



Faculty of Economics and Business

**DETERMINANTS OF INSTITUTIONAL ECONOMICS IN ASEAN-5  
COUNTRIES**

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Bachelor of Economics with Honours  
(International Economics)

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# **DETERMINANTS OF INSTITUTIONAL ECONOMICS IN ASEAN-5 COUNTRIES**

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## Statement of Originality

The work described in this Final Year Project, entitled  
**“Determinants of Institutional Economics in ASEAN-5 Countries”**  
is to the best of the author’s knowledge that of the author except  
where due reference is made

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## **ABSTRACT**

### **DETERMINANTS OF INSTITUTIONAL ECONOMICS IN ASEAN-5 COUNTRIES**

By

**Choo Foong Yien**

The objective of this paper is to determine the factors of institutional economics towards Gross Domestic Product (GDP) in ASEAN-5 countries. The study uses panel data for the period of eighteen years from years 1996 to 2013 and five countries. The data was collected from World Development Indicators and Worldwide Governance Indicators. This panel model uses EViews to test the Pooled Ordinary Least Square (OLS) Regressions, Random-Effect Model, Fixed Effect Model, and Hausman Test. Appropriate and relevant data will be tested in this study to investigate the impact of institutional economics to GDP in ASEAN-5 countries.

## **ABSTRAK**

### **FAKTOR PENENTU EKONOMI INSTITUSI DALAM NEGARA ASEAN-5**

Oleh

**Choo Foong Yien**

Objektif kajian ini adalah untuk menentukan faktor-faktor ekonomi institusi terhadap Keluaran Dalam Negara Kasar (KDNK) dalam Negara ASEAN-5. Kajian ini menggunakan panel data untuk tempoh lapan belas tahun dari tahun 1996 hingga 2013 dan lima negara, Data adalah dikumpul dari Penunjuk Pembangunan Dunia dan Petunjuk Tadbir di Seluruh Dunia. Model panel ini menggunakan EViews untuk mengkaji Regresi Pemusatan Biasa Kurang Persegi, Model Kesan Rambang, Model Kesan Tetap, dan Ujian Hausman. Data yang sesuai dan relevan akan diuji dalam kajian ini untuk menyelidik kesan daripada ekonomi institusi terhadap KDNK dalam Negara ASEAN-5.

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## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.0 Introduction**

Institutional economics is an essential and important aspect in determining the development and economy growth in a country. Accordingly, it clearly shows that the institutional structures are constraining and empowering individuals besides framing their incentives and disincentives in one's life (Hodgson, 2009). Therefore, North (1990) had highlighted the role of institutions that it was the rules of the game in an economy and it was a constraint that devise by human in structuring the human interaction. The constraints include the formal rules, informal constraints, and the enforcement of the both characteristics where formal rules that consists of law, contracts, and market regulations, while the informal rules constraints consists of conventions, norms of behavior, and conduct. Additionally, it shows that politics were indirectly shape the economic performance due to the reason of politician define and enforce the economic rules of the game that include develop policy in order to enforce efficient property rights.

Furthermore, Todaro and Smith (2015), emphasized that institutional economics is an institutions that providing a foundation and supporting of a market economy by establishing the rules of property rights and contract enforcement, improving coordination, restricting coercive and fraudulent, and anticompetitive behavior.

Generally, these institutions provide access to opportunities for a broad population, constrain the power of elites, and manage the conflict. Furthermore, high-income countries are able to afford a better quality of institutional economics, but it does not mean that the better quality of institutional economics contributes to the economic growth in a country.

Moreover, the criterion of institutional economics consists of government effectiveness, corruption, and political stability. Government effectiveness is a crucial factor in determining the growth in a country where the government controls the public service provision, bureaucracy, competence of civil servants, independence of the civil service from political pressures, ability to provide public goods, and the ability of government to be trusted as reliable to give commitment in producing and implementing policies. Subsequently, control of corruption is needed to avoid individuals from taking initiative from their public power or strong position in an organization for their private gain and benefit. Next, political stability is the ability of government to avoid being threatened by illegal and unlawful violence which are politically-motivated violence and terrorism. Therefore, the criterion of institutional economics shows that government and other organizations play an important role in enhancing the economic growth.

Other than that, in a broader aspect, the institutions are the procedure that is generally accepted to govern the process of interaction between members in a society where it includes the habits and beliefs, norms, social cleavages and traditions in education (Brunt, 2007). Therefore, the well-being of human beings and the welfare of people in the

society is also one of the important elements in evaluating institutional economics in a country. This clearly show that the rules, norms, and enforcement mechanisms is very important in determining the way people interact. However, it is also difficult to identify the institutions that are exactly affecting the performance of a country.

According to Samuels (1984), the contemporary institutional economists work self-consciously in the tradition of Thorstein Veblen, John R. Commons and such other figures as Wesley Mitchell, Clarence Ayres, Walton Hamilton, John Maurice Clark, and the philosopher John Dewey. Although there are distinct and somewhat rival forms of institutionalism-one arising from Veblen through Ayres, the other from Commons-both have a common relationship to mainstream neo-classicale economics. Generally, institutional economics is focus on the essential problem of an organization and control the economy as a whole.

Additionally, institutional economics is also known as institutionalism, where cultural development takes place broadly as the evolution of economic institution. According to Veblen who is an American economist and social scientist define the foundation for institutional economics that people are constantly affected by the changing of customs and societies instead of the concept that people as the maker of economic decisions (Encyclopaedia Britannica, 2013). Moreover, it is not important in the normative aspect rather than to the extent where economic system related to the whole in a society.

Furthermore, among the interesting country to have a better understanding of institutional economics is Denmark where it was a country with the least corruption with a perceived as very clean in corruption among 177 countries. Moreover, Denmark free from the risk in the aspect of security, political stability, government effectiveness, legal and regulatory, macroeconomic, foreign trade and payment, tax policy, financial, and infrastructure (Aig, 2014). Therefore, Denmark was performance well in terms of institutions that may enhance development and economy growth in the country.

**Table 1.0: Denmark Overview**

RISK RATINGS	CURRENT RATING	CURRENT SCORE	PREVIOUS RATING	PREVIOUS SCORE
Overall assessment	A	9	A	8
Security risk	A	4	A	4
Political stability risk	A	5	A	5
Government effectiveness risk	A	4	A	4
Legal & regulatory risk	A	3	A	3
Macroeconomic risk	A	20	A	20
Foreign trade & payment risk	A	4	A	4
Tax policy risk	A	6	A	6
Labour market risk	B	29	B	25
Financial risk	A	4	A	0
Infrastructure risk	A	9	A	9

Source: EBB - Denmark Overview

Note: E=most risky; 100=most risky

Corruption is a misuse of delegated power for private gain that wasted the wealth in a country. According to Kaufmann, Kraay, and Mastruzzi (2003), corruption is an action of executing of public power for private gain. Moreover, corruption can consider as bribery and illegal payment that can benefit for both the party involved. It is good for a country to have clean from corruption in order to have a prospect growth in economy.

Therefore, Corruption Perceptions Index (CPI) is useful to ranks countries or territories based on how corrupt their public sector is perceived to be where it reflects the views of observers around the world, including experts living and working in the countries or territories evaluated. The score range from 100 which is perceive as very clean to 0 which is perceive as high corrupt. The survey shows that Denmark was the least corrupt country among 177 countries and territories where its CPI score was 91 in 2013. The reasons for Denmark to maintain as the least corrupt country are they developed a welfare system, which is called as “Danish Model” and they are emphasize on Corporate Social Responsibility. The “Danish Model” is the implementation of trustfulness system such as fair working condition, social security, and heath arrangements that can protect and maximize the welfare of the people in order to abstain from corruption. While the Corporate Social Responsibility is the producer delegated to social responsibility for the product they buy where good business behavior is very important to the expectation of the consumer that their welfare are protected.

**Table 1.1: Corruption Perception Index 2013**

Rank	Country/Territory	Score
1	Denmark	91
1	New Zealand	91
3	Finland	89
3	Sweden	89
5	Norway	86
5	Singapore	86
7	Switzerland	85
8	Netherlands	83
9	Australia	81
9	Canada	81
11	Luxembourg	80
12	Germany	78

12	Iceland	78
14	United Kingdom	76
15	Barbados	75
15	Belgium	75
15	Hong Kong	75
18	Japan	74
19	United States	73
19	Uruguay	73
21	Ireland	72
22	Bahamas	71
22	Chile	71
22	France	71
22	Saint Lucia	71
26	Austria	69
26	United Arab Emirates	69
28	Estonia	68
28	Qatar	68
30	Botswana	64

Source: Transparency International

Apart from that, Denmark has a stable political where it was free from the risk of political stability. This is because Denmark has an open and transparent parliamentary democracy where the legislation enacted under the situation with the negotiations and compromise with non-government or even opposition parties compared to most of the country that the legislation was enacted by the parliament. Therefore, this is benefits to business also because it is able to nurture a stable operating environment where the policies reflect a wide range of interest and rarely reversed even after a change in government.

Additionally, an effective government also is a crucial key to enhance economy growth and performance in a country. It should be able to guarding their citizens from bad environment such as violence. Besides, an effective government needs to protect the

property rights of the people and also provide infrastructure that can convenience the delivery and exchange of goods and services among their citizens in order to improve social welfare. Therefore, Denmark is one of the countries that have effective governance in the political system that is highly decentralized. The government policies are intensively favorable to business enterprise and investment. Furthermore, the Liberal-led government has modernized the central state administration besides making enhancements on cutting red tape. Thus, it enhances administrative efficiency and discourages the corruption in Denmark. Significantly, government effectiveness measures the competence of government institutions.

## **1.1 Background of Study**

### **1.1.1 ASEAN-5**

The Association of Southeast Asian Nations (ASEAN) was established on 8 August 1967 in Bangkok, Thailand and therefore the ASEAN day is on 8 August. The five member states who sign the ASEAN Declaration are Indonesia, Malaysia, Philippines, Singapore, and Thailand, with the seven aims and purposes of the Association. Moreover, in the Treaty of Amity and Cooperation in Southeast Asia (TAC) of 1976, the five ASEAN member states have adopted six fundamental principles with the purpose of ensuring effective cooperation among them. ASEAN-5 has a Motto of “One Vision, One Identity, One Community” (ASEAN, 2014).

In addition, the main aims of establish ASEAN are to accelerate the economic growth, social progress and cultural development in the region and to promote regional peace and stability (NTI, 2015). Furthermore, the ASEAN Vision 2020 was adopted by the ASEAN Leaders, agreed on a shared vision of ASEAN as a concert of Southeast Asian nations that involve outward looking, living in peace, stability and prosperity, bonded together in partnership in dynamic development and in a community of caring societies (ASEAN, 2014).

The implementation of the ASEAN Free Trade Area (AFTA) on 1 January 1993 and the ASEAN Trade in Goods Agreement (ATIGA) on 17 May 2010 was the pusher for the great achievement in the ASEAN where the purpose of both agreements was to reduce and eliminate the tariffs and hence boosting trade amongst ASEAN members. This encourages more business and trading in ASEAN where they are able to save time, have lower costs in doing business in ASEAN and access increased business opportunities (International Enterprise Singapore, 2012).

Currently, Malaysia is the Chair of ASEAN for 2015, with the theme of “Our People, Our Community, Our Vision”, and the Secretary-General of ASEAN 2013-2017 is H.E.Le Luong Minh from Viet Nam. Both Chair and Secretary-General of ASEAN are rotate based on the alphabetical order of the English names of member states. The Chairmanship of ASEAN is rotate annually and the Secretary-General of ASEAN is rotates five years once (ASEAN, 2014).

In addition, Human Development Index (HDI) is important in measuring a country's economic development while Gross National Income (GNI) per capita is important in measuring a country's economic growth. As UNDP (2015) indicates that the countries with a HDI of 0.8 and above are categorized as developed countries and the countries with a HDI below 0.8 are categorized as developing countries. On the other hand, high GNI per capita represent the country good in economic growth and achieve high income country. According to The World Bank (2015), the low-income economies are defined as having a GNI per capita in 2013 of \$1,045 or less, middle-income-economies with a GNI per capita of more than \$1,045 but less than \$12,746, lower-middle-income and upper-middle-income economies as separated at a GNI per capita of \$4,125, and high-income economies are those with a GNI per capita of \$12,746 or more.

**Table 1.2: Human Development Index (HDI) 2013**

HDI RANK	Country	HDI Value
1	Norway	0.944
2	Australia	0.933
3	Switzerland	0.917
4	Netherlands	0.915
5	United States	0.914
6	Germany	0.911
7	New Zealand	0.910

8	Canada	0.902
<b>9</b>	<b>Singapore</b>	<b>0.901</b>
10	Denmark	0.900
...		
<b>62</b>	<b>Malaysia</b>	<b>0.773</b>
<b>89</b>	<b>Thailand</b>	<b>0.722</b>
<b>108</b>	<b>Indonesia</b>	<b>0.684</b>
<b>117</b>	<b>Philippines</b>	<b>0.660</b>

Source: United Nations Development Programme Human Development Reports, 2015.

**Table 1.3: Classification of Economies by Region and Income in year 2015**

Economy	Region	Income Group
Afghanistan	South Asia	Low income
Colombia	Latin America & Caribbean	Upper middle income
Hungary	Europe & Central Asia	Upper middle income
<b>Indonesia</b>	<b>East Asia &amp; Pacific</b>	<b>Lower middle income</b>
Kenya	Sub-Saharan Africa	Low income
Libya	Middle East & North Africa	Upper middle income
<b>Malaysia</b>	<b>East Asia &amp; Pacific</b>	<b>Upper middle income</b>
Niger	Sub-Saharan Africa	Low income
<b>Philippines</b>	<b>East Asia &amp; Pacific</b>	<b>Lower middle income</b>

Romania	Europe & Central Asia	Upper middle income
<b>Singapore</b>	...	<b>High income: non OECD</b>
<b>Thailand</b>	<b>East Asia &amp; Pacific</b>	<b>Upper middle income</b>
United States	...	High income: OECD
Zambia	Sub-Saharan Africa	Lower middle income

Source: World Bank list of economies, January 2015.

**Table 1.4: Gross National Income (GNI) per capita in year 2013**

Country	GNI per capita (US \$)
Indonesia	3,580
Malaysia	10,430
Philippines	3,270
Singapore	54,040
Thailand	5,340

Source: World Development Indicators, 2015.

Among the ASEAN-5 countries, Singapore is the only one country that categorizes as developed country with the HDI of 0.901 and ranked 9 in 2013 and high-income country with a GNI per capita of \$54,040. It indicates that Singapore is good in economic growth because it have high GNI per capita and good in development because it is good in national socioeconomic development based on combining measures of education, health, and adjusted real income per capita. Next, Malaysia, Indonesia, Thailand and Philippines are categorized as developing countries, which are having Human Development Index (HDI) of 0.773 (ranked 62), 0.684 (ranked 108), 0.722

(ranked 89), and 0.660 (ranked 117) respectively. Subsequently, among the four developing countries, Malaysia and Thailand are upper-middle-income economies countries and Indonesia and Philippines are lower-middle-income economies countries with a GNI per capita of \$10,430, \$5,340, \$3,580, and \$3,270 respectively.

**Table 1.5: Global Competitiveness Index in year 2014**

Rank	Economy	Value
1	Switzerland	5.7
<b>2</b>	<b>Singapore</b>	<b>5.6</b>
3	United States	5.5
4	Finland	5.5
5	Germany	5.5
6	Japan	5.5
7	Hong Kong SAR	5.5
8	Netherlands	5.5
9	United Kingdom	5.4
10	Sweden	5.4
...		
<b>20</b>	<b>Malaysia</b>	<b>5.2</b>
<b>31</b>	<b>Thailand</b>	<b>4.7</b>
<b>34</b>	<b>Indonesia</b>	<b>4.6</b>
<b>52</b>	<b>Philippines</b>	<b>4.4</b>

Source: World Economic Forum, 2014.

Besides, World Economic Forum (2014) shows that Singapore ranked 2<sup>nd</sup> with the value of 5.6, Malaysia ranked 20<sup>th</sup> with the value of 5.2, Thailand ranked 31<sup>st</sup> with the value of 4.7, Indonesia ranked 34<sup>th</sup> with the value of 4.6, and Philippines ranked 52<sup>nd</sup> with the value of 4.4 among 144 countries in The Global Competitiveness Report 2014-2015. It shows that in this global competitiveness index, ASEAN-5 country is good in their productivity and prosperity with the value of above median which is 3.61. This result shows that ASEAN-5 countries are having a good set of institutions, policies and factors that determine the high level of productivity, and hence sets the high level of prosperity that can be earned by an economy.

### **1.1.2 INDONESIA**

Indonesia is the country that known as the fourth largest population size in the world with the total of around 250 million individuals and it is also the biggest archipelago in the world. It is unique in the sense of cultural and it is also highly diverse in ethnic and has more than 300 local languages. Besides, it is also the country that has the most populous Muslim population in the world, Indonesia's currency is the Indonesian Rupiah (IDR). Besides, Indonesia was independent on 27 December 1949 after Dutch colonization shape ethnic segmentation of economic roles, unequal spatial distribution of power, and an oppression and violence political system (EH.Net, 2014).