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# The Impact of Political Volatility on Economic Growth: Sri Lankan Experiences

Sri Lanka is currently facing the worst economic crisis and political instability ever after Independence due to manifold reasons both short and long term. The common perception is that several reforms in the sectors of political, economic and social fabric should be carried out in-depth to escape from this grave situation. Discussions have already been opened with the multi-lateral institutions led by the IMF and friendly countries to obtain financial assistance, and restructure outstanding debt, and the outcome of such discussions are positive. Political stability and peace in society are two major conditions that are demanded in building confidence and strength to make such programs a success.

This study examined the relationship between political stability and economic growth together with some other important macroeconomic variables which generally are thought to be selected indicators for evaluating economic growth in Sri Lanka. Political stability is an important factor that influences the creation of existence of strong institutions together with democracy for economic development. Empirical investigations have shown that strong institutions will be supported by political stability and democratic governance, and that these institutions will bring about robust economic growth. In this study, the ARDL estimation model is employed to see the long run relation between political stability and economic growth in Sri Lanka during the period of 1977 - 2021. The study used Political Stability Index (PSI) which is internationally accepted index. Political stability index (-2.5 weak; 2.5 strong), measure the Political Stability and Absence of Violence/Terrorism: Percentile Rank in Sri Lanka was reported at 32.28 % in 2021, according to the World Bank collection of development indicators, compiled from officially recognized sources.

Sri Lanka - Political Stability and Absence of Violence/Terrorism: Percentile Rank - actual values, historical data, forecasts and projections were sourced from the World Bank on May of 2022. The average value for Sri Lanka during that period was -0.86 points with a minimum of -1.9 points in 2020 and a maximum of 0.09 points in 2015. The latest value from 2022 is -2.05 points. For comparison, the world average in 2020 based on 194 countries is -0.07 points. In methodological section, the relationship was examined in two stages. The first stage dealt with a



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bivariate econometric modeling to examine whether each macroeconomic variable has relation with political stability index when this index were determined to be the sole independent variable in the model. In the second stage, PSI index together with other macro-economic variables were modelled into one equation to see the relation between them.

### Political Stability

Politics is handled in conjunction with the "state of the art", which represents the whole of the formal political instruments that comprise the institutions, laws, public policies and key actors of the country as a whole, and the laws, institutions. Some literature highlighted define the political stability as the absence of internal conflict and violence events. It is seen as a symptom of instability if the political regulators change rapidly after the events of violence and incitement. Besides, political instability refers to the force of change of the current constitutional order, political polarization, the high rate of change of coalition governments and governments. There are three basic opinions on the definition of political instability. These are social irregularities, myopia and polarization, and weak government approaches.

The social order refers to the fact that social parts and whole are related to each other in order to form a system in a social structure whereas social disorder refers to the weakness of the connections and interaction between the social parts and the whole within the social system. In terms of myopia and polarization, political instability is

related to the number of government changes. Though, it is not in the economic sense that the economic units cannot see forward, or in other words, the future in the level of data knowledge, the weak government approach is that the serious political problems that threaten the existence of power and life.

### Global Context

As Acemoglu (2000, 2003) has observed the dynamic relation between democracy and economic growth and development of countries, similar conclusions were also drawn by Feng (1997). The author finds that democracy has an indirect effect on economic growth through its effect of government changes when analyzing 98 countries from 1960 to 1980. Further evidence suggests that when growth is negative, this forces ruling parties to lose in election and positive growth increases the chance of ruling parties to stay in power.

In an IMF working paper, Aisen and Veiga (2011) found in their investigation of a sample of 169 countries, higher degree of political instability is linked to a lower level of GDP per capita when using GMM estimator in panel data. The study also point out that political instability also lowers the productivity of the economies. In their thorough investigation, Alesina et. al. (1992) looked for 113 countries whether political instability countries' economic growths are jointly determined. They found that in times of political instabilities the growth rates were lower than the usual times. They further argue that this relationship is even stronger when government



The findings are in line with the literature on this issue. However, no relation between the short term interest rates and economic growth was found during the investigated period. We reached similar conclusion with literature on Turkey. This may be due to the reason that the developed economies such as the US, EU, Japan and the UK, especially after the financial crisis of 2008, have not provided the desired results in economic activities, even if interest rates have been reduced to zero or near-zero. In such a period, the relation of interest rates to economic activities has weakened considerably.

### Lessons Learnt

Political consensus around economic policies in Sri Lanka has always been elusive. In recent political cycles, economic reform agendas have been promptly reversed by the next government, resulting in policy whiplash and macroeconomic damage. This trend must be reversed. Political consensus in key reforms areas, such as fiscal adjustment, market-based pricing of energy, rationalising state expenditure, including state-owned enterprise reform and a halt on state sector recruitment is essential.

Domestic political consensus on the core reform areas must accompany efforts to agree on a reform programme with the IMF that sets the stage for a sovereign debt restructure. The IMF and bondholders need assurances of political continuity. Any attempt to push through the reform programme without clear articulation of its rationale, expected outcomes, and measures to protect the vulnerable, will be met with resistance by politicians and the public.

"Lessons must be learnt from similar experiences from across the world to avoid serious repercussions," said Yamini Mishra. "Any austerity measures introduced in Sri Lanka must be based on a human rights assessment, should be open for public scrutiny and feedback in an inclusive and participatory process, and all alternatives must be explored before they are introduced. Austerity measures must not disproportionately impact the marginalized groups and must be strictly temporary."

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the fluctuation on the Gross Domestic Product. Tuncsiper and Bicen (2014) investigated the effects of economic liberties on economic growth in nine market economies, including Turkey, in between 2000 and 2012. In the study, the general economic freedom index, property rights index, working freedom index, trade freedom index and investment freedom index were used. There is a positive relationship between the trade liberalization index and economic growth, which has a negative relationship between the property rights index and the freedom to invest index and economic growth.

### Outcomes

The findings of first stage appear that there is significant positive long run relation between political stability and macro-economic variables including gross domestic product of Sri Lanka when applying Bound Testing. On the other hand, the outcome of second stage of methodology reveals that Gross Domestic National Income is positively affected by political stability in the long run. The results are statistically significant and positive.

# Pillars of 'Ecotourism' business

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Ecotourism is "environmentally conscious nature-based travel enjoyed by people interested in learning about the nature, history and culture of the area visited, while providing economic and social benefits to host communities by expanding the community's economic base, and contributing to natural resource conservation through nature interpretation and environmental education." Accordingly, ecotourism contributes to the sustainable development.

### Factors for Success in Ecotourism Ventures

Provision of ecotourism means making available the resources people need to get involved in ecotourism activities. Ecotourism is typically provided by a network of businesses that, together, offer the different products and services needed by the ecotourist. This includes food services and food supplies; sports and outfitting equipment and supplies; lodging; and guide services. In the ecotourism business, some underlying characteristics can be identified that make them successful. Table 1 shows the 03 main parts of the ecotourism definition as well as the factors included under each part of definition. These 03 parts and factors are found in any successful ecotourism business.



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**Table 1: Major parts of definition of ecotourism and factors to be included in each part of definition of Ecotourism**

The natural environment is the location where ecotourism takes place. Culture refers to the cultural aspects, including the history, of the host community and of the area that are part of the experience that is provided. Education is provided to increase awareness of the importance of nature to both the eco-tourists and the local people. It is typically provided through nature interpretation and outdoor activities. Business aspects have to do with factors that affect the



viability and profitability of the ecotourism enterprise. Community development refers to "how" and "what" ecotourism contributes to the locale and its people. Natural resource conservation is necessary because ecotourism is a form of nature-based tourism and, as such, depends on the natural environment for its existence.

Factors from Table 1, and those identified from the literature review, are grouped into environmental, economic, and social factors. These factors are described in the following paragraphs.

### Environmental Factors

Environmental factors refer to the natural environment such as natural features and the ecological processes occurring in an area. Natural features, including scenic vistas and landscapes, climate, topography, wildlife and vegetation, are important to the type and level of tourism in an area. Tourism can be important to natural resource conservation because part of the income from tourism can be re-invested in maintaining natural areas. In this sense, tourism has enabled rehabilitation of old as well as creation of new sites, and has fostered administrative and planning controls such as restricted access to sensitive areas that maintain the qual-



ity of the environment. Additionally, the physical location of an area is an important factor in tourism demand. Typically, rural locations relatively close to metropolitan areas are the tourism locations in high demand.

Ecotourism management strategies aim at protecting the environment while providing the tourist with a great ecotourism experience. Since ecotourists are motivated by notions of wilderness, wildlife, parks, learning, nature and physical activity, these ideas should underlie the management of ecotourism. Moreover, ecotourism should be channeled towards activities that would contribute to the health and viability of the environment within which they take place. In many cases, despite good intentions and attempts to reduce the negative effects on the natural environment, tourism has been detrimental to the environment. Damaged vegetation, disruption to wildlife, soil compaction, contamination of water sources, air and noise pollution are but a few of the negative environmental effects caused by tourism. Additionally, protected areas (e.g., national and state parks) have undergone the cumulative and interactive effects of many small scale, independent, low intensity tourism developments over the decades. Hence, an increase in the number of ecotourism activities



can pose environmental problems because, although aiming to be non-consumptive and low-impact, people engaging in ecotourism are bound to consume resources and generate waste.

### Economic Factors

Economic factors are relating to the economic structure and economic development, including the economic base, patterns of investment, and economic leakages. Tourism can help the stability of local economies by diversifying the economy through the creation of businesses providing tours and catering to every other aspect of the tourists' needs. However, the seasonal character of tourism creates economic fluctuations throughout the year that can be detrimental to the stability of the local economy. Additionally, the existence of personnel skilled in the provision and management of tourism enterprises is key to tourism success. The existence of educational programs is fundamental to ensuring such properly trained personnel. Local investment in tourism is important in strengthening the local economy and minimizing economic leakages. Economic leakages occur when profits generated locally are exported (i.e., "leaked") to another locale. Marketing and human

resources too play key roles in the success of ecotourism enterprises. According to scholars for individual businesses, cooperative marketing offers an affordable way to attract visitors to an area. In the case of regional agencies, strategies based on symbols, images and other regional characteristics could be used to attract visitors to the region by setting it apart from others.

### Social Factors

Social factors consist of social structure and organization, including demographic characteristics, the availability and quality of social amenities, attitudes of the local population towards tourists, and local traditions and culture. For instance, a friendly and cooperative host community enhances local business opportunities for tourism. Focusing on impacts, scholars have suggested that those interested in the role of social factors should take into consideration changes in values, relationships, life styles, quality of life, behavior and creative expressions in the particular locale.

Accordingly, ecotourism is based on three pillars of environmental, economic and social factors.

Ecotourism should additionally be locally defined and implemented in terms of specific activities and structures, as well as its potential environmental, cultural, and economic effects for the host area concerned. Visitor guidelines are therefore key to enhancing appropriate behavior on the part of visitors towards both cultural and natural sites. Ecotourism guidelines highlight expected behavior on the part of visitors with respect to nature and to the host community for the purpose of engaging in environmentally sensitive and low-impact activities. According to the scholars, successful ecotourism destinations are those that go beyond quality of services and facilities to include the quality of the experience itself and the positive host environment.

Major Parts of the Definition of Ecotourism	Factors
"environmentally conscious nature-based travel enjoyed by people interested in learning about the nature, history and culture of the area visited,	Natural environment Culture Education Travel People
while providing economic and social benefits to host communities by expanding the community's economic base,	Economic Social Community and contribution
contributing to natural resource conservation through nature interpretation and environmental education	Natural resource conservation Education