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Abstract

Talking about growth and development, economic governance can be understood as referring to the important components of a broad group of institutions. These components comprise of an economy's political institutions, state ability as well as supervision of the economic institutions. Effective governance is essential to ensure that the rules of game are clearly defined and understood by the producers and consumers, thereby creating an enabling environment for the functioning of the economy.

Institutional Economics came into being post the First World War. This school of thought was prominent amongst the American economists. The Old Institutional Economics was based on the notion that an individual cannot be taken as given. Their preference functions depend upon the prevailing socioeconomic environment. However, it failed to develop a cohesive theoretical framework/approach. This paved the way to the emergence of New Institutional Economics (NIE), a term put forth by Oliver Williamson in 1975. In contrast to the Old Institutional Economics, it considers the individuals' preferences to be given. The heart of this theory lies in describing how the institutions come into being when the people communicate with each other.

In light of the importance of an economy's institutional climate in influencing its growth process, the present study aims at the following three objectives: Firstly, calculation of total investment volatility for 20 Asian and African countries during the period 1985-2013; Secondly, to study the impact of economic governance on total investment volatility for 20 Asian and African countries during the period 1985-2013 and Lastly, to study the impact of the subcomponents of quality of governance (law and order, corruption and bureaucracy quality) on the total investment volatility for 20 Asian and African countries during the period 1985-2013.

The results from the volatility calculation for Burkina Faso indicate increase in total investment volatility during 1986-2012. Cameroon's total investment volatility has increased during 2000s as compared to the pre-2000 period. The Indian economy saw a rise in total investment volatility during 1986-2013. Niger, Nigeria, Senegal, Tunisia show a decline over 1986-2013. Lastly, Pakistan's level of total investment volatility during 1986-2013 has been lower than the average level for the included sample of countries.

The long run result from the Pooled Mean Group regression analysis show that an improvement in the institutional quality helps in the reduction of volatility in total investment. On the other hand, increase in official development assistance, trade openness and population growth has a positive impact on total investment volatility. Moreover, a statistically significant and negative coefficient of the error correction term tells us about the movement towards equilibrium in the long run. Among the explanatory variables, only population growth is significant at 5 per cent level of significance. As population growth increases by 1 unit, the total investment volatility increases by 71.57173 units, other things remaining constant.

Out of these three indicators of institutional quality, the coefficient of only 'law and order' has been found to have a statistically significant and negative impact on total investment volatility at 1 per cent level of significance. The bureaucracy quality and corruption fail to have any statistically significant impact on total investment volatility.

Based on the above results of the study, certain policy suggestions can be derived. Investment needs strong institutional capacity to be less volatile. The Government may undertake reforms that guarantee a higher quality of governance that, in turn, is likely to promote higher quality and more productive investment. Further, better diplomatic ties between the countries may help to resolve this issue of unpredictability of foreign aid.