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Economic Freedom, FDI, Inflation and Economic Growth in East and Southeast Asian Countries: A Panel Data Analysis

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A B S T R A C T

This study is panel data that aims to analyze the effect of Economic Freedom, Foreign Direct Investment, and Inflation on Economic Growth in East Asian and Southeast Asian countries from 2000 to 2020. We find that simultaneously, Economic Freedom, Foreign Direct Investment, and Inflation positively affect Economic Growth. The proportion of the influence of all independent variables on the dependent variable is 16.03 percent. We also obtain partial results that Economic Freedom and Foreign Direct Investment positively influence Economic Growth. Meanwhile, Inflation negatively affected Economic Growth in East Asian and Southeast Asian countries from 2000 to 2020. These results have important implications for the governments of East and Southeast Asian countries, especially in responding to Inflation that impacts Economic Growth. Policies aimed at reducing the impact of Inflation on Economic Growth must identify the factors causing Inflation and consider the increase in production costs.

Keywords:Economic Freedom, Foreign Direct Investment, Inflation, Economic Growth, Panel Data
JEL : E6, G0, O4

1. Introduction

Economic growth is the most powerful instrument and is no longer an open secret in reducing poverty and improving the quality of life in every country, especially in developing countries. The oldest theory of economic growth since the 18th century is the classical theory. Adam Smith, a prominent figure who is often associated with this theory, assumes that the economy of the population in a country will be able to reach the highest point through a liberal system. Meanwhile, David Riccardo and Robert Malts focused their theory on three factors influencing economic growth, namely employment and capital accumulation, concerning technology.

Economic growth in a country is supported by several factors: economic freedom, foreign direct investment, human capital, an inflation rate that occurs and others factors. However, among the factors mentioned, economic freedom has been stated as the most crucial factor that can affect economic development and prosperity in a country, which can impact the country's economic growth. Furthermore, the foreign direct investment factor is a way to expand business where one of the benefits is as a development tool for the economy in a country (Haydaroğlu, 2016). As for the inflation rate, which can be interpreted if inflation increases in a country, the purchasing power of money also decreases, which results in a reduction in consumption and therefore makes GDP decline.

High inflation can make investment less attractive, both from outside and within the country, because it creates uncertainty in the future and can affect the balance of payments because exports become more expensive. This indicates that GDP is negatively related to inflation. This statement is supported (Ruzima & Veerachamy, 2016), and (Reddy & Sarma, 2020) shows the negative effect of inflation on GDP growth. However, several studies show that inflation positively affects economic growth. For example, research conducted (Umaru & Zubairu, 2012) and (Anidiobu et al., 2018) regression results show that inflation has a positive but not significant effect on economic growth (measured by RGDP).

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Economic growth is the mainstay of any country's economic development because of its overall benefits for various economic sectors and can increase the standard of living if the nation's wealth is distributed equitably (Razmi & Refaei, 2013). As we know, every country has unequal economic growth, and there are conditions wherein one country's economy continues to grow, but in other countries it still faces minimal income (이병기, 2008). Many researchers have researched economic growth to prove this difference, which showed different results. Obtaining different research results is based on the country's focus, the research period, and the indicators used.

It is familiar to encourage economic growth, namely the ongoing activities of government regulations (Djankov et al., 2008) and (김상헌, 2010). A country with fewer regulations will have greater economic freedom than a one with more regulations. Greater economic freedom indicates that the government offers an effective legal framework and a strong law enforcement mechanism to defend property rights and individual rights(Gwartney & Lawson, 2003). Conversely, low economic freedom is recognized when the government issues several taxes, policies, or expenditures contrary to people's choice, freedom, and market coordination. From this statement, it can be concluded that the greater the level of economic freedom in a country, the higher the level of development in generating rapid economic growth.

Economic growth is one of the most critical issues that must be discussed on an ongoing basis and must be analyzed in every country (Brkić, 2020) . Furthermore, in emerging nations, economic expansion is the most effective tool for decreasing poverty and enhancing quality of life. Indeed, some parts are essential concerns for every country besides economic growth, such as unemployment, poverty, and so on. However, economic growth is a source of other factors that are said to be important in a country (Suparyati & Fadilah, 2015).

Economic freedom is more than a business climate in which entrepreneurship and wealth may flourish and contribute to the nation's economic progress (Miller et al., 2021). Economic growth is a sustained attempt to increase the overall output of commodities and services. In other words, economic expansion is a rise in potential gross domestic output (Samuelson & Nordhaus, 2009). This is in line with (Ivic, 2015) defining economic growth as a continuous increase in the volume of production in a country, generally referred to as GDP growth.

In this context, this paper aims to explore the influence of economic freedom, FDI, and inflation on economic growth in East and Southeast Asian countries using data from the Index of Economic Freedom of Heritage Foundation and the World Bank in the period 2000-2020. The structure of this research is as follows. Part II contains a brief review of this study's relevant conceptual and empirical literature. Part III describes the data, sources, and empirical models used in this study. Part IV presents the results of the empirical analysis and discussion, and part V presents conclusions and suggestions.

2. Literature Review

Economic freedom and economic growth are mutually dependent, determined jointly, and are not easy to distinguish. Economic freedom is influenced by economic growth, and more economic growth can encourage and strengthen economic freedom. It is often assumed that economic freedom increases economic growth, which in turn generates greater economic freedom(Vu, 2010).

There are empirical studies that focus on researching the relationship between economic freedom and economic development and growth (Carlsson & Lundström, 2002; Doucouliagos & Ulubasoglu, 2006; Piatek et al., 2013). Their findings prove a direct and overall positive relationship between economic freedom and economic development and growth. Besides that (Rajasalu, 2003;Pääkkönen, 2009;N'Zue, 2010;Próchniak, 2011;Peev & Mueller, 2012;Hooper, 2019;Brki´c et al., 2020) focus more on the effect of economic freedom on economic growth wherein their research, they found a positive and significant effect of economic freedom with each of the indicators used on economic growth.

Mogens (2008) states a positive and robust causal relationship from economic freedom observed through monetary freedom and trade freedom to economic growth. As for those who confirm that economic freedom affects the rate of economic growth positively through foreign investment (Calvo & Sanchez-Robles, 2003), foreign direct investment inflows (Mun et al., 2008), and domestic volume (Doucouliagos & Ulubasoglu, 2006). A study conducted (Bayar & Aytemiz, 2015) related to the impact of economic freedom in the US on economic growth in 7 Asian countries which proved that economic freedom had a positive impact on economic growth..

Bayar (2016) focuses on the impact of economic freedom and trade openness on economic growth in transition countries. The use of data from 1996-2012 proves that economic freedom and trade openness can increase economic growth in 11 EU member countries. (Ossono, 2012) asserts that in terms of economic freedom, the group of African countries has a statistically significant positive impact on GDP per capita. Following empirical studies (Kiliç & Arica, 2014), economic freedom has a significant positive effect, while the inflation rate has a significant negative effect on economic growth. Continued (Tiwari, 2011) conducting research in Asian countries using an annual time series data set for 1998-2007. This shows that economic freedom has a positive and significant effect, while the entry of foreign direct investment and foreign aid negatively affects economic growth.

The entry of foreign direct investment has a close relationship with economic growth, especially for developing countries, where policies related to the attraction of FDI have become a top priority during the growth and development process in these countries (Vo et al., 2019)&(Chaudhury et al., 2020). Empirical studies (Bosworth et al., 1999;Dinh et al., 2019;Schoors & Tol, 2002) claim that FDI affects economic growth in the long term but has no effect in the short term. A study by Baiashvili & Gattini (2019) found that FDI positively impacts growth. His research detects a statistically significant relationship between the level of national income and the impact of FDI on growth. This finding is in line with (Li & Liu, 2005) finding a relationship between FDI and economic growth both directly and through interactions with local human resources and technology gaps for both developed and developing countries.

Furthermore Opeyemi (2020) also proved in his research that FDI positively impacted growth in the five countries he reviewed. On the other hand (Carkovic & Levine, 2005) found that FDI did not affect economic growth either directly or through the level of human capital. In line with Lyroudi et al., (2004), there was no impact of FDI on economic growth for emerging markets in the short term during 1995-1998. Based on the opinion of several researchers, it can be interpreted that FDI is one of the critical factors to achieve the goal of economic integration. The success of economic integration alone can increase long-term benefits and improve relations between different countries.

Besides FDI, inflation is also one of the factors that can affect growth. Bhowmik (2021) shows that inflation is negatively correlated with economic growth and has not been established as a significant determinant of economic growth in Bangladesh. Also Opeyemi (2020) claims that high inflation tends to hamper growth in Africa. In line with Karki et al., (2020), generally, low and stable inflation can help economic activity, while high inflation is detrimental to growth. From several explanations, it can be concluded that high inflation has a negative impact on economic growth.

Countries with characteristics of low public spending, income distribution, and high savings rates make economic growth in their country very fast. The country is specifically called the Asian Tiger, including Singapore, South Korea, Japan, Hong Kong, and Taiwan (Paldam, 2003). Research conducted shows that the states of South Korea and Taiwan tend to be similar to European countries, which have a slightly lower level of economic freedom. Meanwhile, Singapore and Hong Kong as trading countries have different ownership rights similar to the United States.

Based on the cases above, which focus their research on several countries in knowing their economic growth, some researchers focus more on examining groups of countries and the criteria for certain grouping countries, such as in southeast Europe (Vukotić & Baćović, 2006), Islamic Countries (Türedi, 2013), in the Pacific Island Countries (Juswanto & Ali, 2016), in EU Countries (Ivanović & Stanišić, 2017), and ASEAN countries (Tran, 2019).

3. Research Method

This study uses annual data covering 20 years from 2000-2020 using samples from East Asian countries; China, Hong Kong, Japan, Macau, Mongolia, South Korea. Taiwan is not included in the study because this country is not listed in the Heritage Foundation and North Korea is because the required data is not available at the World Bank. Then the countries in Southeast Asia include; Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste, and Vietnam. The type of data in this study includes secondary data where data collection is done electronically about the state of economic freedom and economic growth of East Asian and Southeast Asian countries.

There are four major categories or pillars of economic freedom that are used based on the Index of Economic Freedom (The Heritage Foundation, 2021) including:

1. Rule of Law (property rights, government integrity, judicial effectiveness),
2. Government Size (government spending, tax burden, fiscal health),
3. Regulatory Efficiency (business freedom, labor freedom, monetary freedom), and
4. Open Market (freedom of trade, investment, financial freedom).

Data on the state of economic freedom are collected based on annual reports published by the Heritage Foundation (*www.heritage.org*). Meanwhile, data collection on economic growth, FDI, and inflation were taken from the official website of the World Bank (*www.worldbank.org*). The data collected in the form of panel data is processed through the EViews program. To analyze the effect of economic freedom, FDI, and inflation on economic growth, we test the following hypotheses.

H_a: Economic freedom, FDI, and inflation have a simultaneous and partial positive effect on economic growth in East Asian and Southeast Asian countries.

H_0: Economic freedom, FDI, and inflation have a simultaneous and partial negative effect on economic growth in East Asian and Southeast Asian countries.

Initial panel regression is defined as follows:

$$GROWTH_{it} = \alpha + \beta_1 \mathrm{IEF}_{it} + \beta_2 FDI_{it} + \beta_3 INF_{it} + e_{it}$$

GROWTH : Economic Growth Rate
IEF: Index of Economic Freedom
FDI : Foreign Direct Investment Ratio
INF: Inflation Rate

4. Results and Discussion

Prior to the panel regression test in answering the problem formulation, a descriptive statistical test was conducted to describe the essential characteristics of the data used in this study. Each variable used has an average value, standard deviation, minimum and maximum values.

Table 1. Descriptive statistics

	GROWTH	IEF	FDI	INF
Mean	3.805247	62.69015	6.433927	4.357740
Median	4.344633	60.70000	3.437026	3.120593
Maximum	22.37633	90.20000	58.51875	39.17819
Minimum	-54.64145	33.50000	-37.17265	-17.61280
Std. Dev.	6.256821	13.39512	9.578727	6.226217
Skewness	-5.166752	0.492711	1.731288	1.544102
Observations	325	325	325	325

Note: Variables are defined as follows: economic growth (GROWTH), Index of Economic Freedom (IEF), Foreign Direct Investment (FDI), and Rate of Inflation (INF).

Table 1 shows the individual characteristics of the variables used, namely the average GROWTH of 3.80 between 2000 and 2020. The maximum GROWTH in 2020 was 22.38, while the lowest in 2000 was -54.64. IEF, FDI, and INF averaged 62.70 percent, 6.43 percent, and 4.36 percent during the 20 year study period.

The Hausman test will next be performed to assess whether the fixed effect or random effect model is better suited for this investigation. Table 2 shows that the probability value of chi-squares is 0.4767, which means it is greater than the significance level (0.47>0.05), so rejecting H_0 means that it is more appropriate to use random effects than fixed effects.

Table 2. Correlated Random Effects – Hausman Test

Test Summary	**Chi-Sq. Statistic**	**Chi-Sq. d.f.**	**Prob.**
Cross-section random	2.492219	3	0.4767

Cross-section random effects test comparisons:

Variable	**Fixed**	**Random**	**Var(Diff.)**	**Prob.**
IEF	-0.026233	-0.148485	0.007399	0.1553
FDI	0.239645	0.214899	0.000906	0.4110
INF	0.181166	0.170437	0.000575	0.6547

After determining the model used in data analysis, a multicollinearity test was carried out on the independent variables, namely economic freedom, foreign direct investment, and inflation. The purpose of the multicollinearity test is to determine if the regression model discovered a high or perfect correlation between the independent variables (Nachrowi & Usman, 2006). Generally, the cutoff value used to indicate the presence of multicollinearity is Tolerance < 0.10 or equal to VIF > 10. Table 3 shows that the VIF value does not exceed 10, and it can be concluded that there is no significant multicollinearity in the sample.

Table 3. Multicollinearity test (variance inflation factor (VIF) values)

Variable	**Coefficient Variance**	**Uncentered VIF**	**Centered VIF**
IEF	0.001034	41.98741	1.827869
FDI	0.001625	2.135173	1.469939
INF	0.003547	2.021441	1.355422
C	4.203475	41.55995	NA

The results of the model feasibility test are reflected in the results of the F test, which can be seen in Table 4, where $F_{count}>F_{table}$ (21.62 > 2.63) and the probability value is smaller than the significance level (0.000<0.05) which means rejecting H0 or overall IEF, FDI and INF together have a positive and significant effect on the dependent variable. In addition, the Adjusted R-squared value obtained is 16.03percent which shows the proportion of the influence of all independent variables on the dependent variable, while other factors outside the model influence the remaining 83.97 percent.

Table 4. Regression Results

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	11.59896	2.050238	5.657374	0.0000
IEF	0.155323	0.032149	4.831406	0.0000
FDI	0.197905	0.040316	4.908839	0.0000
INF	-0.153793	0.059559	-2.582189	0.0103
R-squared	0.168103	Mean dependent var		3.805247
Adjusted R-squared	0.160328	S.D. dependent var		6.256821
S.E. of regression	5.733350	Akaike info criterion		6.342708
Sum squared resid	10551.69	Schwarz criterion		6.389278
Log likelihood	-1026.690	Hannan-Quinn criter.		6.361294
F-statistic	21.62172	Durbin-Watson stat		1.660622
Prob(F-statistic)	0.000000			

The model formed in this study forms the panel data regression equation as follows:

$$GROWTH_t = 11.598 + 0.155_{IEF,t} + 0.197_{FDI,t} - 0.153_{INF,t}$$

Table 4 shows that Economic Freedom has a positive and significant effect on economic growth, as evidenced by $T_{count}>T_{table}$(4.831406>1.966707), and the probability value is smaller than the significance level (0.000<0.05). This assumes that if economic freedom increases, the value of economic growth will also increase. Foreign Direct Investment (FDI) has a positive and significant effect on economic growth, as evidenced by $T_{count}>T_{table}$ (4.908839>1.966707), and the probability value is smaller than the significance level (0.000<0.05). This result assumes that if FDI increases, the value of economic growth will also increase. Then Inflation (INF) has a negative and significant effect on economic growth in East Asian and Southeast Asian

countries, as evidenced by $T_{count}<T_{table}$ (-2.582189<1.966707), and the probability value is smaller than the significance level (0.0103<0.05). This result means that if inflation falls, economic growth will increase otherwise if inflation increases, economic growth will decrease.

5. Conclusions and Suggestions

Economic freedom has been acknowledged as one of the essential factors for economic progress in any nation. Table 4 demonstrates that economic freedom has a favorable and considerable influence on economic growth in East Asian and Southeast Asian countries from 2000 to 2020. This study outlines the index of economic freedom through measures of freedom of the rule of law, government measures, regulatory efficiency, and open markets. Where the level of regulation is low, the availability of a legal framework that is not much but appropriate and supported by solid law enforcement indicates that the country has a higher level of economic freedom. The number of laws issued by the government that are binding but do not lead to the right point reflects low freedom so that it can have an impact on the growth.

Besides that, we can observe economic freedom through the expenditure of tax burdens, policies that are not excessive, and expenditures that do not conflict with people's choices and freedom and market coordination. Fiscal policy is an action taken by the government in taxation and the state budget to influence economic aggregate spending. A decrease in tax policy can have a multiplier effect on income (economic output). Furthermore, the outcomes of this study suggest that trade openness and economic freedom promote economic growth. Consequently, countries must enhance institutional quality and liberalize trade in a sustainable manner. Additionally, a country must have a competent financial infrastructure in order to profit from financial openness.

The entry of foreign direct investment has also positively influenced economic growth in East Asian and Southeast Asian countries during 2000-2020. This indicates that the receipt of foreign direct investment can increase productivity and macroeconomic stability. The source of these funds is very potential as a driver of the economy. Besides, this investment is believed to be relatively safe in the long term. This positive impact due to FDI funds invested into the East and Southeast Asian economies has been able to have a positive impact on increasing growth. FDI is believed to be one of the sources that can make a significant contribution to development through the transfer of assets, technology, and managerial skills to increase economic growth.

Meanwhile, high inflation had a negative impact on economic growth in East Asian and Southeast Asian countries. It is generally believed that high inflation rates can hurt growth, while low, stable inflation helps economic activity. Inflation is a dangerous factor for the growth of every country, not only for the states of East Asia and Southeast Asia. To keep the inflation target range around the inflation rate, it is required to implement policies that increase the rate of economic growth and decrease inflation's negative impact on economic growth. Consideration of the increase in production costs is one of the government's strategies for mitigating inflation's influence on economic growth.

In addition to the research results described, we can provide suggestions for future researchers interested in conducting similar research. It is hoped that they can use a more extended research period and sample and use other indicators to strengthen the latest research results. Can also describe in (more) detail the comparison of economic growth results from one country to another.

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APPENDIX

a. Nations Included in Sample

Brunei Darussalam	South Korea	Philippines
Cambodia	Laos	Singapore
China	Macau	Thailand
Hong Kong	Malaysia	Timor-Leste
Indonesia	Mongolia	Vietnam
Japan	Myanmar	

b. Description of Variables

Variable type	**Variable name**		**Description**	**Source**
Dependent variable	Economic Growth **(GROWTH)**		Annual growth rate of per capita Gross domestic product, presented as a percentage. There is a substantial correlation between sustained economic expansion and poverty alleviation. GDP per capita gives a fundamental measure of output per person, which is an indirect indicator of income per capita. GDP and GDP per capita growth are regarded as broad indicators of economic growth.	*The World Bank*
Independent Variables	Economic Freedom **(IEF)**	Property Rights	The ability to accumulate property rights and personal property that can be guaranteed by the rule of law.	*The Heritage Foundation/ The Wall Street Journal*
		Government Integrity	The government integrity sub-index evaluates economic, judicial, and administrative system-level corruption, although systemic corruption of government institutions is of more importance.	*The Heritage Foundation/ The Wall Street Journal*
		Judicial Effectiveness	A well-functioning legal framework protects the rights of all citizens from violations of the law by others, including by governments and those in power.	*The Heritage Foundation/ The Wall Street Journal*
		Tax Burden	This tax burden reflects the entire tax burden of all kinds of taxes as a proportion of gross domestic product (GDP).	*The Heritage Foundation/ The Wall Street Journal*
		Government Spending	Cost, scale, and intrusiveness of government are a fundamental economic freedom issue that are quantified in a number of ways by the Index.	*The Heritage Foundation/ The Wall Street Journal*
		Fiscal Health	One of the clearest indicators of the extent to which it can respect the principle of limited governance by delineating priorities and allocating resources.	*The Heritage Foundation/ The Wall Street Journal*
		Business Freedom	The ability to set up and run a company without undue interference from the state and without burdensome and excessive regulations that create barriers to entrepreneurial activity.	*The Heritage Foundation/ The Wall Street Journal*
		Labor Freedom	The capacity of a person to locate employment possibilities and of enterprises to freely contract labor and lay off superfluous people when they are no longer needed are vital for boosting productivity and sustaining economic development generally.	*The Heritage Foundation/ The Wall Street Journal*
		Monetary Freedom	As entrepreneurs or consumers, economically free individuals require a stable and trustworthy currency as a means of trade, a unit of account, and a store of value.	*The Heritage Foundation/ The Wall Street Journal*
		Trade Freedom	The government does not restrict its people' ability to participate freely on the worldwide market as buyers or sellers.	*The Heritage Foundation/ The Wall Street Journal*
		Investment	A free and open investment environment offers the greatest	*The Heritage Foundation/*

		Freedom	entrepreneurial prospects and incentives for increased economic activity, higher productivity, and job creation.	*The Wall Street Journal*
		Financial Freedom	A formal financial system that is accessible and effectively operating enables the provision of diverse savings, credit, payment, and investment options for individuals and enterprises.	*The Heritage Foundation/ The Wall Street Journal*
	Foreign Direct Investment **(FDI)**		Foreign direct investment reflects net inflows from investments aimed at obtaining management rights in companies located in other economies (direct investment companies).	*The World Bank*
	Inflation **(INF)**		The continuous increase in the price of goods and services that affects individuals, entrepreneurs and the government resulting in unstable monetary growth.	*The World Bank*