

Financial Inclusion and the Role of Governance in Selected ASEAN Countries

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ABSTRACT

One of the prominently indicators to assessing national economy is per capita income. Most countries are eager to gain higher per capita income. The success of this target is not only depend on monetary factors but also non-monetary. This study using macro data and fix effect model from 8 developing countries in ASEAN collected by The World Bank Data. This research aims to analyze the effect of financial inclusion, good governance, and trade openness on economic growth within 2008-2018. The result shows those variables are significantly give impact on per capita GDP. The government should promote formal financial services, in line with improving public bureaucracy and delivering appropriate policies in field of international trade. This study can be guidance in order to arrange public policy thus can increase the welfare of society generally.

Keywords: *per-capita GDP, Financial Inclusion Index, good governance, trade openness*

1. INTRODUCTION

Economic growth is the key to successful development in a region (Cebula, 2011; Agostino *et al.*, 2016; Rafayet *et al.*, 2017). The success of economic development cannot be separated from the role of the government as policy makers as well as the community and the private sector as the object of the policies. Various things can affect the achievement of economic development targets, from a political perspective such as the level of corruption, political stability and the effectiveness of public services. A good bureaucracy leads the economic development in the modern era (Cebula, 2011; Agostino *et al.*, 2016; Rafayet *et al.*, 2017; Kraipornsak, 2018; Gründler & Potrafke, 2019; Yakubu *et al.*, 2020). Apart from politics, economic factors such as the existence of formal financial facilities also affect the success of a region's economic development. Access to formal financial services is associated with the existence of financial inclusion which allows every level of society to use formal financial services and benefits. In recent years, the issue of financial inclusion has become a global agenda. Various studies have been conducted related to financial inclusion, such as those from the supply and demand side of financial services (Xu, 2019) and it becomes one of the indicators of the success of economic development (Demirguc-kunt, 2012; Kim *et al.*, 2016).

In the economic sector, financial inclusion is proven to increase economic growth through reducing poverty, increasing income distribution and more efficient allocation of resources (Park & Mercado, 2015). Economic openness (trade openness) can increase the flow of foreign capital. The

more open the country's economy by removing trade barriers, the higher the increase foreign inflows.

However, there is a scare in studies that focus on measuring the determinants of economic development in ASEAN based on supply of financial inclusion, quality of bureaucracy, trade openness and foreign investment flows. This paper presents research questions regarding the Financial Inclusion Index, quality of bureaucracy, and the economic openness that influences the economic growth in ASEAN from 2008 to 2018.

2. LITERATURE REVIEW

Existing studies show there is correlation between financial services, governance's performance as well as the openness of the economy. These studies by Gründler & Potrafke (2019) examine corruption and economic growth. Research on economic growth and the quality of the bureaucracy was also conducted by Mira & Hammadache (2018) in MENA for 45 developing countries. Goczek (2018) examines the relationship between corruption, foreign investment and economic growth. Kraipornsak (2018) also examines the quality of bureaucracy in relation to economic growth in Thailand and several countries in the Asian region. In relation to financial inclusion and economic growth, Said (2020) conducted research related to this in MENA (Middle East and North Africa) countries. This study aims to analyze the effect of the availability of access to financial inclusion on economic growth which is analyzed using the GMM model. Rafayet alam *et al.*, (2017) analyzed the impact of government effectiveness on economic growth of 81 countries. This study uses GDP, inflation, Foreign Direct

Investment, economic openness, and dummy year as research variables. By analyzing the GMM model, it was found that the effectiveness of government has a positive impact on economic growth. On the other hand, good public service is one of the pillars of the Millennium Development Goals (MDGs), so all parties should pay attention to external economic conditions and political factors to achieve successful economic growth.

3. DATA & METHODOLOGY

The object used of the study is economic growth which is represented by per capita income; financial inclusion as represented by the number of financial services, the number of deposit accounts, and the proportion of credit and savings in commercial banks; quality of governance by measured of control of corruption, government effectiveness, political stability; and economic openness as represented by the proportion of trade to GDP and the proportion of foreign direct investment inflows to GDP. The research object are selected ASEAN countries which include Indonesia, Malaysia, Brunei Darussalam, Cambodia, Singapore, Thailand, Philippines, and Myanmar from 2008 to 2018 obtained from World Development Indicators, International Monetary Fund, World Government Indicators and several other sources related to the research.

The Financial Inclusion Index is measured based on Sarma (2015) with the three dimensions. On the other hand, institutional indicators which include variables of control of corruption, government effectiveness and political stability are indexes by World Governance Index with numbers between -2.5 to +2. The higher the index number, the better the quality of the bureaucracy in a country. In interpreting the research results, it is necessary to include the standard deviation and mean of each index variable (Kaufmann & Kraay, 2002).

The main equation of this research consists of:

$$Y (L\text{ GDP per capita}) = \beta_0 + \beta_1 X_{FII} + \beta_2 X_{CC} + \beta_3 X_{GE} + \beta_4 X_{PS} + \beta_5 X_{Trade} + \beta_6 X_{FDI} + u \quad (1)$$

The FII is for financial inclusion, CC is control of corruption, GE for government effectiveness, PS defines political stability, while Trade is for percent international trade of GDP, and FDI is percent of foreign direct investment of GDP.

4. RESULT & DISCUSSION

Table 1 shows the distribution of variable data including the mean, standard deviation, maximum value and minimum value. The standard deviation in this table will be used to estimate the value of the influence of the financial inclusion index, control of corruption, government effectiveness and political stability on GDP per capita. By fulfill the classical assumption, there is no issue on it and we obtained the fix effect as the most optimal model.

Tabel 1. Descriptive Statistics

Variables	Unit of measurement	Descriptive Statistics			
		Mean	Std. Dev.	Max.	Min.
Log GDP Per capita	Rupiah (log)	8.629134	1.382411	10.98654	6.623795
FII	Value 0 – 1	0.4205705	0.2015598	0.744	0.0479
CC	Scala -2.5 till +2.5	-0.1025937	1.048954	2.247644	-1.672876
GE	Scala -2.5 till +2.5	0.2822424	1.067325	2.436975	-1.6179
PS	Scala -2.5 till +2.5	-0.0243912	0.9877922	1.615338	-1.1778313
Trade	Percent	124.36	47.49835	16.74176	437.3267
FDI	Percent	5.89585	6.581519	28.59812	6.623795
N observation		88	88	88	88

Of the variables used in this study, there are four variables which are index numbers and the other three variables are level variables (non-index). Variables with index numbers include the independent variable financial inclusion index (FII), the variable control of corruption (CC), government effectiveness (GE), political stability (PS), while the non-index variables include the dependent variable GDP per capita (GDP), the variable independent trade openness (Trade) and variable for foreign investment (FDI).

From the fixed effect model, an increase in the financial inclusion index by 1 standard deviation from the average will increase the estimation by 10.7% in GDP per capita. These results are consistent with research conducted by Michael & Sharon (2014), Davutyan & ztürkkal, (2016), Kim (2016) and Cabeza-garcía, *et al.* (2019) that efforts to improve people's welfare can be done by increasing inclusive financial services.

Financial inclusion can improve income distribution and reduce poverty (Tuesta & Camara, 2014; Corrado & Corrado, 2017). Individuals who are exclusive from the formal financial sector will be more prone to experiencing funding difficulties because they tend to use their assets to meet their needs, even if they need credit facilities, they will choose informal credit through family, partners, or moneylenders. The lower the income per capita of the population, the higher the inequality in the area (Kim, 2016).

Tabel 2. Result of Panel Regression Model

Variables	Panel Regression Model		
	Common Effect Coeff.	Random Effect Coeff.	Fixed Effect Coeff.
Financial Inclusion Index (FII)	2.161*** (0.306)	2.161*** (0.306)	0.503** (0.045)
Control of Corruption (CC)	0.747*** (0.093)	0.747*** (0.084)	0.255*** (0.067)
Government Effectiveness (GE)	0.1398** (0.089)	0.183** (0.089)	0.035* (0.090)

Variables	Panel Regression Model		
	Common Effect Coeff.	Random Effect Coeff.	Fixed Effect Coeff.
Political Stability (PS)	0.237*** (0.046)	0.237*** (0.045)	0.212*** (0.052)
Trade Openness (Trade)	0.909*** (0.005)	0.101*** (0.026)	0.103** (0.014)
Foreign Direct Investment (FDI)	0.403*** (0.005)	0.403*** (0.005)	0.105** (0.004)
Constanta	8.487073* **	8.487073** *	8.23933***
R2	0.9714	0.9734	0.8276

*** p<0.01, ** p<0.05, * p<0.1 probability *p-value*

On the other hand, the increase in control of corruption by 1 standard deviation from the average led to an increase in the estimate of 30.7% in GDP per capita. This variable has a positive effects on the level of community welfare. It means that the government and the entire community must be fully committed to controlling corruption so that the welfare of the population increases (Agostino, *et al.*, 2016; Goczek, 2018; Wang, *et al.*, 2018).

$$dLn(CCij) = 0.255 \times 1.049 \text{ so } dCCij/CCij = (e^{0.225 \times 1.049} - 1) = 0.307 \quad (2)$$

To reduce the risk of loss, investors will choose to invest their assets in countries with low levels of corruption. Developed countries generally have more international funding facilities compared to emerging countries because in developed countries corruption of control is higher and there is individual awareness not to commit corruption (Kraipornsak, 2018; Said, 2020). In the eight ASEAN countries that are the object of this research, the level of corruption control is still low. The country with the highest level of corruption control index is Singapore with an average index value of 2.14 or around 85.6% from a scale of 100. In the second and third ranks are Brunei Darussalam with an average index value of 0.71 and Malaysia with an average value of 0.15. Myanmar is the country with the lowest average corruption control among selected ASEAN countries which only has -1.10 or only around 23% from a scale of 100.

Good public services have a positive effect by increasing 1 standard deviation will leads to 3.8% additional return on economy. There are at least three reasons why good governance must be realized are to guarantee property and individual rights to obtain incentives from saving or investment, contract enforcement to fulfill the promised role in business transactions, and to avoid free riders (Kraipornsak, 2018).

$$dLn(PEij) = 0.212 \times 0.988 \text{ so } dPEij/PEij = (e^{0.212 \times 0.988} - 1) = 0.233 \quad (3)$$

The level of political stability also has a positive slope and is statistically significant to GDP per capita at an alpha of 0.01. An increase in political stability in a country by 1 standard deviation will cause an estimated 23.3% increase in GDP per capita. It means that the government can improve

the welfare of its people by improving the quality of the bureaucracy, the integrity of the state apparatus and improving the quality of policies According with the research of Cebula (2011), Yi Feng (2014), and Said (2020) good governance is not only in making pro-people policies, but also in the commitment of agencies to implement policies optimally. Furthermore, this includes accountability, transparency, rule of law, responsiveness to policy responses, levels of efficiency and effectiveness, participation and ensuring equality and inclusiveness of rights for all levels of society (Agostino *et al.*, 2016).

For the trade openness indicator, this study uses the trade variable (% of trade to GDP) and the FDI variable (% of foreign capital inflows to GDP) which have a significant positive effect on GDP per capita. This study is in line with the research conducted by Yakubu, *et al.* (2020) foreign investment boosts economic growth in Kenya.

5. CONCLUSION

This study analyzes economic and non-economic factors on economic growth represented by the ASEAN GDP per capita variable from 2008 to 2018. Based on the fixed effect model test, it is known that financial inclusion significantly affects economic growth which is represented by the ASEAN GDP per capita. Thus, it is necessary to make formal financial services inclusiveness efforts for all levels of society to be able to improve their welfare (Michael & Sharon, 2014; Davutyán & ztürkkal, 2016; Kim, 2016; Cabeza-garcía, *et al.*, 2019). Indicators of good governance also has a positive effect on increasing GDP per capita. Bad service will lead to economic decline, so that all parties, especially policy makers, must maintain their integrity in providing services to the public (Cebula, 2011; Yi Feng, 2014; Agostino, *et al.*, 2016; Wang *et al.*, 2018; Gründler & Potrafke, 2019; Said, 2020). The trade openness indicator has a positive effect on increasing GDP per capita in each country. For this reason, the government and business people need to create a good climate business to increase foreign trade and investment (Agostino *et al.*, 2016; Rafayet alam, *et al.*, 2017). In general, this research can be used as an evaluation and reference in the formulation of policies to improve people's welfare through increasing per capita income.

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