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Asean Economic Dynamics: An Analysis of The Impact of Trade Openness, Foreign Direct Investment, and Export on Economic Growth

Ajeng Lestari[a*], **Ibnu Muhdir**[b], **Nesha Rizky Ashari**[c]
[a,b,c]Departement of Economics, Faculty of Economics and Business, University of Islam Sunan Kalijaga, Yogyakarta
* Ajengglestari23@gmail.com

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Abstract

This study aims to explain economic growth in ASEAN countries. The variables that affect the rate of economic growth are trade openness, foreign direct investment, and exports. In this study, the data used are secondary data from the World Bank and UNCTAD. The data is annual data from 2018-2022. The analytical tool used is the Vector Error Corrections Model (VECM) using unit root test, optimal lag test, cointegration test, and VECM model. The results show that in the short-term analysis, trade openness, FDI, and exports affect economic growth, but FDI and exports hurt economic growth. In the long run, the results of this study indicate that trade openness does not affect economic growth, while FDI has a significant effect on economic growth in ASEAN countries and exports do not affect economic growth in the period 2018- 2022.

INTRODUCTION

The progression of a nation's economic activities, which leads to an increase in the production of goods and services and subsequently enhances societal prosperity over the long term, is referred to as economic growth. Consequently, economic growth is regarded as a key indicator of a nation's development (Malida and Marselina 2023). Governments undertake national development initiatives to elevate the living standards and quality of life of their citizens (Afzal et al., 2009). Economic growth serves as a benchmark for assessing a country's long-term economic performance and objectives. Nations that effectively optimize their driving factors are more likely to achieve sustained economic growth. The ultimate goal of national development is the enhancement of societal welfare (Yuliawan & Wanniatie, 2021). Globalization incentivizes countries worldwide to broaden their economic horizons. In the contemporary world, trade and financial openness are crucial (Setiawan et al., 2023).

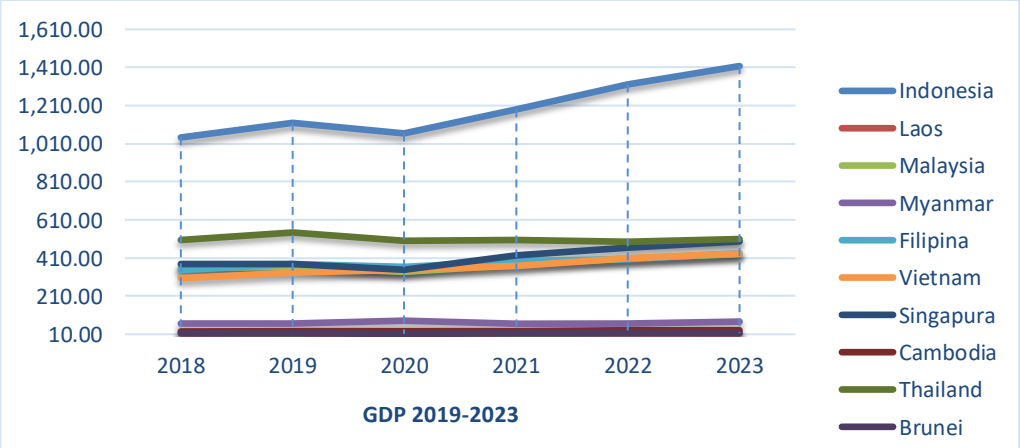
According to Lee and Kim (2009), economic research continues to debate the determinants of economic growth. Several growth factors have been identified, including geography, policy, and institutions. However, experience shows that no conventional component can influence economic performance unless there is a stable and reliable institutional environment that supports the economy. It is important to remember that middle-income countries face the problem of growth traps—or growth slowdowns—as shown by research conducted by the World Bank (2010). Despite the efforts of these countries, they remain increasingly open and integrated with the global economy. In the 1990s, Knack and Keefer (1995) conducted a study linking the law enforcement index of the International Country Risk Guide (ICRG) with cross-border investment and GDP from 1974 to 1989. Their research findings indicate that countries

capable of enforcing property rights laws experience higher levels of investment, which subsequently contributes to economic growth (Wibowo et al., 2021).

According to Yanikkaya (2003), the theoretical literature on economic growth tends to emphasize the relationship between trade barriers and growth rather than the relationship between trade volume and growth. Consequently, conclusions regarding the impact of trade barriers on growth cannot be directly applied to the effects of changes in trade volume on growth. Although trade restrictions and trade volume are closely related concepts, their influence on economic growth can differ significantly due to the impact of various critical factors such as income levels, country size, and geographic characteristics (Rodriguez & Rodrik, 2001). Currently, countries are adopting new strategies that integrate their domestic economies with the global economy through open trade channels (Rasoanomenjanahary et al., 2022).

While the relationship between economic growth and trade openness is unclear, it is theoretically debatable whether trade improves the economy. According to neoclassical growth theory, trade openness encourages capital formation, increasing production, which in turn increases profits and economies of scale (Bond et al., 2005). The indicator that can be used to measure a country's economic growth is the GDP growth rate. In the context of regional economics, the measure used is gross regional domestic product (GDP), namely the amount of gross added value produced by all economic sectors in a region. The economies of ASEAN countries are growing at different speeds, the following is a picture of economic growth in ASEAN countries in 2018 - 2023.

Figure 1. Economic Growth in ASEAN Countries



Source: World Bank, 2024

Based on Figure 1, shows that the GDP values in Indonesia, Laos, Malaysia, Singapore, the Philippines, and Vietnam are stable, as seen from their average GDP which is in the range of 5%-7.5%. Therefore, it provides an illustration that these six countries are experiencing good economic growth because changes over time continue to increase. Indonesia is the country in ASEAN that has the highest GDP in 2023, namely 1,417. 39$. Meanwhile, Cambodia, followed by Brunei, has a very low GDP among other ASEAN countries. It can be said that the country's economic growth has experienced significant changes from year to year. Data from the World Bank shows that economic growth in the last 6 years (2019-2023) in ASEAN countries is still fluctuating (Figure 1). The influence of the demands of the globalization era which expects every country to be able to carry out trade and an open economy has caused the boundaries of economic activity between ASEAN countries to slowly fade (Kurnia Maharani and S. Isnowati, 2014). In research, Redlin and Gries (2012) examined

short-term and long-term dynamics between GDP per capita growth and openness in 158 countries during the period 1970-2009. The results show that there is a long-term relationship between openness and economic growth, showing a positive and significant causal relationship between openness to growth and vice versa.

Economic growth can also be explained by trade openness. Trade openness, FDI, and inflation contribute to export performance (Mwakanemela, 2014). Trade openness and foreign investment have a positive effect on exports. Similarly, research in Southeast European countries by (Fetahi-Vehapi et al., 2015) concluded that countries with higher levels of income and foreign investment would benefit more if they were more open. This can explain why trade openness has a positive effect on economic growth. Moreover, research in ASEAN countries also concluded that free trade policies should be promoted to increase trade openness which will stimulate growth. This implies that more open policies will help achieve higher growth (Jayakumar et al., 2018). Countries in the ASEAN region have achieved high economic growth through the implementation of free trade and investment strategies, making the region a prime destination for foreign investors. FDI inflows to ASEAN have continued to increase, despite the decline in global FDI in recent years. The share of FDI inflows in ASEAN countries compared to global FDI has increased from 7.9% in 2010 to 9.6% in 2014 and to 11.5% in 2018 respectively (ASEAN & UN, 2019). In developing countries, FDI has an impact on growth that leads to the sustainability of economic growth (Azman-Saini et al., 2010). Based on research by Farhan et al. (2014) found differences in the effect of FDI in ASEAN countries depending on the economic environment of each country.

ASEAN (Association of South East Asian Nations) has a large population and focuses on developing markets and human resources. ASEAN's gross domestic product (GDP) capacity is the sixth largest in the world. ASEAN is a place where countries in Southeast Asia can work together to bring about positive change in politics, economics, and culture. ASEAN consists of three pillars: (1) political: creating a region that is safe, peaceful, and free from nuclear weapons and other destructive twilight; (2) economic: working together on trade, investment, employment, poverty alleviation, and reducing inequality; and (3) culture: focusing on building a more prosperous and more prosperous society. Each ASEAN government agrees on three basic pillars: the formation of ASEAN and the era of globalization. To increase their role in domestic markets and promote the liberalization of international capital movements, countries must join in financial ties as a result of increasing trade ties between economies. The state must learn from the reactions of economic actors; they must find a way to distinguish between increasing financial flows and the country's debt problems. Increasingly, foreign direct investment (FDI), or remittances, can play an important role in economic growth (Zardoub & Sboui, 2023).

Trade openness can also help economic growth. Export performance is influenced by increasing inflation, foreign investment, and trade openness (Mwakanemela, 2014). When trade and foreign investment are more open, exports increase. Similarly, research conducted in Southeastern European countries (Fetahi-Vehapi et al., 2015) found that countries with higher levels of income and foreign investment saw greater benefits. This shows how trade openness helps economic growth. In addition, research conducted in ASEAN countries also found that to increase trade openness which will encourage growth, free trade policies must be promoted (Jayakumar et al., 2018).

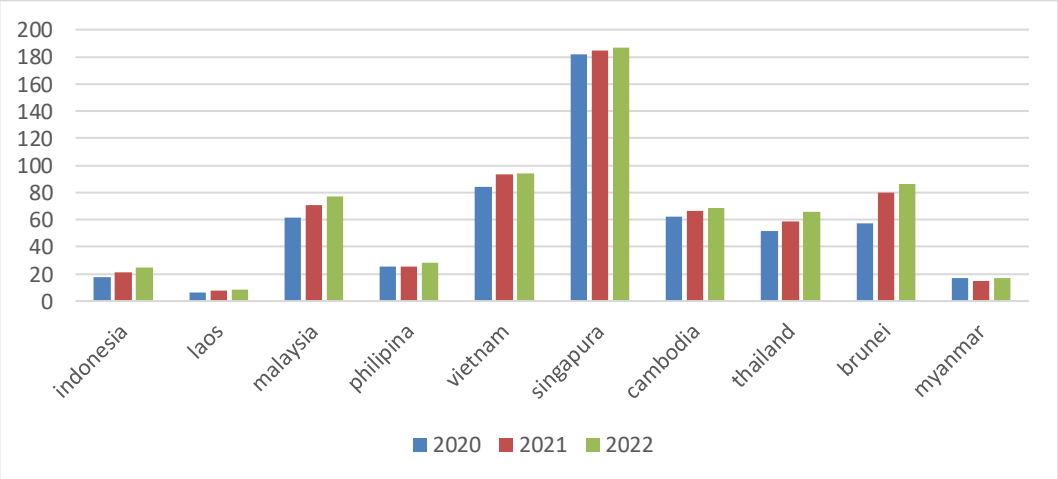
In addition to trade openness, numerous studies explicitly investigate the long-term causal relationship between Foreign Direct Investment (FDI) and economic growth. FDI serves as a primary source of capital and economic development for

developing nations (Azzaki et al., 2023). Empirical evidence indicates that foreign investment significantly contributes to GDP growth in Southeast Asian countries (Choong & Liew, 2009). The ASEAN region has successfully achieved high economic growth by implementing free trade and investment strategies, making it a prominent destination for foreign investors. Despite a global decline in FDI in recent years, FDI inflows into ASEAN have continued to rise. The proportion of FDI inflows into ASEAN countries compared to global FDI increased from 7.9% in 2010 to 9.6% in 2014, and further to 11.5% in 2018 (ASEAN & UN, 2019). In developing countries, FDI impacts growth, fostering sustainable economic development (Azman-Saini et al., 2010). Research by Farhan et al. (2014) reveals that the influence of FDI in ASEAN countries varies depending on the economic environment of each nation.

There are many ways to measure trade openness, and the most common measure shows trade as a share of a country's income. M/GDP, X/GDP, and (X + M)/GDP are some measures of trade openness. In most studies, it is measured as (X + M)/GDP, known as trade share (TS). Regardless of the type of trade openness measure used, each measure provides a way to measure how open an economy is to global trade. Simply put, the higher a country's trade share, the more open its economy is to the benefits of trade (Squalli and Wilson 2011).

Research by Zeren and Ari (2013) indicates that countries incentivized to engage in international trade by exporting goods with a comparative advantage stimulate a long-term production process that fosters positive and sustainable growth and economic development. The following is an overview of export developments in ASEAN countries from 2020 to 2022.

Figure 2. Exports in ASEAN Countries in 2020-2022($)



Source: World Bank, 2024

Based on Figure 2, it can be seen that the value and ratio of exports have increased. Shows that ten countries in the ASEAN region experienced changes in the value of their countries' exports during the 2020-2022 period. During this period, Singapore recorded the highest amount of exports, namely 186,553$ in 2022 compared to other countries. In contrast, Indonesia, Myanmar, and Laos recorded the lowest amount of exports, with Laos having an export ratio of 8,198$ in 2022. On the other hand, Vietnam, Malaysia, and Cambodia showed a relatively stable upward trend compared to other countries. Even though the export ratio looks fluctuating, basically it shows a continuing increasing trend. ASEAN's role in world trade can be seen from

its trade openness which is measured based on the ratio of exports to GDP or trade openness (Purnomo 2020).

Several studies show that macroeconomic variables such as trade openness, foreign direct investment, and exports influence economic growth. (Setiawan, Darmawan, and Marselina 2023); (Purnomo 2020); (Mahfoudh, Alhamshary, and Al Eisa 2018) The results of this research show Trade significantly and profitably enhances the national economy. The ongoing advancements in globalization continue to influence the openness of a country's economy, promoting integration among different regions of the nation. However, Fakhruddin et al., (2023) and Aliedan, (2021) show that Trade openness does not enhance economic growth in the short term; however, it may exert either positive or negative impacts in the long term. Research results (Zardoub and Sboui 2023); and (Zaman et al. 2021) show that foreign direct investment (FDI) significantly positive impact on economic growth. However, (Nadzir and Setyaningrum Kenda, 2023) research findings reveal that, in the long term, foreign investment has a negative and insignificant impact on economic growth. Research results (Natasya and Saputra 2023); (Sayef Bakari, Nissar Fakraoui, and Sofien Tiba, 2019) show that it is implied that each increase in the export variable will drive an increase in the Economic Growth rate in countries. However, (Harahap, Devinda, and Fitra, 2023) the research finding exports do not have a significant impact on economic growth.

Studies regarding the influence of trade openness, Foreign Direct Investment (FDI), and Exports on economic growth are important considering their impact on the economy in ASEAN countries, both in the long and short term. Therefore, this study aims to fill the gap in the literature by using relatively new data in this aspect.

RESEARCH METHODS

This research uses a quantitative approach with a method, namely the Vector Error Correction Model (VECM). The type of data used in this research is secondary data obtained from world banks and UNCTAD statistics for the 2018-2022 period. With the dependent variable, the unit of economic growth uses the gross domestic product (GDP) $), Trade openness is measured by the amount of exports and imports divided by GDP, FDI is measured from net inflow ($), and exports are the independent variable. The dynamic panel model is shown in the formula below:

$GDP = \beta 0 + \beta 1TO + \beta 2FDI + \beta 3EKS + lt$ .....(1)

GDP = Gross domestic product; TO = Trade openness; FDI = Foreign Direct Investment Inflows; EKS = Export; β0 is the constant term, 'T' is the time trend, and 'l' is the error while the regression coefficients, β1, β2, and β3 show how unit changes in the independent variable affect the dependent variable (GDP).

Unit Root Test

As an initial step to achieve stationarity, this study performs unit root tests using the Augmented Dickey-Fuller (ADF) and Philips-Perron (PP) methods. These tests are widely utilized by researchers to determine the presence of unit roots in time series data. The study employs the following procedures to conduct the ADF and PP tests:

$$\Delta Yt = \alpha + \beta t\, yY_{t-1} + x\sum_{i=1}^{m} y\, \Delta Y_{t-I} + \varepsilon_t \quad \text{.....(2)}$$

Where$\Delta Y$is the first level of variable Y to be tested. t is the time trend with parameter coefficients denoted by y and x, symbolizing the stochastic error.$\beta; \varepsilon_t$

Optimal Lag Test

Determining the optimal lag length can be achieved using several criteria, including the Akaike Information Criterion (AIC) and the Schwarz Criterion (SC). The formulas for these criteria are as follows:

$$In\ (AIC) = In \sum ui + \frac{2k/n}{n} \qquad (2)$$

Where ui is the sum of squared residuals, k is the number of independent variables, and n is the number of observations. The criterion that has the smallest LR, AIC, and SC values is the lag used.

Cointegration Test

Cointegration is a combination of linear relationships of non-stationary variables, where all these variables must be integrated to the same order or degree. The cointegration test will be tested with the following equation:

$$Y = C + \beta_1 X_1 + \beta_2 X_{2\ldots\ldots} + + \mathcal{E}\beta_n X_n \qquad (3)$$

Where Y is the dependent variable, X is the independent variable, C is the constant, β is the coefficient of the independent variable, and Ɛ is the residual. If there is no cointegration relationship then analysis using VECM can be carried out. Testing for cointegration can be done using the Johansen test. The hypothesis in the Johannes Cointegration Test method is:

H_0: does not have a cointegration equation
H_1: has a cointegration equation

VECM estimation

After conducting a series of pre-estimation steps, including the data stationarity test, determining the optimal lag length, and performing a cointegration test, the analysis model employed is the Vector Error Correction Model (VECM). The use of VECM estimation is appropriate for the objectives of this research, which aim to identify both short-term and long-term relationships between the independent variables and the dependent variable.

RESULT

The estimation methods used in data processing results with VECM are the unit root test for stationary, optimal lag test, cointegration test, and estimation. This research uses one dependent variable, namely economic growth, and three independent variables, namely trade openness, FDI, and Exports.

Descriptive Analysis

Table 1. Descriptive analysis

Variable	N	Minimum	Maximum	Mean	Std. Deviation
GDP	50	12.01000	1318.180	328.0228	331.8222
TO	50	6.140150	1077.827	82.23332	151.5417
FDI	50	-4950.998	141187.2	174443.36	31114.50
EX	50	5,806000	792.4000	75.74533	114.0450

Based on Table 1 above, it can be seen that descriptive statistics with a sample size of 50. The proxied GDP (economic growth) variable has a minimum value of 12.01000 and a maximum value of 1318.180, the average shows a result of 328.0228

and a standard deviation of 331.8222. The proxied TO (trade openness) variable has a minimum value of 6.140150 and a maximum value of 1077.827, the average shows a result of 82.23332 and a standard deviation of 151.5417. The proxied FDI (foreign direct investment) variable has a minimum value of -4950.998 and a maximum value of 141187.2, the average shows a result of 174443.36 and a standard deviation of 31114.50. The proxied EKS (export) variable has a minimum value of 5.806000 and a maximum value of 792.4000, the average shows a result of 75.74533 and a standard deviation of 114.0450.

Unit Root Test

Table 2. Unit Root Test (Level Variables)

Variable	Augmented dickey-fuller		Philips-perron	
	Statistic test	Prob	Statistic test	Prob
GDP	8.60612	0.9870	8.40691	0.9888
TO	25.4823	0.1836	24.7737	0.2102
FDI	33.8088	0.0274	45.9687	0.0008
EX	25.4075	0.1863	24.7209	0.2123

Table 3. Unit Root Test (First Difference)

Variable	Augmented dickey-fuller		Philips-perron	
	Statistic test	Prob	Statistic test	Prob
GDP	23.5181	0.2641	22.8666	0.2954
TO	17.9725	0.5892	20.0817	0.4528
FDI	26.4765	0.1506	32.4928	0.0383
EX	36.0835	0.0150	19.9279	0.4624

Based on Table 2, the results show that all variables are non-stationary at two lags. This is because the calculated absolute value of the statistical tau (|τ|) does not exceed the critical ADF (or Mackinnon), tau value, which causes the study to fail (or not) to reject the hypothesis (δ=0) that there is a unit root or the time series is not stationary. The same is applied to the Philips-perron test where the calculated absolute value of the statistical tau (|τ|) does not exceed the critical DF tau values (Gujarati, 2004). This research uses two tests for comparison purposes, namely the Philips-Perron (PP) test using a non-parametric approach while the ADF test uses a parametric approach. On the other hand, table 2 shows that all variables become stationary after the first difference as the absolute value calculated tau statistic (|τ|) exceeds the critical ADF (Mackinnon), causing the study to reject the null hypothesis (δ=0). This means that all variables are first-order integrated.

Optimal Lag Test

Table 4. VAR Lag Order Selection

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-758.5539	NA	1.4117	50.83693	51.02375	50.896
1	-558.5031	333.4180	6.6811	38.56688	39.50101	38.8657
2	-538.5949	27.87153*	5.4911*	38.30633*	39.98776	38.8442*

Based on Table 4, it can be seen that the optimal lag length is located at lag 2, namely with sequential modified LR, FPE, AIC, SC, and HQ values the optimal lag is located at lag 2, which can be seen from the most asterisks. Thus the optimal lag recommended is lag 2.

Cointegration Test

Table 5. Cointegration Test

Hyp	Value	T.Stat	Critical.	Prob
1	0.876988	88.14692	29.79707	0.0000
2	0.780072	46.23747	15.49471	0.0000
3	0.549510	15.94840	3.841465	0.0001

From Table 5 above, it can be seen that the test level is 5 percent (0.050. There are three ranks of variables related to cointegration. This can be proven from the trace statistical values of 88.14692, 46.23747, and 15.94840 which are greater than the critical value of 0.05, namely 29.79707 and 3.841465, which means, H0 is rejected and H1 is accepted or in other words, the variables used have a long-term relationship (cointegration) with each other. Therefore, the VECM estimation in this study can be used.

Table 6. Long Term VECM

Variable	Coefficient	Partial T-Statistics
TO(-1)	62.11691	0.59064
FDI(-1)	-0.076487	14.0597
EKS(-1)	-57.04933	-0.54036

Table 7. Short Term VECM

Variable	Coefficient	Partial T-Statistics
CointEq1	-0.012317	-1.80056
D(GDP(-1))	1.460880	-14.0597
D(GDP(-2))	1.575160	2.87837
D(TO(-1))	34.08186	5.36437
D(TO(-2))	27.63900	2.34028
D(FDI(-1))	-1.666694	-9.51938
D(EX(-1))	33.83304	5.27614

From Table 6, it can be explained that in the long term TO at lag 1 has no significant effect on GDP, with a partial t-statistic value of 0.59064. The analysis results show that the TO partial t-statistic value at lag 1 is less than 1.67793 which means, H0 accepted and H1 rejected or in other words, the TO variable has no significant effect on GDP in the long term. In the FDI variable, with a partial t-statistic value of 14.0597, the analysis results show that the FDI t-statistic value at lag 1 is more than1.67793 which means, H0 rejected and H1 accepted or in other words, the FDI variable has a significant effect on GDP in the long term. The EKS variable, with a partial t-statistic value of 0.54036, the analysis results show that the EKS partial t-statistic value at lag 1 is less than1.67793 which means accepted and H1 rejected or in other words, the EKS variable has no significant effect on GDP in the long term.

Based on Table 7, short-term estimates show that GDP itself has a significant effect on lag 1 to lag 2, namely 1.46. This means that if there is an increase in GDP by one point in the previous year, it will increase GDP in the current year by 1.46. The results of the analysis show that the partial t-statistic value of the GDP variable at lag 1 is 1.80056 and *lag*2 of 2.87837 or greater than 1.67793 which meanH0rejected and H1 accepted or in other words, the GDP variable has a significant effect on GDP in the short term. The TO variable, seen from lag 1 and lag 2, shows a positive and significant effect on GDP, namely 34.08 and 27.63. This means that if there is an increase in TO by one point in the previous year, it will increase GDP in the current

year by 34.08 and 27.63 points. The results of the analysis show that the partial t-statistic value of the TO variable at lag 1 and lag 2 is 5.36437 and 2.34028 greater than1.67793which mean H0 rejected and H1 accepted or in other words, the TO variable has a significant effect on GDP in the short term.

The VECM estimation shows that the FDI variable at lag 1 has a negative and significant effect on GDP, namely -1.66. This means that if there is an increase in FDI by one point in the previous year, it will reduce GDP in the current year by -1.66 points. The results of the analysis show that the partial t-statistic value of the FDI variable at lag 1 is -9.51938 or smaller than -1.67793 which means H0rejected and H1 accepted or in other words, the FDI variable has a significant effect on GDP in the short term.

The VECM estimation shows that the EKS variable at lag 1 has a negative and significant effect on GDP, namely -33.8. This means that if there is an increase in EKS by one point in the previous year, it will reduce GDP in the current year by 33.8 points. The results of the analysis show that the partial t-statistic value of the EKS variable at lag 1 is -5.27614 or smaller than -1.67793 which means H0rejected and H1 accepted or in other words, the EKS variable has a significant effect on GDP in the short term.

DISCUSSION

Based on the results of the t-statistical test, it is evident that the three independent variables, namely trade openness, foreign direct investment, and exports, exert an influence on economic growth in the 10 ASEAN countries during the period of 2018-2022. Additionally, the coefficients indicate both positive and negative effects among the independent variables influencing economic growth in these ASEAN countries.

Trade openness has a significant effect on economic growth.

Based on the results of the short-term causality test, it is evident that trade openness (TO) exerts a positive and significant effect on economic growth in ASEAN countries. The partial t-statistic values for the TO variable at lag 1 and lag 2, which are 5.36437 and 2.34028 respectively, surpass the threshold value of 1.67793. These findings suggest that trade openness positively impacts economic growth, aligning with the research conducted by Amala (2015), which emphasizes the close relationship between economic growth and a country's economic openness. According to Amala, international trade plays a vital role in fostering positive and significant economic growth. However, it's noteworthy that in the long term, trade openness does not appear to influence GDP, as indicated by the research conducted by Fakhruddin (2023). Fakhruddin suggests that while economic growth may not directly respond to changes in trade openness over the long term, its short-term impact remains significant.

Foreign Direct Investment (FDI) has a significant effect on economic growth.

Based on the results of the short-term causality test, it is known that foreign direct investment (FDI) has a negative and significant effect on economic growth in ASEAN countriesThe partial t-statistic value of the FDI variable at lag 1 is -9.51938 or smaller than -1.67793. The results of this analysis show that FDI hurts economic growth, based on research Alfaro (2014) stated that not all forms of foreign investment provide benefits for the country, especially investment in natural resources that takes into account certain sectors, needs to consider bureaucratic costs and the economic nature of the host country. However, in the long term, FDI has a positive and significant effect on economic growth in ASEAN countries. Based on research (Abdul et al, 2018; Khamphengvong et al., 2017) There is a one-way relationship between FDI and GDP in developing countries, where FDI significantly influences GDP. For

developed countries, it was found that FDI has a positive influence on economic growth. Runtunuwu (2020) states that the higher a country's economic growth, the higher the level of FDI.

Export does not affect economic growth.

Based on the results of the short-term causality test, it is known that exports have a negative and significant effect on economic growth in ASEAN The partial t-statistic value of the EKS variable at lag 1 is -5.27614 or smaller than -1.67793. The results of this analysis show that exports hurt economic growth, based on research by Harahap et al., (2023)This is possible because data is used from 2018-2022 so that the economies of countries experience negative growth. In the long term, exports do not affect economic growth in ASEAN countries. Based on research by Puspandari et al., (2022) Exports themselves are very influential in changes to economic growth because they can expand domestic production, and efforts are needed to increase export activities.

CONCLUSION

This research aims to analyze the influence of trade openness, foreign direct investment, and exports on economic growth in ASEAN regional countries during the period of 2018-2022. The findings of this study indicate that in the short term, trade openness, foreign direct investment, and exports have an impact on economic growth. However, foreign direct investment and exports exhibit a negative influence on economic growth. Conversely, in the long term, trade openness does not appear to affect economic growth, while foreign direct investment significantly influences economic growth in ASEAN countries. Moreover, exports do not demonstrate a significant effect on economic growth in the long term from 2018 to 2022.

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