| P-ISSN: 2709-6254 | Journal of Development and Social Sciences | April-June 2025, Vol. 6, No. 2 |
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| O-ISSN:2709-6262 | https://doi.org/10.47205/jdss.2025(6-II)14 | [154-164] |

Journal of Development and Social Sciences
www.jdss.org.pk

RESEARCH PAPER

# Political Instability and Exports Dynamics in Pakistan: A Time Series Approach

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**ABSTRACT**

This study examines the impact of political instability on Pakistan's export performance from 1980 to 2022. It aims to identify how governance disruptions deter exports growth compared to regional economies. Pakistan has experienced substantial political instability, fluctuating between democratic and military rule since its independence. Its share in global exports is lagging behind bordering economies. Nations like Bangladesh and India have expanded global trade shares, whereas Pakistan's exports remain constrained by policy unpredictability and institutional weaknesses. Using the Autoregressive Distributed Lag (ARDL) approach, we analyze short- and long-term effects. A composite political instability index incorporates Factors like the state of law and order, internal disputes, and government.. Augmented Dickey-Fuller (ADF) tests verify data stationarity. Political instability establishes significant negative effects on exports both in short-run and long-run. Key transmission channels include disrupted supply chains, unpredictable trade policies, and deteriorating infrastructure. These factors collectively erode Pakistan's export competitiveness in international markets. Building strong political institutions is critical to mitigating instability. Priority reforms should enhance transparency through open governance mechanisms, strengthen accountability via independent oversight bodies, and reinforce the rule of law with judicial reforms. Such institutional stabilization would create a predictable policy environment conducive to export growth.

**KEYWORDS** Exports, Government Stability, State of Law, Internal Disputes, Political Unrest

## Introduction

Pakistan, since its foundation, has struggled with a tumultuous political landscape, witnessing transitions between various forms of governance, including democracy and military rule. This volatility has hindered the country's economic progress, especially in terms of export performance. Over the last two decades, Pakistan's global export share has declined, contrasting sharply with the growth observed in neighboring countries like Bangladesh, India, and Vietnam.

Recent World Bank statistics disclose that, despite starting with higher levels, the business costs in Pakistan and Turkey haven't experienced significant reductions like in many other places as indicated in (ProPakistani, 2023). In Pakistan, this increased cost is mostly linked with higher inflation and interest rates in recent times, along with political instability in the country. claimed that establishing a new business and sustaining prevailing ones has become costlier in Pakistan, particularly over the last decade.

Politically stable economies generally tend to grow faster with rise in economic activities. It encourages both foreign and local investors to put their money into the economy, crafting a safer environment for investment. As people's purchasing power grows, their ability to earn more also increases, due to the boost in investment. This, in turn, leads to higher levels of consumption, savings, and productivity, ultimately boosting exports. It is highly associated with policy continuity. Frequent changes in government or policy shifts can create uncertainty for businesses, affecting long term policies. Stable political environments are more conducive to the formulation and implementation of consistent trade policies that can support exports (Majid et al., 2020).

The instability in politics can greatly affect a nation's economic advancement, with the export industry being especially susceptible to such disturbances. (Barro, 1996) recommends that when countries have limited political rights, granting more of these rights can boost economic growth. Simply put, enhancing political freedom in nations with low initial levels can lead to positive outcomes for their economic development (Mushtaq, Muzaffar & Ali, 2017).

Political stability can play a role in maintaining currency stability (Asteriou et al., 2019). When the political environment is stable, there tends to be less volatility in exchange rates, which is crucial for exporters to manage pricing and stay competitive globally. Political stability influences the perception of a country in the eyes of international buyers. A politically stable country is often perceived as a reliable trading partner, enhancing the reputation of itsexports. (Dalyop, 2023) found that growing uncertainty and instability within a nation can adversely affect its imports, while simultaneously boosting demand for similar or identical products from less risky countries.

Further, (Chaudhary & Qaisrani, 2002) found that export instability has a cascading impact on domestic savings through two main channels. Firstly, any alterations in export earnings directly influence the profitability of export industries, subsequently impacting on their prospective investments. Secondly, a substantial portion of export earnings contributes to government revenue in terms of taxes and profit creating instability in revenue generation. To address this shortage, the government may resort to deficit budgets or seek additional funds through borrowing, both of which significantly impact investment and overall economic growth. Political instability can intricately intertwine with the export sector, exerting notable influences on a nation's external trade dynamics. Therefore, in the current study, political instability is hypothesized to play a critical part in Pakistan's exports development.

The study explores how prolonged periods of political uncertainty contribute to change is export dynamics of Pakistan. The persistent political instability in Pakistan has elevated concerns about its potential impact on the country's export performance. The purpose of this study is to look at the precise ways that Pakistan's export dynamics are impacted by the Political Instability Index.

This study is motivated by the strategic insights and policy implications that policymakers, economists, and business executives can get valued insights from it. The central objective of this study is to discern whether political instability is the primary driver behind these fluctuations. The study provides a comprehensive index of political instability by looking at important elements such law-and-order problems, internal conflicts, and government stability.

## Literature Review

According to Fosu (2003), export performance is negatively affected by an unstable political environment through competitiveness, and PI influences exports more than the overall GDP. Moreover, Khan et al (2015) discovered that exports of Pakistan have declined with the increase in political instability. Additionally, the empirical findings of Cieślik and Goczek, (2015) suggest that there exist a negative and statistically significant relationship between exports and corruption prevailing in a country.

According to the current study political instability effects Pakistan's exports negatively. It also suggests that other macroeconomic factors, such as FDI, GDP, and exchange rates, Domestic loan and imports also influence Pakistan's exports.

**Empirical Evidence Regarding the Impact of Political Instability on Exports Performance**

Qadri et al (2020) discovered that prolonged political instability negatively impacts both international investment and trade in short run. Moreover, Srivastava &Green (1986) contended that countries with bilateral trade relationship tend to engage in high exports level. Economic growth in D-8 countries is boosted less due to low contribution from exports. The major reason behind low exports is the prevailing political unrest which reduces investor confidence and disrupts trade (Al Arif et al., 2021)

Kanze & Kraido(2022) found that during political unrest companies usually experience decrease in number of employees and low productivity .The conflicts like uprisings and terrorism harm efficiency of businesses which led to high production cost and transportation cost (Khalil et al., 2020). Small firms are strained to capacity issues, but large firms are resilient to disturbances

Political instability led by corruption itself didn't really affect how much a company exports. But, when corruption is combined with regulatory obstacles, it apparently had a negative impact on how much the company exported in Tunisia (Bahri et al., 2020). Due to political instability the textile exports in south Asian industries have suffered a lot, the businesses faced huge production costs and high export expenses due to political unrest and corruption (Aziz et al., 2023)

Political instability reduces a country's domestic productivity, therefore, the country depends on imported goods (Özler et al., 2025). Due to high reliance on imported goods the quantity and diversity of commodities available for sale in foreign markets decline consequently. The empirical data of Naeem (2020) clearly indicates that a weak and unstable political system, when combined with insufficient administrative capacity, leads to a decline in the terms of trade of the economy.

Dalyop (2023) argued that political instability in Africa increases exports of fuel and raw material but lessens the export of manufactured products. The major reason behind the decrease in exports of manufactured goods was Africa's weak industrial base. In addition to this, Khalil et al (2020) identified that riots and terrorist attacks have greatly affected businesses' capacity to export goods. Export values and quantity of small and medium-sized businesses have been highly affected.

Anselme Andriamahery & Zhou (2018), found that Madagascar's 2009 political unrest significantly hurt the nation's exports of by reducing investor confidence. Moreover, it weakened government support that deterred production and international trade. However, Krammer et al (2017) contended that political instability negatively affects firm innovation and transformative changes. The impact on exports vary by export and ownership status.

**Empirical Evidence Regarding the Impact of Economic Variables on Exports Performance**

Afolabi &Abu Bakar (2016) suggested that there exists a unidirectional relationship between foreign direct investment (FDI) and trade volume. FDI increases production capacity of a country for exportable goods. However, Majeed & Ahmed, (2018) argued that in developing nations the role of FDI in enhancing exports is still debatable and depend on the investment purpose. The purpose of FDI might be to seize the domestic markets.

Uysal and Said (2018) discovered that Inflation has a detrimental effect on export performance of East African countries, which implies that as inflation rates rise in these countries, the ability of these nations to export effectively diminishes. However, Ergin

Akalpler (2013) argued that Turkey's export capacity was increased not just by inflation alone but other factors such as resource advantage, lower production cost, and innovation also affect exports. Therefore the impact of inflation on exports is debatable. Variation in exchange rate have an impact on export volume (Smith, 2004).

Exports and GDP of a country have a long-term relationship that is interrelated. This supports the economic theory that GDP which measures economic growth, affect exports level (Mehmet ERYİĞİT, 2012). In addition to this, exports are influenced by the long term secured loans, the loans are required by the exporting firms to buy equipment and machineries. Short term loans help to fulfill the short-term needs, but long-term loans are helpful for export related investments (Aadil Nakhoda, 2017).

## Material and Methods

In this section, we establish an analytical framework to assess how political instability impacts Pakistan's export dynamics. We utilize econometric methods, specifically ARDL (Autoregressive Distributed Lag) and EC (Error Correction) techniques, to analyze both long-term and short-term relationships. The study covers annual time series data from 1980 to 2022.

## Conceptual Framework

The primary theories that elucidate the influence of political instability on exports are as follows:

### Political Economy Theory

Adam Smith in "An Inquiry into the Nature and Causes of the Wealth of Nations," asserts that the political landscape can exert considerable influence on economic results. Instances of political instability can breed uncertainty, discourage investment, and have adverse effects on export competences.

### Investment Theory

John Burr Williams in his book "The Theory of Investment Value," contends that political instability can affect both foreign direct investment (FDI) and domestic investment. Investments in infrastructure and technology play a critical role in augmenting export competitiveness. However, political instability has the potential to adversely affect the export performance.

### Institutional Theory

Douglass C. North in his book "Institutions, Institutional Change and Economic Performance" suggests that Political instability can lead to institutional weaknesses, affecting the functioning of markets and trade, thereby influencing export performance.

## Sources of data

All data utilized originates from the World Development Indicators, with the exception of the variables required to construct the political instability index, such as government stability, internal conflicts, and corruption, which are sourced from the International Country Risk Guide (ICRG). Various institutions have defined the political instability index by emphasizing different components.

As per the World Bank, the World Governance Indicator assesses perceptions regarding the probability of political instability and violence, which encompasses factors like terrorism. The Economist intelligence unit (EIU's) considered factors such as government stability, social unrest, and the risk of terrorism or violence. The ICRG by PRS Group includes a Political Risk Index that evaluates political risk factors, including government stability, internal conflict, corruption, and military in politics. To gauge political instability, we create a political instability index for Pakistan by incorporating three distinct variables: government stability, internal conflicts, and the state of law and order, by employing the Principal Component Technique. The index of government stability, internal conflicts range from (0-12) and law and order ranges from (0-6). A maximum score equates to Very Low Risk and a minimum score to Very High Risk.

**Model Specification**

In the regression model for exports, all those factors are considered that can potentially play a meaningful role in the determination of exports along with the main variable, political instability (PI). The regression model based on the conceptual framework discussed above is given below.

$$Exp_t = \alpha_o + \beta_1 PI_{1t} + \beta_2 FDI_{2t} + \beta_3 ER_{3t} + \beta_4 Y_{4t} + \beta_5 Imp_{5t} + \beta_6 lnDL_{6t} + \boldsymbol{\varepsilon}_t$$

| | | | |
|---|---|---|---|
| **Exp** | Exports as percentage of GDP | **PI** | Political instability index |
| **FDI** | Foreign direct investment | **ER** | Real exchange rate. |
| **Y** | GDP per capita | **Imp** | Imports as percentage of GDP |
| **DL** | Domestic loan | **$\alpha_0$** | Intercept term. |

The coefficients ($\beta_1$, $\beta_2$, $\beta_3$, $\beta_4$, $\beta_5$, $\beta_6$) show how each independent variable is thought to affect the dependent variable (exports). When all other variables are held constant, they show the strength and direction of the association between each independent variable and exports. The constant term in the model that represents the value of exports when all independent variables are zero is called the intercept ($\alpha_o$). Error Term ($\varepsilon_t$): This term describes the discrepancy between the export values that were observed and those that the regression model projected. It takes into consideration variables that may impact exports but are not taken into account in the model.

The stationarity of all variables was evaluated using the Augmented Dickey Fuller (ADF) test, while lag selection was determined using the Schwarz information measure. Our analysis will primarily focus on the ARDL error correction model and bound's test, which not only estimates short-term and long-term coefficients individually but also provides the error correction coefficient for the dependent variable, augmenting our understanding of the model dynamics. The bounds test is conducted to determine the presence of a long-term relationship among variables.

**Political Instability Index Calculation**

We developed an index (PCI) to quantify political instability based on three important factors: (1) the state of law and order; (2) internal conflicts; and (3) government stability. The index assigns varying weights (factor loading) to each variable. Each component's impact on political instability is indicated by the numbers; larger values indicate greater influence. Statistical significance was achieved by all covariates ($p < 0.05$). This formula was used to determine the PCI:

**PCI = 0.588 × (Government Stability) + 0.550 × (Internal Conflicts) + 0.587 × (Law and Order)**

To eliminate bias, we normalized the PCI values before utilizing them in the analysis. This approach facilitates equitable comparison of outcomes across several metrics. Positive indicators indicate that as conditions worsen, all variables contribute to political instability. Internal conflicts were marginally less significant (0.550), whereas government stability and law and order were about equally important (0.588 vs. 0.587).

## Results and Discussion

As indicated below (Unit Root Test), all variables were non-stationary at level. However, after taking the first difference, they became stationary, meaning they are integrated of order I (1), except FDI, which was already stationary at level.

**Table 1**
**Unit Root Test**

| Variables | Test at Level | | Test at First difference | | Order of Integration |
|---|---|---|---|---|---|
| | Test statistic | Probability | Test statistic | Probability | |
| EXP | -1.626605 | 0.4604 | -6.383382 | 0.0000 | I (1) |
| PI index | -2.082295 | 0.2525 | -4.782715 | 0.0004s | I (1) |
| EXC | -2.141981 | 0.2300 | -6.126655 | 0.0000 | I (1) |
| IMP | -2.348814 | 0.1622 | -5.794526 | 0.0000 | I (1) |
| Y | -0.313864 | 0.9141 | -4.749368 | 0.0004 | I (1) |
| FDI | -2.996090 | 0.0436 | - | - | I (0) |

Table 1 displays the results of the unit root test. We calculate the order of integration for each time series variable based on the test results and related probability. The results show that FDI is integrated of order zero I(0), which indicates that it is stationary at level, but EXP, PI index, EXC, IMP, and Y are integrated of order one I(1)

**Table 2**
**Lag Selection**

| Variables | Lag | Variables | Lag | Variables | Lag |
|---|---|---|---|---|---|
| EXP | 4 | Y | 3 | IMP | 3 |
| PI index | 4 | FDI | 4 | DL | 2 |
| EXC | 3 | | | | |

Table 2 details the chosen lag order for each variable included in the study. For example, the variable EXP uses 4 lags, while EXC uses 3 lags in the model estimation.

**Table 3**
**Results of bound test**

| F-value = 7.792647 | | | | | |
|---|---|---|---|---|---|
| **10% level of significance** | | **5% level of significance** | | **1% level of significance** | |
| I (0) | I (1) | I (0) | I (1) | I (0) | I (1) |
| 1.99 | 2.94 | 2.27 | 3.28 | 2.55 | 3.61 |

The results of the ARDL bounds test for cointegration are shown in Table 3. The I(0) and I(1) critical bounds are compared with the computed F-statistic (7.79). The test verifies that there is a long-term link between the variables because the F-statistic is greater than the upper bound critical values at the 1%, 5%, and 10% significance levels.

**Table 4**
**Long Run ARDL Results**

| Variable | Coefficient | Std. Error | t-Statistic | Prob |
|---|---|---|---|---|
| PI Index | -0.301 | 0.064 | -4.646 | 0.003 |
| EXC_RATE | 0.005 | 0.026 | 0.170 | 0.000 |
| IMP | -0.065 | 0.004 | -14.70 | 0.000 |
| LN_Y | 0.140 | 0.060 | 2.315 | 0.026 |
| FDI | 0.216 | 0.138 | 1.565 | 0.126 |
| DL | 0.069 | 0.119 | 0.580 | 0.036 |
| | *-0.583 | 0.082 | -7.096 | 0.000 |
| **R-squared** | **0.973** | | | |

The long-run coefficients that the ARDL model estimated are shown in Table 4. It displays the long-term impact of each variable, along with its magnitude, direction (positive or negative), and statistical significance (based on p-values). For example, at standard levels, the PI Index, IMP, LN_Y, and DL show statistically significant long-term effects. The considerable error correction term, which indicates adjustment towards long-run equilibrium, is probably represented by the coefficient with an asterisk.

**Table 5**
**Short Run ARDL Results**

| Variable | Coefficient | Std. Error | t-Statistic | Prob.* |
|---|---|---|---|---|
| LN_EXP (-1) | 0.097 | 0.229 | 0.423 | 0.686 |
| PI Index | -0.704 | 0.225 | -3.126 | 0.020 |
| EXC_RATE | 0.125 | 0.034 | -1.654 | 0.051 |
| IMP | -0.052 | 0.008 | -6.548 | 0.0006 |
| LN_GDP | 0.156 | 0.691 | 0.225 | 0.829 |
| FDI | 0.186 | 0.066 | 2.798 | 0.031 |
| DL | 0.004 | 0.018 | 0.231 | 0.82 |

The F-statistic as shown in **Table 3** of 7.792647, is compared to the critical values for I(0) and I(1) at various significance levels. The reported F-value is 7.792647 and even at 1% level of significance, the F-value exceeded the critical value at I(1) which is 3.61. We can safely conclude that long-run relationships is present, thus validating our ARDL (ECM) model.

**Long Run ARDL Results:**

As **Table 4** illustrates, this analysis shows that Pakistan's political instability has a negative long-term impact on exports. Specifically, for every unit increase in the Political Instability Index (PI-INDEX), exports decrease by 0.30 units. The strong statistical findings support this view. Uncertainty created by political upheaval makes it harder for businesses to maintain steady export operations. Production and delivery delays can result from supply chain disruptions caused by events like strikes, protests, and conflicts. As a result, exporters struggle to meet orders on time, which lowers export volume and alienates customers. In other words, when political conditions are unstable, Pakistan's exports suffer.

According to the study, a stronger currency lowers the cost of foreign goods for consumers, therefore a one-unit increase in exchange rates results in a 0.005-unit increase in exports. Exports are negatively impacted by increased imports, declining by 0.065 units for every unit rise in imports. This is probably because imported items raise manufacturing costs when used as inputs or compete with domestic products, making exports less competitive overseas.

At the 0.0265 probability level, on the other hand, GDP (LN_Y) shows a positive and significant correlation with exports, with a coefficient of 0.140863 and a t-statistic of 2.315759. According to the underlying theory, a country's capacity to manufacture and export goods is positively impacted by a rising GDP.

The study indicated no insignificant relationship between FDI (p-value = 0.1266). This may be due to the fact that FDI does not necessarily increase exports; for instance, if foreign investors concentrate on purchasing domestic companies or making investments in non-export industries like real estate. Conversely, a one-unit increase in domestic loans (DL) results in a 0.069-unit gain in exports. This is probably because enterprises are able to grow their production and export capacity more easily when they have easier access to funding

**Short Run ARDL Results**

Firstly, the lagged value of exports (LN_EXP at time -1) showed a positive coefficient of 0.097, but it was statistical insignificant, with a test statistic of 0.423. The Political Instability Index (PI Index) carried a significant negative coefficient of -0.704. This indicated that there is a short-term relationship between a rise in political instability and a decline in exports.

Real exchange rate (EXC) showed weak positive association with exports. According to the theory of price competitiveness, a depreciation of the domestic currency makes exports cheaper for foreign buyers, leading to an increase in export volumes in the short run. With a coefficient of -0.052, imports (IMP) have a considerable negative impact on exports. In the short term, a rise in imports is correlated with a fall in exports. Foreign direct investment (FDI) is found to be a statistically significant factor with a p-value of 0.031, a t-statistic of 2.798, and a positive coefficient of 0.186. Lastly, the variable of domestic loan (DL) does not exhibit statistical significance with t-statistic of 0.231. In summary, political instability, imports, and foreign direct investment appear to be crucial determinants of short-run export dynamics, while other factors may have limited explanatory power

## Conclusion

Pakistan's political climate has been unstable since its founding, marked by a lack of long-term stability, difficulties with governance, and ongoing internal disputes that have impeded the nation's social and economic advancement. According to the current study, political instability significantly impairs export performance by causing supply chain and infrastructure disruptions as well as investor concern. We examined the variables' short- and long-term associations using the ARDL model. Every variable is stationary, either at first difference or at level, according to the results of a unit root test used to verify the variables' stationarity. The findings indicate that both in the short and long term, political instability significantly hinders Pakistan's exports. The model takes into account domestic loans, GDP per capita, imports, foreign direct investment, and the exchange rate in addition to political instability. Foreign direct investment (FDI) improves export performance in the near term, but it has little effect on export performance over the long run. GDP(Y) has had both short-term and long-term positive effects on exports. The long-run relationship between the exchange rate and exports tends to be more pronounced and significant, the increase in exchange rate increase exports.

## Policy Recommendations

Focus on building strong and stable political institutions to reduce political instability. This may involve implementing reforms to enhance transparency, accountability, and the rule of law.

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