Impact of political instability on financial development of Pakistan

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Abstract:
This study analyzed the impact of political instability on financial development of Pakistan. OLS regression is used for the estimation of data. Time series data is used for the study. 40 years are included in the time series from 1972 to 2011. The variable of interest is political instability controlling the effects of trade openness, legal protection and GDP/capita. The regression results showed that political instability has negative significant impact on financial development of Pakistan. Trade openness is positive but insignificant with financial development. Legal protection and GDP/capita showed positive and significant impact on the financial development of Pakistan.

Keywords: Financial development, Political instability, Trade openness, Legal protection, GDP/capita

1. INTRODUCTION

In simple words finance refers to those activities involved in seeing that an individual or organization has the cash with which to pay its bills readily. The Encyclopedia Britannica Define the concept as follows. “Without suggesting that a word of such considerable practical application can be defined by any simple formula, its importance can be indicated by maintaining that finance is basically taking initiative in order to provide the means of payment. The immediate aim thereby designated to finance in any business is simply that of maintaining at all times an adequate cash balance (in money or bank credit). But the means employed include all the numerous ways of borrowing money and of exchanging one sort of monetary/ fiscal right against another. “Finance” comprises of two activities: 1st how to manage money and 2nd the process to acquire it. It is needed by individuals, businesses and government for their operating activities. They can be categorized as personal finance, corporate finance and public finance. Further it is concerned with its sound acquisitions in the form of high return on investment, credit on low cost etc. Financial management is related with obtaining, management and financing of capital, resources or assets having a well-defined goal in mind. So financial management’s decision functions can be categorized in three areas: asset management decisions, financing and investing (Goizuetu 2013).

Financial sector acts as an important factor in growth and development of any economy. It channelizes the funds from those who have surplus to those with deficit. Financial development enhances incomes of the and reduce the income gap. Financial development’s 40% impacts is visible through poverty reduction and 60% through economic growth altogether enhance the income levels. (Beck, Demirgüç-Kunt and Levine 2007). Financial development helps firms in getting external finance at low cost (Rajan and Zingales 1998). It provides the right measure to finance entrepreneur and companies; and makes sure that the investor would get high return. It sector facilitates whole process at very low cost. It facilitates the entry of new firm in the market (Rajan and Zingales 2003). A developed financial system plays important role in enhancing the services of financial intermediaries by lowering costs of monitoring, operations and information. It identifies good investment opportunities, mobilizes savings, encourage trading activities, hedging and mitigating the risks. As a result of these functions fund are allocated properly, advancements in technological progress and development of physical and human capital. Further all these contribute to economic development of a country (Creane, et al. 2004).

A more developed financial system enhances the process of technological diffusion linked with FDI (Hermes and Lensink 2003). It is measured through money supply, capitalization of stock markets, and bank credit by GDP ( (Roe and Siegel 2011), (Rajan and Zingales 2003), (King and Levine 1993). Legal origins in the form of investor protection foster the development of financial sector. As financial development is the development of financial intermediaries (banks and stock market) and it is possible when debt ensures you fixed amount of interest payments and equity provides its owner with amount of dividends. As a result shareholders have the right to vote for board of directors, and debt make certain that creditors can claim for their collateral when the company is unable to make payments of their debts. By practicing these rights investors can secure their debt and equity. Without these rights, investors would not get back the amount they invested, and in those circumstances they are reluctant to lend and buy share as a result it would be difficult for firms to raise finance externally (LaPorta, et al. 1998).

Financial development in a country is the function of its institutional quality, macroeconomic policies, and geographic factors, as well as the level of income generated by its peoples and cultural individualities (Huang 2006). Economic growth also has a positive impact on financial development of a country (Sunde 2012). Political instability is a situation of a country where government is unstable, political parties are inefficient (Memon, Memon, Shaikh, & Memon, 2010). Political instability results in income inequality, social unrest and in turn affects economic and financial development (Roe and Siegel 2011).

Political instability is a factor that affects economic growth of a country which in return affects the financial development of the country (Carmignani 2003). (Dutt and Mitra 2008). Whereas the latter financial development is related with economic growth, the former political instability tends to interrupt productive activities, and results in negative impact on economic growth. (Campos,
Karanasos and Tan (2011) (Batuo and Kupukile 2009). Political instability can even affect financial development directly (Roe and Siegel 2011). Political instability is also defined as the function of change of leadership by law or unlawfully. They postulated that due to change in leadership the policies related with investments and production decision affected. Foreign investor also seeks for politically stable environment for his investment where legal rights are protected. Political instability weakens the economic growth of the country (Alesina, Ozler, Roubini, & Swagel, 1996). Political instability is referred as the state of violence, rapid change in government, absence of rule of law, frequent structural change that all results in the interrupted productive activities and destabilize economic and financial system (Goldsmith, 1987). Political instability is a composite of different factors like assassinations, frequent turnover of power, guerrilla warfare and the fatalities from domestic political unrest. All these factors contribute in slowing down the investment activities of the country (Bollen & Jones, 1982). Political instability is caused by the killing of general public, revolutionary activities and military coups. All these activities retard the growth of the country by political unrest (Barro, 1991).

1.1. Financial sector of Pakistan:

Pakistan has taken important measures from the last two decades to bring reforms in its financial sector. Macroeconomic policies are likely to bring major financial benefits, through proper usage of peoples' savings and a more effective ways of its allocation. From 1947 to 1980s, the government of Pakistan focused on the development of infrastructure in order to achieve macroeconomic goals. The financial sector of Pakistan always remained under the supervision of central bank. Negative real interest rates were set administratively. Monetary policy has an authority to grant loan. The open market was not performing well at that time, and other markets were nearly absent. Banks lend to main segments by less focusing on the borrowing firm's returning capabilities. Regardless of opening of non-bank firms for the purpose of promoting investment by private sector in mid-1980s, still public financial institutions have the competitive advantage of bank size, liabilities, provision of loans and providing investment opportunities to the whole financial division till the end of 1980s. The incompetencies and improper working of financial sector resulted in the surfacing of economic difficulties on macro level in Pakistan till the end 1970s and 1980s. To reduce the financial problems and to encourage economic growth, the government of Pakistan made remarkable efforts for making improvement in the financial sector’s reforms. Bringing improvement in the financial division was the main element of these reforms. The main idea of these transformations were to pave the ways for banks and stock markets for trans fus ing healthy competition, amplification their corporate supremacy, and developing a market orient ed system for managing credit for profitable provision of monetary resources. These transformations focused seven areas: economic liberalization, empowering the institutions, private loans, and financial management, banking rules and regulations, foreign currency and equity market. In order to provide low cost debt to government and to encourage credit to private sector, SBP has been keeping a comparatively relax bank rate policy. The interest rates on NSS were reduced from 16 % in 9.46 % in 2005 and 12.68 % in 2011. The average deposit as a percent of GDP was 34 % in 1999, 35 % in 2005 and 30 % in 2011. The reduction in lending rate results in improvement in the profitability of the banks. In addition, by reducing deposit rate the saving rate is expected to reduce in the same manner. Due to high rate of inflation, the rate of return on investment is usually negative. The high interest rate made borrowing expensive resulting in low rate of investment, on the other hand low profit on saving discourages both consumption and saving, causing high ratio of debt/GDP hence lower economic growth. In order to attract people towards financial institutions and foreign remittances Pakistani were allowed to open account for their foreign currency which is easily transferable abroad. The income and wealth tax is not applied on these accounts, and they are not enquired about their source of income. The main reason behind these transformations was to stimulate the funds in circulation in order to meet the current liquidity needs. For this purpose, it was essential to expand potential the money market by increasing accessibility to new entrants, mainly to those who have surplus liquidity, like insurance companies, microfinance institutions, SME bank and investment banks. The increase in the players in the money market results in the creation of new financial products, such as deposit certificates, T bills and debentures, which are negotiable. Restrictions were removed from fund flows for attracting foreign direct investment in the country. Industrial investors were allowed buy 100 percent of the equity without any prior approval on reportable basis. In the same way shares issued to non-residents of Pakistan can be exported and their dividends are sent abroad without prior notice to SBP. Foreign borrowing and investment abroad is allowed, similarly restrictions were also removed in 1994. Pakistani currency was allowed to fully convert on international transactions. The creation of an inter-bank foreign exchange market is a step forward towards decentralized management of foreign exchange that allowed market forces to determine the exchange rate. Despite of all these reforms the bank deposits as percent of GDP fluctuated a lot. It was 34% in 1999, 35 % in 2005 and falls to 30 % in 2011. Private sector credit as percentage of GDP also showed the fluctuating trend. It was 55 % in 1999, 75 % in 2005 and falls to 55 % in 2011. Market capitalization as percentage of GDP was 11% in 1999, 42 % in 2005 and falls tremendously to 15 % in 2011 (SBP 2012). The reasons for the fluctuation vary with time the most challenging reason was the social and political unrest in the country.

1.2. Political instability in Pakistan:

Political instability is one of the main threatening problems Pakistan is facing. It acts as the hurdle in the development of Pakistan. Political stability plays an important role in keeping society integrated and in maintaining peace and harmony within the state. It is a prerequisite for the economic development, social wellbeing, and superiority of law in a state. The stability of political system results in state building. The development of nation without political stability is impossible (Memon, Memo, Shaikh, & Memon, 2010).
Political instability and poor law and order situation have taken a toll on Pakistan's economy, while the global financial crisis added substantial downward pressures on its financial markets (World Bank). Pakistan is suffering from high fiscal and current account deficits, rapid inflation, low reserves, a weak currency and a declining economy that have put the country in a very difficult situation. There are also issues surrounding political instability and poor law and order situation. These factors created a terrorizing environment for economic growth. Furthermore, a weak institutional base and the inability of successive governments to undertake long-term and broad-based reforms and policies have made sustained economic growth difficult. Therefore, Pakistan's economy was already in a terrible situation well before the current financial crisis hit the developed countries (Nasir 2009).

Since independence Pakistan experienced rise and fall in the economic growth. The reasons for downturns are consist of multiple factors including, domestic political instability, border conflicts with India which led to three wars, and most importantly internal macroeconomic mismanagement which resulted into consistent high domestic and foreign debt. The economic reforms of 1990s could not contribute much to economic success due to lack of political consensus, implementation these policies, high level of corruption, and political instability. In May 1998, the country's decision for nuclear explosions resulted in severe economic sanctions by the world. The result: by the end 1999, the country had exceptionally high level of debt with foreign exchange reserves enough for mere 3-months of imports. This economic mismanagement led to another military takeover in October 1999. The regime change caused the country to go into a complete isolation (Mohammad & Khalid, 2005).

1.3. Research Objective:
- To analyze the impact of political instability on financial development of Pakistan.
- To analyze the impact of legal origin on the relationship between political instability and financial development of Pakistan.
- To analyze the impact of trade openness on the relationship between political instability and financial development of Pakistan.
- To analyze the impact of GDP per capita on relationship between political instability and financial development of Pakistan.

1.4. Hypothesis of the Study
- H1: Political Instability has a significant impact on Financial Development of Pakistan.
- H2: Trade Openness has significant impact on relationship between Political Instability and Financial Development of Pakistan.
- H3: Legal origin has a significant impact on relationship between Political Instability and Financial Development of Pakistan.
- H4: GDP per capita has significant impact on relationship between Political Instability and Financial Development of Pakistan.

2. LITERATURE REVIEW
Campos, Karanasos and Tan (2011) analyzed in their study that political instability tends to slow down productive activities, in this manner negatively affecting economic growth and as a result affects financial development. Political instability has an indirect effect on financial development of a country.

Ali, Hashmi and Hassan (2013) analyzed in their study the impact of political instability on domestic private investment of Pakistan. They analyzed the data for the period 1972-2009. They found that political instability negatively affects domestic private investment.

Huang (2010) studied the impact of political institutions on the financial development. He used a sample of 90 countries for the period of 1960 to 1999. Ordinary least square was used to estimate the data. He found that increase in financial development is a result of better institutional quality at least in the short run, specifically in lower income countries, ethnically divided and French legal origin countries. He also found that in general instability of political institutions cause volatility in financial development. He also found the influence of institutional reform on the supply side of finance which reflects the strong relationship between institutional quality and economic performance.

Batuo and Kupukile (2009) studied the link between economic liberalization, political liberalization and financial development in African countries. They took the sample of 50 African countries for the period from 1990 to 2005. They used Generalized Method of Moments (GMM) as an estimation technique. They found that economic and financial liberalization significantly affects the financial development. Political stability showed positive effect on financial development. Hence it is concluded that betterment in political and economic environment of the country enhances the performance of financial sector of the country.

Zhang (2007) analyzed the impact of political policies on the financial development of Malaysia and Thailand. It is observed that politicians begin pro-market policy changes and also have strength to implement these changes effectively. Political parties influence market outcomes through financial policies as intervening factors. The study suggests that financial market development in small developing countries reflects policies made by political institutions.
Outreville (1999) analyzed the impact of human capital and political factors on the financial development of 57 developing countries. OLS regression was used as data estimation technique. The results showed that level of financial development is determined by the development in human capital and political stability.

Herrala & Ariss (2013) investigated the relationship between credit constraints, political instability, and capital accumulation in Middle East and North African countries using OLS regression for estimation of data. The study showed that financial under development is the result of credit constraint and political instability.

Bloom (2007) studied the impact of uncertainty shocks (Cuban Missile crisis, the assassination, of JFK, the OPEC I oil- price shock and the 9/11 terrorist attack) on financial development in USA. Vector Auto Regression (VAR) is used as data estimation technique. The study concluded that uncertainty retards the investment and hiring activities of the firms temporarily, productivity also falls. This results in low demand of external finance and affects the financial development.

Herger, Hodler and Lobsiger (2008) examined the relation between culture, institutions and trade on financial development of 129 countries. OLS is used as estimation technique. Study found that trade openness has positive and significant impact on financial development. Secondly institutions that reduce the political interference to exploit financiers also play important role in financial development.

Khalaf and Sanhita (2009) studied the impact of financial liberalization on financial development of Iraq. ARDL (Autoregressive Distributed lag) was used as data estimation technique. The study concluded that there is no link between financial liberalization and financial development. The study suggested that Iraq’s policy-makers should emphasize on private sector investments, control inflation and reduce budget deficits. Most importantly create politically and socially safe environment in order to attain high economic growth.

Girma and Shortland (2008) examined the impact of degree of democracy, regime type, legal origin and trade openness on the financial development of 150 countries of the world. OLS regression was used as data estimation technique. The study concluded that degree of democracy and political stability has a positive impact on financial development.

Kim, Lin and Suen (2010) studied the relationship between trade openness and financial development of 87 countries of the world for the period of 1960-2005. ARDL (Autoregressive Distributed Lag) was used as a data estimation technique. Study found that there is a bidirectional relation between trade openness and financial development. Braun & Raddatz (2008) examined the impact of trade liberalization and product market competition on financial development of 41 developing countries of the world for the period of 1970 to 2000. Regression analysis is used for estimation of data. The study found that countries with firms whose profit margins decrease with trade openness encourage financial development.

Law (2009) analysed the relation between trade openness, capital flows and financial development in developing countries. GMM estimation technique was used to estimate the data. The results showed that trade openness and capital flows are important factor in determining the financial development of the country. Trade openness affects the institutional quality and creates competition which results in demand of external finance and causes financial development.

Acikgoz, Balcilar, & Saracoglu (2012) investigated the impact of trade openness and financial openness on financial development of Turkey. They took the period from 1989 to 2007 for the study. ARDL was used as the data estimation technique. The results indicated that financial openness, trade openness have long run relation with financial development. Financial development in Turkey is a result of financial and trade openness. Do & Levchenko (2005) analyzed the impact of trade openness on financial development of 77 countries (22 OEDC and 55 developing) of the world. The study is done for the period of 1965 to 1995. OLS regression is used as data estimation technique. The results indicates that trade openness has significant impact on the financial development of the developed countries and on the other hand has positive but insignificant impact on financial development of developing countries.

3. METHODOLOGY

The study is based on the time series data from 1972 to 2011. The study have used OLS technique

3.1. Conceptual Framework:
In the conceptual frame work we represent the expected relationship of independent variables (political instability) with dependent variable (financial development) and the controlled variables (trade openness, legal protection and GDP/capita).
Fig 1: Based on (Roe & Siegel, 2011)

\[ Y_t = \beta_1 + \beta_2 X_t + \beta_3 PI_t + \mu_t \]

Where

- \( Y \) = Financial Development
- \( X \) = Vector of controlled variable which includes Legal protection, Trade openness, GDP per capita.
- \( PI \) = Political assassinations, antigovernment demonstrations, revolutions, purges, general strikes, guerilla warfare, riots and major government crises.
- \( FD \) = M2 as % of GDP, stock market capitalization as % of GDP and private credit as % of GDP.
- \( \mu \) = Error term

4. RESULTS

4.1. Regression Analysis:
Regression analysis is used to determine the influence of different independent variables on dependent variable. This regression model has few assumptions about the slope and the intercept that is both slope and intercept are kept constant. The relationship of the variables is analyzed for the period of 1972 to 2011.
Variable & Coefficient & Std. Error & t-Statistic & Prob. 
--- & --- & --- & --- & --- 
C & -0.580407 & 0.315175 & -1.841541 & 0.0762 
TOP & 0.095825 & 0.061905 & 1.547937 & 0.1329 
LP & 0.200158 & 0.109322 & 1.830910 & 0.0778 
GDPPC & 0.000215 & 5.04E-05 & 4.255984 & 0.0002 
GOVCR & 0.000115 & 0.000371 & 0.308943 & 0.7597 
GS & 0.000536 & 0.000479 & 1.117966 & 0.2731 
GWF & -0.000502 & 0.000163 & -3.075916 & 0.0047 
PURGES & 0.001927 & 0.000862 & 2.234144 & 0.2336 
REV & 8.59E-05 & 8.96E-05 & 0.959533 & 0.3455 
ROITS & -8.06E-05 & 0.000135 & -0.597626 & 0.5549 
ANTIGOVDEMO & 0.000127 & 0.000265 & 0.480457 & 0.6346 
ASSASINATIONS & -5.44E-05 & 0.000174 & -0.313130 & 0.7565 

Table 1: Results of Regression Analysis (1972-2011)

4.1.1. Political instability:
We have taken different indicators of political instability. Amongst them only guerrilla warfare has significant negative impact on financial development. Our first proposed hypothesis i.e political instability has significant impact on financial development of Pakistan is accepted. It is significant on 1% level. Gul, et.al (2010), Outreville (1999), Zhang (2007), Roe and Siegel (2011).

4.1.2. Trade Openness:
The second hypothesis i.e Trade Openness has significant impact on relationship between Political Instability and Financial Development of Pakistan is rejected. Our results are consistent with Das & Rishi (2010), Rajan & Zingale (2003).

4.1.3. Legal protection:
The third hypothesis Legal Protection has a significant impact on relationship between Political Instability and Financial Development of Pakistan is accepted. It is significant at 10% level. Our results are similar with LaPorta, et al.(1998), Beck, Demirgüç-Kunt and Levine (2002) and Levine (1998).

4.1.4. GDP per capita:
The fourth hypothesis i.e : GDP per capita has significant impact on relationship between Political Instability and Financial Development of Pakistan is accepted. It is significant at 1% level. The results are consistent with Yartey (2008), Campbell and Mankiw (1990) and Alesina and Perroti (1996).

Table 2: Regression Statistics

Table 2 represents the results of regression statistics The variation discussed by four independent variables on the dependent variable (Financial Development) is 63% approximately as the value of R-squared for financial development is 0.630 and adjusted R Squared value is 0.488 meaning 48% change in Financial Development is explained by independent variables of this study. The value of
adjusted R-squared is 0.488 which is less than value of R-squared. It represents 48% impact of predictors on financial development. The F-test statistic is 4.384 and probability F (statistic) of 0.000 shows the validity and significance of the model.

4.2. Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Mean</th>
<th>Std.Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fd</td>
<td>40</td>
<td>0.34</td>
<td>0.037</td>
</tr>
<tr>
<td>TOP</td>
<td>40</td>
<td>3.5</td>
<td>0.08</td>
</tr>
<tr>
<td>GDPpc</td>
<td>40</td>
<td>0.35</td>
<td>0.27</td>
</tr>
<tr>
<td>Lp</td>
<td>40</td>
<td>2.38</td>
<td>0.51</td>
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<tr>
<td>Assassinations</td>
<td>40</td>
<td>0.75</td>
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<td>GS</td>
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<td>GWF</td>
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<td>GOVCR</td>
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<td>0.52</td>
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<td>Purges</td>
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<td>0.10</td>
<td>0.44</td>
</tr>
<tr>
<td>Riots</td>
<td>40</td>
<td>2.18</td>
<td>3.11</td>
</tr>
<tr>
<td>Rev</td>
<td>40</td>
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<td>0.39</td>
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<tr>
<td>Anti gov demo</td>
<td>40</td>
<td>2.35</td>
<td>3.25</td>
</tr>
</tbody>
</table>

Table 3: Descriptive Statistics

The descriptive statistics shows the mean and standard deviation values of the data. Financial development has the mean value of 0.34 and its standard deviation is 0.037. Trade openness has mean value of 3.5 and standard deviation is 0.08. GDP/capita has mean value of 0.35 and 0.27. Legal protection has mean of 2.38 and standard deviation 0.051. Assassinations have mean value of 0.75 and standard deviation is 1.23. General strikes have mean value of 0.28 and standard deviation of 0.54. Guerilla warfare has mean of 0.18 and standard deviation of 0.38. Government crises have mean value of 0.52 and standard deviation of 0.71. Purges have mean value of 0.10 and standard deviation is 0.44. Riots have mean value of 2.18 and standard deviation is 3.11. Revolutions have mean value of 0.10 and 0.39. Antigovernment demonstrations have mean value of 2.35 and standard deviation of 3.25. In our result some variables have standard deviation higher than the mean value it implies that the observations are not normally distributed and dispersed. Our results are consistent with (Roe & Siegel, 2011)

4.3. Robustness Checks:

Some tests are applied to check the robustness of the results. These tests are also known as diagnostic tests. Here we applied ARCH (Autoregressive Conditional Heteroskedasticity) model to check the hetroskedasticity in the data. Following table shows the results.

<p>| | | | |</p>
<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>F-statistic</td>
<td>5.23E-05</td>
<td>Prob. F(1,37)</td>
<td>0.9943</td>
</tr>
<tr>
<td>Obs*R-squared</td>
<td>5.51E-05</td>
<td>Prob. Chi-Square(1)</td>
<td>0.9941</td>
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</table>

Table 4: Robustness Checks

ARCH models are employed commonly in modeling financial time series that exhibit time-varying volatility clustering, i.e. periods of swings followed by periods of relative calm. They are used whenever there is reason to believe that, at any point in a series, the error terms will have a characteristic size, or variance. In order to have no hetroskedasticity problem, the probability value must be higher than 0.05. The above table shows the value of probability as 0.9943 which is much higher than the required value it means that our data has not the problem of hetroskedasticity.
Further correlogram is used to check the autocorrelation among the variables. The correlogram is a commonly used tool for checking randomness in a data set. This randomness is ascertained by computing autocorrelations for data values at varying time lags. Following table shows the results.

<table>
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<tr>
<th>Autocorrelation</th>
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<th>Prob</th>
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Table 5: Results of Autocorrelation

The above table shows the probability of autocorrelation among the variables. The probability value must be greater than 0.05 so that the data is free from the problem of autocorrelation. All of the probability values in the above table are greater than the required value.

CONCLUSION

The study basically emphasize on the significance of political instability on the financial development of Pakistan for the period from 1972 to 2011. Three controlled variables are used in the study i.e. trade openness, legal protection and GDP/capita.

Four hypotheses were constructed in accordance with the literature. The first hypothesis emphasizing on the significance of political instability on financial development of Pakistan is accepted and is consistent with (Alesina & Perroti, 1996), (Campos, Karanasos, & Tan, 2011), and (Roe & Siegel, 2011) (Lindgren, 2005). They emphasized that the reason of this significance is results of political instability as the conflict distract the attention of public executives; investments are withdrawn from the country; skilled citizens move abroad; hence weakens the roots of economic and financial development. Entrepreneurs become reluctant to invest in physical assets results in low demand of finance. It indicates that political instability plays negatively significant impact on the financial development of the country. We took eight different indicators of political instability (political assassinations, anti government demonstrations, revolutions, purges, general strikes, guerilla warfare, riots and major government crises). The results indicate that among all eight indicators the guerilla warfare is the most negative significant indicator of political instability which affect the financial development of Pakistan. As we know that Pakistan is victim of talibanization for the last two decades. Activities of the talibans caused continuous unrest in the country which has affected lives of the nation as well as the business activities in the countries causing financial backwardness in the country.

The second hypothesis that consists of the significance of trade openness on financial development of Pakistan is rejected though it has a positive but insignificant impact. Our findings are consistent with Das & Rishi (2010), Rajjan & Zingale (2003) (Baltagi, Demirgüç-Kunt and Law, 2007). They have given the rationale for this insignificance that the as financial incumbents fulfill the need of external finance which arose as a result of trade openness and competition so it not merely enhance the financial development. As a result of trade the developing countries’ need to produce financially dependent goods reduces as they import those goods and demand for external finance also falls results in retarding the financial development (Do & Levchenko, 2005).

The third hypothesis that emphasize on the significance of legal protection on financial development is accepted and is consistent with the studies of LaPorta, et al.(1998), Beck, Demirgüç-Kunt and Levine (2002) and Levine (1998). Legal protection gives protection to the investors so that they can rely on financial intermediaries for their safe and profitable investment. Legal protection is measured by the creditors’ rights they are (i) creditors’ consent when debtor files for reorganizations. (ii) whether secure creditors are able to seize their collateral. (iii) whether secure creditors are paid first. (iv) whether an administrator, and not management is responsible for running the business during reorganization (Djankov, McElish, & Shleifer, Private Credit in 129 Countries, 2005), LaPorta, et al.(1998). These rights ensure the creditors that they investment is safe and profitable.

Fourth hypothesis which tells the significance of GDP/capita on financial development of Pakistan is accepted and it is consistent with (Campbell & Mankiw, 1990), (Yartey, 2008) and (Alesina & Perroti, 1996). The studies explain that if the GDP/capita is higher will be the saving rate and higher will be the investment. For saving and investment purposes financial intermediaries in the form of financial development played vital role. As discussed earlier that financial development provide opportunities to the saver to save their money in a proper and profitable way. In the same way higher GDP/capita results in higher savings.

REFERENCES:


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