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# Economic growth and convergence: Do institutional proximity and spillovers matter?

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## Abstract:

This paper extends the existing studies on institutions-growth nexus in two ways: firstly, it estimates a growth model that is spatially augmented to capture the countries' dependence, and secondly it measures the countries' dependence using a newly proposed concept called institutional proximity, in addition to the commonly used geography. Spatial Durbin model, that includes not only spatially lagged dependent variable but also spatially lagged explanatory variables, is shown to be the most appropriate to describe the panel dataset used in this study, which comprises of observations from 58 developing countries for year 1984-2007. The results find that institutions, specifically the property rights institutions, matter for growth in developing countries. The results also find an evidence of indirect institutional spillovers where institutions in a country lead to growth improvement in the country and subsequently generate positive spillover effects on neighbors' economic growth. The results also yield robust support to the concept of augmented convergence process as a result of neighboring effects and its speed is relatively higher than the conventional  $\beta$ -convergence of a standard growth model. The greater convergence speed is consistent across a number of spatial models using both geographical and institutional proximity measures. The paper finally concludes with several policy implications for developing countries as far as the effects of institutional proximity and spillovers on growth and convergence are concerned.

**Keywords:** Economic growth, convergence, institutional proximity, spillovers, spatial Durbin model.

JEL code: C21, O43, R10

## 1. Introduction and background

Institutions matter. The growth literature has arguably already arrived at an academic consensus with strong empirical evidence supporting the significant effect of institutions on cross-country

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