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RESEARCH PAPER

Religious Freedom, Foreign Direct Investment, and Economic Growth: Evidence from South Asian Countries

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ABSTRACT

The focus of the current study is to examine the enormous effects of religious freedom and foreign direct investment on economic growth for Pakistan, India, Bangladesh, and Sri Lanka. These effects are captured by investigating classical production functions where religious freedom and foreign direct investment are the major determinants of economic growth. To determine the significance of these determinants, the study examines the panel data from 1990-2016 gleaned from the World Development Indicator (WDI) and International Country Risk Guide (ICRG). The result of the Hausman test reveals the problem of endogeneity; thus, the model was empirically estimated by employing the 2SLS, and the robustness of the results was also confirmed by using the 3SLS methodology. The empirical result revealed that an increase in religious freedom surges economic activity and enhances growth. The coefficient of foreign direct investment indicates that a rise in foreign direct investment is beneficial for growth in the selected economies. These results confirm that economies with religious freedom attract foreign direct investment, boost their economic activity, and consequently, economic growth. Hence, the government should adopt those policies that promote religious freedom and enhance foreign direct investment to achieve sustained economic growth.

Introduction

Currently, differences in the income level across the economies are the primary concern of the economic literature. Some economies witnessed higher economic growth while others on behind the subsistence level. When a country is on the path of economic growth, it is feasible to improve the living standard of its people. The reason is that a rise in economic growth increases the demand for labour, improving individuals' earnings and enabling them to achieve higher utility levels (Carree & Thurik, 2010). There are significant differences in the income level among the different countries. But the question is why some economies grow faster while others remain behind? In observance of the fact mentioned above, it is essential to elaborate on the factors contributing to a country's economic progress.

Solow (1956) emphasized that a higher level of capital stock and abundance of natural resources do not contribute to sustainable economic growth. The logic is that increase in the stock of physical capital reduces its returns. So, the economies with higher capital stock grow slowly while developing countries have faster growth patterns, and

convergence occurs in the level of income. Furthermore, technological improvement considers to be the main factor for economic growth, but it acts exogenously (Bengoa & Sanchez-Robles, 2003).

In contrast to the Solow growth model (1956), a positive trend was observed in the per capita economic growth in different countries, which was attributed to the endogenous change in the relevant variables. Lucas (1988) examined that the accumulation of human capital is essential for long-term economic growth. Barro (1990) emphasized investment in the public sector, while Romer (1990) examined the significance of innovation for sustainable economic growth. Technology diffusion plays a vital role in higher economic growth among countries (Seck, 2012). So, the importance of domestic as well as world technology is very crucial for economic progress. Catch up on technology exist in high-income countries, is significant for developing economies' economic growth.

Furthermore, considering the model of technology diffusion, economic growth depends on the adoption of technology by underdeveloped economies (Parente, 1994). There are many channels through which an economy adopts technological diffusion. Acquisition of human capital and high technological imports are the main contributors that lead to the transmission of ideas in the world. In addition, the flow of foreign direct investment (FDI) is crucial for the diffusion of technology (Dees, 1998).

Multinational companies invest in different economies to obtain higher returns. This investment process in developing countries enhances technology because big companies are accompanied by higher technologies (Bornschier, 1980). In reverse, a rise in foreign direct investment by multinational companies threatens the existence of local companies (Blomstrom and Kokko, 1998). Because of poor economies, firms do not have the resources to compete with larger firms and leave the markets. So, the dominance of foreign firms over domestic firms negatively affects the utilization of domestic resources and, ultimately, economic growth.

Human capital also plays an essential role in fully obtaining the benefits of foreign direct investment on economic growth. Erum et al. (2016) observed that foreign direct investment induces economic growth. But it is essential to enlarge the stock of human capital to enhance economic growth in the long run. Because in low-income countries, the stock of human capital is low, so this is not necessary that foreign direct investment is beneficial for economic Growth (Borensztein et al., 1998). An increase in foreign direct investment enhances human capital stock and ultimately raises economic Growth (Su & Liu, 2016). The inflow of big companies from abroad hurts domestic investors and is the cause of monopoly, which switch the economy towards an inefficient level. So, this study aims to examine the role of foreign direct investment in the acceleration of economic growth for South Asian countries.

Some intangible elements contribute significantly to economic growth and tangible factors such as physical capital, human capital, and technology. New ideas play a significant role in economic progress. Freedom in the thinking of individuals is the basics of human activity. There are different types of constraints that people face in their daily life practices. These constraints are economic, cultural, social, and religious, but the freedom of spiritual matters is the most substantial.

About 84% of the population is related to a different religion (Pew research centre, 2019). The association of religious data revealed that most countries argue that they believe in religious freedom. Still, the data analysis indicates that about 86% of nations have one law to restrict religious activities. About 38% are those which have more than four laws restricting religious activities. The above statistics revealed how different countries prohibit religious activities. When peoples are free in acting their spiritual matters, it affects

their lifestyle, which influences economic Growth (Alon & Chase, 2005). It describes the significance of religion in the economic and social activity of the world. Lower the cost of religious activities attributes to religious freedom.

Romer (1990) identifies the significance of ideas on economic growth. When there is religious freedom in a country, it helps to consensus on those notions beneficial for economic growth. So religious as well as cultural ideas are essential for human capital accumulation and higher economic growth. These things are excluded from the literature because of the difficulty in measuring religious freedom and ethics (North, 2010). Lyer (2010) examined that practical rationality, prudence, and thrift significantly affect economic progress. The reason is that people do not consider it shameful to supply goods for monetary benefits, and such type of behaviour is a cause of productive innovation and hence higher economic growth. Any discrimination based on politics, social or religion leads to inefficiency in the markets and a sub-optimal economic growth level (Weber & Kalberg, 2013).

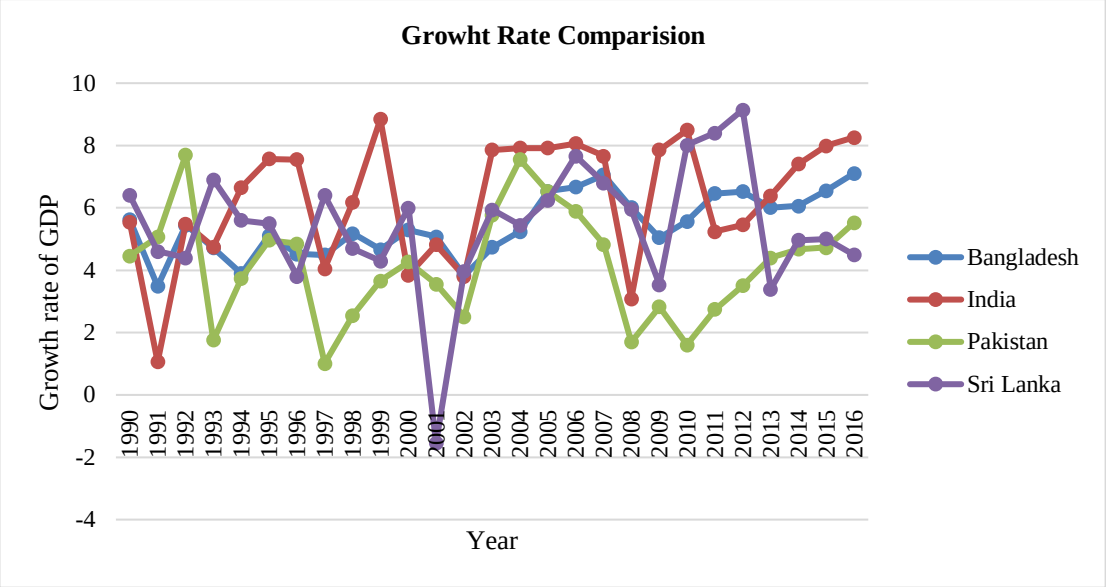

Figure 1: Growht Rate Comparison for the selected countries

The above figure shows that India has the maximum growth rate among the selected south Asian economies, while Sri Lanka is at the bottom compared to GDP growth rates. The reason behind it is that India and Bangladesh are more religion-friendly countries. Religious freedom encourages business and foreign investors to invest in the country, which surges employment and income level.

Moreover, conflicts among the people arise due to differences in religion are increasing. But the economist did not describe that problem in issues related to civil war, but on political grounds, these differences contribute significantly to individual conflicts. These ideas are related to the outcomes of Huntington (2000). The theory explains the significance of cultural dimension in comparison with other explanatory factors for people conflicts. Cultural identity is the main factor influencing individual thoughts. Due to the fracture in the different civilizations, disputes arise among nations. Huntington (2000) assigned religion as a primary factor in world politics. People identify themselves with family, faith, belief, and blood, ready to die for these things.

Based on these differences, crises are emerging among civilizations. Individuals associated with different religions approach differently between God and humanity, groups

and individuals, state and citizens, wife, husband, father and son. People also give additional weightage to their state responsibilities as well as authority and freedom. The difference among civilizations and restrictions on religious activities are the source of conflicts and violence in society. As a result, instability in society severely affects the economic progress in the world.

On the intangible side, an individual's belief is the main factor that affects the activities of people. Changes in individual behavior regarding production and consumption also change economic progress. The significance of religious freedom in the acceleration of economic growth is also to be examined in this study.

The rest of the paper is organized as follows. Section 2 discusses the review of literature on foreign direct investment, religious freedom, and economic growth. Section 3 discusses the material and methods. The results and discussion are in section 4. Section 5 contains the conclusion and policy implications.

Literature Review

Foreign Direct Investment and Economic Growth

Many studies examined the effect of foreign direct investment on economic growth and income distribution to the desirability of technology for multinational companies. But still, it is a controversial topic the effectiveness of foreign direct investment for economic growth. Chenery (1967) examines the effect of foreign assistance on the economic growth of low-income countries. The study results show that the inflow of capital from abroad increases the gross national product but is not sufficient to improve the efficiency of inputs. Long (2020) also observed the positive and significant effect of foreign direct investment and economic growth. Masipa (2018) also observed a positive relationship between foreign direct investment and economic growth.

Borensztein et al. (1998) investigated the relationship between foreign direct investment on economic growth in developing countries. Findings reported that an increase in the inflow of foreign direct investment is a cause of lower economic growth. In contrast, the significance of foreign direct investment is essential for the economic growth of high-income countries. Hayat (2018) observed that the effectiveness of foreign direct investment for economic growth is different for different countries and limited by the extension of natural resources. High-income countries use natural resources extensively, and foreign direct investment-induced economic growth is limited. While the countries lie in the middle- and low-income groups fully absorbed the benefits of foreign direct investment for economic growth. So, the effectiveness of foreign direct investment for economic growth is more in low and middle-income countries than in high-income countries (Ozturk, 2016).

Szkorupova (2014) conducted a study to examine the causality of foreign direct investment and exports to the economic growth of Slovakia. The study results revealed that the inflow of foreign direct investment and higher exports positively affect economic growth. Okodua (2009) observed the relationship between foreign direct investment and economic growth in Nigeria. The results revealed that unidirectional causality exists between foreign direct investment and economic growth in the long run. An increase in foreign direct investment leads to higher economic growth. The reason is that capital inflow improves the stock of human capital (Fassio et al. 2020).

Furthermore, Nguyen (2020) conducted a study to check the significance of foreign direct investment and international trade for economic growth in Vietnam. The results revealed that foreign direct investment is beneficial for economic growth. Le et al. (2021)

observed that foreign direct investment has no significant effect on economic growth in Vietnam. Lack of human capital and poor infrastructure are the main constraints to absorbing the benefits of foreign direct investment fully.

A rise in human capital improves the productivity of inputs and enhances economic growth. In the short run, bidirectional causality was observed in African countries (Seyoum *et al.*, 2015). When foreign direct investment increases, it enhances economic growth, while higher economic growth leads to increased foreign direct investment. Nantharath and Kang (2019) conducted a study to check the effect of foreign direct investment on economic growth in the Lao People's democratic republic. The results revealed that foreign direct investment enhances economic growth. Infrastructure improvement, human capital and quality of institutions attract foreign direct investment.

Wu et al. (2020) examined the effect of foreign direct investment (FDI) on economic growth in China and observed a U shape relationship between FDI and Economic Growth. The reason is that when a country faces a budget deficit, then an increase in budget deficit crowds out foreign direct investment (Lau & Yip. 2019). The results revealed that foreign direct investment ambiguous effect on economic growth. The role of international trade is also significant to check the impact of foreign direct investment on economic growth. Balasubramanyam et al. (1996) found that more open economies benefit mainly from foreign direct investment in economic growth than closed economies. The reason is that trade openness makes efficient use of resources and promotes economic growth. Were (2015) observed that trade liberalization promotes economic growth in high-income economies but negatively affects low-income countries' economic growth.

In conclusion, there is an ambiguous effect of foreign direct investment on economic growth. Some studies favour the inflow of foreign direct investment. On the other hand, some studies tend to restrict the influx of physical capital from abroad. So, this study focuses on examining the effect of foreign direct investment in South Asian countries.

Religious Freedom and Economic Growth

Existing literature ignored the significance of religious freedom for economic growth. A few studies (Barro 1996; Alon & chase, 2005; Barro & McCleary, 2003; Grim *et al.,*2014) examined the relationship between religious freedom's effectiveness on economics. These studies observed that privilege, such as religious or political, promotes economic growth. They argue that religious freedom correlates closely with economic, civic, and political freedom, which established the roots of democracy and enhanced economic growth.

There are different reasons for the effectiveness of religious freedom for economic growth. The rent-seeking approach describes that religious groups use their resources to gain the support of political groups. This activity increases the social cost and determent economic growth due to the wastage of scarce resources. Religious conflicts also affect the accumulation of human capital (Justino, 2011). A rise in conflicts reduces communication among people and diminishes the stock of knowledge. It means that lower communication decreases the diffusion of knowledge and exchange of ideas, which reduces economic Growth (Haftu, 2019).

Alon *et al.* (2017) examined the consequences of religious freedom on economic growth and concluded the inconclusive relationship between religious freedom and economic growth. religious freedom is considered the main ingredient of peace, reducing uncertainty about businesses' outcomes (Jeong, 2017). A change in the industry's consequences affects investment decisions. Religious tension raises conflicts among

individuals (Helgen, 2020). A country with disputes is not capable of attracting investors (Mikesell, 2013).

Dolansky and Alon (2008) observed that the investors are very sensitive to religious conflicts, while the developing economies try to attract capital inflow by enhancing economic growth. Hence, to attract capital inflow to their country, they need to remove the religious conflicts (Perkins, 2020). Developing countries face different religious problems and disputes arising in these countries (Basedau et al., 2016). An increase in conflicts limits the scope of foreign direct investment in these countries. So higher conflicts lead to poor foreign direct investment and drag down economic growth.

Some studies believe that religious freedom hurts economic activity. Institutional theory predicts that religious freedom hurts economic activity in a country with a lower legal framework (North, 1989). When there is no proper legal framework to promote religious freedom, religious activities promote conflicts and dangerous economic conditions.

In conclusion, religious restrictions hurt economic activity in developed countries. But the results of lower-income economies are ambiguous. The reason is that where the legal framework does not promote religious freedom, restrictions on religious activities benefit economic growth. So, this study focuses on examining the effect of religious liberty on economic growth in South Asian economies. To test the hypothesis that religious tensions and foreign direct investment both effects economic growth, the study investigated the panel data of four (04) South Asian countries, including Pakistan, India, Bangladesh, and Sri Lanka, from 1990 to 2016.

Material and Methods

This section explains the model specification, variables and data, and econometric method in following sub-sections.

Model Specification

The study uses the model specification broadly employed by others (Alfaro et al., 2004; Durham, 2004; Azman-Saini et al., 2010), where foreign direct investment is the primary determinant of economic growth. Thus, the production function can be written as,

$$GDPG = f(RT, FDIIN, CPI, TRGDP) \quad (1)$$

Hence, the above production function can be written in the econometrics form as in the following equation. Where the fundamental variables of interest are the religious tensions and the foreign direct investment for the selected countries i at time t as,

$$GDPG_{it} = \alpha_0 + \alpha_1 RT_{it} + \alpha_2 FDIIN_{it} + \alpha_3 CPI_{it} + \alpha_4 TRGDP_{it} + u_{it} \quad (2)$$

Where GDPG is the real GDP growth rate, RT is the religious tensions (an index value taken from International Country Risk Guide (ICRG)), FDIIN (indicates foreign direct investment), CPI measures inflation, and TRGDP shows the trade as a percentage of GDP. The impact of all other remaining determinants of growth is captured in u, the error term. The variable RT and CPI are taken in logarithm form to stabilize variance and make a smooth estimation, so extreme values do not influence the respective coefficients.

Variables and Data

The panel data is helpful to explain the variation over time and across all the selected countries. The selected variables are listed in following table 1, and table 2

depicted their summary statistics. The data set is taken from the world development indicator (The world bank) and International Country Risk Guide (ICRG).

Table 1
Variable Description

Variable	Description
GDPG	The annual growth rate of GDP
RT	Log of religious tensions index (0: highest tension, 4: lower tension)
FDIIN	Foreign direct investment inflow (% of GDP)
LCPI	Consumer price index, used as a measure of inflation
TRGDP	Trade (% of GDP)

The above table depicted the variable description and their construction. The important is the values of religious tension where the lowest value of the index indicates the high religious conflicts and vice versa.

Table 2
Summary Statistics of the Panel Data, 1990-2016

Variable	Obs.	Mean	Std. Dev.	Min	Max
GDPG	108	5.33	1.87	-1.55	9.14
RT	108	2.34	0.98	1.00	4.00
DIIN	108	1.04	0.75	0.00	3.67
LCPI	108	4.06	0.61	2.67	5.05
TRGDP	108	42.07	18.43	15.51	88.64

The GDP growth is the dependent variable, and it is reflecting the speed of economic prosperity. It is calculated as the growth rate of real GDP. The sole determinant of economic growth is foreign direct investment (Alfaro et al., 2004; Azman-Saini & Law, 2010). Furthermore, religious tensions are the cause of instability in the country. Religious tensions also create other problems like law-order conditions and political instability, increasing the country's risk. Similarly, the increase in country risk, the higher the probability of decreasing the foreign direct investment. Consequently, religious tensions determine foreign direct investment and, ultimately, economic Growth (Rafat & Farahani, 2019).

Econometric Methodology

The above equations were estimated by employing instrumental variable (IV) regression methodologies two-stage least squares (2SLS) and three stages least squares (3SLS). The problem of endogeneity was in the data detected by using the Hausman (1978) test, and the result indicates that endogeneity is presented in the selected data. Furthermore, following Greene (2008) and Baum et al. (2003), an instrumental variable approach is suitable for analysis.

Results and Discussion

The stationarity was also checked by employing the panel unit root test, and the results are depicted in table 3. The panel unit root results indicate that all selected variables are stable.

Table 3
Panel Unit Root Results

Variable	Test Statistics	p-value
GDPG	-3.016***	0.001
RT	-2.143**	0.016
FDIIN	-2.894***	0.001
LCPI	-2.247*	0.012
TRGDP	-2.074**	0.019

Note: P-values indicate that all variables are statistically stable. ***, ** and * indicates significant at 1%, 5% and 10% level of significance based on P-statistics

Further, the regression results of the 2SLS methodology are reported in column 1 of Table 4, and column 2 of the same table indicates the result of the 3SLS methods based on the baseline model presented by equation 1. The estimated values of the coefficient and their respected z-stat values are provided in table 4. The overall performance of the economic growth determinants is entirely satisfied with a computed F-value, which far exceeded the critical F-value at a 5 per cent significance level. The study only explains the regression results of the 2SLS methodology; the coefficient signs and values are almost like 3SLS.

Table 4
Regression Results: Economic Growth is a Dependent Variable.

Variable	2SLS	3SLS
Constant	1.526	3.730***
	(1.15)	(7.12)
RT	2.119**	1.369***
	(2.40)	(3.48)
FDIIN	0.542*	0.436*
	(1.76)	(1.65)
LCPI	0.636**	0.009**
	(2.11)	(2.21)
TRGDP	-0.021	-0.013
	(-1.37)	(-1.16)
No. Observation	108	108
Wald (F-stat)	53.23	
First stage (F-stat)	26.713	
Hausman test (p-value)	0.340	

Note: z stat values reported in parentheses, statistical significance at the 10%, 5% and 1% levels are indicated by *, ** and *** respectively. Hausman test is used to check the endogeneity.

Table 5
Hypothesis Remarks

Hypothesis	Path	Proposed	Results
H1	RT → GDPG	Positive	+ Valid
H2	FDIIN → GDPG	Positive	+ Valid

Our regression results are grouped into one category, explaining the impact of religious tensions and foreign direct investment on economic growth. The model's overall performance is satisfactory, with the coefficients correctly signed and three of the four explanatory variables statistically significant. The result in the table is mainly consistent with our expectations.

As discussed above, religious tensions and foreign direct investment are the sole determinants of economic growth. So, the coefficient value of religious tensions is positive and statistically significant at a 5% significance level. It indicated that a decrease in religious tensions would increase economic activity and growth. Lessening religious tensions ensures the law & order condition and smooth economic activity, increasing growth and encouraging foreign investment. The reason behind it is that as the economies promote religious freedom, it creates business trust, increases investment, and generates employment. These results are in line with Busse (2004), Alon and Chase (2005), and Rafat and Farahani (2019). All these researchers observed that religious freedom promotes economic growth.

The foreign direct investment coefficient value is also positive and statistically significant at a 10% significance level. It indicates that there is a positive relationship between foreign direct investment and economic growth. It is a desirable form of capital inflow to emerging and developing countries because such investment is less susceptible to crises and sudden stops. The increase in foreign investment inflow will increase the business activity in different sectors of the economy. It will increase the employment and then income level of the workers and increase both consumption and further investment. This result is expected, given the vital importance of foreign investment to business facilitation and overall economic development. These results are in line with Alfaro et al. (2004), Marwah and Tavakoli (2004), Chakraborty and Nunnenkamp (2008), and Wang (2009).

Mild inflation works as a lubricant for economic growth, and the coefficient value of our results confirms this relationship. Its value is positive and statistically significant at a 5% level of significance and indicates that a 1% increase in inflation will boost the growth by 0.67%. The mild inflation encourages the investor to invest in different projects and increase their profits. The increase in investment will increase employment, income and investment and consumption. These results are in line with Vinayagathasan (2013).

The coefficient value of trade is negative but insignificant. So, in our case, trade is not playing any role in the growth. These results are in line with Were (2015), Kim (2011), and Musila and Yiheyis (2015). The study results are robust, the sign of the coefficients is the same, and their significance level is also similar in both above results (2SLS & 3SLS).

The study used three different tests to check the model's creditability. Wald (F-stat) test, one of the three tests, is used to check the overall goodness of fit of the model. The statistics indicate that the model fits, and all the selected variables explain most economic growth variations. The second test, First-stage (F-stat), is used to check the strength of the included instruments. As the rule of thumb that if its value is less than 10, then the instrument is weak (Stock *et al.,* 2002), but, in our case, its value is 26.7. Hence, the study used robust instruments (religious freedom and foreign direct investment) to determine economic growth. The presence of endogeneity is observed through the Hausman test for endogeneity. The p-value did not accept the alternative hypothesis. i.e. no evidence was found for the endogeneity, and the variables are exogenous.

Conclusion and Policy Implications

The study investigates the relationship between religious tensions, foreign direct investment, and economic growth. Both religious freedom and foreign direct investment are essential for economic prosperity. The result of the study provides empirical support for this existing relationship and an important direction for future prospective. The results indicated that religious freedom is the lubricant for growth, and higher religious tensions act as sand for economic prosperity. Similarly, the role of foreign direct investment cannot

be neglected for economic growth. There is also a positive relationship between foreign direct investment and economic growth.

The findings of the current study are parallel to earlier findings of Busse (2004), Wang (2009), and Rafat and Farahani (2019). The other essential variables under this investigation are inflation and international trade. Inflation is positively and significantly related to economic growth while global trade is not (Kim, 2011; Were, 2015).

Based on the above empirical results, the following policy implication is suggested. The positive coefficient of religious tensions indicates that religious freedom plays a vital role in sustainable economic growth. In this context, the government should promote religious freedom so that all the citizens can perform their religious activities freely according to their norms. It will reduce internal conflict and improve the law & order conditions that boost economic growth. The positive and significant coefficient of foreign direct investment suggests that more FDI will enhance economic growth. So, the policymakers should adopt those policies that will encourage foreign investors.

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