Chapter 1

Introduction

1.1 Statement of the Problem and the Significant of the Study

"What factors make countries experience different levels of economic growth and development?" is a perennial question. The answer remains controversial.

Over decades, macroeconomists have attempted to search and discuss factors that determine the level of growth and development in each country. Meanwhile, several governments and policy makers have sought to design efficient policies and strategies to develop their countries' economies. Since the independence of the former 19th-century colonies was achieved from the late 1940s through the early 1960s, development economics -- one branch of economics that focuses on issues of economic and social development -- has emerged as a major field in economics. Such development does not focus narrowly upon increasing the revenue of citizens of the country, but must also be accompanied with the quality of life. This means having the basic necessities with dignity and adequate freedom of lifestyle. Nobel prizes have been awarded to at least five economists for their direct analyses of under-development. These include Lewis (1960, 1979) for dualistic models of labour transfer, Kuznets (1973, 1977) for the quantification of the structural transformation away from agriculture, Schultz (1971, 1980) for theories of human capital and farmer rationality, Myrdal (1973a,1973b) for descriptions of underdevelopment in Asia, and Sen (1983, 1997) for formulating the just rights of the poor. But other Nobel laureates, notably Frisch (1971), Leontief (1973), North (1989), Solow (1956) and Tinbergen (1954) have also formulated more inclusive theories with strong implications for poor economies.

This body of pioneering development theories clarifies what makes developing economies different from the European and American models upon which modern macroeconomics is based. This body has been validated and nuanced by applications to real-world economies by such applied economists as Chenery and Srinivasan (1988), Hayami and Ruttan (1971), Satya et al. (2006), Mellor (1976) and Ravallion (2007). To the extent that markets are more imperfect, international trade more fettered, information more subject to principal-agent problems, administrators more corrupt, poverty deeper, the safety net more tattered, and the State more over-involved than in industrialized economies, the domain of economic development studies has been justified, and must still be maintained.

However, it must never be forgotten that the goal of economic development theory is eventually to do itself out of a job; i.e., to help the set of low- and middle-income countries to achieve such high levels of income and economic performance that there will someday no longer be a need for development macroeconomists, but simply macroeconomists. The objective of the present study is to take a mid-term progress reading of how far the developing economies have come in the last 60 years towards achieving that goal. We therefore intentionally subject a large sample of low- and medium-income countries to the same kinds of causal tests among the main macroeconomic aggregates that industrialized countries are subjected to. In the previous study, the study of economic growth interested only macroeconomic variables and ignored social and political variables such as crime rate, corruption or lack of freedom which are important to improve economic growth if government can reduce crime rate, corruption or lack of freedom. This study also includes the social and political variables and considers whether standard macroeconomic theory adequate or we need to improve other social and political variables to help to encourage output in developing and developed countries.

Added insight into the relationship between growth in gross domestic product and a wide range of macroeconomic, social and political variables could provide powerful information to policy makers as they adjust and align their domestic and foreign policies for growth, stabilization, and equitable development on the factors for which their region is shown to be lagging. However, to consider only overall result of

developing countries may not be consistent when broken down by regional groupings of low- and middle-income developing economies. The geography must play some rule in determined the different growth in each region and landlocked economies often have lower incomes than coastal economies. Therefore, the objective of this study is to test whether standard macroeconomics, perhaps extended to include institutional indicators, is adequate for the determination of national income in 11 regions in developing countries classified according to continent, climate, and access to sea-lane.

For developed economies as well, it is important to investigate the relationship among macroeconomic variables, social and political variables. The important question will come up as to the most appropriate indicator to measure the country's development level. In traditional economic practice, income per capita was used to classify development. However, the term "development" has always meant – and continues to mean -- different things to different people, such that the result from identifying development with a single indicator will lead to inconsistent results. For example, even when a developing nation reaches its announced economic growth targets, the level of living of the masses of people often remains low due to the unsolved problems of poverty, unemployment and/or inequality. One needs therefore to focus on another indicators such as social, educational, health, cultural, and global indicators of development and find appropriate indicators to capture the true breadth of possible improvements in human well-being associated with development.

1.2 Objectives of the Study

The objectives of this study are as follows:

1) To identify factors affecting economic growth in developed and developing countries.

2) To analyze the relationship among output and macroeconomic variables in a large-sample set of developing countries and compare the result with those from developed countries.

3) To test whether a simple macroeconomic model or a model enriched by social and political variables inspired by the King of Thailand's Sufficiency Economy Philosophy is adequate. We shall also investigate the importance of institutional indicators to determination of national income in developing countries and compare the result with developed countries.

4) To analyze the relationship among output and macroeconomic, social and political variables in 11 regions of developing countries and test whether these relationship differ significantly among regions.

5) To empirically identify the appropriate measures of a country's development.

6) To make a contribution to the econometric literature in the treatment of selection bias.

7) To make policy recommendations for government and the public sector in developing and developed countries as to the optimal and most efficient means of encouraging output growth and improving economic welfare.

1.3 Policy Relevance

The proposed doctoral research will provide an appropriate methodology to investigate the relationships among output, macroeconomic, social and political factors in developing and developed countries. This study also divides by their geography a large sample of developing countries into 11 regions to test whether the optimal design of macroeconomic and social policies can be universal or should be different in each region.

The study will also shed light on the relationship among output, macroeconomic, social and political indicators which government and policy makers should take into account when designing efficient macroeconomic and social policies for their country, whether its economy is developing or developed.

Additionally, we aim to classify country's development, traditional economic provide income per capita which sometime is not appropriate measurement. Therefore, this study will suggest multi-indicator that can be used to measure level of

development. Ozturk (2008) suggests that classifying countries correctly based on a multi-dimension indicator will identify the shortcomings of undeveloped and developing countries and will enable these countries to improve in those areas. We also seek to help foreign investors in their decision making processes where economic indicators are not sufficient to measure a country's development level.

1.4 Structure of the Dissertation

This thesis is divided into seven chapters. The first chapter is the general introduction.

Chapter 2 summarizes standard macroeconomic theories which are Classical Economists, the Keynesians, the Monetarists, the new Classicals, the new Keynesians and the New Growth Theorists. This thesis also reviews the literature on the Miracle of Growth and presents the literature on the determinants of output which are macroeconomic indicators and social-political indicators. This thesis inspired by the Philosophy of sufficient economy in the way that to consider the impact of social-political indicator on economic output, so we present some detail about sufficiency economy philosophy. The last of chapter 2 explains our conceptual framework.

Chapter 3 presents the research methodology and model specification. First, the research design discusses the model that developed from the conceptual framework. Second, the testable hypotheses are provided and next we will present the data and sample selection provides sources of data, the unit of analysis, and the sample size. Finally, data analysis methods are discussed.

Chapter 4 identify, measure, sign and directionalize the dynamic casual relationships linking gross domestic product, money, the interest rate, the price level, the exchange rate, population and the savings rate in 95 developing countries.

Chapter 5 discusses the key factors that determined economic output in developing countries. We first classify data for 95 countries into 11 distinct regions based on continent, climate, and access to sea lanes. We then seek to isolate the intercept and slope shifters of economic growth in four stages. Stage one tests a standard economic model composed only of the interest rate, exchange rate, money

supply and inflation. Stage two adds 10 regional dummy variables to determine which, if any of the regions are significantly higher or lower than the suppressed base region (Southeast Asia). Stage 3 then adds slope-shifting interaction terms between each region and the economic variables to determine which macro variables in which regions display significantly different marginal impacts on growth. Step 4 extends the model of stage 3 by adding the socio-political variables schooling, political freedom, transparency (i.e. absence of corruption), and criminality. The model of step 4 is inspired by the new institutional economics in general and by the "sufficiency" economy model of the King of Thailand and the gross national happiness paradigm of the King of Bhutan, which posit that true development is inconsistent with an increase in criminality, corruption, and political or educational disenfranchisement. Finally, based on the significant results of each stage of the analysis, we draw practical conclusions for development policy by region and for the developing economies as a whole.

Chapter 6 studies the key factors that determined economic output in developed countries. First, we discuss the sample selection problem which came from selection of sample of developed country. This selection could be bias when using only single criteria (such as income per capita) to determined level of development, hence we apply sample selection model to capture the sample selection bias. Moreover, base on the traditional assume of the error term which is bivariate normality which several case are violated. Therefore, we applied copula approach to sample selection model with panel data and the results show the copula approach with panel sample selection is the best fit for economic output model in developed countries.

Chapter 7, firstly summarizes and concludes the thesis generally, and then attempts an outlook on the possible policy for developed and developing countries. The suggestions for further research are made.