



# The economic Effects of Democracy in Pakistan: An Empirical Analysis

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## Abstract

*Pakistan is facing political and economical problems which directly or indirectly effects on people. Soon after the independence, representatives failed to build a healthy political system in a country which affects badly the whole economy. Current study emphasizes on the role of democracy in Pakistan using time series macroeconomic and democracy related variables. The study utilizes the regression technique for estimating the relationship and shows that democracy and durability of democracy effects economic growth positively and internal conflicts effects negatively the economic growth. The study also proposes some valuable policy implications which help policy makers to understand the reality.*

**Keywords:** Pakistan, democracy, economic growth, trade and regime characteristics.

## Introduction

Is economic growth of a country is connected with democracy? Which political system is better in which macroeconomic and socioeconomic variables improved? Literature identifies two political systems which are more discussed by researchers, they are dictatorship and democracy. Researchers have identified that most developed and developing countries became strong when they adopted democracy as a political system. Which system is better? The search for this answer can be better understood by knowing what actually meant by these two terms.

We can define democracy as a type of government which allows all eligible citizens have equal rights of participations directly or indirectly. There are several forms of democracy exist, but there are two fundamental forms, both these fundamental forms consider how will is accomplishes or executes by all competent citizens. One type of democracy is termed as direct democracy in this form of democracy political decisions making involves direct and active participation by all eligible citizens. The second form is democratic republic, in which sovereign power is hold by all competent citizens but political power is used indirectly through elected representatives. In contrast to democracy, a system in which holding of power by an individual or holding by a group of individuals (not restricted by constitution, laws etc) called dictatorship. Dictatorship may be classified as military dictatorship, single party state, personalist and hybrid.

This paper primarily concern with the theoretical and empirical consideration to know the relationship between democracy and economic growth in case of Pakistan. The sequence of paper is as follows. Section I comprised of introduction. Section II covers the extensive literature review. Section III describes the political history of Pakistan. Section IV describes the methodology of paper. Section V represents the finding and discussion. Section VI comprise of conclusion.

**Literature Review:** Empirical and theoretical literature portrait different views about how democracy effects economic growth. Literature suggested three possible ways of causality: one view proposed positive effect; second view proposed negative effect; and third view proposed no systematic effect of democracy on economic growth. This section discusses existing review of literature and endeavor to collect literature at one place which helps to understand the conflicting relationship in a better and in an easy way.

Timothy Besley and Robin Burgess the degree to which physical capital is distributed fairly among members of society can be considered as the determinant of economic growth which effects in the long run. So, it is observe that democratic policies are more apt towards the society related policies like pro-poor taxation, distribution of land, existing of new markets and institution in civil society<sup>1</sup>.

Jose Tavares and Romain Wacziarg they explored that distribution of income is worse in dictatorship due to personal preferences than in democracy. They found that if democracy persists for long period it will reduce income inequality<sup>2</sup>.

Ahmed Mushfiq Mobarak there research suggested that political stability (considered as reduction in uncertainty) has greater effect on long run growth of the country because in dictatorship, the power is not distributed and this monopoly of power creates uncertainty which sluggish economic growth<sup>3</sup>.

Roberto Rigobon and Dani Rodrik in this paper they estimated that democracy and rule of law have positive effect on economic growth<sup>4</sup>.

Alberto Ades and Rafael Di Tella they explored that dictatorship fails to centralized constitutions which increases political

corruption. They found that in democracy which is road to centralized constitutions will help to reduces political corruption<sup>5</sup>.

James Surowiecki in regime of democracy decision making involves group of representative members selected by people of the country, which is more effective decision making than a leader-centered process<sup>6</sup>.

Helliwell and Barro conducted an empirical research that they examined the effect of democracy on growth, after controlling for the endogeneity of democracy. Helliwell found that education and investment is stimulate by democracy, but after controlling for education and investment results showed a negative (and insignificant) effect on growth. On a sense of balance, he concludes that there is no an organized relationship between democracy and economic growth<sup>7</sup>. Barro found a curvilinear relationship, he suggests that at low level of democracy growth exhibit increasing relationship, but growth is decreasing function at high level of democracy<sup>8</sup>.

Chowdhurie-Aziz found direct connection between the extent to which non-elite participate in politics and economic growth<sup>9</sup>. Tavares and Wacziarg utilized simultaneous equations approach and proposed a positive connecting behavior of democracy with growth all the way through improved education, inequality reduction, and with decreasing government consumption<sup>10</sup>.

Olson established that if democracy exist continuing for a long time, it becomes more pluralistic and as a result become less efficient if special-interest groups becomes more powerful. This "political" inefficiency leads to decreased economic performance<sup>11</sup>.

Przeworski and Limongi (1993) revived the argument of 19<sup>th</sup> century that democracy weakens the system of 'property rights' by giving the evicted with an influential political tool for confiscating the wealth of property holders, thus, resulted in lower economic growth because of uncertainty<sup>12</sup>.

Huntington (1968) proposed a negative relationship between democracy and economic growth. This negative relation is due to the fact that in democratic developing countries, government compelled to increase expenditures by people's need increases. Thus, this situation reduces the opportunity for investments (due to reducing of surplus) and crowds out private investment, thus, sluggish the economic growth<sup>13</sup>.

Tavares and Wacziarg (2001) established the view that when government compelled to increase the spending for sustaining the democracy, it will decline the rate of accumulation of physical capital which is useful for long term growth<sup>14</sup>.

Helliwell (1994) proposed that democracy adversely affect economic growth due to countries having low level of income per capita, have a tendency of rapid economic growth, but when income of these countries got the position of wealthy countries

this process become slower than before. He suggested that because of adopting the system of democracy by the country during the development process resulted in slowdown of growth<sup>15</sup>.

Przeworski and Limongi established that democracy erodes the law of property rights, if some groups using political power to take the wealth of property-holders. Therefore, this procedure persuades uncertainty of the economy and, consequently, put negative effect on economic growth. (Kriekhaus, 2006) Likewise, neo-classical political economists have opinion that groups of people having evil-like interest may have influence on government policies and dent the overall economic activities<sup>16</sup>.

Nelson and Singh developed that over the past decades some LDCs showed weak democratic system (declining of political rights and civil liberties) with high economic growth rate. It might be due to the high economic growth has occurred because of unsuitable government intervention in the market. Therefore, there was no free market, meaning a turn down in economic liberty hampers the course of democracy<sup>17</sup>.

Feng established that the advocates of "skeptical" school of thought believes only the existence of democratic system is not sufficient and has no significant effect on economic growth of a country, it also suggested that democratic system must be accompanying by proper and well functioning institutional structure and government development strategies<sup>18</sup>.

Nobel Prize winner Amartya Sen also asserts that democracy smoothing the way for free people, particularly businessmen and business managers, build a country economic performance by practicing their strategic and organizational preferences. Nonetheless, if this situation is not bringing about successfully, it is not suitable to connect economic growth with democracy.

Polterovich and Popov established verification that in countries like Pakistan, Brazil, Honduras, Panama, Peru and Tahiti democracy could not be considered as an important determinant of long run economic growth. (Kisangani 2006) has empirically test using the data of various African countries and found that there is no significant relationship between democracy and economic growth<sup>20</sup>.

## Methodology

**Econometric methodology and data:** Time series data is used for estimating the relationship among variables time span from 1973 to 2006. Time series data has been taken from "POLIY IV PROJECT" which comprises of data related to authority features of countries in the world system for the purpose of qualitative and quantitative research. The concept of 'Polity' was organized by Ted Robert Gurr, with the collaboration of Harry Eckstein. The polity project is widely used by researchers to analyze and monitoring the regime change and regime authority.

This research article utilizes the technique of linear regression model. This basic econometric technique is designed to study the dependence of one variable which is called dependent variable on one or more other variables called independent variables for the purpose of estimating and/or predicting the (population) mean or the average value of the dependent variable in terms of the fixed or known values of independent variables. In this study the following equation is to be estimated.

$$\text{LOG}(\text{GDP}_t) = \text{LOG}(\text{POLITY1}_t) \text{ LOG}(\text{INTENS}_t) + \text{DURABLE}_t + \text{INTERNAL}_t + u_t$$

Where, LOG(GDP<sub>t</sub>) is used as proxy for country's economic growth. LOG (POLITY1<sub>t</sub>) is used as proxy for democracy in a country. LOG (INTENS<sub>t</sub>) is used as proxy for openness of economy (trade openness). DURABLE<sub>t</sub> is used as proxy for measuring how long the democracy prevail in a country. INTERNAL<sub>t</sub> is used as proxy for conflicts in a country. u<sub>t</sub> is disturbance term which shows the unexplained part of the regression

### Definition of Variables

**Durable:** How long the most recent government change, measure in years (alter in the POLITY score over the episode of three years or less is explained by a three point change) or the ending of conversion period explained by the weak political institutions (indicated by a standardized authority score). In manipulating the value of DURABLE, the initial year is considered as the baseline "year zero" in which a new (post-change) polity is recognized and each successive year add one to DURABLE variable successively in anticipation of a new government change or changeover period takes place.

**Internal:** This variable shows the internal armed conflicts (civil war between state and group within its territory. This variable design as if conflict occurs in a year, this variable is valued by "1" otherwise "0".

**Polity1:** The POLITY score is calculated by deducting the AUTOCRACY scores from the DEMOCRACY scores; the outcome of this is the unified polity scale ranges from 0 (strongly autocratic) to 20 (strongly democratic).

**Log (Intens):** is constructed as sum of export and import of a country divided by GDP of the country. This is also called trade intensity. This proxy also represents one aspect of globalization.

Log (GDP) represents the economic growth of a country. It is theorize that GDP is proof to be a better proxy for measuring the overall economic performance of a country. GDP is the production of goods and services produced in a country within given time period.

### Results and Discussion

Table no.1 shows the regression result of the studied model. It is observed that proxy for democracy (POLITY1) is significant from zero at 1 percent level of significance. POLITY1 impact positively on independent variable LOG(GDP). It is estimated that if POLITY1 increases by 1 unit then LOG(GDP) which is used as proxy for growth, is increases on average by 0.0635. It is confirmed by our study that if democracy prevail in Pakistan it will enhance growth of the country. INTER variable which is used as proxy for internal conflicts is negatively related and significant from zero at 10 percent level of significance. The study identify that if internal conflicts prevail in the country it will disturb the economic conditions and slow down the growth of the country on average by 0.058. Pakistan is facing terrorism after the American attack on Afghanistan. Due to these internal conflicts, government is fighting against terrorist and due to this conflicts, the economic environment is under uncertainty putting adverse effect on growth of the country. Theoretically it is suggested that if democracy prevail for a long time or in other words durability of democracy prevail then it will enhance economic growth of the country. This study accept this argument and identify that if DURABLE is increases by one unit, independent variable LOG (GDP) is increases on average by 0.011. This study leads to point that Pakistan needs democracy with durability. Uncertainty in the period of democracy prevail will negatively impact on growth of the country. This study surprisingly came to the point that LOG (INTENS) variable which is used as proxy for trade openness is negative and significant from zero at 1 percent level of significance. It is found by current model that trade will impact negatively on growth. This result is surprising, but it can be thought that this negative relation may be due to the larger amount of import than export. Pakistan is facing trade deficit since many years, this deficit is more in regime of democracy than dictatorship. So the overall impact of trade on economic growth is negative in case of Pakistan.

**Table-1**  
**Regression Results (Least Square Method)**

variables	Coefficient	Std. Error	t-statistic	probability
LOG(INTENS)	-1.014363	0.028685	-35.36276	0.0000
LOG(POLITY1)	0.063562	0.018091	3.513425	0.0015
INTER	-0.058340	0.029708	-1.963793	0.0596
DURABLE	0.011376	0.004820	2.360306	0.0255
CONSTANT	3.392795	0.052986	64.03234	0.0000
R-squared 0.981    Adjusted R-squared 0.978    Durbin-Watson stat 1.557    F-statistic 365.807    Prob(F-statistic) 0.000				

Source: calculated and tabulated by authors

## Conclusion

This study proposed that democracy is better political system in Pakistan. But unfortunately democracy in Pakistan is not persistent and mature. Reasons for democracy failure in Pakistan depend on socio-political system. In a country like Pakistan, where feudalism, illiterate and apathetic people, self imposed leaders and inherited politics are few obstacles in prevailing true democracy. Soon after independence from 1947-1969, civil-military bureaucracy governed Pakistan under oligarchic and authoritarian traditions. Second and third period of dictatorship were during period of 1979 to 1988 and 1999 to 2007. This highlights that democracy is not prevailing continuously for a long period creating unrest situation in the country. Pakistan is under war with terrorism, as a result of this war human loss to Pakistan is more than 52,000 and in term of economic loss due to war against terrorism is estimated as 17.83 billions dollars in 2012, net inflows as percentage of GDP is only 0.4 and about 121 number of educational institutions destroyed in 2012. As final words, Pakistan badly needs a political system that truly reflects the preferences of people and collective decision making at political level. This can be achieved only when true democracy prevail in Pakistan.

**Table-2**  
**Human loss in terrorist violence in Pakistan (2002-2013)**

Year	No. of Attacks	Killed	injured
2002	56	102	311
2003	88	189	168
2004	159	863	411
2005	254	2117	571
2006	675	907	1543
2007	1503	3448	5353
2008	2577	7997	9670
2009	3816	12632	12815
2010	3393	10003	10283
2011	2985	7107	6736
2012	2217	5047	5688
2013	911	4160	3794

PIPS security reports, South Asian Terrorism Portal, Data from National Crisis Management Cell (NCMC), Ministry of Interior.

**Table-3**  
**Estimated Direct/Indirect Cost of WOT (in billion \$)**

Year	Estimated cost of war
2001-02	2.669
2002-03	2.749
2003-04	2.932
2004-05	3.140
2005-06	3.986
2006-07	4.670
2007-08	6.940
2008-09	9.180
2009-10	13.560
2010-2011	17.830
Total	67926

Source: Pakistan Economic Survey 2010-2011, Ministry of Finance.

**Table-4**  
**FDI Inflows to Pakistan 2001-2011**

Year	Net inflows as % of GDP
2001	0.54
2002	1.15
2003	0.65
2004	1.16
2005	1.97
2006	3.4
2007	3.9
2008	3.3
2009	1.4
2010	1.1
2011	0.6
2012	0.4

Source: World Bank Country Reports

**Table-5**  
**Number of educational Institutions destroyed (2003-2012)**

Year	No. of educational institutions destroyed
2003-07	100
2008	119
2009	188
2010	129
2011	142
2012	121
Total	799

Source: Economic Survey of Pakistan

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