Factors Affecting Economic Growth: A Comparative Analysis of Democratic and Non-Democratic Eras of Pakistan

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ABSTRACT

This paper empirically investigated the impact of macroeconomic factors on economic growth during Pakistan's democratic and non-democratic eras. The study employed an ARDL Bounds testing approach along with an error correction model using yearly data spanning from 1971 to 2018. The empirical analysis concluded that export, remittances, and real effective exchange rate are indeed important. Export, remittances inflow, and real effective exchange rate positively influenced economic growth in the long term. Furthermore, imports negatively affect economic growth, but the affect is insignificant. The study reported an insignificant difference in the independent variables that affected the growth process and revealed that non-democratic eras' performance has not remained better than democratic government in Pakistan's case. The study recommends that policymakers pursue appropriate strategies to enhance exports and foreign remittances and appreciate a country's currency to attain long-term economic growth.

1. Introduction

Seventy-three years have been spent since independence, but we are not still successful in developing the best political institutions. The countries which were far behind Pakistan are ahead now. Our history comprises non-democratic and democratic eras and the debate on the role of democratic and non-democratic governments regarding Pakistan's economic growth is not still over. To examine which political system gave the best contribution to the growth of its country? How the economy of Pakistan performed under democratic and non-democratic government regimes? Literature explores two political eras, i.e., democratic and non-democratic governments, and their role in economic performance. Pakistan has faced democratic and non-democratic governments, while in Pakistan, a non-democratic government is always perceived better than a democratic government (Khan et al., 2015). From the day of independence, Pakistan was under the control of dictatorship for many years in which military governments claimed that the economy and economic stability were better than the democratic government (Raheem et al. 1971). The last 60 years were critical in the case of growth and economic management. One of the struggling years was 2007 in the sense of restoration of a democratic system in Pakistan.
The economic growth in Pakistan is seemed to be hovering about 5% for the last 60 years. During the 1960s and 1980s, Pakistan's growth was faster than South Asia by an average of 2%. Albeit, it was observed that the growth rate was lower than the regional average in the 1990s. Problems were created by Social and Political interference in a smooth trend of growth. The economy may be better if a country is politically and socially stable (Umez et al., 2000). Like other developing countries, introducing Pakistan is a solid effort to maintain long-term economic growth. Globally, it is complicated to trace the key indicators: 'what determines growth process.' Many factors affect economic growth by dint of its complex nature. Domestic determinants like human capital and savings have great significance in attaining a higher level of economic growth (Romer 1988, Solow 1956).

Nevertheless, internal factors such as exports, real effective exchange rate, and external factors like foreign imports, the inflow of remittances have also equal importance to augment the economic activities, particularly in developing nations (Tahir et al., 2015). Economic growth boosts the income of the community and keeps a low level of unemployment. Maintaining the growth of an economy is very important because raising the economy is more likely to alleviate poverty and develop the public's standard of life. Besides, the people will get health facilities as well as better education. Earlier studies suggest that economic growth stimulates human progress (Nourzad & Powel, 2003). Undeniably, in the whole world, human progress is the aim of all economic activities. The literature identified two types of political eras in Pakistan's history: democratic and dictatorships. There are different sorts of democracies and non-democracies, but Pakistan has merely experienced military rule and parliamentarian democracy as dictators. Thus, Pakistan's economy is a tangled economy and a mixture of a military coup and parliamentarian democracy. This research has evaluated Pakistan's democratic and non-democratic eras, where democratic eras are 1971-1976, 1989-1998, and 2008-2018 whereas non-democratic eras are 1977-1988 and 1999-2007. Enormous researches have been performed to examine the association between macro-economic factors and economic growth in Pakistan. Despite having several military eras, the economic performance of Pakistan is not investigated under two regimes empirically. This study aims to shed light on the role of dictatorship in Pakistan's economic performance compared to the economic performances of democratic and non-democratic governments using an advanced time series methodology, i.e., ARDL Bounds testing and error correction model (ECM). This paper used observations regarding imports, exports, exchange rate, and remittance inflow in Pakistan over 1971-2018. These four indicators contribute highly to the case of Pakistan's economy. Therefore, it is imperative to explore the nexus between imports, exports, remittances, real effective exchange rate, and economic growth in a long horizon, giving the country and policymakers an advantage. Accordingly, policymakers should initiate plausible policy strategies towards the selected determinants considering their importance for Pakistan's economy. Other developing countries, like Pakistan, can also adopt these policy strategies.

As the previous literature indicated, many studies have been conducted to inspect the nexus between economic growth and its determinants in Pakistan. However, no study investigated and examined the determinants of economic growth in Pakistan's military and democratic systems. So, how does military and democratic governments affect the determinants of economic growth was not explored yet. To examine this problem, this research study is performed to identify the determinants of economic growth in democratic and non-democratic eras.

This research work has certain contributions. This study is comprehensive and is more different in several ways than previous studies. Firstly, this study attempts to check the factors which affect economic growth in the case of Pakistan. Secondly, the study attempts
to identify the relationship of economic drivers and economic growth first time elaborately in
democratic and non-democratic eras of Pakistan. Thirdly, this study performs an advanced
time series methodology called the ARDL Bound testing approach and the ECM model. The
recent paper aims to determine the prime covariates that contribute to economic growth and
a comparative analysis of military and democratic regimes in Pakistan. This paper is comprised
of the following sections. Section two discusses a review of the past studies. Section three
provides the model specification and methodology. In section four, results and their
interpretation are discussed. A final section presents the conclusion of the study along with
policy recommendations.

2. Literature review

Many researchers in the earlier studies have investigated the link between economic
growth and its determinants.

Studies in the 1990s contain Fosu (1990a), Edwards (1992); Dollar (1992); Sachs and
Warner (1995), among others. For instance, Fosu (1990a) conducted a study in Africa using
a sample size consist of 28 countries (less developed) and found that export is one of the
significant covariates of economic growth. Sachs and Warner (1995) established a speed of
integration measure and concluded that speedy integrators usually incorporated East Asia's
exporting economies. The frail and sluggish integrators usually incorporate low-income
countries in Sub-Saharan Africa (SSA), and few such countries have a middle income of Latin
America. Onafowora and Owuya (1998) also found that export positively and significantly
affected the growth process for a sample of twelve SSA countries and inferred that there is
the possibility to accelerate growth via outward-oriented growth policy. The study was carried
out by Ali F. Darrat (1987) about the Krueger (1985) and Findlay (1984) export-led
hypothesis; this hypothesis describes that soaring exports stimulate the process of growth.
The main findings disclosed by Ali F. Darrat (1987) reveals that the economy of Korea,
Singapore, Taiwan, and Hong Kong is not influenced by export. Moreover, he concluded that
there is no causal link amid the economy and exports using the granger causality test.

The influence of imports on economic development is essentially subjected to the firms
of a country. Imports of eatable type commodities are less likely to improve the economic
activities in host countries. Though, if imports include machinery, capital, and intermediate
production inputs, it might augment the importing country’s economic activities. A study was
executed by Zhang and Zou (1995) to investigate the causality amid economic growth and
imports of technology in the context of developing countries; their main findings showed that
transferring foreign technology incentivizes the income growth rate. Furthermore, the
behavior of the growth process fluctuates amid developing and developed nations. In
developing nations, importing equipment and plants and lending technology from abroad play
a prime role.

In contrast, the study was carried out by Siddiqui and Iqbal (2005) and find out that
there is no statistical contribution of imports and exports in promoting economic growth.
Nevertheless, imports indeed play a significant role in the rising economy. That one may
incentivize the local industrial sector through innovative technologies and equipment can
merely be retrieved through augmented imports.

The nexus of inflow of remittance and economic growth has been roughly assessed in
earlier studies. Their empirical results reveal that the inflow of remittances contributes
significantly to improving economic growth, except studies like Barajas et al. (2009), they
showed that remittance inflow does not significantly influence economic growth. The past
studies suggest that remittances inflow and economic growth are directly related (Ahmed et
al. 2011; Shafiq et al. 2012; Khathlan 2012; Driffield and Jones, 2013; Tahir et al. 2015;
Relevant work is conducted by Kock and Sun (2011) on the determinants of remittances in the case of Pakistan. They found that instead of the global economy slowdown in the potential economic and especially the economic decline in main host countries and Gulf Co-operation council for Pakistan’s workers, the remittances inflow to Pakistan are consistent or somewhat rising. The main results were (i) boosting the labour migration leads to enhance the growth in the workers’ remittances inflow towards Pakistan; (ii) trained immigrants, the stability of exchange rates, investment payback in the host country, and development in the economic conditions of Pakistan play an important role to explain more strong remittances inflow; (iii) other factors of resilient remittances inflow towards Pakistan are the comparatively yield on investments and agriculture outcome in the home and host countries. The instability of the exchange rate is the continual rise and fall in domestic currency value relative to other currencies (exchange rate). In the recent literature on international finance, this has gained much attention because of its impact on developing and developed countries. As long as the traded goods sector has higher production, countries have a spur to sustain the relative price of traded goods. Hausmann et al. (2005) argued that the exchange rate's devaluation usually causes sudden fluctuations in growth. Rodrik (2008) found that growth increases after one decade of steady rise in undervaluation in developing countries on average. Razin and Collins (1997) described the idea of real exchange rate for open economies in IS-LM formwork associated with misalignment. Their main results reveal that merely more over-valuation is related to sluggish growth.

On the other hand, a modest peak has occurred with higher growth. Habib et al. (2017) proposed different channels where a lower exchange rate leads to more investment and savings via income redistribution and lower labour costs. Real devaluation augments investment and savings through transferring assets from buyers to financially constrained firms.

3. Methodology
3.1. Model Specification

The prime purpose is to explore the effect of key factors on economic growth during Pakistan’s democratic and non-democratic eras. Based on data availability, imports, exports, remittance inflow, and real effective exchange rate are used to perform multivariate analysis. Statistical analyses are carried out utilizing 48 observations for the period 1971-2018. The empirical model is expressed as;

$$GDP = f (IMP, EXP, REM, REER, DM)$$

GDP represents gross domestic product, IMP represents imports, EXP represents exports, REM represents remittances and REER represents a real effective exchange rate, and DM = 1 indicates non-democratic era and 0 otherwise.

The model may be written in the form of:

$$GDP_t = \theta_0 + \theta_1 IMP_t + \theta_2 EXP_t + \theta_3 REM_t + \theta_4 REER_t + \theta_5 DM_t + \epsilon_t$$

Considering time series, the data properties are susceptible and required in-depth inquiry. Usually, economic variables suffer from a unit root problem and tend to be nonstationary. It is necessary to inspect the unit root issue of each series in the initial step and discover the integration order of the underlying each series. Neglecting the unit root issue and utilizing nonstationary series in the analysis can generate meaningless regression.
Suppose the variables under consideration are suffering from unit root issues. In that case, the suggested technique is to use a cointegration approach or differentiate the series in accordance with integration order and utilize the differentiated series in the empirical analysis rather than the original series. The stationary series can be modeled at level, and thus Granger causality test is applied, whereas dealing with a pure random walk series can be applied to detect a long-term association (Akçay and Demirhan, 2005). There are three main approaches to discovering the association in the long term amongst the nonstationary variables: Engle and Granger (1987), Johansen (1988) and ARDL bound test. The bound testing technique for cointegration is due to Pesaran et al. (2001) and considered very powerful by dint of its potential to control the variables that integrated different orders and work well to use small sample. Hence, in this study, we prefer a bound testing approach to discover the long-term relationship because of nonstationary data.

### 3.2. Cointegration and Error Correction Model (ECM)

As stated before, using series having unit root in the analysis may provide non-sense output, such issues are usually resolved with the help of differencing the underlying series. By difference, however, we lose important information regarding variables. Cointegration mechanism reduces an issue of unit root time series without losing long-term equilibrium relationship if it exists. In accordance with Engle and Granger (1987), using any nonstationary variables (i.e., I(d) series, here d represents the integration order), if the linear combination of two or more series is turned out to be stationary, means I(0), then it reveals that underlying series are co-integrated and the resulting regression will be meaningful. Such variables come close to each other with the laps of time, and the long-term association exists between them. If cointegration does not exist between the two series, then they drift away from one another and indicates the absence of a long-horizon relationship (Afzal, 2007). Usually, by means of these three approaches, cointegration is tested between/among different variables.

- Engle-Granger Approach
- Johansen Procedure
- Bounds Testing Approach

The ECM and cointegration are strongly linked. This linkage has derived from a theorem known as the Granger representation theorem. This theorem describes if two or more variables are co-integrated, then can be expressed as ECM, and it can be concluded that the series are error-correcting cointegrated. In this study, we employ the Bounds testing approach to determine the cointegration relationship among nonstationary variables.

### 3.3. Cointegration analysis (ARDL)

Statistical analysis is carried out with the two goals. In the first instance, to know how the series is linked in the long term; secondly, investigate the dynamic causal linkage amongst the variables. To fulfill these two goals with the precise output, we apply the bounds testing (ARDL) approach. Equ: (1) is re-adjusted as an unrestricted ECM in the ARDL framework as:

\[
\Delta \text{GDP}_t = \alpha_0 + \theta_1(\text{GDP})_{t-1} + \theta_2(\text{IMP})_{t-1} + \theta_3(\text{EXP})_{t-1} + \theta_4(\text{REM})_{t-1} + \theta_5(\text{REER})_{t-1} + \theta_6(\text{DM})_{t-1} + \sum_{i=0}^{n} \gamma_{1i} \Delta(\text{GDP})_{t-i} + \sum_{i=0}^{n} \gamma_{2i} \Delta(\text{IMP})_{t-i} + \sum_{i=0}^{n} \gamma_{3i} \Delta(\text{EXP})_{t-i} + \sum_{i=0}^{n} \gamma_{4i} \Delta(\text{REM})_{t-i} + \sum_{i=0}^{n} \gamma_{5i} \Delta(\text{REER})_{t-i} + \gamma_6 \text{DM} + \epsilon_t
\]

(2)

Where \(\Delta\) indicates the first difference operator and captures the short-run dynamics whereas the slope parameters associated with lag variables, that are without a difference, capture long-run elasticities. To access a parsimonious model, the plausible lags are selected
via the Akaike information criterion. Initially, the cointegration is tested by bound test, which imposed constraints on the parameters of the long-term relationship: GDP, IMP, EXP, REM and REER in Pakistan's economy.

Pesaran et al. (2001) argued that testing cointegration involves the comparison of compound F-statistic with lower critical bound (LCB) and upper critical bound (UCB). Under null hypotheses, it is supposed that there is no cointegration ($H_0: \theta_1 = \theta_2 = \theta_3 = \theta_4 = \theta_5 = 0$) is evaluated against the rival hypothesis, which ensures the presence of long term association that is at least one of $\theta_i$ ($i=1,2,3,4,5$) is different from 0.

There is no evidence of cointegration if the value of the F-statistic lies below LCB. On the other hand, the variables are said to be co-integrated if the F-statistic exceeds UCB. If the F-statistic lies between LCB and UCB, then the result becomes inconclusive. Narayan (2004) stated that the critical values generated by Pesaran et al. (2001) are used in large sample studies and may provide misleading results while using for small sample studies. For a small sample, a new set of critical values was revived by Narayan (2004). In the recent study, the Narayan (2004) critical values are more suitable in a small sample, 46 observations in our case. Initially, the calculated F-statistic value can be compared with Narayan's critical values to conclude the cointegrating relationship. ECM is fitted to identify the short horizon and long-horizon association among the variables in the next step. Finally, to examine the estimated model statistically, we employ reliability as well as stability tests.

4. Estimation

Table 4.1

Descriptive Statistics

|        | GDP     | IMP     | EXP     | REM     | REER    |
|--------|---------|---------|---------|---------|---------|
| Mean   | 4.722842| 19.65361| 13.26889| 4.739808| 143.6894|
| Median | 4.772638| 19.72596| 13.35924| 4.450276| 117.5747|
| Maximum| 10.21570| 24.09992| 17.35930| 10.24763| 253.6000|
| Minimum| 0.468373| 12.78996| 7.142331| 1.453638| 93.71658 |
| Std. Dev.| 2.191843| 2.772493| 2.497102| 2.300180| 50.53349|

Before going to multivariate analysis of the time series data, a detailed statistical analysis of the selected variables is carried out. Table 4.1 provides the descriptive summary and reveals that the average and standard deviation of GDP is 4.72 and 2.19, respectively. The average value for imports is 19.65, along with a standard deviation of 2.77, the mean value for export is 13.26, along with the standard deviation of 2.49. The mean and standard deviation for remittance is 4.73 and 2.30, respectively, and the average real effective exchange rate is 143.68, along with a standard deviation of 50.
According to the above graph, we can conclude that REER and REM are positively correlated along with the magnitude of 0.25. The correlation between REER and EXP is -0.69, which reveals that both variables are moving in the opposite direction. The association between REER and IMP is 0.22, which means that as one variable rises, the other variable comes down. REM and EXP are negatively related with the magnitude -0.37. Graph manifested that REM and IMP are moving in the same direction by magnitude 0.53. Approximately, the data show no association between import and export.

4.1. Cointegration analysis (ARDL)

Table 4.2
Unit root testing

| Variables | At level | At 1st difference |
|-----------|----------|--------------------|
|           | Constant | Constant with trend | Constant | Constant with trend | Conclusion |
| GDP       | -2.650   | -2.585             | -7.083*  | -6.936*             | I (1)      |
| IMP       | -2.503   | -3.007             | -5.453*  | -5.622*             | I (1)      |
| EXP       | -1.620   | -1.287             | -5.199*  | -5.294*             | I (1)      |
| REM       | -1.673   | -1.669             | -4.375*  | -4.332*             | I (1)      |
| REER      | -1.012   | -1.346             | -5.801*  | -5.847*             | I (1)      |

* shows significance at 5 percent.

The ADF test was employed on a dual set, being constant and constant along with trend simultaneously. Their outputs showed that all the time series have unit root at levels under constant and constant trends. Though, all of them were found to be integrated at I(1). The response variable is integrated of order one, which is imperative for cointegration analysis.
The result of the bounds test is provided in Table 4.3. The computed F-statistic value is 4.42, which exceeds UCB at a 5 percent level. This establishes the long term association between the underlying series.

Table 4.4 provides the output of the long term relationship. The empirical evidence showed that the influence of imports is negative but insignificant on economic growth. Furthermore, the study found strong evidence that exports significantly accelerate the economy. The results further revealed that the inflow of remittances contributes positively and statistically to economic growth. The findings come up with evidence of association amid real effective exchange rate and economic growth.

The findings of the ECM are given in Table 4.5. The coefficient of ECT is negative and highly significant at a 1 percent level is another evidence of the stable long-term association.
The estimated ECT magnitude is -0.96 recommends that short-term dis-equilibrium be rectified at the speed of 96 percent. The lag of export and remittances inflow is positive and significant, which clearly demonstrates that both lags significantly contribute to augmenting economic growth. Further, the findings postulated no significant relationship between imports, exchange rate, and economic growth. As the P-value associated with the dummy variable is more than 5%, it demonstrates that covariates’ effect on the dependent variable in democratic eras is not significantly different from non-democratic eras in Pakistan.

The diagnostic tests in panel (B) confirmed that the estimated ECT possesses the desired statistical properties. The LM test for serial correlation, Jarque-Bera test for normality, Breusch-Pagan test for Heteroscedasticity, and Ramsey test for functional form ensured the fitted model’s reliability. Finally, the estimated parameters' stability is assessed via CUSUM and CUSUMSQ of the recursive residuals test. Fig provides the plots of these two tests: 1 and 2, respectively. Figures 1 and 2 showed that the fitted line does not exceed the critical bounds at a 5 percent significance level. Therefore, the estimated model is stable.

5. Conclusion
5.1. Discussion on results

This work's prime concentration was to discover empirically the factors that affect economic growth during democratic and non-democratic eras in Pakistan. This study used data over a period spanning from 1971 to 2018. The empirical analysis is carried out by utilizing the recently developed ARDL technique to cointegrate and ECM for short and long-run associations.

The findings revealed that exports, remittances, and real effective exchange rate inflow certainly matter for long term economic growth. These determinants have indeed stimulated the growth process of Pakistan. Roundabout 7 million Pakistani workers work overseas, mostly in Gulf countries, and transfer remittances to their home country are considered 95 percent of the total foreign trade deficit. Hence, policymakers in Pakistan and other developing countries could take proper strategy actions to improve the outflow of workers. Consequently, it will help Pakistan and other developing countries to attain the desired economic growth in the long horizon. The output of this work is not different from the past studies.

Moreover, there is a negative relationship, but the effect is minimal between Pakistan's imports and economic growth. The fundamental causes cannot be easily explored; thus, the composition of imports exhibits that Pakistan spends a significant chunk of its imports, viz.
30% on petroleum products. In addition, the issues of computations, the structure of imports, and data-related issues are likely to be the possible causes.

Policies related to export promotion should be analyzed so that country avail from export. The fiscal authorities should raise exports and motivate domestic commodities.

A decrease (increase) in REER is regarded as depreciation (overvaluation) of the domestic currency. The REER sign is positive, suggesting appreciation in the Pakistan rupee against other currencies in the whole sample period. An upward trend in the currency is a good sign for the economy of Pakistan.

This article also investigated the factors that affecting economic growth under Democratic and non-democratic eras in Pakistan. The study reported an insignificant difference in the independent variables that affected the growth process and revealed that non-democratic eras' performance has not remained better than democratic government in Pakistan's case.

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