Section: Management and Economics

Potential Impact of Integration of Financial Services on Economic Growth ASEAN5 + Vietnam

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Abstract:
The paper is structured aims to analyze the potential economic impact and the integration of financial services to economic growth ASEAN5 + Vietnam. To estimate the effect of financial integration on economic growth, this paper uses the findings of Edison. This paper will look at the transition from the integration of financial services as mirrored by financial openness to investment by looking at the influence of the government balance, population growth and inflation.

It can be concluded that financial integration is able to boost economic growth through investment channel. In order to integrate the financial sector in ASEAN5+Vietnam, there are three main things that inherent in the financial system namely financial literacy, financial inclusion, and financial deepening. ASEAN5+Vietnam need to develop these three agendas before integrate; hence the multiplier effect on economic growth through investment channel can be lifted up and sustainable at a certain level.

Keywords: financial integration, financial services, financial market, economic growth, economic integration, free trade, foreign investment, population, Balanced Budget and inflation.

JEL Codes: F3, G2, G1, O4, F36, F1, E21, J11, H61 and E31

I. Introduction:

1.1 Background:

Financial development can affect growth via three channels (Pagano, 1993 in Giannetti, et.al, 2002): (i) it can raise the fraction of savings funneled to investment, reducing the costs of financial intermediation; (ii) it may improve the allocation of resources across investment projects, thus increasing the social marginal productivity of capital; and (iii) it can influence households’ saving rate.

While in the first two cases the effect is generally positive, in the third its sign is ambiguous: financial development may also reduce saving, and thereby growth. As capital markets develop, households gain better insurance against endowment shocks and better diversification of rate-of-return risk, consumer credit becomes more readily and cheaply available, and the wedge between lending and borrowing rates shrinks. In this case, the effect on saving and growth is ambiguous. However, especially in economies open to capital flows, domestic investment is to some extent decoupled...
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from domestic savings, so that financial development is unlikely to affect the growth rate via changes in the saving rate – the third channel mentioned above. It is much more likely to do so either via the first and second channel, that is, by reducing the cost of financial intermediation or by improving the allocation of capital across projects. Full financial integration is a rather extreme scenario and is unlikely to be achieved merely through policy reform. Financial and regulatory reform, however, can do a lot to eliminate barriers to integration and to promote financial development. The latter is correlated with several underlying regulatory variables (such as indicators of investor protection, rule of law, etc), which are under the control of national legislators. and EU directives. Guico, et.all (2004) estimate that the effect of achieving full financial integration on the growth of European manufacturing industry is in the ballpark of 0.7 percentage points per year. But this overall growth effect results from themarkedly different country and sector effects, reflecting the heterogeneity of the EU in terms of sector composition and level of financial development. Convergence of regulatory and legal standards would have an average growth effect about 20 percent lower.

Meanwhile, according toUlrich Volz (2013) showed that the processes and mechanisms of financial integration in Europe have contributed to the current crisis. The use of the single currency Euro has triggered a slump in the value of real interest rates in the countries of the periphery and encourages their flights of capital from major countries, such as Germany and France leading to a sort of periphery countries like Greece and Ireland. It is similar to when the capital inflows in very large quantities (capital inflow Bonanzas) and sudden braking or actually turns out (capital flight) at the time of the global financial crisis triggered by the collapse of Lehman Brothers swept Europe. Although financial markets have been integrated Eurozone, the EU has no financial regulator and macroeconomic co-ordination strong at regional level.

Still, according to Ulrich Volz (2013), a tight financial market regulation can prevent the crisis compared with loose regulations applied some countries such as Ireland and Cyprus. Thus, a crisis that has hit Europe is mainly due to weak regulation and lack of coordination at the regional level. To overcome the crisis, it seems necessary to set up a regional crisis resolution mechanism and functioning regional financial regulators supervise banks in the region, as well as the establishment of a sovereign default mechanism in the Eurozone.

At the ASEAN Summit in 2007, ASEAN member countries have committed to establishing the ASEAN Economic Community (AEC) by 2015. The objective is to transform ASEAN into a region free exchange of goods and services, investment, labor, and capital flows. AEC has four major characteristics, namely the single market and production base, competitive economic region, equitable economic development; and integrated into the global economy.

ASEAN has been trying to realize the regional financial system is well integrated and gradually, through the liberalization of the capital account, the establishment of inter-linked financial markets in the region, and strengthening macroeconomic policy coordination among ASEAN member countries. To that end, in 2011 the ASEAN Central Bank Governors has adopted the ASEAN Financial Integration Framework (AFIF) which serves as a general approach to support the initiatives of integration and liberalization of the financial system under the auspices of ASEAN AEC. With the formulation of AFIF expected in the Southeast Asian region has had a semi-integrated financial market in 2020.

As a regional community, the ASEAN Economic Community consist ten countries that have different characteristics. Each country has a system of government, regulatory, currency, and the sovereignty of each. This condition could potentially to hamper the realization of a consensus within the framework of the ASEAN Economic Community.

According to Menzie D. Chinn and Hiro Ito (2008) using data from the IMF's Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER), showed that the degree of financial openness of the member countries of ASEAN, only Singapore and Cambodia has a degree of openness is positive. This indicates the level of cross-border capital transactions in the country.

Meanwhile toMatthew Kwan (2015) the recent establishment of the ASEAN Economic Community (AEC) could potentially have a significantly positive impact on the global economy. By creating a more integrated economic community, the AEC would encourage high-cost production countries such as Singapore and Cambodia to move its production to lower-cost ones such as Laos, Cambodia, and Burma. This would allow ASEAN nations to leverage on each other’s competitive advantage and ensure that efficiency is being

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optimized as much as possible. With the current trade volumes at a low point, the AEC could potentially salvage and mitigate the situation by ensuring that production costs are kept to its lowest possible in the region.

It is not easy to integrate the financial sector, according to Anchalee Pooitwiwong and Byron Ramirez (2016) some of the challenges facing the member countries of ASEAN are: First, some ASEAN countries have high inflation rates. This could result in dissimilar price levels and unequal purchasing power across ASEAN member countries, giving some countries the ability to purchase more goods of another member country. Also, different levels of inflation could result in different levels of investment. This could inadvertently lead to some sectors and industries incurring economic losses and to some workers in the less economically stable countries to consider migrating to more economically prosperous member countries. Many of the ASEAN economies are currently in vastly different stages of development, with large differences between high-saving economies, such as Brunei, Malaysia, and Singapore, and low-saving economies, such as Cambodia, Laos, and the Philippines. Second, there is also a high degree of political and socio-cultural diversity among ASEAN countries which makes economic integration challenging. ASEAN member countries have disparate existing levels of capital market development and financial regulations. Some of the ASEAN member countries do not have the appropriate financial sector regulation and infrastructure necessary for a seamless integration process. We can expect that there will be challenges associated with capital market development, financial services liberalization, capital account liberalization, and an eventual ASEAN currency cooperation.

Third, AEC will also incur costs related to institutional strengthening, costs related to monitoring and evaluating the regional systems within the economic framework, and costs related to developing and managing the regional systems necessary for an effective economic integration. One could also expect other costs to rise, such as those related to urbanization as millions of citizens migrate from rural areas to cities in search of economic opportunities. As most of the ASEAN member countries grow and expand their economic activities, there will be additional costs related to climate resiliency and environmental sustainability. Although the integration of financial services is faced with various problems, on the other hand, if successful will bring good economic impact. Therefore, this paper will analyze the potential economic impact and the integration of financial services to economic growth ASEAN5 + Vietnam. While the objective of this paper is to be(i) measuring the development of preparedness integration of financial services ASEAN5 + Vietnam through several indicators, namely Kaopen and Financial Openness and (ii) to estimate the effect of the integration model of financial services to the region's economic growth ASEAN5 + Vietnam through investment (hybrid monetary-fiscal).

1.2 Methodology:
To analyze the estimated effect of financial integration on economic growth this paper uses the findings of Edison (2002), which concludes the influence of real per capita growth in initial income, capital inflows to GDP, government balance, average schooling, trade openness, and inflation on economic growth per capita a country. Average schooling because the data is very limited, this paper tries to add more independent variables, namely population. This is consistent with the findings of Levine and Renelt (1992) concluded that population growth is a distinguishing factor of economic growth in each country. The model used in this study are as follows:

\[
\text{GrowthGDPPerCapita} = \beta_0 + \beta_1 \text{GrowthGDPPerCapita}_{t-1} + \beta_2 \text{InvestmentRatio} + \beta_3 \text{GovernmentBalance} + \beta_4 \text{Inflation} + \beta_5 \text{PopulationGrowth} + \beta_6 \text{TradeOpenness} + \epsilon_t
\]

Prior to estimating the above model, this paper will look at the transition from the integration of financial services are mirrored by financial openness to investment by looking at the influence of the government balance, population growth and inflation, with the estimation model as follows:
This paper uses data from the source IMF’s Annual Report, World Bank, ASEAN Stocks and other sources, with a range of 1960-2014 period. We also did interpolation for financial openness index due to data limitation.

II. Theoretical Review:
2.1 The impact of the integration of the service sector in economic growth:
The financial landscape has changed significantly since the beginning of the 1980s. Several factors, including the liberalization of international capital movements, financial deregulation and advances in information technology, have contributed to this change. The result is an increase in cross-border capital flows, a greater presence of foreign banks and more international financial integration (Vanassche, 2004).

Vanassche has examined relationship between financial openness and growth. In contrast to a large body of cross-country work investigating this link, I study the impact of financial integration on growth at the industry level. This paper provides evidence that financial openness has a positive effect on the growth of industrial sectors, regardless of their characteristics. Moreover, industries that rely relatively more on external finance grow disproportionately faster in countries with more integrated financial systems. However, this industry-specific effect of financial openness decreases when I control for the development of the domestic financial system. Finally, I test the hypothesis that financial integration improved growth also by enhancing the functioning of the domestic financial system. I find evidence of this indirect transmission channel of financial openness. The study was conducted by Oxford Economics (OE) indicates that the direct contribution of financial services to the Bahamian economy is 15 percent. It is worthwhile noting that the direct economic contribution of tourism is 21 percent. Of the 15 percent direct contribution of financial services, over one-third (5.5% of Bahamas GDP) is generated by international financial service providers. Additionally, many of the domestically licensed banks also provide services to international clients.

The direct effects of the industry are the single most important contribution but, taken together, the indirect, induced and catalytic effects of financial services are significant. The report notes the financial services sector is responsible for oiling the wheels of other industrial sectors, encouraging investment and improving the quality of that investment, providing a secure home for savings and access to capital markets for firms and households alike, as well as providing high-paying job opportunities for Bahamians.

Inklaar, at.al. (2012) has analyzed the impact of financial development and financial integration in Europe on economic growth. They find no reversal of the growth benefits of financial development and integration in recent years. This highlights the economic cost of regulatory changes that would reverse European financial integration. We also find that, following a financial crisis, investment declines more in countries with a greater degree of uncertainty aversion, which can be informative for evaluating post-crisis economic performance.

Arestis, at.al. (2002) collect data on a number of financial restraints, including restrictions on deposit and lending interest rates and reserve and liquidity requirements, from central banks of six developing countries. They estimate the effects of these policies on financial development, controlling for the effect of economic development and using standard econometric techniques. They find that the effects of financial policies vary considerably across our sample of countries. Their findings demonstrate that financial liberalization is a much more complex process than has been assumed by earlier literature and its effects on financial development are ambiguous.

Giannetti, et.al. (2002) have done an assessment of the likely effects of financial market integration on the ability of European countries to grow faster and on how the possible benefits will be distributed among the Community countries and industries. The studies show that the potential benefits from financial integration — interpreted as firms’ access to a financial market similar to that of the U.S. (or of the most developed EU economies) — can have potentially large effects on countries and sectors growth. Simulation analysis also shows that the

\[ \text{InvestmentRatio} = \beta_0 + \beta_1 \text{GovernmentBalance} + \beta_2 \text{Inflation} + \beta_3 \text{PopulationGrowth} + \beta_4 \text{FinancialOpennessIndex} + \epsilon \]

overall effect depends on which institutional determinant of financial development is varied to raise the current standards of the EU financial development. Unsurprisingly, the largest benefits accrue when all determinants are assumed to improve simultaneously.

In line with previous studies, Edison, et all (2002) have conducted an investigation the impact of international financial integration on economic growth and also to assess whether this relationship depends on the level of economic development, financial development, legal system development, government corruption, and macroeconomic policies. Using a wide array of measures of international financial integration in 57 countries and an assortment of statistical methodologies, they are unable to reject the null hypothesis that international financial integration does not accelerate economic growth even when controlling for particular economic, financial, institutional, and policy characteristics.

2.1 Benefits and Risks of Financial Market Integration:

The integration of financial markets in one area at least will bring two benefits for the economy of the region, namely: i) the integration of financial markets will be able to channel capital to countries with a low level of the economy in order to boost economic growth through increased productivity, and ii) create a financial system that is more efficient in terms of competition, the structure, access, and cost.

One of the factors driving economic growth is capital when viewed from the production function. The production function used in measuring the level of output produced a country is Cobb-Douglas (developed by Charless Cobb and Paul Douglas in 1927), where the equation is as follows:

\[ Y = AK^\alpha L^\beta \]  

\[ Y = \text{output} \]
\[ A = \text{total factor productivity} \]
\[ L = \text{employed person} \]
\[ \alpha = \text{share income in capital} \]
\[ \beta = \text{share income in labor} \]

To measure the economic growth used Cobb-Douglas production function as in equation 1.

\[ \Delta \ln Y = \Delta \ln A + \alpha \Delta \ln K + \beta \Delta \ln L \]  

To associate the Cobb-Douglas equation with the level of productivity, the equation 1 will be divided by the variable L, where the definition of productivity is a large amount of output produced per worker (conference board).

\[ \frac{Y}{L} = \frac{AK^\alpha L^\beta}{L} \]  

\[ \text{Where:} \]
\[ L = L^\alpha L^{1-\alpha} \]

To get the final equation productivity, the equation 2 and 5 will be imposed into the equation 4.

\[ y = \frac{AK^\alpha L^{1-\alpha}}{L^\alpha L^{1-\alpha}} \]  

\[ y = Ak^\alpha \]

\[ y = \text{labor productivity} \]
\[ A = \text{total factor productivity} \]
\[ k = \text{capital per employed person} \]
\[ \alpha = \text{share income in capital} \]

Meanwhile, to measure the growth of productivity impose it would be the natural logarithm function in equation 7.

\[ \Delta \ln y = \Delta \ln A + \alpha \Delta \ln k \]  

It can be concluded that one of the factors that affect the level of productivity of a country is the amount of capital in the country.

In addition, through the integration of financial markets, the flow of information and equality of financial knowledge among countries in a region to be relatively the same, as well as the movement of financial services will be more mobile than ever. This resulted in capital inflows will easily fit into a country. Excess capital resources of other countries will be looking for economic resources potentially being able to generate a profit, it will cause a number of inflows into developing countries that have large economic potential. One indicator to measure the magnitude of the economic potential of a country is the demographic advantage, where the...
number of productive age population is more than the amount of non-productive age population. According to Fischer (2000), there are three things that will be formed as a result of financial integration, which is able to benefit the economy of a country: (i) margin intermediation services will be lower due to the intense competition between the actors of financial services, (ii) expand the network of finance and financial inclusion and more diverse financial products that could encourage the creation of financial asset quality better, and (iii) with the liberalization of financial rules will create a better and healthier. All three point is able to transform financial integration creates a financial system that is more efficient in terms of competition, the structure, access, and cost.

One of the conditions the creation of financial integration is openness or transparency of a country's economic system. The biggest risk with increasing degree of openness of a country's economic system is easily exposed to the contagion effect of crises on the partner country or globally. Contagion effect is already being felt by the European Union (EU) during the economic crisis of default of Greek debt in 2010. This has led some countries such as Germany and France to help Greece so that the contagion effect that has occurred does not become larger.

3. Analysis
3.1 Financial Services Integration Readiness of ASEAN:

Financial Openness is indicators that reflect the degree of cross-border capital transaction. There are two indices which are used in the measurement of financial openness, The Chin – Ito Index or KAOPEN developed by Chinn and Ito in 2008 and Financial Openness Index developed by the IMF. This index is binary dummy variables which codify the resistance cross-border financial transaction. The greater the value of the index then indicates increasingly open financial transactions in the country. As for the dummy variables used consists of (i) the variables that represent exchange rate; (ii) the variable that represents the current account transactions; (iii) the variables that represent the capital account transactions; and (iv) the variable that represents the export results.

In general, the level of financial openness in ASEAN5+Vietnam region are experiencing a declining trend since 2008. The downturn trend of financial openness can be used by ASEAN5+Vietnam as an early indicator to prepare each readiness towards ASEAN Financial Integration, that will be initiated in 2020.

Figure 1. Kaopen Index

Figure 2. Financial Openness Index

In addition, based on Chin-Ito Index Calculation (Kaopen Index), there is only one country that has free financial markets i.e. Singapore (with avalue equal to 1). Moreover, the level of financial openness among countries in ASEAN5_Vietnam are relatively different. This indicates that this region is still far from ready to integrate its financial markets. A different situation was found during the integration of financial markets in Europe with the introduction of the Eurozone on January 1, 1999, European countries already have had a relatively same level of financial openness.
Table 1. Financial Openness EURO 1994-1999:

<table>
<thead>
<tr>
<th>Tahun</th>
<th>Austria</th>
<th>Belgium</th>
<th>France</th>
<th>Germany</th>
<th>Italy</th>
<th>Netherlands</th>
<th>Finland</th>
<th>Ireland</th>
<th>Portugal</th>
<th>Spain</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>2.16</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.16</td>
<td>1.90</td>
<td>1.64</td>
<td>1.37</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.16</td>
<td>1.90</td>
<td>1.64</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>2.42</td>
<td>2.16</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.16</td>
<td>1.90</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>2.42</td>
<td>1.90</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.16</td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>2.42</td>
<td>1.64</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
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</tr>
<tr>
<td>1999</td>
<td>2.42</td>
<td>1.64</td>
<td>2.42</td>
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<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td>2.42</td>
<td></td>
</tr>
</tbody>
</table>

Source: IMF’s Annual Report on Exchange Arrangements and Exchange Restrictions/AREAER

Based on the table above, it can be concluded that 4-5 years before integrate, countries in Europe already have had relaterly same level of financial openness. Equality or the convergence degree of financial openness becomes essential for financial integration in the region.

This paper is also trying to look at the potential of Lucas Paradox in financial markets ASEAN5. This study did a plot between yield stock and stock inflow growth of ASEAN5 countries in the period 2004 – 2013. Based on the results of the plot, it can be found indications that there are same patterns of Lucas paradox in ASEAN5 in 2009 and 2012. In 2009 and 2012, yield and stock of every country ASEAN4 increased but the growth rate of foreign funds declined. It also gives an idea that there is a similarity to the nature of the financial market in ASEAN5, this could positively impact because it indicates a high level of convergence, but on the other hand, it gives an indication of the high degree of contagion effect in ASEAN5.

Figure 3. Lucas Paradox in Stock Market ASEAN5 2004-2013

Source: ASEAN Stocks
According to the Lucas Paradox, one of the causes why the flow of foreign funds do not go to the financial markets of developing countries that have a high rate of return is due to an imperfect market as a consequence of sovereign risk and asymmetric information. Based on the rating issued by investment rating agencies, some countries in ASEAN have levels of sovereign risk is quite high, which is indicated by some of the country's low rating.

### Table 2. Credit Rating ASEAN5+Vietnam

<table>
<thead>
<tr>
<th>Negara</th>
<th>S&amp;P Rating</th>
<th>Moody’s Rating</th>
<th>Fitch Rating</th>
<th>TE Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>A-</td>
<td>STABLE</td>
<td>A-</td>
<td>STABLE</td>
</tr>
<tr>
<td>Indonesia</td>
<td>BB+</td>
<td>POSITIVE</td>
<td>BBB-</td>
<td>STABLE</td>
</tr>
<tr>
<td>Filipina</td>
<td>BBB</td>
<td>STABLE</td>
<td>BBB-</td>
<td>STABLE</td>
</tr>
<tr>
<td>Singapura</td>
<td>AAA</td>
<td>STABLE</td>
<td>AAA</td>
<td>STABLE</td>
</tr>
<tr>
<td>Thailand</td>
<td>BBB+</td>
<td>STABLE</td>
<td>BBB+</td>
<td>STABLE</td>
</tr>
<tr>
<td>Vietnam</td>
<td>BB-</td>
<td>STABLE</td>
<td>BB-</td>
<td>STABLE</td>
</tr>
</tbody>
</table>

Sumber: [www.tradingeconomics.com](http://www.tradingeconomics.com)

Meanwhile, the asymmetry of information on financial markets of ASEAN can be indicated by the value of corporate governance (CG) in ASEAN’s stock market. The low value of corporate governance in a country indicates a high degree of information asymmetry between the company and the public. The low value of the CG on ASEAN5+VietNam countries (only 3 countries with a score above 70) indicates lack of efficiency. This will affect the flow of information from the company issuers to the public, leading to some stocks whose value is undervalued or overvalued due to the asymmetry of information. Those factors above, sovereign risk and asymmetric information, which causes ASEAN financial markets do not experience a large flooding flow of foreign funds even though the ASEAN financial markets promises a high rate of return (Lucas Paradox).

### Figure 4. Corporate Governance Emiten in ASEAN

Source: ACMF 2014

### 3.2 Model Analysis:

In order to estimate the effect of financial integration on economic growth through investment in ASEAN5+Vietnam, this paper used a research from Edison (2002) that real per capita growth in initial income, capital inflows to GDP.
government balance, average schooling, trade openness and inflation will affect economic growth. Due to data limitation on average schooling, this paper will use population as an independent variable.

Based on the regression using panel model of foreign investment ratio, it shows that random effect (RE) is better to be used rather than fixed effect (FE) and pooled least square (PLS). However, due to some considerations on R-squared value and the significance of variable, we decided to use PLS. This model has a problem with heteroskedasticity and autocorrelation, hence we did some treatments to have a robust estimation.

Table 3. Model Foreign Investment Ratio

<table>
<thead>
<tr>
<th>Variable</th>
<th>Fixed Effect</th>
<th>Random Effect</th>
<th>Pooled Least Square</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Balance</td>
<td>-0.1362876</td>
<td>-0.0990013</td>
<td>0.4530732***</td>
</tr>
<tr>
<td>Inflation</td>
<td>0.0060039</td>
<td>0.0019269</td>
<td>-0.0577748</td>
</tr>
<tr>
<td>Population Growth</td>
<td>-0.1755027</td>
<td>-0.1695252</td>
<td>0.2160366</td>
</tr>
<tr>
<td>Financial Openess Index</td>
<td>0.9118619**</td>
<td>0.9957171***</td>
<td>0.7077376*</td>
</tr>
<tr>
<td>Constant</td>
<td>4.985844***</td>
<td>4.961546***</td>
<td>4.726054***</td>
</tr>
</tbody>
</table>

R-squared 0.064

Source: Internal Calculation

As for growth rate of GDP per capita, Chow Test, and Hausman Test showed that FE is the best approach and has the highest R-squared value.

Table 4. Model Growth Rate of GDP per Capita:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Fixed Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial GDP per Capita Growth</td>
<td>0.0101470</td>
</tr>
<tr>
<td>Investment Rate</td>
<td>0.3160814***</td>
</tr>
<tr>
<td>Government Balance</td>
<td>0.496048***</td>
</tr>
<tr>
<td>Inflation</td>
<td>-0.1435748***</td>
</tr>
<tr>
<td>Population Growth</td>
<td>-1.684096***</td>
</tr>
<tr>
<td>Trade Openness</td>
<td>-0.013227</td>
</tr>
<tr>
<td>Constant</td>
<td>7.710270***</td>
</tr>
</tbody>
</table>

R-squared 0.3603

Source: Internal Calculation

Based on the calculation above, it can be concluded that the level of foreign investment in ASEAN5+Vietnam is no longer determined by population and inflation, but by the level of financial openness and government balance. This phenomenon is as result of Lucas paradox in...
ASEAN5+Vietnam economy. Sovereign risk and asymmetry information prevent the market to be efficient. The market will be more efficient if it opens and well regulated, as Fischer found. With themore competitive market, it will attract more investors to the country or region, an open financial market will trigger financial integration that will prevent Lucas paradox as suggested by Schularick (2011).

The results of the analysis also show that only the level of foreign investment, the Government balance, inflation, and population growth significantly affects the growth of GDP per capita in ASEAN5+Vietnam. As for the significant positive results from foreign investment ratio is as expected this study, where on previous model foreign investment ratio is affected by financial openness, and in turn, the investment ratio will affect the economic growth per capita. Every 1% increase in financial openness would increase economic growth per capita of 0.71% through investment transmission. This increase is relatively low due to the indication of Lucas paradox in ASEAN+5 Vietnam market. Meanwhile for initial income or GDP in the previous period do not significantly affect economic growth in accordance with Schularik’s findings. According to Schularick, within the framework of economic growth of a developing region that will be integrated, the influence of the economic factors in the past will no longer affect the growth of the economy at the moment, due to exogenous factors will more affect the economic growth.

Further variables inflation and population growth significantly affecting economic growth negatively. For inflation, it is already appropriate with the theory. While population growth is contrary to the theory of Solow (1956) about absolute convergence, however, Timakova (2011) found that in some countries there was a conditional convergence where the addition of a population is no longer a driving factor of economic growth. Similar things are also found by Mathur (2004), it was concluded that absolute convergence only exists in East Asia and Europe, while for another Asian region is indicated to experience the existence of conditional convergence phenomena.

Other variables that affect economic growth per capita of ASEAN5+Vietnam is Government balance, where the level of the budget deficit will encourage economic growth per capita. This is a contrast to the theory regarding the budget deficit, where countries with higher budget deficits will struggle for its economic growth. However, based on the findings of Adam and Bevan (2004) who investigated 45 countries including Indonesia, Malaysia, Singapore, and Thailand, found that in these countries there are limits on budget deficits which are capable of driving economic growth. According to Adam and Bevan, budget deficits under 1.5% will be able to encourage economic growth in those countries.

The trade openness did not significantly affect the growth of GDP per capita despite having a negative slope. Bourdon and Vijil (2011) found the existence of a negative relationship between trade openness with economic growth in countries due to the low level of product quality. As we may be aware that value added export from ASEAN5+Vietnam is still below compare to another region, especially America and Europe region since this region majorly relies on raw materials instead of finished goods to be exported. However, with the ASEAN economic community, the value added of products from ASEAN starts to have competitiveness in international trade in recent years.

4. Conclusion and Recommendation:

It can be concluded that financial integration is able to boost economic growth through investment channel. However, we do believe that in order to integrate the financial sector in ASEAN5+Vietnam, we need to consider three main things that inherent in financial system namely financial literacy, financial inclusion, and financial deepening. ASEAN5+Vietnam need to develop these three agendas before integrate, hence the multiplier effect on economic growth through investment channel can be lifted up and sustainable at a certain level.

Based on the findings above we recommend:

I. to integrate those countries who is ready for financial integration such as Singapore, Malaysia, and Thailand or even ASEAN5+Vietnam as an example or pilot project. This group country then will transfer its knowledge and experience to other countries to be ready for next financial integration,

II. to ensure the flexibility, synergy and security of financial system in ASEAN5+Vietnam, in order to prevent or minimize the effect of contagion effect and Lucas paradox, and
III. to develop a financial system in the region that can support economic growth in certain level.

Reference:


23. Lucas, R.(1990), Why doesn’t capital flow from rich countries to poor countries?, The American Economic Review, 80(2), Papers and Proceeding of the Hundred and Second


