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The Predictors of Economic Growth: An Evidence from SAARC Region

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ABSTRACT

Most of the prior studies carried out in the context of a single country or group of countries for the association of stock market development with economic growth produced incongruent results. Thus, this study enquires the association of stock market development, political stability, controlling corruption and good governance with the economic growth of some selected countries like Pakistan, India, Bangladesh and Sri Lanka from the SAARC region from 2002 to 2018. The application of Pooled Ordinary Least Squares (OLS) with robust options unveiled that stock market development, political stability, and institutional index exert a significant positive impact on economic growth. However, controlling corruption and ensuring good governance have an insignificant positive effect on economic growth. These findings not only contributes to the existing knowledge but also provide insights to all key stakeholders for further improvement in practice and decisions.

INTRODUCTION

The economic growth or increase in national income became hot topics of discussion, especially after the publication of "Wealth of Nations" in 1776. The economic growth is evaluated by an escalation expressed in the real gross domestic product (GDP) (Nowbutsing & Odit, 2009). Dewan et al. (2014) found that increase in the stock market capitalization expedited the growth of economies in Bangladesh, India, Pakistan, Sri Lanka, and Nepal from 1996 to 2010. These findings endorsed both in the short and long run in Bangladesh (Mamun et al. 2018), South Asia (Karim & Chaudhary, 2017) and South Asian middle-income (Murari, 2017). However, it has been noticed that the growth-related policies and reforms are ineffective in absence of good governance or political stability, controlling corruption and supremacy of law, among others (Aggarwal, Klapper, & Wysocki, 2002). It is noted that accountability

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and effective governance (Bhattacharjee & Haldar, 2015) along with political stability, peace, the excellence of law and controlling corruption are important for economic growth in selected South Asian economies and SAARC region (Kacho & Dahmardeh, 2017). The review of the extant literature shows that economic growth has a relation with stock market, political stability, controlling corruption and good governance, among others. However, prior studies not only investigated these relationships in the context of single or developed countries, or region like European Union, Organisation for Economic Cooperation and Development (OECD) and BRIC, etc., but these also carried out the investigations in piece meals and produced incongruent results. Thus, this study adopts a holistic approach to enquire the exertion of stock market development, political stability, controlling corruption and good governance on the growth of economies in Pakistan, India, Bangladesh and Sri Lanka that is overlooked in the past, from 2002 to 2018. In addition to contribute to the knowledge, this study also delivers imperative understandings to improve policy and practice in the SAARC region.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Stock Market and Economic Growth

Stock market mirrors economic growth or financial health of an economy as highlighted and noticed at large by the global financial crisis 2007-08 (Rahman, Ibrahim, & Che-Ahmad, 2017a; Rahman, Rehman, & Zahid, 2018). It attracts investors by offering ownership to earn a profit on one hand and helps firms to raise their funds by selling shares to them on the other hand (Levine & Zervos, 1996). The importance of these is further prominent especially in the countries where the acquisition of loan is difficult (Ross Levine & Zervos, 1996). Accordingly, the regulators and investors of developed countries in general and developing countries especially are keen to ensure smooth functioning and development of the stock markets. Likewise, research studies also found stock market as a key for economic development (Atje & Jovanovic, 1993; Nowbutsing & Odit, 2009). Stock market improves firms' compliance with good practices through intensifying the fear of replacing inefficient management by decreasing stock prices in the market. The stock market is an effective mechanism particularly in the developing countries that channelize savings towards firms which have positive impacts on economic growth (Atje & Jovanovic, 1993). Caporale, Howells, and Soliman (2004) endorse these findings in that an orderly stock market stimulates economic growth.

In contrast, the traditional growth theories assume no significant relation of the stock market and economic growth (Osamwonyi & Kasimu, 2013; Ajit Singh, 1997). Empirically, Pan and Mishra (2016) also validated these theoretical assumptions, especially in the short-run. Many other studies also noted that the stock market has negative impact on economic development as it is vulnerable, particularly in developing countries (Singh 1997; Singh & Weisse 1998). In view of these incongruent arguments and findings, this study, for further investigation, assumes that:

H1: Stock market is a positive predictor of the growth of selected economies from the SAARC region.

Political Stability and Economic Growth

A country that has never been ruled by a dictatorship in the previous 25 years is considered to be politically strong and stable (Lipset, 1959). Sanders (1981) noted that the success of political system, by linking with itself and other political systems, over a period of time, reflects political stability. In other words, political stability accounts for decrease in violence, protests and lockdowns, military takeovers and civil disobedience, among others (Baklouti & Boujelbene, 2018). The subject is important as political instability affect institutions and their efficiency along with property rights which jeopradize economic growth through decreasing investment (Alesina & Perotti, 1996). It also affects economic growth by increasing uncertainties, risks, inflation, volatility and recurring changes in policies and strategies (Campos & Nugent, 1999). Empirically, many endeavours show that political stability has a significant positive relationship with economic growth (Alper, 2018; Gani, 2011) as found in Britain (Asteriou & Price, 2001), Venezuela (Muñoz, 2009) and 17 MENA (Alesina & Perotti, 1996; Baklouti & Boujelbene, 2018), African (Campos & Nugent, 1999) and Asian countries (Younis, Lin, Sharahili, & Selvarathinam, 2008). However, in a study of 19 economies, Kirmanoğlu (2003) could establish no significance of the association between political variability and the growth of 14 economies. In view of these incongruent findings of the prior studies carried out in different contexts, this study, for further investigation, assumes that:

H2: Political stability exerts a positive effect on the growth of selected economies from the SAARC region.

Controlling Corruption and Economic Growth

In various forms and at different levels, corruption is a global menace that exists in almost every country around the globe (Hongdao, Mumtaz, Mukhtar, Saleem, & Azam, 2018). Besides laundering and stealing money, the misuse of government property (vehicles, land, etc.) and powers of the public office for private benefits or getting unlawful profits are also counted as corruption (Hongdao et al., 2018). Corruption adversely affects economic growth by jeopardizing the faith and belief of public and investors in a country and its institution along with business organizations which slow down the pace of economic activities (Pulok & Ahmed, 2017). It has also been found that corruption affects the economy and its growth rate by embezzlements and bribery in the public institutions (Mahmood, Tian, & Azeez, 2018). Prior research noted that corruption and its associated costs increase costs of establishing and doing business that affect economic growth by discouraging investment (Del Monte & Papagni, 2001; Jacob & Umoh, 2017; Pulok & Ahmed, 2017) as found in Lebanon (Farida & Ahmadi-Esfahani, 2006) and in a study of 70 countries (Mauro, 1995). In short, the level or shape of corruption may vary in various countries, but overall the developed countries are good in controlling corruption than the developing countries (Jacob & Umoh, 2017).

On the contrary, an insignificant relation found between corruption and economic growth (Brunetti, 1997) in 30 OECD countries (Akça, Ata, & Karaca, 2012). Some others found that corruption expedites economic growth in that to save time and enhances the efficiency of government institutions (Rose-Ackerman, 1978). Few studies reduce the seriousness or adverse effects of corruption by arguing that Japan, China, Thailand, Korea, and Indonesia have good economic growth despite corrupt practices (Rock & Bonnett, 2004). Méndez and Sepúlveda (2006) are of the view that corruption is dangerous at high level but not at low level. Based on these incongruent findings, this study, for further investigation, assumes that:

H3: Controlling Corruption exerts a positive effect on the growth of selected economies from the SAARC region.

Good governance and Economic Growth

Good governance includes compliance to a set of already established and implemented laws, rules, and regulations in a country by its citizens, officials, employees and institutions (Lisitsyn-Svetlanova, Mal'kob, & Afanas'ev, 2018). It aims and accounts for equality, transparency, and compliance to legal system and categorical classification of the powers and responsibilities among individuals, organizations, and institutions. Prior literature, as well as practice (Rehman, Zahid, Rehman, Jan, &

Rehman, 2019), shows that law has a significant association with economy as sustainable economic development requires the introduction and revision (where and whenever necessary) of relevant legislation which could regulate and discipline economic activities along with contracts and property rights (Rahman, Ibrahim, & Che-Ahmad, 2017b). The formulation, as well as compliance of laws and rules, is also important in that to regulate markets and attract investment for economic growth. The wave of globalization has further increased the importance of good governance as it signals transparency and merit to the investors (Hongdao et al., 2018).

It is evident that the economies in transition have grabbed economic successes by introducing regulatory reforms and market liberalization (Lisitsyn-Svetlanova et al., 2018). Therefore, it is recommended to ensure good governance for a viable economic development (Samuels, 1998) as it combats corruption, among others, which is important for economic growth. Many studies noted that there is a significant positive impact of good governance on economic growth (Dollar & Kraay, 2002; Hongdao et al., 2018) in 30 OECD countries (Akça et al., 2012). Some studies, however, suggest the significance of the relationship in developed countries only (Akça et al., 2012; Hongdao et al., 2018; Lisitsyn-Svetlanova et al., 2018). In view of these contradictive findings and arguments along with the ignorance of the topic in the context of SAARC, this study, for further investigation, assumes that:

H4: Good governance exerts a positive effect on the growth of selected economies from the SAARC region.

SAMPLE AND DATA COLLECTION

The data on the variables of the study collected for Pakistan, India, Bangladesh, and Sri Lanka as a sample from the SAARC region from 2002 to 2018. Others in the region excluded as the required data for those countries was not available for the corresponding period. World Development Indicators (WDI) used for the collection of data for GDP (a proxy of economic growth) and stock market capitalization (proxy of stock market development). Data for political instability, controlling corruption and good governance extracted from the International Country Risk Guide (ICRG) while Principal

Component Analyses used for the the data on control variable - Institutional Index. Following is the econometric model of the study.

$$EG_{it} = \beta 0 + \beta_1 SD_{it} + \beta_2 PS_{it} + \beta_3 CC_{it} + \beta_4 GG_{it} + \beta_5 IIND_{it} + \varepsilon_{it} \quad \text{.....Model 1}$$

Where;

EG= Economic Growth

SD = Stock Market Development

PS= Political Stability

CC= Controlling corruption

GG= Good governance

IIND= Institutional Index

E= Error term

Univariate Analysis

Descriptive Statistics

Table 1 shows that EG and SD have mean values of 1.695 and 3.2834 respectively. Likewise, PS and CC have average values of 2.046 and 0.785 while GG has a mean value of 1.069. The average value for IIND is 1.358. Overall, these statistics are positive but not satisfactory, especially when compared to the developed countries.

Table 1: Descriptive Statistics

1. Variables	2. Mean	3. Std. Dev.	4. Minimum	5. Maximum
6. EG	7. 1.695	8. 0.399	9. 0.474	10. 2.328
11. SD	12. 3.284	13. 0.837	14. 0.594	15. 5.020
16. PS	17. 2.046	18. 0.177	19. 1.609	20. 2.405
21. CC	22. 0.785	23. 0.275	24. 0.000	25. 1.344
26. GG	27. 1.069	28. 0.298	29. 0.041	30. 1.504
31. IIND	32. 1.358	33. 0.093	34. 1.120	35. 1.588

Pearson's Correlation Matrix

The statistics for the Pearson Correlation Matrix as shown in Table 2 indicate that SD, PS CC, GG, and IIND have a significant positive correlation with EG in the SAARC region. Overall, the statistics have no correlation that violates the standard for multicollinearity and hence, there is no such issue.

Table 2: Pearson's Correlation Matrix

36. Variables	37. EG	38. SD	39. PS	40. CC	41. GG	42. IIND
43. EG	44. 1	45.	46.	47.	48.	49.
50. SD	51. 0.460***	52. 1	53.	54.	55.	56.
57. PS	58. 0.275**	59. 0.195**	60. 1	61.	62.	63.
64. CC	65. 0.232*	66. 0.174***	67. 0.361**	68. 1	69.	70.
71. GG	72. 0.077**	73. 0.613**	74. 0.394***	75. 0.285***	76. 1	77.
78. IIND	79. 0.305*	80. 0.192**	81. 0.486**	82. 0.281**	83. 0.253**	84. 1

Significance at 10% is denoted by ***, 5% by **, and 1% by *

FINDINGS AND DISCUSSION

The statistics for Wooldridge test evident autocorrelation as reported in Table 3. Likewise, the statistics show a significance which evident heteroscedasticity. Therefore, this study employed Pooled Ordinary Least Square (OLS) regression estimator with robust options to correct for autocorrelation and heteroscedasticity. The estimator employed in step-wise regression where the model is not estimated as a bunch but in steps and separately.

The statistics reported in column 1 (Table 3) show a significant positive relationship between SD and EG. The findings which accept the first hypothesis H1 of this study explain that the countries in the region which are eager to expedite the growth of their economies should develop stock markets in that to attract investments or increase market capitalization. Stock market attracts investors by facilitating the buyers and sellers from domestic and international markets. The market then channelizes these funds or savings to various activities and projects which boost economic growth. These results validate prior literature that a developed stock market opens avenues to finance economically viable projects which are important for economic growth. The findings of the study are alike to the results of many prior authors (Caporale et al., 2004; Karim & Chaudhary, 2017; Mamun et al., 2018; Murari, 2017). Column 2 of Table 3 i.e. the inclusion of PS in regression shows that it is also a key determinant or predictor of the EG of the selected countries in the study. The exertion of significant positive impact of PS on EG which accepts second hypothesis (H2) elaborates that growth of an economy is positively associated with the political stability of the country. This explains that PS signals continuity of the existing and especially long-term policies and projects which enhance trust and confidence of the investors by decreasing risks and uncertainties (Alesina & Perotti, 1996; Alper, 2018; Baklouti & Boujelbene, 2018). The findings which are similar to many prior studies infer that the selected countries have to strengthen

their political system and institutions for good governance and attracting investment to expedite the growth of their economies (Baklouti & Boujelbene, 2018).

Table 3: Pooled Ordinary Least Square

85. VARIABLES	86. EG	87. EG	88. EG	89. EG	90. EG
91. SD	92. 0.235***	93. 0.276***	94. 0.224***	95. 0.292***	96. 0.267***
97.	98. (0.063)	99. (0.057)	100. (0.065)	101. (0.080)	102. (0.056)
103. PS	104.	105. 0.986***	106.	107.	108.
109.	110.	111. (0.257)	112.	113.	114.
115. CC	116.	117.	118. 0.164	119.	120.
121.	122.	123.	124. (0.233)	125.	126.
127. GG	128.	129.	130.	131. 0.339	132.
133.	134.	135.	136.	137. (0.296)	138.
139. IIND	140.	141.	142.	143.	144. 2.192***
145.	146.	147.	148.	149.	150. (0.550)
151. Constant	152. 0.913***	153. -1.229**	154. 0.823***	155. 1.107***	156. -2.191***
157.	158. (0.215)	159. (0.591)	160. (0.251)	161. (0.273)	162. (0.802)
163. Observations	164. 68	165. 68	166. 68	167. 68	168. 68
169. R-squared	170. 0.212	171. 0.388	172. 0.219	173. 0.231	174. 0.399
175. **Autocorrelation** F (1, 3)	177. 9.098	179.	180.	181.	182.
176. Prob > F	178. 0.0569				
183. Heteroscedasticity		188.	189.	190.	191.
184. **Chibar** 2 (1)	186. 6.84				
185. Prob > Chibar 2	187. 0.0089				
192. Number of Countries	193. 4	194. 4	195. 4	196. 4	197. 4

Standard errors are reported in parentheses. Significance at 1% denoted by ***, 5% by ** and 10% by *

By including CC as shown in column 3 (Table 3), it is evident that CC has a positive but statistically not significant relation with EG. The findings which are interesting reject the third hypothesis (H3) of the study. The results are similar to the Brunetti, (1997) who found an insignificant impact of CC on EG. The inclusion of GG shows that it also has a positive but not significant impact on EG as reported in column 4 of Table3. Thus, these findings reject the fourth hypothesis (H4) of the study. The interesting findings for both the H3 and H4 which reject the two established hypotheses of the study may possibly be due to that only four countries of the SAARC region composed the sample or might be due to a small

number of observations. Last but not least, the IIND exerts a significant and positive impact on EG which endorse Nawaz, Iqbal, and Khan (2014) who found that institutions have a key role in the economic growth as developed countries in Asia have relatively effective institutions than others in the region.

CONCLUSION, CONTRIBUTION AND WAY FORWARD

This study found that the stock market has a pivotal role in accelerating economic growth of the selected countries from the SAARC region. Likewise, the findings also provide evidence that political stability has an imperative role in expediting the growth of the selected economies in the region. The findings indicate that selected countries in the region can attract investors by ensuring political stability and strengthening their political system and institutions. Interestingly, the findings show that controlling corruption has an not a significant but positive link with economic growth in the region. The positive coefficient is logical but the lack of its statistical significance might be due to small size of the sample or short observations. However, it could be implied that the countries in the region should work on controlling corruption for hastening the growth of economies. Likewise, good governance also has a positive but insignificant relation with economic growth which implies that the selected countries in the region should work out on ensuring good governance. They should augment merit and transparency to strengthen the structure, composition, and operations of their institutions for attracting investment and accelerating economic growth. Generally, the findings expound that the selected countries from the region should concentrate on the investment-friendly environment that includes disciplining and regulating stock market, political system and institutions along with controlling corruption and good governance. This study contributes to the literature by adopting a holistic approach in investigating the impact of the stock market development, political stability, controlling corruption and good governance on the economic growth of some selected countries from the SAARC region. The prior literature investigated these relationships either separately or in the context of a single country or developed countries and regions like European Union, OECD, and BRIC. The findings of the study also provide important implications for policy and practice to all the key stakeholders including regulators and policymakers of the region.

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