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The Factors Influencing Economic Growth and Foreign Direct Investment: A Case Study in Cambodia

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Abstract

This research aims to investigate the factors influencing economic growth and foreign direct investment in Cambodia during the period from 1993 to 2023. The data was taken from official website of the World Bank, with analytical procedures performed using the Eviews 12 application. The study employs a Simultaneous Equation Model (SEM) using the Two-Stage Least Squares approach (TSLS/2SLS) to assess the hypothesized effects, which capture the interdependence between economic growth and FDI through two interconnected equations. The result from the simultaneous equation analysis of economic growth shows that FDI, government spending, net exports and labor collectively influence economic growth in Cambodia. Partially, FDI, government spending, and net export has a significant and positive effect on economic growth. Meanwhile, labor has an insignificant positive effect on economic growth in Cambodia. Furthermore, the results of the simultaneous equation analysis of the FDI equation reveals that economic growth, human development, inflation, and interest rates influence FDI in Cambodia. Individually, economic growth and human development have a significant positive effect on FDI. Meanwhile, interest rates have a significant negative effect on FDI inflow in Cambodia. Conversely, inflation has an insignificant negative effect on FDI in Cambodia. Therefore, it is recommended that Cambodia's policymakers should prioritize a stable investment climate, government spending, human development investment, and regulatory streamlining to boost FDI inflows and economic growth.

Keywords: *Economic Growth, FDI, Government Spending, Net Export, Labor, Human Development, Inflation, Interest Rate.*

Introduction

Cambodia is the world's poorest developing country, which has experienced civil wars such as the Lon Nol coup and the Khmer Rouge regime (Kogure & Takasaki, 2024). The Lon Nol coup (1970-1975) led to increased US bombing, military failure, corruption, and economic instability and also raised the Khmer Rouge regime led by Pol Pot during the years (1975-1979) in Cambodia (Kogure & Takasaki, 2024; Nou, 2024). The Khmer Rouge regime turned Cambodia into an agricultural sector country. They abolished cities, religious money, private property and forced millions of people into labor camps (Weng & Ordaz, 2021; Wagner et al., 2021). Due to people being forced to labor camps, it led to widespread famine and disease, which resulted in dying from starvation, overwork, and systematic killings under the Khmer Rouge's rule. An estimated 2.2 million people by mass killing since the first of stated until the end of Khmer Rouge regime (Nou, 2024).

The economy was significantly affected by policies of collectivization caused by private property, currency, and markets being abolished, and the population was forced into agricultural labor camps during the Khmer Rouge Regime (Kar May et al., 2020). The extensive mass killings and systematic destruction of human resources deepened poverty

and created a scarcity of skilled workers (Kogure & Takasaki, 2024; Weng & Ordaz, 2021). This has led to a lack of economic planning, difficult working conditions, and widespread famine, which has led to a collapse of productivity, severe poverty, and the destruction of infrastructure (Kogure & Takasaki, 2024). The destruction of infrastructure has created instability, insecurity, a shortage of skilled labor, and economic instability, depriving it of international trade, making it impossible to function for FDI (Nou, 2024). FDI was expelled, and diplomatic relations were severed, as a result of which FDI was completely abolished in Cambodia during the Khmer Rouge regime (Wagner et al., 2021). The economic decrease to zero and FDI was expelled because of Khmer Rouge regime still impact Cambodia's economic growth, human resources,

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infrastructure, education system, and amount of FDI inflow until nowadays (Nou, 2024).

After the Khmer Rouge regime was removed in 1979, Cambodia's economy was wrecked, and the recovery effort effectively began from nothing (Kar May et al., 2020). Following the Paris Peace Accords in 1991 and the UN-managed elections in 1993, Cambodia moved towards a market-based economy (Weng & Ordaz, 2021). Cambodia joined ASEAN as the tenth member in 1999, which received advantages such as an important role in the region's economy, security affairs, and politics, and attracted FDI inflow into Cambodia (Kar May et al., 2020). The report issued by the Cambodia Chamber of Commerce indicated that the strategy of establishing free trade agreements with China and South Korea supports the country's economic growth. In addition, the US Generalized Tariff Scheme, the EU 'Everything but Arms,' and the Regional Comprehensive Economic Partnership also contribute significantly to the economic growth of Cambodia as they provide preferential access to boost major exports and global markets, create jobs, and attract FDI inflow into the country (Kogure & Takasaki, 2024).

Cambodia has been identified as one of the quickest economies to grow, boasting an annual growth rate of 7% (Elistia et al., 2018). As per the report from the Ministry of Economy and Finance, Cambodia has reached lower-middle-income classification having a GDP per person of $1,875 in 2023, up from just $247 in 1993 (Kogure & Takasaki, 2024). This economic growth in Cambodia is influenced by some factors, including FDI inflow, government spending, net exports, and labor, which stimulate economic growth (Mubarak et al., 2020; Millia et al., 2021; Wardhana et al., 2023; Asamoah et al., 2019).

According to Mohanty & Sethi (2019), economic growth is resulting in increased national income, increased government tax revenue, and increased public investment in sectors like healthcare, education, and infrastructure (Sabado et al., 2023). This investment supports economic growth by reducing transportation costs and improving efficiency (Elistia et al., 2018). Economic growth also generates additional employment opportunities, lowering jobless rates and enhancing quality of life (Mohanty & Sethi, 2019). Consumer spending increases, boosting domestic demand and encouraging business expansion (Asamoah et al., 2019). These factors contribute to poverty reduction, improved social services, and a stronger competitive global economy (Sabado et al., 2023). Economic growth is facilitated by attracting FDI by expanding the investment environment, reducing labor costs, and increasing aggregate demand, while FDI boosts growth by importing new technology and management practices (Millia et al., 2021).

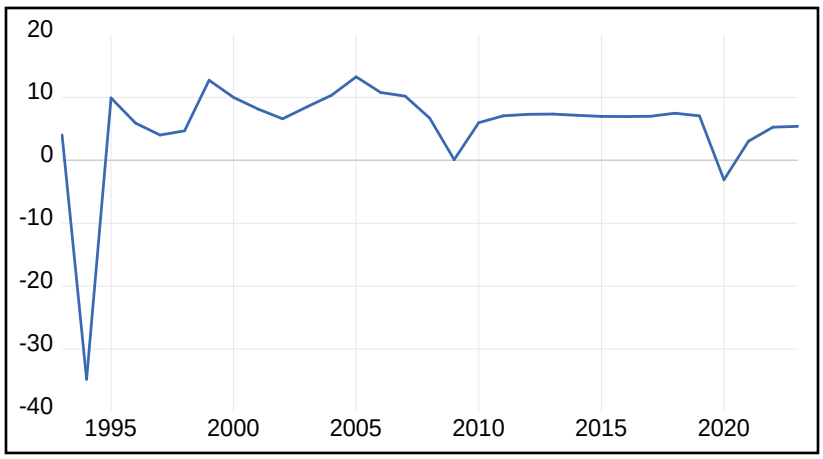

Figure 1. Cambodia's Economic Growth as Percentage From 1993-2023

The lowest economic growth was in 1994, with a contraction of -34.81%. This decline was largely due to ongoing political instability and the lingering impacts of decades of conflict, which discouraged both domestic investment and FDI, leading to limited output and economic growth (Asamoah et al., 2019; Weng & Ordaz, 2021). Cambodia's exports were less than imports, which cannot gather profit from abroad (Millia et al., 2021). The limited government spending on sectors like education, healthcare, transportation, and

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infrastructure, which are the important factors fostering economic growth in Cambodia (Rahman et al., 2023). The scars of labor skill, which limited production capacity, enhanced productivity, and fostered innovation in Cambodia (Mubarak et al., 2020). However, after the 2000s, economic growth was a note from year to year until the global disaster COVID-19 (Nou, 2024). After COVID-19, Cambodia's economy showed signs of recovery and also increased to 5.4% in 2023 (Kogure & Takasaki, 2024).

According to Wardhana et al. (2023), the government spending factor is important for economic growth and societal well-being. Public goods and necessities like infrastructure, healthcare, education, and national defense are funded by government spending in Cambodia (Rahman et al., 2023). During economic downturns, government spending can create jobs, stimulate demand, reduce income inequality, and support vulnerable populations in the country (Chukwuebuka, 2021). Puspitasari (2022) exports as one of the important factors that repatriate revenues, boosting national income and stability. The increase in exports deepens integration into the global economy, drives growth by fostering a dynamic economic environment, encourages industrial development, and creates new job opportunities for Cambodian people (Millia et al., 2021). Cylus & Tayara (2021), a nation's productive potential is increased when its labor force grows, boosting output and economic growth. Greater employment in the nation encourages consumer expenditure, resulting in heightened demand for products and services (Mubarak, 2020). As labor productivity rises, the quality of life improves, stimulating economic growth in the country (Indana & Mulyani, 2021).

Moreover, the primary element necessary for economic growth is FDI, as it introduces capital, technology, and managerial expertise to Cambodia, which increases productivity and efficiency (Ghazalian, 2024). FDI transfers of resources and knowledge, which enhances Cambodia's economic output and potential (Mohanty & Sethi, 2019). If FDI inflows decrease, the economy may also decrease, but when FDI increases, it stimulates economic growth as well (Asamoah et al., 2019). However, FDI inflow also depends on the economic growth in the country, as economic growth enhances political stability, infrastructure, and transportation and logistics and lowers business operational costs, which provides a stable environment and an expanding market for FDI inflow (Suyanto, 2023; Ghazalian, 2024). When economic growth leads to a skilled workforce, better education, and higher productivity (Wardhana et al., 2023). Additionally, human development, inflation, and interest rates are other key factors influencing FDI inflows into Cambodia as well (Bayar, 2020; Mensah, 2024; Emmanuel, 2019).

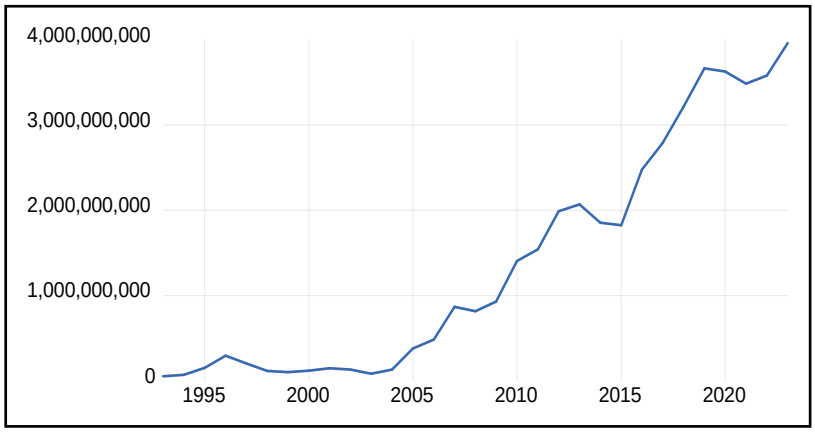

Figure 2. FDI in Cambodia as million US$ from 1993-2023

Cambodia had faced civil war for a long time, which made FDI expelled from 1993 to the 2000s (Kogure & Takasaki, 2024). FDI was still limited because it was the result of a civil war, an unstable policy, a lack of human development, a lack of infrastructure, and a country still full of booms that were unattractive and inaccessible for FDI inflow in Cambodia (Weng & Ordaz, 2021). However, after the Khmer Rouge regime, FDI inflow into Cambodia increased from year to year, as noted in the 2000s, which results from free trade agreements with neighborhoods (Nou, 2024).

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According to Bayar (2020), improved education, skills development, and healthcare contribute to a skilled workforce and are important in attracting FDI through their efficiency, productivity quality, and innovation. Higher human development signals stability, raises living standards, and creates market opportunities in Cambodia as well (Asante Darkwah, 2023). Furthermore, Mensah (2024) stated that moderate inflation boosts investor confidence and reduces price hike risks, while stable inflation protects profit margins and attracts FDI inflow. High inflation signals instability, while low inflation provides cost predictability and stability in Cambodia (Fiona, 2023). According to Tsaurai (2018), Lower interest rates attract FDI by making borrowing costs affordable, promoting expansion and equipment upgrades, and stimulating demand, while high rates can reduce business activity and FDI inflows into Cambodia. (Fiona, 2023).

Based on the above explanation, this research focuses on understanding the multifaceted factors influencing economic growth and FDI in Cambodia. This emphasis is on the interplay between exogenous variables and endogenous variables, especially the connection between economic growth and FDI inflow. Based on theoretical references from Neoclassical theory and Acceleration theory, FDI and economic growth have a positive association. This indicates that a rise in one among them leads to an increase in another, while a decrease in one among them also leads to a decrease in another. This comprehensive analysis used four key factors influencing economic growth, including FDI, government spending, net exports, and labor. Moreover, four primary factors influence FDI, including economic growth, human development, inflation, and interest rates.

Literature Review

FDI and Economic Growth

The economic theory of neoclassical growth has been employed how FDI affects economic growth. Through the development of dynamic comparative advantages that result in technological transfers, FDI can aid in economic progress, essential capital, and modern management practices, which benefit local companies' innovations and enhance their competitiveness in the global market (Akinlo, 2004; Suyanto, 2023). FDI investment facilitates the modernization of industries and infrastructure, resulting in increased productivity and profitability (Sunde, 2017). FDI also boosts incomes and job creation and stimulates domestic consumption (Susilo, 2018). Additionally, FDI encourages the growth of export-oriented industries by enabling foreign companies to establish factories or service centers, which in turn generates foreign currency and boosts foreign trade (Liang & Bifei, 2021). According to empirical research carried out by Suyanto (2023), Liang & Bifei (2021), Susilo (2018), Tshepo (2014), and Ma'in & Mat Isa (2020) found that FDI had a significant positive effect on economic growth. In contrast, the empirical studies conducted by Akinlo (2004); Ousseini et al. (2015); and Sunde (2017) stated that there was an insignificant impact of FDI on economic growth.

Government Spending and Economic Growth

Government spending on key sectors like education, infrastructure, health, and technology is expected to boost economic growth (Chukwuebuka, 2021). Government spending on education helps to improve human capital, the health sector boosts productivity, infrastructure reduces operational costs, and technology supports industrial growth (Wardhana et al., 2023). Increasing government spending boosts economic activity, increases incomes for the population, and increases employment, which encourages consumer spending and fosters economic growth (Rahman et al., 2023). Increasing government spending influences the progress and well-being of society, stabilizes prices of goods and services, boosts productivity innovation, and reduces poverty due to enhanced employment, which influences economic growth in the country (Puspitasari, 2022). According to an empirical previous study by Rahman et al. (2023) and Chukwuebuka (2021), it was concluded that government spending had a significant positive impact on economic growth. On the other hand, a study by Wardhana et al. (2023) said that government spending had an insignificant effect on economic growth.

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Export and Economic Growth

According to Millia et al. (2021) and Chiwira et al. (2023), exports boost economic growth through repatriation; revenue boosts national income and stability. Exports integrated into the global economy promote industrial development, foster a dynamic environment, and create job opportunities in a country (Ali et al., 2017). Higher exports strengthen the balance of payments and contribute to a robust economic foundation. Increasing exports can boost investment in sectors where a country excels, leading to higher national output and also an increase in the pace of economic growth (Chiwira et al., 2023). Better welfare benefits, more efficient production, better resource allocation, etc., are all induced by exporting. Through market openness, encouraging export-led growth policies can increase FDI inflow (Puspitasari, 2022). As the practical research by Millia et al. (2021) and Puspitasari (2022), it was found that exports had a significant positive impact on economic growth. However, a study by Ali et al. (2017) found that exports had an insignificant impact on economic growth in the context of his study.

Labor and Economic Growth

As labor expands, so does a country's income, thereby influencing its overall economic growth (Indana & Mulyani, 2021). The absorption of labor plays a crucial role in the job market and serves as a significant measure of a nation's economic prosperity. The more labor is absorbed, the smoother the advancement of the community's economic activities becomes (Alarcón Osuna, 2016). According to Puspitasari (2022), labor drives economic growth by expanding a country's productive capacity, increasing income, stimulating consumer spending, and creating greater countrywide demand for products and services. According to Indana & Mulyani (2021), more skilled and educated labor increases productivity, improving industry competitiveness and enhancing the overall standard of living, which leads to poverty reduction in the country. This factor leads to economic growth as more people are employed, attracts business investment, and skilled labor contributes to innovation, which boosts the economic activity in the country (Mubarak, 2020). According to Indana & Mulyani (2021) and Puspitasari (2022), empirical studies have shown that labor had a significant positive effect on economic growth. However, an empirical study conducted by Mubarak (2020) found that labor had no significant effect on economic growth in his study.

Economic Growth and FDI

Using the acceleration theory, the effect of economic growth on FDI inflow has been examined. Economic growth attracts more FDI to the country, such as enhancing infrastructure, improving transportation and logistics, and lowering operational costs for FDI (Ghazalian, 2024; Sabado et al., 2023). As economic growth also results in a more skilled workforce, which can produce higher productivity, it is a more attractive investment destination (Anwar et al., 2023). Additionally, economic growth increases domestic demand, creating a stable market for FDI (Sasi & Hristos, 2015; Sabado et al., 2023). Moreover, economic growth indicates potential market size and encourages planning new projects or industrial facilities with international companies in the country (Lee, 2024). Regions experiencing rapid growth generate more profitable opportunities, offering growing markets and profits. Multinational corporations may consider these markets as part of their global expansion strategy (Sasi & Hristos, 2015). Based on research carried out by Ghazalian (2024), Sasi & Hristos (2015), Anwar et al. (2023), and Sabado et al. (2023), found that there was a significant positive impact of economic growth on FDI inflow. Besides this, Lee (2024) and Saleh (2023) found that there was an insignificant impact of economic growth on FDI inflow in their study.

Human Development and FDI

Improved human development generally boosts FDI by improving the investment climate, both directly through increased labor skill levels and indirectly through better health and sociopolitical stability (Bayar, 2020). Asante Darkwah et al. (2023) state that improved education and skills development create a skilled workforce, appealing to FDI seeking efficient labor. Better healthcare ensures a healthier workforce, which reduces absenteeism and operational risks for FDI inflow (Asante Darkwah et al., 2023). Higher human development signals political and social stability, reassuring FDI in a secure investment environment in the country (Alarcón Osuna, 2016). Higher living standards lead to increased consumer demand, creating a

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stable market opportunity for FDI inflow (Bayar, 2020; Alarcón Osuna, 2016). Based on Asante Darkwah et al. (2023) and Bayar (2020), stated that human development has significant positive impacts on FDI, while Alarcón Osuna (2016) found that human development had no significant effect on FDI.

Inflation and FDI

According to Mensah (2024), high inflation can negatively affect an economy's long-term performance by decreasing consumer purchasing power, leading to increased living costs and fewer products being purchased. This act as a decrease in purchasing power can be multiplied across millions of consumer transactions, causing economic activity decreases and a decrease in FDI inflow to the country (Fiona, 2023). While an increase in inflation impacts commodity and equity markets, which results in effecting the FDI inflow levels (Tsaurai, 2018). High inflation also caused a downturn in FDI due to depreciation of the local currency, risking reduced asset value relative to foreign currencies (Fiona, 2023). Moderate inflation can be beneficial for FDI by promoting domestic growth, reducing debts to suppliers, and increasing competition in exports in the country (Tsaurai, 2018; Mensah, 2024; Fiona, 2023). Based on research carried out by Mensah (2024) and Fiona (2023), inflation had a significant negative effect on FDI. However, a study conducted by Tsaurai (2018) found that inflation had a significant effect on FDI inflow.

Interest Rate and FDI

Leasiwal et al. (2022) Interest rates are important in the international exchange market, spot exchange rates, linking interest rates, and foreign exchange rates. Interest rates have a negative impact on FDI, while high rates reduce investment and low rates encourage more FDI inflow (Zuhroh, 2022). Rising interest rates make loans more expensive, limiting the number of projects investors can run. Conversely, a decrease in interest rates makes borrowing costs cheaper, increasing the number of projects investors can run (Leasiwal et al., 2022). Additionally, lower interest rates make loans more accessible to customers, encouraging them to purchase goods, thereby stimulating domestic demand (Emmanuel, 2019). Additionally, interest rates positively impact FDI, with an increase in interest rates resulting in a greater anticipated rate of return on investments made in the destination nation (Fiona, 2023). According to a research study based on observations carried out by Leasiwal et al. (2022) and Zuhroh (2022), interest rates had a significant and negative effect on FDI. However, the study conducted by Fiona (2023) and Emmanuel (2019) stated that interest rates had an insignificant effect on FDI.

Research Method

This research is quantitative research using descriptive and associative methods. This study utilizes secondary data represented as time series data covering the timeframe from 1993-2023, conducted extensively in Cambodia. Data came from the official World Bank website, with analytical procedures performed using the Eviews 12 application. There exist two categories of variables in this research, comprising endogenous variables and exogenous variables. Endogenous variables in this research are economic growth as (Y1) and foreign direct investment (FDI) as (Y2). Exogenous variables are government spending (X1), net exports (X2), labor (X3), human development (X4), inflation (X5) and interest rates (X6). This research uses a simultaneous equation model is statistical models where the endogenous variable is a function of another endogenous variable. Figure 1 is the framework of this research which reveals the factors influencing economic growth including FDI, government spending, net exports and labor. Meanwhile, economic growth, human development, inflation and interest rates influence FDI inflow.

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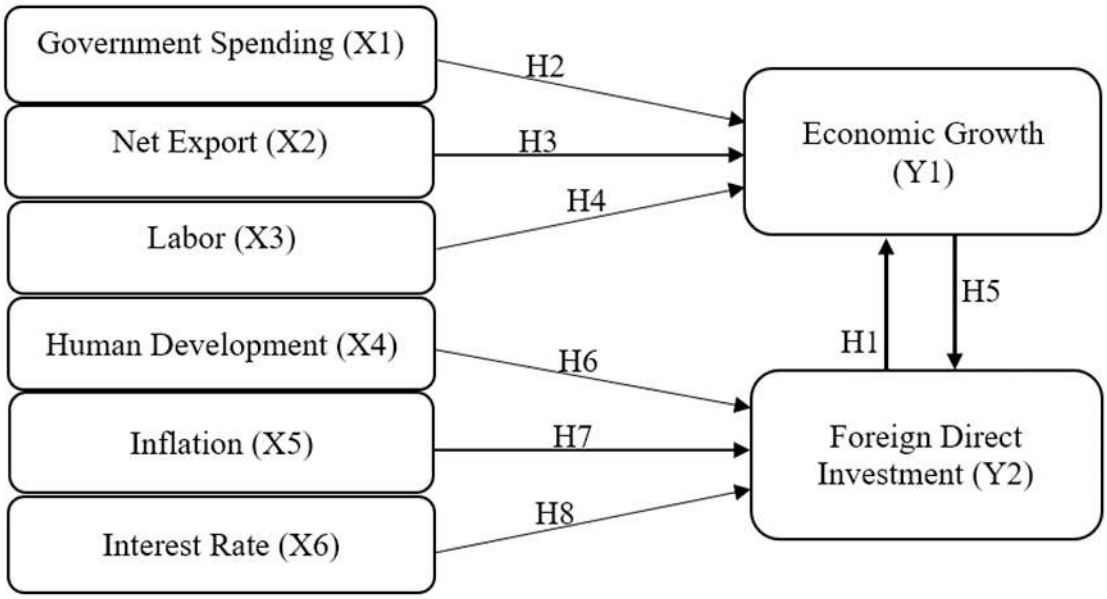

Figure 1. Conceptual Framework

Table 1. Variable Indicators and Data Sources

Variables	Indicators	Source	Units
Economic Growth	GDP Growth	World Bank	%
Foreign Direct Investment	FDI net inflow	World Bank	Million US$
Government Spending	General government Final consumption expenditure	World Bank	Million US$
Net Export	(Export-Import) of products and services	World Bank	Million US$
Labor	Total labor	World Bank	Person
Human Development	Human Development Index	World Bank	Index
Inflation	Consumer Price Index	World Bank	%
Interest Rate	Interest rate per year from National Bank of Cambodia	World Bank	%

Structural Model

The form of the structural equation of the simultaneous equation model in this research can be seen in equations (1) and (2) as follows:

$$Y_{1t} = \alpha_0 + \alpha_1 Y_{2t} + \alpha_2 X_{1t} + \alpha_3 X_{2t} + \alpha_4 X_{3t} + \varepsilon_{1t} \quad (1)$$

$$Y_{2t} = \beta_0 + \beta_1 Y_{1t} + \beta_2 X_{4t} + \beta_3 X_{5t} + \beta_4 X_{6t} + \varepsilon_{2t} \quad (2)$$

Where,

Y_{1t} Economic Growth

Y_{2t} FDI

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X_{1t} Government Spending

X_{2t} Net Export

X_{3t} Labor

X_{4t} Human Development

X_{5t} Inflation

X_{6t} Interest Rate

α, β Coefficient

t time series

ε error term

Identify Simultaneous Equations

According to Gujarati (2012), an equation is identifiable if the equation fulfills the subsequent circumstances:

$$K - k = \text{or} > m - 1 \quad (3)$$

Where,

K = the number of fixed variables that are part of the model.

k = the number of fixed variables that are part of the computed equation.

m = the number of endogenous variables that are part of the computed equation.

The following are the models for the identification equation:

K – k > m – 1 is considered overidentified, the two-stage least square (TSLS /2SLS) approach is used for estimation.

K – k = m – 1 is referred to as just/ exactly identified, so the estimation uses indirect least square (ILS) method.

K – k < m – 1 is referred to be underidentified; hence, the equation whose order condition outcome is recognized and overidentified is the one that the simultaneous equation system can be used to solve.

According to the earlier stipulations, the outcomes in equation 1 and 2 are derived as follows:

Equation 1:

K = Government spending, net export, labor, human development, inflation and interest rate.

k = Government spending, net export, labor.

m = Economic growth, FDI.

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K – k = or > m – 1

6 – 3 > 2 – 1 = 3 > 1 (overidentified) (4)

Equation 2:

K = Government spending, net export, labor, human development, inflation and interest rate.

k = human development, inflation and interest rate.

m = FDI, Economic growth.

K – k = or > m – 1

6 – 3 > 2 – 1 = 3 > 1 (overidentified) (5)

After carrying out this test, it can be concluded that the research is included in overidentified because the value of K – k > m – 1, hence the analysis of simultaneous equations using the Two Stage Least Square (TSLS/2SLS) approach.

Results and Discussion

Simultaneous Equation Analysis of Economic Growth

Based on the findings from the analysis, which obtain from an estimation results for the Simultaneous equation of economic growth (Y1) along with the exogenous variables that influence on it, including FDI (Y2), government spending (X1), net export (X2), and labor (X3).

Y_{1t} = 17.35106 + 2.863992log(Y_{2t})*** + 0.358495log(X_{1t})*** + 0.344055log(X_{2t})*** + 0.359275log(X_{3t}) + 0.131013 (6)

***significant on α=1%,

**significant on α=5%

Table 2. Estimation Results for Simultaneous Equations of Economic Growth

Variables	Coefficient	Std. Error	t-statistic	Prob.	R-squared	Prob(F-Statistic)
C	17.35106	1.633487	10.62210	0.0000	0.862802	0.000000
Log(FDI)	2.863992	0.930878	3.076656	0.0049		
Log(GS)	0.358495	0.085305	4.202502	0.0003		
Log(NE)	0.344055	0.044311	7.764592	0.0000		
Log(LB)	0.359275	1.541774	0.233027	0.8176		

Equation 6 presents the estimation's findings pertaining to the impact of exogenous variables on endogenous variables. If there are no exogenous variables, the economic growth value is only 17.35106%. The influence of the FDI (Y2), government spending (X1), net export (X2), and labor (X3) variables can be seen from the R-squared value of 0.862802. This suggests that 86.28% of the influence of exogenous variables included in the model on endogenous variables, while the remaining overall 13.72% is attributed

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to factors outside the model or outside the research. The standard error of this equation of economic growth is calculated at 0.131013 units in Cambodia.

The effect of FDI (Y2) has a significant positive influence on economic growth (Y1) in Cambodia, because the probability value is 0.0049, which is considerably lower than the standard alpha level of 0.05 (0.0049 < 0.05). The coefficient of FDI is 2.863992, which indicates that each unit rise in FDI results in an economic growth increase of 2.863992 units. Conversely, if FDI decreases by one unit, the economy in Cambodia will decrease by 2.863992 units as well.

Government spending (X1) has a significant and positive influence on economic growth (Y1), because the probability value is 0.0003, which is lower than the standard alpha level of 0.05 (0.0003 < 0.05). The government spending coefficient is 0.358495. This implies that a rise in government spending causes the economy to grow by 0.358495 units. However, a decrease of one unit in government spending would be a decrease of 0.358495 units for economic growth in Cambodia.

Net exports (X2) have a significant and positive impact on economic growth (Y1). The reason behind this is the probability value is 0.0000, which is lower than the standard alpha level of 0.05 (0.0000 < 0. 05). The coefficient of net exports stands at 0.344055, indicating that a one-unit rise in net exports responds to an increase of 0. 344055 units in economic growth. On the other hand, if net exports decreased by a unit, economic growth in Cambodia would also decrease by 0.344055 units.

Labor (X3) shows a positive yet statistically insignificant impact on economic growth (Y1) in Cambodia. A probability value of 0. 8176, which exceeds the norm alpha threshold of 0.05 (0.8176 > 0.05), demonstrates this. The coefficient of labor stands at 0.359275, showing that an increase of one unit in labor correlates to a 0.359275 unit rise in economic growth. On the flip side, reducing labor by one unit would result in a decrease of 0.359275 units in economic growth. However, due to its statistical insignificance, this impact is not deemed significant in this particular context in Cambodia.

Simultaneous Equation FDI Analysis

Based on the findings from the analysis, which obtain from an estimation results for the Simultaneous equation of endogenous variable FDI (Y2) along with the exogenous variables that influence on it, including economic growth (Y1), human development (X4), inflation (X5), and interest rates (X6).

$$Log(Y_{2t}) = 26.20916 + 1.774702(Y_{1t})^{***} + 0.505026(X_{4t})^{***} - 0.434852(X_{5t}) - 0.504129(X_{6t}) ^{***} + 0.368457 \quad (7)$$

***significant on α=1%,

**significant on α=5%

Variables	Coefficient	Std. Error	t-statistic	Prob.	R-squared	Prob(F-Statistic)
C	26.20916	11.80256	2.220634	0.0286	0.742124	0.000000
EG	1.774702	0.471710	3.762274	0.0009		
HDI	0.505026	0.080410	6.280665	0.0000		
IFR	-0.434852	0.390015	-1.114963	0.2680		
IR	-0.504129	0.125991	-4.001314	0.0006		

Table 3. Estimation Results for Simultaneous Equations of FDI

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According to the estimation results in equation 7, it can be seen that there is an influence of exogenous variables on endogenous variables. If there are no exogenous variables, the FDI value is only 26.20916%. The impact of economic growth (Y1), human development (X4), inflation (X5), and interest rate (X6) variables can be seen from the R-squared value of 0.742124. This indicates that 74.21% of the variance in the exogenous variables included in the model influence on endogenous variables, while the remaining 25.79% is attributed to factors outside the model or outside the research. The standard error of the estimation results in simultaneous equations of FDI calculated at 0.368457 units in Cambodia.

Economic growth (Y1) has a significant and positive effect on FDI (Y2) in Cambodia. This is because the probability value is 0.0009, which is far lower than the typical alpha threshold of 0.05 (0.0009 < 0.05). The coefficient of economic growth stands at 1.774702, suggesting that as economic growth increases by one unit, FDI inflows also increase by 1.774702 units in Cambodia. However, a one-unit loss in economic growth is expected to result in a 1.774702 unit drop in FDI inflow.

Human development (X4) has a significant and positive impact on FDI (Y2) in Cambodia. This is evident through a probability value of 0.0000, which is below the standard alpha level of 0.05 (0.0000 < 0.05). The coefficient of human development is 0.505026, which indicates that a one-unit rise in human development results in an increase of 0.505026 units in FDI inflows. On the flip side, FDI inflows to Cambodia would decline by 0.505026 units for every unit drop in human development.

Inflation (X5) has an insignificant and negative effect on FDI (Y2) in Cambodia. The explanation for this is because the probability value displayed in the equation, 0.2680, is more than the usual alpha threshold of 0.05 (0.2680 > 0.05). The coefficient of inflation is -0.434852, this suggests that FDI inflows would decline with a one unit increase in inflation by -0.434852 units. On the other hand, a unit decrease in inflation is linked to an increase of 0.434852 units in FDI inflow in Cambodia. However, this impact is not deemed significant within this context due to its statistical insignificance based on the estimation result.

Furthermore, interest rates (X6) have a significant and negative effect on FDI (Y2) in Cambodia. This is due to the backing of a low probability value of 0. 0006, which is far beneath the conventional alpha threshold of 0.05 (0.0006 < 0.05). The coefficient of interest rate is -0.504129, this implies that FDI falls by 0.504129 units for every unit increase in the interest rate. On the other hand, a rise of 0.504129 units in FDI inflows into Cambodia is correlated with a decrease in interest rates.

Discussion

The Influence of FDI, Government Spending, Net Exports, and Labor on Economic Growth in Cambodia

Considering the results of the estimation of the economic growth equation, it was found that FDI, government spending, net exports, and labor simultaneously had a significant effect on economic growth in Cambodia. This simultaneous effect was obtained with a value of 0.862802 or 86.28%. This suggests that external variables, including FDI, government expenditure, net exports, and labor together influence economic growth in Cambodia. In contrast, additional factors that are not included of the model or this study affect 13. 72%. The initial hypothesis in this study Ha is accepted and H0 is rejected. This signifies that any variation in FDI, government spending, net exports, and labor leads to alterations in economic growth in Cambodia.

First, FDI has a significant positive effect on economic growth in Cambodia. This is caused by FDI bringing capital into critical projects and infrastructure, boosting production, employment, and technology transfer into Cambodia (Suyanto, 2023; Liang & Bifei, 2021; Susilo, 2018). FDI boosts the country's economic stability by enhancing its connection to international markets, fostering new export opportunities, and enhancing domestic industries' efficiency in Cambodia. FDI also brings expertise and human capital development through training and knowledge sharing, fostering a skilled workforce for long-term progress in Cambodia. FDI promotes export growth by generating foreign exchange, stabilizing the national currency, and supporting economic stability in the country. FDI also supports research and development, fueling innovation and empowering Cambodia to create advanced goods and services, which results in

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economic growth. This outcome is similarly with the empirical research carried out by Suyanto (2023), Liang & Bifei (2021), Ma'in & Mat Isa (2020), with the finding that FDI had a significant positive impact on economic growth.

Second, government spending has a significantly positive impact on economic growth in Cambodia. This results from governments spending significant amounts in public infrastructure, social services, and general economic stability in Cambodia. Government spending in Cambodia, particularly in education, healthcare, transportation, and infrastructure, boosts economic growth by reducing business expenses and enhancing trade opportunities. Government investments in health and education increase skill and productivity, stimulate demand, and encourage private sector investments. Government spending also reduces inequality and poverty by increasing per capita consumption and improving access to nutrition, healthcare, and education in Cambodia. This focus on these areas reduces child labor, unemployment, and social conflicts, promoting stable political conditions and a foundation for economic growth in the country. This outcome is similarly with the empirical research carried out by Chukwuebuka (2021) and Rahman et al. (2023), who stated that government spending had a significantly positive impact on economic growth.

Third, net exports have a significant positive effect on economic growth in Cambodia. This causes exports to generate valuable foreign currency and strengthens Cambodia to invest in critical areas such as infrastructure, education, and healthcare. Export levels boost demand for products and services, resulting in heightened domestic production and productivity, which results in economic activity in the country. The results of exports help the country with job creation, higher household earnings, and increased consumer spending, boosting economic growth in the country as well. Positive export results also strengthen Cambodia's economy and promote stability. On the other hand, increased exports generate revenue from overseas markets, providing valuable foreign currency for domestic infrastructure, repaying international debts, and bolstering sectors. This outcome is similarly consistent with the empirical studies conducted by Millia et al. (2021) and Puspitasari (2022), who found that exports had a significant positive impact on boosting economic growth.

Fourth, labor has an insignificant and positive effect on economic growth in Cambodia. This indicates that labor's anticipated contribution to economic growth is constrained. Cambodian labor's influence on economic progress is constrained because low-productivity sectors like agriculture and informal employment, a lack of labor skills, education, and specialized training, which resulted from a high dropout from education. Poor families and long distances from school in the rural areas have dropped out of school due to the fact that they do not have studies to support their studies, which leads to unskilled labor with low-income jobs. A report from the International Labor Organization (2024) says that over one million Cambodians have migrated to Malaysia and Thailand, with 12% of the workforce being from these countries. There are a lot of Cambodian migrants who also move to Korea, Japan, and Taiwan, as they can earn more money through migration. Additionally, many Cambodians move from rural areas to urban centers, working as factory workers with low wages. All of these factors make labor have an insignificant effect on economic growth in Cambodia, because a lot of Cambodian labor migrants have less economic activity in the country, and some work with low productivity. However, this outcome is similarly consistent with the empirical research carried out by Mubarak (2020), who stated that labor had an insignificant and positive effect on economic growth.

The Impact of Economic Growth, Human Development, Inflation and Interest Rate on FDI in Cambodia

The estimated computation of the FDI equation revealed that economic growth, human development, inflation and interest rates all had a substantial impact on FDI intake into Cambodia. An R-squared value of 0.742124 illustrates this, indicating that these exogenous factors account for 74.21% of the variation in FDI, with the remaining 25.79% coming from other sources or attributed to elements outside the model. The initial hypothesis in this study, H0 is refused, but Ha is accepted. Accordingly, any shift in economic growth, human development, inflation, and interest in changes to FDI in Cambodia.

First, economic growth significantly impacts FDI inflows into Cambodia, with each unit increase in growth enhancing the country's appeal to FDI inflow. This positive relationship is primarily due to Cambodia's

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enhanced market potential and profitability for FDI. Cambodia's economic growth signals stability and resilience, which attract FDI inflow due to rising consumer demand and higher returns for investment. The infrastructure, financial stability, and increased purchasing power improve the investment climate and mitigate risks in Cambodia, which is also the key to attracting FDI inflow into Cambodia. On the other hand, economic growth boosts productivity and efficiency, reducing foreign firm costs, which means that there is a high return for FDI. Cambodia's government implements policy reforms to enhance the commercial environment, build investor confidence, and attract FDI as well. Additionally, this outcome aligns with the empirical study conducted by Ghazalian (2024); Anwar et al. (2023) and Sabado et al. (2023) found that there was a significant positive impact of economic growth on FDI inflow.

Second, human development has a significant positive impact on FDI inflow in Cambodia. This results from greater human development promoting a more skilled workforce, reinforcing economic stability, and improving productivity in the country. Cambodia focuses on improving human development by enhancing the education system, healthcare, and social services, which are the key to producing labor productivity, making it a more competitive destination for FDI inflow in the country. This leads to skilled, healthy, and adaptable labor, reducing risks for foreign investors. So, the quality of human development is the critical element in enhancing productivity, this is crucial in drawing FDI into Cambodia. Cambodia's political and social stability also enhances foreign firms' confidence, making it a reliable, low-risk environment. This strengthens Cambodia's global competitiveness and attracts FDI inflows. This result is similarly consistent with the empirical research by Asante Darkwah et al. (2023) and Bayar (2020) studies stating that human development had a significant positive impact on FDI inflow.

Third, inflation in Cambodia has an insignificant negative effect on FDI. This is because investors may perceive inflation as temporary or a natural part of the economic cycle, which could help alleviate worries about future profitability in Cambodia. Foreign investors in Cambodia prioritize actual returns over inflation, which may be lessened by sector-specific dynamics. Global variables damage industrial industries that rely on exports, although stable inflation may help mitigate its effects. However, investors may prioritize other economic factors like corruption perception index, trade openness, exchange rate, interest rates, market potential, human development, and economic growth when evaluating investment opportunities in Cambodia (Tsaurai, 2018; Mensah, 2024; Fiona, 2023). Moreover, the inflation in Cambodia is at a normal level, which other areas are not as important to investors. This research finding is in line with the previous research conducted by Tsaurai (2018), which found that inflation was not statistically significant on FDI inflow.

Fourth, interest rates have a significant negative impact on FDI inflows in Cambodia. Leasiwal et al. (2022) and Zuhroh (2022) state that as interest rates increase, it has an effect on FDI inflows decreasing, while interest rates decrease has an effect on FDI inflows increasing in a country. Elevated interest rates in a host country increase borrowing costs, which causes them to reduce potential investment returns in the country. This can make Cambodia less appealing to FDI as it encourages saving rather than spending, reducing demand for goods and services. Additionally, higher interest rates may discourage FDI by influencing the local currency value, which is unattractive to FDI. However, the empirical result of interest rates has a significant negative impact on FDI inflows because of a gradual decrease in interest rates each year, which raises the need for products and services, low fund projects, and low labor costs, making FDI more confident in investing in Cambodia. Conversely, areas with lower interest rates, affordable capital, and favorable economic conditions enhance the appeal and potential profitability of investments in Cambodia as well. This research result is also similar to previous research by Leasiwal et al. (2022) and Zuhroh (2022), which found that interest rates had a significant negative effect on FDI inflow.

Conclusion

Drawing from testing, data processing, and discussion of the factors impacting economic growth and FDI in Cambodia, the conclusion can be as follows:

- FDI, government spending, net exports, and labor simultaneously have a significant influence on

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economic growth in Cambodia. This means that every change in FDI, government spending, net exports, and labor causes changes in economic growth in Cambodia. Partially, FDI, government spending, and net exports each have a significant positive effect on economic growth, while labor has an insignificant positive effect on economic growth in Cambodia.

- Economic growth, human development, inflation, and interest rates simultaneously have a significant effect on FDI in Cambodia. Accordingly, any shift in economic growth, human development, inflation, and interest rates causes changes in FDI inflow into Cambodia. Individually, economic growth and human development have a significant positive effect on FDI inflows, while interest rates have a significant negative effect on FDI inflows. In contrast, inflation has an insignificant negative effect on FDI inflows in Cambodia.

Based on the empirical results found from analysis data collection, the policymakers in Cambodia should focus on fostering a stable, transparent investment climate by expanding infrastructure, investing in human capital, and streamlining regulations to boost FDI and economic growth in the country. Additionally, strategies to expand net exports, such as trade agreements, export incentives, and sectoral development, can also help diversify economic growth and attract FDI inflow into the country. Addressing high interest rates and maintaining moderate inflation can further improve investment appeal, while targeted programs in health, education, and training will create a skilled workforce aligned with industry needs, attracting long-term FDI inflow and fostering economic growth in Cambodia.

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