– after the end of development models. This remains as a future challenge of this research.

Despite the institutional consolidation of ISI and EOI, the trend of economic liberalization and the reinforcing international trade competition after the 1980s finally blocked both the protectionism in Latin American countries and active governmental interventions for export enhancement in East Asian countries. Finally, the golden days of ISI and EOI came to an end in the mid-1980s and the late-1990s respectively. The main reason of this collapse, however, is not simply due to exogenous factors such as globalisation and liberal economic changes but *the endogenous limitation of political economy coalitions* that support ISI and EOI policies. It is the attenuated political economy incentives to maintain ISI and EOI policies. Especially in ISI countries, serious financial difficulties led to political challenges both internally and externally. The worsening deficit of ISI countries, mainly because of serious distortion of resource distribution and gigantic foreign debts used for maintaining the office and inefficient protective market economy, forced the government to implement austerity measures and liberal economic policies. It was followed by weakened political supports from internal coalition. In their '*State-Business/Capital-Insiders*' coalitions, protected business sectors could not maintain their profits without governmental protectionist supports, and the austerity measures of government attenuated the business incentive to maintain expensive labour market insiders. EOI countries also faced financial and political challenges once economic growth was stagnated and employment were worsened, and labour/student movement against authoritarian controls over the labour force received widespread public support. Finally, it imposed a heavy political burden on the EOI coalition. After all, the changes in coalition, the neoliberal international trends, and the following neoliberal economic reforms produced changes in levels of inequality in both regions.

The Changes in the Existing Coalition and the Levels of Inequality in Latin America

After the Latin American debt crises of the 1980s with the tide of globalisation, Latin American governments mapped out economic reforms and liberalization according to the guidance and pressure from international organizations such as IMF and World Bank. The structural adjustment programs seem to be exogeneous pressure, in fact, this should be interpreted as an voluntary effort to extend the life of incumbent regime to overcome the dire economic conditions by giving up rent income and existing coalitional support. In this context, to establish a new political economy coalition for the survival of government was a foremost task.

Neoliberal economic reform is important in understanding the changes of inequality after the 1980s in Latin American countries, because it was a chance to restructure existing rules and regulations in distorted labour market and biased welfare policies that exclusively favouring ISI elites. One notable point is that the collapse of ISI coalition and neoliberal reforms could bring about positive changes such as the alleviation of inequality in the labour market. It can be a momentum that could turn existing problematic institutions into more equal ones, as globalisation and liberal economic reforms are likely to break the protectionist legacies of ISI, which are not suitable any more in the globalized context. The three typical traits of liberal economic reforms –privatization, flexible labour market, and economic deregulation, could work as measures to reduce inequality in this context. However, contrary to the theoretical expectations, the positive impact of economic reforms on reducing inequality did not actually happen in every old ISI countries, and there seems to be huge variations in the changes of inequality. The extent to which economic liberalization brought about changes in existing institutional setting differs by country. Why is it that and what is the mechanism behind it?

Neoliberal economic reform consists of three policy goals: *flexible labour market, privatization, and economic deregulation.* ***Theoretically***, it is expected that these policies have direct impacts on the levels of inequality in Latin America. Firstly, in terms of labour flexibility, contrary to the expectation of anti-globalisation theorists, reforms for higher labour flexibility is expected to broaden the chance of labour market outsiders to get a job by abolishing labour market entry/firing regulations that were exclusively protective for insiders. Also, it helps to modify the unequal wage premium of insiders. This is especially true in Latin American countries with inflexible labour market regulations and institutions. Secondly, regarding privatization and economic deregulation, they help to renew inefficient state-owned enterprises and to abolish existing regulations which block establishing new firms and encouraging free competition to produce quality goods. In the short run, the collapse of inefficient domestic firms and public enterprises would bring about increase in unemployment rate, but in the long run, this would lead to a huge improvement in employment rate and inefficient distribution of resources (by allowing new firms to be established), thus contributing to the reduction of inequality. In this sense, neoliberal economic reform could be a good opportunity to rectify existing ISI legacies. However, contrary to this theoretical expectation, liberal economic reform was not very successful in every ISI countries. For example, the labour market deregulation was not particularly strong (Rueda, Wibbels, and Altamirano 2015) and the higher levels of labour market rigidity and inequality in old ISI countries are still remaining.

Compensation in Latin America

To explain the phenomenon, we need to think about the political mechanisms behind. Due to tumbling economy and the collapse of common interests, the attenuation of ISI coalition was inevitable. However, the collapse of the triangle coalition does not mean the disappearance of the existing political power of each actor. Although the oligopolistic status of state-owned or government-funded firms has weakened, labour insiders can enjoy organized political power and have strong incentives to go against liberal labour market reforms and to support labour protection for insiders. The politically stronger the labour insiders are, the harder the government goes against them. This is the basic political mechanism of how the inflexible and insider-protective labour market institutions still exist in Latin American countries.

Based on Etchemendy (2011), for incumbent government, liberal economic reform becomes a costly option because it makes old power groups (previously sheltered business actors and labour insiders and union members) as their strongest foe. The power of previous ISI elites and their lasting political legacies can be a major obstacle for conducting a successful economic reform. In this case, government has two options: i) to compensate old ISI elites by providing them with some financial benefits or protections that are still available ii) to make a new political ally, especially traditionally ignored ones (i.e. labour market outsiders and the poor). The point is that whom the government decides to compensate makes a huge difference to the levels of inequality. Compensations to ISI elites have a regressive impact on the levels of inequality, and those to non-elites and labour market outsiders lead to a reduction in inequality. I expect that an incumbent government with less political strength (and with immature democracy) would compensate to old ISI elites as this is a rational choice of weak government that needs support from organized power groups. Then, possibly, the elites will disturb economic reforms by maintaining their privileged position which they previously held.

This argument has considerable historical explanatory power. According to Etchemendy (2011), Latin American countries adopted various forms of compensation, which are different especially in terms of the beneficiaries of the compensation. *"Although the macroeconomics of market adjustment evolved in a similar way, the patterns of compensation delivered by neoliberal governments, and the type of actors in business and the working class that benefited from them, were remarkably different (*Etchemendy 2011, *10)"* According to the three models he distinguished, *Statist*, *Corporatist,* and *Market*, the patterns of compensation differ. *Statist* and *corporatist* paths compensated ISI elites for their losses caused by economic reform, and market-based path did not compensate any ISI elites. The statist and corporatist examples are Brazil under the Collor and Cardoso government (1990~2002) and Argentina under Menem presidency between 1989~1999 (Ibid., 7) On the other hand, countries adopted market-based reform compensated labour market outsiders and traditionally vulnerable working classes and brought about an improvement in distribution. Chile under Pinochet (1973–89) and Fujimori's government in Peru (1990–99) are the main examples (Ibid., 8). To summarize, due to the political power of ISI elites, if political compensation is given to them even after the collapse of the ISI coalition, the reduction in inequality will be small even after the economic reform. This is because the institutional legacies favouring the ISI elites will remain in the labour market and welfare state, and the existing benefits will be largely retained.

Below are the hypotheses based on the aforementioned argument.

H1: Liberal labour market reforms in Latin America can contribute to the reduction of inequality.

H2: However, if the political power of the ISI elites is great, inequality will not be greatly reduced.

H2: Compensation for previous ISI elites will increase the levels of inequality. On the contrary, compensation for non-ISI elites (e.g. labour market outsiders) will decrease levels of inequality. (The factors that determine the types of compensation are the political strength of previous ISI elites and democracy).

The Changes in Political Economy Coalition and the Levels of Inequality in East Asia

East Asian EOI countries also experienced significant challenges in the face of globalisation and economic liberalization because the changing economic environment has made continuous high economic growth and full employment no longer possible. Also, political changes, such as democratisation, imposed restriction on the government's discretion and the power of the 'state-business' coalition. Interestingly, however, this did not lead to the complete discard of export-oriented strategies. The 'state-business' coalition is still valid, but the coalition has slightly changed the way governments react to the slowdown of economic growth and increasing unemployment.

EOI strategies for higher export were supported by cheap labour wages and abundant labour power, and this was possible through governmental labour suppression and controls for labour unions/organizations. The 'state-capital' coalition was also based on aggressive governmental supports for businesses (e.g. dumping, unequal export subsidies for firms). Globalisation and economic liberalization preclude these types of irregular governmental supports and impose restrictions on governments' ability of biased support for business elites. Also, growing price competition from below (e.g. less developed countries such as Southern Asian countries and China) decreases the growth rate and employment rate in major East Asian countries such as Taiwan, South Korea. The myth of 'low inequality based on full-employment (low inequality even without protection and welfare)' was not possible any more after the globalisation, Asian Financial crisis, and severe international competitions. With 'full' employment, government can control public demands without more welfare benefits and labour protection. Without it, however, the miraculously lower levels of inequality cannot be maintained any longer.

After some levels of economic growth, East Asian countries had moved from light manufacturing to heavy manufacturing. The required skill levels increased, and the wage negotiation power of skilled labour was also improved. However, the lack of centralized labour union and fragmented industrial unions made it impossible to make a centralized wage agreement. The wage gaps between the educated, skilled and less skilled started to arise. Vulnerable working class, outsiders, mostly the under-educated and women, experienced troubles in getting gobs, and this trend led to the increase of inequality. In fact, the collapse of full-employment in the 1990s and the mass dismissal following the Asian economic crisis in the late 1990s increased the levels of inequality significantly in many East Asian countries. In this context, institutional arrangements in labour market and welfare system are important in understanding the levels of inequality, because they directly relate to the supports for vulnerable workers, including laid-off and part-time workers. However, the traditionally minimum levels of labour market protection and welfare benefits in East Asian countries were not very helpful to deal with growing inequality and social insecurities. (Rising inequality)

In this context, it would be necessary to reconsider the impacts of globalisation and neoliberal reforms on inequality in East Asia. In terms of *labour flexibility*, firstly, I argue that the reforms for higher labour flexibility increased the levels of inequality significantly. Before the reform, East Asian countries had relatively higher labour flexibility, but the trend of globalisation and economic liberalization required further reforms. The problem is that the liberalization trend compelled countries to increase labour flexibility, even to the countries with low levels of labour protection (and higher levels of flexibility). In East Asia, increases in labour flexibility do not mean anything but to fire workers even more easily than before. This became even worse conditions for workers, thereby producing wider gap between capital and the working class. This actually led to a mass dismissal during economic downturn especially in South Korea. Secondly, with regard to *privatization*, in the 1990s, the international push for economic liberalization speeded up the tide of privatization, and incumbent government privatized state-run enterprises producing electricity, water, and etc. It has two negative impacts on inequality through i) reducing the number of public officials ii) increasing utility fees and living expenses. It is well known that the size of public sector workers is related to lower levels of inequality, because wages in public sector are much flatter than those in private sector. The downsized public sector after privatization would have negative impact on the reduction of inequality. Also, the increase in utility fees would have more negative impact for the lives of the poor and the working class. (It would be necessary to note that there only existed few public firms in East Asia compared to their counterparts, mostly related to the production of public goods. Also, considering the efforts of East Asian government to control price levels (inflation) for more export, there is a possibility that the reforms were unnecessary because it brought about the increase in living expenses of working class). Thirdly, regarding *deregulation*, it seems also regressive in terms of inequality. Neoliberal deregulation policies contributed to making a pleasant and friendly environment mostly for business sectors, and in fact, many rules and regulations including environmental laws and labour laws were eased. This would have a negative impact on protecting vulnerable labours in labour market.

All in all, globalisation and economic liberalization in East Asia are connected to the increase in inequality. Macroeconomic downturns after the 1997 Asian financial crisis affected the decrease in real income of working class due to significant increases in unemployment; however, the reformative programs and changes after the economic liberalization also affected the levels of inequality.

Compensation in East Asia

Compensation was required because of the growing discontentment followed by rising unemployment and the decrease in real income after the 1990s. Since the neoliberal trends and the still powerful coalition between business and government did not allow a huge improvement in labour protection legislation, governmental compensation mainly focused on the increase in welfare spending in order to meet the growing public demands for more governmental protection/benefits. Along with democratic consolidation, East Asian countries increased welfare benefits to a certain level and enacted some labour protection social insurances. The compensations were mainly means-tested benefits, not universal ones, but there was no special bias for specific elite groups or insiders, thereby contributing to the reduction of inequality.

H1: Liberal economic reforms in East Asia will lead to the increase in levels of inequality.
H2: Overall compensation (welfare spending) will contribute to the reduction of inequality in East Asia.

Conclusion

This thesis discussed how development strategy (trade regime) structures inequality. To examine the cause of diverging levels of inequality in Latin America and East Asia, I explained this with development strategy and tried to theoretically explain the mechanisms how development strategies influence inequality via labour market institutions and welfare policies. At the same time, this study stressed the importance of political factors in explaining inequality and provided some criticisms and intuitions regarding the limitation of existing works that have not paid great attention to the political explanations on the choice of trade regime. In sum, this study shed lights on the understanding of inequality in developing countries by considering a development model that has not been widely considered as a factor to determine distribution results. In doing so, it enables a meaningful distinction among groups of countries based on development models, in other words, production regimes. As VoCs theory does, if relevant improvement is applied, it would be possible to provide a more coherent theory to connect development models, specific institutional arrangements, and macroeconomic performances.

Last but not least, this thesis contributes to the practical politics since the study of inequality is of particular importance in recent years. Although a large number of developing countries are facing tough challenges to combat pervasive inequality, they tend to simply believe that a high level of economic growth or transfer payments can always reduce inequality. By paying great attention to the political, institutional, and agency factors more deeply, this study contributes to the understanding of the origins of income inequality in middle-income developing countries.

Appendix I. Data sources

To construct a pooled time-series cross-sectional dataset, I collect some available dataset from various sources. The major sources of this pooled data are World Bank, OECD, IMF, UNESCO, WHO, and etc.

Table 1. Descriptions of Variables and Data Sources

Variable	Description	Data Sources
Independent/Control Variables	Gini Coefficient	SWIID(Solt 2009, 2016)
ISI	the difference between manufacturing production and exports as shares of GDP	Calculated by author based on the data from World Bank World Development Indications (WDI)
Urban-rural dualism	The difference b/w the percent of the labour force in agriculture and agriculture as a share of GDP	Calculated by author based on the data from World Bank World Development Indications (WDI)
Inflation	Actual percentage change in consumer prices	World Bank World Development Indications (WDI)
Unemployment	As a percentage by dividing the number of unemployed individuals by all individuals currently in the labour force	World Bank World Development Indications (WDI), Huber et al(2008)-LAC, IMF (2011), Hong Kong 1961 Census, IMF(GFS)
Job protection for full time workers	Extracted from Economic Freedom Index	Fraser Institute (2011)
Union density	The ratio of wage and salary earners that are trade union members, divided by the total number of wage and salary earners	OECD (Labour Force Statistics), ILO, ICTWSS Lora and Pagés-Serra (2003), and various sources
Education spending	Public Education spending as percent of GDP	Huber et al. (2008)-LAC, Asia Development Bank UNESCO (http://stats.uis.unesco.org), WDI (World Bank), ECLAC, For Latin American Countries, Huber et al (2008) and supplemented by WB and Unesco. For Asian countries, UNESCO is main source and ADB dataset are used after then.
Health spending	Public Health spending as percent of GDP	Huber et al(2008)-LAC World Bank World Development Indications (WDI)

		Asia Development Bank ECLAC(Cepal), Haggard and Kaufman(2008), Keep (2011), OECD, UN Common Dataset
Social Security Spending	Social Security as percent of GDP	Huber et al(2008) Asia Development Bank ECLAC(Cepal),
GDP per capita	GDP per capita (constant 2000 US$)	WDI
GDP per growth		WB(WDI)
FDI	Foreign direct investment	World Bank World Development Indications (WDI)
Democracy	Polity ii (Democracy score – Autocracy Score)	Polity IV
The Strength of Democratic Tradition	Cumulated score of 'polity ii' for the last 20 years from the observation year	Polity IV
Partisanship	Executive party orientation	DPI (2010)
GDP per Capita	GDP per capita (constant 2000 US$)	WB(WDI)
Female labour market participation	Labour participation rate, female (% of female population ages 15+)	WB(WDI)
Trade Dependency ratio	The sum of imports and exports , % of GDP	WB(WDI)

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