

DOES SRI LANKAN ECONOMY DEPICT A POLITICAL BUSINESS CYCLE?



Dr. T.U.I. Peiris
Senior Lecturer
Department of Accountancy and Finance
Faculty of Management Studies
Sabaragamuwa University of Sri Lanka

According to the political business cycle theory, both fiscal policy and monetary policy variables can be affected by elections. Herein, macroeconomic variables like economic growth, inflation, money supply, unemployment, interest rate, and exchange rate can be observed for possible political business cycle effects.



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The hypothesized tendency of governments to adopt expansionary fiscal and monetary policies in election years symbolizes the presence of political business cycle effects. The political business cycle theory argues that in and around an election year, economic activities tend to improve, partly because of the large amounts of spending on political campaigning. On the other hand, economic activities will improve as the incumbent party take every action to show a better “political report card” before an election. It can sometimes be the election year itself or the prior year. However, the best “political report card” would be something that shows better economic performance. For instance, whether economic growth has remained strong or whether the ruling party has succeeded in bringing growth or reviving the economy from recession.

Research studies indicate that to have an attractive “political report card,” the incumbent party would pull the economy down slightly in the initial years of governing but introduce policies so that economic growth reappeared in later years or in time for the next election.

According to the political business cycle theory, both fiscal policy and monetary policy variables can be affected by elections. Herein, macroeconomic variables like economic growth, inflation, money supply, unemployment, interest rate, and exchange rate can be observed for possible political business cycle effects. Therefore, this analysis focuses on Sri Lanka’s inflation for the period starting from 1995 to 2020. During this period, several presidential elections, general elections, and provincial elections were held.

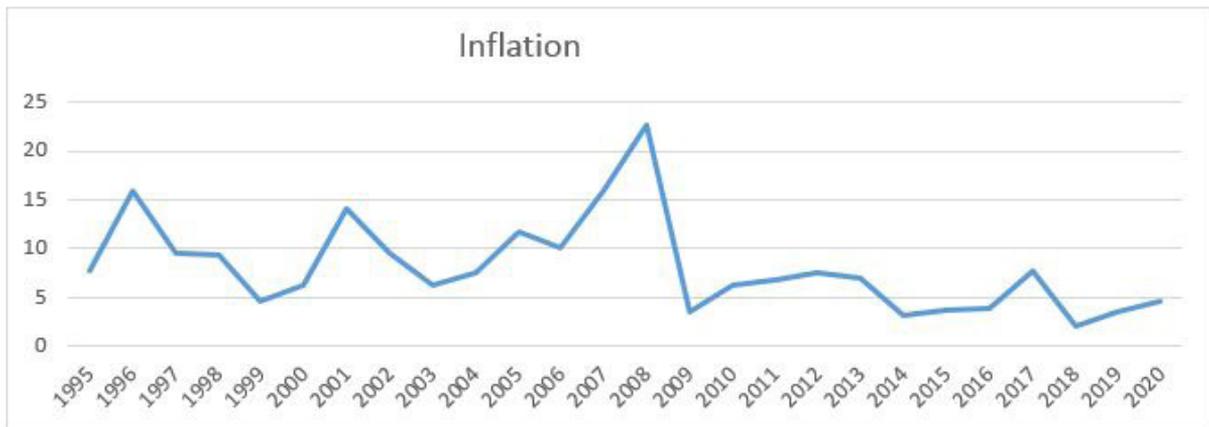


Figure 1: Sri Lankan Inflation (1995-2020)

Figure 1 depicts the characteristics of political business cycle theory as the inflation rates are comparatively meager in the election periods and increases soon after most of the time. For instance, the fourth presidential election was held in December 1999. According to Figure 1, inflation has reduced in that particular year and has increased afterward. Subsequently, the country's fourth and fifth general elections were held in 2000 and 2001, respectively. During this period also the inflation rate has significantly reduced. According to the above Figure, the inflation rate shows a shallow value in 2003 as well. This behavior once again evidences the presence of a possible political business cycle effect during the local government election held in 2003, which was a crucial election in Sri Lankan political history.

The sixth general election held in April 2004 is considered one of the significant turning points as an incumbent loss was recorded. During this election period, inflation has also been managed at a lower level and has increased significantly after that.

A similar trend is shown even around the seventh general election and the sixth presidential election in 2010. According to the above Figure, the behavior of the inflation rate during 2015 recalls the properties of the political business cycle as of the political business cycle as the seventh presidential election and eighth general election were held in January and August 2015, respectively. The period from late 2019 to early 2020 also depicts significantly lower inflation. This lower inflation may be due to the presidential and general elections held during that period. All in all, this monetary policy variable's past behavior might provide evidence for possible political business cycle effect in Sri Lanka as the inflation rate seems well-controlled, especially in the election periods.