

Revisiting the Determinants of Economic Development: Does Economic Freedom Matter?

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Abstract

Is economic freedom related to economic development? We consider economic development of a nation to be measured by its per capita income along with the distribution of income across its citizens. Descriptive data indicates countries with higher economic freedom have on an average a higher per capita income and a more equitable income distribution. Countries with lower economic freedom, on the other hand appeared to fare worse in these measures of development. In this paper we analyze whether greater economic freedom leads to higher development or whether the positive association between economic development and economic freedom arises due to the existence of other complimentary factors conducive to development. In order to conduct a more in-depth analysis, we examine other determinants of economic development, namely, physical capital, human capital and land resource, along with institutional variables which include gender disparity, political stability and government corruption along with economic freedom. Regression analyses reveals that once we control for the above variables, the degree of economic freedom is not significantly related to per capita income. Physical capital investment, gender equality, political stability and government corruption appear to be the most significant determinants, all having a positive and largely significant impact on per capital income. With regard to income distribution however, economic freedom appears to have a significant relation with our measure of income inequality, with greater economic freedom resulting in lesser inequality. Besides economic freedom, gender inequality is significantly related with income inequality, with greater inequality in gender resulting in greater inequality income. Previous studies on the relationship between economic freedom and economic development have not included gender inequality, political stability or government corruption as their explanatory variables. We find these variables to be the most significant variables in explaining differences in the economic development of countries.

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