Chapter 12

Fostering Prosperity:

Unveiling the Impact of Governance Quality on GDP per Capita in OECD Nations

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ABSTRACT

This study aims to investigate the influence of the quality of governance on economic development among 38 OECD countries using a panel data approach. The data was gathered from the World Bank database for the period of 2002-2021 and consists of six governance indicators and two macroeconomic variables. The independent variables are the six governance indicators (WGI): control of corruption (CC), government effectiveness (GE), political stability and absence of violence/terrorism (PS), rule of law (RL), regulatory quality (RQ), and voice and accountability (VA). The dependent variable is the natural logarithm of GDP per capita, and inflation and real interest rates are control variables. The research identifies a direct and significant relationship between GDPPC and GE, PS, RL, RQ, and VA in OECD countries. These findings suggest that the existence of mechanisms for GE, PS, RL, RQ, and VA contribute positively to economic development. Moreover, interest rates and inflation are found to be significant and negatively related to GDPPC.

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1. INTRODUCTION

In recent years, the term "institutions" has become fashionable in social sciences, including economics. In particular, towards the end of the 20th century, institutions began to have an important mission in development economics and studies on the relationships between development economics and institutions increased accordingly. In this context, innovative institutional economics became popular in addressing the development failures of underdeveloped countries, and as it stands, institutions of poor quality considered as a critical factor in economic lagging. Despite the fact that the significance of institutions is widely accepted among researchers, their role and connections with the economy remain unclear (Jütting, 2003).

Terms such as *institutional development, governance reform,* and *good governance* are used interchangeably, and they have been supported by the International Monetary Fund (IMF) and the World Bank (WB) to embrace superior institutions to reinforce economic development since the 1990s (Chang, 2006; Chang, 2011). Consequently, institutions have been commonly used by the IMF and WB to assess the success of countries at many levels, such as social, political and economic (Albassam, 2013). Hereby, these two prominent organizations started to assign some "*governance related conditionalities"* that incorporate various articles about some economic institutions needed to be met by borrowing countries (Chang, 2011). Therefore, it is vital and inevitable that all countries support their economic development through good governance agents. For instance, AlShiab et al. (2020) mentioned in their study that countries with strong legal infrastructure tend to attract more capital from offshore economies. Similarly, many studies have shown that the institutional base is a key factor in the progress of many countries at different levels of revenue. According to Rodrik (2008), one of the main impacts of good institutions on economic development is their interaction with the global economic environment. On the other hand, many government administrators seem to defend against poor politics and institutions preventing economic growth, thereby causing excessive corruption. In this frame of reference, both poor politics and institutions seem to be the number one obstacle for most economies. For instance, interest groups usually see technological progress as a threat to their power and deliberately hinder some necessary technological changes, even though a large part of society and the development of the economy benefits from it (Snowdon & Vayne, 2012).

Within this framework, this chapter examines the relationship between governance quality and GDP per capita in OECD nations, focusing on key theoretical frameworks and citing relevant studies. It begins by defining governance quality and its theoretical underpinnings and then proceeds to summarize key studies that explore this theme. This chapter effectively integrates various perspectives and empirical findings to support its arguments, demonstrating a comprehensive understanding

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