

Political instability leads to economic instability

## 1 Introduction

A. Thesis Statement: Political instability and economic instability are inter-linked. Political instability halts the economic progress indicators like foreign and domestic investment, remittances, business confidence, trade and commerce to name a few

## 2 Understanding Political instability

A. Correlation between Political Instability and Economic Instability

B. Causes of Political Instability

## 3 How Political Instability leads to Economic Instability

A. Foreign Direct Investment and Domestic Investment is halted

B. Diaspora hesitant to send back money ~ Loss of trust and confidence

C. No ease of doing business ~ investor reluctant to invest in tense environment

D. Political Instability a driving

force behind Negative Business Confidence

E. Disrupts governance and policy making in the economic sector

F. Security challenges associated with instability can disrupt Trade and Commerce

#### 4. Consequences of Political instability on the social life in the economic domain

A. Inflation erodes purchasing power

B. Loss of trust in institutions

C. Unemployment and poverty will flourish

D. Contributes to social unrest and protests

#### 5. How to address the challenge of political instability

A. Electoral reforms along with free and fair elections

B. Meritocracy and Technocratic Leadership ~ a case study of Singapore

## C. Strengthening Democratic Institutions ~ a case study of Finland

### 6 Conclusion

Imagine, you have a job and you are uncertain that you will be able to go to your office or not due to the prevailing conditions of social unrest due to the political instability in the country. Indeed, if you do not go to your office you will certainly lose an amount of your salary. This is the same effect of political instability on the economic indicators of the country. Political instability and economic instability are inter-linked to each other. If there is political stability, there will be economic progress and vice-versa. Political instability is a multifaceted phenomenon driven by various factors.

These include: governance failures, weak institutions, socio-economic inequalities and political polarization to name a few. These further leads to economic instability <sup>due to</sup> ~~including~~ the deterrent of foreign and direct investment, loss of trust and confidence <sup>by diaspora</sup> in the state's economic channels, a complex environment of doing business, negative business confidence due to political polarization, disturbance in the governance and policies of the economic sector, and disturbance of trade and commerce due to the security challenges associated with political instability. These further impact social life by increasing inflation, unemployment, and poverty indicators. So, it is necessary to address the challenge of political instability. To address this, we need to have electoral reforms, meritocracy and technocratic leadership, a national dialogue, and strengthening of democratic institutions.

First we need to understand Political instability. Political instability ranges from governmental upheavals and coups to civil unrest and protests. According to the World Bank,

"Political instability is defined as the collapse of government either because of conflict or Competition between various groups and also there exists a subsequent change of government in short time".

Political instability and economic instability are inter-linked to each other. They both depend on each other in a delicate balance.

As political stability ensures economic growth because in political stability there exists stable political institutes, and on the other hand political instability defers economic growth due to

the unstable political institutions.

The causes of political instability are many. These include the governance failures, fragile state institutions including judiciary, law enforcement and civil services and to name a few. When these institutions are not able to perform their duties, they halt processes like rule of law, citizens rights, and socio-economic equalities.

Moreover, political polarization and ideological divide among the citizens are also the root causes of political instability. This include the ethnic, religious or sectarian divisions. These are further exploited by political elites for their own motives.

Moreover, polarization along ideological lines exacerbated by misinformation, propaganda and manipulation of social media

can lead to political gridlock and instability.

Now, we will examine how political instability leads to economic instability.

The very first thing that political instability does is that it halts the foreign direct investment and the domestic investment as well. Foreign Direct Investment includes the investment from the foreign investors. When they see that environment is not favourable for investment, they do not bother to invest in projects.

Because they know, they will reap no benefits. For example, take the example of Pakistan.

Due to the political instability in the country, the investor is hesitant to invest. According to the State Bank of Pakistan, Pakistan received \$1.4bn in Foreign Direct Investment in

the fiscal year 2022-23,  
which is <sup>8480 million</sup> lower than the  
previous year. This decline  
in foreign direct investment  
clearly suggests the impact of  
political instability on the foreign  
direct investment.

Not only this,  
the diaspora which include the  
overseas residents of the mother  
country are reluctant to send  
back money to their homeland  
because of the prevailing social  
unrest due to the political  
instability. They lose trust  
and confidence in the state  
institutions because of their  
ineffectiveness. Remittances are  
key for the economic growth  
of the country. In some parts  
of the world, they are considered  
as driving force of economy.  
However with conditions like  
social unrest and polarization,



remittances are also halted. For example, according to State Bank of Pakistan, Pakistan remittances fell by 13.6% in 2022-23 after the ouster of the ruling government.

Moreover, political instability is also a strong driving force behind negative business confidence. Business confidence indicator provides information about the future progress and development of a country. A positive business confidence is necessary for the growth of country and prosperity. But, this is only possible when there is political stability. But when there is political instability, the negative business confidence prevails. Take the example of Pakistan, who is struggling with its economy and in the last two

years, the economic progress is further halted. According to the Overseas Investment Chamber of Commerce, Pakistan's business confidence dropped to **negative 4** after the political unrest in April 2022, before that it was **positive 17**.

Political instability also affects the governance and economic policies. It lowers the predictability of government policies. As the government changes in short or successive periods, there exists no long term policies and the ruling government try to pursue short-term policies which further deteriorate the economic indicators.

**S. Akbar Zaidi** in his book "Issues in Pakistan's economy: A political perspective" mentions that the short term policies due to the political

Polarization have always halted the progress of Pakistan's economy. According to him, long term policies benefit not only the state but it also benefit the local people by improving the socio-economic indicators. But with political instability prevailing it is difficult to make long-term policies.

Moreover, cabinet changes in short period also lowers the gross domestic product of ~~the~~ country. It is harder for them to commit to aggressive plans for investment and consumption.

According to the **IMF**, a additional cabinet change in a year reduces annual real GDP growth by **two percentage points**.

These all have consequences on the social

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life. First, these economic instabilities leads to high inflation. This erodes the purchasing power of local community. This disrupts the cycle of local people.

Take the example of Pakistan, who is struggling to cope with its record inflation due to the political instability.

According to IMF, Pakistan saw its all time high inflation of about 37.97% in May of 2023.

Moreover, these instabilities also contribute to unemployment. In country like Pakistan, the unemployment rate stands at 8% as of

January 2024. There can be many factors behind it, but this has triggered after the political chaos after the

output of the ruling government.

In short, addressing  
to challenge a political  
instability is necessary. For  
this we need to make  
electoral reforms along with  
free and fair elections.

Meritocracy and Technocratic  
Leadership is necessary.

Singapore has turned into  
a global power by  
countering its political stability  
by introducing meritocracy and  
technocratic leadership in  
its state institutions. If these  
things are taken into account,  
we can achieve political  
stability and this will  
further leads us to  
economic prosperity.