Analysis the Impact of Good Governance on the Non-Oil Export of Oil Exporting Countries

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Abstract

The importance of governance, legislation, and guidance in achieving the economic growth and development is increasing day by day in scientific and political societies. Nowadays, due to high speed of science and technology production, trade and export promotion policies have a great importance and play a significant role in economic development. The economy of oil-exporting developing countries is largely dependent upon oil revenues which are mostly dominated by the governors. Therefore, the type of governance in these countries has a significant effect on economic growth and development, particularly on trade section. The main purpose of this paper is to investigate the effects of good governance on the oil exporting countries non-oil exports. For this purpose, the impact of good governance which the World Bank defines by six indicators such as: the voice and accountability, political stability, efficiency and governmental effectiveness, financial burden of regulations, rule of law, and corruption control are explained on exports, were studied for the twenty three selected oil exporting countries in 2001-2010 by using regression based on panel data. This research results have indicated that the indicators like the voice and accountability, political stability, efficiency and governmental effectiveness, financial burden of regulations would affect non-oil exports of the mentioned oil exporting countries.

Keywords: Good Governance, Non-Oil Export, Panel Data Regression

JEL classification: *H11, F13*

1. Introduction

During the last decade, Good governance theory was the dominant paradigm of the developed countries and has been used as one of the international indices for investigating and comparing different countries. International aid organization such as IMF, WTO, World Bank, amnesty international and human rights watch has announced good governance as one of the prerequisites of the aids. Good governance is a new pattern for sustainable development. In this pattern much emphasis is placed on cooperation and interaction of different sections of the society, so that the governments can use all their capabilities to progress in all aspects. Good governance is a pattern which is presented by developed countries and international societies in response to the inefficiency of the previous mechanisms of development. This phenomenon has received much attention, particularly in developing countries in order to establish a civil society. Good governance has been defined as a system of values, policies and institutions with which the society handles the economic, political and social issues through the interaction among government, private sector, and civil society. In another definition, good governance includes mechanisms, processes, and civil institutions through which the civil institutions and groups seek their own interest interests, maintain their legal rights and fulfill their commitments (UNESCAP, 2001). Good governance has been proposed for the purpose of achieving sustainable development which emphasizes on poverty reduction, employment, sustainable welfare, protection of ecosystem and women's progress. Good governance also includes sustainable development, urban and rural development and socio-economic progress with clear attitude and dominant features of operating the plans and procedures (UNDP, 2000). Although, the methods of maintaining good governance may be different in different societies, the World Bank introduced the following indices for good governance: voice and accountability, government effectiveness, political stability, regulatory quality, rule of law and control of corruption. These indices determine the general features of economic and social systems of the countries.

Nowadays, many developed countries consider good governance as the only means for development and economic progress. On the other hand, international trade plays a very important, ever-increasing role in the economy of the societies which has led to an increase in the world trade volume and has an important role in the development of the countries. The importance of the non-reliance on oil revenues which strongly affects the economy and government revenues due to the fluctuations and volatility of prices and oil demand in the oil exporting countries has led to the fact that the role of non-oil revenues be introduced far greater than a means for attaining foreign exchange earnings. The problems arising from single-product economy and over reliance on oil revenues will definitely make the economic condition of the country sensitive to foreign factors such as fluctuations in the global oil price. There is no doubt that if the prediction of the countries about the revenues of the government from oil export does not become a reality, not only will it affect the operationalization of different plans and the economy of the countries, but also will affect the future plans and economy in a negative way. Thus, it will lead to many problems in different segments of economy. Therefore, non-oil export has been emphasized by many researches and many studies have investigated it.

Sabbaq Kermany and Basqa (2009) investigated the role of good governance in improving the efficiency of the government revenues on services such as education and health in Islamic countries. The findings showed that the increase in the education and health expanses is not always effective, but in countries with higher quality governance the increase in expenses will have more effect on health and education indices. Sahabadi and Pourjavan (2010), investigating the governance, comparability and economic growth in a population of 101 developing, developed and recently industrialized countries, found that the better the governance, the higher the FDI absorption and that countries which had good governance controlled inflation to a large extent. Through establishing a good balance between the economic growth rate and liquidity growth rate and has imposed the cost of the access to the production factor to the market mechanism. The good governance also leads to the increase in the export of high tech goods in proportion to the whole export and an increase in the proportion of added value of the factory segment to the whole added value. Pakdaman (1998) in his study inserts some indices of good governance under the title of legal and political factors and considers export as a function of economic factors such as growth, income distribution, exchange rate, inflation rate; technical factors such as technology, skilled workforce, management; social and cultural factors such as consumption patterns, population growth; legal and political factors such as political stability, legal system, rules and regulations. Komijani and Salatin (2010) in their study investigated the effect of good governance on economic growth in selected OPEC and OECD countries. They found that there was a significant relationship between good governance and economic growth in both groups and that the effect of the governance index on the economic growth of the OPEC members was more noticeable than on that of OECD countries. Moreover, political stability in the OPEC members and Control of Corruption in OECD members had the largest effect on economic growth. Vijayaraghavan (2002), studying the effect of provision of property rights, democracy, governance and government size on economic growth found that government size and property right provision had significant negative and positive effects, respectively. Mayor (1995), Colegio (1997), Knack (2003), Feng (2003) carried out some researches on good governance and unanimously found that the improvement of the rule of law and control of corruption indices will have a direct effect on economic and human development. In addition, Hans, Georgen Vagner (2004), studying the relationship between governance, change and welfare, found that there was a significant positive relationship between good governance and welfare. Knack and Stephan (2002) found that there is an interactive relationship between governance and economic growth. Chong and Gradstein (2004) studying the relationship between good governance and income equality in 121 developed and developing countries, found that the improvement of good governance will decrease inequality. Baptiste(2004), investigating the effect of bad governance on FDI in Haiti in his study, states that inflation, a proxy for political instability, and lack of political rights and civil liberties index, a proxy for bad governance index and sanctions have a significant negative effect on FDI in Haiti. Butkiewicz et al (2006) investigated the effect of rule of law and democracy on economic growth and found that both indices have a positive effect on it. Filer and lee (2007) states that rule of law has a positive relationship with FDI absorption.

In this study an attempt is made to explore the relationship between good governance and non-oil export and determine which index of good governance has the largest effect on non-oil export, so that some effective suggestions can be given to policymakers. The main questions of this study are as follows: Does the quality of governance have a significant effect on non-oil export of oil exporting countries? Which index of good governance has a largest effect on non-oil export of oil exporting countries?

2. Review of the literature

From the emergence of the science of the economic development, policymaking in developing countries can be divided into three phases: maximum governance, minimum governance and good governance. The first phase began after the World War II and continued up to the end of 1970s. The great depression made the Keynes' ideas dominant on economics and policymaking. Keynes believed that the intervention of the government in economy will be the solution for unemployment and recession. Lewis, the noble winner economist, recommended the policymaking government for the development of modernization and was for government's intervention in different levels, from industry to macro level to local and national levels (Williamson, 2004). From the mid 1990s the dissatisfaction towards the minimum government approach grew and since the late 1990s the good governance approach has received much attention. The international circles who recommended minimum governance have disseminated the theory of good governance, but the main theorists propagating it, were economists such as Douglas North, Ronald Coase and most importantly Joseph

Stieglitz who all were noble-prize winners and follow institutionalism. World Bank, international monetary fund and United Nations investigated this issue from different vantage points. United nation development program and international monetary fund introduced good governance as a key factor for development. According to the definition proposed by United Nations development program, good governance is the management of general affairs based on rule of law, an efficient, fair judicial system and the extensive public participation. The stronger the rule of law, and the more efficient and fairer the judicial systems, and the higher the public transportation, the better the rule of law (Johnson, 1997).

The term good governance was first used in economic literature by Williamson in 1979 and since 1980 it was more widely used. Up to 1989 World Bank focused on restricting the government role in achieving higher economic efficiency in operationalizing the development programs and managing public sector, but in his report in 1989 there is no reference to minimizing the government in relation to the economic crisis and the term good governance was first proposed in the report. The writers of the report specified that the economic crisis was due to governance crisis and ignorance of the clarity-based management was mentioned as an index of bad governance. World Bank expressed the features and qualities of good governance through three variables: selection, dismissal and supervision on governance, the capability of the government for establishing and implementing the policies and the function of people and the dominance over the institution in charge of social and economic interactions. Each of these variables is measured through two general indices. The first index, “Voice and Accountability”, which shows the accountability of government to citizens, is the questions people have for government and the capacity of the government to pay heed to people’s ideas. “Political Stability” index consist of criteria like civil riots, coup de tat, terrors and political executions, ethnic and tribal fights, strike and group quarrels. In the second variable the focus is on the “Government Effectiveness” index which represents the efficiency of governmental institutions, the quality of government officials, the capability of the government in operationalizing the plans, independence of employment and services of political pressures , the quality of public services and policy making for the benefit of business. The “Regulatory Quality index focuses on policies such as tariff and non-tariff barriers, controlling prices and fees and import and export regulations. In the second variable, the “Rule of Law” index can be measured through cost of crime, corruption of bank system, prevalence of black market, the independence of the judicial system, trust in the judicial system and the efficiency of security force. “Control of Corruption” index which shows corruption of managers and officials, corruption of public services, bribery, economic compromise and embezzlement is considered as a criterion.

International monetary Fund has defined 10 standards for financial, banking and monetary systems and the definitions of the standards are presented based on the policy that good governance requires the accountability of the governments and this is not possible without financial transparency. The main step towards financial transparency is defining and operationalizing the standards of recording and disseminating the information. World Bank proposes a more complete body of policies and procedures for improving the governance, competition and accountability whose application in different fields, e.g., politics, economy and society lead to the existence of a big circle of policies, the reforms of judicial and educational system to governmental tenders (World Bank, 2003). In good governance there is a close relationship among the three main parts: government, civil society and the private sector. In good governance the interactive relationship among these three parts lead to the optimal management of the public affairs (Johnson and Minse, 1990).

The economic development of most developing countries is dependent upon the raw materials. In order to establish equality among the generation who pave the way for a higher optimal economic development, the planning should concentrate on an increase in the industrial, non-oil export. The business trend in the world has turned the countries with a closed economy to dynamic, open economies. Developing countries must take different steps to gain the opportunity to enter the world market. It must be born in mind that by development of economy, development of the export of the manufactured goods instead of raw materials is meant. The experience of the developing countries shows that with the rise of the export of raw materials, the national product (national income) increases. The experience of most developing countries testifies the fact that there is a significant relationship between the increase in the export of the raw material and the sustainable economic development. Of course, the necessary condition for the realization of this matter is the existence of an appropriate economic, social structure with politico-economic stability and appropriate skills in different industries. In fact, under these circumstances the possibility of the development of non-oil export will be accelerated by public and private sectors and the presence of the country in world trade (Eduardo, 2002). In the non-oil export part, the sales of the consumer and producer surplus will lead to an increase in national product and the access to new markets for investment, employment and higher income (Taghavi and Gharavi-Nakhjavani, 2003).

The commercial diplomacy is a policy to direct and manage the international commercial relationships. In commercial diplomacy, the countries, considering their economic national interests and capabilities, try to pursue their specific operational goals such as the development of export or the absorption of direct investment - utilizing special strategies like promotion export or substitution import strategies - by using special means such as tariff and non-tariff means.(Fathi and Pakdaman, 2010). The quality of the governance determines many factors such as whether to export or not, what policy to adopt: promotion export or replacement of import substitution, which country to transact with, which countries transact with that country, how much bargaining power the country have in economy, etc. since the economic diplomacy is determined by governors, it depends on the quality of governance. Countries continually analyze other countries in international economy with regard to determining political factors in international relationships in terms of experience and determination of political risks. They often use World Bank reports about good governance and its highly acceptable indices. It is quite clear that good governance leads to building up international trust and increasing the foreign trade and consequently the increase of industrial export. It seems that the political instability index has a larger effect on non-oil export.

Political stability leads to establish sustainable security and gain the investor's trust and also absorbs foreign investment. With the introduction of new investments and technology the efficiency of work force and production increase. It also decreases the prices and increases the export. On the other hand it is probable that FDI absorption and entrance of foreign companies to the domestic market may interfere with the market equilibrium and put pressure on domestic agencies and lead to destruction of natural resources and economic dependency and decreases the industrial and non-oil export.

Voice and accountability and the existence of the right of supervision on the performance of the governors in terms of policy making and manufacturing activities and taking steps towards the production of the goods which are advantageous in that country will lead to an increase in trade volume and non-oil export. Corruption is a kind of abuse of power for personal advantages. Corruption can be carried out in different ways such as providing fake licenses for particular activities, compromising in paying tax, distorting the real state affairs and governmental documents, taking part in tenders, auctions and governmental contracts, abusing in the distribution of goods and services, employment and giving official positions (Sabahi and Malekosadati, 2009). The rampant corruption leads to the illegitimacy of the government. The weakening of the government leads to inefficiency of the government in establishing institutions which support the market. If the agencies are able to interfere in the governmental decisions through bribery and other forms of corruption, they can change the reforms to their own advantage and hinder the correct execution of regulations and cause competition in the market. Thus, they will have a negative effect on the market. Therefore, it can be concluded that the governance has a very important role in trade, progress and economic development.

3. Methodology

[1] In this study panel data pattern was utilized to investigate the effects of good governance on non-oil export in selected developing countries. Considering the theoretical discussions and experimental studies related to good governance and non-oil export the econometric pattern can be defined as follows:

$$EX_{it}= \beta_0 + \beta_1 BE_{it} + \beta_2 AP_{it} + \beta_3 GDP_{it} + \beta_4 GI_{it} + u_{it} \quad (1)$$

In which EX, BE and AP denote non-oil export, exchange rate(US dollar) and inflation, respectively. Moreover, GDP and GI_{it} represent Gross Domestic Product and Good Governance Index, respectively. According to Gani and Duncan (2004) is obtained from the arithmetic mean of the 6 indices which comprise good governance. u_{it} shows the error. i denotes sections or countries and t denotes Time.

Table 1. Variables, definitions, and data sources

Variable	*Definition*	*Source*
EX	*Non oil export (current US$), EX= total export good & services (current US$) - oil export (current US$), Exports of goods and services represent the value of all goods and other market services provided to the rest of the world. They include the value of merchandise, freight, insurance, transport, travel, royalties, license fees, and other services, such as communication, construction, financial, information, business, personal, and government services. They exclude compensation of employees and investment income (formerly called factor services) and transfer payments. Data are in current U.S. dollars.*	*World Bank national accounts data, and OECD National Accounts data files. http:// www.economywatch.com / economic – statistics / economic indicators / Value Oil Exports /*
GDP	*GDP (current US$)*	*World Bank national accounts data, and OECD National Accounts data files*
AP	*Inflation ,consumer price*	*World Bank national accounts data, and OECD National Accounts data files*
BE	*Real effective exchange rate index (2005 = 100)*	*World Bank national accounts data, and OECD National Accounts data files*
VA	*Voice and accountability index*	*World bank, good governance matter 2011*
PS	*Political stability and non-violence index*	*World bank, good governance matter 2011*
GE	*Efficiency and governmental effectiveness index*	*World bank, good governance matter 2011*
RQ	*Financial burden of regulations index*	*World bank, good governance matter 2011*
RL	*Rule of law index*	*World bank, good governance matter 2011*
CC	*Corruption control index*	*World bank, good governance matter 2011*
GI	*Arithmetic mean of good governance indices, GI=(VA+PS+GE+RQ+RL+CC)/6*	*The data of the study*

[1] The estimation of a panel under the hypothesis of fixed effects assumes that the differences among countries are captured by allowing a different intercept α_i for each of them. α_i may be estimated, so the specification with k repressor's becomes:

$$y_{it} = \alpha_i + \beta X_{it} + e_{it}, \quad i = 1, \dots, n, \quad t = 1, \dots, T$$

Where i indexes countries and k indexes repressors'. y is the dependent variable, X is an n×k matrix of repressor's, b is a k by 1 vector of parameters and $e_{i,t}$ are the disturbances. Intuitively, the main assumption is that the economic model underlying the estimation is the same for all countries. The variation among countries is captured by the intercept α_i. The estimation is by OLS, which in this case is called Least Square Dummy Variables (LSDV) or within-groups estimation. Instead, random effects consider idiosyncratic features of the units as non-observable and randomly distributed. They are captured by the error terms that, in turn, have a constant (over time) part and a second component that varies over time. The specification in this case becomes:

$$y_{it} = \alpha + \beta X_{it} + u_i + v_{it}$$

where u_i is the random disturbance associated to the ith country, constant over time by assumption. The economic intuition associated with random effects is that the economic model underlying the estimation may change over time. The estimation in this case is performed by Generalized Least Squares.

In order to estimate the pattern of the study, the data for selected developing countries[2] (23 countries) from 2001 to 2010 was collected from the statistics of WDI (World Development indices), IMF and World Bank reports about good governance (Governance Matter, 2011). The sources and measurement of all variables is summarized in Table 1.

4. Results

First the model is estimated despite the arithmetic mean of good governance indices and then each index is inserted into the model and separately estimated to investigate which index has the largest effect. Thus, 7 different patterns are estimated. Prior to the estimation of the effect of the variables on non-oil export it is necessary to test if the variables used in the estimations are stationary or not. For if the variable are not stationary (both with regard to time series and panel data) will lead to spurious regression. For this purpose Levin, Lin and Chu (LLC) test which is suitable just for panel Data was utilized. The results for all variables of the model are shown in Table (2).

Table 2. The Results of The Unit Root Test Developed by Levin, Lin And Chu (LLC)

Variable	*LN EX*	*LN GDP*	*LN BE*	*AP*	*GI*	*GE*	*PS*	*RL*	*RQ*	*VA*	*CC*
Statistic	*-4.423*	*-2.23*	*-3.434*	*-5.370*	*-5.074*	*-5.338*	*-4.540*	*-6.03*	*-6.67*	*-8.63*	*-8.36*
Probability	*0.013*	*0.000*	*0.005*	*0.000*	*0.000*	*0.000*	*0.001*	*0.041*	*0.01*	*0.000*	*0.007*

The null hypothesis of the LLC test states that the variables are non-stationery. The results show that the null hypothesis is rejected, i.e., all variables of the model are stationary. Assuring the reliability of the variables, we don't need to carry out the cointegration test. And there is no probability of a spurious regression. Thus, the model can be estimated.

Before the estimation of the coefficients, the F-Limer test was used to choose between panel data and pool data. The null hypothesis of the study denotes choosing hybrid data and their priority over panel data. Regarding the reported F value in Table 2, the null hypothesis for all patterns is rejected. Therefore, panel data can be used to estimate all patterns. Then Husman test was used for the selection of the estimation method. The null hypothesis confirmed the existence of the random effects in the model. Considering the results of the Husman test, summarized in table 3, except for the third and sixth pattern the null hypothesis is rejected. Thus, it is necessary to estimate these two patterns in terms of random effect and the other patterns in terms of fixed effects.

In all patterns GDP, which is considered as logarithmic, has a significant, positive effect on non-oil export. That is, if GDP increases in, the non-oil export increases as well. Inflation rate that is low has also a positive effect on non-oil export and the increase in prices has increases non-oil export. But regarding the governance, the arithmetic mean of GI (Governance Indices), RL index and CC index do not affect non-oil export due to weakness of governance and the low power of the governance of regulations. But other indices of good governance have significant effect on non-oil export. In the second equation the Voice and Accountability with a coefficient of 0.02 has a positive significant effect which shows that if voice and accountability and the impeachment are stronger and the economic transparency is higher, there will be an increase in non-oil export.

[2] Selected oil exporting countries are as follows : Algeria, Angola, Argentina, Bahrain, Bolivia, Colombia, Ecuador, Egypt, Iran, Kuwait, Libya, Mexico, Morocco, Nigeria, Oman, Panama, Peru, Qatar, Saudi, Syria, Trinidad and Tobago, Venezuela and Yemen.

Table 3. The Result Of Estimation of patterns 1 to 7

	Pattern1	*Pattern2*	*Pattern3*	*Pattern4*	*Pattern5*	*Pattern6*	*Pattern7*
LN GDP	*0.84 (0.000)*	*0.88 (0.000)*	*0.85 (0.000)*	*0.85 (0.000)*	*0.85 (0.000)*	*0.83 (0.000)*	*0.84 (0.000)*
LN BE	*0.11 (0.5)*	*-0.06 (0.19)*	*0.07 (0.67)*	*0.09 (0.609)*	*0.01 (0.93)*	*-0.10 (0.105)*	*0.11 (0.517)*
AP	*0.027 (0.003)*	*0.008 (0.002)*	*0.007 (0.015)*	*0.009 (0.002)*	*0.008 (0.004)*	*0.007 (0.012)*	*0.010 (0.001)*
GI	*-0.0003 (0.67)*	---	---	---	---	---	---
VA	---	*0.021 (0.000)*	---	---	---	---	---
PS	---	---	*-0.012 (0.019)*	---	---	---	---
GE	---	---	---	*-0.014 (0.04)*	---	---	---
RQ	---	---	---	---	*-0.012 (0.025)*	---	---
RL	---	---	---	---	---	*-0.006 (0.269)*	---
CC	---	---	---	---	---	---	*0.0017 (0.974)*
FLIMER TEST	*28.52 (0.000)*	*17.54 (0.000)*	*29.60 (0.000)*	*22.86 (0.000)*	*26.85 (0.000)*	*28.26 (0.000)*	*26.54 (0.000)*
HAUSMAN TEST	*22.26 (0.000) fixed*	*69.01 (0.351) random*	*67.39 (0.000) fixed*	*15.92 (0.003) fixed*	*14.35 (0.006) fixed*	*5.48 (0.241) random*	*26.66 (0.001) fixed*
R2	*0.34*	*0.69*	*0.33*	*0.41*	*0.41*	*0.46*	*0.34*

Three indices, Government effectiveness, regulatory quality and political stability have a weak negative effect on non-oil export. This is due to the weakness of legislative system and low regulatory quality, high rate of violence, political instability and inefficiency of the government which stems from the presence of the minorities that control the performance of the government. In total, voice and accountability and government effectiveness have the highest positive and the lowest negative effect on non-oil export of the selected oil-exporting countries, respectively.

5. Conclusion

In the modern world, all countries are competing to reach economic development and higher growth and each country tries to dominate the market of other countries and develop its export, so that it can increase the domestic production and a more important role in world economy by achieving new markets. This will lead to development and higher economical growth. The export development should focus more on industrial goods than on raw materials and natural resources. For these resources are not renewable, e.g., oil and gas, and will come to an end. Thus, the dependence on oil export and mineral export should be minimized and be finally eliminated in a planned process. As it was mentioned before, good governance largely affects world trade, FDI absorption and economic growth and is used as an international organizations' criterion for the determining relations among governments. Therefore, the policy makers can be advised to pay more heed to accountability towards their actions. Accepting the right of the public to supervise the performance of the government and establishing a stronger mechanism for supervising the government's performance by empowering the parliament in which the representatives of the people are present will lead to the improvement of non-oil export. In addition, government's taking control of the activities which market mechanism fails to perform and non interference of the government in the cases in which the market performs better should be prioritized to improve market effectiveness. The improvement of the quality of rules and regulations, revision of the awkward rules and complete supervision of rule implementation in order to have a law-abiding administrative system, revision, improvement and focus on policies such as tariff and non-tariff barriers, control of prices and incomes and regulations of import and export can also be effective.

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