Determinants of Business Freedom in Developing Countries: The Role of Institutional Development and Policy Mix

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Abstract
Smooth and stable commercial/business activities are the prime concern of every nation, as these activities decide the developmental routes of the economy. This study has examined the role of institutional development and policy mix in determining business freedom in developing countries. Institutional development has been measured with the help of government effectiveness and political stability. Policy mix have been measured with the help of monetary freedom and fiscal freedom. To examine the impact of explanatory variables on the explained variable, this study has used panel least squares, random effect model, and generalized method of moments. The estimated results show that fiscal freedom has a negative and significant impact on business freedom, whereas, monetary freedom has an insignificant impact on business freedom in the case of developing countries. The results show that government effectiveness, political stability, and tread freedom are encouraging business freedom in developing countries. The corporate tax has a negative and significant impact on business freedom. Empirical show that developing countries are more inclined towards non-developmental expenditures, thus to control the negative impacts of fiscal freedom developing countries needs rationalization in government expenditures. Developing countries should promote government effectiveness, political stability, and trade freedom to enhance business freedom. To control the negative impacts of corporate taxes, developing countries should rationalize tax policies to promote business freedom.
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1. Introduction
Simply, business freedom refers to the liberty of each person to control the benefits of her/his labor initiative (Miller and Kim, 2013). Specifically, business freedom is a fundamental right that allows individuals to exercise their economic and personal autonomy. It provides a platform for people to pursue their passion, explore their entrepreneurial spirit, and take risks in pursuit of their dreams. This concept also ensures that everyone has equal access to economic opportunities, regardless of their background or social status. By enabling individuals to control the benefits of their labor, business freedom fosters innovation, drives economic growth, and improves the standard of living for society as a whole (Dale and Hyslop-Margison, 2010). In a business-based free economy, every individual succeeds or fails based on effort and ability (Storper and Venables, 2004; Audi and Ali, 2023; Hasan and Sadat, 2023).
Business freedom describes to all economic activities that generate benefits for individuals or firms through their labor initiatives. These economic activities are directly or indirectly affected by the

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approvals required to conduct business, which may come from local, national, or international authorities (Ng and Loosemore, 2007; Ali, 2022; Ali and Audi, 2023). To attain socioeconomic goals, it is very vital to set roots for a free business environment in an economy (Arenas et al., 2021; Audi and Ali, 2023). It is business freedom that decides the level of domestic and foreign investment in the economy (Goel, 2018; Audi et al., 2022; Namadi, 2023).

In a free business environment, the power of economic decision-making is largely dispersed, and the allocation of resources for production and consumption is based on free and open competition so that every individual or firm has a fair chance to succeed. Thus, the fundamental principle of business freedom is to empower the individual against discrimination and imperfect competition. Although the concept of business freedom is not a new one and has its roots before the colonization by the French and British. But actually, it got much more important in the mid-1990s, when Gwartney et al., (1999) developed an index of economic freedom. Presently, scholars around the world consider business freedom an important determinant of socio-economic development. (Dawson, 1998; Gwartney et al., 2008; Abigail, 2023).

Business freedom established the relationship between individual and state, and how the state or government-controlled, interferes with and limits economic activities. The proponents of business freedom prefer the absence of government coercion or constraint, but to maintain a sense of liberty for all (Ustaoglu & Yildiz, 2023; Skinner, 2008). The individuals can enjoy the blessings of business freedom, in return, they have a responsibility to respect the economic rights and freedoms of others. Heritage Foundation describes that "Business freedom is a quantitative measure of the ability to start, operate, and close a business that represents the overall burden of regulation as well as the efficiency of government in the regulatory process". Governments are instituted to establish necessary safeties against the ravages of nature or the predations of one citizen over another so that positive economic rights such as property and contracts are given societal as well as individual defense against the destructive tendencies of others. Thus, some of the actions of the governments are necessary for the citizens of a nation to defend themselves, promote the peaceful evolution of civil society, and enjoy the fruits of their labor.

Business freedom is a critical factor that impacts the success of businesses, regardless of whether they are operating in a developed or developing country. It is a comprehensive measure of the ease with which businesses can be established, operated, and terminated. Several factors, including human capital, domestic investment, political stability, and economic growth, can significantly influence business freedom. Although it is indisputable that various inputs affect the outputs of business freedom, it is important to note that the complete availability of these inputs does not always guarantee business freedom. Over the past decade, we have witnessed significant changes in institutions and policies that have had a profound impact on business freedom (Dawson, 2003). Most social scientists (Ali and Crain, 2002; De Haan and Siermann, 1998; Heckelman and Stroup, 2000; Nudzor, 2023; Sayvaya and Phommason, 2023) are agreed that business freedom has an intrinsic value in enhancing the socio-economic development. Sen (1999) mentions that every society faces a trade-off between adopting those institutions that preserve the innate freedoms exercised by individuals to enhance their well-being and adopting those institutions that partially constrain these innate freedoms to produce opportunities for all individuals to enhance their well-being by exercising newly created freedoms. But, Tullock (1967) describes the potential for rent-seeking activity by democratic governments in the design and implementation of public policy, benefiting only a few in society at the expense of the many. Ultimately, some democratically determined policies tend to predominantly create opportunities for the benefit of the many in society while other such policies predominantly provide benefits for only a few. So, it is very

necessary to study the determinants of business freedom. The study in hand examines the impact of institutional development and policy mix on business freedom in the case of developing countries. This will open a new venture of knowledge and will be a healthy contribution to the respective literature.

2. Review of Literature

This part of the study is comprised of a literature review, the most relevant and recent studies have been selected for literature review. The ultimate objective of every economy is overall economic development, a statement tested by almost every economist and financial analyst (Haller, 2012; Kirchherr et al., 2017; Munir et al., 2024). However, all types of development, such as social, economic, and financial are linked to real economic activities (Barbier, 1987). These activities are directly or indirectly impacted by local, national, and sometimes international authorities' permissions to conduct business. Setting up a free business environment is crucial to achieving socioeconomic targets of the economy (Arenas et al., 2021; Xiong, 2024). Countries with restricted business environments face more significant challenges in continuing or competing with freer countries (Piatkowski, 2018). Business freedom provides a better environment for domestic and foreign investment (Goel, 2018; Cizakca, 2024). Overall, business freedom is a critical component of economic growth and development. Countries that promote a favorable environment for business activity are more likely to attract investment, create jobs, and drive innovation. As such, efforts to improve business freedom should be a priority for policymakers and international organizations seeking to promote economic development and reduce poverty. Thus, to study business freedom is equally important for financial and real sector activities.

Aggregate economic growth is attached to overall economic activities, these activities are linked to the permission of doing business which is simply known as business freedom (Dawson, 2003; De Haan and Siermann, 1998; Mueller, 2003; Karim & Said, 2024). Bounded countries have to face more back-breaking to continue or compete with freer countries (Craig, 2015). There must be a specific level of business freedom to meet the required socio-economic development. Numerous studies (Lawson et al., 2020; Alley and Melichar, 2021) have provided the details of the causes of business freedom, but none of the studies has examined the impact of institutional development and policy mixed on business freedom in the case of developing countries. Moreover, previous studies (Ali and Crain, 2002; Dawson, 2003; Norton, 1998; Goldsmith, 1995; Senturk and Ali, 2022; Ali, 2022) have used business freedom as the determinant of economic growth, economic and financial integration, and human wellbeing, neither study has tried to examine the determinants of business freedom.

Institutional development is a critical determinant of business freedom in a country. The quality of institutions, such as the rule of law, property rights protection, and ease of doing business, affects the business environment. Countries with better institutional development tend to have higher scores in business freedom, while those with poor institutional development have lower scores. For example, Singapore, New Zealand, and Australia, which have well-established institutional frameworks, rank among the top countries in business freedom. In contrast, countries like Venezuela and North Korea, with poor institutional development, have low scores in business freedom (Heritage Foundation, 2021). Therefore, institutional development is a vital factor that affects the level of business freedom in a country, and policymakers should focus on improving the quality of institutions to promote a more conducive business environment.

There exist two categories of studies that investigate the relationship between business freedom and socioeconomic and financial indicators. The first category examines the impact of foreign aid

and membership in intergovernmental organizations, such as the European Union (EU). The Washington Consensus and the Millennium Development Goals aimed to bring developing countries to the institutional forefront by implementing a range of liberalizations. The impact of membership in such organizations, as well as receiving foreign aid subject to reforms, on the institutional environment, is reflected in the literature on development. Burnside and Dollar (2000) contended that the correlation between aid and growth depends on sound policy, whereas Easterly et al., (2004) discovered the findings to be delicate. Moreover, these outcomes also address the question of whether aid harms institutional quality generally (Berger et al., 2013). The research on intergovernmental organizations, foreign aid, and economic freedom examines these concerns and produces outcomes that are pertinent to the ongoing public debates on the consequences of globalization.

The second set of studies evaluates the consequences of crises, which include financial crises, wars, and adverse macroeconomic shocks. Crises can also have profound effects on social attitudes and norms. In the wake of the COVID-19 pandemic, for example, many countries have witnessed a significant shift towards more authoritarian governance and a tightening of civil liberties (Knutsen, 2021). This is not a new phenomenon; crises have historically been used as justification for curtailing individual rights and freedoms, whether during wartime or in response to perceived threats to national security (Kurlantzick, 2007; Ali, 2022). However, crises can also provide opportunities for progressive change. The global financial crisis of 2008, for instance, led to increased regulation of the financial sector and renewed interest in alternative economic models (Stiglitz, 2010). Similarly, the civil rights movement in the United States gained momentum in the wake of the crisis of the 1960s, which exposed the deep-seated racial inequalities in American society. In addition to their impact on institutions and norms, crises can also have significant economic consequences. For example, the oil crisis of the 1970s led to stagflation in many Western countries, characterized by high unemployment and inflation (Bordo and James, 2010). More recently, the global COVID-19 pandemic has caused widespread economic disruption, with many businesses closing permanently and millions of people losing their jobs (Baker et al. 2020). Overall, while the effects of crises on the institutional environment and broader society are complex and multifaceted, it is clear that they can have far-reaching and long-lasting consequences. Understanding these effects is crucial for policymakers seeking to mitigate the negative impacts of crises and build a more resilient and equitable society.

One of the hypotheses is considered most closely to the relationship between political institutions, rules, freedoms, and economic freedom. Formal political institutions, particularly democracy, have been the subject of many papers. While some research has focused on democracy measures, others have investigated specific elements of democratic systems, such as proportional representation or checks and balances. The notion of using democratic political institutions to protect liberty and prevent tyranny dates back to Montesquieu and contemporary liberalism (Ellerman, 2015), is applied in rational choice theory to the study of political institutions (Buchanan, 1975), and is discussed in recent literature on the significance of "inclusive" institutions (Acemoglu and Robinson 2012). Nonetheless, other scholars have proposed that rule by experts (Brennan 2016) or appropriate incentivization of autocrats (Salter 2016) could result in greater liberty.

Additionally, the interplay between civil liberties and economic freedom has also been the focus of much research. Some scholars argue that civil liberties, such as freedom of speech, are essential for a free society and can contribute to economic freedom (Lukianoff and Haidt 2018). Others suggest that there is a conceptual overlap between free political institutions and free economic institutions, with the rule of law being a core component of economic freedom (Rothbard, 1982).

However, while there may be some overlap, various aspects of political institutions, such as democratic procedures or constitutional rules, are not considered economic institutions or economic freedom. Moreover, recent literature has explored the role of culture in shaping economic freedom. Some studies have focused on the effects of deeply rooted aspects of culture, such as the length of time an ethnic group has had experience with formal states, on economic freedom (Putterman and Weil 2010). Meanwhile, other research has looked into the relationship between inequality and economic freedom, with some arguing that concentrations of economic power can lead to the corruption of democracy and subsequent decreases or increases in economic freedom (Bartels, 2008). General reviews of institutions and inequality can be found in Chong and Calderon (2000).

Lastly, crises can also have significant impacts on economic freedom and institutional modifications. While some scholars argue that crises provide a rationale for market-oriented reforms that promote economic freedom, others suggest that economic crises are the primary cause of government intervention and regulations (Klein, 2007). Furthermore, weak macroeconomic performance has been theorized to drive voters to make poor choices in elections, and foreign intervention can have unintended consequences for both the aggressor and the invaded (Coyne and Hall, 2018). Overall, there are many factors and theoretical frameworks to consider when examining the relationship between political institutions, civil liberties, culture, crises, and economic freedom.

A related hypothesis, which is separated from the question of democracy, concerns the effects of civil liberties and other human rights on economic freedom. Less theoretical or narrative evidence has been presented for this narrow question than regarding democracy, although there remains a significant overlap with the inclusiveness of institutions (Acemoglu and Robinson, 2012). Other theoretical foundations for considering the effects of civil liberties include that such findings may reflect the general necessity of, for example, free speech for a generally free society (Lukianoff and Haidt 2018). Sen's (1999) idea of Development as Freedom may offer an alternative basis for this literature, although, to the authors' knowledge, none of the literature chooses to make this connection. There is, however, some degree of conceptual overlap between free political institutions and free economic institutions. For instance, while the authors believe that the rule of law is properly understood as an economic institution, others may plausibly argue it to be, a legal institution, under the purview of political institutions. Others may associate various human rights like freedom of speech with property rights (e.g., Rothbard, 1982), and property rights are a core component of economic freedom. On the other hand, various aspects of political institutions, such as democratic procedures or constitutional rules, are neither economic institutions nor economic freedom.

One such literature stream has focused on the role of religion in shaping economic institutions and economic outcomes. For example, the Weberian thesis proposes that Protestantism fostered the rise of capitalism and modern economic institutions. In contrast, other research has focused on the impact of Islam on economic development, with some scholars suggesting that the Islamic legal system supports the development of market-oriented economic institutions (Rashid and Islam 2015). Additionally, the impact of culture on the rule of law has been examined, with some scholars suggesting that cultural norms of trust and social capital are critical to the successful implementation of the rule of law (La Porta et al., 1999). Other research has examined the impact of cultural dimensions such as individualism, uncertainty avoidance, and power distance on economic freedom (Hofstede, 1984). Overall, these studies highlight the important role of culture in shaping economic institutions and outcomes.

Moreover, other factors may influence economic freedom. For instance, some scholars argue that international trade plays a critical role in determining a country's economic freedom. The potential benefits of international trade include access to new markets, increased competition, and lower prices for consumers. However, trade policies may also create economic distortions and can negatively impact economic freedom if they are not designed carefully (Irwin, 2002). Another factor that can influence economic freedom is the level of corruption within a country. Corruption can undermine economic growth by distorting market incentives, reducing investment, and increasing the cost of doing business (Mauro, 1995). Additionally, there is evidence that suggests that the legal system can also have a significant impact on economic freedom, as a strong and reliable legal system can help enforce contracts, protect property rights, and promote investment (La Porta et al. 1997).

Numerous studies explore the relationships between democracy, economic freedom, political instability, economic growth, and income inequality. The studies by March et al. (2017), Heckelman and Knack (2009), and Powell and Ryan (2006) investigate the impact of aid on economic freedom with mixed results. Bollen (1979) finds no significant relationship between political democracy and development timing but suggests that international diffusion can provide pressure on developing countries to adopt democratic forms of government. Several other studies (Goldsmith, 1995; Ali and Crain, 2002; Dawson, 2003; Mueller, 2003; Cebula and Mixon, 2012) have investigated the relationship between economic freedom and various factors such as human capital, GDP, productivity, foreign direct investment, and economic growth. But still, there is hardly any study that examines the impact of institutional development and policy mix in determining business freedom in developing countries.

3. Empirical Methodology

Business freedom has been widely used as a measure of a country's economic environment, as it encompasses various policies that can help control economic shocks and limit individual responses to them. These policies include corruption, property rights, rule of law, entry constraints, privatization, and monetary policy, and have been extensively studied in the literature. For example, research has found that corruption hurts economic growth and development (Murphy et al. 1991; Bardhan, 2005), while strong property rights and contract enforcement are associated with higher levels of investment and economic growth (Acemoglu et al. 2012; Bardhan, 2005; Ali and Zulfiqar, 2018).

Similarly, studies have shown that entry constraints and state-owned enterprises can hinder economic growth and development (Djankov et al. 2008), while sound monetary policy is essential for macroeconomic stability. However, these policies are not independent of each other and tend to work in conjunction to create a more enabling economic environment. Therefore, to obtain a comprehensive measure of economic freedom, it is necessary to consider a larger set of policies rather than just a few (Clark and Lawson, 2014).

The institutional theory posits that organizations are not solely influenced by economic factors but also by social, cultural, and political forces that shape the institutional environment in which they operate (Meyer and Rowan, 1977). This theory argues that organizations conform to the expectations of their institutional environment, rather than solely pursuing economic rationality. Institutional theory has gained significant attention in recent years as it offers a framework for analyzing how organizations adapt to their external environment. Institutional theory has been used to explain a wide range of organizational phenomena, including organizational change, diffusion of innovations, and the adoption of sustainable practices (Thoenig, 2012). For example,

scholars have used institutional theory to explain why organizations adopt sustainable practices, suggesting that they do so in response to normative pressures from stakeholders and legitimacy concerns. Following the methodologies (Von Mises, 1990; Goldsmith, 1995; Norton, 1998; Ali and Crain, 2002; Dawson, 2003; Arora and Vamvakidis, 2006; Cebula and Mixon, 2012; Kenworthy, 2014; Imtiaz and Bashir, 2017; Goel, 2018; Piatkowski, 2018; Bukowski and Novokmet, 2021; Audi and Ali, 2024), the functional form of the model becomes as:

$BF_{it}=f(FF_{it}, MF_{it}, GOVT_{it}, POL_{it}, TRAD_{it}, CT_{it})$ (1)

BF= Business Freedom
FF= Fiscal Freedom
MF= Monetary Freedom
GOVT= Government Effectiveness
POL= Political Stability
TRADE= Trade Freedom
CT= Corporate Taxes
i= Set of selected countries (1,..,82)
t= Selected time period (2013-2021)

For examining the relationship between the explanatory variables and explained variables, the mathematical model can be converted into the econometric model. The model can be written as:

$BF_{it} = \alpha + \beta_1(FF_{it} + \beta_2 MF_{it} + \beta_3 GOVT_{it} + \beta_4 POL_{it} + \beta_5 TRAD_{it} + \beta_6 CT_{it} + \mu_1$ (2)

where
α = intercept
β_i = slope coefficient
μ = white noise error term

3.1. Definitions and Measurements for the Variables

BF= Business Freedom (an index measured by Starting a business—procedures (number); Starting a business—time (days); Starting a business—cost (% of income per capita); Starting a business—minimum capital (% of income per capita); Obtaining a license—procedures (number); Obtaining a license—time (days); Obtaining a license—cost (% of income per capita); Closing a business—time (years); Closing a business—cost (% of estate); and Closing a business—recovery rate (cents on the dollar)

FF= Fiscal freedom scores are calculated with a quadratic cost function to reflect the diminishing revenue returns from very high rates of taxation. The data for each factor are converted to a 100-point scale using the following equation:

$\text{Fiscal Freedom}_{ij} = 100 - \alpha (\text{Factor}_{ij})^2$

where $\text{Fiscal Freedom}_{ij}$ represents the fiscal freedom in country *i* for factor *j*; Factor_{ij} represents the value (based on a scale of 0 to 100) in country *i* for factor *j*; and α is a coefficient set equal to 0.03. The minimum score for each factor is zero, which is not represented in the printed equation but was utilized because it means that no single high corporate tax will make the other two factors irrelevant.

MF= Monetary freedom combines a measure of price stability with an assessment of price controls. Both inflation and price controls distort market activity. Price stability without microeconomic intervention is the ideal state for the free market. The score for the monetary freedom component is based on two factors:

- The weighted average inflation rate for the most recent three years and
- Price controls.

The weighted average inflation rate for the most recent three years serves as the primary input into an equation that generates the base score for monetary freedom. The extent of price controls is then assessed as a penalty of up to 20 points subtracted from the base score. The two equations used to convert inflation rates into the monetary freedom score are:

Weighted Avg. $\text{Inflation}_i = \theta_1 \text{Inflation}_{it} + \theta_2 \text{Inflation}_{it-1} + \theta_3 \text{Inflation}_{it-2}$

Monetary $\text{Freedom}_i = 100 - \alpha \sqrt{\text{Weighted Avg. Inflation}_i} - \text{PC penalty}_i$

where θ_1 through θ_3 (thetas 1–3) represent three numbers that sum to 1 and are exponentially smaller in sequence (in this case, values of 0.665, 0.245, and 0.090, respectively); Inflation_{it} is the absolute value of the annual inflation rate in country *i* during year *t* as measured by the consumer price index; α represents a coefficient that stabilizes the variance of scores; and the price control (PC) penalty is an assigned value of 0–20 points based on the extent of price controls.

GOVT= Government Effectiveness: Percentile Rank, according to officially-recognized international sources compiled by the World Bank. Government Effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Percentile rank indicates the country's rank among all countries covered by the aggregate indicator, with 0 corresponding to the lowest rank, and 100 to the highest rank.

POL= Political Stability and Absence of Violence/Terrorism measures perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism. Percentile rank indicates the country's rank among all countries covered by the aggregate indicator, with 0 corresponding to the lowest rank, and 100 to the highest rank. Percentile ranks have been adjusted to correct for changes over time in the composition of the countries covered by the WGI.

TRAD= Trade freedom is a composite measure of the absence of tariff and non-tariff barriers that affect imports and exports of goods and services. The trade freedom score is based on two inputs:

- The trade-weighted average tariff rate and
- Non-tariff barriers (NTBs).

Different imports entering a country can, and often do, face different tariffs. The weighted average tariff uses weights for each tariff based on the share of imports for each good. Weighted average tariffs are a purely quantitative measure and account for the basic calculation of the score using the following equation:

$\text{Trade Freedom}_i = (((\text{Tariff}_{max} - \text{Tariff}_i)/(\text{Tariff}_{max} - \text{Tariff}_{min})) * 100) - \text{NTB}_i$

where Trade Freedom_i represents the trade freedom in country *i*; Tariff_{max} and Tariff_{min} represent the upper and lower bounds for tariff rates (%), and Tariff_i represents the weighted average tariff rate (%) in country *i*. The minimum tariff is naturally zero percent, and the upper bound was set as 50 percent.

CT = Corporate tax rate is a tax collected from companies. Its amount is based on the net income companies obtain while exercising their business activity, normally during one business year. The benchmark we use refers to the highest rate for Corporate Income.

The data of selected variables have been taken from, the World Bank data bases, Heritage Foundation data basses, OECD data basses, and Freedon House databases.

3.2. Econometric Methodology

Following the existing literature, researchers consider panel data analysis the most efficient procedure for data handling in econometrics. Our selected panel data are a balanced panel data set, and following the properties of selected data, we have used the fixed-effect method. The intercept is considered group-specific in the case of the fixed effect method. It reveals that the selected

model can provide different intercepts for every group. Following the procedure of fixed-effect analysis, it is also known as a dummy variable, because when every group has a different intercept in one equation then a specific dummy has been introduced for every group. So, the following equation becomes:

$$Y_{it} = \alpha_i + \beta_1 X_{1it} + \beta_2 X_{2it} + \cdots + \beta_k X_{kit} + \mu_{it} \quad (3)$$

Which can be written in a matrix notation as:

$$Y = D\alpha + X\beta' + \mu \quad (4)$$

$$Y = \begin{bmatrix} Y_1 \\ Y_2 \\ . \\ . \\ . \\ Y_N \end{bmatrix}, \text{D} = \begin{pmatrix} i_T & 0_{\dots} & 0 \\ 0 & i_T & 0 \\ 0 & 0 & i_T \end{pmatrix} NTxk$$

$$X = \begin{pmatrix} x_{11} & \cdots & x_{1k} \\ \vdots & \ddots & \vdots \\ x_{N1} & \cdots & x_{NK} \end{pmatrix} NTxk$$

$$\alpha = \begin{bmatrix} \alpha_1 \\ \alpha_2 \\ . \\ . \\ . \\ \alpha_N \end{bmatrix} NTxk \ , \beta' = \begin{bmatrix} \beta_1 \\ \beta_2 \\ . \\ . \\ . \\ \beta_N \end{bmatrix} NTxk$$

Here dummy variables take different groups' specific estimation procedures in the case of each section separately. For checking the validity of the fixed effects method, we can apply the Hausman test.

The generalized method of moments (GMM) is a generic method for estimating parameters in statistical models. Usually, it is applied in the context of semiparametric models, where the parameter of interest is finite-dimensional, whereas the full shape of the data's distribution function may not be known, and therefore, maximum likelihood estimation is not applicable. The GMM estimators are known to be consistent, asymptotically normal, and most efficient in the class of all estimators that do not use any extra information aside from that contained at the moment conditions. GMM was developed by Pearson (1894) and later augmented by Hansen (1982).

Suppose the available data consists of T observations $\{X_t\}$ t = 1,..., T, where each observation Xt is an n-dimensional multivariate random variable. We assume that the data come from a certain statistical model, defined up to an unknown parameter $\theta \in \Theta$. The goal of the estimation problem is to find the "true" value of this parameter, θ_0, or at least a reasonably close estimate. A general assumption of GMM is that the data c be generated by a weakly stationary ergodic stochastic process. (The case of independent and identically distributed (iid) variables X_t is a special case of this condition.)

To apply GMM, we need to have "moment conditions", that is, we need to know a vector-valued function g(X,θ) such that

$$Y(\theta_0)=E[g(X_t, \theta_0)]=0 \quad (5)$$

where E denotes expectation, and X_t is a generic observation. Moreover, the function m(θ) must differ from zero for $\theta \neq \theta_0$, otherwise, the parameter θ will not be point-identified.

The basic idea behind GMM is to replace the theoretically expected value E[·] with its empirical analog—sample average:

$\hat{Y}(\theta)=\frac{1}{T}\sum_{t=1}^{T} g(Xt, \theta)$ (6)

and then minimize the norm of this expression to θ. The minimizing value of θ is our estimate for θ_0.

By the law of large numbers, for large values of T. The generalized method of moments looks for a number that would make it as close to zero as possible. Mathematically, this is equivalent to minimizing a certain norm of (norm of m, denoted as || Y ||, measures the distance between m and zero). The properties of the resulting estimator will depend on the particular choice of the normal function, and therefore the theory of GMM considers an entire family of norms, defined as

$\left\|\hat{Y}(\theta)\right\|_W^2 = \hat{Y}(\theta)^T W\hat{Y}(\theta)$ (7)

Where W is a positive-definite weighting matrix and denotes transposition. In practice, the weighting matrix W is computed based on the available data set, which will be denoted as. Thus, the GMM estimator can be written as

$\hat{\theta}=\arg \text{Min}(\frac{1}{T}\sum_{t=1}^{T} g(Xt, \theta))^T \hat{W}(\frac{1}{T}\sum_{t=1}^{T} g(Xt, \theta)$ (8)

Under suitable conditions, this estimator is consistent, asymptotically normal, and with the right choice of weighting matrix also asymptotically efficient.

4. Results and Discussions

This part of the study is comprised of empirical results and discussion. The intertemporal properties of the data have been checked with the help of descriptive statistics. The estimated outcomes of the descriptive statistics have been given in table 1. The results of descriptive statistics present the mean, median, maximum, minimum, and standard deviation of the selected variables of the model. The overall results of descriptive statistics reveal that business freedom, fiscal freedom, monetary freedom, trade freedom, and corporate taxes are negatively Skewed, with positive Kurtosis. Whereas, government effectiveness and political stability are positively skewed with positive Kurtosis.

Table 1: Descriptive Statistics

Variables	BF	FF	MF	GOVT	POL	TRAD	CT
Mean	56.01277	68.04029	72.69882	30.54188	33.03939	68.84786	28.00494
Median	55.80000	77.15000	74.05856	24.64455	27.83019	70.00000	30.00000
Maximum	94.30000	99.90390	88.31813	92.30769	93.86793	88.74000	60.00000
Minimum	17.30000	0.000000	0.000000	0.000000	0.000000	23.80000	0.000000
Std. Dev.	13.64923	27.26261	8.346784	22.30390	24.73515	10.12296	11.78885
Skewness	-0.12799	-1.20251	-2.51636	0.694485	0.685487	-0.5785	-0.13758
Kurtosis	3.210640	3.358188	19.33024	2.455115	2.533574	3.740829	3.053770
Jarque-Bera	3.228415	169.9834	8492.484	65.94922	62.12726	53.63594	2.289245
Sum Sq. Dev.	131156.2	512099.1	48559.15	353199.3	434397.5	69784.98	97005.90
Observations	705	690	698	711	711	682	699

The results of the correlation matrix have been given in table 2. The results of the correlation show that all of the selected explanatory variables i.e. fiscal freedom, monetary freedom, government effectiveness, political stability, trade freedom, and corporate taxes have a significant correlation with business freedom. Whereas these explanatory variables do not have a high correlation with

each other which generates the issue of multicollinearity among them. Thus, the selected model is best to use for further empirical analysis.

Table 2: Correlation Matrix

Variables	BF	FF	MF	GOVT	POL	TRAD	CT
BF	1						
FF	0.009	1					
MF	0.108***	0.079**	1				
GOVT	0.645***	0.103***	0.236***	1			
POL	0.392***	0.153***	0.232***	0.524***	1		
TRAD	0.417***	0.016	0.105***	0.377***	0.158***	1	
CT	-0.28***	-0.059	0.099***	-0.169***	-0.193***	-0.25***	1
***, **,* represent significant 1 percent, 5 percent, and 10 percent respectively.							

Since the 1980s, the process and speed of globalization have dominated all the world economies, and all main priorities and trends of the world economy have been set by globalization (Mrak, 2000). At the same time, the current stage of world business freedom is characterized by the role of international financial and economic organizations and the role of transnational companies in the functioning of the national economy by reducing the role of a sovereign state (Gechbaia et al., 2018). Consequently, business freedom leads to both development opportunities and certain problems. Therefore, the responsibility of the government of any country is to find effective ways to maximize profits from the process of business freedom (Gore, 1993; McMullen et al., 2008). The study in hand has examined the impact of institutional development and policy mix in determining the level of business freedom in the case of developing countries. For empirical analysis, this study has applied panel least squares but for comparative analysis, we have also applied random effect model and generalized method of moments. The results of panel least squares, random effect model, and generalized method of moments have been given in table 3.

The estimated outcomes show that fiscal freedom has a negative and significant impact on business freedom in developing countries. Fiscal freedom has multiplier impacts on real and financial activities because these are government revenue and expenditure policies which set the routes for business and economic activities (Baum and Koester, 2011). On one side, the models of standard Real Business Cycles (RBC) proposed that a rise in government expenditures depresses private consumption in general and business activities in specific (Baxter and King, 1993; Christiano and Eichenbaum, 1992; Rahmayanti & Horn 2010). On the other side, standard Keynesian models suggest that a rise in government expenditures raises private consumption and overall economic growth of the economy (Blanchard and Simon, 2001). Our estimated results show an inverse relationship between fiscal freedom and business freedom, the estimates show that a 1 percent increase fiscal freedom reduces business freedom by around 3 percent, following the outcomes of all estimations techniques. This shows that raising the level of revenues or expenditures by developing countries discourages the level of business activities and business freedom. Our findings are consistent with Arora and Vamvakidis (2006), Cebula and Mixon (2012), Clark and Lawson (2008).

The relationship between monetary freedom and business freedom has got much importance during the end of twenty century. Because it is the rate of interest that has special importance to decide the level of business and economic activities (Campbell, 1998). Moreover, its money supply has an encouraging influence on economic growth. Thus, monetary freedom has direct and indirect relation with business freedom (Mathieson, 1980; Asogu, 1998). But our estimated outcomes show

that monetary freedom has an insignificant impact on business freedom in the case of developing countries. One of the main reasons behind this insignificant relationship i.e. monetary policy in developing countries is not independent. The central banks in developing are unable to provide any financial incentive to domestic as well as foreign investors to raise the level of investment (Cantelmo et al., 2022). Thus, inconsistent monetary policy does not play a significant role in deciding the business and economic activities in developing countries.

The debate concerning policy mix (fiscal and monetary policy) in the economic system and their outcome have long history since the Keynesian and Neo-Classical eras and their involvements are justified by the nature of the market economy. There is a contention that the market is not perfect, thus policy mix intervention is required to minimize the distortions which result from market failure. The aim of superseding the economic system is to achieve efficiency, and thus economic growth. However, while correcting the market imperfections policy mix is required not to surrogate the workings of the market system but rather to reimburse for its shortcomings (Prasetyo & Zuhdi 2013). Our results also highlight that policy mix hurts business freedom in the case of developing countries.

Government effectiveness creates an active environment for the citizens to participate in the society and economy (Feldman et al., 2016), at the same time, it establishes roots in business activities through proper competition which is conducive to economic growth. The effective control of the government permits individuals and firms to enjoy the business freedom to operate within a market economy which further has favorable implications for economic growth (McKinnon, 1993). However, frequent ineffectiveness of government leads to shifting economic policies which have a serious threat to business freedom and limit economic growth (Chang, 2003). Our results show that government effectiveness has a positive and significant impact on business freedom in developing countries. The estimates show that a 1 percent increase in government effectiveness raises business freedom between 17 percent to 33 percent, following the outcomes of all estimation techniques. Our findings are consistent with the findings of Beraldo et al., (2009) and Kimaro et al., (2017).

The debate as to whether the political environment contributes to economic growth in developing countries continues to be evasive. Political environment and type of government have significant influence to decide the level of business freedom and economic growth. A democratic political environment provides favorable conditions to flourish business activities (Roy et al., 2015). However, frequent changes in government by the non-democratic powers lead to uncertain economic policies and reduce business freedom. Political instability leads to bribery and corruption among bureaucrats and politicians (Schumacher, 2013). Our findings of panel least squares and generalized method of moments show that political stability has a positive and significant impact on business freedom. The results show that a 1 percent increase in political stability raises business freedom by more than 4 percent. This reveals that political stability is promoting business freedom in developing countries, and these findings are consistent with Rose-Ackerman (1999), and De Vaal and Ebben (2011). Whereas, political stability has an insignificant impact on business freedom while analyzing with a random effect model. This difference in results may be an estimation technique but some political thinkers and economists mention that the democratic rules of developed and western nations do not apply to developing countries. Thus, developing countries should first focus on growth and democracy latter.

The relationship between trade freedom and economic growth has been extensively studied area (Asandului et al., 1999; Bayar, 2016). International trade has massive advantages for the citizens and firms of a country. Specializing in the production of goods and services enables counties to

get huge production benefits, whereas there is an absolute or comparative advantage results in an overall gain in welfare that in turn results in productive and allocation efficiency. This explains that over time trade freedom is attached to higher productivity gains and the accumulation of additional resources to generate more economic and business activities. The process of trade freedom raises the saying by higher output and the economy attains growth in the export sector, this process requires more business freedom to enhance business activities (McMullen et al., 2008; Méndez-Picazo et al., 2021). Our estimated results show that trade freedom has a positive and significant impact on business freedom. The estimates show that a 1 percent increase in trade freedom raises business freedom between 9 percent to 23 percent, following the outcomes of all estimation techniques.

Studying the impact of corporate taxes on investment and business activities is one of the main objectives of financial studies. Different researchers (Barro, 1991; Baumol et al., 2007) mention, this effect matters not only for the evaluation and designing of tax policies but also for the level of economic growth of the economy. Thus, there is a strong relationship between the level of corporate taxes and business freedom. Our estimated results show that corporate taxes have a negative and significant impact on business freedom, by following the outcomes of panel least squares and generalized method of moments. But corporate taxes have an insignificant impact on business freedom by following the outcomes of the fixed effect model. Based on the outcomes of panel least squares and the generalized method of moments, a 1 percent increase in corporate taxes depresses business freedom by around 15 percent. There are many financial studies (Slemrod, 1990; Auerbach and Hassett, 1992; Hines and Rice, 1994; Cummins et al., 1996; Devereux et al., 2002) which find an inverse relationship between corporate taxes and business activities.

Table 3: Empirical Outcomes

Dependent Variable: BF			
Variables	Panel Least Squares	Random Effect	GMM
FF	-0.033797***	-0.026472***	-0.033797**
MF	-0.061701	0.011938	-0.061701
GOVT	0.330626***	0.178878***	0.330626***
POL	0.04506**	-0.051809	0.04506**
TRAD	0.239976***	0.095057**	0.239976***
CT	-0.151219***	0.039203	-0.151219***
C	38.64125***	45.55791***	38.64125***

The results of the Hausman test have been presented in Appendix A. The estimated results of the Hausman test reveal that random effect analysis is more appropriate for analyzing the impact of institutional development and policy mix on business freedom in the case of developing countries. Our estimated results of endogeneity have been given in Appendix B and C. the estimated results show that there is endogeneity has existed and we have to apply GMM.

5. Conclusions and Implications

This study has examined the impact of institutional development and policy mix on business freedom in developing countries. Political stability, government effectiveness, and corporate taxes are taken as institutional development, whereas policy mix has been measured with the help of monetary freedom and fiscal freedom. For examining the impact of explanatory variables on explained variables, and panel least squares, random effect model and generalized method of

moments (GMM) have been applied. Based on estimated results and discussions, this study has some major conclusions. The estimated results show that fiscal freedom has a positive and significant impact on business freedom, whereas, monetary freedom has an insignificant impact on business freedom of developing countries these results are consistent with all the estimated techniques. This shows that policy mix is depressing business freedom in the case of developing countries. The estimated findings show that government effectiveness, political stability, and tread freedom have positive and significant impacts on business freedom, these results are consistent with all the estimated techniques, but the random effect model has opposite results for political stability. The results show institutional development is encouraging business freedom in developing countries. Corporate taxes have a negative and significant impact on business freedom in developing countries, this relationship is insignificant in the case of random effect model analysis. These findings show that a rise in corporate taxes discourages business freedom in developing countries. The overall results of the study show that institutional development and policy mix are playing significant roles in deciding business freedom in developing countries.

Results conclude that fiscal freedom is depressing business freedom. It has been witnessed that fiscal freedom enables the governments of developing countries to make higher non-developmental expenditures and left little for public and private sector investment. Less availability of funds for the private sector depresses business freedom in developing countries. Monetary freedom does play a role in deciding the level of business freedom in developing countries. The extensive involvement of but government make the monetary policy ineffective and restricted to provide benefit to attract domestic and foreign investors. Thus, to raise the level of business freedom the policy mix of the developing countries should be rationalized in such that boost economic and business activities.

Government effectiveness, political stability, and trade freedom have a positive and significant impact on business freedom. Thus, developing countries should maintain stable institutional development to raise the level of business freedom. Corporate taxes are depressing the level of business freedom, as rising taxes reduce the financial benefits of the investors and they reduce economic and business activities. Thus, corporate taxes should be operationalized in such a way that these should not impact negatively business freedom in developing countries.

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Table A: Correlated Random Effects-Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Period random	0.64078	6	0.9957

Table B: Diagnostic Test of Endogeneity

Dependent Variable: BF				
Variables	Coefficient	Std. Error	t-Statistic	Prob.
RESID01	-3.597114	1.911210	-1.882114	0.0615
FF	0.430930	0.318309	1.353811	0.1775
MF	0.089228	0.054160	1.647483	0.1012
GOVT	0.848333	0.423934	2.001098	0.0469
POL	-0.138383	0.091464	-1.512979	0.1321
TRAD	0.135058	0.022871	5.905220	0.0000
CT	30.37107	7.002230	4.337343	0.0000
R-squared	0.189989	Mean dependent var		51.94568
Adjusted R-squared	0.162375	S.D. dependent var		16.59272
S.E. of regression	15.18597	Akaike info criterion		8.316121
F-statistic	6.880151	Durbin-Watson stat		0.473489
Prob(F-statistic)	0.000001			

Table C: Diagnostic Test of Endogeneity

Dependent Variable: BF				
Variables	Coefficient	Std. Error	t-Statistic	Prob.
RESID02	0.609853	0.331234	1.841153	0.0677
FF	-3.873413	1.753073	-2.209498	0.0288
MF	0.130671	0.055068	2.372907	0.0190
GOVT	1.027139	0.433282	2.370602	0.0191
POL	-0.197867	0.092148	-2.147272	0.0335
TRAD	0.172342	0.023240	7.415773	0.0000
CT	34.18124	3.950277	8.652871	0.0000
R-squared	0.313295	Mean dependent var		51.82849
Adjusted R-squared	0.283865	S.D. dependent var		16.13512
F-statistic	10.64537	Durbin-Watson stat		0.483383
Prob(F-statistic)	0.000000			