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Reassessing the Economic Freedom–FDI Nexus: Evidence from ASEAN Economies

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ABSTRACT

The latest literature reports that economic freedom is one of the increasingly significant factors influencing foreign direct investment (FDI). Nevertheless, most literature examines aggregate indices, leaving out the detailed effects of its individual components. Despite its growing role in global FDI flows, the ASEAN region has limited empirical evidence. The study addresses this gap by examining five areas of the Fraser Institute's economic freedom effects on FDI inflows in ASEAN economies from 2010 to 2022. Employing panel data regression, the analysis finds that some areas show significant impacts on FDI, while others do not. The findings underline the importance of distinguishing among the areas when assessing the drivers of foreign investment. These results offer insights for regulators seeking to improve the country's investment climate through reforms focused on strengthening economic governance and institutional quality.

Keywords: Foreign direct investment; economic freedom; ASEAN economies.

INTRODUCTION

Foreign direct investment (FDI) inflows to ASEAN have reached USD 229.8 billion in 2023, reflecting the region's growing attractiveness as an investment destination [3]. The increase is closely related to the implementation of the ASEAN Economic Community (AEC), which aims to raise the region's competitiveness by increasing the degree of economic integration through a freer movement of goods, services, capital, and labour. ASEAN recorded a combined GDP of USD 3.94 trillion and a population of around 679.69 million in the same year. This underlines the region's substantial economic potential. In addition, the region's abundant natural resources, some demographic advantages, and growing consumer purchasing power have strengthened the region's growth prospects.

As a crucial catalyst for economic advancement, FDI plays a key role in supporting growth. It contributes to development not only by increasing the domestic capital base and optimising the use of local resources but also by positively affecting the host country's balance of payments [5]. In addition to capital investment, FDI serves as a conduit for the transfer of advanced technologies and managerial expertise while enhancing the skills of the local workforce, thereby boosting productivity and improving the quality of output [8].

The onset of the U.S.–China trade war in 2018 marked a turning point in global investment flows, with significant implications for ASEAN. Multinational corporations (MNCs) operating in China, confronted with mounting uncertainties and trade barriers during this period, increasingly opted to relocate their operations beyond Chinese territory. ASEAN quickly emerged as a preferred relocation destination due to its several strategic advantages: geographic proximity, cultural and economic familiarity, lower tariff structures, and well-integrated regional and global supply chains that allow firms to manage production and logistics more efficiently [7][32]. Furthermore, ASEAN's participation in major bilateral and multilateral trade agreements—such as the Regional Comprehensive Economic Partnership (RCEP) and the ASEAN–China Free Trade Area (ACFTA)—has further enhanced its attractiveness by reducing non-tariff barriers and facilitating smoother cross-border trade flows [31][49].

In spite of the positive trend in FDI across the region, the FDI distribution remains uneven among member states [28]. This disparity raises important questions regarding the underlying factors that influence investors' decisions when investing capital within the region. Given the geographical proximity and relative similarities in demography, social structure, culture, and living

standards among ASEAN countries, it is plausible that institutional quality and national policies—particularly those upholding economic freedom and implementing investor-friendly regulations—are decisive in attracting FDI to individual countries.

Support from host countries in safeguarding economic freedom has substantial implications for investment attractiveness. It enhances ease of doing business, reduces the overall cost of investment, ensures the protection of property rights, and lowers the perceived risks for foreign firms considering capital commitments. Within the framework of internalisation theory, it is posited that firms are more likely to internalise cross-border transactions through establishing foreign subsidiaries when external market costs (such as those related to searching, negotiating, and enforcing contracts) exceed the costs of managing these activities internally. Internalisation not only allows multinational enterprises (MNEs) to retain control over critical intangible assets such as proprietary technology and brand equity but also helps mitigate contractual risks, maintain product quality standards, and enhance operational efficiency in foreign markets.

Consistent with the theory, the level of economic freedom is regarded as a key indicator of a country's institutional and policy environment, which can significantly impact investment, economic growth, and overall prosperity [41]. The Fraser Institute defines economic freedom as the ability of individuals to make economic decisions without undue government interference, arbitrary regulation, or unlawful restrictions. The economic freedom index comprises five major areas: size of government, legal system and property rights, sound money, freedom to trade internationally, and regulation. Some studies have found that countries with higher levels of economic freedom tend to attract more FDI as a result of their legal stability, protection of property rights, and efficient regulatory frameworks [37][43].

Data from [17] show that Singapore ranks highest in economic freedom within ASEAN and has successfully attracted substantial FDI inflows, mainly due to its investor-friendly regulatory environment and world-class business infrastructure. In contrast, countries such as Laos and Myanmar, which rank lower in economic freedom, continue to encounter challenges related to insufficient infrastructure and burdensome bureaucracy, thus reducing their competitiveness in attracting foreign investment [24][25][26][44].

This study aims to examine the impact of economic freedom on foreign direct investment (FDI) inflows in ASEAN countries during the period 2010–2022, with particular emphasis on the five areas of economic freedom identified by the Fraser Institute: size of government (Area 1), legal system and property rights (Area 2), sound money (Area 3), freedom to trade internationally (Area 4), and regulation (Area 5). It explores the extent to which each of these areas affects the attractiveness of host countries to foreign investors. Accordingly, the main research question addressed is whether the levels of economic freedom across these five domains significantly influence FDI inflows into ASEAN economies. To strengthen the robustness of the analysis, labour productivity, political stability, and the COVID-19 pandemic period are included as control variables within the empirical model.

Previous empirical studies have extensively examined the relationship between economic freedom and FDI across various contexts. For instance, [20] analysed a large panel of developed and developing countries from 1970 to 2016, employing both the Fraser Institute and Heritage Foundation indices to evaluate how different dimensions of economic freedom affect inward FDI. Likewise, [11] investigated the impact of economic freedom on FDI inflows in Vietnam using time-series data from 1999 to 2018, while [12] examined six Southeast Asian countries over the 1995–2022 period, applying multiple panel estimation techniques on the Heritage Foundation index. Earlier regional evidence, such as [40] for East Asia and [13] for sub-Saharan Africa, further highlights the significant role of economic freedom on FDI inflows.

Although prior studies have explored the link between economic freedom and FDI, most have relied on composite indices, thereby, obscuring the heterogeneous effects of specific economic freedom dimensions on FDI behaviour. Moreover, empirical evidence for ASEAN remains fragmented, often focusing on only a few member states. This study addresses these gaps by disentangling the effects of individual economic freedom dimensions and providing one of the first comprehensive analyses across all ten ASEAN countries.

The results of our regression analysis reveal that the influence of economic freedom on FDI in ASEAN is heterogeneous across the five areas. The size of the government, legal system, and property rights consistently exert a significant negative effect on FDI inflows, while sound money and regulation demonstrate a significant positive effect in most model specifications. In contrast, freedom to trade internationally does not exhibit a statistically significant relationship with FDI in any of the estimated models.

International Capital Movement

International capital movement refers to the cross-border flow of capital—such as investment, loans, and financial assets—beyond national boundaries. These flows are generally categorised into two types: portfolio investment and foreign direct investment (FDI). Portfolio investment involves passive cross-border transactions, typically through the purchase of financial assets such as stocks, bonds, and money market instruments. This type of investment is generally short-term and does not grant investors significant control over the entities in which they invest, as the primary objective is to generate returns from asset value fluctuations or dividend income.

In contrast, FDI entails direct investment by individuals or corporations from one country to another with the intent to acquire managerial control or significant influence over a foreign enterprise. Multinational enterprises (MNEs) often seek foreign direct investment (FDI) through greenfield investments, mergers and acquisitions, or joint ventures. They do this mainly to get access to natural resources, advanced technologies, or cheaper labour in the host country

One of the theoretical foundations that explains firms' preference for FDI is the internalisation theory. According to this theory, firms are likely to internalise cross-border transactions—by establishing subsidiaries abroad—when the transaction costs associated with external market mechanisms, such as information searches, contract negotiations, and enforcement, exceed the internal costs of managing these activities. This strategy enables multinational firms to protect intangible assets such as proprietary technology and branding, reduce contractual risks, maintain control over product standards, and improve operational efficiency.

The internationalisation theory (the Uppsala model) supports this idea by saying that expanding into other countries takes time. Firms typically do not engage in large-scale FDI at the beginning; instead, they follow a staged approach, starting with exports, then establishing representative offices, and eventually setting up subsidiaries in foreign markets. Initially, companies tend to enter countries with cultural, legal, and business environments similar to their home country to reduce risk. In its later development, the Uppsala model also emphasises the strategic importance of integrating global business networks as a substantial determinant of international expansion success.

Extending the theoretical frameworks, the Eclectic Paradigm, or Ownership-Location-Internalisation (OLI) paradigm, synthesizes various motivations for undertaking FDI into three components: (1) ownership-specific advantages, e.g., proprietary technologies, branding, or innovation capacity; (2) location-specific advantages, including the availability of natural resources, market potential, or supportive government regulations in host countries; and (3) internalisation advantages, i.e., the net benefits a firm gains by internalising business operations rather than relying on external market mechanisms.

The growing engagement of states in facilitating FDI inflows over the past two decades reflects a shift in the dynamics of FDI push and pull factors [16]. Push factors are often associated with adverse conditions in the home country, which compel firms to seek alternative markets abroad. Political instability, security threats, and economic risks in the country of origin may play a role in driving outbound investment. On the other hand, pull factors are related to favourable attributes in host countries, including market potential, macroeconomic and political stability, sufficient infrastructure, and cost-effective labour.

For host countries, FDI is instrumental in facilitating technology transfer and accelerating the adoption of more efficient managerial practices [8]. Considering these benefits, governments in host countries have prioritised policies to create a more attractive investment climate. Such efforts include improving access for foreign investors, offering tax incentives, establishing special economic zones, and enhancing key dimensions of economic freedom—such as governance effectiveness, legal certainty, intellectual property protection, market openness, and infrastructure development.

Economic Freedom

Economic freedom is widely regarded as a fundamental indicator of a country's institutional quality and policy framework, which is believed to have a substantial influence on investment decisions, economic growth, and overall societal welfare [41]. Currently, there are two major indices that are frequently used to measure economic freedom—namely, the Economic Freedom of the World Index by the Fraser Institute and the Index of Economic Freedom by the Heritage Foundation. Academics, policymakers, international organisations, and other relevant stakeholders commonly employ both indices. In this study, the Economic Freedom Index developed by the Fraser Institute is selected, as it is considered more methodologically robust; to date, researchers have conducted approximately 1,000 empirical studies using this index [17]. The 2024 version of the Fraser Index ranks 165 jurisdictions based on 26 indicators, which are categorised into

five main areas: size of government, legal systems and property rights, sound money, freedom to trade internationally, and regulation.

Size of government (SoG) which evaluates government consumption, transfers and subsidies, government investment, top marginal tax rate, and state ownership of assets measures the degree to which a country's fiscal policies limit the scope of individual economic choice. SoG does not only refer to the amount of public expenditure but also how effectively it is managed.

Governments that prioritise the provision of public goods that support economic growth such as infrastructure and education tend to have a more positive impact. Conversely, excessive government intervention through subsidies, state monopolies, or tightly controlled markets can limit innovation and competition, thereby reducing overall economic efficiency [17]. An oversized government with ineffective bureaucracy is often counterproductive in promoting economic growth and attracting foreign investment. According to the EFI methodology, countries with lower levels of government spending, lower marginal tax rates, less government investment, and less state ownership of assets earn the highest ratings in this area.

Legal system and property rights (LSPR) which includes indicators such as judicial independence, impartial courts, protection of property rights, military interference in rule of law and politics, integrity of the legal system, legal enforcement of contracts, regulatory restrictions on the sale of real property, reliability of the police measures how effectively legal systems (i.e., the institutional and policy environment) protect persons and their property from aggression. The Fraser Institute emphasises that strong protection of property rights and a well-functioning judicial system encourage confidence among investors and contribute to an institutional environment conducive to sustainable growth and innovation. Higher scores in this area reflect a more robust and trustworthy legal infrastructure, which is essential for both domestic and foreign investors.

Sound money (SM) which includes money growth, the standard deviation of inflation, inflation in the most recent year, and freedom to own foreign currency bank accounts—measures the extent to which people have access to currencies that maintain their value over time. This concept is vital, as it helps foster a stable economic environment in which entrepreneurs, investors, and consumers can anticipate and plan with greater certainty.

Sound money is typically characterised by monetary policies that support inflation control and the sustainability of currency value. Countries with a strong sound money performance tend to maintain low and stable inflation rates, which in turn boosts economic confidence and contributes to long-term sustainable growth [18]. A country permitting its citizens to access a currency with low (and stable) rates of inflation and avoiding regulations that limit the ability to use alternative currencies will earn a high rating [17].

Freedom to Trade Internationally (FTI) evaluates the degree to which individuals and firms can engage in international trade with minimal barriers. This area includes indicators such as tariffs, regulatory trade barriers, black market exchange activities, foreign exchange controls, and the movement of capital and people. These indicators collectively reflect the openness of a country's trade regime and its capacity to facilitate international economic engagement. A high level of freedom in international trade implies low tariffs, easy clearance and efficient administration of customs, a freely convertible currency, and few controls on the movement of physical and human capital. Such conditions facilitate smoother integration into global markets, increase competitiveness, and attract foreign investment by reducing transaction costs and regulatory uncertainty.

Regulation measures the extent to which regulations that restrict entry into markets and interfere with the freedom to voluntary exchange reduce economic freedom. The four components of this area account for credit market regulation, labour market regulation, business regulation, and freedom to enter markets and compete. Its purpose is to create a fairer system, ensure healthy competition, protect consumers, and preserve environmental sustainability. In the context of economic freedom, excessive regulation tends to hinder innovation and efficiency, whereas overly lenient regulation can lead to market exploitation and inequality.

Regulation covers a wide range of policies governing business regulation (e.g., regulatory burden, bureaucracy costs, and tax compliance), business competition (i.e., market openness, business permits, and distortion of the business environment), and labour laws (e.g., minimum wages, working hours, hiring and firing, and foreign labour). It assesses the extent to which government regulations interfere with the functioning of markets and the ability of individuals to engage in economic activities. Sound regulation is essential to maintain a balance between market freedom and social or environmental protection. Effective regulatory frameworks help create a more transparent and equitable economic environment and support economic growth by ensuring that business activities comply with established standards [18]. The fewer the restrictions on market access and the less interference in voluntary business transactions, the higher a country's regulation index score [17].

Hypothesis Development

The theory of internalisation posits that foreign firms are generally more inclined to invest in host countries, where government intervention is minimal. Such environments typically entail lower administrative burdens, reduced regulatory complexity, and greater institutional predictability, all of which help decrease the transaction and compliance costs associated with cross-border business activities. From this perspective, the size of government emerges as a critical determinant of foreign direct investment (FDI) inflows, particularly in developing economies where institutional inefficiencies often pose significant barriers to market entry. Governments that maintain a large presence in the economy—characterised by high levels of public consumption, widespread ownership of state enterprises, generous transfer payments, and complex tax structures are often associated with political connections [39], overregulation, fiscal inefficiency, and constrained private sector growth [21]. These characteristics may deter foreign investors by raising the cost of doing business, limiting market flexibility, and reducing the overall return on investment. In contrast, effective government spending on education, health, and business infrastructure can enhance a country's attractiveness to foreign direct investment, as foreign investors tend to favour markets that offer a well-educated and skilled workforce, adequate supporting infrastructure [46], and lower tax rates [2][23].

H_1: The size of government has a significant effect on foreign direct investment.

In the context of foreign direct investment (FDI), investors must ensure that their investments are safeguarded against legal uncertainty and unlawful expropriation. Countries with sound legal systems that uphold property rights and provide legal enforcement of contracts are generally more appealing to foreign investors [33][43]. Insufficient legal safeguards expose investors to heightened legal risks, thereby reducing a country's appeal as an investment destination.

Moreover, some prior studies find that weak legal certainty and insufficient property protection may increase business risk and discourage investment due to foreign investors' fear of expropriation [19][42].

H_2: The legal system and property rights have a significant effect on foreign direct investment.

Sound money, which emphasises monetary stability and effective inflation management, has a significant impact on foreign direct investment (FDI) [29]. In contrast, high inflation and volatile exchange rates pose substantial financial risks, which can deter foreign investors [18].

Additionally, appropriate monetary policies help prevent a high level of inflation and sustain domestic currency value. This enhanced economic credibility creates a more favourable and predictable environment for investment. Consequently, countries with a strong reputation for stable macroeconomic management tend to attract larger inflows of FDI, as they offer a safer and less risky business environment for foreign investors.

H_3: Sound money has a significant effect on foreign direct investment.

A market free from trade restrictions is widely recognised as an important determinant of foreign direct investment [1][43]. Broader access to international markets might reduce transaction costs and allow foreign companies to access more consumer. As such, the implementation of trade-liberalising policies by a host country might positively affect its ability to attract foreign direct investment.

Furthermore, countries that engage in free trade agreements—such as the ASEAN Free Trade Area (AFTA)—are more likely to attract FDI [14][35]. These agreements enable foreign investors to gain easier access to multiple markets without being constrained by heavy trade barriers. In turn, this reduces the cost and risk of investing, making the host country a more appealing destination for FDI.

H_4: The freedom to trade internationally has a significant influence on foreign direct investment.

International capital tends to flow toward countries that offer legal stability and a well-defined regulatory environment. Regulations are among the primary considerations for foreign investors, as they influence both the perceived risk and ease of doing business. Well-designed regulations that liberalise or reform FDI restrictions might cause FDI inflows [43][47]. Prior studies show that countries with transparent, business-friendly regulations are generally more successful in attracting FDI, since foreign companies can plan their investment strategies in more predictable and supportive environments [46].

H_5: Regulation has a significant influence on foreign direct investment.

RESEARCH METHOD

This study covers all ten ASEAN member states—namely Indonesia, Malaysia, Singapore, Thailand, the Philippines, Brunei, Vietnam, Laos, Myanmar, and Cambodia—over a 12-year observation period spanning from 2010 to 2022. The data

used in this research were sourced from several institutions, including the World Bank, the International Labour Organization (ILO), the ASEAN Secretariat, the Fraser Institute, the International Monetary Fund (IMF), and the United Nations Conference on Trade and Development (UNCTAD). The selected observation period reflects the availability and completeness of publicly accessible data; the most recent economic freedom data published by the Fraser Institute in its 2024 report pertains to the year 2022. The following section presents a detailed overview of the variables used in this study.

The foreign direct investment measured by net foreign direct investment (current US$ billions) is obtained from [28]. It refers to the net inflow of investment aimed at securing a significant managerial stake—typically defined as ownership of at least 10% of voting shares—in a business entity operating in a country other than that of the investor. It is the sum of equity capital, reinvested earnings, and both long- and short-term capital flows, as recorded in the balance of payments. According to the sixth edition of the IMF's *Balance of Payments Manual*, financial account balances are derived by subtracting changes in liabilities from changes in assets. Net FDI outflows are assets, and net FDI inflows are liabilities. As a result, FDI data are recorded as negative values when net FDI inflows exceed net outflows.

Economic freedom is proxied using the Economic Freedom Index (EFI) published by the Fraser Institute, which comprises five core areas: size of government (SoG), legal system and property rights (LSPR), sound money (SM), freedom to trade internationally (FTI), and regulation (Reg).

SoG measures the degree to which government consumption, transfers, and subsidies are limited. LSPR assesses the institutional and policy environment that protects individuals and their property from aggression. SM evaluates a nation's monetary stability and the freedom from arbitrary manipulation of currency by the government. FTI measures barriers to international trade, such as tariffs and quotas. Finally, Reg assesses the extent to which government regulations interfere with the functioning of markets and the ability of individuals to engage in economic activities.

In addition to the main explanatory variables, this study incorporates three control variables: labour productivity (Prod), the Covid-19 pandemic (Pandemic) and political stability (Pol). Labour productivity reflects the efficiency of labour in an economy and is commonly regarded as an important determinant of foreign investment. A decline in productivity is generally associated with increased FDI outflows, while improved productivity tends to attract FDI inflows [22]. In this study, labour productivity is proxied by output per hour worked, measured in GDP at a constant 2021 international dollar using purchasing power parity (PPP), with estimates provided by the International Labour Organization (ILO) in 2024 [27]. The Covid-19 pandemic is included as a second control variable to anticipate extraordinary shifts in investment, including FDI flows, during the crisis period (2020–2022) [4][10][15][16][30][34]. The pandemic variable is treated as a dummy, which is Cov=1 during the pandemic years and 0 otherwise. The data on political stability were obtained from Political Stability and Absence of Violence/Terrorism in percentile rank published by the World Development Indicators [45]. It measures perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism. Percentile rank indicates the country's rank among all countries covered by the aggregate indicator, with 0 corresponding to the lowest rank and 100 to the highest rank. Percentile ranks have been adjusted to correct for changes over time in the composition of the countries covered by the WGI.

This study employs panel data regression to examine the effect of economic freedom on foreign direct investment across ASEAN countries. The econometric specification of the research model is presented as follows:

$$FDI_{it} = \beta_0 + \beta_1.SoG_{it} + \beta_2.LSPR_{it} + \beta_3.SM_{it} + \beta_4.FTI_{it} + \beta_5.Reg_{it} + \beta_6.Prod_{it} + \beta_7.Cov_{it} + \beta_8.Pol_{it} + \varepsilon_{it} \quad (1)$$

Notes:

FDI	= Foreign Direct Investment
SOG	= Size of Government
LSPR	= Legal System and Property Rights
SM	= Sound Money
FTI	= Freedom to Trade Internationally
Reg	= Regulation
Prod	= labour productivity
Cov	= pandemic
Pol	= political stability
$\boldsymbol{\varepsilon}$	= error terms

The model selection process follows standard testing procedures (i.e., the Chow, Hausman, and Langrange multiplier tests) to determine the most appropriate panel data estimation technique. To ensure the validity, efficiency, and reliability of the empirical results, diagnostic tests for common econometric issues—namely multicollinearity, heteroscedasticity, and serial correlation—are conducted, particularly for fixed-effects and common-effects panel models.

Multicollinearity is assessed using the Variance Inflation Factor (VIF), which identifies the

presence of high correlations among explanatory variables. Heteroscedasticity is detected using the Modified Wald Test for groupwise heteroskedasticity in the residuals of a fixed-effects model. To test for serial correlation, this study employs a test for serial correlation in the idiosyncratic errors of a linear panel-data model.

RESULTS AND DISCUSSION

Results

The results of the correlation and descriptive statistical analyses are presented in Table 1. As illustrated in the table, Singapore recorded a net FDI inflow of USD 96.53 billion in 2022—this figure reflects inward investment after deducting FDI outflows. According to the Singapore Department of Statistics, the country attracted approximately 63% of the total FDI entering the ASEAN region that year, with the financial and insurance sectors contributing the largest share, accounting for roughly 35% of total inflows. By contrast, Myanmar recorded the lowest net FDI inflow (USD 0.1 billion) among the countries in 2015. Notably, in the first year of the COVID-19 pandemic (2020), ASEAN experienced a net FDI outflow of USD 22.90 billion—this figure represents total outflows after subtracting FDI inflows, indicating a sharp reversal of investment trends amid global uncertainty.

These findings reinforce the earlier observation that FDI distribution among ASEAN member states remains highly uneven. Countries such as Singapore, Indonesia, and Vietnam have consistently dominated FDI inflows within the region. Singapore's exceptional performance can be attributed to its status as the most productive economy in ASEAN [27]. Indonesia's strength lies in its abundant natural resources, which serve as a major pull factor for foreign capital. Vietnam, on the other hand, has been actively offering a number of incentives, such as tax breaks, exemptions from import duties on production machinery, and major upgrades to manufacturing infrastructure, especially during the U.S.-China trade war in 2018.

In contrast, Brunei, Myanmar, and Laos have captured only a relatively small portion of total FDI inflows in ASEAN states. Several structural challenges, such as underdeveloped infrastructure, burdensome bureaucratic procedures, and insufficient human capital quality, contribute to this limited investment appeal. These factors collectively act as major deterrents for multinational enterprises [3].

Table 1 also shows that in 2017, Vietnam sat at the lowest SoG score (5.04) among ASEAN countries, indicating substantial state involvement in the economy. State-owned enterprises (SOEs) in Vietnam maintain dominant positions in key industries and often benefit from privileged access to state-backed resources such as land, credit, and market protections [36][38]. Moreover, political objectives frequently use SOEs as instruments, leading to criticism over their inefficiencies and persistent reliance on government support. Such interventions have the potential to hinder reform and constrain the development of the private sector.

In contrast, Cambodia recorded the highest SoG score (9.26) in the same year, which is largely attributed to the country's reliance on development assistance from international donors. According to [29], donor-funded projects have played a vital role in improving infrastructure and public services at the village level, effectively complementing the government's service provision and reducing the fiscal burden on the state. Such dynamics underscore the varying degrees of state involvement and institutional frameworks across ASEAN, which in turn help explain the divergent levels of FDI attractiveness among member countries.

Table 1. Analysis of Correlation and Descriptive Statistics

	FDI	SOG	LSPR	SM	FTI	Reg	Prod	Cov	Pol
FDI	1,00								
SOG	-0,15	1,00							
LSPR	-0,50	-0,13	1,00						
SM	-0,22	0,56	0,50	1,00					
FTI	-0,44	0,19	0,82	0,65	1,00				
Reg	-0,38	0,00	0,93	0,59	0,83	1,00			
Prod	-0,50	-0,16	0,82	0,41	0,71	0,80	1,00		
Cov	-0,10	0,10	-0,07	0,10	-0,06	-0,05	0,03	1,00	
Pol	-0,36	-0,22	0,64	0,21	0,63	0,59	0,70	-0,03	1,00
Obs	130	130	130	130	130	130	128	130	130
Mean	-7,04	7,22	5,33	8,00	7,11	6,50	24,8	0,27	60,3
SD	14,3	1,00	1,42	1,50	1,17	1,22	28,4	0,49	35,2
Min	-96,5	5,04	2,90	3,92	2,23	3,65	2,45	0,00	1,00
Max	22,9	9,26	8,43	9,81	9,63	8,80	96,2	2,28	119

Regarding the LSPR, the average score across ASEAN countries was 5.33 with a standard deviation of 1.42. The lowest recorded score—2.90 in Myanmar in 2022—was largely a consequence of political instability following the military coup in February 2021. In contrast, Singapore reached the highest LSPR score (8.43) in 2021, reflecting the strength of its judiciary, which is internationally recognised for being impartial, transparent, and efficient. These institutional qualities ensure fair and reliable dispute resolution, thereby fostering a conducive business environment and increasing investor confidence.

Concerning Area 3, the SM suggests positive trends within ASEAN—the regional mean of 8.00 and standard deviation of 1.50, although notable disparities remain. For example, Laos had the lowest SM score in 2022, which was 3.92. This weak

performance was driven by sharp currency depreciation, rising inflation, high dependency on foreign-currency-denominated debt, and limited capacity for effective fiscal and monetary intervention [26][44]. On the other hand, Singapore's SM score of 9.81 shows that it is known around the world for having large foreign exchange reserves and smart fiscal and monetary policy frameworks.

In terms of the FTI, ASEAN countries recorded a relatively high average score of 7.11 during the study period. However, the wide range between the minimum (2.23) and maximum (9.63) values highlights considerable variation in trade openness among member states. Singapore led with a score of 9.63, attributed to its strong trade openness, efficient trade oversight mechanisms, and pro-trade regulations. In contrast, Myanmar recorded the lowest FTI score of 2.23 during 2010–2011, which is much lower compared to Myanmar's FTI value in 2022 after the military coup in 2021. Since the coup, the ruling junta has imposed extensive restrictions on international trade, including limits on import licensing, increased scrutiny of transactions, and constraints on the repatriation of foreign currency. The trade sanctions that advanced economies like the US, the EU, and others implemented after the coup are meant to cut off financial channels by limiting international trade, natural resource revenue, and access to international banking. These developments have severely constrained Myanmar's trade performance, weakened its economic performance, and diminished its attractiveness to foreign investors.

Finally, in the area of regulation (Reg), Singapore's efficient and investor-friendly regulatory frameworks have made it consistently outperform its regional peers, achieving the highest score of 8.80 over the study period. Meanwhile, Myanmar recorded the lowest Reg score of 3.65 in 2015, primarily due to bureaucratic regulatory inefficiencies that lead to high costs and prolong the time required to establish a business [25]. This prevents foreign investment and further weakens the country's institutional competitiveness within the region.

The empirical analysis was conducted by using a panel data regression framework to account for both cross-sectional and time-series dimensions of the dataset. Based on the results of model selection tests, the fixed-effects panel data model was identified as the most appropriate specification for the estimation. Nevertheless, the initial estimation results revealed the presence of heteroscedasticity and serial correlation. These violations of classical linear regression assumptions could bias the standard errors and undermine the reliability of the estimation results.

To address such econometric issues, the Prais–Winsten regression technique, employing correlated panel-corrected standard errors, was implemented. This method adjusts for both heteroscedasticity and autocorrelation across panels, thereby ensuring the robustness of the regression estimates. The results of the estimation are presented in Table 2.

Table 2. Panel Data Regression Results

	Baseline ($FDI_{i,t}$)	Model 1 ($FDI_{i,t}$)	Model 2 ($FDI_{i,t}$)	Model 3 ($FDI_{i,t+1}$)	Model 4 ($FDI_{i,t+2}$)
SOG_t		-5.13***	-6.46***	-4.78**	-5.55**
		(1.57)	(1.76)	(1.88)	(2.20)
$LSPR_t$		-10.50***	-7.87***	-6.43**	-9.11***
		(2.56)	(2.67)	(2.92)	(2.94)
SM_t		2.15*	2.50**	2.3**	1.71
		(1.17)	(1.16)	(1.06)	(1.56)
FTI_t		-.363	-.110	-.955	-.205
		(1.04)	(1.00)	(.957)	(1.24)
Reg_t		4.71***	6.35***	4.95***	6.95***
		(1.49)	(1.84)	(1.87)	(2.20)
$Prod_t$	-.338**		-.24***	-.329***	-.265***
	(.147)		(.07)	(.089)	(.083)
Cov_t	1.45		-1.38	-7.49***	-4.31*
	(2.52)		(2.37)	(1.48)	(2.28)
Pol_t	-.035		-.028	.03	-.026
	(.027)		(.027)	(.029)	(.033)
Cons	1.84	40.26***	28.64**	25.25	31.37**
	(2.59)	(12.23)	(12.10)	(15.56)	(14.01)
Obs	128	130	128	128	118
Wald χ^2	8.69***	18.11***	29.70***	49.85***	26.00***
R^2	.118	.236	.315	.300	.309

Standard errors are in parentheses
**** p<.01, ** p<.05, * p<.1*

The estimation results presented in Table 2 reveal the effects of various areas of economic freedom on foreign direct investment across ASEAN countries. The Basis: The Baseline Models 1 and 2 examine the effects of both the main covariates and control variables on FDI in year *t*. To account for potential endogeneity and the possible bidirectional relationship between FDI and economic freedom, the main covariates in year *t* are also regressed against FDI data with a one-year lead (Model 3) and a two-year lead (Model 4). These specifications provide perspective on how economic freedom indicators may shape FDI behaviour over time.

Model 4, in particular, is designed to assess the impact of covariates on FDI following the official release of the Economic Freedom Index (EFI) Report, which is published with a two-year lag relative to the survey year. For instance, the 2024 EFI Report presents data based on conditions from 2022, thereby justifying an estimation framework that captures investors' delayed responses.

Table 2 further shows that all models exhibit acceptable levels of goodness of fit, as evidenced by significant Wald chi-squared and R^2 values ranging from 10% to 31%. The R^2 values suggest a moderate, yet meaningful, degree of explanatory power. This implies that the selected indicators of economic freedom account for a quite substantial portion of the variance in FDI across ASEAN countries.

The hypothesis tests suggest that the effects of the different economic freedom components on FDI are not uniform across the models. It reveals that two areas—SoG and LSPR—consistently show negative and statistically significant (at the 5% and 1% significance levels) effects on FDI across all model specifications. By contrast, the Reg is found to have a positive and significant impact on FDI across all models. Meanwhile, the SM demonstrates a positive and statistically significant effect on FDI in Model 3 and Model 4, which capture the effects over a longer time horizon. Finally, the FTI does not show any statistically significant effect on FDI in any of the estimated models.

Table 3. Robustness Test Results

	Excluding Singapore			Pandemic period only		
	Model_2 ($FDI_{i,t}$)	Model_3 ($FDI_{i,t+1}$)	Model_4 ($FDI_{i,t+2}$)	Model_2 ($FDI_{i,t}$)	Model_3 ($FDI_{i,t+1}$)	Model_4 ($FDI_{i,t+2}$)
SOG_t	-4.07***	-3.454***	-3.332***	-13.79***	-13.17***	-8.67**
	(.889)	(.882)	(1.055)	(2.74)	(3.35)	(3.68)
$LSPR_t$	-6.843***	-6.712***	-6.604***	-19.34***	-23.12***	-14.31***
	(1.013)	(1.04)	(1.213)	(2.673)	(2.801)	(2.68)
SM_t	.956**	.598**	.380	11.14***	11.36**	18.56***
	(.463)	(.304)	(.734)	(3.18)	(4.51)	(4.892)
FTI_t	.813	.721	1.07	-8.47	-11.02	-54.77
	(.714)	(.778)	(.893)	(5.29)	(6.85)	(34.66)
Reg_t	6.65***	6.753***	6.45***	17.46***	23.63***	29.19***
	(.957)	(.885)	(1.002)	(5.472)	(6.563)	(4.79)
$Prod_t$	-.013**	-.005**	-.017**	-.64***	-.862***	-.816***
	(.006)	(.002)	(.008)	(.185)	(.176)	(.163)
Cov_t	-.513	-1.47*	-.873*			
	(.881)	(.787)	(.452)			
Pol_t	-.02	-.01	-.032	.338	.419	.764
	(.02)	(.022)	(.022)	(.211)	(.270)	(.509)
Cons	6.73	3.831	3.957	42.98	32.09	130.4***
	(4.511)	(4.403)	(5.059)	(30.59)	(35.93)	(39.23)
Obs	115	115	106	30	30	20
W-χ^2	127.85***	164.72***	303.16***	10955***	16829***	64605***
R^2	.276	.256	.245	.779	.798	.929

Standard errors are in parentheses
*** $p<.01$, ** $p<.05$, * $p<.1$

To ensure the robustness of the empirical findings, robustness tests were conducted on the full models—Model 2, Model 3, and Model 4—by re-estimating them using two approaches. First, Singapore was excluded from the analytical model due to its substantially different level of economic freedom compared with the other ASEAN countries. Second, the analysis was confined to the pandemic period, during which the investment and industrial sectors underwent significant contractions. The results (Table 3) show that there were no meaningful changes in the effects of the main covariates on the dependent variable, thereby affirming the consistency of the analytical model.

Discussion

In economics, foreign capital is recognised as a vital resource for national development, particularly in developing countries that frequently face capital shortages—an issue that is commonly observed in many Southeast Asian nations. In response, governments across the region have implemented various strategies to enhance their competitiveness in attracting foreign investors. Among the most critical policy areas receiving attention are size of government, legal system and property rights, sound money, freedom to trade internationally, and regulation, which collectively form the foundation of economic freedom and are widely regarded as essential to fostering an investment-friendly environment, especially for foreign direct investment.

However, the findings from the empirical analysis reveal that not all components of the Economic Freedom Index (EFI) exert a significant influence on FDI inflows across ASEAN economies. Some dimensions appear to play a more decisive role than others. The SoG emerged as a statistically significant contributor to FDI performance. Countries that have little government involvement in business, spend money wisely, and have simple bureaucratic processes tend to get a lot of money from other countries [16].

Similarly, improvements in the legal system and property rights (LSPR) have also had a substantial contribution to FDI inflows. A legal system characterised by integrity, impartiality, and independence from political or military interference reduces legal uncertainty and enhances investor confidence. Moreover, strong property rights protection and respect for contractual obligations have been critical factors of FDI attraction in ASEAN since 2010, offering foreign investors a greater sense of security in doing business.

Regulation, on the other hand, demonstrates a statistically significant influence on FDI, although in a more complex and context-dependent manner. Government-imposed rules and policies are generally intended to foster a fairer economic order by promoting healthy competition, protecting consumer rights, and ensuring environmental sustainability. However, a higher *regulation* score—which reflects fewer restrictions on market access and greater business autonomy—does not necessarily correspond to an increase in FDI net inflows. While regulatory liberalisation is generally expected to enhance market efficiency, excessive deregulation in the absence of robust institutional oversight may instead increase policy uncertainty and diminish investor confidence.

Relatively weak law enforcement, limited transparency, and underdeveloped governance systems continue to characterise the regulatory landscape in many ASEAN economies. As a result, greater regulatory freedom can paradoxically create an unpredictable business environment rather than

providing new investment opportunities. When the degree of regulation is exceedingly low—signifying an overly liberalised market—weak compliance and coordination mechanisms tend to deter FDI inflows [9]. This finding somewhat supports [48]'s proposition regarding the existence of a threshold level in the effectiveness of regulatory policies for attracting foreign investment. Specifically, when a host country's regulatory costs are already sufficiently low, further deregulation may not stimulate and may even reduce FDI inflows. Conversely, beyond a certain threshold, FDI inflows tend to increase markedly as regulatory costs decline.

Given these challenges, ASEAN member states are advised to re-evaluate existing regulations that may unnecessarily limit economic freedom or increase unpredictability in the investment climate. Well-designed, transparent, and stable regulations can serve as powerful signals of institutional credibility, enhancing investor confidence and encouraging FDI inflows, whereas regulatory uncertainty and inconsistency tend to undermine investment decisions by increasing perceived risks and transaction costs.

Sound money demonstrates a statistically significant effect on FDI in Model 3 and Model 4, which capture the effects over a longer time horizon. This pattern implies that sound monetary conditions—characterised by low and stable inflation, stable exchange rates, and money growth—may not yield immediate investor responses but tend to exert stronger influence in the medium term as macroeconomic credibility consolidates. The lagged effect suggests that foreign investors value consistent monetary discipline, especially in emerging markets, where volatility and uncertainty have historically been higher.

Despite the positive statistical relationship, this study's measurement of FDI necessitates careful interpretation. Here, a higher net FDI value reflects a larger outflow relative to inflow, indicating that countries with stronger monetary institutions tend to exhibit rising outward investment. In the context of ASEAN, these results may signal a gradual shift in capital behaviour, where more monetarily sound economies begin to expand abroad as part of regional and global integration. It also suggests that sound money, while vital for maintaining investor confidence, may not solely function as a magnet for inbound capital but rather as an enabler of two-way capital mobility in financially stable environments.

The freedom to trade internationally (FTI), however, does not exhibit a statistically significant effect on FDI across any of the models. One plausible explanation for this insignificance lies in the already high and relatively uniform levels of trade openness across ASEAN member states, particularly since the implementation of the ASEAN Free Trade Area (AFTA) in 1993 and the formal establishment of the ASEAN Economic Community (AEC) in late 2015 [3]. The enactment of the ASEAN Comprehensive Investment Agreement (ACIA) in early 2012 further contributed to regional convergence in trade and investment openness, reducing cross-country variation in this domain. Consequently, the limited variation in FTI scores weakens the indicator's ability to explain variation in FDI inflows across countries. Moreover, research data shows that while FTI scores have remained relatively stable across most ASEAN economies, FDI trends have shown more pronounced fluctuations over time [17]. During the COVID-19 pandemic, FTI scores exhibited marginal improvements in eight ASEAN countries, with the exception of Singapore and Vietnam, where conditions remained largely unchanged.

CONCLUSION

This study examined the relationship between the five areas of economic freedom and foreign direct investment (FDI) flows in ten ASEAN countries over the period 2010–2022. The findings show that only some areas of economic freedom have a statistically significant influence on FDI. Specifically, the size of government and legal system and property rights were consistently significant throughout all model specifications, indicating their strong institutional relevance for FDI attraction. Conversely, freedom to trade internationally did not exhibit statistical significance in any model, suggesting that trade liberalisation alone might no longer be a decisive factor in investment decisions, particularly in a region where trade integration has largely converged since the implementation of the ASEAN Economic Community (AEC).

The results also indicate that institutional quality—particularly in terms of legal protection and state involvement in the economy—plays a critical role in shaping investor confidence. Countries with higher score for government size and stronger legal enforcement tend to receive more favourable FDI inflows. The researcher also found that coherent regulatory frameworks and sound money conditions play a significant role, albeit more variably across time horizons.

Overall, this study offers a more grounded understanding of how location-specific institutional factors shape FDI inflows in the ASEAN context. The significance of selected areas of economic freedom—particularly the SoG and the LSPR—highlights their role as critical advantages that influence multinational corporations' investment decisions.

These findings also align with the internalisation theory, as MNCs seek to minimise external transaction costs and protect intangible assets by operating in environments with stronger legal protections and more predictable regulatory conditions. Additionally, the absence of a significant effect of the FTI on FDI suggests that market accessibility alone is no longer sufficient. Taken together, these results indicate that sustained FDI inflows depend less on regional trade arrangements and more on national efforts to enhance institutional efficiency, legal, and regulation certainty, as well as macroeconomic credibility.

Regardless of research findings, the researcher highlighted two important notes. Firstly, this study employs static data analysis, neglecting dynamic effects or potential endogeneity within the model. Secondly, this research focuses exclusively on the ASEAN region; therefore, the results should be further compared by including other regions—such as the OECD, SAARC, or others—depending on data availability.

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