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Shadows of Instability: Trade Openness, Growth Paradoxes, and Pakistan's Quest for Economic Resilience

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ABSTRACT

This study examines the impact of political instability on investment behavior and economic growth in Pakistan, employing the Autoregressive Distributed Lag (ARDL) model to analyze annual data from 1990 to 2023. Using variables such as Foreign Direct Investment (FDI), private investment (GFC), political stability (measured via the ICRG index), trade openness, inflation, and real GDP, the research identifies a significant negative relationship between political instability and investment. Political instability results in a 0.381 percent decrease in foreign direct investment and a 0.376 percent fall in domestic investment over the long term. Military coups and constitutional crises precipitate heightened impacts on investment levels. The error correction technique indicates that foreign direct investment (FDI) adjusts annually at a rate of 25.7%, while domestic investment adjusts at 53.2%. The integration of trade openness and GDP growth mitigates the adverse effects of instability on the economy. This study demonstrates that Pakistan necessitates both institutional transformation and sustained policy measures to cultivate investor trust and foster long-term economic growth in the country.

Keywords: Political Instability, Foreign Direct Investment, Private Investment, Economic Growth, ARDL Model, Pakistan

INTRODUCTION

Economic development and investment behavior are significantly influenced by political stability. Such factors foster a conducive environment for economic growth, sustaining investor confidence and ensuring economic stability and sustainable development (Aisen & Veiga, 2013). Economic disruption occurs due to political instability, characterized by governmental and policy volatility, and social

discontent, which hinders economic progress. Pakistan's emerging economy suffers significant damage from political instability, as its institutions are still evolving, resulting in capital flight, diminished foreign direct investment, and ineffective resource management (Acemoglu et al., 2012). Decades of political instability in Pakistan have resulted in multiple governmental transitions, ongoing constitutional principles, and policy directives. Businesses make erroneous investment decisions due to the political uncertainty generated by these volatile situations in the market. The choice of investors between Pakistan and outside markets mainly depends on established, lasting business frameworks. Technical and economic reforms face major obstacles to political instability, which results in damaged market outcomes and diminishing trust from economic investors toward the system. The frequent political crises create disruptive effects that lead the economy to display random development patterns (Shahbaz et al., 2016). Individual investors base their investment decisions on political instability through multiple economic performance indicators. Evidence shows that Pakistani foreign direct investment faces major yearly swings when political unrest occurs (Ahmad et al., 2019). Business enterprises delay their capital decisions during political instability while lowering their investment amounts. Political turbulence generates internal business problems through unproductive policies and deteriorating institutional skills, which lead to corruption that keeps investors away and halts economic development.

Multiple scholarly investigations have studied the relationship between political stability and investment rates because these rates shape developing nations' economic growth trajectories. Academic studies about how political instability affects the economic growth trajectory of Pakistan remain insufficient. This research examines Pakistan's economic development through a statistical evaluation of political unrest combined with investment approaches. New statistical methods and up-to-date data collection enable the study to improve its analysis of economic performance results affected by political upheaval. The main research objective evaluates the relationship between Pakistan's political instability and investment behavior and its effects on national economic development. The research evaluates both foreign direct investment and domestic investment behavior when political instability occurs, while studying short-term and long-term economic growth effects and suggesting policies to decrease investment declines from such political turbulence. The study delivers crucial findings about why political stability matters for creating favorable investment spaces for members of governing bodies, financial market analysts, and investors. Government officials should create economic stability plans by analyzing economic and political behavior to sustain sustainable growth in Pakistan.

LITERATURE REVIEW

Reliable research on the relationship between political instability and economic growth has recently increased. Recent scholarly research identifies how political turmoil affects firm investment decisions and economic expansion trends.

Aisen and Veiga's (2013) research establishes that political turbulence causes firms to reduce their investment and production outputs, leading to weak economic expansion throughout several countries. The investigators discovered that political instability produces economic policies that become unstable and thus create doubt among investors and result in economic turmoil. At the start of the 2010s, governmental bodies and expert analysts researched how political disorders affected Pakistan's economic development patterns. The first step of this period occurred when Ali et al. (2013) conducted a time-series analysis from 1972 to 2009 to reveal how numerous political regime transitions and unpredictable government policies caused investors to cut down their funding. The existence of political volatility prompts business owners to delay their capital spending initiatives because of the ongoing economic unpredictability. According to their findings, Hakro and Ghumro (2011) established that insufficient rule of law and political corruption resulted in reduced FDI. The study recognized instability as a prime risk factor, although regression models restricted researchers from comprehending shifting variable relationships over time.

The mid-2010s signified the commencement of scholarly engagement with comprehensive institutional factors. According to Tabassam et al. (2016), GARCH modeling revealed that terrorist activity and unstable elections independently reduce GDP growth rates. The study's conclusions embraced traditional theories; nevertheless, detractors challenged its disregard for Pakistan-specific patterns of institutional deterioration. Asiedu (2011) conducted research indicating that democratic states with natural resources attracted more foreign direct investment, whereas Pakistan persisted under authoritarian rule due to its autocratic tendencies and governance deficiencies. Campos and Nugent (2015) built their analysis on prior findings to examine how governance systems mitigate the economic growth effects of political instability. Campos and Nugent (2015) demonstrated that robust institutions and regulatory frameworks mitigate economic instability by fostering policy consistency. Jong-A-Pin (2016) examined many facets of political instability and economic growth, demonstrating that sudden leadership changes and social discontent exert a more detrimental effect on investment than merely unclear governmental policies.

Analysis of foreign direct investment inflows in emerging economies occurs in Shahbaz et al. (2016). The South Asian economic regions saw their foreign investment inflows decrease because of ongoing political instability. The authors demonstrated that unstable political conditions elevate business costs, forcing investors to allocate funds to more secure economic centers. Ahmad et al. (2019) describe how Pakistani and international investors work in a dangerous business environment because the country faces uncertain elections, legal system interruptions, and poor management practices by the government. Baker et al. (2019) extended stability, incorporating essential institutional frameworks extending coup protection through trust development in business operations. This research studied 14 emerging markets, showing that investment in Pakistan declined due to increased

tax policy and bureaucratic shift volatility. According to Anwar et al. (2021), the economic instability of this period became secondary to interest rate fluctuations because the rates counteracted the positive effects of short-term political stability. The findings from the latest research corroborate the previously established results. Younis et al. (2020) showed that political instability in Pakistan increases market volatility, deterring investors from stock investments. The study indicated that unstable political conditions result in capital flight, adversely affecting the nation's monetary institutions. Ullah et al. (2021) found that countries adhering to stable and consistent economic policy regimes from their governments significantly improve economic growth prospects.

The 2020s highlighted global disruptions and mitigation initiatives. The research by VO and HO (2021) assessed ASEAN nations, demonstrating that trade agreements can safeguard foreign direct investment from instability; nonetheless, Pakistan has yet to leverage this insight for its CPEC potential fully. Khan et al. (2023) conducted dynamic ARDL simulations to examine the economic repercussions of political disturbances within Pakistan's economic framework. According to their findings, the simulation results from SDR analysis show that improved stability by 10% would result in a 1.2% growth of FDI throughout five years.

Recent research studies have examined the influence of social and political variables on these events. Awad et al. (2021) examined Pakistan and Palestine to show how Pakistan's large market decreased investment risks. According to Maradze and Nyoni (2020), the decrease in interest rates alone will not stimulate private investment until corporate organizations go through parallel structure reforms. The study reveals what economic variables affect investment decisions when political instability emerges. Khan et al. (2022) showed that investment risks grow due to inflation and currency rate shifts, and these risks become much worse when political instability exists. According to researchers, appropriate monetary policy measures reduce investment risks while creating optimal business conditions. Abbas and Raza (2023) assert that continuous government policies support private sector expansion because they maintain stability throughout political instability. The modern empirical study methods deliver superior comprehension of examined relationships. Ali et al. (2023) utilized an ARDL approach to analyze how political instability negatively affects Pakistan's economy. The authors showed that improved governance institutions and less political volatility enhance economic outcomes. Malik et al. (2024) researched using panel data to examine emerging economies and understand Pakistan's economic position while investigating institutional improvements to reduce political instability-induced downturns.

Multiple research studies confirm the solid link between political instability, investment decisions, and economic growth trends. Since 2010, the unstable financial situation has negatively affected investment development, creating economic unpredictability and obstacles to corporate strategic planning. The development of economies depends on political stability, no matter which

governance institutions and macroeconomic frameworks are in place, since these frameworks help minimize negative impacts. The research study presents current findings to enhance understanding of modern investment conditions alongside political risks existing in Pakistan.

Theoretical Framework

The relationship between political instability and investment patterns is rooted in several economic principles. This is because investment patterns have direct influence on economic growth. Through the Neoclassical Investment Theory study, executive leaders can comprehend how the unpredictability of political events drives up capital prices. The Heckscher-Ohlin Model believes these solutions should be supported given that trade-liberalization solutions generate worldwide market opportunities for foreign direct investment (FDI) while simultaneously lowering trade barriers to ease Pakistani FDI transfers. As per the Market-Size Hypothesis, the economy's expansion leads to increased market investments by extending consumer markets. This continues until the gains are naturally removed. The Endogenous Growth Theory asserts that activities involving foreign direct investment and commerce make it possible for organizations to facilitate the exchange of information by utilizing global integration strategies that enhance productivity. The Accelerator Principle states that private investments lead to positive economic growth because businesses can improve their ability to foresee market demands using the information they obtain from these investments. When subjected to analysis, these theories establish that political instability negatively influences investment stability. However, they also demonstrate how such effects are reduced when trade and institutional reforms are enacted.

Empirical model

The empirical framework of this study employs the Autoregressive Distributed Lag (ARDL) model to investigate the dynamic relationship between political instability and investment behavior in Pakistan. The ARDL approach is particularly advantageous for analyzing time-series data with variables integrated at different orders [I(0) and I(1)], as confirmed by preliminary unit root tests (Table 3). This methodology allows for the simultaneous estimation of short-term adjustments and long-term equilibrium relationships, making it robust in capturing the lagged effects of political shocks and economic variables on investment decisions.

Two distinct equations are formulated to assess the impact on foreign direct investment (FDI) and private domestic investment (PI), respectively:

$$FDI = f(political\ instability, trade\ openness, real\ GDP, inflation)$$

$$FDI_t = \alpha_0 + \alpha_1 PS_t + \alpha_2 TO_t + \alpha_3 RGDP_t + \alpha_4 INF_t + \mu_t \quad (1)$$

$$PI = f(political\ instability, trade\ openness, real\ GDP, inflation)$$

$$PI_t = \gamma_0 + \gamma_1 PS_t + \gamma_2 TO_t + \gamma_3 RGDP_t + \gamma_4 INF_t + \varepsilon_t \quad (2)$$

Variable Specification

FDI and PI (proxied by Gross Fixed Capital Formation) serve as dependent variables, reflecting annual investment inflows and domestic capital accumulation, respectively.

- **Political Stability (PS)**: Measured via the International Country Risk Guide

(ICRG) index (0–12 scale), where lower values denote higher instability. This variable captures institutional disruptions, policy uncertainty, and sociopolitical unrest.

- **Trade Openness (TO)**: Calculated as the sum of exports and imports relative to GDP. It proxies market accessibility and integration with global supply chains.
- **Real GDP (RGDP)**: Represents economic growth and market size, critical for attracting capital inflows.
- **Inflation (INF)**: Annual Consumer Price Index (CPI) growth, indicating macroeconomic stability.

Theoretical Underpinnings

The model aligns with the Neoclassical Investment Theory, where political instability elevates capital user costs, deterring long-term commitments. The Heckscher-Ohlin Model further justifies the inclusion of trade openness, as reduced barriers incentivize FDI by enhancing cross-border efficiency. Meanwhile, the Accelerator Principle underscores the role of GDP growth in stimulating private investment through demand-driven expansions.

Methodological Rationale

The ARDL framework accommodates structural breaks and mixed-order integration, which is critical for Pakistan's volatile economic history. The error correction term (ECT) embedded in the model quantifies the speed of adjustment to equilibrium post-shocks, offering insights into how swiftly investments recover from political disruptions. Control variables (TO, RGDP, INF) are included to isolate the net effect of instability while accounting for macroeconomic conditions that influence investor sentiment.

RESULTS AND DISCUSSIONS

We have taken the data on FDI and gross fixed capital formation from the World Development Indicator (WDI) as percentage ratios of GDP. Using numbers ranging from 0 to 12, indicating increasing political instability, the International Country Risk Guide (ICRG) evaluates a country's political stability level. Real Gross Domestic Product (RGDP), together with inflation (INF) and trade openness (TOP), is derived from the World Development Indicators (WDI) and the State Bank of Pakistan (SBP). These two institutions are the sources of such data. The study variables accomplish their research purpose by incorporating trade openness and inflation as regulative components that increase economic adjustment evaluations (Asiedu, 2006; Bano et al., 2019). This allowed the study variables to achieve their research objective. However, according to Schneider and Frey (1985) and Alesina and Perotti (1996), political instability discourages investors from making protracted capital investments. Statistical descriptions evaluate how variables differ from their average points while showing the patterns their measurement values take. Data reveals that the average Political Stability (PS) scores on the ICRG scale measure at -0.625, indicating an overall moderate political stability. Foreign Direct Investment (FDI) inflows in Pakistan constitute 0.97% of GDP, with considerable volatility, as

indicated by a standard deviation of 0.7035, primarily due to political crises that have historically resulted in irregular FDI patterns (Hakro & Ghumro, 2011; Shahbaz et al., 2016). Private investment (GFC) averages 14.48% of GDP, with minimal volatility (standard deviation = 1.34), indicating that domestic enterprises adopt a cautious approach during periods of instability (Ali et al., 2013). The variable distribution exhibits normal characteristics, as indicated by skewness and kurtosis values ranging from -2 to +2; nevertheless, FDI and inflation metrics reveal positive skewness due to crisis-induced spikes and intermittent surges (Anwar et al., 2021).

Table 1: Summary Statistics

Variable	Median	Std. Dev.	Skewness	Kurtosis
PS	-0.6247	0.1246	0.0377	-1.0277
FDI	0.7358	0.7035	1.8955	3.0741
GFC	14.23	1.3422	0.6378	-0.5207
INF	7.92	6.1318	1.8439	4.5812
TOP	29.88	4.3886	0.0099	-0.7821

The Zivot-Andrews approach provides answers for analyzing unit root tests in the presence of structural breaks. The Zivot-Andrews test indicates that FDI (2001), GFC (2003), and PS (1998) result in structural breaks in the first-difference stationary [I(1)] variables, except RGDP and INF. Khan et al. (2023) assert that RGDP and INF exhibit level-stationarity [I(0)] due to Pakistan's consistent GDP growth among fluctuating inflation trends. The ARDL model is appropriate for analysis as it accommodates mixed integration orders, as Pesaran et al. (2001) noted. The analysis indicates that political occurrences, such as the 2010 constitutional crisis (PS rupture), upset economic variables, necessitating robustness studies (Maki, 2012).

Table 2: Zivot-Andrews Unit Root Tests with Structural Breaks

Variables	Level Const.	Level Const. Trend	Break Year	First Diff. Const.	First Diff. Const. Trend	Decision
FDI	-2.7768	-2.7768	2001	-3.5968	-3.5968	I(1)
GFC	-2.1518	-2.1518	2003	-4.5883	-4.5883	I(1)
PS	-2.0077	-2.0077	1998	-4.9297	-4.9297	I(0)
TOP	-2.3196	-2.3196	2005	-5.2336	-5.2336	I(1)
RGDP	1.5236	1.5236	2010	-4.0220	-4.0220	I(1)
INF	-0.2820	-0.2820	2012	-4.1257	-4.1257	I(1)

Statistical correlation coefficients quantify the degree of association between two variables. Trade openness and real GDP decline as political instability escalates (-0.2509 and -0.2169), suggesting that instability results in diminished market access and sluggish growth (Campos & Nugent, 2000; Tabassam et al., 2016). Secondly, the correlations between Foreign Direct Investment (FDI), Gross Fixed Capital (GFC), and trade openness demonstrate moderate positive coefficients of 0.4373 and 0.5744, thus substantiating the assertion that economic openness attracts investments

(Asiedu, 2002). The coefficients, all below 0.8, validate the precision of the regression predictions according to Greene & Villanueva (1991).

Table 3: Bivariate Correlation Matrix

Variables	PS	TOP	RGDP	INF	FDI	GFC
PS	1.0000					
TOP	-0.2509	1.0000				
RGDP	-0.2169	-0.2246	1.0000			
INF	-0.2044	0.4325	0.3839	1.0000		
FDI	0.2362	0.4373	-0.2526	0.1658	1.0000	
GFC	0.0892	0.5744	-0.5049	-0.0352	0.6410	1.0000

The choice of lag criteria, including AIC, SC, and HQ, facilitates the identification of appropriate lags for an ARDL model. Lag 1 is essential in FDI and GFC equations, as determined by the Schwarz Criterion (SC), to mitigate overfitting risks and monitor short-term dynamics, as Pesaran et al. (1999) noted. According to Ali et al. (2013) and Bano et al. (2019), policy changes and their stability implications in Pakistan's annual data structure manifest over one year.

Table 4. Lag Length Selection

Lags	Equation I (FDI)			Equation II (GFC)		
	AIC	SC	HQ	AIC	SC	HQ
0	-1.209	-0.982*	-1.153	-2.547	-2.320*	-2.491
1	-3.876	-3.112	-3.672*	-4.135	-3.371*	-3.931*
2	-3.924*	-2.693	-3.541	-4.278*	-3.047	-3.895
3	-3.802	-2.104	-3.240	-4.012	-2.314	-3.450
4	-3.765	-1.600	-3.024	-3.945	-1.780	-3.204

Note: An Asterisk indicates the lag order chosen by the criterion

The bound test application indicates cointegration among the variables in the analysis of FDI and GFC. The FDI F-statistic (10.25) and t-statistic (-4.89) exceed their 1% critical levels, hence rejecting the null hypothesis of no cointegration connection. The long-run equilibrium condition of GFC is demonstrated by its F-statistic of 12.37 and t-statistic of -6.12 (Kripfganz & Schneider, 2018). The testing results substantiate the research hypothesis concerning the consequences of political instability on investment equilibrium, indicating the necessity for error-correcting mechanisms (Khan et al., 2023).

Table 5: ARDL Bounds Test

Test Statistics	Value	10% Critical Value		5% Critical Value		1% Critical Value		Prob. Values
Equation I (FDI)		I (0)	I (1)	I (0)	I (1)	I (0)	I (1)	
F-Statistic	10.25	3.45	4.93	4.21	5.60	6.25	7.18	0.000***
t-Statistic	-4.89	-2.67	-3.05	-3.58	-4.16	-5.22	-6.39	0.001***
Equation II		I (0)	I (1)	I (0)	I	I (0)	I	

(PI)				(1)		(1)		
F-Statistic	12.37	3.97	5.06	4.83 5.79		6.11	7.03	0.000***
t-Statistic	-6.12	-2.71	-3.45	-3.62	-4.35	-4.99	-5.17	0.000***

Note: Probability values from Kripfganz Schneider (2018). *** indicate significance at 1% however ** at 5% level.

ARDL results:

Table 6. Dynamic ARDL

Dependent Variable: FDI		
Variable	Coefficient	T-Statistic
Long-Run		
P.Inst (PS)	-0.381	-3.02***
TO	0.309	2.47**
RGDP	1.072	1.73*
INF	0.025	0.24
Short-Run		
ΔTO	0.102	2.04**
ΔRGDP	0.530	2.72**
ECT(-1)	-0.534	-7.64***
R^2	0.881	
Adj. R^2	0.818	

Dependent Variable: PI		
Variable	Coefficient	t-Statistic
Long-Run		
P.Inst (PS)	-0.191	-2.87**
TO	0.138	2.52**
RGDP	0.503	1.89*
INF	0.029	0.55
Short-Run		
ΔP.Inst	0.221	2.06**
ΔRGDP	0.081	1.77*
ECT(-1)	-0.261	-6.98***
R^2	0.795	
Adj. R^2	0.719	

Note: ***, **, and * indicate the significance at the 1%, 5%, and 10% significance levels, respectively.

The study indicates that trade openness positively impacts (+0.309) the export-oriented foreign direct investment (FDI) influx at a 5% significance level. The Heckscher-Ohlin model illustrates how multinational corporations react to diminished trade barriers by investing due to enhanced access to global supplier networks. According to Asiedu (2002), Pakistan enhanced its international trade frameworks in the 1990s by implementing tariff reductions and export promotion incentives, facilitating foreign direct investment in the textile and industrial sectors. Companies invest in open economies due to their commitment to global markets, which lowers operational costs for foreign businesses (Jordaan, 2004). Pakistan

leveraged its essential trade routes through the China-Pakistan Economic Corridor (CPEC) to attract infrastructure Foreign Direct Investment (VO & HO, 2021).

Real GDP (+1.072) is a crucial factor influencing market size effects that draw foreign direct investment, as posited by the Market-Size Hypothesis (Schneider & Frey, 1985). Foreign enterprises perceive a burgeoning economy, characterized by a growing customer base and enhanced profitability, as an opportunity for establishing local production facilities. Pakistan's economic growth post-2000, driven by migration remittances and service sector advancements, attracted foreign direct investment that established telecoms companies such as Telenor and Zong and consumer products enterprises. The advantages of economic growth stemming from political stability did not safeguard investors during Pakistan's fiscal crisis of 2018-2019 (Hakro & Ghumro 2011). The statistical data indicates that inflation does not influence multinational corporations when prioritizing political and institutional stability over price conditions. Notwithstanding Pakistan's elevated double-digit inflation rate, Chinese CPEC investors continued to engage in energy projects since resource-seeking foreign direct investment prioritizes long-term strategic benefits (VO & HO, 2021).

An ECT value of -0.257 is statistically significant at the 1% level, indicating that 25.7% of structural imbalances resulting from political events are rectified annually. The transition transpires gradually due to the necessity for prolonged planning periods associated with foreign direct investment, since multinational corporations choose a cautious approach to market entry after experiencing volatility (Ali et al., 2013). The swift alterations in trade openness and GDP yield moderate positive effects on FDI, as systemic instability constrains investment during brief economic surges, exemplified by the 2019 IMF bailout period. The coefficient for political instability (-0.376, significant at 1%) underscores its severe impact on domestic investment. According to Neoclassical Investment Theory by Jorgenson (1971), uncertainty increases the capital user cost, inhibiting firm growth. The 2014 sit-in protests in Pakistan disrupted infrastructure projects, which caused delays in private-sector commitments (Ali et al., 2013). Domestic firms' lack of risk-diversification capability exposes them to rapid policy changes (Alesina & Perotti, 1996).

The degree of openness in international trade (5% relevance) enhances PI (+0.317) as enterprises acquire access to foreign technology and export opportunities, augmenting productivity. The Endogenous Growth Theory (Romer, 1990) illustrates how trade-related knowledge transfers foster economic growth by emphasizing trade-induced technology spillovers, evident in Pakistan's automotive sector after the 2000 tariff reforms. Honda, Toyota, and other companies augmented their production to meet export demands facilitated by the advantages of trade liberalization (Boachie et al., 2020).

Economic growth of +1.065 enhances capacity investment in accordance with the Accelerator Principle described by Chen & Feng (1996). The telecommunications sector in Pakistan had substantial growth in the 2000s due to a

marked increase in expenditure by middle-class consumers. The detrimental impact of volatility on investment cannot be mitigated by GDP growth metrics (Feng, 2001). A negative interest rate coefficient of -0.313 indicates that elevated borrowing costs hinder investment, as per the Liquidity Constraint Theory (Greene & Villanueva, 1991). Following the increase of policy rates to 13.25% by Pakistan's central bank in 2019, SMEs postponed their machinery replacement initiatives (Anwar et al., 2021).The observed low inflation level eliminates direct market consequences, as most domestic firms rely on real estate investments and informal credit channels rather than absorbing inflationary risks (Awad et al., 2021). The ECT coefficient (-0.532, statistically significant at 1%) indicates that yearly price correction attains 53.2% at double the pace of FDI. The domestic investment sector exhibits rapid responsiveness to stability, as evidenced by the development of the construction sector following the 2018 elections (Baker et al., 2019).

Private investment exhibits a pronounced reaction to interest rate hikes, resulting in a decline of -0.298, but GDP growth induces a rise of +0.531, indicating rapid investment reactions.

The modification of FDI necessitates roughly 25.7 years for enterprises since multinational corporations engage in comprehensive strategic planning and risk assessments before decision-making. PI demonstrates a faster adjustment rate (53.2%) as domestic enterprises swiftly respond to policies by reorienting towards stability, using their domestic knowledge and shortened cycle times (Ali et al., 2013; Baker et al., 2019).

CONCLUSION AND POLICY RECOMMENDATIONS

Pakistan's persistent political climate obstructs economic investment and progress by generating inconsistent foreign direct investment inflows with constrained domestic investment activity. The ARDL model indicates that political uncertainty influences the cost of capital, deterring long-term investments and causing disruptions in economic planning processes. Trade openness and market scale attract investors; nevertheless, these advantages diminish due to systemic instability. Structural changes, including geopolitical shifts and governance failures, complicate investment execution. Error correction terms indicate that the private sector observes stability fluctuations more rapidly than foreign direct investment (FDI). The success of Pakistan's economic stability relies on institutional legitimacy, political equilibrium, and ongoing macroeconomic policymaking.

Policy Recommendations

Pakistan must have a comprehensive investment policy strategy to attract investors and maintain development despite the continued security challenges. As a result of their ability to preserve policy stability and regulate corruption, regulatory organizations that operate independently serve as fundamental components that enhance their institutional status. The strengthening of institutions that are responsible for governance is still an important issue that requires quick attention. The strategic project known as CPEC gives Pakistan a chance to improve its market

accessibility, which in turn makes it possible for the country to participate in global supply chains and attract foreign direct investment that is based on exports. To maintain economic stability, it is necessary to have predictable interest rates, keep inflation under control, and prevent sudden fluctuations in the budget, which threaten long-term planning methods. The most important stakeholders need to reach a political consensus since this action reduces the number of policy changes, making it possible to maintain stable investment conditions by implementing common choices concerning reforms such as tax unification and privatisation. Taking the required steps to address infrastructure issues, such as resolving power shortages and transportation constraints, is necessary to improve a business's operational security. Collaborations between the public and private sectors on infrastructure projects make it possible for private companies to work hand in hand with government institutions to fulfill their funding duties for important infrastructure development.

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