



UNIVERSITI PUTRA MALAYSIA

**ECONOMIC FREEDOM, INCOME INEQUALITY AND ECONOMIC
GROWTH IN DEVELOPING COUNTRIES**

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By

NORHAZLIN BINTI ISMAIL

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia,
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Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment of the requirement for the degree of Doctor of Philosophy

ECONOMIC FREEDOM, INCOME INEQUALITY AND ECONOMIC GROWTH IN DEVELOPING COUNTRIES

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June 2014

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Faculty : Economics and Management

The importance of economic freedom and income inequality on economic growth has been extensively investigated. Income inequality itself is a problem that needs to be addressed. Yet, the dilemma whether economic freedom and income inequality actually help to explain the corresponding differences in across countries economic growth rates are still in debate. Thus, the aims of this study are to examine the link between income inequality and economic growth, to determine the effect of economic freedom on economic growth and to analyse the impact of economic freedom on income inequality.

In this study, two data sets are utilized corresponding to two economic freedom data sources. In the case where the economic freedom data set is obtained from Fraser Institute's economic freedom 2012, the number of developing countries is 65 countries over the period 1976-2010. In the case where the economic freedom data set is gathered from Heritage Foundation's economic freedom 2012, the same sample countries are employed but the sample periods are from 1996-2010 since the first report started in 1995. Besides, the economic freedom, income inequality and economic growth data, data on institutions, investment, population, human capital and inflation are added in determining variation in economic growth. All the data are analysed using a dynamic system panel GMM estimation technique.

Several important findings are drawn from the study. First, the finding indicates that income inequality has a negative effect on economic growth. Policy makers need to reduce income inequality either through government spending, human capital or through minimum wage policy. Second, economic freedom and institutions variables affect economic growth positively. The sub-indicators of Fraser Institute of economic freedom namely, legal system and property rights, freedom to trade internationally, sound money, and regulation are found to have a positive effect on economic growth. The sub-indicators

of Heritage Foundation of economic freedom namely, monetary freedom and trade freedom are found to have a positive effect on economic growth whereas government spending, property rights, and business freedom are found to have a negative effect on economic growth. Since not all economic freedom sub-indicators contribute to the positive link, it is good for the policy makers to just concentrate on positive sub-indicators. Finally, this study found that economic freedom affects income inequality positively. An increase in economic freedom makes income inequality worsen. Size of government, legal system and property rights, and freedom to trade internationally contribute to the positive relationship between economic freedom and income inequality. Hence, taking into consideration the influence of economic freedom on economic growth, and income inequality, policy makers need to just focus on sound money, and regulation.

An increase in economic growth and income equality has been the centre of economic policymaking in many countries around the globe. As such, the issues presented in this study would serve as important guidelines to understand the influence of the economic variables on economic growth and income equality.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia
sebagaimemenuhikeperluanuntukijazahDoktorFalsafah

**KEBEBASAN EKONOMI, KETIDAKSAMAAN PENDAPATAN DAN
PERTUMBUHAN EKONOMI DI NEGARA-NEGARA MEMBANGUN**

Oleh

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Kepentingan kebebasan ekonomi dan ketidaksamaan pendapatan ke atas pertumbuhan ekonomi telah di kaji secara meluas. Ketidaksamaan pendapatan itu sendiri adalah satu masalah yang perlu ditangani. Namun, dilemma samaada kepentingan kebebasan ekonomi dan ketidaksamaan pendapatan benar-benar membantu untuk menjelaskan perbezaan kadar pertumbuhan ekonomi di seluruh negara masih diperdebatkan. Oleh itu, matlamat kajian ini adalah untuk mengkaji hubungan antara ketidaksamaan pendapatan dan pertumbuhan ekonomi, untuk menentukan kesan kebebasan ekonomi ke atas pertumbuhan ekonomi dan untuk menganalisa kesan kebebasan ekonomi ke atas ketidaksamaan pendapatan.

Kajian ini telah menggunakan dua kumpulan data yang merangkumi dua sumber data kebebasan ekonomi. Kumpulan data pertama merangkumi kebebasan ekonomi dari Institut Fraser yang terdiri dari 65 buah negara membangun, dari tahun 1976-2010. Data negara yang sama di pilih untuk kumpulan data kedua yang merangkumi kebebasan ekonomi dari Yayasan Heritage, tetapi dari tahun 1996-2010 oleh kerana laporan pertama hanya bermula pada tahun 1995. Pemboleh ubah kawalan yang telah dimasukkan ke dalam model dalam menentukan perubahan dalam pertumbuhan ekonomi ialah institusi, pelaburan, jumlah penduduk, sumber manusia, dan inflasi. Kesemua data telah di analisa dengan menggunakan panel teknik anggaran sistem dinamik GMM.

Kajian telah menghasilkan beberapa penemuan penting. Pertama, kajian ini telah mendapati bahawa ketidakseimbangan pendapatan mempunyai kesan negatif ke atas pertumbuhan ekonomi. Pembuat dasar perlu mengurangkan ketidakseimbangan pendapatan sama ada menerusi perbelanjaan kerajaan, pelaburan sumber manusia, atau melalui dasar gaji minimum. Kedua, kebebasan ekonomi dan institusi mempunyai kesan

positif ke atas pertumbuhan ekonomi. Sub-petunjuk kebebasan ekonomi Institut Fraser iaitu sistem undang-undang dan hak kepunyaan harta, kebebasan perdagangan antarabangsa, kekukuhan kewangan, dan undang-undang adalah penyumbang kepada hubungan positif di antara kebebasan ekonomi dan pertumbuhan ekonomi. Sub-petunjuk kebebasan ekonomi Yayasan Heritage iaitu kebebasan kewangan dan kebebasan perdagangan adalah penyumbang kepada hubungan positif di antara kebebasan ekonomi dan pertumbuhan ekonomi manakala, perbelanjaan kerajaan, hak kepunyaan harta dan kebebasan perniagaan telah didapati mempunyai kesan yang negative terhadap pertumbuhan ekonomi. Oleh kerana tidak semua sub-petunjuk kebebasan ekonomi menyumbang kepada hubungan positif, adalah lebih baik bagi pembuat dasar untuk hanya menumpukan perhatian kepada sub-petunjuk positif. Akhir sekali, kajian ini mendapati bahawa kebebasan ekonomi mempunyai kesan positif ke atas ketidakseimbangan pendapatan. Peningkatan kebebasan ekonomi akan memburukkan lagi ketidakseimbangan pendapatan. Perbelanjaan kerajaan, sistem undang-undang dan hak kepunyaan harta dan kebebasan perdagangan antarabangsa adalah penyumbang kepada hubungan positif di antara kebebasan ekonomi dan ketidakseimbangan pendapatan. Oleh itu, mengambil kira pengaruh kebebasan ekonomi pada pertumbuhan ekonomi dan ketidakseimbangan pendapatan, pembuat dasar perlu hanya menumpukan kepada sub-petunjuk kekukuhan kewangan, dan undang-undang.

Peningkatan pertumbuhan ekonomi dan keseimbangan pendapatan telah menjadi dasar ekonomi di kebanyakan negara di seluruh dunia. Oleh itu, isu-isu yang dibentangkan dalam kajian ini akan bertindak sebagai garis panduan penting untuk memahami pengaruh pembolehubah ekonomi dalam meningkatkan pertumbuhan ekonomi dan keseimbangan pendapatan.

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I certify that a Thesis Examination Committee has met on 26 June 2014 to conduct the final examination of Norhazlin binti Ismail on her thesis entitled "Economic Freedom, Income Inequality and Economic Growth in Developing Countries" in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the Doctor of Philosophy.

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Declaration by Graduate Student

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