Chapter 4
Confidence, Governance, and Growth: A Missing Link

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ABSTRACT
The recent financial crisis of the USA and the associated Euro Zone crisis have opened the eyes of the global policy makers and managers of economies in the world in respect of exploring the factors behind it. The present study considers three principal indicators of development—growth, confidence, and governance—for a sample of eight countries with differences in developmental positions to examine whether there is any sort of causal relations among them. By applying the Granger causality test, it observes that in most of the countries, except Greece, there are missing linkages among the indicators in a gross sense. China and India with very poor levels of governance factor have grown at higher magnitudes.

INTRODUCTION
The lessons from the recent crisis in the so called developed economies and its aftermath effects upon the rest of the world have compelled the economists, policy makers and governments of different countries to redefine the concept of long run growth states of an economy. It is proposed in the macroeconomic literature by the growth theoreticians that an economy will reach the long run growth path at a steady state level of growth which is usually a lesser rate of growth compared to the short run growth rates since a sizeable growth rate of GDP is required at the early stages of developments. If it is felt to work good then the growth rates of developed economies like the USA, France, Germany, UK etc. should follow a lower quantitative growth figures. During a few decades back these economies have followed the average growth rates of around 2 to 3 per cent annually. And hence, these economies can be concluded to have attained the long run growth

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paths so far as the postulates of the growth theorists are concerned. The occurrences of the crises have opened the eyes of the economists, planners and governments of different countries. The factors that need to be incorporated as crucial elements in analyzing the developmental status of the world economies in the post globalization scenario are the management of good and proper governance as well as to maintain good confidence level of the active economic agents. Hence the task was to reorient the working of the interlinkages among three prime indicators of developments—Confidence, Governance and Growth. An economy, to have a stable growth path, should have interlinkages among all three indicators to work in a bidirectional way. That means as the economy grows in quantitative terms the confidence of the economic agents, particularly of the consumers and the business houses, tends to rise. At the same time, if the consumers and business houses have better confidence upon the economy then the growth rate of the overall output will tend to rise. Similarly, if the quality of the governance, governance being the normative in nature, improves the growth rate of the overall economy will tend to rise and in the reverse way high growth rate of the economy demands active governance by the ruling government of the country. Likewise, as the quality of governance improves the confidence of the economic agents rise and as the level of confidence rises the government should manage to follow active governance.

By Confidence it is meant how the economic agents perceive the future economic events at least up to six months. There are several economic and non economic factors to determine the level of confidence. The economic factors that determine the consumer and business confidence levels are mainly the overall growth rate of output (GDP), rate of unemployment, inflation and interest rates, movements of stock indices and the government’s debt to GDP ratio. The non economic factors that strongly influence the confidence levels of consumers and businessmen are the governance indicators that are namely the Voice and Accountability (VA), Political Stability and Absence of Violence in the territory (PSNV), Government’s Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL) and Control of Corruption (CC).

The working of the interlinkages among all three indicators, confidence, governance and growth, is required by established as well emerging economies in the globalized world in order to achieve long run objectives. To quote Kofi Annan, former secretary general of UN, ‘good governance is perhaps the single most important factor in eradicating poverty and promoting development’. An economy may not require effective governance in its early stages of developments because of the closed structure as well the small areas of economic activities. The importance of governance is felt relevant in the early 1990’s after the boosting efforts of making all the countries beneath the cover of single umbrella—the global village. The opening up of the doors of most of the countries made possible of flowing resources from one country to another which means one country’s consumers and business houses tend to perceive not only the economic conditions of their own nations but also that of the other nations. Managing good governance was, therefore, a challenge to all the heads of the nations so as to sustain in the competitive world.

Over the last decade the world economies faced two major crises. The first one originated by the fall of Lehman Brothers in the USA in September 2008 that led the country and its associated trading partners into a financial crisis and after that as one of its aftermath effects and with a common currency problem under the low interest rate regimes, the Euro zone crisis originated through the fall of the countries of the southern Europe, namely Greece, Spain, Portugal, Italy and Ireland. The impact of such crises travelled throughout the world like an epidemic via trade and service channels. The shares of exports, imports and total trade volumes of USA, France, UK, Germany, Greece, Japan, South Africa, Brazil, etc in world trade have