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Is Good Governance Good for Business? Insight from ASEAN+3

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ABSTRACT

This study investigates the impact of good governance on the ease of doing business in ASEAN+3 countries (ASEAN nations plus China, Japan, and South Korea) using the Panel Corrected Standard Error (PCSE) method for panel data analysis. The research examines six governance indicators and their influence on business environment metrics like the ease of starting a business. The combined panel and cluster analyses reveal significant disparities in the economic environments of the ASEAN+3 region. Cluster 1 (Cambodia, Laos, Myanmar) faces challenges with low EoDB scores, poor governance, and high corruption, requiring substantial reforms. Clusters 3 and 4 (Japan, Malaysia, China, Thailand, South Korea, and Singapore) benefit from strong governance, effective legal frameworks, and high productivity, illustrating the positive impact of robust institutions and political stability. The panel data analysis highlights the crucial role of government effectiveness, rule of law, and productivity in enhancing economic performance, while political instability and corruption significantly hinder outcomes, underscoring the need for political and institutional reforms.

Keywords: good governance, ease of doing business, ASEAN+3

1. Introduction

Good governance, characterized by principles such as accountability, transparency, rule of law, and inclusive participation, is fundamental to fostering a conducive business environment (Khushnood et al., 2020; Raza et al., 2021). This concept is pivotal in the context of global economics, where effective governance structures can enhance the efficiency and appeal of markets. Good governance refers to the processes and structures that guide political and economic decision-making in a manner that is transparent, accountable, equitable, and inclusive (Cerrillo-i-Martinez, 2023). According to the 1997 UNDP Report Governance for Sustainable Development, good governance ensures that "political, social, and economic priorities are based on broad consensus in society and that the voices of the poorest and the most vulnerable are heard in decision-making over the allocation of development resources" (UNDP, 1997). In business, this translates into a stable environment where companies can operate without undue risk from arbitrary decisions, corruption, or unclear regulations. This foundational stability is crucial for businesses to plan, invest, and expand (Grosanu et al., 2015).

The ease of doing business in a country is significantly influenced by the quality of its governance. The World Bank's Ease of Doing Business Index highlights how regulatory efficiency, property rights protection, and the reliability of contract enforcement can streamline business operations (Ndukwe & Allison, 2021). Good governance reduces the bureaucratic hurdles and corruption that can impede business activities, creating a more predictable and efficient operating environment (Khan & Alam, 2020; Hassan & Zeb, 2021). For instance, streamlined regulatory processes can reduce the time and cost associated with starting a business, thereby encouraging entrepreneurship and investment.

ASEAN+3, consisting of ASEAN nations along with China, Japan, and South Korea, good governance has been increasingly recognized as a critical factor in promoting economic growth and business success. The region's commitment to integration through agreements such as the Regional Comprehensive Economic Partnership (RCEP) further facilitates cross-border trade and investment, creating new opportunities while highlighting the importance of governance in maintaining competitive and attractive business environments (Armstrong & Drysdale, 2022; Zreik, 2024). RCEP is expected to drive economic growth within the region by enhancing market access, reducing costs, and creating

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new opportunities for businesses. According to studies, RCEP could add nearly $186 billion to the global economy by 2030 (Petri & Plummer, 2020).

Doing business in ASEAN+3 countries presents a diverse and dynamic landscape influenced by varying degrees of governance quality, economic policies, and regulatory environments. These countries have made substantial efforts to enhance their business climates through governance reforms aimed at improving transparency, regulatory efficiency, and anti-corruption measures. For instance, Singapore's robust legal framework and streamlined regulatory processes make it one of the most business-friendly environments globally. In contrast, countries like Indonesia and the Philippines continue to face challenges with regulatory complexity and enforcement, which can impede business activities.

Institutional theory suggests that well-established formal institutions (laws, regulations, enforcement mechanisms) provide a stable framework that reduces uncertainty for businesses (Puffer & McCarthy, 2011; Peters, 2022). This stability enables companies to focus on growth and innovation rather than navigating unpredictable governance environments. Additionally, the principal-agent theory emphasizes that transparent and accountable governance reduces the likelihood of opportunistic behavior by government officials, thus fostering trust and collaboration between the public and private sectors (Zardkoohi et al., 2017).

Empirical studies consistently show a positive correlation between good governance and business performance across nations. For example, a study by Nizam & Hassan (2018) found that improvements in governance quality, such as enhanced regulatory practices and stronger anti-corruption measures, were associated with higher levels of foreign direct investment (FDI) in South Asia. This is particularly evident in nations like Singapore, which is often cited for its robust governance framework that supports a dynamic business environment (Vasil, 2020). Conversely, countries with weaker governance structures tend to struggle with attracting and retaining business investments, highlighting the importance of governance reforms.

In Malaysia, governance reforms aimed at enhancing regulatory quality and reducing corruption have been linked to improved business conditions and increased competitiveness on the global stage (Karim & Said, 2024). Similarly, Japan's adherence to stringent governance principles has created a highly efficient market environment conducive to business innovation and growth (Schaede, 2020). These examples underscore the practical implications of good governance: not only does it create a fair and predictable business environment, but it also drives economic development by attracting investment and fostering a culture of compliance and integrity.

The research aims to analyze how good governance practices impact the ease of doing business in ASEAN+3 countries and promote a favorable business environment. By examining governance indicators such as voice and accountability, political stability, GOVEF government effectiveness, regulatory quality, rule of law, and control of corruption, the study seeks to determine how these factors contribute to business growth. The implications of this research are significant for policymakers and business leaders, providing evidence-based insights that can guide reforms to enhance governance frameworks and, consequently, improve the business climate. This could lead to increased foreign direct investment (FDI), accelerated economic development, and strengthened competitiveness within the region, supporting sustainable growth and regional economic integration.

2. Research Method

First, to understand the distribution of ASEAN+3 countries based on their business conditions, a cluster analysis was performed on the Ease of Doing Business (EoDB) scores of each country. It uses the approach of K-means clustering, which partitions data into *k* clusters by minimizing the sum of squares of distances between data points and cluster centroids, expressed as:

$$minimize \sum_{i=1}^{k} \sum_{x \epsilon Ci} \| x - \mu_i \|^2 \qquad (1)$$

Next, the research also employs the Panel Corrected Standard Error (PCSE) method for analyzing panel data to investigate the impact of good governance on the ease of doing business in ASEAN+3 countries. Panel data, which integrates multi-dimensional measurements over time, allows for a comprehensive analysis by combining cross-sectional and time-series data. PCSE is particularly suited for this study due to its ability to address issues of heteroscedasticity and serial correlation, which frequently arise in such data structures. Unlike Ordinary Least Squares (OLS), which assumes constant variance and no correlation among error terms, PCSE adjusts for these issues, offering robust standard errors and more reliable parameter estimates. This adjustment is crucial given the diverse economic conditions and governance practices across the ASEAN+3 countries, which introduce variability in error terms and potentially correlate errors within and across countries.

In implementing the PCSE method, the study follows a detailed approach to ensure robustness and accuracy. Initially, a balanced panel dataset is constructed by aggregating annual data from reputable sources such as the World Bank, the World Governance Indicators, and national statistical offices of the ASEAN+3 countries. This dataset includes governance indicators (e.g., regulatory quality, control of corruption) and business environment measures (e.g., ease of starting a business) spanning from 2010 to 2020. The model specification includes governance indicators as independent variables and business performance metrics as dependent variables, with controls for country-specific and time-fixed effects to account for unobserved heterogeneity. This methodological approach ensures that the analysis accurately reflects the impact of governance on business outcomes, capturing the unique characteristics of each country and accounting for temporal dynamics. The equation is following:

$$BUS_{it} = \alpha + \beta_1 VACC_{it} + \beta_2 POL_{it} + \beta_3 GOVEF_{it} + \beta_4 REG_{it} + \beta_5 LAW_{it} + \beta_6 COR_{it} + \beta_7 PROD_{it} + \epsilon_{it} \quad (2)$$

Where BUS represents the quality of the business ecosystem measured by Ease of Doing Business (EoDB) data, which is influenced by variables representing good governance such as VACC (voice and accountability), POL (political stability), GOVEF (government effectiveness), REG (regulatory quality), LAW (rule of law), and COR (control of corruption). We also use PROD (proportion of the population in the productive age) as a control variable.

3. Results and Discussion

The cluster analysis of the ASEAN+3 region provides a comprehensive examination of the varying business environments across these countries. By categorizing nations into clusters based on their Ease of Doing Business (EoDB) scores, this analysis highlights the distinct differences in their business environment.

Figure 1. EoDB Mapping based on Cluster Analysis
(Source: Data Processed, 2024)

Note:

Darkest blue	: Very good
Dark blue	: Good
Medium blue	: Moderate
Lightest blue	: Bad
Grey	: Not the area of analysis

Figure 1 illustrates the ASEAN + 3 region, categorizing countries based on the quality of their business environment as measured by the Ease of Doing Business (EoDB) scores. Countries shaded in darker blue belong to cluster 1, which indicates a higher EoDB score, signifying a more favorable business environment. This cluster includes countries such as China, Japan, South Korea, and Singapore. These nations are recognized for their streamlined regulations, efficient legal frameworks, and supportive infrastructure that facilitate business operations and attract investment. Their high EoDB scores reflect the effectiveness of policies aimed at reducing bureaucratic hurdles and enhancing the overall ease of establishing and running businesses.

Conversely, countries shaded in lighter blue represent those in the lower cluster, indicating a less favorable business environment with lower EoDB scores. This cluster encompasses several Southeast Asian countries such as Indonesia, the Philippines, and Vietnam. These nations face challenges such as regulatory complexities, inadequate infrastructure, and legal inefficiencies that hinder business operations. The variation in EoDB scores across the ASEAN + 3 region highlights the disparities in regulatory quality and business-friendliness, suggesting areas where lower-performing countries can learn from their higher-performing neighbors to implement reforms that improve their business climates. Addressing these challenges is crucial for fostering economic growth, attracting foreign investment, and enhancing regional competitiveness.

Table 1. Country Clustering

Cluster	Number of Countries	Countries
Cluster 1 *(bad)*	3 countries	Cambodia (53.3), Laos (50.8), Myanmar (46.8)
Cluster 2 *(moderate)*	4 countries	Brunei Darussalam (70.3), Indonesia (69.9), Philippines (62.8), Vietnam (69.8)
Cluster 3 *(good)*	4 countries	Japan (78.0), Malaysia (81.5), PR China (77.9), Thailand (80.1)
Cluster 4 *(very good)*	2 countries	Republic of Korea (84.0), Singapore (86.2)

Source: Data Processed, 2024

The cluster analysis of the Ease of Doing Business (EoDB) scores across the ASEAN+3 countries reveals distinct groupings that highlight varying degrees of business environment quality. Cluster 1, labeled as "bad," includes Cambodia, Laos, and Myanmar, with EoDB scores of 53.3, 50.8, and 46.8, respectively. These countries face significant challenges in creating conducive business environments, likely due to regulatory inefficiencies, inadequate infrastructure, and bureaucratic hurdles. The low scores suggest a need for comprehensive reforms to streamline business processes, improve legal frameworks, and enhance support systems to foster economic growth and attract foreign investment. Addressing these issues is critical for these nations to elevate their business environments and improve their economic competitiveness.

Cluster 2, marked as "moderate," includes Brunei Darussalam, Indonesia, the Philippines, and Vietnam, with EoDB scores ranging from 62.8 to 70.3. These countries have made notable progress in improving their business climates but still face challenges that prevent them from reaching the highest tier. Clusters 3 and 4 represent "good" and "very good" business environments, respectively. Cluster 3 includes Japan, Malaysia, China, and Thailand, with scores between 77.9 and 81.5, reflecting robust regulatory frameworks and supportive infrastructures. Cluster 4, the "very good" cluster, comprises South Korea and Singapore, with the highest EoDB scores of 84.0 and 86.2, respectively. These countries are exemplars in the region, showcasing best practices in regulatory efficiency, transparency, and infrastructure quality. The disparities across clusters highlight the importance of targeted policy interventions and regional collaboration to uplift lower-performing countries and ensure a more uniformly conducive business environment across the ASEAN+3 region.

Table 2. Panel Corrected Standard Error (PCSE) Result

Variables	Coef	Panel corrected Std err	z	P>|z|
VACC	0.535	0.792	0.68	0.499
POL	-4.485	0.671	-6.68	0.000*
GOVEF	11.945	1.401	8.52	0.000*
REG	-1.605	0.987	-1.63	0.104
LAW	15.519	2.125	7.30	0.000*
COR	-12.233	1.118	-10.94	0.000*
PROD	0.544	0.095	7.30	0.000*
Constant	23.863	6.350	-10.94	0.000
Number of observations		128	5.70	
R-squared		0.8907	3.76	
Prob>chi2		0.0000		

Source: Data Processed, 2024
Note:
Significant in alpha<0.001

The panel data analysis presented reveals several significant factors influencing the dependent variable, indicated by the high R-squared value of 0.8907, suggesting that approximately 89.07% of the variability in the dependent variable is explained by the model. The significant coefficients at various confidence levels indicate the strength and direction of these relationships. Notably, government effectiveness (GOVEF) and the rule of law (LAW) have strong positive coefficients of 11.945 and 15.519, respectively, both with p-values less than 0.001. This suggests that improvements in government effectiveness and adherence to the rule of law significantly enhance the dependent variable, aligning with theories that emphasize the role of strong institutions in economic development and business environments (Onuigbo, 2020). Effective governance and legal systems reduce uncertainty, lower transaction costs, and create a conducive environment for business operations, fostering economic growth and stability.

Conversely, political stability (POL) and control of corruption (COR) show negative relationships with the dependent variable, with coefficients of -4.485 and -12.233, respectively, both significant at the 0.001 level. The negative impact of political instability and corruption on economic performance is well-documented in the literature (Baklouti & Boujelbene, 2020; Gharaibeh & Kharabsheh, 2022). Political instability can lead to unpredictable policy changes, disrupting business planning and operations. Corruption increases the cost of doing business, distorts market mechanisms, and undermines the legitimacy of public institutions. These findings highlight the critical need for political reforms and anti-corruption measures to create a more favorable business environment and promote sustainable economic development.

Other variables such as regulation quality (REG) and voice and accountability (VACC) did not show statistically significant relationships with the dependent variable, as indicated by their high p-values of 0.104 and 0.499, respectively. While regulation quality has a negative coefficient, its lack of significance suggests that other factors might be overshadowing its impact in this model. Voice and accountability, despite its importance in good governance, does not appear to directly influence the dependent variable in this context. Interestingly, the productive age population (PROD) has a positive and significant coefficient of 0.544 with a p-value less than 0.001, underscoring the importance of productivity improvements in driving economic outcomes. Higher productivity levels can lead to increased competitiveness, higher output, and economic growth (Jia et al., 2020). Overall, these results underscore the multifaceted nature of economic performance, highlighting the crucial roles of governance, legal frameworks, political stability, and productivity in shaping economic outcomes.

4. Conclusion

The panel data analysis and the cluster analysis together provide a comprehensive understanding of the economic environments in the ASEAN+3 region. Cluster 1 (Cambodia, Laos, Myanmar) struggles with low EoDB scores, poor governance, and high corruption, necessitating substantial reforms. Cluster 2 (Brunei Darussalam, Indonesia, the Philippines, Vietnam) shows moderate EoDB scores with progress in governance but still faces political instability and corruption. Clusters 3 and 4 (Japan, Malaysia, China, Thailand, South Korea, and Singapore) have good to very good EoDB scores, benefiting from strong governance, effective legal frameworks, and high productivity, illustrating the positive impact of robust institutions and political stability on economic performance.

The panel data analysis underscores the critical importance of effective governance and robust legal frameworks, as evidenced by the strong positive impacts of government effectiveness and the rule of law on economic performance. Conversely, political instability and control of corruption significantly hinder economic outcomes, highlighting the need for political reforms and anti-corruption measures. The productive age population also plays a crucial positive role, emphasizing the importance of innovation and efficiency. Although regulation quality and voice and accountability did not show significant effects, the model's high explanatory power suggests that a multifaceted approach addressing governance, legal, political, and productivity factors is essential for fostering a conducive economic environment and sustainable growth.

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