

INNOVATIVE SOLUTIONS FOR ECONOMIC GROWTH: EXPLORING THE IMPACT OF ECONOMIC FREEDOMS ON FOREIGN DIRECT INVESTMENT ATTRACTION

Andelka Štilić¹, Andrea Mastilo², Krsto Vuković³, Dejan Mastilo⁴

Received 03.02. 2023.

Sent to review 13. 02. 2023.

Accepted 05. 06. 2023.

Original Article



¹ Academy of Applied Studies Belgrade,
The College of Tourism, Belgrade, Serbia

² Student of Economics at Royal Russell
London, London, United Kingdom

³ Economics and Finance, Queen Mary
University of London, London,
United Kingdom

⁴ Oikos Institute Research Center Bijeljina,
Bijeljina, Bosnia and Herzegovina

Corresponding Author:

Andelka Štilić

Email: andelka.stilic@assb.edu.rs

JEL Classification:

C35, F43, O11

Doi: [10.2478/eoik-2023-0013](https://doi.org/10.2478/eoik-2023-0013)

UDK: [338.124.4:338.727.22\(100\)](https://ui.adsabs.org/abs/2023arXiv1204.5795)

ABSTRACT

Economic freedoms are essential for the growth and development of countries, but their distribution varies across nations, resulting in differences in economic growth. This study aims to explore the impact of economic freedoms on economic growth, measured by gross domestic product (GDP) per capita and foreign direct investment (FDI) inflow, by examining the influence of institutional quality. Economic freedom indicators were obtained from the 2022 report by the Heritage Foundation, and GDP per capita and FDI indicators were sourced from the World Bank report. This study employs multivariate regression analysis to investigate the relationship between economic freedoms and economic growth. The findings suggest that economic freedoms have a positive effect on both GDP per capita growth and FDI inflow. Government integrity was found to be the primary indicator for GDP per capita growth, while Business freedom was identified as the key factor in attracting FDI. The implications of these results are significant, as they can inform policy decisions aimed at improving the standard of living by increasing GDP per capita and creating employment opportunities through FDI.

Keywords: economic freedoms, gross domestic product, GDP per capita, foreign direct investments, growth, employment.

1. INTRODUCTION

The globalization of business together with information technology development has influenced the changes in the market (Stević, et al., 2021). The process of globalization, followed by the information revolution, has imposed a new global culture (Prevolšek, et al., 2020). Economic freedoms are essential for the market economy to function properly. These freedoms promote entrepreneurship and free trade in a country. The historical dimension has shown that states have adopted different policies concerning market economy interference. Economic freedoms are a crucial factor for the growth and development of a country (Brkić et al., 2020). Increasingly frequent global market changes have induced societies to move towards a free market. In the context of economic growth, institutions are widely recognized as critical determinants, as they create and enforce the rules that govern economic interactions, encourage entrepreneurship, and foster competition. Consequently, some European countries transitioned from a centrally planned to a market economy after the collapse of the Soviet Union in 1991 (Sayari et al., 2018). Today, the majority of the countries

in the world utilize a market economy (Haddad and Hornuf, 2019). Economic freedoms are a prerequisite for reinforcing investments in specific countries (Kolluru et al., 2021), which are crucial for development. These freedoms are also a significant instrument for attracting foreign direct investment (FDI) (Lu et al., 2020) and reducing the informal economy (Vidović and Ritan, 2022).

Greater economic freedom allows countries to attract new investors. However, economic freedoms are not equally applied in all countries. A considerable portion of the world population still lives in poverty, without basic human rights (Dutta and Williamson, 2016). Economic freedoms are closely linked to growth, human development, and overall human well-being (Hall and Lawson, 2014). Hence, for countries to progress, they must have greater economic freedom. Nevertheless, economic freedoms do not always guarantee the attraction of foreign investors to a country. Bashir et al. (2021) demonstrated that Chinese companies invest more in countries with fewer freedoms. The Chinese exploit the unstable situation in these countries, utilizing the workers to the fullest extent possible, knowing that these societies lack basic human rights and suffer from high corruption. Therefore, these countries should have more economic freedom and less political risk to achieve progress.

Economic freedom plays a crucial role in the growth and development of a country (Iamsiraroj, 2016). Therefore, the aim of this research is to demonstrate how economic freedoms impact economic growth and the attraction of FDIs. The Index of Economic Freedom (IEF), published by The Heritage Foundation, will be used to measure economic freedom since it is widely used in practice (Ecer and Hashemkhani Zolfani, 2022). The IEF comprises twelve key indicators, which will be considered as independent variables in this study. Economic growth, as measured by Gross Domestic Product (GDP) per capita, and FDI will be selected as dependent variables. The research will examine the degree to which each of the IEF indicators influences the increase in GDP and the attraction of direct investments.

The aims of this research are as follows:

- to examine which IEF indicators affect economic growth;
- to determine which indicators influence the increase of FDI in the selected countries;
- to use multivariate regression analysis to establish the impact of IEF indicators on economic growth and FDI.

The contribution of this research will be to provide guidelines on which IEF indicators countries should strengthen to achieve economic growth and increase FDI. This will be established by examining the individual impact of IEF indicators on economic growth and FDI through multivariate regression analysis.

The research is divided into six chapters. The introduction provides the basis and objectives of the study. Chapter two provides a theoretical treatment of IEF indicators and their effect on economic growth and FDI, which serves as the basis for forming the hypotheses in chapter three. The hypotheses will be tested through a descriptive analysis and multivariate regression analysis, with the results reported in chapter four. Chapter five will provide a discussion of the results, and chapter six will present the conclusion, including significant findings and guidelines for future research.

2. THEORETICAL FOUNDATIONS OF RESEARCH

The IEF was developed by the Heritage Foundation, which annually publishes a report on this index (Hoque & Liu, 2023). For the purposes of this research, the most recent report available on the Heritage Foundation's website, from 2022, will be used. The IEF evaluates economic freedoms across four categories, with each category comprising three indicators (Murphy et al., 2023), as

follows:

- Rule of law (property rights, judicial effectiveness, and government integrity);
- Government size (tax burden, government spending, and fiscal health);
- Regulatory efficiency (business freedom, labor freedom, and monetary freedom);
- Market openness (trade freedom, investment freedom, and financial freedom).

Each of the indicators is evaluated on a scale from 0 to 100, calculated as the total score of the country based on the mean value without weighting (Jones et al., 2023). A brief summary of each indicator follows.

The **Rule of Law** indicator represents the dimension of trust in the state regarding the execution of contracts, property rights, the judiciary, the police, and the probability of crime and violence in that country (Xede et al., 2023). Within this group, three indicators are considered, namely:

- Property rights, which are a central motivating force for workers and investors. They improve research and development in a country, leading to an increase in the number of innovations and an improvement in financial performance (Boulton, 2023). This leads to an increase in the assets of individuals and strengthens the private sector.
- Judicial effectiveness represents the legal framework that serves citizens, protecting them from illegal actions (Puška et al., 2023). The legal framework is crucial in protecting the rights of citizens against the illegal actions of others (Cabello et al., 2021). This is why the rule of law is needed in every country, so that all citizens have the same rights, without privilege.
- Government integrity is a measure that reduces corruption in a country. Greater corruption leads to legal uncertainty and disrupts economic stability. Government integrity can reduce the risk of financing and investing in projects (Shah et al., 2022), by reducing the level of corruption in the country. Corruption undermines economic freedoms by introducing insecurity and uncertainty into the economic relations that govern society (Cervelló-Royo et al., 2023). These three indicators show how much the government of a country invests in regulating the rights of its citizens, protecting them from corruption with laws and giving everyone equal chances.

The **Government size** indicator includes the fiscal burden, which is measured as the total taxation burden relative to GDP, government spending, which is related to the size of the public sector (Bjørnskov, 2016), and fiscal health, which is measured by budget deficit or surplus and debt burden, caused by poor management of the state budget (Cabello et al., 2021). This group consists of three indicators: tax burden, government spending, and fiscal health. *Tax burden* refers to the fiscal constraints imposed by countries, which include various taxes and fees (Mamkhezri et al., 2022). It is ideal if these burdens do not reduce the income of the population and the profits generated by economic activity, thus reducing the costs of the population and economic entities. *Government spending* represents an opportunity to achieve economic growth. In order to achieve economic growth, it is necessary to increase government spending (Kolawole, 2016). However, excessive government spending burdens the budget, which is mostly funded by taxes. In this way, the costs of the population and the economy increase, and more funds have to be allocated for taxes and fees. It should be noted that a developed infrastructure in the country is needed for the economy to develop, which is financed through government spending. *Fiscal health* represents the state of the country in terms of macroeconomic measures (Puška et al., 2023). A larger deficit in the budget leads to an increase in the country's debt, which results from poor management of the country budget, leading to the deterioration of the country's overall financial health (Cabello et al., 2021). Thus, to improve the economy, a country should use its spending judiciously, taking into account the burden imposed on citizens and businesses, while avoiding an increase in the state's debt. The

government should aim to increase public spending on areas that will contribute to the economic growth of the country, such as infrastructure development, and manage its budget prudently to avoid deficit and debt accumulation. However, finding a balance between public spending and avoiding an increase in the fiscal burden requires careful planning, as increased public spending will inevitably increase the budget burden, which is often filled by taxes and fees.

The **Regulatory efficiency** indicator encompasses the freedom for businesses to operate without excessive interference from the state, thereby promoting monetary and business freedom and contributing to a stable exchange rate (Kuckertz et al., 2016). Increased state control reduces entrepreneurial freedom and stifles entrepreneurial initiative, which is a prerequisite for a country's development. The indicators within this group are:

- *Business freedom* is an indicator of effective regulation of entrepreneurship by the state (Cervelló-Royo et al., 2023). It assesses the ease of starting and carrying out business activities, as well as closing the business, when the state regulates it all (Yalçinkaya Koyuncu and Ünal, 2019). Excessive state regulation makes it impossible for businesses to adapt to market demands, hindering their progress. Therefore, it is crucial to enable each company to adapt to market requirements and to improve the conditions in which economic entities operate.
- *Labor freedom* allows citizens to make decisions about their lives and contributes to the development of a highly qualified workforce, which stimulates economic growth (Tran, 2019). Labor freedom encompasses various aspects of the legal and regulatory structure that govern the labor market (Ahmed et al., 2023). By attracting highly qualified labor, countries can enhance their innovation and business development.
- *Monetary freedom* measures price stability and price control, which promotes efficient allocation of resources and productive engagement of business entities (Ivanović and Stanišić, 2017). This freedom reflects maintaining the level of inflation and price stability in the country.

The **Market openness** indicator refers to the degree of a country's openness to the flow of goods and services, and the extent to which its citizens can engage in international trade (Zahid & Simga-Mugan, 2019). The presence of various restrictions in a country can limit the flow of goods and services in the global market. However, such measures can also protect domestic producers and goods from competition in the international market. Excessive measures, however, can hamper the innovation of domestic producers, limiting their exposure to international competition. The indicators that are used to measure market openness include trade freedom, investment freedom, and financial freedom. *Trade freedom* pertains to the absence of trade restrictions that could impede international trade (Economou, 2019). Low levels of trade freedom can limit international transactions, reduce currency convertibility, and decrease the volume of trade (Tolcha et al., 2021). It is important to consider the measures implemented and their extent. Weak measures or lack of domestic production can expose domestic producers to foreign competitors, who could take over the domestic market due to more favorable conditions. Thus, sound trade protection policies are necessary to provide protection while remaining open to the international market. *Investment freedom* pertains to the ability of companies to move their resources and business activities across the borders of a country without restrictions (Hussain and Haque, 2016). This indicator essentially measures the degree of free flow of investment capital (Puška et al., 2023) into and out of the country. Greater degrees of capital flow create incentives to invest in a country. A country that does not discriminate between domestic and foreign investments provides equal opportunities to everyone. *Financial freedom* pertains to the existence of an efficient financial system that supports business activities within a country (Economou, 2019). This indicator measures the freedom of operation of domestic banks, as well as the degree of government influence. Banks should finance the business activities of economic entities. Greater freedoms in this area lead to increased financing for both citizens and economic entities by the banking sector.

3. METHODOLOGY

In this section of the paper, the methodology of the research will be discussed, along with the research hypotheses.

3.1. DATA SOURCES

The research utilized the IEF report published by the Heritage Foundation to examine economic freedoms. Specifically, the 2022 edition of the report was used, which assesses the level of support for economic freedom across 184 countries. The report highlighted a decline in global economic freedom compared to previous editions, with the potential to improve these freedoms by reducing taxes, rationalizing regulatory policies, opening borders to competition, and increasing anti-corruption measures. The Overall Score was used to categorize countries: seven countries received a score above 80, twenty-seven between 70 and 80, 54 between 60 and 70, and 88 had a score below 60. Seven countries did not receive a score and were thus excluded from the analysis, leaving a sample of 177 countries for this study. In order to examine the impact of economic freedoms on GDP per capita and FDI, the values of these indicators were obtained from the World Bank's yearly reports.

3.2. RESEARCH HYPOTHESIS

In his study, [Gouider \(2022\)](#) examined the relationship between economic freedom and economic growth in Arab countries. His findings indicate that economic freedoms have a significant impact on GDP per capita, and he suggests ways in which these freedoms can be implemented to achieve greater economic growth. [Leite et al. \(2019\)](#) demonstrated in their research that corruption control and economic freedom have an effect on the economic growth of a society. This suggests that societies aiming for significant economic growth must have a positive impact on economic freedoms. [Malanski and Póvoa \(2021\)](#) analyzed the influence of corruption on economic growth at different levels of economic freedom. The results showed that economic freedom acts as a moderator in the relationship between corruption and economic growth. This research also indicated that the more corruption exists in society, the more economic freedoms are abused. [Cervelló-Royo et al. \(2023\)](#) examined the relationship between economic growth, high unemployment rates, and economic freedom factors. They believe economic freedom factors help explain economic growth, employment, and income distribution. The results of their study showed that a high level of economic freedom triggers a high level of economic growth and reduces unemployment. [Tran \(2019\)](#) proved that there is a strong relationship between financial freedom and economic growth. Based on the literature review, the first hypothesis of this research is proposed, which states:

H1. The economic freedoms have a positive effect on the economic growth of a society.

In his research, [Economou \(2019\)](#) argued that the prevailing economic and business freedoms in a society would affect the inflow of international investment and have a positive impact on FDI. [Ghazalian and Amponsem \(2019\)](#) examined whether economic freedoms affect the inflow of FDI and concluded that societies must adapt to the economic and geo-economic characteristics of the host country in order to increase FDI. [Tag and Degirmen \(2022\)](#) demonstrated that FDI increases with the rule of law, expands freedoms, and reduces barriers to investment and business. [Dkhili and Dhiab \(2018\)](#) studied the relationship between economic freedom, FDI, and economic growth in five Arabian Peninsula countries and found that economic freedoms play an important role in attracting foreign investments and significantly influence the economic growth of society. [Ciftci and Durusu-Ciftci \(2022\)](#) confirmed the relationships between economic freedoms, FDI,

and economic growth and found that economic freedoms have a significant impact on FDI and the economic growth of society. Using a gravity model, Xu (2019) showed that economic freedoms have a greater effect on encouraging foreign investment in a country than on original domestic investment. As a result, the second hypothesis is proposed:

H2. Economic freedoms have a positive effect on the attraction of foreign direct investment.

Based on the hypotheses H1 and H2 set in this way, this research will examine each individual indicator of economic freedom, how it affects economic growth and the inflow of FDI, as well as how they collectively influence the dependent variables.

3.2. STATISTICAL ANALYSIS

Different statistical analyses will be utilized in this study, specifically descriptive statistical analysis, correlation analysis, and multivariate regression analysis.

The objective of descriptive statistical analysis is to determine the mean value of the variables and research indicators used in the study. Furthermore, the minimum and maximum values of these indicators will be presented, as well as the value of the standard deviation. This analysis will show how much the data deviates from the overall mean value and how significant that difference is (Puška et al., 2020).

Correlation analysis measures the relationship between observed data (Đakić et al., 2021). In this study, the degree of association between the research indicators will be determined. Correlation analysis will investigate the connection between the observed variables to determine the direction, strength, and form of the relationship. When determining the correlation, the relationship between the variables is crucial (Puška et al., 2018). If an increase in the result value of one variable is associated with an increase in the result value of another variable, a positive correlation is present. Conversely, if an increase in the result value of one variable is associated with a decrease in the result value of another variable, a negative correlation exists. The result of the correlation analysis determines whether a negative or positive correlation is present. When discussing correlation analysis, it is essential to identify a value ranging from negative one to one. If the value is zero (0), there is no connection between the observed variables. If the value is one (1), there is a perfect correlation between the observed variables.

Multivariate regression analysis (MRA) will be employed to test the research hypotheses, as MRA is a statistical method used to analyze the influence of independent variables on dependent variables. In this paper, a simple regression analysis was performed with calculation of OLS effects. A regression model is presented in the form of an equation that includes one dependent and several independent variables. The objective of this analysis is to investigate how the independent variables affect the dependent variables. MRA has two applications: prediction and causal analysis. Predictive analysis aims to create a model that can explain and predict the dependent variable using the independent variables. Causal analysis investigates whether the independent variable has a statistically significant effect on the dependent variable. Additionally, it examines how much and what the influence of independent variables is on dependent variables. This influence can be positive or negative. A positive influence exists when the MRA value is positive, which indicates a positive influence on the direction of the regression function. In contrast, a negative value of the MRA analysis indicates a negative influence on the direction of the regression function. Since this analysis primarily aims to test hypotheses, causal MRA will be employed.

4. RESULTS

Before testing the hypotheses, a descriptive analysis of the observed research variables will be conducted. In the case of the independent variable of the IEF research, the results show that two indicators, namely Property rights and Tax burden, have a maximum score. For five indicators, namely Government spending, Fiscal health, Monetary freedom, Trade freedom, and Investment freedom, some countries have a minimum value of zero. The Tax burden indicator has the maximum average value (mean = 78.265), while the Financial freedom indicator has the lowest average value (mean = 48.857). The standard deviation data indicate the deviation of all data from the average value. As demonstrated in Table 1, the largest dispersion in the scores of the observed countries is found for the Fiscal health indicator (SD = 32.427), while the smallest dispersion is found for the Labor freedom indicator (SD = 9.507).

Concerning the dependent variables, the average value of GDP per Capita is 20,652 USD. However, the lowest value of GDP per Capita is 759.9 USD, while the highest value is 118,002 USD. This indicates a large gap between countries in terms of GDP per Capita. The deviation from the average value is 21304. When observing FDI (see Table 1), the average value of this indicator in the observed countries is 5,017 million USD. However, in some countries, the outflow of FDI is greater than the inflow, so the minimum value of this indicator is -115300 million USD, while the maximum value is 156321 million USD. The deviation from the average value is 21908.

Table 1. Descriptive analysis.

	Mean	Std. Dev.	Min.	Max.
Property rights	55.508	23.893	0.20	100.00
Judicial effectiveness	50.486	26.772	3.90	98.00
Government integrity	45.641	22.102	6.50	99.50
Tax burden	78.265	12.054	42.30	100.00
Government spending	65.368	24.152	0.00	97.00
Fiscal health	60.879	32.427	0.00	99.70
Business freedom	60.575	15.991	25.00	91.40
Labor freedom	55.973	9.507	20.00	81.50
Monetary freedom	74.758	12.353	0.00	87.10
Trade freedom	69.845	11.878	0.00	95.00
Investment freedom	57.257	20.431	0.00	95.00
Financial freedom	48.857	18.190	10.00	90.00
GDP per Capita	20652	21304	759.9	118002
FDI	5017	21908	-115300.0	156321

Source: Authors' calculation.

After conducting the descriptive analysis, the relationships between the observed research variables and their indicators are calculated. The highest correlation between the independent variable and GDP per Capita is found with the Property rights indicator ($r = 0.737$), while the lowest correlation is found with the Fiscal health indicator ($r = 0.124$) (Table 2). It is important to note that there is a negative correlation between GDP per Capita and the Tax burden indicator ($r = -0.202$) as well as the Government spending indicator ($r = -0.388$), indicating that an increase in tax burden and government spending leads to a reduction in GDP per capita in countries. Similar results are observed for the dependent variable FDI, except for the Fiscal health indicator, which has a negative correlation ($r = -0.172$). These three indicators negatively influence the FDI inflow of the countries. However, there is no strong correlation between the IEF indicator and FDI, as the highest

correlation is found with the Business freedom indicator ($r = 0.193$) and the smallest correlation is found with Government spending ($r = -0.006$), indicating almost no correlation between the two indicators. Thus, no specific IEF indicator can be identified as significantly affecting the increase in FDI inflows in countries, based on these indicators.

Table 2. Correlation analysis results.

Variable	1	2	3	4	5	6	7	8	9	10	11	12
1. Property rights	-											
2. Judicial effectiveness	0.882	-										
3. Government integrity	0.908	0.874	-									
4. Tax burden	-0.307	-0.397	-0.354	-								
5. Government spending	-0.519	-0.511	-0.531	0.318	-							
6. Fiscal health	0.079	0.053	0.058	-0.041	0.078	-						
7. Business freedom	0.851	0.751	0.813	-0.210	-0.460	0.129	-					
8. Labor freedom	0.577	0.623	0.560	-0.156	-0.286	0.056	0.531	-				
9. Monetary freedom	0.524	0.471	0.465	-0.101	-0.287	0.158	0.494	0.445	-			
10. Trade freedom	0.592	0.476	0.529	0.008	-0.373	0.106	0.650	0.436	0.465	-		
11. Investment freedom	0.717	0.618	0.640	-0.192	-0.273	0.086	0.675	0.401	0.530	0.489	-	
12. Financial freedom	0.705	0.604	0.671	-0.165	-0.278	0.069	0.737	0.438	0.474	0.565	0.803	-
13. GDP per capita	0.737	0.598	0.762	-0.202	-0.388	0.124	0.730	0.409	0.324	0.555	0.544	0.641
14. FDI	0.124	0.064	0.127	-0.006	-0.013	-0.172	0.193	0.155	0.044	0.127	0.040	0.091

Source: Authors' calculation.

After conducting the descriptive analysis and correlation analysis, the research hypotheses were tested using MRA. The first MRA analysis (Table 3) investigates the impact of IEF indicators on GDP per Capita. The results indicate a strong relationship between the observed research variables, as demonstrated by the multivariate correlation analysis ($r = 0.828$), and the model accounts for 68.6% ($R^2 = 0.686$) of the basic set being explained. The F-test indicates a statistically significant effect of IEF on GDP per Capita (F-test = 29.440, $p = 0.000$), thus confirming the first hypothesis of the study, which posits that economic freedoms have a positive impact on the growth of society, as expressed through the GDP per Capita indicator. Analyzing the individual impact of the IEF indicators on GDP per Capita, it can be observed that three indicators have a statistically significant impact, namely Judicial effectiveness (t-test = -3.656, $p = 0.000$), Government integrity (t-test = 5.264, $p = 0.000$), and Monetary freedom (t-test = -2.255, $p = 0.025$). However, both Judicial effectiveness (Beta = -0.401) and Monetary freedom (Beta = -0.127) have a negative influence on the direction of the regression function. Therefore, it can be concluded that these indicators have a negative impact on the growth of society, as increasing their values results in a decrease in GDP per Capita.

Table 3. Examining the impact of IEF on GDP per Capita.

Dependent variable: GDP per capita	Beta	t-test	p
Property rights	0.309	2.226	0.027
Judicial effectiveness	-0.401	-3.656	0.000
Government integrity	0.624	5.264	0.000
Tax burden	-0.011	-0.219	0.827
Government spending	0.008	0.146	0.884
Fiscal health	0.064	1.406	0.162
Business freedom	0.158	1.641	0.103
Labor freedom	-0.000	-0.006	0.995
Monetary freedom	-0.127	-2.255	0.025
Trade freedom	0.122	1.929	0.055
Investment freedom	-0.078	-0.942	0.347
Financial freedom	0.180	2.121	0.035
Model summary: R = 0.828; R ² = 0.686; F-test = 29.440; sig. = 0.000			

Source: Authors' calculation.

Upon examination of the second hypothesis, it was posited that IEF indicators have a positive effect on the attraction of FDI. The results of the second MRA (Table 4) indicate a weaker connection between the observed research variables compared to the first MRA ($r = 0.368$), with only 13.6% ($R^2 = 0.136$) of the basic set being explained. The F-test results indicate a statistically significant influence of economic freedoms on the inflow of FDI (F-test = 2.117, $p = 0.018$), thereby confirming the second hypothesis of this research. Upon examining the individual impact of the IEF indicators on FDI, a significant statistical impact was found for two indicators: Fiscal health (t-test = - 3.025, $p = 0.003$) and Business freedom (t-test = 2.530, $p = 0.012$). However, the Fiscal health indicator had a negative impact on the direction of the regression function (Beta = - 0.229), suggesting that this indicator has a negative effect on the inflow of FDI.

Table 4. Examining the impact of IEF on FDI.

Dependent variable: GDP per capita	Beta	t-test	p
Property rights	0.097	0.422	0.674
Judicial effectiveness	-0.350	-1.923	0.056
Government integrity	0.116	0.589	0.557
Tax burden	-0.056	-0.666	0.506
Government spending	0.140	1.507	0.134
Fiscal health	-0.229	-3.015	0.003
Business freedom	0.405	2.530	0.012
Labor freedom	0.155	1.585	0.115
Monetary freedom	-0.004	-0.047	0.963
Trade freedom	0.028	0.270	0.787
Investment freedom	-0.122	-0.890	0.375
Financial freedom	-0.081	-0.577	0.564
Model summary: R = 0.368; R ² = 0.136; F-test = 2.117; sig. = 0.018			

Source: Authors' calculation.

5. DISCUSSION

To achieve economic growth, it is imperative to have economic freedoms, as they enhance the competitiveness of nations (Graafland, 2019). Greater economic freedom allows for an equal chance for all individuals to succeed (Mastilo and Čičković, 2017), making it crucial for the market to have economic freedoms that enable inflow of foreign investments (Ding et al., 2021). The research presented in this paper explores the relationship between economic freedoms, economic growth, and the inflow of foreign investments, with data obtained from the Heritage Foundation's IEF report, which was available for the year 2022. The World Bank report provided additional data on GDP per Capita and FDI indicators.

The IEF groups all indicators into four categories, with three indicators used within each group (Murphy et al., 2023). Hence, each indicator plays an equal role in forming the IEF score. The overall IEF score indicates that only seven countries have a score above 80, while 88 countries have a score lower than 60, highlighting a significant disparity in economic freedom across countries. To establish the impact of economic freedom on economic growth and foreign investment inflow, data from 177 countries were used, as the report published by the Heritage Foundation covered 184 countries. Seven countries were excluded from further analysis due to the unavailability of specific indicators of economic freedom.

The impact of economic freedoms on social growth and foreign investments was analyzed using statistical methods. Descriptive analysis revealed that the Tax burden indicator contains the greatest freedoms. It is important to avoid imposing excessive taxes and fees on both individuals and businesses. However, it is also necessary to consider that government spending is primarily financed through fixed levies, so balancing multiple levies through taxes and fees is essential. In contrast, financial freedoms have the lowest average value, indicating that there is no efficiency in the financial system of countries and that freedoms must be improved to enable banks to finance business activities more freely. However, banks may prioritize profits over the interests of the population and businesses (Bretas and Alon, 2020), so countries need to limit banking activities to protect the economy and population. Therefore, this indicator received the lowest score.

Based on the results of the correlation analysis, it is evident that the correlation between the IEF and GDP per capita is significantly stronger than the correlation with the inflow of foreign investments. Specifically, the findings indicate that in order to enhance Social growth, as manifested by an increase in GDP per capita, it is imperative to enhance Property rights, Government integrity, and Business freedom since they are most closely associated with the growth of GDP per capita. The increase in the value of these freedoms results in a corresponding increase in the value of GDP per capita. Hence, it is crucial to increase freedoms in countries to foster prosperity. In addition to these freedoms, it is also necessary to improve the freedoms of other indicators that have positive correlation coefficients. However, the correlation analysis revealed that the Fiscal health indicator has a relatively small correlation coefficient and is, therefore, less critical to the growth of GDP per capita in countries.

In contrast, the freedoms associated with Tax burden and Government spending indicators need to be reduced to promote GDP per capita. This is because these indicators have a negative correlation coefficient, implying that as these freedoms increase, GDP per capita decreases. Therefore, states must enhance certain freedoms while reducing others to boost the value of GDP per capita. This also applies to the inflow of FDI, which exhibit a negative correlation with the Fiscal health indicator and, to a lesser extent, with the other indicators. Nonetheless, the results of the correlation analysis cannot conclusively identify the key freedoms necessary for increasing the inflow of foreign investments since there is either an insufficient correlation or no correlation at all with any of the indicators.

The hypotheses were then tested using MRA, which revealed a positive statistical impact of economic freedom on Social growth and the increase of foreign investments. Notably, the indicator

of Government integrity had a positive statistical impact on the growth of GDP per capita, indicating that it is a key indicator for achieving higher GDP per capita. Countries, therefore, need to reduce corruption to provide equal opportunities to everyone, thereby reducing the risk of financing and investing in projects. Business freedom is the most critical factor for increasing foreign investments, as it facilitates the easy initiation and closure of businesses. Thus, the countries should not exert too much control over these freedoms. Primarily strengthening Government integrity and Business freedom enhances GDP per capita, thereby attracting foreign direct investments. However, other freedoms should not be overlooked since they jointly contribute to the increase of GDP per capita and FDI.

6. CONCLUSION

The research in this paper has demonstrated the significant impact that economic freedoms have on social growth as measured by GDP per capita and on the inflow of foreign direct investments. To prove this effect, the indicators of economic freedom from the Heritage Foundation's 2022 report were used, along with GDP per capita and FDI indicators from the World Bank's report. MRA was employed to test the hypotheses that economic freedoms have a positive effect on both the economic growth of society and the attraction of foreign direct investments, and the results provide strong support for both hypotheses.

It is worth noting that the impact of economic freedoms on GDP per capita is greater than their impact on FDI, and not all freedoms contribute equally to the growth of GDP per capita and FDI. To increase GDP per capita, it is crucial to improve the Government integrity indicator, while the Business freedom indicator has a significant effect on the attraction of FDIs. Therefore, this research provides valuable insights for policymakers on how to improve economic standards, enhance the standard of living by increasing GDP per capita, and ultimately increase the inflow of foreign direct investments.

Future research could explore the impact of economic freedom on other economic indicators, such as employment rates and poverty levels. Additionally, more research could be conducted on the specific mechanisms through which economic freedom affects economic growth and foreign direct investment. Finally, comparative studies across different regions and countries could provide further insights into the relationship between economic freedom and economic development.

REFERENCES

- Ahmed, S., Mushtaq, M., Fahlevi, M., Aljuaid, M., & Saniuk, S. (2023). Decomposed and composed effects of economic freedom on economic growth in south Asia. *Heliyon*, 9(2), e13478. <https://doi.org/10.1016/j.heliyon.2023.e13478>
- Bashir, M. F., Ma, B., Shahzad, L., Liu, B., & Ruan, Q. (2021). China's quest for economic dominance and energy consumption: Can Asian economies provide natural resources for the success of One Belt One Road? *Managerial and Decision Economics: MDE*, 42(3), 570–587. <https://doi.org/10.1002/mde.3255>
- Bjørnskov, C. (2016). Economic freedom and economic crises. *European Journal of Political Economy*, 45, 11–23. <https://doi.org/10.1016/j.ejpoleco.2016.08.003>
- Boulton, T. J. (2023). Property rights and access to equity capital in China. *Global Finance Journal*, 55(100797), 100–797. <https://doi.org/10.1016/j.gfj.2022.100797>
- Bretas, V. P. G., & Alon, I. (2020). The impact of COVID -19 on franchising in emerging markets: An example from Brazil. *Global Business and Organizational Excellence*, 39(6), 6–16. <https://doi.org/10.1002/joe.22053>
- Brkić, I., Gradojević, N., & Ignjatijević, S. (2020). The impact of Economic Freedom on economic growth? New European dynamic panel evidence. *Journal of Risk and Financial Management*, 13(2), 26. <https://doi.org/10.3390/jrfm13020026>
- Cabello, J. M., Vidal, J. R., & Pérez-Gladish, B. (2021). An Alternative Aggregation Process for Composite Indexes: An Application to the Heritage Foundation Economic Freedom Index. *Social Indicators Research*, 153(2), 443–467. <https://doi.org/10.1007/s11205-020-02511-8>
- Cervelló-Royo, R., Devecce, C., & González-Tejero, C. B. (2023). Economic freedom influences economic growth and unemployment: an analysis of the Eurozone. *Economic Research*, 36(2). <https://doi.org/10.1080/1331677x.2023.2175007>
- Ciftci, C., & Durusu-Ciftci, D. (2022). Economic freedom, foreign direct investment, and economic growth: The role of sub-components of freedom. *The Journal of International Trade & Economic Development*, 31(2), 233–254. <https://doi.org/10.1080/09638199.2021.1962392>
- Ding, G., Vitenu-Sackey, P. A., Chen, W., Shi, X., Yan, J., & Yuan, S. (2021). The role of foreign capital and economic freedom in sustainable food production: Evidence from DLD countries. *PLOS ONE*, 16(7), e0255186. <https://doi.org/10.1371/journal.pone.0255186>
- Dkhili, H., & Dhiab, L. (2018). The relationship between economic freedom and FDI versus economic growth: Evidence from the GCC countries. *Journal of Risk and Financial Management*, 11(4), 81. <https://doi.org/10.3390/jrfm11040081>
- Dutta, N., & Williamson, C. R. (2016). Aiding economic freedom: Exploring the role of political institutions. *European Journal of Political Economy*, 45, 24–38. <https://doi.org/10.1016/j.ejpoleco.2016.07.009>
- Đukić, A., Štaka, M., & Drašković, D. (2021). The impact of the COVID-19 pandemic on the macroeconomic aggregates of the European Union. *ECONOMICS - Innovative and Economics Research Journal*, 9(2), 91–108. <https://doi.org/10.2478/eoik-2021-0023>

- Ecer, F., & Hashemkhani Zolfani, S. (2022). Evaluating economic freedom via a multi-criteria merec-dnma model-based composite system: Case of OPEC countries. *Technological and Economic Development of Economy*, 28(4), 1158-1181.
<https://doi.org/10.3846/tede.2022.17152>
- Economou, F. (2019). Economic freedom and asymmetric crisis effects on FDI inflows: The case of four South European economies. *Research in International Business and Finance*, 49, 114-126.
<https://doi.org/10.1016/j.ribaf.2019.02.011>
- Graafland, J. (2019). Economic freedom and corporate environmental responsibility: The role of small government and freedom from government regulation. *Journal of Cleaner Production*, 218, 250-258.
<https://doi.org/10.1016/j.jclepro.2019.01.308>
- Ghazalian, P. L., & Amponsem, F. (2019). The effects of economic freedom on FDI inflows: an empirical analysis. *Applied Economics*, 51(11), 1111-1132.
<https://doi.org/10.1080/00036846.2018.1524979>
- Gouider, A. (2022). The nexus between economic freedom and economic growth in Arab countries. *Montenegrin Journal of Economics*, 18(1), 117-125.
<https://doi.org/10.14254/1800-5845/2022.18-1.9>
- Haddad, C., & Hornuf, L. (2019). The emergence of the global fintech market: economic and technological determinants. *Small Business Economics*, 53(1), 81-105.
<https://doi.org/10.1007/s11187-018-9991-x>
- Hall, J. C., & Lawson, R. A. (2014). Economic freedom of the world: An accounting of the literature. *Contemporary Economic Policy*, 32(1), 1-19.
<https://doi.org/10.1111/coep.12010>
- Hoque, H., & Liu, H. (2023). Impact of bank regulation on risk of Islamic and conventional banks. *International Journal of Finance & Economics*, 28(1), 1025-1062.
<https://doi.org/10.1002/ijfe.2462>
- Hussain, M., & Haque, M. (2016). Impact of economic freedom on the growth rate: A panel data analysis. *Economies*, 4(4), 5.
<https://doi.org/10.3390/economies4020005>
- Iamsiraroj, S. (2016). The foreign direct investment-economic growth nexus. *International Review of Economics & Finance*, 42, 116-133.
<https://doi.org/10.1016/j.iref.2015.10.044>
- Ivanović, V., & Stanišić, N. (2017). Monetary freedom and economic growth in New European Union Member States. *Economic Research*, 30(1), 453-463.
<https://doi.org/10.1080/1331677x.2017.1305803>
- Jones, C., Temouri, Y., Kirolos, K., & Du, J. (2023). Tax havens and emerging market multinationals: The role of property rights protection and economic freedom. *Journal of Business Research*, 155, 113373.
<https://doi.org/10.1016/j.jbusres.2022.113373>
- Kolawole, B. O. (2016). Government Spending and Inclusive-Growth Relationship in Nigeria: An Empirical Investigation. *Zagreb International Review of Economics and Business*, 19(2), 33-56.
<https://doi.org/10.1515/zireb-2016-0007>
- Kolluru, M., Hyams-Ssekasi, D., & Sudhana Rao, K. (2021). A Study of Global Recession Recovery Strategies in Highly Ranked GDP EU Countries. *ECONOMICS - Innovative and Economics Research Journal*, 9(1), 85-106.
<https://doi.org/10.2478/eoik-2021-0011>
- Kuckertz, A., Berger, E. S., & Mpeqa, A. (2016). The more the merrier? Economic freedom and entrepreneurial activity. *Journal of Business Research*, 69(4), 1288-1293.
<https://doi.org/10.1016/j.jbusres.2015.10.094>

- Leite, N. S., Carvalho Lucio, F. G., & Ferreira, R. T. (2019). Long-term effects of corruption control and economic freedom on economic growth. *Theoretical Economics Letters*, 09(08), 2965–2974.
<https://doi.org/10.4236/tel.2019.98183>
- Lu, W., Kasimov, I., Karimov, I., & Abdullaev, Y. (2020). Foreign direct investment, natural resources, economic freedom, and sea-access: Evidence from the Commonwealth of Independent States. *Sustainability*, 12(8), 3135.
<https://doi.org/10.3390/su12083135>
- Malanski, L. K., & Póvoa, A. C. S. (2021). Economic growth and corruption in emerging markets: Does economic freedom matter? *International Economics*, 166, 58–70.
<https://doi.org/10.1016/j.inteco.2021.02.001>
- Mamkhezri, J., Muhamad, G. M., & Khezri, M. (2022). Assessing the spatial effects of economic freedom on forest-products, grazing-land, and cropland footprints: The case of Asia-Pacific countries. *Journal of Environmental Management*, 316, 115–274.
<https://doi.org/10.1016/j.jenvman.2022.115274>
- Mastilo, Z., & Čičković, R. (2017). Structural weaknesses in the economy of Bosnia and Herzegovina - A brake on growth and development. *Applied Economics and Finance*, 4(5), 54.
<https://doi.org/10.11114/aef.v4i5.2620>
- Murphy, R. H., Taylor, E., & Stansel, D. (2023). Economic freedom at metropolitan statistical area borders. *American Journal of Economics and Sociology*, 82(2), 141–149.
<https://doi.org/10.1111/ajes.12500>
- Prevolšek, B., Maksimović, A., Puška, A., Pažek, K., Žibert, M., & Rozman, Č. (2020). Sustainable Development of Ethno-Villages in Bosnia and Herzegovina-A Multi Criteria Assessment. *Sustainability*, 12(4), 1399.
<https://doi.org/10.3390/su12041399>
- Puška, A., Maksimović, A., & Stojanović, I. (2018). Improving organizational learning by sharing information through innovative supply chain in agro-food companies from Bosnia and Herzegovina. *Operational Research in Engineering Sciences: Theory and Applications*, 1(1), 76–90.
<https://doi.org/10.31181/oresta19012010175p>
- Puška, A., Kozarević, S., & Okičić, J. (2020). Investigating and analyzing the supply chain practices and performance in agro-food industry. *International Journal of Management Science and Engineering Management*. 15(1), 9–16.
<https://doi.org/10.1080/17509653.2019.1582367>
- Puška, A., Štilić, A., & Stojanović, I. (2023). Approach for multi-criteria ranking of Balkan countries based on the index of economic freedom. *Journal of Decision Analytics and Intelligent Computing*, 3(1), 1–14.
<https://doi.org/10.31181/jdaic10017022023p>
- Sayari, N., Sari, R., & Hammoudeh, S. (2018). The impact of value added components of GDP and FDI on economic freedom in Europe. *Economic Systems*, 42(2), 282–294.
<https://doi.org/10.1016/j.ecosys.2017.03.003>
- Shah, W. U. H., Yan, H., Hao, G., Yasmeen, R., Padda, I. U. H., & Ullah, A. (2022). The impact of trade, financial development and government integrity on energy efficiency: An analysis from G7-Countries. *Energy*, 255, 124–507.
<https://doi.org/10.1016/j.energy.2022.124507>
- Singh, D., & Gal, Z. (2020). Economic Freedom and its Impact on Foreign Direct Investment: Global Overview. *Review of Economic Perspectives*, 20(1), 73–90.
<https://doi.org/10.2478/revecp-2020-0004>

- Stević, Ž., Tanackov, I., Puška, A., Jovanov, G., Vasiljević, J., & Lojaničić, D. (2021). Development of modified SERVQUAL–MCDM model for quality determination in reverse logistics. *Sustainability*, 13(10), 5734.
<https://doi.org/10.3390/su13105734>
- Tag, M. N., & Degirmen, S. (2022). Economic freedom and foreign direct investment: Are they related? *Economic Analysis and Policy*, 73, 737-752.
<https://doi.org/10.1016/j.eap.2021.12.020>
- Tolcha, T. D., Tchouamou Njoya, E., Bråthen, S., & Holmgren, J. (2021). Effects of African aviation liberalisation on economic freedom, air connectivity and related economic consequences. *Transport Policy*, 110, 204-214.
<https://doi.org/10.1016/j.tranpol.2021.06.002>
- Tran D. V. (2019). A study on the impact of economic freedom on economic growth in ASEAN countries. *BEH - Business and Economic Horizons*, 15(3), 423-449.
<https://ageconsearch.umn.edu/record/301155/>
- Vidović, N., & Ritan, V. (2022). New approach to estimating macroeconomic determinants of informal employment. *ECONOMICS - Innovative and Economics Research Journal*, 10(2), 95-108.
<https://doi.org/10.2478/eoik-2022-0012>
- Xede, J., Simon Peter Dak-Adzaklo, C., Ofosu, E., & Wise Dodzidenu Adza, S. (2023). Competition laws, external financing and investment. *Journal of International Financial Markets Institutions and Money*, 82, 101700.
<https://doi.org/10.1016/j.intfin.2022.101700>
- Xu, T. (2019). Economic freedom and bilateral direct investment. *Economic Modelling*, 78, 172–179.
<https://doi.org/10.1016/j.econmod.2018.09.017>
- Yalçinkaya Koyuncu, J. & Ünal, H. S. (2019). The Impact of Economic Freedom on the Shadow Economy: Panel Analysis. *Sosyal Bilimler Metinleri*, 2019 (2), 35-46.
- Zahid, R. M. A., & Simga-Mugan, C. (2019). An analysis of IFRS and SME-IFRS adoption determinants: A worldwide study. *Emerging Markets Finance and Trade*, 55(2), 391-408.
<https://doi.org/10.1080/1540496x.2018.1500890>