Literature review on determinants of economic growth economics essay

There are numerous of empirical research on economic growth has been done in the past decades. The empirical study of determinant of economic growth by Barro (1991) has been an important reference to future study on the related fields. In this section, a brief review of factors that determine economic growth will be presented. The influences consider here included government spending, inflation, FDI and trade, financial development, and European integration.

The size of the government expenditure and its affect on economic growth has been getting much attention in the past study. Ghali (1997) explored his research on the relationship between government expenditure and economic growth by looking at the interaction among the growth rate in per capita GDP and the share of government spending in GDP over the period of 1960-1996. He used vector autoregressive analysis and Granger-causality in his study and found that there is no consistent evidence that government spending can increase Saudi Arabia’s per capita output growth.

This result was contrasted with the two study by Cheng and Tin (1997), Loizides and Vamvoukas (2005). Both study suggested that government expenditure Granger-cause economic growth. Cheng and Tin (1997) emphasize on the granger causality between government expenditure, money supply and economic growth in South Korea for the period of 1954-1994. They applying the same technique as Ghali (1997) and claimed that money supply affect growth as well but money supply doesn’t Granger-cause government expenditure.

However, the study by Loizides and Vamvoukas (2005) focused on the causal link between the size of the public sector and real per capita income within the bivariate and trivariate frameworks on their sample countries of United Kingdom, Ireland and Greece. They have draw out three conclusions, first, public expenditure Granger causes growth in the short run and long run in all of the sample countries. Second, both bivariate and trivariare framework shows that increase in output would cause growth in public expenditure in Greece. Third, their trivariate model has indicates that causality from national income to public spending in Greece and British. Therefore, the different result from these study lead to a conclusion that in certain circumstances, changes of government expenditure do not necessary cause changes in the economic growth when government spending deliver services in an inefficiency way.

Inflation was another controversial debate issues. Malik and Chowdhury (2001) observed the relationship between inflation and GDP growth for four South Asian countries which is Bangladesh, India, Pakistan and Sri Lanka. They employed the co-integration and error correction models to the annual data retrieved from the IMF International Financial Statistics. They established two results : (i) inflation and economic growth are positively and statistically significantly related for all four countries. (ii) the sensitivity of growth to changes in inflation rates is smaller than that of inflation to changes in growth rates. These results have crucial policy implication, that is, although moderate inflation foster economic growth feeds back into inflation by stimulating the economy.

Another study by Faria and Carneiro (2001) claimed a divergent view from Malik and Chowdhurry (2001). They have measure the relationship between inflation and economic growth in the context of Brazil which has been undergone severe inflation until recently. This study has constructed a bivariate time series model (vector autoregression) with annual data for the period between 1980 and 1995, they argued that although there is a negative relationship between inflation and economic growth in the short run, but in the long run, economic growth does not affected by inflation. Thus, this result supported the theories of hyperinflation usually associated with economic depress and political and social upheavals and as a result, it is against the perspective that inflations affects economic growth in the long run.

In addition to that, foreign direct investment (FDI) and trade were another influence that determined economic growth. Makki and Somwaru (2004) have analyze the role of FDI and trade in promoting economic performance across 66 developing countries, and the interaction among FDI, trade and economic growth by adopting unrelated regression (SUR) method and instrumental variable (3-stage least squares) approach over the period of 1971-2001. They brought to four interesting results. First, the variables of FDI and trade have a strong positive relationship. Second, FDI stimulates domestic investment. Third, macroeconomic policies and institutional stability is the precondition for FDI-driven growth. Fourth, economic growth would facilitated by a lowering inflation rate, tax burden, and government consumption.

Similarly, the study of Yao (2006) investigate the effect of export and FDI on economic performance by using Pedron's panel unit root test, and Arellano and Bond's dynamic panel data estimating technique on the sample data of 28 Chinese provinces. This study has stressed on two essential strategies that adopted by Chinese government to explained why China can be success in the long period. One was the export-push strategy that replaced the self-reliance and import substitution strategy and the other was the adoption of foreign technology and international business practices through the uses of FDI. Their data also indicated that openness can boost economic growth if the unforeseen risk can be managed in the proper way.

Financial development was the fourth factor. Liang (2006) inquired the impacts of financial development on the pattern of regional economic growth in China. The GMM approach has been employed in his research throughout the period of 1990 to 2001. He mentioned that financial development significant contributes to the economic growth in coastal region but not in the inland regions. Even though the structure and the size of financial sector in China are the same, financial function provided by the financial sector might vary across region.

Meanwhile, Ang and McKibbin (2007) included financial liberalization in his observation. This research evaluated whether financial development leads to economic growth or vice versa in the economy of Malaysia. Their analysis was consistent with Liang (2006), which is financial development leads to economic growth. Variety of approaches being used in this study and the empirical evidence asserts that financial sector development in Malaysia can be stimulated through financial liberalization when the repressionist policies

have been removed. Moreover, financial depth and economic development tends to have a positive relationship. They also view that economic growth would generate higher financial depth in the long run.

Growth effects of European integration will be the last factors we discuss here. Henrekson et. al (1997), estimated the effects of European integration in EC and EFTA on economic growth. Their analysis has been conducted across a large sample of both developed and developing countries. They comprised a dummy for membership in EC or EFTA during 1976 -1985. They addressed that there is a significant and positive effects on economic growth but the effects became smaller and significant when the sample was restricted to 22 developed and OECD countries. The effects do not change for membership in EFTA as in the EC due to the technology transfer instead of investment. All the empirical study by these researchers provided a useful guidance for both domestic policy makers and the development partners. Nevertheless, more prospects might be explored on the determinant of economic growth, especially corruption. As in Malaysia, it is a significant variable that should be tested on.