

# Assessing Of The Impact Of Good Governance And Institutions On Economic Growth In Indonesia

Muhammad Ramadhan

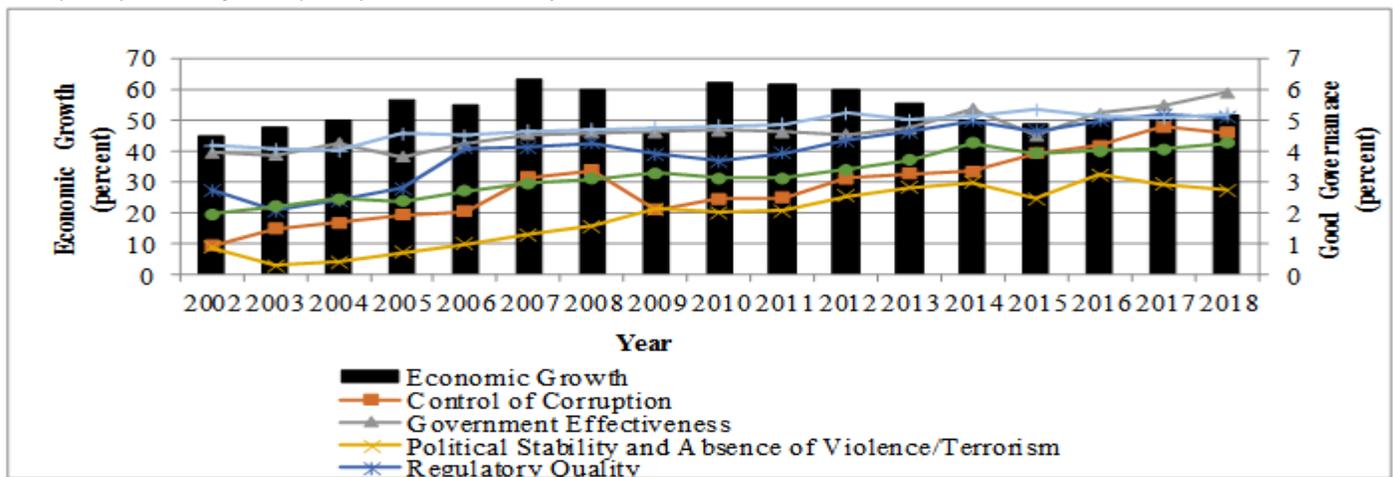
**Abstract:** Government performance and quality of government institutions will encourage economic growth through the creation of effective government systems. The goal of good governance is to manage resources in a country more effectively for sustainable economic development. The research objective is to analyze the relationship between government performance and the quality of government institutions with economic growth in Indonesia. The analysis in this study uses the method Generalized Methods of Moments (GMM) time series. The variables used in this study are the variables of economic growth (GDP), then to describe Good Governance the variable voice and accountability (VA), political stability and absence of violence (PV), control of corruption (CC) and government effectiveness (GE) which is used to describe government performance. While the variable used to describe the quality of the institution is variable the rule of law (RL) and quality of regulation (QR). The results showed that government performance and institutional quality have a role in driving economic growth. Strategies that need to be carried out in improving government performance and institutional quality through evaluation and monitoring.

**Index Terms:** Good Governance, Institutional, GMM, economic growth

## 1. INTRODUCTION

Management of government performance accompanied by a good quality institutional system will support the fulfillment of regional development. According to the World Bank, good government governance or good governance is a reflection of management and management in the orientation of development policies that were directed more positively. Besides that good governance is a concentration of various world institutions such as the UN, World Bank, IMF, OECD and several other world organizations (Huang and Ho, 2017). A good system of government performance and institutional quality will drive a country's economic growth. Literally explain that a country that has good governance will positively correlate to economic growth (Mira and Hammadeche, 2017; Huang and Ho, 2017). Different results with research conducted by Liu et al (2018) and Kim et al. (2018) which explains that good governance has a positive correlation with economic growth. Meanwhile, research conducted by Huang and Ho (2017) and Fraj et al (2018) shows that the positive or

negative effects of good management on economic growth depend on the economic system adopted by a country such as the exchange rate system and economic openness of that country. The difference in income in explaining the relationship of good governance with economic growth makes the need for in-depth research. Based on previous research explaining the relationship between good governance and economic growth, but the impact of a positive or negative relationship depends on a country's economic conditions. Indonesia is a developing country with economic growth influenced by various external and internal factors. On the other hand, the government system in managing government and institutional performance is regulated in regulations. Regulations that form the basis of conducting government systems and running institutional systems sometimes encounter several obstacles. This makes the performance of government and institutional systems in Indonesia still not good.



Source: World Bank (2019) and ARIC-ADB (2019), edited  
**Figure 1.** Economic Growth and Indicators of Good Governance in Indonesia

- Muhammad Ramadhan is lecturer in North Sumatra Islamic University, Indonesia. E-mail: mramadhan030169@gmail.com

Figure 1 explains the relationship of fluctuations in economic growth with indicators of good governance in Indonesia in 2002 to 2018. Indonesia has a volatile economic growth with a range of between 4 to 6% during 2002-2018 except in 2002, which had economic growth of only 4.50%. Meanwhile, when viewed in terms of management and institutional quality in Indonesia tends to increase from 2002 to 2018 except for the indicator of control of Corruption, which experienced a significant decline in 2009. This shows that the level of corruption in Indonesia in 2009 was greater than previous years. In addition to Control of Corruption, several indicators of Good Governance, which also experienced a decline, were Political Stability, Government Effectiveness, Rule of Law, Regulatory Quality, Voice, and Accountability. A decrease in several indicators of indicators Good Governance occurred in the same year, namely 2015. The decline shows that there was a decrease in performance and the quality of institutions from the government, on the other hand the level of economic growth in 2015 also slowed. Therefore, the research will focus on the relationship between good management and the quality of institutions on economic growth in Indonesia.

## 2. LITERATURE REVIEW

Theoretically, the relationship between good governance and economic growth is still a debate among scientists. The World Bank explains that good or bad management of a country's governance can be assessed from the implementation of a country's governance principles and the development of a framework within the framework of economic growth and market development (Mira and Hammadache, 2017). While the definition of management according to the World Bank is how to exercise power in the decision making process and the implementation of the management of a country's social and economic resources (Rahman, 2016). While the goal of implementing good governance according to the World Bank is to build effective institutions in order to support sustainable economic and social development and development in a country. Therefore, if it is concluded that the application and implementation of good governance in a country will have a positive correlation with the growth and economic development of that country. Various studies on the relationship between the quality of governance and economic growth have been carried out, such as the research conducted by Huang and Ho (2017) that examines the causal relationship between governance and economic growth in all countries in the ASIA region. The results of research conducted by Hang and Ho (2017) show that countries with a more open economic system show that governance does not have a significant causality relationship while more closed countries show that governance has a more significant relationship to economic growth. While research conducted by Liu et al. (2018) shows that eastern China has higher economic growth due to the quality of better governance, whereas good governance in western China has an impact on rapid economic growth. Then research conducted by Kim et al. (2018) found that in countries with abundant natural

resources the application of good governance can have an impact on increasing economic growth and the size of power through increased productivity and increased output. Liu et al. (2018) is slightly different from the results of research conducted by Fraj et al. (2018) who found that governance does not have a significant influence on economic growth, while the exchange rate system adopted by a country has more significant influence on economic growth, especially on the market. On the other hand, a government that adheres to a flexible exchange rate system requires good governance to stimulate economic growth so Fraj et al. (2018) concludes that the exchange rate system adopted by a country will determine the quality of governance used. Nirola and Sahu (2019) who examined the impact of the size of government power on economic growth on various quality institutions in 23 Indian states found that greater government power has a negative relationship to economic growth, especially in the State. The size of the negative influence of government power on economic growth in the State depends on the quality of institutions in each State. The negative impact received by States that have good quality institutions will be smaller than those that have poor quality institutions.

## 3 DATA AND METHODOLOGY

The type of data used in this study is the time series with a time range of 2000Q1 - 2018Q4. The variables used in this study are economic growth (GDP), government performance and the quality of government institutions. Government performance variables are reflected in voice and accountability (VA), political stability and absence of violence (PV), control of corruption (CC) and government effectiveness (GE). While the proxy of the institution quality variable is the rule of law (RL) and quality of regulation (QR). Data sources used in this study were from the International Monetary Fund (IMF) and the Asia Regional Integration Center - Asian Development Bank (ARIC - ADB). The model specifications used in this study modify the research conducted by Mira and Hemmadahi (2017), Liu et al (2018) and Siddique et al (2016).

$$GDP_t = a_0 + a_1va_t + a_2pv_t + a_3cc_t + a_4ge_t + a_5rl_t + a_6qr_t + \varepsilon_t \quad (1)$$

Equation (1) explains the performance of government and the quality of government institutions have an influence on improving economic growth. The research method used in this study is Generalized Methods of Moments (GMM). The choice of method is based on the need not to make classical assumptions. On the other hand, the GMM method uses past variables and instrument variables to explain the dependent variable. Transform equation (1) into the GMM method as follows.

$$GDP_t = a_0 + a_1GDP_{t-1} + a_2va_t + a_3pv_t + a_4cc_t + a_5ge_t + a_6rl_t + a_7qr_t + \varepsilon_t$$

equation (2) is a transformation from equation (1) that has used the Generalized Methods of Moments method.

**Table 1. Variable Definitions**

Variable	Definition	Source
GDP (Economic Growth)	<ul style="list-style-type: none"> <li>The rate of economic growth calculated through Gross Domestic Products</li> <li>Unit (%)</li> </ul>	ARIC-ADB
PV (political stability and absence of violence)	<ul style="list-style-type: none"> <li>Perceptions about possible political instability and / or politically motivated violence, including terrorism</li> <li>Unit (%)</li> </ul>	World Bank
CC (Control of Corruption)	<ul style="list-style-type: none"> <li>Assess the problem of corruption</li> <li>Unit (%)</li> </ul>	World Bank
GE (Government Effectiveness)	<ul style="list-style-type: none"> <li>Perceptions of the quality of public services, the quality of civil services and the degree of independence from political pressure, the quality of policy formulation and implementation, and the credibility of the government's commitment to the policy.</li> <li>Unit (%)</li> </ul>	World Bank
RL (Rule of law)	<ul style="list-style-type: none"> <li>Perceptions of the extent to which agents have trust and comply with community rules, and in particular the quality of enforcement of contracts, property rights, police and courts, as well as possible crime and violence</li> <li>Unit (%)</li> </ul>	World Bank
qr (quality of regulation)	<ul style="list-style-type: none"> <li>Perception of the government's ability to formulate and implement good policies and regulations that enable and encourage the development of the private sector</li> <li>Unit (%)</li> </ul>	World Bank

## 4 RESULT AND DISCUSSION

Government performance accompanied by institutional quality of government will have an influence on economic growth. This is because output will increase accompanied by effective government performance and rapid and effective quality of institutions. Proof of the relationship

between government performance and institutional quality on economic growth is analyzed in this study. The use of method Generalized Methods of Moments (GMM) can test the relationship between government performance and institutional quality with economic growth.

**Table 2. GMM Estimated Results**

Variable	Coefficient	t-statistics	Probability
GDP(-1)	0,547	5,315	0,000*
Political stability and absence of violence	0,639	3,611	0,0571***
Control of Corruption	0,315	3,176	0,024**
Government effectiveness	0,542	3,986	0,032**
Voice and accountability	0,011	2,418	0,0676***
Rule of law	0,124	1,798	0,077***
Quality of regulation	0,673	2,474	0,056***
R-Square	0,874		

\* significant  $\alpha=1\%$ , \*\* significant  $\alpha=5\%$ , \*\*\* significant  $\alpha=10\%$

Table 2 is the result of GMM analysis on the relationship between government performance and institutional quality with economic growth. The results showed that government performance and institutional quality have a significant relationship to economic growth with different probability levels. On the other hand, economic growth is not only influenced by government performance and institutional quality, but is influenced by growth in the past period (t-1). This condition can be seen from the probability of economic growth in the past period ( $GDP_{t-1}$ ) of 0,000 which is smaller than the alpha value of significance ( $\alpha = 1\%$ ). Thus, the current movement of economic growth can be caused by economic growth in the past period. On the other hand, the government's performance in maintaining political stability and non-violence has a significant positive effect on economic growth. This can be seen from the probability value of 0.0571 smaller than the alpha value ( $\alpha = 10\%$ ). This condition shows that the government's performance in political stability and non-violence has an impact on economic growth. One source of increased economic growth is investment by investors. Investors will invest in a country with a good level of political stability and a little non-violence (Pay, 2016; Zubair & Khan, 2014). The government's performance in controlling the growth of corruption is one of the efforts to increase economic growth. The relationship between economic growth and corruption

is significantly influential. This condition can be seen from the probability value of the government's performance in controlling corruption by 0.024 less than the alpha value ( $\alpha = 5\%$ ). Government performance in maintaining an increase in corruption will have an influence on economic growth (Salawu, et al, 2018; Shchegolev & Hayat, 2018). The effectiveness of government performance makes it one of the sources of economic growth influence. The effectiveness variable probability of government performance is 0.032 less than the alpha value ( $\alpha = 5\%$ ). The significant correlation between the effectiveness of government performance variables with economic growth shows that the more effective government performance will drive economic growth. Ineffective government performance will reflect the management of government objectives not achieved (Mira & Hammadache, 2017; Yerrabati & Hawkes, 2015). One indicator that reflects government performance is governance accountability. Government accountability probability which shows 0.068 which is smaller than the value of alpha ( $\alpha = 10\%$ ). This shows that the existence of government accountability can affect economic growth. Governments that transparently account for government performance can encourage good economic growth (Habyarimana & Dushimayezu, 2018; Liu, et al, 2018) Indicators of measuring the quality of government institutions through indicators of quality

regulation and legal governance. The legal governance variable with a probability value of 0.077 is greater than the alpha value ( $\alpha = 10\%$ ) indicating that there is a significant influence relationship. Management of the applicable law in a fair work process will encourage economic growth. Simplified rules will encourage economic growth (Mira & Hammadache, 2017; Mohammadi, et al, 2017). The quality of government regulations is also one of the sources in driving economic growth. This can be seen from the probability value of 0.056 which is smaller than the alpha value ( $\alpha = 10\%$ ). There is a significant relationship between government regulations and economic growth indicating that the quality of government regulations will accelerate in completing business administration, so that it can encourage economic growth (Nirola & Sahu, 2019; Samarasinghe, 2018). Based on the results of the analysis that has been done shows that the indicators of good governance have an influence on economic growth in Indonesia. Thus, the need for strategies to improve indicators of good governance aimed at increasing economic growth. The indicators of political stability and absence of violence need to consolidate democracy and diplomacy in the country and abroad in order to achieve political stability and a good level of security. The strategy taken to improve government performance in control of corruption through increasing the effectiveness of independent institutions that have the task of reducing the level of corruption. In the strategy carried out to improve the effectiveness of government through several things, namely improving the quality of human resources, evaluating work systems and achievements and enforcing targets in work. On the other hand, in voice and accountability through reporting financial activities and government performance to the public. The next strategy in improving institutional quality is reflected in the rule of law, the government needs to evaluate and increase the effectiveness of law enforcement agencies. Meanwhile, an increase in the indicator quality of regulation is a reflection of institutional quality by evaluating the flow of regulations and regulations.

## 5 CONCLUSION

Indicators of government performance and the quality of government institutions in Indonesia have an influence on economic growth. This can be seen from government performance indicators that can be seen through voice and accountability, political stability and absence of violence, control of corruption and government effectiveness have a significant effect on economic growth with a probability below the alpha value. On the other hand, indicators of the rule of law and quality of regulation that reflect government institutional quality also have a significant effect on economic growth. The strategy that the government needs to undertake in improving government performance and institutional quality is evaluation and monitoring.

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