Impact of Political Freedom, Economic Freedom and Political Stability on Economic Growth

Malik Fahim Bashir[1*]   Changsheng Xu[2]

1.Graduate Student School of Economics, Huazhong University of Science and Technology, Luoyu Road Wuhan, PR China

2.Professor in Economics School of Economics, Huazhong University of Science and Technology Wuhan, PR China

* E-mail of the corresponding author: malik_fhm@hotmail.com

Abstract

The focus of most previous studies on institutions ignores the full range of political and economic institutions that operate in most countries and their importance for determining economic growth. This study fulfills this research gap and endeavored to identify the direct effect of political freedom, economic freedom and political stability on economic growth by using a Panel Data set of 117 countries covering time period from 1980 to 2012. The data was analyzed using the alternative econometric methodologies including panel ordinary least square (OLS), Panel fix effect (FE) and dynamic system generalized method of movements (SGMM).The results revealed that economic freedom and political stability have positive and statistically robust impact on economic growth while we observed a fragile mixed positive and negative effect of political freedom on economic growth..

Keywords: Political Freedom; Economic Freedom; Political Stability; Generalized Method of Moments; panel data.

1. Introduction

The growth literature is full with empirical studies which have considered various economic determinants of economic growth. The previous studies analyzed the impact of diverse economic factors on economic growth either in new classical or endogenous growth theories framework. The heterogeneity in countries growth patterns implies that economic determinants are not only sources of economic growth but there are some other political and institutional factors also have substantial role as well. There is a near consensus in the literature that poor economic outcomes are often associated with lack of political stability and poor performance of institutions which promote rent seeking and corruption thus impeding the process of economic growth. (Rodrik, Subramanian et al. 2004) believed that institutions are growth-enhancing because they reduce uncertainty and transaction costs and entail incentives for productive behavior. (Rodrik 1998; Rodrik 1999) found that countries with a unified society and stronger institutions of conflict management grew faster than countries with divided society and weak institutions of conflict. Institutions are humanly devised constraints that structure human interactions. They are made up to formal constrains (rules, laws, constitution), informal constraints (norms of behavior and their enforcement characteristic (North 1993).

This study explore the impacts of institutions by analyzing how measure of economic freedom, political freedom (political rights and civil liberties) and political stability are related to economic growth in a panel data set of 117 countries of the world. Economic freedom reflects the ability of individuals to make personal choices in market transactions the protection of personal property and the ability of individuals to engage in mutually beneficial exchange(Farr, Lord et al. 2000).More economic freedom enhance individual incentive to engage in productive market activities. According to (Haan and Siermann 1996) economic freedom affects incentives, productive efforts and the effectiveness of resource use. On the other hand political freedom has to do with political issues. Political rights represent the ability of the citizens to participate in the political process (Vote, lobby and choose among candidates), elections are fair and competitive and alternative parties are allowed to participate freely. While, civil liberties are freedom of press and the rights of individuals to assemble, hold alternative religious views, receive a fair trial and express their views without fear of physical retaliation. Three conflicting hypothesis has been raised concerning the connection between political freedom (democracy) and economic growth. Some scholars believed that political freedom fosters economic performance and growth while other believes that political freedom is negatively associated with economic growth. Recently some scholars asserted that there is no systematical relationship between political freedom and economic growth. Different empirical studies examined the democratic character of national political procedures and institutions concluded that the effect of democracy on growth is mixed (Przeworski and Limongi 1993; Helliwell 1994; Haan and Siermann 1996; Brunetti 1997). There is also no consensus among scholars that democracy is equally beneficial for developed and non-developed nations. In view of (Andreski 1968; Kahn 1979)democracy is not as valid for less developed countries as for industrially developed countries. The argument is that political freedom and democratic government in LDC are likely to lead to corruption, bribery and so on.

Scholars consider political stability as a pre-requisite for economic growth. "Stability is a relative term.

Some countries are more stable than others but few can claim to be absolutely stable"(Zheng 2012). Moreover, all countries have some domestic or international threats of different magnitudes. (Oh and Reuveny 2010) define "the political risk level of a country broadly and include factors such as interstate and/or intrastate militarized conflict, religious and/or ethnic tension, political instability, weak rule of law, civic disorder, low level of democracy, public and private sector corruption, socioeconomic conditions that promote public discontent, inhospitable investment climate, and incapable bureaucracy."

Literature surveyed proved that quality institutions are not only important in promoting economic growth but they also lead towards more politically stable system. Almost all previous studies investigate the relationship among economic growth and any one dimension of institutions (i.e. political in/stability growth, economic freedom growth, political freedom growth). The purpose of current study is to identify the direct partial effect of political freedom, economic freedom and political stability on economic growth. Empirical results revealed positive effect of economic freedom, political stability on economic growth in all models while we observed a negative and statistically significant effect of political freedom on growth in OLS and a fragile statistically non-robust effect on growth in panel FE and dynamic system GMM models. Similarly, we observed that our control economic variables have expected signs in most of models in some case control economic variable has wrong sign without statistical significance.

The reminder of this paper is organized as follows. Section 2 provides a synthesis of previous literature on the impact of political freedom, economic freedom and political stability on economic growth. Data source and methodology are presented in section 3.section 4 presents the empirical results of the paper while section 5 concludes the study.

2. Literature Review

At present, it is believed that economic growth not only depends on economic factors but political and institutional factors also have substantial role. Unfortunately, how and under what conditions such factors effect economic performance is not clear. Previous studies used different proxy variables (including property right and civil liberties, corruption, regime change, democracy and economic liberalization) to study the role of political and institutional factors on economics growth resulting conflicting and contradicting conclusions. Different studies examined the democratic character of national political procedures and institutions concluded that the effect of democracy on growth is mixed(Przeworski and Limongi 1993; Helliwell 1994; Haan and Siermann 1996; Brunetti 1997). There is also no consensus among scholars that democracy is equally beneficial for developed and non-developed nations. In view of (Andreski 1968; Kahn 1979)democracy is not as valid for less developed countries as for industrially developed countries. The argument is that political freedom and democratic government in LDC are likely to lead to corruption, bribery and so on.

Several studies had explained significant relationship between political and economic freedom and rate of economic growth(Farr, Lord et al. 1998; Vega-Gordillo and Alvarez-Arce 2003). Political freedom defined as a situation where citizens are completely free to participate in the political process, where elections are fair, competitive and free trade from corruption while civil liberties to include freedom of press, freedom of association, freedom of religion and freedom of speech. According to (Gwartney, Lawson et al. 2011) economic freedom is defined as: (1) property acquired without the use of force, fraud or theft is protected from physical invasion by others. (2) Citizens are free to use exchange or give property to another as long as their actions do not violate the identical rights of others. It is believed that higher political and economic freedom lead to more economic growth by giving people great choice over what they can do with their lives(USAID 2008). According to (North and Thomas 1973)freedom to choose and supply resources, competition in business, and trade with others and secure property rights are central ingredients for economic progress. On the other hand high economic growth means more funds to establish quality institutions, which lead to further political stability. Similarly more political stability and economic freedom leads to political freedom which reinforces both in opposite way.

During the last two decades many studies highlighted the positive impact of various measures of economic freedom on the rate of economic growth. Some scholars believe that political freedom promotes economic growth (Gupta, Madhavan et al. 1998; Gasiorowski 2000)while others believe that it hinders economic growth (Goldsmith 1995; Gasiorowski 2000; Krieckhaus 2006). Similarly, two conflicting hypotheses have been advanced concerning the connection between economic growth and political freedom. Some economists argue that freedom fosters economic performance and hence economic growth (Friedman 1962; Sen 1999) others pose that high growth rates require economic controls and reduced freedom known as Lee thesis, named after the former Prime Minister of Singapore Mr. Lee Kuan Yew. He asserts that authoritarianism helps rapid economic growth whereas democracy and civil rights hamper it. Those who hold this view base their belief on the observation that a few relatively authoritarian economies, such as South Korea, Singapore, Taiwan, and post-reform China, grew faster than their relatively less authoritarian counterparts.

On the other side some studies elaborated that Political freedom allows citizens to replace politicians who adopt damaging policies, protects individual's property rights and generally serves society's best interests

would lead one to have an optimistic view that political freedom leads to economic growth (Gasiorowski 2000). It can be concluded that the introduction of democratic institutions in the form of more ample political rights, civil rights, and freedom of the press, among others, may or may not be associated with improved governance. More recently economists have come to recognize the value and importance of the political stability and research has focused on the specific effects of the political regime and instability on economic growth. There is clear evidence from previous studies and consensus among the scholars that economic freedom does matter for economic growth (Dawson 1998; De Haan and Siermann 1998; Farr, Lord et al. 1998), whereas, there is disagreement concerning whether the effects of economic freedom on growth are level effects or caused by changes in economic freedom. Furthermore, the issue of causality is subject to controversy when the highly aggregated indices of economic freedom are decomposed and the effects of the single components are investigated separately.(Hanke and Walters 1997; Leschke 2000) by using GDP per capita as dependent variable and level of economic freedom as independent variable and find a positive and significant relationship between two variables while some scholars like (De Haan and Sturm 2000; Heckelman and Stroup 2000; Adkins, Moomaw et al. 2002; Gwartney, Lawson et al. 2011) found no significant effect between economic growth and economic freedom.

Many previous studies also report negative and significance relationship between economic growth and political instability. There are two common arguments in literature about impact of political instability on economic growth. First, political instability increases policy uncertainty affecting incentives of economic agents and therefore growth (Alesina, Özler et al. 1996) Some studies assumed that incumbent governments behave more myopically according to their own agenda in a political system that is both unstable due to a high probability of government changes and polarized due to large differences in political and economic preferences of subsequent government(Persson and Svensson 1989; Alesina and Tabellini 1990). Second, the probability of government change is usually related to economic, political, social and institutional variables. With a high propensity to executive changes comes political uncertainty and possibly threats to property rights (Alesina and Perotti 1996) there by affect growth(Barro 1991). According to (Carmignani 2003) the common between different dimensions of political instability is that all these all these possible events generate uncertainty. Since political instability reduce the supply of both capital and labor. Investment is discouraged due to increased risk of capital loss and political turmoil causes capital flight and brain drain. Political unrest also hampers the establishment of property rights, which are necessary in order to realize gains associated with impersonal exchange. In broader sense political instability create the uncertainty about the country's future economic and political policies and regimes future preferences which further hurt the investors' confidence on that economy. That's why it is believed that political stability is necessary for economic growth. In words of Ben Shepherd when we talk about political stability in the context of growth we mean a specific kind of stability; the rule of law, strong institutions rather than powerful individuals, a responsive and efficient bureaucracy, low corruption and a business climate that is conducive to investment which attracts investment both internally and from outside. Literature surveyed above proved that political freedom, economic freedom and political stability do have a role in economic growth of a nation.

3. Data and Variable Construction

In current section we discuss the regression methodology and variable included in the study. We applied Panel OLS, Panel Fix effect and dynamic system GMM method on level and 3 year average data. Many recent studies support the use of level data in empirical growth models because in their view averaging data mutes the effect of variables with considerable variation within the time span (Eberhardt and Teal 2011; Mollick and Cabral 2011; Peev and Mueller 2012). Use of annual data in empirical analysis has a disadvantage that it is not able to capture the extended effect of any change in institutional variables which last in several years. So, we will transform the data into three year average to eliminate the cyclical components from it as well. Our empirical growth model includes institutional variables (political freedom, economic freedom and political stability) and economic variables (Foreign direct investment, growth rate of population, Investment, life expectancy, human capital). We treat economic variables as control variables. Before explain data analysis methodology it would like to discuss construction of institutional variables in detail.

Freedom House political freedom index which is simple average of political right and civil liberties index. Each country is assigned a numerical rating from 1 to 7 for both political rights and civil liberties, with 1 representing the most free and 7 the least free. In current study we transform index so that higher value represent more freedom and lower values indicate least political freedom. After transforming index we convert its range from 0-10 which helps us to make comparison of different institutional variables on economic growth. Where 0 indicate least free and 10 represent most free country. In current study we used Heritage Foundation economic freedom index because it's not only include more countries of the world compare to Frasier Institute economic freedom index but it has longest continuous time series coverage as well. Heritage foundation aggregate Index of Economic Freedom consist of 10 sub components of economic freedom, which include (Property rights,

Freedom from corruption, Fiscal freedom, Government spending, Business freedom, Labor freedom, Monetary freedom, Trade freedom, Investment freedom and Financial freedom. The 10 component scores are equally weighted and aggregate economic freedom score is simply average of these 10 components of economic freedom. Each of the 10 economic freedoms is categorized on a scale from 0 to 100. We converted the index range from 0 to 10 . Where 0 indicates least economic freedom while 10 represent maximum economic freedom.

International Country Risk Guide (ICRG) published twelve different political risk measures for any country since 1980.It is longest possible political risk time series data set available till date. By using ICRG 12 measures we constructed aggregate Political stability Index/ political risk index which measure the political risk for any country. Political Safety index is an aggregation of 12 indexes consisting of different ranges. Government stability, socioeconomic conditions fueling public discontent, investment profile, internal conflict and external conflict are of range 0 to 12. Corruption, military involvement in politics, ethnic tension, religion in politics, law & order and government democratic accountability is of range 0 to 6. While, bureaucracy quality is of range 0 to 4. Before constructing aggregate index we convert the range of all 12 components of ICRG Political Risk indicators from 0-10 and then we take simple average of all components. The aggregate index ranges from 0 to 100. Where 0 denotes maximum risk (least stable nation) and a score of 100 denotes no risk (politically stability).We converted its range from 0-10 where 0 indicate high risk or low instability while 10 indicate low risk or more stability.Our control economic variables include human capital (proxied by secondary school enrolment), investment (proxied by gross fix capital formation as ratio to GDP), foreign direct investment as ratio to GDP, Annual population growth rate, life expectancy as a proxy for health and lag of GDP per capita. In current study our dependent variable is natural logarithm of per capita GDP while all other independent variables is in level. Data for control economic variables is taken from world development indicators 2014 by World Bank.

4. Data and Estimation Methodology
We used the following econometric model to estimate the impact of institutional model on economic growth.
$$Y_{it} = \alpha Y_{it-1} + \beta X_{it} + \delta W_{it} + \upsilon_i + \mu_t + \varepsilon_{it} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots 1$$

Where Y_{it} is natural log of per capita gross domestic product in country i at time t. X_{it} represents vector of economic determinants while W_{it} is vector of institutional variables in country i at time t. υ_i denotes unobserved country fixed effects that is constant over time and μ_t represent unobserved year/period fixed effects which are common across countries while ε_{it} represent error term which include all other unobserved variables. For disturbance term we assume that it has mean zero conditional on all past values of the endogenous variables and all the past and present values of exogenous variables.

We include country fixed effects in order to remove the impact on economic growth of fixed country characteristics potentially correlated with institutional variables. We also include year fixed effect to remove any common global change in institutional variable that may be correlated with gross domestic product. We include lag dependent variable as regressor for model persistence. According to (Wawro 2002) inclusion of lags accounts for partial adjustment of behavior our time. Another reason to include lags is belief that lags would be account for partial factors, including exogenous shocks that have continual effects over time.(Nickell 1981) believed that lag depend variable is correlated with fix effect which cause dynamic panel bias. In such situations OLS provide inconsistent estimates in both fix and random effect models because lag dependent variable is correlated with error term (Arellano and Bond 1991; Baltagi 2008). As we increase the number of time periods dynamic panel bias would become very small and would disappear (according to Judson and Owen 1999 there is still a bias of 20% in the coefficient of interest for t=30).According to (Hsiao 2003) OLS estimates of panel data will be biased because of unobserved heterogeneity bias and endogeneity. Inclusion of country specific fixed effect in regression solves the problem of unobservable heterogeneity bias.

We can solve the problem of dynamic panel bias by first differencing equation 1 which wipe out the country specific effect but still there is correlation between explanatory variables and the error term because Y_{it-1} in ΔY_{it-1} is by construction correlated with ε_{it-1} in $\Delta\varepsilon_{it}$. If error term (ε_{it})is not serially correlated and the explanatory variables are weakly exogenous we can use lagged level values of endogenous and predetermined variables to solve the problem of simultaneously bias of explanatory variable and correlation between (Y_{it-1}-Y_{it-2}) and (ε_{it}- ε_{it-1}) (Arellano and Bond 1991).This method is known as difference GMM.

According to (Blundell and Bond 1998) although difference GMM solves the problem of simultaneity bias and the country specific effect still it has short coming that lag levels of the explanatory variables are weak instruments for first difference. (Arellano and Bover 1995) propose an alternative system GMM estimator that combines the both difference and level equation. System GMM estimators are much efficient than difference GMM because they are able to reduce biases and imprecision associated with difference GMM (Blundell and Bond 1998). Other reasons of dynamic system generalized method of movements (DSGMM) preference over dynamic difference generalized method of movement (DDGMM) method, include that because difference generalized method of movement perform poorly if there is missing value in data (Roodman 2006). Another

disadvantage of difference generalized method of movements is that we lost a large number of observations due to differencing equation. In current model, most of the variables are random walk or close to random walk. In such a situation, it is better to use System generalized method of movements (SGMM) instead of difference generalized method of movement (DGMM), because SGMM approach produces more efficient and precise estimates compared to DGMM. SGMM approach achieves it by improving precision and reducing sample biasness (Bond 2002; Baum 2006; Roodman 2006; Roodman 2007).We used two step dynamic systems GMM model instead of one step dynamic system GMM because two step estimators asymptotically more efficient than the one step estimators. However the uses of two step estimators in small sample cause a proliferation of instruments.

5. Results and Discussion

The purpose of current study is to analyze the impact of political freedom, economic freedom and political stability on per capita real GDP. Our empirical analyses consist panel data set of 117 countries spanning from 1980-2012.Before discussing our empirical results we proceed with the descriptive analysis of our sample along with correlation analysis both at level and average data analysis. Table 1 consists of the descriptive statistics of whole sample for level and three year averaged data. On whole we observe no significant change in descriptive statistics of all variables in level and average data. We observe slight variation in values of average sample due to rounding after three digits and missing values in level data.

Table 1Descriptive Analysis of whole Sample (1980-2012)

Variable	Level				Average			
	Mean	Std.	Min	Max	Mean	Std.	Min	Max
Lny	8.356	1.591	4.981	11.382	8.325	1.592	4.907	11.340
PF	6.836	2.870	0.000	10.000	6.744	2.873	0.000	10.000
EFI	6.122	1.141	0.000	8.260	6.106	1.113	0.000	8.273
PS	6.759	1.371	2.836	9.716	6.757	1.375	2.701	9.593
LE	69.296	10.237	35.820	85.163	69.106	10.276	36.084	82.843
FDI	3.965	5.781	-55.066	74.711	3.825	4.396	-6.925	51.990
HC	75.098	30.941	5.306	160.619	74.337	31.321	5.374	156.617
GPOP	1.429	1.559	-2.851	17.315	1.423	1.432	-1.899	15.312
INV	21.046	5.570	1.097	45.960	21.004	5.540	2.201	46.047

Source: Authors own calculation based on level and 3-year average data.

Table 2 presents the correlation analysis of all variables included in the current study both at level and average data analysis. Results reveal that all variables of study have a positive and significant correlation with per capita GDP except population growth, which has negative and significant relationship. Economic freedom and political freedom have positive and statistically significant correlation as well in both level and average data. One interesting result is correlation between investment and PFI which is although positive both in level and change data but very low. Similarly, Population growth rate has a negative and significant correlation with GDP per capita. Although correlation coefficient between investment and political stability is positive and significant but its value is very low, it represents that relationship between investment and political stability not very strong.

Table (3) consist the empirical results of dynamic panel least square (OLS),Panel fix effect and dynamic system generalized method of movement(DSGMM) results both on level and average data analysis respectively. Lagged per capita GDP has a statistically robust positive and less than unity coefficient in all models both in level and average data analysis. Political freedom have positive and statistically significant coefficient in OLS model both in level and average data analysis. We observed positive coefficient of political freedom in level data analysis while negative in average data analysis in both panel fix effect and dynamic system GMM method respectively. But political freedom coefficient is statistically non robust in both level and average data analysis in panel fix effect and dynamic system GMM method. Fragile mixed positive, negative and statistically insignificant estimates of political freedom create a puzzle about its impact on economic growth.

We observe such situations in previous empirical studies as well. (Brunetti 1997)examined 17 studies and found "nine studies report no relationship, one study a positive, one study a negative, three studies a fragile negative relationship and three studies a fragile positive relationship between democracy and economic growth". In a recent survey paper (Kurzman, Werum et al. 2002) review 47 quantitative studies of the effect of democracy on economic growth. 19 found a positive relationship between democracy and growth, 6 found a negative relationship, and 10 reported no statistically significant relationship. 7 studies found a combination of positive and non-significant results, depending on the model used and the cases included; 2 found a combination of negative and non-significant results; 2 found mixed positive and negative results; and 1 reported an inverted-U effect. Some scholars believed that inconclusive effect of political freedom on economic growth is due to

imprecise operationalization of democracy, often based on the subjective evaluation of whether or not there was respect for civil rights or the varying degrees of democracy and the problem of proper conceptualization (Diamond 1996 ; Collier and Levitsky 1997).

Table 2 Correlation analysis Between Institutional and Economic Variables Whole Sample (1980-2012)

Level								
	Lny	PFI	EFI	PS	LE	FDI	HC	GPOP	INV
Lny	1.000								
PFI	0.643*	1.000							
EFI	0.656*	0.576*	1.000						
PS	0.744*	0.663*	0.620*	1.000					
LE	0.801*	0.571*	0.571*	0.637*	1.000				
FDI	0.084*	0.121*	0.069*	0.175*	0.108*	1.000			
HC	0.814*	0.594*	0.563*	0.683*	0.832*	0.1638*	1.000		
GPOP	-0.362*	-0.456*	-0.172*	-0.400*	-0.447*	-0.094*	-0.551*	1.000	
INV	0.135*	0.029	0.136*	0.147*	0.250*	0.212*	0.195*	-0.097*	1.00
Average								
	Lny	Lny	Lny	Lny	Lny	Lny	Lny	Lny	Lny
Lny	1.000								
PFI	0.651*	1.000							
EFI	0.668*	0.587*	1.000						
PS	0.750*	0.674*	0.635*	1.000					
LE	0.801*	0.580*	0.586*	0.642*	1.000				
FDI	0.104*	0.150*	0.079*	0.213*	0.130*	1.000			
HC	0.814*	0.598*	0.567*	0.687*	0.831*	0.200*	1.000		
GPOP	-0.370*	-0.473*	-0.176*	-0.422*	-0.458*	-0.122*	-0.565*	1.000	
INV	0.140*	0.025	0.161*	0.158*	0.260*	0.220*	0.214*	-0.105*	1.000

* Shows statistical significance at 5%.

Similarly, we observed positive and statistically significant coefficient of economic freedom and political stability in both level and average data analysis in all models and alternative econometric methodologies applied. There is consensus among scholars that political stability has positive effect on economic growth while we also observed positive effect of economic freedom in previous as in previous studies as well (Dawson 1998; De Haan and Siermann 1998; Farr, Lord et al. 1998). Whereas, there is disagreement concerning whether the effects of economic freedom on growth are level effects or caused by changes in economic freedom in previous studies.Current study proved that economic freedom has positive effect on economic growth in level and average data analysis. According to (Bond, 2002) for validity of GMM estimates lagged dependent variable coefficient value should lie between OLS and panel FE estimates. In current study we observed that lagged dependent variable coefficient is greater than panel FE coefficient but less than OLS in level data analysis but in average data this is not case which arise questions on validity of average data analysis through GMM method. In both models of GMM estimation in level and average data we observed that number of observations are significantly larger than number of instruments. Also there is no second order serial correlation in both models and Hensen test of over identification that check the joint validity of instruments also shows that models have valid instruments.

Now we turn our focus on other control economic variables. We observed a positive coefficient of investment and human capital in all models of level and average data analysis but human capita is statistically insignificant in OLS average data analysis. Similarly, we observed a positive coefficient of FDI and negative coefficient of growth rate of population in most models but FDI have a negative coefficient in average analysis while GPOP has a positive coefficient in level data analysis under DSGMM estimation models. Normally, we believe that life expectancy has a positive effect on economic growth as it is in OLS and panel FE models in level and average data analysis in table 3 but we observed a negative coefficient of life expectancy in both level and average data analysis under DSGMM models. (Caselli, Esquivel et al. 1996) also find a negative and statistically insignificant coefficient of life expectancy in their study while (Acemoglu and Johnson 2006) believed that increased life expectancy reduce capital to labor ratio and land to labor ratio thus decrease economic growth.

Table 3: Impact of Political Freedom, Economic Freedom and Political Stability on Economic Growth

	LEVEL			Average		
	OLS	FE	GMM	OLS	FE	GMM
LnY$_{(t-1)}$	0.992***	0.932***	0.966***	0.971***	0.781***	0.996***
	(-0.001)	(-0.007)	(0.009)	(-0.004)	(-0.020)	(0.040)
FH_PFI	-0.001***	0.0003	0.001	-0.004***	-0.001	-0.019
	(0.000)	(-0.001)	(0.003)	(-0.001)	(-0.003)	(0.012)
HFEFI	0.002**	0.002	0.014***	0.019***	0.026***	0.010
	(-0.001)	(-0.002)	(0.004)	(-0.003)	(-0.006)	(0.014)
PS[a]	0.002**	0.010***	0.015***	0.006*	0.027***	0.078**
	(-0.001)	(-0.002)	(0.005)	(-0.003)	(-0.007)	(0.033)
LE	0.0001	0.003***	-0.002	0.001***	0.003*	-0.017**
	(0.000)	(-0.001)	(0.002)	(-0.001)	(-0.002)	(0.008)
FDI	0.0004***	0.000	0.0004	0.002***	0.0001	-0.004
	(0.000)	(0.000)	(0.0003)	(-0.001)	(-0.001)	(0.005)
HC	0.0001**	0.0003***	0.002***	0.0002	0.001**	0.004***
	(0.000)	(0.000)	(0.0004)	(0.000)	(0.000)	(0.002)
GPOP	-0.007***	-0.009***	0.0004	-0.017***	-0.013***	-0.009
	(-0.001)	(-0.001)	(0.003)	(-0.002)	(-0.004)	(0.018)
INV	0.002***	0.002***	0.002**	0.005***	0.006***	0.012***
	(0.000)	(0.000)	(0.001)	(-0.001)	(-0.001)	(0.003)
R^2	0.999	0.965		0.998	0.894	
Countries	117	117	117	117	117	117
Observations	2072	2072	2072	752	752	752
Instruments			34			22
AR2 (P-value)			0.088			0.0975
Hensen (p-value)			0.379			0.378

Log per capita GDP used as dependent variable. Standard error in parenthesis. Significance at which null hypothesis rejected: ***, 1%;**5%; and *10%. Time dummies included in all regression models. LnY(t-1),FHPFI,EFI,PS,HC and INV were treated as endogenous variables .Their second and onwards lagged values used as instruments in the first difference equations and their level and one lagged first differences were used in the level equation. Two step dynamic System GMM estimations for dynamic panel data along with robust standard errors with Windmeijer's 2005 finite sample correction.

6. Conclusion

At present there is a near consensus in the literature that poor economic outcomes are often associated with lack of political stability and poor performance of institutions. In recent years, a large number of studies provide substantial evidence that the quality of formal institutions is an important determinant of economic growth. (Rodrik, Subramanian et al. 2004) claimed that institutional quality trumps other determinants of growth. The main reason to expect institutional quality to affect growth positively is that it entails decreased transaction costs through reduced uncertainty of economic transactions and productivity-enhancing incentives. The focus of most previous studies on formal political institutions ignores the full range of both formal and informal political and economic institutions that operate in most countries and their importance for determining economic growth.

This research study fulfills this research gape and endeavored to identify the direct effect of political freedom, economic freedom and political stability on economic growth in a sample of 117 countries of the world. To fulfill this task a series of analysis was performed.By using different econometric methodologies including panel ordinary least square (OLS), panel fix effect (FE) and dynamic system generalized method of movement (DSGMM) to quantify the impact of both freedoms and political stability on economic growth. In current analysis we included a set of control economic variables which consist on life expectancy, foreign direct investment, population growth rate, human capita and investment. We used both level and average data set for analysis. The results revealed that economic freedom and political stability have positive and statistically robust impact on economic growth while we observed a mixed positive and negative effect of political freedom on economic growth. Altering political freedom coefficient sign and statistical significance in different regression models perplexed the direct impact of political freedom on economic growth which is also case in previous empirical studies. (Borner, Brunetti et al. 1995) surveyed sixteen empirical studies of the political freedom (democracy) growth nexus, three suggest a positive relationship and three a negative relationship between democracy and economic growth, and the other 10 are inconclusive. (Brunetti 1997) examined 17 studies and found "nine studies report no relationship, one study a positive, one study a negative, three studies a fragile negative relationship and three studies a fragile positive relationship between democracy and economic growth".

Policy implication of current paper is that economic freedom and political stability have positive direct effect on economic growth even if there is no political freedom in a nation.

Although this study have advantage that it measured the direct effect of political freedom ,economic freedom and political stability on economic growth but the main weakness of the study that it ignores these variables indirect effect on growth. Almost all these variables influenced economic growth through different intervening variable or they can have indirect effect on each other. We analyzed the political institution (political freedom, economic freedom and political stability) on economic growth but we not consider the political system of a nation which is closely connected to these institutions. As democratic countries are consider more politically free compare to authoritarian regimes. In depth study of indirect effect of these variable in different political system will be a required to further elaborate political and institutional variables effect on economic growth.

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