

THE INFLUENCE OF INSTITUTIONAL FACTORS ON ECONOMIC GROWTH

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Abstract

Economic growth and the associated standard of living are among the most significant, watched and discussed topics of the general public. For that reason, it is the subject of many economists, scientific literature, and economic models. Opinions about the causes of growth, but also stagnation, of the world's economies vary, whether within economic flows, theories or among economists themselves. Increasingly, it refers to the reduced ability of known theories to answer all the causes of economic differences between seemingly similar countries. One of the modern explanations of the differences between the world's economies is that of the so-called institutional factors of economic development - culture, religion, history, geography, or political regime. Therefore, this research paper analyses the relationship between economic growth and institutional factors of development. In the context of the influence of institutional factors on economic growth, democracy assumes that political competition allows voters to use the state as a source of redistribution. Thus, if the average voter is lower than the average, middle-income and low-income citizens can determine the election result and thus claim higher tax rates for the rich.

Key words

Cohesion, Convergence, Economic Growth

JEL Classification: A13, O4, O10

Introduction

One of the key economic policy objectives is to stimulate total output in the economy, i.e. the macroeconomic output (product), since the level of total income in the economy (and hence the standard of living of every citizen) also depends on the size of the product (Calvo, 2006). Likewise, despite questioning the use of standard macroeconomic aggregates to measure production by some economists, these indicators are still the best possible solution. Furthermore, the most commonly used standard macroeconomic aggregate to measure output (macroeconomic output) is gross domestic product (GDP). It is a monetary expression of the total value of goods and services newly created in a given period in a given territory; while it is used to determine the performance of the economy. It can be defined, respectively calculated in three ways: the production method (approach), the expenditure method and the income method. On a similar note, GDP is a key indicator of economic development. It represents the sum of the value added by processing in all sectors in activities considered in the system of national accounts (SNA) to be

productive (i.e. including services of a market or non-market nature). To exclude the impact of price changes, it is expressed in constant prices. More profoundly, it is the most commonly used aggregate to measure production - all the final output (goods and services) produced in the country over the reference period, by the production factors. It doesn't matter if it's produced by citizens or foreigners. If they are located within the country's boundaries, their production is included in GDP (Romer, 2018). Another standard but less widely used macroeconomic aggregate is the gross national product (GNP). It is the value of the final production produced over a certain period of time by domestic production factors anywhere in the world. Thus, unlike GDP (where the key factor is the location of factors of production), emphasis is placed on the ownership of the factors of production (Tucker, 2018). On the other hand, GDP (even though it is the most important macroeconomic aggregate) has justified doubts about its capability and relevancy. Among its shortcomings is the inability to record the gray economy, i.e. the economy, which includes activities that are carried out without proper permits, offending activities and avoidance of tax payments. Another lack of GDP is the inability to

record the products and services that one provides to himself (the value of free time and this is a major gap in measuring wellbeing).

1. Interaction between Economic Growth and The Business Cycle

So far described the total size of production in the economy (the level of real GDP) represents more or less a static view of reality, since a more perceived indicator than the simple GDP is the dynamic aspect, i.e. the growth rate of output in the economy (growth rate of GDP). There are two basic approaches to economic reality and economic development, which are based on two key issues described by economic theory. First of all, it is the economic cycle that reflects the oscillations that occur in the economy (can be understood as the fluctuations of the short-term growth rates) and second of all, the economic growth, which shows the long-term trend of economic development. The economic cycle is therefore meant the oscillation of the real product around its potential level - it is a periodic occurrence of fluctuations in economic activity (Knoop, 2015). There are two basic circuits of theories dealing with this issue of the cycle (the business cycle, also known as the economic cycle or trade cycle). Business cycles are generally measured / estimated by considering the growth (development) rate of real GDP. Regardless of the regularly-applied term cycles, these changes in economic activity don't display uniform or predictable periodicity. Furthermore, the conventional boom-and-bust cycle alludes to changes in which the extension is swift and the contraction rigid.

The first circle are the traditional theories of the cycle which include the monetarist approach, the approach of the new classical macroeconomics, the approach of Keynesian directions, etc. The monetarist approach sees the source of the oscillation of the economy in the fluctuations of the money supply when the deviation of the actual inflation rate from its expected level increases, the growth rate of real wages, and consequently a decline in costs of businesses and production growth. The approach of a new classical macroeconomic theories is based on the assumption of rational expectations where economic cycles result in an unexpected economic

policy. Keynesian directions operate with the accelerator and multiplier principle. According to the Keynesian approach, cyclical developments are the result of internal market instability - fluctuations in aggregate demand lead to fluctuations in gross domestic product, employment and other economic variables (Hori, 2017). The second circle of theories explains the long-term economic cycles. These theories of a real business cycle see the cause of cycles on the aggregate supply side. Furthermore, these theories reject the claim that there are deviations of the real product from its potential level, but claim that the potential product itself is fluctuating (Grinin, 2018). As the reasons for the fluctuations of potential product, theoreticians of the real economic cycle see, for example, oil shocks, crop failure, war, etc. For the economic growth of the country would be optimal to maintain a stable growth rate, maintaining a steady trend of economic development. Besides, balanced and stable economic development does not occur forever, since in market economies, are typical economic cycles.

1.1 Economic cycle and the Importance of Long-Run Growth

Macroeconomists give careful consideration to long-run growth than they completed two decades back. A large portion of this is the consequence of expanding consciousness of the significance of the subject: not exclusively is for quite some time run economic growth the eventually most vital part of how the economy performs, yet economic arrangements can have powerful effects on the rate of long-run growth. Macroeconomists will in general break the study of long-run growth into two sections. The initial segment is the assurance of an economy's steady-state capital-output ratio (and the speed with which it will unite to that steady-state capital-output ratio). The second part is the assurance of the rate of creation, innovation and advancement. An economy with a higher capital-output ratio will be a more extravagant economy (in the event that it approaches similar developments and advancements). However, an economy with higher rates of development and advancement, quicker aggregate factor profitability growth, will in general end up more extravagant quicker. One approach to build genuine GDP per laborer is to expand the capital stock per worker.

The capital stock per worker can be expanded from numerous points of view - greater venture, slower deterioration, or slower populace growth. As the capital stock per laborer rises, the estimation of the machines and workspace accessible to the normal worker rises. With more help from capital, the normal worker is progressively gainful (Shimer, 2010).

In any case, boosting profitability by raising capital per worker is liable to unavoidable losses: each progressive increment in capital per worker creates less of an expansion underway than did the one preceding. In the long run the lift to add up to profitability given by further increments in the capital stock does not add up to enough to compensate for the mileage on the additional capital utilized. The heft of increments in profitability and material ways of life through the span of decades or generations needs to originate from an unexpected source in comparison to just developing the measure of capital that the economy has.

2. The Relationship between Financial Development and Economic Growth

De Gregario and Guidotti in their research called *Financial Development and Economic Growth* found that financial advancement prompts an enhanced growth efficiency. Wachtel and Rousseau in *Financial Intermediation and Economic Growth* analyzed the causal connection among finance and growth in the United States, the United Kingdom and Canada and that their test for Granger-causality showed that financial advancement causes economic growth. However, Galetovic in *A Synthesis and Interpretation of the Evidence* reports no causal connection between financial improvement and economic growth. Additionally, according to Arestis and Demetriades in their research called *Finance and Growth: Institutional Consideration and Causality* found out that bank-based and capital-market-based financial frameworks and in addition the viability of government approaches in the two frameworks may have suggestions concerning the issue of whether financial developing winds up ready to advance economic growth. Bank-based financial frameworks are the nearby contribution of banks with modern firms. A nearby connection exists among banks and enterprises in bank-based

financial framework. Organization depends on bank credits that is the normal for bank-based financial framework. Subsequently, bank assumes a vital job during the time spent economic advancement. The qualities of capital-based financial framework are exceedingly created capital markets and banks that have moderately low association in the designation of assets of financial resources. Bank-based financial framework empowers long haul finance which is devoted to long haul gainful venture that diminishes theoretical exercises. Consequently bank-based financial framework advances financial strength and help execute economic arrangements effectively. In bank-based financial framework, financial and mechanical capitals are related to the point that theoretical finance cannot impact genuine economic movement as it does in capital-market-based financial framework (Cline, 2010). Bank-based financial framework may help execute expansionary fiscal and mechanical approach, given the connection among financial and modern firms.

In developing economies, financial progression and financial restraint impact economic growth. Financial advancement is portrayed by market decided loan fees which are appealing for surplus units. Financial developing occurs and venture increments. The abrogation of coordinated credit programs enhances the nature of speculation. Higher market decided rate of profits can be earned through venture ventures. In this way, in a changed financial framework, financial improvement and economic growth is decidedly connected with the heading of causality running from financial advancement to economic growth. Actually, the normal for quelled financial framework is that the government keeps falsely genuine loan costs lower. The nature of venture lessens in light of restricted measure of loanable subsidizes rationed in agreement to government mandates (coordinated credit programs and concessionary loaning rates). Both the quality and amount of speculation lessen which thus influence economic growth. Regardless of, a positive connection between financial improvement and economic growth can be acquired. Notwithstanding, in a subdued financial framework financial extending may not be as powerful in advancing economic growth than in a changed framework (Emerson, 2018). Consequently, it appears that connection between

financial advancement and economic growth must be more grounded under changed economies than under subdued economies. Causality connection between financial advancement and economic growth is inspected in this paper in vector autoregressive structure. Financial advancement is proxied as the ratio $M2$ to genuine GDP that is meant by $M2Y$ and economic growth is estimated as the normal rate of genuine per capita GDP that is signified by Y . The structure of cointegration testing methods created by Johansen in *Likelihood-based Inference in Cointegrated Vector*

Autoregressive Models can be connected to assess long-run connections between economic factors. Accordingly, Johansen most extreme probability technique in a vector autoregressive system can give a premise to assessing the long-run connection between financial improvement and economic growth. We use Johansen cointegration strategy to test for the nearness of a cointegrating vector between financial advancement and economic growth. The strategy is based on the most extreme probability estimation of the error correction model (ECM):

$$\Delta x_t = \eta + \Gamma_1 \Delta x_{t-1} + \Gamma_2 \Delta x_{t-2} + \dots + \Gamma_{k+1} \Delta x_{t-(k+1)} + \pi x_{t-k} + \varepsilon_t \quad (1)$$

where the matrix Γ catches the short-run parts of the connection between the components of x_t and the matrix π mirrors the long-run data. There can be at least one than cointegrating relations in a multivariate cointegration model contingent upon the quantity of straight blends of x_t . The position of π , meant by r , can decide the quantity of cointegration relations. The matrix π can be deteriorated in two frameworks, α and β where $\pi = \alpha\beta'$. The loads or the speed of alteration (the error correction coefficients) are contained in matrix α that compel the

arrangement back towards their basic balance relations and the cointegrating vectors are contained in matrix β that condense the hidden long-run relations. Further, $x_t = [Y_t \quad M2Y_t]'$, η is a (2×1) vector of parameters, $\Gamma_1, \Gamma_2, \dots, \Gamma_{k+1}$ and π are (2×2) grids of parameters, and ε_t is a (2×1) vector of white noise errors. For this situation, condition (1) can be revamped in full as:

$$\begin{bmatrix} \Delta Y \\ \Delta M2Y \end{bmatrix} = \begin{bmatrix} \eta_1 \\ \eta_2 \end{bmatrix} + \begin{bmatrix} \Gamma_{i,11} & \Gamma_{i,12} \\ \Gamma_{i,21} & \Gamma_{i,22} \end{bmatrix} \begin{bmatrix} \Delta Y_{t-i} \\ \Delta M2Y_{t-i} \end{bmatrix} + \begin{bmatrix} \alpha_1 \\ \alpha_2 \end{bmatrix} \begin{bmatrix} \beta_1 \\ \beta_2 \end{bmatrix}' \begin{bmatrix} Y_{t-k} \\ \Delta M2Y_{t-k} \end{bmatrix} + \begin{bmatrix} \varepsilon_1 \\ \varepsilon_2 \end{bmatrix} \quad (2)$$

Two probability ratio tests proposed by Johansen are utilized to decide the quantity of cointegrating vector in x_t . These are the maximal eigenvalue test and the follow test. The maximal eigenvalue test evaluates the invalid theory that

there are actually r cointegrating vector against the elective speculation that there is $r+1$. The maximal eigenvalue test utilizes the $(r+1)$ eigenvalue and is given by:

$$\tau_{\max} = -N \ln \left[1 - \Pi_{(k+1)}^2 \right] \quad (3)$$

The follow test assesses the null hypothesis that there are r or less cointegrating vectors against

the alternative hypothesis that there are more than r . This test is defined by:

$$\tau_{\text{trace}} = -N \sum_{i=r+1}^p \ln(1 - \Pi_i^2) \quad (4)$$

Of these two probability ratio tests, the follow test may need control with respect to the most extreme eigenvalue test. For these two tests, asymptotic basic qualities rectified for degrees of opportunity are given by Reimers in *Comparisons of Tests for Multivariate Cointegration*.

2. Different Views on Real Product Growth

Economic growth represents a situation where the potential product level is rising. However, growth in the overall potential product does not automatically mean improving living standards. Potential product is the theoretical overall product of the economy that the economy would achieve in full utilization of its production factors (labor, natural resources, capital). The economy reaches its potential GDP if it moves to the limit of its production potential. In this context, improving living standards depends on potential product growth per capita. Thus, the living standard of the population will only increase if the potential product grows faster than the population. Economic growth can also be defined as a process of increasing the production capacity of the economy. Theories of economic growth then examine what influences the capacity of the economy, i.e., by what basic sources and factors the product's growth is determined. Quantification of economic growth is based on the calculation of the abovementioned change in production (growth rate of output). Economic growth shows the growth of production over a longer period of time. The easiest way of calculating economic growth is thus the geometric mean of year-on-year growth rates over a given period and is basically the approximation of the potential product. Economists focused on economic growth claim that long-term growth per capita is often the only macroeconomic indicator that really matters. The differences in long-term growth rates of GDP thus have a much greater impact on the standard of living of the individual than on short-term economic fluctuations. It is true that short-term stability policy may eventually improve the economic situation in the order of several percent of GDP. However, a policy in the long run capable of increasing the rate of growth may mean a difference in the level of well-being achieved for the economy (Weil, 2012). According to the histogram of annual growth rates per capita in 122 economies of the world in 1965-1985, reported by

Barro and Sala-i-Martin in their publication *Economic Growth*, growth in headline in the fastest growing economies grew at an average rate of 4.8% per annum, which corresponds to an overall increase of 161% over the twenty years under review. The output of the five countries with the worst economic performance declined at -1% per annum, real GDP per capita fell by 18% over the same period. The fastest growing economies thus ended in more than three times the GDP in just 20 years compared to economies with the worst economic performance. In general, one of the most important sources of real product growth is the growth of factors of production, labor, land and capital (extensive growth) and the growth of their overall productivity (intense growth). In practice, however, long-term growth sources vary according to theories and growth models.

The first growth theories originated in the 18th century. Classical economics Adam Smith and David Ricardo considered the main source of economic growth a workforce and its productivity. An important element was an international trade, which, according to the classical theory, through international specialization and division of labor, allows for long-term economic growth. Another classical economist, Thomas Malthus, argued that population growth in the absence of additional loose land would lead to a reduction in per capita product, under the law of declining yields. These first theories have in common that they completely neglect the fundamental influence of capital accumulation and technical progress. The first model of modern theory of growth is the Harrod's model. This is the most significant growth model of the period before the arrival of the neo-classical model Solow and Swan. Harrod's model was an attempt to dynamically conceive of Keynes' theory, linking the theory of short-term imbalances to the growth theory. Harrod's model puts a number of basic requirements on the economy: all savings in the economy are invested, the state has a decisive role in converting savings to investment, the marginal savings tendency, the labor growth rate and the capital intensity of production are constant, there is zero elasticity of substitution between production factors (Jones, 2013). The model expresses the so-called guaranteed growth rate. The guaranteed growth rate is a dynamic balance for continued long-term economic growth. The model also defines the natural growth rate. The natural growth rate is equal to the sum of the

growth rate of the growth of the population looking for work and the rate of growth of the technical progress of the saving work. In this model, the economy achieves long-term equilibrium growth if the actual growth rate in each period is equal to the guaranteed growth rate and natural growth rate, so that the saving rate ensures sufficient capital for production and there is a balance between capital and the supply of efficient labor. Assuming that one unit of capital is needed per unit of production, the rate of savings will determine the actual growth rate. The economy will only achieve long-term sustainable growth if the savings rate is equal to the real growth rate of the product.

The problem is a factor of expectation. If real growth is expected to be greater than the guaranteed growth rate, investors will invest more than they would invest at a guaranteed growth rate. Through a multiplier, these investments will lead to further output growth. Investors do not realize that output growth was due to their expectations, and will expect further output growth in the future. According to Harrod, capitalism is internally unstable, the instability of which lies in forming investment expectations. The model therefore considers it necessary to maintain a certain level of investment to avoid imbalances in inflation or unemployment. The main problem and deficiency of Harrod's model, however, is that it does not define the mechanism by which this equilibrium would be established.

Neoclassical growth theories are based on the theory of factors production. Growth is, according to neoclassical economists, dependent on changes in capital, labor and land, multiplied by their marginal productivity. Neoclassical growth models are based on several conditions. They assume that land gain is equal to zero and no longer has an effect on the growth of retirement. Another assumption arises from the need to incorporate capital into an increase in capital gains, and this effect is therefore included in the change in the marginal efficiency of capital. According to neoclassical economists, each of the factors is infinitely divisible and can be used in any combination with another production factor to produce any amount of production. Any infinitely small change in factors will cause a change in overall production. The most famous neoclassical model is the Solow–Swan model, which significantly extends Harrod's model. Unlike

Harrod, however, Solow–Swan consider capitalism to be a relatively stable system. Their model assumes that technical progress is expanding work so that technological innovations multiply the volume of physical work (so-called Harrod's neutral technical progress). It also assumes positive decreasing labor and capital returns, constant labor growth rate, technical progress, amortization of physical capital, constant saving, saving function, equality of savings and investment, a closed economy, full employment, flexible wages and prices, and a neoclassical production function (Grandville, 2016).

Solow–Swan model operates with the term *steady state*. A steady state represents a situation where each additional unit of capital per employee has no effect on output growth. This is due to the declining marginal product of capital. Under steady state, the growth of capital accumulation will only make sense if labor force growth, if investment serves as a substitute for impaired capital, or if technical progress improves labor. Under the steady state, the rise in the per capita income is due only to the growth of technical progress. Changes in capital accumulation therefore depend on the degree of savings and the size of the product per employee depends on the production function. It is reduced by the rate of labor force growth, the rate of increase in technical progress, and the rate of depreciation multiplied by the amount of accumulated capital per worker. When the economy is in a steady state, the change in capital will be zero. In a steady state, real investment equals maintenance investment. According to Solow–Swan model, every economy is moving towards steady state, while countries with a lower economic level grow relatively faster than countries with a higher standard of living, as poorer countries are more distant from a steady state.

With the expansion of empirical data on long-term growth, some weaknesses of Solow–Swan model began to be highlighted in the 1970s. Solow–Swan model predicts a much faster pace of economic convergence, more significant differences in the rate of return on capital between countries, and the smaller differences between countries in the share of retirement capital than is actually observed. Another weakness of the neoclassical model is that it basically does not explain growth. When the economy comes to a steady state, the growth of retirement per person is

determined only by technical progress and it is exogenous. In order to solve the emerging problems of the neoclassical model, the so-called new theory of growth began to form. The new growth theory can be distinguished in two fundamental streams. The first trend is that the main driver of long-term growth is capital and not technological progress. Capital is widely understood in these theories, and in addition to physical capital, human capital is also included (capital is not a driving force of growth, but unlike Solow's model, it explains the efficiency of work as knowledge and more closely modeling its development over time) (Daly, 2012).

The new theory of growth seeks to endogenize technological progress. The endogenization of technological progress tries to explain better the sustainability of the world economic growth as well as the differences between countries. The so-called AK model of economic growth (a special case of a Cobb–Douglas function with constant returns to scale) are the easiest and most basic model of endogenous growth models. Unlike the Solow model, when the growth rate of savings led to an increase in economic growth only until a stable state is achieved, in the endogenous model the growth rate of savings leads to a steady increase in economic growth. AK models assume that the by-product of investment is knowledge creation. The business that invests, therefore, learns how to produce more efficiently. The impact of this by-product of the investment will be so high that returns on capital will be constant or even rising. Economics in a stable state may not only grow by increasing the rate of technological progress, as explained by Solow's model. Paul Romer's learning-by-doing model assumes positive externalities from the accumulation of capital. Part of the benefit of capital accumulation does not belong to the owners of the capital but to the rest of the company. In the case of capital formation such as an enterprise, new ideas arise, they enter a general inventory of knowledge and are consequently a product of investment in research and development and have a positive effect on the productivity of other enterprises. Private profits may be declining, but global output may have constant or even rising yields. The level of technology, i.e. total productivity, is given by the knowledge of the whole economy.

Another endogenous growth model can be considered two-sector Uzawa–Lucas model, which

extends the AK model by a two-sector setup (physical and human capital are produced by different technologies). Investing in human capital is thus an alternative to technical progress. Another direction of the new growth theory includes R&D models that operate with microeconomic decisions in the area of R&D, precisely describe the innovation process (Weil, 2012). These models are further divided into two groups. The first group of models considers technical progress as the growth of the number of different products and intermediates. The second group deals with product quality.

3. Economic Development and Institutions

The political regime, its characteristics and its impact on economic growth are among the institutional factors of development. The influence of institutional factors, that is, factors influencing the institutional environment, social and legal norms and rules (rediscovering aspects of classical political economy) deals *institutional* (Clarence Ayres, Adolf Berle, John R. Commons, John Kenneth Galbraith, Wesley Mitchell, Thorstein Veblen) and *new institutional economics* (Daron Acemoglu, Masahiko Aoki, Armen Alchian, Yoram Barzel, Ronald Coase, Steven N. S. Cheung, Harold Demsetz, Avner Greif, Claude Ménard, Douglass North, Elinor Ostrom, Oliver Williamson). The main idea of (new)institutional economics assumes that economic growth and development depend decisively on current institutions. Institutional economics should address the question of why some countries are rich and other poor even though they have a similar approach to knowledge, a similar approach to capital markets, the same availability of land and natural resources, similar amenities to human capital. The answer of institutional economists lies in the qualitative differences of national institutions. Economic development and growth (according to institutional economists) are influenced both by formal rules (laws, etc.) and by informal rules (traditions, customs, etc.) (Kapp, 2014). According to Douglass C. North, institutions are "*commonly known rules to structure repetitive interaction situations which are complemented by an enforcement mechanism that ensures that non-compliance with the rule-component is sanctioned*". Five different types of institutions can be distinguished (Table 1), i.e.

institutions that are not enforced by the state and violations of their rules are sanctioned within the company are then categorized as internal institutions. On the contrary, such institutions whose enforcement the state implements and where the state also sanctions their violation are called external institutions.

From the point of view of the influence of the political regime on the institutional environment of the state, the fifth type of institution will probably be the most important - external. The political regime will act most prominently on the institutional environment through the state. In the long run, however, the political regime can also be important for other types of institutions. Voigt also recalls existing relationships between internal and external institutions. In his opinion, the quality of

external institutions is strengthened by internal institutions, but also that their action may be contradictory. What matters is how individual institutions work on economic variables. So how does it work on micro- and macro-economic situations? At the microeconomic level, institutions can act on voluntary exchanges of assets between private actors (types of commodities exchanged, payment methods, etc.), organizing repeated transactions by private individuals, collective bargaining and motivation for collective bargaining (Kasper, 2013). At the macroeconomic level, the institutional environment will act the lawful regulation of private property, contractual freedom, law and hence economic growth and development itself.

Table 1. Types of Institutions

Kind of rule	Kind of enforcement	Type of Institution
Convention	Self-enforcing	Type-1 internal
Ethical rule	Self-commitment of the actor	Type-2 internal
Customs	Via informal societal control	Type-3 internal
Private rule	Organized private enforcement	Type-4 internal
State law	Organized state enforcement	External

Source: Stefan Voigt, 2009

Moreover, efforts to measure and compare the quality of institutions are done by the Index of Economic Freedom. It was developed by renowned economists, The Heritage Foundation and The Wall Street Journal to measure the degree of economic freedom in the world's nations. Its study is based on the assumption that more free institutions, which are not weakened by state action, i.e. state-defined price or quantitative regulations, foreign trade restrictions, tax rates, currency stability, etc., lead to higher economic growth. Earlier studies that looked at the links between economic growth and economic freedom were based on the assumption that freedom must be great everywhere where there are extensive democratic rights. Democracy was therefore a substitute variable of economic freedoms. However, the Index of Economic Freedom first of all tries to quantify the freedom of institutions. It is composed of 21 indicators, which are divided into

seven groups, each of which has a certain share in the total index.

The first group takes into account the state's share of total consumption expenditure and share of transfer payments and subsidies to gross domestic product. The second group measures the importance of the state-owned enterprises, the freedom of enterprises to determine their prices, the level of taxation and the existence of a general defense duty. The third group on monetary policy and price stability takes into account the rate of money supply growth, the range of annual inflation rates and the current inflation rate. The fourth group is based on the possibility or the impossibility for citizens to hold accounts in a non-national currency and the possibility or the impossibility to legally hold accounts in other countries and the magnitude of the difference between the official exchange rate and the black-

market exchange rate. The fifth group takes into account the security of private property rights, equality of citizens before the law, and access to impartial justice. The sixth group measures the amount of taxes levied on foreign trade, along with the average level of taxation on international transactions and the degree of country integration in the world economy. The last group consists of four indicators that ask how many percent private bank deposits are held with private banks, how many percent of the total volume of loans is directed to private entities, how much interest is determined on the market, and to what extent is limited mobility of capital. In the first ten places within the scope of economic freedoms were in 2018 Hong Kong (90,2/100), Singapore (88,8/100), New Zealand (84,2/100), Switzerland (81,7/100) and Australia (80,9/100) (The Heritage Foundation, 2018).

3.1 Democracy, Political Stability and Economic Growth

Numerous examinations have been led on the connection among democracy and growth. The general comprehension of the connection between economic growth and democracy is that democracy cultivates economic growth with respect to non-democracies in a given nation. On the other hand, economic instability has a negative effect on economic growth. Democracy record accelerated growth as it is internally more stable, while higher incomes of the population have a positive effect on the functioning of democracy, but there is no such relationship in autocracy. Authoritarian regimes are generally less stable in the deteriorating performance of the economy, as they lack legitimacy. Authoritarian regimes can survive this period of sustained economic growth, but when the economy begins to stagnate for a long time, the government has a much better chance of remaining a democratic government because it is characterized by legitimacy. Expectations about the future of the political regime are also important. The risk that the country will cease to be democratic is severely damaging to economic growth. As a result, the democracies with a high degree of democratic capital (values, norms, cultural and sociological attitudes of the population) and a long-standing democratic tradition have a demonstrably positive impact on economic growth. Likewise, a stable

democracy encourages economic development, which leads to the strengthening of democratic capital, thereby further enhancing stability and growth (Lewis, 2003). All things considered, this theory has gone under the examination of many market analysts, who call attention to that nations, for example, Hong Kong, Singapore and Taiwan, which accomplished super growth notwithstanding of the truth that the governments of these nations are authoritarian in their nature.

Nonetheless, the aftereffects of measurable examinations directed regarding this matter have been somewhat uncertain. Such uncertain outcomes come from utilizing decreased shape models that pool information from developing and developed nations. On a similar note, economic growth and democracy are two terms that have regularly been heard utilized in a similar setting by open observers, government officials, and well-known media. Subsequently we are regularly looked with the inquiry of whether the theory that democracy encourages economic growth is just the pie in the sky thinking of people who esteem both democracy and growth. The significance of looking at this inquiry in more noteworthy detail lies in the way that it is a key strategy question for some global guide establishments, for example, the IMF and World Bank. This issue is especially essential to many developing nations because of the way that one of the most vital preconditions towards getting help from these establishments is political progression (Dalziel, 2018). Consequently, are approaches of western nations that support the establishment of democracy to goad economic growth in nations like Somalia and Haiti of any practical use? In many developing nations political progression can prompt economic strategies that are hindering to economic growth. For instance, nations that have a more prominent dimension of political opportunity may not actualize strategies, for example, exchange progression that could beneficially affect growth. This can be outlined by looking at the circumstance that South Korea looked amid the late 1980's the point at which its government endeavored to move towards more prominent political opportunity as well as economic opportunity. In this manner with democratization going full bore, Korean premium gatherings, for example, the agriculturists, upset against free market arrangements, for example, import

advancement, keeping the current government from executing free market strategies.

Moreover, the significance of the dimension of democracy can be delineated utilizing the accompanying model. Give us initial a chance to accept that the economy in a given country comprises of various lease looking for gatherings. In a popularity-based country the government is then controlled by one of these gatherings or an alliance of different gatherings. Such situations naturally advance lease looking for as the government tries to fulfill the decision gathering or alliance of gatherings with the expectations of picking up or remaining in power. It very well may be expressed just that the government is childish, as in it is concerned simply with the welfare of its own individuals. The gathering that the government speaks to is essential as the government should then pick between expending or putting resources into physical capital. Along these lines the government faces an exchange off between executing strategies that fabricate political capital through lease looking for exercises that support current consumption and development situated approaches. Along these lines developing nations with equitable routines are bound to advance consumption at the cost of savings. On the other hand, likelihood of losing power is often related specifically with the level of political (in)stability in the country. Such instability can have genuine outcomes on monetary growth as there is an immediate association between capital flight and political instability. At the point when a political routine is unstable, sparing rates decline as instability propels customers to build spending as their savings could end up useless. Savings likewise turned out to be repetitive when political instability prompts the removal of individuals, denying them of a source of living. Investors' interest for settled capital stocks will likewise diminish with expanding political instability. Notwithstanding when investors do invest, they will in general support businesses and investment openings that are fluid and theoretical (Hollyer, 2018). Therefore, investment in such nations tends towards low profitability businesses that are not capital escalated which would give the establishment to advancement. Therefore, two of the most fundamental factors that support financial growth, investment and savings, are influenced antagonistically by political changes.

Various studies have recorded a vigorous constructive outcome of economic freedom on economic growth. Economic freedom can be depicted basically as a measure that describes how much an economy is a market economy. As such, it is an estimation of the capacity to go into willful contracts with restricted government mediation as control, assessments, and principle of law which maintains contracts and secures private property. So how does economic freedom influence growth? Economic freedom builds growth through its impacts on the neoclassical growth factors, physical capital and human capital. The sort of organizations set up importantly affects the impetuses of economic performing artists to be progressively effective or wasteful. Along these lines, hypothetically, establishments that advance economic freedom additionally have the ability to advance motivating forces which in tum advances profitability. Subsequently, it tends to be asserted that economic freedom has the ability to advance effectiveness by urging rivalry because of less directions and government undertakings. It likewise empowers specialization and economies of scale, as economic freedom empowers ability to be designated to where it produces the most noteworthy esteem. Therefore, economic freedom may comprise a logical factor for growth in developing nations. Likewise, Institutions frame the incentive structure of a general public, and the political and economic institutions, in outcome, are the basic determinants of economic execution. Along these lines, the government adequacy marker signifies the nature of open administration arrangement, the quality of the organization, the fitness of government employees, the freedom of the common administration from political weights, and the believability of the government's promise to strategies. As such, government adequacy estimates the fitness of government institutions (Kawanaka, 2016). In this way, hypothetically, if government institutions were working productively by diminishing the costs of exchanges, there would be an expansion in the productivity of the neoclassical growth factors - stimulating economic growth.

In the current literature there are two comprehensively contradicting perspectives relating to this connection among growth and the degree of democracy, the equivalence viewpoint and the contention point of view. The similarity point of view is upheld by a school of financial

specialists and political researchers that keeps up that democracy beneficially affects growth both straightforwardly and in a roundabout way. Then again, the contention point of view is shielded by a second school of thought that keeps up that democracy adverse effect on growth. Protectors of the struggle viewpoint point to nations, for example, Hong Kong, Singapore and Taiwan, which accomplished super growth in any case of the reality that the governments of these nations were authoritarian in nature. Then again, others point to the dismal execution of economies in authoritarian routines in numerous African nations - if dictators made countries rich, Africa would be an economic colossus. The contentions between these two perspectives track with the lines of which routine can keep up property rights, diminish current utilization, and actualize convenient and fitting economic approaches that both lead to and continue growth (Moore, 2018). Defenders of the likeness point of view contend that vote-based foundations make an arrangement of balanced governance that successfully control governmental power and limit the potential for the execution of disliked strategies. Furthermore, it has likewise been contended that democracies are better ready to ensure private property, which numerous financial specialists guarantee to be the establishment of material advance. Likewise, human capital is another channel through which democracy could impact growth as democracies give more noteworthy load towards the fundamental needs of the open (Casasnovas, 2007). Advancement requires expansive sums of investment that requires substitution far from current utilization.

Therefore, proponents of the struggle point of view are wont to contend that a majority rule government can't execute such arrangements because of a paranoid fear of being casted a ballot out of office. It has been stated that, such speculation programs infer cuts in current utilization that would be excruciating at low dimensions of living that exist in every single developing nation. No political gathering can would like to win a fair race on the stage of current penances for a splendid future. Authoritarian routines have progressively brought together power with which to organize economic growth than democracies, especially in developing nations. Nor is there a rule that asserts that non-just governments can't keep up private property. Then

again, it has been contended that democracies in developing nations may really adverse effect private property rights. Democracy offers the individuals who are poor, mistreated or generally hopeless a result of the initial endowments a chance to review through the state. Supplied with political influence in the shape of universal suffrage, the individuals who endure as a result of private property will endeavor to utilize this influence to seize the wealth. The across the board use of democracy as an intermediary for assurances of property rights is in this way unmerited.

Conclusion

In conclusion, we have found out that political competition reduces the rate of physical accumulation of capital and labor, i.e. reduces investment and the supply of labor factor. On the other hand, it increases the rate of human capital and labor productivity. In fact, freer regimes with more political competition may not grow faster than non-free regimes. What is important, however, is the quality and structure of growth - democratic countries will rely on long-term and sustainable intensive growth, undemocratic to short-term and extensive. In the context of the influence of institutional factors on economic growth, democracy assumes that political competition allows voters to use the state as a source of redistribution. Thus, if the average voter is lower than the average, middle-income and low-income citizens can determine the election result and thus claim higher tax rates for the rich. Although this situation would lead to an increase in tax revenue in the short term, it would reduce incentives for capital accumulation, especially among the wealthy. However, political competition can also negatively affect fiscal and monetary policy, since it is the source of a mismatch between the political and economic cycles and leads to a weakening of investment activity. Political competition could have a similar effect on job offer. Moreover, non-democratic regimes simply have the advantage that their lack of social or political pressure makes it possible for people to work, even with a minimum wage. While political competition could discourage investment in physical capital, it could have a positive effect on the human capital. Based on the theory of the media voter, electoral rivalry will

provide incentives to provide public goods, for example, in the area of education and health care, and thus increase the level of human capital. Politically more competitive regimes will also likely increase productivity and technological innovation. political competition stimulates innovation and the dissemination of best practices,

as the best ideas come out of such a free society. more competitively-priced regimes have a greater chance of eliminating different regulations and customs protection, and these pro-market measures should encourage resource efficiency and the development of new processes.

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