



Research Article

Mediating Role of Good Governance between Debt Management and Economic Performance

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ABSTRACT

No one country of the planet is self-sufficient for financial and non-financial resources. Some have abundant of natural resources while someone have abundant of human resources and so on. Due to scarce of resources a country needs effective and efficient utilization of resources. Effective and efficient utilization of resources depends upon good governance, competent and sincere economic managers. Keeping in view of the said perception, current study examined the role of good governance in the debt management and economic performance. Current study used the World Bank data from the period of 1990 to 2020. Economic performance is measured by the per capita income (PCI) and taken as dependent variable. Whereas, debt to gross domestic product (GDP) is taken as independent variable. While good governance (GG) is taken as mediating variable and measured through The Worldwide Governance Indicators (WGI) project constructs aggregate indicators of six broad dimensions of governance such as voice and accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of Law and Control of Corruption. Econometric equation is developed to measure the direct and indirect effect of GG with respect to debt to GDP and PCI. The study results concluded that there is no relationship between debt to GDP and economic development. While interesting finding is that there is significant relationship between GG and economic performance. Study also found insignificant mediation of GG between debt to GDP and economic development.

KEYWORDS

Good Governance, Debt to GDP, Per Capita Income, Economic Performance, Pakistan

1 | INTRODUCTION

The recent world is changing with new approaches, techniques, methods and setting new trends for economic development. Nothing is constant, up and down occurs frequently in the economies due to globalization. Individuals, Institutions, politics even economics of the world need good governance to grow up better. Due to rapid increase of technology all the economies are exposed. All countries of the globe are highly interdependent on each other. To meet the prevailing demand of society a country required robust economic, political and institutional systems. One of the challenge now-a-days facing by the economies is debt management. Due to economic crises a sharp rise of public debt across the planet. Such rises of public debt creates lot of problems and influence the economic determinants (Feldstein, 1988).

Public debt is an important tool for economies to finance investments in growth and development. At the same time it is also important to service the public debt on time and manage it as a sustainable debt. "Entering into debt distress is often a painful process, which may threaten macro-economic stability and set back a country's development for years."

Public debt becomes compulsory when a country facing the problem of fiscal deficit. Debt stress affects the country GDP, interest rate, high inflation, higher taxes, political instability and inconsistent future policies (Barro 1979; Dotsey, 1994). Currently, it becomes a hot issue for developing and emerging economies. There is a negative effect of public debt on growth and sometime it becomes severe and affects the GDP negatively. Debt management is big problem of developing countries. They don't have good economic managers, always facing political instability, no consistent economic policies. Although, consistent economic growth remain the first priority of every government and they always try to control the level of public debt. Macroeconomic indicators directly linked with the political system. Stable political economies perform well as compared to instable political economies (Haber, North, & Weingast, 2008). Taking debt is not a major issue but its non-productive utilization is a main concern. Such problem occurs due to inability to use public debt, weaker institutionalized system and inconsistent of economic policies (Asiedu 2003; Fata's & Mihov, 2013).

World Bank (WB) introduced the term "good governance" in 1989. Such term gained popularity and is being used in different field of study. No doubt, such concept is playing vital role in all field of study. Especially in the economic development of country it's become indispensable. Without quality of governance no one country can get the target of economic development. Many international bodies are supporting and encoring countries to apply the good governance such as WB, International Monetary Fund (IMF), Organization for Economic Cooperation and Development, Asian Development Bank and so on. Quality governance is a win situation for all the stakeholders of a country. It demonstrates fair play and encourages investment to by protecting the rights both parties. It controls the bad practices and promotes the transparency in a country. Transparency controls the corruption and encourages the fair play. It also promotes the healthy competition among the individuals as well as among the organizations (Fraj, Hamdaoui, & Maktouf, 2001).

Present era is the witness of good governance and many recent studies demonstrate that there is positive correlation ship between good governance and economic development. Therefore, there is a consensus that a country debt management depends upon good governance. Quality of governance makes it possible only through efficient and effective monetary and fiscal policies of a country. Previous researches focus only on economic factors and they test their impact on economic development. Non-economic aspect was missing in previous research. Present analysts and researchers they are more concerned about non-economic factors and their impact on economic development such as quality of institutions and their impact on economic development. Rule of law and its role in economic development, impact of corruption on economic development, ethical concern with respect to economic development. Abilities of economic managers and competencies and sincerity of policy makers may affect the economic development dramatically. Finally, poor governance has many serious concerns about economic development, high ratio of public debt, weak exchange rate with dollar, high unemployment rate, low literacy rate, low economic growth, high level of corruption, and no rule of law, low per capita income, and poor infrastructure (Moshammer, Pierluigi & Masuch 2016).

Keeping in view the above concerns such study examines the mediating role of good governance between debt to GDP and economic development of a country. The prediction of such study is that without good governance no country can get the target of economic development. Next prediction is that high debt to GDP distress the economic development of developing countries.

2 | REVIEW OF RELEVANT LITERATURE

2.1 | PUBLIC DEBT AND ECONOMIC GROWTH

The classical economists like Haug, (1990). Leiderman, & Razin, (1988). highlighted that public debt damages a country's economics. This theory demonstrates that public spending whether acquired by taxation or borrowed is equal. It explains that a country's decision to minimize the tax rate and mobilize the economy. In this way individual can save more and make more investment in different securities. While Ricardo pointed out public debt has impartial influence on economic progression. A Keynesian model of macroeconomic of investment suggested that high public debt will promote high income and high prices in a country which ultimate effect the investment return in the shape of high interest rate. On the other hand monetarists claimed public debt has contrary outcome on economic progression. Moreover, theory of debt recommends that an increasing country's debt with respect to its repayment capability further damage the economic growth along with domestic and international investment (Bal & Rath, 2014).

2.2 | ECONOMIC GROWTH AND GOVERNANCE

Every country of the world wants to accelerate economic growth and it is connected to good governance directly and indirectly (Adam & Mengistu, 2008; Ndulu & O’Connell, 1999). Golberman and Shapiro (2002) economic growth and governance have positive relationship. Good governance not only promotes the economic growth but also unequal distribution of income within country. Good governance is getting attention day by day in all over the world, and it is a big question for developing and emerging economies (North, 1990). Weak and ineffective institutions promote poor political and economic system which ultimate encourage non-productive activities. It is mentioned by Jalilian, Kirkpatrick and Parker (2007) economic development not only stimulate the economic resources but also to promote the institutionalized systems. Ultimate the institutions work for rule of law, low level of corruption promotes harmony and justice. In fact, such norms, and best practices can be seen in developed countries as compared to developing countries (Kaufmann & Kraay 2002; Woo, 2009).

2.3 | GOVERNANCE, DEBT AND ECONOMIC GROWTH

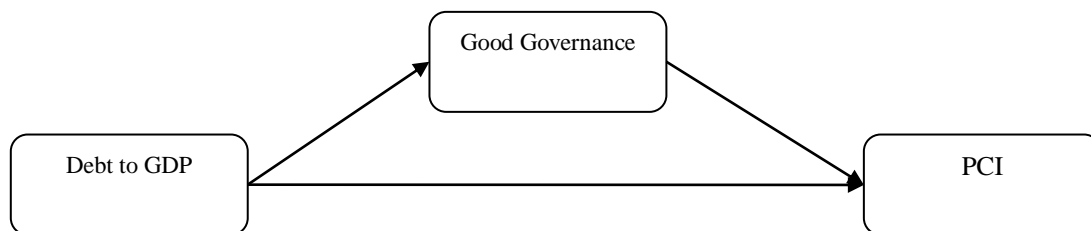
A certain amount of public debt is good for the performance of an economy. And good governance is prerequisite for growth of an economy and vice versa. In this regard the quality institutions play a significant role. It encourages the private investments which ultimate leads to economic development and growth of country (Kaufmann et al., 2005) North (1990) quality institutions prevent corruption, promote transparency, enhance public trust and increase business activities. Business activities generate revenues for government in the shape of tax and get foreign exchange from exports. Lambsdorff (2003) point out that corruption, absence of law, week institutions garbling business activities and enhance the uncertainty in an economy. Such week setup discourages the foreign direct investment and declining the economic growth of country.

3 | METHODOLOGY AND DATA

This scientific enquiry examines the direct and indirect impact of debt to GDP on economic development of two prominent Muslim countries of the world. To measure the direct impact the study analyzes the relationship between debt to GDP (DGDP) and economic development through simple regression and correction. Whereas, indirect impact the study investigate the mediating role of good governance (GG) between debt to GDP and economic development. For the said purpose economic development is taken as a dependent variable and measured through GDP to Per Capita Income (PCI).

Debt to GDP is taken as independent variable and measured through ratio. Good governance is considered as mediator and measured through Worldwide Governance Indicators (WGI) index. WGI consists of six variables such, voice and accountability, political stability and violence, government effectiveness, rule of law, regulatory quality and control of corruption. All six good governance variables are defined a range from -2.5 to +2.5. This study uses the average of these six variables to modify a new index. The greater the mean value means better governance and vice versa.

Data are collected from International Monetary Fund (IMF) over the period of 1980 to 2020 for PCI and debt to GDP. Good governance index is taken from World Bank (WB) WGI. The study measures the direct effect (c) by bivariate regression between DGDP and PCI and indirect effects (a*b) by multiple regression. Step1, direct affects of DGDP and PCI by bivariate regression. Step 2 direct effects by bivariate regression between DGPD and GG. Step 3 direct effects of DGDP and GG on PCI. Step 4, Sobel test uses to test the indirect effect for statistical significance of mediation (GG) between DGDP and PCI. of and indirect effect (a*b) by multiple regression.



This study uses four equations to measure the mediating effect.

$$Y_{it} = \beta_0 + \beta_1 DTG + \varepsilon \tag{1}$$

Where Y indicates per capita income, β_0 represents to constant and β_1 indicates to debt to GDP of country i, and time period t.

$$Y_{it} = \beta_0 + \beta_1 DTG + \varepsilon \tag{2}$$

Where Y indicates good governance, β_0 represents to constant and β_1 indicates good governance of country i, and time period t.

$$Y_{it} = \beta_0 + \beta_1 PCI + \varepsilon \tag{3}$$

Where Y indicates good governance, β_0 represents to constant and β_1 indicates per capita income i, and time period t.

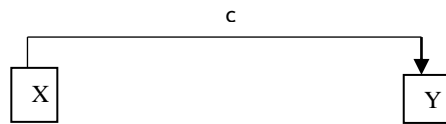
$$Y_{it} = \beta_0 + \beta_1 PCI + \beta_2 GD + \varepsilon \tag{4}$$

Where Y indicates per capita income, β_0 represents to constant, β_1 debt to GDP, β_2 indicates good governance and ε is an error term for country i, and time period t.

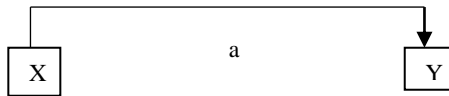
4 | ANALYSIS AND INTERPRETATION

Mediation steps along with visuals (Baron and Kenny)

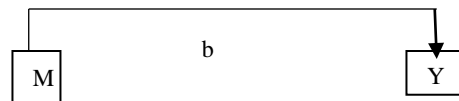
- | Steps | Analysis |
|--------|---|
| Step 1 | Conduct a simple regression with X predicting Y to test for path c alone, $Y = \beta_0 + \beta_1 X + \varepsilon$
Visual Depiction |



- | | |
|--------|---|
| Step 2 | Conduct a simple regression with X predicting M to test for path a, $M = \beta_0 + \beta_1 X + \varepsilon$ |
|--------|---|



- | | |
|--------|---|
| Step 3 | Conduct a simple regression with M predicting Y to test the significance of path b alone, $Y = \beta_0 + \beta_1 M + \varepsilon$ |
|--------|---|



- | | |
|--------|---|
| Step 4 | Conduct a multiple regression with X and M predicting Y to test for path c alone, $Y = \beta_0 + \beta_1 X + \beta_2 M + \varepsilon$ |
|--------|---|

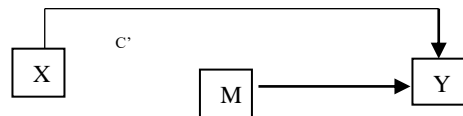


Table 1
Descriptive

	N	Minimum	Maximum	Mean	S.D	Skewness	Kurtosis		
	Statistic	Statistic	Statistic	Statistic	Statistic	Statistic	S.E	Statistic	S.E
PCI	30	546.60	1557.89	9.2335E2	351.66953	.450	.427	-1.363	.833
DTGDP	30	52.50	87.60	67.8800	8.66035	.426	.427	-.135	.833
GG	30	-1.18	-.74	-.9401	.13436	-.068	.427	-1.100	.833

Table 2
Correlations

Variables		PCI	DTGDP	GG
PCI	Pearson Correlation	1		
DTGDP	Pearson Correlation	-.154	1	
GG	Pearson Correlation	-.676**	.421*	1

** . Correlation is significant at the 0.01 level (2-tailed). * . Correlation is significant at the 0.05 level (2-tailed).

The above direct effect table demonstrate the results of F-statistics and regression coefficients. It shows $F(4, 10) = 0.000$, $P < .05$, $R^2 = 0.478$. The overall regression model is significant. The R-squared = 0.478, taken as a set, the predictors DTGDP and GG account for 48% of the variance in PCI. The findings of regression show that there is a statistical insignificant relationship between debt to GDP and economic development. The current study found significant relationship between GG and economic development.

Table 3
Direct Effect

Variables	R	R ²	F-statistics	P	Beta	t-value	Sig
DTGDP	0.691	0.478	2.364	0.000	-.159	-1.040	.307
GG					-0.743	4.849	0.000

Table 4
Indirect Effect

	Regression	R	R ²	F-statistics	Sig	Beta	t-value	Sig
Step-1	IV & DV	.154	.024	.677	.418	-6.238	-.823	.418
Step-2	IV & MV	.421	.177	-6.039	.020	.007	2.457	.020
Step-3	MV & DV	.676	.457	23.5777	.000	-1769.56	4.856	.000
Step-4	IV, MV & DV					-6.476	1.040	.307
		.691	.478	12.364	.000	1945.385	-4.849	.000

Sobel test statistics= 0.690 (Showing insignificant)

The results show no evidence of mediation between debts to GDP and PCI. The study rejected the alternative hypothesis. The results show significant relationship between GG and economic development.

5 | CONCLUSIONS

It has been noted in the previous literature that public debt badly affects the economic growth of country after a certain debt limit level. No doubt, good governance cannot be ignored in stimulating the economic development of country. Keeping in view the above context, the study examines the mediating effect good governance (GG) between debt to GDP and economic development. The study used the sample of two countries during the period of 1990 to 2020 for empirical assessment. The GG data is taken from Worldwide Governance Indicators (WGI). Whereas, debt to GDP and PCI data is taken from World Bank (WB). The study findings show insignificant relationship between debt to GDP and economic development. Pakistan debt to GDP is higher and higher, even that per capita income is very low. The interesting findings are that Pakistan GG is showing significant but negative with respect to economic development. Pakistan can reduce debt burden by good governance. Through good governance it can manage the debt in a better way and can generate positive impact on economic development. All good governance indicators are showing worst in Pakistan. Due to high level of corruption, low level of rule of law, poor implementation of laws, Pakistan is far away from voice and accountability, worst political stability and violence. All these indicators affect the debt and debt adversely effects the economic development. In short, good governance is essential to minimize the adverse outcome of debt and make the effective use of debt in economic development of a country. Poor state government quality and weak institutionalized system is the main cause of adverse of debt on economic development.

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