

Do good governance and Terrorism Distract economic growth? An Evidence from Pakistan

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Abstract: Current study endeavors to examine the effect of terrorism and good governance on economic growth of Pakistan. Quantitative approach has been used and secondary data is collected for the period of 2002-2016. Multiple linear regression is used for the empirical analysis with the help of EVIEWS7 software. This study exposes that good governance indicators containing control of corruption, rule of law and voice and accountability have insignificant impact on GDP. Results may differ by increasing the sample size. Results of the study disclose that number of terrorist attacks have significant and negative impact on GDP%. Terrorist outbreaks have negative impact on the growth of economy. So Government should take proactive measures to switch terrorism. To the greatest of my familiarity, this is the main study which intention is to test the impact of good governance as well as terrorism on economic growth (GDP) in the context of developing country like Pakistan.

Keywords: Terrorism, GDP, Corruption, Rule of Law

Introduction:

Certainly, the nature of governance assumes a pivotal role to encourage a situation for sustainable advancement as well as poverty mitigation particularly for the emerging nations. International Monetary Fund (IMF) communicates its opinion regarding connection among good governances well as economic development, that, “promoting good governance in all its aspects, including ensuring the rule of law improving the efficiency and accountability of the public sector, and tackling corruption can make economies prosper” (IMF, 1997). Economic Growth can be achieved by good governance by generating rigorous business setting. Good governance lessens incidents of bad policy as well as enhances policy execution. According to Kofi Annan “good governance was perhaps the single most important factor in eradicating poverty and promoting development”(UN, 1998).

Keefer (2018) noted that no particular definition for the term “governance” exists. Normally, the term “governance” refers as the way of governing state, association, etc. According to United Nations Development Program (1997) “the exercise of economic, political, and administrative authority to

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manage a country's affairs at all levels. It comprises of mechanisms, processes, and institutions, through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations, and mediate their differences". UNDP (2005) stated "that rampant corruption has the major distributional implications on growth, equity and poverty as well. Corruption causes social disintegration and distorts economic systems; it entails discrimination, injustice and disregard for human self-respect; it imperils the stability of democratic institutions, discriminates in the delivery of government services and therefore violates the rights of the people and the poor in particular. Corruption is considered a failure of institutions, in particular those in charge of investigation, prosecution and enforcement". World Bank (2006) indicated that "Bad governance is associated with corruption, distortion of government budgets, inequitable growth, social exclusion, and lack of trust in authorities". As stated by Besancon (2003), effective performance as well efficient working of government machinery is the outcome of good governance. Bardhan (1997) has stated that corruption, inside conflicts, and over centralization exists in different parts of world. Environment of corruption as well falsifications in economic policy effects from weak governance (i.e. no respect for human rights, corruption, rarity of transparency and ineffectual public administration). The capability of state to execute its roles will be destabilized, if weak governance remains to persist (Abed and Davoodi, 2000). For effective performance of state, good governance is required there. The existence of immense corruption, lack of accountability, poor law and order conditions etc certify the poor governance in a country. The dissimilarity among good in addition bad governance is no discipline to realize. Good governance is legitimacy, responsibility as well as transparent administrative system and rule of law, while bad governance is related to policy making contrasting the rule of law and biased legal system. Gross domestic Product is related to economic growth of a country and this concept is very common since decades, as it is good indicator that is being used to know about the economic health of any country. This notion is being examined with the help of different tools and methods along with diverse dimensions. "**Economic growth** is an increase in the capacity of an **economy** to produce goods and services, compared from one period of

time to another”. Critical goal of every nation is to improve the rapidity of Economic Growth in order to reach economic prosperity. Terrorist sets on making adequate damage of general public, this damage might be in wording of human as well as economic misfortunes. The two sorts of misfortunes uncover the government’s failure to secure nation's resources, in this manner causing a misfortune in the government legality as well as confidence of citizens. Terrorism, through various channels, conceivably influences economic growth as well as these attacks increases insecurity that averts foreign direct investment as well as bonds investments (Abadie and Gardeazabal, 2003, 2008; Enders and Sandler, 1996). Voice and accountability can significantly improve GDP of a country because when everyone is accountable for his/her actions the economy will significantly grow. When rule of law as well as mechanism to control the corruption prevails, it improves economic growth likewise. Everyone in a state follows rules this will help to switch corruption and terrorism equally. When law and order situations are not followed then terrorism and corruption are welcomed by lowering economic growth. Terrorism and GDP goes inversely. Terrorism generates massive damage to the society that ultimately effects the growth of a country.

Three dimensions of good governance are used in this study as per worldwide Governance indicators (WGI) that may include:

- **Voice and Accountability:** It captures that to what extent residents of one state are capable of partaking in the selection of Government. It also refers to freedom of association as well as expression. (WBI)
- **Rule of Law:** It captures that to which extent government as well as citizens know about the law and they follow it.
- **Control of Corruption:** It captures insights that to what degree public authority is being used for private advantage, it also counts petty as well as outstanding practices of the corruption.

1.1: Objectives:

Current study aims to examine the link among governance and economic growth in perspective of Pakistan by also considering terrorism for the period of 2007-2017. Current research aims to concentrate on only three measures of Good Governance according to World Governance Indicators (WGI) that includes “voice and accountability, rule of law and mechanism to control corruption”. Overall perception is that, good Economic Growth as well as Governance will certainly be the outputs as if the “Voice and

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Accountability, Rule of Law and mechanisms for Control of Corruption” exists. And poor growth of an economy will definitely be the output if terrorism subsists.

1.2: Hypothesis:

H1: Voice and accountability has significant effect on Economic Growth.

H2: Rule of law has significant effect on Economic Growth.

H3: Control of corruption has significant effect on Economic Growth.

H4: Terrorism has significant effect on Economic Growth.

2: Literature review:

Good governance is very much important to raise economic growth of the country. If the state is accountable for its actions there will be no frauds and it will help to improve the GDP of that country. In the existence of good governance, the rule of laws will also be followed and corruption can be controlled in a sophisticated manner. According to some research studies governance is positively associated with economic growth and according to some other studies, governance is negatively related to economic growth. Empirical study by Kaufmann, Kraay, and Zoido-Lobaton (1999) who studied the impact of governance on economic outcomes on 160 countries, the results of their study show that good governance have a great impact on economic outcomes.

Another study of Kaufmann and Kraay (2002) for the period 2000/01 on 175 countries showed that quality of governance and per capita income are positively correlated. Huynh and Jacho-Chavez (2009) by using non-parametric test, in their study stated that significant relationship exist between governance and growth. The results of the study show that only 3 “voice and accountability, political stability and rule of law” out of six governance indicators have a significant influence on economic growth. Cebula and Foley (2011) conducted their study on OECD countries for the period of 2003-2006 to test that how quality government regulation affects per capita real GDP, they used PLS and panel data estimation for testing the hypothesis. The findings show the significant positive association among good regulatory quality as well as economic growth.

Emara and Jhonsa (2014) test interrelationship among governance as well as per capita income of 197 countries by using “Two-Stage Least Square

method”. According to them, there is positive as well as significant causation effect of governance on per capita income as well as there is also significant and strong causation effect of per capita income on the excellence of governance. Chauvet and Collier (2004) states that countries with poor quality governance enjoy about 2.3% less GDP per year as compare to other emerging countries. The quality of governance is represented by “rule of law, political freedom and stability as well as civil liberties and human rights”. Henry et al. (1985) in his study, test the link among voice and accountability as well as economic growth. He tested the hypothesis by using correlation model. Results of his study showed positive and significant association among the variables voice and accountability as well as economic growth.

Oraya et al. (2016) conducted the study on east Africa Community to test the relationship among governance as well as economic growth for the period of 1999-2013 by using OLS and Random effect model, results of his study revealed that only “political stability, quality regulatory and control of corruption” were significant. There is negative association among political stability, quality regulation and economic growth and positive association among control corruption and economic growth. In Kenya and Uganda, Voice and accountability effect economic growth significantly. In Kenya as well Tanzania there’s significant effect of quality of regulation on the other hand effect of rule of law was significant merely in Kenya.

Rule of law, is key feature to expand growth of country. Not only establishment of rules but execution of rules is more important.

Corruption does not have positive effect on growth. More corruption lowers the growth of economy. Ahlin and Pang (2008) conduct his research on 71 countries and found that corruption and economic growth and negatively related.

Ehrlich and Lui (1999) plus Meon and Sekkat (2005) according to them corruption negatively effects “business development, economic growth, local and foreign investment and public expenditures”. The course of economic development is harmed by Corruption. Mauro (1995) conducted his research on 67 countries of the world and examined that corruption and economic growth indices are negatively associated.

Bandyopadhyay and Younas (2013) they test the relationship amongst terrorism and the aptitude of developing state to fascinate foreign investment. According to them, terrorism makes the financiers unsafe

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because they are not sure about getting the returns against their investments in future time, investors don't feel safe and they opt for other countries which are free from terrorism in order to make their investments safer.

Ak et al. (2015) test the link amongst economic growth in addition terrorism. Their study illustrates that there is reverse connection amongst terrorism plus economic growth.

3: Data and Methodology:

Secondary data from Pakistan has been collected for the period of 2002-2016 from different sources. GDP data for Pakistan has been taken from the given website (<https://countryeconomy.com/gdp/pakistan>). Data for three governance indicators is extracted from World Governance Indicators (WGI). Terrorism data is collected from Corruption Perception Index (CPI). Dependent variable is economic growth its proxy is GDP growth rate. Independent variable is good governance and terrorism proxies for good governance are control of corruption, voice and accountability as well as rule of law and proxy for Terrorism is no of terrorist incidents. Multiple linear regression is done by using the software EVIEWS 7.

Model:

$$y = \beta_0 + \beta_1x_1 + \beta_2x_2 + \beta_3x_3 + \beta_4x_4 + \varepsilon$$

$$gdp = \beta_0 + CC\beta_1 + RL\beta_2 + VA\beta_3 + TA\beta_4 + \varepsilon$$

Dependent variable:

$$Y = gdp = \text{Annual GDP Growth Rate (\%)}$$

Independent variables:

CC = Control of corruption

RL = Rule of law

VA = Voice and accountability

TA = No of terrorist incidents

ε = Error term

β_0 = Constant

$\beta_1, \beta_2, \beta_3$ and β_4 are coefficients

Results and Discussion:

According to the descriptive statistics, it is observed that total no of observations are 15. Mean score for GDP is 4.49. No of terrorist attacks have highest mean score that is 40.13 the maximum is 144 and minimum value is 8.0. Among other independent variables control of corruption has

lowest mean score that is 18.14 the maximum value is 25.75 and minimum is 13.17. Mean scores for rule of law and voice and accountability are 22.48 and 23.15, congruently. For GDP, control of corruption, rule of law, voice and accountability and no of terrorist attacks skewness is positive meaning that values are on left side.

Multiple linear regression analysis is used to display the link between dependent and independent variables. Dependent variable is annual GDP rate and independent variables are control of corruption, rule of law, no of terrorist incidents and voice and accountability. From 2002 to 2016 total number of observations collected from Pakistan is 15. R^2 defines that 41.7% independent variables explain the variable of interest.

Table 1 shows that, control of corruption has -0.125 impact on economic growth it means that by increasing one unit of control of corruption Annual GDP rate will be decreased by 0.125. Results about the relationship between control of corruption and GDP are insignificant as the p.value is 0.44 which is greater than 5%. Meaning that, there is no impact of control of corruption on Economic Growth in the context of Pakistan because of small sample size. H3 is rejected.

Table 2: Regression analysis:

Dependent Variable: GDP

Variables	Coefficients	P-Values
CC	-0.1254	0.4461
RL	0.0179	0.0535
VA	-0.1468	0.5723
TA	-0.0340	0.0429
C	11.1320	0.0234
R-Squared	0.4173	

Among rule of law and economic growth, slope coefficient is 0.017 which means by increasing one unit of rule of law GDP will increase by 0.017. Standard error is 0.300, by correcting standard error results may turn out to be different. P.value of rule of law is 0.95 which is 95% and it is greater than 5% it does not have any impact on dependent variable GDP. Results may be insignificant because of less no of observations. H2 is rejected.

Voice and accountability has -0.146 impacts on GDP which demonstrates that by increasing one unit of voice and accountability GDP will decreased

by 0.146. Probability value of voice and accountability is also greater than 5% that is 0.57, results are insignificant. There is no relationship between voice and accountability and economic growth. H1 is also rejected.

And if the no of terrorist attacks are increased by one unit, GDP will be decreased by 0.034. Our results show that only number of terrorist attacks has a significant impact on annual GDP rate as the p.value is 0.04 which is less than 5% so number of terrorist attacks is statistically significant and our hypothesis H4 is accepted. It means that more no of terrorist attacks will have negative impact on economic growth. Other independent variables are insignificant. Only H4 is accepted all other hypothesis are rejected.

Conclusion:

Growth paradigm continues to change. The most recent popular expression 'good governance' has persevered for over 10 years. Existing literature maintains requirement for good governance and no terrorism with the aim to improve economic growth of a state. Terrorist outbreaks have a harmful impact on the progress of a nation.in present research, three of governance indicators succeeding from “world governance indicators “alongside with terrorism are being used to illuminate dependent variable “economic growth”. In literature, numerous researchers have patterned the influence oneconomic growth by governance indicators but present research intended to check the effect of governance indicators as well as terrorism on GDP of Pakistan, which is not found in literature to the best of my knowledge.

Empirical outcomes help us to catch that no of terrorist attacks have a significant negative impact on Economic Growth during. Our results validates that terrorism is dangerous for the health of economy. It reduces the economic growth of Pakistan. This Result is consistent with **Ak et al. (2015)** that there is reverse connection among terrorism and Economic Growth.

Centered on empirical results of our study, we find that control of corruption, rule of law, and voice and accountability have insignificant impact on Economic Growth during the period of 2002- 2016. Otherwise speaking, control of corruption and rule of law do not play major role to influence economic growth of Pakistan during the specific time. Hypothesis that was framed for voice and accountability, rule of law and control of

corruption are rejected. This is because in Pakistan there was not a proper mechanism to control corruption rules were not followed properly and people were not accountable for their actions and everything was covered by taking loans and printing more notes, just by having a poor management and window dressing.

Overall, according to our study governance indicators have no impact on economic growth of Pakistan during nominated phase. Limitation of our study is that, sample size is very small that is only 15 observations by intensifying the sample size results will be different and we researcher will find a positive relationship between governance indicators and economic growth. Upcoming research may also consider more indicators of governance and terrorism to test the healthiness of the extant findings. As well as impact of good governance indicators and terrorism should also be checked on different proxies of economic growth.

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