Economic development and institutions in Latin America[1]

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Abstract

This paper aims to collaborate with the discussion about the factors that try to explain the economic behavior in Latin America countries, considering the importance of some attributes related to social capital (i.e. interpersonal trust, which leads to association and civic commitment (Putnam 1993) *pari passu* the institutional behavior, i.e. the 'rules of the game in a society' (North 1990). These two dimensions attempt to explain the behavior of agents facing the rational economic decision of cooperate or not. This decision depends on two factors: (1) the expected behavior of other agents ('I cooperate if the other will also cooperate') and (2) the existence of standards, patterns or rules that hinder or prevent opportunism (in order to avoid that cooperation seems a 'foolish choice'). The key question when considering these two dimensions at the same time is if they are complementary or substitute to each other. In other words, it tries to understand the relationship between formal 'rules of the game' as well as high levels of social capital (that can be considered informal ones) to economic behavior and economic action. Once this is a work in progress paper, it presents a prospective discussion about the variables that can represent both social capital and institutional performance that will later be used to analyze the relationship between these two dimensions and economic performance in Latin America countries. These variables, which can be found in large international databases, provide information with different theoretical conceptions and practical interpretation, making quantitative analysis a great challenge. Social capital is represented by very subjective elements such as trust, values and assimilation of social norms. The same difficulty occurs when institutions are considered, since it is difficult to evaluate them; the simple existence of institutions does not guarantee that they are fulfilling their intended functions.

Key words: Institutions; Latin America; social capital.

JEL codes: A13; B52; O54.

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[1] Paper presented at the 6th World Interdisciplinary Network for Institutional Research (WINIR) Conference in Lund, Sweden, September 19-22, 2019. Preliminary draft.

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Introduction

This paper aims to collaborate with the discussion about the factors that try to explain the economic behavior in Latin America countries, considering the importance of some attributes related to social capital (i.e. interpersonal trust, which leads to association and civic commitment (Putnam 1993) *pari passu* the institutional behavior, i.e. the 'rules of the game in a society' (North 1990). These two dimensions attempt to explain the behavior of agents facing the rational economic decision of cooperate or not. This decision depends on two factors: (1) the expected behavior of other agents ('I cooperate if the other will also cooperate') and (2) the existence of standards, patterns or rules that hinder or prevent opportunism (in order to avoid that cooperation seems a 'foolish choice'). The key question when considering these two dimensions at the same time is if they are complementary or substitute to each other. In other words, it tries to understand the relationship between formal 'rules of the game' as well as high levels of social capital (that can be considered informal ones) to economic behavior and economic action.

Once this is a work in progress paper, it presents a prospective discussion about the variables that can represent both social capital and institutional performance that will later be used to analyze the relationship between these two dimensions and economic performance in Latin America countries. These variables, which can be found in large international databases, provide information with different theoretical conceptions and practical interpretation, making quantitative analysis a great challenge.

Theoretical framework: institutions, social capital, and economic development

Often, the economic agent makes difficult decisions about the expected behavior of his interlocutor or about the formal environment in which it will occur. Agents may base their decisions on personal safeguard mechanisms that attempt to minimize the risk involved, in order not to create prohibited transaction costs and to prevent them from being used to effect transactions.

Living in society implies the establishment and acceptance of rules, because "in social interactions, individuals deal with one another on the basis of some presumption of what they are being offered and what they can expect to get", i.e.," [...] on some basic presumption of trust "(Sen 2000:39). The main argument is that trust can be considered a *spinoff* of social relations.

In early stages of economic development, trust can only be considered in an interpersonal way, making the agent obliged to establish personal relationships with others. With the evolution of economic activities more than interpersonal trust, generalized trust is needed. It depends on personal attributes (as honesty and honour) as well as on social motivators (social norms of conduct) and institutions (rules enforced through formal apparatus). Trust is then related to individual behaviour, based on reciprocity and cooperation, or to the existence of institutions that guarantee or induce cooperative behaviour. Its effect will be felt not only on individual decisions (micro level), but there may also be consequences on the region or locality (meso level) or on the economy as a whole (macro level). In all cases, impact can be perceived in diminishing transaction costs.

Social capital, synthesized in the 'civic community' and social involvement as stated by Putnam (1993), has a positive effect in people's lives, improving them. Then we can understand its economic effects: norms and networks of civic engagement diminish the opportunistic action of the agents while they create norms of generalized reciprocity and facilitate coordination and communication, helping to solve collective action dilemmas. Value-sharing systems, the creation of widespread reciprocity norms, and the establishment of social rules and sanctions against reprehensible behaviour aim to restrain opportunistic behaviour. Social capital may cause positive externalities to individuals: "if we begin with a theory of rational action, in which each actor has control over certain resources and interests in certain resources and events, then social capital constitutes a particular kind of resource available to an actor" (Coleman 1988:S98).

Civic values and trust mechanisms that exist in a society are useful for reducing transaction costs, which facilitates economic and social relations. If trust can the related to a prosperous economic life, its absence is commonly related to underdevelopment

Interpersonal trust generates positive expectations about the behaviour of others through reciprocal mechanisms: people trust another one because it is expected a non-opportunistic behaviour. The explanation may find arguments in Game Theory, which can explain the existence of cooperation in some ways – the reduced number of 'players' or the fact that they are always the same, or known, or recommended, or one has abundant information about each player's past behaviour. In these cases, players may infer about the behaviour of the other agents in order to try to predict actions on his/her expected conduct.

Based on the trust established between two 'players', a network of trust relationships is formed, which is fundamental to Putnam's understanding of social capital (1993:169): "social networks allow trust to become transitive and spread: I trust you, because I trust her and she assures me that she trusts you."

This iterative process of transmitting trust from one to another makes the expectation of reducing opportunism socially widespread. By extrapolating the notion of interpersonal trust indistinctly, it makes possible to obtain generalized interpersonal trust, in a situation where cooperative behavioural patterns tend to prevail, once opportunistic behaviours are expected to be minimized. Widespread trust makes the whole environment more dynamic, facilitating trade and other economic transactions.

In the absence of spontaneous generalized trust, formal institutional arrangements can emerge. The importance of institutions is related to the increasing complexity of economic relations and interdependence between agents. We can find arguments also from Game Theory: cooperation is hard to reach when the *game* is not repeated, when there are gaps in information about the other 'player' or when the number of players is too large and there is no way to predict everyone's behavior. Institutions would be a substitute for trust and interpersonal cooperation.

Institutions are designed to allow or facilitate cooperation between public and private actors, conforming the 'rules of the game' or "rules, enforcement characteristics of rules, and norms of behaviour that structure repeated human interaction" (North 1989). Thus, economic agents - thousands, millions in some cases - can be supported to enforce contracts, agreements and decisions, as "institutions can provide stability in collective choices that otherwise would be chaotic" (Clingermayer and Feiock 2001:3 apud Karlsson 2012:10). This situation is even more evident the more complex the relationships established between agents.

Therefore, institutions affect economic performance because they effect transaction costs. Depending on their behaviour or role, uncertainty will decrease or increase; in the latter case, the predictability horizon of transactions is shortened due to insecurity of property rights, legal structure and court system to enforce contracts, restricting entry and factor mobility and monopolistic or oligopolistic restrictions (North 1990). Through the reduction of the potential return promoted by the productive activity, it will have a consequence in the economic growth.

These conditions alter the actions of agents and modify the context in which decisions are made, especially when considering the typical situations of 'collective action'. These are contexts studied by Game Theory, in which payoffs depend not only on individual behaviour but also on the actions or attitudes of other players – provision of 'public goods', dilemmas of 'collective action', 'prisoner's dilemma' or 'tragedy of the commons'. In any of these situations, the payoffs are based on the behavior of more than one agent, being the result of social interaction and the general conditions under which decisions are made. At all these conjunctures, when individual behavior influences the collective outcome, one can obtain a cooperative outcome, in which individuals collaborate mutually to achieve a result that is favorable to all (or at least the majority) or to a non-cooperative solution, in which desire of one (or a few) overlaps the others'. Individual decision-making process under typical conditions of 'collective action' can lead to situations that constitute a kind of *social trap*,[4] where the result obtained (cooperate or

[4] Rothstein, B. "Social trap and the problem of trust". 2005. Cambridge: Cambridge University Press.

not cooperate) can be disadvantageous to all involved and difficult to achieve. Rational individual action eventually can lead to collective irrationality, consequently affecting the conditions for economic development.

In each of the situations described as 'collective action' problems, players can expect opportunistic behavior from others - desertion, transgression, distrust, omission, exploitation. These dilemmas can lead to uncooperative solutions, because individuals would not *want* to believe in others. Cooperation mechanisms do not emerge automatically as the 'invisible hand of the market' suggests, and the decision to cooperate is rational and linked to two different factors: reciprocity conditions and a minimum of trust.

Social capital, through norms of social conduct and networks between individuals, improve the perception of opportunistic behavior and facilitates the establishment of cooperative relationships. Putnam (1993:177), by the way, goes even further: "success in overcoming dilemmas of collective action and the self-defeating opportunism that they spawn depends on the broader social context within which any particular game is played. Voluntary cooperation is easier in a community that has inherited a substantial stock of social capital, in the form of norms of reciprocity and networks of civic engagement".

Cooperation, trustworthiness, civic behavior and social engagement will reduce the uncertainty and transaction costs involved in 'collective action' situations. In the absence of typical social capital mechanisms, institutions can collaborate in solving these situations.

Decreasing transaction costs should not be the sole purpose of institutions and social capital, but this contribution cannot be neglected either; it is necessary to include this argument in the examination of economic issues, as opposed to simply excluding it.

Amartya Sen's (2000) superb contribution to economic science alters one's perception of development, broadening understanding beyond the process of wealth creation. Development must not be restricted solely to access to material goods. It should consider the maintenance and expansion of basic civil, political and social rights,

including elementary capacities such as "like being able to avoid such deprivations such as starvation, undernourishment, escapable morbidity and premature mortality, as well as freedoms that are associated with being literate and numerate, enjoying political participation and uncensored speech and so on" (Sen 2000:36).

This concept of development interferes not only with the present conditions of the population and the most urgent needs, but also with higher hierarchies of desires. It not only contemplates the benefits of economic growth, but also expands them beyond the consideration of a simple quantitative fact, incorporating the notion of "development as freedom", as "[...] a process of expanding the real freedoms that people enjoy" (Sen 2000:3). This would require the proper functioning of the economy, backed by explicit and implicit rules: "[...] operate the way they do not just on the basis of exchanges being 'allowed', but also on the solid foundation of institutions (such as effective legal structures that support the rights ensuing from contracts) and behavioral ethics (which makes the negotiated contracts viable without the need for constant litigation to achieve compliance). The development and use of trust in one another's words and promises can be a very important ingredient of market success" (Sen 2000:262).

Sen (2000) incorporates institutional variables in his analysis as well as those related to social capital into his conception of economic development. In addition, OECD (2001) highlights the contribution of five capital stocks, directly or indirectly, to the growth process and well-being of nations: (1) physical capital; (2) natural capital; (3) human capital; (4) social capital, understood as the networks, values and shared norms; and (5) a combination of public and private institutions and social arrangements (such as the legal and political system).

It is also possible to emphasize empirical researchs that evaluates the contribution of these social elements. Results indicate that institutions and social capital *do* influence the economic conditions of countries, through the contribution of interpersonal trust, the guarantee of civil and political freedoms to individuals, property rights, and the efficiency of the legal system. The main contribution of these is the idea that institutional factors

and social relations become part of the elements that explain the development of a locality, highlighting the ability of individuals to cooperate, trust and civic participation.

There are three possible hypotheses that allow us to understand the impact of social capital on economic activity. The first is that this capital would be a factor of production similar to the others; it would then be the fourth category of capital in the growth production function, along with natural, human and physical capital. About this, Coleman (1990:304) is categorical: "just as physical capital and human capital facilitate productive activity, social capital does as well". Moreover "like other forms of capital, social capital is productive, making possible the achievement of certain ends that would not be attainable in its absence". The second hypothesis is that social capital, like technical progress, would be an element that transforms the entire production function, altering the productivity of other traditional factors of production. Finally, the third alternative contemplates the idea that it would bring indirect effects to economic activity, as it would alter the decisions of human capital accumulation and/or physical capital as a positive 'externality'. Thus, in societies with high stocks of social capital, or "trusting societies not only have stronger incentives to innovate and to accumulate physical capital, but are also likely to have higher returns to accumulation of human capital" (Knack and Keefer 1997:1253). In all approaches, social capital can transform intangible goods (trust and reciprocity) into tangible goods (public policies and private relations) in order to broaden the country's development

Institutions have an important role in generating stable conditions for development, notably through the guarantee of property rights, the rule of law and democratic governance. Considered the 'rules of the game' that affect the behavior of individuals, institutions can also affect the performance of the economy in general. Both in theoretical terms (e.g. North 1990) and in empirical research (Acemoglu et al. 2001), the contribution of institutions is highlighted; places where 'good' institutions are observed are more prosperous than where institutions are 'weak' or ineffective.

It would be reasonable to consider that social capital has an intersection with the institutional approach in a complementary way (Fukuyama 2000). It is not possible to

think about having economic relationships based strictly on interpersonal trustworthiness. Although the economic effect can be perceived by transaction costs reduction, in any society the establishment of formal institutions is necessary, once cooperation mechanisms do not develop automatically: "[...] no one will volunteer to work for a neighborhood organization if the police cannot guarantee public safety there; no one will trust the government if public officials are immune to prosecution; no one will sign a business contract with a stranger in the absence of tort law and enforceable contracts" (Fukuyama 2004). It is useless to have well-designed institutions, if the people involved with them use it in a misleading way, seeking to achieve individual interests or for their own benefit, or fraudulently and/or with prevalence of corruption. Nor is it possible for people to develop individual mechanisms of trust if there are no formal institutions in which they can apply their virtues.

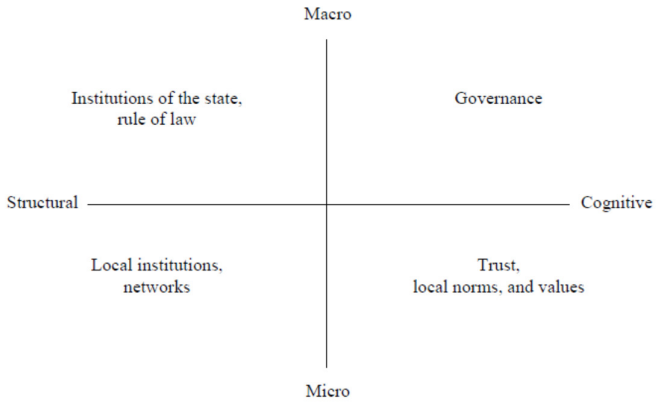
In fact, both authors Putnam (1993) and Coleman (1988, 1990) postulate that there is coexistence of non-economic and other institutional factors that play a significant role in the conditions that promote growth and development. Thus, the analysis of the potential contribution of social capital does not rival the institutional analysis.

Putnam's concern with institutions is evident. Considering them as 'the rules of the game', Putnam believes that respect (or not) for them is not imposed, but is learned or taught from community life itself. Although the author focuses his analysis in interpersonal relations, he considers institutions as a construction resulting from the process of social interaction and social capital. It is also noteworthy that Putnam's book 'Making Democracy Work' (1993) begins with comments about institutions, in chapters that talk about 'Changing the rules: two decades of institutional development' and 'Measuring institutional performance' as well as 'Explaining institutional performance'. Putnam also states, however, that the creation of 'social trust' does not require institutions, as his conclusions can be obtained despite the behavior of institutional elements; the inherent logic is that trustworthiness is one key elements that characterizes social capital, which in turn is responsible for shaping institutions (i.e. trust, social capital

→institutions). Thus, social capital can interfere with formal institutions, throughout informal networks of cooperation and reciprocity.[5]

Grootaert and Von Bastelaer (2002), as shown in Figure 1, defend the relationship between institutions and social capital. The horizontal axis of this figure considers the structural dimension of social capital, formed by formal social structures - networks, associations, standards and procedures - and the cognitive, more subjective elements, such as trust, norms of social conduct and reciprocity, and socially shared values. The vertical axis considers the levels in which social capital is obtained: micro, meso and macro. The micro level considers the relations within households and among individuals; meso evolves regions or communities; and the macro, the environment in general. In the intersection of these two dimensions comes a third, comprising the outputs derived from the interaction between social capital and institutions: trust, local norms and values; local institutions and networks; conditions related to formal institutions - such as the political and judicial system, the rule of law, enforcement of contracts; and, finally, governance.

Figure 1. Dimensions of social capital



Source: Grootaert; Von Bastelaer (2002: 20).

[5] Aron (2000), who considers social capital as one of the forms that institutions can take, provides an opposite explanation. The author presents five categories of institutional variables: the quality of formal institutions (especially those that guarantee property rights), social capital (which includes organizations and civic activity), social characteristics (ethnic, religious, historical and income differences), political institutions and political (in)stability. Putnam's social capital is only a synonym for informal institutions.

Chang (2011:28) also points out this complementary relationship. This author identifies the risks of "institutional imitation" in transposing institutions from one country or region to another: "if this is the case, importing the formal institution is not going to produce the same outcome because the importing country may be missing the necessary, supporting informal institutions". If institutions are considered isolated from social capital one can be tempted to propose a single 'institutional' solution that permeates cultural and social aspects.

The complementary approach is also justified by the fact that if there is distrust in formal institutions, following the rules is foolish. People can perceive that laws are made to be unfulfilled, since "[...] nearly everyone expects everyone else to violate the rules. It seems foolish to obey the traffic laws or the tax code or the welfare rules, if you expect everyone else to cheat" (Putnam 1993:111). Thus, the creation of institutions top-down is not a sufficient condition for development – more than created, they needed to be respected and supported by the population. Putnam (1993) ponders that external or top-down incentive to engage people in civil society associations are more ineffective than spontaneous solidarity mechanisms. Strong formal institutions, in an environment where social capital is weak, may generate perverse effects that undermine a possible individual propensity to engage in collective action. I.e. the internalization of informal social norms, interpersonal trust and the rules of reciprocity and tolerance are more effective as mechanisms for stimulating participation in collective actions than is institutional formalization.

Each locality, region or country has its uniqueness - a different story! Chang (2007), then, opposes what he calls "institutional transplantation", that is, the simple transposition of an institution to another socioeconomic context. Indirectly the author is criticizing the imposition of rules indistinctly over countries, despite the acceptance of the population and local governments. There would be many differences that can be perceived between formal design (theory) and the practice of institutional performance. In other words, there may be a difference between the institutional framework *de jure* (or "on the books") and the *de facto* functioning (or "on the ground"). It is easy to understand that localities

with the same *de jure* institutions have different economic results, because in fact the institutions are distinct.

Chang (2007) also criticizes the current excess of 'formalization' as prescribed by 'Global Standard Institutions' especially based on the Anglo-American tradition, as one remedy for all ills. Also North (1993) also considers that the mere transfer of formal institutions from developed countries to developing countries is not a sufficient condition for the establishment of 'good institutions' in these countries.

The context to be analyzed: a brief synthesis of Latin America

Latin America, broadly speaking, is a region composed of around 20 countries with deep income inequalities and at the same time with the lowest interpersonal and interinstitutional confidence indices among all democratic economies.

The existence of low confidence may be related to historical conditions: institutional behavior in Latin America seems to be related to the Iberian colonial past. As researched by North (1989; North et al. 2000) institutions of a given set of countries are positively related to their economic conditions, while in others there was no development of institutions that guarantee the good enjoyment of economic activity. Their studies conclude that while some countries, like the United States of America, deepened institutions that were initially developed in their metropoles – especially regarding to property rights – Latin America countries maintained institutional structures linked to its origin and colonial status. The institutions present in the XVI-XVIII centuries in the metropoles were transferred to Latin American countries.

These countries were exploitation colonies, mainly from Portugal and Spain, and served as sources of precious metals and other products of commercial interest of European countries (Acemoglu et al. 2001). Exploitation or transfer of resources and wealth to Europe should be at the expense of the smallest possible disbursement of financial resources in order to maximize metropolitan gains. There was no interest in developing institutions locally that could safeguard property rights, as established on European land,

nor incentives for the development of human capital of the settlers, as occurred in settler colonies. These colonial conditions would have been perpetuated in Latin America, even after the processes of independence.

The existing bureaucratic structures that formerly existed in Portugal and Spain can be recognized in the personalist of economic and political relations, state regulation, and the poor definition of property rights in theirs colonies. This behavior induced and maintained rent-seeking activities in the colonies, perpetuated inside the economy of Latin American countries (Bjørnskov 2009). In the 21st century, there are still traces or remnants of exclusivist institutions of the colonial period, which have not adapted to the complex world of contemporary economic relations. These gaps persisted as the institutional vices introduced by the metropoles remained in 'exclusive groups' - elites who continued to take advantage of this fragile institutionality, with no interest in modifying them to provide greater economic dynamism. It reminds the expected behavior of Olson's (1965) 'exclusive groups', whose membership benefits are privately appropriated only by those who are *insiders*. Thus, the unequal appropriation of the benefits generated in colonial times remain contemporary and may account for some of the low interpersonal and institutional trust.

The common historical origin of the Latin American countries may contribute to a possible explanation for the distrust and disbelief in public activities that, contrary to being understood as 'being of all', seems to 'be of no one'. They also make it possible to understand some kind of 'repulsiveness' from involvement in political activities. This malaise, distrust, and apathy towards institutions - especially formal ones - constitute an obstacle to the general sense of belonging to civil society in Latin America.

With a viewpoint focused on the analysis of democratic institutions, Booth and Richard (2009) observed a correlation between formally constituted groups and countries with longer established democracy, with informal groups inversely correlated with the longevity of democracy.[6] They explain that years of political repression - including civil

[6] Considering eight Latin American countries: Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua and Panama.

wars – may have contributed to the establishment of informal groups, and curtailing the formal network constitution. Repressive and vigilant political regimes that took place in Latin America may have kept political activity within strict limits and attempted to end participatory culture (Klesner 2007), resulting in a passive, weakened and disorganized civil society. It is possible to relate the low trust with the marks of political authoritarianism, being the distrust a response of the population or a "way of surviving against the past and history" (Lopes 2004). The interpersonal and institutional distrust that characterizes low social capital seems to be occurring and having been fostered through formal structures. The attitude of remaining silent and the resulting passivity towards the political, economic and social context would reflect this distrust.

The implementation of democracy in Latin America may not have been sufficient to ensure access to more equitable social and economic opportunities, nor to conditions for effective and proactive participation and involvement in political issues. This has led to disillusionment or dissatisfaction with political institutions, demonstrating that Latin Americans "[…] have lost faith in the ability and capacity of governments to solve society's essential problems (health, education, housing and security)" (Baquero and Gonzalez 2010:254). On the other hand, the simple creation of top-down institutions is not a sufficient condition for development - they need rather to be respected and supported by the population. "The idea that when manipulations occur, the introduction of simple institutions corrects and solves the problem does not apply in countries with significant material deficits," such as those observed in Latin America (Baquero and González 2010:256-257). It not worthwhile the 'empty institutionality': rules that are not followed; existence or prevalence of corruption to circumvent the pre-established; or free rider situations.

Unfortunately, this behavior is common in Latin America. There is a gap between the *legally* established country and the *real* country, or between what the law dictates and what can be perceived in societies. This dissociation between *de jure* and *de facto* may explain part of the interpersonal and institutional distrust in the region.

This mix between legality and illegality, which is translated into what is called the 'Latin American way', produces institutionalized corruption and "the lack of credibility on politicians and political institutions undermines governance that is also limited by the process of inequity, adding to the cultural process of decoupling ethics and economics"(Baquero and González 2010:254). This 'flexible' feature of the region supports the understanding of transgressive behaviors in which non-compliance with legality can be rewarded and not punished. Considering that "equality is a legal standard and a value, not a fact; is not an assertion, but rather a prescription" (Ottone and Sojo 2007:20-21), breaking the laws in Latin America is almost a 'natural' assumption: there is a tendency to break legal precepts and not recognize them as legitimate.

The mismatch between discourse and practice is felt in another dimension. On the one hand, there is the commitment and effort of the state to design laws, programs and public policies and on the other hand the ineffectiveness in implementing them or getting the laws 'out of the paper'. In contrast, these two dimensions end up with consequences: apathy or anomie with public affairs, failing in promoting common goods - which would also justify the current lack of trust in public institutions. This is because Latin America has always lived with a paradox. On one hand, the belief of many that governments need to plan and command the economy and social life and, on the other hand, the reality of a weak, poorly institutionalized state captured by different combinations of public entities, under authoritarian or democratic regimes, private interests, clientelistic networks and populist arrangements (Schwartzman 2009:89).

At the same time it is found "Latin America's secular self-image as a continent with a particularly entrenched cultures of transgression" (Sorj and Martuccelli 2008:156), based on the 'legalistic' tradition present on the continent, the existence of institutions that differentiate citizens - often based on economic criteria - and acceptance or tolerance of non-compliance with legal norms. This feature leads to ambiguous behaviors such as overwritten and poorly enforced rules; coexistence of arbitrariness and condescension; severity in law enforcement for some and impunity for others (Baquero and González 2010). Incidentally, the existence of institutions that do not guarantee law enforcement

is characteristic of several developing countries, such as the Latin American countries (Borner et al. 2004).

How is it possible, in this context, to respect the institutions if those responsible for their design are the most adept of ordinary transgressions?

The answer can be supported in the idea of 'confidence radius' as proposed by Fukuyama (2000). There would be two parallel systems in Latin America with different 'radii of confidence': one valid for close friends and family, and one for 'the others'. As a result, confidence would reside only in family and in strict groups of friends; the 'strangers' or 'the others' fall into another category. Excessive preoccupation with family and/or nuclear family life and reluctance to engage in public or collective affairs would lead to excessive individualism. It is the underlying idea of 'amoral familism': the individual feels morally bound only to his family, excluding any cooperation derived from impersonal social interactions.

The excess of individualism has as consequence low associative life, and the low commitment and interest with public, collective or community aspects (Ottone and Sojo 2007). The incorporation of strict market forces - transforming the environment into a large 'everyone for himself' - leads to social and economic atomism, increasing transaction costs and lower potential gains from economies of scale. Without cooperation and trust among individuals in the broad sense, and closed, exclusive, and restrictive groups impose negative externalities on Latin American economies. Social relations are diminished and, consequently, the possibility of establishing economic relations; institutions 'may have less power' than 'known ones'.

This controversial economic structure in Latin America has produced a vicious circle that results in the coexistence of poverty and inequality and distrust of political institutions and politicians in general, which would be characteristic of societies with great fragmentation and social inequality, as hypothesized by O'Donnell (1991 *apud* Baquero and González 2010). Low education and qualification (human capital) lead to persistent income inequality, which generates greater perception of distributive injustice, higher distrust on institutions, less involvement with political issues and may represent

the existence of ineffective, corrupt, and exclusivist institutions as well as little committed to collective well-being, which leads to perpetuation of poverty conditions (Ottone and Sojo 2007). This is because "even the best-designed political institutions cannot alleviate social conflicts if they are deep enough" (Fukuyama 2010). An endless vicious circle...

Databases and variables

Not everything that can be counted counts,
and not everything that counts can be counted. (Albert Einstein)

This study aims to assess the contribution of two elements to the economic development: social capital and institutions. Theoretically, it can be discussed the relationships that can be established between these concepts, as outlined in advance, but in practice there is a great methodological difficulty to quantify these aspects.

Measuring development is a huge task, as there are several indicators that can be used to represent it. Also measuring social capital can be complex because it involves very subjective elements such as trust, values and social norms. The same difficulty occurs when considering the role played by the institutions; since there may be difference between the design of the institution and its practical behaviour, it is difficult to evaluate the effective contribution of formal institutions to economic performance.[7]

With this in mind, this section will present databases that can be used to obtain variables that represent economic development, social capital and institutions features, which can be useful in investigating Latin America. Once this is a work in progress paper, only

[7] Beyond the theoretical clash regarding these three elements, with different understandings, concepts and views, there are also difficulties to measure them. The most common solution is the use of proxy data, which summarize the understanding of these concepts. Several studies have already identified good proxies using different methods of qualitative and quantitative comparative research, which are useful for the purposes of measurement and comparison. It must be emphasized, however, potential difficulties about endogeneity of variables.

databases and variables can be quoted; a later research will be conducted deepening the econometric relationship between the variables.

The *World Values Survey* (WVS, created by World Values Survey Association), is a survey that includes a representative sample of the population of 97 countries (about 90% of world population), gathering opinions on subjects ranging from personal and labour relations to the welfare of democracy governance and political, associative and social participation. Focused specifically in Latin America, the *Latinobarómetro* brings together the opinions of about 19,000 people in 18 countries in the region, about important social, political, economic and cultural issues in a survey conducted since 1995. The *Americas Barometer,* database created by the Latin American Public Opinion Project, evaluates opinions about trust in institutions; political tolerance; participation in civil society; perceptions on the economy; support for democracy; political legitimacy; voting behaviour; participation and attitudes towards local government in 26 countries.

The Heritage Foundation presents the *Index of Economic Freedom*, which aims to evaluate the interference of the state in economic activity in 185 countries. It is considered that 'freedom' is fundamental to economic relations and any State intervention in the economy is frowned upon, since it is presupposed as based on discretionary attitudes, personalist criteria or is less efficient than those obtained through the market are.

Other index is calculated for 144 countries by the Economic Freedom Network and Fraser Institute and is called *Economic Freedom of the World - EFW*. This index considers that there is economic freedom when the citizens of a country are free to set voluntary economic relations with each other, safeguarding the property rights.

A database called *Freedom in the World*, calculated by Freedom House, considers on the other hand freedom as access to civil liberties and political rights, as stated by the International Declaration of Human Rights, regardless of geographic location or political orientations, ethnic, religious or economic locations.

A large database called *Worldwide Governance Indicators* (WGI) is calculated by the World Bank for 215 countries, considering that as "traditions and institutions by which

authority in a country is exercised. This includes the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them" (World Bank 2012).

The Group Political Risk Services (PRS) presents a general index of risk for 140 countries, as well as three others indexes of political, financial and economic risk, in a database named *International Country Risk Guide* (ICRG).

Finally, the *Polity IV* database is part of a larger project, called Polity Project - Political Characteristics and Transitions Regime of the Center for Systemic Peace, which summarizes information returning to 1800. It is commonly used for data evaluation and comparison of the governance attributes political regimes and regime change.

Variables

The main objective of this paper is to present databases and variables that summarizes attributes related to social capital and institutional quality.

Social capital is comprehended following Putnam (1993), as features of a location such as association environment, civic engagement and trust. Although it is not possible to use identical variables proposed by his book 'Making democracy work', it is proposed by this paper the usage of similar variables that can synthesize these attributes. Then, selected variables represent proxies to those one stated by Putnam, and represent interpersonal and generalized confidence as well as the civic respect and associative participation.

An important role is played by the trust, which promotes a healthy environment for the establishment of subsequent cooperative relations, once it can lead people to a non-opportunistic behaviour.

Three variables represent 'interpersonal trust', a traditional measure of social capital: the percentage of people that answered that in general, they "can trust people". Information about 'generalized trust' can be summarized by confidence in specific institutions or groups: (1) public institutions – the government, Parliament, the judiciary, political parties, public management, and local governments; (2) private institutions – trade unions, private companies and banks; and (3) mass media - newspapers, television, and radio.

Association also plays an important role in social capital. It was possible to identify variables that consider the percentage of associates or members of formal groups. Membership in these groups was separated in two more specific segments, as stated by Knack and Keefer (1997): association to horizontal groups, called Putnam groups or *P-groups*, traditionally linked to the civic community of Putnam;[8] and Olson groups or *O-groups*, clearly related to economic interest that brings together all participants (Olson 1965).[9]

Finally, it was also identified some variables that represent 'civic engagement', when trying to capture the interest and proactivity in solving collective problems.

The synthesis of representative variables of social capital, as well as data sources, is presented in Table 1.

[8] Sport clubs or recreational and social activities, artistic, musical or educational associations and religious organizations.
[9] Professional associations, trade unions and political parties.

Table 1. Variables considered as *proxies* of social capital, description and source

Source	Concept	Description
World Values Survey	Interpersonal trust	% replies that answered that "generally speaking, would you say that most people can be trusted"
Latinobarómetro	Interpersonal trust	% replies that answered that "generally speaking, would you say that you can trust most people"
The Americas Barometer	Interpersonal trust	% replies that answered that "and speaking of the people from around here, would you say that people in this community are" very trustworthy
Latinobarómetro	Generalized trust: public institutions	average % of replies that answered that have "a lot" of confidence in public groups or institutions[a]
Latinobarómetro	Generalized trust: private institutions	average % of replies that answered that have "a lot" of confidence in private groups or institutions[b]
Latinobarómetro	Generalized trust: mass media	average % of replies that answered that have "a lot" of confidence in mass media[c]
Latinobarómetro	Association: Putnam groups	average % of replies that answered that participate of Putnam groups[d]
Latinobarómetro	Association: Olson groups	average % of replies that answered that participate of Olson groups[e]
The Americas Barometer	Civic engagement	average % that answered that "in the last 12 months have you tried to help solve a problem in your community or in your neighbourhood" at least once a week, once or twice a month, or once or twice a year in the last 12 months

[a] The government; Parliament; judiciary; political parties; public administration; local government; the state.
[b] Banks; private companies; trade unions.
[c] Newspapers; television; radios.
[d] Putnam groups: religious, cultural and/or artistic, and sportive groups.
[e] Olson groups: political, labour, student, communal, voluntary, ecological, and other groups.

Institutions, as stated by North (1990), are the "rules of the game", i.e. general rules that establish the relations between economic agents. Implicitly literature considers 'good institutions' as those able to provide investment incentives, improvements in the distribution of produced wealth, innovation, and efficient allocation of resources. They established a framework of incentives that reduces risk and uncertainty of the decisions, reducing thus transaction costs, whose potential effect would be to increase the efficiency and strengthen economic activity in general.

Governance is considered as a synonym for 'institutional quality', i.e. it comprises mechanisms, processes and institutions through which citizens articulate their interests, exercise their legal rights, meet their obligations and mediate their differences. When considering institutions we mean 'good governance': formal rules, laws and contractual procedures; the environment in which laws are made and enforced; restrictions on political and economic power; facility for intra-group mobility; and institutional promotion of 'political voice' and participation (Farole et al. 2011). These features have important theoretical and empirical contributions. Aron (2000) presents a synthesis of studies that show correlation results between growth and / or economic development and institutional variables: property rights and enforcement of contracts (seven studies), civil liberties (10 studies), political rights and democracy (10 studies), institutions that encourage cooperation (clubs and associations, what happens in four cases) and lack of political instability (which occurs 15 times).

Then, proxies that attempt to synthesize these perceptions represent institutional quality (or governance): respect for contracts and property rights, behaviour and quality of bureaucratic structure and political and civil liberties, rather than its characteristics or attributes. This is because the functions performed by the institutions can be more important than its forms (Aron 2000; Chang 2011).

At first, a general recommendation in all writings about governance is maintaining property rights (Chang 2011). In this regard, Adam Smith states (as quoted by O'Driscoll Jr. and Hoskins 2003:3-4): "the first and chief design of every system of government is to maintain justice: to prevent the members of society from encroaching on one another's property, or seizing what is not their own. The design here is to give each one the secure and peaceable possession of his own property". Another commonly discussed aspect when talking about institutional quality is the rule of law, a characteristic of legal organization that asserts itself through standards or impersonal rules, that are effective and enforceable in fact; it considers the autonomy and independence of the legislative and judicial branches. It should be noted that these two indicators have commonly been used as proxies of institutional quality in literature concerning aspects of economic growth (e.g. Acemoglu and Robinson 2010; Rodrik et al 2002).

Contract enforcement can be defined as institutional conditions that make it possible for agents to establish exchanges and contracts with economic purpose with each other. It considers the effectiveness of legal norms and the existing guarantees and grants that contracts will be respected. The important thing to be pointed is not the simple existence of 'laws' but their effects, perceptions and applications in daily life. Literature also refers to formal or structural constraints to the discretion of political power and its consequent interference in economic activity. It can be justified as a feature of institutional quality, respect for political and civil rights, i.e. the state's ability to serve and respect the agents (Baliamoune-Lutz 2005; Voigt 2006).

Finally, it is considered as an institutional quality aspect the existence of conditions to facilitate intra-group mobility. It considers the potential conflict in populations, assessed by the existence of 'religious and 'ethnic' tensions.

A synthesis of these representative variables of institutional quality, as well as data collection sources, is presented in Table 2.

Table 2. Variables considered as *proxies* of institutional quality, description and source

Concept	Description	Source
Property rights	Score to indicator concerning Property Rights	Index of Economic Freedom
Rule of law	Score to indicator 'Rule of law'[a]	World Governance Indicators
Law and order	Index of subcomponent 'Law and Order' of Political Risk Index	International Country Risk Guide
Contract enforcement	Subcomponent 'Legal enforcement of contracts' of Economic Freedom of the World Index	Economic Freedom of the World
'Public Voice'	Score to indicator 'Voice and Accountability'[b]	World Governance Indicators
Executive constraints	Index of Executive Constraints	Polity IV
Political stability	Index of subcomponent 'Government Stability' of Political Risk Index	International Country Risk Guide
Political stability	Score to indicator 'Political Stability/ Absence of Terrorism'[c]	World Governance Indicators
Respect to political rights	Rating to political rights	Freedom in the World

Concept	Description	Source
Respect to civil liberties	Rating to civil liberties	Freedom in the World
Intra-group mobility (religious fragmentation)	Index of subcomponent 'Religious Tensions' of Political Risk Index	International Country Risk Guide
Intra-group mobility (ethnical fragmentation)	Index of subcomponent 'Ethnic Tensions' of Political Risk Index	International Country Risk Guide

[a] Reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

[b] Reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.

[c] Reflects perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism.

Further steps

The further steps of this research will focus on an econometric analysis of the variables that could help in understanding the contribution of social capital and institutions to economic growth and development in Latin America. There is a great methodological problem because of the difficulties on measuring social capital, whicht can be represented by very subjective elements such as trust, values and assimilation of social norms. The same difficulty occurs when institutions are considered, since it is difficult to evaluate them; the simple existence of institutions does not guarantee that they are fulfilling their intended functions. These variables, as are the variables that represent economic development, make quantitative analysis a great challenge.

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