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THE EFFECT OF TRILEMMA TOWARD ECONOMIC GROWTH OF NEWLY INDUSTRIALIZED ECONOMY IN SOUTHEAST ASIA

Abstract:

Southeast Asia is a growing region in terms of its economic activities characterized by its high economic growth, integration toward global economy and high capital accumulation. Nevertheless, Asian financial crisis in 1997 has disturbed the achievement of some newly industrialized countries (NICs) and has changed some of their macroeconomic policies orientation. This experience has disenchanted Southeast Asian countries to be more concerned about the effect of global financial fragility to its own domestic economy. For instance, they began to impose, at certain degree, capital mobility restriction and managing exchange rate stability. With regard to this issue, this paper examines the effect of monetary independence, capital control and exchange rate stability toward economic growth of NICs in Southeast Asia. However, most of the articles regarding to trilemma did not come up with proper quantitative approach in assessing the degree of capital control, monetary independence, and exchange rate stability policy imposed by several countries. Therefore, we applied Aizenman, Chinn, and Ito index in measuring monetary independence, exchange rate stability, financial openness or capital control. We used balance panel data from 1990 to 2011 of Indonesia, Malaysia, Thailand and Philippine as representation of NICs in Southeast Asia. We estimated economic growth as our dependent variable with several factor such as openness and inflation, beside trilemma variable, as our main variables. We followed panel data procedure in our estimation. By applying Chow test, LM test, and Hausman test the evidence exhibits that fixed effect specification is preferable in this model. The result of the estimation shows that financial openness index and monetary independence index are negatively significant toward economic growth. In another hand, higher exchange rate stability is positively affected economic growth although it was not statistically significant. Based on this evidence we can infer that managing capital mobility or imposing capital control at some degree are preferable rather than implementing monetary independence and implementing exchange rate stability for enhancing economic growth since three of them cannot be applied at the same time. Besides, Inflation is positively significant in determining economic growth while trade openness is not statistically significant in determining economic growth.

Keywords:

the effect of trilemma; economic growth; Southeast Asia; panel data; fixed effect.

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