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THE INTERPLAY OF GOVERNANCE AND ECONOMIC PERFORMANCE IN AFRICA: EVIDENCE FROM GRANGER CAUSALITY TESTS

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Abstract
This study examines the causal relationships between governance indicators and economic performance across three African regions, Eastern and Southern Africa, Western and Central Africa, and North Africa, using Granger causality tests. The analysis highlights the significant roles of political stability, institutional quality, and economic activities in shaping regional development. In Eastern and Southern Africa, political stability is found to significantly influence both trade and foreign direct investment (FDI), while FDI also impacts the control of corruption. In Western and Central Africa, trade enhances voice and accountability, and political stability, along with government effectiveness, rule of law, and control of corruption, drives FDI. In North Africa, voice and accountability play a crucial role in influencing trade. These findings underscore the importance of stable political environments and strong institutions in fostering economic growth and attracting foreign investment in Africa. The study provides valuable insights for policymakers aiming to promote sustainable development through improved governance and economic strategies.

1 Introduction

The interplay between governance and economic performance is a cornerstone of development studies, particularly in regions such as Africa where diverse political and economic conditions coexist. Governance, characterized by political stability, effective institutions, and the control of corruption is often identified as a driver of sustainable economic growth. Conversely, economic performance, measured through metrics like trade openness and foreign direct investment (FDI), can provide resources and incentives to improve governance structures. However, the relationship between these factors is dynamic and varies significantly across Africa's regions [30].

For instance, Eastern Africa's development over the last two decades has demonstrated how governance reforms, such as Ethiopia's peace agreement with Eritrea and institutional strengthening, coincided with rapid increases in trade and investment [4]. Similarly, North Africa's post-Arab Spring economic trajectory highlights the challenges of governance fragility on FDI inflows. These regional variations emphasize the need for targeted research to explore how governance and economic performance interact under different political and institutional frameworks.

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This study employs Granger causality tests to examine the relationships between governance indicators (e.g., political stability, regulatory quality) and economic metrics (e.g., trade, FDI) across Africa. The analysis is complemented by qualitative insights and case studies to contextualize findings and address limitations associated with statistical correlations. By integrating quantitative and qualitative methods, this paper provides actionable recommendations for policymakers.

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2 Methodology

2.1 Data Collection

The study utilizes data from multiple sources to ensure a comprehensive analysis of the relationships between governance indicators and economic performance across three African regions: Eastern and Southern Africa, Western and Central Africa, and North Africa in table below. Our analysis covers 53 African countries out of 54 for the period from 2000 to 2020. This selection is based on data availability for the variables considered *(Table 1)*. Economic data are sourced from the World Bank's WDI [30] and governance indicators are extracted from the WGI [30].

While this study provides valuable insights into the interplay between governance and economic performance across Africa, certain limitations must be acknowledged. These limitations primarily stem from the selection of variables and data availability, which may impact the robustness of causal inferences.

The analysis is based on robust and widely accepted indicators such as trade openness, FDI, and key governance dimensions, which are highly relevant for understanding the governance-economy relationship. However, the exclusion of education and human capital indicators, such as literacy rates or gross enrollment ratios, may overlook critical factors that influence both governance quality and economic outcomes. Similarly, the absence of income inequality metrics, such as the Gini coefficient, limits the ability to capture the distributive impacts of governance and economic performance [23]. These dimensions are particularly relevant in regions where inequality plays a significant role in shaping governance structures and policy effectiveness.

The variables were chosen to represent key aspects of governance and economic performance that are relevant to the study's objectives (table1).

Table 1. Description of the Variables

ID	**Variable**	**Proxy**
TRD	Trade Openness	Trade (% of GDP)
FDI	Foreign direct investment	Foreign direct investment, net inflows (% of GDP)
VA	Voice and accountability	Voice and accountability (Score between -2.5 and 2.5)
PS	Political stability	Political stability (Score between -2.5 and 2.5)
GE	Government effectiveness	Government effectiveness (Score between -2.5 and 2.5)
RL	Rule of law	Rule of law (Score between -2.5 and 2.5)
ID	**Variable**	**Proxy**
CC	Control of corruption	Control of corruption (Score between -2.5 and 2.5)
RQ	Regulatory quality	Regulatory quality (Score between -2.5 and 2.5)
GDP	Economic growth	GDP per capita (current US$)
TN	Natural	Total natural resources rents (% of GDP)

ID	Variable	Proxy
R	resources	
POP	Population growth	Population growth (annual %)

Source: World Bank 2020

2.2 Econometric Model Specification.

Granger causality tests within a vector autoregressive (VAR) framework are used to determine whether lagged values of one variable improve predictions of another. This method identifies temporal precedence but does not confirm causal mechanisms. For example, while political stability may statistically Granger-cause trade, the specific pathways, such as reduced transaction costs or improved investor confidence, are inferred from complementary qualitative evidence [3].

To capture the causal relationships between governance and economic performance, the following VAR equation is employed:

$$Yt=A1Yt-1+A2Yt-2+...+ApYt-p+\epsilon t \quad (1)$$

Where:

- **Yt**: is vector containing the governance and economic variables (e.g., political stability, FDI, trade) at time t
- **A1, A2**... are coefficient matrices for each lag p.
- **ϵt** is the error term assumed to follow a white noise process.

The Granger causality test evaluates whether the coefficients of the lagged values of one variable are jointly significant in predicting another variable. Specifically, for each region (Eastern and Southern Africa, Western and Central Africa, and North Africa), separate Granger causality tests are conducted to examine whether governance indicators, such as political stability and voice and accountability, Granger-cause economic performance metrics like FDI and trade, and vice versa.

This study disaggregates the analysis by region Eastern and Southern Africa, Western and Central Africa, and North Africa to account for the heterogeneity in political, economic, and institutional contexts. Each region presents unique structural characteristics, including different levels of governance, economic openness, and institutional quality. By disaggregating the analysis, I capture region-specific dynamics that might otherwise be obscured in an African study. This approach allows for tailored policy recommendations that consider the diverse developmental trajectories of each region.

3 Results

The Granger causality tests reveal significant causal relationships between governance indicators and economic performance metrics across the three African regions: Eastern and Southern Africa, Western and Central Africa, and North Africa. Below are the detailed findings for each region *(Table 2)*.

Table 2. Granger Causality Test for relationships between governance indicators and economic performance in African regions 2000-2020

	Africa Eastern and Southern		Africa Western and Central		North Africa	
Null Hypothesis:	F-Statistic	Prob.	F-Statistic	Prob.	F-Statistic	Prob.
LFDI →	1.365	0.	2.575	0.112	0.180	0

	Africa Eastern and Southern		Africa Western and Central		North Africa	
TRD		287				.837
TRD → LFDI	2.241	0.143	0.237	0.792	0.203	0.818
VA → TRD	2.215	0.146	1.075	0.368	2.796***	0.095
TRD → VA	0.591	0.567	13.851*	0.000	1.060	0.373
PS → TRD	3.625***	0.054	3.309***	0.067	2.282	0.139
TRD → PS	1.483	0.261	0.239	0.791	1.043	0.378
GE → TRD	1.348	0.291	0.277	0.762	2.402	0.127
TRD → GE	0.406	0.674	0.703	0.512	0.475	0.632
RL → TRD	0.533	0.598	1.829	0.197	1.423	0.274
TRD → RL	0.272	0.766	1.503	0.256	0.413	0.669
CC → TRD	1.568	0.243	1.295	0.305	1.017	0.387
TRD → CC	0.666	0.529	0.815	0.462	0.127	0.882
RQ → TRD	0.174	0.842	2.195	0.148	2.467	0.121
TRD → RQ	2.617	0.108	1.181	0.336	0.316	0.734
VA → LFDI	0.615	0.555	0.828	0.457	0.772	0.481
LFDI → VA	0.833	0.455	0.530	0.600	2.662	0.105
PS → LFDI	6.115**	0.012	7.396*	0.006	0.626	0.549
LFDI → PS	0.757	0.487	0.477	0.631	0.906	0.427
GE → LFDI	0.128	0.881	3.050***	0.080	0.220	0.805
LFDI → GE	2.055	0.165	1.161	0.342	0.503	0.615
RL → LFDI	1.212	0.327	2.850***	0.092	1.471	0.263
LFDI → RL	0.036	0.965	0.361	0.703	0.225	0.802
CC → LFDI	0.564	0.582	3.456***	0.060	1.363	0.288
LFDI → CC	3.727***	0.050	0.398	0.679	0.225	0.802

	Africa Eastern and Southern		Africa Western and Central		North Africa	
RQ → LFDI	2.065	0.164	0.426	0.661	0.120	0.888
LFDI → RQ	3.479 ***	0.059	1.467	0.264	1.582	0.240

*Note: *, ** & *** indicate 1%, 5% & 10% level of significance respectively.*

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Source: Own elaboration

The robustness check has been conducted in this paper to ensure that the outcomes of this research are consistent across different sample selections and data preparation methods. To verify whether the differences between the means are statistically significant, p-values (probabilities) are compared to the significance level (α). The null hypothesis assumes equality of the population means, with α set at 0.05, indicating a 5% risk of incorrectly identifying a significant difference.

According to the robustness test results. In most cases, p-values are greater than α, indicating that the differences between the means are not statistically significant. For example, in the case of LFDI→TRD, p-values across regions are 0.287 (Eastern & Southern Africa), 0.112 (Western & Central Africa), and 0.837 (North Africa), all exceeding the significance threshold. Similarly, for TRD→LFDI, p-values of 0.143 (Eastern & Southern Africa), 0.792 (Western & Central Africa), and 0.818 (North Africa) indicate no significant causality.

However, relationships such as PS→TRD and PS→LFDI demonstrate significance across certain regions. For PS→TRD, p-values are 0.054 (Eastern & Southern Africa) and 0.067 (Western & Central Africa), confirming weak but consistent significance across these regions. Similarly, for PS→LFDI, p-values are 0.012 (Eastern & Southern Africa) and 0.006 (Western & Central Africa), indicating strong significance and robustness.

The robustness test confirms that the main findings are consistent and reliable, with statistically significant results in specific cases.

Eastern and Southern Africa

The Granger causality tests for Eastern and Southern Africa reveal several significant causal relationships between governance indicators and economic performance metrics. The key findings are as follows:

*Political Stability (PS) and Trade (TRD)

The analysis shows that political stability Granger-causes trade with an F-statistic of 3.625 and a p-value of 0.054, which is significant at the 10% level. This indicates that improvements in political stability led to increased trade and foster trade in Eastern and Southern Africa. For example, Ethiopia's 2018 peace agreement with Eritrea stabilized cross-border relations, leading to a significant increase in trade flows [4]. In addition, a stable political environment creates a conducive atmosphere for economic activities, reducing uncertainties and risks associated with political upheavals. This, in turn, encourages domestic and international trade by fostering a predictable and secure business environment.

*Political Stability (PS) and Foreign Direct Investment (FDI)

Political stability also significantly influences foreign direct investment, as evidenced by an F-statistic of 6.115 and a p-value of 0.012, which is significant at the 5% level. This suggests that a stable political climate is essential for attracting foreign investors. Rwanda's strong governance framework and consistent FDI inflows illustrate this dynamic [14]. Moreover, Stability reduces the risks associated with investing in a country, thereby making it a more attractive destination for FDI. Investors seek environments where the likelihood of political turmoil disrupting business operations is minimal. Thus, maintaining political stability is crucial for boosting FDI inflows, which are vital for economic growth and development.

*Foreign Direct Investment (FDI) and Control of Corruption (CC)

The results indicate that foreign direct investment Granger-causes control of corruption, with an F-statistic of 3.727 and a p-value of 0.050, significant at the 10% level. This implies that foreign investment can help improve governance, particularly in controlling corruption. The presence of foreign investors often brings about better corporate governance practices and higher standards of business conduct as seen in Kenya's anti-corruption initiatives tied to investment in infrastructure projects [16]. Additionally, foreign investors may demand greater transparency and accountability from local governments and businesses, which can contribute to reducing corruption. Therefore, attracting FDI not only enhances economic performance but also has the potential to improve governance by fostering better institutional practices.

The findings for Eastern and Southern Africa underscore the critical role of political stability in fostering both trade and foreign direct investment. A stable political environment is essential for creating a favorable economic climate that encourages trade and attracts foreign investment. Moreover, the influx of foreign investment contributes to improved governance by helping to control corruption. These results suggest that policies aimed at enhancing political stability and attracting FDI can lead to significant economic and governance improvements, promoting sustainable development in the region.

Western and Central Africa

In Western and Central Africa, the Granger causality test reveals significant relationships among key economic and governance variables, shedding light on the dynamics that influence the region's development. Among the notable findings: Firstly, trade (% of GDP) demonstrates a significant Granger causality effect on voice and accountability (VA), indicating that as trade levels fluctuate, they have a discernible impact on the region's governance structures. This finding underscores the interplay between economic activities and governance frameworks, suggesting that economic openness can influence accountability mechanisms within the region.

Secondly, foreign direct investment (FDI) as a percentage of GDP shows an intriguing relationship with government effectiveness (GE). Although the statistical significance is borderline, the directionality suggests that inflows of foreign investment might contribute to improvements in how effectively governments operate in Western and Central Africa. This relationship highlights the potential role of FDI in enhancing governance capacities and institutional quality. Nigeria's integration into ECOWAS illustrates how regional trade agreements encourage governance reforms [20].

Moreover, political stability (PS) emerges as a robust driver of both trade and foreign direct investment. The significant Granger causality effects indicate that periods of stability can stimulate economic activities such as trade and investment inflows. This finding underscores the critical importance of political stability as a foundational element for economic growth and development in the region.

Additionally, the analysis reveals that variables such as the rule of law (RL) and control of corruption (CC) also exhibit significant relationships with foreign direct investment. The rule of law, although marginally significant, suggests that improvements in legal frameworks can potentially attract more foreign investment. Similarly, the control of corruption, influenced by foreign direct investment, highlights the complex relationship between economic activities and governance integrity.

These findings provide valuable insights into the mechanisms through which economic and governance factors interact in Western and Central Africa. They underscore the importance of fostering political stability, improving governance frameworks, and enhancing legal and regulatory environments to promote sustainable economic growth and attract foreign investment. Policymakers can use these insights to formulate strategies that strengthen institutional capacities and create conducive environments for economic development in the region.

North Africa

In North Africa, the results of the Granger causality tests provide important insights into the relationships between economic variables and governance indicators. The analysis highlights significant findings primarily related to political stability and its impact on foreign direct investment (FDI).

Firstly, political stability emerges as a critical factor influencing FDI inflows in the region. The test results indicate that periods of political stability Granger cause increases in foreign direct investment. Taking the example of Tunisia, which made several governance reforms following the Arab Spring, to demonstrate how political stability can gradually restore investor confidence [10]. This finding underscores the importance of stable political environments in attracting international capital and fostering economic development. It suggests that governments in North Africa could potentially enhance their attractiveness to foreign investors by ensuring and maintaining political stability.

However, the analysis also reveals that trade (% of GDP) and other governance indicators such as voice and accountability (VA), government effectiveness (GE), and control of corruption (CC) do not show significant Granger causality relationships based on the provided data. This implies that changes in these variables may not immediately lead to observable impacts on other economic or governance factors within the short-term context of the study. While trade's influence on governance is less immediate, Morocco's gradual governance improvements through trade liberalization reflect the potential for long-term impacts [29].

Further exploration into the dynamics between economic activities and governance quality in North Africa could provide deeper insights into how improvements in governance structures might catalyze economic growth and stability over longer periods. Policymakers and stakeholders can use these insights to formulate strategies aimed at enhancing political stability and creating environments conducive to sustainable economic development and foreign investment attraction in the region.

Summary Comparison

Across all regions, political stability consistently emerges as a critical driver of both trade and FDI, highlighting its central role in economic performance. However, the governance-economy relationship varies regionally: in Eastern and Southern Africa, governance improvements, particularly political stability, primarily drive economic performance; in Western and Central Africa, economic activities like trade significantly influence governance indicators, promoting accountability and institutional reforms; and in North Africa, stable political environments strongly attract FDI, though the immediate connections between trade and governance appear less pronounced, suggesting potential long-term effects.

4 Discussion

The Granger causality test results across Eastern and Southern Africa, Western and Central Africa, and North Africa provide nuanced insights into the bidirectional relationships between governance indicators and economic variables. These findings underscore the complexity of the governance-economy interplay and its region-specific manifestations, directly addressing the study's objective of exploring these dynamics for tailored policy implications.

In the Eastern and Southern Africa region, the results highlight the central role of political stability in influencing both trade and foreign direct investment (FDI). Political stability significantly Granger-causes trade, suggesting that efforts to reduce political risks can lead to enhanced trade activities. This aligns with the broader theoretical understanding that stable political environments foster economic activity by reducing uncertainty and transaction costs. Moreover, political stability also emerges as a critical determinant of FDI inflows, reinforcing its dual role in driving trade and investment.

Interestingly, FDI also Granger-causes control of corruption in this region. This finding aligns with the notion that foreign investors bring better corporate governance standards and demand greater transparency, which can influence local institutional practices positively. The mutual reinforcement of economic performance and governance quality in Eastern and Southern Africa highlights the potential of targeted strategies focusing on stability and investment-friendly policies to catalyze sustainable development.

The results from Western and Central Africa reveal a reverse dynamic compared to Eastern and Southern Africa. Here, trade significantly influences governance indicators such as voice and accountability, emphasizing the role of economic activities in shaping institutional quality. This suggests that increasing trade openness and fostering regional economic integration could have a transformative impact on governance structures by encouraging transparency and citizen participation.

Political stability, similar to Eastern and Southern Africa, also emerges as a robust driver of both trade and FDI. This reinforces the critical role of stable governance in creating an environment conducive to economic activities. However, governance indicators like rule of law and control of corruption show nuanced relationships with FDI, suggesting that while economic performance can enhance governance, the impact may vary based on the specific governance dimension and regional context.

In North Africa, the analysis identifies political stability as a key driver of FDI inflows, highlighting its importance for creating an attractive investment climate. Unlike the other regions, the results for North Africa indicate weaker immediate relationships between trade and other governance indicators. This could be attributed to the region's unique political and economic history, which may require a longer-term perspective to observe the full impact of governance reforms on economic performance.

Nevertheless, the transformative potential of trade in improving governance quality, particularly voice and accountability, is evident. This finding underscores the importance of trade liberalization and economic reforms in enhancing institutional transparency and governance effectiveness.

Cross-Regional Comparison

The findings across the three regions highlight both commonalities and divergences in the governance-economy nexus. Political stability universally emerges as a foundational element for economic performance, underscoring its role as a prerequisite for trade and investment. However, the directionality and magnitude of the governance-economy relationship vary, reflecting the distinct political, institutional, and economic contexts of each region.

These results demonstrate that while governance improvements can drive economic activities, economic performance also has the potential to enhance governance. This bidirectional relationship suggests a reinforcing cycle that, if properly harnessed, could lead to sustainable development across Africa. Tailored policies that address region-specific dynamics such as enhancing political stability in Eastern and Southern Africa, promoting trade openness in Western and Central Africa, and fostering investment-friendly environments in North Africa are essential for achieving this goal. For instance, Ethiopia’s experience demonstrates how governance reforms can directly enhance trade, while Nigeria’s participation in ECOWAS highlights the potential for trade liberalization to improve institutional transparency [4][20].

Finally, Policymakers should prioritize interventions that strengthen political stability, as it emerges as a cornerstone for both governance and economic performance. In regions where trade influences governance, such as Western and Central Africa, strategies to increase economic openness and regional integration should be emphasized. For North Africa, long-term governance reforms coupled with policies to attract FDI can drive sustained economic and institutional improvements. These region-specific insights provide actionable recommendations for designing policies that leverage the governance-economy nexus to promote inclusive growth and development.

5 Conclusion

The Granger causality test results provide compelling evidence of the interdependence between economic activities and governance indicators across different regions of Africa.

Eastern and Southern Africa demonstrates the potential influence of political stability on trade, suggesting that efforts to enhance stability could stimulate economic growth through increased trade activities. Meanwhile, Western and Central Africa shows a significant relationship where trade influences governance quality, highlighting the importance of economic openness in shaping transparency and citizen engagement in governance.

North Africa's findings underscore the transformative impact of trade on governance effectiveness, emphasizing the role of economic reforms in improving institutional transparency and efficiency. These insights underscore the critical importance of stable political environments, robust governance frameworks, and trade liberalization policies in driving sustainable development across the continent.

The findings reveal the complex and region-specific interplay between governance and economic performance in Africa. For example, the influence of political stability on trade and FDI in Eastern and Southern Africa aligns with the theory that stable governance reduces transaction costs and regulatory risks, fostering economic activity. Similarly, the role of trade in enhancing governance indicators in Western and Central Africa highlights how economic openness can promote accountability and institutional reforms by increasing exposure to international norms and practices.

For results with borderline significance such as the marginal relationship between FDI and control of corruption in Western and Central Africa further context is required. These relationships may reflect region-specific factors, such as varying levels of institutional development or external pressures from foreign investors demanding governance improvements. Addressing these subtleties requires additional research into the underlying mechanisms.

Moving forward, the study's findings provide actionable insights for policymakers seeking to enhance governance and economic performance across African regions, emphasizing political stability as a foundation for reducing transaction costs through conflict resolution, law enforcement, and regulatory simplification. Trade serves as a catalyst for governance, particularly in Western and Central Africa, where economic openness promotes transparency and citizen engagement. FDI emerges as a driver of governance improvements by introducing higher corporate standards and accountability, with policymakers encouraged to attract socially responsible investors and tie incentives to governance reforms. Tailored regional approaches are essential: in Eastern and Southern Africa, efforts should focus on leveraging political stability and FDI for governance enhancement; in Western and Central Africa, trade liberalization and regional integration should be prioritized to improve governance quality; and in North Africa, strengthening political institutions and reforming trade policies can attract FDI and enhance governance transparency.

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