**What Interactions between Institutional Governance, Foreign Direct Investment and Economic Growth in Developing Countries: An econometric analysis in panel data.**

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| AbstractThe relationship between governance and economic growth is the subject of several controversial theoretical developments.  The purpose of this paper is to test some basic assumptions in a group of developing countries. First, we develop a theoretical and empirical analysis grid around the issue in the light of different currents of economic thought. Then, we approach our problematic in its empirical dimension. Using statistical and econometric tools, we propose, using the Arrelano and Bond [1991] model in a dynamic framework on panel data, using the generalized moment’s method (GMM) to the direct impact of institutional governance on key macroeconomic variables, as well as the indirect impact of interactions between governance components and foreign direct investment in relation to economic growth. From this model, we can deduce that the direct impact of the indicators of governance is statistically significant and positively affect economic growth. But once these indicators, especially political stability and the quality of regulation, interact with the foreign direct investment of the countries in our sample, the indirect effect becomes significant and acts negatively on the level of economic growth. This confirms that institutional governance has an isolated effect rather than complementarity with foreign direct investment in stimulating economic growth.Key words: Governance, Foreign Direct Investment, Growth, GMMrésuméLa relation entre la gouvernance et la croissance économique fait l’objet de plusieurs développements théoriques controversés. Le présent article vise à vérifier et tester certaines hypothèses de base dans un groupe de pays en développement. Tout d’abord, nous élaborons une grille d’analyse théorique et empirique autour de la question à la lumière des différents courants de pensée économique. Ensuite, nous abordons notre problématique dans sa dimension empirique. A l’aide d’outils statistiques et économétriques, nous proposerons, par l’utilisation du modèle d’Arrelano et Bond [1991] dans un cadre dynamique sur les données de panel, utilisant la méthode des moments généralisés (GMM) à mettre en évidence l’impact direct de la gouvernance institutionnelle sur les principales variables macro-économique, ainsi que l’impact indirect des interactions entre les composantes de la gouvernance et des investissements directs étrangers en relation avec la croissance économique. A partir de ce modèle, nous pouvons déduire que l’impact direct des indicateurs de la gouvernance est statistiquement significatif et agissent positivement sur la croissance économique. Mais une fois que ces indicateurs notamment la stabilité politique et la qualité de réglementation rentrent en interaction avec l’investissement direct étrangers des pays de notre échantillon, l’effet indirect devient significatif et agit négativement sur le niveau de la croissance économique. Ce qui permet de confirmer que la gouvernance institutionnelle exerce un effet isolé et pas de complémentarité par rapport à l’investissement direct étranger dans la stimulation de la croissance économique. Mots clés: Gouvernance, Investissement Direct Etranger, Croissance, MMG. |

**Introduction:**

The notion of governance becomes one of the main concerns of development and poverty reduction policies, According to Kaufmann and Kraay (2002), it is defined as the process by which the authority of institutions is exercised in the country for the common goods. Consequently, this precision attributes a multidimensional character to the notion of governance insofar as it takes up several aspects: the democratic nature of political institutions that encourage people's participation in the decision-making process, political instability and violence, the effectiveness of public authorities, the fight against corruption, the weight of regulations and the primacy of law....On the other hand, governance seems to borrow the assumptions and microeconomic framework of the New Institutional Economy (NIE), the theory of public choice, and other theoretical paths converging with each other.In this context, it is part of the functionalist paradigm of efficiency and the distribution of value by the organization[[3]](#footnote-3), to define itself as the exercise of public, economic and administrative authority within the framework of management of the affairs of a country.

Behind this variety of meaning and initiatives, in a few decades, it has become a "paradigm" of public policy and analyzer of the changes of the State model[[4]](#footnote-4). It is also a concept shared between two approaches: on the one hand, the American conception "corporate governance" which translates a part taken for the free play of competition, with a minimum of regulation, and on the other side the European and United Nations Organization which favors a political model where the decision-making process is legitimate, efficient decisions and decision-makers are accountable. In this perspective, the study of the relationship between governance and economic growth arises acutely, and today debates and of reflections enrolling rather in the continuity that in the break. It calls, to be apprehended, the history of the political institutions of the countries, the political culture which prevails among citizens and decision-makers alike. Its development is largely dependent on a variety of factors, among other things, the degree of political development, the strengthening of the democratic and institutional process.

The purpose of this article is to assess the extent to which the influence of governance, through good institutional quality, affects the economic growth of developing countries. Using the panel data GMM method developed by Arrelano and Bond (1991), we will try to test empirically the following hypotheses:

**Hypothesis 1**. Good institutional governance has a positive and significant impact on the main macroeconomic variables and the economic growth of the developing countries.

**Hypothesis 2**. Poor institutional governance has a negative impact on the major on the economic performance of developing countries.

**Hypothesis 3** .Interacting the different dimensions of institutional governance with foreign direct investment must translate into a positive effect on economic and social performance in developing countries.

The approach taken in this study is exclusively quantitative. It is based essentially on the Econometric Model in Panel Data covering the period 1996-2013 and covering a sample of 30 developing countries.

This paper is structured as follows: we first examine a synthesis of the main results obtained from the theoretical and empirical literature dedicated to the relationship between governance and economic growth.

Secondly, an econometric application will be developed to illustrate the direct impact through institutional governance and the indirect impact of foreign direct investment on economic growth.

**1. The relationship between institutional governance and economic growth:**

**1.1 Review of the theoretical literature:**

Several currents of thought have been developed to determine the relationship between governance and economic growth. These include:

Krueger's theory of rent-seeking (1974)[[5]](#footnote-5) which, economic agents strive to obtain the highest income in the absence of economic and social rules of conduct with a basic motivation that is the search for rent.

Moreover, the theory of the normative public economy, which makes the maximization of the collective surplus or the Paretian criterion of optimal allocation of resources, a primordial role of the State to correct market imperfections and failures.

Similarly, Similarly, the theory of capture, still known as the theory of regulation, which comes from the positive economy of regulation (Stigler 1971)[[6]](#footnote-6), describes how political actors and interest groups use their coercive powers of states and the means of regulation to conduct laws, rules and a large number of regulatory processes in favor of these groups to defend their private interests by maximizing the satisfaction of their members.

With regard to the Niskanen model (1971)[[7]](#footnote-7), it shows that public agencies grow in a bureaucratic sense of waste, because officials with privileged information and willing to increase their power, and therefore, tendency to overestimate the amounts of their investment needs without concern for their effectiveness, so that the burden of budgetary expenditure increases only periodically, without the public interest justifying it. This explains fundamentally the growing interest in the question of the efficiency of administrative institutions necessary for the functioning of a market economy; which is intimately linked to the effectiveness of the role of the State in the conduct of development.

As for the theory of the new public economy, it is interested in analyzing the failures of the state as a legislator and proposes to correct them, because the market is not the only source of imperfections.

In this sense, the new institutional economy argues that institutions are a determining factor in long-term economic growth and shows that effective institutions can make a difference in the success of market reforms. North (1990)[[8]](#footnote-8) states that "Third World countries are poor, because the institutional constraints that define a set of costly economic policies do not encourage economic activity that does not encourage productive activity, all the more so, an effective institutional environment is one that allows economic transactions, minimizes uncertainties and guarantees property rights. The main areas of analysis were institutional factors that could have an influence on the uncertainty environment and included "corruption, political violence, forced nationalization, contract denial, government instability, weakness the authority of the law and the absence of civil liberties»

In the same order of ideas, Ono and Shibata (2001)[[9]](#footnote-9) showed that spending by the public authorities despite the environment detrimental to good governance leads to a sustained increase in GDP and a gradual accumulation of capital. This reflection has prompted economists to turn to institutional variables to try to find a justification for the differences in production between countries unexplained by economic data alone.

In the following, the corrosive influence of the phenomenon of corruption and political instability on the dynamics of economic growth is examined, and then the notorious effect of respect for property rights and administrative procedures on economic growth is examined.

**1.2 Review of empirical literature:**

The limiting effects of corruption and political instability on economic growth:

To illustrate the relationship between growth and corruption, much of the research begun focuses on the negative impact of corruption on economic performance. This corruption is often presented as a direct consequence of the weak institutional capacity in a country, and which discourages any possibility of investment from outside.

In a series of experiments, Morisset and Neso (2002) show that corruption can be both the cause and the consequence of high administrative barriers in many developing countries.

In a more recent study, Nkendah (2007) confirms that the level of corruption influences administrative costs, as bureaucrats and politicians are more likely to monopolize additional rents. In the case of the same author which examined the case of countries in sub-Saharan Africa, he concludes that the current high levels of corruption in most of these countries complicate business operations and increase uncertainty for investors. According to North (1990), dishonest bureaucrats could delay the distribution of permits and licenses, which leads to slowing down the process by which technological advances integrate into new equipment or production procedures.

In addition, Shleifer and Vishney, (1993) see that bureaucrats can misguide investments to projects offering better opportunities for corruption such as defense and infrastructure.

In addition, some studies clearly show a negative effect of corruption on investment in relation to gross domestic product. The pioneer is Mauro (1995) who identified corruption and other institutional factors affecting economic growth and quantified the magnitude of these effects. Indeed, the latter uses the corruption index provided by Business International for the period 1980-1983. It limits its analysis to nine indicators of institutional effectiveness. . Therefore, it follows that the said indices are positively correlated; this result is explained by certain factors: corruption is widespread in countries where the paperwork slows bureaucratic procedures.
For Mauro bureaucratic efficiency is measured by the simple average of the judicial system and the paperwork and corruption index. As for political stability, it is evaluated by the simple average of institutional change, social change, the opposition of potentially powerful groups, stability of work, relations with neighboring countries and terrorism.

Then, Mauro aggregated the bureaucratic efficiency index and the index of political stability into an index called the institutional efficiency index (the correlation coefficient between these indices is 0.67). This confirms that corruption significantly reduces levels of economic growth.

Tanzi and Davoodi (1997) have proved the empirical impact of corruption on the quality of public investment. When the state has just offered good quality public investment, while maintenance is compromised, since in countries where governments play a major role in the economy: the costs and nature of public spending in these countries are very high, corruption encourages policy-makers to direct public spending through channels that make it easy to collect bribes, leading to a proliferation of large-scale projects with high added value. The results of the empirical tests conclude that public investment in relation to gross domestic product is firmly linked to corruption.

In addition, Mauro (1998) extended the study to a wider sample of countries and examined the links between corruption and investment, the effects of corruption on the composition of public expenditure.  The results of this extension of the study confirm Mauro's, earlier findings that corruption significantly affects economic growth and investment in the economy.

Let us note in passing that corruption is a corollary of a strong economy of rent:  indeed, corruption can have an impact on the competitiveness of companies. "The degree of competitiveness of firms can have two opposite effects on their incentives to offer corruption ". On the one hand, the most competitive firms are the most profitable; they realize significant profits and this allows them to pay large amounts of corruption (Jellal (1998), Ades and Di Tella (1999), Bliss and Di Tella (1997) and Svensson, (2003)). On the other hand, the need to obtain rents for firms that lose in competitiveness encourages them to offer the corrupt pact in order to compensate for this loss of competitiveness by influencing the rules of economic activity to reduce certain costs (tax evasion), obtain a competitive advantage (barriers to entry) compared to other firms (Gauthier and Reinikka, 2001) or public procurement.

In the same line, other studies such as Wei's (2000) successfully demonstrate the negative impact of corruption on foreign direct investment, international investment should make the "corruption tax". In turn, Mo (2001) concludes that the indirect impact of corruption is more than halved through its effect on political stability, more than 20% by investment, and 15% by its unfavorable impact on training. Human capital. So, Anoruo and Braha (2005) find that corruption hampers African economic growth by directly reducing productivity by 0.87%, and an indirect reduction of 4.69% in investment.

In addition, Gyimah - Brempong et al (2006) obtained the following result: a 10% decrease in corruption increases the rate of income growth by about 1.7% in OECD and Asian countries, 2.6% in Latin America and 2.8% in African countries.

The main result of Baliamoune-Lutz and Ndikumona (2007) argue that the discouragement of private investment is explained by the fact that corruption increases the costs of doing business. While increasing the uncertainty expected return on capital. It follows that corruption undermines growth.

In an original contribution, authors such as Asiedu and Freeman (2009) consider that the effect of corruption on investment varies considerably from region to region.For countries in transition, corruption is the most important determinant of investment. In the MENA countries, low-investment decisions are dependent on poor governance.

Several political and institutional factors were put forward: Democracy at Barro (1996), respect for property rights by Clague, Keefer and Olson (1996), political instability in Alesina and Perotti (1994). Rodrik (1999) supports the idea that good governance is a necessary condition for the success of market economies.

All empirical studies dealing with the relationship between political instability and growth are generally unanimous on the negative effect of political instability on growth.

Indeed, Alesina, Ozler, Roubini and Swagel (1996) find that a political sample of 113 countries over the period (1950-1982) has a negative and significant effect on economic growth. Revolutions and shots of State then seem to negatively affect growth, but these effects disappear when property rights are controlled.

The model of Landregan and Poole (1990), which is based on a sample of 121 countries covering the period (1950-1982), shows that the low rate of growth increases the probability of a shots of State.

In turn, Svensson (1998) notes a negative link between political instability and the quality of property rights. He concludes that if property rights are included in the investment equation, the variables of political instability cease to be important. According to these empirical studies, the direct and negative impact of political instability on growth is significant.

From another angle, Kolstad and Tondel (2002) find that countries considered to be less risky attract more foreign direct investment per capita in an empirical analysis of the social and political development of foreign investment in developing countries, as it happens, this study was corroborated by that of Sachs and Sievers (1998) on the basis of a survey of foreign - owned companies in Africa. The two authors note that the greatest concern for business owners is political stability.

As for the Basu and Srinivasan (2002), in a study of seven countries in Africa, point out that political stability is one of the most important determinants of attracting foreign direct investment alongside macroeconomic stability and corruption.

The notorious effects of respect for property rights and administrative procedures on economic growth.

Several empirical contributions focus on respect for the right to property. Drabek and Payne (2001), Globerman and Shapiro (2003) the protection of property rights is a kind of insurance for firms who seek to establish new investments abroad to be able to reap the benefits of their efforts in the future, and they have shown that it is vital for firms, without this insurance, investors are discouraged to take risks to invest.

Moreover, it is quite obvious,  for Smith (2001) and OECD (2002), that regulations aimed at protecting property rights, particularly intellectual property rights, are likely to increase the attractiveness of the host country to international investment, both that their protection makes it more difficult  the spread of knowledge elements specific to the company. According to Ozyurt, (2008), respect for the regulation of property rights has a decisive influence on the choice of the country. In the facts, the weakness of the protection of property rights in developing host countries push the development research activities of multinational firms largely reserved in the countries of origin or in a limited number of industrialized countries today.

Emery et al. (2000) confirm that the protection of property rights, administrative procedures and regulations on foreign direct investment can constitute a significant barrier to investment, especially in developing countries, witch procedures are long and excessively costly to establish and do business inevitably push its potential investors to postpone their investments elsewhere. On the same register, for Nkendah (2007) the case of the African countries illustrates this fact because of the requirement of complex administrative procedures to set up a company and conduct business.

Using the institutional profiles developed by the French Ministry of Finance, Bénassy-Quéré et others (2005) found that, regardless of the level of gross domestic product, the effectiveness of the public authorities such as the tax system, ease of doing business, absence of corruption, protection of property rights and respect for justice is a major determinant of the entry of foreign direct investment.

Many econometric studies link, at the international level, indicators of democracy identified at the level of nation states and different economic indicators. They generally use subjective indicators for cross-sectional studies.

Indeed, the synthesis of Borner and others (1995), which have identified 16 studies on the relationship between democracy and growth, found that three empirical studies have a positive relationship between these two variables, three were in the opposite direction and ten did not identify any conclusive relationship.

Following Kormendi and Meguire (1985) and Scully (1988) who used cross-sectional growth regressions and the civil and political rights indices of Gastil, these authors suggest a direct impact of improved growth.

Barro (1991) finds that civil and economic freedoms will have a positive effect on growth insofar as they reflect less involvement of the State in the economic activity of the country.

Moreover, some authors, such as Helliwell (1994) and Feng (1997), have demonstrated positive global correlations between democracy and economic growth, because democracy facilitates development by guaranteeing stability of the general rules of the game long-term and by instituting executive control through the principles of accountability and the responsibility.

Their counterparts Clague and others (1996) have even shown that democracies better protect property rights and contracts, which is essential for attracting investment and growth.

 They insist that statistically democracy offers better guarantees for the implementation of property rights and contracts, provided that it is politically and socially "anchored" rather than authoritarian regimes with the same level of political stability.

Another Barro (1996) study of panel data and period (1960-90), in which he used a Solow model and political rights indices, and transformed the political rights indices into three categories: high, average and low measures of the quality of democracy, he therefore finds that the average level of democracy favors growth the most. The result is that when a moderate number of political rights already extended, a further increase could actually decrease growth, perhaps due to pressures on income redistribution.
Democracy, according to Rodrik (1998), creates greater stability in economic performance than authoritarian regimes, that the presence of social freedoms and political rights enhances the economy's ability to adjust to the international environment and democracy favors a better distribution of income. It should also be pointed out that studies that use indicators linked to transparency and the guarantee of property rights are considered as studies between democracy and growth. Moreover, Aron (2000) states that transparency and public accountability tend to improve economic growth and in particular the guarantee of property rights and respect for contracts.

From this synthesis of these empirical studies, it can be seen that despite their diversity in the methods and variables used, these empirical studies conclude that the quality of institutions and the components of good governance for economic growth.

In the following we will first propose to present the basic growth model and its specification, as well as a descriptive analysis of the data on the variables used that we use in this paper. Finally, we will present the results of estimation of the dynamic model obtained with their interpretations.

**2. Data and Methodology:**

In this section we present the model, the variables, the data, the estimation method, the results and the interpretation.

 **2.1 Presentation and Specification of the Model**

It is more precisely a standard model of endogenous growth in which the variable of interest is that of governance. This theoretical model is as follows:

 ***Yit* =*f* (Yt-1, *GOVit* , *FDIit* ,*GOV* \* *FDIit* ,*CONTROLSIt* )**

 t=1,2……..T i=1,2……..N

Y: the growth rate of the gross domestic product.

Yit-1: the rate of growth of the gross domestic product delayed by a period.

The interest variables are the ratio of foreign direct investment to GDP, and

***GOVit (CCit ,GEit .PSit ,RQit ,RLit ,VAIt )***  represents respectively:

(CC): Index of fight against corruption.

(GE): Index of government effectiveness.

(PS): Index of political stability.

(RQ): Index of the quality of the regulation.

(RL): Index ofRespect for Law.

(VA): Index Voice and Accountability.

GOV \* IDEit: represents the term of interaction between governance and foreign direct investment.

In reference to the theories of exogenous and endogenous growth, we use a set standard control variables that are represented by the ratio of exports to GDP(X), population growth rate(POP), secondary school enrollment ratio(SCOL), gross fixed capital formation to GDP ratio(GFCF).

Our sample is made up of 30 developing countries, the choice was based on available statistical sources, and the data used in our estimation are from the World Bank (World Develop Indicators and World Governance Indicators) covering the period (1996-2013).

 **2.2 Statistical analysis of data:**

This descriptive analysis of the research variables (Table 1) shows that the average per capita growth rate of 30 countries is 3.847%. The strongest growth (13.55%) and the lowest (-13.12%) of the series observed.

The governance variables are all close to the average range between -0.1 and -0.3%, indicating a weakness in the quality of the institutions of the countries in our sample. Concerning the ratio of foreign direct investment to gross domestic product, it is, on average 3.21%, reflecting the low contribution of outside capital to the development of the national wealth of the countries studied.

 **Table 1:** Data descriptive statistics

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Variable** | **Observations** |  **Average**  | **Standard deviation** | **Minimum** | **Maximum** |
| **X** |  540 | 34.842 | 18.83672 | 5.34363 | 121.3118 |
|  **POP** | 540 | 1.646 | 0.6705216 | -0.0627996 | 3.944395 |
|  **SCOL** | 540 | 66.641 | 20.63108 | 14.48152 | 109.1773 |
| **GFCF** | 540 | 21.938 | 5.940696 | 8.685182  | 46.87646 |
| **FDI** | 540 | 3.214 | 3.558828 | -6.465317 | 47.5834 |
|  **Y** | 540 | 3.847 | 3.246151 | -13.12672 | 13.5516 |
| **CC** | 540 | -0.314 | 0.6266804 | -1.506604 | 1.561873 |
| **GE** | 540 | -0.195 | 0.5902121 | -1.531401 | 1.277847 |
| **PS** | 540 | -0.524 | 0.7891875 | -2.5000855 | 1.186454 |
| **RQ** | 540 | -0.101 | 0.6055156 | -1.605528 | 1.644733 |
| **VA** | 540 | -0.268 | 0.6912938 | -1.883294 | 1.244145 |
| **RL** | 540 | -0.371 | 0.6360164 | -1.633458 | 1.366822 |

 **Source:** Calculated by the author by using Stata11 software.

According to the correlation matrix in Table 2, in the first zone, the ratios: Export, population growth rate, enrollment ratio, gross fixed capital formation, foreign direct investment are weakly correlated comparatively and respectively (6.55%, 6.04%, 7.17%, 24.6% and 18.59%) with the growth rate.

In the second zone of the same table, it is known that the correlations between the variables taken in pairs suggest interesting relationships. For example, there is a strong positive correlation (86%) between the efficiency of the administration and the fight against corruption, it is the same for respect for the law and the quality of regulation with the fight against corruption, which together represent 89% and 79% respectively. This strong correlation means that a government cannot be effective if it does not operate within a framework that respects the rule of law.

The quality of regulation has a positive influence on government effectiveness (84%) and political stability (54%). There is also a strong correlation (60%) between government effectiveness and freedom of expression and accountability. Similarly, there is a correlation of (67%) between regulatory quality and voice and accountability.

However, there has been a correlation, relatively moderate, between the quality of regulation and political stability (about 55%). However, these governance dimensions are only weakly correlated with the growth rate following multicollinearity detected at the level of governance indicators. These different correlations inform us about the institutional fragility that leads to poor economic performance.

**Table 2:** Correlation matrix for the countries of North Africa, ASIA and Latin America

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Variables** | **Y** | **X** |  **POP**  |  **SCOL** | **FBCF** | **IDE** | **CC** | **EG** | **SP** | **RQ** | **VA** | **RL** |
| **Y** | 1  |  |  |  |  |  |  |  |  |  |  |  |
| **X** | 0.0655 | 1 |  |  |  |  |  |  |  |  |  |  |
|  **POP** | 0.0604 | 0.0920 | 1 |  |  |  |  |  |  |  |  |  |
| **SCOL** | 0.0717 | 0.1243  | -0.3839 | 1 |  |  |  |  |  |  |  |  |
| **GFCF** | 0.2467 | 0.2259  | 0.0275  | 0.2025  | 1 |  |  |  |  |  |  |  |
| **FDI** | 0.1859 | 0.0474  | 0.0349  | 0.0741  | 0.1412  | 1 |  |  |  |  |  |  |
| **CC** | 0.0971 | 0.1480  | -0.3637 | 0.4205  | 0.0330 | 0.1761  | 1 |  |  |  |  |  |
| **EG** | 0.1070 | 0.3209  | -0.3906 | 0.4737  | 0.0983 | 0.1103  | 0.8618  | 1 |  |  |  |  |
| **SP** | 0.0640 | 0.2004  | -0.2305 | 0.2418  | 0.0114  | 0.0950  | 0.6769  | 0.5979 | 1 |  |  |  |
| **RQ** | 0.0399 | 0.1617  | -0.3909 | 0.3485  | 0.0140 | 0.0950  | 0.7963  | 0.842 | 0.5442 | 1 |  |  |
| **VA** | 0.0339 | -0.0239 | -0.4091 | 0.3330  | -0.0994 | 0.0275  | 0.6732  | 0.6048 | 0.6267 | 0.7003 | 1 |  |
| **RL** | 0.0934 | 0.2865  | -0.3046 | 0.4902  | 0.1329 | 0.1403  | 0.8911 | 0.8642 | 0.6852 | 0.7608 | 0.5719 | 1 |

 **Source:** Calculated by author using Stata11.

To verify the presence of multicollinearity between the exogenous variables, we use the VIF (Variance Inflation Factors) test. Table 3 presents the results of the multicollinearity tests between the different variables used in our model. The results found that some factors of inflation variance of foreign direct investment variables, fixed capital formation, export, enrollment rate and population growth rate have a value of less than 3, the tolerance values ​​exceeding 0.4. For governance variables, their inflation variance factors have a value greater than 3 with tolerance values ​​not exceeding 0.4.

**Tableau 3:** Multicollinearity test**:** Variance Inflation Factors (VIF) and Tolerance values

|  |
| --- |
|  **Variable VIF Tolerance values** |
| **FDI**  3.00 0.3315 |
| **GFCF** 1.15 0.8710 |
| **X** 1.40 0.7160 |
| **SCOL** 1.48 0.6747 |
| **POP** 1.36 0.7339 |
| **CC** 24.20 0.0413 |
| **EG** 25.05 0.0399 |
| **PS** 13.22 0.0756 |
| **RQ**  18.38 0.0544 |
| **VA** 15.74 0.0636 |
| **RL** 34.22 0.0292 |
|  **Average VIF** 12.66 |

 **Source:** Calculated by author using Stata11.

**2.3. Dynamic model estimation method**

In the case of a dynamic panel, it is not appropriate to use the ordinary least squares method because it can give biased estimates because of the presence of the dependent variable delayed to the right of the equation.

The estimates by the OLS would be inconsistent because Yi t-1 is correlated with the error term (Arellano and Bond,(1991))[[10]](#footnote-10),Baltagi(2008)[[11]](#footnote-11).
If the study period is large, the bias becomes small and the problem disappears (Aisen and Veiga, (2013))[[12]](#footnote-12). So,given the relative short period of our study, the problem persists. Equation (1.3) in first difference suppresses the individual effects αi and eliminates thus the potential source of this bias.

Let us first note that the dynamic model is characterized by the presence of one or more delayed endogenous variables among the explanatory variables.in our case, there is only one delayed endogenous variable.

In the logic of Arrelano and Bond we proceed first of all by estimating the basic growth equation in first difference, including the explanatory variables usually used in previous work with, in particular, foreign direct investment variables, gross fixed capital formation, human capital, exports and population growth rate.

We introduce six governance variables into the different regressions, our theoretical model becomes:

**Yit = δYit-1 + 𝛽1FDIit + 𝛽2 FBCFit + 𝛽3 Xit+ 𝛽4 SCOLit****+ 𝛽5 POPit+ 𝛽6 CCit + 𝛽7 GEit + 𝛽8 PSit + + 𝛽9 RQit + 𝛽10 VAit + 𝛽11 RLit****+εi,t (1.2)**

Then, we introduce the cross-variables of governance with foreign direct investment to identify possible interaction between them. To this end, our model becomes after transformation as follows:

**Yit = δYit-1 + 𝛽1 GFCF** **it + 𝛽2 Xit****+ 𝛽3 SCOLit****+ 𝛽4 POPit+ 𝛽5 CCit \* FDI****+ 𝛽6 GE \* FDI + 𝛽7 PS \* FDI + 𝛽8 RQ\*** **FDI + 𝛽9 VAit\* FDI + 𝛽10 RLit \* FDI+εi,t ( 1.3 )**

The estimate that we present here corresponds to the GMM estimate in first differences of Arellano and Bond (1991).We limit ourselves to the results of this estimate because it makes it possible to eliminate rigorously any bias associated with the unobserved individual heterogeneity and offers, therefore, a better efficiency of the estimation results. Tables 4 and 5 below summarize the main results regressions made:

 **Table 4:** Result of estimation of the dynamic model with the governance variables.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Variables** | **4.1** | **4.2** | **4.3** | **4.4** | **4.5** | **4.6** |
| ***D \_Y (-1)*** | -0.005(-0.12) | 0.007(0.17) | 0.002(0.05) | 0.011(0.24) |  -0.004(-0.09) | 0.006(0.14) |
| ***D\_*GFCF** | 0.438(7.94)\*\*\* | 0.437(7.82)\*\*\* | 0.429(7.72)\*\*\* | 0.450(8.10) \*\*\* | 0.439(7.95) \*\*\* | 0.437(7.89) \*\*\* |
| ***D\_FDI*** | 0.131 (2.16)\*\* | 0.118 (1.94)\*\* | 0.125(2.06)\*\* | 0.124(2.02)\*\* | 0.140 (2.30)\*\* | 0.116 (1.91)\*\* |
| ***D\_X*** | 0.133(3.88)\*\*\* | 0.131(3.80)\*\*\* | 0.132(3.82)\*\*\* | 0.124 (3.49)\*\*\* | 0.131(3.80)\*\*\* | 0.137(3.94)\*\*\* |
| ***D.POP*** | -1.136 (-1.59) | -1.15 (-1.59) | -1.38(-1.90) | -1.068(-1.47) | -1.302(-1.81) | -1.080(-1.50) |
| ***D\_SCOL*** | -0.063(-3.23)\*\*\* | -0.067(-3.45)\*\*\* | -0.063(-3.22)\*\*\* | -0.073 (-3.57)\*\*\* | -0.071 (-3.63)\*\*\* | -0.062 (-3.15)\*\*\* |
|  ***D\_*CC** | 2.47(2.38)\*\*\* |  |  |  |  |  |
|  ***D\_*EG** |  | 1.452(1.08) |  |  |  |  |
|  ***D\_*PS** |  |  | 1.505(2.45)\*\*\* |  |  |  |
|  ***D*\_RQ** |  |  |  | -0.426(-0.40) |  |  |
|  ***D*\_VA** |  |  |  |  | 2.888(3.40)\*\*\* |  |
|  ***D\_*RL** |  |  |  |  |  | 3.022 (2.25)\*\*\* |
| **constant** | -4.01(-1.86) | -4.11 (-1.88) | -3.38(-1.55) | -4.28(1.94)\* | -3.22(-1.48) | -3.93(-1.82) |
| ***Wald Test*** | 110.72 | 105.64 | 110.01 | 104.47 | 115.57 | 108.74 |
| ***P-value*** | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| **instrument**  | 146 | 146 | 146 | 146 | 146 | 146 |
| ***N*** | 480 | 480 | 480 | 480 | 480 | 480 |
| **country** | 30 | 30 | 30 | 30 | 30 | 30 |
| **Sargan Test** | 244.64 | 246.96 | 241.70 | 247.08 | 236.81 | 241.86 |
|  **p-value** | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |

 **Source**: the author, based on the results from Stata11.

(D\_): the first difference operator

 Numbers in parentheses represent Student statistics.

 (\*\*\*) indicates significance at 1%, (\*\*) significance at 5%, (\*) significance at 10%.

**Table 5**: Result of estimating the dynamic model of governance variables in interaction with foreign direct investment.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **VARIABLES** | **5.1** | **5.2** | **5.3** | **5.4** | **5.5** | **5.6** |
| **D .Y (-1)** | 0.015 (0.35) | 0.014 (0.31) | 0.01 (0.28) | 0.01 (0.32) | 0.01 (0.35) | 0.01(0.30) |
| **D. GBCF** | 0.45 (8.32)\*\*\* | 0.46 (8.39)\*\*\* | 0.45 (8.39)\*\*\* | 0.46 (8.39)\*\*\* | 0.45 (8.32)\*\*\* | 0.46 (8.38)\*\*\* |
| **D . IDE** | 0.13 (4.02)\*\*\* | 0.13 (4.00)\*\*\* | 0.13 (4.04)\*\*\* | 0.13 (3.97)\*\*\* | 0.13 (3.95)\*\*\* | 0.13 (4.06)\*\*\* |
| **D. X** | -1.00 (-1.39)\* | -1.04 (-1.45)\* | -1.02 (-1.43)\* |  -1.08 (-1.50)\* |  -1.08 (-1.51)\* | -1.03 (-1.43) |
| **D.POP** |  -0.06(-3.48)\*\*\* |  -0.07 (-3.52)\*\*\* |  -0.06(-3.47)\*\*\* |  -0.06(-3.52)\*\*\* |  -0.06(-3.50)\*\*\* |  -0.06(-3.46)\*\*\* |
|  **D.CC \*IDE** |  -0.09 (-1.52) |  |  |  |  |  |
|  **D. EG\*IDE** |  | -1.11 (-1.70) |  |  |  |  |
|  **D. PS\*IDE** |  |  | -0.06(-2.04)\*\*  |  |  |  |
|  **D .RQ\*IDE** |  |  |  | -0.12(-2.19)\*\* |  |  |
|  **D .VA\*IDE** |  |  |  |  | -0.08 (-1.93)\*\*\* |  |
|  **D. RL\*IDE** |  |  |  |  |  | -0.09(-1.95) \*\*\*  |
| **Constant** | -4.99(-2.31)\*\*\* | -4.90(-2.27)\*\*\* | -5.04 (-2.35)\*\*\* | -4.76(-2.21)\*\*\* |  -4.73(-2.20)\*\*\* | -5.07(-2.36)\*\*\* |
| **Test Wald** | 100.85 | 101.79 | 104.28 | 103.68 | 103.38 | 102.95 |
| **P-value** | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| **instrument**  | 145 | 145 | 145 | 145 | 145 | 145 |
| **N** | 480 | 480 | 480 | 480 | 480 | 480 |
| **Countries** | 30 | 30 | 30 | 30 | 30 | 30 |
| **Sargan Test** | -246.55 | 246.17 | 247.75 | 244.1 | 247.28 | 246.91 |
|  **P-value** | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |

 **Source**: the author, based on the results from Stata 11.

(D\_): the first difference operator

 Numbers in parentheses represent Student statistics.

 (\*\*\*) indicates significance at 1%, (\*\*) significance at 5%, (\*) significance at 10%.

**2.4 Results and Interpretation**

Despite the limitations of the small number of countries and periods to the validity of the asymptotic properties of statistical tests, some differences depending on the test type are displayed. But the conclusions are consistent across all variables. in our estimation we used  the first differences  of the basic variables, the test results of the instruments in the estimates provided in the different models confirm the validity of the instruments used. Also the Wald tests provided with the results, confirm the good quality of the estimates in terms of significance overall.

These tables present results of the estimates and some preliminary tests from Stata 11. These provide the following lessons: According to the first regression in Table 4, it appears that the dependent variable (yi, t-1) is negative and not significant, which explains why the growth rate of the year (t) does not depend, negative manner, of the year (t-1).The fact that this variable is not significant seems to us logical Insofar as economic growth in developing countries varies greatly from one year to the next. This reflects the persistence of the growth process in developing countries.

We note from columns 4.1 to 4.6 that the coefficients of the macroeconomic variables used in the estimation of the standard equation of economic growth all have signs that corroborate the theoretical literature and are generally significant: Indeed, gross fixed capital formation has a positive influence on the growth rate of these countries because its coefficient is always positive and statistically significant reporting a preponderant effect on economic growth.

Everything is equal otherwise. It can be argued that an increase in the FDI ratio of 5% implies a 0.13112 point increase in the GDP growth rate. This variable is significant and positively correlated with economic growth, as long as there are FDI incoming as long as there are an improved growth in these countries. This result may explain the continued interest of developing countries in attracting more FDI, which may be an alternative source of financing for their activities, given the weakness of their national savings and the burden of their indebtedness; and also shows the importance of the training and learning effects of FDI emphasizing the importance of the policy of opening up to foreign and the driving role of foreign direct investment in the growth process of developing countries.

Exports are positively correlated with the per capita GDP growth rate of 90%. Thus, an increase of 1 percentage point in the supply of enterprises to exports has improved the growth rate by 0.1338%.This positive influence of the trade flow variable confirms the openness of the economy of most developing countries. Indeed, this result can be justified by the fact that openness to exchange encourages investors to invest more through the supply of new outlets in larger markets, and also in line with the idea that the economies of the developing countries are export-oriented in order to gain international competitiveness, which has a positive impact on the rate of growth.

For the population growth rate (POP) variable, it is negatively correlated with economic growth and has no significant role; but its coefficient amounts to -1.136 points. So population growth is a slowdown in economic growth hence the necessity to keep it at a low level, which joins some of the theoretical models even arriving at opposite conclusions. For example, the model of Robert Solow argued confirms a negative correlation between economic growth and population growth. Population growth also requires more public services and more infrastructure; to which developing countries cannot always respond.

The coefficient sign of the enrollment ratio is negative, significant and amounts to -0.062 point, which would mean that an increase in the enrollment rate of 1% would result in a decrease in the economic growth rate of 0.062 percentage point. Our findings are consistent with some studies, for example Bashir (1999) reported a negative correlation between human capital and growth in a study conducted in a number of countries in the MENA region. The explanation of this result originates in the diversity of countries in the sample with different levels of development, as well as the choice of the human capital indicator that does not assess the quality of education in the country (Knight et al., 1993).

 In several works using a panel data approach, the direct effect of the human capital represented by the secondary school enrollment rate on growth is difficult to detect. The effect of human capital on growth is not very robust because this indicator is a qualitative variable, this result is counter-intuitive with some theoretical and empirical works, such as Borensztein et al. (1998), Makki and Somwaru (2004). A high level of education means that the labor force is internationally competitive and contributes positively to the productivity and attractiveness of foreign direct investment.

Consideration of the quality of institutions in the estimates of columns (4.1 to 4.6) in table 4 results the meaning of other variables. However, the absence of econometric link between the others Institutional Components and growth, means that the improvement in economic growth in these countries is not generally explained by their progress in domains the quality of regulation and the effectiveness of governmental interventionism.

In the same line, Mauro (1995, 1998), who worked on a large sample of countries through a cross-sectional analysis, concludes that corruption has little effect on long-term economic growth but has a strong and negative impact on investment. He thus joined Gyimah-Brempong (2002) whose the work has focused on a panel of data from African countries that has led to evidence that corruption reduces economic growth, especially as it reduces physical capital to be injected into the economy.

In the third model (4.3) of Table 4, we introduce the variable political stability, its coefficient is positive and significant. Everything is equal otherwise. Any 1% increase in political stability results in a 1.505 point increase in the rate of economic growth. Several explanations can be advanced to include the merits of this result. indeed, it should be noted that many publications have found results attesting to the positive effect of political stability on economic performance. Thus, Alesina et al. (1996) analyze the effect of shots of State and conclude that it is negative for countries and periods when such unconstitutional changes in government have occurred. In the same order of ideas, Alesina and Perotti (1996) examine the influence of a composite measure of political instability on investment and find the expected negative effect.

Moreover, in the fifth model (4.5) of Table 4, we introduce the "voice and accountability" index, it has an effect preponderant on economic growth, its coefficient is always positive and statistically significant. This result is comparable to several other in the matter. Thus, Kormendi and Meguire (1985), who examined the effect of civil liberties and political rights on economic growth and investment for 47 countries over a period from 1950-1977, confirm that countries with high level of civil liberties are the more efficient.

In the sixth model (4.6), we added the variable "respect of law".  The estimation results show that this variable contributes 2.88 points to growth and is statistically significant at the 1% threshold. For example, countries that to respect contractual clauses and honoring them are those who will experience a high and sustainable growth rate. Our results confirm the work of Acemoglu, Johnson and Robinson (2004) who have shown that the growth gap between rich and poor countries is due, in large part to the difference, in the guarantee of property rights in these countries.  Thus, Rodrik, Subramanian and Trebbi (2004), in their study, confirm the idea that the guarantee of property rights accelerates growth. The second indicator (4.2) and the fourth regression (4.4) in Table 4 show that the two indicators of government effectiveness and the quality of regulation do not seem to have an impact on the economic growth of these countries since their coefficients are both positive and negative and present respectively 1.45 point and -0.42 point not statistically significant. They only contribute by a marginal effect in the triggered process of economic growth, which no longer verifies the Kirkpatrick and Parker (2005) study that a change of one unit in a variable combining quality and efficiency of regulation is, on average, associated with an increase of about 0.6 to 0.7 percent of economic growth.

However, the weakness of these coefficients also reflects the inability of the government of these countries, covered by our analysis, to provide and to put in place policies and regulations and thus to initiate institutional reforms promoting economic development to create an enabling environment for the business climate.

According to Table 5 above, it results that the regression results estimated in first differences in the case of the generalized moment’s method also confirm our expectations concerning the sign of the control variables. Indeed, the coefficients of the macroeconomic variables: Gross fixed capital formation, exports, and enrollment rates become significant except for the rate of growth of the population which is always negative and contributes only by a marginal effect in growth.

From column 5.1 to column 5.6, the results of the estimates have led to the conclusion that institutional variables are not without effect on economic growth. In order to check whether or not there is complementarity between governance indicators and foreign direct investment, it should be noted that in the four models 5.1, 5.2, 5.5, 5.6 as shown in Table 5, the cross variable fight against corruption, government effectiveness, voice political empowerment and respect for the law in interaction with foreign direct investment, have all signs that become negatives, this means that even the countries in our sample expect an improvement in their index of 1%, economic growth is reduced by 0.09.1.11.0.08.0.09 point and less sensitive to changes in foreign direct investment,

In other words, these foreign direct investments interact negatively with the rate of growth of these countries when these four variables of governance are important.

Concerning the sign and the coefficient relating to the variable fight against corruption and foreign direct investment following a drop of 0.09 percentage point confirms the work done by Mauro and Wei (1997) which showed that corruption penetrates domestic and foreign investment, it therefore reduces the rate of economic growth. The negative sign of the variable fight against corruption crossed with foreign direct investment, sometimes constitutes an opportunity and not an obstacle to the attractiveness of foreign direct investment.This could be interpreted by the multiplicity of restrictions in these countries, which makes the practice of corruption a solution.

Moreover, the result of the cross-term government efficiency and foreign direct investment is no longer in line with statistical observations and only contributes negatively through the transmission channel of foreign direct investment to growth. Regarding the term of interaction, voice and political accountability with foreign direct investment, it is a negative sign and not significant, leading to a drop in economic growth of 0.08 points face to a variation of foreign direct investment, this result no longer corroborates Maria-Angels and others (2002) who have studied the relationship between political institutions, foreign direct investment and growth in 119 developing countries. They concluded that democracy has a positive effect and significant impact on economic growth because good democracy encourages foreign direct investment, which is the input of a country's economic growth. So, they recommend that governments should to strive for develop and guarantee the rule of law and transparency.

Otherwise, in regards to the negative sign and the non-significant coefficient of the term compliance with the law and foreign direct investment, it is in contradiction with the contribution of Barro (1997) who asserted that respect for the law is favorable to stable economic growth and does not confirm the study by Bénassy-Quéré, Coupet and Mayer (2007) who try econometrically assess the role of institutional a set of 52 countries on FDI in both the native country and in the host countries, including an institutional variable during the period 1985-2000, they lead to positive and significant coefficients their explanatory variables for the security of property rights, security of private contracts, respect for intellectual property and efficiency of justice. The respect of the law protection of property rights is a necessary condition in a market economy as foreign investors do not take the risk to be deprived of the return on their investment.

The reading of our empirical results reveals two main points. The first concerns the coefficients associated with the variables of foreign direct investment interaction measures and the weight of the regulation, are individually negative and significant. It confirmed the substitutability between these two factors in the promotion of growth. The substitutability is due to the fact that, more the weight of regulation is important to stimulate the dynamics of foreign direct investment, more it induces so a 0.12 percentage point drop in economic growth, this decrease is less sensitive to variations of foreign direct investment. This result contradicts the empirical results obtained by Simeon Djankov and others (2006) who found a significant relationship between the quality of regulations which is harmonious with business and higher rates of growth.

In the same line, Yahyaoui, Rahmani (2009), and Chtourou (2004) argue that the impact of institutional quality on long - term economic performance spread by reducing transaction costs, limiting risks and eliminating rigidities which affect the functioning of markets.

We can explain this result probably by the growing difficulty of these economies to bring a real positive change in terms of improving the quality of institutions, knowing that the countries studied are handicapped by the bureaucratic slowness and a complex regulation, in addition, these countries are characterized by the persistence of the scourge of corruption that erodes economic freedom and amplifies the sense of insecurity and uncertainty among investors.

The second remark relates to a strategic importance of the result in Table 5, which also shows that the coefficient of the interaction term political stability and foreign direct investment is the sign economically negative and statistically significant at the 1% threshold for the 30 countries covered by the analysis. On the quantitative side, any improvement in the indicator of political stability of 1% leads to a 0.06 percentage point decrease in growth through foreign direct investment. It is an inverse relationship between political stability and economic growth of these countries via the channel of foreign direct investment. As paradoxical as it may seem, the empirical result seems to indicate that the rate of growth is less sensitive to the FDI ratio when political stability is high. This confirms once again the substitutability of these two variables in order to stimulate economic growth. Our results glue perfectly with those of Barro (1991), for whom the instability of economic growth can be the source of political instability. In the same framework, Alesina and Perotti (1993) detect an inverse relationship between instability and growth.

Teaching to draw is that political stability is an important element of economic policy. In fact, an unstable political environment is more conducive to corruption. And nobody wants to invest in a corrupt economy. Easterly, on its side, proved that corruption and growth are inversely correlated, as well as corruption and the ratio of investment to Gross Domestic Product .Corruption also has an indirect effect on growth because it deteriorated the political conditions that facilitate it.

In summary, political instability also leads to institutional fragility which, in his turn will create institutional instability; this instability will lead to corruption with all its consequences: governmental inefficiency, lack of transparency accountability and no respect of the rules of law. All this contributes to creating an unfavorable climate for economic growth.

Certainly, the institutional infrastructure composed of the quality of regulation, political stability, the fight against corruption, the effectiveness of the intervention of public authority, the quality of the rule of law and the degree of participation of citizens in democratic construction, remain of the necessary determinants, but not sufficient to achieve economic and social growth sustainable of the countries in question.

**Conclusion**

After presenting an empirical state of art including the main studies that interest the relationship between governance and economic growth. Using the appropriate indicators of measures, we took a sample of 30 developing countries during the period 1996-2013.

The empirical results based on a dynamic panel data approach show that the direct effect of good governance, through the good institutional quality on economic growth, appears positive and significant for these countries.

Otherwise, the regression of institutional variables does not seem to be marginalized. Their effect depends on the effects of macroeconomic variables, such as foreign direct investment, investment and human capital.

We have been able to show that there is an indirect effect of these variables on economic growth which has given us a negative and significant result. The introduction of cross-variables between foreign direct investment and institutional quality provide us with answers about this unexpected sign.

Indeed, the negative link between institutional governance and flows of foreign direct investment tends to suggest that governance is a substitute for foreign direct investment. This result informs us about the importance of political stability and the quality of regulation and the reasons why it should be considered as important elements of economic policy. Because an unstable political environment is more propitious to the recrudescence of corruption which, is in turn, is not any more favorable to economic and social growth.

However, to allow this dimension of Governance to register in the context of complementarity with the dynamics of external investment flows. Primarily, developing countries should increase the efficiency of the productive system so that these external flows can generate intense growth and sustained development, the quality of governance must first be improved by the creation of a rule of law, the generalization of the principles of transparency and non-discrimination, which generally weaken the conditions in which enterprises operate. The establishment quality institutions, incentives that adapt to change to encourage dynamic companies functioning rationally, as well as a system of property rights characterized by credible rules for the protection of individuals, contracts must be prevalent in order to reduce transaction costs and uncertainties in trade relations.

Similarly, an active fight against corruption is essential to fight against the economy of rent and promote fair competition, and the promotion of a stable, consensual and effective political, legal and regulatory regime is such as to enable the private sector to boost the economic performance of developing countries.

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