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Political Stability and Macroeconomics Variables Volatility in India

KEYWORDS: POLITICAL STABILITY, ECONOMIC VOLATILITY, GDP, INFLATION, EXCHANGE RATE, CAGR

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ABSTRACT *This paper investigates the relationship between Political Stability and Economic growth for the period of 1996-97 to 2012-13 quarterly in India. Political Stability is measured by duration of government and economic volatility analyzed by the GDP growth, Inflation and Exchange Rate. This paper also examines the coordination of Finance Ministry and Prime Ministry to tackle the problem of economics. How much ruling government controls the economic indicators? Stable government also helps in growing the positive sentiments in an economy. But the tenure of NDA cannot fulfill the targeted growth rate with the experiment to change the finance ministers. Second tenure of UPA government hurts the public with higher inflation rate and lower growth rate.*

Introduction

Economic Growth and Political (connected with the state, government or public affairs or connected with the different groups working in politics, especially their policies and the competition between them) Stability (the quality or state of being steady and not changing or being disturbed in any way) are deeply interconnected. The uncertainty associated with an unstable political environment may reduce investment, speed of economic development, production or labor supply. Developing countries performance may lead to government collapse and political unrest. A high propensity of a change of government is associated with uncertainty about the new policies of a potential new government. Political instability is likely to shorten policy makers' horizons leading to suboptimal short term macroeconomic policies. This leads to a more frequent switch of policies, creating volatility and thus, negatively affecting macroeconomic performance. Political instability as measured by cabinet changes is the number of times in a year in which a new premier is named of the cabinet posts is occupied by new ministers. The regime of the prime ministers and finance ministers are used as a period of stability. Prime minister's periods are nearly for 10 months each for two prime ministers from June 1996 to April 1997 and April 1997 to March 1998 respectively. This was the short period which has been analyzed in this paper with the coordination of Finance minister's time period. During the period of two prime ministers three Finance ministers were appointed for different times to tackle the issues of economy. As in March 1998, the new government joins the work of economy and new finance minister were appointed by them. This was the National Democratic Alliance government with the prime ministerial candidate Atal Bihari Vajpayee, the great poet and philosopher. Two finance ministers were appointed for this duration for different time period to handle the finance ministry and coordinate the work of economy. The time period was from March 1998 to May 2004. After May 2004, the new government took the charge of country which was under eminent scholar of economics Dr. Manmohan Singh who represented the UPA government for two periods and for a decade to work with the theoretical concepts of economics. The coordination of finance ministry was handled with the appointment of five finance ministers for different periods. The time offered many challenges to them because many crises and fluctuation were observed in different countries. The planning commission decided that the targets could not be achieved by a single person during their time period. But they were near to the target for every numbers of targets. Whole effect had been seen by the volatility in different numbers of growth. Risk-averse economic agents or investors may hesitate to take economic initiatives or may pull out from home economic, by investing abroad. Conversely, foreign investors prefer a stable political environment, with less policy uncertainty and less uncertainty about economic endowments. The time period of political stability is measured in round form of quarters. The source of data for the tenure of government is available online. Macro economic variables data is also used quarterly. Data for macro variables is taken from Handbook on Indian Economy published by Reserve Bank of India. Compound Annual Growth Rate in percent (CAGR) is used to measure the growth of macroeconomic indicator quarterly separate for the tenure of Finance Minister and Prime Minister.

Theory of Stability and Growth

Mancur Olson has challenged the mainstream view of the benefits of "Pattern Maintenance". Explicitly treating political stability as an independent variable, he claims in his book that a more complex relationship exists with economic growth. Political stability can be economically dysfunctional and cause growth to decelerate. Olson's theory implies that political stability and instability are dichotomous: instability must reach a threshold to disrupt distributional coalitions. Lesser degrees of instability may not trigger this effect at all. The discontinuous character of stability suggests political systems by four characteristic growth patterns. (1) The Chronically Unstable states should exhibit persistently slow growth. (2) The Consistently Stable ones should grow relatively quickly but show a declining trend over time. (3) The Stabilizing political systems that are settling into a new pattern of political order should undergo a spurt in growth rate. (4) Finally, there are regimes that are becoming less stable. Olson does not make an explicit prediction about these Destabilizing systems, but the inference is that their growth rates would drop sharply.

Historical Evidences

Alberto Alesina et. al (1992) investigated the relationship between political instability and per capita GDP growth in a sample of 113 countries for the period 1950-1982. They define "political instability" as the propensity of a govern-

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ment collapse, and they estimated a model in which political instability and economic growth are jointly determined. The main result of this paper was that in countries and time periods with a high propensity of government collapse, growth was significantly lower than otherwise. This effect remained strong when they restrict our definition of "government change" to cases of substantial changes of the government.

Fabrizio Carmignani(2003) focused on the relationship between political instability policy-making and macroeconomic outcomes. The theoretical section explored various models that explain the effect of instability on growth, budget formation, inflation and monetary policy. The empirical section predictions were generated by theoretical models. The analysis was of few general issues concerning the specification and estimation of econometric models with political variables. Some new results were produced on the empirical relevance of theories of strategic use of fiscal deficit. Conclusion of his paper included phenomena of social unrest, volatility of policymakers, fragmentation of the decision-making process, and electoral uncertainty, political instability is expected to be a determinant of economic decisions and output.

Ari Aisen et al (2011) empirically determined the effects of political instability on economic growth. Using the system-GMM estimator for linear dynamic panel data models on a sample covering up to 169 countries, and 5-year periods from 1960 to 2004, found that higher degrees of political instability were associated with lower growth rates of GDP per capita. Regarding the channels of transmission, they also found that political instability adversely affects growth by lowering the rates of productivity growth and, to a smaller degree, physical and human capital accumulation. Finally, economic freedom and ethnic homogeneity are beneficial to growth, while democracy may have a small negative effect.

Ranmali Abeyasinghe (2004) examined the hypothesis that democracy and political stability have significant effects on economic growth in developing countries. Previous empirical studies found rather ambiguous results when testing for the relationship between democracy and growth. This paper extends these past studies by focusing on the effects of democracy and political stability in developing countries. It also attempted to differentiate the effects of political stability and democracy on economic growth. The results suggested that democracy has a negative effect on economic growth. However the results also suggested that political stability regardless of the level of democracy has been greatest effect on a countries economic growth.

Martin Paldam (   ) attempted to summarize the state of knowledge in a field dominated by belief and opinion. Two contrasting hypothesis was developed: the good growth hypothesis and the destabilizing growth hypothesis. The good growth hypothesis probably the more widely supported, and held that as economic growth is good for people, it must also promote political stability. This is produced in the good circle form mechanism where growth creates political stability and vice versa.

Political regime and Economics
To ensure better macro stability for foreign investors and domestic consumer there is a need to focus on political stability as it is dependent on it. Animal spirit is the term of J. M. Keynes which describes human emotion that drives consumer confidence. As the regime of political parties are direct related to human emotions to cast their vote for stable government and to explore the right way of investment and consumer confidence. The short period of ten month shows the higher CAGR for Gross Domestic Product i.e. 2.97 percent and 7.03 percent for serial number 1 and 2 respectively. This was the time period of United Front (a conglomeration of non-Congress and non-BJP regional parties) and United Front with INC (Indian National Congress) which was failing to curtail the Inflation rate and Exchange rate. Inflation rate shows the higher CAGR during the period of April 1997 to March 1998 which hurt the consumer confidence in government. In the earlier stage from June 1996 to April 1997 government tried to control the inflation rate and exchange rate. Results were the positive to curtail inflation and the power of rupees. The reason for the positive period was the good work of earlier government. Exchange rate had also gone up due to the mismanagement of Rupees and Dollar in short time period of government. Traders sentiments did not believe in the then government. It was also the reason from the side of economy to change the government with the fresh policies.

NDA government which has completed his tenure fulfills the requirement of poor people to bridle the inflation rate 1.16 percent per annum which was positive impact on the consumer side. Producers' side hurt by lower inflation rate was a constraint in the production which is direct function of profit. Per annum lower growth rate had been lowering the confidence of foreign investor and weakening the economy. Exchange rate per annum for that period was stable i.e. 0.57 percent to given the strong value of rupees.

UPA government is pursuing their job before the election of 2014 for a decade. UPA government recorded the higher growth rate than NDA due to long ruling period. Inflation was higher than NDA i.e. 1.75 percent annually for their regime. 0.61 percent Exchange rate is noticed which is higher than the earlier government.

Table 1: CAGR for different government's duration (%)

Sr. No.	Parties or Alliance	GDPmp (Rs. Billion,constant)	WPI Inflation 2004-05	Exchange Rate
1	United Front	2.97	1.08	0.67
2	United Front with INC	7.03	1.89	3.17
3	NDA	1.35	1.16	0.57
4	UPA	1.81	1.75	0.61

If we study the tenure of finance ministers it is clear that the period from June 1996 to March 1998 was the same as above discussed. Two finance ministers for the different time periods in NDA government are analyzed. Firstly, the focus was on the bridle inflation and exchange rate i.e. 1.13 percent and 1.08 percent per annum respectively with lower growth rate of output. Secondly, the focus was on growth rate and exchange rate but not on inflation rate. Perhaps that was the specialization of their skills to combat the problem from different angle for particular field. UPA tenure starts with the higher growth rate 2.15 percent and lower inflation and exchange rate i.e. 1.33 percent and -0.10 percent. For the period from January 2009 to June 2012, New Finance minister took the responsibility

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with uncertainties in international environment of economies with the lower growth rate for output (1.72 percent) higher inflation rate (2.25 percent) and higher exchange rate (0.64 percent) annually. As the finance minster shifts to President's house the responsibility of finance minister was taken by the prime minister and after that a new skilled finance minster was appointed. The period from June 2012 to period of New Finance Minister as taken charges of ministry, data was full of uncertainty in international environment and domestic issues of different scams influenced the economy adversely. Low annual Growth rate (0.39 percent), Inflation rate was higher (1.50 percent) and exchange rate (2.71) break the record adversely in international market of currency. That was the circumstance for the failure of the policies towards change and the ruler was silent killer for economy without taking any strong decision being a student of economy.

Table 2: CAGR for different FM's duration

Sr. No.	As a Finance Minister of different governments	GDPmp (Rs. Billion,constant)	WPI Inflation 2004-05	Exchange Rate
1	P. Chidambaram	2.97	1.08	0.67
2	Inder Kumar Gujral & P.Chidambaram	7.03	1.89	3.17
3	Yashwant Sinha	1.14	1.13	1.08
4	Jaswant Singh	2.5	1.59	-1.24
5	P. Chidambaram & Dr. Manmohan Singh	2.15	1.33	-0.1
6	Pranab Mukerjeee	1.72	2.25	0.64
7	Dr. Manmohan Singh & P. Chidambaram	0.39	1.5	2.71

NDA and UPA both the governments are playing their role with the best captions. Prime ministers regimes as a sign of stability in politics. They are selecting their cabinet as per their choice without coordination with the different ministry.

Short period of the government was much influenced by the previous position of stability in politics. During the five years tenure NDA focused on the inflation rate and stable exchange rate. UPA for the tenure of a decade focused on growth of output. Higher output feed the more but it was on higher cost. Duration of political parties helps to give the way of success in their span as well as pull the country on back foot with negative results of macro variables.

Conclusion

Political uncertainty, no doubt, is an investor's nightmare,political stability volatility proves their mean to disturb the economic environment. As international sentiments hurts the economy in terms of output and exchange rate political instability also hurt the economic activities. If the political system is stable and they have everything all figured out they will know what is best for economy. Everywhere a stable government can help get what the people need and want. Cabinet change is the example of this as explained above. The tenure of the government is also affected on the economic policies. A scenario of political stability suits only the politician and not the common man on the street. Stability only allows the politician to relax for the five year tenor of the parliament. Short term government period cannot fulfill the proper implementation of the policies. As the long period of NDA was focused on the poverty to control inflation and given the strength to rupee. But the tenure of NDA cannot fulfill the targeted growth rate with the experiment to change the finance ministers. That was the reason to change the government. On the other hand UPA government fulfills the target of Growth, inflation and exchange rate in their first tenure. Second tenure of UPA government hurts the public with higher inflation rate and lower growth rate. Weak position of Rupee in terms of exchange rate affects trade. Trade balance more sensitive to exchange rate movement. Stable government also helps to grow the positive sentiments in an economy.

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