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Analysis Of The Effect Of Political Instability On National Economic Development Of Pakistan

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Abstract

The role of political stability cannot be overlooked in the socio-economic development process of any country. The purpose of this study is to evaluate the effect of political instability along with some other controlled variables namely corruption, terrorism and international investment on the national development of Pakistan from the period of 2002 to 2020. Based on the nature of the data, the method of Ordinary Least Squares (OLS) along with the method of Robust Least Squares (RLS) is implemented to obtain more robust results. The regression results showed that FDI is positive significant on national development, while corruption and terrorism are negative and insignificant on economic growth. Political stability shows positive results and significant to economic growth of Pakistan. It is proposed that the government should focus on the issue of terrorism and corruption. Government should adopt policies to control these for the improvement of economic growth in the country. To be most active and effective in tackling terrorism and chronic corruption, it is necessary to get to the roots of the problem. Whereas political interference should be discouraged, improving accountability, as well as enforcing law and regulation for all equally. We additionally used sophisticated Econometrics technique namely Robust Least Square for empirical estimated. The set of variables used in this is visibly different if compared to almost all prior studies.

Keywords: Political stability, terrorism, economic development, Pakistan.

Introduction

The word politics was introduced by Greek philosopher Aristotle; he has explained that it is the form of civilization that works as normal good. Politics aims to guide public development by identifying common goals and methods of achieving them. Political instability may have a direct impact on aggregate productivity of a country, as badly dismayed market functioning (Drazen, 2000). National economic development and political stability are intensely interrelated. The system in Pakistan dictates that the winner takes everything and the loser has nothing.

Pakistan has failed to be established political stability. The reason is the stagnant democratic system, lack of economic problems and lack of social development. It has been observed that in Pakistan, political instability has gravely impacted the prospects of aggregate output, though Pakistan is a rich country in natural resources. Uncertainty weakens socio-economic spheres in the country. In a study, Frischtack (1994) clarifies that undoubtedly “good governance” indicates sustained economic growth and development. It implies that as the quality of governance is expanding, it leads to contraction of corruption epidemic and consequently booms the rate of economic growth. The aim of good government is to

promote the economic and social change of the country. It has been observed that corruption should have a lot of effect on economic development in the long run (Azam, 2016). Terrorism affects the country's politics, economics, and foreign affairs. Terrorism affects the economy of a country due to loss of human and physical investments and the decision of investment confidence. It adversely affects the performance of financial markets (Meng *et al.*, 2018). Political instability is one of the key force problems Pakistan is facing. Pakistan's progress is underway.

Political stability plays an important role in maintaining peace in society and harmony between the state and the harmony of the society. The state has an essential condition for the economic development and development of law. The development of state without the political stability is impossible (Memon *et al.*, 2011). Development of the state without an organized system of politics is not possible. Unfortunately, political instability has been going on and becoming more visible in the region. The lack of mature leadership is a serious threat to the crises in the state; vast corruption, contest between the main organs of state, strong bureaucracy and crises of governance are the immediate threats to democracy in Pakistan (Javed & Mamoon, 2017).

Political stability is a significant positive determinant of growth. The probability of losing power is directly with the degree of political instability in the country. Such instability has serious effects on economic growth. To find causes of political instability and to give a good suggestion to the country's authority to implement policies to reduce political instability ratio of the country. Broad objectives of the study are to explore the association between political instability and economic growth and to suggest some policy measures based on result of the study.

Literature Review

In a study, Devereux and Wen (1998) using endogenous growth model observed that political instability has negative impact on the aggregate output. Aisen and Veiga (2006) generally collected the data for 100 countries from (1960-1999) using the GMM method and panel data that high inflation reduces society welfare. The results reveal that both higher political instability and higher inflation have bad influence on overall development. Khan and Saqib (2011) study analyzed the impact of political instability on rise in general price (inflation) in Pakistan over the period covering from 1951-2007. The results showed that the political instability has disadvantages over the years, and at that time there is not a much more inflammatory country.

Aisen and Veiga (2013) analyzed the effects of political instability on economic growth by using data for the period of 1960-2004. The study used the GMM regression for

the linear dynamic panel data model. The hypothesis that affects political instability and other political institutes is tested by panel data model for GDP per capita. It is found that political instability significantly reduces economic growth both economically and statistically and badly affects growth by lowering the rate of productivity growth. It is concluded that economic freedom and cultural homogeneity are beneficial for growth while democracy may have small negative effects.

Okafo (2017) conducted an empirical study on examining the link between political instability and economic growth for 15 Community of West African States (ECOWAS) countries during 2005–2012. The results from the empirical analyses revealed that poor governance, terrorism, social unrest, youth joblessness and natural resource rent have adverse associations with economic growth. More recently, the study of Elbargathi and Al-Assaf (2019) examined the effect of political instability on the growth in four Arab countries namely Egypt, Lebanon, Jordan, and Tunisia during 1996-2016. Results revealed that that there is a robust long-run link between the many political indicators upon the growth in Arab countries.

Literature on Pakistan

Tabassam et al. (2016) carried out a study that surveyed the influence of political unrest on development of Pakistan, using 22 years of annual data for empirical examination. The study observed that undeniably political instability has a negative effect on economic development, which was statistically significant. The study suggested that the government of Pakistan should take remedial measures to get political stability in the country. Zahra et al., (2017) conducted a study on the effect of political instability on financial development in Pakistan during the period of 1972-2011. The results exhibited that political instability has undesirable influence on financial development over the study period.

Muhammad et al., (2018) examined the impact of development expenditure, military expenditure, political stability, debt, foreign direct investment, income equality and unemployment in Pakistan using time series data for the period of 1980-2014. In Pakistani society, the income inequality is wreck due to which income gap is increasing between poor and rich. Income inequity, poverty and unemployment have created a dreadful situation as compared to other nations. It's found that increase in development expenditures cause a decrease in poverty and unemployment but increase in inequity due to capitalism. Foreign direct investment decreases inequality and unemployment. The results also showed that political instability is responsible for increasing poverty and unemployment. Some more related studies are given in Table 1. This is a macroeconomic problem.

Now-a-days political instability is a serious problem in developing countries. It has a

negative effect on the economy of a country. The results of Azam et al. (2019) study exhibited that both terrorism and endemic corruption have significant harmful effects on overall national economic development in Pakistan. The study also suggested that the government must take effective measures in order to control corruption and terrorism in the country.

Methodology

Data

The study is based on annual secondary data from 2002 to 2020. Details of the variables and their sources are given in Table 1.

Variables of the Study

Five variables are used in this study for finding the determinants of political instability. GDP is used as a dependent variable while independent variables are corruption, terrorism, foreign direct investment and political stability as defined.

GDP: The dependent variable gross domestic product is a monetary measure of the market value of all the final goods and services produced within a country border in a period of time.

Corruption: It is a form of dishonesty started by a person entrusted with a position of authority, often to achieve personal benefit.

Terrorism: Refer to violent acts which may be intentional to create fear.

Direct Foreign investment: FDI is an investment made by a firm or individual in one country by an entity based in another country.

Political stability: political stability works by any person in society that affects the distribution of power to make society decisions.

Table 1: Variable's description and data source

S.No	Variable description	Data sources
1	GDP growth rate (%) (Constant fc)	Pakistan economic and social indicators (2022)
2	Corruption Index -2.5 (weak) to 2.5 (strong) governance performance)	World governance indicator (2022)
3	Terrorism (losses in billion USD)	Pakistan economic survey (2022)
4	Political stability	World governance indicator (2022)
5	Net FDI (BoP, current US\$)	World development indicator (2022)

Econometric Model

To examine the empirical impact of political instability (i.e., corruption, terrorism, political stability, and foreign direct investment) on economic growth of Pakistan. The following model is based on growth theory. Similar models are also used by many studies such as Zahra et.al (2017); Azam (2019; 2020), Khan and Saqib (2011) and Aisen and Veiga (2013) for 169 countries; Uddin et al (2023) and Minhajuddin et al (2022). The study uses the general regression equation, which can be written as follow:

$$EG_t = \beta_0 + \beta_1 CR_t + \beta_2 TR_t + \beta_3 PS_t + \beta_4 FDI_t + \varepsilon_t \dots\dots\dots (1)$$

Where in equation (1), EG shows the economic growth rate, CR shows that corruption, TR shows the terrorism where the PS shows the political stability and FDI shows the foreign direct investment (Foreign direct investment, net inflows (BoP, current US\$), and ε is the error term.

Estimation Techniques

In this study we used two methods- Ordinary Least Squares (OLS) and Robust Least Squares (RLS). Because our result in OLS has a little bit of error and the result in RLS is correct.

First, we used the OLS; OLS is one of the simplest methods of linear regression. The goal of OLS is to closely "fit" a function with the data. It is minimizing the sum of squared errors from the data. OLS is also used at times when there is no trend in the data. The statistical properties of OLS are based on the assumptions of CLRM (classical linear regression model). Similar methods are also used by many studies such as Abadie (2006), Asteriou & Price (2001) for UK, Zahra et al. (2017) for Pakistan.

Second, we used the method of RLS. The RLS method has been developed for many common problems such as estimating location, scald, and regression parameters. Robust least square is used when there are too many outliers in the data, and it is important to have all the data points. It also overcomes the influence of extreme observation of data. Similar methods are also used by many studies such as Mauro (1998), Alesina et al., (1996) for 113 countries.

Results and Discussions

Descriptive statistical results are given in table 2. In this study we cannot use a unit root test because the time period is less. If the time period is less than 30 years, then there is no need for a unit test. Descriptive statistical results are given in Table 2. The descriptive statistics help to give us the analysis of data signify or summarize data in a meaningful way or a set of brief statistics that signify measure of significant tendency include mean, median, standard deviation, minimum, maximum variables, kurtosis, and skewness. Descriptive statistics are essential because if we simply present a time series data it would be difficult to visualize

what the data shown more. It enables us to represent the data in a more meaningful way which is shown in simpler interpretation of the data.

Table 2 : Descriptive Statistics

Statistics variables	GDP	CR	FDI	PS	TR
Mean	4.49	-0.93	2244.73	-2.28	7.82
Median	4.10	-0.91	1868.00	-2.47	6.94
Maximum	9.00	-0.76	5590.00	-1.55	23.77
Minimum	0.40	-1.09	534.00	-2.81	2.63
Std. Dev	2.01	0.12	1601.42	0.44	5.65
Skewness	0.38	-0.02	1.16	0.67	1.51
Kurtosis	3.69	1.37	3.09	1.84	5.17
Jarque-Bara	0.66	1.65	3.38	1.98	8.70
Probability	0.71	0.43	0.18	0.37	0.01
Sum	67.40	-14.09	33671.00	-34.31	117.37
Sum sq. Dev	56.86	0.20	35903629	2.80	447.38
Observations	15	15	15	15	15

Source: Eviews output

Regression Results

Regression results of this study are presented in Table 3. Political stability has significant impact on economy of Pakistan. Unfortunately, the result on OLS is not according to our hypothesis. Our hypothesis is that political stability (PS), foreign direct investment (FDI) should be positive and corruption (CR), Terrorism (TR) should be negative. Which is not similar to our hypothesis and the p-value of all the variables is greater than (0.05%) so in this case we cannot find the significant of these independent variables to dependent variable. For obtaining good and robust empirical results many previous studies used RLS for example Mauro (1998), Alesina *et al.*, (1996) and Khan and Khan (2023). The result which we obtained from RLS is similar to our hypothesis which is significant.

So in the Table 3 results on FDI which is explanatory variable are significant which influence the dependent which is GDP because the P value is less than (0.05%) which is (0.009) meaning that the relationship between FDI and GDP are significant, further more PS, CR is also significant to GDP. We can also see the value of R-square which is (0.91) meaning that 91% are X-variables have been explained during the study or estimation. R^2 which is greater than 60% means that we accept the model and if it is less than 60% then we reject the model.

The results of other explanatory variables in the model are also found statistically significant and carry the predictable sign. FDI (+) sign. Results of FDI show a positive relationship with growth in this study. These results match the results of Benmamoun & Lehnert (2013) for 180 countries and Adeleke (2014) for 31 SSA countries. The finding implies that one unit change increase in FDI brings increase in economic growth. CR (-) sign shows a negative relationship with growth in this study. These results are matching with the results of Mauro (1995) for 68 countries, Ghalwash (2014) for Egypt and Azam & Emirullah for 9 Asian countries. The finding implies that one unit change increase in corruption brings decrease in economic growth. Corruption is one of the essential elements of weak governance. PS (+) sign shows a positive relationship with growth in this study. The results achieved have expected positive coefficient sign that supports the study hypothesis is statistically significant. TR (-) sign shows negative relationship with growth in this study. These results match the results of Sonmez & Graefe (1998) for Asia. The finding implies that an increase in terrorism can decrease the growth. The analysis suggests that terrorism has negatively affected the economic growth in Pakistan. Among the various variables that were used, terrorism and corruption are the most significant and major contributors in reducing economic growth. However, the results find that FDI and PS have positive impact on economic growth while CR and TR have negative impact on economic growth in Pakistan. Overall the results match the results of Bakar et al. (2014); Haseeb et al. (2014); Azam (2015); Zubair & Khan (2014), Azam and Ahmed (2015); Gaibullove & Sandler (2009), Azam et al. (2019), and Haseeb et al. (2018).

Table 3: Regression results								
variables	OLS Results				RLS Results			
	coeff	stnd.err or	z-stat	Pro p.	coeff	stnd.err or	z-stat	Prop.
FDI	0.000616	0.000371	1.659998	0.1279	0.000369	0.000143	2.579024	0.0099
CR	-2.346759	4.535697	-0.517398	0.6161	-5.724185	1.747916	-3.274863	0.0011
PS	4.012018	1.977505	2.028829	0.0699	2.219021	0.762068	2.911840	0.0036
TR	0.084318	0.165687	0.508897	0.6219	-0.048580	0.063850	-0.760845	0.4467
C	9.422501	5.474651	1.721114	0.1160	4.241579	2.109759	2.010456	0.0444
						Robust Stat.		
	R ²	0.47				R ²	0.35	
	Mean dep var	4.49				Adj. R ²	0.090	
	Adjusted R ²	0.26				Rw square	0.91	
	S.D. vard	2.01				Akaike info criteri	38.84	
	S.E. of regression	1.73				Schwarz criterion	47.55	
	Akaike info criteri	4.19				Devianc e	7.29	
	Sum	29.93				Scale	0.46	

squared resid		
schwarz criterion	4.43	Rn- 42.11 squared statistic
Log likelihood	-26.46	Prob(Rn 0.00 - squared stat)
Hannan- Quinn criter	4.19	
F-statistic	2.24	
Durbin- Watson stat	1.08	
Prob(F- statistic)	0.13	

In Table 4, the value in the square bracket is standard error and in round bracket is z-statistics and the other one is coefficient. In these regression estimators, first we individually estimate the variables with dependent variable than combine variables. The estimation of FDI is positive in all the columns, which is significant and has a positive effect on the economy. The estimation of CR is negative in column 6, 7, 11 and 12, which is not best for the economy of the country. Political stability is also positive in all the estimation, which is significant and has a positive effect on the economy of the country. Terrorism has negative sign in all of the columns, it shows that terrorism badly damage the economy of the country.

Regr essio n estim ator	1	2	3	4	5	6	7	8	9	10	11	12
	Coe ff.	Coe ff.	Coe ff.	Coe ff.	Coe ff.	Coe ff.	Coe ff.	Coe ff.	Coe ff.	Coe ff.	Coe ff.	Coe ff.
FDI	0.00 03 [0.0 002] (2.8 859)				0.00 02 [0.0 001] (3.0 990)			0.00 03 [4.6 7E- 05] (7.1 647)	0.00 03 [0.0 001] (2.4 038)			0.00 03 [0.0 001] (2.5 790)
CR		7.17 92 [2.5 853] (2.7 769)			4.39 93 [1.4 195] (3.0 990)	- 0.76 28 [4.2 837] (- 0.18 37)	- 5.62 23 [4.4 564] (- 1.26 16)				- 5.27 14 [4.2 461] (- 1.24 14)	- 5.72 41 [1.7 479] (- 3.27 48)
PS			2.44 06 [1.0 581] (2.3 064)			2.51 77 [1.1 639] (2.1 631)		1.18 06 [0.1 669] (7.0 709)		1.62 58 [1.7 945] (0.9 060)	1.36 72 [1.5 243] (0.8 969)	2.21 90 [0.7 620] (2.9 118)
TR				- 0.12 66 [0.0 815] (- 1.55 32)			- 0.21 35 [0.0 958] (- 2.22 76)		- 0.04 90 [0.0 372] (- 1.31 67)	- 0.05 69 [0.1 420] (- 0.40 10)	- 0.14 68 [0.1 349] (- 1.08 85)	- 0.04 85 [0.0 638] (- 0.76 08)
R ²	0.21 653	0.15 296	0.20 887	0.13 944	0.33 683	0.20 649	0.17 819	0.39 850	0.26 699	0.15 788	0.17 858	0.35 070

	8	5	0	6	4	6	6	6	1	0	1	3
Adj . R ²	0.15 627 2	0.08 780 8	0.14 801 4	0.07 325 0	0.22 630 6	0.07 424 6	0.04 122 9	0.29 825 7	0.14 482 3	0.01 752 6	- 0.04 544 3	0.09 098 4
RW ²	0.56 466 5	0.45 877 3	0.35 354 7	0.24 171 7	0.76 397 9	0.36 524 6	0.42 461 6	0.94 570 9	0.63 084 9	0.37 353 6	0.61 600 9	0.91 494 7
Ad.R W ²	0.56 466 5	0.45 877 3	0.35 354 7	0.24 171 7	0.76 397 9	0.36 524 6	0.42 461 6	0.94 570 9	0.63 084 9	0.37 353 6	0.61 600 9	0.91 494 7
Devi ance	13.7 022 7	27.6 931 2	31.8 278 2	31.3 092 7	11.1 683 6	31.5 212 1	29.5 050 8	3.58 200 3	11.8 756 1	27.7 671 8	22.5 109 6	7.29 770 4
Scale	0.65 669 1	1.09 093 7	1.38 109 1	1.21 725 2	0.63 735 7	1.35 687 2	1.19 949 3	0.30 047 9	0.61 803 7	1.09 979 3	0.93 405 8	0.46 321 7
Rn sq stat	8.32 870 6	7.71 148 5	5.31 978 1	2.41 254 6	24.0 501 3	4.79 286 5	4.99 724 6	82.1 331 1	9.17 776 9	3.52 785 4	8.05 383 2	42.1 177 6
Prob	0.00 390 2	0.00 548 7	0.02 108 5	0.12 036 6	0.00 000 6	0.09 104 2	0.08 219 8	0.00 000 0	0.01 016 4	0.17 137 1	0.04 491 2	0.00 000 0
Sch warz crite rion	37.1 900 2	28.6 848 1	22.1 024 8	26.5 467 0	35.6 172 6	25.2 450 0	28.6 311 1	47.7 973 9	39.2 146 1	31.0 808 9	36.6 337 9	47.5 511 0
Akai ke info crite rion	34.3 942 7	25.6 285 3	20.2 114 0	24.4 633 9	30.2 852 3	22.4 699 0	25.6 919 2	41.5 621 2	35.0 473 5	28.8 993 2	33.0 419 0	38.8 480 7

Table 4: Regression results (Dependent variable is GDP growth rate

Summary and Conclusion

Main findings of this study are that FDI has a positive relationship with the economic growth of Pakistan as well as political stability also positively effect on

growth. Terrorism has negative effects on economic growth of Pakistan. Corruption has also a negative effect on economic growth of Pakistan. Corruption is one of the essential elements of weak governance. After that we estimated the variable individually with the dependent variable. Political instability is one of the most common issues all over the world. It has become a major problem for developing countries. It is very consistent problem and for many countries it is difficult to manage like Pakistan.

In this study we used two methods. First, we applied the OLS method but unfortunately the results were not according to our hypothesis. For obtaining good results we also used RLS method. The empirical findings reveal that terrorism and corruption have negatively relation with economic growth. Therefore, the negative effects of terrorism and corruption on growth as hypothesized are conform. Thus, the empirical finding on FDI has a positive relation with economic growth while political stability has also positive relation with growth.

It is recommended that the government should focus on the issues of terrorism and corruption. Government should adopt policies to control these for the improvement of economic growth in the country. Therefore, controlling corruption and terrorism should be among the main factors for consideration for policymakers in making and executing macroeconomics and public policies. To be most active and effective in tackling terrorism and chronic corruption, it is necessary to get to the roots of the problem. Weak state institutions need to be improved, by improving the bureaucracy include expanding their capacity; merits should be strengthened in requirement. Whereas political interference should be discouraged, improving accountability, as well as enforcing law and regulation for all equally.

The contributions of this study are a very fresh and updated study on political instability and economic growth with reference to Pakistan. We additionally used sophisticated Econometrics technique namely RLS for empirical estimated and set of variables used in this is visibly different if compared to almost all prior studies.

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