Chapter 1

Convergence Analysis of Households’ Consumption Expenditure: A Cross Country Study

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ABSTRACT

Households’ consumption expenditure becomes an important determinant of GDP of a country, particularly when the economy is struck by depression with low levels of private and public investments. So maintaining growth of this head of expenditure over time becomes the crucial agenda of the policy makers all over the world. The present chapter tries to analyze whether the developing countries’ levels of households’ consumption expenditure are converging to the ones in the developed countries during 1980-2013 in the sample of 40 countries. The study reveals that there is no significant absolute β and σ convergence among either in the cross section or in pooling of the data during the given period. But population growth factor is making the countries converge significantly in conditional sense. By separating the entire data we observe that, for the entire period, the developed countries are significantly converging in absolute sense while the developing countries are not, although there are mixed results in σ convergence.

INTRODUCTION

The post neoclassical economic thought is strongly engaged in the determination of the national output and employment under the system of effective aggregate demand where there is a general excess supply of goods and services. Aggregate demand side output is generated by the volume of aggregate consumption expenditure of four economic agents, viz. households, firms, government and international consumers. Households’ aggregate consumption expenditure becomes one of the major determinants of aggregate national output particularly in a closed economy without the public sector. We observe since the aftermath of World War II that starting from the pertinent differences among the developed and backward countries the economies of poor nations are growing over time with their potential domestic markets and trying to catch up with the so called developed nations through opening up of their economies to the world markets. Besides, the so called developed economies have been hit hard by several economic and political shocks till date and to get rid of them they have been trying to rely upon the economies of the so called poor nations. In other way to state that there have been strong emergence of a few nations particularly from the Asian and Latin American Zones who have been chasing the base GDP levels of the developed countries by growing at a faster rates compared to the developed ones and trying to become the part and parcel of world governing communities.

To catch up with the advanced economies, one of the simplest ways for the backward ones is to run through the free flow of goods and services across the borders as is happening now in Globalization. Globalization can be made possible by liberalizing the domestic economies through lifting trade restrictions on the flow of goods and services. In the short run, the effect of globalization falls directly on the prices of goods and services traded then it affects the income levels of all the globalized countries. In the long run it leads to homogenization of tastes and preferences across the economies along with homogeneity of cross economy cultures and social practices. Globalization, in that case, becomes truly fruitful and the world then becomes a global village with all the countries become homogeneous representative units in the unionized umbrella. When the process of globalization works the low and middle income countries get access to new dreams that enable them to grow at a faster rates than that under autarchy position and the so called high income countries of the west also get access to the disposal of their produced technology oriented capital goods to the avenues of the middle and low income countries and try to reach to their next better levels. In other way to say that there is always a better chance of the backward nations to grow at higher rates than the advanced nations. This process is known as the Convergence across the world economies as proposed by the neoclassical economists like Solow (1956), Barro and Sala-i-Martin (1992), Mankiw, Romer and Weil (1992), Friedman (1992), Quah (1993), etc.

The theory of convergence or the chasing up of the backward regions to the advanced ones has two dimensions. One is the concept of Beta (β) convergence and another concept is the Sigma (σ) convergence. By Beta (β) convergence we mean to a process in which poor or backward regions grow at faster rates than the rich or developed ones and therefore the former catch up on the latter provided that all the economies in the group are homogeneous in other aspects of growth and developments. The concept of β convergence is directly related to neo-classical growth theory of Solow (1956) where one of the key assumptions is that factors of production, in particular capital, are subject to diminishing returns over the quantity of use of the factor. Accordingly, the growth process should lead economies to a long-run common steady-state characterized by a rate of growth which depends only on the exogenous rates of technological progress and growth of labour force of the economy which is generated out of the active population volume. Diminishing return to the variable factor also implies that the growth rate of poor/