TRADE OPENNESS, EXPORT, IMPORT AND ECONOMIC GROWTH IN ASEAN-5 AND JAPAN

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FACULTY OF BUSINESS, ECONOMICS AND ACCOUNTANCY

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DECLARATION

I hereby declare that the material in this thesis is my own except for quotations, equations, summaries and references, which have been duly acknowledged.

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ABSTRACT

This study examined the relationship between trade openness, exports, and imports, on economic growth of ASEAN-5 countries and Japan between 1980-2018. The dependent variable used was Gross Domestic Product whereas independent variables were trade openness, export and import. In order to reduce bias result, explanatory variables such as Foreign Direct Investment, Capital Formation and Real Effective Exchange Rate were included. To examine the stationarity of the data, two tests for Unit Root test were performed which were the Augmented Dickey–Fuller (ADF) test and Phillips Perron (PP). Then, ARDL were employed to identify the co-integrating vectors for determining a long-run relationship between the variables. The last step was to use Wald test for identifying the short-run and causality relationship between the variables. The results were that all variables had a long-run relationship with each other, and there were co-integrating vectors among the variables. Based on the ARDL Bound test, Thailand was the only country where there was a positive and significant relationship between trade openness and economic growth. In addition, the economic growth in Malaysia and Singapore were highly influenced by Foreign Direct Investment while economic growth in Indonesia was very much affected by Real Effective Exchange Rate. The finding was that in short run, that there exists a causality between trade openness and economic growth for Singapore. Also, exports have strong influence on economic growth in short-run, for Malaysia, Thailand, and Singapore. Imports have a positive and significant relationship with economic growth in only in one country, which was Malaysia. For the Philippines and Japan, the results show that there was no long-run effect between the independent variables and dependent variable. Almost all relationships are negative and not significant. The foreign direct investment, however, was found to be not significant but are positive for both countries. This result implies that the economic growth in the Philippines and Japan was not influenced by trade openness.

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ABSTRAK

KETERBUKAAN PERDAGANGAN, IMPORT,EKSPORT DAN PERTUMBUHAN EKONOMI DI NEGARA ASEAN-5 DAN JEPUN

Kajian ini memerika hubungan di antara keterbukaan perdagangan, export dan import dengan pertumbuhan ekonomi di negara anggota ASEAN-5 dan Jepun dalam tempoh dari tahun 1980 sehingga 2018. Pemboleh Ubah Dependent yang digunakan adalah Keluaran Dalam Negara Kasar manakala pemboleh ubah Independent adalah Keterbukaan Perdagangan, Eksport dan Import. Pemboleh Ubah explanatory seperti Pelaburan Langsung Asing, Pengumpulan Modal dan Kadar Pertukaran Wang Asing Efektif Sebenar telah digunakan untuk mengurangkan dapatan bias. Untuk memeriksa kepegunan data, kajian ini memilih dua kaedah menguji iaitu menggunakan ujian Augmented Dickey–Fuller (ADF) dan ujian Phillips Perron (PP). Selepas itu, kajian ini menggunakan kaedah ADRL untuk mengenalpasti kewujudan kointegrasi vektor di antara pemboleh ubah dan sama ada hubungan ko integrasi tersebut wujud dalam jangka masa Panjang. Langkah akhir dalam kajian ini adalah pengunaan ujian Wald bagi mengenalpasti kewujudan hubungan jangka pendek dan hubungan kausaliti di antara pemboleh ubah tersebut. Keputusan ujian adalah kesemua pemboleh ubah mempunyai hubungan dengan satu sama lain dan wujud ko integrasi vektor di kalangan pemboleh ubah tersebut. Berdasarkan Ujian ARDL Bound adalah didapati juga hubungan di antara Keterbukaan perdagangan dan pertumbuhan ekonomi adalah positif dan significant hanya bagi negara Thailand. Tambahan pula, pertumbuhan ekonomi bagi negara Malaysia dan Singapura adalah sangat dipengaruhi oleh FDI manakala pertumbuhan ekonomi Indonesia sangat terjejas oleh kadar pertukaran pertukaran wang asing efektif sebenar. Manakala bagi negara Singapura, terdapat hubungan kausaliti di antara keterbukaan perdagangan dan pertumbuhan ekonomi hanya dalam jangka pendek. Selanjutnya, dalam jangka pendek, eksport juga didapati mempunyai pengaruh yang sangat kuat terhadap pertumbuhan ekonomi negara Malaysia, Thailand dan Singapura. Import juga didapati mempunyai hubungan positif dan significant dengan pertumbuhan ekonomi hanya di sebuah negara sahaja, iaitu Malaysia. Bagi negara Filipina dan Jepun, keputusan menunjukkan pemboleh ubah independent dan pemboleh ubah

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dependent tidak mempunyai dalam hubungan jangka penjang. Hampir kesemua hubungan di antara pemboleh ubah didapati negative dan tidak significant. Manakala, Pelaburan Langsung Asing didapati tidak significant tetapi positif untuk kedua-dua negara tersebut. Keputusan ini menunjukkan bahawa pertumbuhan ekonomi negara Filipina dan Jepun tidak dipengaruhi oleh keterbukaan perdagangan.

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LIST OF ABBREVIATION

ASEAN	**-**	Association Of Southeast Asian Nations
LGDP	**-**	Log Gross Domestic Product
LTO	**-**	Log Trade Openness
LCF	**-**	Log Capital Formation
LFDI	**-**	Log Foreign Direct Investment
LREER	**-**	Log Real Effective Exchange Rate
LX	**-**	Log Export
LM	**-**	Log Import
WTO	**-**	World Trade Organization
IMF	**-**	International Monetary Fund

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CHAPTER 1

INTRODUCTION

1.1 Background of Study

One of the contested issues in the field of international trade that has garnered researchers' attention is the impact of trade openness on economic growth i.e. Gross Domestic Product (GDP) . The founding members of Association of Southeast Asian Nations that is Malaysia, Singapore, Indonesia, Philippines and Thailand (known as ASEAN-5 countries) has achieved high economic growth over the period between 1980 and 2018. Many researchers think international trade openness was the main catalyst for the ASEAN-5 economic miracle (Andersen and Babula, 2008; Stiglitz and Yusuf, 2001; Jomo et al., 1997; World Bank, 1993). A study by Furuoka (2007) found that international trade and export were the main engine for Malaysia remarkable economic growth.

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Trade openness can be defined as the country's integration with the world, in which there is a free movement of labour, capital, and trade among them. Trade openness is assumed to be an important source of economic growth, it can be measured based on two approaches, by the activities or by the incentives. The activities consist of indicators, such as export, import rate and GDP. In activities approach, trade are strongly influenced by the export activity, the size, and a country's trade policy. In incentive approach, trade openness are related mainly to free movements of goods and services.

Economic growth measured in GDP are defined as the sum of gross value added by all resident producers in the economy plus any product taxes and minus any subsidies not included in the product value (World Bank Indicator, 2019). Numerous empirical studies have demonstrated the notable link between trade

openness and economic growth (Chang et al., 2009). In many ways, trade openness promotes economic growth, which includes resource allocation and specialization. Past studies also indicated trade openness leads to the efficient allocation of resources. This subsequently could helped generate a steady state level of income that leads to an increase in economic growth (Solow, 1956). In addition, it was found that the more open the country is to trade, the higher their ability to export higher quality products.

The effects of trade openness on economic growth have been debated for generations. Trade openness is a multidimensional subject; it can be traced to FDI, labour mobility, research and development, technology, and knowledge. In this study, one of the dimensions that is the trade index, is not included due to insufficient data. Instead, this study focused on trade openness, which refers to the sum of import and export as a percentage of gross domestic product (GDP). There are plenty of empirical evidence supporting and rejecting the notion that trade openness are the main engine for generating high economic growth, particularly for developing countries in South East Asia. The perennial question was 'to what extent and under what conditions can trade openness be the main driver of economic growth?'

This study examined the effects of trade openness on the economic growth of the ASEAN-5 countries namely Singapore, Malaysia, Thailand, Indonesia, the Philippines and Japan. The ASEAN-5 countries has many similarities in terms of international trade, firstly, they used (between 1980- 2000 except during short period of 1997-98 aftermath of Asian currency crisis) to have large trade surpluses with Japan. In other words, Japan was their major international trading partner for almost three decades. It was during these three decades that the ASEAN tigers that is Malaysia, Indonesia, Thailand and Philipines experienced economic miracle of high economic growth. During the economic growth miracle era, Singapore was already a developed and high income country at par with Taiwan and South Korea, both has been Japan's most important trading partner after the US and Europe. This is true until some 15 years ago when China became the major trading partners for ASEAN-5 and Japan. None the less, the trade between Singapore and Japan today is still substantial higher than the intra trade with ASEAN-5 countries combined. In fact, Japan is still a very important trading partner to all 10 ASEAN countries. The total

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value of bilateral trade between the 10 ASEAN Member States and Japan grown to more than 25 trillion yen in 2018, accounting for about 15% of Japan's total trade with the Japan was ASEAN-10 second largest trading partner after China, the EU, and the US (ASEAN-Japan relation). Both Singapore and Japan is in their own league in terms of very high volume GDP hence much richer (high GDP per capita), both way above the ASEAN-4. Japan recorded rapid economic development and high economic growth from 1950 until the burst of the economic bubble in the 1980s. This remarkable achievement was attributed to many factors, including industrial export strategy and growth-oriented or outward-looking policies without much commitment. Some scholars have linked the emergence of Japan as an economic superpower due to the foreign aid provided the United States right after Japan's defeats in WWII. Both Japan and Singapore are included in the study as a benchmark to study the impacts of free trade or trade openness on the economic growth of the less richer Malaysia, Thailand, Indonesia and Philippines.

It is in this context that this study intended to re-test the hypothesis that trade openness caused high GDP for the ASEAN -5. It is interesting to test this hypothesis in the context of ASEAN-5 because they were known to have been implementing import substitution and only in recent decades moved into export oriented industrial policies.

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The literature on the intra or inter trade among ASEAN -10 and the bilateral trade between Japan and ASEAN-5 is very large and extended over five decades or so. However, it should be stated on the onset that, the ultimate aim of ASEAN's is to form an ASEAN Economic Community through free trade block among its member countries. Over the past decade, ASEAN countries have been at the forefront of promoting trade openness to generate high economic growth. The economic cooperation among the six founding members of ASEAN has become stronger since the ASEAN Free Trade Area (AFTA) was established in 1992. ASEAN Free Trade Area was established to promote high economic growth, free or open trade, and competitive advantage in line with global economic development. so far ASEAN has signed Free Trade Agreements (FTA) with Japan in 2008, with Australia-New Zealand in 2009, with China and South Korea both in 2010.

The main objective of bilateral and unilateral trade agreements is to strengthen intra-regional economic cooperation and be part of the global exchange. It is expected that AFTA member countries will enjoy the positive outcomes from economic integration. In this regard, AFTA was aimed to remove obstacles to free trade and increases the competitiveness of ASEAN countries as a global competitive production base. Have they been economically growing as expected? To what extent can it be associated with the level of their trade openness? This study intended to shed some light on economic growth in ASEAN-5 and in Japan with FTAs signed under the initiatives of AFTA, ASEAN Economic Commuinity and quite recent TPPA, in the background.

It also includes the Common Effective Preferential Tariff (CEPT), a type of Custom Union that promotes the free flow of goods between member states. At that time, the new members such as Vietnam, Laos, Burma, and Cambodia were given longer time frames to meet AFTA's tariff reduction obligations. The ASEAN-10 plus Papua New Guinea and East Timor as Regular Observers, has agreed to eliminate tariffs among themselves. ASEAN members have been working hard to lower their import duties to member states, targeting zero import duties by 2016. In 2015, a single market called ASEAN Economic Community was finally established. For the ASEAN Economic Community, free or open trade are the means an end i.e. economic growth. This study intended to explain economic growth level for each ASEAN-5 country after the formation of AFTA in 1992 and after 2015- ASEAN Economic Community.

It is important to note that many studies find that the weak economic growth among ASEAN countries has been largely attributed to internal conflicts and government failures. It was reported that millions of people are still earning the same income as 200 years ago (Milanovic, 2012). The divergence of economic growth among ASEAN member countries needed further investigation. It is related to trade openness or not, if it is related, how, why and when, exactly?

There is a large volume of published studies describing the effects of trade openness on economic growth. Popular independent variables used were export, foreign direct investment (FDI), capital formation, but the exchange rate was seldom included. These studies showed that trade openness brings economic benefits, such

as enhancement of technology transfer, skill transfer, increased workforce and productivity factors, and economic growth and development. The direction of causality and the effects of these two variables have been somewhat neglected (Edwards S., 1998). Earlier studies have employed neoclassical model frameworks that emphasize the effects of investment on GDP. This study expanded the model by adding trade openness, export and import as the key variables.

So far, there are at least two ways to explore the effects of trade openness on economic growth. First, examining the effects of trade openness on economic growth to see whether openness to foreign trade was beneficial to the selected countries. The second approach is by measuring the degree of openness (how free is it) of each selected country. Such measurement involved subjective judgment on tariffs and non-tariff trade restrictions and production mobility factors indicated by exchange rate regimes as shown in Sach and Warner (1995) and Collier and Dollar (2002).

The trade openness of ASEAN-5 with each other (intra and inter) and with the rest of world indicated by exchange rates regimes, arranged in historical order are presented in Table 1.1 below. The brief history of exchange rate regimes followed by the countries under investigation is an important background information because it is related to one of the explanatory variables i.e. Real Effective Exchange Rate (REER). As specified in Table 1.1, Thailand is always open to trade, while Malaysia has been open to trade since 1963. Japan has opened for trade since it assumed the obligations of Article VIII of World Trade Organization (WTO) and established full currency convertibility. Singapore opened its trade in 1965, followed by Indonesia in 1970. At this time, Indonesia's export rate was growing rapidly, and imports have increased at a fast rate. The Philippines opened its trade in 1980. Trade policy changes involving trade liberalization or exchange rate regimes are usually associated with the growth rate (output). This observation was a guidepost for investigating how, why, and how trade openness affects income, i.e., gross domestic product (GDP) per capita. Open economies experience more rapid economic growth than fully closed economies, such as North Korea, Myanmar, and Laos in the ASEAN region. Trade openness has been debated by hundreds of scholars who investigated its impacts on economic growth. Previous scholars also looked into common global

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phenomena, such as why some countries are slow growing hence still poor and why some countries are growing faster than others hence getting richer and how it is related to degree of trade openness.

Table 1.1: Trade Openness indicated by the Exchange Rate Regimes in ASEAN-5 and Japan

No	Description
1	**MALAYSIA** Open since independent 1963. The black-market premium has never exceeded 2% in 1965. International Monetary Fund (IMF) reported that most imports were permitted freely under open general licenses. Exchange rate regime.
2	**JAPAN** Open since 1964, when Japan assumed the obligations of article VIII of WTO and established full currency convertibility.
3	**SINGAPORE** Open since independent in 1965 and used managed floating with no pre-determined path for the exchange rate (Rajan, 2010)
4	**INDONESIA** Open since 1970. Indonesia has dual exchange rate system. The important of trade liberalization were introduced between May 1966 and July 1967
5	**PHILIPPINES** Open since 1988. The assessment that the Philippines was not sufficiently open in 1980s. Philippines was used Independently floating exchange rate regime. (Rajan,2010)
6	**THAILAND** Always open countries and used managed floating with no pre-determined path for the exchange rate. (Rajan 2010)

Source: Sachs & Warner 1995: 72-95

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1.2 Problem Statement

There is ample evidence that economic growth leads to income inequality. This can be observed by looking at the divergence and convergence between developed countries, such as Japan and Singapore, with developing countries like Malaysia, Indonesia, the Philippines, and Thailand. As stated in the table 1.2 it shows that the gap between lower income countries with the high income countries. Economic growth is the means to achieve an end i.e. GDP Percapita -a primary indicator of Human Development Index or in short how wealthy (materially) a country is at given time period. This study wanted to find out why some countries of ASEAN -5 grow faster while the other is slower by exploring trade openness and its impacts on their economic performance.

Several measurements have been used to identify the relationship between trade openness and economic growth. The most measured aspects of trade openness are the export plus import as a share of GDP. Other than that, there were measures for barriers, including tariff rates, export taxes, taxes on international trade, and indices of non-tariff barriers and as previously mentioned – exchange rate regimes. This study focused on trade openness as reflected by export and Import contribution (percentage) to GDP. However, other indicators, like data on direct measurement of trade policy, were not included due to unavailable of good quality data .

Unlike other previous studies, this study goes further to investigate the correlation between trade openness and economic growth. Both indicators for trade openness i.e. export and import rate, were combined to examine the significant impact of trade openness on the economic economic of developing countries (ASEAN-4) and developed countries (Singapore and Japan). Previous studies find that openness plays an important role in the economic growth of these two developed countries. At the same time, other studies concluded that openness always plays a significant role in developing countries of ASEAN-4. These conflicting findings reflect the lack of a clear consensus on the exact relationship between trade openness and economic growth. In Keho (2017) for instance, it was mentioned that the relationship between trade openness and economic growth have been debated extensively yet the results so far, has been mixed and inconclusive.This is because of the difference

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