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## DOES ECONOMIC LIBERTY BOLSTER ECONOMIC PERFORMANCE?

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**Abstract:** Institutional quality and economic liberty have emerged as key determinants of economic growth and development. This study investigates the relationship between economic liberty and economic growth in the Southern African Development Community (SADC) region. Utilizing a dynamic system generalized method of moments (GMM) and Granger causality analysis, the research reveals a positive and significant relationship between components of economic liberty and economic growth. The findings also indicate that economic liberty and economic growth are interdependent, suggesting that they are jointly determined. These results underscore the importance of deepening regional integration among SADC member states through increased intra-regional trade, financial integration, and the implementation of infrastructure projects to lower business costs.

**Keywords:** economic liberty; economic growth; SADC; system GMM

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### INTRODUCTION

Natural resource endowment has traditionally been regarded as a fundamental determinant of national income, with the assumption that resource-rich countries would naturally experience higher economic growth. However, a substantial body of empirical research challenges this notion, revealing that countries endowed with abundant natural resources often grow more slowly than their resource-poor counterparts. Notably, the seminal works of Sachs and Warner (2001) and Davis and Tilton (2005) provide compelling evidence of this counterintuitive phenomenon, often referred to as the "resource curse." This paradox has catalyzed a shift in focus towards understanding the role of unconventional determinants of national income, with institutional quality emerging as a critical factor in contemporary economic discourse.

Institutions, whether formalized through laws and regulations or embedded in cultural norms and practices, constitute the framework within which all economic activities occur. The quality of these institutions is pivotal in shaping economic outcomes, influencing everything from resource allocation and trade patterns to the enforcement of property rights. The growing recognition of the importance of institutions has led to an

expanded exploration of how economic, political, and civil institutions can drive or hinder economic growth. These institutions are increasingly seen not merely as background conditions but as active agents that can enhance economic performance by creating incentives for innovation, increasing productive efforts, and ensuring the efficient use of resources.

Higher quality institutions are believed to contribute to faster economic growth by fostering a stable environment that supports entrepreneurship, investment, and the efficient functioning of markets. In this context, the relationship between institutional quality and economic growth becomes particularly crucial, as it can lead to a more sustained increase in national output, thereby improving living standards and supporting broader social and economic goals. However, defining and measuring institutional quality, particularly economic institutions, remains a contentious issue among scholars. The debate centers on what constitutes "economic liberty" and how it should be quantified.

Different perspectives on economic liberty reflect this debate. For example, Ivana (2020) conceptualizes economic liberty as the individual right to engage in taxed economic activities, such as labor, trade, and property ownership, asserting that these rights are fundamental to economic participation and growth. Conversely, The Heritage Foundation (2021) adopts a broader definition, describing economic liberty as "the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond what is necessary to protect and maintain liberty." This definition underscores a more laissez-faire approach, emphasizing minimal government intervention in economic activities.

To empirically assess economic liberty, several indices have been developed, each offering a unique perspective on the concept. Among the most prominent are the Economic Freedom Index by The Heritage Foundation, the Fraser Institute's Economic Freedom of the World Index (Gwartney et al., 1996), and measures proposed by scholars like Spindler and Miyake, as well as Scully and Slottje. These indices differ in their emphasis and methodology, capturing various dimensions of economic freedom, including trade freedom, business freedom, investment freedom, labor freedom, and property rights. For the purposes of this study, the Economic Freedom Index from The Heritage Foundation is employed. This index is particularly valuable because it provides a comprehensive view of economic freedom, incorporating multiple facets that are essential for understanding how economic liberty influences economic outcomes.

## LITERATURE REVIEW

Governments frequently intervene in markets through regulations designed to manage the use, allocation, and ownership of resources. These interventions aim to maintain law and order, conserve scarce resources, and fulfill the unlimited needs and wants of society.

However, different schools of thought present divergent views on the extent and impact of government intervention. Free-market economists, for example, argue for minimal government involvement, positing that such interventions often lead to inefficient resource allocation (Carlsson & Lundstrom, 2002). In contrast, other economists argue that government intervention is necessary in specific areas, such as addressing externalities, managing public goods, and regulating monopoly power to correct market failures (Dollar & Kraay, 2003). This ongoing debate raises a critical question central to the concept of economic liberty: to what extent should the government intervene in markets?

The Economic Freedom Index serves as a measure of a country's level of business friendliness and openness, encompassing various components such as labor freedom, investment freedom, trade freedom, government integrity, fiscal burden, property rights, monetary freedom, and government spending (Naape, 2021). This index provides a comprehensive assessment of the economic environment, allowing for a nuanced understanding of how government policies impact economic performance.

While the relationship between economic freedom and economic growth is well-documented, with many studies establishing a positive correlation between these two variables, the causal mechanisms remain unclear and underexplored. Additionally, most existing studies focus on broad cross-country analyses, often neglecting regional contexts and the specific institutional dynamics within smaller economic communities. For instance, while Bergh and Bjørnskov (2019) explored the distributional consequences of economic freedom on income distribution, their analysis did not account for regional variations or the unique institutional characteristics of specific regions, such as the Southern African Development Community (SADC).

Moreover, studies like those by Chheng (2005) and Ivana, Nikola, and Svetlana (2020) have examined the effects of economic freedom in broad geographical contexts, yet the specific interaction between economic freedom and growth within regional economic blocs like SADC remains largely unexplored. Similarly, while Heckelman (2020) and Erdal (2004) have investigated the bidirectional relationship between economic freedom and economic growth, their findings have not been extensively tested in the context of developing regions with distinct institutional and economic frameworks.

This study seeks to address these gaps by focusing on the SADC region, a specific regional economic bloc that has been underrepresented in the literature on economic freedom and growth. By employing a dynamic system generalized method of moments (GMM) and Granger causality analysis, this research will provide new insights into the bidirectional relationship between economic freedom and economic growth within the SADC context. This approach not only allows for a deeper understanding of how economic liberty influences growth in this region but also sheds light on the regional integration efforts and institutional reforms needed to enhance economic performance.

Furthermore, the study introduces a nuanced analysis of the components of economic freedom, such as labor freedom, investment freedom, and trade freedom, examining their individual and collective impact on economic growth within the SADC region. This focus on the granular aspects of economic freedom represents a novel contribution to the existing body of literature, as it moves beyond general correlations to explore specific mechanisms and their implications for policy and regional development.

In summary, this research fills a significant gap in the literature by focusing on the SADC region, providing a detailed analysis of the relationship between economic freedom and growth, and offering novel insights into how regional economic policies can be optimized to foster sustainable development.

## METHOD

This section outlines the empirical methods employed in the study to estimate the impact of economic freedom on economic growth within the Southern African Development Community (SADC) region. The analysis uses panel data covering the period from 2007 to 2018. Data on the components of economic freedom were sourced from The Heritage Foundation, while data on Gross Domestic Product (GDP) were obtained from the World Development Indicators. Given the nature of the data and the study's objectives, dynamic panel data methods were utilized.

The model used in this study can be expressed as follows:

$$y_{it} = \beta_0 + \beta_x \sum_{i=1}^n \delta_{it} + \epsilon_{it} \quad (1)$$

Where:

- $y_{it}$  represents the dependent variable, which is GDP per capita.
- $\beta_0$  is the constant term.
- $\beta_x$  denotes the coefficients to be estimated.
- $\delta_{it}$  is a vector of economic freedom variables.
- $\epsilon_{it}$  is the idiosyncratic error term.

To ensure the reliability of the results, the variables were first tested for unit roots using the Levin, Lin, and Chu (2002) (LLC) unit root test. Although unit root analysis is not a strict requirement when using panel data methods, it provides a preliminary check on the stationarity of the data. Additionally, Pearson correlation tests were conducted to assess the strength and direction of the association between the dependent variable (GDP per capita) and the independent variables (components of economic freedom).

The primary estimation technique used in this study is the System Generalized Method of Moments (GMM). This technique was chosen due to the nature of the dataset, where the number of time periods (T) is less than the number of cross-sectional units (N). The GMM technique is particularly advantageous as it controls for potential endogeneity, which is a common issue in dynamic panel data models. The GMM model can be mathematically represented as:

$$y_t = \delta y_{it-1} + \beta x_{it} + \mu_i + v_{it} \quad (2)$$

Where:

- $y_t$  is the dependent variable at time  $t$ .
- $y_{it-1}$  is the lagged dependent variable.
- $x_{it}$  represents the independent variables (economic freedom components).
- $\mu_i$  denotes the unobserved country-specific effects.
- $v_{it}$  is the error term.

Following the estimation of the primary model, the study also explored the bivariate relationship between economic liberty and economic growth. Specifically, the study examined whether economic liberty Granger-causes economic growth, or if the reverse is true, or if they are jointly determined. This was done using Granger causality analysis, as outlined by Granger (1969). The Granger causality model can be expressed as:

$$GDPPc_t = c_1 + \sum_{z=1}^q \alpha_{1,z} \Delta GDPPc_{t-z} + \sum_z \beta_{1,z} \Delta EL_{t-z} + \mu_{y,t} \quad (3)$$

$$EL_t = c_2 + \sum_{z=1}^q \alpha_{2,z} \Delta EL_{t-z} + \sum_z \beta_{2,z} \Delta GDPPc_{t-z} + \mu_{x,t} \quad (4)$$

Where:

- $c$  represents the constant term.
- $q$  indicates the number of lagged variables.
- $\mu_t$  is the innovation term.

The Granger causality test is crucial for determining whether one time series is predictive of another. The results of these empirical analyses are presented in the following section.

## RESULT AND DISCUSSION

This section discusses the econometric results in light of earlier studies, offering insights into the relationship between economic freedom and economic growth in the SADC

region. The analysis begins with descriptive statistics, followed by unit root analysis, correlation analysis, GMM regression analysis, and concludes with Granger causality analysis.

### Descriptive Statistics

Table 1 provides a summary of the descriptive statistics of the variables, including the mean, standard deviation, skewness, minimum, and maximum values. Descriptive analysis reveals the individual characteristics of the variables, with minimum values ranging from 0 to 30 and maximum values from 4.35 to 90. Most variables exhibit average values between 30 and 60, with GDP per capita having the lowest mean value of 3.59. Standard deviation values are generally high, ranging between 10 and 20, indicating that the data points are widely dispersed. In contrast, GDP per capita shows a lower standard deviation, suggesting that its data points are more concentrated around the mean. The total number of observations is 175.

Table 1: Descriptive Analysis

|              | GDP_PC | BUSI  | FINA  | GOV   | INVE  | LAB   | PROP  | EFI   |
|--------------|--------|-------|-------|-------|-------|-------|-------|-------|
| Mean         | 3.59   | 57.59 | 45.20 | 33.85 | 47.08 | 55.70 | 37.94 | 55.92 |
| Median       | 3.46   | 59.90 | 50.00 | 31.00 | 50.00 | 57.30 | 37.30 | 57.00 |
| Maximum      | 4.35   | 83.30 | 70.00 | 64.00 | 90.00 | 90.90 | 75.00 | 77.00 |
| Minimum      | 2.92   | 30.00 | 10.00 | 12.80 | 0.00  | 21.90 | 5.00  | 21.40 |
| Std. Dev.    | 0.42   | 13.35 | 15.75 | 11.77 | 19.54 | 14.81 | 16.65 | 10.67 |
| Skewness     | 0.21   | -0.19 | -0.51 | 0.67  | -0.37 | 0.07  | 0.16  | -0.62 |
| Kurtosis     | 1.61   | 1.98  | 2.95  | 2.56  | 3.07  | 2.46  | 2.58  | 4.13  |
| Jarque-Bera  | 15.29  | 8.67  | 7.48  | 14.39 | 3.96  | 2.22  | 2.09  | 20.72 |
| Probability  | 0.00   | 0.01  | 0.02  | 0.00  | 0.14  | 0.33  | 0.35  | 0.00  |
| Observations | 175    | 175   | 175   | 175   | 175   | 175   | 175   | 175   |

*Source: author's computations*

### Unit Root Analysis

The next step in the analysis involved examining the variables for unit roots using the Levin, Lin, and Chu (2002) (LLC) unit root test. The results, summarized in Table 2, indicate that all variables are stationary at the level, with the exception of property rights, which only became stationary after including trend and intercept. Although unit root analysis is not mandatory for dynamic panel data techniques, it was conducted as a standard econometric procedure to ensure robustness.

Table 2: Unit root analysis

| Variable               | LLC       | Trend and intercept | Conclusion |
|------------------------|-----------|---------------------|------------|
|                        | Intercept |                     |            |
| Business freedom       | -3.04*    | -10.48*             | I(0)       |
| Financial freedom      | -3.84*    | -2.71*              | I(0)       |
| GDP per capita         | -6.67*    | -10.83*             | I(0)       |
| Government integrity   | -4.32*    | -2.95*              | I(0)       |
| Investment freedom     | -5.31*    | -8.69*              | I(0)       |
| Labour freedom         | -4.67*    | -5.35*              | I(0)       |
| Property rights        | 0.54      | -1.95*              | I(0)       |
| Economic freedom index | -1.47***  | -3.33*              | I(0)       |

Source: author's computations; asterisks \*, \*\*, \*\*\* denote statistical significance at the 1%, 5% and 10% level, respectively

### Correlation Analysis

Table 3 presents the results of the correlation analysis, which estimates the association between the dependent variable (GDP per capita) and the explanatory variables (components of economic freedom). The findings reveal that all economic freedom variables are positively associated with economic growth, and these associations are statistically significant. This is consistent with earlier studies such as Dawson (1998), De Vanssay and Spindler (1994), and Ivana et al. (2020), which have documented similar positive correlations between economic liberty and growth. Specifically, components like government integrity, business freedom, labor freedom, investment freedom, financial freedom, property rights, and the overall economic freedom index are all robustly correlated with economic growth in the SADC region.

Table 3: Correlation Analysis

| Probability | GDP_PC | BUSI  | FINA  | GOV   | INVEST | LABOUR | PROP  | EFI  |
|-------------|--------|-------|-------|-------|--------|--------|-------|------|
| GDP_PC      | 1.00   |       |       |       |        |        |       |      |
| BUSI        | 0.65*  | 1.00  |       |       |        |        |       |      |
| FINA        | 0.51*  | 0.72* | 1.00  |       |        |        |       |      |
| GOV         | 0.69*  | 0.74* | 0.72* | 1.00  |        |        |       |      |
| INVEST      | 0.46*  | 0.68* | 0.85* | 0.68* | 1.00   |        |       |      |
| LABOUR      | 0.62*  | 0.63* | 0.54* | 0.72* | 0.62*  | 1.00   |       |      |
| PROPERTY    | 0.59*  | 0.72* | 0.78* | 0.78* | 0.78*  | 0.58*  | 1.00  |      |
| EFI         | 0.59*  | 0.82* | 0.88* | 0.76* | 0.91*  | 0.64*  | 0.83* | 1.00 |

Source: author's computations; asterisk\* denotes statistical significance at the 1% level

### GMM Regression Analysis

Table 4 summarizes the findings from the GMM regression analysis, where the estimated R-squared value is 58%, suggesting that the model explains a significant portion of the variation in GDP per capita. The results indicate that business freedom, labor freedom, and government integrity have a positive and statistically significant impact on economic growth. This implies that policies promoting business activities, labor market flexibility, and governmental integrity contribute positively to economic performance.

Conversely, investment freedom was found to have a negative and statistically significant impact on economic growth. This could imply that excessive freedom in capital movements, particularly capital outflows, may adversely affect domestic economic activities by reducing available investment within the country. These findings align with studies by Edlund (2017) and Dung (2019), which also observed that different components of economic liberty can have varying impacts on growth.

Table 4: Regression Analysis

| Variable                       | Coefficient | Std. Error         | t-Statistic | Prob.    |
|--------------------------------|-------------|--------------------|-------------|----------|
| Business freedom               | 0.006       | 0.003              | 1.963       | 0.051**  |
| Financial freedom              | 0.000       | 0.003              | 0.033       | 0.974    |
| Government Integrity           | 0.012       | 0.004              | 3.069       | 0.002*   |
| Investment freedom             | -0.010      | 0.003              | -3.299      | 0.001*   |
| Labour freedom                 | 0.007       | 0.003              | 3.192       | 0.002*   |
| Property freedom               | 0.004       | 0.003              | 1.009       | 0.314    |
| Economic freedom index         | 0.013       | 0.007              | 1.838       | 0.068*** |
| C                              | 2.036       | 0.193              | 10.545      | 0.000*   |
| Effects Specification          |             |                    |             |          |
| Period fixed (dummy variables) |             |                    |             |          |
| R-squared                      | 0.581       | Mean dependent var | 3.591       |          |
| Adjusted R-squared             | 0.532       | S.D. dependent var | 0.422       |          |
| S.E. of regression             | 0.288       | Sum squared resid  | 12.99       |          |
| Instrument rank                | 20          | Prob(J-statistic)  | 0.000       |          |

Source: author's computations; asterisks \*, \*\*, \*\*\* denote statistical significance at the 1%, 5% and 10% level, respectively

The overall economic freedom index, which measures a country's openness and business friendliness, was found to have a positive and statistically significant effect on economic growth in the SADC region. This suggests that economic liberty, in conjunction with regional trade among SADC member states, has been a key driver of economic growth during the study period.

### Granger Causality Analysis

The final analysis involved estimating the bivariate relationship between economic growth and economic liberty using Granger causality tests, as shown in Table 5. The results indicate that economic freedom Granger-causes economic growth, and, in turn,

economic growth Granger-causes economic freedom. This bidirectional causality suggests that economic freedom and economic growth are jointly determined, reinforcing the hypothesis that these variables influence each other over time.

Table 5: Granger causality analysis

| Null hypothesis  | Obs | F statistic | Prob   |
|--|-----|-------------|--------|
| economic freedom index does not Granger cause GDP per capita | 146 | 6.36        | 0.00*  |
| GDP per capita does not Granger cause economic freedom index |     | 4.05        | 0.02** |

*Source: author's computations; asterisks \*,\*\* denote statistical significance at the 1% and 5% level, respectively*

The findings of this study highlight the positive impact of economic freedom on economic growth in the SADC region. Key components of economic freedom, such as business freedom, labor freedom, and government integrity, have been shown to significantly enhance economic performance. However, the study also underscores the complex nature of economic freedom, where certain aspects like investment freedom may have unintended negative consequences. The bidirectional causality between economic freedom and growth further emphasizes the need for carefully designed policies that foster both economic liberty and sustainable economic development.

## CONCLUSION

The primary objective of this study was to investigate the relationship between economic liberty and economic growth in the Southern African Development Community (SADC) region. Utilizing panel data from 2007 to 2018, the analysis was conducted in three key steps: estimating the correlation between components of economic freedom and economic growth, assessing the impact of these components on economic growth, and exploring the bivariate relationship between economic freedom and economic growth.

The findings of the study revealed a positive correlation between components of economic freedom and economic growth, with the associations being statistically significant. The results from the GMM regression analysis further demonstrated that most components of economic freedom—except for investment freedom—exert a positive and statistically significant influence on economic growth in the SADC region. Additionally, the Granger causality analysis indicated a bidirectional relationship between economic freedom and economic growth, suggesting that these variables are jointly determined.

Given these findings, there is a clear need to deepen regional integration among SADC member states. This can be achieved through increased intra-regional trade and financial integration, identifying and leveraging potential value chains, and implementing both hard and soft infrastructure improvements to reduce the cost of doing business and enhance economic growth across the region.

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