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Governance and public debt accumulation: quantitative analysis in MENA countries

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Abstract

This paper studies how institution quality, through the worldwide governance index, affects public debt accumulation in 17 countries of MENA region. By testing the hypothesis that poor governance leads to higher accumulation of MENA public debt over the period 1996-2015, the results show that only three governance indicators support well this hypothesis. These variables are *Political Stability* and *Absence of Violence* index, *Regulatory Quality* index and *Rule of Law* index. Moreover, the estimates suggest a significant indirect impact of bad governance operating via decreased GDP growth. These findings have important implications for policy makers of these countries which are currently facing major fiscal and external imbalances due to the high cost of war and terrorist attacks, low oil prices and a decline in trade. Sound public debt management represents an urgent task especially that public debt management problems often find their origins in the lack of attention paid by policymakers to the costs of bad governance and weak macroeconomic management

Key Words Governance, worldwide Governance Index, public debt accumulation, Panel data analysis, MENA countries

1. Introduction

Government debt rose considerably over the past decades and many researches sought to pin down and explain the possibly negative impact of public debt on economic growth. Their main findings support a non-linear impact of external debt on growth, with deleterious effects only after a certain debt-to-GDP ratio threshold (Reinhart et Rogoff 2009 and 2010; Ferreira 2009; Kumar et Woo 2010; Checherita and Rother 2010; Panizza and Presbitero 2012). Furthermore, in developing countries, several empirical studies show that the link between public debt and economic growth depends not only on the size of the debt, but also on the quality of policies and institutions. Cordella et al. (2010) and Presbitero (2008) find that in countries with poor institutional quality, debt ratios are lower than in other countries, but without overlooking the size of the debt burden. In the same context, other studies (Asiedu 2003; Dessy and Vencatachellum 2007) show that a certain level of institutional quality is necessary in order to encourage investment, stimulate growth and benefit from the policy of debt relief. Consequently a broad consensus has developed that good governance can help countries to effectively manage their public debt by reducing their

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