FACTORS AFFECTING PERCEIVED ECONOMIC GROWTH OF KHYBER PAKHTUNKHWA-PAKISTAN: A COMPARATIVE STUDY OF FORMAL AND INFORMAL USERS

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Abstract

This comparative study finds the impact of perceived political, cultural, religious and economic factors on the perceived economic growth of Khyber Pakhtunkhwa, in the users of formal and informal financial systems. A questionnaire was sent to 500 respondents selected as sample for the target population. Out of 500, 369 responded to the questionnaire. After scrutiny, 309 were found valid. The outcome of the study suggested a very strong strategic role of formal and informal financial institutions in economic growth of the province . In this study, users of formal system showed a significant impact of perceived political stability, perceived cultural stability , perceived religious stability and perceived economic growth on the economic growth of the province. In informal financial system users, perceived economic stability, perceived political stability and perceived economic growth has significant impact on the economic growth, where perceived religious stability has insignificant impact on economic growth. Difference between Perceived economic stability, Perceived political factors, perceived religious factors, and perceived cultural factors also found insignificant across the users of formal and informal financial systems. However, the combination of the results were also associated with present political, cultural, religious and economic factors and the assumed results were debated with more implications at KP province.

Keywords: Economic, Growth, Financial System, Political Stability, Religious Factors.

JEL Classification: E000

Introduction

The neighboring countries of Pakistan are experiencing economic slowdown, but the war affected Khyber Pakhtunkhwa is badly affected and experiencing the worst economic meltdown. Khyber Pakhtunkhwa is the smallest province geographically among the four provinces of the country, but the third largest province in terms of contribution to gross domestic product (GDP). According to the

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Economic Survey of Pakistan, the Khyber Pakhtunkhwa province share to the GDP is 13% against the total population of 14.69 % of the total population of Pakistan. According to survey reports, the current annual economic growth in Khyber Pakhtunkhwa province has been recorded at 4.5 %. Total Remittances from overseas contribute to 5% of GDP and the poverty rate is approximately 39%.

The economic indicators in terms of banking industry of Pakistan has shown a remarkable growth in terms of assets base and total deposits doubling its size since 2008 but the ratio of Gross Domestic Product (GDP) to private sector credit have been on the decline, lending to private sector fell from 22 percent in 2009 to a low 14.7 percent in 2014. So, the economic factors in the area of banking services in Pakistan recorded a declining trend in total. Astonishingly, the agricultural sector which is the backbone of the economy and contributed 21 percent to the GDP and constitute 60 % of the total labor force, has just secured 6 percent of the total bank financing. This lopsided relationship has led to the decline of the agriculture sector in the country in general and Khyber Pakhtunkhwa in particular. On the other hand the private business sector in Pakistan has been availing 40 percent bank credit with major portion being taken by large business entities in the country and the statistics shows startling 0.4 percent large subscribers availing 65 percent of bank credit to the private sector.

The above situation shows an economic crunch in the region. Thus, it is essential to find out the factors that cause economic slowdown in order to improve the economic situation in the province. The investigators defined several factors that are responsible for the poor economic circumstances (Abadie, 2006; Easterly, 2001; Ali 2010; Barro, & McCleary, 2003). However, limited information is available about the reasons that are correlated with economic crash in Khyber Pakhtunkhwa province of Pakistan. Thus, the current study focused on exploring the factors in users of informal and formal financial system that help the economic development of the Khyber Pakhtunkhwa.

The current study also attempt to provide insight into the volume and dynamics of informal finance in the economy and to raise awareness in the stakeholders linked with informal and formal financial system. The current worse condition of economy in the country in general and in Khyber Pakhtunkhwa in particular substantiates the need for starting new research efforts to clarify the extended problems into the political, religious, cultural and economic factors into the intimate structure of formal and informal economies and suggestions for its resolute solutions.

The study aims to support the process of decision making by explaining the impact of factors affecting the economy of Khyber Pakhtunkhwa province and to measure the differences between users of formal and informal financial systems in terms of its supportive or competitive nature. The study will be supportive in recommending feasible options to the economic problem of Khyber Pakhtunkhwa province by analyzing the impact of political, religious, cultural and economic factors recorded by formal and informal financial systems.

Literature Review

Informal and Formal Financial Markets in Pakistan

The history of formal financial institutions like banks, cooperative societies, and insurance companies can be traced back to the British colonial period. On the other hand, informal finance markets have an extended history long before the existence of formal markets and a strong and widespread existence in much bigger parts of the country. Part of transactions in informal markets, particularly in urban parts, can be traced to the 'black economy', undocumented and hidden in order to evade taxes and statutory regulations. This is especially true for some of the self-employed individuals and groups involved with underground economic activities and proceedings. One of the premier State sector institutions namely, Pakistan Institute for Development Economist (PIDE) in its reports (PIDE, 1998,2003) found that formal economy has been way behind the informal one in terms of reach and magnitude of the total economy. The proportionate difference between the two has been estimated to be towering figure of 54.5 percent in 1998 from just 20 per cent in 1973 of the GDP. The inclining trend ceases to exist in the year 2002 to 37.25. Tax evasion trends by the stakeholders recorded similar patterns in the said period.

Ali and Qasim (2012) argued that access to formal financial institutions and its products are greatly hindered in the developing countries with multi-faceted and diverse reasons. The estimated magnitude is around 2.5 billion people which amounts to roughly 33 On the contrary, many studies have concluded that the root cause of social distortion and poverty has been the financial exclusion (Khandkher,2005; Karlan & ZInman, 2009; Banerjee, Duflo, Glennerster, & Kinnan, 2015; & Levine & Beck, 2002). Those researchers were of the vew that separation of formal and informal financial activities have brought financial disasters to the stakeholders. The countries, which develop their formal financial institutions have given way to the economic development on long-term basis and avoided economic issues.

It is interesting to note the modern technological advancements have automatically boosted the efforts of financial inclusion in many parts of the globe. For example, many online financial products by financial institutions have been offered through mobile technology and burdensome regulatory conditions have given way to more relaxed and open regulations. Noticeably the mobile technology is used across the board by all sections of the society and discrimination is not observed at any level in the context of formal and informal financial subscribers.

Table 1
Usage of financial products from the formal financial institutions

	Pakistan (%)	India (%)	South Asia (%)	East Asia (%)
All Adults	10.3	35.2	33.0	54.9
Male Adults	17.3	43.7	26.7	57.6
Female Adults	3.0	26.9	25.0	52.3
Adults living in Rural Areas	7.2	33.1	30.8	49.5
Adults living in Urban Areas	15.4	40.9	39.7	70.8

Source: World Bank Findex 2011

The above data sufficiently shows that Pakistan is lagging way behind its Eastern and Southern competitors when it comes to the usage of financial products from the formal financial institutions. A lot need to be done in terms of financial inclusion in order to reduce the gap between usage of products and services of formal and informal financial system in Pakistan.

Ayyagari, Demirguc-kunt, and Maksimovic (2010) prove from the available that Chinese economy is a counterexample of finance and growth in the context of discussion on informal economy and its role in economic development. The banking system at the time was found quite weak in China. The study however, noted that the Chinese economy is growing at a very fast pace and safely one can conclude that it is one of the fastest growing economies of the world and the results of the study suggested that although its faults in financing from the financial system are strongly connected with faster firm growth while the alternative channel is not the fund raising. They incorporated a mixed model; their outcomes found that formal financial system has no evidence over the results arise for the selection of firms that have access to this.

Qian, Allen and Qian (2005) also had a study in China by getting survey responses from 17 corporate entrepreneurs and executives from the Zhejiang and Jiangsu Provinces in China. They suggested that the non-availability of formal financial services in the vicinity tends to give opening to a more efficient alternative, the informal channels such as those based on goodwill and interactions to support the growth of the private sector.

Ngalawa and Viegi (2013) selected different sectors to evaluate the relationship of informal and formal financial markets and the role they play in the economic growth of developing economies which are a mixed blend of developed and developing market economies. An extensive impact of informal sector in support with formal sector is associated with the economic growth and its development but its contributions to optimize the GDP growth cultivated more effectively in the developing countries (Ayyagari, Demirguc-Kunt, & Maksimovic, 2010). In Pakistan informal sector facilitates around 72.6% population in this sector of the economy in spite of people working in agricultural sector. The scope of acceptability of this sector has been realized in rural and urban areas. Meanwhile, the formal sector revealed its dignity and an impressive growth 27.4% during 2015 has found from 26.4% in 2014 whereas; informal growth in 2015 has diminished at 1.35%.

Alesina and Perotti (1996) conducted a detailed study in 113 economies across the globe covering a period of 1950-1982. According to their findings countries having volatile political systems and frequent government changes are more exposed to economic calamities and GDP growth has been found at quite lower ebb. Pin (2009 in his study observed that significantly lower GDP in different countries have been found to be having relatively lower political stability. Alesina and Perotti (1996) suggested that national and international investment is also subjected to the presence of conducive political environment in a country which brings in its wake the economic development thereby reducing the risk factor for the investor. Political upheaval constitutes a major component in the overall fabric of risk management in international direct investment. The strength of the investment regulations can only be achieved when there will be political stability in a country and rule of law will get flourish in case of consistency in governance actions. In countries, where there is political stability, will lead to faulty policy making and discourage foreign and local direct investments.

Aisen and Veiga (2006) explained lack of political stability increases inflationary trends in a country. Wealth is hoarded in few hands and the benefits of social justice and social comforts are not widespread in such societies. Muller (1985) commented on such state of affairs that, “It seems believable to expect that in societies with high inequality, where the distribution or scope of dissatisfaction is seemingly widespread; discontent is more likely to be mobilized somehow, than in societies with low inequality”.

Cheibub, Przeworski, Limongi Neto, and Alvarez (1996) observed some exciting patterns in economic growth arising due to intrusion of political institutions in developing, poor and developed countries. The countries where the democratic norm of Government was on strong footing exhibited good economic growth as compared to countries where the helm of affairs was led by dictatorial individuals and can be termed as dictatorial form of Government.

Aisen and Veiga (2013) in their study recommended that political instability badly hamper the economic growth in any country. They suggested that political instability affects the decision making of the policy makers and they tend to plan for shorter terms for political gains. According to the authors frequent changes in the cabinet also affect policy making which affects macroeconomic performance of the economy. They further elaborated that countries with political instability have lower Gross Domestic Product (GDP) growth per capita than countries which had higher and consistent political stability.

Sule, Roubini, and Swagel (1996) also conducted a study regarding political instability and its impact on per capita GDP growth. They comprehensively selected 113 countries across the globe and analyzed their respective economies from 1950 to 1983. It was observed in the study by them that the South American country, Argentina was among the top 20 economies of the world in the decade of 1950’s and was much stronger at that time than the Japanese economy.

Weingast (1995) opined that a stable Political system facilitates and safeguard contract between different entities and limits the power of the state to confiscate property. When political system gets proper breathing space, they tend to be strengthened against all external and internal threats and develop the power of resistance. Strong institutions are difficult to bypass by individuals in times of turbulence and chaos. Political stability tends to encourage entrepreneurial growth and provides conducive environment for economy to grow. Four aspects of political instability were discussed.

Okafor (2017) explored the main factors behind instability in Western African states. His research found that terrorism, corruption, bad governance, unemployment among youth, social unrest and lease of natural resources were the leading factors that bring political instability among the western African countries. These factors had negative impact of economic development of those countries.

Joshi (2017) elaborated that Indian economic decision choices have been shaped by socio, cultural and political experiences of the decision makers. It was also influenced by the external political developments in the region. According to author, India has a very rich history of political and economic engagement and tolerance in the world. It helped them make good political decisions, which has good impact on the economic development.

The multiple reasons responsible for the economic backwardness are sufficiently detailed by researchers (Abadie, 2006; Barro, & McCleary, 2003). The political, religious, cultural and economic factors are concluded by researchers to have significant impact on the economic development however, there are some potential pitfalls on the existing understanding of the relationship between these factors and economic development. Firstly, studies conducted in this arena are based on time series or longitudinal data which do not capture people perception. Secondly, the studies conducted in foreign countries does not capture the Pakistan and especially the KP perspective. Thus, the current study aims to investigate the difference in the impact of cultural, religious, political and economic factors on the economic development in Khyber Pakhtunkhwa in the users of formal and informal financial systems.

Hypotheses of the Study

Hypotheses are statements subjected to proper exploration and research. The following hypotheses have been tested as a testable prediction for the observed phenomenon in this study.

As the current study is a mixed blend of qualitative and quantitative research methodologies, the research questions have been supplemented by hypothesis as part of compliance to the requirements of quantitative study.

The following hypotheses have been tested during the course of this study:

H_1: There is a significant difference in perceived role of political, cultural, religious and economic factors between the users of formal and informal financial systems.
H_2: There is a significant difference in perceived economic growth between the users of formal and informal financial systems.

Undergoing a rigorous search for finding answers to the above has paved the way to suggest appropriate policy recommendations aiming at problem resolution in the arena.

Conceptual Framework

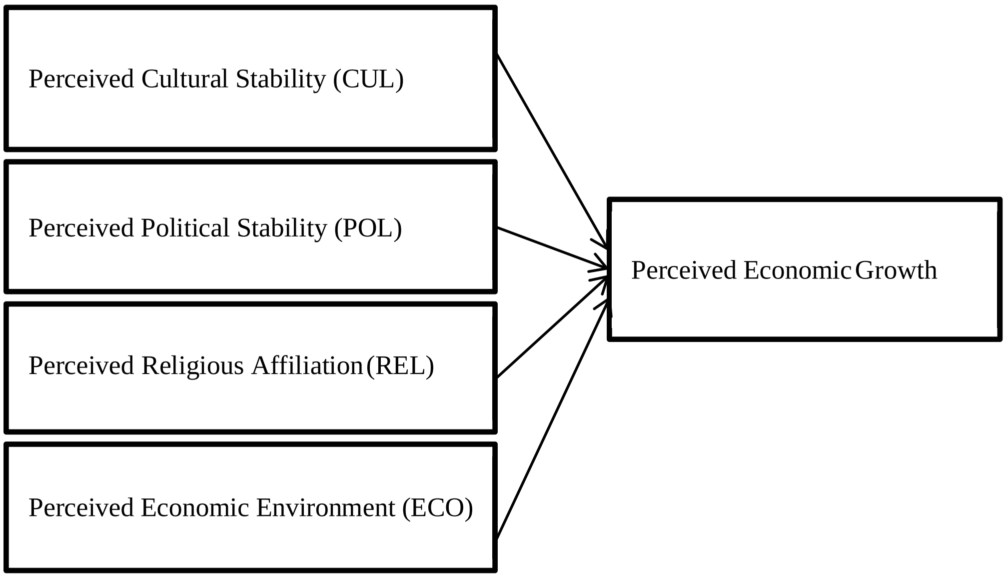

Figure 1: Conceptual Framework

Research Methodology

Population and Sample of the Study

The population for this research study are managers who are money dealers and lenders in private sectors, Small & Medium Enterprises (SME's) and scheduled commercial banks in public and private sector in the Province of Khyber Pakhtunkhwa. Five hundred (500) users (subscribers) have been selected from both informal and formal financial sectors as a sample. Out if which 369 responded and a total of three hundred and nine were found valid therefore the response rate came to 61.8 %. Sekaran (2001) recommended a sample between 200 to 500 as acceptable range for conducting perceptual research studies. Keeping above characteristics of both approaches and study objectives in mind, snowball sampling has been used during the proceedings of this research study for collecting responses from users of informal financial institutions while convenience sampling method has been used for collecting responses from users of formal financial system. So snowball sampling and convenience sampling methods have been used during the course of the present research.

Time frame of the Research

Present study is not reviewing the post and pre situation therefore present research is cross-sectional research as there is no need to collect data at more than one point of time. The researcher collected the data within a span of 3 months starting from March, 2017 and completed in May, 2017.

Data Analysis Techniques

To answer the research questions of the study and assess the validity and reliability of the data and to substantiate the hypotheses of the study, different statistical analysis techniques have been utilized by the researcher in the present study includes descriptive statistics, Factor analysis and Structural Equation Modeling etc.

Data Analysis and Results

Evaluating Structural Model

In order to evaluate the relationship between the hypothetical constructs in the study, structural model are developed (Gotz et al., 2010). Coefficient of determination is used and is the essential criterion for assessment of the structural model (Henseler et al., 2009). The coefficient of determination or R square shows how much change in the dependent variable can be accounted to the independent variable. It is recommended that R^2 must be at least .10 in order for the latent construct to be considered acceptable (Falk & Miller, 1992). R^2 values of .67,.33 and.19 indicate substantial, moderate and weak effects (Chin, 1998b).

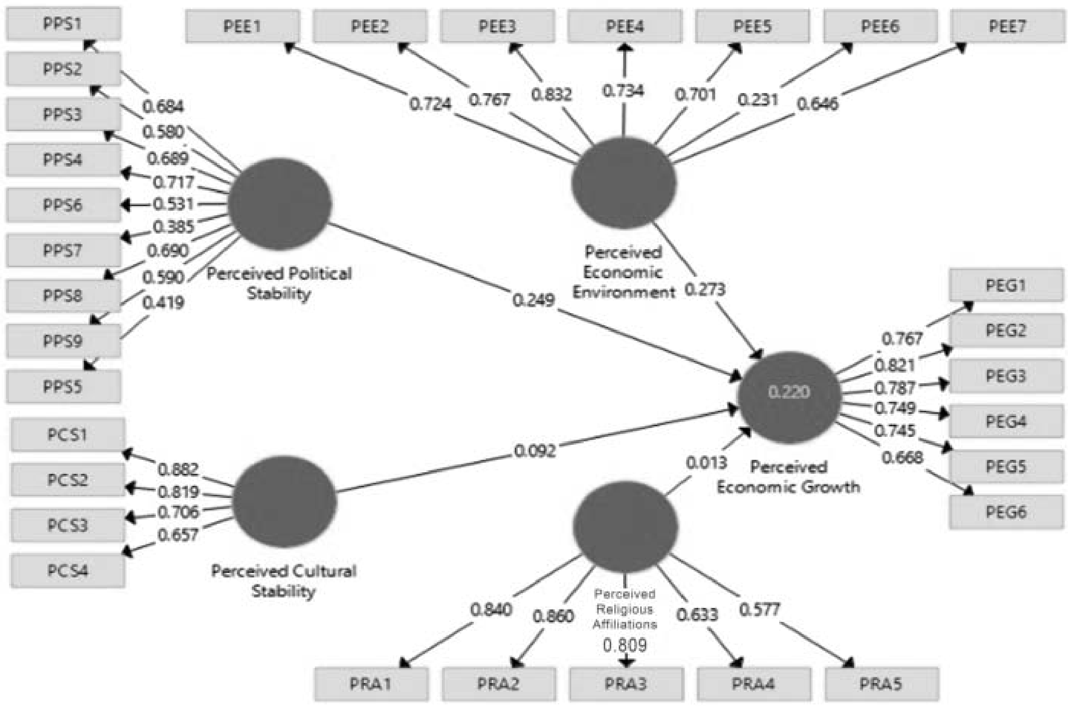

Figure 2: Initial Model with Item Loading

The results from initial model analysis in SMART-PLS showed that all factors has good Cronbach's Alpha value and Composite Reliability. However, the AVE values for Perceived Economic Growth and Perceived Political Stability were below the suggested value of .50. Analysing factor loadings for these two factors revealed a number of items having loadings below the recommended .70. Stepwise each item with lowest loading was removed and model was re-run to evaluate the reliability and validity values.

One Item (PEE6) having factor loading .231 was removed from Perceived Economic Growth, and the model was re-run. Having reevaluated the model with the removal of PEE6, the results showed acceptable AVE value. Five items (PPS2, PPS5, PPS6, PPS7, and PPS9) were removed from the factor Perceived Political Stability due to low factor loadings. After removal of the items acceptable value for Perceived Political Stability was obtained. The final model after removal of some items is shown in the following figure.

The factor loadings for each of the construct in the modified model are presented in the following table. Although some of the items still have loadings below .70. However, since acceptable values for Alpha, CR, and AVE were attained. The items weren't removed from further analysis.

The results of the Alpha and Composite Reliability are shown in the below figure. The alpha of the constructs in the present study range between .762 and .854 while CR values ranged between .841 and .890. Results indicate that reliability of all the constructs is well above .70 which indicates good reliability is attained. Descriptive for scale item if deleted were also analyzed to check if there is a substantial increase in reliability upon deletion of an item. It was found that removing an item would not improve the construct reliability.

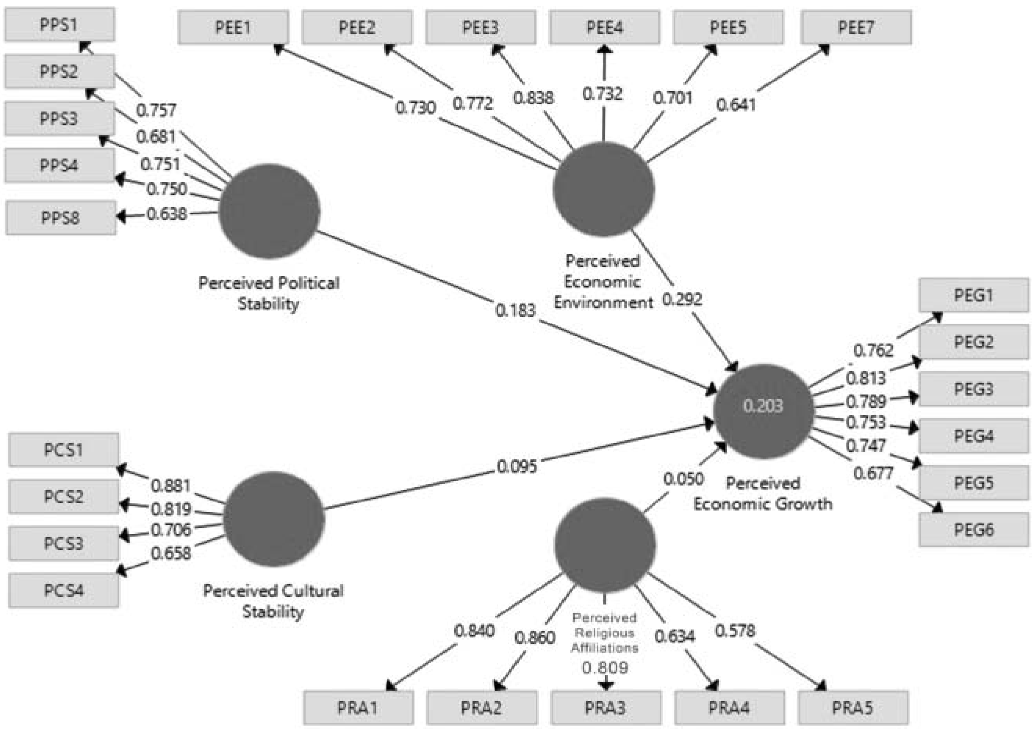

Figure 3: Alpha and Composite Reliability

Table 2
Reliability analysis of the constructs

	Cronbach's Alpha	Composite Reliability
Perceived Cultural Stability	0.788	0.853
Perceived Economic Environment	0.834	0.877
Perceived Economic Growth	0.854	0.890
Perceived Political Stability	0.762	0.841
Perceived Religious Affiliation	0.821	0.865

The comparison of significance of the impact of the factors namely perceived cultural stability, perceived economic environment, perceived political stability, and perceived religious affiliation on perceived economic growth revealed that in the overall complete model perceived economic environment and perceived political stability had a significant impact on perceived economic growth while the impact of perceived cultural stability and perceived religious affiliation had an insignificant impact. In comparison to the overall model in the users of formal financial system only perceived economic environment had a significant impact on perceived economic growth while in the users of informal financial system, the results show that users show that the perceived economic growth is significantly influenced by perceived cultural stability, perceived economic environment, and perceived political stability. The comparisons are summarized in the following table.

Table 3
Model Significance comparison between FFS and IFS

	Formal	Informal	Overall
Perceived Cultural Stability -> Perceived Economic Growth	.966	.001	0.217
Perceived Economic Environment -> Perceived Economic Growth	.009	.001	0.000
Perceived Political Stability -> Perceived Economic Growth	.421	.000	0.024
Perceived Religious Affiliation -> Perceived Economic Growth	.281	.393	0.528

Difference between Formal and Informal Financial System

In order to assess research question to evaluate whether there exist significant different in the perception of users of formal and informal financial system for perceived political stability, perceived economic environment, perceived cultural stability, perceived religious affiliation, and perceived economic growth.

The results show that there exist no significant difference ($t = 1.049$, $p > .05$) in perceived political stability between users of formal ($M = 3.15$, $SD = .76$) and informal financial systems ($M = 3.05$, $SD = .75$).

The results show that there exist no significant difference ($t = .429$, $p > .05$) in perceived economic environment between users of formal ($M = 2.89$, $SD = .62$) and informal financial systems ($M = 2.85$, $SD = .91$).

The results show that there exist no significant difference ($t = -.548$, $p > .05$) in perceived cultural stability between users of formal ($M = 3.76$, $SD = .67$) and informal financial systems ($M = 3.81$, $SD = .76$).

The results show that there exist no significant difference ($t = .327$, $p > .05$) in perceived religious affiliation between users of formal ($M = 3.62$, $SD = .66$) and informal financial systems ($M = 3.59$, $SD = .88$).

The results show that there exist significant difference ($t = 3.348$, $p < .005$) in perceived economic growth between users of formal ($M = 3.47$, $SD = .60$) and informal financial systems ($M = 3.18$, $SD = .77$). The perception of perceived economic growth is increasingly positive in the users of formal financial systems in comparison to the uses of informal financial system.

Discussion and Conclusion

This study's main objective is to contribute in the literature by covering the gaps like say, for instance, it is the first attempt to examine the perceived effect of different factors on economic growth particularly in the context of Pakistan. Overall the results for the hypothesis of the study reveals that there exist no significant difference in perceived political stability ($t = 1.049$, $p > .05$), perceived economic environment ($t = .429$, $p > .05$), perceived cultural stability ($t = -.548$, $p > .05$), perceived religious affiliation ($t = .327$, $p > .05$) across the users of formal and informal financial systems. Results of the present study support the inference of the past studies like say for instance; Aredo (1993) argue that informal financial sector operates in the environment where government involvement is negligible, it possess well organized and self-oriented mechanism which changes with the passage of changing the environment. Similarly, Pakistan is found to be a least financially inclusive country of the world, where determinants of financial inclusion stated as below the average of South Asian countries (Zulfiqar, Chaudhary, & Aslam, 2016), which represents the low level of involvement particularly of socio-economic determinants. Based on the given discussion hypothesis H_3 remains to stand with; due to the poor performance of the indicators pertinent to financial inclusion, the role of political, cultural, religious and economic factors in informal financial systems is the same as the informal financial system. Leading the argument in the special context of KP, during the completion this study scholar observed that KP province is very dynamic in nature because the surrounded territory of KP consisting different geographic areas including tribal areas etc. where they have there some special set of political and religious affairs, on the other side urban areas have very organize and consistent setup for conducting business or religious concerns so in future in-depth study is more required to explore those factors in the context of said study.

Similarly, results reported a significant difference ($t = 3.348$, $p < .005$) in perceived economic growth across the users of formal and informal financial systems. According to McKernan, Pitt, and Moskowitz (2004), there is a large difference across the users (Male/Female) of financial and informal financial services. On the same side, the informal financial sector is considered to be a useful instrument of economic development for underprivileged areas of the country, while for urban areas the formal financial sector is most reliable (Karunagoda, 2007). Therefore, the study concluded that the results of the study are in the alignment of the previous studies. The reason behind that is a majority of the users are unaware to formal financial practices and belongs to rural areas that's why they adopt old traditional tactics for operating businesses which leads to the difference in perceived economic growth because of the users of the formal and informal financial system. In the context of KP, as stated earlier people belong to rural areas are much influenced or tied up with their traditions or course of actions as suggested by their ancestors. However, people of urban areas equipped or support their way of living by adopting contemporary approaches i.e. schools, formal financial or non-financial institutions etc. Therefore, the results of the study reveal the difference in economic growth across the formal and informal users of the financial system.

From the above-stated discussion, the conclusion can be drawn that majority of the results were supported by the previous studies (Zulfiqar, Chaudhary, & Aslam, 2016; Upreti, 2015; McKernan, Pitt, & Moskowitz, 2004), like to say for instance there is a significant impact of Perceived political stability, Perceived economic factors have been found on Perceived economic growth. Similarly, a significant difference in Perceived economic growth across the formal and informal users has also been revealed by the results.

On the other side, there is an insignificant influence (Ciobanu & Bahna, 2015) of Perceived cultural factors, Perceived religious factors have been accounted on Perceived economic growth. Difference between Perceived political stability, Perceived economic factors, perceived cultural factors, and perceived religious factors also found insignificant across the users of formal and informal financial systems. However, the blend of the results were also linked with present political, cultural, religious and economic factors and the said results were discussed with more implications at KP province, many of the results found satisfactory in compliance with reality and this was also the ultimate aim of the researcher to represent the true picture of the KP and proposed viable solutions for it.

Policy Recommandations

Since the previous one decade Pakistan and especially KP province faced drastic changes in political, cultural and religious environment that radically cause economic environment as well as KP economy on both formal and informal sector. Therefore, it is suggested that policy makers or practitioners should have to work out on the laws governing harmony in cultural and religious environment and as well as Govt. of KP should strive to make political environment less panic because the notion of change indeed change the perception of the people of KP. Once a strong bond between the variables like political, cultural, religious and economic environment is buildup the economy of KP will starts flourishing.

While looking toward the regression results there is a large magnitude effect exist by the perceived political, cultural, religious and economic environment on economy of KP in the context of informal rather than the formal financial system and same with the comparative results between the formal and informal financial system. Hence, it is recommended that Govt. should have to take the steps to channelize the informal setups in to the main stream of the economy by bringing industrial and taxation reforms so that the fruits from the formal financial system can be maximizes.

Recommandations for Further Research

First, the research study intended to focus on people perspective about formal and informal financial system, the future researcher can investigate the strategic orientation towards firm performance in formal and informal financial set up.

Secondly, the future researcher should take into consideration the possibility of including greater clientele in the data collection process. The future researcher should also concentrate on broadening the scope of the study by including institutions like ‘not-for-profit’ organizations. For data collection, apart from survey method, other data collection techniques shall also be relied upon.

Third, the present research study concentrated on only one Province; Khyber Pakhtunkhwa in this study with focus on big cities, the future researcher should include other provinces of Pakistan also along with concentration to get data from smaller cities of Pakistan to overcome this sort of limitation.

Fourth, the present study used positivistic approach for collection and analysis of data. This procedure has resulted in data collection through survey instrument only. The future researcher is suggested to focus on a more pragmatist approach to get hold of deep routed information regarding people perceptions about the financial systems.

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