

Regionalism, Globalization and Economic Development in the World

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Abstract: This study assesses the effects of regionalism on economic development in the world based on 217 countries. Overall, regionalism pursued by countries via their respective regional organizations was found to have no significant independent effects on economic development. Regardless of regionalism, 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, individual sovereign member states of the regional organization are independent of the collective institutional design of the regional organization they are affiliated with.

JEL Classification: F50, F59, O19

Key words: regionalism, regional intergovernmental organizations, globalization, suppressor variable, economic development

Introduction

The purpose of this paper is to analyze the effectiveness of regionalism by regional organizations in the world in affecting economic development. Not only regional intergovernmental organizations (RIGOs) such as European Union (EU), African Union (AU) and Association of Southeast Asian Nations (ASEAN), but also regional free trade agreements (RFTAs) such as 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 the regionalism should also cover 'all' regions in the world and this study is based on major regionalisms, aiming to cover all regions/subregions in the world: Europe, Africa, Southeast Asia, South Asia, Pacific Rim, Central Asia, North and South America, and Middle East.

Many Views of the 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, K., and D. Snidal 1998; Karns, M. P., and K. A. Mingst 2010, 6). 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 as well.

Rosenau, J. N. (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, A. (2003) has also defined global governance as the management of global processes in the absence of global government. According to Weiss, T. G. (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, M., and K. 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 economic development. Globalization is one of them²⁸. There have been pros and cons of the role of globalization in enhancing economic growth and/or quality of life. Stiglitz, J. (2003) was critical of globalization, as it has deepened global inequality between the haves and have-nots, particularly in the less developed countries. Goklany, I. M. (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 roles of MNCs in economic development in host countries, developing or developed, have nevertheless been controversial (Nunnenkamp, P., and J. Spatz 2003).

Terms of trade, favorable or unfavorable, could 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, P. C. Y. 1987; Appleyard, D. R., A. J. Field, Jr., and S. L. Cobb 2008, 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, C. M. 2004).

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

Russett, B. (2005) found democracies are considered efficient in generating wealth and economic growth, which also lessen the frequency of internal conflict. Authoritarian political systems turn out to be more conflict-ridden than democratic counterparts and they lower the quality of life. Authoritarian political systems are unable to effectively manage external debt

²⁸ 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 (Zurich, Switzerland).

and foreign assistance as well. Many developing countries have implemented 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 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 rapid economic growth without undertaking significant political liberalization. South Korea was able to rapidly develop during the 1970s and 80s while its political system was still authoritarian.

When inequality of income distribution is related to ethnicity, gender, or geographic region, Clemens, M. A. (2007) argues that a stronger role for the state (that is, 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, J. (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 countries²⁹.

A huge military spending disproportionate to economic capacity is siphoning off the resources, which otherwise could have been used for economic growth and quality of life (Sivard, R. L. 1991). Some found the trade-off between the defense spending and economic growth. Benoit, E. (1978), based on the 44 developing countries, argued that there is a positive correlation between military expenditures and economic growth over the period 1950-65. Klare, M. T. (1987) demonstrates that every additional dollar spent on defense in developing countries reduce 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 found to still 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, H. S. 1996). Ethnic heterogeneity has been impeding enhancement of quality of life (Collier, P. 1999; Collier, P. 2007). Empirical evidences have shown that demographic variables such as ethnic composition (Alesina, A., A. Devleeschauwer, W. Easterly, S. Kurlat, and R. Wacziarg 2003), urbanization (Todaro, M., C. S. Stephen 2012, 312-318) and population growth (McNicoll, G. 1995) have significant effects on quality of life. What affects economic development is not only domestic but also international. This study will employ ‘multiple’ variables, domestic and international, including the regionalism. In order to identify an independent (that is, a

²⁹ 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).

‘pure’) effect of the regionalism on economic development, all other international and domestic variables assumed to affect economic development as well will be controlled.

Methodology

Dependent variable: Economic Development

Economic development was treated as dependent variable. Economic development was based on the per capita GDP PPP (Purchasing Power Parity), which indicates gross domestic product (GDP) at purchasing power parity (PPP) per capita. When comparing cross-national differences in the development, including economic development, a PPP basis is arguably accurate and useful.

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. Those countries affiliated 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 becomes African Union’s 54th Member, 28 July 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 expenditure 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 given 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.

Two hundred and seventeen (217) countries are used in this analysis. The data cover the 2005-2011 period 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 regression will test whether the regionalism affects economic development regardless of other international economic and domestic variables.

Results

Table 1 presents regression analysis, which assesses the effect of regionalism on economic development. The table (Regionalism ALONE) aims to assess how regionalism 'alone' affects economic development. The finding demonstrates different kinds of the effect of regionalism on economic development: positive, negative and no effects. Out of the 14 regionalisms, the 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 1: Multiple Regression: Regionalism ALONE and Economic Development (Per Capita GDP PPP)

	EU	AU	NAFTA	APEC	SAARC	SCO	LAS	ANDEAN	ASEAN	ECOWAS
Economic Development	<u>0.366</u>	<u>-0.549</u>	0.122	<u>0.181</u>	<u>-0.135</u>	-0.058	-0.003	-0.005	-0.041	<u>-0.343</u>
	MERCOSUR	ANDEAN	OAS	CARICOM	PC					
Economic Development	0.021	-0.005	0.094	0.068	-0.087					

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. 2007-2011. *The Nations of the World/ Britannica Book of the Year*; KOF Index of Globalization. <http://globalization.kof.ethz.ch<Globalizaion Index 2011>>; http://en.wikipedia.org/wiki/Quality-of-life_index<The Economist Unit's quality-of-life Index 2005>.

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>-0.166</u>	0.063	-0.008	0.089	-0.008	<u>0.159</u>	0.101
Globalization	<u>0.196</u>	<u>0.212</u>	<u>0.223</u>	<u>0.220</u>	<u>0.222</u>	<u>0.231</u>	<u>0.223</u>
Terms of trade	<u>0.178</u>	<u>0.177</u>	<u>0.183</u>	<u>0.182</u>	<u>0.184</u>	<u>0.203</u>	<u>0.196</u>
Debt Sustainability	-0.046	-0.070	-0.053	-0.061	-0.053	-0.004	0.052
Urbanization	<u>0.343</u>	<u>0.373</u>	<u>0.373</u>	<u>0.362</u>	<u>0.375</u>	<u>0.399</u>	<u>0.346</u>
Ethnic homogeneity	0.073	<u>0.150</u>	<u>0.152</u>	<u>0.155</u>	<u>0.153</u>	<u>0.150</u>	<u>0.136</u>
Population growth	<u>-0.215</u>	<u>-0.176</u>	<u>-0.212</u>	<u>-0.214</u>	<u>-0.212</u>	<u>-0.216</u>	<u>-0.246</u>
Political system	0.101	0.111	0.114	0.108	0.116	0.084	0.101
Military expenditure	0.022	0.027	0.030	0.031	0.030	0.062	0.060
R square (%)	(76.3)	(75.0)	(74.8)	(75.6)	(74.9)	(77.0)	(75.6)

(continued)

	SAARC	SCO	ANDEAN	LAS	ECOWAS	MERCOSUR	PC
Regionalism	0.079	-0.011	-0.025	0.051	<u>-0.136</u>	-0.033	<u>-0.127</u>
Globalization	<u>0.238</u>	<u>0.222</u>	<u>0.219</u>	<u>0.211</u>	<u>0.216</u>	<u>0.214</u>	<u>0.214</u>
Terms of trade	<u>0.177</u>	<u>0.183</u>	<u>0.186</u>	<u>0.180</u>	<u>0.164</u>	<u>0.181</u>	<u>0.182</u>
Debt Sustainability	-0.059	-0.052	-0.050	-0.048	-0.038	-0.050	-0.080
Urbanization	<u>0.396</u>	<u>0.376</u>	<u>0.378</u>	<u>0.369</u>	<u>0.374</u>	<u>0.384</u>	<u>0.381</u>
Ethnic homogeneity	<u>0.139</u>	<u>0.153</u>	<u>0.152</u>	<u>0.145</u>	<u>0.110</u>	<u>0.158</u>	<u>0.163</u>
Population growth	<u>-0.214</u>	<u>-0.213</u>	<u>-0.209</u>	<u>-0.229</u>	<u>-0.196</u>	<u>-0.211</u>	<u>-0.193</u>
Political system	0.103	0.111	<u>0.118</u>	<u>0.127</u>	<u>0.134</u>	<u>0.115</u>	<u>0.124</u>
Military expenditure	0.021	0.028	0.032	0.013	0.032	0.025	0.015
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. 2007-2011. *The Nations of the World/ Britannica Book of the Year*; KOF Index of Globalization. <http://globalization.kof.ethz.ch<Globalizaion Index 2011>>; http://en.wikipedia.org/wiki/Quality-of-life_index<The Economist Unit's quality-of-life Index 2005>.

Multiple regression in Table 2 (Regionalism CONTROLLED) assesses whether the regionalism in Table 2 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 Figure 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.’

Figure 1: Different Patterns of Regionalism

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

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. They are EU, APEC and SAARC. Both EU and APEC were previously found to have significant positive effects on economic development, while SAARC negative effect. 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 with low globalization and unfavorable terms of trade as well as domestic conditions of low urbanization, high population growth and heterogeneous ethnic composition of the 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.’

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 the regionalism on economic development emerges

significant, whether positive or negative. CARICOM was found to have positive effect on economic development, while PC negative (see also Table 1 and 2). The change from insignificant to significant effects indicates that the original effects of the regionalism on economic development were suppressed (hidden): That is, 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 the regionalism and economic development. These are suppressor variables, concealing the true relationship between the regionalism and economic development. This pattern of regionalism is labeled 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 AU, ECOWAS and NAFTA. The AU and ECOWAS were previously found to have negative effects on economic development, while NAFTA positive. The significant negative effects of the two regional organizations in Africa, 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 low urbanization, high population growth, and heterogeneous ethnic composition of the member states associated with each of the two regional organizations, 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 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 of international economic and domestic variables of individual member states: they are SCO, OAS, LAS, MERCOSUR, ANDEAN and ASEAN (see also Table 1 and 2). These regional organizations were found incapable of affecting economic development, whether positive or negative, 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, favorable terms of trade by 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 AU, EU, ASEAN, NAFTA, APEC, CARICOM, OAS, SAARC and SCO, the political system was found to have no significant effects on economic development, while 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 expenditure was found to have no significant independent effect on economic development. The finding does 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 urban, 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 which also experience with a high population growth. AU and ECOWAS in Africa, however, are exceptional in that ethnic composition, heterogeneous or homogeneous, was found to have no significant effects on economic development regardless of their respective regionalisms.

Conclusion

Regionalism realized by the collective institutional design via regional organizations was found not to be free from the conditions and constraints of individual sovereign member states. Collective regional/global governance as well as institutional capacity of the regional organizations was found not to be independent of the individual member states when affecting economic development. The effects of regionalism on economic development were 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 respectively on economic development. Rapid population growth and heterogeneous ethnic composition have negative effect on economic development, while urbanization has positive effect. In some regionalisms, political democracy was found to have positive effect on economic development, while many other regionalisms show that political democracy is not necessarily significant determinant of economic development. 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 to enhance economic development, institutional capacity of the 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 regardless of domestic socioeconomic, demographic and political conditions of the member states. Unless regional organizations are institutionally capable of making their respective regionalism globalized beyond their internal integration and global/regional governance they aim to pursue, the 'collective' regionalism alone is not likely to have positive determining impact on economic development that 'individual' sovereign member states pursue.

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