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The Impact of Democratic and Economic Freedom on Economic Growth in Developing Countries: Pooled Cross Country Data Evidence

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Abstract: Main objective of this study is to investigate that whether free economic and political policies promote economic growth in developing countries or not. This study employs least square quantitative methodology to estimate the effects of freedoms. This study found a strong negative relationship between political freedom and economic growth in more than 70 developing countries from all regions during 2000-2004 by using an econometric model based on new classical growth theory. Economic freedom is negatively related with economic growth, but has no significant effect. Freedom for joint collective decision of people for selecting central leadership in developing countries is challenge for achieving rapid economic growth. These results differ from most of existing literatures and policy prescriptions on that positive role of democratic and economic freedom for economic growth which is precondition of economic development.

Key words: Authoritarianism, democratization, political instability, visionary leadership, information infrastructures, globalization, political enthusiasm

INTRODUCTION

Developed countries and international political and economic institutions in the world are emphasizing developing countries to persuade free economic policies as well as to work free democratic political system to stabilize their economies and societies. The ground conditions of the developing nations to practice competitive text book approach of free economic and political system are challenges due to the lack of information among the economic agents. Developing countries are unable to attain higher economic growth even they have predominant natural resources. Sociopolitical factors effect the economic growth of those countries. More freedom in economics as well as in politics without appropriate institutions is challenge for growth of these countries due to the lack of institutions. Democratic or economic freedom or both does not promote economic growth of developing countries. This is key research problem to be discussed in this study. Most of developing countries which have less democratic freedom have higher economic growth than those having higher democratic freedom.

We can see two types of viewers in the relation of democratic freedom and economic growth. First one, pessimistic viewers. Political freedom is not well for economic growth. Democratic politics leads to demands for welfare spending, which turn blocks social saving and accumulation of capital, consequently impeding economic

growth. Politicians are running out treasury to keep their power in pork barrel politics. There is a trade off between popular government and economic development. The two goals are incompatible-poor countries must choose democratic freedom or material growth, not both. Since developing countries cannot simultaneously pursue democracy and a larger national income, authoritarian serves them better in the early stage of development. In some cases, democracy allows the non visionary politician to seed heterogeneities among the societies in the forms of ethnics, languages, casts, regionalism and religions. It grows as a tree and leads to conflicts or war; finally, it leads to downfall of economy. Corrupted democratic politics in some developing countries is a business to politicians to make wealth. The overall economy is unstable.

Second, according to the optimistic viewers, they are hopeful about humanity capacity to act in its self-interest; this line of analysis holds to the contrary that democratic freedom accords with capitalism and therefore economic progress. Democratic political structures foster private investment by bolstering belief in the political system's durability. They also nurture a climate of open debate that is helpful for the efficient allocation of resources. Rather than clashing with a competitive economic system, therefore a competitive polity imperative for it. Both democracy and capitalism foster freedom of choice and trend to unleash people's creative energy. Whatever works in the long term is authoritarian

campaign to derive society forward in a forced march to modernization. Democratic freedom yields long run growth rate that is more predictable. It produces greater stability in economic performance and handles adverse shock much better. Democracy pays higher wages.

Under what types of political regimes are investors, consumers, producers, likely to feel that they have strongest safeguards? Are democratic institutions usually best answers? Many doubt it. Especially, in developing countries investors, consumers and producers do not feel that democracy institutions are strongest safeguards. Because, they do not function properly. They are only carrying names. People do not have capability to use their democratic rights in proper manners in developing countries. Politicians exploit people's rights by giving short run attractive benefits to them. Educated people are falling on trap of politicians by getting rent seeking benefits. The government is formed by alliances and political uncertainty is continued in many developing nations. Average investment as percentage of GDP in China during 2000-2005 is 37%. It is 26% in India. Foreign direct investment in china was to US\$ 54.9 billions in 2004 and it was just US\$ 5.3 billions in India.

Democratic freedom differs from civilian's freedom. Philosophers have long distinguished, democracy from liberalism and political rights from civil rights. They may be unbundled in practices. Chinese people have civil rights but do not have political rights to choose central authority. There is no particular association, according to this view point, between the freedom to joint collective decision and the freedom to use and dispose of properties (Goldsmith, 1995). USA and her friends in Iraq and Afghanistan are fighting to bring democracy. However, one country which has economic freedom does not mean that country must have political freedom. Singapore is second rank of economic freedom in the world. But it has a lowest score in democratic freedom. East Asian success stories- Singapore, Hong Kong, Taiwan and South Korea developed their economies under authoritarian regimes which controlled opposition parties partially or fully. These countries enjoyed rapid economic growth during a long period. Even United States, the highly democratic nation in the world, controls small political parties which have no chance of coming to power. Present global economic and political trend emphasize both freedoms simultaneously. A large No of lives had been lost to make democratic foundation in world. I deeply belief that democracy is credible to development. But developing countries have to postpone democratic rights and have to practice with economic controls until they will achieve economic prosperity due to the lack of information infrastructures.

Barro (1996a) has done empirical studies about determinants of economic growth in more than hundred countries across the world. He came to a conclusion that higher initial schooling, life expectancy, lower fertility, lower government consumption, better maintenance of the rules of the law, lower inflation and improvements of term of trade are positively influencing on economic growth. Initial level of real per capita GDP and political freedom has negatively influence on the growth. Political freedom has only a weak effect on economic growth but there is some indication of a non- linear relation. At low levels of political rights, an extension of these rights stimulates economic growth. However once a moderate of democracy has been attained, a further extension reduces the growth (Barro, 1996b). Extent of democracy does not emerge as critical determinant of growth. In an extreme dictatorship, an increase in political rights trends to raise growth because the governmental is critical. However, if some political rights already achieved, further democratization may retard growth because of the height tended concern with social program and income distribution. Political stability influences on the economic growth. It is said politicization of the economic growth (Hibbs, 2001). Role of the property rights, effectiveness of the legal system, corruptions, regulatory structure and quality of governance influence on economic growth. Carmignani (2003) examines that social and political instability effects the three crucial macroeconomics aspects: Growth, fiscal policy and trade off between inflation and unemployment

Jakob (1998) with experiences of 100 countries shows that the poor property rights resulted by political instability leads to lower investment. Investment activities go to out of the taxable projects and it reduces the government's revenues and ability of spending comes down due to the sociopolitical instability. Barro (1991) reported by using data of 98 countries from 1960 to 1985, that growth rate is negatively related to the measures of political instability. He makes the use of variables like figure on revolution, coups and political assassinations, since this relation could involved adverse effect of political instability on property rights and therefore private investment. Similarly, Livine and Renelt (1991) conclude that the figure on revolution and coups per year is robustly negatively correlated with investment share of domestic product. Przworski and Limongi (1998) summarize the 18 studies with 21 findings which examined the impact of political regime on economic growth. Among them, eight were found in favor of democracy, eight in favor of authoritarianism and five discovered no differences and he could not come to a conclusion whether political regimes effect growth or not. He left with

wide open for reflection and research. Gerring *et al.* (2006) have done a heavy work on democracy and economic growth. They have rejected the conventional wisdom on that there no same time negative relationship between democracy and growth. They found long-term democracy positively effect economic growth. Democratic capitals, institutionalization are the key determinants to economic growth. Bluedorn (2001), Comeau (2003), Mohtadi and Roe (2003), Ali (2004), Butkiewicz and Yanikkaya (2006) and Saiz (2006) have done the empirical studies on the relation of democracy and economic growth and show positive and negative relationship between democracy an growth.

The model and data: The following new classical growth model is used to investigate impact of political and economic freedom on economic growth.

$$\text{Growth} = g(y_0, k, h, D, E_t) \quad (1)$$

Where Growth is real output change representing economic growth, y_0 is initial per capita income for convergence theory, k is physical capital accumulation, h is human capital accumulation, D_t is democratic freedom and E_t is economic freedom. According to the growth theories and most of existing empirical literatures, the relationships are as $g_1 < 0$, $g_2 > 0$, $g_3 > 0$, $g_4 > 0$ and $g_5 > 0$. Estimation is as:

$$\text{Growth} = b_1N + b_2A + b_3Z + u \quad (2)$$

N is vector for theoretical variables of new classical growth model, A is vector for variables of democratic freedom, Z is vector for variables of economic freedom and u is error term. This study selects 70 developing countries which had less than US\$ 3000 per capita income in 2000 from all regions of the world. The average of 5 years period, 2000-2004 is used as observations; All data are average of five year period, 2000-2004. Economic growth is measured by average GDP growth rate period 2000-2004; initial income is per capita income for year 2000. Physical capital accumulation is measured by average investment expenditure as percentage of GDP during the period 2000-2004. Human capital accumulation is measured by proxy of average enrolments of tertiary education as percentage of gross enrolments during 2000-2004. All these data are taken from data query of World Development Index (WDI) of World Bank group.

The objective variable of democratic freedom is measured by index for democracy, taken from polity iv report. This index takes a score from zero to ten. Average score of period 2000-2004 is considered

as measure of democratic freedom. Score ten means highest democratic freedom and zero means no democratic freedom. Variables of economic freedom are taken from index for economic freedom, made by heritage foundation. This index is average of ten variables such as trade, fiscal burden, government intervention, monetary policy, foreign investment, banking finance, wages and price, property rights and regulation informal market. The countries with average overall score of 1.99 or less are free economies. The countries with average overall score of 2.00 to 2.99 are mostly free economies. The countries with average score of 3.00 to 3.99 are mostly unfree economies. The countries with average score of 4.00 or higher are repressed economies. Hong Kong is first rank with around 1.5 score and North Korea is last one with 5 score. Index for economic freedom plays two roles in this model. First, it serves as sole objective variables for all measures of economic freedom, second it represents as an environmental and control variable for economic growth model by including trade, foreign investment, property rights and monetary and fiscal policy etc. Average score of period 2000-2004 is considered as measure of economic freedom as well as economic policy environmental variable for economic growth.

Empirical results: Average economic growth, per capita income, investment ratio, tertiary education enrolment, democratic freedom and economic freedom in selected countries are 5.33%, US\$ 870, 22.64%, 16.71%, scores 4.43 and scores 3.43 respectively (Table 1). Average democratic freedom of developing countries are lower than average of scores and economic freedom is also less than average scores in the term of degree of economic freedom (Higher scores means lower economic freedom).

Results of Table 2 indicate that the theoretical relationships between economic growth and physical and human capital are positive. Initial level of per capita income has negative effect on growth. These relations are consistent with growth theory. The correlation between economic freedom and growth is negative. (Be sure on that high value of index for economic freedom means low economic freedom. For simple understanding, the sign of economic freedom is changed to opposite sign on correlation and regression results). Relationship between democratic freedom and economic growth is also negative. Initial per capita income positively related with physical and human capital accumulation. Correlations between initial income and human capital, democratic freedom are 0.65 and 0.40, respectively. Either democratic freedom or economic

Table 1: Descriptive statistics

(Averages for period, except for initial per capita income)						
	GROWTH	y ₀	k	h	D	E
Mean	5.334262	870.6557	22.649840	16.71328	4.436066	3.434098
Median	4.940000	500.0000	21.330000	10.15000	4.600000	3.460000
Maximum	13.760000	2900.0000	42.000000	66.70000	10.000000	4.670000
Minimum	-0.760000	100.0000	12.200000	0.40000	0.000000	2.240000
Std. Dev.	2.829933	770.7375	6.813478	17.66149	3.339363	0.515973
Observations	61	61	61	61	61	61

Table 2: Correlation matrix

(Averages for period, except for initial per capita income)						
	Growth	y ₀	k	h	D	E
Initial level income(y ₀)	-0.1397	1				
Physical capital accumulation (k)	0.3579	0.1019	1			
Human capital accumulation (h)	0.1603	0.6545	0.0431	1		
Democratic freedom (D)	-0.2922	0.4044	0.0510	0.36830	1	
Economic freedom (E)	-0.2871	0.5428	-0.04024	0.3323	0.5467	1

Table 3: Impact of democratic and economic freedom on economic growth in LDCs

	(Dependent variable: GDP growth)		
	(1)	(2)	(3)
Initial level income (y ₀)	-0.0017 ^a (3.16)	-0.0014 ^a (2.57)	-0.0013 ^b (2.13)
Physical capital accumulation (k)	0.16 ^c (3.61)	0.17 ^a (3.88)	0.16 ^c (3.56)
Human capital accumulation (h)	0.075 ^a (3.15)	0.085 ^a (3.74)	0.082 ^a (3.57)
Democratic freedom (D)		-0.28 ^a (2.83)	-0.27 ^b (2.42)
Economic freedom (E)			-0.46 (0.59)
R ²	0.284	0.371	0.383
F-statistics	7.810	8.500	6.830
Observations	63.000	63.000	61.000

Variables explanations are in correlation matrix table. Regressions are estimated by ordinary least squares. Significant levels are indicated by a, b and c which denote 1%, 5% and 10%, respectively. t-Statistics are in parentheses. Intercept is included but not reported in table

freedom does not correlated with physical capital accumulation in a considerable extend. Democratic freedom and economic freedom positively correlated with human capital. Higher economic freedom is associated with higher democratic freedom. It is almost 0.546.

Regression one shows the theatrical determinants of economic growth (Table 3). Signs and significant of coefficients are consistent with theory. In second column, when democratic freedom variable is added (It is said by political scientists, first political freedom and later economic freedom); democratic freedom has negative significant effect on growth. One score increases of democratic freedom leads to around one fourth percent reduction of economic growth in developing countries during 2000-2004 (Four scores reduces around one percent economic growth). Third regression shows measures both, democratic and economic freedom. But,

economic freedom has negative effect on growth. Even it does not have significant level, the effect is negative. Higher economic freedom is associated with lower growth. Although sample period is 5 years; this results differ from most previous existing findings that more democratization and economic freedom lead to rapid economic growth in the world.

Ground conditions and realities of developing nations for functioning free democratic and economic policies based on competition theories completely differ from developed nations. Policies must be formed based on the reality of people, instead blindly copying of western system. China has control on democratic freedom. Therefore, the studies on which whether democratic and economic freedom positively effect economic growth or not must be done separately to developing nations. Economic and politic agents (people) in developing countries do not have perfect information to access and enjoy free economic and political policies by competition. More freedom with lack of information leads to social unrest hence sociopolitical instability and damages economic growth. It does not mean that dictatorship brings social and political stability hence rapid economic growth. Instead, it means that one party political system with limited democracy and full power of the government is creditable for economic prosperity to fight with present economic world locally and internationally. Economic reforms without political freedom in china led it to an economic power with rapid economic growth with lowering inflation. (Its inflation is almost equal to developed nations) But, in former soviet union, the people who had money in the bank to buy a car before reforms in economic and politic freedom was just enough to buy a train ticket after reforms by reforms which allowed the economic and political freedom simultaneously. If Chinese

authority had allowed Tianmen square democratic revolution in 1989, China would be like Soviet union which is unable to stabilize its economy even 15 years passed in reforming, or like India which is unable to form a government with single party to take over reforms, or like Sri Lanka which lost more territory control in north east of Sri Lanka without a peace solution with minorities within one country.

Economic freedom in developing countries based on free market philosophy associated with democratic freedom (Table 1). Removal of restrictions on the trade, abolishing or reduction of tariffs and devaluation of exchange rate are major means of economic freedom. In developing countries, these are emphasized often by westernized policy makers for rapid economic growth and development. They often show model of Hong Kong for free market economy policy. During our sample period, economic freedom negatively related with economic growth in developing countries. So there is no a stable positive relationship between economic freedom and economic growth in developing countries (Appendix 1). Indeed, democratic governments in developing countries do not have bargaining economic policies with industrialized countries. Instead they loose their bargaining power on developed countries and international economic institutions with conditionality of aids associated with economic freedom to finance their increased budget deficit. Authoritarian types of governments like china have their internal and external power to implement any policies, if only they are necessary for their economic development. China does not undertake reforms due to the pressure exerted by international donors or due to break down of the Soviet Union which was an ideological partner of China's economic and political policies during cold war. But India have implemented reforms due to the international pressures mainly by foreign aid donors nations. We can observe gradual implementations and stability of economic policies in economies which have authoritarian governments in the world. Economic liberalism with limited democratic rights which does not change the central power of government for long period of time makes rapid economic growth. Finally, why we do not think in the line of theory of Deng Xiaoping on that building free market economy under system of socialism to overcome economic problems of developing nations, especially for passive economic growth. China's success story of economic growth makes lessons to developing countries on that how they must copy western democratic and economic theories wisely and how they should not copy them blindly.

Appendix 1: Sample of countries

Asia	Europe	Latin and Caribbean	Middle East and Africa
1.Nepal	14.Russia	26.Bolivia	37.Algeria
2.India	15.Azerbaijan	27.Colombia	38.Iran
3.Indonesia	16.Georgia	28.Guatemala	39.Egypt
4.Pakistan	17.Tajikistan	29.Peru	40.Jordan
5.Sri Lanka	18.Kyrgyzstan	30.Dominican	41.Morocco
6.Philippines	19.Turkmenistan	31.El Salvador	42.Tunisia
7.Cambodia	20.Ukraine	32.Honduras	43.Burundi
8.Bangladesh	21.Uzbekistan	33.Jamaica	44.D.R.Congo
9.China	22.Latvia	34.Nicaragua	45.Angola
10.Laos	23.Lithuania	35.Ecuador	46.Eritrea
11.Thailand	24.Romania	36.Haiti	47.Nigeria
12.Vietnam	25.Kazakhstan		48.Uganda
13.Mongolia			49.Central
			50.Rep.Congo
			51.Ethiopia
			52.Rwanda
			53.Benin
			54.Guinea
			55.Cameroon
			56.Chad
			57.Ghana
			58.Kerya
			59.Lesotho
			60.Mozambique
			61.Niger
			62.Senegal
			63.Tanzania
			64.Togo
			65.Zambia
			66.Malawi
			67.Mali
			68.Namibia
			69.Madagascar
			70.Mauritania

CONCLUSIONS

No any other word, democratic and economic freedom are sources of social and economic capital and contributing for long run economic growth of developed nations. In the case of developing countries, because of the lack of information infrastructures and institutions, higher illiteracy rate and backwardness of socio-cultural values, people do not use those freedoms in productive manners. It makes unstable government with non visionary corrupted leaderships. This study could not find a positive relationship between democratic, economic freedoms are economic growth during sample period. Controls of democracy and some restrictions on economic freedom are necessary conditions until they will achieve a considerable level of development. It does not mean that developing countries must pursue dictatorship regime. They can learn some experiences on freedom from Singapore. Present democratic freedom in most of developing countries has been copied from western without proper sociopolitical institutions. Germany and Switzerland are more democratic countries but they have

standard institutions to protect people. Their governments are very strong to implement rules and regulations. Developing countries are implementing all those freedoms what developed countries had implemented with different sociopolitical back grounds. It took hundred years to developed countries. In Asia all economic successors except Japan such as Singapore, South Korea, Taiwan of China's province, Malaysia and China had achieved higher economic growth with controlling democracy by allowing economic freedom whereas Sri Lanka, India, Bangladesh and Mongolia are unable to attain a higher economic growth even they have more democratic and economic freedoms. Limited freedom in politics or economics with visionary leadership is necessary but not sufficient condition for rapid economic growth which is backbone of economic development of developing countries.

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