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The effect of good governance on economic growth in oil countries in the MENA

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Abstract. This study is focused on the effect of good governance on eeconomic growth in the number of oil producing countries of MENA (Algeria, Egypt, Iran, Syria, Tunisia, United Arabic Emirates and Yemen) during 1996-2010. The used method is panel data also was used of cross section data for examining. Based on the results of the investigation also estimation of the model we concluded that oil revenues have a negative effect on economic growth also democracy has a significant and positive effect on the economic growth. So with increasing of public participation the economic growth will increase in these countries. Indicators of good governance have a significant and positive effect on the economic growth, which with improvement of the institutions then the economic growth will also increase. Economic freedom has not significant impact on the economic growth in these countries.

Keywords: Good governance, Economic growth, Democracy, MENA countries.

1. INTRODUCTION

Nowadays there are high tendencies for understanding the nature of governance as a tool to promote the development process. International financial institutions such as the World Bank and International Monetary Fund, all believed that good governance is a critical need to contribute to the realization of development programs. In the recent decades, especially in the 90s numerous studies performed by researchers in the field of public management and choosing the best government's governance framework that the World Bank has a special place. Governance is known as a broad concept that has a direct relation with factors such as economic environment or in other words, economic security, politics, society and rights. The World Bank in a report which happened in 1977 under the title “government’s role in a changing world” not only noted on decisive role of government in about economics' changes and transformations but also expanded the theoretical and empirical discussions about the function of government at the global level which finally mentioned discussions lead to define the concept of governance. The World Bank, defines governance as a way to use of power in management of economic and social resources for achieving to sustainable development, ’Latif, 1991, quoted from Jahangard and et al’

2. THEORETICAL FOUNDATIONS

Political institutions in countries with abundant resources are appropriate determinants about the manner of impact of the country's natural wealth. Economic explanations relating to Dutch disease for describing an inverse relationship between natural wealth and growth are helpful but it does not mean that each country with rich natural resources led to slow growth. The wealth of natural resources caused all the government agencies are responsible. Therefore, these institutions will contribute to the prosperity of the country through its natural resources. It should be stressed that natural resources are not in itself preclude while lacking of good

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governance and democracy that is the problem. Overcoming the institutional problems requires changes in law and practice and not investing in resources. It should be mentioned that for understanding the resource curse need to understand that how the economic factors shape the institutions and vice versa .Increasing of transparency in about agencies payments to government, increasing of government transparency about management of natural resource revenues ,encouraging the preventive diplomacy, creation of restrictions on the exchange of goods with high risk and conflict also revenues from these natural resources can be used to support the development growth,' Alayli,2005'.

Since the late1990s, international institutions of economic policy such as the World Bank, United Nations Development Programme and partly International Monetary Fund expressed that good governance can be as a key for development puzzle. The word reign means the managing and regulating the affairs and known as relationship between citizens and government. According to the United Nations Development Programme, ggood governance consists of management of public affairs based on the rule of law, efficient and equitable food system and people's wide participation in the process of governance.' Johnson, 1997'.

In other words, if all the above mentioned items be implemented well in a country so governance will be higher there.

The World Bank defines good governance based on 6features

1. Right to comment and accountability
2. Political instability and violence
3. Effectiveness of government: Government efficiency in performing duties
4. Quality of regulations
5. Rule of law
6. Controlling of Corruption

In these definitions , whatever the positive features such as the rule of law, accountability, regulations quality and effectiveness of government be more in a society also political instability and violence be less so governance would be more appropriate in that society in order to achieve appropriate economic development, 'Johnson, 1997'. During the last years very broad topics based on this title published by mentioned international institutions. The main topic of good governance is about achieving to a government that lead to development of democracy and egalitarian. The World Bank, International Monetary Fund and United Nations Development Programme studied on this issue from different aspects. International Fund studied on financial and monetary transparency as a prerequisite for increasing of government accountability. The World Bank suggests broad set of policies and measures for strengthening the governance and its improvement. The two main mechanisms of the World Bank for improving the governance are strengthening the competition and accountability that their application in various areas of political, economic and social included very wide circle of policies such as reforming the judicial and education system up to government tenders.' Pour Kazemi Mohamadi, 2011'.

3. RESEARCH BACKGROUND

In this section, some of the external and internal studies relevant to the subject include:

Iimi&Ojima (2005) with cross-country data from 59 developing countries for the period 1998-2002, it is empirically found that abundant resource endowment per se does not contribute to economic development, but if a government has sufficient ability to formulate and implement sound and effective policies for managing natural resources, natural resource richness is conducive to economic growth .It is commonly accepted that developing countries endowed with abundant natural resources tend to grow more slowly than resource-scarce countries. Under such a scenario, it is surmised that natural resource wealth results in internal discord and social lethargy for developing countries. There also is a theoretical expectation that resource-rich economies are in a position to accumulate more economic and human capital, thereby accelerating their rates of growth. This paper constructs a simple endogenous growth model with exhaustible natural resources; empirically finding that natural resources do generally slow growth but that for governments with a sufficient ability to implement sound resource management policies, resource richness is an instrumental economic development tool.

Ditez&Neumayer (2007) studied on the “effect of institutional quality on GS in 115 countries”. They regress gross and genuine saving on three indicators of institutional quality in interaction with an indicator of resource abundance. The indicators of institutional quality are corruption, bureaucratic quality and the rule of law; also resource-rich economies have historically grown more slowly than resource-poor economies, particularly in the last thirty years or so. They find that reducing corruption has a positive impact on genuine saving in interaction with resource abundance. That is, the negative effect of resource abundance on genuine saving is reduced as corruption is reduced and they show that corruption is a significant factor for GS in resource-rich countries. They also found that improvement of Rules and principles has the same effect as reducing corruption.

Sup Kim &Sil Kim (2008) evaluated “the natural resource abundance and economic growth revisited”: Latin America and Developed Countries from a Comparative Perspective. From 1970 to 2005, Latin American countries had very disappointing performance in terms of economic growth. The well-known article by Sachs and Warner (1995) presents the reasons for poor economic growth in Latin America by providing evidence of the negative relation between resource-based exports and economic growth rates. Evidence suggests that the Latin American continent as a whole was concentrating on producing primary goods; in other words, they had not developed other sectors, such as the manufacturing industry, for export purposes. Natural resource abundance may not always have a negative effect on economic growth. These different outcomes can be caused by the difference in quality of institutions, human capital, savings, and capital formation. Better institutional quality may lead to better use of the resources obtained through the export of natural resources and accelerate the formation of human as well a physical capital, which may lead to higher economic growth.

Rahmani and et al (2009) reviewed on the “oil resources curse and rent-seeking on income distribution in selected countries oil”. The results of regression showed that oil revenues in most countries with low efficiency of government which having weak institutional and legal infrastructure lead to increasing of inequality of income distribution. On the other hand oil revenues in developed countries with high index of government efficiency which having strong infrastructure lead to reducing of inequality of income distribution and its effect is far more.

Shirkhani and et al (2010) evaluated "theory of resources curse or the manner of oil revenues management ". They compared the manner of oil management in Iran with Norway as a successful model about this matter. This comparison was based on the three indicators, mechanism, transparency and performance. They found that the formation of currency reserves account in Iran not only did not reach to the considered results but also at some point appeared as a problem and caused increasing of liquidity and inflation, increasing of government dependency to oil revenues, enlargement of the government, increasing of liquidity and reduction of fiscal discipline.

Pourkazemi Mohamadi (2011) studied on the “impact of good governance on the economic growth and human development of 41countries” which having abundant natural resources during years 1996-2009.The findings showed a positive effect of good governance on the economic growth and human development in the studied countries.

4. THE INTRODUCTION OF THE MODEL AND RESEARCH VARIABLES

The research’s model is derived from the model that Ojima (2005) used it for studying on the effect of good governance on the economic growth in OPEC and OECD countries. He used of variables such as knowledge and technology, employees in research and development , the number of patented points, registration of invention along with population and good governance index .In this paper we will use of indicators such as good governance, population, oil revenues, GDP and trade freedom then the considered model will be as follows:

$$GDP_{it}=\beta_0+\beta_1 \ GC_{it}+\beta_2 \ OILIN_{it}+\beta_3 \ RUL_{it}+\beta_4 \ DEM_{it}+\beta_5 \ REG_{it}+\beta_6 \ GOV+\beta_7 \ FD+\varepsilon_{it}$$

Which in this model the variables are as follows:

Table1.Introducing the variables of the model-researches’ results

Variable	Explanation	Source
GDP	GDP as fixed prices of America’s dollars in 2005	World Bank (2013)
GC	The size of government as fixed price of America’s dollars in 2005	World Bank (2013)
OILIN	Oil revenues in millions dollars	OPEC (2013) & BP (2013)
RUL	Rule of law	World Bank (2013)
DEM	Democracy	Center for Global polity George Masom University (2013)
REG	Quality of law regulation	World Bank (2013)
GOV	Government effectiveness	World Bank (2013)
FD	Economic freedom	Heritage (2013)
ε	Error term	

In the above model, the rule of law, quality of law regulation and effectiveness of government all are as indicators of good governance.

-The test of stationary and non- stationary

After gathering the relevant information, should be ensured about their non-stability and non-stability till did not create false regression because they are for periods 1996-2010.The Unit root tests were examined on all variables and between model’s variables, government spending or government size, the rule of law, GDP, effectiveness and efficiency of government and economic freedom all were non- stationary and other variables such as democracy , oil revenues and the quality of law regulation were stationary. Also after estimation of research’s models the unit root test on the residuals of the model which was tested and residuals were in stationary level which showed that the estimated model is as reasonable model in this paper.

The results of unit root test for all variables are shown in table 2:

Table 2, stability and non-stability of variables based on ADF test

Variable	Prob.	T-statistics
GDP	0.7263	0.6016
GC	0.9843	2.15

OIL	0.0000	4.23
RUL	0.9846	2.15
DEM	0.0141	2.11
REG	0.0002	3.56
GOV	0.9703	1.88
FD0.0892		1.38
RESIDUAL	0.0000	6.5

Source: research Calculations

-The test of fixed effects and random effects

F-Limer test

Based on the Panel data econometrics literature the homogeneity of data was tested by using of F test also with using of Panel data estimation method.

Table 3: F-Limer test

Prob	d.f.	Statistic	Effects Test
0.7110	(6,76)	0.623319	Cross-section F
0.6395	6	4.275284	Cross-section Chi-square

Source: research Calculations

The results of the test indicated that the H_0 hypothesis was rejected. Therefore preferred method for estimating the model will be pooled effects.

5. SPECIFICATION OF MODEL AND RESEARCH METHODOLOGY

The examined countries are a number of MENA countries such as: Algeria, Egypt, Iran, Syria, Tunisia, United Arabic Emirates and Yemen.

-The estimation of the Model

The examined period is 1996-2010.

The estimation results are as follows:

D (LGDP) = 0.05 - 0.0002*OIL - 0.0029*D (GC) + 0.044*D (RUL) + 0.0001*REG + 0.65*D (GOV) - 0.0001*D (FD) + 0.0007*DEM - 0.012*DUM

Table 4. The calculations of research

Prob	t-statistic	coefficient	variable
0.0001	-4.009676	-0.000186	OIL
0.0000	-4.565290	-0.002773	D(GC)
0.0000	5.587618	0.053074	D(RUL)
0.0519	1.976475	0.000147	REG
0.0058	2.843049	0.067176	D (GOV)
0.6375	-0.473159	-0.000257	D (FD)
0.0000	14.60794	0.000731	DEM
0.65	R^2		
1.94	Durbin-Watsonstat		
6.62	F-statistic		

According to the results the oil revenues has negative coefficient of 0.0001.Also with increasing of oil revenues in these countries the economic growth will be reduced because of inappropriate institutions in these countries. This matter happened mostly in developing countries and countries with inappropriate institutions. Although the oil revenues could lead to increasing of prosperity and economic growth, but they have negative effect on economic growth in these countries. It should be stressed that natural resources are not in itself preclude while lacking of good governance and democracy that is the problem. Overcoming the institutional problems requires changes in law and practice and not investing in resources. Also it should be mentioned that for understanding the resource curse need to understand that how the economic factors shape the institutions and vice versa. Increasing of transparency in about agencies payments to government, increasing of government transparency about management of natural resource revenues ,encouraging the preventive diplomacy, creation of restrictions on the exchange of goods with high risk and conflict also revenues from these natural resources can be used to support the development growth,' Alayli,2005'. Government spending has a negative effect of 0.002 on economic growth. Therefore if the size and costs of government is increased so the economic growth in these countries will be reduced.

There are different theories about the government size. Some people accepted positive impact of government size on the economic growth such as chlorine and others (1999) suggested that some costs like education and government's construction costs lead to increasing of economic growth. But some other costs like security and welfare do not have any effect on economic growth and some others believed that it has negative effect on it like Barrow et al (1999), Gartner and others (1998) also Barrow in (1989), showed that large government is as obstacle for economic growth. Some others believed that it does not have any effect, like Sally martin (1997) that showed that there is a weak relationship between economic growth and the government size. The rule of law, quality of law regulation, the effectiveness and efficiency of government all have a significant and positive effect on economic growth in these countries. Therefore with increasing of each of these indicators of good governance so the economic growth also will increase. The good governance, according to its characteristics and indicators requires a government that led to participation of other sectors in developing. In the new model, the government should create stability in the society, imposes some effective and appropriate legal framework for public and private sector activities also creates stability and fairness in the market and should has mediator role in about public interest and effectiveness also accountability about presentation of public services,' UNDP,1997'. In such circumstances, government administration will change from public administration to public governance. The public governance has more emphasizing on the legal and legitimate values instead of economic and efficiency values also creation of democracy is important for it,' Walter & Kickert,2002'.

These results were consistent with previous results and confirm the previous theories. Democracy has a significant and positive effect on the economic growth in these countries also whatever the public participation be more in the economy and people feel that are owner of that country then the economic activities will be more prosperous. Therefore economic growth will increase. An attitude which accepted among most scholars it is that bad institutions are at the heart of the resource curse. But it is not clear that what forms of government create them. Despite the numerous definitions of democracy believed that all forms of democracy lead to accelerating the development of civil society. Civil society is referred to the interactions between citizens of a country as well as, a range which the citizen voices heard by government, Karl, 1997'. Karl argues that many countries with rich resources did not develop a civil society. Because the government of these countries didn't never need to their citizens 'tax .The amount of public participation in community affairs is one of the major foundation of good governance . Participation can be done directly or indirectly through legal institutions, although cannot be expected that all comments will be considered in a country's system decision-making, but here's participation means freedom of expression and diversity of views and organizing a civil society,'Sabaghi and et al,2009'. Economic freedom does not have any significant effect on economic growth in these countries and in this period.

The amount of R^2 is 0.65 and the amount of Durbin Watson is 1.94 which have appropriate figures and represents that the model is appropriate also shows lacking of correlation between the variables.

6. RESULTS AND CONCLUSIONS

This study is focused on the effect of good governance on economic growth in the number of oil producing countries of MENA during 1996-2010.The used method is panel data also was used of cross section data for examining. Based on the results of the investigation also estimation of the model we concluded that oil revenues have a negative effect on economic growth. These results were consistent with previous theoretical and confirmed them. Democracy has a significant and positive effect on economic growth. So with increasing of people participation then the economic growth in these countries will increase. The indicators of good governance have a significant and positive effect on the economic growth. Therefore, with improvement of the institutions, also the economic growth will increase. This result is consistent with previous theories. The economic freedom has not any significant effect on the economic growth in these countries. So the first hypothesis of this study will be accepted and has a significant and positive relationship between the quality of law regulation and economic growth. But the second and third research's hypothesis will be rejected and there is a significant and negative relationship between economic growth and oil revenues .Also there is not significant relationship between economic growth and economic freedom.

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