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Research Article

Governance Effectiveness and Economic Growth: Empirical Evidence from ASEAN

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Abstract

This study aims to analyze economic growth in the ASEAN region by examining economic indicators such as trade openness, labor force, and foreign direct investment (FDI) flows. To provide a broader perspective, an Islamic analysis is incorporated to offer a comparative view. Additionally, the study introduces a variable for government governance to evaluate its moderating effect (using Moderating Regression Analysis) on the relationship between dependent and independent variables. The research period spans from 2017 to 2022, covering ten ASEAN member countries as the sample. Secondary data sourced from the World Bank, and Our World In Data were analyzed using a panel data approach. The study's findings reveal that trade openness has a negative and insignificant effect on economic growth, the labor force has a significant positive effect, and foreign direct investment has a negative and insignificant effect. Furthermore, the Good Governance Indicator effectively moderates the impact of the labor force on economic growth. These findings provide valuable insights for policymakers and practitioners in formulating sustainable and inclusive economic development strategies in the ASEAN region. Such strategies include promoting equitable trade policies, implementing selective investment strategies, and improving governance across ASEAN member states. Moreover, this study emphasizes the importance of fostering regional cooperation among ASEAN countries to share best practices in implementing good governance principles, consistent with Islamic values, to achieve economic stability and collective prosperity.

Keywords: Economic Growth, Governance Effectiveness, Islamic Perspective

Introduction

The challenges of globalization necessitate that every nation adapts, particularly in economic aspects, which are crucial for achieving regional prosperity and stability. These challenges align with the long-term goals of ASEAN (Association of Southeast Asian Nations), a regional organization in Southeast Asia founded on August 8, 1967, in Bangkok. ASEAN has three primary objectives: reducing internal tensions within the region, countering external influences, and fostering the development of social, economic, and cultural subsystems (Azam et al., 2015).

Numerous studies highlight the significant role of trade openness in shaping economic dynamics. For instance, Keho (2017),suggest that increased trade volumes can drive national economic growth, provided policymakers implement optimal trade policies. Open trade policies facilitate access to foreign resources, increase domestic market share, and enhance productivity through technology transfer and innovation diffusion (Raghutla, 2020).

Endogenous growth theory underscores the importance of internal factors, particularly labor, in fostering economic growth (Todaro, 2015). Labor significantly influences production capacity, provided job creation and skill development align with workforce expansion. Empirical evidence demonstrates that a skilled workforce drives innovation and attracts multinational investments (Intisar et al., 2020).

Similarly, FDI plays a crucial role in technology transfer, capital inflow, and market expansion, strengthening ASEAN's economic foundations. However, attracting FDI depends on market size and governance quality (Nguyen, 2021). Indicators of good governance such as accountability, rule of law, and corruption control are vital for fostering an economic environment conducive to sustainable growth (Hong Vinh et al., 2017).

This study uniquely incorporates an Islamic perspective to provide alternative solutions for achieving sustainable economic growth (Arie, 2015). Islamic economics emphasizes welfare and moral values, integrating normative and positive principles for holistic development (Suntana, 2010). For instance, the Quran emphasizes the significance of hard work (QS. An-Najm [53]:39):

وَاَنْ لَّيْسَ لِلْاِنْسَانِ اِلَّا مَا سَعٰىۙ

Meaning:

And that there is not for man except that [good] for which he strives.

This verse underscores the importance of productivity and sustainable effort in achieving progress, aligning with the study's goal to analyze the effects of trade openness, labor, FDI, and governance effectiveness on ASEAN's economic growth.

Literature Review

Trade Openness

According to economic analysis, one of the primary benefits of trade openness is achieving rapid and stable economic growth and development. For instance, Grossman & Helpman (1990), developed an endogenous growth model suggesting that trade between developed and developing countries, under certain conditions, can increase the long-term growth rate in less developed countries. To catch up with developed nations, higher and sustainable economic growth is essential for these countries.

Trade openness in each country finds its roots in the mercantilist theory of the 15th and 16th centuries, which emphasized an international trade policy aimed at maximizing exports while minimizing imports. This theory served as a signal for countries to accumulate wealth, particularly in the form of precious metals. As a reaction to mercantilism, a new theory emerged as its antithesis: the theory of comparative advantage, popularized by David Ricardo (1772–1833). Ricardo argued that to excel in trade, it is more crucial for countries to maximize their comparative advantages (Ricardo, 1821).

From an Islamic perspective, trade is considered a muamalah (transactional) activity designed to benefit all parties involved. Conventional economic theory posits that trade openness can lead a country toward prosperity. In Islamic economics, this sector also holds significant importance as it is closely tied to the real sector. Quraish Shihab states that the Qur'an teaches economic activities should adhere to social dimensions, guided by ethical and moral values of sharia . This perspective integrates physical, mental, spiritual, and social needs while maintaining a balance between strong and weak groups, avoiding hostility. Islam encourages individuals to work and earn profit without harming society (Karim, 2001). In the context of international trade, Islam underscores that the ultimate goal is to fulfill human physical and spiritual needs naturally, contributing to environmental welfare and economic growth. This aligns with the Quranic verse:

He has created you from clay and made you to prosper the earth" (Hud: 61). Based on this theoretical foundation and literature review, the following hypothesis is proposed:

H1: Trade Openness Positively Affects Economic Growth.

Labor Force

The International Labour Organization (ILO) defines the workforce as the population aged 15 years and above who are capable of producing goods and services when there is demand and are willing to participate in such activities. The quality of human resources is a critical factor for long-term economic growth. However, this requires adequate education, access to modern technology, and high productivity levels. Therefore, the workforce significantly impacts economic growth (Todaro, 2015).

Economist Arthur Lewis highlighted that excess labor in a country presents an opportunity for growth. A large workforce can support multiple sectors, thereby increasing output. Lewis's model emphasizes two key sectors in developing countries: the traditional and modern sectors. During industrialization, excess labor is often absorbed by the informal sector, which functions as a subsystem of employment security. This process ultimately increases rural wage levels and, consequently, economic growth (Safira et al., 2018).

In Islamic thought, employment plays a central role in economic activity, contributing to value creation and wealth. This perspective emphasizes ethical aspects as a form of responsibility. Governments are encouraged to expand employment opportunities to improve societal welfare and stimulate economic growth. Ibn Khaldun described work as a self-correcting activity and a manifestation of human stewardship, carrying both material and spiritual significance (Saprida, 2017). Based on this foundation, the following hypothesis is proposed:

H2: The Workforce Positively Influences Economic Growth

Foreign Direct Investment

Foreign direct investment (FDI) represents the provision of capital from developed to developing countries. To achieve this, countries must attract foreign investors to boost economic growth. In line with the growth theories of Harrod (1939) and Hagemann (2009), savings are critical for driving capital accumulation and economic development. Aizenman et al. (2019), further emphasized the importance of savings in development. However, for developing nations, mobilizing savings in the short term remains a challenge. Consequently, international institutions like the IMF and World Bank recommend foreign funding through FDI mechanisms.

FDI often involves companies from one country investing in another, typically classified as foreign investment. In Islamic economics, while specific mechanisms and provisions for FDI are not detailed, the emphasis lies on permissible muamalah (economic activities). Investment capital must not support industries engaging in prohibited activities or those contrary to sharia (Nguyen, 2021). Therefore, while Islam does not explicitly distinguish between domestic and foreign investors, it requires compliance with ethical and religious principles. Based on this, the following hypothesis is proposed:

H3: Foreign Direct Investment Positively Affects Economic Growth.

Governance Effectiveness

Governance Effectiveness index reflects the quality of policies and management that positively impact government performance. According to the World Bank, governance quality—measured by the implementation of sound principles—forms a framework for fostering economic growth. Wibowo (2020) argues that quality governance contributes to economic growth through effective policies. Studies by Kaufmann et al. (1999) have shown a positive relationship between good governance and economic growth.

Islamic economic history provides examples of effective governance by integrating religious principles into practical policies (Jajang, Nur Rianto, 2021). This approach emphasizes moral accountability and aligns governance with the principles of Maqashid Syariah:

1. **Hifdz ad-Din** (protecting religion)
2. **Hifdz al-Maal** (protecting property)
3. **Hifdz al-Aql** (protecting reason)
4. **Hifdz an-Nafs** (protecting life)
5. **Hifdz an-Nasl** (protecting descendants).

Given the importance of governance in economic development, this study proposes the following hypotheses:

H4: Governance Effectiveness moderate the effect of trade openness on economic growth.

H5: Governance indicators Effectiveness moderate the effect of the workforce on economic growth.

H6: Governance Effectiveness moderate the effect of FDI on economic growth.

Research Method

This study uses a prophetic paradigm, which is a scientific process by connecting comprehensive studies through religious studies. In addition, the type of data selected is panel data and uses multiple regression to provide further information. The number of countries selected is 10 ASEAN member countries with a five-year period (2017–2022).

Tabel 1. Definition of Variable

Variable	Type of Variable	Measurenment	Source
Economic Growth (EG)	Dependen	(% dari PDB)	World Bank
Trade Opennes (TO)	Independen	(% of GDP)	World Bank
Labor Force (LF)	Independen	(% of total population aged 15-64 years)	Our World In Data
Foreign Direct Investment (FDI)	Independen	(% of GDP)	World Bank
Governenca Effectiveness	Moderating Variable	Score -2.5 (weak) to 2.5 (strong)	World Bank

Source: Computed by Authors

Table 1, shows the variables used, types of variables, measurements, and sources of research data. As explained previously, this study uses panel data to improve the quality and reliability of model estimation. Therefore, the equation model built is:

$$EGi,t = \alpha + \beta 1TOi,t + \beta 2LFi,t + \beta 3FDIi,t + \beta 4TO * GEi,t + \beta 5LF * GEi,t + \beta 6FDI * GEi,t + \mathcal{E}$$

The formulation above can be interpreted as follows: EG (Economic Growth) is the dependent variable, serving as the main focus of this study. LF (Labor Force) represents the independent variable, while FDI (Foreign Direct Investment) and GE (Governance Effectiveness) act as moderating variables. α denotes the constant, while i and t indicate the country and year of the study, respectively. Finally, Ɛ represents the error term.

Result and Discussion

Descriptive Statistics

Table 2. Descriptive Statistics

	EG	**TO**	**LF**	**FDI**	**IG**
Mean	260.000	554.9885	32.618.234	17.400.000	-0.079.167
Rata-rata	180.000	116.7429	17.112.873	8.490.000	-0.29
Maximum	1.190.000	26551.34	137.000	1.410.000	1.65
Minimum	-1.628.332	2.004156	206.363	-4.950.000	-1.46
Std. Deviasi	309.000	3413.936	38.972.606	3.010.000	0.768045
Observasi	60	60	60	60	60
Probability	0.000	0.000	0.000	0.000	0.0 220

Source: Data Processed

Based on the descriptive statistical test, the characteristics of each research variable can be assessed as follows. First, the research data is considered to meet the normality requirements since the number of observations exceeds 30. The study utilizes a sample of 10 ASEAN countries over a six-year period (2017–2022), resulting in a total of 60 observations.

Table II presents the dependent variable, economic growth, with a mean value of 260,000, a median of 180,000, a maximum value of 1,190, a minimum of -1,628, a standard deviation of 309,000, and a probability value of 0.000. This indicates that variations in the economic growth data significantly differ or are not uniform. The Trade Openness variable exhibits a mean value of 554,980, a median of 116,742, a maximum value of 26,551.34, a minimum of 2.0041, a standard deviation of 3,413.93, and a probability value of 0.000. These results suggest that the differences in the trade openness data significantly impact or deviate from uniformity.

The Labor Force variable shows a mean value of 32,618, a median of 17,112, a maximum value of 137,000, a minimum value of 206,363, a standard deviation of 38,972, and a probability value of 0.000. These findings indicate significant variations in the labor force data characteristics. For Foreign Direct Investment (FDI), the results show a mean value of 174,000, a median of 88,490, a maximum value of 1,410, a minimum value of -4,950, a standard deviation of 3,010, and a probability value of 0.000. This suggests that the FDI data exhibits significant variations and unequal influences.

Finally, the Governance Effectiveness, used as a moderating variable, records a mean value of -0.790, a median of -0.29, a maximum of 1.65, a minimum of 1.46, a standard deviation of 0.76, and a probability value of 0.000. This indicates that variations in the governance indicator data significantly influence the results.

Panel Data Regression Analysis and MRA

Before determining the best model, the researcher used three stages of Chow test, Hausman test, and Lagrange Multiplier test. However, to save space, this study only displays the best model, namely the Random Effect Model (REM), as the selected model and further analyzed.

Table 3. Panel Data Regression Analysis and MRA

Variable	Coeficient	Std. Eror	T-statistic	Prob.	Result
C	98.600.00	45.5	2.167069	0.0348	
TO	-9554250	7436696	-1.284744	0.2046	Not Significant
LF	8621.357	1321.807	6.522402	0.0000	Significant
FDI	-4.216572	6.057379	-0.696105	0.4895	Not Significant
GE(M)	-7.060.000	363.5	-0.111192	0.9119	Not Significant
GE*TO	247758.1	449888.9	0.55071	0.5842	Not Significant
GE*LF	11435.1	3710.833	3.081546	0.0033	Significant
GE*FDI	3.15975	3.70972	0.851749	0.3983	Not Significant
R-squared	260				
Prob(F-statistic)	0.000				

Sumber: Eviews Diproses

Discussion

Impact of Trade Opennes on Economic Growth

Based on the statistical test results above, the coefficient of the trade openness variable shows a negative and insignificant value, with a probability of 0.20 > 0.05. These results contradict the hypothesis proposed by the researcher. Referring to the hypothesis test results, the findings are inconsistent with the theory proposed by Grossman & Helpman (1991), which suggests that international trade can drive higher and more sustainable economic growth. Additionally, the study fails to confirm prior empirical research by Akhtar et al. (2023), which indicated that international trade is a significant means of enhancing economic growth across various countries. However, the results align with findings, which Ulaşan (2015), concluded that all measures of openness, such as real openness and import duties, are not significantly related to economic growth. This implies that trade openness policies in some countries may not fully enhance economic growth.

To address inconsistencies between modern economic theory and empirical findings regarding the role of trade openness in economic growth, it is essential to evaluate and amend government policies. International trade theory presents a paradox: some theories yield benefits, while others lack positive implications for participating nations. This underscores that domestic trade policies must consider global trade frameworks. Islam offers a unique perspective on international trade, emphasizing trade principles based on subjects rather than commodities. Islamic economics prioritizes market participants' integrity over material aspects, ensuring that trade fosters humanitarian, not materialistic, values (Jaelani, 2018). This principle highlights the significance of achieving *maslahah* (public welfare) and fulfilling *maqashid sharia* (Islamic objectives).

The Influence of the Labor Force on Economic Growth

The findings reveal that the workforce variable positively affects economic growth, as evidenced by a probability value of 0.00 (<0.05). This indicates that workforce growth contributes significantly to economic development, aligning with the hypothesis that the workforce can drive ASEAN's economic growth. These results are consistent with Lewis' theory, which posits that the workforce is a critical driver of economic growth. The analysis highlights that ASEAN's workforce during the study period demonstrated good quality and productivity, positively influencing economic performance. Additionally, the study confirms prior findings by Intisar et al. (2020), which show that an innovative and educated workforce significantly supports economic growth.

From an Islamic perspective, laborers are encouraged to pursue excellence and achieve their goals, fostering broader economic progress. Fadllan & Maufiroh (2022), asserts that Islam views work as a production subsystem grounded in *istikhlaf* (trust), inspiring social responsibility and the efficient utilization of resources entrusted by Allah. This underscores the importance of intellectual capacity, honesty, professionalism, devotion, and responsibility in work environments. Therefore, enhancing workforce skills is essential to meet job market demands effectively.

Influence of Foreign Direct Investment on Economic Growth

The analysis of the relationship between FDI and economic growth reveals a negative and insignificant correlation, with a probability value of 0.52 > 0.05. These findings are inconsistent with the hypothesis that FDI positively influences economic growth. The results also contradict Hymer (1960), theory, which suggests that FDI boosts economic growth, as well as claims by the IMF and World Bank regarding FDI's importance for development. The findings highlight the need for ASEAN governments to focus on improving human resource quality alongside infrastructure development. Long-term investments in human capital are crucial for sustained economic growth. Policymakers must adopt conducive FDI strategies, emphasizing sectors that align with long-term development priorities. Effective management of investment funds is imperative to ensure that they support targeted government programs.

From an Islamic perspective, investment is seen as part of the *fiqh of muamalah* (Islamic commercial jurisprudence), where all forms of transactions are permissible unless explicitly prohibited. Governments should ensure that investments prioritize public welfare, promote equitable resource distribution, and foster sustainable development. Chapra (2000),emphasizes that investments must produce competitive profits, adhere to *halal* (permissible) principles, prioritize environmental sustainability, and align with divine pleasure. This holistic approach ensures that investments benefit society at large

Impact of Trade Openness on Economic Growth with Governance Effectiveness as a Moderating

The analysis of the MRA model regarding the correlation between trade openness and economic growth in this study did not reveal a statistically significant positive relationship. This conclusion is based on a probability value of 0.58, which exceeds the α threshold of 5%. These results contradict the researchers' hypothesis, which suggests that governance does not moderate the impact of trade openness on economic growth in ASEAN countries. This outcome also diverges from previous studies conducted Holdren & Ehrlich (1974), which examined the relationship between good governance defined as governance that enhances market functionality and economic growth, and found a positive relationship between the two. However, the findings of this study align with those presented by (Arohman et al., 2023). In their research, demonstrated that the economic growth of countries in the Middle East and North Africa was not significantly influenced by their governance structure.

The Impact of Labor Investment on Economic Growth with Governance Effectiveness as a Moderating Variable

The analysis of the MRA model regarding the correlation between the labor force and economic growth in this study revealed a statistically significant positive relationship. This conclusion is based on a probability value of 0.003, which is below the α threshold of 5%. These findings support the hypothesis proposed by the researchers, suggesting that governance has the capacity to moderate the impact of the labor force on economic growth in ASEAN countries. This result contrasts with previous studies conducted by Kraay et al. 2010), which examined the relationship between good governance defined as governance that enhances market functionality and found favorable outcomes, indicating a positive relationship between good governance and economic growth. However, this study aligns with findings Ihsan (2021), who examined countries in the Organization of Islamic Cooperation (OIC) and concluded that the governance index can significantly influence a country's economic growth.

Impact of Trade Openness on Economic Growth with Governance Effectiveness as Moderating Variable

The examination of the MRA model on the correlation between foreign direct investment (FDI) and economic growth in this study failed to reveal a statistically significant positive relationship. This conclusion is based on a probability value of 0.398, which exceeds the α threshold of 5%. These results contradict the hypothesis formulated by the researchers, which posited that governance cannot moderate the impact of trade openness on economic growth in ASEAN countries. This finding contrasts with earlier studies Wibowo (2020), which examined the relationship between good governance defined as governance that enhances market functionality and reported favorable outcomes, indicating a positive relationship between good governance and economic growth.

However, this finding aligns with Linawati et al. (2021), whose research demonstrated that state governance is not the primary determinant in enhancing a country's economic growth. Based on the results of the moderating effect of governance variables, the authors emphasize that states must simultaneously address the demands of economic development, political and social integration, and growing public demands for equitable development. In turn, good governance is not only essential for protecting human rights and civil liberties but is also strongly correlated with economic development and holds the potential to significantly improve living standards.

Sharma (2007), highlighted that increased government spending and improved governance quality have significant implications for economic growth. Accordingly, optimal management of the public budget and its allocation to good governance programs can directly contribute to economic progress. Lesmana & Soetjipto (2022), interpreted good governance as administrative and institutional competence that ensures the efficient allocation and management of resources. Thus, good institutional governance under government oversight is critical for driving economic growth.

The assessment of ideal governance is fundamentally consistent with the indicators developed by the World Bank and also aligns with the principles of Islamic governance. Substantially, achieving institutional and societal progress requires reform and a sincere commitment to change. The Islamic paradigm views good governance as encompassing economic, financial, legal, political, and social improvements that are integrated and compliant with sharia provisions (Abdul Qoyun, 2021).At its core, this approach is based on five dimensions: Hifdz Ad-Din (protection of religion), Hifdz Al-Maal (protection of wealth), Hifdz Al-Aql (protection of intellect), Hifdz An-Nafs (protection of human dignity), and Hifdz An-Nasl (protection of future generations).

Conclussion

This study aims to examine the factors influencing economic growth in ASEAN countries during the period 2017–2022, using governance as a moderating variable. The results reveal that trade openness and foreign investment do not have a significant impact on economic growth. In contrast, the labor force variable exhibits a positive and significant effect on ASEAN economic growth. Moreover, the MRA results indicate that the governance variable significantly moderates the relationship between the labor force and economic growth. By summarizing the findings, this study provides insights into the economic growth dynamics of ASEAN countries during the specified period, analyzed through the generalized least squares method. This model can serve as a reference for future research seeking to explore economic growth more critically with different datasets or samples.

From a policy perspective, governments should consider trade and FDI policies by implementing appropriate regulations, controlling trade liberalization, and assessing their implications for economic growth. Additionally, careful screening of foreign investment is essential to ensure that the benefits of generated wealth are fully realized by local communities while prioritizing sustainable development. In the context of economic development from an Islamic perspective, it is crucial to incorporate maqashid sharia as a framework for social control to achieve human welfare. This concept offers a rational and philosophical basis that ensures social and economic activities remain flexible, progressive, and meaningful.

For future research, it is recommended to extend the study period and employ alternative research models to obtain varied results and interpretations. Exploring different moderating variables or including additional variables not tested in this study could provide deeper insights. A notable limitation of this study lies in its simple research model and the inability of the dataset to encompass all ASEAN member countries. As a result, the analysis and discussion of economic growth in ASEAN countries may lead to multiple interpretations due to the limited sample size

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