



Political Stability and Economic Growth in Asia

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Abstract: This study investigates the effects of various factors of political instability on economic growth in selected ten Asian economies during 1990-2005. Our empirical findings show a close relationship between political stability and economic growth. We have analyzed the data by using ordinary least square econometrics methods, which conclude that 32.35 scores increasing of index of political stability leads to one percent increase in economic growth. From these finding based on Asia experiences, we can conjecture that political stability plays a dominant role in determination of economic growth and sources of capital accumulation. This study uses the average proportion methods and Tinbergen diagrams to show the relative importance of political stability than economic freedom to accumulate capital, measured by four sources of capital accumulation which are proximate causes for economic growth. The results also clearly show that the role of political stability in accelerating economic growth is more vital than economic freedom.

Key words: Authoritarianism, democratization, political instability, visionary leadership, Globalization and longevity of regime

INTRODUCTION

Economic growth contributes for economic development as root for tree. Why most of developing countries are unable to enjoy rapid growth? In Asia, rapid economic growth of newly industrial countries (Singapore, Taiwan, South Korea and Kong Hong), Malaysia and recently china has attracted the world. They had enjoyed more than ten percent average growth during 1980 and 1990s. China has been enjoying rapid economic growth for last two decades. The Chinese Communist Party is in power since 1949. China introduced economic reforms in 1978 under one party political system. Many studies have identified various sources of rapid growth in those economies such as human capital accumulation, physical capital accumulation, technology improvement, foreign trade, foreign trade investment and attitudes of people. Even all those factors positively contributed to economic growth, all of them directly and indirectly depend on political stability which those economies had during their period of development. This study focuses mainly on, how political stability, combined with political system affect the sources of economic growth indirectly and economic growth directly ^[1].

There are some research questions which need to be tested in this paper. Is there any relationship between political stability and economic growth among Asian economies? If there is relationship, to what an extent, political stability affects the growth? Whether economic factors or political factors affect economic growth more? These are very interesting questions in the context of Asian experience to be analyzed in this study.

Real increase in gross domestic product or gross national product is called economic growth. Many factors influence economic growth. Harrod-Domar emphasizes that economic growth ($G = f(s/v)$) is determined by saving(s) and capital output ratio (v). According to Neo-classical growth model (Solow), economic growth depends on capital per worker ($Y/L = f(K/L)$). Baizhu Chen and Yi Feng consider technology as an important factor that determines economic growth. Further, Lucas paid more attention to human capital and the factors which create knowledge or technology for economic growth ^[2]. Growth theory is regarded as development theory.

Robert. J. Barro, ^[3] concluded that higher initial schooling, higher life expectancy, lower fertility, lower government consumption, better maintenance of rules and laws, lower inflation and the improvement of

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terms of trade have positive influence on economic growth. Initial high level of real per capita GDP and political freedom have negative influence on growth. Some researchers argue that studies on economic growth should take into account the nation's culture. Inequality and poverty also influence the economic growth^[4]. Most of the prior studies on economic growth have found that unstable political regimes hamper growth, whereas stable political systems act as catalyst for growth. These studies suggest that political instability often leads to slower economic growth. However, analysts differ about the channels through which political instability translate into a slower economic growth. Some studies suggest that political instability retards growth, directly lowering total factor productivity. In a seminal article^[5], it was found that measures of political instability, such as coups, revolutions, and political assassinations, are inversely correlated with the growth of gross domestic product (GDP) and investment share of the GDP. He concluded that political instability, through its adverse effect on property rights, reduces growth and investment.

Political stability influences economic growth. It is called "politicalization of the economic growth". Institutional framework for economic growth can be facilitated by the social capability, social infrastructure, good governance and rules and regulations. Ethnic heterogeneity, political conflicts and ethnic diversity also influence economic growth^[6-9]. Ethnic conflict = f (ethnic diversity, institutional quality).

Several recent studies highlight the rapid economic growth of China and India.. All these studies focus on the economic factors that determine economic growth in both economies^[10-13]. My study focuses on the socio-political factors which determine, directly and indirectly, the economic growth in short and long run. we will therefore analyze the political factors that caused the rapid economic growth in China and India during the period of economic reforms and compare them. we will use qualitative and quantitative methods for this study.

Stability of political regimes is referred to as the longevity of ruling authority in a country: that ruling authority may be a single party in a one party dominant system or in an authoritarian regime or under military rule or a single party or a coalition of some parties in a multi party political system but the important thing is that it rules the country for a long period without any major political upheaval or turmoil. In economics, the phrase 'stability of political regimes' is used differently than in political science. Economics is not concerned whether the regime is a democracy or a dictatorship. Whether the regime is democratic, dictatorship or soft

dictatorship is of no concern to the economists. Their main concern when analyzing the relationship between political regimes and economic growth is the longevity of the regime. If it has longevity in a peaceful manner, the country is considered to have political stability. Political freedom has only a weak impact on economic growth but there is some indication of a non linear relationship. In countries with low level of political rights, giving additional rights stimulates economic growth. However in countries that have a moderate level of democracy further improvement of political rights reduces growth^[14]. Extent of democracy does not emerge as a critical determinant of growth. In an extreme dictatorship, improvement of political rights tends to raise growth. However, in countries that have moderate level of political rights further democratization may retard growth because the rulers may be more concerned with social program and income distribution. Mitchell A, Seliyson and John Passe- Smith (1998)^[15] have summarized the findings of some studies which relate economic growth and political regimes. Their study calls for further work. The influence political regimes wield on economic growth depends on the level of democracy a country enjoys. In Africa and Middle East countries, it has been found, democracy positively influences economic growth. Brazil failed to achieve success in economic liberalization due to the political reforms and democracy development. In Egypt, success of reforms has been credited to the political strength of the bourgeoisie. Greater democracy is thought to hinder growth by raising the pressure for immediate consumption, which reduces investment. Critics argue that dictatorship is better suited to transferring resource from consumption to investment. Indices of political instability include political assassinations, violent deaths, coups, revolutions, and political riots, indices of executive adjustments, major constitutional changes, and major government crises excluding revolts, politically motivated purges, war, and separatist movements. They all find that political instability is negatively correlated with economic growth.

MATERIALS AND METHODS

Measures of political stability: This study created an index using proxy variables for political stability during 1990-2005. Our purpose is to measure the effect of political instability on growth related variables through this index. This study used the following measures to create the index for political stability in a long period 1990-2005 in selected ten Asian economies at various income levels.

Proxy variables for political stability:

Longevity of the regime- X_1 : stands for the number of times the ruling party was changed during the selected period. It indicates the continuity of government policies. When the number of time increase political stability decreases. It indicates that the stability of the regime is weakened

Election Density Ratio (EDR) - X_2 : Election density ratio (EDR) = the research period (15) is divided by number of times general elections were held. A country that holds several elections in a given period is politically unstable. Higher the value of EDR greater the country's political stability. Lower the value of EDR the political regime's instability is greater.

Increase in the number of political parties- X_3 : The increase in the number of parties or alliances, having at least two seats in the national assembly (With respect to first and last elections from 1990 to 2005) also indicates political instability.

Strength of ruling party – X_4 :Average of the percentage of the seats the majority party that was in power for more terms during the period had in the national assembly. It indicates that within the period, which party was in power more times and each time what percentage of the total seats it got in the national assembly. And finally we take the average of the percentage. It indicates the strength of leading party in a country.

Military Expenditure as a percentage of GDP– X_5 : Military expenditure is an indicator of peace, thus political stability, in a country. We take the changes in military expenditure as percentage of GDP between 1985 and 1995 fiscal years for all countries.

Index of democratization. X_6 : It measures the extent of democracy (or degree of authoritarian regime). Higher the degree of competition and participation, higher the level of democratization in a particular political system. Competition is defined as the electoral success of small parties. Percentage of the population that actually voted in these elections is used as the measure of the degree of electoral participation. Generally, in middle income developing countries, greater democracy indicates higher instability of the regime and less democracy greater stability. (There may be some exception) In the scale, first rank means higher degree of democratization and fifth low degree of democratization. The index is for 1998.

Composite of ICRG risk Rating – X_7 : This is an index to assess the government's risk rating. Higher value means low risk and low value higher risk. This is also one of the indicators used to measure political stability. Higher value indicates the stability of the regime and low value its instability. It is for February, 1999.

Number of persons internally displaced – X_8 : It indicates that the country is afflicted with internal socio- political problems. Higher number indicates political instability and less number the political stability. It is for 2005.

Increment of political parties in national assembly- X_9 : This indicates the maximum increment of political parties that have at least two seats in national assembly during the 1990-2005. Higher numbers mean political instability and low numbers political stability. This variable differs from X_3 which indicate the increase of political parties between first and last elections during 1990-2005.

All the above variables of measures which determine the political stability of a country are transformed as a one index called index for aggregate political stability. It takes zero to hundred points. A low point means a political instability and a high point indicates strong political stability. According to index for aggregate political stability, China, Singapore and Malaysia have higher political stability whereas India, Philippines, Pakistan and Sri Lanka have worse political instability. Thailand and South Korea possess average political stability. China ranks first and India the last.

Political stability determines the factors which determine economic growth such as investments (foreign direct investment (FDI), stock market capitalization, private investment) technologies which comes with FDI and skilled labor who migrate to countries which have political stability. So political stability indirectly determines economic growth. Short run economic determinants of output such as fiscal, monetary policies, exchange rate policy, trade policy and other types of policies also determine long term growth. Those entire short run economic variables are measured by Index of economic freedom The factors determine the economic freedom can be assumed and taken as economic factors determine the investment and growth. Index for economic freedom includes more than 50 variables which fall into the following 10 categories or factors, of economic freedom such as trade policy, fiscal burden of government, government intervention in the economy, monetary policy, capital flows and foreign investment, banking and insurance,

wages and prices, property rights, regulations and black market activities. All those variables indicate degree of liberalization.

RESULTS AND DISCUSSION

Partial analysis: We make correlations, average proportions and regression on index for political stability and index of economic freedom with variables which determine economic growth. This section evaluates the effect of political and economic freedom on various sources of capital accumulation. (Physical and human) It shows the indirect effect of political stability on economic growth.

Variables on sources of capital accumulation

- Y₁ Average annual growth rate of gross domestic investment (1990-1999)
 - Y₂ Gross domestic investment as percentage of GDP (average of sum of 1990, 1999 and 2005)
 - Y₃ Stock market capitalization (Changes during 1990-1999 in \$ US Million)
 - Y₄ Foreign direct investment (Changes during 1990-2004 in \$ US Billion)
- Observations – 10

Table 1: Correlations among the variables

	IPS	IEF	Y ₁	Y ₂	Y ₃	Y ₄
IPS	1.000000	-0.401019	0.448236	0.760211	0.673449	0.669827
IEF		1.000000	0.204033	-0.339321	-0.060037	0.181419
Y ₁			1.000000	0.276602	0.586752	0.692579
Y ₂				1.000000	0.784902	0.676614
Y ₃					1.000000	0.861411
Y ₄						1.000000

Table 2: Partial correlation among the dependent and independent variables

	Y ₁	Y ₂	Y ₃	Y ₄
IPS	0.590	0.7244	0.7101	0.8142
IEF	0.468	-0.0572	0.3099	0.6611

William Kruskal proposes an average proportion method to analyze the importance of independent variables on dependent variable.

$$\begin{aligned} \text{Average proportion of IPS} &= (r^2_{Y_1|IPS} + r^2_{Y_2|IPS,IEF})/2 \\ &= (0.448236+0.590)/2 \\ &= 0.51915 \end{aligned}$$

$$\begin{aligned} \text{Average proportion of IEF} &= (r^2_{Y_1|IEF} + r^2_{Y_2|IEF,IPS})/2 \\ &= (0.204033+0.468)/2 \\ &= 0.336016 \end{aligned}$$

The results of average proportion method computed from table 1 and 2 shows that variable of economic freedom (IEF) have a weak effect on growth rate of domestic investment in selected countries. Variable of political stability (IPS) has a considerable effect on growth rate of domestic investment. We can show this relationship to other dependent variables. Table 3 shows results of average proportion methods of four variables.

Table 3: Partial correlation among the other dependent variables

Average	Y ₁	Y ₂	Y ₃	Y ₄
IPS	0.5191	0.7423	0.6917	0.7421
IEF	0.3360	-0.1983	0.1249	0.4210

According to the table 3 computed from table 1 and 2, we conclude that political stability is more important than economic factors since value of proportion of IPS is more than values of proportion of IEF. Political stability is playing an important role in the determination of capital sources of economic growth than economic policy variables. In regression analysis in table 4, the political stability has significant effect on growth of domestic investment, percentage of domestic investment in GDP, stock market capitalization and foreign direct investments whereas Index of economic freedom has significant effect just only with FDI.

Table 4: Regression Results of Sources of capital accumulation for economic growth

	Y ₁	Y ₂	Y ₃	Y ₄
IPS	0.074**	0.1470**	2308**	0.3873*
IEF	2.928	-0.4463	41030.7	12.90**
R ²	0.376	0.579	0.5060	0.690
F	2.112	4.820	3.586	7.79

1: Capital sources of Y₁, Y₂, Y₃ and Y₄ are dependent variables on independent variables IPS and IEF

2. *, **and *** are 1, 5 and 10 percent significant level respectively.

Jack Johnston explains a graphical method to show the relative importance of variables. Figure.1, 2, 3 and 4 show that the relative importance of political stability and economic freedom in the determination of sources of capital accumulation by using Tinbergen diagram. The values are calculated in the following methods.

The values of relative importance of IPS and IEF on each dependent variable are calculated as follow

$$IPS = \text{Coefficient of IPS} / (\text{Coefficient of IPS} + \text{Mean value of IPS})$$

$$IEF = \text{Coefficient of IEF} / (\text{Coefficient of IEF} + \text{Mean value of IEF})$$

In figure 1,2,3 and 4, If the values of each observation are around zero, it means that the variable does not have more effect on dependent variable. Instead, the values have more fluctuations; it means the variable has more effect on dependent variables.

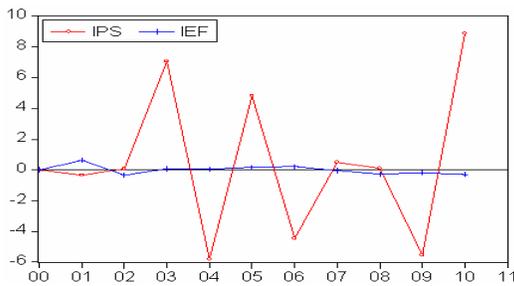


Fig.1: Average annual Growth rate of domestic investment

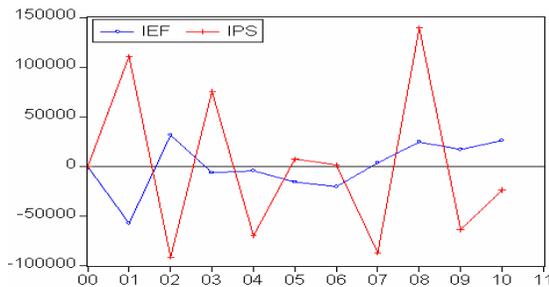


Fig.2: Gross domestic investment as % of GDP

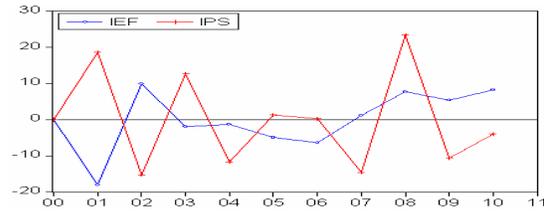


Fig.3: Stock market capitalization

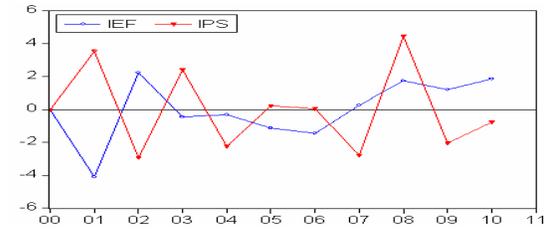


Fig.4: Foreign Direct Investment (FDI)

Figure1, 2, 3 and 4 clearly show that political stability (IPS) has more effect on sources of capital accumulation than economic freedom (IEF).

General analysis: The effects of political stability on economic growth are measured with variables which determine economic growth in theoretical literature. Capital, labor and human capital with technology are key economic determinants of economic growth in growth theories. Different studies have used different variables to measure sources of growth. Other variables such as foreign trade, removal of exchange rate controls and trade control can affect growth also. These factors can be measured by proxy variable of Index of economic freedom. Political stability may have direct effect on growth. But it has a strong effect on sources of capital accumulation. We can make a general model as follow.

$$G_t = f(K_t, L_t, HDI_t, IEF_t)$$

Growth rate (G_t) = f(Growth of labor force(L_t), Growth of capital(K_t), level of human capital(HDI_t), Degree of economic freedom(IEF_t))

t means averages or changes of variables in the period of 1990-2005 not a given year. Because we can not see the effects of political stability of a year at same year. It has many year's lagged effects.

$$G_t = B_0 + B_1 L_t + B_2 K_t + B_3 HDI_t + B_4 IEF_t + e_t$$

Growth rate (G_t) is measured as average annual GDP growth rate during 1990-1999

Growth of labor force (L_t) is taken as average annual growth of labor force during 1990-1999. Growth of capital (K) is taken as average annual growth of domestic investment during 1990-1999. Human development index is for year 1999. Index of economic freedom is for 1999.

$$G = 5.3568 - 1.7625L^{***} + 0.3181K^{**} + 3.188HDI + 0.1837IEF$$

$$t(0.6529) (-2.2244) (3.064) (0.5007) (0.1491)$$

$$R^2 = 0.8298, F = 6.0959$$

According to the regression results for sources of growth, only variable capital is significant at 5 percent level. Labor is significant at 10 percent level but there has been a negative relationship with growth. Human capital and economic freedom does not have significant effect in this model. These results clearly indicate that capital is key determinant of growth. Since capital is key determinant of growth, the political stability that key determinant of sources of capital accumulation is highlighted as dominant determinant of growth in Asia. If we include variable of political stability, the model gives following results.

$$G = 1.7888 - 1.1852L^{***} + 0.1980K^{**} + 2.8429HDI + 0.8303IEF + 0.0309IPS^{**}$$

$$t(0.350) (-2.3) (2.6796) (0.7361) (1.070) (3.099)$$

$$R^2 = 0.9499, F = 15.18$$

Even this model has high value of R^2 and F statistics which may be sign of multicollinearity, index of political stability has significant at 5 percent level whereas other variables (HDI, IEF) does not have significant even 10 or 15 percent. Political stability effects economic growth not only indirectly by sources of capital accumulation but also directly on growth than labor, human capital and economic freedom in Asia. In a quantitative approach, Political stability is playing a predominant role in determination of economic growth directly and indirectly in selected Asian economies.

CONCLUSION

Political stability is playing an important role in determining economic growth in Asian economies. There is direct and indirect relationship between political stability and economic growth. China's rapid economic growth and economic boom depend mainly on political stability which is based on its one party political system. India's growth is facing some political challenges at present and will have to face them in the future also because of the political instability bred by its multi party and democratic political system. Experiences of growth in Asian countries clearly show that economic analysis must take into consideration political and sociological issues. China is likely to open up more sectors for foreign investors thus increasing the possibility of higher economic growth in a limited democratic system. Economic growth of India may be limited in the future also due to its socio-political instability. But China because of its political stability will continue its march forward on the path of robust growth.

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