Economic Governance and Human Development: Evidence from Pakistan

Muniba Zulfiqar[1], Samar Shakeel[2] and Dr. Parvez Azim[3]

Abstract

This article empirically explores the impact of economic governance indicators on human development in Pakistan for the period 1976-2009. Using ordinary least square regression analysis on time series data, this study finds that some of the indicators pointing towards good governance are also positively impacting the Human development in Pakistan. This study suggests a further exploration of the link between two variables i-e. Economic governance and human development by using large data set with most appropriate indicators for effective policies.

Introduction

"Good governance can be a single element for poverty reduction and development." (Court and Hayden, 2005). For the previous some decades, much attention is centered on growth and development in economic science. Stabilization and structural adjustment programs for market friendly nature and sustainable growth and development were initiated under the hood of international organization since 1980s. But many economies, including Pakistan, have not been able, yet, to achieve desired goals in an efficient way. Consequently, it raised many questions about the effectiveness of such programmes (Stiglitz, 2002). Much of the attention, was then, focused on having better and efficient policies and participation of government to improve economic governance in growth and development related issues (Kankwanda et al., 2000). Human living conditions are uniquely affected by alteration of world's economic, social and political commute which can also create suspicions and confronts (Petrovsky). Among other issues, increasing number of studies is now indicating how the governance related to economic issues is positively associated with growth and social development. There is now a demand of sound and efficient economic governance for better standards of living (Basu, 2003).

State's actions relating to management and execution of effective policies while containing the role of corruption forms the basis of Economic governance. It includes the activities of both, private and public sector. "Governance has three legs: economic, political and administrative. Economic governance includes decision-making processes that affect a country's economic activities and its relationships with other economies. Political governance is the process of decision-making to formulate policy. Administrative governance is the system of policy implementation. Encompassing all three, good governance defines the processes and structures that guide political and socio-economic relationships." (UNDP; 1997). Thus, Economic Governance "…combines the philosophy and architecture of economic policy-making with the institutions, machinery and practices that shape the evolution of the economy." (Howarth, 2005). Economic governance forms one of the three closely integrated pillars of "good governance" (Fig. 1). Transparency, impartiality, participation, accountability and efficiency are principles of "good governance".

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[1] Graduate, University of Gujrat, Pakistan
[2] Graduate, University of Gujrat, Pakistan
[3] Dean, Faculty of Arts and Social Sciences, GC University Faisalabad, Pakistan
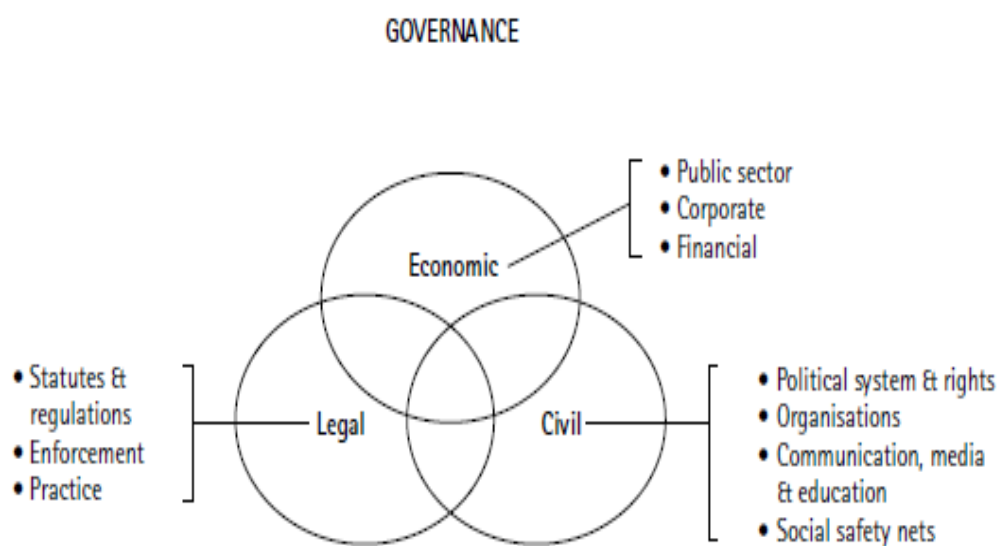
GOVERNANCE

Source: UNDP, 1997

Good governance is one of the key ingredients of economic growth, development and poverty alleviation. The objective of an economy, in general, is to increase the level of wellbeing of its people. Traditionally, per capita GDP has been used to measure the wellbeing of the people. This is, however, increasingly being questioned in the recent era, since pure economic indicators cannot capture the wellbeing of people in its broad perspectives, such as economic, social and cultural (Despotis, 2005; Pradhan, 2007). In fact, per capita GDP is neither the quality of life nor an end in itself. It is only considered as a means but the end of development is the welfare of human beings. So the emphasis has now shifted to multidimensionality of human development, which ensures an overall development of human beings and the society and plays a key role in the development process (Clarke et al., 2006: World Bank, 2004; Clarke and Islam, 2004; Stiglitz, 2002; Nussbaum, 2000; Dodds, 1997; Daly, 1996; McGillivray, 1991; Doyal and Gough, 1991).

During the 1990s, the Human Development concept has been accepted by an increasing number of researchers, policy advisors, politicians and social practitioners, most evidently in the publication of the global Human Development Reports (HDR). The first of these was published in 1990 and defined human development as "the process of enlarging people's choices. The most critical of these wide-ranging choices are to live a long and healthy life, to be educated and to have access to resources needed for a decent standard of living."(HDR, 1990) The Human Development Index reflects the essential choices of people by combining life expectancy, school enrollment, adult literacy and average income.

The HDI—three dimensions and four indicators
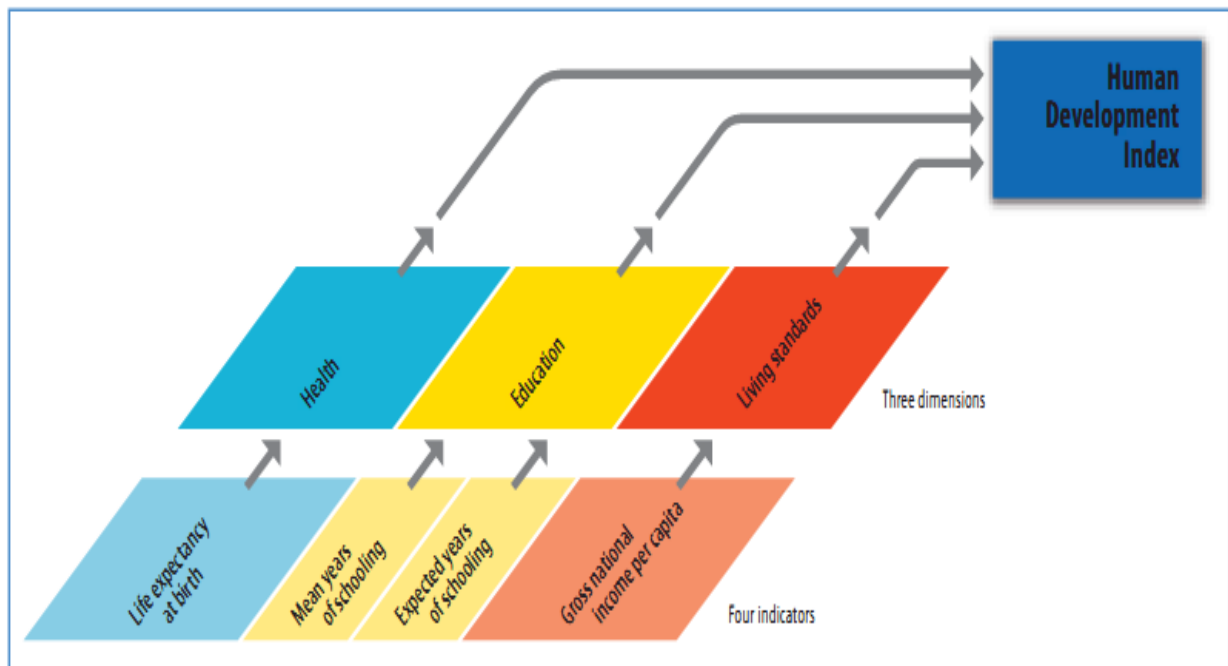
Source: HDR (2002)

An achievement of high human development depends upon a substantial set up in all the dimensions simultaneously. This is because they are very interrelated to each other. The lack of one leads to lack of others, resulting in overall degradation of human development. However, to maintain the balanced development of all the dimensions, government intervention or quality of governance is very essential. The absence of the same leads to low human development in the economy. According to Fukuda-Parr (2003), governance through political institutions that expand the power and voice of the people, and ensure the accountability of decision maker, is an important condition for promoting human development. In the last decade of the 20th century, the need for good governance has been an impact and recurring theme in the literature dealing with human development- both research and popular. There is now a growing body of evidence, which shows that the quality of governance is related to differentials in growth and development (Ramachandran, 2002; Dwivedi and Mishra, 2005; Moore, 2006; Rayp and Van de Sijpe, 2007). This is because government can efficiently deliver the resources to the public so as to improve the well being of people.

This paper seeks to examine the impact of economic governance on human development in Pakistan. Pakistan economy is still considered as developing despite decades of conceptualizing, formulating and implementing various types of economic policies and programs. Per capita income in Pakistan is $ 1051 with literacy rate 54% and life expectancy only 13 % (economic survey, 2009/10). The overall HDI value of Pakistan is 0.490 with a rank of 125 among 192 members (UNDP-HDI, 2010). This study will highlight the importance of economic governance in alleviating poverty and to achieve the Millennium Development Goals in Pakistan.

Literature Review

Good governance plays important role in human development. In recent years, these concepts are very valuable and researches about both governance and human development are increasing, but the majority of literature is written on the relation between corruption and human development. Akhter (2004) found the relation between governance, as measured by

corruption and human development and saw the effect of globalization on human development through economic freedom. He established a positive relation between human development and globalization in an environment of good corruption characterized by low corruption. Akçay (2006) explored the relationship between corruption and human development in a sample of 63 countries to test the impact of corruption on human development. He used three different corruption indexes. Results were statistically significant and showed negative relationship between corruption indexes and human development. Empirically this study proved that more corrupt countries tend to have lower levels of human development. Nielsen and Haugaard (2000) established two hypotheses in their paper. First one was that the higher levels of corruption correspond with lower levels of human development and second was that the process of consolidating democracy lowers corruption. Their main findings were firstly that corruption hindered human development. Secondly, along with economic development, state intervention, and a measure of culture, democratic consolidation was significant and lowers the level of corruption. In case studies of Bolivia and Nicaragua- countries which have high levels of corruption and modest levels of development- results showed corruption constrained human development by preventing access to public services, by lowering social expenditure, and by causing economic inefficiency. Pradhan and Sanyal (2011) in their paper developed a conceptual framework to study the interface between good governance and human development in India. Their results showed that good governance was the potential factor through which human development can be improved in the Indian economy. Mauro (1998) found that corruption affects education and health by reducing government expenditure on them. Mauro (1996) and Leite and Weidman (1999) in a cross country study found a negative relation between corruption and GDP per capita growth and claimed that high and rising corruption increases income inequality and poverty. Gupta, Davoodi, and Alonso-Terme (1998) showed that corruption negatively affects social spending, education equality, secondary schooling and distribution of land. They also found that corruption increases income inequality and poverty. Gupta, Davoodi, and Tiongson (2000) checked the relationship between corruption, health and education and found that corruption affects the cost and quality of these services. Gupta, Davoodi, and Tiongson's empirical analysis revealed that corruption has positive impact on child and infant mortality rates. Kaufmann, Kraay, and Zoido-Lobaton (1999) found that corruption has negative impact on life expectancy and literacy and positive impact on infant mortality rates. Samimi and Jahadi in their study examined the effect of governance matters on human development in OPEC countries for the period 2002 to 2007. The result showed positive and significant impact of governance matters (Political Stability, Rule of Law and Control of Corruption) on Human Development. Li, Xu and Zou (2000) found an inverted U-shaped relationship between corruption and inequality. Empirically their findings showed a negative impact of corruption on growth and it has very harmful effect when government spending is very high.

Theoretical Background

Impact of any macroeconomic policy has been examined by studying its impact on economic growth and income. In recent years polices have been directed toward reducing the level of poverty and inequality through raising quality of life in society by providing efficient and effective governance. This new economic philosophy has resulted in a massive change in the policy orientation of countries; the priority is now centered on issue of governance and focus is now shifted towards a qualitative nature of its growth and development. According to Sen (1983), the realization of human capabilities, that enlarge the range of human choices, is essential for a broader notion and measure of economic well-being. The institutional frame

work is then considered as one of the essential elements for translating growth and well-being into a sustainable process.

Impact of different policy instruments depends on how effectively public sector performs to achieve these objectives. If expenditure use on regulation and control of corruption then it will help to improve income per capita and output growth rate of the economy. Equal distribution of the income, will improve welfare of the society. So there is need to have strong government that implement policies and increase expenditure for raising income and GDP growth rate of the economy. When GDP growth rate increase then per capita income increases but Good Governance also has other objectives. All segment of the economy should be under consideration so it reduced trap of poverty. When government expenditure on education and health sector increases, it improves human capital of the economy and helps to increase employment opportunity in the economy that in turn reduces unequal income distribution from the economy and improves welfare of the society. As population growth rate is high in Pakistan, so when labor force participation rate increases then income also increases because of proper utilization of underutilized resources of the economy and helps to increases demand for goods and services. It also helps to increase output in the economy because demand creates its own supply and benefit of output goes at gross root level. When reserves ratio increases in the economy it shows that there are unutilized resources in the economy and effect welfare of the economy negatively by increasing unequal income distribution. (Reserves show that there is trade surplus and government has enough resources to finance and help to improve output growth rate).when inflation will low then low prices will stimulate export, current account balance will improve which lead to improve economic situation, employment opportunity will increase, expenditure on health and education will increase which lead to human development. Governance will bring favorable environment for local and foreign investment. When investment opportunities will increase it will generate employment opportunities and help to improve output growth rate in the economy. When remittances will increase then it means reserves increase which shows underutilization of resources which lead to unequal distribution of income.

Good governance influence economic growth positively. Evidence suggests that bad governance hinders growth and investment, and aggravates poverty and inequality. If there is governance problem then every effort to improve infrastructure, attract investment, and raise educational standard will not be useful. In developing countries there are large problem including weak institutions, low growth, poverty and inequality all which translate into low levels of human development. Good governance will provide favorable environment for saving and investment, risk taking, incentives to producers, certainty in markets, removing barriers to international trade, and improvements in competitiveness. All these factors will contribute to human development positively. And which will also lead to growth.

Methodology and Data

While most of the research relating governance and human development has focused on the democratic or political governance aspects and developing and transitional countries at large, or being region\state specific, this paper aims to find out the impact of economic governance (indicators)on human development in Pakistan for the period 1976-2009. This time period is selected because of the restricted availability of data. Simple ordinary least square method will be used to check the relationship between the concerned variables after checking the stationarity.

Following Basu (2003) this study will use quality of economic governance index (QEGI) indicators. QEGI is a latent variable model which is linearly dependent on a set of observable indicators plus a disturbance term capturing error.

$$QEGI = \alpha + \beta_1 X_1 + \ldots\ldots + \beta_k X_k + e$$

Where X1, X2 ….. Xk are set of indicators use to measure Quality of economic governance index. The total variation in the QEGI is composed of two parts: a) variation due to set of indicators, and b) variation due to error. If the model is well specified, including adequate number of indicators, then the total variation in QEGI is largely explained by the variation in the indicators (i.e., the indicators that are used to compute the QEGI).[4]

This study will employ four indicators of QEGC as identified by Basu, to check the effect of economic governance in Pakistan. These are: workers' remittances, gross national expenditures, total reserves and inflation rate.

The choice of selecting these indicators for present analysis is driven by few key considerations.

Government spending for public projects is shown by gross national expenditure. The capacity of governments spending for public works depend primarily on countries revenue generating capacity, and related policies and incentives (Basu, 2001). Economies providing more public funds are assumed to perform comparatively better than the opposite. In other words, have good economic governance and improved human development.

To seize the overall availability of resources to the government total reserves is used as proxy. This indicator captures the economy's strength with foreign and domestic reserves in hands. Moreover, adequate foreign currency reserves provides countries the required currency stability, and also helps in augmenting the capital stock (both physical and human) for utilisation in domestic economic investment.

External sector's condition indicator (remittances) shows the country's macroeconomic stability. Economies with strong external sector tend to have good economic governance condition and human development.

Financial and investment attractive environment of the economy is shown by inflation rate. The higher values of this indicator would definitely be a negative pointer for the international and domestic investors. They would not risk investing in those economies, and thereby the economies would face a resource crunch, providing negative impetus to economic performance and human development.

Indicators pointing toward good economic governance will be used as an indication towards improved HDI of Pakistan.

All the above mentioned indicators as a measure of economic governance have been taken from World Bank development indicators (WDI, 2009).

To measure the human development, human development index, calculated by United Nations development program, is used. The data will be taken from UNDP. The study will use Hybrid HDI[5] which reports HDI trends since 1970 for the purpose of study time period.

Functional Form of the Model:
HDI = f (Government Expenditure, remittances, Inflation, Reserves)
The following equation based on model will be estimated:
$$\ln(HDI) = \alpha_0 + \alpha_1 \ln(GNE) + \alpha_2 \ln(REMIT) + \alpha_3 \ln(INFLA) + \alpha_4 \ln(RES) + \varepsilon$$
Where;
HDI = Human Development Index
GNE = Gross national expenditures
REMIT = Remittances
INFLA = Inflation

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[4] The methodology and computation of QEGI-type index is also described in Nagar and Basu (2000, 2002), Basu (2001, 2002, 2003).

[5] The hybrid HDI is a different version of the HDI that applies the same aggregation formula as the new HDI, but to a set of indicators used in the previous HDI – life expectancy, adult literacy, gross enrolment ratio and GDP per capita. It is used in the 2010 Report for analysis of historical HDI trends since 1970 because there is much more data available from past decades for those indicators. The hybrid HDI uses annual data from 1970 to 2010 for 135 countries.

RES = Total reserves
ln= natural logarithm

Estimation Results:

Table 1 shows the results of the model. By taking first difference, all the series are being made stationary in order to avoid spurious results. Results show that some of the coefficients are consistent with the theory. Only 28% of total change in human development index is predicted by the independent variable. One possible reason for too low R^2 is the lack of control variable. A Durbin Watson value, close to 2, is an indication of no autocorrelation. This model satisfies all the diagnostic tests like Jarque Bera normality test, ARCH hetroscedasticity test.

Table 1

Dependent Variable: DLHDI

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.009558	0.002777	3.441783	0.0018
LGNE	0.099843	0.051189	1.950459	0.0012
LREMIT	-0.014968	0.006150	-2.433661	0.0216
LINFLA	-0.007072	0.003763	1.879669	0.0406
LRES	0.007455	0.003320	2.245618	0.0328
R-squared	0.285288	Durbin-Watson stat		1.811702
Adj R-squared	0.183186	F-statistic		2.794150
		Prob(F-statistic)		0.045320

First the coefficient of gross national expenditure is positive and significant at 5% level of significance. This means that a one percent increase in gross national expenditures increases the HDI by 0.09%. The effect of these expenditures on overall HDI is too low because the expenditures on education and health are just a minor part of all the national expenditures. That is why; expenditures have a minimum share in increasing the human development of Pakistan.

The negative coefficient of remittances shows a negative impact on human development. One percent increase in remittances reduces the HDI by 0.014% (minor impact shows that resources from foreign earnings are diverted to activities other than promotion of human development activities. This coefficient is also significant at 5% level of significance.

As expected, inflation is negatively and significantly affecting the human development condition in Pakistan. One percent increase in inflation, other things being equal, decreases the HDI by 0.007%.

In last, reserves are affecting the human development positively and significantly. One percent increase in reserves increases the HD by 0.007%. This result contradicts with previous findings which showed a negative impact of reserves on human development. Results show that some of the variables which points out towards good economic governance are positively affecting the human development in Pakistan.

Conclusion and Suggestion:

Overall results are showing that economic governance condition is improving in Pakistan which is affecting the human development condition, to some extent, positively. Although the results of coefficients are significant, but this topic highlights the need for further research by

using appropriate proxies of most of the variable, by using quality of economic governance index which is the most appropriate index for economic governance. Due to unavailability of such an index in Pakistan, this study has employed four of the indicators in effort to capture the sectors under which economic governance persists.

The findings of this paper are indicating that Pakistan government must work more efficiently and consistently in order to improve the human development in the country. This study can also be used to design appropriate policies or to redesign the previous ones in order to achieve the millennium development goals.

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