IMPACT OF FOREIGN AID ON GOVERNANCE: A LATIN AMERICAN PERSPECTIVE

By

CHANG, Hana

THESIS

Submitted to
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Committee in charge:

Professor Kye Woo LEE, Supervisor Lee, Kyewoo

Professor Chang Yong CHOI Changyong Choi

Professor Dong Young KIM Dong Young Kim

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ABSTRACT

IMPACT OF FOREIGN AID ON GOVERNANCE: A LATIN AMERICAN PERSPECTIVE

By

Hana Chang

The development literature has long examined the relationship between foreign aid and governance with a focus on Africa, employing governance indicators such as the ‘rule of law’ and ‘corruption,’ mainly from the ICRG (International Country Risk Guide). This study suggests a different approach with wider variance in the governance indicators and from the conventional focus on the African region. The study looks at the level of aid as a share of GNI in 16 former Spanish colonies in Latin America from 1999 to 2013, and assesses its impact on the region’s governance qualities. The six governance indicators adopted in this study are (i) accountability, (ii) transparency, (iii) rule of law, (iv) government effectiveness, (v) regulatory quality, and (vi) political stability. The empirical findings from this study present some interesting results, and leave an implication that aid alone is not enough; aid should be complementary to other policy measures to combat the social, economic, and political structural barriers that hinder development as a whole, in particular the quality of governance in the Latin America.

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I. Introduction

1.1 Purpose of the Study

The main purpose of this study is to assess the impact of foreign aid on governance. Many development banks and other international organizations have long provided foreign aid to developing countries on the premise that aid will help enhance their institutional qualities.[1] However, the concept of 'governance' is quite broad and vague. Different organizations have provided various definitions of governance, depending on the objectives and missions that they intend to pursue. Its broad concept and the complex nature of foreign aid have limited many studies from understanding the cause-and-effect relationship between foreign aid and governance, along with many other social and economic variables (e.g. level of human development) that could influence the relationship. Therefore, the debate over foreign aid's impact on governance has remained controversial, drawing criticisms from government officials, scholars, and aid practitioners alike.

Owing to its complex nature, this study seeks to provide deeper and wider understanding of the aid-governance relationship by taking a regional approach. The gains from this study will not only supplement the existing understanding of the issue; it will also provide empirical grounds to the existing and potential donors in determining the use and size of their aid

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[1] Akramov, Kamil. *Foreign Aid Allocation, Governance, and Economic Growth*. Santa Monica: RAND Corporation 2006. p. 47-48.

disbursement, and give insights on what kinds of bottleneck problems to tackle down to address the current development challenges that are related to governance issues. Accordingly, the international community will be able to devise proper plans and draw collaborative support to achieve sustainable development in the Post-2015 era.

1.2 Statement of the Problem

The provision of foreign aid initially began with the Cold War as a measure for the United States to secure influence on European countries with its political ideology (i.e. Marshall Plan). Since then, foreign aid has evolved and diversified into various forms, according to different motives and intentions of the donors, such as military, humanitarian, developmental, and even commercial. In 2000, when the United Nations adopted the *Millennium Development Goals* (MDGs) the international community had expected that foreign aid (especially in terms of its disbursement size) will play a catalytic role in achieving the eight MDGs goals by the end of 2015. However, despite the collective global efforts and some notable achievements, the need for a new approach to development arose. As a response to the mounting criticisms against the MDGs structure and its effectiveness on the ground, countless state leaders, scholars, and aid practitioners have speculated about what may have limited the impact of foreign aid in developing countries. Some of them argued that one of the major obstacles to aid effectiveness was the quality of the state institutions in developing countries. Basically, aid has failed to fulfill its purpose since institutions in many developing countries lack the virtue of ‘good governance.’

According to a World Bank study (2000), there is 'overwhelming evidence that good governance is crucial for successful development.'[2] In fact, most countries with efficient institutions have shown substantial level of socio-economic development. Good governance, at the same time, also plays a considerable role in increasing aid effectiveness in developing countries.[3] Effective aid, in turn, will bring greater impact in promoting further development. Hence, there is a mutually reinforcing relationship between aid and governance. However, it is quite difficult to conclude which causal direction has greater significance; and the debate over good governance being a pre-condition or the goal in the development process remains endless.

1.3 Importance of the Issue

The heated controversy over the aid-governance relationship implies that governance is in fact a considerable element in the development process. Its importance is also recognized in the recently established *Sustainable Development Goals (SDGs)* by the United Nations, as major governance indicators such as transparency and accountability are included in the general and specific sectors of the SDGs.[4]

Despite its highlighted importance, however, different institutions have slightly different understanding of governance according to their institutional interests. Nevertheless, its role in development cannot be underestimated for its broad scope. Despite the differences in their

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[2] World Bank. *Reforming Public Institutions and Strengthening Governance: A World Bank Strategy.* Washington, DC: World Bank 2000. p.175.

[3] Akramov, *Foreign Aid Allocation, Governance, and Economic Growth.*

[4] United Nations. *Proposal for Sustainable Development Goals.* Sustainable Development Knowledge Platform. United Nations Department of Economic and Social Affairs, Web. 04 Feb. 2015.

understanding of governance, major international organizations and financial institutions have long emphasized the significance of governance, as in the following statements:

> "Governance consists of the 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."[5] (Joseph Stiglitz, Economist at World Bank)
>
> "…Good governance involves promoting the rule of law, tolerance of minority and opposition groups, transparent political processes, an independent judiciary, an impartial police force, a military that is strictly subject to civilian control. A free press and vibrant civil society institutions, as well as meaningful elections. Above all, good governance means respect for human rights."[6] (Kofi Annan, 7th Secretary-General at United Nations)
>
> "Good governance is…closely related to our surveillance over macroeconomic policies—namely, the transparency of government accounts, the effectiveness of public resource management, and the stability and transparency of the economic and regulatory environment for private sector activity."[7] (Michel Camdessus, Managing Director of IMF)

Here, it is worthwhile to take note that the term 'institution' or 'institutional quality' is used as references to 'governance.' In fact, institutions provide more concrete concept than governance itself, since political and economic institutions determine and demonstrate how authority is exercised in a country, as well as reflect the country's policy measures. In this sense, many scholars have studied the relationship between the quality of institutions and economic performance, as to grasp the impact of governance on development.

In fact, various scholars have found empirical evidences that institutions play a vital role in development (especially in terms of economic growth). For instance, a study by Rodrik et al.

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[5] Stiglitz, Joseph. "The World Bank at the Millennium," *The Economic Journal* 109, November 1999.
[6] Kofi Annan, "Preventing War and Disaster," *Annual Report on the Work of the Organization*, 1999.
[7] Michel Camdessus, "Fostering an Enabling Environment for Development," International Monetary Fund, Web. 10 Oct. 2014.

(2004) speculates that "institutional quality has a positive and significant effect on integration (to world economy)." Their findings indicate that "countries with stronger institutions (as represented by the level of rule of law) have higher possibility to have higher levels of income." The existence of sound institutions that protect property rights in particular provide an incentive to invest in a country, allowing the accumulation of physical capital, which is a proximate determinant of economic growth.[8] Another study by Acemoglu and Robinson (2008), have also found a significant relationship between economic institutions and economic performance—that a country with strong protection of property rights tend to have higher levels of income per capita. Likewise, their findings indicate that individual property rights should be guaranteed across different sectors of an economy to sustain its economic performance.[9]

Considering these findings, we can expect that if a country successfully establishes and retains sound institutions or policies (i.e. good governance), it is likely to show higher economic performance. Moreover, the achievement of good governance across different political and economic institutions will enable the country to go one step closer to achieving sustainable development. In this sense, it should be worthwhile to study the ways a country can improve its governance qualities through different state institutions.

1.4 Research Question

This study stems from a curiosity in whether foreign aid can *buy* good governance, especially in Latin America. The study will address this very sensitive, yet critical question by

[8] Rodrik, D., Subramanian, A., and Trebbi, F. "Institutions rule: the primacy of institutions over geography and integration in economic development," *Journal of economic growth*, 9(2), (2004): 139-147.
[9] Acemoglu, D., and Robinson, J. *The role of institutions in growth and development. World Bank, Washington DC*. 2008.

observing empirical evidences such as aid disbursement flows and governance trends within the region; and pave a way to gaining a deeper understanding on the aid-governance relationship in Latin America.

H_1: Foreign aid helps to strengthen a country's governance qualities.

H_2: The pattern pertains to Latin America.

II. Literature Review

The literature review will first provide an overview on the concept of governance, and its relationship to economic development. The study will then make an observation on the impact of foreign aid on governance through the precedent empirical studies on the aid-governance relationship. Gaining an extensive understanding on the current body of literature will guide this study to suggest a new approach to examining the aid-governance relationship, and further contribute to the existing literature and practices in the fields of international development.

2.1 Dimensions of Governance

Despite its highlighted importance, the conceptual definition of governance has been vague and abstract for its broad scope. Many development-related agencies provide different definitions of governance depending on their institutional interests, and it further complicates our understanding (Table1). Owing to that matter, it has been quite difficult to understand the characteristics of governance as well as to measure its qualities. However, the dimensions of governance that these institutions define suggest that there are some fundamental characteristics.

[Table 1] Dimensions of governance in major international organizations

World Bank[10]	1. Voice and accountability 2. Political stability and absence of violence/terrorism 3. Government effectiveness 4. Regulatory quality 5. Rule of law 6. Control of corruption
OECD[11]	1. Participation 2. Transparency 3. Accountability 4. Rule of law 5. Effectiveness 6. Equity, etc.
UNDP[12]	1. Participation 2. Rule of Law 3. Transparency 4. Responsiveness 5. Consensus Orientation 6. Equity 7. Effectiveness and Efficiency 8. Accountability 9. Strategic Vision
IMF[13]	1.Rule of Law 2. Efficiency 3. Accountability 4. Corruption 5. Other essential elements with which economies can prosper

As noted earlier, the above major international institutions suggest slightly different, but common elements of governance such as the rule of law, accountability, and transparency. How

[10] Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi. *Governance Matters VIII: Aggregate and Individual Governance Indicators 1996–2008*. Working paper no. 4978. World Bank, June 2009.
[11] OECD, *DAC Guidelines and Reference Series Applying Strategic Environmental Assessment: Good Practice Guidance for Development Co-operation*. OECD, 2006.
[12] Graham, John, Bruce Amos, and Tim Plumptre. *"Principles for Good Governance in the 21st Century." Principles for Good Governance in the 21st Century 15.* (2003): 6. Institute on Governance, Aug. 2003. Web. 23 Feb. 2015.
[13] International Monetary Fund. *"Partnership for Sustainable Global Growth: Interim Committee Declaration."* IMF, 1996.

then, might these elements of governance be related to development? Do empirical evidences suggest that countries with good governance experience higher socio-economic development?

2.2 Governance and Economic Development

Over the last decades, numerous scholars have conducted extensive research on the relationship between governance and development. Many of these empirical studies have found that good governance, or having effective institutions in other words, can be one of the contributing factors to development, especially in terms of economic growth.[14]

In one of the studies, Olson (1996) concluded that the reason behind the gap in per capita income in different countries is due to the differences in quality of institutions and their economic policies.[15] This finding also relates to the popular economic theory that development is initially fostered through the guarantee of individual property rights and contract enforcement.[16] His findings are then supported by Mauro (1995) that good governance fosters economic growth, by promoting private sector through efficient resource allocation and investment attraction; and explicitly illustrates the impact of bureaucratic efficiency on economic development:

> "…If Bangladesh were to improve the integrity and efficiency of its bureaucracy to the level of that of Uruguay (corresponding to a one-standard-deviation increase in the

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[14] See Mauro, P. "Corruption and Growth," *The Quarterly Journal of Economics* 110.3 (1995): 681-712; Knack, Stephen, and Philip Keefer. "Institutions and Economic Performance: Institutional Measures Cross-country Tests Using Alternative Institutional Measures," *Economics and Politics* 7.3 (1995): 207-27; Campos, Nauro F., and Jeffrey B. Nugent. "Development performance and the institutions of governance: evidence from East Asia and Latin America," *World Development* 27.3 (1999): 439-452; Olson, Mancur. "Distinguished lecture on economics in government: big bills left on the sidewalk: why some nations are rich, and others poor," *The Journal of economic perspectives* (1996): 3-24.

[15] Olson, *Bill bills left on the sidewalk,* 19.

[16] Knack and Keefer, *Institutions and Economic Performance.*

bureaucratic efficiency index), its investment rate would rise by almost five percentage points, and its yearly GDP growth rate would rise by over half a percentage point."[17]

Moreover, these findings remain persistence in other regional analyses on Latin America. Empirical evidences indicate that governance is generally a contributing factor to growth to some extent, although the degree of correlation between specific governance characteristics and growth indicators may vary in different countries. For example, a study by Campos and Nugent (1999) have found that governance indicators such as the 'rule of law' and 'quality of governance' explain differences in the level of income per capita in Latin America, [18] while development performances of the region have improved on the account of 'effectiveness of rule of law.'[19]

2.3 Aid and Governance

Countless state and non-state institutions have long provided grants and loans to developing countries with aims to promote socio-economic development and fight poverty. Theoretically, as Busse (2009) illustrates in his paper, aid could be helpful in fostering governance as it could release governments from the revenue constraints and enable them to concentrate on enforcing law and order or fighting corruption. In addition, developing countries could also receive technical assistance as a part of receiving aid in building effective institutions to improve the quality of state institutions.[20]

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[17] Mauro, *Corruption and Growth*, 705.
[18] Campos and Nugent, *Development performance and the institutions of governance,* 446.
[19] Ibid. 449.
[20] Busse, Matthias and Groning, Steffen. "Does foreign aid improve governance?" *Economics Letters* 104, (2009): 76-78.

However, many of the countries with high levels of aid are blamed for having developed dependency on foreign aid. Some governments are rebuked for their rent-seeking behaviors instead of fostering improvements (e.g. reforms) in their governments, economies, and societies. In such cases, it can be inferred that aid has been ineffective. In fact, some studies have found that aid effectiveness could be conditional on the institutional quality and fiscal policy of the recipient country.[21] This rationale has led more aid-related institutions and practitioners to raise their voices to carefully deploy scarce aid resources with greater selectivity.[22] They argue that grants and loans should be given to countries that have good governance structures, or aid should be used as an incentive for developing countries to take an active role in their own development processes.

The heated debate over the aid-governance relationship has attracted scholars to extend the scope of the literature. However, as much as studying the plain relationship between aid and governance seem simple and superficial, there is much need for closer examination.

2.3.1 Findings: Negative Relationship

Empirical studies that focus on aid dependency and its impact on institutional qualities in developing countries usually indicate a negative association between foreign aid and governance. For example, a popular study by Brautigam and Knack (2004) finds that aid can be harmful to governance as receiving aid over a long period of time can undermine the ability of state

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[21] Burnside, Craig and Dollar, David. (2000). "Aid, Policies, and Growth," *American Economic Review* 90(4), September.

[22] Brautigam, Deborah (2000). "Aid Dependence and Governance," *Expert Group on Development Issues* 2000:1.

institutions to change and therefore ultimately deteriorate the quality of governance.[23] Boone (1996) also supports their findings by demonstrating that aid only increases government consumption without any increase in growth or governance qualities.[24]

Other studies have elaborated these empirical findings and stated that receiving aid may "weaken the incentive to tackle difficult collective-action problems underlying the institutional barriers to faster and more equitable growth."[25] For example, Rajan and Subramanian (2007) have found that some industries such as manufacturing tend to grow slowly in countries with high levels of aid and thus block their economies from having fast growth.[26] Another popular cross-country analysis by Knack (2001) concludes that the impact of foreign aid on the quality of governance is negative, especially in the areas of bureaucratic quality, corruption, and the rule of law. [27]

2.3.2 Findings: Positive Relationship

Despite the large body of literature that asserts a negative association between foreign aid and governance, some scholars have managed to find a positive influence of aid on several governance characteristics. A regional analysis by Goldsmith (2000) provides exemplary evidence and asserts that there is little evidence that foreign aid has worsened governance. In

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[23] Brautigam, D. and Knack, Stephen. "Foreign aid, institutions, and governance in sub-Saharan Africa," *Economic Development and Cultural Change* 52, (2004): 255-285.

[24] Boone, Peter. "Politics and the Effectiveness of Foreign Aid," *European Economic Review* 40, (1996): 289-329.

[25] Booth, David. "Aid, institutions and governance: what have we learned?," *Development Policy Review* 29.s1 (2011): s11

[26] Rajan, Raghuram and Subramanian, Arvind "Does Aid Affect Governance?" *American Economic Review* 97(2) May 2007.

[27] Knack, Stephen. "Aid Dependence and the Quality of Governance: A Cross-Country Empirical Analysis," *Southern Economic Journal* 68(2), (2001): 310-329.

particular, there is consistent evidence that foreign aid is a 'minor net plus' for good governance in the African countries.[28] Interestingly, many of these findings suggest that foreign aid can be effective if used in a 'right way.' In fact, as Brautigam (2004) elaborates in her study, "high levels of aid channeled to governments with clear development agendas can be used to improve the quality of the civil service, strengthen policy and planning capacity, and establish strong central institutions."[29]

Apart from foreign aid being clear on its objectives, there exists other factors that help boost the effectiveness of foreign aid in strengthening governance qualities. The relationship might not be direct, however, it is suggested that high levels of foreign aid (around 40% of GDP) will promote economic growth in a country where good macroeconomic policies are in practice; in turn, it will help strengthen the institutional quality of its government. This is due to the fact that foreign aid can relieve financial constraints of a government to allow funding for its improvement, especially when it has a strong commitment to development.[30]

III. Methodology & Data

3.1 A New Approach

After reviewing at length the current body of literature on the relationship between governance and foreign aid, this paper came to the same conclusion as Busse (2009) that the literature is "missing an analysis on the direct impact of foreign aid on governance over time and

[28] Krasner, Stephen D. "Sharing sovereignty: new institutions for collapsed and failing states." *International security* 29, no. 2 (2004): 85-120.
[29] Bräutigam, Deborah A., and Stephen Knack. "Foreign Aid, Institutions, and Governance in Sub-Saharan Africa," *Economic development and cultural change* 52.2 (2004): 260.
[30] Ibid.

across countries."[31] In addition, much of the past literature has maintained its focus on Africa, giving little attention to differences in regional characteristics. In order to bridge such gap, this paper will attempt to expand the scope of current literature with a different approach from the previous studies. First, the aid-governance relationship would be re-interpreted with empirical evidences from Latin America as an attempt to provide a different regional perspective from the previous studies. In addition, whereas previous studies have assessed governance mainly in terms of 'rule of law' and 'corruption' using data from the International Country Risk Guide (ICRG), this study will adopt six indicators from the World Governance Indicators (WGI) by the World Bank for a closer analysis. The WGI indicators provide a more comprehensive measurement of the dimension of governance, in line with the major international institutions' definition of governance (Table 1), with wider range of scale (-2.5 to +2.5) compared to that of the ICRG (0-6 scale).

It is expected that the findings of this study will demonstrate a positive relationship between foreign aid and governance in Latin America. Even if the impact is found minimal, there might be a specific area among the study variables that has stronger correlation; leaving possibilities for further investigation. Moreover, even in case of contrary findings, the study will still contribute to the advancement of the development literature and its practice with further policy implications.

3.2 Methodology and Data

[31] Busse, M. and Groning, S. (2009): 76.

This study aims to explore the relationship between foreign aid and governance in Latin America using multiple regression analysis. The countries of interest are former Spanish colonies in the region (16 countries) as these countries tend to share historical origin, culture, and other characteristics through almost 300 years of Spanish colonization. This study assumes that the similarity in the levels of development in these countries is largely due to their institutional background from the colonial period, as the ruling elites had often abused local institutions to seize wealth and power for their own benefits. Of course, the initial level of governance for each country may differ at the time of their independence. However, the common colonial history enables the study to control different heritages in nurturing institutions (governance) in the subject countries over the years.

[Table 2] Countries of interest and their colonial history

	Country	Onset of Colonization	End of Colonization		Country	Onset of Colonization	End of Colonization
1	Argentina	1580	1819	9	Honduras	1524	1821
2	Bolivia	1538	1825	10	Mexico	1521	1821
3	Chile	1541	1818	11	Nicaragua	1523	1821
4	Colombia	1536	1819	12	Panama	1519	1821
5	Costa Rica	1524	1821	13	Paraguay	1537	1811
6	Ecuador	1534	1822	14	Peru	1533	1824
7	El Salvador	1524	1821	15	Uruguay	1625	1828
8	Guatemala	1524	1821	16	Venezuela	1528	1821

The timeline of the study is from 1999 to 2013 (15 years), considering data availability. The time series for net ODA flow and governance quality in terms of (i) accountability, (ii) transparency, (iii) rule of law, (iv) government effectiveness, (v) regulatory quality, and (vi) political stability will be examined. In addition, the study identifies five explanatory variables such as (i) secondary school enrollment, (ii) foreign investment inflow, (iii) GDP per capita, (iv) trade volume, and (v) government polity (Table 3).

[Table 3] Study variables

Independent	Dependent		Confounding
Net ODA	Governance (Composite)	▪ Accountability ▪ Transparency ▪ Rule of law ▪ Government effectiveness ▪ Regulatory quality ▪ Political Stability	▪ Secondary school enrollment ▪ GDP per capita ▪ FDI Inflow ▪ Trade ▪ Government Polity

The study defines foreign aid as ODA as a share of GNI. The six governance indicators will be contrasted to the level of ODA in a country separately and comprehensively using a composite index by adding up the indices of the six governance indicators. This way, the composite index will allow the study to assess the overall quality of governance. Apart from aid and governance, the study adopts five explanatory variables to examine possible social and economic influence on governance. First of all, the study expects that high rates of GDP per capita will have a positive impact on governance. National wealth could indicate a favorable environment, for instance, for good governance through better education and healthcare, inclusive society, and higher demands for stronger institutions to sustain prosperity.

Higher education is also expected to promote governance as highly educated (or informed) citizens are likely to participate in the social and political decision-making processes, and demand the government to meet their needs and expectations. The same applies to FDI and trade; as higher levels of accountability and transparency are often required in the open economies as they interact with foreign investors and business partners. Moreover, the type of government polity is expected to affect the quality of governance, as democratic countries are often characterized by having accountable, transparent, and effective institutions. Moreover, the study will further examine if the impact of ODA differs when aid is given to a certain type of government. It is expected that foreign aid is more effective in democratic states.

This study employs various secondary data from reliable sources (mainly from the World Bank) due to time limits and other constraints in data production and collection. These data consider the availability that suits the study framework, as well as how it best reflects the concept (definition) of each variable (Appendix 1).

IV. Findings and Interpretation

[Table 4] Empirical results

VARIABLES	(1) Composite	(2) Transparency	(3) Effectiveness	(4) Stablity	(5) Regulation	(6) Rule of law	(7) Accountability
ODA	-0.0759	0.0638	0.0689	-0.143*	-0.0632	-0.0682	0.0653
	(0.216)	(0.0568)	(0.0480)	(0.0739)	(0.0719)	(0.0495)	(0.0427)
Log(gdppc)	0.605***	0.133***	0.0579*	0.188***	0.0706	0.0309	0.125***
	(0.143)	(0.0375)	(0.0317)	(0.0489)	(0.0475)	(0.0328)	(0.0282)
Education	-0.0215***	-0.00410**	0.00105	-0.00573***	-0.00528**	-0.00385***	-0.00359***
	(0.00631)	(0.00165)	(0.00140)	(0.00215)	(0.00209)	(0.00144)	(0.00124)
FDI	0.0644***	0.00648	0.0120**	-0.00582	0.0271***	0.0199***	0.00461
	(0.0221)	(0.00580)	(0.00490)	(0.00755)	(0.00734)	(0.00506)	(0.00436)
Trade	-0.0254***	-3.23e-05	-0.00270**	-0.00400**	-0.0116***	-0.00617***	-0.000906
	(0.00526)	(0.00138)	(0.00117)	(0.00179)	(0.00175)	(0.00120)	(0.00104)
Polity	0.210***	0.0315***	0.0115	0.00567	0.0614***	0.0417***	0.0578***
	(0.0330)	(0.00867)	(0.00733)	(0.0113)	(0.0110)	(0.00756)	(0.00652)
ODA*Polity	0.0170	-0.00719	-0.00691	0.0166*	0.00934	0.0104*	-0.00522
	(0.0270)	(0.00707)	(0.00598)	(0.00920)	(0.00895)	(0.00617)	(0.00532)
Constant	-4.854***	-1.347***	-0.741***	-1.233***	-0.00509	-0.436*	-1.091***
	(1.008)	(0.265)	(0.224)	(0.344)	(0.335)	(0.231)	(0.199)
Observations	211	211	211	211	211	211	211
R-squared	0.365	0.143	0.115	0.098	0.411	0.412	0.383
Number of cn	16	16	16	16	16	16	16

Standard errors in parentheses
*** $p<0.01$, ** $p<0.05$, * $p<0.1$

The study expected a positive impact of ODA on governance in the 16 Latin American countries. Surprisingly, the results of the empirical analysis present some unexpected findings (Table 4). As the study had assumed, it was found that GDP per capita and government polity (democracy) are positively related to governance. However, trade seems to have a negative impact on governance while FDI leads to an improvement in governance. In addition, the results suggest a negative association between governance and education, which is contrary to what the study had expected.

Most importantly, findings of the study show that higher levels of aid slightly worsen political stability and violence in Latin America even though the correlation between the two variables is comparably weak (with p-value of 0.1). The analysis could be somewhat superficial without assessing the correlation based on the type of aid disbursed. However, considering social and political climate of the region, it might be that the recipient government had allocated increased government revenue to combat non-state military actors. In addition, the aid given could have been redirected to sustain the government in power without serving its intended purposes to foster socio-economic development. In such case, citizens and other state actors could oppose the government and cause politically motivated violence. On the other hand, interestingly, the empirical results indicate a positive impact of aid on political stability when it is given to a more democratic government. It can be assumed that a democratic government values the virtues such as transparency and accountability, and therefore lives up to the expectations and demands of its people. In addition, it is likely that a democratic government has mechanisms to solve conflicts in fair and peaceful way.

Another interesting result of the study is the negative correlation between trade and governance unlike FDI. Trade, according to the findings, worsens the quality of governance as a whole, and specifically the government effectiveness, regulatory quality, and rule of law. First, it is important to take into consideration the degree of corruption of the actors involved in trade negotiations. If the private sector is corrupt, it is more likely that the trade negotiation itself will be corrupted as much. In addition, in case of Latin America, it might be important to consider the nature of different trade agreements and their impact on the economy. If the trade regulations and liberalization policies are hurting the activities of the national enterprises, an increase in trade will not always be translated into economic growth. In fact, as the empirical results suggest, there is a highly positive correlation between GDP per capita and governance. In this sense, bad trade policies and regulations could deteriorate governance by negatively affecting the economies of the Latin American countries.

Lastly, the study presents an interesting finding that an increase in educational attainment is highly related to the worsening of governance qualities in Latin America. The empirical analysis shows that education in Latin America is deterrent to governance as a whole, and across the six dimensions of governance except for the government effectiveness. The result can be assessed in two different aspects: the access to education and its quality. First, education can negatively affect governance in case the highly educated are mostly of the ruling elites, due to the deep-rooted inequality in the region. In this case, there is a high chance that the educated elites in office might abuse their power to sustain their status and wealth, just as in the colonial period. Moreover, low educational quality could deteriorate governance in a sense that students will not be prepared to read, write, or to participate in the social and political decision making processes in their communities and countries.

V. Conclusion

The empirical analysis on the aid-governance relationship presents some unexpected and contrary results to the hypothesis of the study that an increase in aid will improve the quality of governance in Latin America. The findings suggest that foreign aid given to the 16 Latin American countries have not been effective in improving governance, and that it rather has negatively affected the region's governance qualities in terms of political stability. In addition, while positive correlations have been found between governance and GDP per capita, government polity (democracy), and FDI, negative associations were found with trade and the educational attainment.

Here, it is also important to recognize the limitations of the study. While the analysis has narrowed the scope of research with a regional focus as well as its colonial background, the variables used in this study are only one-dimensional. For example, the study uses aggregate amount ODA as a share of GNI as a measurement for foreign aid. However, in reality, it would be more proper to consider different types of aid or its purposes. The same limitation applies to the proxy for government polity. A narrower classification of the government type would have presented a more detailed policy implication. Moreover, a more sophisticated research using other statistical method such as the system-GMM or 2OLS might be necessary in order to properly assess the complex interactions among the study variables. Last but not least, the problem of reverse causation poses another limitation in reflecting the impact of the study variables on governance qualities.

While the empirical analysis presents some contrary findings to the original assumptions of the study, it still leaves some room for meaningful policy implications. As the findings indicate that aid is positively correlated to governance when it is disbursed to more democratic countries, the polity of the government should be considered more closely to maximize its effectiveness in different countries. In addition, as the study suggests that an increase in GDP per capita is most closely related to improving governance, various policy measures should be sought to break down the structural barriers of the region to increase national wealth. However, these policy measures should not only focus on increasing the size of an economy, but also consider the distribution of wealth and social inclusion to achieve sustainable development.

Finally, the analysis of the empirical results makes it evident that aid alone is not enough to improve the quality of governance in the recipient country. It suggests that foreign aid is rather complementary to other policy measures in different fields such as education and trade. The study recommends that closer attention should be given to devising the right policies that work on the ground, as well as to implementing the devised policies properly.

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APPENDIX

Appendix A: Data Source and Definitions

Variable		Definition	Source
Net ODA (% GNI)		Official development assistance in % of GNI	World Development Indicators (WDI)
Governance	Voice and Accountability	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	World Governance Indicators (WGI)
	Rule of Law	Perceptions of the extent to which agents have confidence in and abide by the rules of society, in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence	
	Control of Corruption (Transparency)	Perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests	
	Government Effectiveness	Perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies	
	Regulatory Quality	Perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development	
	Political Stability and Absence of Violence	Perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism	
Secondary School Enrollment (% Gross)		Total enrollment in secondary education, regardless of age, expressed as a percentage of the population of official secondary education age. GER can exceed 100% due to the inclusion of over-aged and under-aged students because of early or late school entrance and grade repetition	World Development Indicators (WDI)
GDP per capita (Current US$)		GDP per capita is gross domestic product divided by midyear population. It is calculated without making deductions for depreciation of fabricated assets or for depletion and degradation of natural resources	
FDI Net Inflow (%GDP)		Net inflows (new investment inflows less disinvestment) in the reporting economy from foreign investors, and is divided by GDP	
Trade (%GDP)		Trade is the sum of exports and imports of goods and services measured as a share of GDP	
Government Polity		Political Regime Characteristics and Transitions, 1800-2014, annual, cross-national, time-series and polity-case formats coding democratic and autocratic "patterns of authority" and regime changes in all independent countries with total population greater than 500,000 in 2014	Polity IV

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