



Available Online

Journal of Economic Impact

ISSN: 2664-9764 (Online), 2664-9756 (Print)

<http://www.scienceimpactpub.com/jei>

AN ECONOMIC IMPACT OF POLITICAL INSTABILITY: AN EVIDENCE FROM PAKISTAN

Abdul Rehman Nawaz^{a,*}, Usama Anwar^a, Fizza Aquil^a

^a School of Economics, University of the Punjab, Lahore 54590, Pakistan

ARTICLE INFO

Article history

Received: April 04, 2021

Revised: April 22, 2021

Accepted: April 26, 2021

Keywords

Corruption
Democracy
Economy
Instability
Investment
Terrorism

ABSTRACT

The economy of Pakistan has been badly damaged by the political instability in the country. Despite its enormous economic resources, Pakistan's economy remained under dark shadows during most of its historical discourse. The economic indicators describe a significant relationship between politics and the economy of Pakistan. The following study, by reviewing previous studies, concludes that there is a negative relationship between political instability and economic growth in Pakistan from 2000 to 2019. Political instability flourished corruption and reduced the economic growth of the country. Moreover, a weak political system and government institutions could not resist the political tension in the country. The study finally concludes that political instability reduces economic growth in the country and economic growth reinforces political stability in the country.

* Email: abdulrehmanar1242@gmail.com

<https://doi.org/10.52223/jei3012106>

© The Author(s) 2021.

This is an open access article under the CC BY license (<http://creativecommons.org/licenses/by/4.0/>).

INTRODUCTION

Pakistan The substantial nexus between political stability and economy has been the center of attention for many social scientists, philosophers, and economists. Aristotle had devoted two of his famous books to Politics (Goldsmith, 1987). Political instability can be defined as an unanticipated potential change in the government, political structure, and leadership of a country. The more regular power exchanges, the higher the political stability a country faces. Ake (1975) defined political instability as an irregular flow of political exchange. Political instability can also result from natural disasters such as floods, earthquakes, and famines (Dalby, 2018). One can alter or affect the decision-making patterns of the society, and it is also a type of political instability. A higher level of smooth political behavior in society discourages political instability. Consequently, there would be no more irresistible fluctuations and violations in the system.

The interconnection between economic growth and political stability has been the center of policy-making in almost all the economies of the world. In recent decades developing countries are witnessing higher-level of

political instability and lack of law and order. Since developing countries are characterized by low per-capita GDP and national income, there are more frequent chances that these countries will fall prey to political instability. Barro (1991) showed the positive trends between political stability and economic growth rates in 98 countries. It would not be wrong to say that poor economic growth leads to backlash and political unrest in the country. But it is also true that political instability may impact economic activities and thus reduce economic development. As a result, many social scientists labeled the relationship between political stability and economy: a two-way relation (Husain, 2009; Paldam, 1998; Zablotsky, 1996).

The relation between economic growth and political stability is more significant to study in the case of Pakistan, as Pakistan has been a victim of political instability since its independence. The shuffle of the military and civil regimes did not let the institutions work to their full potential. Swagel *et al.* (1992) found that economic growth is significantly affected in those countries where the propensity for government collapse

is very high. A substantial change in government that does not involve a critical change in ideology or irregular power transfer also equally affects economic growth as that of a government collapse (Swagel *et al.*, 1992). Sallahuddin and Awan (2017) found that two elements i.e. public debt and inflation rate, badly affect political stability. More debt creates instability which leads to a slowdown of economic growth and minimizes the GDP growth rate. Moreover, results, by using panel data, indicate that there is an inverse relationship between these two elements and political instability. Zouhaier and kefi (2012) found that investment and political instability interact negatively with each other. They studied the interaction on empirical grounds and found that political instability influences the behavior of people; the liability on private investment increases and people are reluctant to invest their money. This negative interaction increases unemployment and reduces productivity. Przeworski and Limongi (1993) concluded that political regimes do not affect economic growth significantly, while the stability of political institutions is

of importance in whatever regime they are working. Some pieces of evidence showed that a liberal democratic system keeps the spirits of people high to investment.

Pakistan has been a victim of political unrest and its economy is seen fluctuating in the course of its history. Aside from natural disasters and international politics, political unrest is a matter of serious concern that damaged the institutional structure at its extreme level (Fahad, 2018). Shehnaz (2018) concluded that political unrest has greatly damaged the economic institutions of Pakistan. This political unrest influenced the leaders to focus on short-run policies to remain in power. They find that economic growth in military regimes is better than that of democratic regimes. Tabassam *et al.* (2016) used elections, strikes, terrorism, and regime as the proxies of political instability and took GDP to measure economic growth. By using the data from 1988 to 2010, it is found that political instability has a profound negative impact on the GDP in Pakistan.

Table 1. Insight from the literature review.

Studies	The relation between political stability and economic growth
Bashir and Xu (2014)	(+)
Ramadhan, Jian, Henry, and Pacific (2016)	(+)
Feng (1997)	(+)
Cebula (2011)	(+)
Paldam (1998)	(+)
Mueller (1982)	(+)

Table 1 reflects the importance of political stability and economic growth in a country or region. Many scholars, such as Bashir and Xu (2014); Cebula (2011); Feng (1997); Mueller (1982); Paldam (1998); Ramadhan *et al.* (2016), by using different data sets and statistical approaches, have found a significant positive effect of political stability on economic growth and vice-versa. The following paper tries to address the economic complications that may arise due to political unrest in the country. The economy of Pakistan is shaped by politics on a larger scale. Both military and civil regimes have ruled Pakistan and the military is said to be the decision-maker under civil regimes too (Staniland *et al.*, 2020; Rizvi, 1991). There is seen no significant change in economic growth during different political regimes. The economy of Pakistan has been lacking a stable growth trajectory for many years. There are many factors such as natural disasters, global economic

recessions, social and political imbalances that can have a direct or indirect impact on economic growth. The present study focuses more on the political factors that are possible hindrances in the way of economic growth. Previous studies have also shown that political instability has affected the economic growth of many countries. Pakistan has also been a victim of political imbalance due to frequent change of government, coup d'état, and conflict among political parties. For this purpose, the study reviews the statistical and analytical reports to analyze the impact of political stability in context to the economic growth of Pakistan.

METHODOLOGY

The study is mainly an analysis of reports, books, and scholarly articles. This study was carried out in February 2021. A total of 30 studies were downloaded from Google Scholar and were carefully analyzed. In

addition to this, the data on GDP growth, corruption index, and political stability index is taken from World Bank and World Governance Indicators and presented in the form of table and graphs.

DISCUSSION

Decade of 2000

Pakistan's economy remained under dark clouds for many reasons, and political instability is one of them. No election has been peaceful ever in the history of Pakistan. The past two decades have been the worst as compared to the whole economic and political history. Moreover, Pakistan remained almost 30 years under the direct control of military governments. Hassan (2011) highlighted that unstable government, weak political systems, inexperienced administrated staff, and regional conflicts are the causes that intrigue Pakistan's army to intervene in the system. The military-bureaucracy held dominant positions in Pakistan, which led to the failure of a parliamentary system. Moreover, Hossain (2000) mentioned some internal and external causes of the 1999 Marshal. The internal causes included weak political control and a high level of corruption among politicians, while external factors

included the influence of international political bodies. On October 12th, 1999, the Chief of army staff kicked off the PML-N government. He proclaimed Marshal Law and dismissed Prime Minister Nawaz Sharif forcefully. When Musharaf toppled the government, the economy was growing at the rate of 4.2 %.

The people of Pakistan had a notion that military proclamation would be for a temporary time period and after the turmoil calms down, Musharaf would assist in holding an election for the National Assembly. Instead, he was forced to reinstate the National Assembly by the Supreme Court. In 2002, general elections of national and provincial assemblies were held, and the Muslim league Quaid-e-Azam won the election. During that time, Pakistan was also fighting the war against terrorism after 9/11. Terrorism incidents have changed the socio-economic and geopolitical situation of Pakistan. The economic costs of terrorism are unfathomable in Pakistan, which includes the destruction of infrastructure, capital flight, and fewer exports, resulting in poor economic growth (Ali, 2010). Moreover, terrorism has also a negative impact on FDI inflows (Anwar & Afza, 2014).

Table 2. Estimated loss (2001-2009).

Years	\$ Billion	Rs. Billion
2001-02	2.67	163.90
2002-03	2.75	160.80
2003-04	2.93	168.80
2004-05	3.41	202.40
2005-06	3.99	238.60
2006-07	4.67	283.20
2007-08	6.94	434.10
2008-09	9.18	720.60
2009-10	13.56	1136.40
Total	50.10	3508.8

Source: Ministry of Finance, 2014.

From 2001-2009, Pakistan incurred the direct and indirect cost due to incidents of terrorism amounted to US\$ 50.10 billion which equivalent to Rs. 3508.8 billion. Detail is given in the Table 2.

Yousufi and Islam (2018) discussed that the coalition of Pakistan and the USA against terrorism after the 9/11 incident led Pakistan into various social issues. It induced extremism and violence in society, which caused further terror attacks. Governmental instability and fragile policies caused the post 9/11 terrorism.

During the government of Pakistan Muslim League Quaid-e-Azam, the GDP growth rate concerning

annual changes is given in Figure 1. In 2002, a 2.5 % GDP rate was observed, less than that of previous years. In the next three years, economic growth was fair.

The next National Assembly elections were supposed to be held in 2007 but President Musharaf declared a state of emergency and elections were postponed till 2008, which contributed to the GDP growth rate falling from 4.8% annual change to 1.7% annual change. In 2006 and 2007, a wave of terrorist attacks, including suicide attacks, killings, and assassinations, started destabilizing the country socially, politically, and economically.

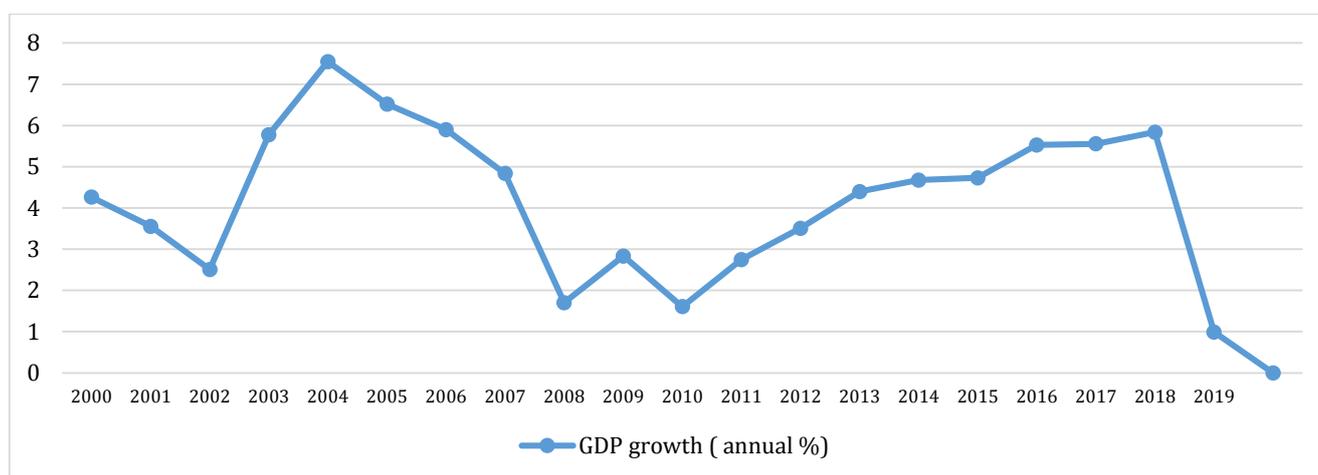


Figure 1. GDP growth rate of Pakistan (2000-2019).

Source: World Bank, 2019.

A significant blow-up of 2007 was the assassination of twice the prime minister of Pakistan and senior politician Benazir Bhutto. This incident showed the nation into a state of uncertainty. When Asif Ali Zardari became the President of Pakistan in 2008, the economic growth was residing at 1.7% due to political tension and corruption. The transition from military control to a democratic government was handled improperly. The ignorance towards economic and institutional policies caused macroeconomic instability, which left the country in the midst of a crisis. At that time, the global economy was also undergoing financial turmoil which negatively affected the foreign private inflows and the demand for exports from Pakistan also decreased. The two sitting prime ministers gave resign on account of corruption charges.

On the whole, economic performance remained satisfactory during Musharraf's tenure. The per-capita income increased twice the rate of population growth. But unfortunately, no significant impact on poverty has been observed (Dawn, 2007).

Similarly, at the time of Marshal law, the score of control on corruption was at -0.8. This score has been fluctuating throughout his tenure. Meanwhile, an increase in the political stability index has been observed. In 2007, political stability was -2.4 as compared to -1.1 in 2000. Despite all these interventions by the military, on August 14th, 2000 military government of Pakistan established local councils to bring democracy back. Figure 2 shows the corruption index of Pakistan from 2000 to 2019.

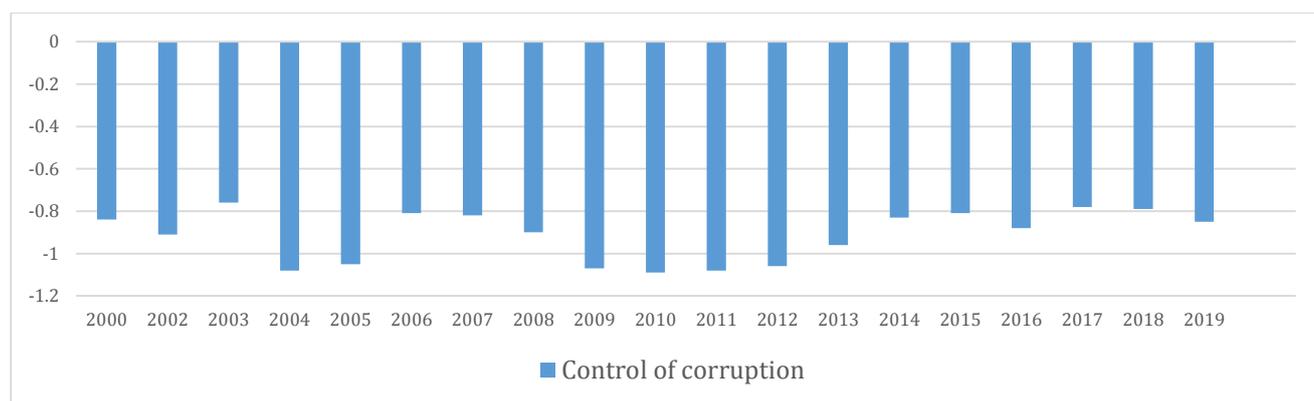


Figure 2. Corruption index of Pakistan (2000-2019).

Source: WGI, 2020.

Figure 3 shows the political stability index of Pakistan over the years 2010-2019. It shows that the value of political stability has decreased gradually but succeeded

to keep it stable during 2002-2005. It never exceeded the value of -2.25 during this time period. The lowest dip it took was in 2011 which was -2.81.

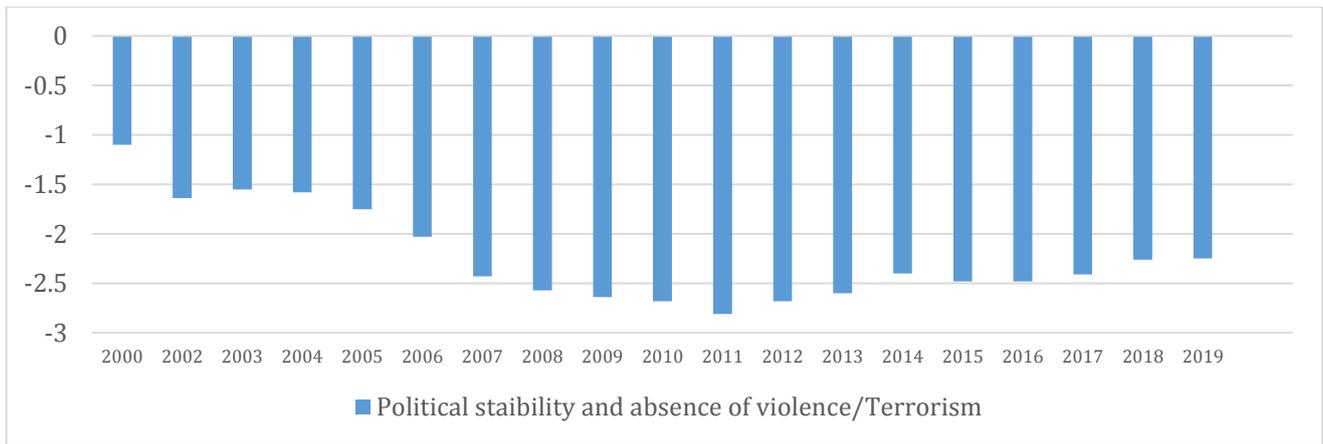


Figure 3. Political stability index of Pakistan (2000-2019).

Source: WGI, 2020.

Decade of 2010

The tenure of the Pakistan Peoples’ Party is known as the tenure of poor planning in Pakistan: because from 2008 to 2013, Pakistan's economic growth remained low and corruption increased. From 2008 to 2013 corruption index remained constant at -1. Moreover, political stability continued decreasing. In the last year of the PPP government, the economic growth rate was 4.3%, while control on corruption and political stability were at points -1 and -2.6, respectively.

Pakistan has been facing Natural disasters since its emergence and these disasters have a massive cumulative effect on Pakistan’s economy. In recent

disasters, the floods of 2010, 2011, 2012, 2013, and 2014 were severe. The flood of 2010 also had some impact on the economy. This caused damage to 3.3 million ha of standing crops, 400 miles of railways, and more than 200 health facilities and caused a two percentage point reduction in GDP growth that year (Looney, 2012).

The total estimated damages were 855 billion rupees which are equating to 5.8% GDP of 2009-10. The agriculture and housing sector was. Figure 4 shows the damages by provinces and Sindh was the worst affected 43% and Punjab, Balochistan, KPK, and AJK were affected by 26%, 6%, 12%, and 1%, respectively.

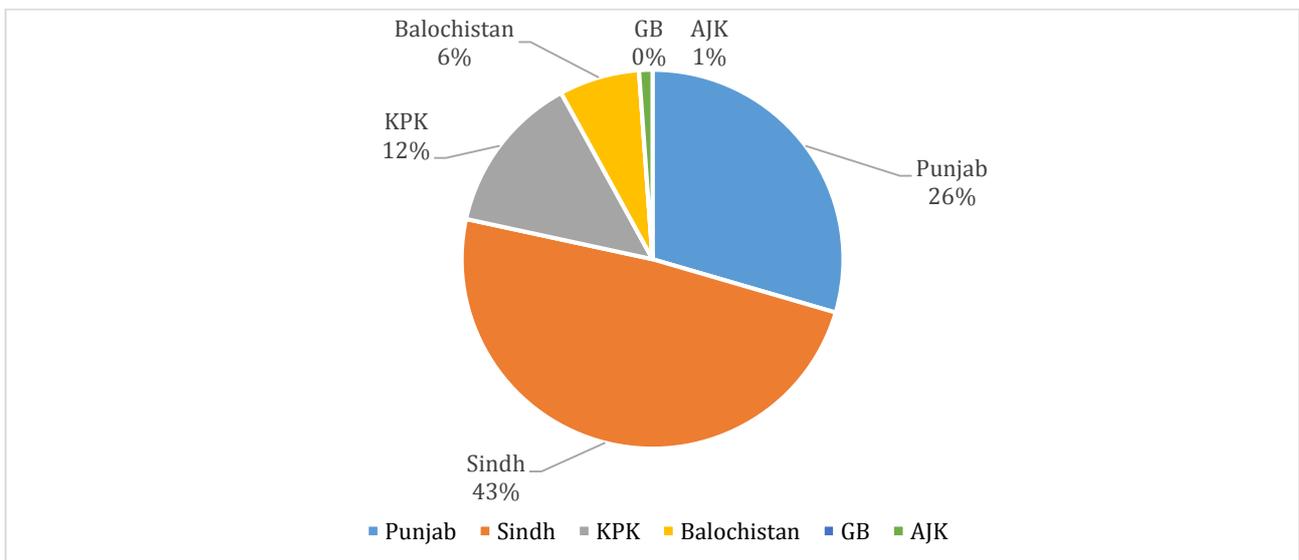


Figure 4. Total damages.

Source: NDMA, 2011.

In 2012, 5 million people, 14,270 villages, and 1.1 million acres of crops were affected by flooding. In August 2013, around 1.5 million people, almost 80,000 houses, and 1.5 million acres of crops were affected. Similarly, in 2014, the

floods killed 367 people and affected more than 2.5 million people, and 129,880 houses were damaged or destroyed. Over 1 million acres of cropland and 250,000 farmers were affected (Rehman *et al.*, 2016).

In 2013, an election was held again, and Pakistan Muslim League Nawaz won the election. Nawaz Sharif became the Prime Minister of Pakistan. At that time, Pakistan had a GDP growth rate of 4.40%, while the political stability index was -2.6. In his reign, economic growth did not boost due to Imran Khan's political Campaigns. Moreover, Panama cases also created significant hurdles in the way of economic growth. Panama papers came upfront in 2016, which contained detailed financial information of offshore entities. Pakistan Tehreek-e-Insaaf (PTI) spent 126 days in Islamabad for the dismissal of Prime Minister Nawaz Sharif. A crowd of people invaded the Pakistan Television Head office and spread violence. Owing to this, the Chinese president delayed his visit to Pakistan and China Pakistan Economic Corridor (CPEC) project was delayed.

Due to Pakistan Tehreek-e-Insaaf sit in Islamabad, Pakistan economy has faced unprecedented directly and indirectly losses as trade routes had been closed and business activities have been frozen. In 2014, the PML-N government claimed economic losses of PKR 500-800 million, while the advisor to PM claimed that losses had reached PKR 610 billion (Mamoon *et al.*, 2017).

The foreign direct investment in Pakistan is also affected by the political situation in the country. A comparatively stable political situation attracts foreign investors, as seen during the power shift from military to civil government in 2008. Aside from the power shifting and natural disasters, political unrest in civilian government discouraged investors. It was seen in 2014-2015, FDI fluctuated badly due to Panama leaks when the respective PM was declared inefficient for the office. Qureshi *et al.* (2010) showed that political instability had affected the behavior of investors. The study has done Time Series analysis from 1972-2009 and estimated that political instability has a significant negative relation with domestic private investment in the short-run as well as in the long run. This negative relation between investment and political instability slowed down economic growth (Qureshi *et al.*, 2010).

In 2018, a general election was held and Imran Khan became the Prime Minister of Pakistan. In 2018, Pakistan witnessed a 5.9% growth rate while political stability and corruption index were at -2.26 and -0.7, respectively. After the election, all the opposition parties started protests against Khan's government all across Pakistan. The government signed an agreement with the IMF with strict conditions. The government set the highest tax target in history. As a result, just in year economic growth decreased to 1%.

It is obvious from the data that gross domestic income showed a steady flow during times of political instability. While the increase in gross domestic income was lower than expected due to political unrest that halted the growth and production in the country. A reduction in production increases unemployment, which in turn reduces gross domestic income. The political instability has not only a negative impact on economic growth but also threatened the sovereignty of Pakistan.

CONCLUSIONS AND RECOMMENDATIONS

It is concluded that political instability and economic growth interact in a negative manner with each other. Political unrest in Pakistan reduces economic growth and the inverse of it is also true. A weak government increases liability on the money of investors and investment in the country is reduced. The government is also incapable to control corruption. This reduces development and employment in the country. The stability of political institutions is important as compared to political regimes while discussing the economy of Pakistan. Therefore, Pakistan's economy performed better under different regimes when political institutions were stable. Political instability patronages the benefits of democracy. The democratic system should be allowed to run smoothly and responsible leadership and governmental accountability will provide stability that will eventually bring the system to equilibrium. With political stability, the social disorder will reduce and more investors will find it as an encouraging opportunity, promoting economic growth. Terrorism has been a barrier to achieve economic growth which has been addressed in the past and there should be no future compromise on that front. Governmental bodies should establish the objectives of the economy and formulate smart policies accordingly.

Acknowledgments

The authors would like to acknowledge School of Economics, University of the Punjab, Lahore 54590, Pakistan.

Author's Contribution

All authors contributed equally in designing, data collection, assimilation, and writing of this manuscript, and the final version was read and approved by all authors.

Conflict of Interest

The authors declare no conflict of interest.

REFERENCES

- Ake, C., 1975. A definition of political stability. *Comparative Politics*, 7(2), 271-283.
- Ali, A., 2010. Economic cost of terrorism. *Strategic Studies*, 30(1/2), 157-170.
- Anwar, Z., Afza, T., 2014. Impact of terrorism, gas shortage and political instability on FDI inflows in Pakistan. *Science International*, 26(1), 507-511.
- World Bank, 2019. GDP growth (annual %) of Pakistan. World Bank Data Indicators. Retrieved from: <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG>.
- Barro, R.J., 1991. Economic growth in a cross section of countries. *The quarterly journal of economics*, 106(2), 407-443.
- Bashir, M. F., Xu, C., 2014. Impact of political freedom, economic freedom and political stability on economic growth. *Journal of Economics and Sustainable Development*, 5(22), 59-67.
- Cebula, R.J., 2011. Economic growth, ten forms of economic freedom, and political stability: an empirical study using panel data, 2003-2007. *Journal of Private Enterprise*, 26(2), 61-81.
- Dalby, S., 2018. Climate change. In *Encyclopedia of the Anthropocene*.
- Dawn, 2007. The Economy under Pervaiz Musharraf. Dawn. Retrieved from <https://www.dawn.com/news/271347>.
- Fahad, S., 2018. Historical review of political instability and economic growth of Pakistan. *Historical Review*, 8(9). 9-18.
- Feng, Y., 1997. Democracy, political stability and economic growth. *British Journal of Political Science*, 27, 391-418.
- Goldsmith, A.A., 1987. Does political stability hinder economic development? Mancur Olson's theory and the Third World. *Comparative Politics*, 19(4), 471-480.
- Hassan, M., 2011. Causes of military intervention in Pakistan: a revisionist discourse. *Pakistan Vision*, 12(2), 66.
- Hossain, I., 2000. Pakistan's October 1999 military coup: its causes and consequences. *Asian Journal of Political Science*, 8(2), 35-58.
- Husain, I., 2009. The role of politics in Pakistan's Economy. *Journal of International Affairs*, 63(1), 1-18.
- Looney, R., 2012. Economic impacts of the floods in Pakistan. *Contemporary South Asia*, 20(2), 225-241.
- Mamoon, D., Javed, R., Abbas, D.Z., 2017. Political instability and lessons for Pakistan: case study of 2014 PTI sit in/Protests. *Journal of Social and Administrative Sciences*, 4(1). 27-37.
- Ministry of Finance, 2014. Impact of war in Afghanistan and ensuing terrorism on Pakistan's economy. Retrieved from: http://www.finance.gov.pk/survey/chapters_15/Annex_IV_War_on_Terror.pdf
- Mueller, D.C., 1982. Redistribution, growth, and political stability. *The American Economic Review*, 72(2), 155-159.
- NDMA, 2011. NDMA Annual Report 2010. Islamabad. Retrieved from: http://nidm.edu.pk/Documents/AnnualReports/NDMA_Annual_Report_2010.pdf
- Paldam, M., 1998. Does economic growth lead to political stability? In *The Political Dimension of Economic Growth* (pp. 171-190), Palgrave Macmillan, London.
- Przeworski, A., Limongi, F., 1993. Political regimes and economic growth. *Journal of economic perspectives*, 7(3), 51-69.
- Qureshi, M.N., Ali, K., Khan, I.R., 2010. Political instability and economic development: Pakistan time-series analysis. *International Research Journal of Finance and Economics*, 56, 179-192.
- Ramadhan, A.A., Jian, Z.H., Henry, K.K., Pacific, Y.K.T., 2016. Does political stability accelerate economic growth in Tanzania? A time series analysis. *Global Business Review*, 17(5), 1026-1036.
- Rehman, A., Jingdong, L., Du, Y., Khatoon, R., Wagan, S.A. and Nisar, S.K., 2016. Flood disaster in Pakistan and its impact on agriculture growth (a review). *Environ. Dev. Econ.*, 6(23), 39-42.
- Rizvi, H.A., 1991. The military and politics in Pakistan. *Journal of Asian African Studies*, 26(1-2), 27-42.
- Sallahuddin, N.A., Awan, A.G., 2017. Impact of political instability on Pakistan's economic growth. *Global Journal of Management, Social Sciences and Humanities*, 3(4), 729-748.
- Shehnaz, 2018. Political instability and economic growth of Pakistan. Retrieved from: https://www.researchgate.net/publication/329013510_Political_Instability_and_Economic_Growth_of_Pakistan.
- Staniland, P., Naseemullah, A., Butt, A., 2020. Pakistan's military elite. *Journal of Strategic Studies*, 43(1), 74-103.
- Swagel, P., Roubini, N., Ozler, S., Alesina, A., 1992. *Political instability and economic growth*, Harvard University Press, Cambridge, MA, available at: <https://repositorio.leon.uia.mx/xmlui/handle/20.500.12152/36039>.
- Tabassam, A.H., Hashmi, S.H., Rehman, F.U., 2016. Nexus between political instability and economic growth in Pakistan. *Procedia-Social and Behavioral Sciences*, 230, 325-334.

WGI, 2020. World Governance Indicators. Retrieved from:
<https://info.worldbank.org/governance/wgi/>.

Yousufi, M., Islam, F., 2018. Political causes of terrorism after 9/11 in Federally Administered Tribal Areas and Khyber Pakhtunkhwa. *The Dialogue*, 13(3). 245-258.

Zablotsky, E.E., 1996. Political stability and economic growth: a two way relation, CEMA working papers: Serie Documentos de Trabajo 109.

Zouhaier, H., Kefi, M. K. (2012). Interaction between political instability and investment. *Journal of Economics and International Finance*, 4(2), 49-54.

Publisher's note: Science Impact Publishers remain neutral with regard to jurisdictional claims in published maps and institutional affiliations.



Open Access This article is licensed under a Creative Commons Attribution 4.0 International License, which permits use, sharing, adaptation, distribution and reproduction in any medium or format, as long as you give appropriate credit to the original author(s) and the source, provide a link to the Creative Commons license and indicate if changes were made. The images or other third-party material in this article are included in the article's Creative Commons license, unless indicated otherwise in a credit line to the material. If material is not included in the article's Creative Commons license and your intended use is not permitted by statutory regulation or exceeds the permitted use, you will need to obtain permission directly from the copyright holder. To view a copy of this license, visit <https://creativecommons.org/licenses/by/4.0/>.