



Democracy and Economic Growth in Lesotho: An Analysis of Long-Run relationship from 1994 to 2024

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Abstract

This study investigates the impact of democratic governance on economic growth in Lesotho from 1994 to 2024, addressing the gap in empirical evidence on how political institutions influence long-term economic performance. Using the Autoregressive Distributed Lag (ARDL) approach, the study examines the long-run dynamics among the variables. The results reveal a long-run cointegration relationship, indicating that democracy is positively and significantly associated with economic growth. Sustained democratic governance over long periods appears to support improved economic performance. However, democracy alone is not sufficient to drive growth; it functions as a platform that facilitates other growth-enhancing factors. The macroeconomic control variables, including foreign direct investment, human capital, trade, and external debt, were generally insignificant or showed divergent effects on growth. Based on these findings, the study recommends that policymakers implement targeted reforms in human capital development, trade policies, fiscal management, and innovation-driven industries to enhance the effectiveness of growth-promoting strategies and support sustainable and inclusive economic development.

Keywords: Democracy, economic growth, ardl, lesotho

Introduction

In the contemporary global landscape, the pursuit of sustained economic growth remains a central objective for governments across all regime types. Kariş (2020) ^[12] positions democracy characterized by institutional quality and good governance as a prerequisite for stable economic growth. He argues that democratic governance not only legitimizes economic policy but also fosters conditions conducive to investment, protects property rights, and promotes human capital development. Economic growth trajectory changed in Sub-Saharan Africa's after the region underwent substantial political liberalization in the 1990s (Masaki & van de Walle, 2014) ^[13]. The region has experienced substantial and sustained growth, where the overall gross national product (GNP) growth increased from 1.7 percent during the 1980s to 2.5 percent in the 1990s. World Bank (2014) suggest gross domestic product (GDP) growth at 5.3 per cent in 2012 and 5.6 per cent in 2013.

Despite this optimistic view, the relationship between democracy and economic growth remains a contested issue, particularly in developing and underdeveloped countries. A key question persists: Does democracy promote economic growth? Democracy is frequently portrayed as a pathway to prosperity for countries in the Global South. The prevailing perspective suggests that nations with strong democratic institutions are less prone to corruption and more capable of fostering technological advancement, open markets, and inclusive economic systems. Masaki and van de Walle (2014) ^[13] contend that the acceleration of economic growth in Africa since the 1990s can largely be attributed to democratization efforts. They emphasize that the longer a democracy is sustained, the more likely it is to produce positive economic outcomes, underscoring the importance of democratic consolidation for long-term development.

In Lesotho, since the first democratic elections in 1993 post the military regime, the concepts democracy and economic

growth have been a recurring theme in political discourse and media narratives. Citizens have been promised improved living standards, higher employment, and better access to social services. Democratic regimes have often been credited with safeguarding fundamental freedoms and establishing institutions aimed at advancing societal development. Sen (2015) ^[18] argues that the state must create rules that guarantee protective security and ensure the safety of individuals and their property. These institutional rules, in turn, influence economic growth and determine the overall wealth of the population.

Despite ongoing democratization, Lesotho continues to face persistent economic challenges, with its gross domestic product (GDP) growth lagging behind that of less democratic or authoritarian regimes. Recent growth trends observed in parts of South Asia, Latin America, and Africa suggest that countries with limited democratic institutions have, in certain cases, experienced more rapid economic development (Uslu, 2022) ^[19]. This paradox challenges the widely held assumption that democratic governance leads to stronger economic performance, raising important questions about the nature and direction of this relationship particularly in the context of Lesotho.

The relationship between democracy and economic growth remains ambiguous among scholars. According to Kariş (2020) ^[12], there is no systematic connection between the two, signifying that democracy and economic growth are largely unrelated. However, other studies argue that while democracy may not have a direct impact on economic growth, it generates positive externalities that support economic development (Kabir & Alam, 2021) ^[11]. In contrast, Knutsen (2012) found a positive correlation between democracy and economic growth, indicating that democratic institutions may indeed foster economic progress. Overall, the debate remains unresolved, and the hypothesis that democracy has a positive relationship with

economic growth continues to be tested and contested in academic research. Therefore, the study seeks to contribute by examining the relationship between democracy and economic growth in Lesotho.

Literature Review

The Concept of democracy

The concept of Democracy is traceable to the ancient Greeks and specifically the city-state of Athens in the fifth century B.C. The democracy term is derived from the Greek word *Dēmokratía*, which means rule of the people and it was coined from *demos* (people) and *kratos* (power). Yangailo (2024) ^[21], define democracy is a system of government in which the people have the final say and are generally free to participate in the making of public policy. Equally, Becker (2008) views democracy as a government that stems from the people, exercised by the people and for the purpose of the people's own interests. (Rand, 2014) ^[17] further explain it as a form of government in which power and civic responsibility are exercised by all adult citizens, directly or indirectly through their freely elected representatives.

Scholars generally categorize democracy into two main types: direct (or participatory) democracy and representative democracy. In a direct democracy, citizens are directly involved in decision-making without relying on elected or appointed officials. Conversely, representative democracy involves citizens choosing officials who then make political decisions, create laws, and implement programmes on their behalf. In the context of Lesotho, governance operates through a representative system where citizens elect individuals to represent them and form a government. Thus, for the purposes of this study, democracy is understood as a system of governance in which people rule indirectly through their elected representatives. These representatives are, in principle, accountable to the electorate and are expected to act in line with the views and interests of those they represent (Dike & Onyekwelu, 2018) ^[8].

The Concept of Economic Growth

Economic growth represents the continual increase in the output of goods and services in an economy of a nation overtime. It reflects the expansion of an economy's productive capacity, which enable higher levels of production and income in succeeding periods (Dragoi, 2020) ^[9]. Jhingan (2007), view economic growth as the sustained increase in the country's per capita output or income accompanied by the increase in labour force, consumption and volume of trade. Raisová and Čurťová (2014) ^[16] argue that economic growth arises primarily from two key sources: the accumulation of capital inputs (such as physical infrastructure and human capital) and improvements in the productivity of existing resources, including technological innovation and institutional efficiency. These drivers translate into measurable outcomes that affect long-term development trajectories.

Economic growth is most commonly measured using macroeconomic indicators such as Gross Domestic Product (GDP) and Gross National Income (GNI), adjusted for inflation to capture real growth. GDP quantifies the total market value of all final goods and services produced within a country's borders, serving as a core indicator of domestic economic performance. The growth rate of GDP is often used as an indicator of the general health of the economy

(Bartholomew *et al*, 2023) ^[2]. Thus, an increase in real GDP is interpreted as a sign that the economy is doing well. GNI, by incorporating net income earned from abroad, offers a broader perspective on national economic well-being. These indicators are crucial tools for assessing the performance, potential and structural transformation of economies over time.

Studies on Democracy - Economic Growth nexus

The nexus between democracy and economic growth has been widely disputed by scholars, with empirical findings producing mixed outcomes. Mohammadi *et al* (2023) ^[14] investigated the causal relationship between democracy and economic growth across OECD and selected developing countries from 1990 to 2020 using a Panel VAR approach. Their results revealed causal relationship from democracy to economic growth in OECD countries. But no such causal relationship was detected in developing countries. The study concludes that in these developing economies, democracy alone does not drive economic growth; instead, its effectiveness is dependent upon the presence of key structural factors, including social, human, and physical infrastructure.

Xinyi *et al.*, (2022) ^[20] investigated the dynamics between economic growth, military expenditure, and democracy across 126 countries over the same period (1990–2020) using a PVAR model and k-means clustering technique. Their analysis affirms positive impact of democracy on economic growth, accenting that increase in democratic institutions consistently enhances growth. The study indicates that democracy positively affect growth through the aspects of property rights, investment, predatory rules, insulation against particularistic pressure and technological change.

Bartholomew *et al.*, (2023) ^[2] assessed the performance of military versus civilian rule using an ARIMA (1, 1, 0) time series model with exogenous variables such as per capita GDP and intervention periods in Nigeria. Their findings revealed that since the return to civilian rule in 2005, Nigeria's GDP has increased on average by \$10 billion annually. Forecasts also suggest a continued upward trend in GDP under democratic power. These results align with the broader literature that economies governed democratically tend to experience faster growth than those under authoritarian rule.

In another study, Densumite (2023) ^[7] analysed the democracy–growth relationship in 33 countries between 2010 and 2020 using a panel data regression model. The results showed that democracy has a positive impact on economic growth, particularly in the long run. Although the short-term effect was found to be negligible, a significant long-run causality from democracy to real GDP was established.

Despite the supportive findings, not all studies accord with a positive link. Brunetti (2002) ^[5] empirically examined the association between democracy and economic growth in seventeen studies in cross-country growth analysis. The results showed no consensus on the relationship since the results reported both positive and negative correlations. This conclusion is in total concordance with the finding of Jacob and Osang (2003) ^[10] who used GMM framework to explore the longer-term impact of democracy and other explanatory variables on economic growth covered from 1961 to 2010. They found that measures of democracy matter little for the

economic growth process. Given the mixed results, study turns to a more nuanced frameworks, which seeks to understand the conditions under which democracy and economic growth can effectively reinforce each other.

Compatibility Approach on Democracy and Economic Growth

The compatibility approach posits that democracy and economic growth are mutually reinforcing. This approach highlights the essence of institutional factors such as an independent judiciary, the rule of law and the protection of individual rights as prerequisites for both democratic consolidation and sustainable economic development. According to (Kariş, 2020) [12], secure property rights and enforceable legal contracts are essential conditions for long-term economic growth. Similarly, political pluralism and institutional checks and balances are viewed as safeguards against systemic abuse and predatory governance (Narayan & Smyth, 2006) [15]. Democracy, by limiting rent-seeking behaviour through transparency and accountability mechanisms, helps reduce corruption and mismanagement. Barro (1996) [1] supports the notion, arguing that democracy is more conducive to economic growth and individual freedom than authoritarian systems. In democracies, political legitimacy often depends on delivering economic rights and opportunities to the population. Also, democracy creates a favourable environment for innovation, entrepreneurship, and efficient resource allocation by decentralizing economic power and ensuring a stable, predictable investment climate (Bhagwati, 2002) [3]. In this context, democratic governance not only enhances civil liberties but also facilitates economic decision-making that is responsive to public needs and market dynamics. Based on this theoretical orientation, the present study hypothesizes a positive relationship between democracy and economic growth.

Methodology

Data and Data Source

This study uses secondary data obtained from the World Bank and Freedom House on Lesotho, covering the period from 1994 to 2024. This timeframe is primarily due to its focus on the era when the country was being recognized as being fully democratic, which is particularly relevant for understanding current patterns of economic growth. The analysis aims to accurately capture the relationship between democracy and economic growth. The dependent variable, economic growth, is proxied by the GDP per capita (*GDPGr*) and while the independent variable, democracy, is proxied by democracy index (*DemIndx*). The indicators reflect the yearly changes. The control variables are incorporated to account for their potential influence on economic growth. These control variables include the net inflows of foreign direct investment (*NetfdI*), industry (including construction) value add (*IndvaD*), human capital (*HCI*), inflation (*InflaT*), trade openness (*TrdOp*) and external debt (*ExtDet*).

Data Analysis Technique

The autoregressive distributed (ARDL) is mainly employed in the study to explore the relationship between democracy and economic growth. ARDL models are linear time series models in which both the dependent and independent variables are related not only contemporaneously, but across historical (lagged) values as well. This method suitable for

datasets with different order of integration. In the process of analysis, the initial phase involves checking the order of integration of each variable using the augmented Dickey-Fuller (ADF) tests. The variables not to integrating after the first-round differencing would be omitted. Then ARDL bounds test could be applied to investigate the cointegration relationship between democracy and economic growth. The error correction version of the ARDL model pertaining to the variables incorporated in the study is stated as

$$\Delta y_t = \alpha + \sum_{i=1}^p \beta_i \Delta y_{t-1} + \sum_{j=0}^q \gamma_j \Delta x_{t-j} + \phi_1 y_{t-1} + \phi_2 x_{t-2} + \epsilon_t$$

Where y_t represents the dependent variable and x_t the independent variables. Δ denotes the difference operator, p and q are the optimal lag lengths determined by criteria AIC, ϕ_1 and ϕ_2 are the long-run coefficients, and ϵ_t is the error term.

Results and Discussion

The analysis commenced with an assessment of stationarity to mitigate the risk of spurious regression. Accordingly, the Augmented Dickey-Fuller (ADF) test was employed to evaluate the stationarity properties of the two series variables and to identify their respective orders of integration. The unit root test results, summarized in Table 1, reveal that the *DemIndx*, *HCI*, *IndvaD*, *InflaT* and *ExtDet* are stationary at first level, implying integration of order zero, I (0). While *GDPper*, *NetFdl*, *HCI*, and *TrdOp* become stationary after first differencing, indicating integration of order one, I (1).

Table 1: ADF Unit Root Test

| Variables | Level Form | | First Difference | | Order of Integration |
|-----------|-----------------|-------------|------------------|-------------|----------------------|
| | Test Statistics | Probability | Test Statistics | Probability | |
| GDPper | -1.368 | 0.5974 | -4.565 | 0.0001 | I (1) |
| DemIndx | -3.596 | 0.0058 | | | I (0) |
| NetFdl | -2.029 | 0.2741 | -6.967 | 0.0000 | I (1) |
| IndvaD | -3.095 | 0.0270 | | | I (0) |
| HCI | -0.458 | 0.9000 | -4.407 | 0.0003 | I (1) |
| InflaT | -4.407 | 0.0003 | | | I (0) |
| TrdOp | -1.485 | 0.5407 | -7.052 | 0.0000 | I (1) |
| ExtDet | -5.074 | 0.0000 | | | I (0) |

H0: The series has a unit root.

The study further uses the Autoregressive Distributed Lag (ARDL) bounds testing approach to examine the existence of a long-run equilibrium relationship among the model variables. This method is particularly appropriate when the variables under consideration are a mixture of stationary, I (0), and non-stationary, I (1), processes, but none are integrated of order two, I (2). The specified model includes four (7) regressors to assess the extent of the long-run association among the variables. The results of the ARDL bounds test are presented in Table 2.

Table 2: Results of ARDL bounds test for cointegration

| Test | Value | Significance (%) | I (0) | I (1) |
|----------------|-------|------------------|-------|-------|
| F – statistics | 5.846 | 10 | 2.03 | 3.13 |
| | | 5 | 2.32 | 3.50 |
| | | 2.5 | 2.60 | 3.84 |
| | | 1 | 2.96 | 4.26 |

H0: no levels relationship

The F-statistic value (5.846) exceeds the upper critical bound of I (1) at the one percent significance level. The results support the rejection of the null hypothesis; there is a long-run cointegrating relationship among the variables in the model. Thus, changes in one variable have a persistent long-run impact on the others.

Long-Run ARDL Estimates

The ARDL long-run results in Table 3 indicate that the model explains approximately 89.9 percent of the variation in GDP per capita. The adjustment term (GDPper L1) is negative and highly significant at one percent level, confirming that short-run deviations from equilibrium are corrected at a speed of about 1.20 per period. This implies that the model converges rapidly toward its long-run equilibrium path.

The coefficient of the Democracy Index is positive and statistically significant at the 1 percent level, implying that improvements in democratic governance have a strong positive effect on economic growth. Specifically, a one-unit increase in the Democracy Index is associated with a \$52.86 rise in GDP per capita in the long run when the GDP per capita is measured in levels. This finding underscores the vital role of democratic institutions and political stability in fostering sustainable economic growth. The findings align with previous studies, such as (Masaki & van de Walle, 2014; Bozkurt & Altiner, 2018) [4, 13] which emphasize that democratization enhances transparency, accountability and property rights, thereby creating conducive environment for investment, foreign direct investment (FDI) and human capital development. Together, these mechanisms contribute to improved economic performance and long-term growth.

Foreign direct investment (FDI), measured as net inflows (% of GDP), has a positive and marginally significant effect on GDP per capita. A one-percentage-point increase in FDI inflows is associated with a long-run rise of approximately \$102.82 in GDP per capita. This result emphasizes the growth-enhancing role of FDI through capital formation, technology transfer, and employment creation (Chizema, 2025) [6].

Table 3: Estimated Long-run Coefficients of the ARDL Model

| Regressor | Estimate | Std. Error | t-statistics | Prob | Sign |
|-----------------|----------|------------|--------------|-------|------|
| Adjustment term | | | | | |
| GDPper L1 | -1.1982 | 0.2082 | -5.76 | 0.000 | *** |
| demIndx | 52.8621 | 6.8492 | 7.72 | 0.000 | *** |
| NetFDI | 102.8184 | 49.1522 | 2.09 | 0.058 | * |
| IndvalAd | -11.6314 | 4.1198 | -2.82 | 0.015 | ** |
| HCI | 1082.45 | 806.8035 | 1.34 | 0.205 | |
| Influa | 4.2556 | 6.1984 | 0.69 | 0.505 | |
| TradeOps | 1.4035 | 1.0198 | 1.38 | 0.194 | |
| ExtrDeb | 1.2139 | 1.9886 | 0.61 | 0.553 | |

Number of obs = 30 R-squared = 0.8991

Note: *** p < 0.01, ** p < 0.05, * p < 0.10

Industry value added (*IndvaD*) exhibits a negative and significant effect on GDP per capita (p = 0.015), implying that a one-percentage-point increase in industrial output reduces GDP per capita by about \$11.63 in the long run. This suggest that the growth contribution of industry may be constrained by structural inefficiencies, capacity underutilization or resource bottlenecks in Lesotho’s industrial sector. The remaining variables, human capital (*HCI*), inflation (*InflaT*), trade openness (*TrdOp*), and

external debt (*ExtDet*) display positive but statistically insignificant coefficients. While these variables are associated with an upward movement in GDP per capita, their long-run effects appear limited, possibly due to policy implementation challenges or structural misalignments with national development goals.

To ensure that the estimated model is reliable and valid for inference, diagnostic tests for serial correlation, functional form and heteroscedasticity of the models were conducted. The diagnosis results are presented in Table 4 below, which confirm the reliability of the regression results. The Breusch-Godfrey LM test appraises the existence of serial correlation in the residuals. The p-value indicates the presence of serial correlation, warranting the rejection of the null hypothesis of no serial correlation. Thus, the residuals are not independent across time. The Breusch-Pagan/Cook-Weisberg test evaluates heteroskedasticity in the model. Considering that the p-value is greater than the 0.05 significance level, the study fails to reject the null hypothesis of homoskedasticity. This implies that the residuals exhibit constant variance.

Table 4: Diagnostics checks: Model Assumptions

| Test | Hypothesis | Value | Prob |
|---|------------------------------------|-------|----------|
| Breusch–Godfrey LM test for autocorrelation | Ho: no serial correlation | 4.542 | 0.0331** |
| Breusch–Pagan / Cook–Weisberg test for heteroskedasticity | Ho: Constant variance | 0.66 | 0.4162 |
| Ramsey RESET model specification test | Ho: model has no omitted variables | 2.45 | 0.1299 |

Note: *** p < 0.01, ** p < 0.05, * p < 0.10

The Ramsey RESET test measures whether the model suffers from omitted variable bias or incorrect functional form. The study fails to reject the null hypothesis, indicating that the model has an appropriate functional form and does not show signs of misspecification. The diagnostic results reveal that while the ARDL model is correctly specified and the residuals are homoscedastic, there is evidence of serial correlation. Therefore, appropriate corrections such as including additional lag terms or using robust standard errors may be necessary to ensure unbiased and efficient estimation.

Conclusions and policy recommendations

This study examined the relationship between democracy and economic growth in Lesotho over the period 1994 to 2024, using GDP per capita and the Democracy Index as key indicators. The analysis aimed to understand how the association of democratic institutions influences economic performance in the context of Lesotho. The empirical findings demonstrate that democracy is positively and significantly associated with economic growth. Specifically, a one-unit increase in the Democracy Index is linked with a notable rise in GDP per capita in the long run. This underscores that sustained adherence to democratic governance can create conditions conducive to long-term economic growth.

The control variables, however, displayed divergent effects on economic growth. While some variables, such as foreign direct investment, contributed positively to growth, others, including industry value added and external debt, had limited or negative effects. This highlighted that economic

growth in Lesotho cannot be achieved solely through democratic consolidation. Instead, democracy provides a platform that facilitates the implementation of complementary growth-enhancing policies.

While democratic governance positively influences economic growth, its benefits are maximized when complemented by well-designed policies that promote human capital, innovation, investment, and fiscal stability. Continuous and strategic policy reforms are essential for steering Lesotho toward sustainable and inclusive economic development. The study outlines the subsequent policy

recommendations

1. Strengthening human capital development: Investing in education, skills training, and health can enhance labour productivity and promote sustainable growth.
2. Reforming trade and industrial policies: Aligning trade openness and industrial strategies with national development goals can improve economic efficiency and competitiveness.
3. Managing external debt effectively: Prudent debt policies are necessary to avoid fiscal constraints that may limit growth potential.

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