Does Governance Matter to Economic Growth? Evidence from MENA Countries

Hamid Lahouij
Eastern Illinois University

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Does Governance Matter to Economic Growth?

Evidence from MENA Countries

Hamid Lahouij

Abstract

This research paper uses panel data for the time period 2002-2013 to investigate the impacts of governance and other economic growth determinants on economic growth of some selected oil-importing MENA countries. This paper contributes to the literature on governance, economic development indicators, and economic development in novel ways. The research finds that governance is strongly associated with the economic development. However, the results of this research might conflict with others’ results if their research combines oil-exporting and oil-importing countries in their sample or use different methodologies. Therefore, the policy recommendations should be used cautiously.

Keywords: governance, economic growth determinants, economic growth.
1. Introduction

Economic growth is essential to economic development. A country’s population benefits when the country’s national income grows. Since there is no magic formula for countries to spur their economic growth and become developed countries, the need for using a country’s resources more efficiently and rationally has become crucial today. To do so, one of the most important things a country has to have is the “ability to put in place an institutional environment in which contracts can be enforced and property rights can be established” (Looney, 2013).

Governance is a broad notion. The concept has many definitions provided by different scholars and organizations. According to Kaufman et al the concept can be defined as “the traditions and institutions by which authority in a country is exercised” (World Bank, WB). Scholars and policymakers have been focusing on a new notion known as “good governance.” “Good governance is, among other things, participatory, transparent and accountable. It is also effective, equitable, and it promotes the rule of law. Good governance ensures that political, social, and economic priorities are based on broad consensus in society and that the voices of the poorest and the most vulnerable are heard in decision-making over the allocation of development resources" (UNDP, 1997).

A growing consensus among scholars, policymakers, civil society groups, and aid donors has emerged emphasizing that governance matters to development and thereby to economic growth. This consensus has become more visible as a result of numerous empirical investigations that have taken place in the last decade showing vigorous positive effects of good governance (WB, 2008). Thereby the significance of governance to the economic growth of a country has become almost axiomatic (Looney, 2013). Governance has to be an indispensable part of a
country’s strategy because of the very important role it plays in maintaining a sustainable growth rate.

The Middle East and North Africa (MENA) region is one of the richest areas in the world because of the abundant human and natural resources in the region, the immense share of sources of energy the region contains, and the reasonable standard of living, on average, the region enjoys. Within this general description, countries differ significantly in resources, standard of living, economic and geographical size, and population (El-Erian et al, 1996). Even though MENA states benefit from these and other advantages, the region as a whole has had disappointing growth performances in the last few decades compared to other developing countries. Growth rate in the region has been volatile and sometimes lower than that of some poor regions such as Sub-Saharan Africa (Fattah et al, 2006). One of the most important causes of this state of failure and underdevelopment is poor governance (Ciborra and Navarra, 2005).

If we compare MENA states’ quality of governance to other regions in the world, they notably rank well below the global average. In 2014 and for the control of corruption indicator, 14 out of 24 MENA countries ranked below the 50th percentile, 8 of which ranked below the 25th percentile and 17 countries were given a negative governance score. For the government effectiveness metric, 17 MENA states had a negative governance score and 14 were below the 50th percentile, 10 of which ranked below the 25th percentile. For the political stability indicator, 20 MENA nations were ranked below the 50th percentile, 15 of which ranked below the 25th percentile and 20 countries were given a negative governance score. For the regulatory quality indicator, 16 states of the region got a negative governance score and 15 countries ranks were lower than the 50th percentile, 9 of which ranked below the 25th percentile. For the rule of law metric, 15 states were ranked below the 50th percentile, 9 of which were given a rank below the 25th percentile and
15 had a negative governance score. Finally, for the voice and accountability indicator, 23 countries were given a negative governance score and 23 countries again ranked below the 50th percentile, 16 of which were below the 25th percentile.

Since the Arab Spring started in December 2010, many MENA countries have been encountering some important governance challenges, such as the unlimited political and economic power the governing elites and their clans possess, the dearth of accountability and transparency of state agents and inequality and lack of social justice, in general (Heidenhof, 2014). For so many governments within the region, such failures to address these and other problems and their inability to provide their nations with good governance that can boost growth can be explained by: carrying out some unsound economic policies that give the governing elites unrestrained power over the allocation of the national resources; the country experiences an uncontrolled corruption and cronyism in all its organs; and lack of political freedom and democracy, which leads to a dearth of accountability.

Since the 1950s, many MENA countries, in particular poor countries with small income compared to the size of their population, adopted state-driven models that emphasize control of the state over major industries, the allocation of resources, foreign trade, and capital inflow. Researchers have pointed out that these models are the key reason why the pace of poor MENA countries has been slower than other countries that adopt economic policies that are more market oriented. In MENA states with a high natural resource income, economic policy critics have shed light on both politicians and bureaucrats who exert a harmful and severe state control and a general disinterest (Emara and Jhonsa, 2014).

The main focus of this research paper is to investigate the relationship between the overall governance and the economic growth of non-oil exporting MENA states. That is, this paper aims
to examine to what extent the indicators of rule of law, political stability, control of corruption, voice and accountability, regulatory quality, and government effectiveness jointly affect the economic growth in MENA countries in the long term. Each of the governance indicators has its own significance. However, within the MENA region, where many governance issues already exist, this paper endeavors to empirically assist policymakers and to suggest policies that might improve the institutional quality of MENA states so as to maintain a sustainable growth rate. As a general perception, given that good governance exists, economic growth will be one of the results. Moreover, we conclude this research paper by studying the different channels through which governance may affect economic development.

2. Literature Review

Good governance has recently been seen as one of the most important factors to achieve a sustainable growth and thereby development. A large academic literature has developed models to cast light on how governance affects economic growth. Most of these studies have shown that good governance and economic growth are strongly positively correlated. One such research, where Kaufmann, Kraay, and Zoido-Lobatón (1999) studied more than 150 countries, provides empirical evidence that good governance matters a great deal for economic outcomes. Kaufmann and Kraay (2002) conducted another study of 175 countries for the period 2000/01, asserting that good governance is necessary for high per capita income and economic development. The same result was concluded by Knack (2002). It is worth mentioning that Kaufmann (with other authors) has examined the impact of governance on economic outcomes in many studies. In each one of them, he comes to the same conclusion stated above.
Moreover, the results of a study by Calderoân and Chong (2000) have confirmed that there is strong causality from institutional quality to economic growth. The authors’ results have also shown that economic growth causes institutional quality. Although their findings indicate that policies that attempt to improve the state’s institutional quality by securing propriety rights, controlling corruption, and limiting uncertainty need considerable time to achieve the desired goal, these policies are important for economic growth. In addition, such a study has shown that institutional reforms have high influence on economic growth, especially for the very poor countries. Furthermore, by answering the question: why do some countries produce so much more output per worker than others? The results of Hall and Jones (1998) have revealed that a country’s long-run productivity, capital accumulation, and thereby productivity per worker are influenced the most by institutions and government policies.

Huynh and Jacho-Chavez (2009) have used a nonparametric method to analyze the relationship between governance and growth. Their findings indicate that three of the six indicators of governance: voice and accountability, political stability, and rule of law are economically and statistically significant, while regulatory control, control of corruption, and government effectiveness are insignificant. The authors state that their empirical results support the findings of Glaeser, La Porta, de Silva, and Shleifer (2004) that poor countries get out of poverty and grow through good policies pursued by a dictator.

The study by Han et al (2014) determines whether countries with below-average governance grow slower than countries with above-average governance. Their results show that government effectiveness, political stability, control of corruption, and regulatory quality are more significantly positively correlated with economic growth than rule of law and voice and
accountability. The results also indicate that the studied Asian countries’ above-average governance grow faster than those with below-average governance.

In sharing his ideas on governance with World Bank economists, Rodrik (2008) said that governance is an important tool for development. He suggests that it is a good instrument to achieve better economic outcomes and enhance a country’s policy making. Rodrik also distinguishes between governance as a means and as an end. The author advises economists not to try to address governance as an end because it is the political scientists’ task. For governance as a means, however, he argues that only countries having governance as binding constraint can give a governance reform the priority to boost their economic growth.

Emara and Jhonsa (2014) used the Two-Stage Least Square method for a cross-sectional dataset of 197 countries to investigate the interrelationship between the improvement in the quality of governance and the increase in per capita income. Their findings show that there is a strongly positive and statistically significant causation from the quality of governance to per capita income. The results also prove a positive causation in the opposite direction. The authors used their results to interpret the relationship between the studied variables for 22 MENA countries. They contend that one of their surprising results is that even though most of the studied MENA countries had low performance on all six indicators of governance, these MENA countries’ income per capita is relatively higher than the rest of the countries in the sample.

Using the PRASH Model, Campos and Nugent (2000) analyzed the relationship between the growth volatility and political stability of Argentina over the period of 1896-2000. The authors’ findings suggest that “informal” political instability, such as assassinations, directly and negatively affects economic growth; and “formal” political instability affects economic growth indirectly.
Alesina et al (1996) also studied the effects of political instability on per capita GDP growth of a sample of 113 countries over the period 1950-1982. The major result of their paper is that political instability has negative effects on economic growth. That is, political instability lessens the growth. Moreover, their results suggest that regime changes affect growth adversely. The same findings were reported by Feng’s (1997) study. Using the three stages least-squares estimation for data covering 96 countries covering the period of 1960-80, the author’s findings demonstrated that political instability has significant and negative effects on economic growth.

Another study was done by Aisen and Veiga (2013) to determine the impact of political instability on the growth. The authors used the system-GMM estimator for linear dynamic panel data models on a sample covering 169 countries for the period of 1960-2004. Their results have proved that political instability and lower GDP per capita are strongly associated. Political instability has negative effects on economic growth by reducing the rates of productivity growth, and lowering capital and human accumulation.

Morita and Zaelke (2007) have studied the link between the rule of law, good governance, and economic development. The authors argue that rule of law and good governance are important to achieve sustainable development. They also emphasize that good governance and sustainable development goals will not be achieved just by making laws and regulations, rather by enforcing those regulations and laws by governments.

Dam (2006) reviewed the relationship between the rule of law and the economic growth of China. The author argues that China is currently facing the same type of governance issues that Asian Tigers have experienced. Asian Tigers’ economic growth has been negatively affected by such governance issues. The author contends that these issues may affect China’s economic growth as they have affected Asian Tigers’ growth. Dam avers that China’s governance weaknesses are
associated with many problems, such as a weak judiciary. Additionally, the author concludes that there is nothing in China’s experience from which one can conclude that institutions and rule of law are not important for economic development.

Acemoglu et al (2005) examined the link between institutions and long-run growth. They argue that when political power is allocated to groups that enforce propriety rights, when there are few rents that can be sought by the groups in power, and when there are effective constraints on power-holders, there will surely be a causality from economic institutions to economic growth.

Many studies have been done to determine the relationship between corruption and growth at the macro-level. One such study has been conducted by Hodge et al, (2009) where the authors used an econometric methodology that can take into account the multidimensional nature of, as well as the inherent endogeneity in, the relationship corruption-growth. Overall, their results have shown that corruption has negative impacts on investment in human capital, physical capital, and political stability, which means that corruption indirectly impedes growth.

Drury et al (2006) studied the connection between corruption, democracy, and growth in more than 100 countries for the period 1982-97. The authors’ findings show that corruption does not have any significant impact on growth in democracies, whereas corruption has strong negative effects on growth in non-democratic countries.

Ahmad et al (2012) used panel data over the period of 1984-2009 for 71 developed and developing countries to test whether corruption affects growth. Their study demonstrates that the relationship between corruption and long-run economic growth is hump-shaped. Their results also suggest that the quality of public institution has a crucial impact on any country’s growth performance. They conclude that there are many ways though which corruption can lessen
economic growth, such as lowering domestic and foreign direct investment, and overblown
government expenditure.

**Guisan (2009)** examined the link between government effectiveness, education and
economic development by comparing European countries to the U.S. and Canada over the period
of 2000-07. The author’s results have shown the importance of government effectiveness to
economic development.

**Amirkhalkali** and **Dar**’s study investigates the connection between regulatory quality
and economic growth of the 23 OECD countries over the period 1996-2008. They use a
generalized version of the production function model of Solow. Their findings suggest that
regulatory quality and economic growth are positively correlated. That is, a better regulatory
quality leads to a high growth rate. The authors argue that regulatory quality has an impact on
economic growth through its effects on total factor productivity.

Another study was conducted by **Cebula** and **Foley (2011)** to test three hypotheses, one of
which is about how quality government regulation affects per capita real GDP. By using panel
data and PLS estimation for OECD countries over the period of 2003-06, the authors conclude that
better regulatory quality is positively associated with economic growth because it has a positive
effect on the way market functions, and it allows for the avoidance of unnecessary costs of
managing businesses in the marketplace.

Therefore, from the above literature one can conclude that the effects of governance on
economic growth might be positive or neutral. Finally, the different conclusions raise important
policy questions. Does governance improve the long-term economic growth of a country? Why
would some countries benefit more from a governance reform than other countries? Can
appropriate policies make a contribution of governance more efficient? These are challenging questions to answer because there are many interrelated factors that affect the long-term economic growth of a country. In spite of that, one empirical fact is that nations can improve economic growth by adopting appropriate policies. Therefore, one of the goals of this study is to measure association between governance, economic growth determinants and economic development, and to suggest appropriate policies for a country.

3. The Endogeneity of Governance

The literature review suggests that the relationship between governance and economic growth is theoretically ambiguous. This section goes further by arguing that even the causality between the two variables is ambiguous, as well. In other words, as we highlighted the conflicting effects of governance on economic growth, one may suggest reasons why economic growth may have conflicting impacts on governance.

On one hand, most governance measures are based on surveys, which may make them subjective and limited. The respondents of these surveys are either experts or businesspersons. For instance, if a country’s economy is growing, one may contend that those people may have a positive judgement about the institutional framework within that country. Furthermore, Kurtz and Schrank (2007) argue that there is “far more reason to believe that growth and development spur improvements in governance than vice versa.”

On the other hand, one may also argue that economic growth does not promote good governance. Kaufmann and Kraay (2002) showed that improved governance tends to spur growth but not vice versa. They contend that, on average, long-term economic growth has a negative impact on the quality of governance in different countries around the world.
4. Conceptual Framework

Even though there are many determinants that affect the economic development of a country, in this study we choose the most relevant ones based on the literature. In this section, a description of the chosen variables is given. This explanation will help us to choose the appropriate methodology to examine the relationship between governance and economic growth. Therefore, the focus of this section is to establish a theoretical framework for our quantitative research.

Economic Growth

The main focus of this paper is to explore the relationship between governance and economic growth of non-oil exporting MENA countries, which are: Comoros, Djibouti, Egypt, Israel, Jordan, Lebanon, Mauritania, Morocco, Sudan, Tunisia, Turkey, and Yemen.

The data used in this paper is collected from World Bank and Fraser Institute. However, some countries do not have enough data for some variables and some years. Therefore, some countries have been removed from the primary database to improve the robustness of data. Finally, this empirical study is established on a panel dataset over the time period 2002-2013 to investigate the impacts of governance and other economic growth determinants on economic growth of the following MENA countries: Egypt, Israel, Jordan, Morocco, Tunisia, and Turkey.

Annual percentage growth rate of GDP per capita is one of the best indicators to measure a country’s economic performance. In this research, the GDP per capita growth based on constant 2005 U.S. dollars is used as a proxy for economic growth. The main motivation of using this variable rather than other variables is its popularity in governance literature (Huynh and Jacho-Chavez, 2009 and others). As a result, GDP per capita is the dependent variable.
Economic Growth Determinants

The research uses overall governance (the average of governance indicators), investment, human capital, government expenditure, foreign direct investment, and economic freedom, which are considered as major economic determinants.

- Governance Indicators

The aggregate indicators of governance integrate the views of large number of citizen, enterprise, and expert survey respondents. They are based on hundreds of variables obtained from over 30 data sources (WB). The WB captures six dimensions of governance. These six dimensions are sorted into three features of governance: the political aspect, which is measured through the indictors of “Voice and Accountability” and “Political Stability and Absence of Violence/Terrorism”; the economic aspect, which is evaluated based on the indicators of “Government Effectiveness” and “Regulatory Quality”; and the institutional aspect, which is estimated by the indicators of “Rule of Law” and “Control of Corruption” (Kaufman, 2011).

These six dimensions of governance are measured both by: a governance score that gives a country a score on the aggregate indicator that ranges approximately from -2.5 to 2.5 (high values correspond to better governance), and a Percentile Rank, which indicates the country's rank among all countries covered by the aggregate indicator, with 0 corresponding to the lowest rank and 100 to the highest rank (WB). These indicators can be defined according to Kaufmann et al (2011) as follows:

Voice and Accountability (VA): expresses to which extent a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association and free media.
Political Stability and Absence of Violence/Terrorism (PS): captures “the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism.”

Government Effectiveness (GE): represents “the quality of public services, the quality of 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 (RQ): captures “the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.”

Rule of Law (RL): expresses “the extent to which agents have confidence in and abide by the rules of society, and 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 (CC): “captures 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.”

• Investment

Investment is one of the most relevant determinants that directly affect a country’s economic growth. Gross capital formation (percentage of GDP) is used in this paper as a proxy for investment. Gross capital formation is also referred to as gross domestic investment. It is a good measurement of real investment because it “consists of outlays on additions to the fixed assets of the economy plus net changes in the level of inventories” (WB).
• Human Capital

Most scholars agree that human capital plays a major role in a country’s economic growth. However, it is difficult to find a good proxy for this variable. The most common variable used in literature as a proxy for human capital is secondary school enrollment as percentage of the population aged 15 or over. This variable is excluded from this research because there is not enough data to include it.

• Government Expenditure

General government final consumption expenditure is used as a benchmark of government expenditure. This benchmark shows the effects of government expenditure on economic growth. The source of the data of this variable is the World Bank.

• Economic Freedom

Charles Koch Institute defines economic freedom as “the key to greater opportunity and an improved quality of life. It’s the freedom to choose how to produce, sell, and use your own resources, while respecting others’ rights to do the same.” It is one of the crucial factors that improve prosperity, well-being, and quality of life of individuals. High levels of economic freedom in a society lead to higher incomes (Economicfreedom.org). Fraser Institute is the data source for this variable.

• Foreign Direct Investment

This paper uses foreign direct investment, net inflows (percentage of GDP) as a proxy for foreign direct investment (FDI). Foreign direct investment refers to direct investment equity flows in the reporting economy (WB). The FDI data source is the World Bank dataset.
5. Methodology

The research uses panel data for the time period of 2002-2013 to investigate the impacts of governance and other economic growth determinants on economic growth of six non-oil-exporting MENA countries.

In this paper, we work with the following equation:

\[
\text{Growth}_{it} = \varepsilon_0 + \varepsilon_1 \text{govexp}_{it} + \varepsilon_2 \text{inv}_{it} + \varepsilon_3 \text{fdi}_{it} + \varepsilon_4 \text{ecofree}_{it} + \varepsilon_5 \text{gov}_{it} + \lambda_{it}
\]  

(1)

Where, the subscript \(i\) (=1,⋯, n) represents country and \(t\) (= 1,⋯,T) the period (years.) \(\text{Growth}_{it}\) indicates annual percentage growth rate of GDP per capita, \(\text{govexp}_{it}\) represents general government final consumption expenditure (percentage of GDP), \(\text{inv}_{it}\) denotes gross capital formation (percentage of GDP), \(\text{fdi}_{it}\) is foreign direct investment, net inflows (percentage of GDP), \(\text{ecofree}_{it}\) refers to economic freedom index, \(\text{gov}_{it}\) symbolizes the average of governance indicators, and \(\lambda_{it}\) stands for the error term.

The main goal is to determine whether the average of governance indicators has a significant effect on the economic growth. That is, to test whether \(\varepsilon_5\) is statistically significant or not.

The results can be found by using different models such as OLS, fixed effect, or random effect. In this paper, however, we use fixed and random effects. Then, the Hausman test is used to determine the best model that fits this study.

Propositions

Based on the literature, this paper develops the following hypothesis:

**Proposition 1: Economic Growth and Governance**
There is a strong argument whether the effect of governance on economic growth is positive or insignificant. However, this study assumes that better governance lead to higher economic growth (Kaufmann and Kraay, 2002). Thus, $\varepsilon_5 > 0$ is tested against the null hypothesis $\varepsilon_5 = 0$.

**Proposition 2: Economic Growth and One-Year Lag Governance**

The effects of governance reform may not appear immediately after implementing a new policy or making a new law. However, governance impact on growth might take time to be noticed and become conspicuous. Therefore, checking the impact of one-year lag governance on economic growth is highly important. This study tests the null hypothesis $\varepsilon_5 = 0$ against the alternative $\varepsilon_5 > 0$.

**Proposition 3: Economic Growth and Investment**

Solow model (1956) indicates that domestic investment is a sign of high savings and resources of economic growth. Since the domestic investment is used in this paper, it is assumed that investment will have a positive impact on the growth. Therefore, $\varepsilon_2 = 0$ is verified against $\varepsilon_2 > 0$.

**Proposition 4: Economic Growth and Economic Freedom**

Many studies have shown that there is a high correlation between growth and economic freedom. They show evidence that economic freedom environment will attract the necessary inputs that will help to boost the growth (Gwartney, Lawson, and Block, 1996). As a result, this paper assumes that economic growth has a positive impact on growth. In other words, a null hypothesis $\varepsilon_4 = 0$ is verified against $\varepsilon_4 > 0$. 


**Proposition 5: Economic Growth and Government Expenditure**

On one hand some studies have shown that there is no significant association between government expenditure and economic growth. On the other hand, other studies have shown that there is a negative relationship between the two variables (Barro, 1991). In this study we test the null hypothesis $\varepsilon_1 = 0$ against the alternative hypothesis $\varepsilon_1 < 0$.

**Proposition 6: Economic Growth and FDI**

A considerable argument among scholars is taking place about the relationship between the growth and the FDI. On one hand, Alfaro’s (2003) study has shown that the relationship between the two variables is ambiguous. On the other hand, Forte and Mora’s (2010) study concludes that FDI has a positive effect on economic growth. Moreover, Hermes and Lensink (2003) argue that the two variables are significantly positively correlated, given that the recipient country of the FDI has developed its financial system. Thus, this study hypothesizes that $\varepsilon_3 = 0$ against the alternative hypothesis $\varepsilon_3 > 0$.

6. **Data, Summary Statistics, Results and Economic Insights**

6.1 **Data and Summary Statistics**

The Table 5.1 displays the descriptive statistics for each variable.
Table 1: Summary Statistics

<table>
<thead>
<tr>
<th>Variables</th>
<th>Observations</th>
<th>Mean</th>
<th>Standard Deviations</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP per Capita Growth (Annual Percentage)</td>
<td>72</td>
<td>2.89</td>
<td>2.48</td>
<td>-6.00</td>
<td>7.88</td>
</tr>
<tr>
<td>Overall Governance Score</td>
<td>72</td>
<td>-0.09</td>
<td>0.36</td>
<td>-0.91</td>
<td>0.64</td>
</tr>
<tr>
<td>Investment (Percentage of GDP)</td>
<td>72</td>
<td>23.40</td>
<td>5.62</td>
<td>14.18</td>
<td>38.12</td>
</tr>
<tr>
<td>General Government Final Consumption Expenditure</td>
<td>72</td>
<td>17.61</td>
<td>4.30</td>
<td>10.89</td>
<td>26.76</td>
</tr>
<tr>
<td>(percentage of GDP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Direct Investment, net inflows (Percentage of GDP)</td>
<td>72</td>
<td>4.12</td>
<td>4.01</td>
<td>-0.20</td>
<td>23.54</td>
</tr>
<tr>
<td>Economic Freedom</td>
<td>72</td>
<td>6.74</td>
<td>0.65</td>
<td>5.48</td>
<td>7.91</td>
</tr>
</tbody>
</table>

The first row suggests that on average the GDP per capita growth (annual percentage) is nearly 2.89%. However, the lowest is negative -6.00% (Turkey, 2009), the highest is about 7.88% (Turkey, 2004), and the standard deviation is nearly 2.48. The second row confirms that the average of governance overall score is approximately negative 0.09. Besides, the lowest score is negative 0.91 (Egypt, 2013), the highest score is about 0.64 (Israel, 2011), and the standard deviation is nearly 0.36.

The third row supports that on average the score of voice and accountability is approximately negative 0.48. However, the lowest score is about negative 1.37 (Tunisia, 2010), the highest is around 0.76 (Israel, 2006), and the standard deviation is nearly 0.61. The fourth row confirms that on average the score of rule of law is about 0.17. Moreover, the lowest score is negative 0.60 (Egypt, 2013), the highest score is 1.06 (Israel, 2002), and the standard deviation is about 0.39.
The fifth row displays that the average score of regulatory quality is nearly 0.16. In addition, the lowest score is negative 0.70 (Egypt, 2013), the highest score is 1.32 (Israel, 2011), and the standard deviation is approximately 0.49. The sixth row presents that on average the score of politic stability is about negative 0.67. Furthermore, the lowest score is about negative 1.62 (Israel, 2009), the highest is nearly 0.31 (Tunisia, 2003), and the standard deviation is negative 0.67.

The seventh row exhibits that the mean of government effectiveness score is about 0.23. In addition, the lowest is negative 0.89 (Egypt, 2013), the highest is approximately 1.37 (Israel, 2010), and the standard deviation is nearly 0.55. The eighth row shows that the average of control of corruption score is almost 0.3. Additionally, the lowest score is negative -0.71 (Turkey, 2002), the highest is almost 1.29 (Israel, 2002), and the standard deviation is nearly 0.48.

The ninth row proves that the mean of investment or gross capital formation (percentage of GDP) is nearly 23.40%. Besides, the lowest is about 14.18 (Egypt, 2013), the highest is almost 38.12% (Morocco, 2008), and the standard deviation is approximately 5.62. The tenth row approves that general government final consumption expenditure (percentage of GDP) average is about 17.61%. However, the lowest is nearly 10.89% (Egypt, 2008), the highest is 26.76% (Israel, 2002), and the standard deviation is about 4.30.

The eleventh row confirms that foreign direct investment, net inflows (percentage of GDP) mean is approximately 4.12%. Furthermore, the lowest is less than -0.20% (Egypt, 2011), the highest is almost 23.54 (Jordan, 2006), and the standard deviation is about 4.01. The last row shows that on average economic freedom score is almost 6.74. Besides, the lowest is about 5.48 (Turkey, 2002), the highest is nearly 7.91 (Jordan, 2013), and the standard deviation is approximately 0.65.
Results and Economic Insights

6.2 Economic Growth, Overall Governance, and One-Year Lag Overall Governance

Table 2: Economic Growth, Overall Governance, and One-Year Lag Overall Governance

<table>
<thead>
<tr>
<th>Variables</th>
<th>Primary Model</th>
<th>One-Year Lag Overall Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Observations</td>
<td>72</td>
<td>66</td>
</tr>
<tr>
<td>Number of Groups</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Constant</td>
<td>10.38***</td>
<td>11.59***</td>
</tr>
<tr>
<td>(3.87)</td>
<td></td>
<td>(4.24)</td>
</tr>
<tr>
<td>General Government Final Consumption Expenditure</td>
<td>-0.33***</td>
<td>-0.32**</td>
</tr>
<tr>
<td>(0.12)</td>
<td></td>
<td>(0.13)</td>
</tr>
<tr>
<td>Investment</td>
<td>0.14**</td>
<td>0.14**</td>
</tr>
<tr>
<td>(0.06)</td>
<td></td>
<td>(0.06)</td>
</tr>
<tr>
<td>Foreign Direct Investment, net inflows</td>
<td>0.26***</td>
<td>0.27***</td>
</tr>
<tr>
<td>(0.08)</td>
<td></td>
<td>(0.08)</td>
</tr>
<tr>
<td>Economic Freedom</td>
<td>-0.83</td>
<td>-1.04</td>
</tr>
<tr>
<td>(0.63)</td>
<td></td>
<td>(0.68)</td>
</tr>
<tr>
<td>Overall Governance</td>
<td>3.16***</td>
<td>------</td>
</tr>
<tr>
<td>(1.15)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>One-Year Lag Overall Governance</td>
<td>------</td>
<td>3.34**</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(1.31)</td>
</tr>
<tr>
<td>R squared within</td>
<td>0.30</td>
<td>0.30</td>
</tr>
<tr>
<td>R squared between</td>
<td>0.84</td>
<td>0.84</td>
</tr>
<tr>
<td>R squared overall</td>
<td>0.33</td>
<td>0.32</td>
</tr>
<tr>
<td>Wald Chi2 Value</td>
<td>32.89***</td>
<td>27.97***</td>
</tr>
</tbody>
</table>

Note: Model is based on Random Effect Method. Furthermore, *=10% significance; **=5% significance; ***=1% significance. Standard errors are in parentheses below the estimated coefficients.

Table 5.2 shows that the overall governance and one-year lag overall governance are highly positively associated with economic growth holding other control variables constant. A potential inference of this highly significant impact of overall governance might be the lack of governance from which the region, in general, suffers compared to the economic achievement. We can therefore conclude that governance in MENA countries is a binding constraint, as it was suggested
by Rodrik (2008). As noted, many factors might be behind the failure of MENA countries’ governments to implement better governance policies in order to boost their economic growth. For instance, governments implement economic policies that cause distortion of resource allocation; absence of democracy and political freedom cause a lack of accountability (Emara and Jhonsa, 2014).

Furthermore, the lack of governance might be explained in terms of geography. In fact, there is a strong association between the quality of governance and the geographical location of the country. For instance, the quality of governance in Europe is good, in Africa is poor, and in Asia and South America is somewhere in the middle. One possible explanation for that might be that each country is influenced by the performance of its neighbors (Huther and Shah, 2005).

In addition, another reason that may explain the lack of governance is the “government orientation.” If a government focuses on serving its citizens, that will minimize corruption, bureaucracy, and rent seekers. It will also compel accountability through the fair decisions made by policymakers. Such an orientation is lacking within MENA countries (Huther and Shah, 2005).

Another reason that might explain the lack of governance in this region could be the strong interest and intervention of foreign powers in the region. These foreign powers have played a dominant role in hampering the development of most of the accountable and inclusive systems because of the high benefits and alliances, in general, they get from the authoritarians regimes (Casero, 2003).

Many policies can be suggested to MENA countries to be implemented in order to bridge the gap of governance. According to Casero (2003), any plan that is made to enhance governance
in the region should take into account the values of inclusiveness and accountability. Casero argues that the first value refers to different basic rights, such as the right to equality before the law, the right to equal treatment by government agencies, and the right to participate in governance process, all of which should be included in all elements of a program. For accountability, the author contends that any program should be designed using transparency and contestability as guidance in the whole process.

Moreover, the model suggests that foreign direct investment (net inflows) has a positive impact on economic growth. However, it is moderately different from zero. Such a result is not surprising because of the small amounts of the FDI the selected countries received during the period of the study (Bashir, 1999).

Nevertheless, general government final consumption expenditure has a negative and statistically significant effect on economic development. This adverse impact of government expenditure on economic growth is consistent with earlier empirical studies (Landau, 1983; Barro, 1991; Abu-Bader and Abu-Qarn, 2003). Governments of non-oil exporting MENA countries have played an important role in their economies through different means, such as the control of resources, the contribution of these government in the total production, and their effect on economic incentives. These governments have invested almost in all economic sectors (Eken et al, 1997). This implies that government spending is neither rational nor productive. In other words, corruption is the main problem. For instance, in Morocco, the elected politicians benefit from the widespread corruption and bribery and use tenders to pass deals either to the bidder who offers bribes or to a relative bidder. Also, when a new government is elected or designated, the new government would replace office supplies, although the previous ones are still in good shape.
Moreover, our findings indicate that investment is positively associated with economic growth and statistically significant at a level of 10%. However, the coefficient is moderately different from zero. Such a result was found by Artadi and Sala-i-Martin (2003). They have shown that even though a slight increase in investment might be emanating from some reforms implemented in the last few decades, which led to a tenuous growth rate, the level of the investment is too low to help to boost and to improve the growth over the next decades. This implies the existence of incomplete crowding out of private investments.

Conversely, economic freedom is not significant in this model, which is different from what was found by previous studies (Ramzi et al, 2013; Panahi et al, 2014). On one hand, a potential reason of this result might be the small number of the observations in our model. On the other hand, trade openness, which in previous studies was found to have a minimal impact on economic growth, is one of the components of economic freedom used in this paper. Since oil-importing MENA countries are not industrialized countries, the biggest share of their exported goods is composed of low elastic products. Moreover, the exportation of low elastic products is not affected by the degree of trade openness of a country. Therefore, it is possible that the relative importance of trade openness has a biased economic freedom result.

7. Conclusion

This research paper explores the impact of governance and other growth determinants on economic development. The research has important policy recommendations:

First, governance can strongly explain the economic growth of the selected MENA countries in the long run. Therefore, as governance can generate growth through the channels of economic freedom and foreign direct investment, policymakers should give priority and attention
to governance so as to achieve higher growth rates. Second, MENA countries should also focus on investment and foreign direct investment inflows because these two factors can accelerate economic development in the region. Conversely, governments should reduce government spending on final consumption because over spending reduces the income of a country. Ultimately, economic freedom is not related to economic development in our study.

These conclusions are subject to a number of limitations. Firstly, using the average of the six indicators of governance may bias our results because the relative weight of each indicator might be different from one country to another. Moreover, this study focuses on the selected non-oil-exporting MENA countries. Thus, these results might conflict with others’ results if their research combines oil-exporting and oil-importing countries in their sample. The small number of observations might be a limitation in this study that could further impact our results. Therefore, these results should be taken cautiously.

Since this study focuses on how overall governance generates economic growth, future research should be done to explore how each of the governance indicators affects economic development in order to determine which one has the largest impact on the growth.

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