GOVERNANCE AND ECONOMIC GROWTH IN LATIN AMERICA: SOME STYLIZED FACTS AND RELATIONS

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ABSTRACT
Some stylized facts and relations appear between the governance and the economic growth in Latin America. The principal findings suggest that: 1) In the region, the worst perception recounts to the indicator Rule of Law; nevertheless, this indicator is the one that best explains governance at aggregated level; 2) the indicators Voice and accountability, Rule of law and Control of corruption have relationship with the form of inverted U growth; and 3) the indicators Stability - politics, Governmental Efficacy and Regulative Quality have linear and positive relations with the growth. The panel of information includes annual indicators for eleven economies during the period 2001-2010.

INTRODUCTION
Traditionally it is considered that the development of an economy depends on the existence of "good governance" (see Knack, 2003; Feng, 2003). This belief is often supported by specialists from the growth and economic development and by international institutions of development and aid. So the relationship between governance and economic growth is often seen as unambiguous, positive and significant. Moreover, some people assume that governance is a prerequisite to increase living standards in a sustained manner (see Dellepiane-Avellaneda, 2010).

Paradoxically, the literature shows that there is no such consensus. This situation occurs for conceptual, empirical and ideological reasons. First, governance is a multidimensional concept difficult to conceptualize and measure (Bevir, 2011). Usually, governance refers to the forms of social coordination and governance practices in an economy. For this reason,

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it is usually defined in terms that are difficult to assess and quantify (social, political and institutional). In fact, the measurement of governance causes major controversy among specialists (Norris, 2011).

The empirical literature on governance and economic growth also tends to be ideologically polarized. This polarization is usually manifested between those who argue that governance is linked only to democratic regimes. So some argue that the relationship between governance and growth may be positive, negative or not significant (see Feng, 2003; Dellepiane-Avellaneda, 2010). In addition, some argue that political governance is not linked with political regimes. In the vision of these last, what matters are the institutions and property rights (North 1990 and 2005; Acemoglu and Robinson, 2006 and 2012; Acemoglu, Johnson and Robinson, 2005).

In this study some stylized facts and empirical relationships on governance and economic growth in Latin America are shown. Methodologically, the research is based on using descriptive statistical techniques, principal components and ordinary squared minimums. To ensure international and intertemporal consistency of indicators databases "Worldwide Governance Indicators, WGI" and "CEPALSTAT" are used. The panel includes annual data for the eleven indicators economies during the period 2001-2010.

Conceptually, here the definition of governance by Kaufmann, Kraay and Mastruzzi (2010:6) is used. Thus, governance is equivalent to the traditions and institutions by which authority in a country is exercised. It includes: a) the process by which governments are chosen, monitored and replaced; b) the effective capacity of the government to formulate and implement reasonable policies; c) the respect of citizens and the state with the institutions that govern economic and social interactions among them. This definition is used because the WGI data base is built assuming the validity of it.

Methodologically, the research uses descriptive statistics and principal components regression techniques. The technique of principal components is used to construct and analyze an aggregate indicator of the Governance by the data contained in the WGI. The WGI includes six variables related to different dimensions of governance. Regression analysis is used to estimate the empirical relations between governance and growth. The seven estimated relationships are analyzed from a medium-term perspective. For simplicity, the estimated results are presented graphically.

The document is divided into six sections. The second section includes a review of the literature. The third describes the economic and institutional indicators. The fourth includes the descriptive analysis of indicators to show some stylized facts on governance and growth in Latin America. It also builds and analyzes the aggregated indicator of the Governance

by main components. In the fifth estimated empirical relationships between governance and growth is. The sixth section summarizes and discusses the results.

1. LITERATURE REVIEW

This section provides an overview of the theoretical discussions and empirical studies examining the relationship between governance and economic growth. In this context, it should be noted that although there is no consensus on the definition of governance, it has a prescriptive connotation as it means an end and a result (Aguilar, 2010). Therefore, in the first paragraph it is prescriptive and normative connotation in the context of relations between governance and economic growth is emphasized. In the second section the empirical literature is reviewed.

1.1 GOVERNANCE AND ECONOMIC GROWTH

The literature that has studied the relationships of governance and economic growth is linked to the institutionalists theories proposed, among others, by North (1990) and Olson (1996), and the proponents of the "School of Compatibility". These theories argue that development depends on the ability to secure property rights and enforce contracts in the economies. Governance, and eventually democracy, promotes growth because they ensure property rights, business transactions, social rights and the provision of public goods.

Studies of the relationship between governance and growth cannot be separated from the debate about the role of government in the economy. Particularly, Bevir (2007) and Aguilar (2010) argue that the concept of governance reflects the transformation in the vision of the State that occurred after the reforms of the public sector of the years 1980 and 1990. As is known, these reforms reduced the importance of bureaucracy and introduced market criteria in decision-making. For this reason, studies on governance have normative connotations.

Governance has changed the way of formulating and implementing public policies; these are no longer considered as unilateral processes. Public decisions, from the perspective of governance, involve coordination, discussions, understandings, negotiations, agreements and public, private and social commitments[1].

In this context, Bevir (2007) and (2011), highlights the importance of markets, social networks and non-state actors for public policy. For this reason, Bevir emphasizes that governance defines rules that go beyond those defined by the formal powers of the State[2].

Traditionally it is assumed that an improvement in governance and institutions can promote economic growth (North, 1990 and 2005; Acemoglu, Johnson and Robin-

[1] A comprehensive review of the concept of governance can be found in Bevir (2011).

son, 2005, Acemoglu and Robinson, 2006 and 2012). So, some argue that consolidated governance and democratic institutions can enhance the growth of developing economies. However, it should be recognized that this regulatory requirement has been questioned by Glaeser et. al. (2004) and by advocates of the "School of Conflict" and "skeptical school". Therefore, despite popular belief, there are still theoretical debates on the relationship between governance and economic growth.

1.2 EMPIRICAL STUDIES

In the empirical literature there are several studies that have examined the relationship between governance and economic growth. Among these studies are found the Knack and Keefer (1995), Mauro (1995) and Alesina (1997). These studies were pioneers in evaluating the mentioned relationships focusing on the role of institutions and property rights. They pioneered the use of cross-sectional indicators for statistical validation. Furthermore, they were the first to consider governance as a multidimensional phenomenon and that its analysis could be separated from the political regimes.

Contemporary studies on the relationship of governance and economic growth emphasize the role of property rights and the quality of institutions. These studies tend to find positive relationships between the development of institutions and growth. Among these studies are those of Knack and Keefer (1995) and Ndulu and O'Connell (1999), who evaluate how risk and violence are linked to economic growth. Rivera-Batiz (2002), meanwhile, analyzes the relationships between democracy, good governance and economic growth.

The mentioned studies are important because they tend to support the institutionalist theories (see North, 1990 and 2005; Olson, 1996). Furthermore, they are important because they complement other studies on economic development. In particular, they complement studies that emphasize the role of political rights and civil liberties (Grier and Tullock, 1989), democracy and social conflicts (Keefer and Knack, 2002) and the importance of social capital (Gutierrez-Banegas and

2 These new rules emphasize the ethical content of the political and economic institutions, while desirable aspects such as honesty and independence prescribe justice, low corruption or civic responsibility. See Jalalian Kirkpatrick and Parker (2006).

Ruiz-Porras, 2014). Also they complement studies that emphasize the role of labor institutions (Freeman, 1988 and 1998) and financial (King and Levine, 1993) institutions.

Methodologically, the main limitation of the empirical studies is that there are few consistent measures of quality of institutions and governance (see Kurtz and Shcrank, 2007; Bevir, 2011; Norris 2011). As indicated, the measurement of governance causes strong controversy. So far, the most ambitious project to measure governance consistently is the database *Worldwide Governance Indicators* (WGI) developed by Kaufmann and Kraay and extended by Kraay and Mastruzzi (2007, 2010). In this project, governance is assumed as the ability of institutions to exercise authority and promote economic, social and political long lasting development.

WGI data base has been used to evaluate the relationships between governance and economic performance. Particularly, Gani (2011) found that political stability and government efficiency are significantly and positively correlated with growth. Voice prompts and accountability, and control of corruption are correlated significantly and negatively. Ruiz-Porras and Hosten (2012), meanwhile, found that governance is positively related to foreign direct investment and that this relationship is of long term for Latin American economies.

The theoretical and methodological debates on the relationship between governance and growth justify the need to develop empirical research. In this context, it should be considered that governance has a multidimensional nature and linear relationships could not exist. It also should be noted that a first evaluation should focus on the "stylized facts" of relations between governance and growth. These considerations are emphasized because these are what define the methodological approach of the research conducted.

2. ECONOMIC AND INSTITUTIONAL INDICATORS

In this section data and indicators used in this research are described. Particularly, governance indicators are constructed using the database "*Worldwide Governance Indicators*" (WGI) from the World Bank. The economic indicator of economic growth is the one included in the base "Cepalstat" of the Economic Commission for Latin America and the Caribbean (ECLAC). The set of variables analyzed is a balanced annual panel of 110 observations. It comprises data from eleven Latin American economies for 2001 and 2010.

Statistically, the panel includes data comparable and consistent over time. The panel includes data for Bolivia, Brazil, Colombia, Costa Rica, Ecuador, Honduras, Panama, Paraguay, Peru, Uruguay and Venezuela. The panel comprises several variables and indicators adjust-

ed. Panel variables include variables of disaggregated economic growth and governance. The WGI uses six variables of governance because it is believed that it is characterized as multidimensional. Table 1 describes the variables of growth and governance used in the study.

TABLE 1. VARIABLES OF GROWTH AND GOVERNANCE.

	Name	Variable	Source
Economic Growth	Per capita GDP growth	GDP	Cepalstat
Governance	Voice and Accountability	VAA	WGI
	Political Stability	PSAA	WGI
	Regulatory Quality	RQ	WGI
	Government Effectiveness	GE	WGI
	Rule of law	ROL	WGI
	Corruption control	COC	WGI

Source: Own construction.

Analytically, disaggregated governance variables allow building governance adjusted indicators underlying the analysis of stylized facts. As mentioned, Kaufmann, Kraay and Mastruzzi (2010) note that variables of governance are built on the assumption that governance are the traditions and institutions by which authority in a country is exercised. This definition is emphasized here because there is no agreed framework of governance from an empirical perspective. Disaggregated indicators are defined in the table 2[3].

3 Governance variables are estimated using unobservable component models using qualitative indicators on the perception of government. The indicators are derived from surveys, NGOs, information providers in commercial enterprises and organizations of public sector.

TABLE 2. DISAGGREGATED INDICATORS OF GOVERNANCE.

Indicator	Definition
Voice and Accountability	It measures the extent to which citizens of a country can participate in selecting their government, as well as freedom of expression, freedom of association and freedom of the media
Political Stability	Measures perceptions of the likelihood that the government will be destabilized or taken by unconstitutional or violent means, including acts of political violence or terrorism
Government Effectiveness	It measures the quality of public services, the quality of public administration and its degree of independence from political pressures, the quality of the formulation and implementation of public policies and the credibility of the government's commitment to such policies
Regulatory Quality	It measures the ability of the government to formulate and implement appropriate policies and to enable and promote private sector development regulations.
Rule of law	It measures the extent to which agents have confidence and obey the rules of society; in particular, it measures the quality of contract enforcement, the actions by the courts and the police force; as well as the likelihood of crime and violence acts to be committed.
Corruption Control	It measures the extent to which public power is exercised for private gain and corruption in small and large scale, as well as control of the state by elites and private interests.

Source: Own based on Kaufmann, Kraay y Mastruzzi (2010).

Methodologically, it should be noted that the six governance indicators disaggregated are adjusted to facilitate their interpretation. Adjustments are made so that the indicators are expressed on a scale of zero to 100[4]. Also, the data is adjusted so high indicator values indicate high levels of governance. In this context, and to simplify the analysis, an aggregate indicator referred as Indicator Added Governance is estimated. The indicator summarizes the information of the disaggregated indicators based on the main components method.

4 The adjustment is required due to the fact that governance variables are expressed on a scale of -2.5 to 2.5.

3. ANALYSIS OF DESCRIPTIVE STATISTICS AND PRINCIPAL COMPONENTS

This section shows the descriptive statistics of the indicators of growth and governance for Latin American economies during the analyzed period. The analysis of the main components is also developed.

An analysis of the Governance aggregate indicator is needed to assess the representativeness of the indicator and to analyze the contribution of disaggregated indicators in its construction. For simplicity, the results are shown in tables. Table 3 shows the descriptive statistics. Tables 4 and 5 show the results of principal component analysis.

TABLE 3. DESCRIPTIVE STATISTICS OF THE GROWTH INDICATORS AND GOVERNANCE.

Indicator	Obs.	Average	Standard Deviation	Slant	Kurtosis	Mínimum	Maximum
Growth							
Growth rate	110	2.711	4.109	-0.422	5.221	-11.000	16.190
Governance							
Indicator Added Governance	110	46.694	26.417	0.505	2.154	0.000	100.000
Voice and Account-ability	110	51.447	11.191	0.481	1.997	31.970	72.740
Political Stability	110	40.582	15.727	-0.032	2.508	2.200	69.730
Regulatory Quality	110	45.768	11.232	-0.519	2.332	17.840	61.940
Govern-ment Effec-tiveness	110	42.587	10.139	0.283	1.763	27.430	62.730
Rule of law	110	39.105	12.434	0.567	2.297	17.100	63.920
Corruption Control	110	42.848	12.878	0.766	2.987	21.090	74.890

Source: Own based on Kaufmann, Kraay y Mastruzzi (2010).

Table 3 shows some facts concerning the behavior of the indicators. In particular, the table shows that, on average, the economies had annual growth rates of per capita GDP of 2.7 percent. Similarly, with respect to indicators disaggregated governance, the table shows that: 1) The best perception of governance in Latin American countries refers to Voice and Accountability; 2) refers to the worst perception rule of law; and 3) perceptions of Political Stability experience the greatest variations among the analyzed economies.

TABLE 4. MAIN COMPONENTS AND CORRELATIONS.

Component	Eigenvalor	Diffrence	Proportion	Cumulative
Comp1	5.08	4.56	0.85	0.85
Comp2	0.52	0.29	0.09	0.93
Comp3	0.23	0.16	0.04	0.97
Comp4	0.07	0.02	0.01	0.99
Comp5	0.06	0.03	0.01	1.00
Comp6	0.03	.	0.01	1.00

Source: Own calculation.

TABLE 5. MAIN COMPONENTS AND EIGENVECTORS.

Variable	Comp1	Comp2	Comp3	Comp4	Comp5	Comp6
Voice and Accountability	0.4312	0.2063	0.0135	-0.4485	-0.1224	-0.7451
Political Stability	0.3589	0.7829	0.2349	0.2309	0.3037	0.2399
Regulatory Quality	0.3872	-0.4882	0.6632	0.3714	0.1176	-0.1419
Government Effectiveness	0.4221	-0.3002	-0.1650	-0.5430	0.4968	0.4034
Rule of law	0.4341	-0.0049	0.0150	-0.0732	-0.7912	0.4242
Corruption Control	0.4108	-0.1268	-0.6909	0.5544	0.0779	-0.1564

Source: Own calculation.

Tables 4 and 5 show the analysis of the main components. Table 4 shows that the aggregate indicator of Governance summarizes the 85 percent of the indicators disaggregated information. Table 5, shows the informational contributions from the six disaggregated governance indicator. These contributions, measured from highest to lowest, are: 1) Rule of Law; 2) Voice and Accountability; 3) Government Effectiveness; 4) Control of Corruption; 5) Regulatory Quality; and 6) Political Stability.

Finally, it should be emphasized that the main stylized facts on growth and governance are: 1) on average, the economies had annual growth rates of GDP per capita of 2.7 percent; 2) the best insight on governance refers to Voice and Accountability; 3) the worst perception refers to rule of law; 4) added Governance Indicator 85 percent summarizes the information disaggregated indicators; 5) Rule of Law provides the greatest contribution to build the aggregate indicator; and 6) Political Stability provides the lowest contribution.

4. ANALYSIS

This section estimates and analyzes the estimated empirical relationships between economic growth and governance. To do this the average of both types of each economy indicator are calculated. These averages are used to study the relationships seen from a medium-term perspective. Methodologically the ordinary minimum squares method are used to analyze these relationships. In all cases, governance indicators linear and quadratic used to estimate potential nonlinear relationships. For simplicity, the estimated results are presented graphically.

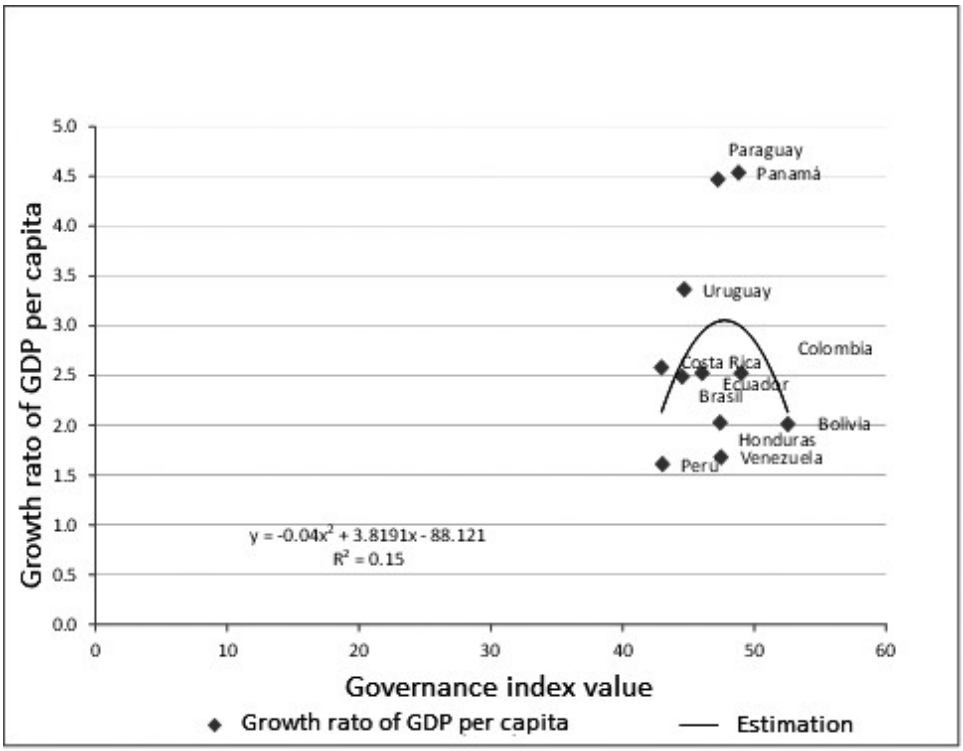

Figure 1. Rates of Growth and Governance Indicator Added.
Source: Own calculation.

Figure 1 shows the relationship between the growth rate and the aggregated Governance Indicator. The econometric relationship clearly shows the shape of an inverted U in the medium term. So there is a positive relationship between growth and governance when governance indicators are low. However, this relationship becomes negative when the indicators are high. Apparently, the turning point occurs when rates exceed 3 percent annually. Moreover, the estimate suggests that improvements in aggregated governance indicator could be associated with higher growth rates in Brazil, Ecuador, Honduras, Peru and Venezuela.

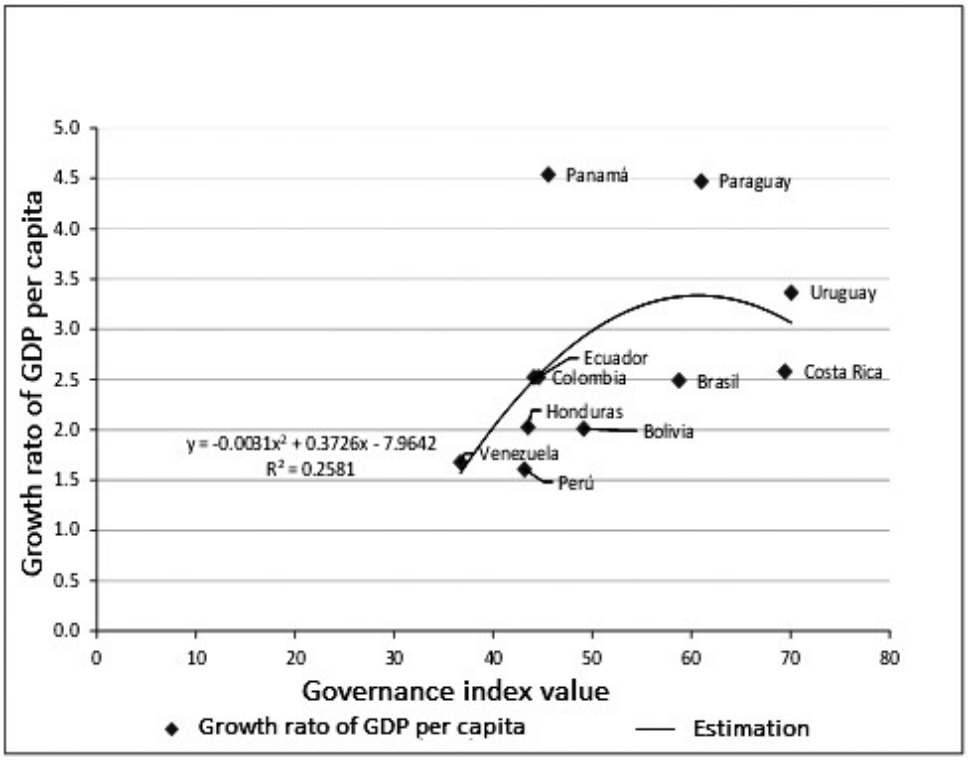

Figure 2. Growth rates and voice and accountability.
Source: Own calculation.

Figure 2 shows the relationship between the growth rate of GDP and Voice and Accountability indicator. The estimated econometric relationship, as in the previous case, shows the shape of an inverted U in the medium term. Apparently, the turning point occurs when governance indicators exceed the value of 60 or when growth rates reached 3.2 percent on a sustained basis. Moreover, the estimate suggests that improvements in Voice and Accountability could be associated with higher growth rates in Bolivia, Colombia, Ecuador, Honduras, Peru and Venezuela.

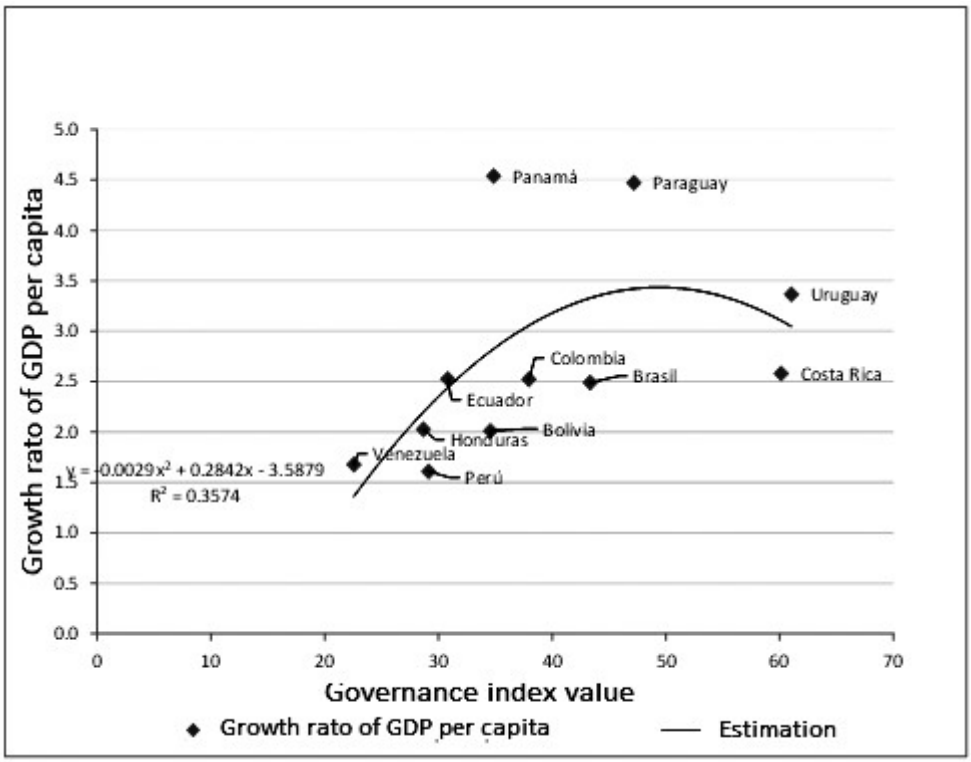

Figure 3. Growth Rates and Rule of Law.
Source: Own calculation.

Figure 3 shows the relationship between the growth rate of GDP and the Rule of Law indicator. The estimated, as before, econometric relationship shows an inverted U shape in the medium term. Apparently, the turning point occurs when governance indicators exceed the value of 49 or when growth rates reached 3.4 percent on a sustained basis. Moreover, the estimate suggests that improvements in the Rule of Law could be associated with higher growth rates in Bolivia, Colombia, Ecuador, Honduras, Peru and Venezuela.

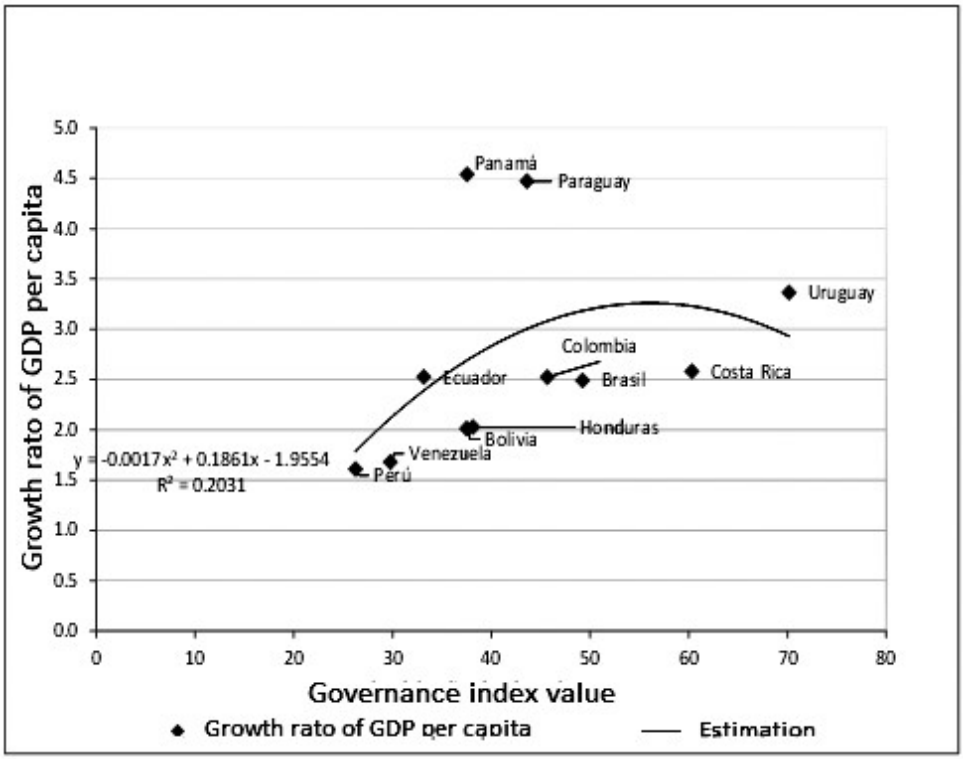

Figure 4. Growth Rates and Control of Corruption.
Source: Own calculation.

Figure 4 shows the relationship between the growth rate of GDP and Control of Corruption indicator. The estimated, as before, econometric relationship shows an inverted U shape in the medium term. Apparently, the turning point occurs when governance indicators exceed the value of 55 or when growth rates reached 3.1 percent on a sustained basis. Moreover, the estimate suggests that improvements in Control of Corruption could be associated with higher growth rates in Bolivia, Ecuador, Honduras, Peru and Venezuela.

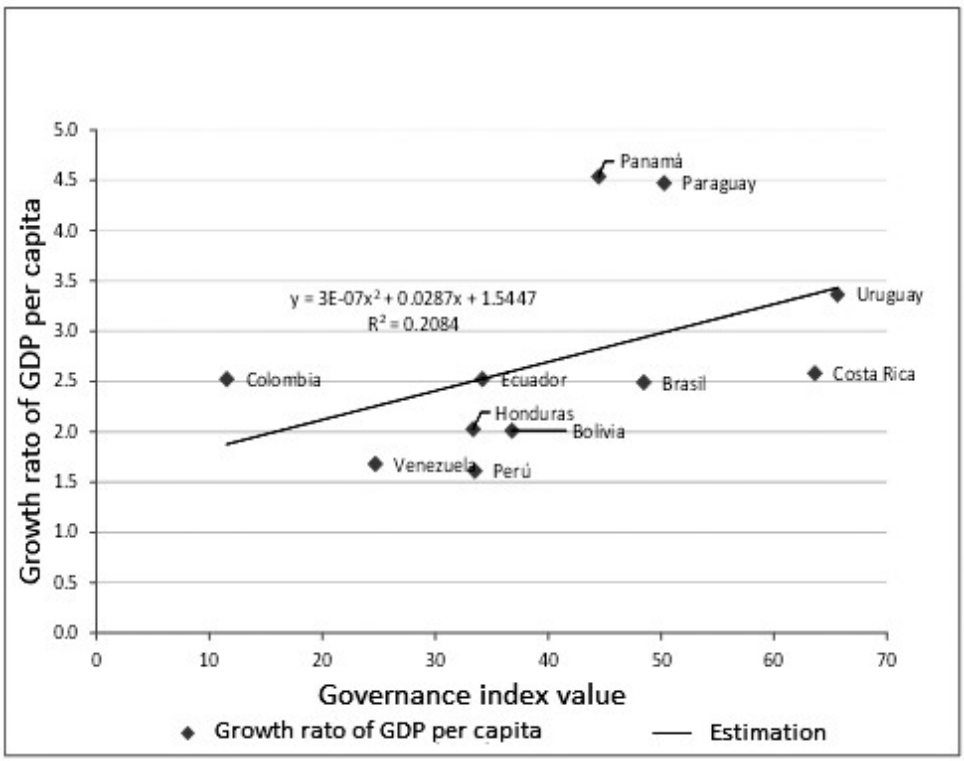

Figure 5. Growth Rates and Political Stability.
Source: Own calculation.

Figure 5 shows the relationship between the growth rate of GDP and Political Stability indicator. The estimated econometric relationship is virtually linear and positive in the medium term. The regression results suggest that for every unit in which the governance indicator increases, the annual growth rate increased by about 0.03 percent. Likewise, the estimate suggests that improvements in Political Stability may be associated with higher growth rates in Bolivia, Ecuador, Honduras, Peru, Uruguay and Venezuela.

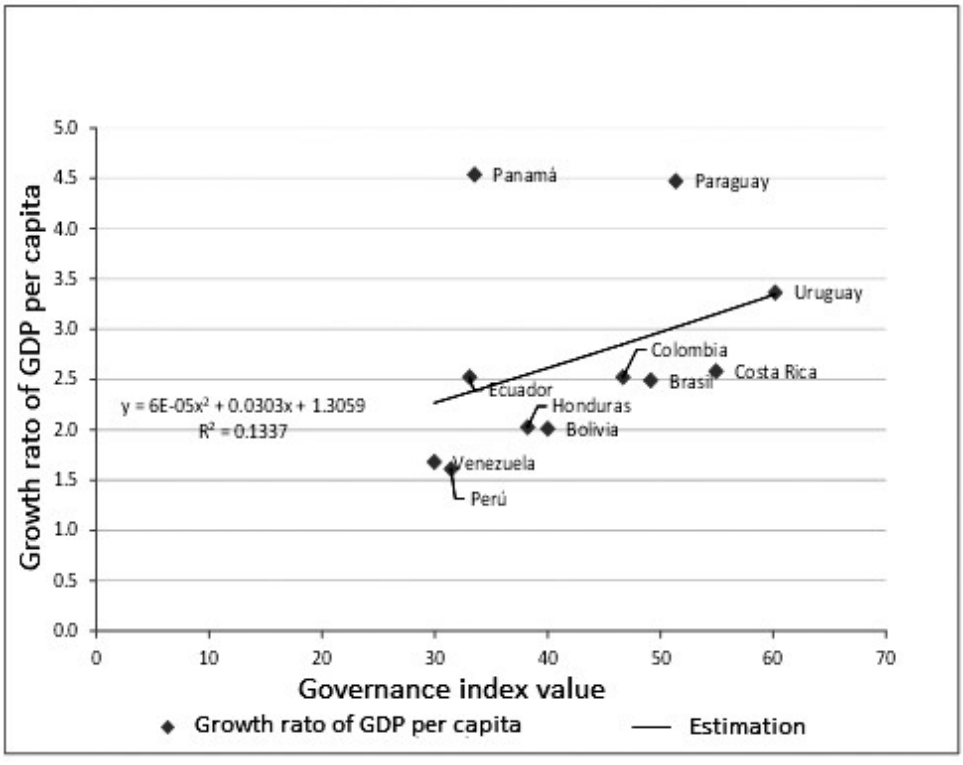

Figure 6. Growth Rates and Government Effectiveness.
Source: Own calculation.

Figure 6 shows the relationship between the per capita growth rate of GDP and the Government Effectiveness indicator. As in the previous case, the estimated econometric relationship is substantially linear and positive in the medium term. For approximately every unit in which the governance indicator increases, the annual growth rate increased by 0.03 percent. Likewise, the estimate suggests that improvements in Government Effectiveness may be associated with higher growth rates in Bolivia, Honduras, Peru, Uruguay and Venezuela.

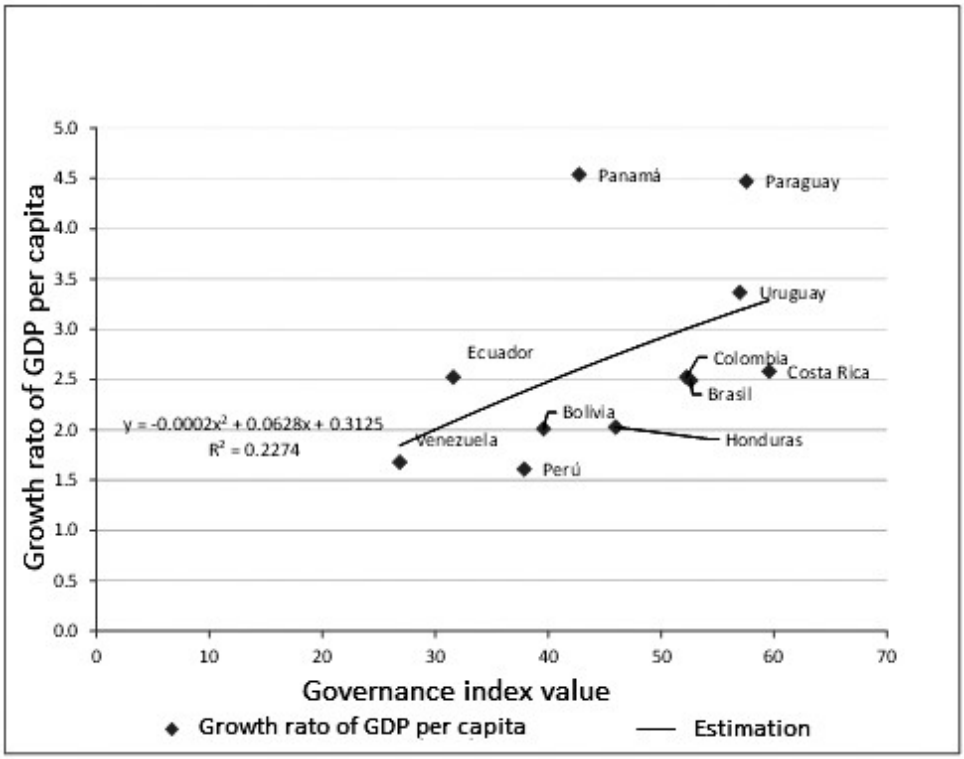

Figure 7. Growth Rates and Regulatory Quality.
Source: Own calculation.

Figure 7 shows the relationship between the per capita growth rate of GDP and Regulatory Quality indicator. The estimated, as before, econometric relationship is virtually linear and positive in the medium term. For approximately every unit in which the governance indicator increases, the annual growth rate increased by 0.06 percent. Likewise, the estimate suggests that improvements in Regulatory Quality could be associated with higher growth rates in Bolivia, Honduras, Peru and Venezuela.

Analytically it is interesting to note some singular facts in the analyzed relationships. The first is that Paraguay and Panama have the highest growth rates despite their governance indicators are in the average of the sample. This suggests that Paraguay and Panama´s growth was unusual during the period analyzed. The second is that Uruguay and Costa Rica have relatively low growth rates despite having the highest indicators of governance in the region. This suggests that there is conditional convergence between governance and economic growth[5].

Empirical relations can be synthesized between governance and economic growth as follows: 1) Aggregate Governance Indicators, Voice and Accountability, Rule of Law and Control of Corruption are related with growth with inverted U-shape; 2) Political Stability, Government Effectiveness and Regulatory Quality indicators have a linear and positive relationship concerning growth; 3) the growth of Paraguay and Panama has been atypical in the analyzed period; and 4) there may be conditional convergence between governance and growth in Latin America.

6. CONCLUSION

In this study we have shown some stylized facts and empirical relationships on governance and economic growth in Latin America. Methodologically, the research has been based on the use of techniques of descriptive statistics, principal component and OLS. To ensure international and intertemporal consistency of the indicators databases have been used "Worldwide Governance Indicators" and "CEPALSTAT". The panel includes annual data for the eleven indicators economies during the period 2001-2010.

The results of the analysis of descriptive statistics and principal components show the following stylized facts in the region: 1) On average, Latin American economies had annual growth rates of 2.7 percent; 2) the best insight on governance refers to Voice and Accountability; 3) the worst perception refers to rule of law; 4) Added Governance Indicator summarizes the

5 The traditional convergence hypothesis states that poor economies tend to grow faster than rich economies and in the long term, production and productivity tend to converge between the two types of economies. The conditional convergence hypothesis suggests that production and productivity in the long term will depend on the technological, institutional and public policy of the economies (see Barro and Sala- i- Martin, 2004) . The conditional convergence hypothesis on the relationship between governance and economic growth has been discussed, among others, Olson (1996) , Knack (2003) and Dellepiane - Avellaneda (2010).

85 percent of the disaggregated indicators information; 5) Rule of Law provides the largest contribution in the aggregate indicator; and 6) Political Stability provides the lowest contribution.

The regression analysis suggests that there is the following empirical relationship between governance and economic growth: 1) Aggregate Governance Indicators Voice and Accountability, Rule of Law and Control of Corruption have a growth relationship with the U-shaped inverted; 2) Political Stability, Government Effectiveness and Regulatory Quality indicators have linear and positive relationship with growth; 3) economic growth of Paraguay and Panama was unusual; and 4) there may be conditional convergence between governance and growth.

The above results have implications for policy makers in Latin America. Particularly the results suggest that policies should consider: 1) The elements of governance have a distinct importance; 2) the relationship between governance and economic growth may not necessarily be linear or positive; 3) the construction of governance seems to depend, in the first instance, it has a good perception of the rule of law; and 4) therefore, what matters is that the agents trust and obey the rules of society.

Finally it only remains to emphasize that the results are consistent with the hypothesis that there are significant relationships between governance and growth. However, it should be recognized that empirical analysis should be further deepened to make policy recommendations. In this context, it is required to validate the existence of not spurious and long-term relationships. Also, it should be determined the causality in the relationship of governance and other variables. For these reasons, we can say that the analysis of governance and its relations is a promising field of research for development.

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