

THE IMPACT OF POLITICAL INSTITUTIONS ON ECONOMIC GROWTH IN POST-TRANSITION EUROPE

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ABSTRACT

Purpose The significance of political institutions in promoting economic growth is well acknowledged within institutional economics; however, empirical results often display considerable variation, especially in European post-transition economies. As noted by North (1990) and Acemoglu and Robinson (2012), institutions influence incentives, mitigate uncertainty, and dictate the efficiency of resource allocation. Nonetheless, evidence from transition countries indicates that the relationship between political institutions and economic outcomes is contingent upon specific contextual factors.

Earlier studies have yielded mixed results regarding the relationship between economic and political freedoms. Piątek *et al.* (2013) found that economic freedom fosters growth in transition countries, while political freedom appears to have a neutral effect, suggesting that political reforms may lag behind market liberalisation. In contrast, Uzelac *et al.* (2020) and Bayar (2016) demonstrate that democracy, political stability, and the quality of governance, particularly in controlling corruption and upholding the rule of law, positively influence economic performance in Central and Eastern Europe. Alexiou *et al.* (2020) report similar long-term advantages associated with institutional quality, indicating that voice and accountability can enhance growth once the institutional framework becomes stable. Additionally, Tamulina and Tamulina (2014) contend that the growth of post-communist countries relies more on the maturity of political institutions than on their economic counterparts, emphasising the significance of institutional evolution over formal design. Conversely, some scholars, including Hodgson (2006) and Bonnal and Yaya (2015), note that democracy can have neutral or even adverse short-term effects, particularly in fragmented or unstable institutional environments.

In this context, the current study aims to contribute to the ongoing debate by empirically re-evaluating the impact of political institutions, assessed through the Freedom House Index (which measures political rights and civil liberties) (Freedom House, 2024) and the Polity IV Index from the Center for Systemic Peace (which evaluates executive constraints and participation) (Marshall *et al.*, 2019), on economic growth in thirteen European post-transition economies from 1996 to 2019. This paper offers updated, dynamic empirical evidence that

resolves long-standing inconsistencies in the literature on institutions and growth in post-transition Europe. The topic remains highly relevant, as political and institutional reforms continue to influence the region's prospects for convergence, resilience, and long-term development. Building on prior research, this paper utilises a system generalised method of moments (system GMM) to explore the relationship between political institutions and economic growth.

The aim of this study is to assess whether advancements in political institutions, characterised by increased democratic participation, improved accountability, and reinforced constraints on executive power, result in higher GDP per capita growth in post-transition Europe. Consequently, the primary hypothesis examined is: Political institutions that promote greater transparency, participation, and checks on executive authority have a positive, statistically significant effect on economic growth in European post-transition economies.

Design/methodology/approach The empirical analysis utilises a dynamic panel-data framework, focusing on thirteen European post-transition economies¹ over the period from 1996 to 2019. To address potential endogeneity, the study employs the system GMM estimator developed by Arellano and Bover (1995) and by Blundell and Bond (1998). This methodology facilitates consistent estimation in dynamic contexts where the lagged dependent variable is included as a regressor and the number of time periods is relatively limited compared to the cross-sectional units.

The dependent variable in this analysis is GDP per capita growth, while the primary explanatory variables are political-institutional indicators. These include the Freedom House Index, which assesses political rights and civil liberties (Freedom House, 2024), and the Polity IV Index from the Centre for Systemic Peace, which evaluates executive constraints, political participation, and regime durability (Marshall *et al.*, 2019). Additionally, control variables include the logarithm of GDP per capita in purchasing power parity (PPP), gross fixed capital formation (GFCF) as a measure of physical capital, human capital and population growth.

Before conducting the main regression analysis, the study examines partial correlations between GDP per capita growth and the two institutional indicators, while controlling for all other growth determinants. This approach aims to isolate the relationship between political institutions and economic performance, independent of structural and macroeconomic influences. The validity of the instruments and the absence of serial correlation are assessed using standard diagnostic tests.

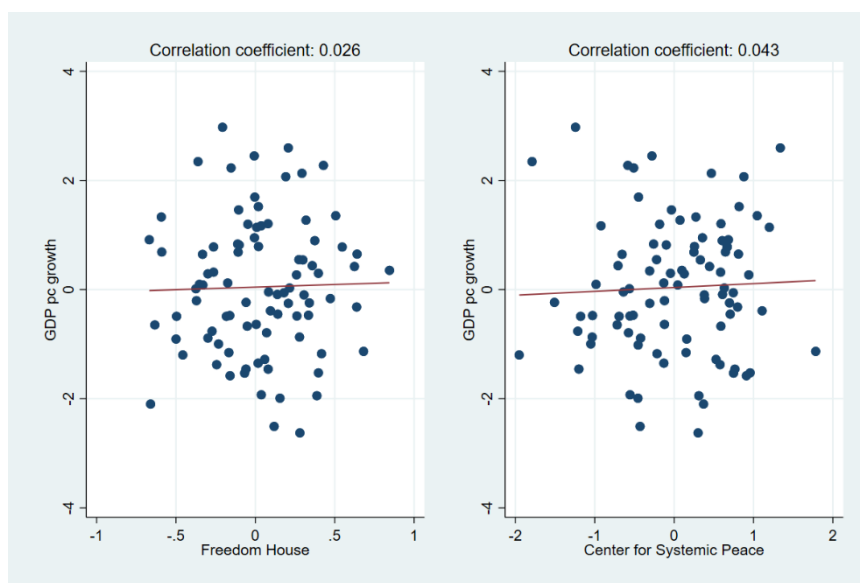
Findings When accounting for the influences of various macroeconomic variables, including initial income, gross fixed capital formation, human capital, and population growth, the partial correlations between GDP per capita growth and the two institutional indicators remain positive, though modest in magnitude. This pattern suggests that enhancements in political rights, civil liberties, and executive constraints are consistently associated with higher growth, provided that structural and demographic factors are controlled for.

The system GMM estimation reinforces these associations, demonstrating that political institutions have a positive and statistically significant impact on economic growth. The coefficient for the Freedom House Index is 0.421 ($p < 0.05$), while the Polity IV Index from

¹ Albania, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, North Macedonia, Poland, Romania, Serbia, the Slovak Republic and Slovenia.

the Center for Systemic Peace shows an even stronger and highly significant effect of 0.446 ($p < 0.01$). Diagnostic tests validate the robustness of the model, with results indicating AR(1) $p = 0.006$; AR(2) $p \approx 0.48$; and Sargan $p \approx 0.45$. These findings support the validity of the instruments used and confirm the absence of higher-order serial correlation. The lagged GDP per capita term is negative and significant, indicating conditional convergence, whereas human capital demonstrates a substantial positive contribution to growth. Conversely, population growth has a negative effect, and gross fixed capital formation has a negative, significant coefficient, suggesting capital inefficiencies. This aligns with the argument that institutional weaknesses can impede the efficient allocation of investment resources.

Figure 1: Scatter charts of the partial correlation



(Source: Authors' calculations.)

Table 1: Regression results

Variable	Dependent variable: GDP per capita growth	
	Model 1	Model 2
GDP per capita growth (L1)	0.191 (0.119)	0.169 (0.110)
Logarithm of GDP per capita PPP (L1)	-2.468** (0.972)	-2.863*** (0.555)
Gross fixed capital formation (L1)	-0.136*** (0.0355)	-0.122*** (0.0414)
Human capital (L1)	3.029** (1.410)	3.717*** (1.161)
Population growth (L1)	-1.690*** (0.321)	-1.777*** (0.383)
Freedom House (L1)	0.421** (0.182)	
Center for Systemic Peace (L1)		0.446*** (0.143)
Constant	16.44** (6.857)	16.46*** (4.289)
Observations	91	91
Number of groups	13	13

AR(1) p-value	0.00678	0.00619
AR(2) p-value	0.478	0.494
Sargan test p-value	0.500	0.434
Fixed effects in periods	✓	✓

(Source: Authors' calculations)

These findings underscore the significance of political institutions as a crucial factor influencing economic performance in post-transition Europe. They build upon and refine previous empirical results. While Piątek *et al.* (2013) suggested that political freedom was largely neutral for growth when economic freedom was accounted for, our analysis reveals that, through dynamic estimation and appropriate controls, political institutions emerge as a significant catalyst for growth. The pronounced positive impacts of Freedom House and Polity IV align with the conclusions of Uzelac *et al.* (2020) and Bayar (2016), who identified that democracy, political stability, and the control of corruption substantially affect GDP growth in Central and Eastern Europe. Additionally, the long-term positive correlation between institutional quality and growth, as established by Alexiou *et al.* (2020), is reinforced here, particularly with respect to voice, accountability, and the rule of law.

Furthermore, our findings support the theoretical framework proposed by Tamilina and Tamilina (2014), which posits that growth in post-communist economies is more reliant on the maturity and functionality of political institutions than on economic factors. Our evidence reinforces this assertion by showing that, when controlling for endogeneity and persistence, the democratic aspects of institutional quality, such as participation, transparency, and executive accountability, emerge as statistically significant predictors of growth. In contrast to the conclusions drawn by Bonnal and Yaya (2015), who found no meaningful impact of political institutions on global growth rates, our study reveals that, within the specific institutional context of post-transition Europe, these effects are demonstrably positive. Additionally, our results provide a counterargument to Hodgson (2006), who identified a negative relationship between democracy and growth in institutionally fragile settings. The period and countries included in our analysis represent a more consolidated stage of institutional development, which likely alleviated those adverse dynamics.

The combination of positive partial correlations and robust system GMM coefficients provides compelling empirical support for the hypothesis that well-functioning political institutions—marked by democratic accountability, civil liberties, and practical constraints on executive power, facilitate sustainable economic growth in European post-transition economies. This aligns with the theoretical insights of North (1990) and Acemoglu *et al.* (2005), who argue that inclusive political institutions foster credible expectations, enhance governance, and cultivate an environment conducive to long-term development.

These findings carry significant implications for policymakers in post-transition Europe. The demonstrated positive influence of political rights, civil liberties, and executive constraints on economic growth underscores the necessity of continued progress in democratic consolidation and institutional strengthening to sustain development. Reform initiatives should prioritise enhancing judicial independence, ensuring transparent electoral processes, strengthening anti-corruption mechanisms, and promoting broader civic participation. Such measures not only enhance the quality of governance but also cultivate a predictable and trustworthy environment that encourages investment, supports efficient resource allocation, and mitigates the economic costs associated with institutional uncertainty. By reinforcing the maturity and effectiveness of

political institutions, post-transition economies can expedite their convergence with more established democracies and secure more resilient long-term growth trajectories.

While the findings of this study are robust, several limitations should be noted. Due to data constraints, not all post-transition European countries could be included, which may affect the generalizability of the results. Additionally, the analysis is based on two institutional indicators; broader, composite measures might capture additional dimensions of political institutions. Although the empirical strategy employed addresses key endogeneity concerns, alternative methodological approaches could be considered in future studies to further validate and refine the results. Future research could also broaden the range of countries examined and investigate whether different institutional dimensions influence growth through distinct channels.

Originality/value This study presents new empirical evidence regarding the relationship between political institutions and economic growth in European post-transition economies, with a specific focus on the quality of democracy, levels of participation, and executive constraints. This approach contrasts with the more commonly analysed factors, such as economic freedom or corruption. The findings indicate that political institutions, as measured by the Freedom House and Polity IV indices, have a positive and significant long-term effect on GDP per capita growth. This underscores the importance of institutional consolidation and democratic accountability as critical drivers of development in the post-transition phase.

The paper contributes originality by reconciling the mixed evidence from previous studies. While Piątek *et al.* (2013) found that political freedom has a neutral impact on growth, and Bonnal and Yaya (2015) indicated a lack of a systematic global relationship, this study demonstrates that, with appropriate dynamic specification, inclusive political institutions actually enhance growth. This supports the assertions of Tamilina and Tamilina (2014) and North (1990) that mature political systems promote credible governance and sustained development. The findings underscore that deepening democracy and reinforcing checks on power are not just political milestones, but essential economic imperatives for achieving long-term growth and convergence in post-transition Europe.

Keywords: *Political institutions, Economic growth, European post-transition countries, System GMM*

JEL classification: *O11, O43, P20*

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