Good Governance: Pakistan's Economic Growth and Worldwide Governance Indicators

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Abstract

It is generally perceived that an Economy will experience rapid growth provided following Worldwide Governance Indicators (WGI) are in positive direction i.e. political instability is low, mechanisms for voice and accountability exists, control of corruption subsists and the rule of law prevails. The study aims at exploring relationship between aforementioned WGI indicators and economic growth (GDP) using estimates related to Pakistan, provided by World Bank. Moreover, researchers attempt to identify which of the WGI indicators under consideration contribute most towards economic growth. A quantitative research strategy has been adopted and statistical tools (Spearman's rho correlation and regression) have been used to test the hypotheses that researchers developed using available literature. The study concludes that out of the four dimensions of good governance, political stability contributes highly towards economic growth.

Keywords: economic growth (GDP), good governance, worldwide governance indicators, Pakistan.

1. Introduction

Governance is a broad concept, having number of dimensions along with various definitions being provided by individual scholars as well as development institutions like United Nations Development Program (UNDP), World Bank (WB) and others. According to the World Bank, governance refers to "rule by the rulers" under some defined laws, processes and vivid authority.

"Governance comprises of mechanisms to look into the economic, political and administrative affairs of a country" (UNDP*).*

Recently a concept which is being focused all over the globe and is being used as a key indicator of the overall health of a country is Good Governance (GG)**.** According to Besancon (2003), Good governance is a result of effective performance and efficient working of the state machinery. Universally acceptable codes of good governance are not easy to be defined (Graham et al. 2003). However, researchers have defined four

dimensions of Good Governance through extensive literature that have been used in this study and these are briefly discussed next.

First comes Rule of law (RL), it is about adhering to constitution and other legal provisions that exist through various legislations. RL is ensured when every individual or entity goes by defined rules and is accountable and transparent in its processes.

Second dimension is Political Stability (PS). For purpose of this study, it can be said that absence of Political Stability is actually the presence of Political Instability (PI). Political Instability (term as used in WGI) is regarded by economists as a serious disease which is harmful to economic performance. The more instable political arena of a country, the more it is likely to negatively affect micro and macroeconomic policies. Policy makers need to adjust to continuously changing circumstances in order to ensure fit between the dynamic environment and future economic goals (Mueller, 1982).

Control of Corruption (CC) is another dimension of Good Governance. Corruption is a serious malaise, that if prevails in any society or economic system can lead to devastating effects. Corruption here has been taken as financial mismanagement.

Lastly, another important concept in this study is that of Voice and Accountability (VA). It is necessary for any society have mechanisms available to ensure voice against malpractices and to hold the culprits in any domain accountable. If these mechanisms do not exist, no fear factor shall be present among the wrong doers.

Furthermore, Economic Growth, in terms of Gross Domestic Product (GDP), is a concept that is being studied since decades. Different tools and methodologies are used to study this concept through different dimensions. Economic Growth here has been conceptualized as escalation in amount of goods and services produced by a country over a specific time period. The ultimate aim of any country is to achieve economic prosperity by increasing the rate of Economic Growth. This is that area which is influenced by all factors and itself, influences many factors whereas in this study, researchers have tried to investigate whether to which extent these aforementioned dimensions of GG have influenced Economic Growth (GDP).

1.1 Importance of Good Governance

Good Governance is needed for sustaining and maintaining a sound political system in a country. Once political system becomes stable then Economic Growth seems to be inevitable. So, Good Governance is really important at macro level. Furthermore, Good Governance is really required at micro level as well even when someone runs a small shop or runs a national level company. The agenda for establishing Good Governance is being highly discussed in today's academic environment and is also a part of many political slogans. As per various studies, Good Governance is a prerequisite for Economic Growth, but the relation between the two variables is not universal.

1.2 Objectives of the study

➢ To investigate the relationship between Rule of Law and the Economic Growth in Pakistan's perspective.

➢ To find out the relationship between Political Stability and Economic Growth in Pakistan's perspective.

> ➤ To examine the relationship between Control of Corruption and the Economic Growth in Pakistan's perspective.

> ➤ To explore the link between Voice and Accountability and the Economic Growth in Pakistan's perspective.

> ➤ To determine which of the four dimensions contributes highest to Economic Growth.

1.3 Significance

This study aims to focus four dimensions of Good Governance. General perception is that, if Rule of Law and Political Stability prevail and mechanisms for Control of Corruption and Voice and Accountability exist, Economic Growth and Good Governance will surely be the outputs. Theoretically, all governance indicators have their own significance, but for developing nations where multiple issues related to governance already exist, this study shall assist policy makers to focus and prioritize which area should be relatively addressed more in order to ensure Economic Growth.

2. Literature Review

Governance is one major concept and is highly significant in ensuring economic development. Many of the studies have been conducted till date about Economic Growth and Good Governance. Most of them have shown a positive relation between them. One such study by Kaufmann and Kraay (2002) established that higher level of governance is necessary for higher per capita income. Furthermore, Grindle (2004) emphasized that the concept of governance is not so simple or straightforward to be linked with development. Basic agenda of Good Governance is to work for poverty reduction, countering corruption and other factors that are a hurdle in development.

In addition, Campos and Nugent (2000) used GDP as dependent variable and developed their own measures for determining level of rule of law and political stability by using indices. They concluded that, rule of law and political stability are necessary to ensure clean systems and strong legal support to remove any hurdles in bringing foreign investment which is one of the key factors that contribute to Economic Growth (Goldsmith, 1987).

In this study, literature review circles around the four dimensions of Good governance and its impact on Economic Growth. Researchers have discussed all these four dimensions one by one in the following section;

Initially the link of Rule of Law with Good Governance is explored. Good Governance and Rule of Law are important elements of development. Governments focus on merely making laws in order to ensure good governance, but only making or drafting laws is not the solution, in fact ensuring the implementation of these laws and rules is important (Morita and Zaelke, 2007).

Rule of Law is not just the only pre-requisite for Good Governance; rather it demands transparency as well as answerability in various sectors under the governmental control. Strong checks on financial and human capital are important elements in ensuring Good Governance (Morita and Zaelke, 2007).

Lane (2010) divides rule of law into two parts, first being judicial independence and the second one being called constitutional democracy. Later, he links economy with rule of

law in general, combining the two above mentioned categories. This study concluded that legally and constitutionally safeguarded property rights are key to optimal market activity i.e. when more legal protection to business community is available, they will be more encouraged to invest and contribute.

Moving onto the other variable; Political Instability, Zureiqat (2005) investigated relation between the two variables i.e. economic performance and political instability. In order to measure former variable, GDP per capita was used whereas Polity II democratization score was used to determine level of political instability. Using the data from twenty five countries, he empirically concluded that there is an inverse relation between the two aforementioned variables.

Similarly, Gyimah et al. (1999) explored the association between Economic Growth and Political Instability in Less Developed Countries (LDC). Quantitative techniques were used to investigate the above relationship, in different Sub Saharan African countries. Their findings show that there is a two-way causal connection between Economic Growth and Political Instability.

Looking from a different perspective, Kirmanoglu (2003) examined the connection between Political Instability and Economic Growth by using "Granger causality" tests. Study included 19 countries as a sample and used GDP per capita and an index of political freedom as core measurements. However, in his findings there was no empirical significant relationship between Political Instability and Economic Growth in 14 out of the 19 countries that were examined. Two countries showed theoretically desired results whereas rest of the countries showed statistically insignificant outcomes.

Grindle (2010) interestingly calls the hype of the concept of good governance as, "inflation of an idea". Talking about the other side, she questions the idea, that good governance is positively linked to Economic Growth. The basis of the argument is the growth in china. Author says, "China would rank poorly on most scales of good governance, yet it has experienced growth and development over the past decade. So if China can flourish without good governance, what does that imply for the concept of good governance in general?"

Similarly, United States, a nation apparently renowned for good governance and its Economic Strength, exhibited a failure in that area with its response to Hurricane Katrina, whereas Pakistan acted speedily after the 2005 earthquake.

Considering the next variable regarding Control of Corruption, few evidences support this view point that control of corruption can lead to productive economy. Mauro (1995) took the sample of 67 different countries and found out an indirect relation between the corruption index and Economic Growth indices existed. Ahlin and Pang (2008) took a sample of 71 countries and found a negative relation between level of corruption and economy. Mo (2001) used a sample of 46 countries and concluded that if there is 1% increase of level of corruption than there shall be decrease of 0.72% in the Economic Growth.

Literature opposing the aforementioned view is also available as well. Li et al. (2000) took the sample of 46 countries and though they found that with increase of corruption, economy declines but it was restricted to only few regression models. With other models, this relation was not proved. Similarly, Mendez and Sepulveda (2006) also carried out research on this subject and with the help of their findings, they concluded that low level

of corruption is beneficial for Economic Growth and it proved to be detrimental on large scale of corruption.

Lastly, Glaeser and Saks (2006) in an attempt to find out the relationship between Corruption and Economic Growth in United States of America concluded that a weak negative relation between the two variables was present.

It is important to note that less amount of research work is available on last dimension of Good Governance (Voice and Accountability) and the relation between Voice and Accountability, and Economic Growth. Henry et al. (1985) have explored the association between these variables. They used Correlation model to test hypothesis and concluded the moderate positive relationship between Voice and Accountability, and Economic Growth was visible statistically.

2.1 Hypotheses

Following are the ideally generalized hypotheses researchers have formulated:

- ➢ H_0 (a): There is no relation between Political Instability and Economic Growth.
- ➢ H_1 (a): There is a negative relation between Political Instability and Economic Growth.
- ➢ H_0 (b): There is no relation between Voice and Accountability and Economic Growth.
- ➢ H_1 (b): There is a positive relation between Voice and Accountability and Economic Growth.
- ➢ H_0 (c): There is no relation between Control of Corruption and Economic Growth.
- ➢ H_1(c): There is a positive relation between Control of Corruption and Economic Growth.
- ➢ H_0 (d): There is no relation between Rule of Law and Economic Growth.
- ➢ H_1 (d): There is a relation between Rule of Law and Economic Growth.
- ➢ H_0 (Regression): Full Model is insignificant.
- ➢ H_1 (Regression): Full Model is significant.

3. Methodology

The purpose is to study whether there is any relation between the identified variables. The two variables i.e. Economic Growth and Good Governance which are under study will be explained below.

3.1 Research Strategy

Quantitative strategy has been adopted for this research. The reason for using this technique is that, researchers want to explore the relation and the strength of the association amongst the variables discussed below. For exploring the relation, Correlation and Regression analysis have been conducted.

3.2 Variables and Data Source

In the following section, variables under study have been explained along with their data sources.

3.2.1 Independent Variables

Independent variable for this study is Good Governance and following are its four dimensions under investigation:

- Political Instability.
- Voice and Accountability.
- Control of Corruption.
- Rule of Law.

The data pertaining to Independent Variable (i.e. its dimensions) has been taken from WGI developed by the World Bank. The Worldwide Governance Indicators (WGI) are a research based dataset comprising of the perceptions on quality of governance provided by a large number of stakeholders such as general masses, enterprises, expert opinions, non-governmental sector and different think tanks.

3.2.2 Dependent Variables

- Economic Growth (GDP)

For the dependent variable, source of data is World Bank (World Development Indicators). An alternate source available for the GDP data could be Economic Survey of Pakistan. The reason for choosing World Bank data set is that it provides the GDP in U.S Dollars which is a more stable currency than Pakistani Rupees (Rs.) and U.S. Dollar currency is world-wide acceptable for trade purposes. Data are in current U.S. dollars. Dollar figures for GDP are converted from domestic currencies using single year official exchange rates.

3.3 TimeLine

10 years Data (i.e. 2002-2011) pertaining to variables under study has been included.

3.4 Statistical Tests

The two tests that have been conducted include Correlation and Regression Analysis using Statistical Package for Social Sciences (SPSS).

4. Data Analysis and Results

Before applying the main Statistical tests to meet the objectives of this study, it is important to check some of the pre-requisites of a certain key statistical application. For this study, prior to application of Correlation (between dependent and independent variables) and regression, the data is checked for **Normality** and **Multi co-linearity**. Table 1 and Table 2 show the Normality and Multi co-linearity results of the data respectively:

Table 1: Normality Check using Shapiro-Wilk		
	Statistic	**P-Value**
Economic Growth	.957	.747
Political Instability	.869	.097
Voice and Accountability	.834	.058
Control of Corruption	.802	.055
Rule of Law	.940	.548

If we assume the null hypothesis for all variables to be "Data follows normal distribution", it can be concluded on the basis of P-Values that for all the variables, data is normally distributed. The reason for this conclusion is the fact that as the P-Values for all variables (as shown in the Table above) are greater than Significance Level, (of 0.05) null hypothesis can be declared as accepted.

Table 2: Correlations for Checking Multi Co-linearity			Rule of Law	Control of Corruption	Voice and Accountability	Political Instability
Spearman's rho	**Rule of Law**	Correlation Coefficient	1.000	-.031	-.234	.151
		Sig. (2-tailed)	.	.933	.210	.191
		N	10	10	10	10
	Control of Corruption	Correlation Coefficient	-.031	1.000	-.205	.122
		Sig. (2-tailed)	.933	.	.245	.364
		N	10	10	10	10
	Voice and Accountability	Correlation Coefficient	-.234	-.205	1.000	-.136
		Sig. (2-tailed)	.210	.245	.	.070
		N	10	10	10	10
	Political Instability	Correlation Coefficient	.151	.122	-.136	1.000
		Sig. (2-tailed)	.191	.364	.070	.
		N	10	10	10	10

Moving on to the second assumption i.e. Multi co-linearity Table 2 above shows that the variables are not correlated as the P-Values for all correlations are greater than Significance level and also the values for all correlations are very small. Therefore, it can be declared that the data is not facing the problem of Multi co-linearity.

With these assumptions being fulfilled in the right direction as suggested by the literature, researchers find it appropriate to move on with the Correlation and Regression analysis.

4.1 Correlation Test

Spearman's rho correlation has been used to find the relationship between GDP and WGI. The reason for selecting this type of Correlation is that GDP is the Scale Variable whereas WGI are Ordinal Variables.

4.1.1 Economic Growth and Political Instability (H_1a)

Table 3: Correlations			
		Economic Growth	**Political Instability**
Economic Growth	Spearman's Rho Correlation	1	**-0.927**
	Sig. (2-tailed)		.000
	N	10	10
Political Instability	Spearman's Rho Correlation	**-0.927**	1
	Sig. (2-tailed)	.000	
	N	10	10

Correlation of the Economic Growth and Political Instability is calculated to be-0.927 at significance level of 0.05. The P-Value is 0.000 which is less than the Significance level hence H_0 (a) is rejected, therefore it may be concluded that negative relation exits between the two variables under study as per the Hypothesis 1 (H_1a).

4.1.2 Economic Growth and Voice and Accountability (H_1b)

Table 4: Correlations			
		Economic Growth	**Voice and Accountability**
Economic Growth	Spearman's Rho Correlation	1	**0.948**
	Sig. (2-tailed)		.000
	N	10	10
Voice and Accountability	Spearman's Rho Correlation	**0.948**	1
	Sig. (2-tailed)	.000	
	N	10	10

Correlation of the Economic Growth and Voice and Accountability is calculated to be 0.948 at significance level of 0.05. The P-Value is 0.000 which is less than the Significance level hence H_0 (b) is rejected, therefore it may be concluded that positive relation exits between the two variables under study as per the Hypothesis 1 (H_1b).

4.1.3 Economic Growth and Control of Corruption (H_1c)

Table 5: Correlations		Economic Growth	Control of Corruption
Economic Growth	Spearman's Rho Correlation	1	**-0.322**
	Sig. (2-tailed)		.047
	N	10	10
Control of Corruption	Spearman's Rho Correlation	**-0.322**	1
	Sig. (2-tailed)	.047	
	N	10	10

Correlation of the Economic Growth and Control of Corruption is calculated to be-0.322 at significance level of 0.05. The P-Value is 0.047 which is less than the Significance level hence H_0 (c) is rejected; therefore a negative relation exists between these two variables.

4.1.4 Economic Growth and Rule of Law (H_1d)

Table 6: Correlations		Economic Growth	Rule of Law
Economic Growth	Spearman's Rho Correlation	1	**-0.683**
	Sig. (2-tailed)		0.030
	N	10	10
Rule of Law	Spearman's Rho Correlation	**-0.683**	1
	Sig. (2-tailed)	0.030	
	N	10	10

Correlation of the Economic Growth and Rule of Law is calculated to be -0.683 at significance level of 0.05. The P-Value is 0.030 which is less than the Significance level; hence H_0 (d) is rejected.

4.2Regression Analysis (Linear)

4.2.1   Regression Analysis using Enter Method:

Table 7: Regression Analysis (Full Model)			
	Criterion Variable: Economic Growth(GDP=Y)		
	R^2	B	P-Value
Predictors:			
• Constant(B_0)		76.293	
• Rule of Law(X_1)		-44.45	0.628
• Control of Corruption(X_2)	**0.909**	-53.83	0.581
• Voice and Accountability(X_3)		-23.42	0.349
• Political Instability(X_4)		104.35	0.000
Significant at Level 0.05			

R^2 value of the Full Model regression is 0.909 at P-Value of 0.008, which is less than significance level of 0.05 so it provides enough evidence that our model is significant with df= 9.

Full Model: Y = 76.293 - 44.45 X_1 - 53.83 X_2 - 23.42 X_3 + 104.35 X_4

Regression Analysis using **Backward Elimination** for **Best Model** to identify which of the dimensions of Good Governance contribute highest to Economic Growth:

4.2.2   Backward Elimination for Best Model

Table 8: Regression Analysis (Best Model)		
	Criterion Variable: Economic Growth(GDP=Y)	
	R^2	P-Value
Model:		
1*	0.909	0.577
2*	0.904	0.409
3*	0.899	0.334
4*	0.868	0.007
Significant at Level 0.05		

1* means all predictors included.

2* means all predictors included except Rule of Law.

3* means all predictors included except Rule of Law and Control of Corruption.

4* means all predictors included except Rule of Law, Control of Corruption and Voice and Accountability.

According to the backward elimination method predictor 4 i.e. Political Instability alone is statistically significant giving a high R^2 value of 0.868 at P-Value of 0.007, which is less than significance level of 0.05 with df= 12. If we include all other predictors then we have to lose 3 degree of freedom which may not be statistically ideal. So the best model is as follows:

Best Model: $Y = 76.293 + 104.35\ X_4$

5. Conclusion

Good Governance is a key to success for any country as it can contribute positively towards boosting economy. Four dimensions of good governance provided by World Wide Governance and their relation with economic growth have been investigated. After the thorough analysis, hypotheses formulated about Political Instability and Voice and Accountability were accepted as per the discussion in literature review section. This clearly shows that Pakistan is moving somehow in same direction as other developed countries.

Whereas, hypotheses formulated about Rule of Law and Control of Corruption were rejected in Pakistan's scenario. This was not totally something out of the blue. According to some of the studies, low level of Corruption is beneficial for Economic Growth (Mendez and Sepulveda, 2006). Moreover, results related to Rule of Law are not in coherence with general perception that Rule of Law and Economic Growth are positively related. Taking a general view of WGI, Kaufmann (2010) highlights some key findings and a different angle of these globally accepted data sets, economically strong countries are not necessarily always the best governed. If we go through WGI and take an average of the governance ratings of G-20 countries, 75 from around the globe rank higher than the average rank of G-20 on Rule of Law.

Looking into the Regression Equation (Best Model) and Correlation strength between Economic Growth and Political Instability, reduction in Political Instability contributes most to Economic Growth. Therefore, as per the statistical analysis, ensuring politically stable environment should be amongst the highest priorities of all governments as far as a developing country like Pakistan is concerned, but this does not mean that other factors related to Rule of Law, Control of Corruption and, Voice and Accountability can be ignored.

5.1 Limitations and Research Implications

This research aimed at understanding the relationship between some of the governance indicators and the Economic Growth of a country. Researchers tried to develop a model using regression analysis and statistically find out which of these four factors contribute highest to the Economic Growth. This study is not of course without any limitations. First limitation is that only 10 years data has been included for analysis, till date WGI data for most of the countries including Pakistan is available from 1996, so another study utilizing the entire data set can be conducted.

Moreover, researchers suggest that there is room available for a "Cross-Economy" comparison of the WGI where the concept can be statistically verified in terms of reliability by using estimates of variables from one developed, one developing and one underdeveloped country; provided similar methodology is used.

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