Causal Linkage between Political, Economic, Institutional Governance & Economic Growth: An evidence from the selected GCC Countries

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ABSTRACT

The current study measures the causal relationship between governance and economic growth in GCC countries from 2001 until 2016 with Granger causality. This study found the economic governance and institutional governance are significant to the GCC economic development, while the political governance is not significant. There is bidirectional causality between institutional governance and growth. Evidence of bidirectional causality between economic governance and growth in GCC countries also implied the liberalisation of the market matters for their economic development. In other words, although political governance does not cause economic growth, the finding of unidirectional causality from institutional governance and political governance suggest that the political leaders might influence the democracy of the GCC countries. A major policy implication emanating from the findings was that the economic governance and the institution's governance were crucial to the achievement of sustained economic growth in GCC countries due to the reinforcing effect. However, both economic governance and institution governance are independent of each other.

Keywords: *Governance, Economic Growth, Granger Causality, GCC Countries.*

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INTRODUCTION

Government's institutions are the compass of any developmental, social, or economic policy. In the current time, there is a growing realisation among international development experts that quality of governance is vital for development (Asongu, 2017). The performance of government entities is very crucial due to its over-reaching impact on different aspects of economic development. Furthermore, the level of economic growth and development is much reliant on the effectiveness and quality of governments. According to North (1990), governmental institutions and entities can be defined as humanly-devised constraints which mould people interactions, and influence and shape the incentives of economic operators. In the presence of good governance; there are higher chances of prospering economic growth due to the promotion of more competent divisions of labour, faster implementation of economic and social policies, and more productive investments (Alam, Kiterage, & Bizuayehu, 2017).

A socially accountable government that is efficient and effective in services delivering and responsive to the needs of its people will eventually establish and generate a democratic atmosphere leading to the comprehensive human development and economic growth (Emara & Chiu, 2016). In the same vein, good governance indicates to secure contracts, protected property rights, valued human rights, less corruption, efficient and effective administration, democratic political environment and global solutions to promote and boost the economic development processes (Fraj, Hamdaoui, & Maktouf, 2018; Kurtz & Schrank, 2007). On the other hand, most experts unanimously coincide that malgovernance and political governance (corruption) are amongst major obstacles of the economic and social development in the developing nation (Kurtz & Schrank, 2007). In recent decades, economic historians and experts in the field have started to assert the significance of effective government institutions management with the interactions of the country citizens. An effort of restriction in political power and lessening of political abuse by the institutional governance in shaping the prospects for economic growth in the country was also taken into account (North, 1991). Moreover, these disputations are also incorporated empirically into cross-country analysis, "e.g., Acemoglu et al., 2001; Hall & Jones, 1999; Rodrik et al., 2004" (Wilson, 2016).

Furthermore, within the last 30 years, government institutions have increasingly attracted the attention and focus of policy-makers, development experts, and researchers. The bulk of theoretical and empirical research expanded over time has concluded that the institutional framework of a nation is vital in shaping the country economic performance (Nawaz, 2015). The crucial role of the quality of governance also demonstrated by anecdotal evidence confirming that nations with a higher quality of governance with scarce resources (Hong Kong, Singapore, and Taiwan) achieved such greater economic growth levels. In comparison to nations with the poor quality of governance but abundant natural resources (Egypt, Syria, Sudan, Libya, Iran, Venezuela, Nigeria, Mexico) (Al Mamun, Sohag, & Hassan, 2017). Thus, government practices and performance both directly and indirectly affect the level of economic growth in a country. Moreover, the World Bank, and The International Monetary Fund, and the United Nations have an accord that good governance is an instrument to achieve certain ends like economic growth (AlBassam, 2013b).

Also, the previous study also suggests that governance provides an explanation on the continuous state of high-income inequality amongst nations as a result of differences in governance or institutions or the rules of the game in society (Al Mamun et al., 2017). In line with that, many researchers, analysts, and scholars have long-established the positive association between improved governance quality and the growth performance (Emara & Chiu, 2016). Likewise, the bulk of literature suggests a positive and strong linkage between government institutions and economic growth (Nawaz, 2015). Similarly, prior study like Fraj et al. (2018) has discovered the governance has a vital role of in stimulating growth development.

Despite the increasing number of empirical studies on the link between governance and economic growth, there is a paucity in the literature which has yet to examine the causality of the GCC region governance and the economic growth. Thus, the literature of further analysis is required to understand the effects of the different domains of governance such as political governance, economic governance, and institutional governance on economic growth in the GCC countries. To this end, this study is to examine the causal association between economic growth and political, economic, and institutional governance in the selected GCC economies over the 2001-2016 period with a reliable dataset of composite ratings from the World Bank Governance Indicator. The finding of this study will thus provide the governance and utilisation of resources as the right stimulant of economic growth in the GCC countries.

In the remaining article, section 2 discusses the literature review on the nexus and causal relationships between governance and economic growth. Section 3 continues with the methodology of this study and followed by Section 4 with the discussion of the results. Finally, Section 5 concludes the finding of this article.

LITERATURE REVIEW

For decades, the notion of governance has been rigorously discussed in public administration and political science research. Governance has been depicted as an alternative to the conventional methods of governing. In the traditional approach to governing, governments have the upper hand in the process of decision-making (AlBassam, 2013b). Kaufmann and Kraay (2002) provided one of the most used definitions of governance in the earlier literature which dealt with questions of public institutions effectiveness. In their analysis, the authors noted that the government relies on institutions to manage and organise its public affairs.

Governance can be portrayed as the capacity of governments to respect property rights, to guarantee the efficiency of services, and to manage resources. Also, it also establishes institutions that manage the linkage between social and economic interactions and enables effective regulatory policies. In other words, governance is a multi-dimensional concept insofar as it covers and touches various areas of political actions such as democracy, violence, fight against corruption, regulation and law enforcement, and effective management of public affairs (Fraj et al., 2018). On the other hand, economic growth is defined as the increase of real gross domestic product (GDP) or other measurements of aggregate income. According to the World Bank (2004), "economic growth is quantitative change or expansion in a country's economy" (AlBassam, 2013b).

Nevertheless, the manner in which an economy accomplishes long-term and steady growth continues to be a mostly inexplicable phenomenon. In a typical growth model, the immediate factors of economic growth are labour, productivity, and capital. Many important features of the economy namely: population, geography, trade, governance, culture, and institutions have been described as causing disparities in economic growth across countries (Alam et al., 2017).

The causal link between governance and economic growth continues to be a matter of reality even it has been an issue under study for several decades. Currently, these concepts have increasingly become important for regional and international organisations, development agencies as well as for the political economy. It is important to realise that this field is essentially concerned with the examination and analysis of the systems of governance across countries. In this context, the decisive role of governance whatever its nature (bad or good) has been emphasised by the World Bank since the 1990s. Since then, governance resembles the effectiveness of the state to develop institutions which can organise and manage markets (Fraj et al., 2018). Hall and Jones (1999), suggest that government policies and government institutions shape the economic environment in which firms accumulate capital and produce output, and individuals accumulate skills. Whereas good government by its efficient provision of social goods and infrastructure that protects against diversion, can enhance economic growth, bad government by its confiscatory taxation, expropriation, and bad laws and regulations can generate public diversion in an economy (Alam et al., 2017).

Previous studies have produced various evidence which established the connection between governance and economic growth across different countries. The economic growth has been linked to governments practices and the way governments govern both directly and indirectly. Researchers and scholars argue that a solid connection exists between economic growth and governance. However, it is controversial whether economic growth leads to good governance or whether good governance practices lead to economic growth (AlBassam, 2013b). Other researchers argue that both potential directions of causality between the quality of governance and economic growth have supporting evidence in the previous empirical and theoretical literature. By first looking at the impact of governance on economic growth, we can find several potential channels through which causality may function (Wilson, 2016). There are some empirical examinations, based on the WGIs which have scrutinised the effect of governance on economic growth; most of these studies indicated that governance significantly affects the economic growth. For instance, Dollar and Kraay (2002) and Rigobon and Rodrik 2005) studies both suggest and provide evidence to support that the rule of law has a significant impact on economic growth.

Similarly, Kaufmann et al. (1999), in their study which was based on the KKZ indicators found that good governance is advantageous for economic growth (Kaufmann, Kraay, & Zoido-Lobaton, 1999). Meanwhile, De Groot et al.

(2004) in the similar study also based on the KKZ indicators have found that in democratic nations, the regulatory quality has a positive impact on both economic growth and trade (De Groot, Linders, Rietveld, & Subramanian, 2004). Similarly, Easterly and Levine (2003), using the average of six KKZ indicators, proposed that governance has a positive impact on per capita income (Easterly & Levine, 2003). Likewise, Méndez-Picazo et al. (2012), found that four indicators of WGIs "voice and accountability, government effectiveness, the rule of law, and control of corruption" to have a positive effect on economic growth (Méndez-Picazo, Galindo-Martín, & Ribeiro-Soriano, 2012). Moreover, Jalilian et al. (2007) in their study, found that government effectiveness and the regulatory quality of WGIs have a significant positive effect on the GDP per capita in developing nations (Jalilian, Kirkpatrick, & Parker, 2007). In addition, Alam et al. (2017) in their investigation used a system GMM method to examine the effect of government effectiveness on the economic growth of a panel of 81 nations; the results of the study suggested that government effectiveness has a significant and positive effect on economic growth (Alam et al., 2017). However, in a study on twelve Asian countries by Huang and Ho (2017), the authors used a frequency domain method to examine whether a Granger causality running from governance to economic growth exists in these Asian countries from 1996 to 2014. Their results showed that except South Korea, other countries showed no significant causality running from most dimensions of governance to economic growth (Huang & Ho, 2017).

On the other hand, economic growth has also been linked to governance improvement (Albassam, 2013a; Furubotn & Richter, 2005; Kaufmann, Kraay, & Mastruzzi, 2007; Mantzavinos, 2001). Garcia-Sanchez et al. (2013) analysed the effectiveness of the entire governments of 202 countries for the period 2002–2008 using GMM estimator for panel data models. The evidence obtained showed that Economic development is among the determinants of government effectiveness(Garcia-Sanchez, Cuadrado-Ballesteros, & Frias-Aceituno, 2013). Also, (Przeworski, Alvarez, Cheibub, & Limongi, 2000) think that economic development affects political stability. (Kaufmann et al., 1999), and (Adams & Mengistu, 2008) suggest that better-developed nations tend to have greater political stability than less-developed countries. Furthermore, governing processes are affected by economic crises (Furubotn & Richter, 2005; Smith, 2007). Moreover, Wilson (2016) tested the causal relationships between the quality of governance and economic growth at the provincial level in China during the post-Mao reform era by exploiting the wide cross-provincial variation and rapid change over time in governance institutions and economic performance in China during this period (covering 1985–2005). Using new heterogeneous Granger causality tests that allow for potential differences in the causal relations across provinces, a significant and positive effect of economic growth on subsequent quality of governance, largely driven by growth in the secondary sector (Wilson, 2016). Also, Kurtz and Schrank (2007) argue that evidence suggests that there is far more reason to believe that growth and development spur improvements in governance than vice versa (Kurtz & Schrank, 2007).

Finally, the disparities in physical capital, human capital, and technology are only proximate causes in the sense that they pose the next question of why some nations have less developed physical and human capital, physical, and technology and why some of these nations make poor and inefficient use of their opportunities and factors. Thus, to reach more reasonable answers to questions of why some nations are much richer and developed than others and why some nations grow and prosper much faster than others, we must search for potential vital causes, which may be underlying these proximate differences across (Acemoglu & Robinson, 2010). This study sought to examine the causal relationship between governance and economic growth in the GCC region over the period 2001-2016 with Granger causality to contribute to the body of knowledge and provide practical contribution into the question of economic growth and governance determinants. The purpose of this study is to provide empirical evidence on the causal linkage between these two substantial determinants of human development in a region where empirical studies are very scarce. According to Mehanna et al. (2010), “the issue of causality between governance and economic development is crucial and has many implications from an international agency perspective; resolving this issue would assist international organisations in their choices between prioritising pro-growth or institutional policies” (AlBassam, 2013b, p. 123).

METHODOLOGY

This study with a panel-data set that is covering the selected GCC (Bahrain, Oman, Qatar, Kuwait, and KSA) countries, over the annual data from 2001-2016 to examines the causal nexus between Politics, Economic, and Institutional Governance and economic growth. For these five countries in the GCC and data selection, it is based on the availability of data, which is published. This study will use the composite rating data sets from the World Bank’s Governance Indicators that developed by Kaufmann, Kraay, and

Zoido-Lobatón (2000) and further description on the data is elaborated in the data sets. This study used individual components rather than the whole of the indicators. Firstly, it is subjective by nature as the derivation scores are computed from the country experts, and secondly, the components had been taken out to best suit the area of this study in GCC countries. The concept of economic governance will be proxy by government effectiveness, institutional governance will be proxy by corruption control, and political governance will be proxy by voice and accountability.

The current empirical analysis relies on a functional relationship that can be expressed as shown in Equation [1]:

$$GDP = f(VA, GE, CC,) \qquad [1]$$

where the *GDP* denotes growth, *VA* represents voice and accountability, *GE* represents government effectiveness, and *CC* is corruption control.

Testing for Causality

Causality is the idea arguing that the future is not capable of causing the past. However, the past is possible can cause the future (Granger, 1988). According to Granger description of causality, X_t causes Y_t, if Y_t is capable to predict efficiently by employing the past values of X_t. Thus, if previous values X_t considerably add to predicting Y_t that moment, X_t is believed to Grange causes Y_t. Conversely, causality running from the *Y* to the *X* may as well be explained as when previous values of Y_t considerably donate to predicting X_t, at that moment Y_t is supposed to Granger causes X_t. The Granger causality technique considers estimation of the null hypothesis that does Y_t is not caused by X_t and vice versa. Equations [2] and Equation [3] are used in estimating causality:

$$Y_t = \alpha_0 + \sum_{i=1}^{n} \alpha_{1i} Y_{t-1} + \sum_{i=1}^{n} \beta_{1i} X_{t-1} + \varepsilon_t \qquad [2]$$

$$X_t = \beta_0 + \sum_{i=1}^{n} \alpha_{2i} Y_{t-1} + \sum_{i=1}^{n} \beta_{2i} X_{t-1} + \varepsilon_t \qquad [3]$$

where are the error term and the number of lagged variables are presented by *n*. The null hypothesis (H_0), Y_t is not Granger caused by X_t is not accepted if β_{1i} are significant jointly. Similarly, the H_0 that X_t is not Granger caused by Y_t is not accepted is α_{is} are rejected jointly.
The Granger causality method that is proposed in this study is developed

based on extension from Equation [2] and Equation [3] H_0 is represented by Equation [4] and Equation [5]:

$$\Delta GDP_{it} = \alpha_{1i} + \sum_{k=1}^{m} \alpha_{11ik} \Delta GDP_{it-k} + \sum_{k=1}^{m} \alpha_{12ik} \Delta \mathrm{GE}_{\mathrm{it\text{-}k}} + \varepsilon_{1it} \quad [4]$$

$$\Delta GE_{it} = \alpha_{2i} + \sum_{k=1}^{m} \alpha_{21ik} \Delta GE_{it-k} + \sum_{k=1}^{m} \alpha_{22ik} \Delta \mathrm{GDP}_{\mathrm{it\text{-}k}} + \varepsilon_{2it} \quad [5]$$

$$; i = 1, \ldots, N \text{ and } t = 1, \ldots, T$$

Where Δ denotes a first difference operator, k = 1,…,m represents as the optimal lag length as suggested by the Final prediction error and Akaike information criterion,α_{ji} (j=1,…,2) is the fixed country effect, and *GDP* denotes the real gross domestic product and *EG* denotes the indicators of Government effectiveness, and ε is the random disturbance term that is assumed to be uncorrelated with zero means. The standard panel Granger causality developed by Granger (1969) is compatible with homogenous panels and considers all the intercept and the slope coefficients to be the same.

DISCUSSION

The following segment as in below Table 2 aims to reveal the outcomes regarding the causality direction between political, economic, and institutional governance with economic growth in the selected GCC countries.

Table 2 revealed that despite there is no evidence of political governance and the growth, evidence of bidirectional causality between economic governance and institutional governance with growth were found in GCC countries. Both growth and economic governance have the reinforcing effect on each other. Likewise, growth and institutional governance also have the reinforcing effect on each other. Indeed, Hvidt (2011) posit that GCC countries have been operating by economic and institutional reforms in building the groundwork of a production-oriented economy.

Furthermore, the management of institutional governance also enhances the political governance of the GCC countries. This study finding of unidirectional causality of corruption control and voice accountability also in agreement Azariadis and Lahiri (2002) where management of corruption control will lead to efficiency of the bureaucrats that have lesser discretionary power and the country citizens in freedom of speech and democratic actions. Thus, suggests that the government of GCC countries that increase institutional governance (corruption control) would have an impact on the political governance (voice and accountability) as well.

Table 2

Pairwise Granger Test Result

Null Hypothesis:	F-Statistic	Prob.	Conclusion
VA does not Granger Cause GDP	0.473	0.702	Zero causality
GDP does not Granger Cause VA	0.217	0.885	
GE does not Granger Cause GDP	2.628**	0.059	Bi-directional causality
GDP does not Granger Cause GE	8.513**	0.000	
CC does not Granger Cause GDP	4.183**	0.010	Bi-directional causality
GDP does not Granger Cause CC	4.515**	0.007	
GE does not Granger Cause VA	0.291	0.832	Zero causality
VA does not Granger Cause GE	1.247	0.301	
CC does not Granger Cause VA	6.468**	0.001	Unidirectional causality
VA does not Granger Cause CC	0.991	0.404	
CC does not Granger Cause GE	0.989	0.404	Zero causality
GE does not Granger Cause CC	0.138	0.937	

Note: ** represents 5 percent level of significance.

This study highlights that along with robust institutional governance and economic governance at the GCC countries will create favourable conditions that enhance economic growth due to the reinforcing effect and the evidence of the bidirectional causality. Evidence of bidirectional causality between economic governance and institutional governance with growth revealed that in the future, the government governance would able to diversify the production of their economy. Admittedly, the policymakers in GCC countries must stress the economic growth as the priority beforehand. Altogether, this study is devoted in having a better understanding of the resources utilisation in GCC countries by empirically showing that the governance of the government regarding economic and institutional does have a reinforcing effect on growth.

CONCLUSION

GCC countries have experienced substantial economic growth in recent years, initiating the path towards the examination of the different determinants of economic development, this study sought to investigate the nexus between governance and economic growth. With a panel data of 5 GCC countries, this study has offered an empirical analysis of the causal relationship between governance and economic growth in GCC countries from 2001 until 2016 with Granger causality. The analysis revealed that the economic governance and institutional governance are significant to the GCC economic development, while the political governance is not significant. The empirical analysis also showed that there is bidirectional causality between institutional governance and growth. Additionally, evidence of bidirectional causality between economic governance and growth in GCC countries also implied the liberalisation of the market matters for their economic development. Furthermore, the finding of unidirectional causality from institutional governance and political governance suggest that the political leaders might influence voice and accountability of the GCC countries development. To sum up, a major policy implication emanating from the findings was that the economic governance and the institution's governance were crucial to the achievement of sustained economic growth in GCC countries. However, both economic governance and institution governance are independent of each other.

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