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The Effects of Institutions on Economic Growth in East Asia

Ahmad Syarief Iskandar[1], Muhammad Nur Alam Muhajir[2], Ambas Hamida[3], Erwin[4]

[1]Faculty of Islamic Economics and Business, Palopo State Islamic Institute, Indonesia
[2]Faculty of Economics and Business, Gadjah Mada University, Indonesia
[3]Faculty of Islamic Economics and Business, Palopo State Islamic Institute, Indonesia
[4]Faculty of Islamic Economics and Business, Palopo State Islamic Institute, Indonesia

E-mail: mnur_alam@iainpalopo.ac.id

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Abstract

This study aims to analyze the influence of institutions on economic growth in East Asian countries. The research data were collected from 5 countries in East Asia from 2005-2020. Model analysis was performed using dynamic panel data using the Generalized Method of Moment Arellano-Bond approach. The results showed that Voice and Accountability, Political Stability and Absence of Violance, Government Effectiveness, and Rule of Law had no influence on economic growth in East Asia. Meanwhile, Regulatory Quality and Control of Corruption have a significant effect on economic growth in East Asia. Regulatory quality variable has elasticity of long term effect on economic growth in East Asian countries.

Keywords: Institutional, Economic Growth
JEL Classification: O17, O47

INTRODUCTION

Institutions Institutions have an important role in supporting economic growth. Because institutions focus on how to arrange alternative institutions that facilitate economic stability and economic growth. The political economy of East Asia's growth, from developing countries to micro-institutions (Robert Stimson, 2009). Economic growth is the development of activities in the economy that causes goods and services produced in society to increase and the prosperity of society to increase. Of the many countries in various parts of the world, there are countries that have the potential to have high income, namely East Asian countries. In the last 10 years, the economic growth of the East Asia region has become the engine of global growth. Based on data, East Asian countries such as China have the second largest economy in the world by GDP, reaching US$ 10,380 billion. In addition, other East Asian countries South Korea ranks 12th in the world by GDP (Sarel, 1996). Asia is recorded to grow twice as fast as other regions in Asia or even three times faster than Latin America and South Asia (Ministry of Finance, 2018). The high incomes in these East Asian countries encourage their economies to develop so fast. The economic situation in East Asian countries which is growing rapidly has certainly led to many interpretations for economists to formulate the factors that caused this success. Countries in East Asia with significant economic developments are Taiwan, Japan, and South Korea. The following is data on GDP growth in the East Asia Region in 2018-2021.

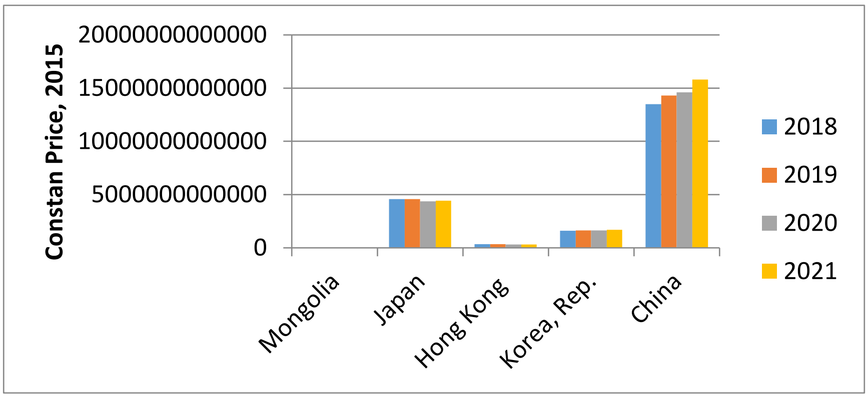

Figure 1. GDP per Capita East Asia 2018-2021 (Constant 2015 US$)
Source : World Bank

Based on figure 1, it is known that by using a constant price approach, GDP growth in China, Japan and South Korea experienced significant growth. The data shows that China is a country that has the highest GDP per capita compared to other countries in the East Asia region during the 2018-2021 period. Furthermore, Japan and China ranked second and third. Meanwhile, Mongolia has the lowest GDP per capita in the East Asia region during the 2018-2021 period.

Neoclassical economists claim that the cause of this development is that countries in East Asia can take comparative advantage of economic activities in their countries so that they can compete in international trade. However, if we look more deeply, it turns out that economic growth in East Asia was not achieved with the prescription of liberalism and free trade as stated by the neoclassicals, but economic growth in East Asia was driven by the dominant role of the state in economic activity.(Johnson, 1982). Based on the data, it is stated that the productivity growth rate during 1975-90 in East Asian countries was very high. For example, Hong Kong is 0.6%, Taiwan is 0.8% and Korea is 1.1%. in China, and extraordinary in Korea (Sarel, 1996).

There are five important elements in good governance, namely voice of accountability (arresting the participation of others), there should be no violence or people suffering because of the decisions made, there should be an element of quality regulation, the rule of law, and most importantly there should be no elements. corruption. Research by Evans (1997) reveals the influence of bureaucracy on economic growth in 35 developing countries in 1970-1990. This study uses GDP data as economic growth and factors in the bureaucracy with government policies. The results show that the Weberian bureaucracy has a significant influence and deserves to be included in the economic growth model.

Based on the studies that have been carried out, it is explained that good government governance will encourage economic growth where government institutions function to create a conducive political and legal environment, the private sector creates jobs and income, while the community plays an active and positive role in social interaction through non-governmental organizations. Chang (1998) reveals that theoretical and empirical discussions show how misleading the current widespread suggestion that many Asian countries need to launch radical institutional reforms that will bring them closer to the “best practices” that Anglo-American institutions should undertake. Not only is there no single best institution that every country should adopt, but many Asian institutions, currently accused of causing inefficiency and even being responsible for the current crisis, have served useful functions in their development. If many Asian countries are forced or persuaded to change their institutions towards Anglo-American direction, especially in a short period of time, the changes are likely to be ineffective and at worst dysfunctional.

Stephan Hagard (2004) points out two findings. First, there are many institutional means to solve the collective action, credibility, and information problems that are barriers to growth. The search for a single institutional "taproot" for growth is likely to be a misguided exercise, and more attention should be paid to understanding the varieties of capitalism in East Asia. Second, institutions themselves are endogenous to other political factors that appear more consequential to growth, including in particular the nature of the relationship between the state and the private sector.

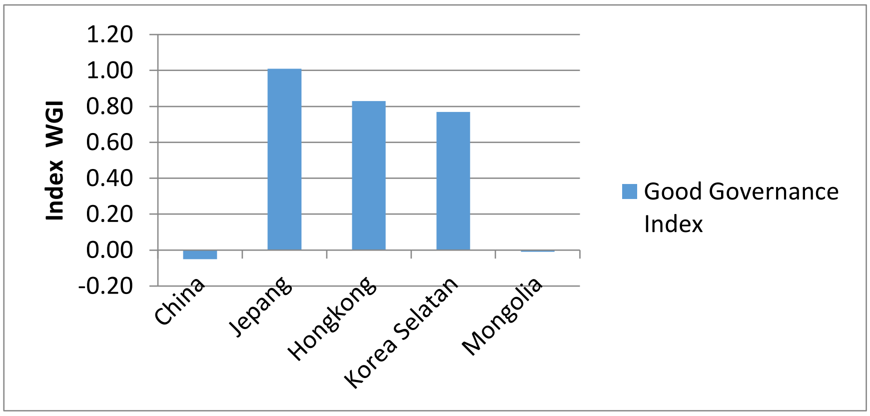

Figure 2. Good Governance Index in East Asia, 2021
Source: Worldwide Governance Indicators

Based on the figure, it is known that Japan is the country that has the best quality institutions in the East Asia region in 2021 with an index score of 1.01 points. Next, followed by Hong Kong with an index score of 0.83. Meanwhile, South Korea, China and Mongolia respectively had institutional quality index scores of 0.77 points, -0.05 points and -0.01 points. Research conducted by Hasyim (2008) found that countries with high growth rates have good institutional characteristics, as measured by several variables, such as judicial efficiency, economic freedom, low levels of corruption, effective government and property protection. Economic freedom is an important factor in influencing growth and investment, economic freedom also describes a good institution. Regional economic development cannot be reduced to a narrow set of economic factors, but will be influenced by various social and cultural factors, including leadership and institutional factors. The ability of an area to effectively cope with these endogenous factors will determine its agility and ability to respond quickly in responding to changing circumstances and will affect its capacity to deal with shocks.(Robert Stimson, 2009). According to Healey (2009), good governance is the effectiveness of high-level organizations in relation to policy formulation and which are actually implemented, especially in the implementation of economic policies and their contribution to growth. It is important to write this paper to determine the influence of institutions on economic growth in East Asian countries by using institutional components, especially five East Asian countries, namely China, Japan, Hong Kong, South Korea and Mongolia.

LITERATURE REVIEW

The role of good governance in contributing to economic growth has often been studied in several literature studies. Research by Evans (1996), entitled Bureaucracy and growth: A Cross-National Analysis of the Effects of “Weberian” State Structures on Economics Growth, reveals the influence of bureaucracy on economic growth carried out in 35 developing countries in 1970-1990. This study uses data GDP as economic growth and factors - factors in the bureaucracy with government policies. The results show that the Weberian bureaucracy has a significant influence and deserves to be included in the economic growth model. Based on the research that has been done,

Chang (1998) reveals that theoretical and empirical discussions show how misleading the current widespread suggestion that many Asian countries need to launch radical institutional reforms that will bring them closer to the “best practices” that Anglo-American institutions should undertake. . Not only is there not a single best institution that every country should adopt, but many Asian institutions, currently accused of causing inefficiency and even being responsible for the current crisis, have served a fruitful function in their development.

Several econometric studies were conducted by Daniel Kaufmann and Aart Kraay (2002), Robert J Barro (1996, p. 2). Daniel Kaufman (2010, p. 4) introduces six variables of good governance, namely: 1) freedom of opinion and responsibility 2) political stability and low levels of violence/terror intensity, 3) government effectiveness, 4) quality of legislation, 5) supremacy law, 6) corruption control. According to Kaufmann, the six variables of good governance are correlated with market efficiency and economic growth.

Meanwhile, Khan (2007, p. 3) mentions that Daniel Kaufmann is a representative of a liberal economist who is oriented towards an enhancing market governance approach. The approach focuses on improving governance to drive market improvements to reduce transaction costs and enable marketplaces to work more efficiently. According to Khan, Kaufmann's study was challenged by heterodox economists who thought that an efficient market alone was not enough. Moreover, it is necessary to increase productivity based on technological innovation, political stability and rapid transformation (growth enhancing governance). However, Kaufmann considers that the heterodox economist's growth enhancing good governance approach requires an increase in government capabilities (growth enhancing government capabilities). The Khan Study (p, 8,

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Research conducted by Hasyim (2008) found that countries with high growth rates have good institutional characteristics, as measured by several variables, such as judicial efficiency, economic freedom, low levels of corruption, effective government and property protection. Economic freedom is an important factor in influencing growth and investment, economic freedom also describes a good institution.

Meanwhile, Edy Wibowo (2013, pp. 8-10) concludes that freedom of expression and responsibility, political stability, quality of regulations, and control of corruption have no effect on economic growth in five EAST ASIA countries, during 2011 – 2017. Only the effectiveness variable governance and the rule of law that affect economic growth.

Jonathan Lehne, Jeffrey Mo and Alexander Plekhanov (Jonathan Lehne, Jeffrey Mo and Alexander Plekhanov, 2014) in their study in 121 countries including Indonesia divided the indicators of good governance introduced by Kaufmann into two categories. The two categories of indicators are: a) economic institutions, and b) political institutions. The indicators of economic institutions include: i) quality of legislation, ii) effectiveness of government; iii) the rule of law; iv) corruption control. Indicators of political institutions include: i) freedom of expression, and ii) political stability. According to Jonathan, political institutions have a correlation with economic institutions. Autocratic countries generally have weak political institutions and weak economic institutions (except Singapore). On the other hand, democracies have strong political and economic institutions. However, in practice, this relationship is influenced by the wealth of natural resources; history (colonial), geography (natural disasters; climate), ethnic race; economic openness. This political institution variable is symbolized as polity in this study. The polity index ranges from -10 (corresponding to a fully autocratic regime, such as a monarchy) to 10 (corresponding to a well-functioning democracy). Countries with a polity score below -5 are labeled as "autocracies" (Center for Systemic Peace). This political institution variable is symbolized as polity in this study. The polity index ranges from -10 (corresponding to a fully autocratic regime, such as a monarchy) to 10 (corresponding to a well-functioning democracy). Countries with a polity score below -5 are labeled as "autocracies" (Center for Systemic Peace). This political institution variable is symbolized as polity in this study. The polity index ranges from -10 (corresponding to a fully autocratic regime, such as a monarchy) to 10 (corresponding to a well-functioning democracy). Countries with a polity score below -5 are labeled as "autocracies" (Center for Systemic Peace).

Kaufman's study became the inspiration for the next research using the regression method. Noha Emaran and I Ming Chiu (2016, p. 135) conclude that there is a positive relationship between good governance and per capita income in Middle Eastern and North African countries. Income per capita increases by 2% if good governance increases by 1 unit.

Md Rafayet Alam and friends (2017, p. 5) in their study of 81 sample countries, provide empirical evidence that government effectiveness has an impact on economic growth. The Khan study has the support of Richard Mira and Ahmed Hammadache (2017, pp. 234-235). Good governance is relevant to economic growth in countries that have economic and social policies that enable the development of governance institutions. Rachid Mira, citing Khan's study, stated that there were two weaknesses in the study of Kaufmann and his followers, namely the temporality factor, and political and institutional capacity. Good governance indicators in the eighties and nineties were not correlated with economic growth that produced the same period. Puruweti Siyakiya, (2017, p. 16) using a sample of 28 European Union countries,

Jean-Baptiste Hanyarimana and Berttrand Dushimayezu (2018, p. 13) also provide empirical evidence. Good economic performance and economic growth and development in Rwanda are supported by good governance.

Paitoon Kraipornsak (2018., p. 102) concludes that good governance is a crucial factor in contributing to economic growth in 16 developing Asian countries including Indonesia in 1996-2016. According to Kraipornsak, if the economy manages to achieve a composite index of good governance of 1 percent from last year, it can help increase the per capita income of Asian countries in the sample by US$ 31.34 or 0.54 percent per year. Jiandang Liu and friends (2018, pp. 1-23) also conclude that the quality of good governance in China has a positive impact on economic growth. This positive impact is possible because good governance reduces the pressure of arbitrary power.

Tharanga Samarashinge (2018., pp. 33-34) concludes that effective corruption control contributes to economic growth in several Asian, African and North American countries. However, effective corruption control and at the same time maintaining political stability and zero terrorism have a greater impact on economic growth. Samarange further found that freedom of speech, and political stability, did not have a positive effect on economic growth. The positive influence of institutional development in promoting economic growth in the Balkans in 2006 – 2016 is concluded by Anna Marija and Krista Bulderberga (2018, p. 33). Anna's study uses WGI data plus other variables. These variables are: a) global comptetitiveness index for institutional pillars, b) macroeconomic index, c) demographic index, d) economic freedom.

The same study was also conducted by Chan Phuc Nguyen, Thanh Dinh Su, Thai Vu Hong Nguyen (2018, p. 1952) in 29 emerging market countries in 2002-2015. Canh concludes that institutional quality plays an important role in stimulating economic activity and accelerating economic growth. Definition of institutions in the study of Anna Marija Radzevica and Krista Bulderberga (2018), Puruweti Siyakiya, (2017); Canh Phuc Nguyen, Thanh Dinh Su, Thai Vu Hong Nguyen (2018), basically use six indicators of good governance.

Kokou Dzifa and Kossi Edem Baita (2019, p. 2) provide empirical evidence that improvements in good governance contribute to increased economic growth, in Sub-Saharan Africa. According to Kokou, the effectiveness of government and the rule of law are important factors to support economic growth. Muhammad Ramadhan (2019, p. 2596) with 2002-2018 data concludes that six good governance variables have a significant positive influence on Indonesia's economic growth.

The same study was carried out by Zhang Zhuo, Sultan of Almaki, Bashir Muhammad Sherkan (2020, p. 2) with panel data from 31 developed European countries during the period 2002-2018. The study found a significant effect of supremacy law, control of corruption and freedom of speech and responsibility for growth economy. Zhang's study also found the effect of a 1% increase in effectiveness governance and political stability, as well as the quality of regulations,against decline economy.

Good Governance Indicators (WGI, 2022)

In general, the measurement of institutions for countries in the world refers to the Worldwide Governance Indicators (WGI) whichbased on more than 300 underlying data sources. The WGI indicator is used to make comparisons between countries more broadly by taking into account trends from time to time.The scope of indicators listed in the WGI is quite complex**.**

a. Voice and Accountability

Voice and Accountability is the extent to which citizens can participate in choosing parties and leaders, as well as freedom of opinion, association and determining public policy. Accountability is the main key to good governance. Accountability is the same as accountability. Accountability means us
can answer when something is decided like that, or not decided like that, and when asked or sued by the public, we can already answer. The most important part of accountability is related to legality, where the things that are done must have integration with constitutional or constitutional rights, how protection to the public can be given equally (equally), there should be no partiality, how the protection of people's rights is carried out, and most importantly how public information can be provided (Hadi, 2019).

b. Political Stability and Absence of Violance

Political stability and absence of violence is a measure of the perception that the government will be stable or can be overthrown by law or by force.

c. Government Effectiveness

Government Effectiveness is a measure of the quality of public services, the quality of civil services, policy implementation and government commitment to policies.

d. Regulatory Quality

Regulatory Quality is a measure of the government's ability to formulate and implement policies and regulations and promote private sector development.

METHOD

Variables and Construction

Previous studies have examined and tested the variables in this study, but have not studied by linking various components of institutional indicators to economic growth in East Asia. The independent variables in this study are the components of institutional variables, namely Voice and Accountability, Political

Stability and Absence of Violance, Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption. While the dependent variable in this study is economic growth (GDP).

Data source

This study uses secondary data taken from Worldwide Governance Indicators (WGI). The population in this study are East Asian countries. While the samples used were 5 East Asian countries (China, Japan, Hong Kong, South Korea and Mongolia) from 2005-2020.

Model Specification

The specification of the model built in this study consists of the GDP model. The model built is as follows:

$$GDP_{it} = \beta_0 + \beta_1 VA_{it} + \beta_2 PS_{it} + \beta_3 GE_{it} + \beta_4 RQ_{it} + \beta_5 RL_{it} + \beta_6 CC_{it} + e_{it}$$

$GDP_{it}$is an indicator that measures economic growth in a country. VA_{it} is Voice and Accountability, PS_{it} is Political Stability and Absence of Violance GE_{it} is Government Effectiveness, RQ_{it} is a Regulatory Quality,RL_{it} is the Rule of Law and CC_{it} is the Control of Corruption.

Data analysis method

This study uses dynamic panel data using the Generalized Method of Moment Arellano-Bond approach. Because this model aims to assess and measure the short-term and long-term effects of the independent variable model on the dependent variable. Furthermore, the Generalized Method of Moment Arellano-Bond is also a suitable method for researching the proposed theoretical model. Preceding the examination of the model, namely instrument validity and consistency, then the Arellano-Bond GMM Estimation is carried out. The analytical steps to be carried out in this study are as follows.

1. Estimating using GMM ArellanoBond.
2. Testing the significance of instrument validity and consistency
3. Testing the parameter specifications on the model using the Arellano-Bond test and the Sargan test.
4. Draw conclusions based on the results of the analysis.

RESULTS AND DISCUSSION

EstimateGMM Arellano-Bond

The estimation used in this study uses the GMM Arellano-Bond two step estimator. The results of simultaneously testing the significance of the parameters can be seen that the p-value is 0.000. So the decision is to reject H0 which indicates that there is at least one significant coefficient on the model. Further testing the significance of the parameters partially will be explained in Table (2).

Table 1. Partial Test Results

Predictor	Coefficient	Standard Error	t	P Value
$GDP_{i,t-1}$	.918786	.0642902	14.29	0.000
$VA_{i,t}$	.0112719	.1496484	0.08	0.940
$PS_{i,t}$	-.0722261	.1164991	-0.62	0.535
$GE_{i,t}$	.0136915	.0663531	0.21	0.837
$RQ_{i,t}$	.2476827	.0981083	2.52	0.012
$RL_{i,t}$	-.0061851	.1227592	-0.05	0.960
$CC_{i,t}$	-.1346886	.0674813	-2.00	0.046
β_0	2.186446	1.546632	1.41	0.157

Source: Processed by the Author, 2022

Based on Table (2), it can be seen that Voice and Accountability (VA), Political Stability and Absence of Violance (PS), Government Effectiveness (GE) and Rule of Law (RL) have p-values greater than the 0.05 significance level. So the decision is to fail to reject H0 which shows that Voice and Accountability (VA), Political Stability and Absence of Violance (PS), Government Effectiveness (GE) and Rule of Law (RL) have no significant effect on the model. However, Regulatory Quality (RQ) and control of corruption (CC) have a significant effect on the model. After testing the significance of the parameters, the next step is to measure the criteria for the best model. The dynamic panel method with the Arellano-Bond GMM approach can be said to be good if it meets the criteria for consistency and instrument validity.

Table 2. Results of Model Criteria

Statistical Value	P- Value
Arellano Bond test	
-1.341 (m1)	0.1799
-1.2102 (m2)	0.2262
Sargan Test	
82.88391	0.1788

Source: Processed by the Author, 2022

Based on Table (3), it can be seen that the dynamic panel method with the Arellano-Bond GMM approach has met the criteria for the best statistically consistent model and the instrument variables used are valid. The results of Arellano-Bond (AB) on m2 show a p-value of 0.2262. In this study using of 5 percent, so the decision is to fail to reject H0. So, the estimate can be said to be consistent and there is no autocorrelation in the second-order first difference error. Sargan's estimation results show a p-value of 0.1788. In this study using of 5 percent, so the decision is to fail to reject H0. Thus, there is no correlation between residuals and over identifying restrictions or the instrument variables used are more than the number of predicted parameters.

Short-Term and Long-Term Effects

The advantage of the dynamic panel model is that it can determine the short-run effect and long-run effect. The elasticity results are shown in Table (3).

Table 3. Elasticity of Short-Term and Long-Term Effects

Predictor	Short-term	P Value	Long-term
$GDP_{i,t-1}$	.918786	0.000	
$VA_{i,t}$	.0112719	0.940	.1387922
$PS_{i,t}$	-.0722261	0.535	-.8893305
$GE_{i,t}$	.0136915	0.837	.1685853
$RQ_{i,t}$	.2476827	0.012	3.049753
$RL_{i,t}$	-.0061851	0.960	-.0761586
$CC_{i,t}$	-.1346886	0.046	-1.65844
β_0	2.186446	0.157	-

Source: Processed by the Author, 2022

Based on Table (3), it can be seen that the model obtained. The GDP model obtained is in the following equation.

$$\mathrm{GDP}_{\boldsymbol{it}} = 2.186446 + 0.918786\ \mathrm{GDP}_{i,t-1} + \mathbf{0}.0112719\mathrm{VAit} + (-.0722261\mathrm{PS}_{it}) + 0.0136915\mathrm{GE}_{it} + 0.2476827\mathrm{RQ}_{it} + (-0.0061851\mathrm{RL}_{it} + (-0.1346886\mathrm{CC}_{it})$$

After getting the model, then the short-term and long-term elasticity can be known. The sign on the Voice and Accountability coefficient is positive. This shows that Voice and Accountability will increase economic growth. The short-run elasticity of GDP is.0112719. This shows that for every 1 percent increase in the Voice and Accountability of an East Asian country, it will increase current GDP in the short term by 0.0112719percent. Voice and Accountability long-term elasticity of 0.1387922. This shows that for every 1 percent increase in Voice and Accountability in EAST ASIA, it will increase GDP in the long term by 0.1387922percent. The relationship between the value of the elasticity coefficient of Political Stability and Absence of Violance (PS) and GDP is negatively related

Discussion and Theory Implications

The results of this study indicate that institutional variables generally have an influence on economic growth in East Asia. This is in line with the research proposed by(Guan, 2009) in his research entitled Growth Theory Needs an Institutional Structure reveals that the Neoclassical and Endogenous growth theory pioneered by Solow and Romer is not sufficient to explain variations in economic growth, both theories ignore the structure of intuition, even though intuition is believed to be able to provide an explanation. better about economic growth. The results of this study are reinforced by Barro (1996), who also reveals that the Endogenous growth theory is no different from the growth theory expressed by Solow. This theory only expands the model variables by involving the human capital component.

The results show that Regulatory Quality has a positive and significant impact on economic growth in East Asian countries. Previous studies or research support the results of this study. Marlina (2016) states that regulatory quality is a condition of government that is able to formulate and implement policies and regulations that aim to promote private sector development. In contrast to the results of research proposed by Huynh and Jacho-Chavez (2009) that Regulatory quality has no effect on economic growth. The results of the study stated that regulatory quality has shortcomings so that it cannot be used as an indicator to measure economic growth. This is because the decision-making process or policy only prioritizes individual interests over the interests of society in general. However, research conducted by Badun (2005) states that regulatory quality has a positive and significant influence on economic growth in Croatia. This research is not in line with research conducted by Bayar (2016) which states that regulatory quality has no impact on economic growth.

Control of Corruption has a positive effect on economic growth in East Asia.Research conducted (Hasyim, 2008), states that countries with good economic growth are due to good institutional characteristics, as measured by low levels of corruption, effective government and property protection. This shows that when a country is able to exercise good control over corruption cases, it will certainly have an impact on economic stability. Because a high level of corruption will have a bad impact on the economy. The study is supported by the opinion of Hunyh and Jacho-Chavez (2009) which states that control of corruption is part of government governance, control of corruption has a good and positive influence on economic growth. A similar opinion also emerged from Aidt,

Managerial implications

This study highlights the importance of institutions or institutional systems for economic growth by using indicators of Voice and Accountability, Political Stability and Absence of Violance, Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption. So that a good institutional system is able to support the economy of a country. To fulfill this, government policy must create a good institutional system in terms of Voice and Accountability, Political Stability and Absence of Violance, Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption. To be clear, if any of these constructs or indicators is missing, it will automatically start reducing the overall value of the institution.

Limitations and future research

Although this research has contributions related to institutions and economic growth, of course, this research also has limitations. First, this study uses samples from East Asian countries, so the findings of this study cannot be generalized to other countries. Second, this study shows that there are other variables that should be included in the model to increase its predictive power. Future studies should pay attention to the potential of endogeneity on institutional variables Such as democracy, inflation, and foreign direct investment variables.

CONCLUSION

This study examines the relationship between institutions and economic growth using institutional variable components, namely Voice and Accountability, Political Stability and Absence of Violance, Government Effectiveness, Regulatory Quality, Rule of Law, Control of Corruption. This study leads to two important conclusions. First, this study confirms the model that Regulatory Quality and Control of Corruption have a significant effect on economic growth in East Asian countries. Second, this study reveals that in the model it is known that the variable that has the highest yield for long-term elasticity of the model is the Regulatory Quality variable.

Strengthening the quality of institutions or institutions is an important requirement in increasing long-term economic growth in the East Asia region.Such institutional reforms include strengthening the quality of regulations, the effectiveness of preventing corruption and significant changes in the legal and organizational framework, and in the limitation of civil rights (Tanzi, 1998).

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