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# The impact of economic freedom on foreign direct investment: a study of selected Southeast Asian economies

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## Abstract

**Purpose** – This study investigates the impact of economic freedom and its components, including business freedom, trade freedom, investment freedom, financial freedom and monetary freedom, on foreign direct investment net inflows (FDI net inflows).

**Design/methodology/approach** – The sample consists of six Southeast Asian countries, which are Cambodia, Indonesia, Malaysia, the Philippines, Vietnam and Thailand, covering the period from 1995 to 2022. The study employs various panel data estimation methods, including fixed-effects model (FEM), random-effects model (REM), generalized least squares (GLS) and the Driscoll–Kraay standard error method to operationalize our research objectives.

**Findings** – The research results show that the economic freedom index has a positive impact on FDI net inflows. However, the effects of the subcomponents of economic freedom vary. In particular, trade freedom and financial freedom positively impact FDI net inflows, while monetary freedom has a negative relationship with FDI net inflows. Moreover, we find no evidence of a relationship between business freedom, investment freedom and FDI net inflows.

**Practical implications** – The findings imply that Southeast Asian governments should consider further improving economic freedom, trade freedom and financial freedom policies to strategize for attracting FDI.

**Originality/value** – This study is the first to explicitly examine the impact of economic freedom and its components, including business freedom, trade freedom, investment freedom, financial freedom and monetary freedom, on foreign direct investment net inflows in the context of Southeast Asian countries. This aspect has not been clearly addressed in previous research.

Keywords Economic freedom, Trade freedom, FDI net inflows, Southeast Asian

Paper type Research paper

# 1. Introduction

In the current era of globalization, attracting foreign direct investment (FDI) has become one of the key factors driving economic development and structural changes in many developing countries worldwide. Organizations such as the IMF and the World Bank have pointed out that attracting large FDI inflows significantly impacts the economic development of countries (Khadaroo and Seetanah, 2009).

International capital flows have become more notable since 2018, when the trade war between the two largest economic blocs, the United States and China, created instability in trade relations between these economies. Consequently, many businesses and foreign investors have been skeptical concerning the stability of the business environment in China. Some major corporations have relocated part of their production out of China to avoid rising



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We are deeply grateful for the valuable comments and suggestions provided by the Editor and anonymous reviewers, which have significantly enhanced the quality of our research. We would also like to express our thanks to Phan Dang Bao Anh for assisting with the proofreading of the manuscript. costs due to international trade tensions. During this period, Southeast Asian countries have emerged as prominent destinations for absorbing FDI inflows, especially those originating from China.

When it comes to FDI flows, the primary matter for discussion is what characteristics give countries an advantage over others in attracting FDI. There are many debates and diverse opinions on this issue. Hoang (2012) points out that labor costs, human resources and labor productivity are factors contributing to appealing FDI. Meanwhile, other studies emphasize the importance of macroeconomic policies such as exchange rates, economic growth or political stability in attracting FDI (Ghazalian and Amponsem, 2019; Khandare, 2016; Saha et al., 2022). Othman et al. (2018a) and Khadaroo and Seetanah (2010) indicate that public investment, particularly in transportation infrastructure, is a main factor attracting FDI. However, recent studies by Sevoum and Ramirez (2019), Ghazalian and Amponsem (2019) and Dia and Ondoa (2023) suggest that economic freedom and trade freedom are critical and direct factors influencing FDI attraction. Therefore, the impact of economic freedom on FDI requires a more detailed examination. However, previous studies on how economic freedom influences FDI net inflows within the context of Southeast Asian countries remain limited. In particular, there is a paucity of studies exploring the specific effects of sub-components of economic freedom, including business freedom, trade freedom, investment freedom, financial freedom and monetary freedom, on FDI net inflows.

In this study, our contributions to the current debates on the role of economic freedom in FDI net inflows are twofold. First, and most importantly, the main contribution of this research lies in its focus on examining how specific components of economic freedom, including business freedom, trade freedom, investment freedom, financial freedom and monetary freedom, influence the ability of Southeast Asian countries to attract foreign direct investment. This disaggregated and in-depth analysis remains largely unexplored in the existing literature. Second, we also clarify the impact of the overall economic freedom index on foreign direct investment net inflows in countries within this region. These contributions are especially relevant as most Southeast Asian economies are classified as developing and are increasingly participating in major international trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

The results of this study have important implications for policymakers in formulating strategies related to attracting foreign investment. This is crucial as it affects the economic growth and strength of national economies.

#### 2. Literature review

#### 2.1 Overall economic freedom and FDI

Miller *et al.* (2018) define economic freedom as the right to work, produce, consume and invest without restrictions imposed by the government. If any intervention exists, the government's role is limited to protecting this right to the extent necessary to maintain it. The Economic Freedom Index, published annually by The Heritage Foundation, comprises 12 components (Miller *et al.*, 2018), specifically: property rights, judicial effectiveness, government integrity, tax burden, government spending, fiscal health, business freedom, labor freedom, monetary freedom, trade freedom, investment freedom and financial freedom. Among these five components, including business freedom, trade freedom, investment freedom, financial freedom and monetary freedom, represent the efficiency of governance and the openness of an economy. These factors are directly linked to the business environment and influence the investment decisions of foreign investors. Moreover, a common characteristic of these economic freedom components is their role in reducing transaction costs, which is a crucial factor in attracting higher levels of FDI (Grosse and Trevino, 2005).

The impact of economic freedom on FDI is prominently explained by the OLI theory developed by Dunning (1993). The OLI theory provides a theoretical framework for factors

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influencing FDI, addressing three advantages: ownership advantage, location advantage and internalization advantage. Location advantage depends entirely on the host country's characteristics, where trade freedom, tax policies, good infrastructure and cost advantages of local resources are crucial factors that significantly impact FDI attraction. Sooreea-Bheemul *et al.* (2020) argued that economic freedom represents an important location advantage in attracting FDI to recipient countries. Accordingly, countries with better economic freedom typically have better protection of intellectual property rights, lower government intervention in business activities, lower levels of government corruption and better contract enforcement, making multinational corporations more confident in making capital investments.

Many previous empirical studies support the notion that enhancing economic freedom is a key strategy for attracting foreign direct investment (FDI). Imtiaz and Bashir (2017), in the context of South Asia, and Quazi (2007), focusing on East Asia, both find that overall economic freedom is a critical component of the investment environment and has a significant influence on FDI inflows in these regions. In the case of developing countries in sub-Saharan Africa, Fofana (2014) and Dia and Ondoa (2023) also provide evidence of the positive impact of economic freedom on FDI attraction. Furthermore, several other studies suggest that improving and promoting economic freedom constitutes an effective strategy for attracting FDI (Seyoum and Ramirez, 2019; Moussa *et al.*, 2016; Subasat and Bellos, 2011). In summary, based on previous research findings, we propose the following research hypothesis:

H1. Overall economic freedom has a positive relationship with FDI net inflows.

# 2.2 Business freedom and FDI

Business freedom refers to the ease of establishing, operating and dissolving business activities (Miller *et al.*, 2018). This increases a country's attractiveness to foreign investors, thereby positively influencing FDI inflows (Economou, 2019). Most previous empirical studies provide evidence that countries with a more liberal business environment, characterized by fewer regulations on business establishment or closure, tend to attract higher FDI inflows (Economou, 2019; Sambharya and Rasheed, 2015; Serin and Çaliskan, 2010). However, some studies have found no significant impact of business freedom on FDI (Júlio *et al.*, 2013; Ibrahim *et al.*, 2022). Empirical research on Asian countries by Ullah and Khan (2017) indicates that countries with effective implementation of business freedom policies tend to attract higher levels of foreign direct investment. Accordingly, we propose the following research hypothesis for the case of Southeast Asian countries:

H2. Business freedom has a positive relationship with FDI net inflows.

## 2.3 Trade freedom and FDI

Trade freedom refers to the reduction of trade costs, including import tariffs, export tariffs and nontariff barriers, facilitating the flow of goods and services across countries (Miller *et al.*, 2018). Theoretically, the impact of trade freedom on FDI depends on the nature and strategy of multinational enterprises (Dia and Ondoa, 2023). Markusen and Venables (1998) argue that trade freedom encourages investment based on the vertical strategy rather than the horizontal strategy, as it benefits from reduced import and export costs. Vertical FDI occurs when multinational enterprises invest in production in a host country with the objective of exporting products to other target markets, including their home markets or other international markets. This strategy is typically aimed at optimizing transaction costs and leveraging resources in the host country. In contrast, horizontal FDI occurs when multinational enterprises invest in a country to produce and sell products directly in the local market. Protectionist countries are often more suitable for FDI adopting a horizontal strategy. Several studies emphasize that export-oriented FDI firms prefer countries with high trade freedom (Asiedu, 2002; Blonigen and Piger, 2014; Amiti and Javorcik, 2008). Previous empirical studies also support the positive impact of trade freedom on FDI attraction (Economou, 2019; Ghazalian and

Amponsem, 2019; Tag and Degirmen, 2022). Based on these findings, we propose the following research hypothesis:

H3. Trade freedom has a positive relationship with FDI net inflows.

## 2.4 Investment freedom and FDI

Investment freedom refers to the ability of individuals and businesses to transfer capital in and out of a country without facing barriers such as capital controls, investment restrictions or complex and nontransparent regulations (Miller *et al.*, 2018). Sambharya and Rasheed (2015) argue that multinational corporations highly value the security and long-term feasibility of their investment projects, which largely depends on the transparency of FDI-related rules and regulations in each country. A lack of transparency in FDI capital management can create uncertainty, increase transaction costs and raise risks for investors. Therefore, liberalizing FDI restrictions through a more transparent and open regulatory system not only facilitates capital inflows but also plays a crucial role in strengthening foreign investor confidence (Sambharya and Rasheed, 2015). Several empirical studies also provide evidence of the positive impact of investment freedom on FDI inflows (Economou, 2019; Singh and Gal, 2020; Albulescu and Ionescu, 2018). Accordingly, we propose the following research hypothesis:

H4. Investment freedom has a positive relationship with FDI net inflows.

### 2.5 Financial freedom and FDI

Financial freedom refers to the development of the financial system, including banks, stock markets and other financial institutions, which facilitate business and individual access to financial services. More specifically, financial freedom refers to an accessible and efficiently functioning formal financial system that ensures the availability of a wide range of savings, credit, payment and investment services for individuals and businesses. Government regulations on banking and finance that go beyond ensuring transparency and integrity in financial markets may hinder efficiency, increase the cost of financing business operations and constrain competition (Miller *et al.*, 2018). Economou (2019) asserts that minimal government intervention in the financial sector (i.e. financial freedom) undoubtedly creates favorable conditions for foreign investment and positively affects FDI inflows. Findings from previous empirical studies also support the positive relationship between financial freedom and FDI (Albulescu and Ionescu, 2018; Júlio *et al.*, 2013; Ciftci and Durusu-Ciftci, 2022). However, some studies suggest that a lack of financial freedom does not significantly impact FDI attraction (Subasat and Bellos, 2011). Based on these insights, we propose the following research hypothesis:

H5. Financial freedom has a positive relationship with FDI net inflows.

## 2.6 Monetary freedom and FDI

Monetary freedom relates to price stability and interest rates, reflecting the ability to control inflation (Miller *et al.*, 2018). Achieving price stability without government intervention in the monetary market is considered the ideal state of monetary freedom, whereas price manipulation is viewed as a limitation on such freedom (Heritage Foundation, 2025). A country that maintains price and interest rate stability effectively controls potential transaction costs. This is one of the key factors influencing the investment decisions of multinational corporations (Grosse and Trevino, 2005). Sambharya and Rasheed (2015) also argue that countries with well-managed economies through stable monetary policies and minimal government intervention attract higher FDI inflows.

However, in the case of China, Cardoso and Duarte (2017) point out that for many years, China's export sector has benefited from an "unfair" competitive advantage gained through deliberate manipulation of its currency value. In other words, while such manipulation may

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JED lower a country's monetary freedom score, it has contributed to a significant increase in FDI inflows into China over the past few decades (Singh and Gal, 2020). Similarly, Lily *et al.* (2014) provide evidence that some Southeast Asian countries, including Singapore, Malaysia and the Philippines, have adopted restrictive monetary freedom policies, which have positively influenced FDI inflows. Therefore, in the context of Southeast Asian countries, we propose the following research hypothesis:

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*H6.* Monetary freedom has a negative relationship with FDI net inflows.

#### 3. Methodology

3.1 The model

We refer to the research models by Ghazalian and Amponsem (2019), Economou (2019) and Seyoum and Ramirez (2019) and propose a research model for the case of Southeast Asian countries as follows:

FDI net inflows = f (Economic freedom, Macroeconomic factors)

where:

- (1) Economic freedom is the main explanatory variable of the model. Economic freedom is represented by the overall economic freedom index. Additionally, we will extend the analysis by replacing the overall economic freedom index with the subcomponent indices of economic freedom, including business freedom, trade freedom, investment freedom, financial freedom and monetary freedom, as the explanatory variables of the model.
- (2) Macroeconomic factors serve as control variables in the research model, including important characteristic factors of each country such as government expenditure, exchange rate, GDP per capita growth, population age rate, political stability, rule of law and inflation.
- (3) Government expenditure: Government expenditure refers to spending aimed at serving public interests, such as investment in infrastructure, education, healthcare, social welfare and other public services to build more efficient human resources and improve domestic facilities. These factors are crucial in attracting FDI (Molana and Montagna, 2007). However, empirical studies do not agree on the impact of government expenditure on attracting FDI. Some studies suggest that government expenditure contributes to increasing FDI attraction (Othman *et al.*, 2018a, b). On the contrary, some studies find evidence of a negative impact of government expenditure on FDI attraction (Bénassy-Quéré *et al.*, 2007; Chen and Lee, 2005).
- (4) Exchange rate: A stable exchange rate reduces risks for foreign investors and creates predictability for business activities. Previous empirical studies have found varying results on the impact of exchange rates on FDI attraction. Some studies indicate a positive relationship between exchange rates and FDI attraction. Boateng *et al.* (2015) argue that when the exchange rate rises, it means that the local currency depreciates relative to foreign currency, making asset purchases cheaper for the investing country. Therefore, a higher exchange rate stimulate more FDI attraction. However, other studies indicate that a depreciating local currency can be a barrier to attracting FDI. Tan *et al.* (2021) and Yu and Cheng (2010) both studied the impact of exchange rates on FDI inflows to China during different periods. Their results consistently show that an increased exchange rate (depreciation of the Renminbi) reduces FDI inflows to China. The advantage of attracting FDI lies in labor and labor costs. However, both an increasing exchange rate and rising labor costs erode the financial condition of multinational companies (Yu and Cheng, 2010). Other studies also support the inverse

relationship between exchange rates and FDI attraction (Asiamah *et al.*, 2019; Dal Bianco and Loan, 2017; Qamruzzaman *et al.*, 2019).

- (5) *GDP per capita growth:* Economic growth measures the development of an economy and is often used in policy studies. Asiedu (2002) argues that higher GDP growth rates reflect higher infrastructure quality, increased investment productivity and thereby attract FDI. Additionally, GDP per capita growth indicates rising incomes of the local population and their increasing consumption potential (Tintin, 2013). This serves as a motivation and a competitive advantage to attracting FDI (Boateng *et al.*, 2015; Ghazalian and Amponsem, 2019; Saha *et al.*, 2022).
- (6) Population age rate: The demographic composition of a country plays a crucial role in forming its attractiveness to foreign direct investment (FDI). A higher working-age population rate not only indicates a larger labor force but also a younger, more productive and innovative workforce. Vernon (1992) explains that the reason for capital shifts from older populations to younger economies can be traced to the product life cycle theory. As populations remain stable and more people retire in an economy, who generally consume less, the mature stage of the product life cycle arrives sooner. Therefore, producers seek lower-cost production destinations or markets with higher consumption. Recent studies also indicate that countries with higher working-age population rates are strong FDI attractors (Ghazalian and Amponsem, 2019; Nguyen and Lee, 2021; Naanwaab and Diarrassouba, 2016).
- (7) Political stability: Alesina et al. (1996) define political instability as changes in power within a country, which can occur through legal means or military coups. Such changes often impact economic development and multinational companies may decide not to invest in politically unstable countries. Conversely, political stability helps protect investments and ensures a predictable business environment (Asif et al., 2018). Most empirical studies show a positive relationship between political stability and FDI inflows (Asif et al., 2018; Kurecic and Kokotovic, 2017; Brada et al., 2006). However, political stability does not always help attract FDI. Saha et al. (2022) suggest that government efficiency and political stability have no significant impact on FDI attraction. Kim (2010) studied the relationship between political instability and FDI inflows in 28 countries from 1990 to 2002. Kim (2010) found paradoxical results where countries with higher corruption and lower democracy levels attracted more FDI. Canh et al. (2020) explain that while domestic political instability can increase FDI inflows to these countries.
- (8) Rule of law: The rule of law refers to the principle that all citizens and institutions within a country, state or community, including lawmakers and leaders, are accountable to the law. It provides a framework to ensure the security, safety and peace necessary to maintain reasonable transaction costs and economic activities (Fogel, 2006). Most studies suggest that countries with higher and more stable rule of law indices make FDI businesses feel safer and more protected in developing their activities; in other words, improving the rule of law helps attract FDI (Fofana, 2014; Ghazalian and Amponsem, 2019; Seyoum and Ramirez, 2019).
- (9) Inflation: Inflation is the general increase in the price of goods and services over time, accompanied by a currency's depreciation. Inflation in a country is one of the factors directly affecting FDI inflows. Kumari and Sharma (2017) and Buckley *et al.* (2009) argue that inflation represents economic instability. Therefore, high inflation rates reduce FDI attraction. This negative result is also supported by studies by Nguyen and Lee (2021), Boateng *et al.* (2015) and Azam and Haseeb (2021). However, in some cases, studies suggest that higher inflation can drive more FDI attraction (Ghazalian and Amponsem, 2019; Asongu *et al.*, 2018).

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The variables in the research model are summarized in Table 1 (Supplementary file).

## 3.2 Data

The research data includes six Southeast Asian countries: Cambodia, Indonesia, Malaysia, the Philippines, Vietnam and Thailand for the period from 1995 to 2022. Data on economic freedom and its subcomponents were collected from The Heritage Foundation. Data on government expenditure were collected from the International Monetary Fund. All other macroeconomic data, including foreign direct investment net inflows, GDP per capita growth, official exchange rate, political stability, rule of law, population age rate and inflation, were collected from the World Bank.

Data related to foreign direct investment net inflows includes some observations with negative values, posing a problem when taking the logarithm (five cases for Indonesia from 1998 to 2001 and 2003 and one case for Thailand in 2020). To address this, we used the method of Busse and Hefeker (2007), Gholipour Fereidouni and Ariffin Masron (2013) and Hsieh *et al.* (2019), where negative observations are calculated by

$$\ln \left(FDI_{it} + \sqrt{\left(FDI_{it}^2 + 1\right)}\right)$$

#### 3.3 Estimation method

Similar to Ghazalian and Amponsem (2019), Asongu *et al.* (2018) and Moussa *et al.* (2016), we use panel data estimation methods, including fixed effects and random effects models, to estimate the research models, followed by the Hausman test to choose the appropriate estimation method. However, issues of autocorrelation and heteroscedasticity may arise, affecting the accuracy of the research results. Therefore, we will conduct tests to detect these issues, and if present, we will use the generalized least squares (GLS) method to address these shortcomings. The results from the GLS method will form the basis for discussions in this study. Additionally, we conducted robustness tests using the Driscoll–Kraay standard error estimation method developed by Driscoll and Kraay (1998). This method demonstrates superior performance in addressing issues of heteroskedasticity and autocorrelation (Ridwan *et al.*, 2024; Tesega, 2022).

*3.3.1 Data description*. Table 2 presents descriptive statistics of the variables in the research model. The data are unbalanced panel data. Moreover, there is no significant difference

Variable	Obs	Mean	S.D.	Min	Median	Max
FDI	162	22.02	1.33	18.22	22.25	23.95
ECO	166	0.60	0.07	0.39	0.60	0.75
BUS	166	0.60	0.14	0.29	0.60	0.94
TRA	166	0.71	0.11	0.15	0.74	0.87
INV	166	0.45	0.14	0.15	0.50	0.70
FIN	166	0.48	0.11	0.30	0.50	0.70
MON	166	0.75	0.06	0.49	0.76	0.89
GOV	160	0.21	0.04	0.12	0.20	0.31
EXC	168	5.96	3.24	0.92	5.87	10.05
GDP	168	0.04	0.04	-0.14	0.04	0.11
LAB	168	0.65	0.04	0.52	0.65	0.72
PS	144	0.34	0.19	0.03	0.31	0.68
RL	144	0.41	0.17	0.10	0.40	0.71
INF	168	0.05	0.06	-0.02	0.04	0.58
Source(s): C	alculations by the	he authors based	on the dataset a	nd using the Stata	software	

Table 2. Descriptive statistics

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between the mean and median values, suggesting that the data generally follows a normal distribution and is suitable for estimation and regression.

In Table 3, we analyze the correlation between the variables in the research model. The results show that most correlation coefficients between variables are below 0.8 (except for the correlation coefficient between rule of law (RL) and business freedom (BUS)), indicating no severe multicollinearity issues (Gujarati and Porter, 2009). Due to the importance of the rule of law and business freedom variables, we retain them in the estimation model. Furthermore, the simultaneous presence of both variables occurs in only one of the estimated models.

# 4. Results and discussion

## 4.1 Empirical results

Table 4 (Supplementary file) presents the estimation results of the impact of economic freedom on net FDI inflows using fixed effects model (FEM) and random effects model (REM) estimation methods. All models, from model (1) to model (6), were tested using the Hausman test, and the results indicated that the FEM estimation method is more appropriate. However, the modified Wald test and Wooldridge test both indicate that all these models suffer from heteroskedasticity and autocorrelation, leading to unreliable results.

Therefore, we used the GLS estimation method to address the issues of heteroskedasticity and autocorrelation. The estimation results of the impact of economic freedom on FDI net inflows using the GLS method are presented in Table 5, and these results will form the basis for our research discussion.

Table 5 shows that the regression coefficient of the variable ECO has a value of 2.90 and is statistically significant at the 10% level in model (7). This result supports Hypothesis H1, indicating that overall economic freedom has a positive relationship with FDI net inflows. The regression coefficient of the variable BUS is 0.68 but is not statistically significant in model (8). In other words, the empirical evidence does not provide sufficient support for Hypothesis H2, suggesting that business freedom has a positive relationship with FDI net inflows. The regression coefficient of the variable TRA is 2.59 and is statistically significant at the 1% level in the model (9). This result supports Hypothesis H3, confirming that trade freedom has a positive relationship with FDI net inflows. The regression coefficient of the variable INV is 1.10 but is not statistically significant in the model (10). Therefore, the empirical evidence does not provide sufficient support for Hypothesis H4, which posits that investment freedom has a positive relationship with FDI net inflows. The regression coefficient of the variable FIN is 1.68 and is statistically significant at the 5% level in model (11). Consequently, this result supports Hypothesis H5, which states that financial freedom has a positive relationship with FDI net inflows. Finally, the regression coefficient of the variable MON is -1.85 and is statistically significant at the 5% level in the model (12). This finding supports Hypothesis H6, indicating that monetary freedom has a negative relationship with FDI net inflows.

#### 4.2 Discussion

4.2.1 Impact of economic freedom on FDI net inflows. These results indicate that overall, economic freedom positively impacts FDI net inflows. This result aligns with our expectations and most previous studies (Fofana, 2014; Moussa *et al.*, 2016; Seyoum and Ramirez, 2019). However, in more detail, not all components of economic freedom have positive impacts on FDI net inflows. Our empirical findings indicate that trade freedom and financial freedom have a positive impact on foreign direct investment net inflows. In contrast, monetary freedom shows a negative effect on FDI net inflows.

Thus, policies promoting trade freedom by removing barriers such as tariffs and non-tariff barriers to international trade will help increase FDI net inflows. Removing technical and tariff barriers will help FDI enterprises reduce input production costs (including domestic enterprises) while facilitating export activities (Sooreea-Bheemul *et al.*, 2020), which is

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Table 3. Correlation matrix of variables

	FDI	ECO	BUS	TRA	INV	FIN	MON	GOV	EXC	GDP	LAB	PS	RL	INF
FDI	1.000													
ECO	0.234	1.000												
BUS	0.372	0.731	1.000											
TRA	0.506	0.510	0.384	1.000										
INV	-0.110	0.590	0.110	0.093	1.000									
FIN	0.085	0.637	0.268	0.250	0.517	1.000								
MON	-0.072	0.473	0.192	0.139	0.251	0.250	1.000							
GOV	0.338	0.276	0.365	0.312	-0.104	-0.102	0.144	1.000						
EXC	-0.093	-0.700	-0.662	-0.255	-0.284	-0.321	-0.390	-0.489	1.000					
GDP	-0.084	-0.297	-0.235	-0.183	-0.206	-0.086	0.047	-0.214	0.255	1.000				
LAB	0.704	0.305	0.423	0.518	-0.096	0.128	0.037	0.378	-0.084	-0.099	1.000			
PS	0.109	-0.037	0.110	-0.211	-0.112	-0.362	0.260	0.459	0.004	0.128	0.210	1.000		
RL	0.500	0.520	0.810	0.372	-0.097	-0.004	0.143	0.471	-0.655	-0.208	0.494	0.340	1.000	
INF	-0.056	-0.192	-0.176	-0.167	0.005	-0.201	-0.137	-0.293	0.280	-0.260	-0.100	-0.117	-0.242	1.000
Source(s)	): Calculatio	ons by the au	thors based	on the datas	et and using	the Stata so	ftware							

Variable	Model 7 Coef.	<i>p</i> -value	Model 8 Coef.	<i>p</i> -value	Model 9 Coef.	<i>p</i> -value	Model 10 Coef.	<i>p</i> -value	Model 11 Coef.	<i>p</i> -value	Model 12 Coef.	<i>p</i> -value
ECO	2.90*	0.07										
BUS			0.68	0.41								
TRA					2.59***	0.00						
INV							1.10	0.13				
FIN									1.68**	0.05		
MON											$-1.85^{**}$	0.05
GOV	7.09***	0.01	5.81**	0.05	5.80**	0.03	7.02**	0.02	7.51***	0.01	5.07*	0.09
EXC	0.17***	0.00	0.10**	0.04	0.11***	0.00	0.14***	0.01	0.15***	0.00	0.06	0.19
GDP	3.23*	0.08	3.07*	0.08	3.36*	0.06	3.30*	0.07	3.22*	0.07	3.07*	0.08
LAB	12.27***	0.00	14.65***	0.00	11.35**	0.00	15.11***	0.00	13.21***	0.00	16.02***	0.00
PS	$-1.86^{***}$	0.00	-1.54***	0.02	-1.28**	0.04	-1.90***	0.00	$-1.61^{***}$	0.01	-1.41**	0.03
RL	4.27***	0.00	3.58***	0.00	3.63***	0.00	4.38***	0.00	4.33***	0.00	3.45***	0.00
INF	2.05*	0.06	1.70	0.12	2.15**	0.04	2.06*	0.06	2.22**	0.05	1.92*	0.08
_cons	8.52***	0.00	9.16***	0.00	9.64***	0.00	8.05***	0.00	8.76***	0.00	10.42***	0.00
Sample period	1995–2022		1995–2022		1995–2022	2	1995–2022		1995–2022		1995–2022	
Observations	138		138		138		138		138		138	
F stat/Wald chi2	155.20		119.96		177.31		135.72		133.4		127.29	
Prob (F statistic/chi2)	0.00		0.00		0.00		0.00		0.00		0.00	
Note(s): *. ** and ***	denote statistic	al significa	ince at the 10.	5 and 1% le	evels, respect	ivelv						

Table 5. Impact of economic freedom on FDI net inflows estimated using the generalized least square (GLS) method

**Note(s):** \*, \*\*\* and \*\*\* denote statistical significance at the 10, 5 and 1% levels, respectively **Source(s):** Calculations by the authors based on the dataset and using the Stata software

consistent with the OLI theory. Our research results also align with previous studies by Economou (2019), Ghazalian and Amponsem (2019) and Singh and Gal (2020) (with samples from South Asia, Sub-Saharan Africa, Eastern Europe and the Middle East and North Africa) on the positive impact of trade freedom on attracting FDI. Similarly, implementing financial freedom policies through maintaining transparent financial markets and facilitating businesses and individuals to access diverse financial services and capital at competitive costs is in favor of increasing FDI net inflows. This result is consistent with the studies by Economou (2019) and Tag and Degirmen (2022).

The findings of this study reveal that monetary freedom has a negative association with net FDI inflows, which is consistent with previous research conducted on selected Southeast Asian countries (Lily *et al.*, 2014; Singh and Gal, 2020). In the past, government intervention in monetary markets, including efforts to maintain exchange rate stability, may have reduced monetary freedom scores but effectively contributed to attracting FDI inflows into Southeast Asia. However, such policies, which rely on currency manipulation to gain the competitive advantage, are not considered a sustainable long-term strategy. As Southeast Asian countries move toward more liberal monetary policies, there is a potential risk that they may become less attractive destinations for foreign direct investment.

The effects of business freedom and investment freedom on FDI inflows appear to be statistically insignificant. This suggests that foreign investors may not be particularly responsive to improvements in business and investment freedom policies in the Southeast Asian region. One possible explanation is that foreign investors tend to prefer investing in emerging markets with institutional environments that are comparable to or better than those in their home countries (Ullah and Khan, 2017; Lucke and Eichler, 2016).

4.2.2 Impact of macroeconomic factors on FDI net inflows. The regression results indicate that several macroeconomic and institutional factors influence FDI inflows. Higher government expenditure (GOV) supports FDI by enhancing infrastructure and human capital, consistent with Molana and Montagna (2007). Currency depreciation (EXC) attracts FDI by lowering asset costs (Boateng *et al.*, 2015) and improving export competitiveness (Singh and Gal, 2020). Economic growth (GDP) positively correlates with FDI, reinforcing the market size effect (Tintin, 2013). A larger working-age population (LAB) signals a productive labor force and market potential, aligning with the Flying Geese Paradigm (Akamatsu, 1962). Surprisingly, political instability (PS) does not deter FDI, as global uncertainty can drive capital inflows (Canh *et al.*, 2020). Stronger rule of law (RL) fosters investor confidence, while inflation (INF) does not necessarily hinder FDI, as currency depreciation can enhance foreign purchasing power.

## 4.3 Robustness test

Table 6 presents the estimation results using the Driscoll–Kraay standard error method. The results are largely consistent with those reported in Table 5, indicating that the findings of this study are robust and reliable.

## 5. Conclusions and policy implications

This study aims to analyze the impact of economic freedom on attracting FDI (FDI net inflows) in some Southeast Asian countries. The research sample includes six countries: Cambodia, Indonesia, Malaysia, the Philippines, Vietnam and Thailand for the period from 1995 to 2022. We used panel data estimation methods, including FEM, REM and GLS estimation, to estimate the research models and employed the Driscoll–Kraay standard error method for robustness testing. The results show that economic freedom positively impacts FDI net inflows. However, the components of economic freedom have different impacts on FDI net inflows. Trade freedom and financial freedom positively impact FDI net inflows, while monetary freedom negatively impacts FDI net inflows. Meanwhile, business freedom and

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Variables	Model 13 Coef.	<i>p</i> -value	Model 14 Coef.	<i>p</i> -value	Model 15 Coef.	<i>p</i> -value	Model 16 Coef.	<i>p</i> -value	Model 17 Coef.	<i>p</i> -value	Model 18 Coef.	<i>p</i> -value
ECO	4.35*	0.10										
BUS			0.63	0.58								
TRA					3.93***	0.00						
INV					0.00	0.00	1.68*	0.07				
FIN							1100	0.07	2.16*	0.06		
MON									=	0100	-0.38	0.87
GOV	11.49***	0.01	8.86**	0.02	6.74*	0.08	11.70***	0.00	11.97***	0.00	8.85**	0.02
EXC	0.24***	0.00	0.16***	0.00	0.15***	0.00	0.23***	0.00	0.22***	0.00	0.17***	0.00
GDP	4.65	0.14	3.17	0.33	3.59	0.21	4.67	0.11	3.88	0.16	3.30	0.29
LAB	9.22**	0.01	12.19***	0.00	10.19***	0.00	10.23***	0.00	8.90***	0.00	11.73***	0.00
PS	-2.33***	0.00	-2.16***	0.00	-1.23***	0.01	-2.60***	0.00	-1.97***	0.00	-2.06***	0.00
RL	4.90***	0.00	4.93***	0.00	3.81***	0.00	5.74***	0.00	5.45***	0.00	4.56***	0.00
INF	2.49**	0.04	1.12	0.50	2.97**	0.02	2.31**	0.04	2.99*	0.09	1.00	0.50
cons	8.15***	0.00	10.25***	0.00	8.91***	0.00	9.13***	0.00	9.61***	0.00	10.58***	0.00
Sample period	1995-2022		1995-2022		1995-2022		1995-2022		1995-2022		1995-2022	
Observations	138		138		138		138		138		138	
R square	0.57		0.55		0.59		0.57		0.57		0.55	
Prob ( <i>F</i> -stat)	0.00		0.00		0.00		0.00		0.00		0.00	
Note(s): *, ** and	d *** denote st	atistical sign	nificance at the	10, 5 and 1	% levels, respe	ectively						

Table 6. The impact of economic freedom on FDI net inflows estimated using the Driscoll-Kraay standard error method

**Source(s):** Calculations by the authors based on the dataset and using the Stata software

investment freedom show no significant impact on FDI net inflows. Additionally, we considered some important macroeconomic factors in this study. The results show that government expenditure, official exchange rate, GDP per capita growth, population age rate, rule of law and inflation rate positively correlate with FDI net inflows, while political stability negatively correlates with FDI net inflows.

Therefore, our study contributes to the recent debates on the role of economic freedom in FDI net inflows in the context of Southeast Asian countries. We provide evidence that overall economic freedom positively impacts FDI net inflows. Specifically, trade freedom and financial freedom contribute to increasing FDI net inflows, while monetary freedom reduces FDI net inflows due to various other factors, especially exchange rate policies. Meanwhile, business freedom and investment freedom do not show clear evidence of positive impacts on FDI net inflows.

Based on these results, we suggest that Southeast Asian governments consider enhancing economic freedom, trade freedom and financial freedom policies to strategize for attracting FDI. For instance, governments could consider the following suggestions to attract FDI:

- (1) Implement policies to promote trade freedom by reducing or eliminating tariffs on imported and exported goods, facilitating easier market access for foreign businesses. Additionally, governments could consider removing non-tariff barriers, such as simplifying custom regulations, minimizing complex administrative procedures and reducing technical obstacles to international trade.
- (2) Implement policies to enhance financial freedom by fostering an efficient and transparent financial market, improving the legal framework, and strengthening financial oversight systems to protect investors' rights. Additionally, governments should maximize opportunities for businesses and individuals to easily access diverse financial services and funding sources at competitive costs.

## 5.1 Limitations and future research directions

We have made significant efforts to study the impact of economic freedom on FDI net inflows in the context of Southeast Asian countries. However, the study has some limitations: Firstly, it does not fully consider all components of the economic freedom index. In addition to the overall economic freedom index, the study only considers another five factors: business freedom, trade freedom, monetary freedom, investment freedom and financial freedom, while many other components of economic freedom have not been examined. Secondly, potential endogeneity issues between the dependent and explanatory variables have not been thoroughly considered. Therefore, we propose some directions for future research: Firstly, future studies should consider simultaneously the impact of all components of economic freedom on FDI net inflows. Secondly, future research methods should consider potential endogeneity issues between key explanatory variables and the dependent variable. In addition, economic freedom may have significant implications for key sectors such as banking. Therefore, future research could explore the impact of economic freedom on the stability and efficiency of banks, which represents a meaningful and worthwhile line of inquiry.

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# Supplementary file

The supplementary material for this article can be found online.

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