

The Impact of Corruption and Fiscal Policy on Economic Growth in ASEAN Countries

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Abstract

This study investigates the impact of government spending, the interaction between corruption and fiscal levels, government debt, and foreign direct investment on economic growth in seven ASEAN countries. Using the World Development Indicators database in the form of time series from the World Bank and the Asian Development Bank for 2000-2021. The approach used is panel data regression using a fixed effect model. The findings show that government spending and foreign direct investment have positive and significant contributions to the economic growth of seven ASEAN countries. There is strong evidence that the interaction between fiscal levels and corruption can distort the fiscal policy mechanism, thereby inhibiting economic growth. Additionally, there is strong evidence that high government debt causes economic growth to contract. Policymakers must strike a compromise between promoting economic expansion through public expenditure and preserving fiscal stability through debt management. To foster an environment that is favorable to investment, efforts to combat corruption must be constantly carried out. To promote equitable and long-term growth, authorities must also concentrate on enhancing the caliber of infrastructure and human resources.

Keywords: *Corruption, Fiscal Policy, Economic Growth*

JEL Classification: Z0; E62; O4

INTRODUCTION

The global issue of corruption impedes economic development and progress in many nations, including those in the ASEAN region (Naher et al., 2020; Song et al., 2021). Inequality, inefficient resource allocation, and a decline in public trust in government can all result from widespread corruption (Rothstein, 2011). However, as a key tool for managing the economy, fiscal policy also plays a critical role in promoting economic expansion (Ahuja & Pandit, 2021). Nonetheless, corruption can undermine the efficacy of fiscal policy. A key tool the government uses to accomplish its objectives for economic development is fiscal policy. However, opaque and unaccountable fiscal policy can serve as a springboard for unethical behavior, such as a lot of leeway in allocating funds and carrying out infrastructure projects for individual or collective interests (Otusanya & Uadiale, 2014).

Corruption and ineffective fiscal policy can exacerbate existing problems with economic growth (Elliott, 1997; Del Monte & Papagni, 2001; d'Agostino et

al., 2016). Corruption has the potential to undermine fiscal policy, which in turn can have a negative impact on economic growth (Dimakou, 2015; d’Agostino et al., 2016). Corruption can lead to inefficient use of resources and waste in government spending, which directs the budget to less productive or inefficient projects (Achim et al., 2018). In efforts to advance democracy, fiscal policy plays an important role in supporting the achievement of predetermined development goals. These functions are the role of fiscal policy to achieve economic growth; create jobs; reduce poverty; implement government programs efficiently, effectively, and on target; and prevent corruption (Rauniyar & Kanbur, 2010; Perera & Lee 2013).

Corruption is a big problem in every country. Abuse of office is for personal gain. If it cannot be overcome, it will cause losses for the country. Corruption hurts economic growth, including (1) reduced investment; (2) misallocation of resources; (3) increasing transaction costs; and (4) reduced productivity, which can overall hinder economic development and increase poverty levels. In addition, corruption can erode public trust in the government, which has the potential to create political and social instability (Cieřlik & Goczek, 2018; Song et al., 2021; and Spyromitros & Panagiotidis, 2022). Corruption can increase government spending as well as the cost of acquiring goods and services because economic actors may raise the prices of goods and services by paying government officials. Additionally, corruption can lead to financing budget deficits with debt because the government may use debt to cover inefficient spending. Corruption’s detrimental influence will eventually have an impact on investment. In a number of ways, corruption will lower foreign direct investment. According to a study by Zakharov (2019); Karim & Karim (2029); and Kurniasih et al. (2023), FDI in five ASEAN nations is significantly impacted by the Corruption Perceptions Index (CPI). These studies conclude that corruption results in a decrease in foreign direct investment because investors may be reluctant to invest in countries where corruption is high. Corruption can increase investment costs because investors have to pay bribes to obtain permits and investment contracts (Hoang, 2018; Abotsi, 2016; and Bardhan, 2017).

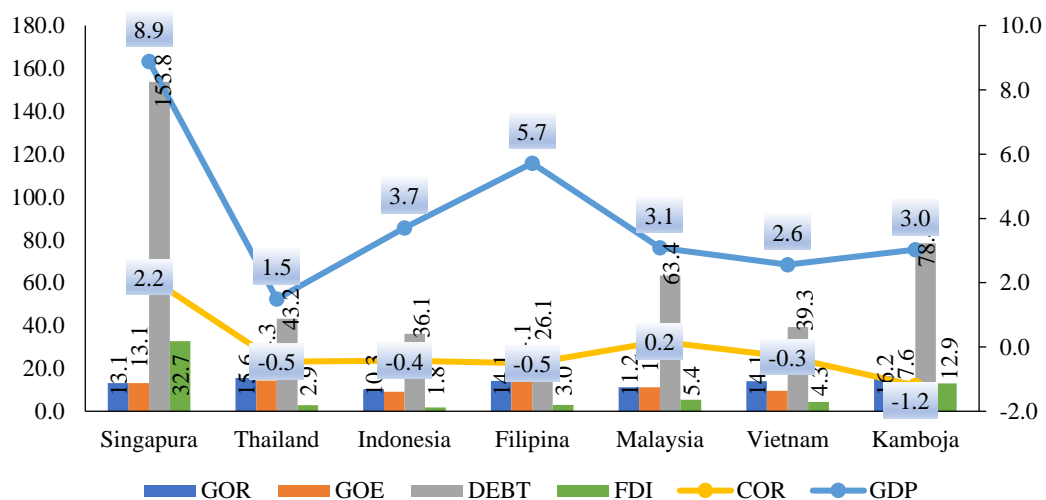


Figure 1. Corruption Index, Fiscal Policy and Economic Growth in ASEAN
 Source: World Bank and Asian Development Bank

Figure 1 presents trends in corruption variables, fiscal policy, and economic growth in seven ASEAN countries in the 2021 period, namely Indonesia, the Philippines, Malaysia, Thailand, Vietnam, Cambodia, and Singapore. Some of these countries have similarities, including: first, in the economic sector, namely that all countries have experienced significant economic growth over the last year in achieving development indicators. Second, government leadership: the government has a role in regulating and directing economic and social policies in all these countries. The data shows that Singapore has the highest GDP ratio compared to the other six ASEAN countries, at 8.9%. Then followed the Philippines, Indonesia, Malaysia, Cambodia, Vietnam, and Thailand. Meanwhile, for the level of corruption, Singapore is the country with the highest corruption score, meaning that Singapore is the country with the lowest corruption cases. The low number of corruption cases in Singapore is accompanied by high economic growth. On average, each country spends more than it receives as income, which then means a deficit and government debt. This shows that the government has the fiscal strength to overcome sudden economic shocks. Singapore still has the highest debt-to-GDP ratio, ranking at 153.8%. The high ratio of Singapore's debt to GDP is because Singapore relies on the international trade sector, so it requires a large budget to build infrastructure, manufacturing, and portfolios. And to get out of the economic crisis.

ASEAN countries, as developing countries, face unique challenges in controlling corruption and achieving sustainable economic growth. Weak governance, low public awareness, and the pressures of globalization are some of the factors that complicate efforts to eradicate corruption in the region. Countries such as Malaysia, Cambodia, Thailand, Vietnam, the Philippines, and Indonesia have relatively low debt levels compared to Singapore. This is because these countries rely on the agricultural, plantation, and mining sectors. These sectors have lower risks than the financial sector, so the government does not need to take on a lot of debt to finance its development. Indonesia's debt-to-GDP ratio will be 36.1% in 2021. This is still below the limit set by Checherita-Westphal & Rother (2012) stated that government debt has a threshold of around 85% of GDP.

To achieve maximum growth rates. Every country needs to encourage FDI. This can be done by increasing investment in the economy. This process will stimulate economic growth, create jobs, and increase government revenues, thereby reducing government deficits and debt. This will also reduce government spending and divert most of the expenditure from the consumption side in the form of social security, aid, and health to public economic investment. Therefore, this study aims to examine the relationship between corruption, fiscal policy, and economic growth in ASEAN countries. Specifically, it investigates the impact of corruption and fiscal policy on economic growth and the contribution of external debt and foreign direct investment to sustainable economic growth in ASEAN countries.

LITERATURE REVIEW

Corruption is a problem for every country that is detrimental to the economy. In several articles, there are several different explanations regarding the effect of corruption on economic growth. Corruption estimates that the higher the value of the level of corruption, the cleaner the region is from corrupt acts, and vice versa. When the value of the level of corruption is low, it shows the magnitude of acts of

corruption in a country. Studies by Lučić et al. (2016); Sharma & Mitra (2019); dan Spyromitros & Panagiotidis (2022); and Ganda, (2024) show that there is a positive relationship between the level of cleanliness of an area from corruption and its level of economic growth. However, studies by Bozhenko et al. (2022); Bereziuk & Yaremchuk (2020); and Mombeuil & Diunugala (2021) looking deeper into rare cases, some types of corruption can temporarily boost economic activity, but over time, high levels of corruption hinder sustainable economic growth.

To overcome the problem of corruption, the government can implement fiscal policy. Fiscal policy is one of the tools that the government can use to intervene in the real sector by determining government income, which includes taxes, government spending, debt, and capital formation. According to Keynes's theory, government policy is needed to create stability and good economic growth, and one way the government plays a role is by implementing fiscal policy (Dinh et al., 2024; Muzayyanah et al., 2023).

Studies by Etim et al. (2020); Das (2024); and Akanbi (2020) suggest that tax revenues have a positive impact on economic growth by involving various stages in the policy analysis process. It includes policy formulation, agenda setting, policy adoption, policy assessment, and policy implementation, which shows that tax reform contributes effectively to economic growth. Also, these findings support the findings presented in research conducted by Odinakachi et al. (2021) which shows that government income has a positive impact on economic growth. This occurs because increasing government revenue growth will provide the government with adequate resources to carry out development in various sectors. With an even distribution of development, this will encourage increased national productivity and production, which will then support the country's economic growth.

Studies related to government spending, such as the study by d'Agostino et al. (2016); Dudzevičiūtė et al. (2018); Alqadi & Ismail (2019); and Wahyudi (2020) show that government spending has a positive impact on economic growth. One of the significant government expenditures aims to support financing for infrastructure development, which has a key role in accelerating economic growth effectively and maintaining community welfare. These findings provide support for the Peacock and Wiseman concept, which states that increased economic growth can contribute to increased government revenues and expenditures. This also reinforces the concept that government spending has the potential to trigger national economic growth, assuming that such spending is directed at encouraging economic activity.

Countries with large public debt typically have slower economic growth because of increased interest payment commitments, which cut into budgets for productive spending like infrastructure and education (Reinhart et al., 2015; Akram, 2015; and Misztal, 2021). For example, Greece experienced a protracted recession when its debt-to-GDP ratio hit 175% because the heavy debt burden deterred both private and state investment (Laskaridis, 2014; Christodoulakis, 2015). According to Oladokun (2015); Shastri et al. (2017); and Shen et al. (2018) government debt used for unproductive expenditures like energy subsidies frequently results in growing budget deficits without making a substantial contribution to economic expansion. However, Zou et al. (2022); and Wei et al. (2022) said that nations like China, which use debt to finance infrastructure development, sustain steady economic growth by utilizing FDI to fund strategic initiatives.

Empirical findings conducted by Freckleton et al. (2012); Okada & Samreth (2014); and Yahyaoui (2024) show that corruption and foreign direct investment have a significant positive impact on economic growth. The results of the fixed effect model test, this implies that foreign direct investment plays an important role in determining the rate of economic growth because it can increase the supply of capital goods needed for the production process. The results reflect that an increase in foreign direct investment is significantly positively related to economic growth (Shevelova & Plaskon 2018). This implies that FDI has a crucial role in supporting economic growth by increasing labor productivity and production capacity (Jakšić et al. 2019; Osano et al., 2016).

METHOD

The scope of this study is to investigate the impact of corruption and fiscal policy, namely tax revenue, government spending, government debt, and foreign investment, on economic growth. This study applies a panel data regression model with a period of 2000-2021 with observations in countries of ASEAN-7, namely Indonesia, Singapore, Malaysia, Thailand, the Philippines, Vietnam, and Cambodia. The data sources for this study were obtained from the World Bank (WB) and Asian Development Bank (ADB) databases.

Table 1. Description of variables

Variables	Measurement	Source
Economic Growth (lnGDP)	The ratio GDP (constant 2015 US\$)	WB
Corruption Index (COR)	Control of corruption: Estimate	WB
Taxes revenue (lnGOR)	Taxes (% of GDP)	ADB
Government Expenditure (GOE)	Government final consumption expenditure (% of GDP)	WB
External Debt (DEBT)	External debt (% of GNI)	ADB
Foreign Direct Investment (FDI)	Foreign direct investment, net inflows (Bop, current US\$)	WB

This study applies a panel data regression model by referring to several previous studies such as those conducted by Haini (2021); Khan et al. (2024); Yang et al. (2024); Efayena & Olele (2024); From this study, we consider the interaction between corruption and fiscal impact needs to be included in the model to investigate how corruption control moderates' fiscal policy (tax revenue and expenditure) impacts on economic growth. Specifically, this interaction tests the hypothesis that corruption undermines the efficiency of government fiscal policy. By analyzing this interaction, it can reveal the extent to which corruption distorts the fiscal mechanism that impacts economic growth, especially in ASEAN countries. The following is the panel data regression model formed:

$$\ln GDP_{i,t} = \beta_0 + \beta_1 \ln GOE_{i,t} + (\beta_2 \ln GOR_{i,t} - \beta_3 \ln GOE_{i,t}) \times COR_{i,t} + \beta_4 \ln DEBT_{i,t} + \beta_5 \ln FDI_{i,t} + e_{i,t}$$

Where lnGDP denotes economic growth for each country; COR is the corruption control index for each country; lnGOR is tax revenue for each country; lnGOE is government expenditure for each country; DEBT is external debt for each country;

lnFDI is the foreign direct investment (inflow) for each country; β_0 is intercept; β_1, \dots, β_5 is parameters coefficient; and $e_{i,t}$ is the error term.

RESULTS AND DISCUSSION

Result

Unit root testing, or unit root test is a method to determine whether the data used in research is stationary or not. Because panel data is a mixture of cross-section and time series data, it is necessary to examine stationary tests on both aspects.

Table 2. The Result of the Unit Root Test

Variables	Test	Method	Statistic	Prob.**
GDP	Level	ADF- Fisher Chi-Square	20.833	0.106
		ADF- Choi Z-stat	-1.761**	0.039
	1 st difference	ADF- Fisher Chi-Square	28.197**	0.013
		ADF- Choi Z-stat	-2.763**	0.002
COR	Level	ADF- Fisher Chi-Square	289.194**	0.000
		ADF- Choi Z-stat	-8.245**	0.000
	1 st difference	ADF- Fisher Chi-Square	315.122**	0.000
		ADF- Choi Z-stat	-10.789**	0.000
GOR	Level	ADF- Fisher Chi-Square	20.642	0.111
		ADF- Choi Z-stat	-0.205	0.418
	1 st difference	ADF- Fisher Chi-Square	52.721**	0.000
		ADF- Choi Z-stat	-5.078**	0.000
GOE	Level	ADF- Fisher Chi-Square	15.952	0.316
		ADF- Choi Z-stat	-0.208	0.417
	1 st difference	ADF- Fisher Chi-Square	54.342**	0.000
		ADF- Choi Z-stat	-5.031**	0.000
DEBT	Level	ADF- Fisher Chi-Square	17.324	0.239
		ADF- Choi Z-stat	-0.807	0.209
	1 st difference	ADF- Fisher Chi-Square	32.93**	0.002
		ADF- Choi Z-stat	-3.049**	0.001
FDI	Level	ADF- Fisher Chi-Square	18.095	0.202
		ADF- Choi Z-stat	-0.755	0.225
	1 st difference	ADF- Fisher Chi-Square	84.474**	0.000
		ADF- Choi Z-stat	-7.095**	0.000

Note: **significant level at 5%

Table 2 reports the results of the unit root panel test on each variable in the model equation. The results of the unit root test on I(0) or level show that not all have a statistical p-value greater than 0.05. There is one stationary variable at that level, namely the corruption variable (COR) with a probability of less than 5% ($p < 0.05$). This result implies that several other variables show signs of unit root. Next, the test is continued using I(1) or first difference. At this stage, all probability values of each variable are less than 5% ($p < 0.05$), this implies that all variables, economic growth, corruption, tax revenue, government spending, government debt, and foreign direct investment, have reached stationarity at the first difference.

Table 3 reports the results of the correlation matrix to see how big the relationship is between the independent variables in the research model, the results show that the relationship between the independent variables is still within the

threshold, this implies that there is no multicollinearity problem in the variables in the model.

Table 3. Matrix Correlation for Multicollinearity Degrees Detect

Variables	COR	GOR	GOE	DEBT	FDI
COR	1.000	-	-	-	-
GOR	-0.017	1.000	-	-	-
GOE	0.459	0.186	1.000	-	-
DEBT	0.701	-0.210	0.030	1.000	-
FDI	0.636	0.257	0.464	0.252	1.000

Table 4 reports Chow test results, in which the cross-section F-stat found in the data analysis is 32.631 and the probability is less than the significance level at 5% ($p < 0.05$), we reject the null hypothesis, therefore, as a result, the model chosen was the fixed effect model. While, from the Hausman test shows the chi-square statistic value is 0.812711 with a probability of 0.9762 which exceeds the 5% error significance level. Thus, it is concluded that the null hypothesis is accepted and as a result, the model determined is the fixed effect model.

Table 4. The Results of Panel Regression Using Fixed Effects Methods

Dependent variable = lnGDP		
Variables	Coefficient	t-Stat
Intercept	12.069*** (0.280)	43.103
lnGOE	0.231*** (0.062)	3.726
$\Delta \ln(\text{GOR}-\text{GOE}) * \text{COR}$	-0.202*** (0.056)	-3.607
lnDEBT	-0.312*** (0.050)	-6.240
lnFDI	0.026*** (0.006)	4.333
R ²	0.9983	
F-stat	6.718***	
D-W stat	1.748	
Selected method		
Chow test	32.631***	
Hausman test	0.812	
Diagnostic test		
Normality	0.682	
White	1.115	

Note: ***significant level ($p < 0.05$)

Based on the normality test in Table 4 it is shown that the Jarque-Bera test with a probability value is 0.682, which is greater than 0.05, this implies that the data has a residual normal distribution. Table 4 also shows that the white test for heteroscedasticity has a probability greater than 0.05, this implies that the residual variance is constant, which means that there is no heteroscedasticity problem. Additionally, Table 4 reports the goodness of fit depicted in the high R² value of 0.9983, this implies that this model can explain almost all variations in the

dependent variable (lnGDP) of 99.83%. Jointly the independent variables have significant effect on dependent variables depicted in the significant F-statistic value, this implies that overall, this regression model is statistically significant.

Table 4 also reports the results of panel data regression estimation using fixed effects, the results show that the intercept value is positive and significant in seven ASEAN countries, this implies that economic growth will increase by 12,069% when all independent variables are constant. lnGOE has a positive and significant sign to lnGDP, this implies that a 1% increase in government spending significantly contributes to an increase in economic growth of 0.231%. This means that the greater the proportion of government spending to GDP, the higher the economic growth that can be achieved. The same results on lnFDI have a positive and significant sign on lnGDP, this implies that a 1% increase in foreign direct investment will increase economic growth by 0.026%. This indicates that FDI has an important role in driving economic growth. ln(GOR-GOE)*COR has a negative and significant sign to lnGDP, this implies that statistically the interaction between the level of corruption and fiscal shows that the inefficiency of government fiscal policy increases by 1% will significantly reduce economic growth by -0.202%. This means that the greater the corruption distorts the fiscal mechanism (government revenue and expenditure) will hamper economic growth. Likewise, lnDEBT which has a negative sign and is significant to lnGDP, implies that a 1% increase in government debt will reduce economic growth by -0.312%. This means that the higher the debt-to-GDP ratio, the slower economic growth tends to be in seven ASEAN countries.

Discussions

The findings provide some interesting findings, such as government spending has a positive sign and a significant effect on economic growth in seven ASEAN countries, this result supports the view that effective government spending can be a stimulus for economic growth. However, it is important to note that not all types of government spending have the same impact. Productive government spending, such as investment in infrastructure and education, tends to contribute more to economic growth than consumptive spending. These findings are in line with studies conducted by d'Agostino (2016); Wahyudi (2020); Onifade et al. (2020); and Olaoye et al. (2020) which claims that government spending significantly affects economic growth and has a positive sign. Other conflicting results were found by Christie (2014); and Aydin (2016) who stated that government spending has a negative sign and a significant influence on economic growth. Spending increases by the government will immediately raise the economy's aggregate demand. Demand growth may incentivize producers to boost output, ultimately leading to economic expansion. By reducing transportation costs and expanding access to markets, government spending on infrastructure development—such as ports, roads, and bridges—can boost economic productivity. Furthermore, government spending on public goods and services like health and education can raise the standard of human resources and enhance people's welfare, both of which promote long-term economic growth. Similarly, through the leverage effect, government expenditure can also encourage private investment. Government expenditure increases have the potential to boost investor confidence and motivate

them to make larger investments. The results of this study provide strong support for the hypothesis that effective government spending can be a stimulus for economic growth. However, it is important to remember that the effectiveness of government spending depends heavily on a variety of factors, including the quality of institutions, the level of corruption, and other macroeconomic conditions. Governments need to design prudent and evidence-based fiscal policies to maximize the positive impact of government spending on economic growth.

The interaction between the level of corruption and fiscal has a negative sign and is significant for economic growth. The interaction between the level of corruption and fiscal shows that corruption can distort the fiscal mechanism causing fiscal inefficiency which in turn can hinder economic growth. This indicates that corruption tends to lead to inefficient resource allocation and reduce the effectiveness of government spending. These results are consistent with research by Ghosh & Neanidis (2017); and Khan et al. (2024). For example, Singapore and Malaysia can maintain strong economic growth because of their efficient fiscal policies and comparatively low levels of corruption. On the other hand, nations with more pervasive corruption problems, such as Indonesia and the Philippines, see a decline in investment, tax income, and public trust. These differences demonstrate the necessity of adopting fiscal policy reforms and combating corruption in each nation using customized strategies. Corruption has a multifaceted impact on economic progress. Underreporting income by individuals or firms is known as tax evasion because it lowers government revenues, which restricts the amount of money available for infrastructure development and public services. Moreover, higher prices for goods and services result from corruption in procurement procedures, which raises government spending without providing commensurate benefits. Both economic progress and public trust in government institutions are hampered by this inefficiency.

Government debt has a negative sign and a significant effect on economic growth, this result is consistent with the economic literature which shows that high government debt can hinder economic growth by increasing interest burdens and reducing fiscal space for other stimulative policies. These results are consistent with findings made by Panizza & Presbitero (2014); Elom-Obed et al. (2017); Pegkas (2018); and Ghourchian & Yilmazkuday (2020). Another conflicting result was found in a study conducted by Spilioti & Vamvoukas (2015); Burhanudin et al. (2017); and Yusuf & Mohd (2021). The increase in debt will be followed by an increase in the interest burden that must be paid by the government. Large interest burdens can erode the government budget and reduce fiscal space for other productive activities such as investment in infrastructure and education. High government debt can lead to crowding out of private investment. This happens because the government must compete with the private sector to obtain funds in the financial market. As a result, the cost of borrowing from the private sector becomes more expensive and the interest in investing decreases. High debt levels can increase economic uncertainty. Investors become more concerned about the government's ability to repay its debts and can reduce their interest in investing in the country. In addition, high debt can encourage the government to make inefficient resource allocations. The government may focus more on debt payments

than on other productive activities. The results of this study provide strong support for the hypothesis that high government debt can hinder economic growth. The government needs to manage state debt carefully to avoid negative impacts on long-term economic growth.

We also find that foreign direct investment has a positive sign and is significant for economic growth, this result confirms the important role of FDI in driving economic growth. FDI can bring new technology, improve production efficiency, and create jobs. This result is consistent with the findings of the studies of Dinh et al. (2019); Bouchoucha & Yahyaoui (2019); Osei & Kim (2020); and Cung (2020). Other results that contradict these findings, such as the study conducted by Saqib et al. (2013); and Sokhanvar (2019). Overall, the results of this study provide strong support for the hypothesis that FDI has a positive effect on economic growth. However, it is important to remember that the effectiveness of FDI is highly dependent on various factors, such as government policies, macroeconomic conditions, and the characteristics of the recipient country. The government needs to design appropriate policies to maximize the benefits of FDI for economic growth.

CONCLUSION

The conclusion of this study provides strong supporting evidence that increased government spending has contributed significantly to economic growth in seven ASEAN countries. This suggests that expansionary fiscal policy, especially that directed at infrastructure investment and public services, can be a catalyst for growth. The interaction between fiscal (tax revenue and government spending) and the level of corruption provides strong evidence that corruption can distort the fiscal policy mechanism, which should encourage economic growth into an obstacle to economic growth due to the still high level of corruption in several ASEAN countries. Rampant corruption can divert resources from productive projects, reduce efficiency, and reduce investor confidence. Other evidence from this study shows that high government debt has been shown to have a negative impact on economic growth. The large interest burden and economic uncertainty caused by high debt can discourage investment and consumption. We also find evidence that foreign direct investment flows in these seven ASEAN countries still make a significant positive contribution to economic growth. Foreign direct investment brings new technology, creates jobs, and improves production efficiency.

The results of this study have important policy implications, ASEAN countries should implement a comprehensive plan to reduce corruption and improve the effectiveness of fiscal policies to address these issues. Opportunities for bribery can be reduced but made easier. Restoring public trust can be facilitated by increasing accountability and transparency in public spending. ASEAN countries can foster a better climate for long-term economic growth by combating corruption and improving fiscal governance. Additionally, policymakers need to balance between encouraging economic growth through government spending and maintaining fiscal stability by controlling debt. Efforts to eradicate corruption must continue to be carried out consistently to create a conducive investment climate. In addition, policymakers also need to focus on improving the quality of human resources and infrastructure to support long-term and inclusive growth.

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