

# Political Instability Leads to Economic Instability

## OUTLINE:

### I. Introduction:

a. Overview

b. Thesis Statement

"Political instability and economic instability are interdependent. Political instability often leads to economic turmoil as the mistrust hinders investments inflows and social unrest increases economic cost."

### II. Main body:

a. The interplay between political stability and economic stability -

① Political stability boosts business confidence thus attract investments.

② Political certainty promote consumer confidence and spending, contributing to economic growth -

③. Political stability fosters long term policy making which leads to consistent economic policies.

b. How political instability leads to economic instability -

- ①. Political uncertainty creates trust deficit in the business market, reducing chances of investments.
- ②. Increased government spending to tackle political chaos leads to budget deficit.
- ③. Socioeconomic outcomes i.e. hyper-inflation, unemployment etc due to political mismanagement have heavy economic cost.
- ④. Frequently changing governments stain the international image of the country leading to economic isolation.

c. Case Studies to prove that political uncertainty leads to economic instability -

- ①. The Great Depression (1929) - Post WWI political decisions contributed to economic crisis.

- ②. 2020-Brexit and the following economic repercussions for Britain
- ③. The vote of no confidence (2022) elevated the political instability contributing to default risks in Pakistan.

#### d. Recommendation to control political instability and achieve economic stability.

- ①. Promote strong institutions to ensure rule of law.
- ②. Focus on inclusive and long term policy making for sustainable economic growth.
- ③. Encouraging conflict resolution and political dialogue to eradicate mistrust.

### III - Conclusion :

- a. Review of the essay and reiteration of thesis statement.

Political instability is a state of uncertainty characterised by frequent change in leadership, social unrest and short term policy measures to deal with the chaos. Wherease, economic instability is the market uncertainty which shapes the economic performance. These two concepts are interdependent. Political instability often results in economic turmoil and uncertainty. This essay aims to explore the interplay of political instability and economic instability.

Economy thrives on strong political institutions. In an environment where politics ensure rule of law, social institutions are strong, economy grows rapidly. The political representation is successful in communicating their interests thus attracting investors to achieve their economic goal. A political stable environment facilitates the investors to explore their options and maximise their profit in lucrative businesses.

A politically stable country ensures that the agreements will not be violated, and policy will continue. This is crucial for a conducive business environment as investor trust in political institutions brightens chances of foreign direct investments and domestic investments. This contributes to economic growth of the country. In the words of Charles Edison,

"Economics, politics and personalities are often inseparable."

The interdependence of economic stability on political stability is also evident from the fact that a strong and stable political system has the trust of public who spends and contribute to economic prosperity. The cycle of economy is continued when the purchasing power parity of the masses shows sustainable growth. This consumption increases the living standards of public contributing to human development.

When the leadership of the country is stable, the policy making will be inclusive and long-term. This will facilitate consistent economic policies to deal with fluctuating market trends thus leading to economic stability. United States of America is one of the oldest democracies of the world. As a developed nation with a consistent political process and a leading economy, America's economic success is the result of political equilibrium.

The foundation of policy formulation and implementation lies in political stability. If political governments change frequently, ad hoc solution to problems will hinder economic growth. Lack of effective decisions and implementation will send the country in the spirals of chaos starting from economic crisis. In 2022, the Sri Lankan default took its roots from the political mismanagement. The inconsistent policies led the Island Nation to economic downfall.

"For commerce, the most important thing is trust."

(Jack Ma)

In his book, "Alibaba, The house that Jack Ma built", Duncan Clark quotes Jack Ma to emphasize that in a business environment, trust is crucial. The trust deficit created between investor and investee due to political uncertainty of the country reduces the chances of investments - This has a negative impact on an economy which thrives on investments.

Political uncertainty has several consequences that contribute to economic instability - Decline in business confidence tops the list - lack of foreign direct investments eliminates the prospects of economic growth and contributes to balance of payment crisis - The budget deficit also grows and country's dependence on foreign loan increases.

The social unrest generated from political instability also costs governments big time. To deal with social chaos, the government resort to short term policy measures which contribute to economic downfall.

The latest report by International Monetary Fund, a global organization, explains how social unrest can pose a challenge to recovery of global economy.

" Any rise in social unrest could pose a risk to global economy's recovery as it can have lasting impact on economic performance. "

Inconsistent political leadership takes short term political measures to deal with crisis at hand resulting in accumulation of chaos for the future. The defective policy measures contribute to socio-economic outcomes like inflation, unemployment, protests etc which hampers economic growth.



Lack of investments will lead to industrial shutdown, which will increase reliance on imports and unemployment. This will give rise to inflation and increase cost of living ultimately contributing to economic instability. The example of political chaos in 2022 in Pakistan leading to possible default rumors is a case in point.

Secondly, the political instability followed by frequent regime changes also impact the international image of the country. This prevents any cooperation agreements with other states to promote <sup>economic</sup> progress and innovation in the country. The economic isolation of the country due to political mismanagement also leads to its downfall. The government resort to short-term popularity measures through public speaking and subsidies which stain the economy further.

The subsidies given by government in order to deal with political chaos as a short term strategy leads to budget deficit, debt burden and balance of payment crisis. The country's reliance on imported products further deepens the divide. The resources are mismanaged and conflicts are harnessed which leads to social divisions and destabilize the economy. Unequal access of resources and opportunities delay economic progress and impedes social cohesion.

The social divide increases and an elite-favoured policies are adopted to promote one's own self interest in the name of politics. According to the theory of Karl Marx, the divide between haves and have-nots increases and one class prevails over the another. This hinders economic growth as the repressed class can't contribute but only produces the goods.

The best way to understand the impact of political instability on economic situation is through the case study of Great depression. There seems to be many causes of Great depression but one of the leading cause is the faulty political policies in the end of World War I that sparked the economic crisis. According to Milton Friedman,

"The Great Depression, like many other periods of severe unemployment was produced by government-mismanagement rather than by any inherent instability of the private economy."

The political instability, particularly in Europe, played a significant role in the onset of economic chaos that led to the Great Depression. The protectionist policies only to protect domestic industry from foreign competition,

led to the loss of investors confidence and ultimately the decline in international trade contributed to slow global economic growth and downturn. The political instability played a crucial role in undermining the economic confidence, disrupting international trade, hindering effective policy response and resulting in social unrest.

Similarly, the Britain's decision to unilaterally withdraw from the European Union in 2020 following a 2016 referendum, resulted in economic crisis. The Britain economy took a hit from the political decision which divided the political parties and international community. According to the Financial Times analysis, the Brexit costed Britain 2% of their GDP or 1.3% of their national income resulting in economy meltdown.

The situation in Pakistan in 2022 followed a similar trajectory. The political instability that resulted in premature exit of a Prime Minister from office resulted in ad hoc measures to deal with the economy. The new government came for a short time and implemented policies to favour their government.

The gasoline to the political bonfire resulted in an absolute political chaos which brought the country on the brink of economic default. The economic instability of Pakistan is the result of inconsistent policy making and frequent change in leadership which results in loss of investors interest.

Today despite having the most abundant natural resources and landscape in the region, Pakistan's economy is suffering from the worst phase in its history because of political instability.

Political

Economic

# Political Instability leads to Economic Instability

Introduction

Conclusion

## Interdependent relations

### between Pol. St & Eco. St.

1. Pol. stability boosts business confidence thus attracting investment
2. Pol. stability promotes consumer confidence and spending thus contributing to economic growth
3. Pol. stability fosters long term policy formation which leads to consistent economic policies

## How Pol. Inst leads to

### Economic Instability

Pol. instability creates among

1. Trust deficit between ~~investor~~ <sup>business</sup> investors ~~leads to~~ in the business market which reduces chances of investments which slows economic growth
2. Govt spending to tackle Pol. chaos leads to budget deficit.
3. Pol. mismanagement leads to socioeconomic outcomes like unemployment, inflation, social unrest which has heavy economic cost. <sup>from frequently changing govt.</sup>
4. Pol. chaos stains the international image of the country thus losing FDI, cooperation agreements and impact ready to economic isolation

## Case study to prove that PI leads...

Global level

### - Historical

1. GD. <sup>Pol. decision post WWI led to economic crisis and thus GD.</sup>

### - Present

1. 2020 Brexit & the following economic crisis for UK.
2. 2022 <sup>rise of cost of</sup> no confidence in <sup>Pol. banks that lead to eco. instability</sup>

## Recommendations

to achieve

econo. stability through Pol. stability checks & balance

1. Promote strong institutions to ensure rule of law
2. Encourage pol. dialogue among major stakeholders & conflict resolution
3. Transparent and accountable policy making process for long term growth