# AN ASSESSMENT OF PAKISTAN'S CORPORATE INVESTMENT CYCLES AND POLITICAL UNPREDICTABILITY (2000-2022)

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## ABSTRACT

Between 2000 and 2022, this project monitors changes in corporate expenditure patterns related to Pakistani national elections. As a starting point, the Investment-Q model with firm fixed effects has been employed. We demonstrate that firms often spend less on investments during election years than they do during non-election years after controlling for company characteristics and economic circumstances. The report also noticed the use of the political-economic cycle theory at the time as well as pre-election manipulation. This research noted variations in the length of investment cycles depending on Pakistan's numerous national characteristics, parliamentary elections, and company characteristics. We observed that the nation's features of political, economic, and governmental freedom had a significant negative influence on investment during the election season. The percentage of government expenditure and the balance of checks and balances, on the other hand, had minimal impact on investment during an election year. When examining the effect of political uncertainty across elections, we found a more pronounced investment cycle for tight polls.

The research also demonstrated how sensitive companies, investments that benefited the market, and investments that were postponed altered their investments in the run-up to national elections. The study discovered that market-friendly and delayed investments had unfavorable significant consequences but that the findings for Pakistan's sensitive sectors were not statistically significant. In order to execute a simultaneous equation of cash holdings and investment regression for the cash holding principle in options theory, we utilized a three-stage least square full estimate maximum likelihood estimation. The cash regression and investment outcomes are also consistent with the real option theory's forecast of a cautious effect, which contends that during times of significant political unpredictability, firms should hold on to more cash and postpone investing.

The study also examined the relationship between investments and political and economic freedom. Additionally, the impact of political and economic freedom on investment during election season was investigated. It was shown that both forms of liberty had a detrimental effect on investment. Finally, the study also looked at how political and economic freedom affects investment and provide some interesting results. The study found that lack of political and economic freedom in an economy has a detrimental impact on investment. The study's conclusions suggest that the government maintains a stable.

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# INTRODUCTION

## Background

Recent years have seen much research on the topic of political unpredictability. Riots, protests against governments, assassinations, constitutional changes, genocides, cabinet changes, coups d'états, civil wars, border disputes, turbulence, and political crises are often associated with political disturbance. Social discontent, political violence, and political changes have also been found as the drivers of political instability (constitutional or not). Changes in the government and domestic and international policy are only a few examples of the many ways that politics may be unpredictable. Uncertain political events resulting from a potential change in national leadership or government policy might result in political instability that interferes with company operations as usual.

In this study, we focus primarily on the uncertainty surrounding elections as a kind of politics. The most significant political events for any economy are elections because of the uncertainty they might produce with regard to governmental choices and policies. Fiscal and regulatory measures, as well as those directed at a specific economic sector or the society as a whole, may all be included in different policies. Investors start making predictions about election outcomes before the elections because changes in legislation brought on by political unrest may have an impact on the company's earnings. Elections themselves are considered to be another element that would increase the level of uncertainty around elections. Because they may alter the balance of political power and have an impact on a country's future economic and political policies, national elections are seen as important political events in democratic societies. Consequently, the environment for investors is unpredictable.

## Scope of Research

The impacts of political instability on investment cycles seem to be particularly important and fascinating for firms operating in Pakistan. Pakistan is now going through much difficulty as a result of several political problems. These political issues in Pakistan have also affected the business climate for companies doing business there, which raises the risks involved in a company's operations. These include a volatile political climate, rivalry between political parties, a fight for power, unfair party operations, mistrust of politicians, a fragile democracy, and repeated military interventions. In order to investigate the impact of political uncertainty on the investment choices made by businesses operating in Pakistan, it would be highly beneficial and exciting to use national elections as our proxy for political uncertainty. As a consequence, we utilize data from companies that operate in Pakistan to assess the performance of our suggested model since we believe that political instability would have a more significant impact on how businesses behave and make investment choices.

Company investment choices are impacted by political unpredictability, which also discourages business investment and impedes economic growth. Prior studies on the link between political ambiguity and investment have supported the partly irreversible investment hypotheses. Developing economies have gotten less attention since political ambiguity and business investment choices have been the subject of many studies in industrialized nations. Because of their unique political settings and economic systems, developing countries are more vulnerable to the consequences than industrialized ones. Prior studies on Pakistan have focused on the relationship between political irrationality and economic growth. But the goal of our research is to look at how political uncertainty

affects business investment behaviour in Pakistan using rational elections as a proxy for political uncertainty.

## RESEARCH METHODOLOGY

### Study Participants and Data Set

The sample for this research consists of businesses rather than banks that are listed on the Pakistan Stock Exchange. Four hundred forty-six of the 559 businesses listed on the Pakistan Stock Exchange are not financial institutions. The initial sample size for the research was 446 non-financial companies listed on the Pakistan Stock Exchange. However, businesses without complete or incomplete data were not considered. Finally, out of 446 non-financial firms, 180 are included in order to study the impact of political instability on investment cycles in Pakistan. Corporate reporting distinguishes between financial and non-financial companies, which is why the former were omitted. From 2000 to 2022, the data set covers three general elections in Pakistan: 2002, 2008, 2013 and 2018.

### The Art of Political Risk Assessment

Researching the correlation between political unpredictability and corporate investment is laden with endogeneity concerns related to economic growth and uncertainty because of the major role that economic decline plays in creating political uncertainty. Finding a proxy for the uncertainty variance should be our first priority in order to avoid endogeneity difficulties. One method that follows the ones suggested and executed by Durnev (2010) and Julio & Yook (2012) is to utilise the dates of national elections as a stand-in for the variation in uncertainty. A dummy variable is required for the purpose of recording the dates of elections. It will have a value of one in election years and a value of zero in other years.

Since the precise hour of elections is often decided by constitutional and governing organisations, we will make up our own fictitious time for elections (Julio & Yook, 2012). We may use the date of elections as a proxy for political uncertainty as it is known to increase in the days leading up to elections (Boutchkova et al., 2012). Furthermore, Baker et al. (2016) found that their measure of economic policy uncertainty increased during U.S. elections, lending credence to the argument that political uncertainty rises during elections.

### Election Data

This study focusses on three national elections that were conducted in Pakistan from 2000 to 2022. The vast majority of the information on national elections comes from a variety of sources. The Polity IV database, maintained by the Centre for International Development and Conflict Management at the University of Maryland, is our primary resource. This database contains annual statistics on all sovereign states with populations exceeding half a million, and it offers information on authority and regime aspects. A second potential source for such information is the Database of Political Institutions maintained by the World Bank. This database contains information on the classification of political platforms, specifics about the electoral rules for elected leaders and candidates, and more. Data that was missing from other databases was often downloaded from the website of the Election Commission of Pakistan (ECP).

**Economic Analysis Tool**

***Investing in National Elections by Corporations.***

Our analysis follows the investment-Q model as the baseline specification, as suggested by Julio & Yook (2012). In contrast to competing investment regression models, it is well-supported both theoretically and empirically. Eberly et al. (2008) discovered that basic investment-Q regression performed poorly when compared to the common empirical model of investment. Investment-Q specification has been used in a number of empirical settings in the past. Financial frictions (Hennessy et al., 2007), business spin-offs and divestitures (Çolak & Whited, 2007), political instability and investment (Julio & Yook, 2012), and internal capital markets are also part of this category.

$$I_{it} = \alpha_i + \beta_1 \text{Election Dummy}_t + \beta_2 Q_{i,\, t-1} + \beta_3 CF_{it} + \beta_4 \text{Growth of GDP} + \varepsilon_{it} \quad (1)$$

Business entities are denoted by i, while time is denoted by t. The model's dependent variable is investment. An election dummy variable is an explanatory variable. To account for variations in company features and expansion opportunities, we use Tobin's Q, cash flow, and GDP growth. B1 is the coefficient on the election dummy that is used to ascertain the dispersion of the conditional investment rates one year before to elections, with consideration given to both company investment opportunities and national economic conditions.

**Investment**

Here, we are keeping tabs on the investment. The definition is the ratio of total assets measured by book value to capital expenditures.

**Election Dummy**

The value of an election dummy, an explanatory variable, is one for the year the election was held. This variable takes the value one for each firm year when the election date is sixty days before fiscal year t's end to two hundred seventy-four days after its completion; otherwise, it takes the value zero.

**Control Variables**

As a percentage of total asset value, Tobin's Q measures how much an asset is worth relative to its book and market values. Divide the entire book value of assets by earnings before interest and taxes (EBIT), then add back in amortisation and depreciation to get the cash flows. Conversely, the annual GDP growth rate is calculated by the World Bank Database using the percentage change in real GDP.

Bernanke (1983) put out the "bad news" concept, which states that waiting becomes more useful when faced with uncertainty. Businesses will likely reduce investments in the face of increasing uncertainty if there is a chance of unfavourable results. Businesses delay investments just before national elections in the hopes that governments would change their macroeconomic, tax, regulatory, or monetary policies. Here is a notion I've come up with based on the data we have:

***Hypothesis 1: Investment expenditure is expected to drop during election years.***

**Role of Country Characteristic and Political Uncertainty in Corporate Investment**

Economic freedom, political freedom, government spending stability, and checks and balances are all part of the country characteristic Xt, which includes the election year dummy Electt.

$I_{it} = \alpha i + \beta 1 Elect_t + \beta 2 Elect_t \times X_t + \beta 3 X_t + \beta 4 Q_{i,\, t-1} + \beta 5 CF_{it} + \beta 6 \text{Growth of GDP} + \varepsilon it$ (2)

**Check and Balances**

The information about checks and balances is sourced from the World Bank's Database of Political Institutions. It annually gathers data on all political systems. This measure, which counts the number of political decision-makers, is based on the current election rules and procedures. Basically, it's a tally of the political players who can block changes to the current policy by using their veto power. The issue of whether a single political party has sway over both houses of Congress and the president is also considered. The separation of powers that occurs when different political parties hold different branches of government is undermined when the same party controls all of them. In a parliamentary system, the prime minister's party and the largest party in any particular coalition both count as one, whereas the number of parties in the house of parliament counts as two. On the other hand, the chief executive or prime minister's party counts as three.

**Political Consistency**

The International Centre for Resource Evaluation (ICRG) is the primary source for government stability statistics. Government stability is rated and published monthly by the ICRG. In this index, a number between zero and twelve is assigned; governments with lower values are considered less stable, while governments with higher values are considered more stable. It is a reflection of the government's ability to maintain power and carry out its declared programs and intentions.

**Funding by the State**

This statistic, which is presented as a proportion of GDP, was obtained from the World Bank database.

Businesses in Pakistan are unlikely to be uniformly impacted by the uncertainty surrounding the approaching elections. The "bad news" approach, proposed by Bernanke (1983), also shows that different businesses and elections have different advantages when it comes to postponing investments. Even within the same country, an election cycle for a firm could change from one election to the next. According to Julio & Yook (2012), investment tends to drop in countries with poorer democratic institutions, higher spending, and fewer checks and balances. Expansive policies are often introduced by newly elected administrations in nations exhibiting these characteristics. Based on the findings of this literature study, three theories have been proposed:

***Second Hypothesis:*** The possibility of policy changes after an election has a more noticeable effect on investment cycles.

**Predictability of Outcome**

To find out whether political uncertainty has different effects in different countries, we examine the elections in Pakistan.

$I_{it} = \alpha + \beta 1 \text{Election}_t + \beta 2 \text{Election}_t \times \text{Close}_t + \beta 3 Q_{i,t-1} + \beta 5 CF_{it} + \beta 5 \text{Growth of GDP} + \varepsilon_{it}$ (3)

A new variable called "close" has been added to this equation; it represents the distance between the votes cast for the winner and the runner-up.

Close

The variable "close," a stand-in for election margin of victory, is accounted for in the World Bank's

database of political institutions. The proportion of the vote that differentiates the top two parties is called the margin of victory. In a binary data set, this variable would be set to 1 if the margin of victory between the two candidates' vote shares is less than the average margin in the first quartile of the sample's elections, and 0 otherwise. The source is Julio & Yook (2012). Based on the findings of Jens (2017), a smaller margin or fewer difference votes indicates greater political risk and uncertainty, whereas larger vote disparities reflect less electoral uncertainty. Only the 2008 and 2002 general elections in Pakistan were seen to have been very close.

According to Julio & Yook (2012), it is impossible to measure the level of uncertainty in election results. The tallies, however, will reveal the election's outcome. They made the assumption that similarity in vote counts is proportional to the level of uncertainty surrounding the election. In elections with a narrow winner's margin of victory, investment cycles are longer than in elections with a wide winner's margin of victory, the data show.

***Hypothesis 3:*** In elections with tight outcomes, investing cycles stand out more.

**Investment Return Rates Following the Vote**

Once the elections are over and the anxiety around them has passed, we will see if companies increase their investment expenditure. The "post-election dummy" variable is our answer to this riddle.

$$I_{it} = \alpha_i + \beta_1 Election_t + \beta_2 Post\text{-}Election_t + \beta_3 Q_{i,\,t-1} + \beta_4 CF_{it} + \beta_5 \text{ Growth of GDP} + \varepsilon_{it} \quad (4)$$

**Post-Election Dummy**

Similar to election, but with the direction of change reversed, is post-election, a dummy variable. For a firm year, it is worth one if the election is held between sixty days after the start of fiscal year t and no earlier than 274 days before the start of fiscal year t; otherwise, it is worth zero. In order for a company's fiscal year to be deemed "post-election," a minimum of 80% of the days must occur after the election date.

In contrast to the decline in investment that occurs just before an election, Julio & Yook (2012) found that the number of elections actually increases after the fact.

The total return on investment after the election is lower than it was in the autumn before the election. Here is the working theory we have:

***Hypothesis 4:*** Businesses are more likely to invest after an election if they perceive a certain result.

**Strength and Durability**

We repeatedly tested the system's resiliency throughout this period. In order to do this, we provide the notion of "sensitive firms," "market friendly," and "lagged investment" as external factors.

Using the criteria suggested by Herron et al. (1999), we begin by segmenting the politically sensitive companies, as their level of interest in election outcomes varies.

$$I_{it} = \alpha_i + \beta_1 Election_t + \beta_2 SI_{it} + \beta_3 Election_t \times SI_{it} + \beta_4 Q_{i,\,t-1} + \beta_5 CF_{it} + \beta_6 \text{ Growth of GDP} + \varepsilon_{it} \quad (5)$$

**Sensitive Firms**

Since different companies place different amounts of importance on election outcomes, we use classification by Herron et al. (1999) to find the politically sensitive ones. Industries that deal with healthcare, tobacco, natural gas, transportation, and telecommunications are among the most politically sensitive (Herron et al., 1999). A sensitive industry dummy is given a value of one if any of the companies in our sample are in one of these categories, and a value of zero otherwise.

Investment cycles are more common among enterprises working in susceptible industries, according to study by Julio & Yook (2012). Consequently, the intensity of investment cycles is proportional to the degree of uncertainty surrounding each election. Thus, it stands to reason that industries most exposed to volatility would be the first to reduce investment expenditure. The empirical literature that I have examined supports the hypothesis that companies operating in politically sensitive areas experience greater levels of election uncertainty.

**Market that Prioritises Customers**

Next, we investigate whether the current government's political agenda influences the impact of election uncertainty on investment by introducing the "market friendly" variable.

The equation Iit may be written as follows:

$$Iit = \alpha i + \beta 1 Electiont + \beta 2 Electiont \times MFit + \beta 3 Qi, t-1 + \beta 5 CFit + \beta 6 \text{ Growth of GDP} \quad (6)$$

**Market that Prioritises Customers**

The present government's political leanings may determine how heated the election atmosphere becomes. We classify the present government's political leanings according to information from the political handbook and the World Bank's database of political institutions. A conservative, Christian democratic, or right-wing government is defined as one that leans to the right by the World Bank. Communist, socialist, left-wing, and social democratic parties are examples of those that lean towards the left. Within a social-liberal framework, centrist parties support the development and growth of private sector businesses. Governments are considered "market friendly" if, in the year before an election, the World Bank labels them as centrist or right-leaning, in agreement with Julio & Yook (2012). If the incumbent-friendly administration wins, companies may take no position, but if the incumbent-unfriendly government loses, they may take a negative attitude.

A few of Pakistan's most well-known political factions are included below in the World Bank's Database on Political Institutions: The political parties in Pakistan range from the moderate Pakistan People's Party (PPP) and the far-left Awami National Party (ANP), to the right-wing Pakistan Tehreek-e-Insaf (PTI) and the Pakistan Muslim League (PML(N)), to the centrist Muttahida Qaumi Movement (MQM), and finally, to the far right, the religious Muttahida Majlis e Amal (MMA), due to the absence of Christian parties in the country.

Investment rates fall sharply when the incumbent government becomes more pro-market, conservative, or moderate during election season, claim Julio & Yook (2012). Our premise is that: Hypothesis 6: Investment cutbacks are worse when the present government is pro-market.

In light of the fact that Eberly et al. (2008) found a correlation between delayed investment and current investments in many data sets, we thirdly adjust the right-hand side of the equation to include this variable.

$$Iit = \alpha i + \beta 1 Electiont + \beta 2 Ii, t-1 + \beta 3 Qi, t-1 + \beta 5 CFit + \beta 6 \text{ Growth of GDP} \quad (7)$$

**Corporate Investment and Economic Freedom**

The following regression model is used in this section.

$$Iit = \alpha + \beta 1 EFt + \beta 2 Qi,t-1 + \beta 3 CFit + \beta 4 \text{ Growth of GDP} + \varepsilon t \quad (8)$$

To determine the effect of economic freedom on investment, we include it as a variable in our investment model in this equation.

**Achieving Financial Freedom**

The economic freedom index developed by the Frasier Institute is used in this study. Annually, a large number of countries are included in a research that evaluates economic freedom worldwide. Information about EF has been available since 1972. The economic freedom index assesses nations using 24 major criteria and 42 sub-categories. Size of government, legal system and property rights, solid currency, freedom of international commerce, and regulations are the five primary parts that make up the index. Each sub-component is given a score between 0 and 10, with 0 indicating the least level of economic freedom and 10 the highest.

**Political Liberty and Corporate Funding**

The section makes use of the following regression model.

$$Iit = \alpha + \beta 1 PFt + \beta 2 Qi,t-1 + \beta 3 CFit + \beta 4 \text{Growth of GDP} + \varepsilon t \quad (9)$$

To determine the effect of adding a variable for political freedom to our investment model, we plug it into this equation.

**Freedom in Politics**

For the political freedom variable, we go to the Freedom House's yearly Freedom in the World report. The present study evaluates the current state of political and civil rights throughout the world. It ranks about 195 countries and 14 territories and includes descriptive and extra textual information for each. This report, first published in 1973, tracks the developments in worldwide freedom over the previous 40 years. Academics, activists, politicians, and journalists from every corner of the world read and cite this paper often.

It is possible to construct a measure of political freedom by including civil liberties and political rights as independent variables. The political rights variable is ranked on a scale ranging from 1 to 7. Degrees of freedom range from one (the most) to seven (the least). Three subcategories—electoral process, political pluralism, and public participation and government efficiency—are used to examine each country's level of political freedom. Based on the following subcategories, civil liberties are graded from 1 (the greatest) to 7 (the worst): freedom of religion and expression, rule of law, rights of organisations and organisations, and individual and personal autonomy. To make the political freedom ratings in our study more comprehensible, we have reorganised them so that 1 is the lowest and 7 is the highest.

**The Hypothesis of the Political-Business Cycle**

We look at a number of ways elections may affect the economy here. We use a method suggested by Alesina & Roubini (1992) to validate the idea of the political economic cycle. We adhere to the following standard.

$Yt = \alpha + \beta1Yt-1 + \beta2Yt-2 + \beta3\text{Growth of GDP} + \beta4\text{Elect} + \varepsilon t$ (10)

Yt is the variable representing the macroeconomic policy. Yt−2 denotes a lag of two years, whereas Yt−1 denotes a lag of one year.

Inflation rates, real interest rates, increase in government spending, and M1 are the four separate macroeconomic policy variables that we use.

Incumbents try to influence monetary and fiscal policies to increase economic activity before elections, in the hope of being re-elected, according to model of political business theory (Nordhaus, 1975). Additionally, compared to privately-owned banks, government-owned banks in India have a quicker rise in lending in the run-up to elections (Cole, 2009). We note that the political business cycle model indicates that investments would rise during election times, despite the common belief that political instability hurts investment. As a consequence of PBC, corporate investments should be less impacted by uncertainty. Even if the current president is running on a platform of economic stimulus, private investment might be dampened by his campaign promises.

The days before elections usually see an uptick in economic activity, which is in line with H7.

**Investment Rates and Cash Holdings**

Now we'll talk about the company's cash on hand throughout the time of political unrest. The following equations provide light on the popular decision to spend in election-related projects. To get this estimate, we apply the 3sls full information maximum likelihood estimation.

Gulen & Ion (2012) found that cash on hand was positively and statistically linked with policy uncertainty at both the industry and business levels. On the other hand, Julio & Yook (2012) discovered that cash on hand grew after taking firm-specific characteristics and macroeconomic variables into consideration. Consistent with the substantial increase in cash on hand, investments saw a steep decline throughout the campaign season. Keeping cash on hand with the firm is advised during this uncertain period, since it might be used for

$Iit = \beta0 + \beta1\text{Election Dummy}t + \beta2Qi,t-1 + \beta3CFi,t-1 + \beta4\text{ Growth of GDP} + \varepsilon it$ (11)

$Cashit = \beta0 + \beta1\text{Election Dummy}t + \beta2Qit-1 + \beta3CFi,t-1 + \beta4Sizei,t-1 + \beta5LEVi,t-1 + \beta6\ Iit + \beta7\sigma(CF)it + \beta8\ DIVit + \varepsilon it$ (12)

companies are holding onto their investments till the political turmoil subsides. My working theory is based on the following literature:

H8: a rise in cash on hand in the year before an election.

## RESULTS AND DISCUSSION

### Statistical Descriptions

The study's univariate analysis for several components is shown in Table 1. Panel A of Table 1 reviews the election statistics. The first row displays the election program of the present government. To categorise the present administration's political leanings, we use a number of sources, such as yearbooks and political manuals derived from the World Bank's register of political institutions. A conservative, Christian democratic, or right-wing government is defined as one that leans to the right by the World Bank. Communist, socialist, left-wing, and social democratic parties are examples of those that lean towards the left. Within a social-liberal framework, centrist parties support the development and growth of private sector businesses. Parties that lean to the middle or right are referred to as "market friendly" by us. Our data reveals that in the years leading up to an election, only 29.41% of the current government is seen as being favourable to the market, while the remaining 70.58% lean more to the left. Adding to the mystique of the election, we display the number of votes that separated the victor and the runner-up. The winning candidate typically obtains 58.7 percent of the vote, with the runner-up receiving 41.29%. On average, there are 2.411765 checks and balances in a sample, according to the statistics, and the standard deviation is 1.497647.

The companies that were part of our sample are shown in Panel B of Table 1, which contains the summary statistics. The variables, their measurements, and the data sources are all thoroughly described in the appendix. The investment rate data shows a mean of 0.056 and a standard deviation of 0.076, with a range of values from 0.00014 to 0.744. On the other hand, Tobin Q ranges from 0.353 at its lowest point to 1.280 at its maximum point, with a standard deviation of 0.121. about 4,930. Finally, cash flow may be anywhere from -0.250 to 0.437, with 0.077 being the average and 0.121 being the standard deviation. Notably, our study only covers publicly listed non-financial firms in Pakistan, thus we cannot draw any conclusions regarding private enterprises in the country. If you look at panel C of table 1, you can see the average investment rates right around election time. The data demonstrates that the average investment rate was.0539 when comparing total assets to capital expenditures before the election. In the election year, the rate drops to 0.0478%. Across all firms in our sample, the unconditional mean investment rates were 11.3% lower than they were in non-election years. We also provide the test for differences in investing strategies between election and non-election times. A simple t test reveals that investment drops significantly in the months before the national election in a univariate situation.

Panel D provides an in-depth examination of the impacts on company investment rates before to and after the election year's conclusion. A value of 0 indicates the election year, whereas -1 and -2 denote the first and second years prior to the election period, respectively. There has been a noticeable downward trend in investment over the last two years, with a 13.09% dip just before election season. Investment likewise increases in the years after the election, going up from.0478 to 0.0544. Then, after accounting for business and economic variables, we examine the post-investment rate in more detail. However, there is little support from the univariate analysis for the hypothesis that companies are less likely to invest when elections are uncertain.

*Table 1: Descriptive statistics*

| | Mean | Median | Stv.Dev |
|---|---|---|---|
| **Panel A: Election Characteristics** | | | |
| Political Platform of Government | | | |
| Market-Friendly (%)<br>Left leaning (%) | 29.41 70.58 | | |
| Percent of Votes | | | |
| Winner Runner-up (%) | 58.7 41.29 | | |
| Checks and Balances | 2.411 | | 1.497 |
| ICRG Government Stability | 7.581 | | 1.839 |
| Government Spending/GDP | 16.247 | | 1.264 |

| **Panel B: Firm Characteristics** | | | | | |
|---|---|---|---|---|---|
| | N | Mean | Std. Dev. | Min | Max |
| Investment Rate (It/At−1) | 3060 | 0.056 | 0.076 | 0.00014 | 0.744 |
| Q | 3060 | 1.280 | 0.736 | 0.353 | 4.930 |
| Cash Flow | 3060 | 0.077 | 0.121 | -0.250 | 0.437 |

| **Panel C: Mean Investment Rates in Election Years vs. Nonelection Years** | | | | | |
|---|---|---|---|---|---|
| | N | Mean | Std. Dev. | Min | Max |
| Election Years | 540 | .0478 | .048 | .0003 | .304 |
| Nonelection Years | 2520 | .0539 | .064 | .0003 | .395 |
| Difference | | -0.006 | | | |
| Diff (t-stat) | | -2.801 | | | |

| **Panel D: Mean Investment Rates around Election Years** | | | | | |
|---|---|---|---|---|---|
| Year | -2 | -1 | 0 | 1 | 2 |
| Investment Rate | 0.055 | 0.053 | .047 | 0.050 | 0.054 |

Our next move will be to analyse the impact of political uncertainty on corporate investment choices using a multivariate methodology. Factors such as economic conditions and company traits are taken into consideration. To evaluate the impact on company investment during the election period that is not explicable by the typical explanatory variables, we use a modified version of the traditional investment-Q specification.

**Investment Regression**

Table 2 displays the outcomes of the baseline regression. The results of the regression analysis using just the election dummy and investment variables are shown in the first column. Column 2 includes the dummy variables for investments and elections. Column 3 includes the control variable Tobin q in addition to the investment and election dummy variables. In columns 4 and 5, the regression equation also includes other control variables, such cash flows and GDP growth. With the exception of capital flows, all control variables, including Tobin Q and GDP growth, show a positive correlation

with investment across all specifications. Businesses with a higher Tobin Q are more likely to be active investors. We find that the election dummy negatively affects investment, and the results are statistically significant, which is in line with our assumption that investment reduces during election season due to political uncertainty. The lower investment rates could range from 0.00503 to 0.00608, depending on the different criteria. Investment rates decline by an average of 0.00608 after taking company characteristics and economic conditions into consideration, as seen in column 5 of table 2.

*Table 2: Investment regression*

| | | | | | |
|---|---|---|---|---|---|
| Election Dummy | -0.00530** (0.00206) | -0.00503** (0.00205) | -0.00542*** (0.00208) | -0.00538** (0.00208) | -0.00608*** (0.00207) |
| Q | | | 0.00565** (0.00271) | 0.00580** (0.00273) | 0.00579** (0.00264) |
| $CF_{it}$ | | | | -0.00551 (0.0106) | -0.00879 (0.0107) |
| $GDP_{t-1}$ | | | | | 0.00129*** (0.00048) |
| Constant | 0.0534*** (0.00282) | 0.0538*** (0.00036) | 0.0466*** (0.00342) | 0.0468*** (0.00344) | 0.0323*** (0.00624) |
| Obs | 3060 | 3060 | 3060 | 3060 | 3060 |
| R2 | 0.0546 | 0.00144 | 0.00467 | 0.0048 | 0.0107 |
| F-Stats | | 6.03 | 4.997 | 3.475 | 6.286 |
| F-Stats(P-value) | | 0.015 | 0.0077 | 0.0173 | 0.0004 |
| Firm Fixed Effects | No | Yes | Yes | Yes | Yes |

At the10, 5, and 1 percent levels, it shows statistical significance. Bracketed and organised by company, the standard mistakes are shown below.

According to the survey, businesses cut down on investment and hold off on making any major moves until the national elections, when there is less uncertainty. In keeping with previous studies, the results of our baseline regression are in line with earlier work (Jens, 2017; Bernanke, 1983; Leahy & Whited, 1995; Rodrik, 1991; Vervoort, 2017; Julio & Yook, 2012).

**Company Investments Are Influenced by Political Uncertainty and Country Features**

After showing that investment always declines in the year leading up to an election, we extend our technique to detect changes in uncertainty level using many data sets from Pakistan, taking it a step further.

Table 3 displays the results of the regression analysis according to the characteristics of the nations. Features of a nation and the ways in which those features interact with the election dummy are now a part of it. The degree of uncertainty that investors face in the year before an election is defined by the interaction term. The results for the term "checks" may be found in Column 1.

Since this coefficient is negative and insignificant, it follows that the number of veto players does not significantly affect the results of elections. The results presented here are consistent with those of Vervoort (2017). Looking at column 2, we can see that there is a negative and statistically significant

interaction term between the election dummy and Gov. Stability. This suggests that when the government is less stable, corporate investment declines more.

*Table 3: Country characteristics and political uncertainty in corporate investments*

| | Checks and Balances | Gov. Stability | Gov. Spending | Economic Freedom | Political Freedom |
|---|---|---|---|---|---|
| Election Dummy | -0.00818* (0.00452) | -0.0364** (0.0153) | -0.0803 (0.0769) | -0.253* (0.131) | -0.0488** (0.0217) |
| Country Characteristic * Election Dummy | -0.0000841 (0.00149) | -0.00622*** (0.00212) | 0.00255*** (0.000779) | 0.00439* (0.00236) | -0.0356*** (0.00560) |
| Country Characteristic | -0.00624*** (0.00117) | 0.00203 (0.00138) | 0.000803 (0.000870) | 0.00398*** (0.00129) | 0.0174* (0.0104) |
| Q | 0.00571** (0.00254 | 0.00658** (0.00271) | 0.0105*** (0.00309) | 0.0102*** (0.00308) | 0.00587** (0.00266) |
| Cfit | -0.00328 (0.0103) | -0.00975 (0.00977) | -0.000454 (0.0103) | -0.00325 (0.0104) | -0.00871 (0.0108) |
| Gdpt–1 | 0.00364*** (0.000880) | 0.00302*** (0.001) | 0.00176*** (0.000537) | 0.00112** (0.000518) | 0.00116** (0.000503) |
| Constant | 0.0751*** (0.00845) | 0.0266*** (0.0101) | 0.204*** (0.0716) | -0.192*** (0.0718) | 0.0344*** (0.00646) |
| Obs | 3060 | 3060 | 3060 | 3060 | 3060 |
| R2 | 0.0256 | 0.0303 | 0.0309 | 0.0306 | 0.0120 |
| F-Stats | 8.936 | 8.936 | 7.975 | 8.46 | 6.228 |
| F-Stats(P-value) | 0.0000 | 0.0000 | 0.0000 | 0.0000 | 0.0000 |
| Firm Fixed Effects | Yes | Yes | Yes | Yes | Yes |

At the10, 5, and 1 percent levels, it shows statistical significance. Bracketed and organised by company, the standard mistakes are shown below.

In the third column, we can see the government spending to GDP ratio and how it relates to the election dummy. Government spending on campaigns does not cause a sharp decline in investment by businesses since there is a positive and statistically significant interaction term and a negative but insignificant election dummy coefficient.

The results shown in the fourth column indicate economic freedom. As we can see from the interaction between economic freedom and the election dummy, there is a noticeable and positive coefficient. In contrast, a big and statistically negative election dummy coefficient suggests a robust investment cycle. What this means is that the amount of slobs in a country's voting booth is proportional to its degree of economic freedom. The results presented here are consistent with those of Vervoort (2017).

The findings of the examination of the correlation between political freedom and election dummies will be shown in the final column. The interaction between political freedom and the election dummy shows a negative coefficient that is statistically significant. The election dummy's substantially

negative coefficient, on the other hand, shows that investment drops during national election seasons, when political freedom is limited.

**Predictability of Outcome**

In order to determine whether the impact of uncertainty differs, we examine the Pakistani elections. Since less political uncertainty would result from knowing the results in advance, investments shouldn't take a significant hit during election season. If the election outcome is unexpected and difficult to forecast, on the other hand, we expect investment rates to be significantly affected.

*Table 4: Predictability of outcome*

| | Full Sample | Close Election | Post-Election |
|---|---|---|---|
| Election Dummy | -0.00608*** (0.00207) | -0.00377 (0.00393) | -0.00577** (0.00223) |
| Election Dummy * Close Election | | -0.0163*** (0.00455) | |
| Post-Election Dummy | | | 0.00173 (0.00309) |
| Q | 0.00579** (0.00264) | 0.00509 (0.00268) | 0.00594 (0.00269) |
| CFit | -0.00932 (0.0108) | -0.0074 (0.0107) | -0.00879 (0.0107) |
| GDPt−1 | (0.00048) 0.0323 | 0.00119** (0.00048) | 0.00139 (0.00052) |
| Constant | 0.0324 (0.00622) | 0.0350*** (0.00633) | 0.0315 (0.0066) |
| Obs | 3060 | 3060 | 3060 |
| R2 | 0.0107 | 0.0153 | 0.011 |
| F-Stats | 6.286 | 9.392 | 4.08 |
| F-Stats(P- value) | 0.0006 | 0.0000 | 0.0000 |
| Firm Fixed Effects | Yes | Yes | Yes |

At the10, 5, and 1 percent levels, it shows statistical significance. Bracketed and organised by company, the standard mistakes are shown below.

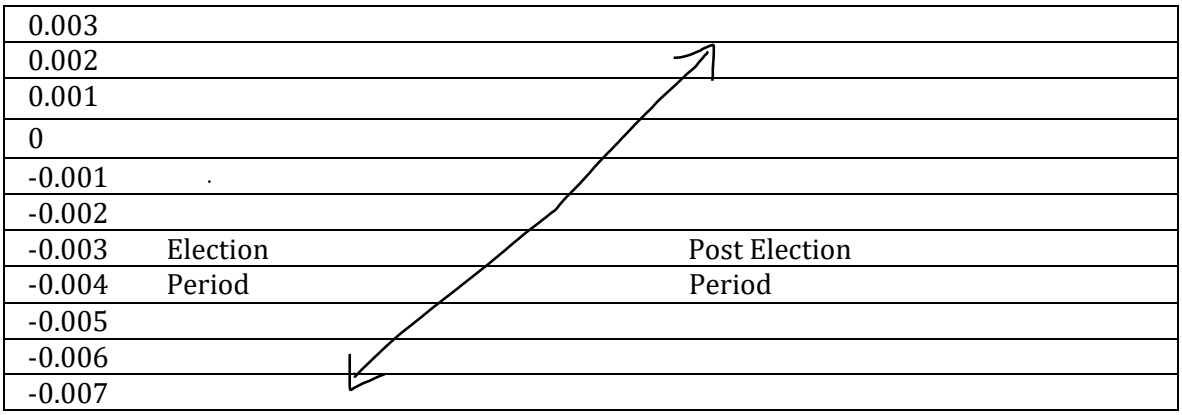
The first column of Table 4 shows the results of our whole-dataset regression analysis, while the second column shows the results of our close-call election interaction. A negative interaction term is seen, and it is statistically significant. Based on Table 4, it is clear that the election dummy's full-sample coefficient is lower than the interaction coefficient with the close election. The data back up our premise that investment cycles are more noticeable during close elections.

**Profits from Investments After the Final Count**

Up until recently, our focus has been on the subject of whether or whether businesses reduce investments leading up to an election. After the political anxiety around the election has subsided, the question of whether corporations would increase investment becomes more logical. We included a post dummy variable to our regression model to help us reach this objective.

The results of the regression analysis with the post dummy variable are shown in Table 4. Despite being positive, the post-election dummy coefficient does not have statistical significance, according to the data. This suggests that investment levels go up after an election, but not quite as much as they go down in the year leading up to the vote. Based on the data, we may conclude that corporations will increase investments once the uncertainty around the election is resolved. Investment rises after elections with a lesser effect than declines before, which is consistent with our results and those of Julio and Yook (2012). However, the overall decline in investment before to the election was far higher than the increase subsequent to the election.

*Figure 1: Change in investment rates in the election and post-election period*




Using projections from table 4, Figure 1 depicts the investment cyclical effect of election uncertainty; the solid blue line indicates the shifts in investment around the elections. The decline in investment before to elections is far more pronounced than the rise in investment after the election.

**Additional Tests and Robustness**

We perform several robustness checks in this section.

Table 5 includes further test results and measures for robustness. Column 1 displays the outcomes after we include an interaction term for sensitive industries and an election dummy. It is clear from the positive but little coefficient that sensitive sector firms are unaffected by election-related uncertainty during election years. Consequently, the findings contradict the idea that susceptible enterprises are more prone to uncertainty due to elections.

Table 5, column 2, displays the results of the current ideology. The interaction term between the election dummy and the ideology of the incumbent shows a negative coefficient that is statistically significant. Based on the interaction term, our results support the concept that election cycles are more pronounced when a market-friendly administration is in office.

Column 3 displays the results, and the right side of the equation incorporates the lag independent variable. In a number of datasets, Eberly et al. (2008) found a correlation between current investments and lagging investments. In this research, we demonstrated that capital expenditure autocorrelation could have had a role in the election cycle. Our results are not diminished when lag investment rates are included.

*Table 5: Additional test and robustness*

| | Sensitive industries | Market friendly | Lagged investment |
|---|---|---|---|
| Election Dummy | -0.00813*** (0.00224) | -0.000177 (0.00311) | -0.00694*** (0.00238) |
| Sensitive Industry | 0.000716 (0.00645) | | |
| Election Dummy * Sensitive Industry | 0.00712 (0.00574) | | |
| Election Dummy * Market Friendly | | -0.0146*** (0.00395) | |
| Lagged Investment | | | 0.240*** (0.0285) |
| Q | 0.00768*** (0.00285) | 0.00627** (0.00266) | 0.00532** (0.00238) |
| CFit | 0.00545 (0.0107) | -0.0102 (0.0108) | 0.0101 (0.0113) |
| GDPt−1 | 0.00125 (0.00047) | 0.00434*** (0.000923) | 0.000824* (0.000429) |
| Constant | 0.0300 (0.00611) | 0.0381 (0.00386) | 0.0238 (0.00566) |
| Obs | 3060 | 3060 | 3060 |
| R2 | 0.0744 | 0.0316 | 0.106 |
| F-Stats | 4.02 | 9.092 | 15.96 |
| F-Stats(P- value) | 0.0018 | 0.0000 | 0.0000 |
| Firm Fixed Effects | Yes | Yes | Yes |

At the10, 5, and 1 percent levels, it shows statistical significance. Bracketed and organised by company, the standard mistakes are shown below.

**Corporate Investment and Economic Freedom**

Additional robustness results are also included in Table 6. Column 1 displays the results of the regression model with an overall index variable included. Government size, legal systems, sound money, international trade freedom, and regulation are the five areas that make up the economic freedom index, sometimes known as the summary index. Each category is given a mean value. The economic freedom score has a positive and statistically significant correlation with investment. Every other area, with the exception of sound money, has a positive and statistically significant link with investment. Results are in line with previous studies (Chen et al., 2015; Feldmann, 2017; Zghidi et al., 2016).

There is a negative coefficient of sound money with investment because sound money is comprised of four components: money growth, inflation standard deviation, inflation of the most recent year, and freedom to keep a foreign currency account. There has been no change to Pakistan's foreign currency account over the years that we have examined. Schneider and Frey (1985) and Kormendi & Meguire (1985) contend that investment and inflation are inversely related.

In this situation, we opted for summary ratings rather than area ratings due to the interconnected nature of economic freedom, which is likely to impact the collective consequences of business investment.

*Table 6: Corporate investment and economic freedom*

| | **Overall index** | **Size of government** | **Legal systems** | **Sound money** | **Freedom to trade internationally** | **Regulation** |
|---|---|---|---|---|---|---|
| Election Dummy | -0.00889 (0.00254) | -0.00539 (0.00201) | -0.00594 (0.00205) | -0.00461 (0.00208) | -0.0134 (0.00263) | -0.00807 (0.00223) |
| Overall Index | 0.0370 (0.00999) | | | | | |
| Size Of Government | | 0.00651 (0.00387) | | | | |
| Legal Systems | | | 0.0394 (0.00775) | | | |
| Sound Money | | | | -0.0130** (0.00595) | | |
| Freedom To Trade Internationally | | | | | 0.0162*** (0.00408) | |
| Regulation | | | | | | 0.0380 (0.00886) |
| Q | 0.0129 (0.0031) | 0.0106 (0.00298) | 0.0120 (0.0030) | 0.0121 (0.00322 | 0.0122 (0.00313) | 0.0123 (0.00309) |
| CFit | 0.00689 (0.0108) | -0.00981 (0.0107) | 0.00505 (0.0103) | -0.00467 (0.0103) | -0.00688 (0.0104) | -0.00749 (0.0104) |
| GDPt−1 | 0.00245 (0.0006) | 0.00509 (0.00104 | 0.00216 (0.000573) | 0.00132 (0.000515) | 0.00217 (0.000561) | 0.00153 (0.000514) |
| Constant | -0.180 (0.0618) | 0.0223 (0.0328) | -0.124 (0.0322) | 0.103 (0.0373) | -0.0840 (0.0282) | -0.221 (0.0579) |
| Obs | 3060 | 3060 | 3060 | 3060 | 3060 | 3060 |
| R2 | 0.028 | 0.0345 | 0.0402 | 0.021 | 0.0265 | 0.0315 |
| F-Stats | 13.08 | 4.865 | 6.749 | 6.771 | 9.115 | 7.383 |
| F-Stats(P-value) | 0.0000 | 0.0007 | 0.0000 | 0.0000 | 0.0000 | Firm Fixed Effects |
| Firm Fixed Effects | Yes | Yes | Yes | Yes | Yes | Yes |

At the10, 5 and 1 percent levels, it shows statistical significance. Bracketed and organised by company, the standard mistakes are shown below.

**Corporate Investment and Political Freedom**

The results of the additional robustness tests are also shown in Table 7. Column 1 displays the results of include the political freedom variable in the regression model. The concept of political freedom is the sum of all other liberties and civil rights. When looking at the economic freedom index, a negative link with investment is statistically significant. The statistically substantial negative correlation between investment and the other two groups shows that investment has dropped since political freedom is low. The findings were consistent with those of Bhatti et al. (2008) and Feng (2001).

Remember that the level of political freedom in a nation is indicative of the level of civil and political rights enjoyed by its inhabitants. Its essential nature is an integral part of the democratic process that is associated with private sector investments. Political freedom contributes to civil liberties and political rights, which in turn inspire confidence in the private sector among investors. When a country's economy lacks political independence, however, private investment tends to dwindle.

*Table 7: corporate investment and political freedom*

| | Political Freedom | Freedom Rights | Civil Rights | PF* EF |
|---|---|---|---|---|
| Election Dummy | -0.0130*** (0.00234) | -0.0133 (0.00233) | -0.00603 (0.00208) | -0.0182 (0.00440) |
| Political Freedom | -0.0345 (0.00546) | | | 0.0816 (0.0276) |
| Political Rights | | -0.0179*** (0.00315) | | |
| Civil Rights | | | -0.0142*** (0.00407) | |
| Economic Freedom | | | | 0.0778*** (0.0182) |
| Political Freedom*Economic Freedom | | | | -0.0166*** (0.00485) |
| Q | 0.00765*** (0.00266) | 0.00765*** (0.00266) | 0.00758*** (0.0027) | 0.00961*** (0.00281) |
| CFit | -0.012 (0.0109) | -0.012 (0.0109) | -0.00727 (0.00974) | -0.00836 (0.0106) |
| GDPt−1 | 0.00301*** (0.0009) | 0.00301*** (0.0009) | 0.00121** (0.00051) | 0.00289*** (0.0009) |
| Constant | 0.0576*** (0.00895) | 0.0486*** (0.00575) | 0.0646*** (0.00936) | -0.401*** (0.108) |
| Obs | 3060 | 3060 | 3060 | 3060 |
| R2 | 0.0306 | 0.0306 | 0.0139 | 0.049 |
| F-Stats | 6.761 | 6.761 | 8.421 | 6.556 |
| F-Stats(P- value) | 0.0000 | 0.0000 | 0.0000 | 0.0000 |
| Firms Fixed Effects | Yes | Yes | Yes | Yes |

At the10, 5 and 1 percent levels, it shows statistical significance. The bracketed standard errors are the clusters of firms.

The fact that true democracy has never flourished in Pakistan is another explanation put forward by Bhatti et al. (2008) about the negative coefficient of political freedom. There is a lengthy history of military dictatorships overthrowing democratic administrations in Pakistan. He immediately appoints someone incapable of making difficult decisions to the position of prime minister upon his departure. Investors in fixed capital consistently put off investing in his ideas because they lose trust in them.

Economic freedom, political freedom, and the interaction between the two are all factors included in the final column. This research found a favourable and statistically significant relationship between

investment and economic and political freedom. Interactions between economic and political freedom, however, might have unexpected consequences. Even in economies where political freedom is nonexistent, it is shown that investment is inversely linked to economic freedom. Because of this, it is clear that political and economic freedom are necessary for businesses to feel comfortable investing. "No doubt relationships between political freedom and economic freedom are complex," remarks Friedman (1962, p. 10). However, he points out that "facts proved that economic freedom facilitates political freedom but political once established, has a tendency to destroy the economic freedom."

**Political Business Cycle Regression**

*Table 8: Political business cycle regression*

| | **Gov spending** | **M2** | **Real interest rates** | **Inflation** |
|---|---|---|---|---|
| Election dummy | 1.081*** (0.00287) | -3.003*** (0.00319) | 2.855*** (0.0130) | -1.775*** (0.00249) |
| Yt-1 | 0.359*** (0.000312) | 0.0848*** (0.0000541) | 0.118*** (0.000480) | 0.476*** (0.0000990) |
| Yt-2 | 0.189*** (0.0000106) | -0.175*** (0.0000395) | 0.526*** (0.000837) | 0.110*** (0.0000976) |
| GDPt−1 | -0.0707*** (0.000255) | 0.620*** (0.000270) | -0.102*** (0.00119) | -0.113*** (0.000120) |
| Constant | 40.41*** (0.0291) | 11.79*** (0.00346) | 0.732*** (0.00179) | 5.127*** (0.00189) |
| Obs | 3060 | 3060 | 3060 | 3060 |
| R2 | 0.211 | 0.053 | 0.213 | 0.392 |
| F-Stats | 145563.7 | 37533.1 | 19047.7 | 544221.5 |
| F-Stats(P- value) | 0.0000 | 0.0000 | 0.0000 | 0.0000 |

At the 1%, 5%, and 10% levels shows statistical significance. Bracketed and organised by company, the standard mistakes are shown below.

You can see the results of political business cycles in the tableau. We infer that government spending and real interest rate were modified before the election as we identified statistically significant positive impacts for both variables. According to Cole (2009), lending rose higher at government-owned banks than at privately-owned banks in the months leading up to the 2009 Indian elections. Since these economic indicators tend to rise and fall around election times, it's reasonable to assume that political incumbents' opportunistic behaviour is to blame for the annual cycle in corporate investment.

During the three months before an election, the government of Pakistan is not allowed to launch any new projects or initiatives. Spending increases on authorised programs start in the weeks leading up to the national election, although approval is often granted three months in advance. The government spending coefficient on the election dummy has a statistically significant negative result, and this explains why.

M2 and inflation both had very unfavourable results. When it comes to inflation, Sieg & Batool (2012) reached similar findings; they found that inflation was lower during election year and higher when the newly formed government was put into place.

**Rates of Investments and Available Funds**

As a last step in our evaluation, we will examine the corporations' cash holding behaviours before the elections and how they alter. There are a number of reasons why companies maintain a cash reserve. Opler et al. (2019) shown that holding cash in U.S. firms is a substantial preventative measure. Now we'll talk about the company's cash on hand throughout the time of political unrest.

*Table 9: Investment rates and cash holdings*

| LHS Variable | Election Dummy | Q | Cash Flow | GDP Growth | Size | Leverage | Investment | CF volatility | Dividend |
|---|---|---|---|---|---|---|---|---|---|
| Investment | -0.00747 (0.00368) | 0.0163 (0.00226) | 0.0559(0.0135) | 0.0093 (0.00053) | | | | | |
| Cash Holdings | 0.00612* (0.00354) | 0.00771 (0.00224) | 0.0818*** (0.0138) | 0.00173*** (0.00052) | 0.0106*** (0.00104) | -0.0484*** (0.00672) | -0.0933*** (0.0241) | -0.0362 (0.025) | -0.00337 (0.0034) |
| H0:βinv_elec + βcash_elec =0 chi2(1) P-value | 4.22 0.0400 | | | | | | | | |

At the10, 5, and 1 percent levels, it shows statistical significance. The bracketed reports display common errors categorised by firm.

Table 9 shows the results of the estimations obtained from the system of equations. The outcomes of investment regressions are similar, which is in line with what the single regression equation found. However, the regression of cash on hand yields some interesting conclusions. Cash on hand increases in value by 0.00612 in the pre-election year. In fact, the data show that this disparity is statistically significant. Companies reduce spending and increase savings in the year leading up to an election, according to the data. This allows their cash reserves to develop until the political uncertainty fades.

Companies' increased cash buffers more than offset their reduced investment rates, according to the statistics. There is a 0.00747 decrease in investment rates and a 0.00612 increase in cash holdings during the election year. From what we can see in table 9, businesses reduce their investment spending and hold onto their cash until the election is over and the political uncertainty fades.

Our results are consistent with those of Gulen & Ion (2016), who similarly found a positive and statistically significant association between company cash on hand and policy uncertainty at the industry and business levels. In spite of taking into consideration firm traits and economic conditions, Julio & Yook (2012) found that cash flow grew. They argue that companies should temporarily hold

onto cash instead of investing it while political uncertainty is high. They could keep their money if they used this tactic.

Our cash regression results are also in line with the cautious influence that real option theory predicts. According to this notion, businesses should save more cash on hand and postpone making any choices until the ambiguity surrounding political instability is resolved.

## CONCLUSION AND POLICY RECOMMENDATION

### Conclusion

This study investigates the impact of political uncertainty produced by national elections on corporate investments in Pakistan using the investment-Q model as a baseline specification and firm fixed effects. This sample is based on the performance of 180 non-financial firms that were listed on the Pakistan Stock Exchange from 2000 to 2022. Specifically, our study looked at the 2002, 2008, 2013 and 2018 general elections in Pakistan. Our real option theory, the political business cycle hypothesis put out by Nordhaus (1975), Bernanke (1983) notion of irreversibility, and our own theory were all tested. We found that corporate investment tends to fall the year before a national election. Investments in Pakistani businesses declined by 11.3% during election years compared to years without elections, as shown by univariate study. Businesses would be more careful and delay investment in the days leading up to and after national elections, according to Bernanke (1983), because of the inherent uncertainty in these times. This idea is supported by our findings. We learnt about manipulation and the political business cycle theory before the national election. Using a three-stage least-squares full-estimate maximum likelihood estimation, we ran an investment and cash equation simultaneously to validate real option theory's validity. Investment and cash regression outcomes are consistent with the cautious influence predicted by real option theory. According to this school of thought, businesses should save more cash and wait for political unpredictability to subside before making investments.

We also considered how different aspects of the country's character impacted the election's impact. We used measures of political and economic freedom, government stability, government spending as a proportion of GDP, and checks and balances to compile this profile of Pakistan. Investment, economic freedom, and governmental stability all plummeted as the election season rolled around. Regardless of the ratio of government spending, the investment system of checks and balances remains unaltered throughout election season.

When we do thorough evaluations, we also discover that the impact of electoral uncertainty differs among elections. In close elections, we found an investment cycle that was more apparent. We re-evaluate investment rates after the election season ends and any uncertainty surrounding the election have been resolved. According to the data, firms in Pakistan increase their investment rates after the national elections, but at a slower pace than in the years leading up to the elections. In line with predictions, this analysis showed that sensitive enterprises' investments changed around national elections, and that market-friendly and laggard investments also had negative significant consequences. However, sensitive industries did not provide statistically significant outcomes for Pakistan. One last thing we looked at was how investment relates to political and economic freedom. The results showed that political freedom in Pakistan discouraged investment, which is in agreement with previous studies by Feng (2001) and Bhatti et al. (2008). Investment, on the other hand, is aided by economic liberty. We aimed to explore the interplay between political and economic freedom and its impact on investment, and our results are rather fascinating. When economic freedom is present but political freedom is not, we find that investment is negatively correlated.

Our data support two important issues. To start, company investment decisions are significantly impacted by political factors. Investment decisions made by businesses are affected by changes in

policy and the normal course of politics. Second, fluctuations in the level of political uncertainty, a crucial component in the dynamics of company investment, lead investment expenditure to go through cycles (Bernanke, 1983; Julio & Yook, 2012). Additionally, it would be helpful for future research to look at developing countries other than Pakistan to see how political instability impacts corporate investments.

**Policy Recommendations:**

Numerous policy implications stem from the study's findings. First, a politically stable atmosphere is necessary for the stabilisation and growth of corporate investments; otherwise, businesses would be hesitant to engage in projects during periods of uncertain policies. This can only be accomplished by maintaining a strong political system and a steady political atmosphere. Secondly, if we are looking for reliable investments over the long run, we need to ditch the short-term tactics that don't have any visible results.

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