



Are Business Regulations Improving Economic Growth? Case Study between ASEAN and European Union

Karuniana Dianta A. Sebayang¹, **Belinda Febrina**²

¹ Universitas Negeri Jakarta, Indonesia

² Universitas Negeri Jakarta, Indonesia

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Abstract

Economic activities require a transparent regulatory and policy environment that is accessible to all levels of society. This study aims to explain the impact of ease of doing business on economic growth in both ASEAN and the European Union since doing business indicators applied globally. Gross Domestic Product is used as a proxy variable for economic growth as Gross Domestic Product is an indicator to measure economic growth. This study uses a descriptive quantitative research model and uses multiple regressions to determine the effect of ease of doing business on economic growth in ASEAN and the European Union by comparing the result of each ASEAN and European Union. In this study it was found that in ASEAN, there are four indicators of doing business have significant impact to economic growth, while in the European Union five indicators have significant impact to economic growth.

Abstrak

Aktivitas perekonomian memerlukan lingkungan regulasi dan kebijakan yang transparan yang dapat diakses oleh semua lapisan masyarakat. Penelitian ini bertujuan untuk menjelaskan dampak dari kemudahan berusaha terhadap pertumbuhan ekonomi baik di ASEAN maupun Uni Eropa mengingat bahwa indikator kemudahan berusaha berlaku secara global. Produk Domestik Bruto digunakan sebagai variabel proksi untuk pertumbuhan ekonomi sebagaimana Produk Domestik Bruto adalah salah satu indikator untuk mengukur pertumbuhan ekonomi. Penelitian ini menggunakan model penelitian kuantitatif deskriptif dan menggunakan regresi berganda untuk mengetahui pengaruh kemudahan berusaha terhadap pertumbuhan ekonomi di ASEAN dan Uni Eropa dengan membandingkan kedua hasil pada dua organisasi regional tersebut. Pada penelitian ini ditemukan bahwa di ASEAN, terdapat empat indikator kemudahan berusaha yang berpengaruh signifikan, sedangkan di Uni Eropa terdapat lima indikator yang berpengaruh signifikan terhadap pertumbuhan ekonomi.

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* Corresponding Author.

dianta@unj.ac.id. Karuniana Dianta A. Sebayang

INTRODUCTION

The importance of private sectors and good business' environment in economic growth and economic development has been studied in many literatures. Entrepreneurial activity is a support for economic growth. The entry of new firms into an economy creates jobs that contribute to the development of the private sector and economic growth. Government puts enough concern with the aim to increase the score and rank of Ease of Doing Business Index, thus later will accelerate and facilitate investment inflows thus later affect economic growth. To uphold private sector growth, many economies have aimed of simplifying the business registration process. By simplifying regulations, no doubt that governments hope it will ease the business actors in order to establish or maintain their businesses.

The business regulatory index and growth are consistently positively correlated. Countries with less burdensome business regulations are growing faster. In his research, Djankov included a variable for each quartile business regulatory index in the OLS regression. The results showed that business regulation increased from the quartile (First) to best (fourth) shows an increase in the average annual growth of 2.3 percent (Djankov, McLiesh, & Ramalho, 2006).

Simplification of regulations encourages the formation and development of new businesses. However, it turns out that regulatory simplification is not sufficient to support economic growth. Although the formation of new businesses and entrepreneurial activities have a positive impact on production efficiency, the formation of businesses is not sufficient to promote economic growth. New businesses that are formed must be directed at sectors that encourage technological innovation and also have the aim of developing into large businesses (Rico & Cabrer-Borras, 2019).

In terms of new businesses formation, entrepreneurship is essential in the economy. The benefits to society can be far greater if entrepreneurs are able to operate flexibly and be able to develop their ideas. In order to attract productive entrepreneurs, the government needs to simplify regulations (Kritikos, 2014). In order to increase economic growth in a country, new businesses formation plays an important role. The formation of new businesses has an effect on economic growth by helping to absorb labour. For example, in the United States in 2007, new businesses accounted for nearly two-thirds of the workforce. This reflects that new companies and the entrepreneurs who form them are a factor in job creation and economic recovery (Stangler & Litan, 2009).

Businesses that continue to develop and innovate encourage economic growth and employment, both of which will improve people's welfare. Stable economic growth created through innovation plays an important role in increasing per capita income. Small changes to economic growth will have a large impact on per capita income over time (Ahlstrom, 2017). However, it does not mean that the formation of many new businesses will encourage economic growth. Only business activities with the potential to develop rapidly have a significant impact on economic growth. New fast-growing enterprises -not new ones in general- that play an important role in creating jobs through small and medium enterprises in developed countries (Wong, Ho, & Autio, 2005). Tristan Canare found that the ease of doing business' indicators those roles the most in firm creation overall in 120 countries are starting a business and paying taxes. Thus with more firm established, will affect to increase of economic growth (Canare, 2018).

In terms of measuring how simple and effective are the business regulations, World Bank had launched a publication since 2004 titled Doing Business. Doing Business is the project of World Bank that focused on measuring how effective are the business regulations and its enforcement to domestic business among 190 countries and chosen cities in the world. Doing business elaborates economic to be more competitive and more efficient; providing measured indicators for reformation; as well as source for academicians, journalist, private sectors' actors, and those who interested to economics (World Bank, 2017).

Messaoud and Teheni investigated the impact of business regulations to economic growth in 162 countries from 2007 to 2011 by using ten indicators of doing business. The result provided in this research is that there is robust link between business regulations and economic growth, except for trading across border and dealing with construction permit. Most regulations are positively

correlated to growth rate but as well as have a negative effect to economic growth through substantial cost and undesirable distortions (Messaoud & Teheni, 2014).

The study by Ani examines the effect of ease of doing business on economic growth in selected economies in Asia in 2014. This study covered 29 economies in Southeast Asia, East Asia, and South Asia. The indicator for doing business were the ten Doing Business Indicators provided by World Bank, while Gross Domestic Products is used as the indicator for economic growth. This study has conducted multiple regression analysis. Construction permit, getting credit, registering property, and trading across border have statistically significant coefficients in which dealing with construction permit and getting credit affected GDP negatively while registering property and trading across border affected GDP positively (Ani, 2015).

Haidar examines the impact of corporate regulatory reform on economic growth. It studied the relationship between corporate regulatory reform and economic growth in 172 countries over the five years from 2006 to 2010. The analysis uses data on microeconomic reforms obtained from various sources such as the World Bank's Doing Business report, indicators of world development. The dependent variable is the growth rate of GDP per capita, while the main explanatory variable is the total number of reforms in each country during the period covered. Ten separate regressions were performed using the number of reforms in each regulatory reform category as the main explanatory variable. The findings provide strong enough evidence of the significant and sizeable positive impact of corporate regulatory reforms on economic growth (Haidar, 2012).

The impact of doing business in Africa has been investigated in a research by Bonga and Mahuni which conducted panel data regression by dividing countries into three groups according to the GDP and the period from 2010–2016. This study implies that trading across border, getting credit, registering property, dealing with construction permit, and starting a business affect economic growth of Africa Free Trade Zone (AFTA) member countries. According to this results, Bonga and Mahuni suggest each member country to pay attention to affecting variables that have been identified to boost economic growth in AFTA (Bonga & Mahuni, 2018).

The relationship between business environment in Middle East and North Africa (MENA) countries has been studied by Razavi et al in 2017, measuring business environment by using doing business indicators. The result suggests that there is a positive and significant impact of business environment to economic growth in MENA countries, with enforcing contracts impacts more than others. But since regression results on some individual indicators of doing business differ, these suggest that we cannot rely on individual indicators of doing business to see their impact to economic growth (Razavi, Padash, & Nesbati, 2017).

There is a correlation between doing business index with economic growth. The framework can be formulated as seen in Figure 1. Based on the design of the model, the proposed hypotheses are:

$H_0 = \beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = \beta_6 = \beta_7 = \beta_8 = \beta_9 = \beta_{10} = 0$, means that the value of doing business indicators which consist of starting a business, dealing with construction permit, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across border, enforcing contracts, and resolving insolvency partially does not have a significant impact to economic growth.

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Those 190 countries in this world are divided into several organization, especially regional organizations due to their location. By the establishment of these regional organizations, it puts lots of hopes to do a cooperation, thus will support progress of the member countries. There are two regional organizations as well as economic organizations in this world, namely ASEAN and European Union. European Union and ASEAN have a lot of different characteristics and each of them has their own problems as well as obstacles. Most of ASEAN's member countries are

developing countries with one developed country, Singapore. When on the other hand, European Union's member countries consists of several developed countries such as France, Netherlands, Germany, etc. other than that, ASEAN and European Union also have different geographic which could be one of the factors those affect economic condition in both regional organizations.

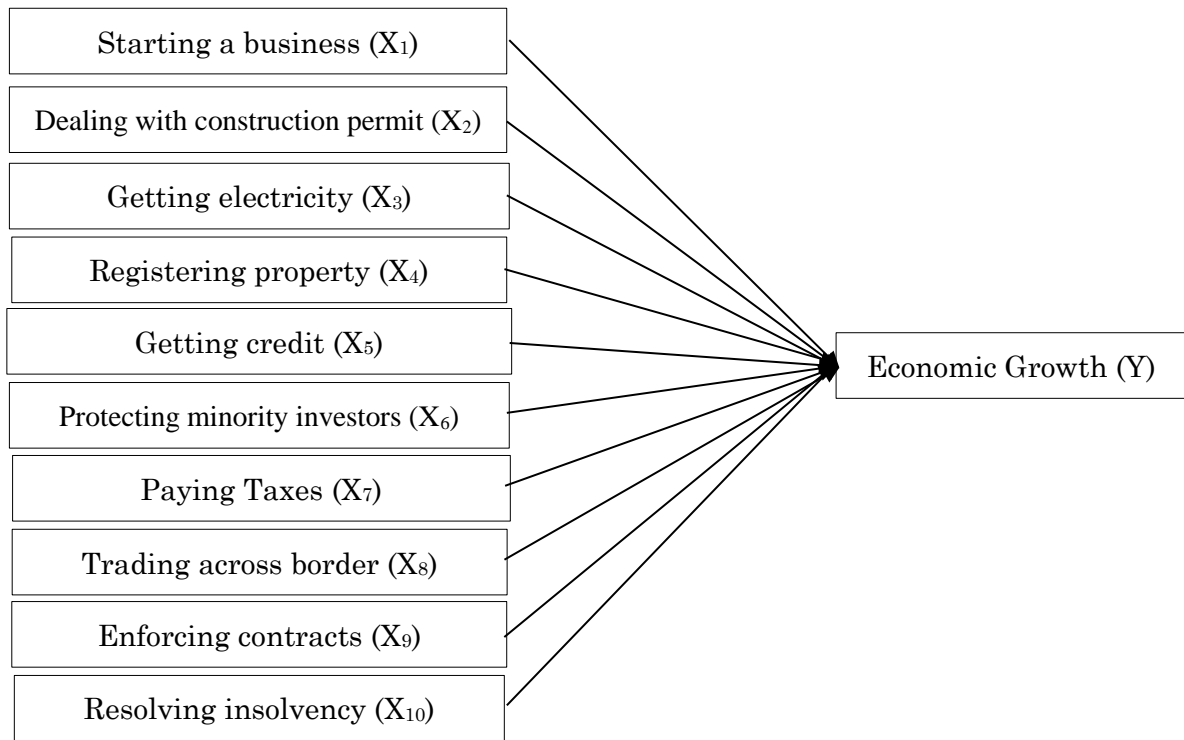


Figure 1. Conceptual Framework

In ASEAN 2019, compared to other economies, the best regulatory performance in terms of starting a business was Singapore (98,23); in terms of dealing with construction permit was Malaysia (86,96); in terms of getting electricity was Malaysia (99,27), in terms of registering property was Singapore (83,14); in terms of getting credit was Brunei (100); in terms of protecting minority investors was Malaysia (81,67); in terms of paying taxes was Singapore (91,58); in terms of trading across border was Singapore (89,57); in terms of enforcing contracts was Singapore (84,53); in terms of resolving insolvency was Thailand (76,64). In ASEAN, Singapore has favorable entrepreneurial ecosystem and ranked first as the most innovative cities in Asia Pacific (Rosenberg & Polland, 2013). Singapore of ten ranked as one of the easiest countries in the world in which to do business as well (Scott, 2015).

In European Union 2019, compared to other economies, the best regulatory performance in terms of starting a business was Ireland (95,91); in terms of dealing with construction permit was Denmark (86,94); in terms of getting electricity was Germany (98,79); in terms of registering property was Lithuania (92,96); in terms of getting credit was Latvia (85); in terms of protecting minority investors was Ireland (75); in terms of paying taxes was Ireland (94,46); in terms of trading across border were Netherlands (100), Belgium (100), Luxembourg (100), Denmark (100), Portugal (100), Austria (100), Italy (100), Czech Republic (100), Hungary (100), France (100), Poland (100), Slovenia (100), Slovakia (100), Romania (100), and Croatia (100); in terms of enforcing contracts was Lithuania (78,8); in terms of resolving insolvency was Finland (92,81).

ASEAN member countries unite as a single community known as ASEAN Economic Community (AEC). The AEC is the realisation of the ASEAN's end goal of economic integration. It envisions ASEAN as a single market and production base, a highly competitive region, with equitable economic development, and fully integrated into the global economy (ASEAN, 2020), and so does community in European Union, unity as one known as European Economic Community. So,

for the integration on the same business environment it is an important point.

With those considerations mentioned above, there are differences in doing business in both regional organizations. Of course, there are differences in indicators which determine economic growth in ASEAN as well as European Union. Research about impact of doing business to economic growth has been widely conducted. However, this research used panel data from member countries of two regional organizations namely ASEAN and European Union which has 37 countries in total.

The objectives of the studies are to know how much is the effect of Ease of Doing Business' Indicators to economic growth in both ASEAN and European Union during 2015 to 2019, as well as to know the differences between ASEAN and European Union which indicators of Doing Business those affect them a lot. Several variables were used in this study which are indicators of doing business consists of: starting a business, dealing with construction permit, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across border, enforcing contracts, and resolving insolvency; as well as Gross Domestic Product as the proxy variable for economic growth from 37 countries in ASEAN and European Union. In addition, data for all variables were obtained from the World Bank from 2015 to 2019.

This study uses the panel data regression method to determine how much influence each indicator of ease of doing business has on economic growth by comparing ASEAN and the European Union in order to see the difference in indicators that affect economic growth in these two regional organizations. The results of this study can be used as material for consideration in improving policies that can boost economic growth, especially in ASEAN and the European Union. Since indicators in Doing Business applies globally, it is useful for policy makers in countries in both ASEAN and European Union, including Indonesia as one of them to considering crucial indicators which affect economic growth in order to set policies related to business creation.

METHOD

The researchers analysed the impact of doing business to economic growth both in ASEAN and European Union. This study used panel data from 37 countries; which ten countries from ASEAN and 27 countries from European Union. Furthermore, the variables were indicators of doing business which are starting a business, dealing with construction permit, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across border, enforcing contracts, and resolving insolvency as independent variables. Meanwhile economic growth was the dependent variable with Gross Domestic Product as the proxy. The data used were from 2015 to 2019.

Panel regression equation were performed using Generalized Least Square (GLS) method. The equation of the panel regression can be written as follows:

$$EG_{it} = \alpha + \alpha_1 SB_{it} + \alpha_2 CP_{it} + \alpha_3 GE_{it} + \alpha_4 RP_{it} + \alpha_5 GC_{it} + \alpha_6 PI_{it} + \alpha_7 PT_{it} + \alpha_8 TAB_{it} + \alpha_9 EC_{it} + \alpha_{10} RI_{it} + \varepsilon \dots \dots \dots (1)$$

EG is the economic growth proxied by Gross Domestic Product in each country. SB is starting a business, CP is dealing with construction permit, GE is getting electricity, RP is registering property, GC s getting credit, PI is protecting minority investors, PT is paying taxes, TAB is trading across border, EC is enforcing contracts, and RI is resolving insolvency. All of the independent variables are taken from score of doing business indicators. Furthermore, α is a Constanta, α_1 α_2 α_3 ... α_{10} are the coefficient estimate, ε is the error term, i is the country both in ASEAN or European Union, and t is the time period.

Generally, there are two models used in GLS method, Fixed Effect Model and Random Effect Model (REM) (Clark & Linzer, 2015). The Common Effect Model or what is also known as Pooled Least Square is deemed not suitable for the purpose of using panel data. This is because the Pooled Least Square cannot distinguish between different observations in the same period, or cannot distinguish between the same observations in different periods so that the resulting parameters will

be biased (Firdaus, 2020).

To determine which model is better to be used, a test is necessarily conducted. Hausman test a test for choosing between FEM or REM and it is conducted by looking at the hypothesis. If the random cross-section is less than 0.05, then it is better to use FEM, and vice versa. REM is used when the random cross-section is greater than 0.05.

Generally, this study has conducted several steps for data analysis, namely: (1) describing each of research variables; (2) selecting the panel data model through Hausman Test; (3) testing the panel data model; (4) analysis of estimates; (5) interpreting the estimation results; and (6) discussion.

RESULTS AND DISCUSSION

From the test results for selecting the panel regression model through the Hausman test, the Fixed Effect Model (FEM) was the best from the Random Effect Model (REM) for European Union data. Shown in table 1 that the cross-section F value was less than 0.05. Likewise, the random cross-section value was less than 0.05. This means that the FEM model was better than REM.

Table 1. Hausman test for European Union

Test Summary	Chi-Sq. Statistic	Chi-Sq. d. f.	Prob.
Cross-section random	27.656781	10	0.0020

Meanwhile for ASEAN, the best model was Fixed Effect Model since the Random Effect requires numbers of observations should be greater than numbers of independent variables. Numbers of observations for ASEAN is ten with ten independent variables. Due to that reason, Hausman test cannot be conducted.

Table 2. Result of independent and dependent variable

Variables	ASEAN			European Union		
	Coefficient	t-stat	p-value	Coefficient	t-stat	p-value
Constant	1.793526	2.541110	0.0155	2.729501	8.305682	0.0000
SB	0.000286	0.041038	0.9675	-0.007168	-3.14931	0.0022
CP	-0.000321	-0.028154	0.9777	-0.000950	-0.80889	0.4205
GE	0.011454	1.412585	0.1664	0.002487	2.521034	0.0133
RP	-0.018545	2.463934	0.0187	-0.003134	-2.205157	0.0298
GC	0.030309	-3.473879	0.0014	0.002534	2.369557	0.0198
PI	0.023084	1.947880	0.0593	0.001742	1.132237	0.2603
PT	-0.031175	-4.210971	0.0002	9.97E-05	0.078780	0.9374
TAB	-0.012204	-1.591356	0.1203	0.002675	4.228648	0.0001
EC	-0.006507	-0.857807	0.3967	-0.002002	-1.966824	0.0520
RI	0.015099	1.827272	0.0760	-0.000930	-0.771522	0.4423
R ²	0.781362			0.997840		
Adjusted R ²	0.720629			0.997047		
Prob (F-Stat)	0.000000			0.000000		

Table 2 showed that registering property has a negative and significant effect to economic growth in ASEAN, the estimated value was -0.018545 significant at 5 percent, then H₁ was accepted and H₀ was rejected. It means that each increase in registering property score will decrease economic growth by 1.85 percent. Getting credit has a positive and significant effect to economic growth in ASEAN, the estimated value was 0.030309 significant at 1 percent, then H₁ was accepted and H₀ was rejected. It means that each increase in getting credit score will increase economic growth by 3.03 percent. Paying taxes has a negative and significant effect to economic growth in ASEAN, the estimated value was -0.031175 significant at 1 percent, then H₁ was accepted and H₀ was rejected.

It means that each increase in paying taxes score will decrease economic growth by 3.12 percent. Furthermore, other variables such as starting a business, dealing with construction permit, getting electricity, protecting minority investors, trading across border, enforcing contracts, and resolving insolvency have no effect to economic growth in ASEAN since they have probability value more than 0.05, then H_1 was rejected and H_0 was accepted.

Overall, in ASEAN all of the doing business indicators have significant effect to economic growth in ASEAN evidenced by the F-stat value of 0.000. Adjusted R² of 0.720629 indicates that economic growth in ASEAN can be explained by ten indicators of doing business by 72 percent, the other 28 percent can be explained by other factors outside this research.

The result showed that paying taxes impacts economic growth. This is in line with the research of Canare which stated that the indicators that impact firms creation the most are starting a business and paying taxes (Canare, 2018). The test results also showed that paying taxes affects economic growth negatively. The government of each country requires income in order to finance social infrastructure such as education, health, and so on. However, the challenge is to choose carefully the tax rate and tax base. The government also needs to design a taxation system that makes it easier for taxpayers to pay. Companies in the economy with a better Doing Business score on the Paying Taxes indicator tend to pay lower taxes and tax administration is much easier (World Bank, 2018). ASEAN is dominated by developing countries, where state revenues still have a high dependence on corporate income tax. If the tax rate is reduced but not accompanied by an increase in the number of companies or foreign direct investment, then this will have an impact on reducing government revenue. As stated by Canare that starting a business and paying taxes may impact economic growth if followed by establishment of new firms (Canare, 2018).

Meanwhile in European Union, starting a business has a negative and significant effect to economic growth in European Union, the estimated value was -0.007168 significant at 1 percent, then H_1 was accepted and H_0 was rejected. It means that each increase in starting a business score will decrease economic growth by 0.72 percent. Getting electricity has a positive and significant effect to economic growth in European Union, the estimated value was 0.002487 significant at 5 percent, then H_1 was accepted and H_0 was rejected. It means that each increase in getting electricity score will increase economic growth by 0.25 percent. Registering property has a negative and significant effect to economic growth in European Union, the estimated value was -0.003134 significant at 5 percent, then H_1 was accepted and H_0 was rejected. It means that each increase in registering property score will decrease economic growth by 0.31 percent.

The test results showed that getting credit affects economic growth both in ASEAN and European Union. This finding is supported by several previous studies and in line with the research by Bonga and Mahuni which implies that trading across border, getting credit, registering property, dealing with construction permit, and starting a business affect economic growth. Banking credit, especially for the private sector, has a positive impact on Gross Domestic Product (Emecheta & Ibe, 2014). Banking credit has an important role in the growth of the manufacturing industry, the real sector, small and medium enterprises, and total economic growth. With the growth in the industry, it will have an impact on increasing economic growth (Fithriyah & Malik, 2008). Credit will have a big impact if it is allocated to a productive sector (Orimogunje, 2019). There are two important points that are considered in measuring credit granting scores, namely legal rights and depth of credit information (World Bank, 2019). The legal rights of borrowers and lenders related to guaranteed transactions are one of the important points in applying and providing credit. The legal right guarantees the borrower the certainty of the loan agreement (Saputra, 2019), and the lender's legal right provides certainty regarding the repayment of the loaned funds (Rahmahafida, 2020). With this legal right, it provides extra certainty and security for both borrowers and lenders.

In terms of registering property, there was a negative and significant effect to economic growth both in ASEAN and European Union. This is supported by research conducted by Byamugisha in which it is stated that one of the components of property registration is land certification. In the short term, land certification has a negative effect on economic growth, but has a positive impact in the long term. This is because proposals for better property rights are often not supported by simplification of regulations, usually associated with a lot of government interference

and the complexity of the bureaucracy, so that later it has a negative impact on productivity (Byamugisha, 1999). Investors certainly prefer to invest in places with lower costs. Land that is not certified, has much cheaper price than land that is certified (Palupi, 2017). The ease with which land certification increases the land that is certified and narrows the opportunities for investors to get land at a lower price as land to build their business.

In European Union, getting electricity has positive and significant effect to economic growth, although EU has a lot of developed countries as member, but getting electricity is the crucial factors to increase economic growth. This is related with electricity provided by using renewable energy source. The cost of electricity is likely more expensive because of the usage of renewable energy source. It cost more because the operational cost to cultivate renewable energy source to electricity costs more than unrenovable energy source does. But in long-run, operational cost of getting electricity from renewable energy source get cheaper (Moreno, Lopez, & Garcia-Alvarez, 2012). The finding of this study is supported by the study done by Georgeta, Anca, Mihaela, and Mircea which conclude that in European Union, the usage of renewable energy source to provide electricity has a positive impact, but not that much (Soava, Mehedintu, Sterpu, & Raduteanu, 2018).

For trading across border, European Union has positive and significant impact of trading across border to economic growth. This is supported by the fact that net export is one of the factors that enlarge GDP, and the amount of export in European Union is much bigger that the import. European Union accounts around 15 percent of the world trade in goods (Eurostat, 2021). Trade theories indicate generally that there is always a positive association among openness of an economy, inflation, Investment to Gross Domestic Product (GDP) ratio and export to GDP ratio (Frieden & Rogowski, 2016).

European Union in term of starting a business has negative and significant effect to economic growth. This is supported by the research done by Shane in 2009 that firm productivity increases with firm age. It means that the average new firms make worse use of resources than the average existing firm and the impact is economic growth benefits more from expansion of existing firms than new firms' formation. Supports more people to start a business will not improve economic growth or create more jobs because generally it does not become a source of economic vitality or jobs creation (Shane, 2009). And it is supported by the fact that it is not always the formation of many new businesses will encourage economic growth. Only business activities with the potential to develop rapidly have a significant impact on economic growth (Wong et al., 2005).

CONCLUSIONS AND SUGGESTION

In both ASEAN and European Union during 2015 to 2019, getting credit has a positive and significant impact to economic growth since credit has an important role on monetary transition because it is financing production, consumption, and capital creation, thus will affect economic growth. But on the other hand, that it is possible that better property rights are correlated with higher government intervention, which negatively impacts productivity especially in agricultural sector.

In ASEAN during 2015 to 2019, paying taxes has a positive and significant impact to economic growth. ASEAN is dominated by developing countries, where state revenues still have a high dependence on corporate income tax. If the tax rate is reduced but not accompanied by an increase in the number of companies or foreign direct investment, then this will have an impact on reducing government revenue.

In European Union during 2015 to 2019, getting electricity has a positive and significant impact to economic growth which caused by the usage of renewable energy source in electricity provision that leads to electricity values lot to European Union industries. As well as trading across border has a positive and significant impact to economic growth since the amount of export in European Union is much bigger that the import and there is always a positive association among openness of an economy, inflation, Investment to Gross Domestic Product (GDP) ratio and export to GDP ratio. In the other hand, starting a business has negative and significant impact to economic growth much likely because new firms in European Union have not develop rapidly and make worse

use of resource compare to existing firms.

This indicates that business regulations taken by both governments in ASEAN and European not always have positive impacts on economic growth. In order to increase economic growth both in ASEAN and European Union, government in each member country should repair, reform, and put more concern to the indicators those have negative impacts to economic growth, and adjusted it to each country's condition. Need to simplify the bureaucracy to establish an enterprise, develop a climate that supports investment, ease the construction permit, support lending but also have to consider the solvability.

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