DOES GOVERNEMNT INTERVENTION MATTERS ON ECONOMIC GROWTH (CASE STUDY ASEAN COUNTRIES)

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Abstract

Subsidies and Governance are a form of government intervention that is thought to influence economic growth. This research was conducted in 11 ASEAN countries during the 2008-2015 period. By using data that has been published by the World Bank, the data is processed using the panel data method. The results of the study indicate that subsidy policies do not significantly affect economic growth, on the contrary the implementation of good governance represented by government effectivity, rule of law, quality of rule and control of corruption variables significantly influence economic growth in ASEAN. Subsidies that are not well targeted and transferred to the unproductive sector will suppress economic growth and must be avoided. Several countries in ASEAN, such as Singapore, Cambodia and Malaysia have removed this policy. It is recommended that more generous subsidies be given to make them more targeted.

Keywords: *governemnt intervention, good governence governemnt, economic growth*

Background

Economic growth is inseparable from the role of government, both intervening directly and indirectly in the market. One of the policies that directly intervene in the market is subsidies. The subsidy policy will encourage increased production, lower the price level and increase the purchasing power of the people, while indirect interventions are when the government implements good governance that can provide investors with a sense of security, comfort, and calm to do business in the country. Spencer and Amos, Jr. (1993) states that subsidies are intended to enable producers to produce in more enormous quantities or at lower prices. Likewise, the IEA, OECD & World Bank (2010) define subsidies are a policy that can help increase production through reducing production costs to increase people's purchasing power, while Omar (2016) describes subsidies as a tool to enhance development, improve people's welfare and increase economic growth and subsidies can be a form of protectionism by making domestic goods and services artificially competitive against imports. Countries in ASEAN apply the most significant subsidies compared to other countries and currently try hard to apply the principles of good governance. Nevertheless, the question is to what extent the level of economic growth is in line with government intervention?

Several empirical studies have found that subsidies cannot be adequately responded directly to economic growth. Subsidy policies implemented in ASEAN member countries have different impacts. Indonesia, for example, has the highest subsidy policy compared to 10 other ASEAN countries, 63.58%, while the lowest subsidy policy is implemented in Singapore, which is 0.28%. However, the two countries have almost the same economic growth.

In addition to the subsidy policy, another form of government intervention that does not directly spur economic growth is governance. The concept of good governance was first proposed by the World Bank, UNDP and the Asian Development Bank (ADB), where success in implementing good governance is determined by the involvement and synergy of three leading roles, namely the government apparatus, the community, and the private sector, and the most dominant is the government (Agus, 2011). The concept of governance related to economic growth is an exciting topic to study at this time because good governance has stimulated the enthusiasm of European countries and China to invest in the ASEAN region. There are four dimensions of governance that will affect economic growth effectively, namely government effectiveness, the rule of law, control of corruption and regulatory quality (World Bank, 2017). Md Rafayet et al. (2017) states that government effectiveness has a positive and significant impact on economic growth in a country, as well as

Sedarmayanti (2003) states that high government effectiveness will encourage better economic growth.

In contrast, Wibowo (2013) found that government effectiveness has a significant negative effect on economic growth when government spending increases when the government implements policies and provides public services. To achieve good governance requires rules in society and law enforcement, the Rule of law is one of the essential indicators in creating good governance in influencing economic growth, where every level of society until the government carries out its authority, rights, duties, and responsibilities the answer is proportional. Badun (2006) states that the quality of government has a positive effect on economic growth; this is also supported. Edy (2013) which states the rule of law has a significant positive effect on economic growth. If there is an increase in public compliance in obeying regulations and enforcing the law it will increase the rate of economic growth. The application of a clear rule of law can reduce unlawful actions carried out by economic actors to increase economic growth in the country.

Regulatory quality can have a positive effect on economic growth. Marlina (2016) found that regulatory quality is a measure of the government's ability to formulate and implement policies and regulations and promote the development of the private sector to improve a country's economy, but Wibowo (2013) in his research stated that regulatory quality otherwise. Kaufman et al. in Huynh and Jacho-Chávez (2009) states that control of corruption is a measure of the extent to which power is used for personal gain and to commit acts of corruption. In contrast, Huynh and Jacho-Chávez (2009) found that control of corruption, which is part of governance does not have a significant effect on economic growth. Research from Aidt, Dutta, and Sena (2008) found that in countries with low institutional quality, corruption had no significant effect on economic growth, while Sanyal (2011) stated that control of corruption had a positive effect on economic growth.

Goal of Research

The purpose of this study is to provide empirical evidence that whether subsidy policies, governance represented by government effectiveness, the rule of law, regulatory quality, and control of corruption affect economic growth in ASEAN countries during 2008-2015.

Literature Review

Economic growth, according to Kuznets is a continuous increase in per capita or worker product, while according to Samuelson (2005) economic growth shows the expansion or increase of the Gross Domestic Product (GDP) of a country through capital accumulation, population growth, and technological progress. Keynesian suggested that there should be government intervention to increase economic growth with various policies, such as subsidies. The provision of subsidies is still debatable, as long as the subsidies provided for productive activities will encourage the economy; on the contrary, it will suppress when it is not on target. Subsidies can improve the welfare of life, especially to groups that are at a low economic level (Omar, 2016) or as a tool to shape the country's wealth, or both simultaneously. With subsidies, the general price level in the market is lower. This is due in part to the costs of producing and marketing the goods borne by the government in the number of subsidies. The primary purpose of the existence of subsidies is to increase consumption of the poor and keep the poor so that they can continue to enjoy public services, economic, and social development.

In addition to quantitative measures, economic growth is also influenced by good governance. According to the World Bank, measuring the quality of good governance can be represented by the variables of control of corruption, government effectiveness, political stability and absence of violence, regulatory quality, rule of law and voice and accountability. Significant investment to spur growth, one form is foreign direct investment. According to Krugman (1994), foreign direct investment is an international capital flow where companies from one country establish or expand their business in another country. Foreign direct investment will involve not only the transfer of resources but also the enforcement of controls. Investments will provide regular benefits to investors if they can control their factories or companies well, increase real income, and absorb employment.

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Research Method

This study uses panel data covering 6 of 11 countries in ASEAN which has the most complete data. Data were obtained from the World Bank, which consisted of variables of economic growth, subsidies, Foreign Direct Investment (FDI), and governance. Economic Growth (Y) is $\left(\frac{GDP_t - GDP_{t-1}}{GDP_{t-1}}\right) X\ 100\%$, subsidy ($X_1$) which is the percentage of subsidies and other transfers to costs incurred by the government, Foreign Direct Investment (FDI) (X2) is the percentage of the value of FDI inflow to a country's GDP as well as Governance variables measured in index figures consisting of Government Effectiveness (X3) , namely a measure of the quality of public services, Rule of Law (X4), a measure of the extent to which people comply with rules and enforce the law, Regulatory Quality (X5), a measure of the ability of governments to formulate and implement policies, regulations and promote the development of the private sector; Control of Corruption (X6), a measure of the extent to which power is used for personal gain. The research period of 2008 - 2015, which according to the OECD was the best period, where economic growth in ASEAN countries experienced significant growth. World Bank is the best and most stable period. Using the data technique, several stages of analysis are carried out to determine the best model, which starts from the Chow Test, is compared to the Haussman Test. The best regression equation results are then analyzed qualitatively. The econometric model is used, namely:

$$Y = \alpha + \alpha_1 SUB_{it} + \alpha_2 FDI_{it} + \alpha_3 GE_{it} + \alpha_4 RL_{it} + \alpha_5 RQ_{it} + \alpha_6 CC_{it} + \varepsilon_{it}$$

Where Y is Economic Growth (%), SUB is subsidy (%), FDI (%), GE is Government Effectiveness (index), RL is Rule of Law (index), RQ is Regulatory Quality (index), CC is Control of Corruption (index).

Hypothesis

Subsidies, Foreign Direct Investment (FDI), government effectiveness, the rule of law, regulatory quality and control of corruption have a significant effect on economic growth in ASEAN countries during 2008-2015.

Result and Discussion

By using panel data with the best model found is the Fixed Effect Model (FEM), the following equation is obtained:

$$Y_{it} = -377{,}8082 + 0{,}660836\ SUB_{it} + 16{,}77764\ FDI_{it}^* + 204{,}2730\ GE_{it}^* - 1133{,}416\ RL_{it}^* + 673{,}7250\ RQ_{it}^* + 345{,}1575\ CC_{it}^*$$

An interesting finding from this research is the direct government intervention in the economy in the form of government affects economic growth in seven countries in ASEAN. On the other hand, the subsidy policy does not. So this sub-sector policy needs to be considered if it will continue because it suppresses growth. Allegedly, the subsidy policy which is part of aggregate expenditure in the form of government spending that is not on target will suppress economic growth. Some ASEAN countries have begun to abolish it and have chosen to allocate this aggregate expenditure for infrastructure development and to encourage a productive economy. However Hadi (2014) states that the subsidy policy will encourage growth if it is focused on efforts to support the economy of small communities, small and medium industries, agricultural sectors and basic public needs. Furthermore, FDI will provide positive energy to the economy through technology transfers that occur that strengthen a more stable business environment (Plummer, 2007). Economic and political stability as an essential factor in attracting FDI (Urata and Ando, 2010).

Table: Cross Individual Effect

Fixed Effect (Cross)	Effect
INDONESIA	124,1122
CAMBODIA	-103,3702
LAOS	484,1748
MALAYSIA	-105,9443
THE PHILIPPINES	47,47016
SINGAPORE	-481,6215
THAILAND	35,17888

The panel data method is capable of producing individual sample characteristics, and each country being sampled has its characteristics. Cambodia, Malaysia, and Singapore have negative coefficients, which indicate that economic growth in these three countries relies heavily on government intervention, both in the form of subsidy policies and good governance as well as foreign investment. Without these three elements, economic growth will slow down. In contrast, Indonesia, Laos, the Philippines, and Thailand have positive fixed effect coefficients, which means that the four countries' economic growth is not too dependent on government intervention and foreign investment, but by other dominant economic factors.

Discussion.

Effective subsidies if the subsidies are right on target, which will cut production costs and selling prices, thereby increasing the purchasing power of the poor, which in turn has an impact on improving the economy in the long run. The government must be able to control the distribution of subsidies so that it is right on target through clear boundaries. Governance especially the rule of law in ASEAN countries needs to be improved and become a concentration for the government so that law enforcement can support the growth of the country's economy. With proper law enforcement, it is hoped that it will increase the economic growth of ASEAN countries. In the three Cambodian countries, Malaysia and Singapore, governance is needed to enhance economic growth.
Meanwhile, four other countries, namely Indonesia, Laos, the Philippines, and Thailand, showed that economic growth was driven more by other factors such as natural resources, agriculture, population, infrastructure and investment. So from these results, each country can explore its potential to improve the economy. The flow of foreign investment should be directed towards technology transfer and investment expansion. The government must be more sensitive to events both in the economic field or other external factors and improve the business climate so that investors are interested in investing. This will encourage sustainable economic growth.

Conclusion

The effect of subsidies on the economy in some studies is still debatable. This research proves that subsidies that are not on target and unproductive will depress economist growth. Several countries in ASEAN, such as Singapore, Cambodia, and Malaysia, have removed this policy. FDI, Rule of Law, Regulatory Quality, and Control of Corruption have a positive effect on economic growth in seven ASEAN countries during the period 2008-2015.

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