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Welfare spending and political conflict in Latin America, 1970–2010

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ABSTRACT

We study an age-old question in political economy: does government spending on welfare ensure peace? This question was at the heart of the European Welfare State model of the early 20th century, and remains relevant today in face of rising inequalities and political conflict. Yet there is limited empirical evidence about this question. We make use of a panel of 12 Latin American countries over the period 1970–2010 to show that welfare spending has led to substantial reductions in conflict across the region. This effect is more pronounced when associated with reductions in inequality and increasing social and institutional trust.

1. Introduction

The relationship between government welfare spending and political conflict has deep historical roots. Chancellor Otto von Bismarck famously implemented the world's first social insurance programme in the late nineteenth century in Germany as a response to social demands, increasingly stronger workers unions' movements and the threat of political violence. The idea of using government transfers to ensure political stability spread rapidly across Europe (Esping-Andersen, 1990). This was accompanied by the extension of voting rights in Western societies during the late 19th and early 20th centuries, viewed by many also as a response to the threat of civil unrest (Acemoglu & Robinson 2000; Meltzer & Richard, 1981). Yet, to date, there is limited empirical evidence on the effectiveness of government welfare spending to prevent or reduce political conflicts, or on the mechanisms that may shape such effects. This paper contributes to filling this gap. We address this important empirical question in the context of Latin America, where political conflict has been rife over the past century.[1]

A substantial body of literature has attributed the causes of political conflict in Latin America to the historically high levels of inequality experienced in the region (see Machado, Scartascini, & Tommasi, 2011). The debt crisis in the 1980s is a case in point where adjustment policies worsened income distribution, fuelling violence in many parts of the region (Arias & Goldstein, 2010; Voth, 2011). As a result, distributional considerations became central to policy agendas across Latin America (Cornia, 2014). One of the most significant changes in that period was related to social welfare spending, which started to increase in the 1990s, and kept on rising throughout the 2000s. Over the same period, the region experienced a gradual and persistent reduction in violence. Whether these two trends are related remains an open question.

We exploit this historical variation in government social policies and political conflict to investigate empirically the effect of

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[1] Political conflict is understood in this paper as a contestation between two parties (in which one is the government) where the use of armed force results in at least 25 annual battle-related deaths (Gleditsch et al., 2002). Under this definition, 'political violence', 'armed conflict' and 'violent conflict' are terms used interchangeably throughout the paper. In later sections, the paper will consider more restrictive definitions of political conflict such as smaller internal conflicts, civil wars and guerrilla wars.

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government welfare spending on the incidence of internal political conflict. The analysis uses a longitudinal dataset compiled across 12 Latin American countries over the period 1970–2010.[2]

Identifying the effect of government welfare expenditure on political conflict is a challenging task because standard OLS estimates may be biased due to reverse causality and omitted variable biases. The direction of potential biases is a priori ambiguous. OLS estimates could be biased upwards if, for instance, political conflict increases social demands for government welfare expenditure – something that is quite plausible in contexts where conflicts are driven by inequalities and grievances, as in many parts of Latin America. Other shocks, such as the financial crises that took place across the region in the period under consideration, may also lead to upward biases in the OLS estimates since they may result in increases in both political conflict and government expenditure in the form of populist policies (e.g. Sachs, 1989). OLS estimates could be biased downwards if, for instance, governments restrain welfare expenditure in areas more heavily affected by conflict (in fear of funds being appropriated, or as a form of punishment against insurgent groups and their support bases), or are not able to raise enough revenue to fund social policies in face of the economic destruction caused by the conflict.

We adopt several empirical strategies to address these concerns. The first is the use of a country-fixed effects model, which controls for time-invariant differences between countries. This is useful because there is a large variation in conflict experiences across the countries in the sample. The second strategy is the use of instrumental variable models that exploit exogenous variation in the value of welfare spending in neighbouring countries to proxy for government welfare expenditure. This strategy is based on the assumptions that fiscal design has had spill-over effects across the region, and that welfare spending in neighbouring countries has no impact on political conflict other than through its influence on domestic fiscal policy. We test also an alternative instrumental variable in the form of an exogenous impact of natural disasters. Third, we make use of the long-time dimension of the data to address potential endogeneity using regression models with instruments generated by applying Lewbel (2012)'s method and the Hausman-Taylor estimator. We find across all model specifications a strong and statistically significant negative effect of government welfare spending on the incidence of political conflict across Latin America in the period between 1970 and 2010.

While all the empirical strategies we employ have inherent weaknesses, the consistency of the results across all models – in terms of size and significance of the estimated coefficients – reassures us about the strength of our main result. This analysis is further supported by the empirical testing of four mechanisms that may shape the relationship between government welfare spending and political conflict: absolute levels of inequality, perceptions of fairness of inequality, trust in government institutions and social trust. We find that the conflict-reducing effect of government welfare spending is more pronounced in countries that experienced reductions in the levels of inequality and improved perceptions about the fairness of inequality, as well as in countries with increasing levels of social trust and trust in state institutions. Additional results show that only welfare spending has an effect on political conflict. All other forms of expenditure do not affect political conflict, while high levels of expenditure on the military are associated with increases in political conflict across Latin America.

These results entail important contributions to several bodies of literature. Although a number of political science papers have examined the effect of government spending on political violence (De Juan & Bank, 2015; Fjelde & de Soysa, 2009; Taydas & Peksen, 2012; Thyne, 2006), this is, to the best of our knowledge, one of the first studies to analyse which specific forms of expenditure and which mechanisms may shape the relationship between government spending and political conflict. The paper contributes also to a growing economics and political science literature on the effects of counterinsurgency and aid interventions in modern political conflicts. Several studies have shown how improved provision of social services and public goods may have contributed to reducing insurgent violence in Iraq (Berman, Shapiro & Felter, 2009), India (Khanna & Zimmermann, 2017) and Afghanistan (Beath, Christia & Enikolopov, 2012). However, literature on the effects of aid on political conflict has portrayed a different picture. Crost, Felter, and Johnston (2014) show that aid in the form of a community-driven development programme in the Philippines led to increases in conflict among communities that were eligible to receive the programme, while Nunn and Qian (2014) find that increases in US food aid increase both the incidence and duration of armed conflicts among recipient countries. Theoretically, there is no reason to expect external aid flows and internal government expenditures to have similar effects on political conflict. This is because internal government expenditures are a direct reflection of the social contract between governments and citizens, while external aid may be implemented without affecting this relationship. The result in this paper suggests that this mechanism may have been strongly at play in Latin America in the period being considered. Finally, the paper offers also an important contribution to recent literature on state capacity. Several studies have argued that state capacity is key to political stability and successful economic development (Besley & Persson, 2009b, 2010; Acemoglu, Garcia-Jimeno, & Robinson, 2015). In the case of Latin America, Centeno (2002) has linked economic failure and political conflict to limited state capacity. This paper contributes to this literature by showing how increased capacity of states to provide social welfare programmes (in the case of Latin America, largely in the form of cash transfer programmes) may improve political stability, which in turn may strengthen state capacity in the future as state institutions will be better able to focus on social development rather than military expansion.

2. The relationship between government welfare spending and political conflict

The relationship between redistribution, government expenditure and political conflict is not a new concern in the political economy literature. In a series of influential papers, Grossman (1994, 1995) modelled formally how redistributive policies, such as wage subsides, lump-sum transfers or land reforms, may reduce the probability of extra-legal appropriative activities. Azam (1995, 2001) showed subsequently that public expenditure with a strong redistributive content (for instance, in education and health) may strengthen the social contract and prevent the outbreak of political violence. This theoretical literature has provided important insights about the relationship between government redistributive policies and political conflict; empirical evidence is in contrast weaker.

A small literature in political science has examined correlations between government social expenditures – education expenditure, in particular – and the incidence of armed conflict (Taydas & Peksen, 2012; Fjelde & de Soysa, 2009; Thyne, 2006). De Juan and Bank (2015) show that the risk of violence in the recent conflict in Syria between March 2011 and November 2012 was lower in sub-districts where government provision of electricity was higher. A related body of literature has attempted to isolate the causal effects of government transfers on crime reduction.

[2] The sample includes the following countries: Argentina, Chile, Colombia, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.