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Holy Spirit University of Kaslik (USEK)

(The Impact of Political Stability on Economic Growth, Evidence from Developing Countries)

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ABSTRACT

The goal of this study is to analyze whether political stability and governmental decisions have a significant impact on countries with a developing economy, for a practical implication of fighting poverty and realizing convergence between countries relatively poor and countries with abundance of wealth, for the ultimate benefit of the society.

Keywords:- *Economic growth, Gross Domestic Product, Political stability, rule of law, Control of Corruption, Quality of regulations, Government effectiveness*

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CHAPTER ONE

INTRODUCTION

A. Background and Statement of the Problem

In a world were according to theories, economies of countries tend to converge and according to reality the differences between developing and developed countries is in some cases increasing and the difference in the quality of living widening, Scholars argue about why the Solow model of convergence between countries failed but what they do agree about is that it did fail and the gap instead of tightening, widened (Snowdon, 2009)

B. Purpose and Significance of the Study

The purpose of this study is to analyze one of the possible reasons of the failure of developing economies to converge with developed countries and even though politics is part of the social sciences, yet if it is the variable that is restraining poor countries from developing (Guo& Wang, 2022) is related to politics it would be obvious that as finance professionals we need to tackle this subject and analyze a significant possible effect of governance related criteria to economics.

C. Nature of the Study and Research Question

To answer what criteria related to politics, stability rules and regulations are of significant impact on economic growth, the study will use a fundamental approach through quantitative secondary data via reliable international sources and even though in the specific case of developing countries data are somehow limited (Inaba& Omar, 2020) yet through the statistical method of regression the study attempts to identify whether several criteria are together or solely the roots behind the actual widening gap of wealth between developing and developed countries.

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CHAPTER TWO

LITERATURE REVIEW

A. Mainstream Literature Review

While in many countries, the government lead the people towards prosperity (Han et al., 2020) yet in many cases this is not the reality especially in countries where the corruption index is high (Ali et al., 2019) and instead of poverty reduction strategies and theories the result would be wealth and abundance for corrupt officials combined with poor infrastructure reducing the efficiency of even the most successful of firms on a national scale.

Many firms perform a regular study to identify their strengths, weaknesses, opportunities and threats, this SWOT analysis enables a corporation to enhance its efficiency by, in addition to analyzing itself internally, analyzing the external environment in which it operates to seize opportunities when present and to control threat when possible, and if Foreign Direct investment FDI increases in developed countries due to proper infrastructure (Abbas et al., 2019) it would be logical that it poor infrastructure would decrease FDI in the case of developing countries.

Furthermore, in an age of globalization and transportation development many national corporations would move their headquarters outside their original country and in some cases their entire plant and area of operations towards wealthier countries, not only to control the threat caused by corruption and poor infrastructure, but also to seize the opportunity of increasing their profits by operating in countries in which both the demand and the price of goods are much higher Corruption and poor infrastructure are not the only reasons for relocation, for if the latter encourages large organization to consider relocation, War and violence would in some cases force them to do so to continue running properly (Lee & Wang, 2021).

In fact, both geopolitical risks and regulatory changes are part of the risk governance framework of many large companies running in developing countries and in an era of extreme competition worrying and solving macro-economic issues would decrease efficiencies in companies that ought to focus more their internal processes, strengths and weaknesses to maximize profits instead of having management worrying about external risks.

Scholars argue that in addition to stability, transparent regulations would increase FDI (Mosteanu, 2019), this was the case for United Arab Emirates where as per the government's strategy to decrease the economy's dependency on Oil Export, the tactical decision was to enhance regulation's quality to attract more successful firms to the Country, in addition to regulation both the law the ability to enforce the law are possible factors influencing firm's decision to enter a new market (Haines & Macdonald, 2021), together for proper law without enforcement has an intangible effect, and strong law enforcement without proper law would have an adverse tangible effect, it is not surprising that countries who value property rights the most are the countries in which innovation as well as research and development prosper the most.

B. Theoretical Framework

Previous theories that would be put to the test for significance include the uncertainty theory (Jung et al., 2021) according to which geopolitical instability would negatively impact large public firms and their stock prices as well as, to a lesser extent, small and medium enterprises SMES, another theory related to sound governance is the public interest theory of regulation which claims that government regulations act to benefit the public yet in many cases the impact of excessive regulation was adverse as such interventions made private investment less secure and increase the risk premium and thus the cost of raising capital for many firms (Wilson, 2021).

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Finally, the third and possibly most important theory is the theory of Violence and political economy that was originally developed by Adam Smith that argues that during political instability and violence individuals tend to care little about saving and investing and therefore the overall economic growth of the country goes into contraction (Paganelli, 2022).

C. Research Context and Hypothesis Development

In such a context of variable theories, many hypotheses can be developed with an independent variable of economic growth which needs to be quantitatively measured through Gross Domestic Product GDP which is the total value of all goods and services produced within a specific country and in the study's case the selected countries need to have a developing economy, because political stability and government effectiveness are already pillars in developed economies.

- Hypothesis one: Political stability and the absence of violence have a significant impact on the performance of developing countries.
- Hypothesis two: The quality of public services and Government effectiveness have a significant impact on the performance of developing countries.
- Hypothesis three: Sound policies and regulations have a significant impact on the performance of developing countries.
- Hypothesis four: Law enforcement and property rights have a significant impact on the performance of developing countries.
- Hypothesis five: Control of corruption have a significant impact on the performance of developing countries.

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CHAPTER THREE

RESEARCH METHODOLOGY

A. Data Collection and Sampling Method

A collaboration between worldwide governance indicators (WGI) and the world bank Group which is one of the largest international financial institution that promote sustainable prosperity lead to the spreading of the valuable secondary data used in the study, the sampling method was nonrandom judgmental sampling as in addition to the reliability of the data, the countries chosen needs to have developing economies, it is the ministry for foreign affairs in Australia that provided a recent list of developing countries (Government of Australia, 2022)

B. Empirical framework, Data Treatment and Variable characteristics

Independent Variables	Dependent Variable
Political stability and non-violence	GDP
Government effectiveness	GDP
Regulatory quality	GDP
Rule of Law	GDP
Control of Corruption	GDP

Table 1: List of Variables

Note. The Score of independent variables is related to the percentile rank among all countries ranging from 0 as lowest to 100 as highest

Research Type	Empirical
Hypothesis 1	Effect of Political stability on economic growth
Hypothesis 2	Effect of Government effectiveness on economic growth
Hypothesis 3	Effect of Regulatory quality on economic growth
Hypothesis 4	Effect of Rule of law on economic growth
Hypothesis 5	Effect of Control of corruption on economic growth
Approach	Quantitative
Branch of Science	Statistics – regression analysis
Data Collection method	Secondary Data – World Bank
Data Sample	Five Countries
Sample type	Developing countries
Time Scale	2002 – 2021 (20 years)
Confidence interval	95%

Table 2: Research Framework Summary

Note. A rather long time scale of twenty years is used to improve output reliability

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CHAPTER FOUR

RESULTS AND DISCUSSIONS

A. Results

Regression Statistics	
Multiple R	0.820400237
R Square	0.67305655
Adjusted R Square	0.556291032
Standard Error	8635324703
Observations	20

Significance F
0.004292829

ANOVA

	df	*SS*	*MS*	*F*
Regression	5	2.14914E+21	4.29828E+20	5.764172172
Residual	14	1.04396E+21	7.45688E+19	
Total	19	3.1931E+21		

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	42691344605.78	11052262486.53	3.86	0.00
Political stability	374333349.00	569487058.46	0.66	0.52
Government effectiveness	-86710598.95	432558034.86	-0.20	0.84
Regulatory quality	1380103596.38	547847252.58	2.52	**0.02**
Rule of Law	-2367393377.44	829628356.98	-2.85	**0.01**
Control of Corruption	287627962.30	832771300.25	0.35	0.73

Table 3: The case of Lebanon

Note. At a significance effect of 0.004 and a power value below 0.05 we successfully reject null hypotheses H03 and H04 According to which regulatory quality and rule of law have no significant impact on the GDP of the developing economy of Lebanon.

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Regression Statistics	
Multiple R	0.43935967
R Square	0.19303692
Adjusted R Square	-0.09516418
Standard Error	13474505146
Observations	20

Significance F
0.652844089

ANOVA

	df	*SS*	*MS*	*F*
Regression	5	6.08052E+20	1.2161E+20	0.669799385
Residual	14	2.54187E+21	1.81562E+20	
Total	19	3.14992E+21		

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	1.12443E+11	1.55419E+11	0.723	0.481
Political stability	-302646694.5	770452555	-0.393	0.700
Government effectiveness	-992778568.9	2103153785	-0.472	0.644
Regulatory quality	34570796.83	1630182525	0.021	0.983
Rule of Law	991871626	1337835549	0.741	0.471
Control of Corruption	-1248089149	1205699317	-1.035	0.318

Table 4: The case of Jordan

Note. With a significance above 0.05 we fail to reject all null hypotheses related to the impact of the above variables on the GDP of Jordan.

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Regression Statistics	
Multiple R	0.965832827
R Square	0.93283305
Adjusted R Square	0.908844854
Standard Error	8743338602
Observations	20

Significance F
0.00000010

ANOVA

	df	*SS*	*MS*	*F*
Regression	5	1.48638E+22	2.97277E+21	38.8871692
Residual	14	1.07024E+21	7.6446E+19	
Total	19	1.59341E+22		

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	2.29946E+11	47825862825	4.808	0.000
Political stability	1788767155	178184049.4	10.039	**0.000**
Government effectiveness	463557350.3	580137453.4	0.799	0.438
Regulatory quality	-1159814064	446995084.7	-2.595	**0.021**
Rule of Law	-3357110097	624721139	-5.374	**0.000**
Control of Corruption	-45379437.44	668789728.1	-0.068	0.947

Table 5: The case of Sri Lanka

Note. With a significance of 0.0000001 and power value below 0.05 we successfully reject Null hypothesis one, three and four related to the significance of political stability, regulatory quality and Rule of law on the GDP of Sri Lanka, a developing country.

Regression Statistics	
Multiple R	0.87045696
R Square	0.75769532
Adjusted R Square	0.671157934
Standard Error	1.03443E+11
Observations	20

Significance F
0.000610999

ANOVA

	df	*SS*	*MS*	*F*
Regression	5	4.68452E+23	9.36904E+22	8.755699209
Residual	14	1.49807E+23	1.07005E+22	
Total	19	6.18259E+23		

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	1.3997E+12	2.72944E+11	5.128	0.000
Political stability	-10445170473	4585713851	-2.278	**0.039**
Government effectiveness	8413521751	6643508500	1.266	0.226
Regulatory quality	695044063	7098408176	0.098	0.923
Rule of Law	-9493459656	8652880887	-1.097	0.291
Control of Corruption	-7047166335	3406979409	-2.068	0.058

Table 6: The case of Mexico

Note. With a significance level of 0.0006 and a power value of 0.039 we successfully reject null hypothesis one related to political stability and fail to reject null hypotheses two to five in the case of the developing country of Mexico.

Regression Statistics	
Multiple R	0.781468574
R Square	0.610693132
Adjusted R Square	0.471654965
Standard Error	3512373035
Observations	20

Significance F
0.012940506

ANOVA

	df	*SS*	*MS*	*F*
Regression	5	2.70932E+20	5.41864E+19	4.392269719
Residual	14	1.72715E+20	1.23368E+19	
Total	19	4.43647E+20		

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	30027128681	14683059200	2.04502	0.06013
Political stability	-371563500.4	270482938.7	-1.37370	0.19113
Government effectiveness	601883.767	261592895	0.00230	0.99820
Regulatory quality	300453221.3	153001695.3	1.96372	**0.06974**
Rule of Law	-383823850.9	247077268.2	-1.55346	0.14262
Control of Corruption	252016199.5	169035839.8	1.49090	0.15817

Table 7: The case of Mongolia

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Note. Even with a significance level of 0.0129 we fail to reject any null hypothesis H0 related to the five variables of political stability, government effectiveness, regulatory quality, rule of law and control corruption in the case of Mongolia

B. Discussion and interpretation

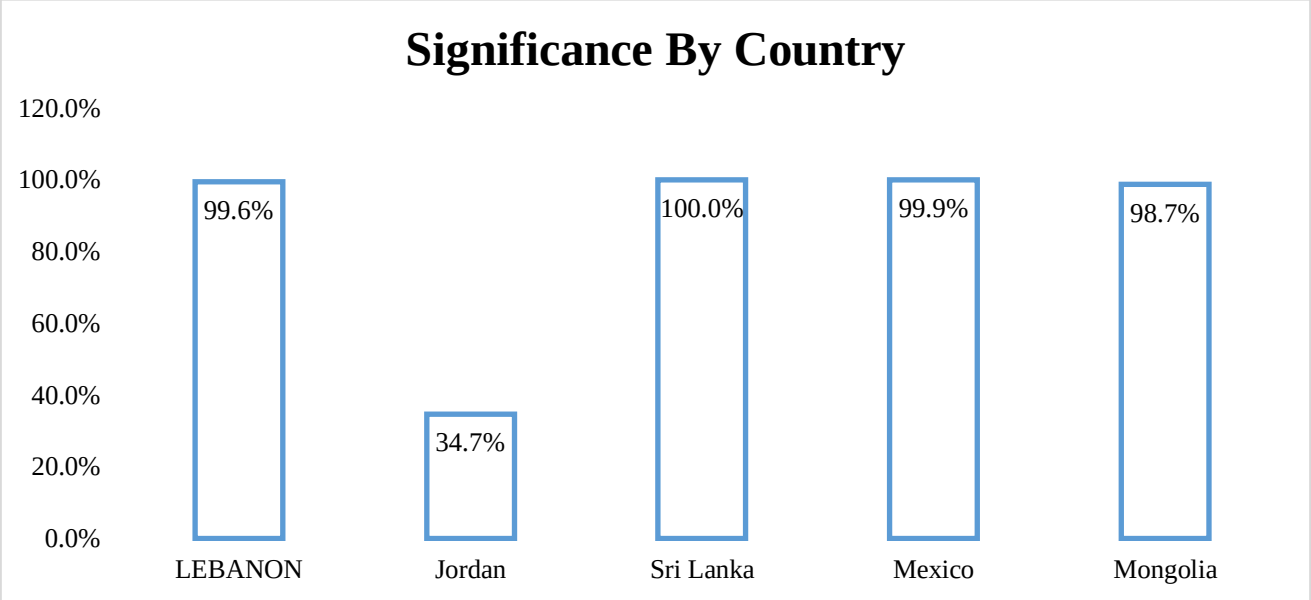

Fig. 1: Results Significance by Country

Note. As we discuss the results, in four out of five developing countries the collective impact of the variables of political stability, government effectiveness, regulations quality, rule of law and control of Governance had a significant impact on the output of the economy of the developing countries that were part of the study, confirming that a one of the reasons of the weak economy of the countries above is related to political factors.

C. Limitation& Further research

The time frame of twenty years was long enough, yet the number of countries that were part of the study is relatively small in compared to population of over 160 developing countries, further research should include more countries.

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CHAPTER FIVE

CONCLUSION

A. Contribution of findings and implications

In theory, it has been proven that one of the main reasons why developing and developed economies are not converging is not the erroneous model of Maslow's Equation for economic growth, but the incompleteness of the latter, for theoretically speaking one of the most important factors in the increase of Gross Domestic Product of developing countries is related to Geopolitical and governmental issues, a variable that may be disregarded for developed countries but that is Significant for countries that are still in the process of developing.

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