

Economic Growth, Political Freedom and Human Development: China, Indonesia and Malaysia

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Abstract

This paper aims at analyzing the main elements of successful performance in economic growth among developing nations in East Asia particularly China, Indonesia and Malaysia. The approach however does not identify all the variables and indicators that are attributable to economic growth across these countries, rather it is an attempt to discern which factors are the most critical and imperative that illuminate the differences between fast and slow growing economies. There are three dimension of explanatory variables that have been categorized as the determinants of economic growth; (1) demographic variable (life expectancy at birth); (2) policy variables (openness to trade, civil liberties and political rights, foreign direct investment (FDI) and (3) human development indicator which can be explained by fertility rate. Real GDP per capita, on the other hand is used as a proxy variable to measure economic growth. Data were collected for three East Asian countries including China, Indonesia and Malaysia from 1980-2005. Using a least square quantitative method, our findings suggest that life expectancy, foreign direct investment, openness and political freedom have positive influences and statistically significant determinants of growth in China, Indonesia and Malaysia during 1980-2005. The result also shows that fertility rate and civil liberty are positively related to economic growth, but have no significant effects on these developing nations. In the concluding section, we demonstrate several important elements that have accelerated economic growth in each country. FDI and civil liberties are the major significant determinants of growth in China while the persistence of high fertility rate and greater openness are found to be significantly stimulating GDP in Indonesia. Malaysia, on the other hand, is performing well in both political freedom and civil liberty.

Keywords— civil liberty, economic growth, foreign direct investment, human development, openness, political freedom.

INTRODUCTION

ECONOMIC growth is the essential ingredient in alleviating poverty and generating the resources necessary for human development. 'Human development has been defined as enlarging people's choices in a way which enables them to lead longer, healthier and fuller lives' [1]. Under the concept of leadership of Mahbub ul Huq, there are some human development aspects that attributable to increase standard of living and people's well being, such as education, access to health and nutrition, to the widening of choice and enhanced empowerment including political freedoms, prosperity, participation and cultural aspects [2]. While we recognize all these elements and contributions, this paper will sharpen understanding the linkage between human development and economic growth while restricting to the political aspects as well as political and economic freedom and physical aspects of human development. This paper also aims at analyzing the main elements of successful performance in economic development among developing nations in East Asia particularly China, Indonesia and Malaysia. We exhibit that East Asian growth are characterized by a mixed conditions, human development, economic freedom and political freedoms.

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We also discuss the major elements of economic development indicators in each country and provide empirical cross-country evidence to determine which dimensions of economic and human development variables are the most significant factors to rapid growth in each country. In the concluding section in turn will provide us to determine the successful elements in phasing of policy and suggest recommendations for the policy. Many studies have shown a direct correlation between gross domestic product (GDP) per capita and other development indicators such as political and civil rights, adult literacy, lower birth rate and fertility rate. However, economic growth alone does not translate into human development. Increased longevity and ease of access to health and educational services, good governance, foreign direct investment and reform policy also play the vital roles to raising standards of living. GDP, on the other hand remains a proxy variable to measure human well-being.

Most analysts expect Asia's economic performance will continue to grow and has been very good since 1980s. The world economy had witnessed a remarkable rise of the dynamic East Asian economies region comprising China, the four 'Asian Tigers' of Taiwan, South Korea, Hong Kong and Singapore and the 'Newly Industrialized Economies' of Malaysia, Thailand and the Philippines. While Indonesia was following closely behind. All these economies had recorded an impressive economic growth at 6-8% before the financial crisis struck these regions during 1997. Many studies have shown various sources and key factors that lead to economic growth in those economies including human capital accumulation, physical capital accumulation, foreign trade investments and favorable macroeconomics policy and political stability. There were four key reasons that had brought to tremendous growth in East Asian countries; due to the process of catching up (since they entered the 1960s with relatively low incomes and relatively well-educated workers), favorable geographical and structural characteristics, demographic changes that lead to more rapid growth after World War II, and their conducive economic policies and strategy [3]

Among of these fast emerging East Asian economies, China had recorded with more impressive growth. From 1997 to 2005, the Chinese economy has an annual rate of 9.6% of real GDP while in absolute terms, China's total GDP sextupled between 1980 and 2000, due to its success in market-oriented reform [4]. The Chinese economic takeoff had experienced fast growing growth since the initiation of economic reforms of Deng Xiaoping's policy in 1979. China's economic growth can be divided into two periods; the pre-reform era (before 1979) and the post-reform era (after 1979). Since the introduction of economic reforms, the year 1979 represents a milestone of economic development, economic performance as well as human development [5].

Many economists speculate that China would continue to achieve spectacular growth performance due to its success in exports and FDI, provided that government is able to continue and deepen economic reforms and several physical indicators. China's economic reforms have captured the imagination and attention of the world with the responses range from utter pessimism to fear of a strong China. Some economists saw China 'on the brink of disaster' [6] while others wondered of the collapse of China's economy in the next future [7]. At the other camp who advocates a strong China indicated China becoming the next America [8] while others provided substantive reasons of becoming optimistic that the reform process will keep the Chinese economy on the sustainable growth [9]. However, despite of sustaining its continuing high growth in the next lap, China will have to grapple with several structural and difficult challenges such as growing population and income inequality that threaten the social stability [10].

Malaysia, on the other hand, generally performed well in terms of life expectancy, education and access to health services. According to the Human Development Index developed by the United Nations Development Program, Malaysia ranked fourth in the world during 1970-2000 in terms of human development improvements. Accordingly, the Malaysian government had invested more in development projects that built roads and improved communications equipment in order to increase access to schools and encourage the poor Malays in school enrollment [11]. Malaysia's growth continued to be strong through the 1990s with the real GDP was on average of 4.5% per year. The IMF wrote in 2001 "As an emerging market economy, Malaysia is clearly a success story" [11]. Indonesia has experienced dramatic structural changes over the past 20 years. Its burgeoning economic expansion before 1997 was as dramatic as the aggravation of the post-1997 Asian financial crisis. During the so-called New Economy from 1966 to the end of Suharto regime, Indonesia had given more emphasis at strengthening the economy than at improving social conditions with the petroleum fueled the initiatives, as it became the major source of government's earnings from oil exports and gearing it towards advance the development goals [12]. One of these goals was education attainment through expanding education initiatives, particularly for primary school children.

With a very successful birth control program which is called as the PKBI or the Indonesian Family Planning Association, Indonesia had achieved nearly universal primary education, which had slowed population growth [12]. He also pointed out that Indonesia during post-Sukarno New Order government had committed to reduce absolute poverty through a broad-based rural development strategy and increased production in the rice sector. The government had paid substantial effort to reduce the mortality rates through the present, improved nutrition, environment, and access to health care through local public health clinics. However, despite of its outstanding spectrum in terms of infrastructure provision and social services, the country witnessed a sudden deterioration of its gross domestic product (GDP) and rising poverty, owing to the Asian Financial Crisis during 1997-2000. Lack of private and public sector investments since the crisis, aggravated by poor coordination among different levels of government and prevalent corruption had resulted to a negative development and declining competitiveness. Strengthening macroeconomic policy and fiscal policy on the other hand would help to overcome the economic, political and social instability [13].

literature review

Policy variables

Several studies had demonstrated a significant relationship between the levels of civil, economic and political freedom and the rate of growth [14] and [15]. ‘Political freedom as a situation where citizens are completely free to participate in the political process; where elections are fair, competitive, and free trade from corruption while civil liberties to include freedom of the press, freedom of association, freedom of religion, and freedom of speech’ [16]. Economic freedom is defined as the presence of these characteristics (1) property acquired without the use of force, fraud, or theft is protected from physical invasion by others; and (2) citizens are free to use, exchange, or give property to another as long as their actions do not violate the identical rights of others [17]. The greater political or civil rights the higher level of GDP was expected to attain. ‘The ultimate value of growth lies in expanding freedom: by giving people greater choice over what they can do with their lives’ [18]. Increasing degree of economic freedom and level of openness were also expected to have a positive impact on economic growth. This was supported by previous studies that had concluded the openness had positive relation with GDP growth [3], [19], [20], [21], [22], [23], [24], [25].

A fourth policy variable is a measure of the impact of massive inflows of foreign direct investment on economic growth. Many studies have been carried out to investigate the fundamental theories of FDI, the advantages and disadvantage of FDI, and the relationship between FDI and economic development [26], [27], [28], [29], [30], [31],[32]. Most of them agree that foreign direct investment has a positive effect on economic performance. While study on the financial sector development as a variable to examine the causality between FDI and economic growth was still scanty, a study had been conducted to analyze the links between FDI and economic growth in three developed countries (Japan, the United States and the United Kingdom) and some selected East Asian countries particularly Indonesia, Malaysia, Korea, the Philippines, Singapore and Thailand by including the development of the domestic financial sector [33]. The findings suggested that two developing countries (Malaysia and Thailand) and three developed countries (Japan, the United Kingdom, and the United States) provided enough evidence to support the hypothesis that FDI inflows led to economic growth after taking into consideration the influence of the domestic financial sector.

FDI could benefit most of host countries through technology transfer and spillover efficiency. The success among East Asian economies were explained by the accomplishment of utilizing FDI to enhance economic growth, resulting from their export-promotion strategy, improving education and human capital, policies that encourage export-oriented FDI, adopting trade liberalization and macroeconomic stability [24]. It was illustrated that FDI-to-growth causality was underpinned by capital stock propensities, greater trade openness, limited rule of law and lower income level while greater political rights and limited rule of law were the major factors that explained growth-to-FDI causality. The results showed some causality relationships with a positive correlation between FDI and economic growth in seven of the nine Asian countries [34].

Demographic variable

In this paper, we use life expectancy at birth as a demographic variable, measured at the initial year of the growth period. It is expected that the higher the life expectancy, the healthier and the more productive the workforce is.

It means that a person with higher life expectancy tends to have a longer span of retired working, can earn and save more income and thus boosts economic growth by supplying more working age population. East Asia recorded a higher level of life expectancy with was already 63 years in the Four Tigers in 1965, while South and Southeast Asia were 49 years and 52 years, respectively [35]. It is predicted that for a given population growth rate, the growth of GDP is favored when the working age population outpaces the population growth. Demographic variables including population change as a result of changing in fertility rate, mortality and birth rate are strongly associated with differences in growth rate. East Asian countries grew faster than the rest of the world for four key reasons: they had potential for catching up, given their geography and structural characteristics, demographic changes worked in favor of more rapid growth and their conducive economic policies [3]. While South Asia had a deliberate growth performance partly due to a slower increased of the working age population as compared to East Asia [36]. Demographic variables had played a vital role in East Asia's economic success. East Asia had favorable demographic characteristics with high life expectancy and low fertility which in turn led to a decrease in the youth dependency ratio and induced growth rates of income per capita [37].

Human Development Indicator

The persistence of higher fertility rate is an indispensable asset for development and economic growth. Lower fertility rate can be translated as demanding fewer children in most developing countries. As households move from agrarian to industrialization, they would choose to have fewer children as they are no longer valuable becoming farm workers. This would decline dependency burdens, which in turn, creates the possibility of higher investment in education of each child. Better educated, more skilled worker is likely to produce more outputs given the resources base than the less-skilled workers. In this paper, we use fertility rate as our primary measure to proxy human development [35]. It is predicted that higher fertility rate would hamper economic growth. One would expect that a high total fertility rate would have significant effects on the supply of labor (employment), and thus increase the youth dependency burden that consequently have impinged on development and human welfare. This can be translated by the cost of excessive population growth. The more rapid population growth, the greater proportion of children dependency ratio and the greater the number of potential parents as this youth reaches adulthood.

Human capital investment was assumed to be negatively associated with high fertility rate. Lower fertility rate would reduce the cost of human capital investment and accelerate the rate of human capital accumulation [38]. Improvements in health and reductions in fertility had induced demographic dividend more rapidly, resulting changes in age structure. Beginning 1970s, China introduced a new policy that called for couples to have fewer children. The adoption of its one-child policy had encouraged young couple to have only one child, and thus propelled the sharp decline in the fertility rate which subsequently triggered a significant rise in the working age population ratio [39]. East Asia had recorded significant decline in fertility rates during 1970-2004 (Table 1). The use of family planning among married women rose from a low of 10 percent in 1960 to 60 percent in 2003, due in part to modern contraceptive prevalence, immense investment in education, women's productive health and improvements in standard of living fertility rate has declined in most developing countries [40].

Table 1: Total Fertility Rates by Region

Region	1970	1980	2004
East Asia & Pacific	5.4	3.0	2.1
Europe & Central Asia	2.5	2.2	1.6
Latin America & Caribbean	5.3	4.2	2.4
Middle East & North Africa	6.7	6.2	3.1
South Asia	6.0	5.2	3.1
Sub-Saharan Africa	6.8	6.7	5.4
High income	2.5	1.9	1.7
World	4.8	3.7	2.6

Source: World Bank Database

Methodology

Data were collected for three East Asian countries including China, Indonesia and Malaysia from 1980-2005. Data pertaining to Political Freedom were obtained from *Freedom in the World* reports published by the Freedom House.

This data is reported in two time series, which ranking both political rights (Political) and civil liberties (Civil). Each is measured using an ordinal seven-point scale with a score of 1 corresponds to the greatest freedom while a score of 7 representing the lowest political rights and civil liberties. In this study, political freedom is measured as the sum of political rights and civil liberties. Freedom House also reports the aggregate status of freedom for each nation (Status); the numerical scores for political rights and civil liberties are averaged and used to assign each country the status of “Free”, “Partially Free” or “Not Free”. In this equation, this variable (Status) is measured using an ordinal scale with 1 representing “Free”, 2 representing “Partially Free and 3 representing “Not Free”. However, we do not account this variable since there are no significant patterns or changes captured in both Malaysia and China regions over the time period. The level of economic well-being is captured in our regression equations by using the real per capita gross domestic product adjusted for changes in the terms of trade (*GDP*) available from the Penn World Tables, 2005. Data including life expectancy, fertility and foreign direct investment were obtained from World Development Indicator 2005 while Openness data from Penn World Tables version 6.3.

Model

We incorporate all the aforementioned variables in the following growth model using Ordinary Least Squares (OLS) regression.

$$GDP_{it} = a + \beta_1 \text{Fertility}_{it} + \beta_2 \text{Life Expectancy}_{it} + \beta_3 \text{FDI}_{it} + \beta_4 \text{Open}_{it} + \beta_4 \text{Political}_{it} + \beta_5 \text{Civil}_{it} + e_{it}$$

where the dependent variable is the annual growth of real GDP per capita between 1980-2005, as measured by the World Development Indicator. Fertility is the ratio of fertility rate, total (births per woman); Life expectancy is measured as total (years) of total life expectancy at births; FDI is the Foreign direct investment, net inflows (% of GDP); Open is a trade openness which is measured as the value of exports plus imports divided by GDP. Political is the political freedom with an ordinal seven-point scale to represent political rights while Civil is civil liberties which are averaged and used to assign each country the status of “Free”, “Partially Free” or “Not Free”.

Dependent Variable: GDP per capita

Variable	China	Indonesia	Malaysia	Region
Constant	-1049.479* (1593.01)	1125.78*** (218.73)	2547.440 (3894.541)	-1928.851** (882.348)
Fertility	-126.389* (-68.801)	215.216*** (21.974)	-1310.44*** (249.507)	74.636 (84.607)
Life_Expect	53.764* (26.188)	1.289 (1.752)	87.721* (46.218)	18.653* (7.628)
FDI	8.19E09*** (1.59E-09)	1.840E-08* (7.069E-09)	4.775E-09 (2.413E-08)	1.80E08*** (2.88E-09)
Openness	4.917** (2.252)	3.133* (1.160)	3.738* (2.170)	19.709*** (0.710)
Political	142.627 (102.080)	-16.856 (16.586)	-259.758*** (40.136)	-90.723* (48.299)
Civil	-183.117*** (58.982)	-13.308 (19.608)	-167.473*** (54.959)	55.291 (56.799)
R ²	0.968	0.955	0.988	0.950

*** Significant at the 1% level

** Significant at the 5% level

* Significant at the 10% level

Standard errors are in parentheses

Result and discussion

The results in Table 2 are estimated using ordinary least squares. We did regression on the estimated relationships for each country particularly China, Indonesia and Malaysia and included a pooled cross-section/time series data for these countries over a twenty-five year period (1980-2004). Many studies and previous literatures suggest that political stability or increase in political right and civil liberty often leads to rapid economic growth. We find some empirical evidence that supports this theory. According to the table 2, we conclude that political rights in a region equation which represent all these countries are more important than civil rights since the value is statistically significant at 1% level and has an expected sign. The estimated coefficient for political rights (Political) in a region equation is -90.723; a 1 unit increase in political rights (a decrease on the Freedom House scale) would increase the per capita GDP by 90.7%. Only Malaysia records a positive growth associated to political rights (-259.758) while China and Indonesia are insignificant and show a weak relationship between these variables. However, the estimated coefficient on the civil rights variables are negative and highly significant for China (-183.117) and Malaysia (-167.473); an increase of civil liberties (a decrease on Freedom House scale) by 1 unit would increase the per capita GDP by 183.117% and 167.473% respectively. We find a weak direct link between civil rights and growth in Indonesia and region equations.

All four regression models indicate that openness has a positive, strong association with per capita GDP. The estimated coefficients have the expected signs and are statistically significant. These results confirm the earlier findings that openness to international trade foster economic growth and contribute to an increase in per capita GDP [41],[42],[43]. Demographic variables show a strong correlation with the growth rate. We find evidence that the first variable, higher fertility rate has a strong, negative and large effect on economic growth for all three countries. This upholds the previous finding that East Asia's fertility transition, which occurred in the mid-1970s, had led to a decline in a dependency ratio as a consequence of a declining rate in birth rate [42].

Our result shows that life expectancy at birth also supported economic growth. We find that the estimated coefficients of life expectancy are statistically significant at the 10% level across China and Malaysia. However, there is not enough evidence to support that life expectancy has a positive impact on economic growth in Indonesia since the estimated coefficient has an expected sign (positive) when it is insignificant. In addition, the result shows a positive and significant relationship for the region across countries. The R^2 for our region specification is 0.95, indicating that this set of variables explain about 95 percent of the variation in economic growth. Of course, some countries may differ in terms of magnitude of relationship, considering that the average relationships across countries are not a precise recipe applicable to all countries across time.

Our result shows that foreign direct investment has a positive relationship with economic growth and statistically significant for both China and Indonesia at 1% level and 5% level respectively. However, the estimate coefficient of foreign direct investment with equal to 4.77 for Malaysia is not statistically significant even though it has an expected (positive) sign. An earlier study has explored this relationship by providing a direct test of causality between FDI and economic growth in South and Southeast Asia. The result shows that there is no direct causal relationship between two variables exists in Malaysia. For the region sample as a whole, the effect of FDI on economic growth is statistically significant at 5% level [34].

The positive effect of FDI on economic growth is consistent in East Asia and Latin America. FDI may potentially be a growth-enhancing factor to the four Asian countries (China, Indonesia, Singapore and Taiwan) due to their export-promotion strategy, improving human capital and education, macroeconomic stability, along with the policies that favor export-oriented FDI [33]. On the other hand, Malaysia and Thailand are more complex significance, reflecting the impact of other forces that affects economic growth and FDI inflows. This result is also parallel with previous FDI literatures that suggest FDI accelerates economic growth [30],[31],[44],[45].

Conclusion

This study examines the impact of openness, economic freedom, in the form of political freedoms and civil liberties, foreign direct investment, life expectancy and fertility rate on economic growth (level of per capita income) in China, Indonesia and Malaysia during the 1980-2004. Using the cross-country growth regression, the results show that life expectancy, FDI, openness and political freedom variables are significant determinants of economic growth and the most important players behind these East-Asian phenomenal growths, which are concurrent with most of previous literatures.

Of course, this framework does not fully explain all the critical factors that accelerates economic growth and does not wholly capture the relationships between macroeconomic variables, policy variables, natural resources and economic outcomes. However, it does highlight several important elements that contribute to rapid economic growth in these economies. Each country has its own policy and different approaches to gear towards robust economic growth. Given per capita income is not a good measure of development for the countries as a whole, due to lack of inclusiveness of the measure, no indicator of the degree inequality in income distribution, differences in the exchange rates, population and prices of goods and services, it is very difficult to do a comparative analysis across countries and it is not surprisingly to see the discrepancies between the region and each country growth regressions.

In this study, the main factors that explain rapid economic growth in China are direct foreign investment, fertility rate, life expectancy, openness and civil liberties. Among these variables, FDI and civil liberties are observed to have large positive effects on economic growth at a statistically level, which seem to support previous findings. With the incentive policy of 'Reforms and Opening Up', China has successfully attracted foreign technology and capital which has triggered technological progress and accelerates economic growth [45]. A key of human development, which explained by the persistence of high fertility rate, favorable policies towards greater openness and a conducive foreign direct investment climate are the critical determinants of increasing income per capita in Indonesia. A very successful birth control program that was called PKBI (Perkumpulan Keluarga Berencana Indonesia- the Indonesian Family Planning Association) in the mid-1980s had endeavored nearly universal primary education attainment and slowed population growth [12], which explains the most significant factor among all other variables to the economic growth. A positively significant sign of trade openness shows that greater openness and fewer restrictions will speed up economic growth.

Malaysia, on the other hand, is performing well in term of economic freedom; both political freedoms and civil liberties that have been characterized by higher level of per capita GDP. Both political freedoms and civil rights are found to be significantly stimulating economic growth. These results will strengthen the view that societies with greater freedom and democratic tend to have higher level of per capita GDP. Another important factors that are positively significant to higher GDP per capita including openness to trade, life expectancy and persistence of fertility rate. In addition, education has increased empowerment of women, supply working age population as fertility rate declines, and increase savings as a result of higher life expectancy, which in turn, would contribute to increase in level of per capita GDP.

These findings can propose important considerations for policymakers in China, Indonesia and Malaysia. The empirical evidence suggests that FDI, openness and civil liberties are significant elements to enhance China's economic growth. Indonesia, besides of its successful fertility persistence program, they could consider to formulate policy that will attract and benefit more from FDI inflows and greater openness. While Malaysia could focus on implementing policies that favor to economic prosperities, both political freedoms and civil liberties, greater level of openness, declining fertility and rising life expectancy, which are the main factors that are significantly affecting level of per capita GDP.

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