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ECONOMIC FREEDOM, FINANCIAL DEVELOPMENT, AND SUSTAINABLE ECONOMIC GROWTH: PANEL EVIDENCE FROM SOUTH ASIA

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Abstract
This study investigates the influence of financial development and economic freedom on economic growth in five South Asian economies—Pakistan, India, Bangladesh, China, and Sri Lanka—using annual panel data covering the period 2000–2024. The analysis is motivated by the growing importance of financial sector reforms and market-oriented policies in promoting sustainable economic development across emerging economies. Economic growth is measured using GDP growth, while financial development is represented by domestic credit to the private sector, and economic freedom is captured through business freedom and labour freedom indicators. To obtain reliable estimates, the study incorporates key macroeconomic control variables, including inflation, population growth, labour force participation, government spending, trade openness, and foreign direct investment. The findings indicate that financial development exerts a significant negative effect on economic growth, suggesting that expansion of financial resources alone is insufficient to stimulate growth without efficient financial intermediation and strong institutional quality. Economic freedom exhibits a positive relationship with economic growth, although its significance varies across estimation methods. Inflation adversely affects economic performance, whereas population growth contributes positively to economic expansion. Foreign direct investment shows an insignificant contribution to growth within the selected economies. The study highlights the importance of strengthening financial sector efficiency, improving institutional quality, and maintaining macroeconomic stability to maximize the growth benefits of financial and market-oriented reforms. These findings provide valuable policy implications for governments seeking to achieve sustainable long-term economic growth in South Asia.
Keywords: *Financial Development, Economic Freedom, Economic Growth, South Asia*

INTRODUCTION

Economic growth remains one of the foremost objectives of national economic policy because it reflects improvements in productivity, income, employment, and overall social welfare while providing the foundation for long-term sustainable development (Tobin, 1964; Acemoglu, 2008; Ali & Rehman, 2015; Abdulle et al., 2025; Khalid et al., 2025; Anus et al., 2025; Kachalia et al., 2026; Ajeeb et al., 2026). A sustained increase in economic output enables countries to reduce poverty, improve living standards, strengthen public services, and enhance economic resilience against internal and external shocks. In an increasingly integrated global economy, maintaining stable economic growth has become more challenging because countries must simultaneously address financial instability, technological transformation, demographic changes, globalization, and institutional reforms (Moyo, 2018; Matyushok et al., 2021; Ali, 2022; Marc et al., 2022; Akhyar & Rahmi, 2024; Ammar et al., 2025; Berebon, 2025; Audi et al., 2026; Hill, 2026). Financial development plays a fundamental role in promoting economic growth by improving the efficiency with which financial resources are mobilized, allocated, and utilized throughout the economy. An efficient financial system encourages savings, facilitates investment, reduces transaction and information costs, improves capital allocation, and expands access to financial services for households and businesses (van Zanden, 2023; Marc & Ali, 2023; Hasan, 2024; Bukhari et al., 2025; Udohaya, 2025; Umair et al., 2025; Al-Masri & Audi, 2026; Sari, 2026; Naeem et al., 2026). Through these mechanisms, financial development stimulates entrepreneurship, supports technological innovation, enhances productive investment, and accelerates capital formation. Consequently, well-developed financial markets and institutions contribute to higher productivity, greater resource efficiency, and stronger long-term economic growth (Marc et al., 2023; Li & Du, 2024; Marc & Al Masri, 2024; Naeem et al., 2025; Imran et al., 2025; Aman et al., 2025; Chen et al., 2026; Tahir et al., 2026; Damasa et al., 2026). Nevertheless, the contribution of financial development is not unconditional. Weak regulatory institutions, inefficient financial intermediation, excessive credit expansion, and poor governance may distort capital allocation, increase financial vulnerability, and weaken economic performance (Makhdum et al., 2022; Wang

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et al., 2023; Audi, 2024; Okolo et l., 2024; Ditta et al., 2025; Ali et al., 2025; Faisal et al., 2025; Fatima et al., 2026; Vi et al., 2026).

Economic freedom reflects the extent to which individuals and businesses are able to make economic decisions within a transparent institutional environment characterized by secure property rights, efficient regulations, competitive markets, and limited unnecessary government intervention (Ali, 2015; Audi, 2016; Ali & Naeem, 2017; Ausat, 2023; Stiglitz, 2024; Nwosu & Folarin, 2025 Iqbal et al., 2025; Ali et al., 2025; Daud et al., 2026; Hardi et al., 2026). Such an environment promotes entrepreneurship, encourages innovation, strengthens market competition, attracts domestic and foreign investment, and improves resource allocation (Ali, 2018; Zhang et al., 2023; Igweh & Chukwuka, 2024; Ali et al., 2025; Hamasalih et al., 2025; Kha et al., 2026; Adamu et al., 2026). As businesses operate under fewer institutional barriers and greater regulatory certainty, production efficiency increases, investment expands, and productivity improves, ultimately contributing to stronger economic performance. However, the effectiveness of economic freedom is closely associated with institutional quality, governance effectiveness, political stability, and legal enforcement, causing its impact on economic growth to differ substantially across countries (Ali & Bibi, 2017; Ali & Audi, 2018; Abate, 2022; Beyene, 2024; Ali et al., 2025; Tuyet & Dinh, 2025; Javed et al., 2026; Halaç et al., 2026). The complementary relationship between financial development and economic freedom has become increasingly important in explaining differences in economic performance across countries (Ali et al., 2016; Arshad & Ali, 2016; Butt, 2023; Ali et al., 2025; Karim et al., 2026; Uzar, 2026). A competitive and market-oriented economy requires an efficient financial system capable of mobilizing savings and channeling financial resources toward productive investment, while financial institutions perform more effectively when supported by transparent regulations, sound governance, and stable legal systems (Sajid & Ali, 2018; Kassem et al., 2019; Roussel et al., 2021; Mehmood et al., 2022; Marc & Ali, 2023; Ahmed et al., 2022; Kingsly, 2025; Ali et al., 2025; Sinha, 2025; Aziz et al., 2025; Kumar et al., 2025; Rauf et al., 2026; Ivanov, 2026).

The relevance of these relationships is particularly evident in South Asian economies, which have undergone substantial financial, institutional, and structural transformations during the past two decades. Financial sector liberalization, banking reforms, increasing foreign direct investment, trade integration, and institutional improvements have reshaped the economic landscape of countries across the region. While economies such as China and India have experienced rapid industrialization supported by expanding financial markets and progressive economic reforms, Bangladesh has demonstrated remarkable resilience through export-oriented growth and improved financial inclusion. In contrast, Pakistan and Sri Lanka have implemented a series of financial and institutional reforms while continuing to face recurring macroeconomic challenges. These differences in financial market development, regulatory quality, institutional effectiveness, and economic performance make South Asia an appropriate setting for examining the relationship between financial development, economic freedom, and economic growth within a comparative framework. Accordingly, this study examines the impact of financial development and economic freedom on economic growth across Pakistan, India, Bangladesh, China, and Sri Lanka using annual panel data covering the period from 2000 to 2024.

LITERATURE REVIEW

The relationship between financial development, economic freedom, and economic growth has been extensively examined in both theoretical and empirical literature. Over time, economists have proposed different explanations regarding the mechanisms through which financial systems and institutional arrangements influence long-term economic performance. The explicit connection between finance and economic growth was established by Schumpeter (1917), who viewed financial institutions as active agents of economic transformation rather than passive intermediaries. Banks perform a fundamental role by identifying and financing innovative entrepreneurs whose investments generate technological progress and structural transformation through the process of creative destruction. Financial institutions therefore become catalysts for innovation, productivity improvement, and long-term economic development. McKinnon (1973) and Shaw (1973) further strengthened the theoretical importance of financial development through the Financial Repression Hypothesis. The excessive government intervention in financial markets—including interest rate controls, directed credit policies, and restrictive banking regulations—reduces savings, discourages productive investment, and weakens economic growth. Conversely, financial liberalization improves the efficiency of financial intermediation by allowing market forces to determine the allocation of capital, thereby encouraging higher savings, greater investment, and stronger economic performance.

The Endogenous Growth Theory introduced by Romer (1986) and Lucas (1988) significantly expanded the understanding of long-run economic growth by arguing that technological progress is generated within the economic system through investments in human capital, innovation, research and development, and

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institutional quality. Unlike earlier growth theories, endogenous growth models identify financial development as a critical mechanism through which resources are mobilized and allocated toward productive activities that generate sustained increases in productivity. Levine (1997) further explained that efficient financial systems promote economic growth by mobilizing savings, improving capital allocation, facilitating risk diversification, reducing information asymmetry, and strengthening corporate governance. Similarly, economic freedom enhances these growth mechanisms by protecting property rights, reducing regulatory barriers, encouraging entrepreneurship, and creating incentives for long-term investment and innovation. Financial openness also facilitates technology transfer, improves financial efficiency, and accelerates economic growth through stronger international financial integration (Wu et al., 2012; Ali, 2022; Ali et al., 2023; Khan et al., 2025; Aqeel et al., 2025; Khalil et al., 2025; Zahid et al., 2026; Choudhary et al., 2026).

Numerous studies conclude that well-developed financial systems contribute positively to economic growth by improving investment efficiency, facilitating capital accumulation, and strengthening productivity. Shahbaz et al. (2022) demonstrated that the impact of financial development on economic growth is nonlinear and asymmetric, implying that improvements in financial development do not produce identical growth effects across different stages of financial maturity. Similarly, Asteriou et al. (2024), using panel evidence from twenty-six European Union countries, reported that financial development promotes economic growth under normal economic conditions, although its contribution weakens significantly during periods of financial instability. Mohamed Sghaier (2023), examining North African countries, found that financial development positively influences economic growth and that its benefits become stronger when accompanied by greater trade openness, highlighting the complementary relationship between financial and institutional development. Likewise, Bijlsma et al. (2018) synthesized evidence from a large number of empirical studies and confirmed that financial development generally promotes economic growth. Despite these methodological differences, the overall empirical literature consistently supports the proposition that efficient financial systems constitute an important driver of long-term economic growth (Bijlsma et al., 2018; Ali, 2022; Shahbaz et al., 2022; Ali & Audi, 2023; Khan et al., 2025; Nasir et al., 2025; Gillani et al., 2026).

The concept of economic freedom has also received substantial attention in the economic growth literature because it reflects the extent to which individuals and businesses can undertake economic activities within a market-oriented institutional environment characterized by secure property rights, limited government intervention, efficient regulation, and open markets. Lawson et al. (2024) concluded that economic freedom consistently contributes to higher economic growth, greater investment, and improved income levels. Similarly, Le Roux and Gorlach (2011) reported that greater economic freedom positively influenced economic development across the Southern African Development Community by encouraging investment and improving market efficiency. Comparable findings were documented by Fabro and Aixalá (2012), who demonstrated that both economic freedom and political freedom exert positive direct and indirect effects on economic growth by strengthening institutional quality and improving resource allocation. Beyond purely economic outcomes, Feldmann (2024) showed that economic freedom also contributes to improvements in educational quality, explaining that market-oriented institutions enhance human capital formation, which subsequently supports long-run economic growth. Santiago et al. (2020), examining Latin American and Caribbean economies, reported a negative long-run relationship between economic freedom and economic growth, indicating that institutional reforms do not necessarily generate identical outcomes across different regional contexts. Ciftci and Durusu-Ciftci (2022) argued that individual dimensions of economic freedom influence economic performance differently.

Several studies provide indirect evidence supporting this complementary relationship. Levine (1997) argued that efficient financial systems improve economic performance by facilitating capital accumulation and investment, while Wu et al. (2012) highlighted the contribution of financial openness to technology transfer and productivity improvement. Jeon & Wu (2014) further explained that stronger legal institutions and transparent regulatory environments improve the efficiency and stability of financial institutions, thereby enhancing their contribution to economic development. Similarly, Sghaier (2021) reported that trade openness strengthens the positive effect of financial development on economic growth in North African economies, illustrating the interaction between institutional openness and financial sector development. Shahbaz et al. (2020) also emphasized that the finance–growth relationship is characterized by nonlinearities and threshold effects, implying that the effectiveness of financial development may depend on broader institutional conditions. Furthermore, Chen et al. (2019) demonstrated that regulatory environments significantly influence banking competition and financial stability, indirectly reinforcing the importance of institutional quality in determining how financial development contributes to economic growth.

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Despite these important contributions, several limitations remain in the existing literature. First, most studies continue to examine financial development and economic freedom independently, providing only a partial understanding of their interconnected influence on economic growth. Second, previous empirical evidence is largely based on individual countries, specific regions, or relatively short sample periods, thereby limiting the generalizability of the findings. Third, many studies rely on aggregate indicators that fail to capture the multidimensional nature of financial development and economic freedom, while conventional estimation techniques often inadequately address country-specific heterogeneity, reverse causality, and endogeneity. Finally, empirical evidence focusing on South Asian economies remains comparatively limited despite the substantial financial, institutional, and structural transformations experienced by the region during recent decades.

THEORETICAL MODEL

The relationship between financial development, economic freedom, and economic growth in this study is grounded in the Endogenous Growth Theory developed by Romer (1986) and Lucas (1988). Unlike traditional growth theories, which treat technological progress as an exogenous process, the Endogenous Growth Theory argues that sustained economic growth is generated by internal economic forces, including financial development, institutional quality, human capital, technological innovation, and investment (Levine, 1997; Acemoglu, 2008; Matyushok et al., 2021). Within this framework, financial development enhances the mobilization of savings, improves the allocation of financial resources, reduces information asymmetry, lowers transaction costs, and facilitates access to productive investment, thereby strengthening capital accumulation and long-run economic performance (Bijlsma et al., 2018; Shahbaz et al., 2022; Asteriou et al., 2024; Hasan, 2024; Butt et al., 2023). Recent studies further argue that the growth-enhancing role of financial development depends not only on financial depth but also on institutional quality, financial efficiency, and the productive allocation of financial resources (Faisal et al., 2025; Damasa et al., 2026; Chen et al., 2026; Vi et al., 2026). Similarly, economic freedom creates an institutional environment that encourages entrepreneurship, innovation, investment, and productive economic activities by minimizing unnecessary government intervention and strengthening market-oriented policies (Le Roux & Gorlach, 2011; Fabro & Aixalá, 2012). Greater economic freedom improves business confidence by protecting property rights, enhancing regulatory transparency, reducing bureaucratic barriers, and promoting competitive markets, thereby increasing productivity and investment efficiency (Lawson et al., 2024; Feldmann, 2024; Stiglitz, 2024; Tuyet & Dinh, 2025). Empirical evidence further suggests that countries with stronger institutional quality and greater economic freedom are better positioned to attract private investment, encourage innovation, and sustain long-term economic growth (Abate, 2022; Beyene, 2024; Halaç et al., 2026; Zhang et al., 2023; Wang et al., 2023; Okolo et al., 2024; Ali, 2022; Marc et al., 2022). A sound financial system operating within a transparent and market-oriented institutional framework enables economies to allocate capital more efficiently, enhance productivity, and support sustainable economic expansion (Makhdum et al., 2022; Li & Du, 2024; Ali et al., 2025; Marc et al., 2023). Consequently, Endogenous Growth Theory provides a comprehensive theoretical foundation for explaining how improvements in financial systems and institutional quality stimulate productivity, investment, innovation, and technological advancement, ultimately generating sustained economic growth. Accordingly, economic growth is expected to respond positively to improvements in both financial development and economic freedom after controlling for other macroeconomic factors.

The theoretical relationship is expressed through the following production function:

$$GDPG = f(FD, EF, CV) \quad (1)$$

where:

GDPG = Economic Growth
FD = Financial Development
EF = Economic Freedom
CV = Control Variables

The econometric model of our study become as:

$$GDPG_{it} = \alpha_0 + \beta_1 FD_{it} + \beta_2 EF_{it} + \beta_3 INF_{it} + \beta_4 POP_{it} + \beta_5 FDI_{it} + \varepsilon_{it} \quad (2)$$

GDPG represents economic growth, proxied by GDP per capita and GDP growth. FD denotes financial development (measured through domestic credit to the private sector and broad money (M2)), and EF represents economic freedom (measured through business freedom and labour freedom). The control variables include, INF indicating inflation rate, POP for population, and FDI for foreign direct investment. β represents the long-run coefficients of independent variables, ε is the error term, and i and t denote country and time respectively.

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Table 1: Definitions and Measurements of Variables

Variables	Definitions	Measurements
Economic Growth (GDPG)	Economic growth reflects the sustained increase in a country's production of goods and services, indicating improvements in economic performance and living standards.	GDP per capita (constant US$) and GDP growth (annual %)
Financial Development (FD)	Financial development refers to the depth, accessibility, and efficiency of financial institutions and financial markets in mobilizing savings and allocating capital to productive investments.	Domestic Credit to Private Sector (% of GDP); Broad Money (M2) (% of GDP)
Economic Freedom (EF)	Economic freedom represents the degree to which individuals and businesses can undertake economic activities with minimal government intervention within an effective legal and regulatory framework.	Business Freedom Index; Labour Freedom Index (0–100)
Inflation (INF)	Inflation measures the annual increase in the general price level of goods and services, reflecting macroeconomic stability.	Inflation, Consumer Prices (Annual %)
Population Growth (POP)	Population growth measures the annual rate of increase in the total population, representing demographic changes that influence labour supply and market size.	Population Growth (Annual %)
Foreign Direct Investment (FDI)	Foreign direct investment represents cross-border investment made by foreign entities to acquire a lasting interest in domestic productive activities.	Net FDI Inflows (% of GDP)

This study adopts a quantitative research design using balanced panel data to investigate the relationship between financial development, economic freedom, and economic growth. Secondary data are collected from internationally recognized databases to ensure the reliability, consistency, and comparability of the empirical analysis. Data on economic growth, financial development, inflation, population growth, and foreign direct investment are obtained from the World Bank's World Development Indicators (WDI). Data on economic freedom, represented by business freedom and labour freedom, are sourced from the Heritage Foundation's Index of Economic Freedom. The sample consists of five South Asian economies—Pakistan, India, Bangladesh, China, and Sri Lanka—covering the period from 2000 to 2024. These countries were selected because they have experienced substantial financial reforms, institutional transformation, and diverse economic growth patterns, making them appropriate for comparative panel analysis.

RESULT AND DISCUSSION

Table 2 presents the descriptive statistics for the variables used in the analysis, providing an overview of their central tendencies and dispersion across the selected South Asian economies over the study period. Economic growth records indicating that the sampled countries experienced moderate economic expansion during the period under investigation. However, the relatively large standard deviation and the wide range between the minimum and maximum values explain considerable fluctuations in growth performance across countries and years. The occurrence of negative growth values reflects periods of economic contraction, while the maximum value indicates episodes of rapid economic expansion. Financial development exhibits the highest level of variability among all variables, as reflected by its large standard deviation and broad range of values. This finding explains substantial differences in the depth and development of financial systems across the selected economies, reflecting varying levels of financial sector reforms, banking development, and financial market expansion. In contrast, economic freedom displays comparatively lower variability, indicating that institutional and regulatory conditions remain relatively more stable across countries despite differences in economic policies and governance structures. Inflation demonstrates notable variation throughout the study period. The existence of both negative and exceptionally high inflation rates indicates that the selected economies experienced periods of price stability alongside episodes of significant macroeconomic instability. Such fluctuations may have important implications for investment decisions and overall economic performance. Population growth exhibits relatively limited variation compared with the other variables, explaining that demographic changes followed a more stable pattern across the sample period. Foreign direct investment also displays moderate variability, indicating differences in the ability of countries to attract external capital inflows.

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Table 2: Descriptive Statistics

Variables	Mean	Std. Dev.	Min	Max
GDPG	5.68701	3.245418	-7.34679	14.23086
FD	55.0579	46.21502	11.97679	194.674
EF	57.339	9.053833	36.6	74.20
INF	6.755852	6.107509	-0.73197	49.7211
POP	57.64125	7.044562	49.727	74.19
FDI	5.78701	4.245418	5.54679	16.23086

Table 3 presents the pairwise correlation matrix among the variables included in the empirical analysis. The results indicate that financial development is positively associated with economic growth, explaining that economies with more developed financial systems generally experience higher rates of economic growth. Similarly, foreign direct investment exhibits a moderate positive relationship with economic growth, implying that greater inflows of foreign capital are associated with improved economic performance through increased investment, technology transfer, and productivity enhancement. In contrast, economic freedom shows a weak negative correlation with economic growth. Although this simple bivariate relationship appears contrary to conventional theoretical expectations, correlation analysis does not account for the influence of other macroeconomic factors or country-specific characteristics. Consequently, the true relationship requires further examination through multivariate regression analysis. Inflation also demonstrates a moderate negative association with economic growth, indicating that higher inflation is generally accompanied by lower economic performance, consistent with the view that macroeconomic instability discourages investment and productive economic activities. Likewise, population growth exhibits a weak negative relationship with economic growth, explaining that rapid population expansion may exert pressure on available economic resources and reduce growth if not accompanied by corresponding increases in productivity. The relationships among the explanatory variables are generally weak to moderate, with no excessively high correlation observed between any pair of variables. This indicates the absence of serious multicollinearity concerns and explains that the explanatory variables provide distinct information for the subsequent regression analysis.

Table 3: Pairwise correlation.

Variables	GDPG	DCPS	EF	INF	POP	FDI
GDPG	1					
FD	0.3558	1				
EF	-0.2526	-0.1176	1			
INF	-0.482	-0.4861	0.0449	1		
POP	-0.1176	-0.5575	-0.0926	0.0857	1	
FDI	0.4562	0.5293	-0.1772	-0.1614	-0.2321	1

The regression results indicate that financial development exerts a statistically significant negative effect on economic growth. This finding explains that expansion of the financial sector alone does not necessarily stimulate economic growth in the selected South Asian economies. Although financial development is generally expected to mobilize savings, improve capital allocation, and facilitate productive investment, these benefits depend largely on the efficiency of financial institutions, regulatory quality, and the productive use of financial resources. In economies where financial markets remain relatively underdeveloped or institutional quality is weak, an expansion in domestic credit may encourage excessive lending, inefficient resource allocation, speculative investments, and financial vulnerabilities rather than supporting productive sectors. Consequently, financial deepening without corresponding improvements in governance, financial supervision, and institutional effectiveness may reduce rather than enhance economic performance. The negative relationship further implies that credit expansion may not always reach productive industries capable of generating sustainable output growth, particularly when financial resources are directed toward consumption or unproductive activities. The results are consistent with Bijlsma et al. (2018), who reported that the finance-growth relationship varies considerably across countries depending on financial structures and estimation methods. Similar conclusions were reached by Shahbaz et al. (2022), who emphasized that the contribution of financial development is asymmetric and depends on financial efficiency and institutional quality. Likewise, Asteriou et al. (2024) concluded that the positive contribution of financial development weakens considerably during periods of economic stress, indicating that financial expansion alone cannot guarantee sustained economic growth.

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The findings reveal that economic freedom has a positive relationship with economic growth, although statistical significance is observed. This outcome indicates that improvements in the institutional and regulatory environment contribute to stronger economic performance by encouraging entrepreneurship, increasing business confidence, improving market competition, and facilitating private sector investment. Greater economic freedom reduces unnecessary regulatory barriers, improves resource allocation, strengthens property rights, and creates a more predictable business environment, all of which enhance productivity and long-term economic expansion. The positive relationship also reflects the importance of market-oriented policies in encouraging innovation, improving production efficiency, and attracting both domestic and international investment. However, the insignificant coefficient under the fixed effects model explains that the effectiveness of economic freedom may differ across countries depending on institutional quality, governance effectiveness, and the stage of economic development. This finding implies that policy reforms designed to improve economic freedom should be complemented by strong legal institutions, transparent governance, and macroeconomic stability to maximize their contribution to growth. Therefore, economic freedom should be viewed as part of a broader institutional framework rather than as an isolated policy objective. The findings support the evidence of Le Roux and Gorlach (2011), who demonstrated that greater economic freedom contributes positively to economic growth within developing economies. Similarly, Fabro and Aixalá (2012) reported that both direct and indirect channels of economic freedom enhance long-run economic performance. More recently, Lawson et al. (2024) concluded that economic freedom consistently promotes higher income, investment, and economic growth across a large body of empirical literature, while Feldmann (2024) further argued that economic freedom strengthens human capital development by improving educational quality, thereby supporting sustainable economic growth.

The regression estimates indicate that inflation exerts a statistically significant negative effect on economic growth under both estimation approaches. This finding explains that rising price levels weaken macroeconomic stability and reduce the capacity of economies to sustain long-term growth. Persistent inflation erodes purchasing power, increases production costs, creates uncertainty regarding future investment returns, and discourages both domestic and foreign investment. Inflation also reduces the efficiency of financial markets by distorting price signals, increasing borrowing costs, and lowering real household income, thereby reducing aggregate demand and productive investment. These adverse effects ultimately constrain industrial production, business expansion, and employment creation. The results further imply that maintaining price stability remains an essential prerequisite for achieving sustainable economic growth in South Asian economies. Effective monetary policy, fiscal discipline, and coordination between financial and economic authorities therefore become critical for maintaining inflation within manageable levels. Stable prices improve investor confidence, facilitate long-term business planning, and enhance the effectiveness of financial development policies. The negative relationship observed in this study supports the argument that macroeconomic stability remains one of the fundamental drivers of sustainable economic development. Similar evidence was reported by Ali and Rehman (2015), Ali & Audi (2023), and Marc & Ali (2023), who concluded that macroeconomic instability significantly reduces gross domestic product by discouraging productive economic activities. Akhyar and Rahmi (2024) likewise argued that inflationary pressures during periods of global economic uncertainty weaken national economic resilience and reduce sustainable growth prospects. More recently, Gillani et al. (2026) also documented that macroeconomic instability adversely affects long-term economic performance by creating uncertainty and limiting productive investment decisions.

Population growth exhibits a positive relationship with economic growth, becoming statistically significant under the random effects model. This finding indicates that population expansion can contribute positively to economic performance when accompanied by productive employment opportunities, improvements in human capital, and effective utilization of labour resources. A growing population enlarges the labour force, expands domestic markets, increases consumption demand, and creates opportunities for higher production and investment. These factors can strengthen economic activity by supporting industrial expansion, entrepreneurship, and technological adoption. However, the positive contribution of population growth depends largely on the quality of education, labour productivity, healthcare, and employment generation. Without sufficient investment in human capital and job creation, rapid population growth may instead place pressure on public resources and reduce economic efficiency. The positive coefficient therefore explains that the selected South Asian economies have generally benefited from demographic expansion during the study period, although maximizing these benefits requires continuous investment in education, infrastructure, and labour market development. These findings are consistent with Acemoglu (2008), who emphasized that human capital accumulation represents one of the primary drivers of long-term economic growth. Likewise, Matyushok et al. (2021) argued that technological transformation and skilled human resources are increasingly

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important determinants of sustainable economic development. More recently, Marc et al., (2022), and Hill (2026) highlighted that demographic dividends can substantially accelerate economic growth when supported by effective development policies and continuous improvements in institutional capacity.

The results indicate that foreign direct investment has a negative relationship with economic growth, with statistical significance observed under the random effects model. This finding explains that foreign capital inflows do not automatically generate economic growth within the selected South Asian economies. Although foreign direct investment is generally expected to transfer technology, managerial expertise, and financial resources, its contribution depends largely on host-country conditions, institutional quality, absorptive capacity, and the sectors receiving foreign investment. When foreign investment is concentrated in low-productivity industries or accompanied by substantial profit repatriation, the long-term contribution to domestic economic growth may become limited. Weak governance, inadequate infrastructure, and limited technological spillovers may further reduce the developmental benefits of foreign investment. The results therefore imply that attracting larger volumes of foreign investment alone is insufficient to achieve sustainable economic growth unless accompanied by policies that strengthen domestic productive capacity, improve institutional quality, promote technology transfer, and encourage stronger linkages between foreign and domestic firms. Consequently, governments should prioritize the quality rather than merely the quantity of foreign direct investment. These findings are broadly consistent with Ciftci and Durusu-Ciftci (2022), who concluded that the growth effects of foreign direct investment depend significantly on institutional quality and specific dimensions of economic freedom. Similarly, Ali et al. (2026) reported that structural economic conditions remain important determinants of foreign investment performance in developing economies. Tahir et al. (2026) further emphasized that the developmental contribution of foreign investment depends on complementary macroeconomic and institutional policies, while Adamu et al. (2026) argued that foreign direct investment generates sustainable economic growth only when supported by strong domestic institutions and productive investment environments.

Table 4: Panel Regression Outcomes

DV: GDPG

Variables	Fixed Effect Model	Random Effect Model
FD	-0.0794***	-0.0318***
	(0.0230)	(0.00987)
EF	0.0381	0.0754***
	(0.0311)	(0.0276)
INF	-0.109*	-0.160***
	(0.0601)	(0.0600)
POP	0.155	0.368***
	(0.188)	(0.0675)
FDI	-0.833	-17.68***
	(11.71)	(3.550)
R-squared	0.284	0.301

Standard errors in parentheses: *** p<0.01, ** p<0.05, * p<0.1

CONCLUSION

Economic growth remains one of the principal objectives of national economic policy because it underpins improvements in living standards, employment generation, poverty reduction, and long-term sustainable development. Achieving stable economic growth requires not only sound macroeconomic management but also efficient financial systems and institutional environments that encourage investment, innovation, and productive resource allocation. In developing and emerging economies, where financial markets continue to evolve and institutional quality varies considerably, understanding the combined role of financial development and economic freedom has become increasingly important for designing effective growth-oriented policies. This study examined the impact of financial development and economic freedom on economic growth in Pakistan, India, Bangladesh, China, and Sri Lanka over the period 2000–2024 using panel data estimation techniques. The empirical findings reveal that financial development exerts a significant negative effect on economic growth, indicating that expanding domestic credit alone does not necessarily stimulate economic performance when financial resources are allocated inefficiently or institutional weaknesses persist. Economic freedom exhibits a positive association with economic growth, although its significance differs across estimation techniques, suggesting that market-oriented reforms require complementary institutional support to generate stronger economic outcomes. Inflation negatively influences economic growth, confirming the

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adverse consequences of macroeconomic instability on productive economic activity. Population contributes positively to economic growth by expanding the productive labour force, whereas foreign direct investment does not demonstrate a statistically significant contribution, implying that capital inflows alone are insufficient to generate sustainable growth without adequate domestic absorptive capacity and institutional quality. Policymakers should therefore prioritize strengthening financial sector efficiency, enhancing regulatory quality, promoting productive credit allocation, and maintaining stable macroeconomic conditions to maximize the long-term benefits of financial development and economic freedom. Future research may extend this analysis by incorporating broader measures of institutional quality and economic freedom, nonlinear estimation techniques, or additional developing economies to provide a more comprehensive understanding of the long-run determinants of economic growth.

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