Journal of Economic Cooperation and Development, **37**, 4 (2016), 21-50

Does Governance and Foreign Capital Inflows Affect Economic Development in OIC Countries?

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The objectives of this study are to verify the impacts of governance and foreign capital inflows on economic growth in 20 countries from Organization of Islamic Cooperation (OIC) Member State. Governance is measured by corruption index and inflation, while, foreign capital inflows consist of Foreign Direct Investment (FDI), workers remittances, external debt and foreign aid. To achieve objectives of the study, probabilistic econometric model based on growth theory and panel data set over the period between 1986 through 2012 are used. The random-effects and fixed-effects models based on the Hausman's test are employed as analytical techniques for parameters estimation. The results reveal that corruption index and inflation have significantly negative impacts on economic growth, indicating the prevalence of weak governance which is detrimental to economic growth. In the same way, the impacts of incoming FDI and remittances found are significantly positive, while, external debt and foreign aid have significantly negative impacts on economic growth. The empirical results of foreign capital inflows indicate that FDI and remittances are benign, whereas, external debt and foreign aid are malignant to economic growth. Thus, the empirically findings indubitably vindicated the significance of good governance, and foreign capital inflows in the shapes of FDI and workers remittances in the process of economic growth and development. Appropriate policy measures are also discussed.

1. Introduction

Achieving the desirable level of economic growth and development is the leading objective of every state public policy to enhance social welfare. There are sundry factors which play important role in the determination of aggregate output, where, the crucial role of governance and foreign capital flows cannot be overlooked. As the goal of the "good governance" is to promote the economic and social development of a

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country and thereby improve living standard and mitigate poverty. In good governance, there is transparency in public action, less or no corruption, security, equitable and fair rule of law as well as stability in macroeconomic indicators. In a study, Frischtack (1994) expounds that undeniably, "good governance" indicates sustained economic growth and development. It implies that as the quality of governance expanding, it leads to abridged endemic corruption and consequently upsurges the rate of economic growth.

According to the World Governance Indicators (WGI) there are six governance indicators such as voice and accountability, political stability and absence of violence/terrorism, government effectiveness, regulatory quality, rule of law and control of corruption, however, this study uses only corruption and inflation as elements of weak governance for empirical examination. As per the World Bank definition "governance is the manner in which power is exercised in the management of a country's economic and social resources for development" (World Bank, 1992: 1). Governance is "the exercise of economic, political and administrative authority to manage a country's affair at all levels. It comprises mechanisms, processes and institutions, through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences." (UNDP, 1997: 2-3). Corruption is not a new word or phenomenon and exists in every society and country though varies society to society and country to country. Corruption in the forms of bribes, favoritism, nepotism, theft of public resources by public officials (embezzlement), fraud, and extortion are evidently undermine economic growth process. Corruption is "behaviour that deviates from the formal duties of a public role (elective or appointive) because of private regarding (personal, close family, private clique) wealth or status gains"(Nye, 1967:416). Corruption is "behaviour that deviates from the formal rules of conduct governing the actions of someone in a position of public authority because of private-regarding motives such as wealth, power, or status" (Khan, 1996:12). Shleifer and Vishny (1993) notes that especially, weak governance which do not managing their agencies would indication to ultra-high corruption levels. The outcomes of weak governance explicate that in some developing; corruption is very high and very costly to the development.

Governance crises are equally important that is described by pervasive corruption and a weak institutional structure for abridging poverty and nourishing economic growth and development. Prevalent corruption in government may have added to growing poverty in three ways: (i) Corruption create indeterminate policy environment and a restraint to appraising correct project feasibilities. Consequently, it could be likely to retard investment growth and employment. (ii) The handover of some of the private sector's local savings to the corrupt and dishonest politicians and government officials which can be invested could be another factor to reduce the pace of Gross Domestic Product (GDP) growth rate. (iii) In the existence of corruption, financial cost of individual projects enlarged; by this means at the same time reducing GDP growth for investment and it discourage employment opportunities[2]. It is also endorsed by Ehrlich and Lui (1999) that corruption and per capita income are predicted to be inversely associated across various stages of economic development. If differentiate between corruption and crime, so corruption is basically depends on investment in political capital as a coupon for entrance to the bureaucratic ranks, while, for entrance to various criminal activities some skill are required.

Indeed, good governance can perform a vital role by enabling an environment for economic development and poverty reduction specifically for developing countries. According to the United Nations (1998) report Mr. Kofi Annan highlights at several occasion that "good governance was perhaps the single most important factor in eradicating poverty and promoting development". Thus, good governance is always and everywhere undeniably desirable because in good governance the individual presumed to be happier and as a result several of developing countries would be much better off, if society life were governed within impartial and unbiased institutions, judicious, transparent, accountable and sincere bureaucracy. In this regard, the study of Grindle (2010) notes that it is obvious from the notion of good governance that it has constructive and encouraging feature of political systems, whereas, weak governance is a hindrance and flaw that countries required to be abridged. The World Bank ascertains that corruption and fraud are prodigious hurdles to economic and social development. Explicitly, corruption slows down the process of development by distorting the rule of law and undermining the institutional foundation which plays major

[2] UNDP (2003).

role in economic growth. The destructive impacts of corruption are exclusively severe on the world's poorest people, who are most dependent on the endowment of public services, and are least able of giving the additional costs connected with corruption and fraud (World Bank, 2004; Al-Sadig, 2009; Wang & You, 2012). It has been observed that corruption should have many unfavorable impacts on economic growth in the long-run, thereby; researchers usually concern more regarding such long-run results of corruption than the short-run impacts. The study of Sundaram and Chowdhury (2013) opines that there is now an overall consensus on the role that good governance plays in attaining impartial and sustainable development in Africa. Sundaram and Chowdhury further maintain that many prior studies corroborates that good governance is indispensable for sustainable economic growth (high GDP per capita). Better governance countries tend to enhance higher levels of FDI and rapid economic growth rates than others. The study of Oral and Sayin (2015) empirically verified that tax audit decreases corruption in the long run in Turkey during the period of 1985-2011.

Similarly, foreign capital inflows significantly contribute to the economic growth and development of a country. The available studies reveals that capital inflows are a crucial source of external finance which may simplify the transmission of the modern technology and inventions of industrialized economies to developing economies, thereby facilitating them to enhance the rate of their economic growth and development (Borensztein *et al.*. 1998; Bosworth & Collins, 1999; Kyophilavong & Toyoda, 2009; Insah, 2013; United Nations, 2014; Azam & Ather, 2015)[3]. The potential benefits of international flows of capital also highlights by Lipsey et al. (1999) that bring about manifold of functions in the world economy. It facilitates the recipient countries to achieve an investment level that is larger than their own levels of local savings. In a study, Nunnenkamp (2002) indicates that in relative terms, FDI inflows acts relatively more vigorous role in developing countries as compared to developed countries.

A study by Prasad et al. (2007) opines that foreign capital inflows do not assuage growth in developing countries, but they do not support

[3] The impact of FDI inflows on a recipient country's economy is dependent on some factors including the country's absorptive capacity in terms of its human capacity as well as the level of development, (Borensztein *et al*., 1998; Mengistu & Adams, 2007)

either. Developing countries are typically inhibited not by resources, but by the investment prospects that they can successfully using arm's-length finance. As a result, capital inflows are not directly destructive; it mostly cannot be used healthy, predominantly in investment intensive, low-initial-cash flow and long-gestation projects. Although, Rajan (2006)[4] expounds that foreign capital is not remedy for capital-poor economies, though precise forms of foreign capital such as FDI may be valuable. While, the study of Fu et al. (2011) suggest that the impact of incoming FDI on the recipient economy yet mixed. The foreign capital inflows adherents are of the view, that it is noteworthy for economic growth and development in developing countries. They studied that foreign aid supplements domestic resources and complements domestic savings to fill both the saving-investment and foreign exchange gaps by the provision of additional financial resources to resources deficient countries. In addition, from satisfying these gaps, it also provides approach to up-to-date technology, managerial skills and international markets (Chenery & Strout, 1966; Kargbo, 2012). The study of Arndt et al. (2010) reveals that foreign aid remains a significant tool for augmenting the development prospects of poor economies. While, some erstwhile studies find that in practice, foreign aid is doing insignificant to eradicate poverty and stimulate economic growth and development in the developing countries (Sadeq, 2002). A study by Doshi (2014) also reveals that positive relation between foreign aid and economic development is questionable however.

In a similar vein, another form of capital inflows namely workers remittances are also one of the significant factors and contribute positively to the economic growth. The encouraging effects of workers remittances on economic growth have been well recognized by many prior studies. For example, Gupta et al. (2007) opines that higher level of remittances are appreciated by migrant workers to send it to their family as it signify streams of income which can be utilized for consumption as well as investment, which further boosts the demand for goods and services, and thereby stimulate economic development. Many other studies reveal that it plays a constructive role in increasing

[4] The co-author of Prasad et al. (2007) paper namely Rajan (2006) lectured the same paper at a conference prepared by the Federal Reserve Bank of Kansas City Jackson Hole, Wyoming, August 25, 2006.

the social and economic conditions of the recipient families and as a result, it adds considerable to the GDP (Ratha, 2013; Julca, 2013).

The broad purpose of the present study is to enlarge understanding of the impacts of governance and foreign capital inflows on economic growth using panel data over the period between 1986 through 2012 for a set of 20 countries from OIC. As per the World Bank classification on the basis of GNI per capita the countries used in this study are low, lower middle and upper middle income countries (see appendix Table A1). Whereas, the characteristics peculiar to each of all these countries are assumed to be held similar. An effort has thus been made in this study to understand the impacts pf weak governance in the form of high corruption and inflation, and foreign capital inflows in the forms of FDI, remittances, external debt and foreign aid on economic growth through empirical exercise and to offer policy suggestions based on the study findings. Presumably, this study is different from the earlier studies in the sense that this is the first study on the topic under the study on OIC countries. Also set of regressors is unique and almost different from the prior studies and the study used large time period in order to obtain more robust results. Moreover, this study will significantly add value to the literature on governance, and foreign capital inflows impacts on economic growth in OIC countries and can be extended to the other countries also.

This study proceeds by reviewing the available literature on the impacts of governance and foreign capital inflows on economic growth and development in Section 2. Empirical methodology as well as discussion of data is described in Section 3. The empirical findings of the study are carried out in Section 4. Finally, conclusion and some policy implications are summarized in Section 5.

2. Existing Literature

The available literature reveals that relationship between governance; capital inflows and economic growth have been evaluated theoretically as well empirically by some prior studies. The literature part of this study is divided into two sub-sections as given below:

2.1 Previous Studies on the Relationship Between Governance and Growth

The empirical findings of Mauro (1995) study indicate that corruption lowers private investment, in that way depressing economic growth. For instance, if Bangladesh was to boost the reliability and competence of its bureaucracy to the level of Uruguay its investment rate would upsurge by nearly 5 percentage points, and its annual GDP growth rate would increase by over half a percentage points. The study of Kaufmann and Kraay (2003) using data from WGI covering 175 countries during 2000/01, and use the findings to translate the association between per capita incomes and governance in the Latin America and the Caribbean region. The empirical results suggest that incomes per capita and the quality of governance are positively and significantly related across countries. Sumarto et al. (2004) carried out a study to investigate the effect of bad governance practices in Indonesia on poverty reduction in the country. The outcomes indicates that the practices of bad governance has adversely affected the poor class, and the study further maintains that bad impact of bad governance on the poor class is factual, and thereby weakens the efforts to mitigate poverty in Indonesia. Though, in those regions, where, the practice of better governance is prevailing can mitigate poverty faster. In a study Badun (2005) indicates that institutional weaknesses have obstructed the current level of real GDP per capita in Croatia out of total 25 countries (i.e., European Union=14, and Transition countries=11) covering the four group periods (95/96, 97/98, 99/00, 01/02). The results further show that more quick and actual reforms of the judiciaries and the public administration, and the clampdown of corruption would have encouraging impacts on future economic growth and development.

In a similar vein, the study of Meon and Sekkat (2005) detects a negative impact of corruption on both economic growth and investment in a sample of 63-71 countries during 1970-1998. Using data on corruption from a cross-section of countries, Lambsdorff (2005) concludes that corruption evidently goes along with a low GDP, discrimination of income, rise inflation, enlarged crime, policy distortions and deficiency of competition. Akcay (2006) discovers that corruption reduces economic growth, hampers long-term foreign and local investments, upswing inflation, devalues national currency, condenses spending for education and health etc. Uddin and Joya (2007)

find that good governance is obligatory in South Asia, particularly for Bangladesh, because mis-governance is a great impediment to economic development. The study of Cooray (2009) reveals that both the size and quality of the government are imperative for economic growth for 71 developed and developing countries during 1996-2003. Pulok (2010) observes that the long-run results suggest that corruption has direct negative effect on economic development measured by GDP per capita of Bangladesh during 1984-2008. Ahmad et al. (2012) find that a reduction in corruption increases the economic growth of 71 developed and developing countries over the period of 1984-2009. However, the study of Saha and Mallik (2012) observe that corruption levels do not seem to lower economic growth at all levels, though, the level of corruption influences economic growth, but this impact is non-linear in 150 countries during 1984-2009. Whereas, corruption characteristically stimulating economic growth in those countries where corruption is low. Using primary data gathered through direct interview from 50 economists, Roohollah et al. (2014) results indicate that political stability had the maximum positive influence on economic growth of Iran.

On the other hand, the studies of Friedrich (1972) and Adit (2003) explores that corruption greases the wheels of business and commerce and accelerates economic growth as well as investment processes. Similarly, Resnick and Birner (2006) after review surveys suggest that governance indicators consist of political stability and rule of law, are related with growth but yield mixed results in regard to poverty alleviation. Dzhumashev (2014) observe that particularly, corruption increases economic efficiency only when the actual government size is above the optimal level. It suggests that a growth-maximizing level of corruption is conceivable. Using cross-sectional observations of 197 countries for the year 2009, Emara and Jhonsa (2014) study used the estimation results to interpret the linkage between governance and economic growth (per capita income) for 22 MENA countries. The findings indicate that various MENA countries have attained a fairly high standard of living for their inhabitants thanks to other factors, while, these factors are plenty of natural resources.

A study by Faria and Carneiro (2001) find that inflation does not affect real output in the long-run, but that there exists a negative impact from inflation on real output in the short-run in Brazil during 1980:1 to

1995:7. However, the regression results of Barro (2013) study show that the impact from a rise in average inflation by 10 percentages annually will reduce the growth rate of real GDP per capita by 0.2 to 0.3 percentages points annually, while using data for 100 countries during 1960-1990.

2.2 Previous Studies on the Relationship Between Foreign Capital Inflows and Growth

The empirical findings of Fambon (2013) study suggest that domestic capital stock and FDI have significantly positive impacts on economic growth both in the short and long-runs in Cameroon during 1980-2008. Orji et al. (2014) finds that foreign capital inflow contributed positively to aggregate growth in Nigeria during 1981-2010. Whereas, foreign aid has a positive relationship to output growth in Sierra Leone and Ghana, while, FDI inflows encourages more output growth in cases of Nigeria and Gambia. Similarly, workers remittances have the maximum contribution in output growth of Liberia, though; the study fails to find any positive impact of capital inflows on Guinea's economic growth. Azam and Ather (2015) observe that FDI inflows have an accelerating role in encouraging economic growth in ten countries from Commonwealth of Independent States. Ikechi (2015) conducted a study on three Sub-Saharan countries namely Nigeria, Ghana and South Africa during 1980-2010. The study finds no expressive long-run connection between foreign capital inflows and economic growth in Nigeria and South Africa. Using a panel data set comprising of eight separate 5-year periods data ranging from 1970- 2009, the study of Nwaogu and Ryan (2015) observe that foreign aid and FDI inflows impact economic growth in Africa, while after controlling for all three variables, only FDI influences economic growth in 53 African countries. Similarly, foreign aid and workers remittances affect economic growth in 34 Latin America and the Caribbean during the periods under the study.

Using data over the period from 1990-2010 for five North African countries namely Algeria, Egypt, Morocco, and Mauritania and Tunisia, the study of Ali and Sadraoui (2013) finds that debt service has a negative relationship with economic growth. Azam et al. (2013a) find that external debt and inflation rate have significantly negative impacts on Indonesia's economic during 1980-2012. While, the findings of Uzun et al. (2012) study support a positive connection between GDP per

capita and foreign debt in the 19 transition countries during 1991-2009. In a study, Fayissa and El-Kaissy (1999) discovers that foreign aid has a significantly positive impact on economic growth in developing countries during 1971-1990. A study by Hatemi and Irandoust (2005) also finds that foreign aid has a statistically positive and significant influence on economic activity in Botswana, Ethiopia, India, Kenya, Sri-Lanka, and Tanzania during 1974-1996. On the other hand, the study of Ali (2013) suggests a negative and significant effect of foreign aid on growth in Egypt during 1970-2010 in the long and short-runs. The empirical results of Azam (2014) study support the existence of a significantly negative association between foreign aid and economic growth for Pakistan during 1972-2012. On the relationship between remittances and growth, the study of Catrinescu et al. (2009) observes that remittances inflows has a weak positive effect on long-run aggregate output 1970-2003 in 12 countries. The significantly positive impact from remittances inflows on economic growth in cases of Azerbaijan and Armenia over the period of 1995-2010 have also detected by Azam and Khan (2011). In a similar way, the study of Benmamoun and Lehnert (2013) reveals that workers remittances, incoming FDI, and aid have statistically positive effects on the economic growth of low income countries during 1990-2006. Where, the contribution of international remittances is more as compared to the other forms of capital inflows. A study by Nsiah and Fayissa (2013) finds significantly positive relationship between remittances and economic growth for 64 countries from Africa, Asia, and Latin America and the Caribbean region during 1985-2007. Some more empirical studies on the impacts of governance and foreign capital inflows on economic growth are given in Table 1.

Table 1: Compact Previous Studies on the Impacts of Governance and Foreign Capital Inflows on Economic Growth

Author (s)	Time periods, Country(s)	Estimator(s)	Response variable	Regressors	Findings
Azam and Emirullah (2014)	1985-2012 9 Asian countries	FE and RE	GDP per capita	Inflation, corruption, openness to trade, and dependency ratio	Inflation (-), Corruption (-)
Ghalwash (2014)	1990- 2012 Egypt	GMM	Real GDP Growth rate	Corruption, FDI, government expenditure, openness	Corruption (-)
Adeleke (2014)	1996 -2010 31 SSA countries	Pooled OLS , FE and RE	Real GDP	FDI, governance, human capital, capital formation, inflation, exchange rate, government spending and money supply	Weak governance (-), when interacted with FDI (+)
Zubair and Khan (2014)	2002-2011 Pakistan	OLS	GDP	Political instability, voice and accountability, control of corruption, rule of law	Political stability (+)
Azam et al. (2013b)	1985 -2011 South Asian-5	Fixed and random-effects	GDP per capita	Corruption index, FDI, and remittances	Corruption (-), FDI (+), remittances (+)
Tanzi and Davoodi (1997)	1980-1995 68 countries	OLS	Real GDP per capita	Corruption	Corruption (-)
Mauro (1995)	1980-1983 68 Countries	OLS, 2SLS	Real GDP per capita	Corruption	Corruption (-)
Benmamoun and Lehnert (2013)	1990-2006 180 Countries	GMM	Real GDP per capita	FDI, remittances, foreign aid, and openness	FDI (+), remittances (+), Aid (+)
Driffield and Jones (2013)	1948-2007 1984-2008 entire developing countries	3SLS panel system estimator	GDP per capita growth	Remittances, inflation, FDI, ODA, human capital, population, investor profile, capital formation and bureaucratic quality	Inflation (-), remittances (+), FDI (+), Aid (-)
Fayissa and Nsiah (2010)	1980-2004 36 African countries	Random and Quasi-Fixed Effects	Real GDP per capita	Remittances, FDI, Aid, trade openness, fixed capital formation, schooling and economic freedom	Remittances (+), FDI (+), Aid (-)
Chami et al. (2005)	1970-1998 113 Countries	OLS	Real GDP per capita	Remittances, net private capital flows initial income, investment,	Remittances (-)

Source: Author's compilation

LSDV= Least Squares within Dummy Variables GLS=Generalized Least Squares GMM= Generalized Method of Moment OLS=Ordinary Least Squares FE and RE= Fixed-effects and random-effects 2SLS=Two Stage Least Squares

3. Data and Methodology

To examine empirically the impact of governance (i.e. corruption and inflation), and foreign capital inflows (i.e., foreign direct investment, foreign remittances, foreign debt and foreign aid) on economic growth in a group of 20 OIC countries, this study uses, the following general regression equation[5], which can be written as follows:

$$G_{it} = \alpha_i + \alpha_1 CRP_{it} + \alpha_2 INF_{it} + \alpha_3 FDI_{it} + \alpha_4 FRM_{it} + \alpha_5 FDBT_{it} + \alpha_6 FAID_{it} + \varepsilon_{it} \quad (3.1)$$

$$G_{it} = \alpha_i + \alpha_1 CRP_{it} + \alpha_2 INF_{it} + \alpha_3 FDI_{it} + \alpha_4 FRM_{it} + \alpha_5 FDBT_{it} + \alpha_6 FAID_{it} + \mu_i + v_{it} \quad (3.2)$$

Where, i = 1, 2, …, N=20; t = 1, 2,…, T=27

In equations (3.1 and 3.2) α_1, α_2, α_3, α_4, α_5, and α_6 are the estimated coefficients; *i* and *t* denote the i^{th} country and the t^{th} time period, respectively. G stand for the GDP per capita, CRP is corruption index, *INF* represent inflation, FDI indicates foreign direct investment, FRM is workers remittances, FDBT is foreign debt and FAID is foreign aid. Table 2 portrays the variables description and data sources. In equation (3.1), the term α_i shows the constant parameter that differs across countries, but not over time. Every individual constants control for country-specific differences, whereas, the stochastic terms (ε_{it}) are assumed to be independent, with mean zero and constant variance (σ_ε^2) for all included countries and through the time periods. Similarly, μ_i is the country-specific random-effect that takes the variation across countries. It is assumed to be random and not correlated with the independent variables included in the model. Also, the v_{it} term is the country-specific error. Data on FDI, workers remittances, external debt and foreign aid were in current US$ and converted to GDP ratio. The expected signs of $\partial / G_{it} / \partial CRP_{it}$, $\partial G_{it} / \partial INF_{it}$, $\partial G_{it} / \partial FDBT_{it}$, and $\partial G_{it} / \partial FAID_{it}$ are postulated to be negatively related to economic growth, while, $\partial G_{it} / \partial FDI_{it}$, and $\partial G_{it} / \partial FRM_{it}$ are expected to be positively related to economic growth in this study.

[5] The model used is inverse semilogarithmic, where the response variable is in log form (Gujrati, 2004: 52).

For empirical investigation, a balanced panel data set of 27 years is employed for 20 OIC countries. The sample size is 540 (n= 27 x 20). A brief summary of the descriptive statistics as well as correlation matrix are reported in Table 3. Table 3 indicates that the results of correlation have expected signs and support the hypotheses of the study.

Table 2: Variables Description and Data Sources

S. No	Variables description	Sources
1	GDP per capita in current USD and it represent economic growth and development	World Development Indicator (WDI) (2014), the World Bank
2	The index of corruption is one of the components of Political Risk rating system with 6 points out of 100, where 0 shows the highest level of corruption and 6 the lowest level. In the present study, this index has been rescaled by subtracting the original corruption index from 6, reversing the order such that a rating of 6 represents for the highest level of corruption while 0 the lowest level of corruption.	International Country Risk Guide (ICRG), the Political Risk Service (2010, 2013).
3	Inflation, GDP deflator (annual %)	WDI (2014)
4	Foreign direct investment: Foreign direct investment, net inflows (BoP, current US$)	WDI (2014)
5	External debt stocks, total (DOD current US$) and it is the aggregate of public as well as publicly guaranteed, and private nonguaranteed long term debt, short term debt and use of International Monetary Fund (IMF) credit	WDI (2014)
6	Foreign aid or net official development assistance received (current US$)	WDI (2014)
7	Foreign remittances or personal remittances, received (current US$)	WDI (2014)

Source: Author's compilation

Table 3: Descriptive Statistics and Correlation Matrix

Statistics/ Variables	G	CRP	FDI	FAID	FDBT	FRM	INF
Mean	1288.145	2.3110	2.179	8.372	79.908	3.787	14.376
Median	675.169	2.000	1.227	4.030	59.3251	2.328	5.715
Maximum	10660.73	4.000	37.685	74.137	469.517	25.107	181.450
Minimum	132.895	0.000	-28.624	-0.453	1.943	0.000	-9.824
Std. Dev.	1688.526	0.908	3.771	11.453	64.724	4.410	25.082
Skewness	3.101	-0.015	3.044	2.751	2.267	2.173	3.144
G	1.000						
CRP	0.188	1.000					
FDI	0.116	-0.017	1.000				
FAID	-0.349	0.072	-0.037	1.000			
FDBT	-0.268	0.087	-0.119	0.678	1.000		
FRM	0.009	0.167	0.155	-0.119	-0.058	1.000	
INF	-0.070	-0.039	-0.119	0.252	0.360	-0.182	1.000
Observations	540	540	540	540	540	540	540

Source: Author's computation.

4. Results and Discussion

As regards to estimates of the regression model where economic development is measured by GDP per capita is the dependent variable and the explanatory variables are corruption index, inflation, FDI inflows, external debt, workers remittances, and foreign aid. The traditional panel approach is to be used as the basic aim of the study is merely to analyze the impact of governance and foreign capital inflows on economic growth. The Hausman's test (Hausman, 1978) can be used in order to select between the random-effects and fixed-effects model for estimation (see Greene, 2008). Where, an insignificant p- value ($p>0.05$) indicate that the use of random-effects model is benign, otherwise the fixed-effects model ought to be employed (Klarner, 2010: 138).The Hausman's test of the study indicates in some specifications effects-the random model is better to the fixed-effects model, while in some specifications fixed-effects is better to the random-effects model and the results are given in Table 4. The results reveal that overall the estimated coefficient seems with predicted signs and are significant statistically.

Thirteen versions of the model are regressed by the random-effects and fixed-effects based on panel data for 20 OIC countries over the period between 1986 through 2012, in order to obtain robust and well-argued empirical results. In view of that, Table 4 column 1-13, portrays the estimation results of the Fixed Effects (FE) and Random Effects (RE) model. It is evident from Table 4 that in case of RE the R^2 values are relatively small but mostly the estimated coefficient is statistically significant with expected signs. Though, the F-ratios found are to be statistically significant, which shows that all regressors jointly have significant relationship with response variable. Similarly, Table 4 column 7-13 show that the reported F-ratio is relatively large to accept that there is joint significance of the incorporated six regressors namely corruption index, inflation, FDI inflows, external debt, workers remittances, and foreign aid. Whereas, interestingly, all of the six explanatory variables tested do in fact impact economic growth in selected 20 OIC countries during the period under the study, and are also individually significant which drastically vindicate and suggest that the model is almost statistically as well as technically acceptable.

Corruption measured by corruption index is one of the essential elements of weak governance, which is also an institutional quality variable. The empirical result on corruption index reveals, it is significantly and negatively related to economic growth, indicating that high level of corruption dampens economic growth. The estimated coefficient of the corruption index variable correctly reflects the theoretical expectations. Where, the estimated coefficient of corruption index variable found is -0.001 and significantly positive at one percent level of significance. The results show that one unit increase in the corruption index will stifle 0.112 percentage points in the GDP per capita. The empirical result is in accordance with the findings by Mauro (1995), Mo (2001) and Record (2005), Azam and Emirullah (2014). Similarly, inflation is incorporated in the study to determine the macroeconomic instability and is also one of the components of the weak governance which believably impair economic growth. The empirical result shows that it carries the anticipated negative sign. The results do favor the hypothesized negative inverse relationship between inflation and economic growth. The estimated coefficients in all eight specification obtained are -0.002, -0.005 and -0.006 for the inflation variable which are mostly statistically significant at the one percent level of significance. The results implies that if the inflation rises by one

percent, it will weaken economic growth by -0.002, -0.005 and -0.006 percent. The robust negative effect of inflation on economic growth is consistent with the findings of Barro (2013), Driffield and Jones (2013) and Azam and Emirullah (2014). Thus both components of the weak governance namely high corruption and high inflation are detrimental to economic growth.

The empirical results of different components of foreign capital inflows reveals that incoming FDI has been found to be statistically significant at one percent level and also bears the correct positive sign, thereby, verifying the basic hypothesis that FDI is growth-stimulating. The estimated coefficients in all four specifications found are 0.035, 0.029, 0.009, and 0.017 for the FDI variable. It indicates that the theoretically positive association between FDI inflow and economic growth has been corroborated by the empirical results. It has been expected that economic growth increases with foreign remittances inflows. The empirical results reveal that foreign remittance has a positive effect on economic growth. The estimated coefficients of 0.026 and 0.015 are obtained for the foreign remittances variable which is found to be statistically significant at the one and ten percent levels of significance respectively (Table 4 columns 7, 11). The results indicate that one unit increase in the remittances will enlarge by 0.026 and 0.015 percentage points in economic growth. The empirical result on FDI and remittances are in accordance with the findings by Fayissa and Nsiah (2010), Benmamoun and Lehnert (2013), Driffield and Jones (2013), and Azam and Ather (2015).

The results for other explanatory variable included in the model are also found to be statistically significant and carry the expected sign. Where, it has been predicted that foreign aid has a negative impact on the economic growth and has been found to be statistically significant at one percent level and also bears correct negative sign, thereby confirming the basic hypothesis that foreign aid is growth-discouraging. The estimated coefficient of -0.021 and -0.017 are obtained for foreign aid variable. The finding implies that with one unit increase in the foreign aid brings about 0.021 and 0.017 percent decrease in economic growth (Table 4 columns 4 and 10 FE). The empirical findings of this study are consistent with the findings of Fayissa and Nsiah (2010), Driffield and Jones (2013), and Ali (2013). In the same way, over dependency on the external debt is usually considered undesirable in the sense that it makes

economic growth impair and thus it is negatively related to economic growth. The results achieved have the expected negative coefficient sign that supports the study hypotheses and is statistically significant. The estimated coefficient of -0.007 and -0.006 are found in all four speciation for the external debt to be statistically significant at the one percent level (Table 4 columns 3, 9, 12, 13). The result suggests that if the external debt increases by one percent, it will dampen economic growth by -0.007 and -0.006 percent. The result of negative relationship between external debt and economic growth of this study are in accordance with the other studies, for example, Checherita and Rother (2010), and Ali and Sadraoui (2013). The empirical findings of foreign capital inflows suggest that FDI inflows and workers remittances are blessing, while, external debt and foreign aid are burden to the recipient countries.

Table 4. Panel Estimates (Response Variable is GDP per capita)

Regressors/ Estimators	1	2	3	4	5	6	7	8	9	10	11	12	13
	RE	RE	RE	FE	RE	RE	RE	RE	RE	FE	RE	RE	RE
	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.	Coeff.*
CRP	-0.001[a] [0.0004] (2.469)						-0.001[b] [0.0004] (2.481)	-0.001[a] [0.0004] (2.613)	-0.001[a] [0.0003] (3.232)	-0.001[a] [0.0004] (2.869)	-0.0008[c] [0.0004] (1.959)	-0.001[a] [0.0003] (3.274)	-0.001[a] [0.0004] (3.119)
FDI		0.035[a] [0.005] (6.509)						0.029[a] [0.005] (5.423)				0.009[b] [0.004] (2.269)	0.017[a] [0.005] (3.485)
FDBT			-0.007[a] [0.0003] (20.880)						-0.007[a] [0.0004] (18.815)			-0.006[a] [0.0004] (17.741)	-0.006[a] [0.0004] (15.354)
FAID				-0.021[a] [0.003] (7.306)						-0.017[a] [0.003] (5.929)			
INF					-0.006[a] [0.0009] (6.987]		-0.006[a] [0.0009] (6.983)	-0.005[a] [0.0009] (5.991)	-0.002[b] [0.0007] (2.245)	-0.005[a] [0.0009] (5.569)	-0.006[a] [0.0009] (6.725)	-0.002[c] [0.0007] (2.001)	-0.002[b] [0.0007] (2.265)
FRM						0.026[a] [0.009] (3.069)					0.015[c] [0.009] (1.773)		0.007 [0.007] (1.032)
Intercept	6.582 [0.209] (31.494)	6.549 [0.208] (31.487)	7.159 [0.197] (36.243)	6.786 [0.029] (230.006)	6.712 [0.207] (32.405)	6.522 [0.207] (31.569)	6.673 [0.213] (31.266)	6.598 [0.219] (30.083)	7.122 [0.207] (34.338)	6.783 [0.033] (203.719)	6.619 [0.218] (30.320)	7.082 [0.212] (33.472)	7.035 [0.215] (32.768)
R^2	0.012	0.072	0.459	0.818	0.083	0.017	0.094	0.142	0.455	0.831	0.099	0.461	0.432
adj. R^2	0.009	0.069	0.447	0.811	0.081	0.015	0.091	0.137	0.452	0.824	0.094	0.457	0.427
S.E. reg.	0.447	0.433	0.335	0.429	0.430	0.446	0.427	0.416	0.330	0.415	0.426	0.329	0.334
F-stat	6.101	42.476	436.796	117.46	48.903	9.438	27.814	29.454	149.436	115.910	19.69	114.390	78.328
Prob(F-stat)	0.014	0.000	0.000	-299.241	0.000	0.002	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Hausman Test	0.891	0.012	0.062	5.215	0.012	0.158	0.968	0.878	2.176	8.131	0.981	2.382	3.111
P-value	0.3453	0.912	0.803	0.022	0.914	0.691	0.616	0.831	0.537	0.043	0.806	0.666	0.682

Note: Asterisks a, b and c shows significant at 1%, 5 % and 10 % levels of significance respectively. Ceoff. is coefficients, RE and FE are random-effects and fixed-effects

* indicates that in the column all independent variables are in one period lagged form.

5. Summary and Conclusion

The main purpose of this study was to evaluate how far governance and foreign capital inflows affects economic growth in 20 countries of OIC. Using adequately long series of panel data, the study employed the random-effects and fixed-effects models based on the Hausman's test. The study found theoretically consistent empirical results and also supportive both of theoretical expectations and previous empirical findings. The empirical findings reveals that corruption index is significantly negatively related to economic growth, therefore, the negative impact of corruption on economic growth as hypothesized is confirmed. Whereas, price instability in the form of inflation has significantly negative impact on economic growth, thereby, the negative impact of inflation on economic growth as expected is also validated. Thus, the empirical findings on governance suggests that weak role of government have added vulnerabilities to economic growth of the sample economies under the study. Similarly, incoming FDI and remittances have significantly positive impact on economic growth, while, external debt and foreign aid have significantly negative impact on economic growth. Thus, the empirical findings of foreign capital inflows reveal that FDI and remittances are benign, whereas, both external debt and foreign aid are malignant to economic growth of a set of countries under the study.

The results indubitably vindicated the importance of good governance, and foreign capital inflows in the shapes of FDI and workers remittances in the process of economic growth and development. Therefore, controlling corruption and adjusting inflation should be among the main factors for consideration for policymakers in devising and executing macroeconomic and public policies. To be most active and effective in tackling chronic corruption, it is necessary to get to the root of the problem. Weak state institutions needs to be improved by improving the bureaucracy include expanding their capacity, implementing performance indicators, restructuring public service processes, merit in recruitment should be strengthen, whereas political interference and their unnecessary like and dislike should be discouraged, improving accountability and transparency as well as enforcing ethics, laws and regulations for all civil servants. Likewise, inflation needs to be control through effective, coordinated fiscal and monetary policies without causing any adverse impacts on economic growth. Whereas, on the

supply side, the sates needs to accelerate the production and distribution of the basic societal needs such as food, energy and other necessities through the provision of needed infrastructure and investment conducive environment. In the same way, the policy of receiving external debt and foreign aid should be redesign, while, foreign remittances inflows should be strengthen and utilized for productive investment purposes. The investment environment in the recipient countries should be facilitated and enhance potential investors through constructive business climate and economic policies.

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Appendix

Table A1. List of Countries Used

S.No.	Economy	Income Group	Group #	Region
1	Bangladesh	Low income	1	South Asia
2	Burkina Faso	Low income	1	Sub-Saharan Africa
3	Cameroon	Lower middle income	2	Sub-Saharan Africa
4	Cote d'Ivoire	Lower middle income	2	Sub-Saharan Africa
5	Egypt, Arab Rep.	Lower middle income	2	Middle East & North Africa
6	Guinea-Bissau	Low income	1	Sub-Saharan Africa
7	Indonesia	Lower middle income	2	East Asia & Pacific
8	Jordan	Upper middle income	3	Middle East & North Africa
9	Malaysia	Upper middle income	3	East Asia & Pacific
10	Morocco	Lower middle income	2	Middle East & North Africa
11	Mozambique	Low income	1	Sub-Saharan Africa
12	Niger	Low income	1	Sub-Saharan Africa
13	Nigeria	Lower middle income	2	Sub-Saharan Africa
14	Pakistan	Lower middle income	2	South Asia
15	Senegal	Lower middle income	2	Sub-Saharan Africa
16	Sierra Leone	Low income	1	Sub-Saharan Africa
17	Sudan	Lower middle income	2	Sub-Saharan Africa
18	Togo	Low income	1	Sub-Saharan Africa
19	Tunisia	Upper middle income	3	Middle East & North Africa
20	Turkey	Upper middle income	3	Europe & Central Asia

Source: http://www.gfmag.com/global-data/economic-data/pagfgt-countries-by-income-group
Note: Group: - Upper middle income: US$ 4036 to US$ 12475 - Lower middle income: US$1026 to US$ 4035 - Low income: US$1025 or less World Bank list of economies (July 2012)