

Regionalism, Globalization, and Economic Development of the World*

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This study evaluates the effects of regionalism on economic development in the world basing on the panel data of 217 countries. In general, regionalism pursued by countries via their respective regional organizations was found to have no significant independent effect on the economic development. Regardless of regionalism, the international economic variables such as globalization and terms of trade, as well as domestic variables such as population growth, urbanization and ethnic composition were found to have significant impact on economic development. In affecting economic development, the individual sovereign member states of regional organizations are independent of the collective institutional design of the regional organization they are affiliated with.

Keywords: regionalism, regional intergovernmental organizations, globalization, suppressor variable, economic development.

The purpose of the present article is to analyze the effectiveness of regionalism by regional organizations in the world in affecting economic development. Not only regional intergovernmental organizations (RIGOs) like the European Union (EU), African Union (AU) and Association of Southeast Asian Nations (ASEAN), but also the regional free trade agreements (RFTAs) like North American Free Trade Agreement (NAFTA) are the driving forces of regionalism. The task of empirically assessing the effects of regionalism on economic development has been a critical challenge not only in developing but also in developed countries. There are many other international as well as domestic variables that could also affect economic development. The effect study of regionalism should also cover 'all' regions in the world and this study is based on major regionalisms, aiming at covering all regions/subregions in the world: Europe, Africa, Southeast Asia, South Asia, Pacific Rim, Central Asia, North and South America, and Middle East.

Different Views on Regionalism

Regionalism is based on the following three ingredients: identifiable geographical region, geographical proximity and an organization with a common sense of identity and purpose (economic, political, security/military, *etc.*) among the member states. There are many views of the whys and wherefores of the joining the regional organizations. One of them is the efficiency of collective activities (Abbott and Snidal 1998; Karns and Mingst 2010: 6). The economic integration via regional organizations generates economies of scale. The regionalism by RIGOs is also viewed from the perspectives of global and/or regional governance

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as well. Rosenau (1995) has used the 'governance' to denote the regulation of interdependent relations in the absence of an overarching political authority such as in international system. Najam (2003) has also defined global governance as the management of global processes in the absence of global government. According to Weiss (2000), global governance refers to concrete cooperative problem-solving arrangements. The governance undertaken by international organizations (IOs), global or regional, over the member states is to deal with many global and regional issues, which are related to economic development, among others. If the member states wish to benefit from regionalism, they must align with the principles, norms, and rules of the IOs. According to the constructivism, IOs serve as agents of social construction and they can construct a social world in which international cooperation and interaction take place. That is, global governance is possible via international cooperation and interaction, which shape identities and interests of member states as argued by the constructivism (Finnemore and Sikkink 2001).

International Economic Variables and Economic Development

Regionalism is not the only determinant of economic development. Many other international economic variables could also affect it. Globalization is one of them.¹ There have been pros and cons of the role of globalization in enhancing economic growth and/or quality of life. Stiglitz (2003) was critical of globalization, as it has deepened global inequality between the haves and have-nots, especially in the less developed countries. Goklany (2007) argued for a positive effect of economic globalization based on free trade, and demonstrated that the free trade helped to enhance the human well-being. Foreign direct investment (FDI), a cross-border investment, is undeniably an important ingredient of economic globalization. Multinational corporations (MNCs) are international 'carriers' of the FDI. The role of MNCs in economic development in host countries, developing or developed, has nevertheless been controversial (Nunnenkamp and Spatz 2003).

Terms of trade, favorable or unfavorable, could also affect economic development. It is not necessarily the 'quantity' but the 'quality' ('terms') of trade that affects economic development. Unfavorable terms of trade will result in a negative or low economic growth particularly in developing countries, as they rely on the export of a single or a few primary commodities (Chow 1987; Appleyard *et al.* 2006: 214–215 and 416–417). External (foreign) debt sustainability, strong or weak, is assumed to affect economic development as well. The debt sustainability is an essential condition for economic development (Loser 2004).

Domestic Variables and Economic Development: Politics, Defense Spending, and Ethnic-Demographic Conditions

Russett (2005) found that democracies are considered efficient in generating wealth and economic growth, which also lessen the frequency of internal conflicts. The authoritarian political systems turn out to be more conflict-ridden than democratic counterparts and they lower the quality of life. The authoritarian political systems are unable to effectively manage external debt and foreign assistance as well. Many developing countries have imple-

¹ The globalization based on the KOF globalization index was used in this analysis. The KOF Index of Globalization was introduced in 2002. The KOF Index of Globalization measures the three main dimensions of globalization: economic, social and political. KOF index of globalization is released annually by the KOF Swiss Economic Institute (Dreher, Gaston, and Martens).

mented liberal economic reforms in recent decades. They have been successful in economic growth (*e.g.*, Chile, Brazil, *etc.*), yet there are still many other developing countries that remain poor and have not experienced any significant economic growth. While political liberalizations and reforms with minimal corruption are required for sustainable economic growth, China and Singapore, for example, with their respective 'authoritarian capitalism' have documented a rapid economic growth without undertaking significant political liberalization. South Korea was able to rapidly develop in the 1970s and 80s while its political system still remained authoritarian.

When inequality of income distribution is related to ethnicity, gender, or geographic region, Clemens (2007) argues that a stronger role for the state (*i.e.*, authoritarian political system) is advantageous for equal distribution of income, and the most vulnerable members of societies can be safeguarded by the role of stronger authoritarian government. Stiglitz (2003) argues that policies emanating from the Washington Consensus produce disappointing result as they are anchored in a free-market dogma, which ignores the unique socio-cultural contexts of countries where they are applied. The G20 group of governments agreed in 2010 on a 'new' Seoul Development Consensus. In contrast with the 'older' Washington Consensus, the Seoul Consensus allows a larger role for state intervention. Rather than seeking to impose a uniform top-down solution, the Seoul Consensus postulates that solutions should be tailored to the requirements of individual developing countries.²

A huge military spending disproportionate to the economic capacity is siphoning off the resources, which otherwise could have been used for economic growth and improvement of the quality of life (Sivard 1991). Some found the interaction between the defense spending and economic growth. Benoit (1978), basing on data on the 44 developing countries, argued that there is a positive correlation between military expenditures and economic growth over the period from 1950 to 1965. Klare (1987) demonstrates that every additional dollar spent on defense in developing countries reduces domestic investment by 25 cents and agricultural output by 20 cents. Their findings supporting the trade-offs were based on the Cold War period. Defense spending was still found to have a significant effect on the level of quality of life during the post-Cold war era. Countries with greater defense burden retain a lower quality of life regardless of population growth, urbanization and ethnic diversity (Kim 1996). Ethnic heterogeneity has been impeding the enhancement of quality of life (Collier 1999, 2007). Empirical evidences have shown that demographic variables such as ethnic composition (Alesina *et al.* 2003), urbanization (Todaro and Stephen 2009: 320–359) and population growth (McNicoll 1995) have significant effects on quality of life. What affects economic development is not only domestic but also international. In our study we will employ 'multiple' variables, domestic and international, including the regionalism. In order to identify an independent (*i.e.*, a 'pure') effect of regionalism on economic development, all other international and domestic variables assumed to affect economic development will be also controlled.

² The term Washington Consensus (1989) refers to market-friendly policies, which were generally advised and implemented both for advanced and emerging economies. It is also used to refer to economic reforms that were prescribed just for developing countries. In November 2010, the G20 group of governments agreed on a 'new' Seoul Development Consensus. The Seoul Development Consensus for Shared Growth is a set of principles and guidelines set up to assist the G20 nations and other global actors in working collaboratively with less developed countries in order to boost their economic growth and to achieve the UN's Millennium Development Goals (MDGs).

Methodology

Dependent Variable: Economic Development

Economic development was treated as dependent variable. Economic development incorporates not only economic growth (quantitative) but also standard of living (qualitative). PPP (Purchasing Power Parity) indicates the real GDP using a common set of international prices for all goods and services and provides more accurate comparisons of both economic growth and standard of living. Per Capita PPP was used to measure the economic development.

Independent Variable: Regionalism

The regionalism is based on the membership of each country with a regional intergovernmental organization or regional free trade agreements. The regionalism is measured by the affiliation of countries with each of the 14 regional intergovernmental organizations (RIGOs) or regional free trade agreements (RFTAs) selected. The affiliated countries are coded as 1, while others (non-affiliated) as 0. The regionalism is treated as a dummy variable. The major RIGOs and RFTAs, along with their respective regions, are as follows:

- ANDEAN (Andean Community of Nations: 4 countries) / South American region;
- APEC (Asia-Pacific Economic Co-operation: 21 countries) / Asia-Pacific region;
- ASEAN (Association of Southeast Asian Nations: 10 countries) / Southeast Asian Region;
- AU (African Union: 54 countries) / African region (note: South Sudan became the African Union's 54th Member on July 28, 2011 and the new country's data was not included in this analysis);
- CARICOM (Caribbean Community: 15 countries and dependencies);
- ECOWAS (Economic Community of West African States: 5 countries);
- EU (European Union: 27 countries) / European region;
- LAS (League of Arab States: 22 countries) / Arab region (Middle East);
- MERCOSUR (Common Southern Market: 4 countries);
- NAFTA (North America Free Trade Agreement: 3 countries) / North American region;
- OAS (Organization of American States: 35 countries);
- PC (The Secretariat of the Pacific Community or Pacific Community: 22 countries and territories);
- SAARC (The South Asian Association for Regional Cooperation: 8 countries) / South Asian region;
- SCO (Shanghai Cooperation Organization: 6 countries) / Central Asian region.

Control Variables

Both international economic variables and domestic variables were treated as control variables: globalization, terms of trade and external (foreign) debt sustainability are selected as international economic variables, while ethnic homogeneity, population growth, urbanization, types of political system and military expenses as domestic variables. Each of the eight control variables is also operationalized (measured) as follows:

- Globalization: it is based on the KOF Index of Globalization, which measures the three ('plural') dimensions of globalization: economic, social, and political (see Note 1 for the detailed measures of globalization).
- Terms of trade: the measure is based on the index of the price of a country's exports (benefits) in terms of its imports (costs).

- Debt sustainability: it is measured by per capita amount of external (foreign) debt divided by per capita amount of export. The large ratio means a weak sustainability, while the low ratio means a strong sustainability.
- Ethnic homogeneity: it is measured by percentage of the dominant ethnic-racial groups within each nation.
- Urbanization: the measure is based on urban-rural dichotomy; ‘urban’ refers to a group of allegedly nonagricultural pursuits while ‘rural’ to agriculturally oriented employment.
- Population growth: the natural increase per 1,000 of the population, based on the difference between birth and death rates of respective population.
- Types of political system: countries are classified as ‘not free’, ‘partly free’, and ‘free’ in terms of the degree of political freedom represented by both political rights and civil liberties. Countries with ‘not free’ were coded as 1 (highly authoritarian), ‘partly free’ as 2 (authoritarian), and ‘free’ as 3 (democratic).
- Military expenditure: the measure is based on military expenditure as a percentage of GDP.

The data on 217 countries are used in this analysis. The data cover the period from 2005 to 2011 depending on their availability for each and every of the countries. This study, for that matter, is not amenable to a time-series analysis but to a cross-national comparative analysis. A multiple regression analysis is used. The multiple regressions will test whether the regionalism affects economic development regardless of other international economic and domestic variables.

Results

Table 1. Multiple regression: Regionalism ALONE and economic development (per capita PPP)

	EU	AU	NAFTA	APEC	SAARC	SCO	LAS	ANDEAN	ASEAN	ECOWAS
Economic Development	<u>.366</u>	<u>-.549</u>	.122	<u>.181</u>	<u>-.135</u>	-.058	-.003	-.005	-.041	<u>-.343</u>
	MERCO-SUR	ANDEAN	OAS	CARICOM	PC					
Economic Development	.021	-.005	.094	.068	-.087					

Note: Standardized regression coefficients (beta) are presented and the underlined ones are significant at .05 level. All variables are log-transformed.

Source: Data from CIA, *World Factbook* (2007, 2008, 2009, 2010, 2011); Encyclopedia Britannica, Inc., *The Nations of the World / Britannica Book of the Year* (2007, 2008, 2009, 2010, 2011, Chicago: Encyclopedia Britannica); *Index 2011* (URL: http://en.wikipedia.org/wiki/Quality-of-life_index).

Table 1 presents the regression analysis, which assesses the effect of regionalism on economic development. The Table (Regionalism ALONE) aims at assessing how regionalism 'alone' affects economic development. The finding demonstrates different effect of regionalism on economic development: positive, negative and no effects. Out of the 14 regionalisms, six (6) regionalisms such as EU, NAFTA, AU, APEC, SAARC and ECOWAS were found to have significant effects, positive or negative, on economic development; EU, NAFTA and APEC were found to have positive effects on economic development, while AU, SAARC and ECOWAS were found to have negative effects. But the remaining eight (8) regionalisms such as SCO, LAS, ANDEAN, ASEAN, MERCOSUR, OAS, CARICOM and PC were found to have no significant effects on economic development.

Table 2. Multiple regression/regionalism CONTROLLED: Regionalism and economic development controlling international economic and domestic variables

	AU	EU	ASEAN	NAFTA	APEC	CARICOM	OAS
Regionalism	<u>-.166</u>	.063	-.008	.089	-.008	.159	.101
Globalization	<u>.196</u>	<u>.212</u>	<u>.223</u>	<u>.220</u>	<u>.222</u>	<u>.231</u>	<u>.223</u>
Terms of trade	<u>.178</u>	<u>.177</u>	<u>.183</u>	<u>.182</u>	<u>.184</u>	<u>.203</u>	<u>.196</u>
Debt Sustainability	-.046	-.070	-.053	-.061	-.053	-.004	.052
Urbanization	<u>.343</u>	<u>.373</u>	<u>.373</u>	<u>.362</u>	<u>.375</u>	<u>.399</u>	<u>.346</u>
Ethnic homogeneity	.073	<u>.150</u>	<u>.152</u>	<u>.155</u>	<u>.153</u>	<u>.150</u>	<u>.136</u>
Population growth	<u>-.215</u>	<u>-.176</u>	<u>-.212</u>	<u>-.214</u>	<u>-.212</u>	<u>-.216</u>	<u>-.246</u>
Political system	.101	.111	.114	.108	.116	.084	.101
Military expenditure	.022	.027	.030	.031	.030	.062	.060
R square (%)	(76.3)	(75.0)	(74.8)	(75.6)	(74.9)	(77.0)	(75.6)
	SAARC	SCO	ANDEAN	LAS	ECOWAS	MERCOSUR	PC
Regionalism	.079	-.011	-.025	.051	<u>-.136</u>	-.033	<u>-.127</u>
Globalization	<u>.238</u>	<u>.222</u>	<u>.219</u>	<u>.211</u>	<u>.216</u>	<u>.214</u>	<u>.214</u>
Terms of trade	<u>.177</u>	<u>.183</u>	<u>.186</u>	<u>.180</u>	<u>.164</u>	<u>.181</u>	<u>.182</u>
Debt sustainability	-.059	-.052	-.050	-.048	-.038	-.050	-.080
Urbanization	<u>.396</u>	<u>.376</u>	<u>.378</u>	<u>.369</u>	<u>.374</u>	<u>.384</u>	<u>.381</u>
Ethnic homogeneity	<u>.139</u>	<u>.153</u>	<u>.152</u>	<u>.145</u>	<u>.110</u>	<u>.158</u>	<u>.163</u>
Population growth	<u>-.214</u>	<u>-.213</u>	<u>-.209</u>	<u>-.229</u>	<u>-.196</u>	<u>-.211</u>	<u>-.193</u>
Political system	.103	.111	<u>.118</u>	<u>.127</u>	<u>.134</u>	<u>.115</u>	<u>.124</u>
Military expenditure	.021	.028	.032	.013	.032	.025	.015
R square (%)	(75.4)	(74.9)	(74.9)	(75.0)	(76.3)	(74.9)	(76.3)

Note: Standardized regression coefficients (beta) are presented and the underlined ones are significant at .05 level. All variables are log-transformed.

Source: Data from CIA, *World Factbook* (2007, 2008, 2009, 2010, 2011); Encyclopedia Britannica, Inc., *The Nations of the World / Britannica Book of the Year* (2007, 2008, 2009, 2010, 2011); *Index 2011* (URL: http://en.wikipedia.org/wiki/Quality-of-life_index); http://www.economist.com/media/pdf/QUALITY_OF_LIFE.pdf.)

Multiple regressions in Table 2 (Regionalism CONTROLLED) assess whether the regionalism in Table 1 has significant ‘independent’ effect on economic development regardless of international economic and domestic variables, which are also assumed to affect economic development. Table 2 shows a ‘pure’ effect of regionalism on economic development when controlling the effects of international economic and domestic variables. The findings based on both Tables 1 and 2 indicate the following four different patterns of effect of regionalism (see Fig. 1 below) on economic development. The figure shows how the effect of regionalism on economic development changes between the ‘regionalism alone’ and the ‘regionalism controlled’.

Fig. 1. Different patterns of regionalism

<u>PATTERNS</u>	Regionalism <u>ALONE</u>		Regionalism <u>CONTROLLED</u>
<i>I. Spurious Regionalism</i>	Significant EU/APEC (+) SAARC (-)	TO	Insignificant (0) (0)
<i>II. Suppressed/Hidden Regionalism</i>	Insignificant CARICOM (0) PC (0)	TO	Significant (+) (-)
<i>III. Affective Regionalism</i>	Significant AU/ECOWAS (-) NAFTA (+)	TO	Significant (-) (+)
<i>IV. Non-Affective Regionalism</i>	Insignificant SCO, OAS, LAS, MERCOSUR, AN- DEAN and ASEAN (0s)	TO	Insignificant (0s)

Note: (+) positive significant; (-) negative significant; (0) insignificant.

Each of the four different patterns is discussed as follows.

Pattern I. Some regionalisms, previously (see Table 1) found significant, were found to have no significant ‘independent’ effects on economic development. That is, once the effects of international economic and domestic variables are controlled, all of those significant effects of the regionalisms on economic development disappear.³ They are the EU, APEC and SAARC. Both the EU and APEC were previously found to have significant positive effects on economic development, while SAARC would have a negative effect.

³ It is very important to take into account at this point that the author speaks here about the disappearance of a significant impact of regional organizations of the first type in their mathematical model and not in reality. In no way this statement should be understood as claiming that such an impact existed sometime ago and later it disappeared. – *Editors.*

It was found that the original positive effects of the EU and APEC on economic development were a product of the effects of high globalization and favorable terms of trade as well as the effects of low population growth, high urbanization and ethnic homogeneity of individual member states. The positive effects were not a function of the collective institutional capacity of each of the two respective regional organizations. The original negative relationship between the SAARC and economic development was also a product of international economic variables featuring low globalization and unfavorable terms of trade as well as domestic conditions of low urbanization, high population growth and heterogeneous ethnic composition of individual member states. The SAARC was found to have no independent effect on economic development. In these three regionalisms, international economic and domestic variables of 'individual' member states make it difficult for the 'collective' regional organization to significantly affect economic development. The ability of the collective regional organization is constrained by the individual member states. The original significant, positive or negative, effects of the regionalism were found spurious. This pattern of regionalism is labeled as '*spurious regionalism*'.⁴

Pattern II. Some regionalisms were found to have no significant effects on economic development. But once the effects of international economic variables as well as domestic variables of the member states are controlled, the effect of regionalism on economic development appears significant, whether positive or negative. CARICOM was found to have a positive effect on economic development, while PC – the negative one (see also Tables 2 and 3). The change from insignificant to significant effects indicates that the original effects of the regionalism on economic development were suppressed (hidden). That is to say, the international economic variables such as economic globalization and terms of trade as well as domestic variables such as population growth, urbanization and ethnic composition were found to hide/conceal the 'true' relationship between regionalism and economic development. These are suppressor variables, concealing this true relationship. This pattern of regionalism is denoted as '*suppressed/hidden regionalism*'.

Pattern III. There are regionalisms whose effects on economic development remain unchanged regardless of international economic and domestic variables of the member states. They are the AU, ECOWAS and NAFTA. The AU and ECOWAS were previously found to have negative effects on economic development, while NAFTA's effect was positive. The significant negative effects of the two regional organizations in Africa (*i.e.*, of the AU and ECOWAS) on economic development remain unchanged regardless of international economic and domestic variables of the member states. Regardless of low globalization and unfavorable terms of trade as well as of low urbanization, high population growth, and heterogeneous ethnic composition of the member states associated with each of the two regional organizations, the institutional design of these two respective organizations was still found to have significant independent and negative effects on economic development. NAFTA was found to have positive, although weak, effect on economic development and the effect remains unchanged regardless of international economic and

⁴ Note that the author considers the regional organizations as units of his analysis. It is quite clear that if he studied, for example, the impact of the joining the European Union by individual countries on the economic development of particular countries, he would discover that this impact in many cases is rather significant. At such a level of analysis one would have to take into account many other factors not considered by the author – for example, the requirements that regional organizations impose on new members with respect to particular social, economic, and institutional indicators. – *Editors*.

domestic variables of the member states. This pattern of regionalism is labeled as '*affective regionalism*'.

Pattern IV. There are regionalisms whose effects on economic development remain solidly unchanged with their respective insignificant effects on economic development regardless the international economic and domestic variables of individual member states: they are the SCO, OAS, LAS, MERCOSUR, ANDEAN and ASEAN (see also Tables 2 and 3). These regional organizations were found incapable of affecting economic development, whether positively or negatively, under any international economic and domestic conditions of the member states. They are simply insignificant. This pattern of regionalism is labeled as '*non-affective regionalism*'.

The Effects of International Economic and Domestic Variables

Table 2 shows that regardless of any 'patterns' of regionalism discussed above, globalization was found to have strong and positive effects on economic development across all fourteen regionalisms. Regardless of regionalism, the favorable terms of trade in the member states were also found able to enhance economic development. External (foreign) debt sustainability, however, was found to have no significant effect on economic development, indicating that external debt, whether sustainable or unsustainable, is neither necessarily negative nor positive in affecting economic development. The effect of political system, democratic or authoritarian, on economic development is mixed. In the AU, EU, ASEAN, NAFTA, APEC, CARICOM, OAS, SAARC and SCO, the political system was found to have no significant effects on economic development, while the ANDEAN, LAS, ECOWAS, MERCOSUR and PC show that the more democratic political system, the higher economic development, yet the positive effect of political system on economic development was found relatively weak. Military expenditures were found to have no significant independent effect on economic development. Our findings do question a long-held view of the trade-offs, positive or negative, between the defense spending and economic development. Urbanization, ethnic homogeneity, and population growth were found to have significant independent effects on economic development. Regardless of regionalism, the more urbanized, ethnically homogeneous countries, which are also associated with a lower population growth, are likely to maintain a higher level of economic development than the rural, ethnically heterogeneous countries with a high population growth. The AU and ECOWAS in Africa, however, are exceptional in that their ethnic composition, heterogeneous or homogeneous, was found to have no significant effects on economic development regardless of their respective regionalisms.

Conclusions

The regionalism realized by the collective institutional design via regional organizations was found to depend from the conditions and constrains of individual sovereign member states. Collective regional/global governance as well as institutional capacity of the regional organizations was found to be dependent of the individual member states when affecting economic development. The effects of regionalism on economic development varied. Some regionalisms were found spurious or suppressed by the effects of conditions and constraints of the member states. Some regionalisms were found affective, indicating they are significant, positive or negative, in affecting economic development. But still many other regionalisms were found non-affective, indicating that they are simply insignificant

in affecting economic development regardless of international economic and domestic variables of the member states.

Regardless of regionalism, both globalization and favorable terms of trade of individual member state were found to have strong positive effects on economic development. The rapid population growth and heterogeneous ethnic composition have a negative effect on economic development, while urbanization has a positive effect. In some regionalisms, political democracy was found to have a positive effect on economic development, while many other regionalisms show that political democracy is not necessarily a significant determinant of economic development. The debt sustainability/unsustainability, as well as defense spending, was found to have no significant effect on economic development regardless of regionalism.

When/if regionalism via regional organization aims at enhancing the economic development, then the institutional capacity of regional organization based on the rules, norms and principles should be able to increase globalization as well as to produce favorable terms of trade for the member states. This is irrespective of the domestic socioeconomic, demographic and political conditions of the member states. Unless the regional organizations are institutionally capable of making their respective regionalism globalize beyond their internal integration and global/regional governance they aim, 'collective' regionalism alone is not likely to have a positive determining impact on economic development that 'individual' sovereign member states pursue.

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