

# CHAPTER I

## INTRODUCTION

### 1.1. Problem Identification

As a major maritime route that has linked the east with the west for centuries, the Malacca Strait has become center of trade and cross-cultural interaction. The Strait was a section of the maritime silk road in the past, which facilitated trade between China, India, the Middle East, and other regions (Khoo, 2017). Additionally, it was crucial to the expansion of Islam throughout Southeast Asia (Andaya, 2008). Because of the location at a crossroad for trade, travel, and cultural influences, the Strait has played a significant historical role for some countries near the strait.

The rise of the Srivijaya kingdom in the seventh century marked a starting point in the Malacca Strait's history. With its capital at the Strait, Srivijaya built a powerful empire that ruled over trade and politics in most of Southeast Asia (Hall, 2018). The Majapahit kingdom replaced the domination of Srivijaya in the region in the fourteenth century. In addition, Majapahit dominated most of Southeast Asia and had tight ties to South China Sea (Ricklefs, 2019). The Malacca Strait's political and economic environment was affected for centuries by the emergence and collapse of these empires.

The importance of the strait increased when the Malacca Sultanate was controlling the strait during fifteenth century. Under its centralized authority, merchant ships traveling through the strait was guaranteed safety and security. Then, until the sixteenth century, when Europeans arrived, the Malacca Strait was in its prime. The Malacca Strait's history was drastically altered by the Portuguese invasion in the early sixteenth century. They took control of Malacca in 1511 and built a fortified trading port (Setiawan, 2023). The Dutch, the British, and the French all fought for control of the Strait after the Portuguese.

In the seventeenth century, the Dutch East India Company (VOC) became a major force in the Malacca Strait, opposing Portuguese authority and taking control of Malacca in 1641. For more than 200 years, the Dutch maintained its rule over the strait and advanced the plantation economy in the area (Borschberg, 2010). Scholars have recently started delving into the social and cultural aspects of the VOC existence in the Malacca Strait, looking at things like the company relationships with the local community and the creation of a hybrid Creole culture (Andaya, 2015; Tan, 2018).

After the British East India Company (EIC) presence in the Malacca Strait. They established a trading base on Penang Island in 1786, which gave them access to the lucrative Strait trade routes. The British steadily increased their power in the area over time, and in the early 1800s they took over Singapore. This acquisition was a wise strategic choice as Singapore grew to become a major trading hub in the Malacca Strait. The region economic development and geopolitical significance were significantly impacted by EIC presence in the Malacca Strait, and these effects are still evident today (Borschberg, 2010).

Malacca Strait strategic location status as a key maritime hub for trade, capital, and labor movement due to its location between the Indonesian island of Sumatra and the Malay Peninsula. Braginsky (2002) emphasized that the strait strategic placement between the Indian Ocean and the South China Sea accounts for its key role in maritime trade. According to the United Nations Trade and Development (2023), about 25% of all 11 maritime traffic is estimated to pass through the strait each year, making this maritime crossroads a major hub for global trade. The transportation of commodities, manufactured goods, natural gas, and oil between major economies like as China, Japan, India, the Middle East, and Europe is made easier by the strait location.

Indonesia, Malaysia, and Thailand are three countries located near to the Malacca Strait. This geographical proximity has played a critical role in determining their historical, cultural, and economic paths. For centuries, the

Malacca Strait has served as a hub of trade and business, facilitating the interchange of products, ideas, and technologies between the East and West. The three countries have benefited greatly from their closeness to this important waterway, establishing bustling ports and economic centers. The region has seen empires rise and fall, colonial powers establish themselves, and modern nation-states arise. Today, Indonesia, Malaysia, and Thailand are still important actors in the global economy, using their strategic location to encourage commerce, investment, and regional cooperation.

Labor force, investments in education and skill development, and the allocation of capital are some assumed variables that impact the economic growth of the sub-region. They actively participate in international trade as well, exporting commodities, services, and manufactured items. They have grown as a result of regional accords like the ASEAN Economic Community. Investment, both domestic and foreign, is essential because stable macroeconomic conditions and policies that promote investment in productive sectors (Hirst et al., 2020).

In Southeast Asia, the idea of regional economic integration has a long history. From the time of the ancient Majapahit and Srivijaya empires to the colonial era, several initiatives were made to promote economic cooperation in the area. Unfortunately, political and economic unrest turned out to be strong barriers that prevented these from succeeding. However, the desire for economic cooperation has still remained to integrate the regional economy.

During the second world war, there was a revived interest in regional economic integration in Southeast Asia. Several reasons contributed to this were including the cold war, the emergence of regionalism, and the region increasing economic interdependence. The Association of Southeast Asian Nations (ASEAN) was formed in 1967. The organization made substantial contributions to regional economic cooperation and integration. The organization played an important role in promoting regional economic cooperation for southeast asian countries (ASEAN Charter, 2007).

The IMT countries like Indonesia, Malaysia, and Thailand have a great contribution to ASEAN economies. Indonesia has an abundance of natural and labor resources, Malaysia has a strong manufacturing industry, and Thailand is a large agricultural exporter. This complementarity opens up chances for collaboration in a variety of industries, including agroprocessing, automotive, electronics, and tourism. Through international cooperation, IMT countries can promote economic growth in the sub-region.

The Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) is a sub-regional economic cooperation formed in 1993 by three Southeast Asian countries near the Malacca Strait. With their status as developing countries, IMT-GT seeks to stimulate economic growth, particularly in the areas of trade, investment, tourism, and infrastructure development (IMT-GT, 2021).

Figure 1.1. IMT-GT Regional Trade Corridor



Source: IMT-GT 2036 Vision (2021)

Indonesia, Malaysia, and Thailand have established a number of cross-border economic zones known as the IMT-GT Economic Corridors. For the three nations, the IMT-GT Economic Corridors might have a major positive economic impact. The corridors can aid in attracting investment, boosting regional trade, creating jobs, and stimulating economic growth by improving connectivity (IMT-GT, 2021).

The IMT-GT enjoys a number of economic benefits, such as a rich supply of natural resources, a large and expanding labor force, and a prime location at the intersection of important shipping lanes (IMT-GT, 2021). In Southeast Asia, the IMT-GT has the potential to grow into a powerful economic force proved by 15.2% contribution to ASEAN GDP in 2022 (ADB, 2022). However, the establishment of IMT-GT since 1993 has doubtfully met the economic growth expectation.

According to the IMT-GT Vision 2036, the idea is going to be an inclusive, integrated, sustainable region in 2036. IMT-GT aims to attain local regionalism through local economic cooperation and integration on the basis of economic complementarities. This report shows that the economic actors in the subregion have been able to exploit these complementarities with some degree of success, as indicated by the positive IMT-GT goods flows, human flows (business visitors, tourists), and capital flows (foreign direct investment).

The IMT-GT has made great strides toward accomplishing its goals. Since the IMT-GT established in 1993, cooperation in trade and investment has grown dramatically. The economic growth in the region has grown significantly and infrastructure development has advanced significantly. Furthermore, the IMT-GT has actively promoted collaboration in projects aimed at sustainable development which has advanced the area as a whole.

With a combined GDP about USD 1 trillion, the IMT-GT region has great economic potential because of its big and growing population (Setyaningrum, 2020). The area offers access to some markets in Asia, and other regions due to its strategic location. In addition, the IMT-GT countries have a wealth of labor forces in the area which supports the region economic growth. Together, these elements support the region optimistic vision and present chances for cooperation and investment across a range of industries.

The Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) region must be developed using the interconnection of trade, FDI, and economic growth. The exchange of goods and services between the IMT-GT countries, or trade, is a major factor in economic growth since it promotes trade complementarity and supports regional economies (Baharumshah, 2011). Moreover, FDI stimulates economic growth by promoting export expansion, job creation, and technology transfer. The IMT-GT nations have put in place a number of measures to entice foreign direct investment (FDI), such as tax breaks, investment promotion organizations, and special economic zones, which create a climate that is favorable to FDI (Sands, 2019).

However, in order to achieve IMT-GT Vision requires a thorough grasp of the complex relationships between economic variables. The IMT-GT is difficult to study because of the diversity of the countries, as well as the restricted availability of public IMT-GT regional data. Despite these challenges, research by Ramli et al. (2023) has given light on economic convergence within IMT-GT. Further research is required to properly understand the intricate links between trade, investment, and economic growth in the subregion, as well as to overcome data and heterogeneity concerns. A study can give policymakers with vital insights into regional economic integration and sustainable growth.

To build effective strategic policies for trade promotion, attracting FDI, and achieving sustainable growth, policymakers require strong empirical information on the direction and strength of the linkages between trade, foreign direct investment (FDI), and growth. Evidence-based policymaking is critical for the Indonesia-Malaysia-Thailand expansion Triangle (IMT-GT) subregion, which

has seen fast economic expansion in recent decades but confronts a number of problems, including heterogeneity and income inequality (UNDP, 2017).

Robust empirical evidence can assist policymakers in understanding the intricate interactions between trade, foreign direct investment, and long-term growth, as well as identifying the most effective policies to promote economic growth. Similarly, FDI can bring capital and jobs to poor nations, but it can also cause environmental degradation if not managed effectively (United Nations Conference on Trade and Development, 2018).

Policymakers in the IMT countries can establish policies that maximize the benefits of trade and FDI by studying the research on the links between capital, labour, education, trade, and FDI on economic growth. It will contribute to the subregion long-term and inclusive economic growth, benefiting all segments of society and resurrecting the Malacca Strait's golden age.

## **1.2. Problem Formulation**

Despite the potential benefits of regional integration, the IMT-GT face significant challenges unfulfilling its full economic potential. Furthermore, the influence of specific policy actions on economic growth in member countries needs to be seen. To thoroughly investigate the intricate interplay between trade, FDI, economic growth, and other key elements inside the IMT-GT, this study will use a Dynamic Panel Data Generalized Method of Moments (GMM) approach.

This econometric technique is well-suited to dealing with the particular issues of panel data research, such as heterogeneity, potential endogeneity, omitted variable bias, and the dynamic character of the connections being investigated (Roodman, 2009). These situations can result in erroneous and inconsistent estimates in standard regression models (Wooldridge, 2010).

Furthermore, the dynamic nature of economic relationships needs a model that can account for temporal dependencies, as previous economic performance can influence current and future outcomes. The dynamic panel GMM framework

explicitly accounts for the impact of lagged dependent variables, resulting in a more realistic portrayal of the long-term consequences of economic policies and shocks (Arellano and Bond, 1991).

Nurjannah (2023) in his research within ASEAN countries found that positive influence on regional trade and human capital development, while FDI surprisingly demonstrates a negative effect. The research model has similar characteristics to IMT countries due to the existence within the ASEAN region. This research aims to find several variables that assumed contribute to economic growth since the establishment of IMT-GT in 1993.

The analysis will use panel data on relevant economic indicators from IMT-GT member nations, such as real GDP, capital formation, labor force, education, regional trade export, and FDI over a time period that captures the dynamics of regional integration started from 1993 to the recent data of 2022. The System GMM technique in the analysis will allow us to disentangle the intricate interrelationships between these variables, giving strong empirical data to drive policy decisions aimed at promoting sustainable and equitable growth within the IMT-GT framework.

This study focuses on economic growth in Indonesia, Malaysia, and Thailand, three key countries within the IMT-GT region. While the analysis utilizes national-level data for these countries, the findings and policy recommendations are specifically relevant to the IMT-GT.

### **Research Questions:**

1. **Persistence of Real GDP Growth:** Is there evidence of persistence in real GDP growth within the IMT-GT member countries since 1993?
2. **Impact of Capital:** Does capital formation within IMT-GT member countries promote economic growth?
3. **Impact of Labor:** Does a number of the labor force within IMT-GT member countries promote economic growth?

4. **Impact of Education:** Does the length of education within IMT-GT member countries promote economic growth?
5. **Impact of Trade:** Does trade among IMT-GT member countries promote economic growth?
6. **Role of FDI:** Does FDI promote economic growth within the IMT-GT member countries?

By addressing these research questions, the study will contribute to a deeper understanding of the determinants of economic growth within the Indonesia, Malaysia and Thailand (IMT-GT member countries) especially in determining whether the region either capital or labor intensive, measuring the trade contribution, and the role of FDI. The result will provide evidence-based policy recommendations by bringing the IMT-GT Vision and Mission.

### 1.3. General Research Objectives

There are several objectives of this research as follows:

1. **To analyze the dynamic relationship between real GDP growth and its determinants.** This objective focuses on understanding the changes in the critical factors of economic growth and any potential feedback loops or interactions among the factors.
2. **To evaluate the effectiveness of policies aimed at promoting economic growth.** By understanding the determinants of real GDP growth, this objective aims to provide insights for policymakers on how to design and implement effective policies to stimulate economic growth within the IMT.
3. **To inform policy decisions:** Provide recommendations to IMT-GT member nations on strategies to enhance trade, attract FDI, and promote long-term economic growth within the regional cooperation framework.

#### 1.4. Research Advantages

The advantages of this research were highlighted as several stakeholders:

1. **For Scholars:** Research plays a vital role in the academic world, contributing to expanding knowledge boundaries, challenging theories, and driving progress. Research also helps solve societal problems, promote interdisciplinary collaboration, and enrich intellectual discourse.
2. **For Governments:** The prioritization of evidence-based policymaking, program evaluation, and proactive anticipation of future challenges, as well as fostering innovation within the IMT-GT member nations, is imperative. Rigorous research provides governments objective data, analysis, and insights to support effective policy development and implementation. Research also helps governments assess program outcomes and impacts, identify areas for improvement, and plan for future challenges.
3. **For International Institutions:** Research conducted by international organizations like the UN, World Bank, and IMF plays a pivotal role in understanding and addressing global issues. Additionally, research informs advocacy efforts to raise awareness of global issues, influence public opinion, and shape agendas, thus contributing to informed decision-making and fostering global cooperation in IMT-GT.
4. **For Businesses and Investors:** The study delves into the regional economic landscape, enabling businesses and investors to navigate the unique dynamics of the IMT-GT, tailor their strategies, and build stronger relationships with regional stakeholders. By leveraging the findings of this research, businesses can gain a competitive edge in the market, while investors can identify promising opportunities for high returns.

## **1.5. Research Scope and Limitation**

This study will analyze the role of capital, labor, education, trade, and FDI in IMT economic growth, including Indonesia, Malaysia, and Thailand. Using secondary data from The IMF, UNDP, and World Bank provided for countries where this research was based. The annual data spans from 1993, when the establishment of IMT-GT, until the recent data of 2022.

## **1.6 Writing System**

The writing system consists of several chapters, each giving an overview of the study conducted. This study consists of five chapters, namely:

### **Chapter I: Introduction**

This chapter explains the research introduction and consists of several subsections, including problem identification, problem formulation, general research objectives, research advantages, research scope, limitations, and writing system.

### **Chapter II: Theoretical Framework**

This chapter explains some theoretical frameworks related to the research. This chapter has three parts: theoretical background, empirical review, and research framework. The theories underlying this study are explained in the theoretical background section.

### **Chapter III: Research Methodology**

This chapter contains several subsections, including the research data, types and sources of data, operational variables, methods, and analysis used in analyzing the data.

### **Chapter IV: Result and Discussion**

This chapter is a discussion section containing the descriptive analysis, results, and interpretation of the analysis process.

### **Chapter V: Conclusion and Recommendation**

This chapter describes the essence of the research conducted to be compiled in conclusion. Recommendations are also presented after conclusions are drawn, which can be a reference for several stakeholders.