

Poverty and Financial Inflows in Latin America

Diploma thesis

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Declaration

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Abstract

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The diploma thesis focuses on the assessment of poverty in Latin America and the Caribbean region for a period of 1995-2015. A cluster analysis is applied to divide the region according to the sub-indices of the Human Development Index. Later, a simple regression analysis is used to evaluate the relation between poverty and decisive indicators such as GDP per capita, unemployment rate, and inequality level. Furthermore, the relation between poverty and financial inflows is examined via a multiple-regression analysis. Development of decisive indicators during the observed period is accompanied by trend analyses. On the basis of the analyses conducted, the evaluation of poverty reduction with regard to the financial inflows in the region of LAC is carried out.

Keywords

poverty, income inequality, GDP per capita, foreign direct investments, remittances, official development assistance

Abstrakt

Birčiak, M. *Chudoba a finančné prítoky v Latinskej Amerike*. Brno: Mendelova univerzita v Brně, 2016.

Diplomová práca je zameraná na zhodnotenie chudoby v Latinskej Amerike a Karibiku medzi rokmi 1995 a 2015. Krajiny regiónu sú rozdelené pomocou zhlukovej analýzy na základe subindexov Human Development Index. V práci je sledovaný vzťah medzi chudobou a rozhodujúcimi faktormi ako napríklad HDP na obyvateľa, nezamestnanosť, príjmová nerovnosť, pomocou jednoduchej regresnej analýzy. Viacnásobná regresná analýza je použitá na skúmanie vzťahu medzi chudobou a finančnými prítokmi. Vývoj rozhodujúcich faktorov je počas sledovaného obdobia sledovaný trendovou analýzou. Na základe vykonaných analýz je následne vyhodnotené znižovanie chudoby vzhľadom na finančné toky do regiónu Latinskej Ameriky a Karibiku.

Kľúčové slová

chudoba, príjmová nerovnosť, nezamestnanosť, HDP na obyvateľa, priame zahraničné investície, remitancie, oficiálna rozvojová pomoc

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1 Introduction

The phenomenon of poverty has been known across the world from the ancient times. Even now some parts of the world struggle with the poor population which affects basic standards of living in the society. The poverty itself can be looked at from various points of view; the measurement of this phenomenon can be conducted differently as well. However, if a person is poor, it highly affects his or her well-being, and thus the standard of living of the whole society. Moreover, poverty can influence the whole economy of the countries affected since poor population requires special attention in terms of poverty eradication.

The incidence of poverty has been a characteristic feature for many developing regions in the world for many years. Latin America and the Caribbean have been fighting the poverty for decades as they still have not got rid of the drawback of the whole society. At the Millennium Summit in September 2000, world leaders agreed to halve the proportion of poor people in the world by 2015 – meanwhile, in the region of Latin America and the Caribbean the success has been observed. The region as one of the few was able to decrease the poverty by almost 70 %. With regard to the huge disparities across the region of Latin America and the Caribbean, the poverty has been effectively reduced only in some sub-regions, thus, it remains an up-to-date issue for many countries in that part of the world. When we look at the financial incentives which helped to reduce the poverty incidence in the region, it should be accounted mainly for Personal Remittances, Foreign Direct Investment, and Official Development Assistance. These financial flows represent, for the region of Latin America and the Caribbean, crucial capital inflows in terms of poverty eradication itself. Since the mentioned inflows can also harm the countries in the region, they should be handled with appropriate policies cleaned up of the corruption which represents another major issue in that part of the world.

The real risk of poverty does not consist only in the state of being poor; however, for many inhabitants in the region of Latin America and the Caribbean, the term is connected with exclusion from the society.

2 Aim

The main aim of the thesis is to assess the poverty development in Latin America and the Caribbean with regard to the financial inflows streaming into the region (Personal Remittances, Foreign Direct Investments, and Official Development Assistance).

In order to reach the main aim of the thesis, it is vital to set interim goals. The interim goals are as follows:

- to divide the region of Latin America and the Caribbean based on the Human Development Index,
- to examine the development of poverty rate in the sub-regions of LAC between 1995-2015,
- to examine the development of the decisive indicators such as GDP per capita, Unemployment rate, Gini Index and to find out the relationship of the decisive indicators with regard to the poverty reduction in Latin America and the Caribbean between 1995-2015.

Hypotheses

Via following hypotheses, the interim goals as well as the main goal of the thesis will be analysed:

- **Hypothesis 1:** Economic growth reduces poverty incidence.
- **Hypothesis 2:** Unemployment increases the level of poverty.
- **Hypothesis 3:** Income inequality increases poverty.
- **Hypothesis 4:** Poverty is reduced by Foreign Direct Investments, Personal Remittances, and the Official Development Aid.

3 Review of the literature

3.1 Standard of Living

Defined by Investopedia (2016), the term *Standard of Living* is related to a level of wealth, comfort, and necessities which are available to a certain socioeconomic group in a given area. It is furthermore defined that the term also includes areas of life such as gross domestic product, income, safety, and climate. Standard of Living can be understood also as a complex of demographic characteristics such as length of life, health care, education, gender (in) equality, political situation which are later on expressed as statistical quantities. (Wise Geek, 2012)

As he points out, Maddison (2003) understands that standard of living can be affected by both economic and social aspects of the life. Furthermore, he adds that living standard in Latin America during the 20th century was primarily influenced by those two aspects where GNI per capita played a crucial role.

The economic view of the Standard of Living is created by the components which can be expressed by measurable units. In this sense income, unemployment, revenues and expenditures are considered to be the crucial aspects in considering Standard of Living from the economic point of view. (Mărcuță, 2013)

The term standard of living cannot be considered only from the economic angle. There are many authors who perceive the term more from the socio-logical point of view as they do not agree that living standard is determined exclusively by spending and material means. Many times, the living standard is determined by non-material aspects which cannot be bought for money. It was detected that in many cases the living standard of people from lower-income groups was higher than the living standard of people from higher income groups. (Šrůtka, 1968)

Smeeding et al. (1993) argue that income has a direct impact on the level of households' standard of living. In their research they found that cash and non-cash inflows, to a household or a family, do have a crucial influence on the living conditions and living standard. By cash flows the income is determined as the main factor which presents the household to fall into poverty, and thus sustains its level of standard of living; on the other hand, for the non-cash flows there are health care, education, child care, food and production for one's own consumption considered. All these cash and non-cash flows prevent families from crossing the threshold of poverty, and thus help them keep a decent standard of living.

3.2 Measurement of Standard of Living

Economic and non-economic approaches are used for measurement and evaluation of standard of living as such. Due to a number of definitions existing for standard of living, there cannot be only one indicator that would objectively measure the standard of living in a given society. Yet, the most commonly used one for assessing the living standard is the Gross Domestic Product per Capita (GDP per Capita). On the other hand, there are alternative indicators which consider the living standard more from a non-economic point of view. (Kao, 2013)

3.2.1 GDP per Capita

Since World War II nations equated economic growth with prosperity. Economic prosperity was identified by an increase in the production and consumption of goods and services measured by Gross Domestic Product. GDP thus became a standard measure for an economic progress which equals people's wellbeing as well. (Steady State Economy, 2010)

Gross Domestic Product per Capita is a commonly used measure for an economic performance and output, and at the same time it is accepted as a broad measure of living standards or economic well-being with regards to some recognized shortcomings. (OECD, 2009)

Datta (2015) reminds that the GDP per capita does not merely measure the economic output; moreover, it looks at the level of income enjoyed by citizens of a given country.

The measure GDP per capita as the appropriate tool to measure living standards was accepted not only by several economists and scientists but also worldwide. Theyson (2015) agrees with using the GDP per capita as an appropriate tool for measuring standard of living while creating more complex indices to cover more aspects of a human life as well.

With regard to a claim that this indicator directly reflects the living standard of a society, Krugman et al. (2012) argue that the indicator is not sufficient for the evaluation of the living standard. Furthermore, they explain that an increase in an individual income does not necessary mean an increase in one's standard of living as the extra portion of money may or may not be used to increase the well-being of an individual, and thus the standard of living of the whole society. Therefore, it is clear that the GDP per capita does not reflect the standard of living; however, it represents only one of many determinants of population's living standard.

One of the reasons why the GDP per capita is considered to be an inappropriate indicator of standard of living is stated by McGlade et al. (2013). They claim that standard of living cannot be evaluated by an indicator which

in a case of an ecological catastrophe regards only the economic side of the whole problem. When such a situation occurs the effort used to eliminate the catastrophe is connected with spending which promotes the GDP per capita within the economy, and thus one would assume that the standard of living increases but it actually does not do so.

Van den Bergh (2009) claims that the GDP cannot reach the black or grey market, thus the results of the indicator are not precise. Among other drawbacks of GDP per capita as an indicator, he highlights the inequality in income distribution where the GDP per capita cannot see the gap between the rich and poor; therefore, it can seem that a country with high GDP per capita can have income allocated only in the rich minority.

Stiglitz (2009) points that out as well, and focuses more on the inequality within the economy in which the GDP per capita is used for evaluating the living standard. He says that the main drawback of the indicator is rooted in its calculation and its results, which could be distorted as the indicator will grow evenly when only one part of the population has more assets than the other one.

3.2.2 Human Development Index

Since the economic growth does not reflect the true level of living standard in an observed country, the Human Development Index (HDI) was created. The index was created in order to emphasize that people and their capabilities should be the ultimate criteria while evaluating the development of a country. Furthermore, the index itself can be used to evaluate political decisions of two economically even countries with different human development outcomes. (UNDR, 2016)

Ranis et al. (2011) rather criticize the Human Development Index with regard to evaluation of human development. They argue that the HDI does not cover all the aspects of human life as some of the crucial elements are left behind.

Cahill (2005) explains the direct link between the GDP per capita and HDI by the sub-indices of the latter. For calculation of the HDI an income based sub-index is calculated from the GDP per capita, and thus strong statistical relationship between those two ones arises.

Klugman et al. (2009) explain the measurement of the sub-indices of the Human Development Index. The health dimension is evaluated by the life expectancy at birth, the educational dimension is measured by a mean number of years of schooling for adults at the age of 25 years and more, and by expected years of schooling for children of school entering age. Last but not least, the living standard element is defined by the gross national income per capita.

The scores for each of the components which can reach values between 0 (low development) and 1 (high development) are later aggregated into one composite index using a geometric mean.

The educational component, already defined by the mean number of years of schooling for the adults aged 25 and by expected years of schooling as well reached its maximum between 1980 and 2012 in the USA with a value of 13.3 years. The expected years of schooling reach the maximum at the age of 18 years.

The health component of the Human Development index is measured by the life expectancy at birth. Thus, if a child is born in a country where average life expectancy at birth is 55 years, the value of the sub-component will be 0,551.

The standard of living indicator is characterised by the Gross National Income per capita which can be explained as follows: $GNI = GDP + \text{net primary income from abroad}$. To show the decreasing importance of income the Human Development Index uses a logarithm to do so while the GNI per capita is on the increase. (HDR, 2014)

Overall, there are basically 2 steps to calculate the Human Development Index correctly. The first - defined by creating dimension indices - is done in order to transform the indicators into indices between 0 and 1 of maximum and minimum values while the maximum values were set in the 1980 - 2012 survey and the minimum values are chosen separately for each of the indicators. The minimum value for life expectancy is set for 20 years, for the educational aspect it is 0 years and \$ 100 for Gross National Income.

When the maximal and minimal values are set, the indices are calculated according to the equation 1 as follows:

$$\text{Dimension indices} = \frac{\text{actual value} - \text{minimum value}}{\text{maximum value} - \text{minimum value}}$$

The second step in calculation of final Human Development Index contains an aggregation of the already calculated sub-indices in order to create the Human Development Index. As it is depicted in equation 2 the Human Development Index puts all the sub-indices to a geometric mean to produce final value of the index (HDR, 2015):

$$HDI = I_{Life}^{1/3} \times I_{Education}^{1/3} \times I_{Income}^{1/3}$$

3.3 Income, income distribution and inequality

Saunders et al. (2002) explain the direct link between income and poverty when the increase in an individual's income is related to an increase in his or her well-being and also the poverty because the individual has enough means for increasing the consumption.

The widely accepted definition of income could be the one offered by Investopedia (2013) which defines *income* as an amount of assets, typically money, received by an individual for exchange for providing goods and services, or through investing capital.

With regard to the income distribution within a country, many countries around the world try to diminish the income inequality. Income inequality is understood as unequal distribution of monetary means towards individuals (or households) within the whole economy (typically a state). Very often it is expressed in percentage where for instance 20 % of population holds 70 % of total income of a given country. (GDP Fetishism, 2009)

Among other factors influencing the income distribution within an economy, also a number of poor people and the average quality of life are those which should not be ignored regarding the income distribution. (Soubbotina, 2000)

The income distribution inequality can be measured by several ways. The most common and widely used way how to measure the inequality is by the Gini coefficient. (Heshmati, 2004) Gini coefficient can reach values from 0 to 1, where 0 means total equality and 1 total inequality. In the first case, where the Gini coefficient is equal to 0, all the individuals within the economy have the same income. On the other hand, if the Gini coefficient is equal to 1, there is only one individual who gets all of the income of the economy. (Charles-Coll, 2011)

Inequality as the main burden for Latin America and the Caribbean has been the topic for a discussion for several decades. While other countries on the similar economic level caught up with the developed economies, Latin America and the Caribbean region lagged behind. While inequality does not refer merely to unequal distribution of income, the phenomenon exhibits also unequal access to education, health care, water, and electricity. Another issue arises when this inequality affects also the poverty reduction of the countries in Latin America and the Caribbean and slows down the development process itself. (World Bank, 2003)

3.4 Poverty

Poverty as an aspect of daily life and of society itself has been here for a long time and surely will persist. This dimension of human life, and most importantly society, cannot be unambiguously defined, nor exists a definition that would be accepted worldwide with regard to a number of features of poverty. It is much discussed in regard to inability to cover basic needs, insufficient education, or health care of an individual or a society. Among other features there can be added malnutrition, criminality, insufficient hygiene or the inability to adapt to a society. (Hagenaars and De Vos, 1988)

Traditionally poverty is understood as a material deprivation; however, when we look at the poverty from a wider scope it can be said that poverty is deprivation of well-being of an individual. Thus, except for low income and low consumption, poverty is characterised by the poor nutrition and poor living conditions. (Soubbotina, 2004)

In their book, *Handbook on Poverty and Inequality*, Haughton and Khandker (2009) define poverty from the economic point of view as they see that poverty is always tied to an economic insufficiency in a human life, and therefore, the individual or the whole society is poor. Moreover, they claim that such a state of economic inability to cover basic needs such as food or shelter, is caused by various factors, e.g. not-properly functioning health system, unemployment, etc. Yet, poverty is by many understood as a cause for social exclusion.

Of course, there are more definitions of poverty. Income or consumption are widely used by economists to evaluate the poverty of the individuals. Another meaning of the word "*Poverty*" could be understood in terms of material lack or want. Other assets than income are included in this group - such as shelter, clothing, personal means of transport, radio, or television. Moreover, this meaning of poverty often refers to a very poor access to services. (Malik, 2013)

Reflecting more dimensions of poverty a term of *Multidimensional Poverty* had been developed. Since the poverty cannot be evaluated merely according to income, there are other aspects of poverty that have to be taken into account. Multidimensional Poverty is defined as poor health or malnutrition, a lack of clean water or electricity, none or poor quality of education or work, all of which contribute to the overall state of poverty of an individual or of a society. While evaluating poverty properly one cannot look at one factor of poverty only. Income as such is not sufficient to truly depict the reality of poverty. (HDR, 2015)

With regard to multidimensional deprivation of an individual for a long period of time (typically the whole life) the term *Chronic Poverty* was defined. Hulme et al. (2001) explain that multidimensional poverty in the long-run can grow into

chronic poverty which is characterised by both absolute and relative poverty, vulnerability, social exclusion and others. Furthermore, they state that the chronic poor are a heterogeneous group which is likely to experience multiple and overlapping vulnerabilities, while as an example of such groups are named those discriminated against because of their social position in the community or household, those with health problem and impairments, and people living in rural areas, in ghettos or in areas where violent conflicts and insecurity take place.

In this sense, Bermant (2008) continues and defines the term *Intergenerational Transmission (IGT) of Poverty* as public or private transfer from one generation to another, typically from parents to their children, of key deficits in resources and assets. He states that this transmission can be done through transfer of physical and financial assets such as savings, land, or livestock.

Kabeer and Mahmud (2003) believe that positive policies, transfers, and investment can break the cycle of the chronic poor, while negative processes can rather result in intergenerational transmission of poverty.

In their work *Left Behind*, they point at the dramatic poverty reduction across Latin America; however, they also mention that in the region of Latin America and the Caribbean one out of four Latin Americans still remains poor. They also distinguish whether these individuals fall into poverty only temporarily, called “*transitory poor*”, or these people are born into poverty and never escape it - also called the “*chronic poor*”. Furthermore, they state that the prospects for the latter to eventually escape poverty are weak in the near future. (Vakis et al, 2016)

Poverty as such could be divided into absolute and relative. While the former refers to a situation when the population does not own enough assets to secure basic needs such as food, clothing and shelter, the latter is related more to the overall quality of life. Since the relative poverty is mainly related to an economic status of the individual within an economy it is often characterised by the social inequality within a country. (UNESCO, 2014)

Financial flows and the development of financial sector is observed in sub-Saharan Africa (SSA) by Gupta et al. (2007). They examined the financial flows to the region in a form of remittances which could possibly influence the poverty reduction in countries of SSA. Although the region receives only small part of this kind of financial flow it proves that a development in financial sector is equal to poverty reduction during an observed period. (Odhiambo, 2010)

A similar study was conducted by Sehrawat (2016) who agrees with the assumption that financial flows connected to development in a financial sector do improve the living conditions of the poor population.

Global economic integration and capital flows connected with it should help poor people to escape poverty by receiving capital flows from abroad. While this

simple interpretation is understood as natural by many, Harrison (2006) analysed the relationship and found out that capital inflow does help the poor countries to develop; however, the profit made by the MNEs has to be reinvested in the country of production in fields such as human capital and infrastructure.

To measure the poverty in relative terms various methods have been developed. In 1985 a line of 1.00 USD per day was adopted as the main economic threshold in terms of poverty measuring. Although the term „dollar a day“ still features in many popular discussions, a new line 1.25 a day was developed in 2005 prices, which corresponds to the average of the poverty lines found in the poorest 15 countries in terms of per capita consumption. Though, there can be more thresholds and lines for poverty evaluation based on different methodologies. (Chen and Ravallion, 2008)

With regard to the changes of the prices in the developing world the poverty threshold has to be periodically updated, and thus a new line of 1.90 USD a day was adopted in 2015. (World Bank, 2016)

3.5 Financial Inflows

In the research of financial inflows in the developing countries among the significant factors which have direct impact on the inflow of assets to the country there are GDP per capita, GDP growth, real interest rate, inflation rate, gross capital formation included. Furthermore, adult literacy rate, labour force growth rate, real interest rates, inflation rate, number of telephone lines per 1 000 people and official exchange rate are considered to be important factors with regard to the FDI inflow. On the other hand, the export of goods and services alongside energy consumption are understood as insignificant. (Bekana, 2016)

International financial flows are considered a booster for the recipient economy. With such a boost in economic activities the economic growth is inevitable. Hand in hand with the economic growth the poverty reduction is in place, and thus with higher income from international financial flows it lowers proportion of poor people living in the society. (Zhang, 2006)

Mosley (2012) identifies the main institutions that provide developing countries with financial help for poverty reduction. These are: The World Bank and The International Monetary Fund. Indeed, there are more contributors - either official or unofficial - who directly influence the level of poverty in less developed countries.

3.5.1 Personal Remittances

Remittances as a flow of financial assets to a country are described as funds which are sent by an emigrant to a country of their origin via wire, mail, or online transfer. Such a type of financial transfers is economically significant for many countries which receive them. (Investopedia, 2016)

World Bank (2016) defines personal remittances as transfer of cash or in-kind transfer which are received by a resident household from non-resident households. Thus, those transfers include all current transfers between resident and non-resident individuals.

Analytical studies tend to characterise the term as a sum of selected balance of payments to a given country. From this angle, it can be said that remittances represent an important source of income for households, particularly in developing countries. This type of financial flow is the most protected financial flow against economic downturns and that is why it remains a stable source of income. (Alfieri, 2006)

The IMF (2009) recorded a sharp increase in the amount of remittances between 2001 and 2007, where the amount doubled in comparison with the previous years of surveys. The main reason was found in rising migration and labour mobility accompanied by more liberal and competitive financial intermediaries alongside with improved data recording. The amount of remittances in the world was so huge that this kind of financial inflow to a country exceeded even the Foreign Direct Investment and Official Development Assistance in several countries.

It is argued that remittances represent an essential part of household income in many developing countries, while in other countries this type of financial support from abroad represents a major part of GDP of the given country. While many official definitions define remittances as electronic transfers of money, it is known that this type of financial transfer is represented also by crossing a border with cash in a pocket, and thus it represents also the informal flows and ways how to support a household. (IMF, 2009)

Lucas and Stark (1985) found that the main factors or motivators which encourage migrants to send financial support back home range mainly from altruism (the quality of unselfish concern for the welfare of others) to self-interest.

Nnyanzi (2016) argues that alongside altruism that drives remittances to countries there are other factors which facilitate and encourage the process to remit back to the country of origin. Among others, there are control of corruption, financial development and reduction in unofficial economic activity in a receiving country included.

In the case of Latin American countries Cavellos (2005) noted that remittances do reduce poverty in that part of the world; while the impact of remittances is huge mainly for those who receive the money from abroad directly. He continues with the assumption that at least half of the population in the region of Latin America and the Caribbean would be poor if they did not have an emigrant who would support them from a foreign country. Furthermore, he emphasizes that *The Organization of American States* perceives remittances not to be the right instrument to combat poverty in Latin America and the Caribbean since the funds received from remittances represent only a temporary relief from poverty for households, rather than a permanent route to financial security.

In Latin America and the Caribbean the remittances have influence on the poverty eradication and inequality as well. It was found that remittances have increased growth and reduced inequality and poverty. Moreover, the survey found that that remittances have a negative, albeit relatively small effect on reduction of poverty and inequality in Latin America and the Caribbean countries. (Acosta et al., 2008)

3.5.2 Official Development Assistance

Widely accepted definition by OECD (2015) defines Official Development Assistance (ODA) as a government aid which is designed to support and promote economic growth, development and welfare of less developed countries, while military loans and credits are from this form of aid excluded. The aid can be done bilaterally from a donor to a recipient, or through a multilateral development agency (e.g. the United Nations, the World Bank). The aid includes grants, "soft" loans, and technical assistance. The term "soft" loans is furthermore defined as a loan where the grant element is at least 25 % of the total value. For now, the ODA flows to over 150 countries, while the long-term United Nations target is to have developed countries devote 0.7 % of GNI to Official Development Aid.

With regard to Official Development Aid the Multilateral Organizations play a crucial role. Except for the United Nations and the World Bank, another multilateral organisation could be Commodity Futures Trading Commission and the Asian Development Bank, which were set up to speed up the process of development of developing countries. Ariff (1998) questions the positive effect of the ODA in the developing countries, while at the same time he points out that many influential writers prove the importance of ODA for developing countries as this form of financial inflow supports the socio-economic development and growth in developing countries, as it was already mentioned.

Hansen and Tarp (2000) explain that Official Development Aid improve the economic growth only in developing countries with functioning and healthy political and economic institutions.

Knack (1999) proved that Official Development Aid (ODA) rather harms the receiving country. He sees the ODA as an aspect which can undermine the quality of governance and public sector intuitions by encouraging corruption, fomenting conflict over control of aid funds and weakening accountability. He proved that higher aid levels erode the quality of the government measured by the indices of rule of law, bureaucratic quality, and corruption.

With the political assumption also Boone (1996) continues who insists that the majority of the financial aid provided by developed countries flows directly to a wealthy elite in a receiving country mainly due to corruption.

In his study, Bahmani-Oskooee (2009), conducted a survey on the effect of Official Development Aid on poverty eradication in 49 developing countries. The results of his research contradict with the so far known literature reviews of the topic, when he found out a negative relation between official development aid and poverty eradication, and thus with an increase in ODA the poverty ratio is declining.

On the other hand, Arvin and Barillas (2002) did not find a mutual relationship between foreign aid and poverty reduction, conditioned on the state of democracy in selected countries. They insist that foreign aid flows do not impact poverty, nor that poverty affects foreign aid inflows.

Dollar and Collier (1999) strongly criticize the system how the foreign aid is distributed. They point out that by a wrong distribution of foreign aid among the poor countries the effect of poverty eradication in the developing world is diminished. Moreover, they noted that aid flows respond to policy improvements that create better environment for poverty eradication. Furthermore, they suggest that the actual aid is allocated on the basis of how poor the countries are as well as on the basis of the quality of their policies.

3.5.3 Foreign Direct Investments

In general, investment is a purchase of goods and services which are not consumed immediately but are used in the future to generate profit and wealth. Thus, Foreign Direct Investment is an investment in a particular country made by an individual or a company in business assets in another country. The crucial feature of the Foreign Direct Investment is rooted in investments that establish effective or substantial influence over the decision-making process of a foreign business. It is important to emphasize that the FDI differs from the so-called portfolio in-

vestments in which the investor only buys equities of foreign-based companies. (Investopedia, 2016)

In their work Nocke et al. (2008) define the conduction of FDI by firms. They explain that firms conduct the FDI either by engaging in Greenfield investment or in cross-border acquisitions. While the latter refers to trading of heterogeneous corporate assets across the border, the former includes establishing a new production division in a foreign country. Moreover, the cross-border acquisitions are used when the production costs differences between the countries are small while Greenfield investments are set up for the FDI flowing from high-cost into low-cost countries.

The Organisation for Economic Cooperation and Development (OECD) continues with the definition of the crucial feature of the FDI, where at least 10 % of the voting power owned by the investor is considered to be a basic criterion. Moreover, the OECD characterises the Foreign Direct Investment (FDI) as a key element in international economic integration. According to the organisation direct, stable and long-lasting links are created between economies by the FDI. (OECD, 2008)

With the incoming foreign direct investment into a host country the prices of the goods and services tend to go lower. The main reason behind this phenomenon is included in the fact that with an introduction of MNE's goods and services to host's market the competition rises, and thus the prices of the goods and services go down. (Pîndiche, 2014)

Biswas (2002) claims that there are traditional and non-traditional factors which have a direct influence on the inflow of the FDI in the economy. Among the traditional factors the author includes wage, infrastructure, market size, proximity to the local market, while the non-traditional factors are regime type, regime's duration, property right's index, etc.

The financial flows of the foreign direct investment consist of cross-border transactions of its components (equity transactions, reinvestment of earnings, and intercompany debt).

The flows can be divided according to the direction of the flow with regard to the reporting economy (OECD, 2008):

- Outward flow (FDI outflow) is reported to be transactions that increase the investment which the investors of reporting economy have in foreign economy.
- Inward flow (FDI inflow) increases the value of the investment of what non-resident (foreign) investors have in enterprises in the reporting economy.

A backward action of investments is called *disinvestment*. Disinvestment is commonly known as an action of an organisation or government to stabilise the other investments and maximize the return on investment into costs related to labour, infrastructure and capital goods. This action can be done by selling or liquidating an asset or subsidiary. (Investopedia, 2016)

Negative foreign direct investments indicate that at least one of the components of FDI (equity transactions, reinvestment of earnings, and intercompany debt) is negative and not balanced by the positive ones, and thus this can occur while selling of interests occurs, an affiliate pays of a loan from its direct investor, or an affiliate loses money. (UNCTAD, 2015)

Shiralashetti et al. (2009) state positive correlation between FDI and standard of living, and add that since 1991 in India the total living standard went up mainly thanks to the foreign direct investment which had a decisive impact on the whole economy. Moreover, an increase has been noticed in the areas such as the GDP growth, employment creation, infrastructure, poverty reduction, etc.

FDI also increases tax revenues accompanied by improved management, technology, alongside skilled labour force in a host country. Additionally, the FDI can help the country end the poverty and elevate standard of living by breaking out of a cycle of underdevelopment. (Hayami, 2001)

The main desire of the host country to receive the FDI is to enhance the economic development and increase standard of living of its population. The industrial progress and development are also important drivers for the host country to receive a FDI. (Ugochukwu et al., 2013)

It may seem natural that foreign direct investments have a positive influence on the economic growth for the host countries; however, this may vary across sectors of the economy. Alfaro (2003) argues that foreign direct investments exert an ambiguous effect on economic growth. While the investment in a primary sector can have a negative character, the investments in manufacturing has a positive one. Furthermore, she stresses out that the influence of FDI on the GDP cannot be seen in the short-run but in the long-run.

Likewise, Kisswani et al. (2015) agree that the impact of the FDI on the economic growth and development can be seen only in the long-run.

Gray (2002) defines the importance of FDI for developing countries as: "*Foreign direct investment has been seen as a panacea for economic development, bringing in necessary technology, expertise, and financial resources to developing economies.*" (Gray, 2002, p.306)

Positive relation of the FDI and GDP is expressed also by Lim when he summarizes that the positive correlation is determined by market size, infrastructure quality, political/economic stability, and free trade zones. (Lim, 2001)

Almfraji et al. (2014) argue the significant positive relation; however, in some cases the relation can be negative or even null. Furthermore, he adds that the factors which have a direct and an indirect influence on the link are the adequate level of human capital, well-developed financial markets, complementarity between domestic and foreign investment, and, last but not least, the open trade regimes.

Human capital criterion is, according to Borensztein et al. (1998), the crucial precondition for the developing countries to utilise FDI to boost up their GDP, and thus the economic growth. It was proved that FDI is an important vehicle for the technology transfer while at the same time contributing to the national economy more than the domestic investment.

A strong statistical correlation between the income inequality and foreign direct investment was proved by Pan-Long (1995). He argued that in less developed countries foreign direct investments put more pressure on the unequal distribution of income across society.

Research conducted by Velde (2003) on the income and income inequality towards FDI in Latin America showed a positive relation in both cases. The positive correlation between growth of income and FDI was found as well as the income inequality and FDI. The latter case in Latin America is more significant while the main causes of such a significant relationship could be found in at least three factors: the distribution of factors of production (labour or human capital), the demand for those factors, and the supply.

Concerning the poverty and poverty reduction number of empirical studies it indicates that FDI does have a direct positive relation towards the poverty reduction. In their work, Babajide and Shuaibu (2014) found out that FDI does truly contribute to poverty reduction in developing countries. They also state that the reduction thanks to FDI is more fluent and stable due to functioning of the financial system and human capital development in the observed economy.

Poverty incidence could be reduced due to inflow of FDI into a country – the research conducted over a long period of time (1984-2005) indicated that in Malaysia the relative poverty rate decreased while the inflow of FDI in the country grew. (Noor Al-Huda and Shabbir, 2009)

Jalilian and Weiss (2002) analysed the inflow of the FDI region and proved that FDI neither weakens nor reduces the income of the poor population; quite the opposite, they found a strong positive relationship between FDI and average income growth which is highly related to the income growth of poor people.

Huang et al. (2010) compared regions of East Asia and Latin America in terms of general openness and outflows of foreign direct investments and its influence on the poverty rate in each region. The results of the examination were

that trade openness and economic growth are associated with lower poverty rate; however, in both cases inflows and outflows of the Foreign Direct Influence adversely affect the mean income of the poorest quintile of the population, with Latin America lagging behind the East Asia region.

From another point of view, poverty is understood as one of the factors for attracting FDI to a country. Panigrahi et al. (2015) argue that except the poverty there are other determinants that can influence the decision making while considering the right destination for FDI, these are: Gross Domestic Product, Per capita income, level of education, etc.

4 Methodology

In the first part of the thesis the basic concepts and definitions of poverty, financial flows, and related topics are stated. The information used in the first part of the thesis are obtained from monographic sources as well as from professional journals, all stated in the list of used literature in the final part of the thesis.

The own work of the thesis will include analyses using secondarily obtained data. Among the main sources of the data used in the analyses there are the database of the World Bank, the United Nations Development Programme, and others. The period of observation is set for 1995-2015 to fully cover the development of the indicators and poverty itself.

Firstly, the countries in the region will be divided on the basis of Human Development Index decomposed into clusters via cluster analysis applied on the sub-dimensions of the Human Development Index, and thus: health dimension, education dimension, and standard of living dimension for final year of the observation 2015. Further analysis will be applied on the countries divided into the clusters. For the countries to be divided – based on the living standards – a cluster analysis will be applied on the decomposed value of the Human Development Index. First step for the cluster analysis is to select a distance measure to actual (dis)similarity. Euclidean distance will be used in the cluster analysis. It can be said that this type of distance is basically a geometric distance in multidimensional space which can be expressed by the following equation (Rimoldi, 2002):

$$D_{ij} = \sqrt{\sum_{k=1}^n (X_{ki} - X_{kj})^2}$$

Where D_{ij} represents distance between cases i and j ; X_{ki} stands for a value of variable X_k for case i ; and X_{kj} represents a value of variable X_k for case j .

In the second step, Hierarchical clustering method will be used. In that method Agglomerative clustering will be used. Each of the objects will represent an individual cluster, those clusters will then be sequentially merged according to their similarity. The highest similarity of the first two clusters will result in a new cluster at the bottom of the hierarchy. In the next step, another pair of clusters will be merged and linked to a higher level of the hierarchy, and so on (Bouguettaya, 2015). The results of the hierarchical cluster analysis will be depicted in Dendrogram which will be also used for interpreting the results of the analysis in the thesis. The input data used in the cluster analysis will be, as it was already mentioned, the decomposed values of the HDI – dimensions of Health, Education and Standard

of living of countries in the region of Latin America and the Caribbean for years between 1995 and 2015.

Later, the poverty incidence will be expressed by the Poverty Headcount ratio at 1.9 USD per day to reflect the portion of poor people in the region of LAC. Furthermore, income inequality as one of the main issues in the region will be measured by the Gini index reaching values between 1, absolute inequality, and 0, absolute equality in income distribution across the region of Latin America and the Caribbean (Charles-Coll, 2011).

The equation for calculation of the Gini index can be expressed as follows (Dong, 2014):

$$G = \left| 1 - \sum_{k=0}^{k=n-1} (X_{k+1} - X_k)(Y_{k+1} - Y_k) \right|$$

Another factor which can have a direct impact on poverty eradication is unemployment rate. The proportion of unemployed people will be examined from the cluster point of view as well as from the total average point of view for the whole region of Latin America and the Caribbean.

In order to analyse the trend of the data observed a simple linear trend analyses will be conducted. The linear trend equation can be expressed as follows (Anderson, et Al 2014):

$$Y_T = \alpha + b * T$$

Where α is the initial value of the trend line, b is the slope of the trend line and T is the observed period of time.

The hypothesis of the positive influence of the economic growth on poverty reduction made by Roemer And Gugerty (1997) will be measured by the Gross Domestic Product per capita where the clusters will be compared with each other and with the total average for the whole region of Latin America and the Caribbean and the relationship with Poverty Headcount ratio at 1.9 USD will be examined via simple regression analysis.

Later the hypothesis concerning the positive effect of unemployment rate increase on poverty rate stated by Ukpere and Slabbert (2009) will be examined via simple regression analysis.

Expressed by Haughton and Khandker (2009) an assumption that income inequality is positively correlated with poverty rate will be evaluated via simple regression analysis.

A multiple-regression analysis featuring poverty rate as the dependent variable and financial flows like personal remittances, foreign direct investments, and

official development as the independent variables will be used to evaluate the hypothesis of Benmamoun and Lehnert (2013).

For these analyses of the relation between poverty and dimensions of socio-economic situation in Latin America and the Caribbean a regression analyses will be used. For the purpose of regression analyses a regression model will be composed. The condition of linear dependency will be used between dependent variable y and independent variables $x_1, x_2, x_3, \dots, x_n$. The regression equation could be expressed as follows (Anderson et al., 2007):

$$y = \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \dots + \beta_n x_n + \varepsilon$$

Where $\beta_1, \beta_2, \beta_3, \dots, \beta_n$ are parameters, and ε is a random component which includes random effects that are not covered in the model.

The intensity of the relationship will be expressed by the index of determination R^2 . Simple regression analysis will be used for the relation between poverty and decisive indicators, while poverty rate will be used as the dependent variable, and decisive indicators such as GDP per capita, Unemployment rate, Gini Coefficient, will be used separately as the independent variable.

For the analyses conducted in the thesis software IBM SPSS Statistics, STATISTICA 12, and Microsoft Office Excel will be used.

On the basis of the obtained results of the analyses, poverty as an aspect of standard of living will be assessed and recommendations will be made.

5 Own work

5.1 Standard of Living in Latin America and the Caribbean

Widely accepted indicator - The Human Development Index - has been used since 1980 to objectively evaluate the living conditions and not only economic standard of living of an observed society. Once decomposed, the index consists of education index, health index, and standard of living index. The result values range from 0 to 1, where 0 represents low development, and 1 stands for high development in a society.

In order to divide the region of Latin America and the Caribbean according to living standards, a Cluster analysis - based on single-linkage method and Euclidean distance - was applied on the sub-indices of the Human Development index. Figure 1 displays the results of the cluster analysis in the form of a Dendrogram with specified clusters.

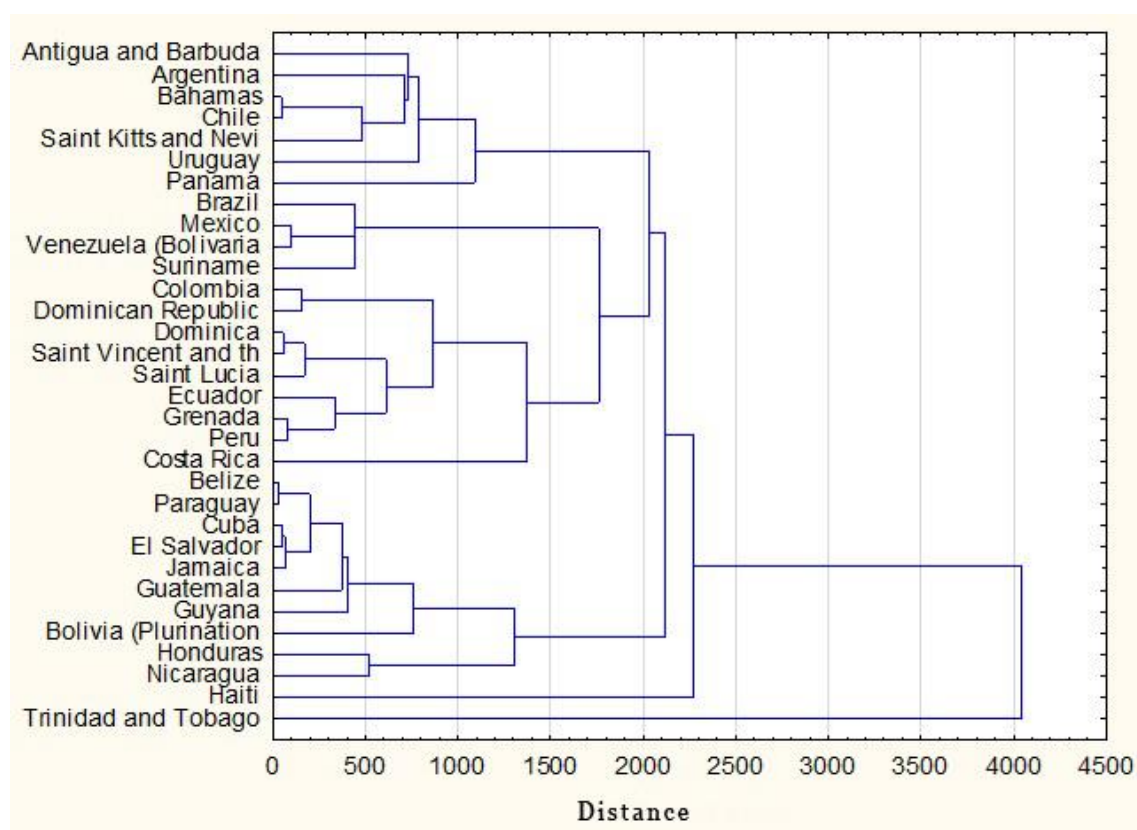


Figure 1 Dendrogram – Standard of Living Based on the Decomposed Human Development Index in Latin America and the Caribbean (2015).

Source: Author's calculation based on data from the World Bank database (2016)

Based on the results of the cluster analysis applied on the sub-indices of the Human Development Index, 3 clusters were created. Complete distribution of Latin America and the Caribbean countries is summarized in the following Table 1.

Cluster	Countries
1.	Antigua and Barbuda, Argentina, Bahamas, Chile, Saint Kitts and Nevis, Uruguay, Panama, Trinidad and Tobago
2.	Brazil, Mexico, Venezuela, Suriname, Colombia, Dominican Republic, Dominica, Saint Vincent, Saint Lucia, Ecuador, Grenada, Peru, Costa Rica
3.	Belize, Paraguay, Cuba, El Salvador, Jamaica, Guatemala, Guyana, Bolivia, Honduras, Nicaragua, Haiti

Table 1 Cluster Membership Based on Sub-indices of HDI

Source: Author's calculation based on data from the World Bank database (2016)

In the first cluster, there are the following countries covered: Antigua and Barbuda, Argentina, Bahamas, Chile, Saint Kitts and Nevis, Uruguay, Panama, and Trinidad and Tobago; while countries with the highest total HDI within the region of Latin America and the Caribbean are Argentina, Uruguay, Chile, and Panama. With regard to the distinction it can be noted that Chile and the Bahamas share less differences within the cluster with Panama, and Antigua and Barbuda could be considered as the most distinct members of the cluster. The average total value of the Human Development Index is stated between 0.752 (Saint Kitts and Nevis) and 0.836 (Argentina).

The second cluster was created by countries such as Brazil, Mexico, Venezuela, Suriname, Colombia, Dominican Republic, Dominica, Saint Vincent, Saint Lucia, Ecuador, Grenada, Peru, and Costa Rica. Within the cluster it is possible to observe the highest distinction between Costa Rica and Colombia. On the other hand, Dominica and Saint Vincent are considered to be countries of which the value sub-indices of HDI differ rather less. Across the rest of the countries within the cluster, the (dis)similarity can be observed in Figure 1, while the values of the total HDI vary between 0.769 (Cuba) and 0.715 (Dominican Republic).

With regard to the third cluster of the cluster analysis applied on the decomposed Human Development Index, countries such as Belize, Paraguay, Cuba, El Salvador, Jamaica, Guatemala, Guyana, Bolivia, Honduras, Nicaragua, and Haiti are included. The smallest differences among the members within the cluster can be found between Belize and Paraguay, while Haiti as the underdeveloped country in the region joins the cluster as the last member – the results of the analysis proving the wide gap while compared with the rest of the observed countries. Countries covered in the cluster are considered to be with

the average score of HDI ranging from 0.483 (Haiti) to 0.679 (Paraguay) as countries with average medium human development.

Concerning the geographical depiction of the distribution of the clusters within the region of Latin American and the Caribbean, Figure 2 shows such distribution. The first cluster is depicted in red colour, while the second cluster corresponds to green colour, and finally, the third cluster is pointed out in yellow in the map below. Countries which were not included in the cluster analysis, due to the lack of data available, are depicted in grey colour.



Figure 2 Cluster Membership across the Region of LAC.

Source: Own work based on data from the World Bank database (2016)

As it is possible to observe from the geographical point of view, all clusters are represented in the sub-regions of Latin America and the Caribbean. In the north, the prevalence of the second cluster in form of Mexico is displayed, while continuing to the Central America all 3 clusters are included. Concerning the Caribbean

part of the region, approximately equal distribution of the clusters is observed. With regard to the southern part of the Latin American and the Caribbean regions, the dominance of the second cluster is clear, mainly thanks to the largest country in the region – Brazil. While the first cluster is represented by countries of the southern part of the South American continent, countries of the third cluster can be found rather in the centre and in the north of the continent.

Standard of living has been for many years evaluated mainly from the economic point of view, and thus economic indicators have been used for such measurement of living standard of a society. The Gross Domestic Product (GDP) per capita evaluates the economic performance of an observed economy; however, with regard to a link between welfare and standard of living, it has become the major indicator of living standard. Worldwide trend of the indicator is positive, and thus GDP per capita should increase over time as it is expected that countries in the world develop.

The following Figure 3 represents the development of Gross Domestic Product per capita for each of the clusters. In order to present non-distorted situation in the region of Latin America and the Caribbean the values for each of the clusters are in average with regard to the number of members within each cluster, respectively.

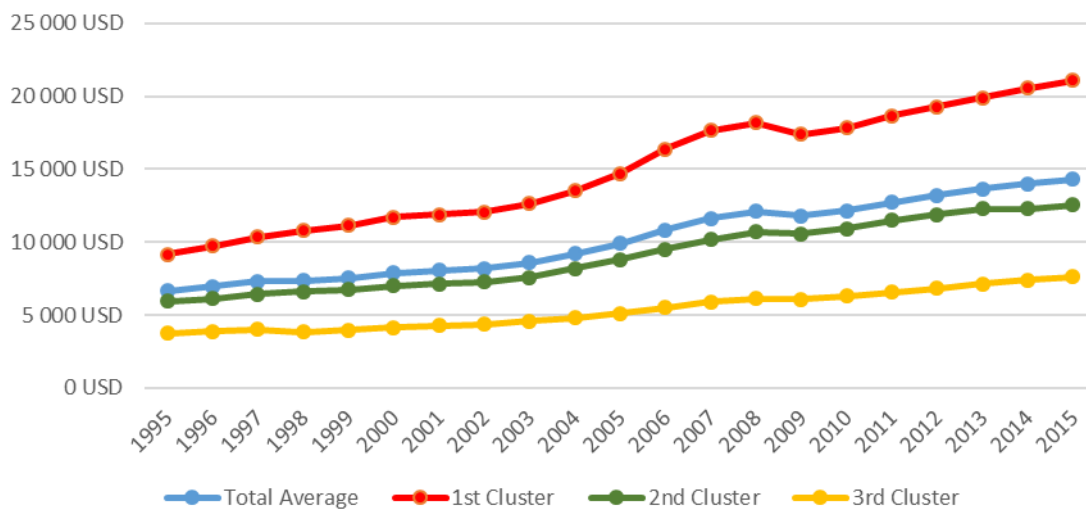


Figure 3 GDP per capita, in USD (1995-2015)

Source: The World Bank database (2016)

First of all, it is possible to observe from the Figure 3 that the lowest share in the comparison of the cluster with regard to the Gross Domestic Product per capita is in case of the 3rd cluster with the average value of 5346.97 USD, while the highest share is among the countries of the 1st cluster with the average value of

GDP per capita of 14,984.41 USD. The 2nd cluster is situated between 3rd and 1st cluster with the average value of GDP per capita of 9,063.40 USD. It is possible to observe, the Total Average line for all the clusters was developing steadily during the whole observed period as the countries in the region of LAC developed over time. Indeed, it is possible to see some downward trend over the observed period, more specifically in 2009 when the whole region experienced the Global Economic Crisis. Should we look closely on the influence of the crisis on the countries in the clusters, from the Figure 2 it is possible to see that significant decreases are observable in the case of the 1st cluster as majority of the countries in that cluster is heavily export-oriented and recorded a decline in GDP per capita of 820.5 USD. While in the case of the 2nd cluster countries such as Brazil, Ecuador, and Mexico, they have also export-oriented policies which were struck by the Global Economic Crisis - which caused a decline in the GDP per capita of 127.17 USD. In the case of the 3rd cluster countries, the influence of the crisis was modest as the change from 2008 to 2009 was presented as -43.70 USD.

The following Figure 4 represents the GDP per capita annual growth expressed in percentage for Latin America and the Caribbean region during 1995 - 2015 period.

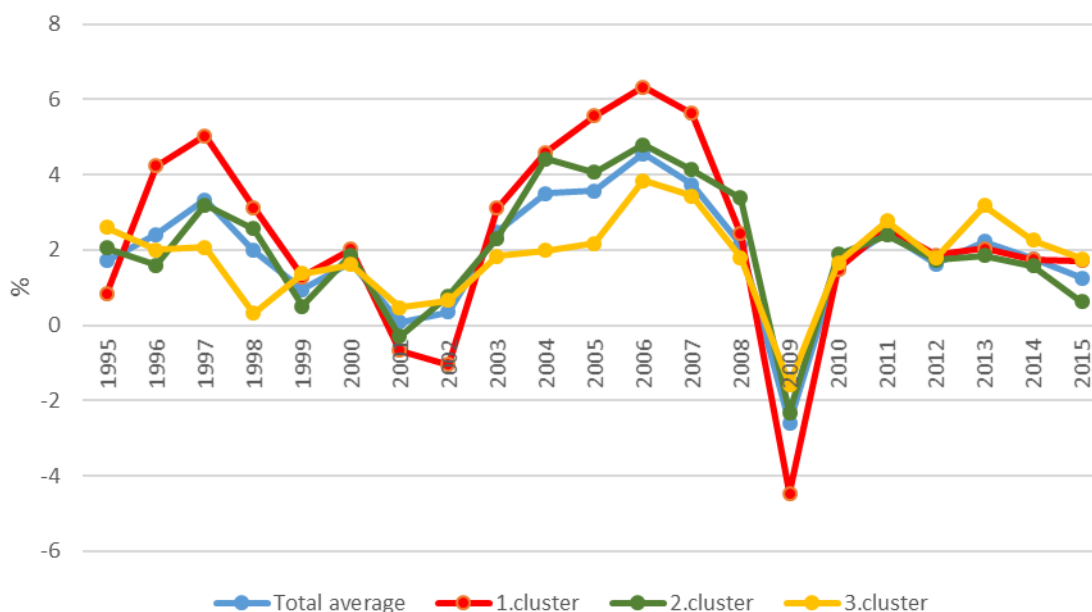


Figure 4 GDP per capita growth (annual %), (1995 – 2015)
Source: The World Bank database (2016)

From the beginning until the end of the observed period it is possible to see various fluctuations accompanied by negative growth of the Gross Domestic Product in the region of Latin America and the Caribbean. At the beginning of the observed

period, in 1995, it is possible to see an increase in growth in case of the 1st cluster countries (e.g. Argentina, Chile, Uruguay, etc.) encouraged by the huge capital inflow into the region of LAC. For the 2nd Cluster countries (Mexico, Brazil, Ecuador, etc.), year 1995 was characteristic with the Mexican Peso Crisis when the government of Mexico triggered devaluation of the monetary unit Peso against the US dollar. That decision led to a crisis and decrease in the growth of the Gross Domestic Product per capita, thus the development of standard of living was slowed down in countries of the second and third clusters. One year later, the countries regained what they lost during the Mexican Peso Crisis, and the GDP per capita growth was on rise. That did not last long since in 1997 Latin America Financial Crisis erupted. The East Asian crisis in 1997 spilled into Brazil, and later it put the whole continent of Latin America and the Caribbean on the edge of negative GDP per capita growth. In 1998 and 1999 most of the Latin American companies recorded economic recession that drove corporations into insolvency and thus forced man to a close-down. The main reason of the crisis is considered by many economists to be a short-term financial capital inflow to emerging markets including Latin America and the Caribbean as a part of the process of globalisation. As a result of such a recession the first time negative GDP per capita growth was recorded in 2001 when the first cluster recorded a negative growth of -1.04 %. Majority of the countries recovered; however, Argentina as a crucial economy for South America experienced economic depression lasting until 2002. From 2002 it was possible to observe an increase in the GDP per capita growth - as one year later, in 2003, countries were already in green numbers in terms of GDP per capita growth, and the economies developed and expanded at a faster pace. A strong positive development of the GDP per capita growth for the whole region of LAC was reordered between 2002 and 2006 as the countries became attractive for foreign investors who started to invest into the region and its development. In 2006 GDP per capita growth reached the value of 6.32 % as it counts for the 1st cluster of countries. In 2007 it was possible to observe a sharp decline in the GDP per capita growth thanks to the beginning of the Global Economic Crisis which took part in that region as well. As it was the peak of the mountain in 2006 for the 1st cluster of countries, in 2009 the region hit the bottom with value of -4.47 % of GDP per capita growth. The impossibility to maintain export, driven accumulation sustained by restrictive monetary and fiscal policies became clear for countries such as Argentina, Brazil, Mexico, Colombia, and Paraguay. Closing the end of the observed period a relative recover from the last crisis was experienced by most of the countries in form of a positive economic growth which was sometimes disturbed by unexpected economic changes in the region. Comparing the beginning with the end of the observed period the values of the Total Average of the GDP per capita growth

come with 1.71 % and 1.25 %, respectively. Overall, the development of the Gross Domestic Product per capita as an indicator of standard of living was affected by several economic crises which put many citizens if not to then closer to poverty, and thus the development of living standard was slowed down.

With overall positive growth of GDP per capita the economic situation in the region is improving; therefore, the job creation should take place in order to secure much needed income for the individuals and households. If the individuals or households do not have appropriate level of income caused by high unemployment rate in the country, people are shifting closer towards poverty line of 1.9 USD per day. The following Figure 5 depicts the development of the unemployment rate expressed as the percentage of total labour force between 1995 and 2015.

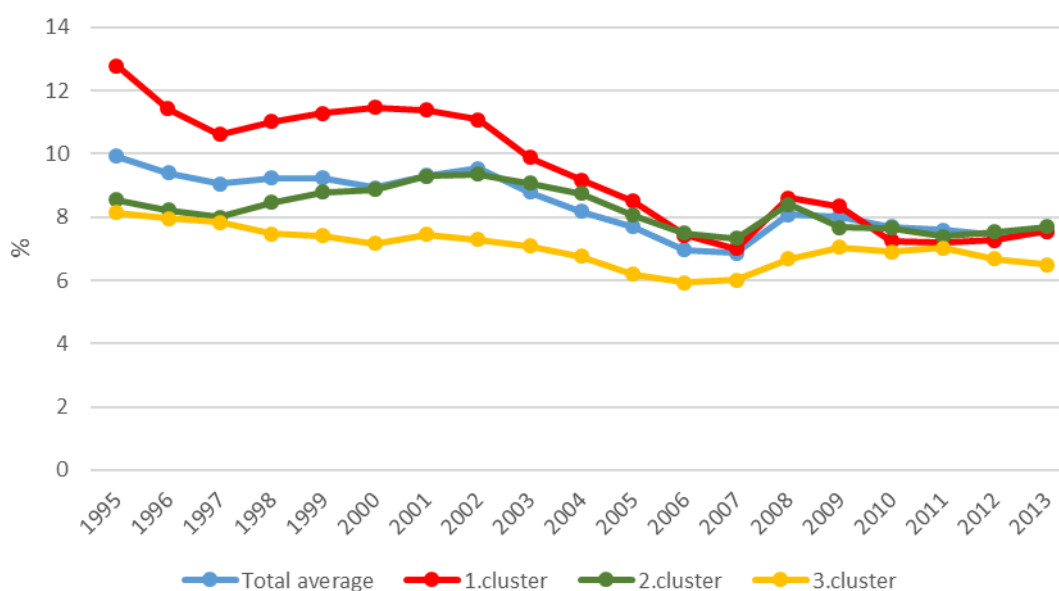


Figure 5 Unemployment, total, in % (of total labour force), (1995-2015)
Source: The World Bank database (2016)

The unemployment rate is closely related to the economic situation in the region, thus the fluctuations do have a lot to do with the GDP per capita growth during the observed period of time in the region of Latin America and the Caribbean. From the beginning of the period the region registered a decline in the number of unemployed people as this was triggered by the massive capital inflows to the region of LAC. With regard to the comparison of the three clusters at the beginning of the observed period it can be noted that the lowest unemployment rate was recorded by the 3rd cluster with value of 8.13 %, and with the 2nd cluster's value of 8.54 %, while the highest unemployment rate in 1995 was noted in case of the 1st cluster of 12.78 %. With the already mentioned Latin America Financial Crisis (1998-2002)

the unemployment rate rose during that period of time. Since the year 2002 and the end of the Argentina Great Depression a steady pace of decrease in unemployment rate took place. Until 2007 the economic boost in the region was reflected in the reduced number of unemployed people. It was in 2008 when the Global Financial Crisis struck many Latino American industries which were put into recession - which finally resulted in increasing the number of unemployed in the society. After the recession the rate peaked again in 2009 with Total Average of 8.02 %. After that year, the unemployment rate was on decline mainly thanks to the increased inflow of the Foreign Direct Investment which boosted the economy toward the creation of workplaces. During the observed period the clusters did not fluctuate with major deviations; on the contrary, it is possible to see a similar trend in case of each cluster regarding the unemployment rate reduction. More than 2 % negative growth is observed while looking at the beginning (9.92 %) and the end (7.72 %) of the Total Average for the examined period. Should the crisis in 2007 have not taken place, the unemployment rate of the countries in Latin America and the Caribbean would have been lower; therefore, the population would not live at the edge of the poverty line, or fall into poverty itself.

Income inequality as another obstruction for the countries in order to reduce the number of poor people within the society is generally understood as unequal distribution of financial means (income) within a country, which can be measured for instance by the Gini index. The Gini index can reach values from 0 (0 %) = equally distributed income within the society, to 1 (100 %) = unequally distributed income within the society. With regard to income inequality within the region of Latin America and the Caribbean, the following Figure 6 was composed to display the development of Gini index over 1995-2015 period of time.

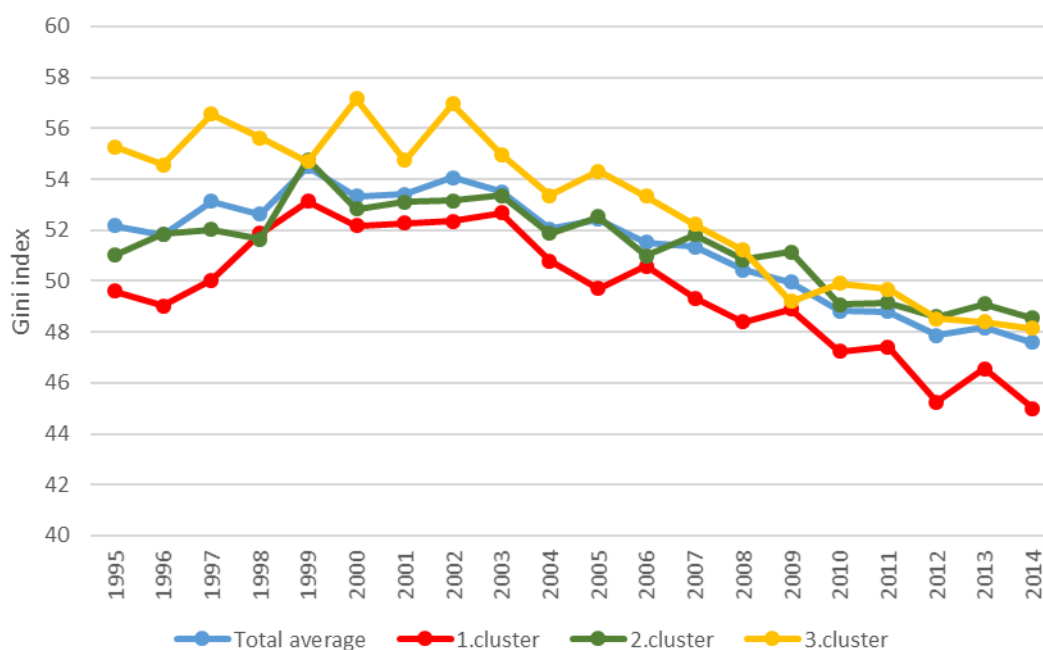


Figure 6 Gini Index, in %, (1995 - 2015)
Source: The World Bank database (2016)

The income inequality has been an issue for many decades across the whole region of Latin America and the Caribbean. As it is possible to observe from the Figure 6, the overall trend of the income inequality is negative, and thus the income has been gradually distributed within the society more equally. From the beginning of the examined period the Gini index starts with value of 51.81 corresponding to Total Average in 1995. While there are many factors influencing the income inequality and distribution within the society such as the number of poor people in the country, the final value for Total Average of the Gini index was observed in 2014 reaching 47.51 which means 4.3 decrease over the examined period. The highest inequality in terms of income distribution is recorded by the 3rd cluster of countries which decreased the unequal income distribution over the observed period by 7.14 in absolute terms. On the other hand, the lowest values of the Gini Index are explained by the 1st cluster as countries in that cluster fight the income inequality more efficiently than the rest of the clusters, and the difference between the first year of survey and the last year of survey corresponds to 4.7 decrease in absolute terms. It is obvious from the Figure 6 that the 2nd cluster was somewhere between the 1st cluster and the 3rd cluster, closely copying the total average value of the region of LAC. However, by the end of the observed period that 2nd cluster recorded the highest values of the Gini coefficient in comparison with the

rest of the clusters. The total change of the 2nd cluster in terms of inequality reduction is 2.88 which is the smallest change in these terms.

5.2 Poverty in Latin America and the Caribbean

For many years, poverty has been a drawback in the economic growth of the countries in Latin America and the Caribbean. As such poverty rate in the countries of this region topped other developing countries in the world. With the beginning of the year 2000 and the introduction of Millennium Development Goals poverty across the region of LAC started to vanish. Much of the effort has been put on the poverty eradication with the help of capital inflows to the countries; however, only some countries were able to diminish the number of poor population effectively to reach astonishing results at the end of 2015. Despite the major step towards the poverty eradication, many Latino American countries lag behind and record high rates of poverty incidence. Among the main reasons why that is so could be considered drug trafficking, which is a major issue in that region, government rivalries and disputes over foreign aid, and, last but not least, the security and trust in the region. The following Figure 7 represents development of the poverty rate across the region measured by 1.9 USD per day as a percentage of population.

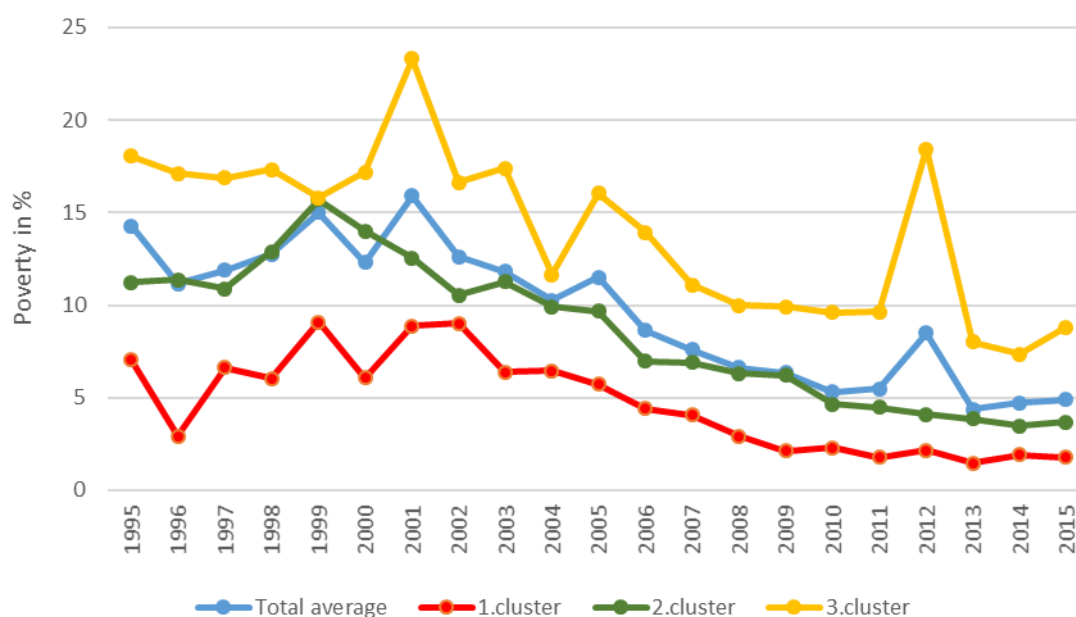


Figure 7 Poverty headcount ratio at \$ 1.90 a day, in % of population, (1995-2015)
Source: The World Bank database (2016)

The major success in form of poverty eradication can be seen in the Figure 7. Looking at the beginning of the observed period, the Total Average value of the poverty

rate within the region of Latin America and the Caribbean is of 11.16 %. In spite of the obvious fact that the poverty headcount ratio was growing during the economic crisis the region had experienced, the overall decline can be seen. In 2015 the poverty incidence is expressed by 4.87 %, of total population, which means reduction of more than 6 % during that period. For many Latin American countries that represents cutting the poverty in half, and thus emergence of the middle class in the society. In case of the first cluster the total development of poverty rate in the countries was stable with little increase between years 1996-2002 which was featured by the economic crisis. Later, the poverty eradication policies with foreign aid were effective while bringing the poverty rate to 1.78 % in 2015. Concerning the second cluster, this cluster has been influenced by the same factors as the rest of the clusters; however, it kept higher average poverty headcount ratio in comparison with the first cluster countries. The poverty eradication was very successful as the results are comparable with the poverty reduction of the first cluster countries. Should we have a look at the poverty reduction development of the third cluster, it is necessary to note that that cluster of countries is composed mainly of Central American countries such as Guatemala, Belize, El Salvador, and Honduras, along with the Caribbean countries such as Cuba and Haiti. In such a case, the poverty ratio was way above the rest of the clusters as the region suffered the most from drug trafficking, instability, and the exposure to natural disasters. Regarding all the mentioned factors which influence the development of the poverty reduction efforts, the third cluster started with 18.06 % of poor people. During the observed period, it is interesting to note that this cluster highly influenced the Total Average value of the poverty headcount ratio between the years 2000 and 2015. As the development of the rate was not merely negative during the whole observed period, it is possible to see an increase in 2002 caused by the already mentioned economic instability in the countries, and in 2012 when the region of Central America and the Caribbean was hit by natural disasters. Various other issues connected with nature took place in the region of 3rd cluster countries, thus the poverty rate rose at the end driving the final value to 8.81 %. The total reduction of almost 10 % was recorded for the countries of the third cluster; however, the poverty incidence remains the highest in the region with regard to Haiti, for instance, where 54 % of the population live below the poverty line of 1.9 USD.

To compare the poverty reduction efforts on the level of clusters Table 2 was composed. In the table initial and last survey values of the poverty headcount ratio at 1.9 USD are displayed next to Average annual reduction achieved during the number of surveys which in this case is 10 surveys for each of the clusters. Most importantly, the Average annual reduction achieved expressed in percentage is displayed in the last column of Table 2.

Countries	Initial survey year	Last survey year	Average annual reduction achieved	Number of surveys	Average annual reduction achieved in %
1 st Cluster	4.71	1.68	0.90	10	9.84
2 nd Cluster	9.77	4.06	0.92	10	8.41
3 rd Cluster	15.30	7.34	0.93	10	7.08

Table 2 Poverty Outcomes by Clusters

Source: Author's calculations based on data from the World Bank database (2016)

5.2.1 Trend Analysis of Poverty

A cubic trend analysis was applied on the poverty rate development in the region of Latin America and the Caribbean for a period of 1995-2015. The analysis was applied in order to better understand and examine the development of the poverty incidence within the region of LAC and predict the future situation in terms of poverty reduction. As it is possible to see from the Table 3 below, the adjusted index of determination is of a relatively high value.

Model Summary					
R	R Square	Adjusted R Square	Std. Error of the Estimate		
.929	.862	.837	1.391		
ANOVA					
	Sum of Squares	df	Mean Square	F	P
Regression	193.966	3	64.655	33.437	.000
Residual	30.939	16	1.934		
Total	224.905	19			
Coefficients					
	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Case Sequence	1.863	.611	3.203	3.048	.008
Case Sequence ** 2	-.236	.067	-8.766	-3.532	.003
Case Sequence ** 3	.007	.002	4.840	3.176	.006
(Constant)	9.343	1.519		6.151	.000

Table 3 Results of the Trend Analysis: Poverty

Source: Author's calculations based on data from the World Bank database (2016)

The following Figure 8 represents a graphical depiction of the results of the applied trend analysis with Poverty Rate on X-axis, and the time on the Y-axis. It is obvious that the poverty incidence across the region of Latin America and the Caribbean declined over the observed period as it is indicated by the cubic trend line. With regard to the adjusted index of determination (see Table 3) the relationship might be presented as strong.

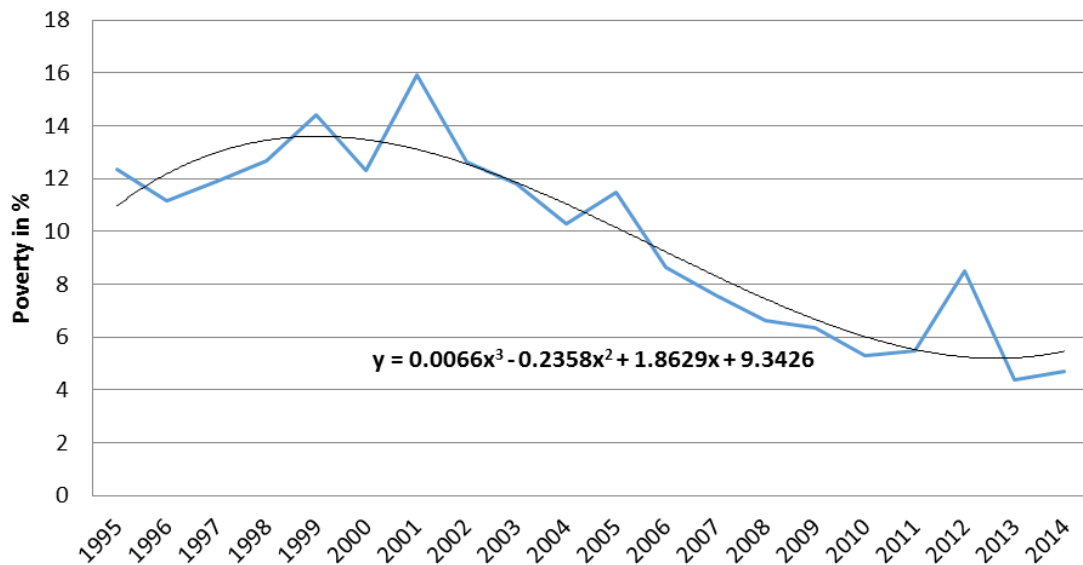


Figure 8 Trend Analysis: Poverty

Source: Author's calculations based on data from the World Bank database (2016)

5.3 Poverty and Decisive Indicators

In this part of the thesis, a simple regression analyses will be used to examine the relationship between poverty and the Gross Domestic Product, Unemployment rate, and Inequality measured by Gini index – respectively, as these are considered, by literature, to be the most significant aspects while decreasing the number of the poor within the society.

Poverty as an examined aspect of Standard of Living will be presented in the regression analyses as a dependent variable, while the above mentioned indicators will be used as independent variables.

5.3.1 Gross Domestic Product per capita and Poverty

By many the development of the Gross Domestic Product is accompanied by the poverty eradication; in case of Latin America and the Caribbean, this does not have

to be necessarily true. As it is expressed by various authors, the GDP per capita should be examined in terms of its annual growth with regard to poverty reduction; therefore, more precise results might be obtained. (Nazima, 2011)

A simple regression analysis was applied on the relationship between Poverty rate and the Gross Domestic Product per capita annual growth. While the P value of this analysis is below the 0.05 criterion, this regression analysis is statistically significant. With regard to the following Table 4 we can observe very low value of index of correlation (R) and adjusted index of determination (Adjusted R Square) where the values reach 0.152 and 0.020, respectively. This means that the relationship between Poverty rate as a dependent variable and GDP per capita as an independent variable is very low.

Model Summary					
R	R Square	Adjusted R Square	Std. Error of the Estimate		
.152	.023	.020	6.966		
ANOVA					
	Sum of Squares	df	Mean Square	F	P
Regression	314.091	1	314.091	6.473	.012
Residual	13246.708	273	48.523		
Total	13560.799	274			
Coefficients					
	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
GDP	-.290	.114	-.152	-2.544	.012
(Constant)	10.166	.492		20.654	.000

Table 4 Results of the Regression Analysis: Poverty and GDP per capita
Source: Author's calculations based on data from the World Bank database (2016)

The following Figure 9 demonstrates the relationship of Gross Domestic Product per capita growth and the Poverty rate.

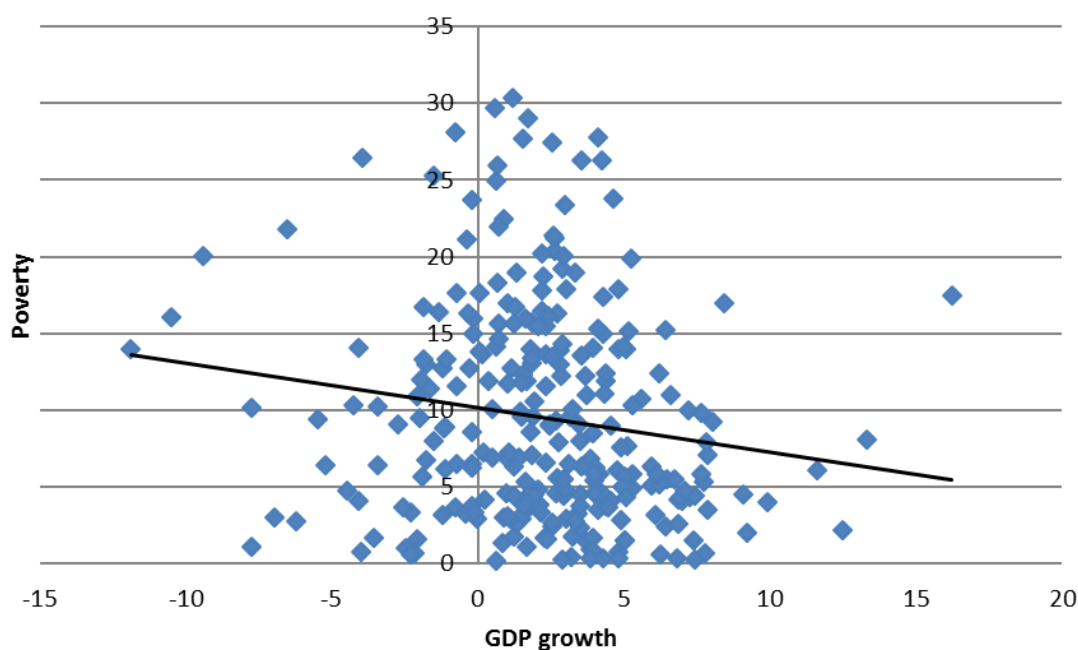


Figure 9 Regression Analysis: Poverty and GDP per capita growth

Source: Author's calculations based on data from the World Bank database (2016)

From the Figure 9 it is obvious that the relationship is negative, thus with an increasing value of the Gross Domestic Product per capita growth the poverty rate declines. With regard to a very weak relationship between those two variables, it can be noted that the economic growth does not affect the poverty eradication effectively, and the majority of the poor does not see the benefits of Gross Domestic Product per capita. One of the possible reasons of such a situation, when the GDP per capita does not influence the poverty eradication more effectively, could be found in a form of corruption that is a widespread issue across the region of Latin America and the Caribbean, and also with income inequality, which could be seen in the Figure 6. As the former one can be measured with more precise results, it can be noted that with an increase in economic growth the increase in income is inevitable; however, as the income inequality (measured by Gini coefficient) is still relatively high, the actual financial assets do not flow to the poor community but rather to the wealthy group of the society.

5.3.2 Unemployment and Poverty

Another important relationship is observed between poverty and unemployment. While the former is expressed in poverty headcount ratio of 1.9 USD, the latter refers to percentage of labour force which is currently without work. The purpose of employment as such is that if person is employed, he or she does have a stable in-

come, and thus can avoid the state of poverty. However, if the person is unemployed, the stable income is missing, and thus he or she is falling into poverty. First of all, from the Table 5 it is possible to notice that the P-value of this regression analysis stays low – of 0,001, therefore, the analysis is statistically significant. Furthermore, low index of correlation as well as the index of determination indicate that the unemployment rate does not explain much of the poverty rate in the society, and therefore there could be other factors which do contribute to poverty eradication. “Mercado Negro” or so called “Black Market” could be considered as one of those factors as people in the society tend to work unofficially elsewhere. Prostitution, illegal drugs, sexual exploitation, forced labour, and tobacco, or simply vending at the streets are few of the activities which can be imagined under that term in case of Latin America and the Caribbean.

Model Summary					
R	R Square	Adjusted R Square	Std. Error of the Estimate		
.231	.054	.044	6.782		
ANOVA					
	Sum of Squares	df	Mean Square	F	P
Regression	757.306	3	252.435	5.489	.001
Residual	13383.153	291	45.990		
Total	14140.460	294			
Coefficients					
	Unstandardized Coefficients		Standardized Coefficients	t	P
	B	Std. Error	Beta		
Unemployment	-4.646	1.533	-2.657	-3.031	.003
Unemployment ** 2	.423	.169	4.780	2.500	.013
Unemployment ** 3	-.012	.006	-2.270	-2.079	.039
(Constant)	24.170	4.169		5.798	.000

Table 5 Results of the regression analysis: Poverty and Unemployment
Source: Author’s calculations based on data from the World Bank database (2016)

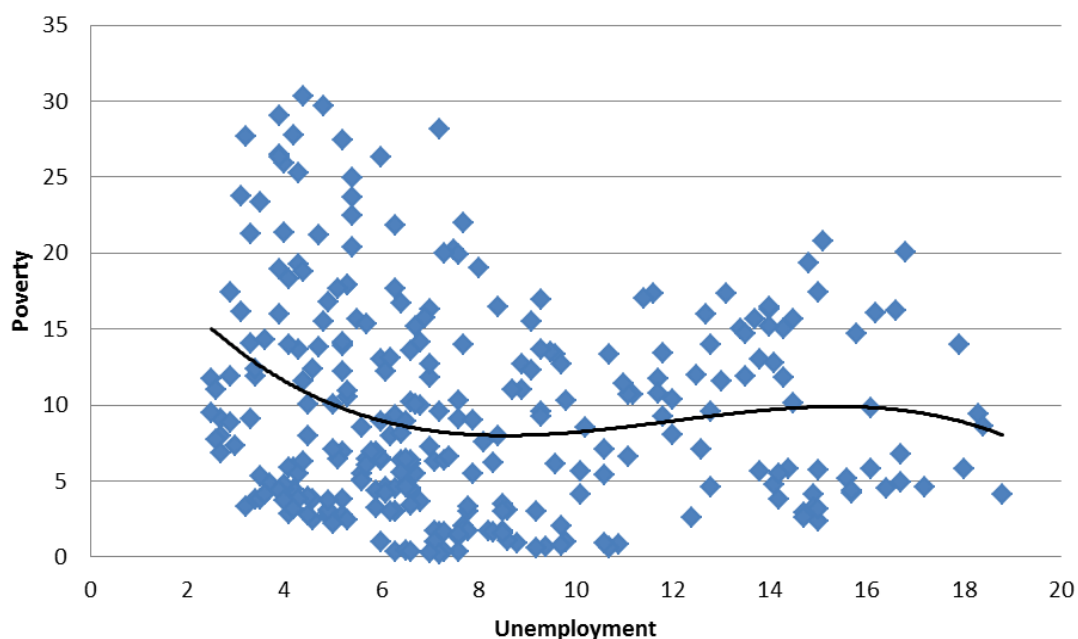


Figure 10 Regression Analysis: Poverty and Unemployment

Source: Author's calculations based on data from the World Bank database (2016)

To say whether the unemployment rate does reduce the poverty incidence in the region of LAC is unambiguous. From the Figure 10 where the poverty rate is presented on the X-axis while the unemployment rate is displayed on the Y-axis, the relationship fluctuates. As it is possible to see from the trend line, the negative relationship is possible to be observed between the values of 2.3 % - 9 % and 15.9 % - 19 % of unemployment rate which indicates that with an increasing number of unemployed population the incidence of poverty is decreasing. A positive relationship, normally indicating (together with increasing unemployment) the number of poor people, is increasing as well, and can be seen between the values 9 % - 15.8 % presented on the Y-axis.

5.3.3 Income inequality and Poverty

The relationship between income inequality and the poverty incidence has been a topic for discussion among researchers as well as economists for many years. The income distribution within the economy has a direct impact on the poverty rate within the society, thus influencing the living standard of the population. It is assumed that with increasing inequalities within a society the poverty incidence grows as well. With an increasing trend in the income inequality within the society a so called "Polarisation" can occur. This phenomenon is connected with the flow

of the income only to 2 income groups within the society, the poor and the rich, and thus the middle class does not exist at all. (Chakravarty, 2009)

Bearing this in mind, a regression analysis was applied onto the relationship between poverty and income inequality across the region of Latin America and the Caribbean. Poverty expressed in the headcount ratio of 1.9 USD per day was put into regression with inequality represented by the Gini coefficient. The following Table 6 summarizes the model summary of applied regression analysis.

The poverty rate was set as a dependent variable, while as an independent variable Gini coefficient was used. As it is possible to see from the Table 6, the P-value indicating the significance of the regression analysis is of 0.00, thus it can be said that the analysis is statistically significant. Furthermore, the adjusted coefficient of determination $R^2=0,527$ indicates a medium dependence.

Model Summary					
R	R Square	Adjusted R Square	Std. Error of the Estimate		
.727	.529	.527	.692		
ANOVA					
	Sum of Squares	df	Mean Square	F	P
Regression	155.749	1	155.749	325.640	.000
Residual	138.702	290	.478		
Total	294.451	291			
Coefficients					
	Unstandardized Coefficients		Standardized Coefficients	t	P
	B	Std. Error	Beta		
GINI	.155	.009	.727	18.046	.000
(Constant)	.002	.001		2.258	.025

Table 6 Results of the regression analysis: Poverty and Inequality (Gini Index)
Source: Author's calculations based on data from the World Bank database (2016)

The following Figure 11 displays the results of the regression analysis where on the X-axis the poverty rate is depicted, while on the Y-axis the GINI index is shown

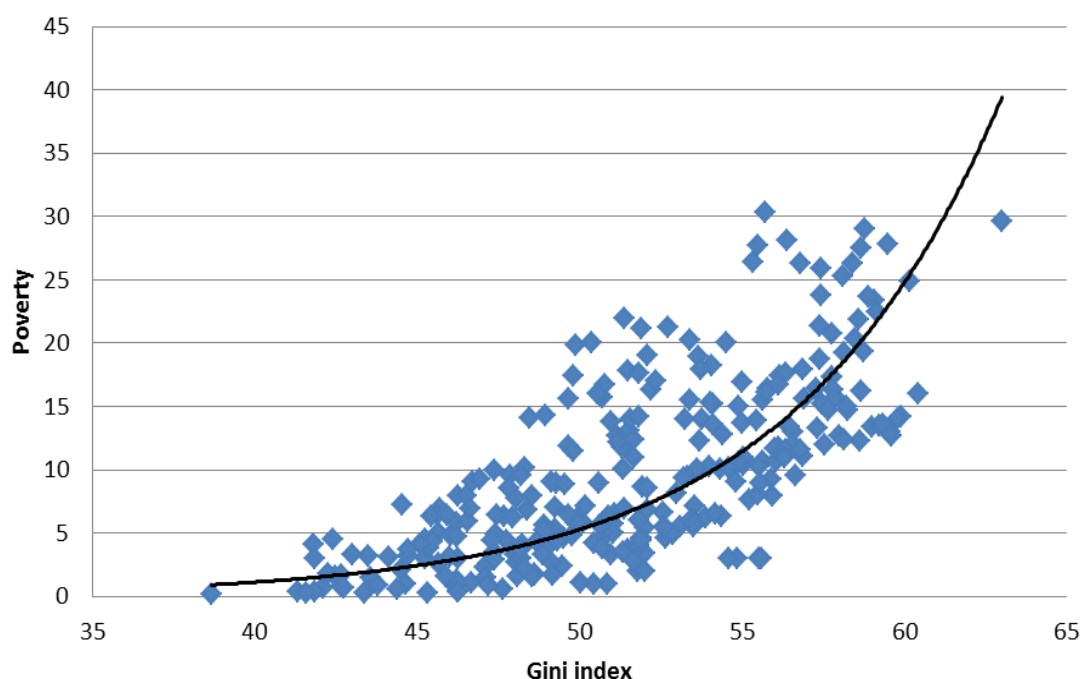


Figure 11 Regression Analysis: Poverty and Gini Index; Source: Author's calculations based on data from the World Bank database (2016)

From the Figure 11 it is obvious that the relationship between poverty incidence and the Gini index is truly positive; thus, according to the exponential trend line the results could be interpreted in the way that with an increasing inequality in income, the poverty incidence increases as well.

5.4 Financial Inflows

With regard to financial inflows into the region of Latin America and the Caribbean, three types of inflows have been identified with regard to the poverty reduction across the region of LAC. Those are: Foreign Direct Investments (FDI), Personal Remittances (PR), and the Official Development Assistance or Aid (ODA). It has been proved that with the influx of financial assets to a country the economic growth improves, the living standard should grow as well. The following Figure 12 represents the distribution of financial inflows into the region of Latin America and the Caribbean by type, thus the FDI, PR, and ODA are observed in case of all the three clusters. The time series in which that distribution is observed has been set so that the starting year, the middle year, and the final year of the whole observation are covered.

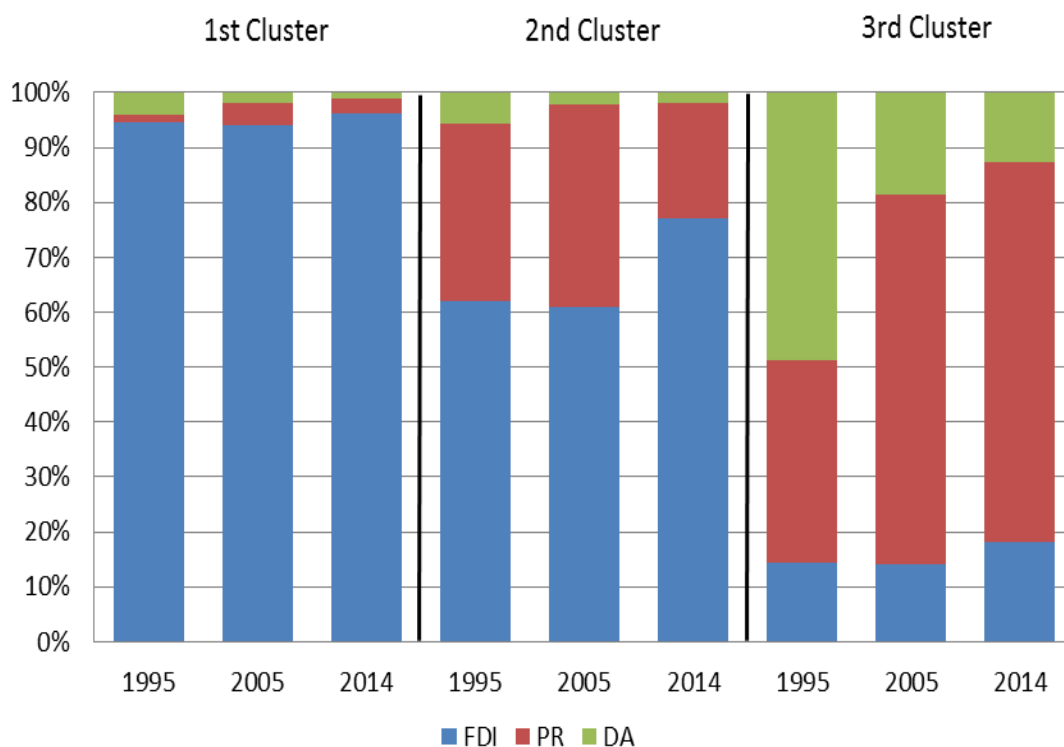


Figure 12 Distribution of Financial Inflows by Cluster and Selected Year, in %
Source: Author's calculations based on data from the World Bank database (2016)

Should we look at the first cluster and the distribution of those three inflows to the countries, there can be noticed a major prevalence in case of Foreign Direct Investment with comparison to Personal Remittances and the Official Development Aid. In the first year of the observation, 1995, the Foreign Direct Investment inflow represented 95 % of those three inflows to the 1st cluster of countries. The Personal Remittances accounted for 1 %, while the Official Development Aid represented 4 % of the total share. The successive year of 2005 recorded an increase in Personal Remittances to 4 % on the costs of the Foreign Direct Investment 94 %, and the Official Development aid, which was accounted for 2 % of the total share. A main reason behind that increase in Personal Remittances can be seen in an increased number of labour force working in foreign countries (especially USA) while sending money back home to support families. The last year of the observation for the 1st cluster of countries is characterised with an increase in Foreign Direct Investment to 96 %, while Personal Remittances and Official Development Aid are accounted for 3 % and 1 %, respectively.

In case of the 2nd cluster of the countries, the distribution of the financial inflows is more equal. While for the first observed year the Foreign Direct Invest-

ment accounted for almost 62 % of the total share, the Personal Remittances piece represented 32 %, the Official Development Aid in that year was recorded for 6 % of the total share. If the results are to be compared with the first year of the observation of the 1st cluster, the difference is obvious as the Personal Remittances grew proportionally. Should we look at the middle year of the examination, an increase in form of Personal Remittances can be noted when that type of inflow accounted for 37 % of the total flows. The FDI and the ODA accounted for 61 % and 2 % of the total flows. A factor which encouraged the growth in Personal Remittances could be an increasing trend of migrants from Latin America and the Caribbean towards a more developed country, especially the USA, which peaked in 2007. The final year of the observation is characteristic by a decrease in PR and ODA, and with an increase in FDI, as those three types of inflows accounted for 21 %, 2 %, and 77 %, respectively.

The 3rd cluster of countries is characterised by the Official Development Assistance in 1995 which accounted for almost 50 % of the total inflows. It must be noted that in those countries there are included the least developed countries from the region of LAC, thus the values of Official Development Aid are understandable. The second most popular inflow to the countries of the 1st cluster is Personal Remittances accounting for 37 % of the total share in the given year. Last but not least, the Foreign Direct Investment component is represented by minority of 14 %. In the middle year of the observation, it is possible to observe an increase in PR along with a decrease of Official Development aid, while the FDI components remain the same at the level of 14 %. The final year of the observation is featured by the diminishing trend of the Official Development Assistance reaching final value of 13 %, while the PR grows to 69 % and the FDI accounts for 18 %. Overall, there can be noted a declining trend in Official Development Aid which at the beginning of the observed period accounted for 49 % and at the end of it was just of the value 13 %. A reason behind that decrease could be found in the policy implications of the donor countries for this part of the world since other forms of inflow, such as Personal Remittances, which grew over time represent a more important income for the countries of the 3rd cluster. In case of the Foreign Direct Investment, there can be noted a growth which is not significant for the growth in PR.

The distribution of those forms of financial inflows to the region of LAC can be seen from various points of view. While the first cluster countries received more FDI than the rest of the clusters in average, in the 2nd and the 3rd clusters bigger proportion of Personal Remittances is presented. The reason that caused an increase in PR to the region could be found in the economic instability in the region which arose during the 1998-2002 economic crisis. The Crisis encouraged the labour force to move abroad to work, and thus send financial assets back home

to support their relatives. A diminishing trend of ODA can be seen across all clusters and years as that type of financial support is being gradually replaced by more appropriate forms of financial inflows.

5.4.1 Personal Remittances

The influx of Personal Remittances to the region of Latin America and the Caribbean represents a solid share on the GDP growth for some countries. Since the number of emigrants who send financial support back home was on increase during the observed period, the volume of the remittances increased as well. For many households that form of financial inflow represents the only income which prevents them from falling into poverty.

The following Figure 13 displays the development of that type of financial inflow to the region of Latin America and the Caribbean expressed in millions of USD.

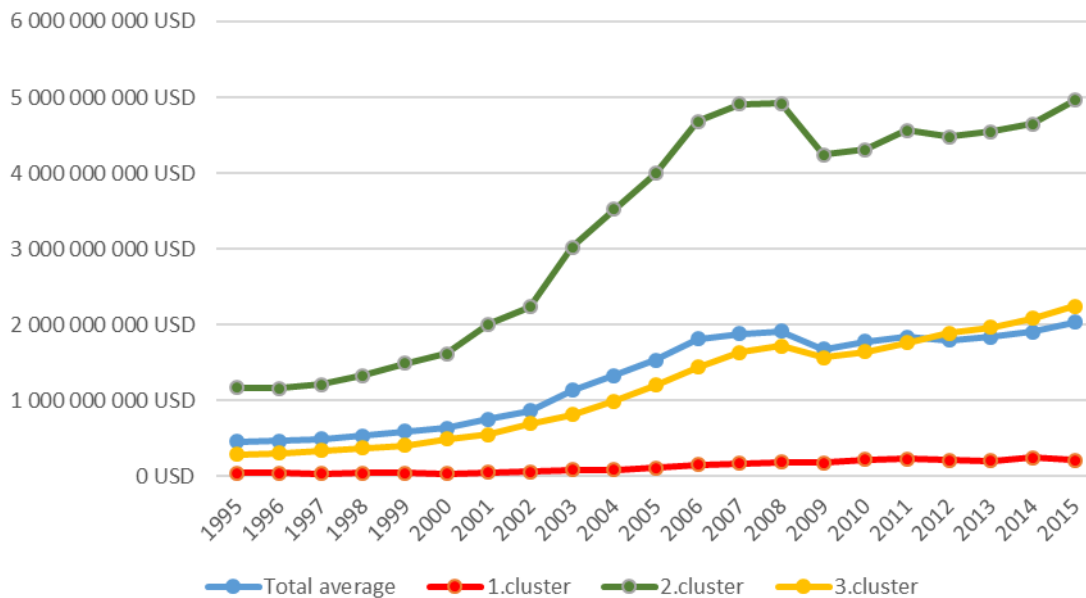


Figure 13 Personal Remittances by clusters, (1995-2015)

Source: Author's calculations based on data from the World Bank database (2016)

As it is possible to see from the first year of observation, the total average of the personal remittances was falling down; it was in 1998 when the personal remittances increased due to the growing number of workers in foreign countries. Relative increase can be seen until 2007 when the US recession occurred and caused approximately 15 percent drop in remittances overall. In the following years, the amount of remittances kept growing while it hit its peak in 2011. In the final part of the observed period there can be seen a drop in the amount of remittances pos-

sibly caused by non-favourable exchange rate which occurred in many Latin American countries.

The increasing trend for all of the clusters observed is obvious from the Figure 13 – when the amount of personal remittances grew year by year. Indeed, it is possible to see some decreases during the development; however, in the long-run the development is positive. As it was already analysed (see Figure 12) Personal Remittances are by major share represented in 2nd and 3rd clusters in comparison with the 1st cluster. From the Figure 13 it is therefore possible to observe that the development of personal remittances of the 1st cluster does not set the pace with regard to the Total Average values. Furthermore, the first cluster is somehow resistant to economic changes which can be noticed in the Figure 13, in the year of 2009. The main reason for that non-dependency can be a low proportion of the Personal Remittances on the total share of financial inflows for the 1st cluster of countries. In the case of the second cluster of countries, the proportionally higher values of the personal remittance occur. One of the major contributors to that form of financial inflows for the 2nd cluster countries is Mexico with the best geographical location for accessing the more developed US market. The second most successful country in terms of remittances is Colombia. In case of the 3rd cluster countries the remittances sometimes represent even 20 % of the total share of Gross Domestic Product – as in the case of Haiti the average for observed period is set to be 20.19 % of the total Gross Domestic Product. In spite of the fact that the amount of personal remittances is lower in case of the 3rd cluster countries while suggesting the major share on the Gross Domestic Product of these countries, it has to be stated that majority of those countries are small island nations whose economies are not developed to such a high level – compared to countries from the second or the first cluster.

The following Figure 14 represents the total average of the Personal Remittances received in the region of Latin America and the Caribbean for which a trend analysis was applied.

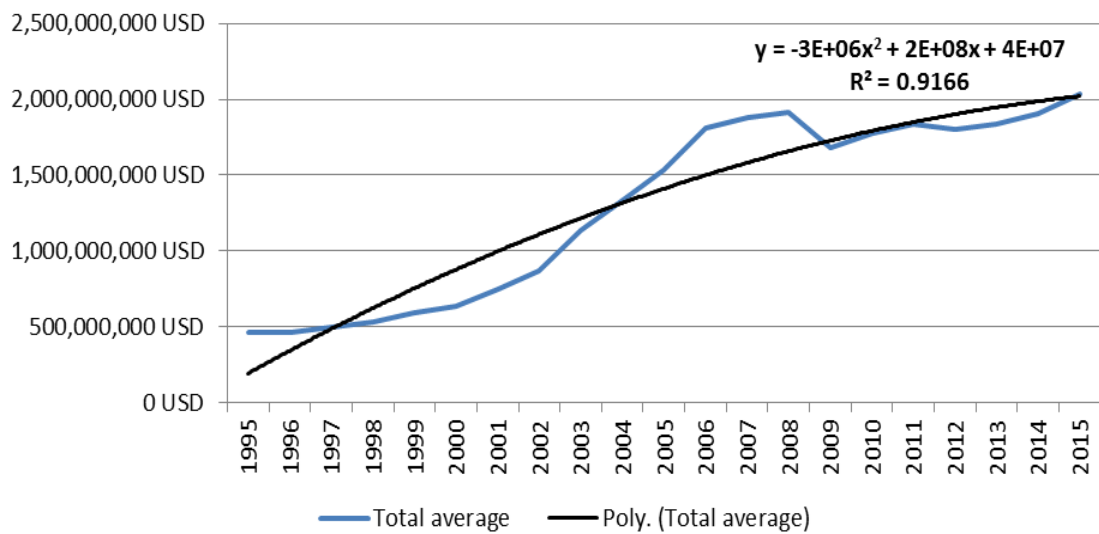


Figure 14 Trend Analysis: Personal Remittances, in USD (1995-2015)

Source: Author's calculations based on data from the World Bank database (2016)

The overall relationship is positive, thus with progress in time the amount of remittances increases as well. While the index of determination maintains a relatively strong value (0.91), it can be noted that time had a positive impact on the development of personal remittances in Latin American and the Caribbean region between 1995 and 2015.

5.4.2 Official Development Assistance

As the official development aid is directly pointed towards the development and poverty eradication, it represents an important external financial inflow to the region of Latin America and the Caribbean. The distribution of this financial flow was displayed in Figure 12 where the proportionally significant values were presented for countries of the 3rd cluster. Just as a reminder the year 1995 would serve when that form of external financial flow accounted for almost 50 % of total financial flows examined in this work. The following Figure 15 represents the development of this form of the financial inflow expressed in US dollars.

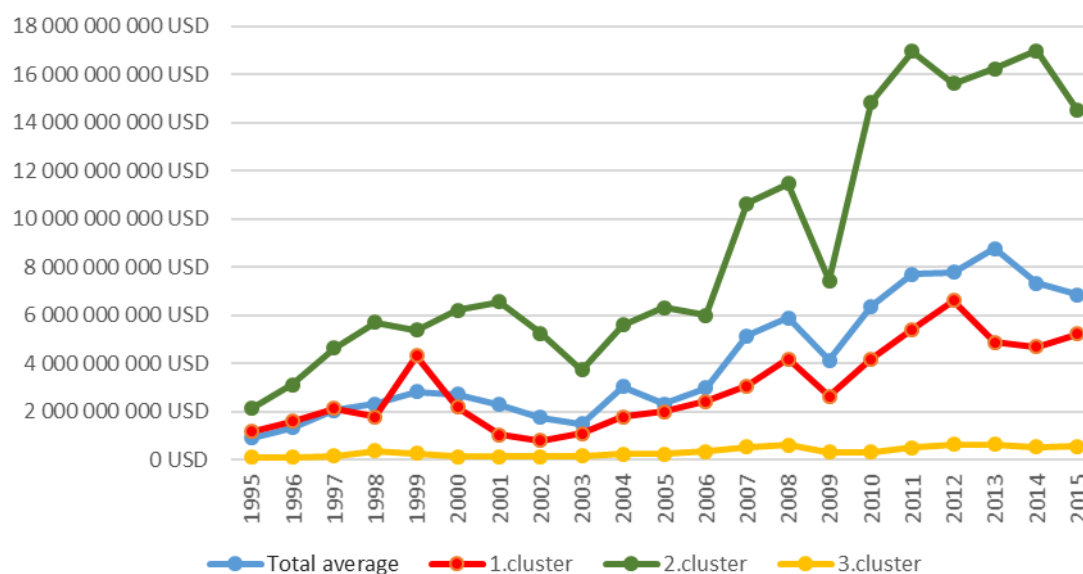


Figure 15 Official Development Assistance by cluster, in USD (1995-2015)

Source: Author's calculations based on data from the World Bank database (2016)

While two out of three clusters are above the total average line, the 1st cluster stays below as the share of the Official Development Aid is overcome by other types of financial inflows to those countries. Moreover, in case of the first cluster a relatively low overall growth can be observed when in 1996 the development assistance started to fall down; however, it recovered in the years of the Global Economic Crisis as the countries in Latin America could not cope with the consequences effectively. In case of the second cluster, which received (in average) bigger amount of the ODA in comparison with the two clusters, the overall trend of the second cluster is positive with decreases only during the 1998-2002 crisis and also during the 2008 Global Economic Crisis. The 3rd cluster which received the highest amount of the Official Development Aid in comparison with the rest of the clusters was highly dependent on the economic situation in donor countries. As the Official Development Aid represents a solid share on the Gross Domestic Product of some countries in that cluster, an inflow of such form of financial assets fluctuated during the whole observed period. It is worth noticing that in 2008 when the Global Economic Crisis erupted that cluster kept its positive growth of the Official Development Aid, and even one year later the ODA went higher. A possible reason behind that phenomenon could be found in the fact that countries of the 3rd cluster are still highly dependent on import. Thus, with Global Economic Crisis affecting also the import and export system the need for the countries of the third cluster was in place as they were not able to secure basic needs for their citizens.

A trend analysis was applied on the total average of the Official Development Assistance for the countries of Latin America and the Caribbean over observed period 1995-2015. The development of the total average of the ODA and the trend analysis are to be seen in the following Figure 16.

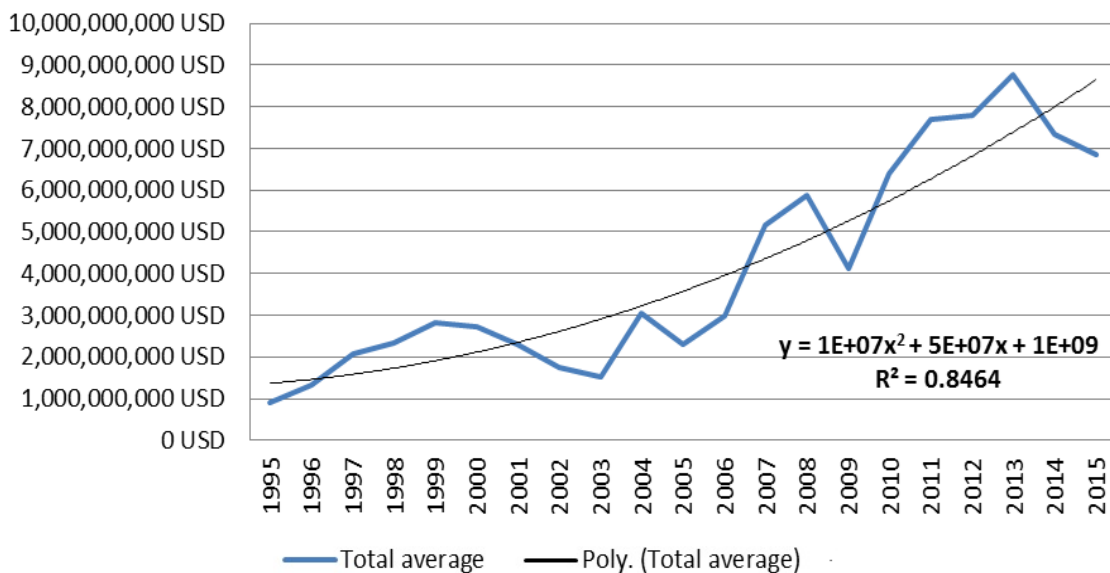


Figure 16 Trend Analysis: Official Development Assistance, in USD (1995-2015)
Source: Author's calculations based on data from the World Bank database (2016)

From the beginning until the end of the observed period, it is possible to record a positive development over the observed period. The line representing the total average of the Official Development Assistance recorded small ups and downs during the economic crisis which affected the region. Moreover, an absolute peak of the Official Development Assistance in terms of USD received can be seen in 2011 when the ODA accounted for almost 310 million of US dollars. This robust peak was one year later changed for a fall in the ODA as the aid from the European Union (the main donor) fell by 7.4 % in comparison with the previous year. That fall could be explained by a wake of Eurozone crisis which could have affected also the development assistance for the countries of Latin America and the Caribbean. Overall, the trend line has a positive slope with equation displayed directly in the Figure 16. The index of determination represents a relative high value of 0.859.

5.4.3 Foreign Direct Investments

The financial inflow which has a direct impact on the recipient economy is Foreign Direct Investment. With the development of this inflow the economic growth is inevitable alongside with employment creation. Thus, the reducing trend

in poverty rate should take place. The following Figure 17 represents the development of the inward Foreign Direct Investment in the region of Latin America and the Caribbean during 1995-2015 period expressed in USD.

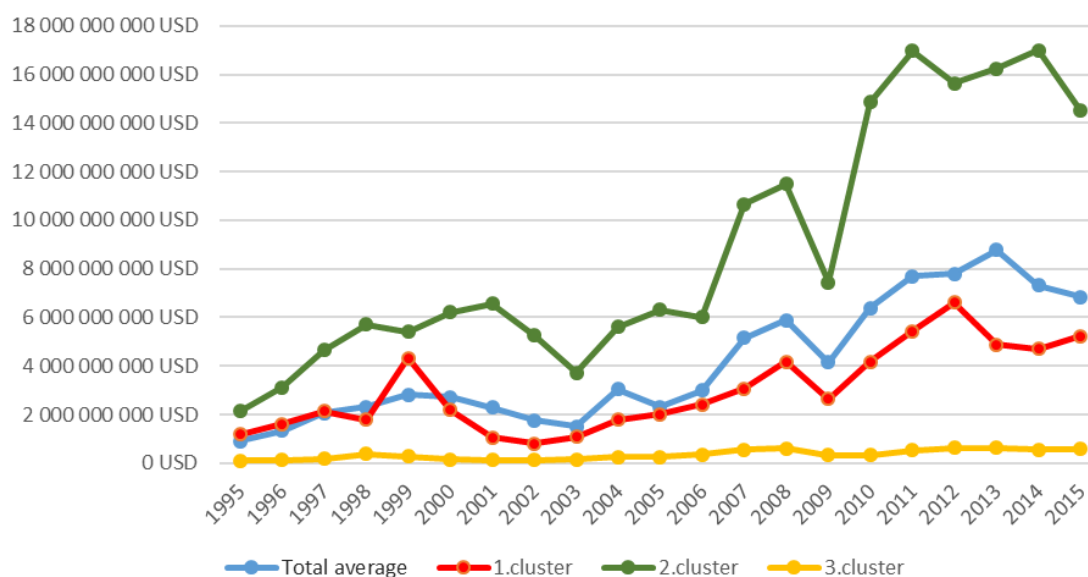


Figure 17 Foreign Direct Investments inflow by cluster, in USD (1995-2015)
Source: Author's calculations based on data from the World Bank database (2016)

The total development of the Foreign Direct Investment in the region is positive over the observed period of time. The major decreases could be noticed in 2003 when the effect of the 1998-2002 crisis took place. Later, the inflow was on increase until another economic crisis in 2005 occurred dragging the Foreign Direct Investment inflow down. The recover in the region for the FDI did not last long as another economic crisis struck in 2009 bringing the development of the Foreign Direct Investment low. Further development can be seen in the Figure 17 as from 2013 the total Average for the Foreign Direct Investment inflow to the region was decreasing until the end of the observed period. Among the possible factors which caused such decline could be added the absence of major corporate acquisitions during the first half of 2013, as well as various other factors characteristic for each of the country in the region, such as deceleration in mining investments due to lower prices for metals in the global market.

With regard to the cluster level development of the Foreign Direct Investment inflow in the region of Latin America and the Caribbean, the most vulnerable cluster is the 1st cluster as that cluster receives proportionally higher amounts of FDI in comparison with other clusters, and thus the development of the FDI of the first cluster highly influences the development of the total average. The mining

industry as one of the most significant recipient industries of the first cluster is the easiest one to be influenced as the price for the metal in the global market is not stable which might be seen on the development line of the cluster. The 2nd cluster pretty much copies the total average development in terms of ups and downs as the majority of the portion received flows to service sector alongside with manufactures sectors, those two sectors exceeding the natural resources sector in the cluster. The development of the 3rd cluster and its FDI inflows is quite stable as the cluster does not receive a significant portion of the foreign direct investment, thus it is not dependent on such a form of inflows encouraging the economic growth. However, the main industries of the 3rd cluster which directly benefit from the low inflow of the FDI to the cluster are: Natural resources (e.g. Bolivia), and Service sector (e.g. Belize, Guatemala, Dominican Republic).

Figure 18 represents a trend analysis applied on the total average of the clusters in terms of inward Foreign Direct Investments.

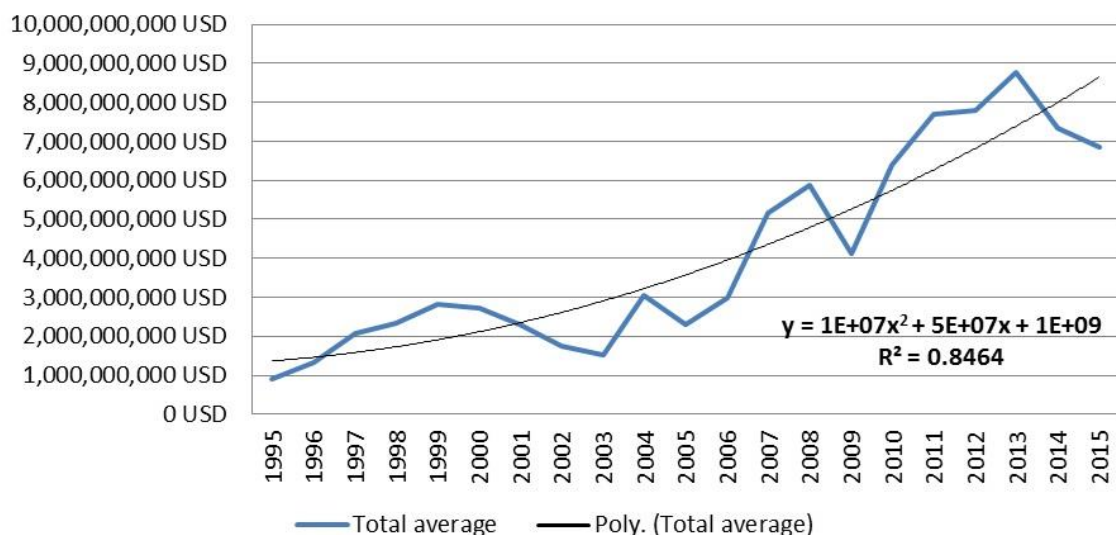


Figure 1812 Trend Analysis: Foreign Direct Investments, in USD (1995-2015)

Source: Author's calculations based on data from the World Bank database (2016)

From the Figure 18 it is obvious that the amount of Foreign Direct Investment inflows grows over the observed period of time, which is also indicated by the exponential trend line. The equation of the trend analysis alongside with the coefficient of determination, which is of a relatively high value, can be found in the Figure 18.

5.5 The Influence of the Financial Inflows on Poverty Rate in Latin America and the Caribbean

In order to analyse the main contributors to poverty reduction within the financial flows, a multiple regression analysis was applied for the following Equation 1:

$$\text{Model: } \textit{Poverty} = \beta_0 + \beta_1 \cdot \textit{FDI} + \beta_2 \cdot \textit{PR} + \beta_3 \cdot \textit{ODA}$$

In the Equation 1, the dependent variable is set to be Poverty; as the independent variables there are the following ones set:

- Foreign Direct Investments (FDI),
- Personal Remittances (PR),
- Official Development Aid (ODA).

For the countries of 1st cluster (Argentina, Chile, Uruguay, Panama, etc.) the following Table 7 displays the results of the multiple regression analysis.

Model Summary								
Model	R	R Square		Adjusted R Square		Std. Error of the Estimate		
1	.865	.748		.704		1.41724		
ANOVA ^a								
Model		Sum of Squares	df	Mean Square	F	P		
1	Regression	101.416	3	33.805	16.831	.000		
	Residual	34.146	17	2.009				
	Total	135.562	20					
Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	9.548	.949		10.063	.000		
	FDI	-4.994E-011	.000	-.033	-.164	.872	.371	2.693
	PR	-2.472E-008	.000	-.739	-3.748	.002	.381	2.623
	ODA	-3.516E-008	.000	-.217	-1.643	.119	.851	1.175

Table 7 1st Cluster: Results of the Multiple-regression Analysis

Source: Author's calculations based on data from the World Bank database (2016)

With regard to the low P-value of the model it can be said that the analysis is statistically significant. With a relatively high value of the adjusted index of determination $R^2=0,704$ it can be noted that the model explains 70.4 % of the poverty reduction effort in the countries of the first cluster. Should we look at the coefficients in Table 8 and thus the independent variables which have an impact on the poverty change, it is possible to observe that all of the forms of the financial inflows do have a negative impact on poverty reduction and thus they effectively diminish the poverty incidence across the countries of the 1st Cluster. The standardized values of Beta represent the percentage change effect of each of the independent variable used in the model. To be compared, the most effective in terms of poverty reduction according to the analysis seems to be personal remittances followed by official development Assistance while foreign direct investments are the less effective in terms of poverty reduction with regard to the financial inflows in the 1st cluster countries.

The results of the analysis conducted for the countries of the 2nd cluster (Brazil, Mexico, Venezuela, etc.) are displayed in following Table 8.

Model Summary								
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate				
1	.937	.878	.857	1.43790				
ANOVA								
Model		Sum of Squares	df	Mean Square	F	P		
1	Regression	254.059	3	84.686	40.960	.000		
	Residual	35.148	17	2.068				
	Total	289.207	20					
Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	16.889	.877		19.252	.000		
	FDI	-1.802E-010	.000	-.239	-1.454	.164	.266	3.762
	PR	-1.131E-009	.000	-.446	-3.222	.005	.373	2.684
	ODA	-1.252E-008	.000	-.327	-1.950	.068	.254	3.939

Table 8 2nd Cluster: Results of the Multiple-regression Analysis
Source: Author's calculations based on data from the World Bank database (2016)

Low P-value of this analysis proves that it is statistically significant. High adjusted index of determination $R^2=0,857$ indicates that the independent variables in this model (Foreign Direct Investments, Official Development Assistance, and Personal Remittances) explain the poverty reduction (change) by 85.7%.

With regard to the most effective financial inflows in terms of poverty reduction, the Table 8 presents that Personal Remittances have the biggest impact on the poverty reduction in the countries of the 2nd cluster. Official Development Assistance accounts as the 2nd most effective financial inflow in terms of poverty reduction, while the third is Foreign Direct Investments.

Table 9, displayed below, represents the results of the multiple regression analysis for the countries of the 3rd cluster.

Model Summary								
Model	R	R Square		Adjusted R Square		Std. Error of the Estimate		
1	.791	.626		.560		2.89084		
ANOVA								
Model		Sum of Squares	df	Mean Square	F	P		
1	Regression	237.988	3	79.329	9.493	.001		
	Residual	142.068	17	8.357				
	Total	380.056	20					
Coefficients								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	22.792	3.104		7.342	.000		
	FDI	-1.978E-009	.000	-.087	-.284	.780	.234	4.270
	PR	-3.514E-009	.000	-.545	-1.478	.158	.162	6.174
	ODA	-1.210E-008	.000	-.226	-1.058	.305	.482	2.073

Table 9 3rd Cluster: Results of the Multiple-regression Analysis

Source: Author's calculations based on data from the World Bank database (2016)

Low P-value secures that the analysis is statistically significant. The adjusted index of determination $R^2=0.560$ indicates that the independent variables in this analysis explain the dependent variable by 56%.

Moreover, it is possible to see that personal remittances have the most effective impact on poverty reduction in the countries of the third cluster while Offi-

cial Development Assistance is second and Foreign Direct Investments account as the 3rd most effective financial inflows across the 3rd cluster countries.

As it could have been seen across the analyses all the financial inflows do have a negative relationship with poverty change in the region of Latin America and the Caribbean. With regard to the adjusted index of determination it can be said that the poverty incidence is by major part effectively diminished by the financial inflows in 1st and 2nd cluster. In the 3rd cluster the index represents a medium value which corresponds to smaller effect of the financial inflows in terms of poverty eradication. A possible reason behind this phenomenon could be found in corruption issues which plague the region of Latin America and the Caribbean. Should we look at the financial inflows and their influence separately cluster by cluster it can be noted that foreign direct investments prevail in 1st and 2nd cluster countries over the rest of the financial inflows, while in the 3rd cluster countries personal remittances account for the biggest share in terms of poverty reduction. Official Development Assistance was found always as the second most important and effective financial inflow in the analyses conducted.

6 Discussion

The thesis was focused on the assessment of poverty in the region of Latin America and the Caribbean during the observed period of 1995-2015.

Firstly, the countries in the region of Latin America and the Caribbean were divided based on the standard of living. The sub-indices of the Human Development Index were used as the input data for the cluster analysis which determined 3 clusters of countries in the region of LAC. While in the 1st cluster countries such as Chile, Argentina, Panama were presented, in the 2nd cluster Brazil, Mexico, Colombia, Peru were included. The 3rd cluster corresponded to the countries in the region with the lowest values of the HDI such as Belize, Guyana, Bolivia, Honduras, and Haiti.

As it is expressed by Vakis et al (2016) poverty as such represented for many years a drawback for the whole region of LAC. During the observed period of 1995 – 2015 the development of poverty rate in the region was examined. As it was promised at the United Nations conference in 2000 that the poverty would be halved by 2015, in case of LAC the progress is visible. In all three clusters the poverty rate kept falling from the beginning until the end of the observed period most possibly thanks to the right policy measures and investments made to help the poor to escape this social status. Therefore, it can be said that the region of LAC did fulfil the promise and halved the poverty incidence across the countries in this part of the world.

Decisive indicators which could have an influence on poverty incidence in countries of Latin America and the Caribbean were later examined. Gross Domestic Product per capita considered as the main indicator of standard of living and thus partially poverty incidence, had been developing over the observed period steadily with increasing trend overall. This indicator was put into regression with poverty incidence while the influence of GDP per capita was examined with regard to the poverty level. The results suggested there is a weak relationship between these two variables however with increasing values of GDP per capita the poverty incidence was decreasing. The weak relationship could be associated with inequality which is presented in many fields across the economy in the countries of LAC. Moreover, corruption yet another important issue could have a decisive impact on this relationship.

The influence of unemployment rate on the poverty incidence was examined via regression analysis which proved rather unexpected results. The analysis showed that the poverty level kept dropping steadily when the unemployment rate reached 16% and more. This unusual phenomenon could be easily connected to

Black Market considered as the factors as people in the society tend to work unofficially elsewhere. Prostitution, illegal drugs, sexual exploitation, forced labour, and tobacco, or simply vending at the streets are few of the activities which can be imagined under that term in case of Latin America and the Caribbean.

As it is stated by various authors income and income distribution can have a decisive effect on the level of poverty in the society. Income inequality and its possible effect on the poverty development in LAC was observed during the given period time. As Soubbotina (2000) points out that the income distribution influence the number of poor people in the society, the regression analysis proved that there is a positive relationship between level of poverty and income inequality in the countries of LAC which means that with increasing values of the income inequality (measured by Gini index) the incidence of poverty is increasing as well.

The distribution of the financial inflows in the region of Latin America and the Caribbean was observed from the cluster – point of view. While in the 1st (Argentina, Chile, etc.) and 2nd (Brazil, Mexico, Panama, etc.) cluster the prevalence of FDI is solid, in the 3rd cluster (Haiti, Cuba, Honduras, etc.) personal remittances represent the major share. Official Development Assistance accounted between Foreign Direct Investments and Personal Remittances in terms of amount received by all three clusters.

As Zhang (2006) argues that with stable inflow of capital into the country the poverty eradication is inevitable, in countries of Latin America and the Caribbean this relationship was observed via multiple regression analysis. The dependent variable Poverty rate was put into regression with independent variables: Foreign Direct Investments, Personal Remittances, and Official Development Assistance. While this relationship was observed for each cluster separately, the results suggested that the financial inflows do diminish the poverty incidence across all clusters. It was found out that all of the financial inflows examined with regard to the poverty incidence do have a negative influence on the poverty level across all cluster countries of LAC. The effectiveness of each of the inflows was examined on the cluster – based level where it was found out that personal remittances do contribute the most to eradicate the poverty in all three clusters observed. Official Development Assistance accounted as the second most important financial inflow in terms of poverty reduction across all clusters while the Foreign Direct Investments represented the less effective financial inflow in clusters examined. An interesting feature could have been noted in case of Foreign Direct Investments, the P value in the model was proportionally higher than the rest of the financial inflows observed indicating that this kind of inflows does not influence the poverty eradication in the region of LAC. A possible explanation behind this phenomenon could be found in inappropriate structured policies for management of this kind of financial inflow

mainly in countries of the 1st (Chile, Argentina, etc.) and 2nd (Brazil, Mexico, etc.) clusters where this type of financial inflow prevails during the observed period.

In the context of developing problems and poverty reduction, it is interesting to note that in the region of Latin America and the Caribbean the common analogy of poverty reduction does not work as it should, or at least as it works in other developing regions. There are number of examples stated in the thesis, such as the weak effect of Gross Domestic Product per capita growth on the reduction of poverty incidence within the region, or a weak relationship between unemployment and poverty. Those and other rather extraordinary findings could be associated with issues such as inequality, corruption, or the developing black market economy in the region of Latin America and the Caribbean.

With regard to the lack of long-term data, the assessment of the poverty eradication across the region of Latin America and the Caribbean was somehow limited. To fully scope and evaluate the topic into depth the analyses should be conducted on a country-based level, thus understanding the poverty eradication across the region of LAC from that perspective as well. Moreover, there is certainly number of other factors which should be examined and evaluated in order to reflect more precise situation within the region of Latin America and the Caribbean. Bearing all the facts in mind, there are various possibilities for other researches to be conducted on the topic of poverty eradication in Latin America and the Caribbean.

6.1 Evaluation of the hypotheses

After the hypotheses were set, it is necessary to summarise and evaluate the results of the analyses conducted. In order to obtain the most precise data, four simple regression analyses and one multiple regression analysis were used to verify the hypotheses.

Hypothesis 1: Economic growth reduces poverty incidence

A simple regression analysis which was applied on the relationship of the GDP per capita growth and the Poverty rate proved that economic growth does have a negative effect on the poverty incidence across the region of Latin America and the Caribbean. Thus, with increasing growth of the GDP per capita the poverty incidence decreases.

Hypothesis 2: Unemployment increases level of poverty

From the results of the simple regression analysis applied on the relationship of Unemployment Rate and Poverty rate it was obvious that poverty incidence was

increasing when the unemployment rate reached values between 9 % and 15.8 %. Therefore, it can be said that unemployment increases the poverty incidence – though only partially, probably due to the black-market economy.

Hypothesis 3: Income inequality increases poverty

The relationship between Gini Index and Poverty rate was examined via a simple regression analysis which proved a positive relationship between those two indicators in the region of Latin America and the Caribbean.

Hypothesis 4: Poverty is reduced by Foreign Direct Investments, Personal Remittances, and the Official Development Aid.

A multiple regression analysis was applied on the relationship between poverty rate, as a dependent variable, and Foreign Direct Investment, Personal Remittances and Official Development Assistance, as independent variables across all clusters. It was found out that the financial inflows do diminish the poverty incidence across all clusters. While in all three clusters personal remittances account as the most effective financial inflow, official development assistance represented the 2nd most effective financial inflow in terms of poverty reduction in cluster countries. Foreign Direct Investments are the less effective financial inflow with regard to poverty eradication in all three clusters. Therefore, it can be noted that poverty is reduced by personal remittances, foreign direct investments, and the official development aid.

7 Conclusion

Poverty represents a major issue for many Latin American as well as Caribbean countries. Issues connected to that phenomenon plague the whole economy of the region as well as its development. In the thesis the region of Latin America and the Caribbean was divided into sub-regions and a cluster analysis was applied on the decomposed Human Development Index. As a result, three clusters of countries were formed.

The Gross Domestic Products per capita as the main indicator for standard of living and also for poverty eradication kept improving from the beginning of the observed period in 1995 until the end of it in 2015. In absolute terms it can be said that increase of approximately 7,600 USD was made between 1995 and 2015. With regard to number of crises by which the countries in the region were hit the indicator kept growing. The main turmoil could be recorded in the years 1998 - 2002 and in 2009 when economic crises occurred. Among the three clusters compared on the same scale the lowest GDP per capita was recorded by the 3rd cluster, while the highest GDP per capita was characteristic for the 1st cluster of countries. The 2nd cluster appeared on the figure somewhere between those two clusters as it was close to the Total Average for the region between 1995 and 2015. With regard to the GDP growth over the observed period of time, major decreases could be found in the years of economic crises of 1998-2002 and 2009 when many of the countries recorded a negative growth in terms of GDP per capita. The lowest value for the economic growth was recorded by the 1st cluster countries in 2009 when reaching -4.47 %; on the other hand, the highest value was recorded by the same cluster in 2006 with GDP per capita growth of 6.32 %. The 2nd and the 3rd clusters were closely copying the Total Average development of the GDP per capita growth during the whole observed period.

During the observed period of 1995-2015, the poverty rate kept falling and reached final decrease of almost 10 % over the observed period. From the three clusters examined the 1st and 2nd clusters remained below the average value of the observed period, while the 3rd cluster recorded the highest value of the Poverty rate in 2001 with 23.31 %. On the other end, the lowest value of the indicator was seen in case of the 1st cluster of countries in 1996 when it reached as low as for 2.93 %. A trend analysis was applied on the development of Poverty rate over the observed period of time, while a cubic trend line indicated an increase of Poverty rate between 1995 and 1999, and a long-term decrease was seen between 1999 and 2012. Later, from 2012 until the end of the observed period an increase in the poverty incidence was recorded. With regard to the poverty eradication effort a

simple regression analysis was applied on the relationship of GDP per capita and Poverty rate proved that Gross Domestic Product per capita does affect the poverty incidence across the region of LAC; however, the intensity of the relationship is not strong with value of the index of determination being $R^2=0.02$.

During the observed period the unemployment rate of the countries in LAC was decreasing with total average of unemployment rate of 8 %. As the unemployment should have a direct impact on poverty reduction, a simple regression analysis indicated that poverty incidence was decreasing while the value of unemployment rate was between 2 % and 8 %; and later, when the unemployment rate reached values of 9 % - 15 %, the incidence of poverty was rising. It is also important to note that the value of the index of determination in that case was $R^2=0.044$.

Income inequality, measured by Gini index, developed negatively over the observed period since the values of the Gini index were – in total average – the highest in 1999 when Gini index equalled 54.7. The lowest value was recorded in 2014 with the number of 47.6. Various studies describe the relationship between poverty and inequality as a positive one. From the analysis applied, there can be seen a positive relationship in the region of Latin America and the Caribbean, as with increasing incidence of poverty across the countries the income inequality measured by Gini index is also rising.

Financial inflows represented by Personal remittances, Foreign Direct Investment, and Official Development Assistance represented a crucial part with regard to capital inflows to the region. FDI represented a major share on the inflows for the 1st and 2nd cluster countries. Personal remittances dominated in the 3rd cluster countries, while a small share was recorded also in the 2nd cluster countries; on the contrary, the 1st cluster countries had a minor part of that flow. Official Development assistance was presented by a solid share in the 3rd cluster countries, while in the 1st and 2nd cluster countries that form of financial flow did not represent a major share.

In case of Personal Remittances, the development has been stable during the whole observed period, but the 2nd cluster countries recorded much bigger portion of PR than the rest of the region. A small decrease in the PR flow to the region was recorded in 2009 with Economic Crisis affecting the whole world. The smallest share on the PR was presented by the 1st cluster countries, while the 2nd cluster countries were closely following the total average for the region. Development of Official Development assistance in the region was steadily increasing over the observed period – the major share flew to the 3rd cluster countries, followed by the 2nd cluster countries and the 1st cluster countries which received the least. Finally, Foreign Direct Investment developed over the observed period in a positive way.

Major decrease could be seen only in 2009 when the total average for the region decreased; however, from the overall, it can be said that increase in total inflow of that kind of financial flow was seen.

The influence of the financial inflows on the poverty eradication was analysed via the multiple regression analyses for each cluster – it was found out that the poverty incidence is decreased by all financial inflows in all observed clusters. While in all three clusters the poverty rate was most effectively decreased by personal remittances, official development assistance accounted as the second most effective financial inflow in terms of poverty reduction across all clusters. Foreign Direct Investment represented the less effective financial inflows in terms of poverty reduction in clusters observed. Indeed, it would be appropriate to find the extend of the decreasing effect of the financial inflows on the poverty incidence within the region of LAC as well as the exact groups of the poor population across the region in terms of geographical location to better understand and analyse the results of the financial inflows in the region of Latin America and the Caribbean. Financial inflows represent a fragile and at the same time very effective tool in case of poverty eradication, which should be appropriately controlled in terms of amount received. Appropriate policies should be established in order to better regulate the whole process of incoming financial flows to the region and to have effective results on the poverty eradication in the region of Latin America and the Caribbean – since an inappropriate regulation can result in stagnating or even increasing the poverty rate across the region of Latin America and the Caribbean.

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9 List of abbreviations

FDI	Foreign Direct Investments
GDP	Gross Domestic Product
GNI	Gross National Income
HDI	Human Development Index
IMF	International Monetary Fund
LAC	Latin America and the Caribbean
ODA	Official Development Assistance
PR	Personal Remittances
UNCTAD	United Nations Conference on Trade and Development
UNDR	United Nations Development Report

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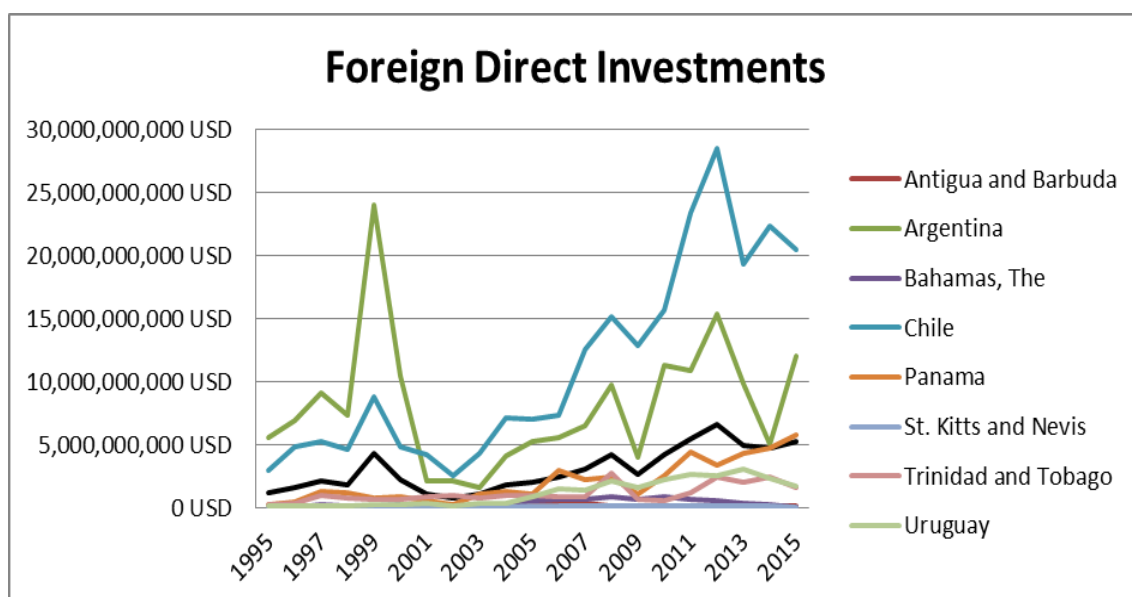


Figure 19 Development of Foreign Direct Investments in the 1st cluster
Source: Author's calculations based on data from the World Bank database (2016)

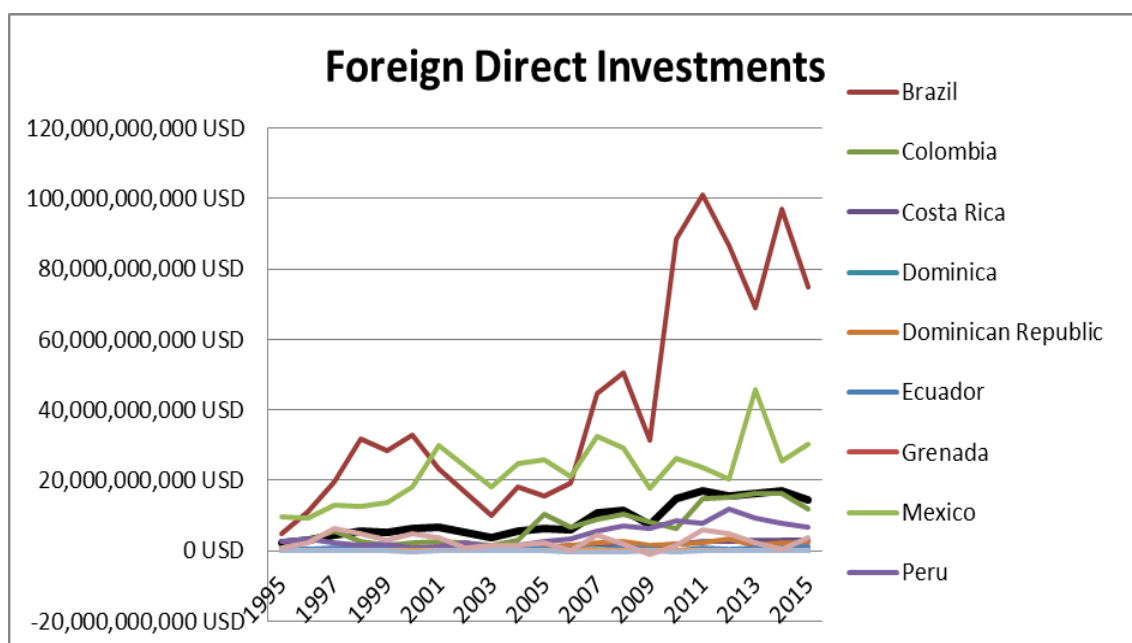


Figure 20 Development of Foreign Direct Investments in the 2nd cluster
Source: Author's calculations based on data from the World Bank database (2016)

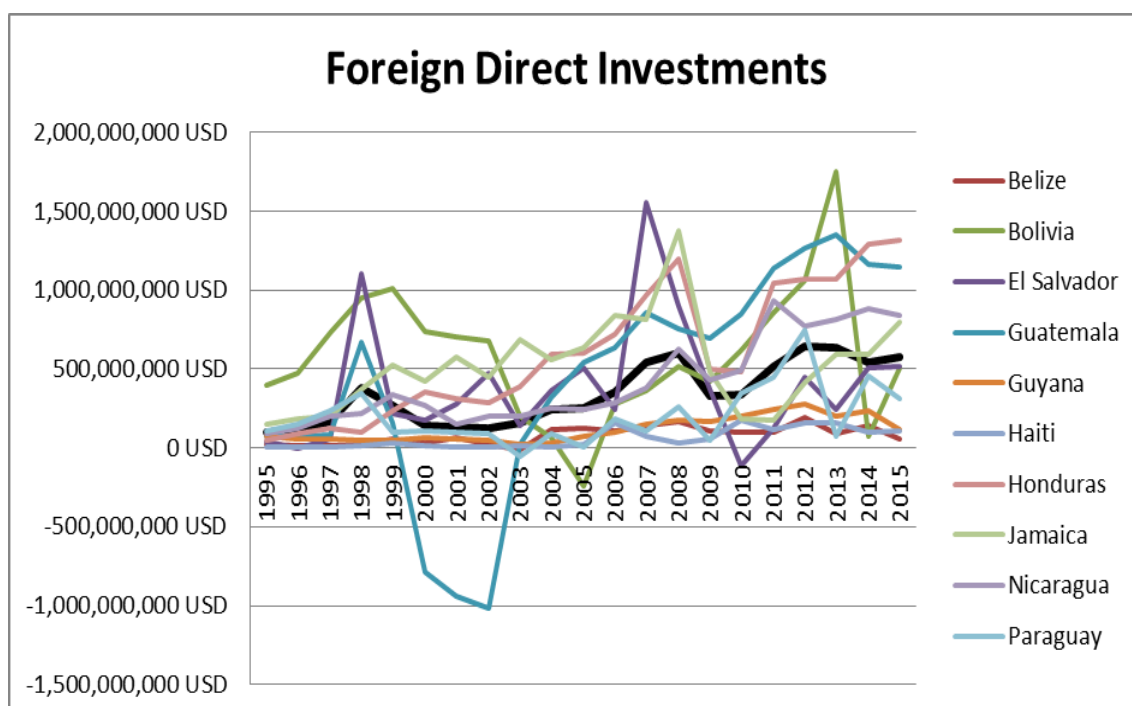


Figure 21 Development of Foreign Direct Investments in the 3rd cluster
Source: Author's calculations based on data from the World Bank database (2016)

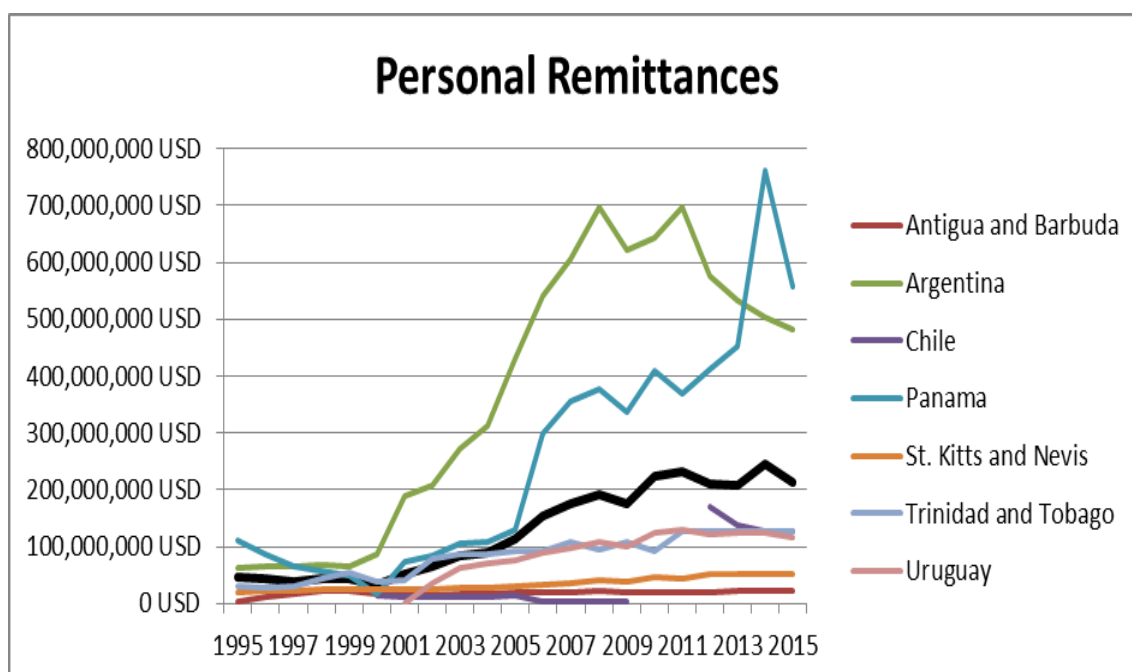


Figure 22 Development of Personal Remittances in the 1st cluster
Source: Author's calculations based on data from the World Bank database (2016)

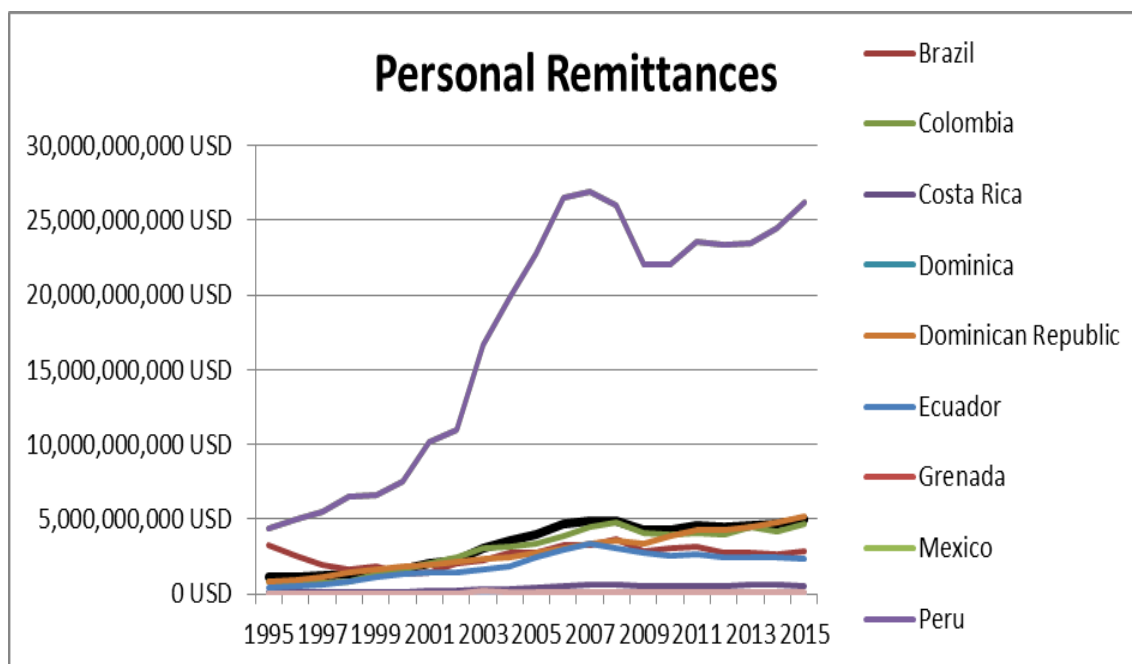


Figure 23 Development of Personal Remittances in the 2nd cluster
Source: Author's calculations based on data from the World Bank database (2016)

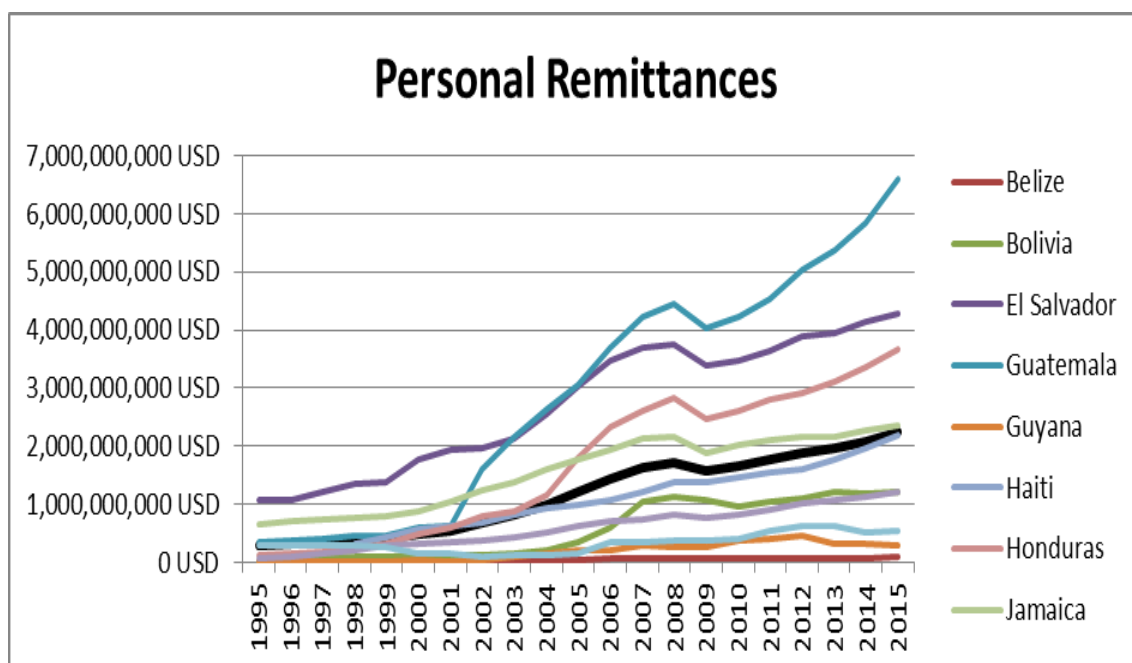


Figure 24 Development of Personal Remittances in the 3rd cluster
Source: Author's calculations based on data from the World Bank database (2016)

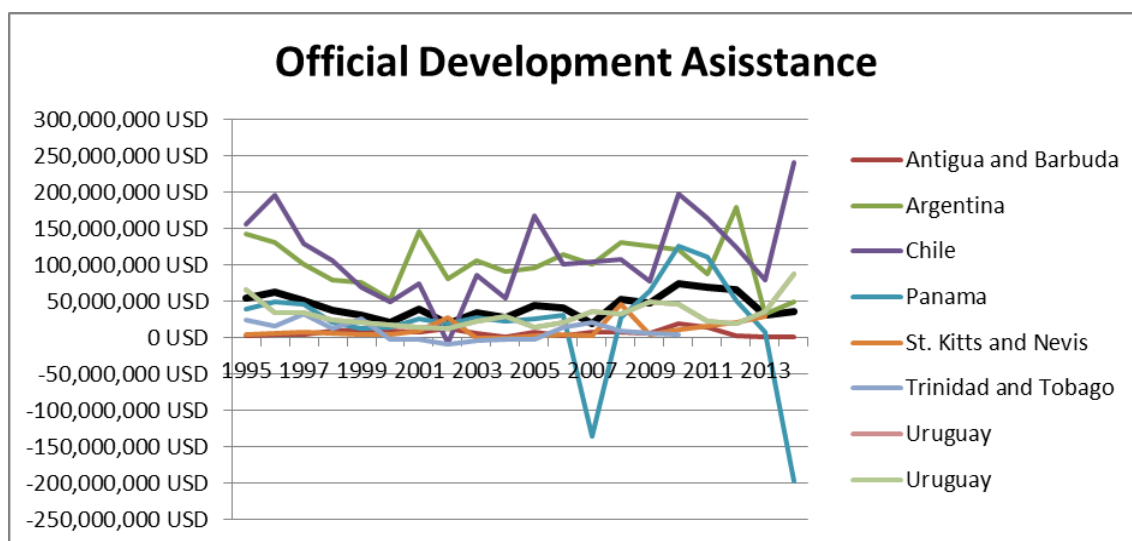


Figure 25 Development of the Official Development Assistance in the 1st cluster
Source: Author's calculations based on data from the World Bank database (2016)

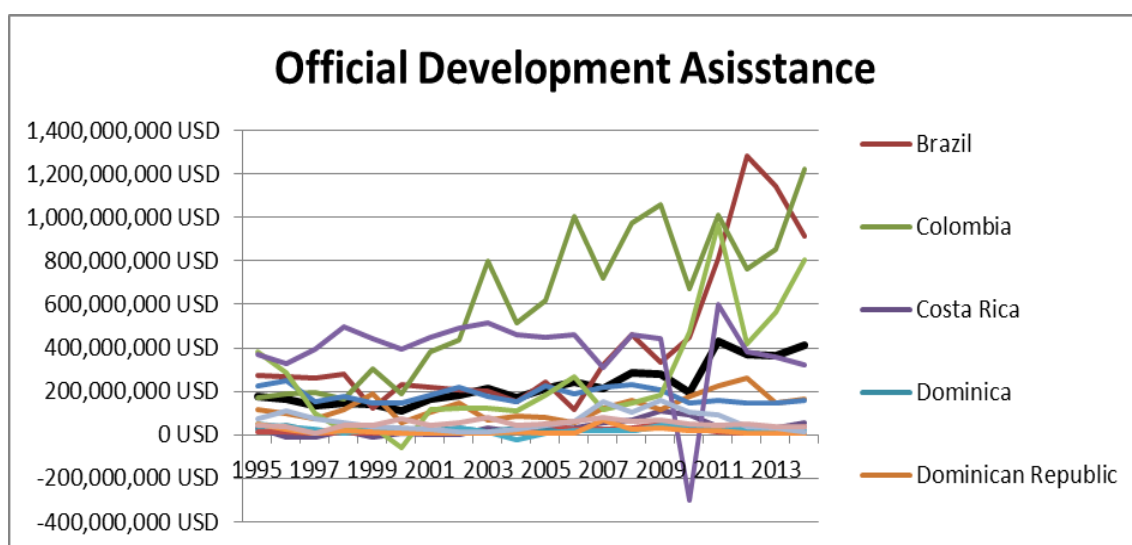


Figure 26 Development of the Official Development Assistance in the 2nd cluster
Source: Author's calculations based on data from the World Bank database (2016)

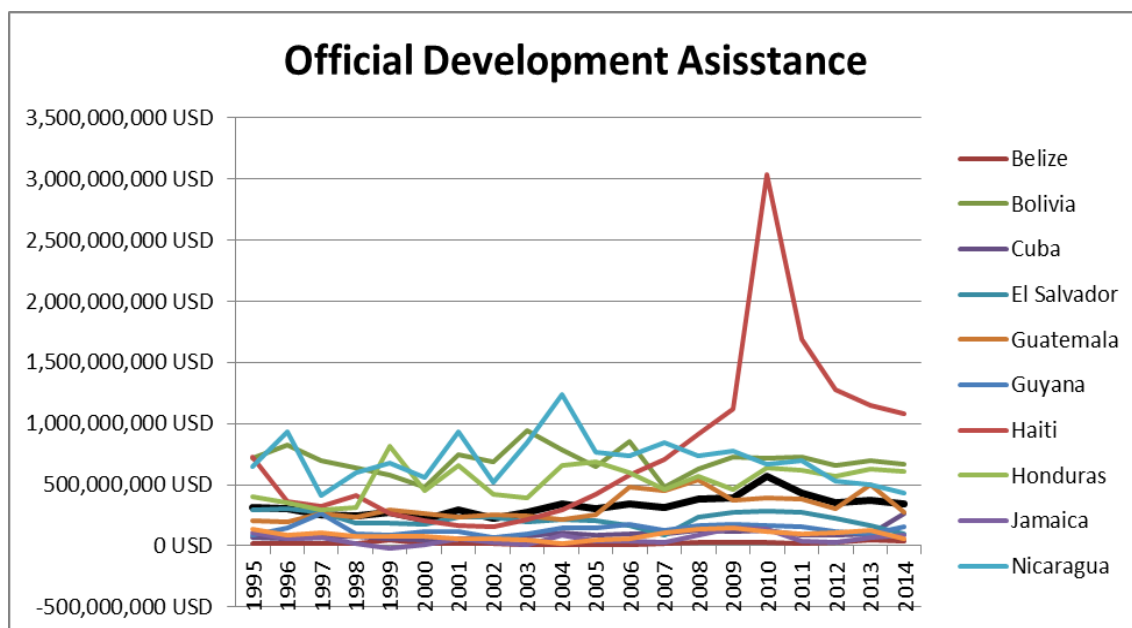


Figure 27 Development of the Official Development Assistance in the 3rd cluster
Source: Author's calculations based on data from the World Bank database (2016)