

**THE IMPACT OF GOOD GOVERNANCE (GOVERNMENT  
EFFECTIVENESS) ON STOCK MARKET TURNOVER IN PAKISTAN  
(2014-2023)**



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Fall 2025**

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## DECLARATION OF AUTHENTICATION

*I, **Zaib Shah**, MBA Student in the Department of Management Sciences, Bahria University, Islamabad, certify that the research work presented in this thesis is to the best of my knowledge my own. All sources used and any help received in the preparation of this dissertation have been acknowledged. I hereby declare that I have not submitted this material, either in whole or in part, for any other degree at this or any other institution.*

*Signature -----*

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## **Abstract**

Governance plays a crucial role in shaping the economic development of a country, especially in developing economies such as Pakistan. Among the various dimensions of good governance, government effectiveness is particularly important as it reflects the government's ability to design and implement sound policies, deliver public services, and maintain a stable economic and business environment. Effective governance strengthens institutional trust, enhances investor confidence, and supports sustainable economic growth.

This study examines the impact of government effectiveness on Pakistan's economic performance over the period 2014 to 2023. The analysis is based on secondary data obtained from the World Bank's Worldwide Governance Indicators and World Development Indicators. A quantitative research approach is adopted, and Ordinary Least Squares regression is employed to examine the relationship between government effectiveness and economic growth.

The findings indicate that improvements in government effectiveness are associated with more stable and positive economic outcomes. Periods marked by better policy implementation, administrative efficiency, and institutional stability tend to coincide with improved economic performance. Conversely, weak governance is linked with economic uncertainty and inconsistent growth patterns.

The study highlights that improving government effectiveness is not only a governance objective but also an economic necessity. For Pakistan, sustained economic development requires stronger institutions, consistent policy execution, and improved accountability mechanisms. The results provide useful insights for policymakers and contribute to the existing literature on governance and economic growth in developing economies.

**Keywords:** Government Effectiveness, Economic Growth, Governance Quality, Pakistan, Time Series Analysis, World Governance Indicators (WGI) World Development Indicators (WDI) OLS Regression.

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## **Chapter 1: Introduction**

### **1.1 General Discussion about the Topic**

Good governance has become one of the drivers of speed in the growth of nations, the political stability of nations and the fitness of financial systems in the past few years. Not only about governments dotting the boxes or playing by the book it is really about the way the public institutions run the show, how they handle money, and safeguard the rights of people, economic and human ones. The manner in which a government is run influences all matters including the policies that it formulates and implements, the way these policies are assessed and refined. When you enlarge nations such as Pakistan, good governance is not merely an ideal or a beautiful motive among the political leaders. It is vital to keep the economy on track, attract investment and ensure that progress is here to stay.

Good governance is a wide area: the accountability, transparency, the rule of law, good regulations, political stability, combating corruption and fair doing of things. Among them, the effectiveness of the government is outstanding. It is the essence of the performance of the institutions and the healthiness of the economy. It is just that, when a government provides adequate public services, adheres to its own policies, and ensures that its officials perform their duties competently and without scrupulousness, then things work. What you get is a stable environment which would contribute to the growth of the economy and the financial sector. However, when the governing process fails, you end up having messy organization, corruption, and policies that keep on shifting every five minutes. Investors become aware of it and they begin losing trust and this pulls down the markets.

It is all played out in the financial markets particularly the stock market. The stock market is not merely a selling and buying stock market, but it is almost a mirror of the economy of the country and how it is being managed. Investors will feel more secure and become involved when rules are well understood and applied, and when the government institutions perform their roles. However, when the institutions of the state are weak, and no one is aware of what the policy will be next, the risk increases. Those who are investing withdraw, and the market decelerates. Therefore, the connection between the level of governance and market performance is enormous, at least in case you desire to know the drivers of efficiency and investor choice in emerging countries.

Take Pakistan, for example. The financial markets are directly influenced by the quality of governance. The last several years have seen Pakistan struggling with every kind of trouble: political intrigue, changing policies, inability to enforce the rules, and lack of administrative strength. All these have rocked investor confidence and caused boom and decline in the stock market. A rather transparent insight into this relationship is provided by the stock exchange of Pakistan (PSX). The turnover ratio which is simply the number of shares that are traded divided by the total market value informs you of the amount of activity that is being done and the confidence that investors have. High turnover normally implies that people have faith in the market and feel things are being managed in a proper manner. Once it falls, it is usually an indicator that investors are concerned and they do not trust the system.

Therefore, an examination of the relationship between the effectiveness of the government in relation to the stock market turnover would be of great help to you in understanding how good governance ensures financial stability. When governments have performed their task effectively, policies are predictable, information is more transparent and the regulations seem just. That reduces the distortions in the market and predisposes people to long-term investments. In addition, good governance makes financial regulations more acceptable and thus the investors trust the market and those who are in charge of regulating the markets. The end result? The market expands, the liquidity increases and the financial system becomes more efficient in the way it distributes resources to actual economic development.

The deterioration of governance perceives it when corruption, lax policy, or a poor bureaucracy-markets. Investors notice. They begin to demand more when it is just to hang around, or they make a rush and short-lived gains and pull out when it starts to look risky. At times they simply withdraw their money. All these pull trading down, distort prices, and prevent the economy to have the market contribute towards its growth. Then there is the question of what actually causes stock market turnover in Pakistan, and the answer to it is that the effectiveness of the government should be considered within the framework.

This is more important to a nation such as Pakistan, where locations are heading towards open and market based economy. In the last 10 years, Pakistan has experienced much reforms, uncertainty, ups and downs in the economy. Government has made an attempt of cleaning up the institutions, updating regulations, and drawing in more foreign investors. Part of these attempts were successful and some were not. Frankly speaking, we have not yet learned enough about the relationship between these changes in governance and what is going on in the financial markets.

The evidence in this regard is quite clear across the world: the stronger, deeper, and more stable markets are associated with better governance. Good governance gives things a clearer picture, reduces costs and gives the investor a better confidence. It also implies that contracts and property rights are in fact enforced which, to be honest, is the source of any functioning financial system. Nations that have effective, corrupt free bureaucracies get more capital and trading in their stock markets. The safety of investors in these markets is enhanced and investors become more willing to make long term commitment. On the other hand, where governance becomes shaky, markets dry up, prices fluctuate erratically and money is likely to disappear.

Finally, individuals are beginning to understand that governance is relevant to financial development, yet little research has been conducted regarding the impact of specific segments such as the effectiveness of government on the trends of the stock market in Pakistan. The majority of studies are more about such elements as interest rates, inflation, or currency fluctuations, and do not really delve into the institutional aspect. However, it is usually those issues of governance behind the scenes that elucidate the reason why markets are failing or why people are staying out.

Pakistan has been rated on various global governance indicators such as the World Governance

Indicators (WGI) which has divided governance into six components: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption. Within this, government effectiveness in particular addresses the effectiveness with which the government services are operated, the capacity of the civil servants, independence of the bureaucracy as well as whether policies are actually implemented. Such things determine the climate of investment and how the financial institutions operate. This analysis narrows down on an aspect of governance that actually drives the needle in the performance of the market by focusing on government effectiveness.

The period used in this case 2014-2023 represents a decade of an era of political and economic transformations in Pakistan. There are periods of democracy, reformist thrusts, and the influence of global financial changes, all of which are affecting the manner in which institutions and markets are run. These years were the time when Pakistan attempted to tighten the budget, attract more foreign capital and reform the financial sector. Meanwhile, it had actual issues of currency fluctuations, massive deficits, and haphazard regulation that rattled investor confidence. A glance at this time would provide a clear picture of how the interplay between the government effectiveness and the market behavior would be in a time where all is in the process of change.

This research burrows into the effectiveness of the government and its effects on the stock market turnover in Pakistan. It questions whether good governance indeed increases liquidity in the market and more investors participate in it which leads directly to broad objectives such as economic growth and financial stability. The findings are important to any one attempting to make the financial markets in Pakistan better and more aligned with the global standards, be it a policymaker, a regulator, or an investor.

In sum it all, the debate continues to revert to the same argument; good governance is at the core of economic and financial development particularly in developing nations. The government effectiveness is not merely about the running of things smoothly, it is the driver of the market performance, the building of trust in investors and the growth of the economy. Connecting the dots between the quality of governance and stock market turnover, one forms a clear vision of how more robust and resilient financial systems can be constructed in places such as Pakistan and elsewhere by having better institutions.

## **1.2 Background of the Study**

There has always been an argument on the extent to which good governance influences the economy of a country. There is consensus among the economists, political scientists and financial experts that good governance leads to good countries. Good governance implies transparent policies, institutions that do not only get things done, but also resource allocation in a manner that benefits people, and not just a select few of those in power. That is even more important in the developing countries, where the poor institutions often suppress economic growth.

The Pakistani situation is not that new. The nation had suffered unstable policy, corruption, mixed up regulations as well as political theatre over the decades. This has all eroded the effectiveness of the government and made people less trusting towards it. Despite this, Pakistan has not been taking it easy.

The government has been attempting to change by establishing independent regulators and introducing fiscal responsibility legislation and driving digital solutions to make the public sector more effective. On the truth though, nobody knows whether these attempts have actually transformed the game, particularly in the stock market. That is one of the areas that we still require a serious research.

The stock market responds quickly to the happenings in a given country. Change of policy, new regulations, elections, global shocks you call it, the market experiences it almost immediately. When it comes to proper governance, the business world and investors are aware of what to expect. Reduced risk increases the number of individuals that are interested in it, thus, the market activity and trading increases. However, lack of good governance kills trust. Investors become jittery and trades become sluggish and the market is likely to come to a halt.

The stock market of Pakistan has experienced certain major changes in the past ten years. The three-way patchwork of three distinct exchanges became the Pakistan Stock Exchange (PSX) which operates by international standards. This was meant to open things up as a way of attracting foreign investment as well as ensuring that the market is honest. The PSX is important in converting savings into actual investments which benefit the economy. Nevertheless, good economic figures are not sufficient. In case of weak governance, investors are afraid and the market suffers.

An effective framework is required in order to properly gauge governance. The World Governance Indicators (WGI) of the World Bank subdivides it into six indicators, namely, government effectiveness, political stability, regulatory quality, rule of law, control of corruption, and voice and accountability. Government effectiveness is distinguished by whether government institutions work or not, whether any of the government services are good and whether the bureaucrats can get the job done without overly outside intervention. These factors determine the level of confidence of investors and the smooth running of the markets.

The world literature is not deficient in providing evidence that the effectiveness of a government does matter. Well-managed governments in the developed world accompany the presence of deep, stable and flourishing financial market. The bad governance in emerging economies usually translates to low number of people engaging in the market and money is not utilized as effectively as it should be. To Pakistan, this is even more critical as it is still in the process of reforming its economy and institutions. Even though there has been some improvement, such ills as a change of direction in policies, a sluggish administration, and overlapping rules continue to emerge. They are not only frustrating to people but these weaknesses also alter the way investors behave and influence the amount of trading that occurs on the stock market.

The period 2014-2023 will provide a good media house with room to explore this relationship. It was a period of major political changes in Pakistan, significant economic fluctuations and a reform wave that actually defined the manner in which the nation was run, as well as the functioning of its financial markets. As projects such as China-Pakistan Economic Corridor (CPEC) were launched, the rupee was being stabilized, and a combination of fiscal and monetary policies, the environment continued to evolve, which naturally reflected on governance and investor sentiment on the market. At the same time, the Pakistan Stock Exchange (PSX) experienced changes new owners brought in, technology was upgraded, and the market began to open up into the world. All this changed the way that trades occurred

and the level of money that circulated in the system.

The analysis of this period provides us with an opportunity to observe the impact of the alteration in the way the government conducts affairs on the stock market. Solid politics and stable policies? Those tend to attract more investors and keep that market going. However, when things become tectonic or the government is challenged, the market becomes stagnant. By narrowing down on this decade, the study is able to follow the ups and downs of the decades making it easier to observe how the governance influences the financial market over time.

Most of the previous studies in Pakistan have concentrated on macro-economic interest rates, inflation, exchange rates, GDP growth and their role in driving the stock market. That has been a helpful work, however, in most cases, it runs over the role the institutions and governance play in the background. More recently, however, increasing numbers of people are coming to realize that market fluctuations, which cannot be attributed to mere economic data, can be attributed to things such as the effectively doing its job by the government. On paper two countries may appear to be identical, but when one of the governments is more open and accountable, their market may be much better.

Thus, this paper examines the concept of the effectiveness of the government and its connection to stock market turnover in Pakistan. The turnover ratio essentially, the degree of trading relative to the amount of the entire market is an indication of how active and confident the investors are. A high ratio means the market is buzzing and when the ratio falls, you can be sure that there is market confusion or it is inefficient somewhere. Relating this to the effectiveness with which the government operates, the research is set to reveal the extent to which institutional performance is important to the market even in the absence of the classic culprits in the economy.

And the policy aspect is actually important. In case the study reveals that there is a definite connection between a robust government and market turnover, then it provides a compelling argument in support of a reform. The aspects that the policymakers could work on to ensure that the government work is faster, the policies are more understandable and also stricter in the regulation. Such an adjustment would most likely attract more investors, domestic as well as foreign, increase activity and stabilize the economy in general.

This is not only regarding Pakistan. Many developing nations are afflicted by the same governance problems that play around with their markets. Determining the role of government efficacy in the actions of the stock in this case may provide other states with ideas on the further development of the financial system. The outcomes may even bring something new into the international debate on governments and market, particularly in those places where reform remains the order of the day.

Bottom line? The research is on the border between governance and financial development. The quality of the government directly influences the investor confidence, faith in the policy, and the level of efficiency in the market. This relationship is significant to Pakistan as a country where the market is a reflection as well as a driver of the economic growth. The study bridges the research gap by addressing the question of how the effectiveness of the government affects turnover in stock markets between 2014 and 2023, and provides policymakers, regulators, and investors with a real object of study.

### **1.3 Research Gap**

The role of governance in financial market development has been widely discussed in international literature, yet evidence from Pakistan remains limited and fragmented. Most empirical studies related to Pakistan's stock market focus primarily on macroeconomic variables such as inflation, interest rates, exchange rates, and GDP growth, while institutional and governance-related factors receive relatively less attention (Ali & Rehman, 2015; Iqbal & Javed, 2017). This creates a significant gap in understanding how the internal functioning of government institutions affects market behavior. International evidence suggests that strong institutions and effective governance improve market efficiency, investor confidence, and liquidity by reducing uncertainty and transaction costs (North, 1990; La Porta et al., 1998). Studies have also shown that governance quality is positively associated with financial market development and trading activity, particularly in emerging economies (Beck et al., 2000; Hameed & Ashraf, 2019). However, such findings are largely based on cross-country analyses and are not deeply explored within the context of Pakistan.

In Pakistan, limited studies have addressed governance indicators, and those that do often examine governance as a broad concept without isolating government effectiveness as a distinct and measurable institutional factor (Kaufmann et al., 2011). Moreover, most domestic studies rely on short time periods or outdated datasets, failing to capture recent governance reforms, stock market restructuring, and policy shifts that occurred after 2014.

Another important gap lies in the choice of market performance indicators. While prior research commonly examines market capitalization or overall stock returns, very few studies focus on stock market turnover, which directly reflects liquidity and investor participation (Levine, 2002). The lack of time-series evidence linking government effectiveness to stock market turnover in Pakistan highlights a clear research gap.

Therefore, this study addresses these gaps by focusing specifically on government effectiveness and its impact on stock market turnover in Pakistan over the period 2014-2023, using a time-series econometric approach.

### **1.4 Problem Statement**

The performance of the financial markets of the developing countries is extremely dependent on the way their governments operate. Take Pakistan, for example. The capital market is also still struggling with volatiles, poor liquidity and no investor confidence despite the myriad of policy reforms in the country and the massive structural changes within the country. Pakistan people have started to wonder what exactly is going on in the institutions and systems of governance that has characterized the financial landscape in the country. The efficiency of the government is among all the important variables. This is not merely a political thing but is it that the public services are actually doing their job, are the rules sensible and unchanged and whether one can trust the government. The markets are more dynamic and the trading decisions are made when the state institutions can get things done, implement intelligent regulations and adhere to their policies. But, given that the system is choked with ineffectiveness or as a new rule is introduced in every other month, then the investors pull out and growth consequently slows down.

The turnover in Pakistan Stock Exchange has been trending all over a decade. Naturally, such problems as inflation, interest rates and currency fluctuations are also present, but non-economic factors political drama, policy flip flops play a substantial role as well. The point is that most of the researches talk about economic aspects and excludes how the effectiveness of governments is incorporated. It merely lacks a lot of tough information proving the connection between the change in government performance and the trading and liquidity in the Pakistani stock market.

Investment is not only made in the stock exchange where people sell and buy it, but also, diversifies the risk and drives the growth in an economy. Yet, it cannot do all that when the population does not trust the government and its regulators. Investors will tend to trade far more when they feel that the government has a rein in on the issues of enforcing the laws, running the services and transparency of the rules that they are all about. They can back off when they see red tape, sudden changes in the policies or corruption and the markets dry. Such an association might be logically obvious, but not many people have ever dug deep to understand how the performance of the Pakistani market (especially turnover) is connected to the efficiency of the government (as determined by the World Governance Indicators).

The period of 2014-2023 witnessed some notable changes in Pakistan: the governance reform, modernization and privatization of the stock exchange, and several political and economic shocks seizing the market. It is however unclear whether all deliberation on better governance was indeed converted into greater trading or whether the old market ills had persisted because of bad institutions. There is no guaranteed method of mending the situation without a valid answer by policymakers.

Most studies in Pakistan consider governance as this large and unclear concept without scrutinizing each aspect of the same. It is a problem, as the effectiveness of the government is a specific, measurable variable and it literally defines the mood and spirit of investors, and also their decision-making process. Combining it with such factors as political stability or corruption, the studies fail to arrive at a point of much clarity and, thus, mixed outcomes. Additionally, majority of these studies merely compare Pakistan with the other countries and not an analysis on how things have changed in the country. Something in that is wanting the very story of the institutions and of the hustles of Pakistan itself.

The other one: the turnover of the stock market basically, the level of trading is a good indicator of market liquidity and efficiency. When analyzing governance, turnover is very little scrutinized by the people of Pakistan. Most of them live on such factors as size of the market or foreign capital investment without putting into consideration the factor that turnover reflects the degree of confidence of the investors. This lack of understanding has created a gap in knowledge that is enormous since nobody ever bothered to research this relationship.

The state of affairs concerning the way scholars have been viewing the relationship between governance and market performance is real. In most cases, they merely run simple correlation or to stir around some descriptive statistics. That's not enough. They outdo the tools that do record cause and effect. And at this stage we are not really in a position to know whether, larger government really adds to the sum of trading, or whether larger economic forces drown whatever government can do.

The bridge that fills this gap has been made in this paper. I am performing an entire time-series regression of the effectiveness of government versus the stock market turnover in Pakistan, 2014-23. I am summons the information of the World Governance Indicators and Pakistan Stock Exchange and then I will conduct the regression models of the data in STATA to gauge exactly what is happening to market action under the influence of institutional efficiency. The rationale behind this is to put into place

the presence of the stronger government and trading and liquidity or it seems that stronger governance does not move the needle at all without greater economic reforms in its favor.

At the heart of it, is just lack of enough real data concerning the role that government effectiveness plays in affecting the stock market turnover in Pakistan. The absence of this aspect renders the policymakers incapable of making smart reforms which can change the standards of governance and the functions of the financial markets. It does not simply concern filling in some holes in the literature it is interested in in the real-world decisions. In this study we can also give more answers regarding the question of how improvement of the institutions can result in more investor confidence, liquidity in the markets and development of the financial system in Pakistan.

### **1.5 Research Questions**

This study excavates the responsiveness of government in determining the stock market performance of Pakistan in terms of running the institutions properly, how policies are actually implemented, and how this impacts investors and the market performance. Essentially the question we are posing is: Does an improved governance make people trade more? Does it instill confidence on the market with investors? And does it increase liquidity and trading in general?

1. Does government effectiveness influence stock market turnover in Pakistan?
2. Does the government effectiveness have a high level of correlation with investor confidence?
3. What is the effect of level of institutional effectiveness on market liquidity and trading?

These are the questions that would guide the entire study. They assist us in developing the hypotheses and the econometric model, which we would test with time series regression. The replies to them will help us in a better understanding on how improved governance can result in a busier and more efficient financial market.

### **1.6 Objectives of the Study**

This paper excavates the impact of the effectiveness of government on stock market turnover in Pakistan covering the period between 2014 and 2023. The entire purpose is rather simple: to answer the questions of the research and contribute something significant, in theory and in the practice, to the discussion about governance and financial development. Here's what we're looking at:

1. To test the effectiveness of government on the turnover of the stock market in Pakistan.
2. To test the hypothesis of how effective the government is and the level of investor confidence.
3. To examine the relationship between institutional efficiency and liquidity and trading activity on the stock market.

By addressing these issues, the study will provide a bit of concrete evidence on the role of good governance particularly when the institution performs their mandate well on the behavior of the stock market. The results need to shed more light on how governance quality is related to the performance of financial markets. Ultimately, it must assist policy makers and regulators in Pakistan in developing superior plans, reinforce their institutions and create a stable and easier to trade in capital market.

### **1.7 Significance of the Study**

The study is important in that it illuminates the way government effectiveness affects financial market in emerging economies and particularly in Pakistan. Financial markets are not only the processes of transferring money but they are important in making economies expand by facilitating capital raising, matching savers and investors, and risk management. However, it is not only the economic figures that lead to these markets. The manner in which the institutions operate and the effectiveness with which the government performs its mandate are actually the determinant of the confidence of investors and market dynamics.

The stock market of Pakistan has been having a rollercoaster ride over the past ten years. The trading volumes go up and down, in most cases when political changes, change in management, and major economic decisions occur. The process of determining the relationship between government effectiveness and market liquidity is not merely an academic game of guesses that provides us a glimpse of the way people invest as they do and reforms actually work in practice. By excavating this, the study arrives at the core of the role of good governance in shaping the markets in the countries which are still trying to develop an appropriate system of institutions.

Academically, much work has been done relating governance to economic growth or investment but not as much of looking deep into stock market turnover. Turnover is important because it depicts the degree of activity and liquidity of a market, and how eager individuals are to make the leap. This work fits a blank in our knowledge about a place where the rules are still being drafted and the system is not always stable, by placing the focal point on Pakistan. These results assist in creating a clearer image of how better governance might result in more financial results that are quantifiable.

To the policymakers, the value is simple. The study provides actual facts that can be used in making decisions regarding the way to reform and operate markets. To the extent that increased market activity is the result of increased government effectiveness, there is a clamor thereupon to continued institutional reforms consider stronger regulations, more stable policies, and greater investor protection. Such lessons can be used to create more intelligent policies to develop capital markets in Pakistan. In addition, it is always good to know how the governance change process unfolds and how leaders should formulate reforms that are long-term and not temporary measures that would run out of breath at the slightest hitches on the road.

The findings of this research can be real-world guidelines to investors and financial institutions when they size up the role of governance in determining the risks and opportunities in the market. When the trading activity increases due to good governance, then those institutional indicators become effective financial risk model tools. It implies that investors enjoy a better insight that they can identify governance indicators and make more intelligent decisions when dealing with their portfolios. And having known how governance changes dislocate market liquidity, you will be in a better position to spot instances of market stability and take the advantage of new investing opportunities.

In the greater scale, this study brings home to the point just how closely the governance and economic performance are interconnected. Effective governance does not merely ensure that financial markets continue operating without problems but it also creates trust in the population, reduces corruption and preconditions actual and sustainable growth. This paper indicates that as governments become more efficient, the number of stock market turnovers also increases. In essence, governance is not only a source of economic growth, but it is also an entity which becomes more powerful with the economies. Improved governance will give rise to enhanced markets which in turn will generate further institutional advancement.

The manner in which this was conducted can also be said. The research draws a good foundation of

evidence by excavating ten years of secondary data and applying sound econometric techniques. This strategy can be used to reveal patterns and cause and effect relationships that are likely to be overlooked otherwise. So the approaches through this can be used to inform other developing nations that are seeking to break the same puzzle.

Ultimately, there is much more than just Pakistan that is happening. These findings have some valuable lessons that can be learnt by other emerging markets also experiencing the same institutional struggles. In the current state of globalization of markets, financial stability and credibility are not based on only the economic policies but also on the quality of governance that they are anchored on. Participating in this worldwide discourse, the research does not merely contribute to the discussion; it introduces concrete understanding to the question of any person who might be interested in reforming of the government, financial development, and creation of sustainable economies.

### **1.8 Limitations of the Study**

This study is subject to certain limitations that should be considered when interpreting the findings. First, the analysis relies on secondary data obtained from the World Governance Indicators and the Pakistan Stock Exchange, which may involve perception-based measures and reporting limitations. Second, the study focuses only on government effectiveness as a governance indicator, while other dimensions such as political stability, regulatory quality, and control of corruption are excluded to maintain model simplicity. Third, external shocks such as global economic fluctuations or political events may influence stock market turnover but cannot be fully controlled within the model. Lastly, the ten-year time frame, although adequate for trend analysis, may not capture long-term structural institutional changes.

### **1.9 Delimitations of the Study**

This study is subject to certain limitations that should be considered when interpreting the findings. First, the analysis relies on secondary data obtained from the World Governance Indicators and the Pakistan Stock Exchange, which may involve perception-based measures and reporting limitations. Second, the study focuses only on government effectiveness as a governance indicator, while other dimensions such as political stability, regulatory quality, and control of corruption are excluded to maintain model simplicity. Third, external shocks such as global economic fluctuations or political events may influence stock market turnover but cannot be fully controlled within the model. Lastly, the ten-year time frame, although adequate for trend analysis, may not capture long-term structural institutional changes.

## **Chapter 2: Literature Review**

### **2.1 Critical Literature Review**

It has been widely recognized in both academic and policy discourses that good governance is a core to economic and financial development. In recent 20 years, economists and financial researchers pay more attention to the role of institutions and quality of governance in determining economic performance, investment behavior, and market efficiency. Governance identifies the effectiveness of the government in formulating and implementing sound policies, providing the government services, and administering the administrative processes. Government effectiveness is considered one of the most important of the

six World Governance Indicators since it encloses the quality of the government administration, policy making, and ability of civil service.

The idea about the effectiveness of the government began gaining traction as the attention to the fact that markets cannot promote development on its own without the backing of powerful institutions increased. North (1990) asserted that institutions established the rules of the game in the society and that their quality defines the economic outcomes. Effective institutions in the case of financial markets guarantee predictability, transparency, and enforcement of contracts which in effect limits uncertainty and participation by the investors. In a case where the governments are operating effectively, investors will experience a decrease in risks and hence increased liquidity and increased volume of trading in stock markets. On the other hand, bad governance brings about uncertainties in policies, low confidence in financial laws, and discourages trading.

Inefficiencies in governance have been commonly attributed as an issue limiting performance in financial markets in the Pakistani environment. Although the Pakistan Stock Exchange (PSX) has been subjected to various reforms, there are still challenges evident in the form of limited participation of investors, lack of depth in the market and intermittent volatility of the market. These predicaments are usually associated with systematic institutional shortcomings, including haphazard policy execution, bureaucratic wastefulness and weaker regulatory enforcement. Research by Saba and Javed (2015) and Malik and Anwar (2019) shows that the changes in PSX are closely related to the governance conditions. As the effectiveness of the government increases, markets react in a positive way with more trading activities and higher turnover ratios. These results however are founded on short periods of time, which leaves gaps about the causal relationship between the quality of governance and the stock market turnover in the long run.

Past literature review on the relationship between governance and financial performance can be classified into two; global literature that emphasizes on cross country comparisons and country specific literature that examines internal institutional dynamics. It was demonstrated through global studies like that of La Porta et al. (1997) and Levine (1998) that the stronger the legal and regulatory frameworks of a country, the stronger the liquid and developed capital markets of such countries are. Likewise Kaufmann and Kraay (2008) discovered that effectiveness of the governments is positively associated with the financial stability and flow of investment. They also underscored that lower risks to investors would be experienced when the institutions of the public sector are competent and predictable thus resulting in an active financial system.

Nevertheless, the results of such studies are sometimes not applicable to the developing nations such as Pakistan because the institutional settings are more complicated, and the political changes are common. Studies of new Asian economies like that of Ang and McKibbin (2007) discovered that in Malaysia and Thailand, reforms in governance enhanced the stock markets and the inflow of foreign investments. This implies that in the even transitional economies, the positive impact of governance can be felt on financial development. However, not many studies have focused on whether the same happens in Pakistan, where the quality of governance has varied over time as a result of varying political regimes and priorities in policies.

The empirical studies in Pakistan are small and scanty. Numerous previous researches assume governance as a broad composite measure instead of the study of the dimensions. Consequently, the effect of the government effectiveness on the financial indicators like the stock market turnover has not been explored appropriately. Akbar and Khan (2019) discovered that the improvement of governance increases financial stability; however, no attempt was made to distinguish the role of government

effectiveness in their analysis. In the same vein, Tariq and Abbas (2021) also investigated the governance and investor sentiment in Pakistan, albeit without necessarily addressing the issue of stock market turnover as a performance metric. This lack of specific research on causal relationship between government performance and market action is a major knowledge gap that would be addressed by this study.

The second significant weakness in the literature lies in the fact that there has not been a rigorous methodology in the testing of the governance-finance nexus. Although some studies involve correlation or descriptive analysis some studies do not prove causal relationships. This analysis, in its turn, uses time-series regression analysis with data available in 2014 to 2023, which enables a comprehensive insight on how the transformations in the government effectiveness can affect the trading activity over a certain time. In addition, the global comparability and reliability of the data are guaranteed by the utilization of the World Governance Indicators (WGI) data, whereas the turnover of stock markets is a direct metric of the liquidity and investor confidence.

The literature review shows clearly that, though there was a substantial amount of evidence in the world and the region pointing towards the positive association between governance and financial development, there is still no focused empirical investigation in Pakistan with regard to incidence of government efficiency with regard to turnover in stock markets. This gap does not only add to academic literature but also the policy implications of improving the governance structures and increasing the growth of Pakistan capital markets.

### **2.1.1 Additional Empirical Literature on Governance and Stock Market Turnover**

Several empirical studies further strengthen the relationship between governance quality and stock market performance. Beck, Demirgüç-Kunt, and Levine (2003) argue that effective public institutions reduce transaction costs and enhance market liquidity by improving investor protection and regulatory enforcement. Their findings indicate that institutional quality plays a crucial role in determining trading activity and market depth, particularly in developing economies.

Levine and Zervos (1998) found that stock market liquidity, measured through turnover ratio, is positively associated with economic growth and institutional stability. They emphasized that markets operate more efficiently when governance structures ensure transparency and credibility. Similarly, Acemoglu, Johnson, and Robinson (2005) provided strong evidence that institutional effectiveness is a fundamental determinant of long-term economic and financial development.

In emerging markets, Bekaert, Harvey, and Lundblad (2011) showed that governance reforms significantly improve stock market participation and trading volume. Their results suggest that improvements in policy implementation and administrative effectiveness directly affect investor behavior. In the South Asian context, Hameed and Ashraf (2019) concluded that governance indicators, particularly government effectiveness, significantly influence market liquidity and financial integration. Despite this growing international evidence, country-specific studies for Pakistan remain limited, particularly those examining stock market turnover rather than broader market indicators. This highlights the importance of conducting focused empirical research within Pakistan's institutional and economic context.

### **2.1.2 Research Gap**

Although international literature strongly supports the view that good governance enhances financial market development, there is a noticeable gap in the empirical literature concerning Pakistan. Most domestic studies focus on macroeconomic determinants such as inflation, interest rates, and exchange

rate volatility when analyzing stock market performance, while governance-related variables are often overlooked or treated as secondary factors.

Furthermore, existing Pakistani studies generally use composite governance indices without isolating government effectiveness as a distinct institutional dimension. As a result, the specific impact of government effectiveness on stock market turnover—an important indicator of market liquidity and investor participation—has not been sufficiently explored. In addition, many prior studies rely on short sample periods or cross-sectional approaches, limiting their ability to capture time-based institutional changes.

Another critical gap lies in the selection of market performance measures. While market capitalization and stock returns are frequently used, stock market turnover has received limited attention despite its direct relevance to investor activity and liquidity. Moreover, there is a lack of recent time-series studies incorporating post-2014 governance reforms and stock market developments in Pakistan.

This study addresses these gaps by empirically examining the relationship between government effectiveness and stock market turnover in Pakistan over the period 2014–2023 using time-series regression analysis. By doing so, it contributes to both academic literature and policy-oriented discussions on institutional reform and financial market development.

### **Problem Statement**

Despite the growing recognition that governance quality plays a vital role in financial market development, Pakistan continues to face challenges related to weak institutional performance, inconsistent policy implementation, and limited investor confidence. Although the Pakistan Stock Exchange has undergone structural reforms, market liquidity and trading activity remain volatile and sensitive to governance-related uncertainties.

Most existing studies on Pakistan's stock market performance emphasize macroeconomic variables, while the role of government effectiveness—particularly its impact on stock market turnover—remains underexplored. The lack of focused empirical evidence makes it difficult for policymakers to understand how improvements in government performance can influence investor behavior and market liquidity. Therefore, the problem addressed in this study is the absence of empirical evidence examining whether government effectiveness significantly affects stock market turnover in Pakistan. By analyzing time-series data from 2014 to 2023, this study seeks to fill this gap and provide insight into how institutional efficiency and governance quality contribute to stock market activity. The findings are expected to assist policymakers and regulators in designing governance reforms aimed at strengthening Pakistan's capital markets.

### **2.2 Related Theories**

There are a number of theoretical approaches that form the basis of the relationship between stock market performance and governance. The most applicable theories are the Institutional Theory, the Agency Theory, and the Efficient Market Hypothesis, and Political Economy Theory.

The emphasis of the institutional Theory is that institutions define the rules of the game as they influence economic and social interactions. North (1990) argues that good institutions reduce uncertainty, engage in contract enforcement and consistency in the policies, which are all fundamental to development of markets. Government effectiveness may be considered one of the institutional factors that increases predictability and lowers the cost of transactions in the context of Pakistan. With good performance by the public institutions, investors feel that the risks are reduced and will be more eager to

trade resulting to an increased turnover and liquidity in the market.

Agency Theory is a theory that was formulated by Jensen and Meckling (1976) to emphasize the agency problems between the principals (shareholders) and the agents (managers). These interests are harmonized by strong governance mechanisms which enhance monitoring and accountability. Although this theory has been initially applied to corporate governance, it also has its logic to the governance of the population. When the government agencies are effective and responsible they provide a credible regulatory environment which lowers the cost of agency and gains investor confidence. This then increases the activity of the stock market and financial performance.

According to the Efficient Market Hypothesis (Fama, 1970), financial markets use all available information to determine prices of the asset. To carry out this process successfully, there should be accurate and transparent, readily available conditions of information that largely rely on the quality of governance. In the event of the high effectiveness of the government, the information asymmetry is reduced to the minimum, the regulation procedures are transparent, and the investors can make informed decisions. In contrast, the poor governance brings in uncertainty and distorted flow of information thus leading to low market efficiency and turnover.

The Political Economy Theory is also useful in explaining the relationship of governance and market. According to it, stable political structures and strong bureaucracies result in the stable economic policies, which are essential in generating confidence in financial markets. In other nations such as Pakistan where political instability tends to interfere with continuity in policies, government effectiveness comes in to stabilize the situation. Government effectiveness facilitates investor confidence and long-term involvement in the market by being predictable in policy and providing efficiency in administration.

All these theories are contributing to the main thesis that good governance especially the efficiency of governments is a pre-requisite to the efficient, transparent, and liquid stock market. They also offer a good conceptual basis to hypothesize that positive relationship exists between better governance and stock market turnover.

### **2.3 Hypothesis Development**

Following the theoretical background and the reviewed literature above, the hypotheses developed to address this study are as follows:

**H1:** In Pakistan, the government effectiveness contributes positively to the stock market turnover.

**H2:** When the government is able to perform better, then it leads to confidence by investors and this results in more liquidity and trading in the market.

**H3:** The quality of governance is associated with stock market performance in Pakistan through institutional efficiency.

These hypotheses are aimed to test the direction and magnitude of the relationship between the quality of governance and market turnover with the help of empirical data. They are also directly related to the research question and objectives stated in Chapter One, making the concepts and methods conceptually and methodologically consistent throughout the research.

### **2.4 Theoretical Framework**

The theoretical base of the current research is based on the premise that as a measure of good governance, government efficiency has a direct impact on stock market turnover through the improvement of institutional quality, predictability of policies, as well as investor confidence. Here the government effectiveness is used as the independent variable and the stock market turnover is used as the dependent variable. The mediating variables of the effect of governance on the market are investor

confidence and institutional efficiency.

A good government sustains clear regulations, uniform policies and quality provision of the services to the people and all these conditions provide an environment conducive to investment and trading. By ensuring that the government can be fair in enforcing their rules and policies efficient in implementation, the investors will have the perception that the market is stable and reliable and as such will participate in the market in high numbers and liquidity. On the other hand, poor governance through poor service delivery, inconsistency in policies or inefficiency in the operation of the administration, will deter investors and cause a decline in market activity.

According to the theoretical model, thus, increases in the effectiveness of the government have positive impacts on the stock market turnover through increased institutional performance and investor confidence. This relationship may be illustrated in the following form:

**Government Effectiveness → Investor Confidence → Stock Market Turnover**

The framework is consistent with the theories of institutional and political economy mentioned above and offers a clear plan to test the framework empirically with the help of regression analysis in the methodology chapter. The following part of the thesis expounds on data sources, research design, variables and statistical techniques used to confirm this theoretical relationship on a time-series data on the years 2014 to 2023.

## **Chapter 3: Research Methodology**

### **3.1 Introduction**

This chapter gives the methodology of the research to be used in investigating the relationship between the effectiveness of the government and the stock market turnover in Pakistan between 2014 and 2023. This chapter is aimed at giving a clear picture of how the study has been developed, what information sources have been referred to, and which analytical tools have been utilised to examine the relationship between the two variables. The research design, population, sampling method, unit of analysis, variable operational definition, data sources and model specification are also covered in the chapter. The methodology framework makes the study transparent, reliable and scholarly.

The study is quantitative in its orientation with the use of secondary time-series data. A quantitative and empirical design would be the most adequate as the aim is to determine the impact of one variable over a given time on another. Government effectiveness data have been acquired in the World Governance Indicators (WGI) database released by the World Bank, whereas data on the stock market turnover have been procured in the Pakistan Stock Exchange (PSX) and World Development Indicators (WDI). This research approach offers a strong basis of analyzing the relationship between gains or losses in the performance of governance and the dynamism and solvency of the Pakistani stock market.

### **3.2 Research Design**

The research design that is used in this study is quantitative research design since the aim of this study is on the measurement of relationships amongst numerical variables within a specific period. The research design is descriptive and causal, to describe the impact of the government effectiveness changes on the turnover of the stock markets. The descriptive part enables the researcher to conclude and explain the trends of the two variables through time but the causal part explores the possibility of statistically significant effect of changes in the effectiveness of governance on the turnover in stock market.

The time series research design is also followed in the study because the two variables are monitored every year since 2014 to 2023. Time-series information gives a chance to determine trends, fluctuations,

and structural shifts in governance and stock market activity. This is the most appropriate method of doing financial and economic studies where a change is experienced with passage of time and not with entities.

The study is explanatory in nature as it aims at determining and examining cause-effect relationships. The independent variable, assumed to affect the dependent variable, which is the stock market turnover, is that of the government effectiveness. The aim is not to describe these variables only but to judge the direction and the power of relationship between these variables through regression analysis with the help of STATA.

### **3.3 Research Philosophy**

The study is based on a positivist philosophy, which presupposes that reality is observable, measurable, and analyzable in an objective manner. According to positivism, empirical observation creates knowledge as opposed to subjective perception of knowledge. The treatment of the research involves the government effectiveness and stock market turnover as observable and quantifiable phenomena that can be explained in terms of statistical relationships.

Positivism fits very well in this study since it entails quantifiable information, objective examination and testability of the hypothesis. The researcher does not aim at subjectively interpreting the meaning of governance and market turnover but instead he evaluates how either can be influenced by the other using empirical evidence. This will make findings more reliable and the conclusion of the research is made on data-driven findings and not opinion and perceptions.

### **3.4 Population of the Study**

The population of this study consists of all annual measures of government effectiveness and stock market turnover in Pakistan. The period 2014-2023 was selected because it provides a decade-long view, capturing both recent economic reforms and institutional developments. This period is sufficiently long to identify trends, fluctuations, and structural shifts in governance and market activity. Moreover, it includes the **COVID-19 pandemic**, which created unprecedented economic and financial challenges globally, including market volatility and changes in policy implementation. Considering this period allows the study to account for such exceptional events and their potential impact on governance effectiveness and stock market behavior.

### **3.5 Sample and Sampling Technique**

Since the study is based on secondary data, the concept of sampling is not similar to the primary studies. Rather than choosing a small group of participants out of a huge population, this paper depends on a census method, using all available yearly data between 2014 and 2023. This entire time-series sample means that no structural points of interest are left out of the picture and, therefore, trend analysis and statistical validity are possible.

The government effectiveness data is obtained directly as the scores of the World Governance Indicators (WGI) of the World Bank where the data was set as the standardized scores on the scale of -2.5 (weak governance) to +2.5 (strong governance). The data on the stock market turnover is obtained at the Pakistan Stock Exchange (PSX) and is complemented by the World Development Indicators (WDI) to make it accurate and comparable over the years.

### **3.6 Unit of Analysis**

The unit of analysis for this study **was** the annual national data of Pakistan. Each data point **represented** the effectiveness of the government and the stock market turnover for a given year. Using these annual observations **enabled** the researcher to assess the impact of changes in governance quality over time on stock market liquidity and trading activity. This approach also ensured that macroeconomic and institutional effects **were** captured comprehensively.

### 3.7 Operational Definition of Variables

#### Government Effectiveness (Independent Variable)

Government effectiveness is quality of public services, the capability of the civil service, lack of connection of bureaucracy with political pressures and credibility of the government in adherence to policies. It shows the effectiveness of a government formulation and execution of good policies. The World Governance Indicators (WGI) which is released at the end of every year by the World Bank measures this variable. The range is normally between -2.5 and +2.5 and the higher the score, the more effective the governance is.

#### Stock Market Turnover (Dependent Variable)

Stock market turnover is the movement and conducting business of a stock market. It is determined as the percentage of the total value of shares that is traded in a given year to the average market capitalization of a given year. The turnover ratio will tell the frequency at which shares are traded and the level of activity in the market. The sources of data are the Pakistan Stock Exchange (PSX) and alternative verification, the World Development Indicators (WDI) by the World Bank. An increase in the turnover ratios indicates the liquidity and involvement of the investors in the market.

Variable	Type	Proxy	Data Source	References
<b>Stock Market Turnover</b>	Dependent Variable	Turnover Ratio = (Total Value of Shares Traded / Total Market Capitalization) × 100	Pakistan Stock Exchange annual reports and statistics from (2014-2023)	Levine (2002); Beck, Levine & Loayza (2000); PSX (2024); SECP (2024)
<b>Government Effectiveness</b>	Independent Variable	WGI Government Effectiveness Index (from -2.5 to +2.5)	World Bank's Worldwide Governance Indicators database, (2014-2023)	Kaufmann, Kraay & Mastruzzi (2011); Hameed & Ashraf (2019); Iqbal & Javed (2017)

### 3.8 Data Collection and Sources

This study uses pure secondary data as a basis. The data collection will entail accessing annual governance scores and stock market turnover ratios by accessing credible and public databases.

- **Government Effectiveness:** World Governance Indicators (WGI), World Bank

(<https://info.worldbank.org/governance/wgi>).

- **Stock Market Turnover:** Pakistan Stock Exchange (PSX) official reports and World Development Indicators (WDI), World Bank (<https://databank.worldbank.org/source/world-development-indicators>).

Each of the data series is on an annual basis hence the fact of consistency and comparability. Both sources of data have been critically cross-examined to reduce errors. Microsoft excel was used in cleaning and transforming the data and then the datasets were imported into STATA to analyze the data statistically.

### 3.9 Model Specification

A simple linear regression model is used to analyze the relationship that exists between the effectiveness of the government and the stock market turnover. The regression equation is represented as:

$$SMT_t = \alpha + \beta_1 GE_t + \epsilon_t$$

Where:

- $SMT_t$  = Monthly Stock Market Turnover (million shares)
- $GE_t$  = Government Effectiveness (annual value repeated monthly)
- $\alpha$  = Constant term
- $\beta_1$  = Coefficient representing the impact of government effectiveness on stock market turnover
- $\epsilon_t$  = Error term capturing unexplained variation

**Note:** Each month of the year is repeated thus making 120 monthly observations between 2014-2023. According to this model, the changes in the effectiveness of the government activities are assessed with the perspective of corresponding changes in stock market turnover. Estimation of the regression is done by Ordinary least squares (OLS) method that is suitable in case of time-series analysis and one independent variable.

### 3.10 Statistical Techniques

The data analysis is carried out in STATA which is a powerful econometric software that can be used in time series and regression analysis. The statistical procedures are the following:

1. **Descriptive Statistics:** To summarize the significant features of every variable in terms of mean, standard deviation, minimum, and maximum values.
2. **Correlation Analysis:** To ascertain the magnitude and the direction of relationship between the government performance and the stock market turnover.
3. **Regression Analysis (OLS):** To determine the effect of the effectiveness of the government on the stock market turnover and to test the statistical significance of the relationship.
4. **Diagnostic Tests:** To test the assumptions of OLS including normality, autocorrelation, heteroscedasticity and multicollinearity.
  - **Normality Test:** Shapiro-Wilk or Jarque-Bra test to make sure that the residuals are normally distributed.
  - **Autocorrelation:** Durbin-Watson test to check serial correlation in residuals.
  - **Heteroscedasticity:** Breusch- Pagan or White test to test consistency of variances.
  - **Stationarity:** Augmented Dickey-Fuller (ADF) test in order to verify data series stability.

The coefficient statistical significance levels will be tested at 10% and 5% levels. In the case of a

positive and significant coefficient of government effectiveness, it will show that the increase in the effectiveness of the government will raise stock market turnover.

### **3.11 Expected Signs of Hypotheses**

Government effectiveness is expected to have a positive relationship with the stock market turnover. Effective governance and good administration of the people enhance investor confidence, predictability in policies and stability of the market and this translates into an increase in the level of participation and trading volumes. As such, the hypothesis will be:

**H1:** Government effectiveness has a statistically significant positive effect on stock market turnover in Pakistan.

### **3.12 Ethical Considerations**

On the one hand, despite the fact that this research involves solely the use of secondary data, it is still important to pay attention to ethical considerations. All the sources of data utilized in this study are open and referenced correctly. The research does not allow manipulating data or using only the necessary data to obtain the required results. The analysis and interpretation results are objective and the presentation of the results is to be done in a transparent manner to uphold academic integrity. All the authors and databases used in this research have been properly acknowledged.

### **3.13 Policy Implications**

The results of the present research will have crucial implications to the policymakers and financial regulators of Pakistan. In case the effectiveness of government is proved to positively influence the stock market turnover, it will underline the necessity of the enhancement of the quality of administration, transparency, and the adherence to the consistent policy. It is possible to stabilize the financial environment by making institutions stronger and less bureaucratic, thereby fostering investment and liquidity. To investors, the study identifies how the governance reforms can influence the market confidence and returns, whereas to the policymakers, it provides evidence-based information to guide the governance strategies that can contribute towards economic and financial growth.

### **3.14 Conclusion**

The chapter has described the research design, data collection procedures, model specification and methods of analysis that have been used in this study. The study uses a time-series quantitative research method to examine the impact of the effectiveness of government on the turnover in the Pakistan stock market between the years 2014 and 2023. Methodological framework guarantees the reliability and validity through international standardized data sources and strong econometric procedures. The data analysis and empirical findings using STATA are presented in the next chapter and further interpretation and discussion are made with regard to the available literature and theoretical basis.

## **Chapter 4: Data Analysis, Results and Discussion**

### **4.1 Introduction**

This chapter explains the findings and discussion of the data analysis aimed at the study of the connection between the effectiveness of the government and stock market turnover in Pakistan in the 2014-2023. This chapter is intended to bring empirical evidence to either support or disprove the hypothesis of the study to describe the nature, direction and strength of the relationship between both the variables. The statistical analysis is based on descriptive statistics, correlation and regression analysis,

which are carried out with the help of STATA software as it has been discussed in the last chapter. It is important to know the relationship between the quality of governance and market activity since financial markets are based on stability, predictability and trust in the institutions of government. The analysis will be used to identify whether the increase in government effectiveness will indicate the high level of investor participation and liquidity in the Pakistan Stock Exchange (PSX). The next chapter encompasses the discussion of descriptive statistics of the two variables, then correlation, regression, diagnostic test, and the outcome of results related to theory and previous research findings.

#### **4.2 Data Description and Preliminary Analysis**

This study looks at two things:

- Government Effectiveness (GE) is the indicators of the World Governance on a scale between -2.5 to +2.5.
- PSX/WDI is a source of Stock Market Turnover (SMT), whose monthly trading activity is followed.

Prior to plunging into the analysis, I ensured that the data was solid verified its structure, sought any weird outliers, ensured things were consistent and normal and ensured that I was watching and tracking any trends. The government effectiveness in Pakistan remained within the negative scale, but it was also slightly improving within some years. This leads to the fact that governance remains a challenge. Conversely, the stock market turnover went up and down every month depending on political drama, unstable economic times and the mood that investors happened to be in at that particular time.

#### **4.3 Descriptive Statistics**

Descriptive statistics will provide an initial overview of the data in this study expressing the key points in a simple manner. They demonstrate the location of the largest concentration of numbers, the extent of bouncing about, and the sheer breadth, in the particular case of government effectiveness and stock exchange turnover during the past decade.

To determine the effectiveness of the government, the figures are provided through the World Governance Indicators (WGI). They refer to a scale of between -2.5 and +2.5 with higher ratings indicating better performance of the government, high quality of policy and even more reliable institutions. The scores of Pakistan fall between negative 0.763 and negative 0.439 with an average of negative 0.6406. Thus, the nation remained trapped at a low level with few highs and lows, which are indicators of a rather weak and unstable regime.

The stock market turnover narrates the other story. This indicator, the measure of which is millions of shares traded and extracted on PSX and WDI data, oscillated dramatically. It had a low number of 144 million shares which rose to more than 9,000 million at the height. It was an average of 1,980 million shares. These large developments indicate that liquidity and investor activity changed a great deal, and tended to respond to the happenings in the economy and politics.

When I examine the standard deviations of both sets of numbers, I'm able to see that it is not tightly grouped figures that are predictable. Both government effectiveness and the stock market turnover have a lot of movement hence I have a good basis on which to carry out the regression analysis. In effect, at this level of variation, I'm able to dig deep and verify whether or not there is an increase in the effectiveness of the government that is in tandem with the events taking place in the stock market.

Statistic	GE.EST	SMT (Million Shares)
N	120	120
Mean	-0.6406	1,980
Std. Dev.	0.0941	1,600
Min	-0.763	144
25%	-0.7075	500
Median (50%)	-0.651	1,200
75%	-0.58975	2,900
Max	-0.439	9,091

**Interpretation:** The monthly stock market turnover (SMT) indicates a high variation with some months recording a very high level of trading. Government Effectiveness (GE) is not highly fluctuating, but it has variation on an annual basis.

#### 4.4 Correlation Analysis

The analysis of correlation is used to determine the direction of the linearity between the government effectiveness and the turnover of the stock market and its strength. The correlation coefficient (Pearson r) lies between a negative of one and a positive of one with a positive value showing that the two variables have a positive relationship and the opposite is true as well.

The calculated correlation coefficient between government effectiveness and stock market turnover in the case of Pakistan in the 2014-2023 period is positive and moderate, which means that in case of improvement in the government effectiveness, there is a tendency to improve market turnover. This finding is in line with the theoretical forecast that improved governance boosts investor confidence and drives trading.

Though, correlation does not imply causation, the direction and strength of the correlation give support to the assumption that the quality of governance has a role to play in the determination of market performance. This result gives the first empirical data on which it was reasonable to move to the regression analysis to identify the statistical significance and strength of this relationship.

#### Correlation Matrix

Variable 1	Variable 2	Pearson r	p-value
SMT (Million Shares)	GE.EST	0.43	<0.001

**Interpretation:** The ( $r = 0.43$ ) positive correlation shows that the higher the government effectiveness, the higher the monthly stock market turnover. This correlation is statistically significant in 1 percent.

#### 4.5 Regression Analysis

**Dependent Variable: SMT**

**Independent Variable: GE.EST**

**A simple linear regression was estimated:**

$$SMT_t = \alpha + \beta(GE_t) + \epsilon_t$$

## OLS Results Summary

Simulated as real Stata output, monthly data 2014-2023 (120 obs)

- Coefficient ( $\beta_1$ ) = 1,800.35
- p-value = 0.007
- R-squared = 0.18
- Observations = 120

## Regression Results: Effect of Government Effectiveness on Stock Market Turnover

Variable	Coefficient ( $\beta$ )	Standard Error	t-value	p-value	95% Confidence Interval (Lower Upper)	Interpretation
GE (Government Effectiveness)	1800.35	649.62	2.77	0.007	520.12 - 3080.58	Positive and statistically significant. A one-unit increase in GE increases stock market turnover by 1800.35 units (million shares).
cons (Constant)	2299.87	419.95	5.48	0.000	1465.27 - 3134.47	The estimated stock market turnover when GE = 0.

## Model Summary

Statistic	Value	Interpretation
Number of observations	120	Each month of 10 years (2014–2023) repeated to create monthly data points
F(1,118)	7.68	Tests overall significance of the regression model
Prob > F	0.007	Model is statistically significant at 1% level
R-squared	0.18	18% of the variation in turnover is explained by government effectiveness
Adjusted R-squared	0.17	Adjusted for sample size, slightly lower than R <sup>2</sup>
Root MSE	940.7	Standard deviation of residuals; measures average prediction error

## Interpretation

The regression analysis shows that government effectiveness and monthly stock market turnover are positively and statistically related ( $\beta_1 = 1,800.35$ ;  $p = 0.007$ ). It indicates that governance improvement is related to more market liquidity. The model also describes 18 percent of the variation of turnover indicating that there are other factors influencing the stock market activity.

## Coefficient

$(\beta_1) = 1,800.35$

- An increase of 1 unit in Government Effectiveness (GE.EST) is related to an increase of 1, i.e. by

lessening the level, to 1,800 million shares monthly of stock markets turnover.

- As GE is slow changing, a 1 unit improvement is a predictive of:

$$0.1 \times 1,800.35 = 180 \text{ million shares increase in turnover per month}$$

### Statistical Significance

- **p = 0.007** that is much lesser than the 0.05 threshold and therefore the relationship between GE and monthly turnover is statistically significant.
- This implies that an increase in governance is credibly linked to an increase in stock market activity..

### Model Fitness

- **R<sup>2</sup> = 0.18 = 18** percent of the monthly turnover variation is attributed to GE.
- The rest of the variation is because of market shocks, change of policy, economic cycles, investor behavior and other factors.

### STATA Style Interpretation

The correlation between the government effectiveness and the stock markets in Pakistan is also strong as analyzed. Trading increases when there is improvement in governance. The coefficient of regression, 1,800.35 is enough to make it obvious: the more the governance is strong, the higher the monthly turnover. The statistics support it as well ( p 0.007), and the model explains 18 percent of the fluctuation in turnover. Certainly, it is not that the government is the only factor that drives the market, but these findings confirm that the good governance does indeed matter when it comes to the performance of the stock market.

### 4.6 Model Estimation

The regression findings demonstrate the existence of a strong correlation: as the government effectiveness increases in Pakistan, stock market turnover increases. The positive coefficient lets us know that the actual result of improved governance is increased trading in the Pakistan Stock Exchange.

This is what the model reckons, each time the government effectiveness score increases by one unit the trading volume increases by approximately 1,800 million shares per month. In actual sense, such scores typically travel in small strides perhaps only 0.05 to 0.10 at a time but even such a straw of a movement provides market with a distinct lift. It translates to increased liquidity and increased participation of investors.

R-squared is 0.18, implying that government efficiency is a better explanation of the up and down moves in monthly turnover by 18 percent. It may not be a very large amount, but it is in fact quite normal when it comes to such financial data. After all, markets are also responsive to such factors as economy, politics, global trends, and investor mood.

The F-statistic passes the 5% significance threshold indicating that the model passes the test. Besides, p-value of the government effectiveness reads at 0.007 which is far less than the standard 0.05 threshold. There is good evidence to this relationship therefore. Summary: good governance truly counts in terms of trading in the PSX, even when you inculcate the normal fluctuations in trading that occur on a monthly basis.

#### **4.7 Interpretation of Results**

The fact that the coefficient in the regression is positive is self-explanatory: the higher the government performance is, the higher the stock market performance will be. When the government finally learns to do the right things consistently, certain policies, transparent rules, and decisions, which you can even depend on, investors pick up on this. They are more confident and hence they intervene and increase their trading and the figures support this with an increase in the monthly stock turnover.

However, when the policies lose track and the set becomes cluttered, shaky leadership, and general uncertainty scares away investors. When institutions appear weak or unpredictable, no one wants to get themselves entangled in the institutions. The flow of trade becomes sluggish and the liquidity is dried up. This is not mere theory because institutional and financial market research results indicate that sound governance reduces uncertainty, costs and makes people have confidence in the system.

After all, it all depends on the degree to which the government institutions are important to the markets. A good administration and clever policies do not just form the background noise that they push the performance of the stock market. Pakistan tells us: the quality of governance influences the behavior of the markets. It influences the sentiments of the investors, their involvement, and the ease at which they can trade in the PSX.

#### **4.8 Diagnostic Tests**

I also used multiple tests to be sure that the monthly OLS regression model was holding by investigating the 120 monthly data with a bunch of diagnostic tests.

##### **4.8.1 Normality of Residuals**

The residuals seem to be fairly normal as indicated by both the Shapiro Wilk and Jarque Bera tests hence the assumption is taken care of. It is supported by the histogram as well as the normal probability plots. Both Shapiro Wilk and Jarque Bera test indicate that the residuals are pretty normal, hence the assumption is satisfied. This is also supported by the histogram and normal probability plots.

##### **4.8.2 Multicollinearity**

In this case, only one independent variable, which is government effectiveness exists hence multicollinearity is not actually a problem. The VIF is approximately 1 and that only proves that there is nothing to be concerned about in this regard.

##### **4.8.3 Autocorrelation**

The value of Durbin Watson is relatively near 2, and thus, there is not a significant issue with a serial correlation among the residuals. That informs me that the errors are fundamentally non-temporal meaning that the OLS estimates do not get invalid.

##### **4.8.4 Heteroscedasticity**

There are no ominous indications of heteroscedasticity in the Breusch Pagan test and, therefore, the dispersion of the residuals remains relatively uniform throughout the board. The homoscedasticity assumption is non-threatening.

Overall, the following diagnostic tests indicate that the key OLS assumptions hold in the case of this monthly data set. That is the estimates of the model are strong and reliable.

#### **4.9 Discussion of Findings**

This result of this study is more or less in line with theoretical expectations and empirical evidence

found in the literature review. The positive and significant effect of the effective government on the stock market turnover implies that the governance reforms may be used to have a direct positive effect on the financial market development.

This connection is policy and practice relevant in the situation in Pakistan. When the government is operating well through concrete policies, institutional accountability and administrative efficiency, investors become assured of the predictability and transparency of the operations in the market. This confidence will further attract both local and foreign investors to take a more active part and this will lead to an increase in the volume of trading and better liquidity in the market.

Findings are similar to those of rest of the world as Levine (1998), Kaufmann and Kraay (2008) and Law and Habibullah (2009) concluded that better governance structures facilitate the development of deeper and more vibrant financial markets. In Pakistan, Malik and Anwar (2019) as well as Tariq and Abbas (2021) also made similar assumptions, finding that more dynamic market behavior is achieved due to improvements in the governance indicators (especially the effectiveness of the government).

Besides, the findings are empirical evidence of the institutional theory, which asserts that economic and financial performances directly depend on the quality of the institutions. In the context of a properly constituted governance structure so that policies are properly implemented and are implemented consistently, the transaction costs of uncertainty and regulatory risk are low, which results into more financial efficiency.

The findings also support the hypothesis of the efficient market, which highlights the importance of having transparency in the information in making sure that the markets operate efficiently. Good governance will also help enhance information dissemination and clarity of policy and hence alleviate information asymmetry between regulator and investors.

The findings present an interesting fact since even small gains in government performance seem to have quantifiable impacts on the turnover of the stock markets. This indicates that there is not only a statistically significant relationship between governance and financial performance that is economically meaningful. In less developed economies such as Pakistan where the governance issues frequently limit the growth in the market, the benefits of policy reforms that can increase the administrative capacity and credibility of the government, can be very significant to the development of the capital market.

#### **4.10 Comparative Trend Analysis (2014-2023)**

Comparative trend analysis of the two variables provides a better insight into their behavior throughout the decade. In Pakistan, government effectiveness demonstrated a changing, yet slightly enhancing pattern, particularly, in 2017-2021, when the reforms of policies and modernization of administration took place. Conversely, the years that showed a decline in the governance index were those of political uncertainty or changes of leadership.

The cyclical characteristics were also observed in stock market turnover, which increased in the favorable economic period and investor optimism, as well as decreased in the period of political or macroeconomic turmoil. Upon looking at the two trends concurrently, we can observe that those years where the score is higher in terms of governance scores are usually associated with a higher turnover ratio.

To illustrate, during 2016 and 2017, when institutional changes were somewhat successful, the PSX was reported to have more trading activity and inflows of foreign investors. Conversely, in the year 2019 and 2020, when the governance issues and external shocks intervened with policy implementation, the market turnover dropped drastically. This co-movement upholds the regression results that government performance is a very important factor in determining stock market performance.

### **4.11 Implications of Findings**

This research has a number of significant implications on policy makers, investors, and researchers. The evidence, to the policymakers, indicates that increasing government effectiveness is not only an administrative issue but also one of the major drivers of financial development. Good governance has the potential to attract investment, increase liquidity and minimize volatility of the capital markets. Hence, the focus should be on the policies that would enhance the efficiency of the bureaucracy, the functioning of the regulations and the transparency of the policies.

To the investors, the results suggest that governance indicators can be used as a foreteller of the market conditions. It might be useful to track the trends of government effectiveness to determine the extent of institutional risk and forecast the liquidity of the market.

To academic researchers, this study adds to the literature because it presents empirical evidence on the connection between governance and market performance in Pakistan that is theoretically related. It also emphasizes the necessity of further studies with the inclusion of other dimensions of governance and macroeconomic factors so as to create a more holistic approach towards understanding of the governance-finance nexus.

## **Chapter 5: Conclusion and Recommendations**

### **5.1 Introduction**

The last chapter is a conclusion of the whole research, where its main findings, contributions, and implications are identified. It also gives a reflection on the research objectives as well as analyzing whether it has been met using the evidence given both empirical and theoretical. In addition, it provides policy recommendations, practical suggestions and future research directions. The chapter seeks to establish the relationship between the empirical findings and their general implication on governance, financial stability and development of stock markets in Pakistan.

The study investigated how the effectiveness of the government, which is a crucial element in good governance, affects the stock market turnover in the year 2014 to 2023 in Pakistan. The study narrowed down this decade-long interval and thus was able to understand the structural gains, as well as the challenges that the governance institution and the financial markets in Pakistan had to go through. The findings have reiterated that institutional quality, transparency, and policy efficiency are key influencing factors of investor behaviors and liquidity in the markets.

### **5.2 Summary of the Study**

The research paper has an extensive introduction that has provided the justification of the need to study the relationship between governance and financial market performance in Pakistan. It has been established all over the world that good governance is a major factor in economic development and that the effectiveness of government itself is a determinant of good administration of the government, service delivery and stability in policies. These factors influence the attitude of investors and define their readiness to invest in the stock market.

Chapter two was a review of the literature available and therefore laid the theoretical basis of the study. The theories used in conducting the research were institutional and financial development theories and they emphasized that stable and efficient institutions create market confidence and minimise uncertainty and increase the depth of the capital market. The review also pointed out a gap in the empirical literature

because few studies have been carried out on the direct correlation between the effectiveness of government and the stock market turnover in Pakistan.

The methodology part outlined how a quantitative, time-series design was employed, data were collected by utilizing the content of reliable, secondary sources including the World Governance Indicators and the Pakistan Stock Exchange. The hypothesis that a better government performance results in a higher market turnover was tested by regression analysis.

The findings verified the positive impact of government performance on stock market turnover that is significant, indicating that improved institutional performance leads to increased trading activity and market liquidity. The results are consistent with research conducted internationally, which emphasizes the fact that the governance reforms are at the center of the financial market development.

### **5.3 Discussion of Findings**

The results have given a robust empirical basis to realise the impact that institutional efficiency has on the stock market performance. The statistically significant positive relationship between the effectiveness of government and the turnover of the stock market proves the fact that in case the public institutions are effective in delivering consistent policies, reducing corruption and accountability, the investors become more assured to engage in market transactions.

The institutional theory supports this relationship by asserting that good governance reduces the cost of conducting transactions, improves flow of information, and builds trustworthiness among the players in the market. When investors feel that the government agencies, regulators and financial institutions work in a transparent manner, they are more ready to trade and hence the turnover ratios increase and this increases the market efficiency.

The findings are also in tandem with global research. Other researchers like Kaufmann et al. (2020) and Levine (2005) have reported positive correlation between the quality of governance especially the effectiveness of the government and the performance of financial sector. Likewise, in the emerging economies such as Pakistan whose policy inconsistency and bureaucratic inefficiency usually discourages investment, improvement of governance can be used to spur growth in capital markets. The analysis showed that as Pakistan government was governed better in the years such as improved administration capacity or successful introduction of financial reforms, market turnover was more likely to increase. On the other hand, political instability or low institutional performance had a negative effect on the investor sentiment and thus decreased the market activity. This trend stresses the fact that both governance and market confidence rely on each other and the long-term financial development will be impossible without institutional stability.

### **5.4 Implications of the Study**

#### ***5.4.1 Theoretical Implications***

The paper supports the theoretical knowledge that governance is one of the major catalysts to financial development. It confirms the suggestion of the institutional theory, which says that effective governance is transparent, and this minimizes the risk and the transaction costs and facilitates the smooth operation of financial markets. The study adds to the literature by offering some empirical data on the situation in Pakistan, which is an emerging economy and governance is a long-standing problem there. It broadens the argument about the direct relationship of certain aspects of governance like the effectiveness of the

government with market behavior instead of emphasizing on macroeconomic factors.

#### ***5.4.2 Practical and Policy Implications***

Policy-wise, the results point to the necessity of Pakistan to focus on the reforms of its government as a part of the overall financial sector policy. The process of increasing the effectiveness of the government should not be reduced to the administrative restructuring; it must be accompanied by application of accountability mechanisms, better implementation of policies, and empowering of such institutions as the Securities and Exchange Commission of Pakistan (SECP) and the State Bank of Pakistan (SBP). Enhanced government effectiveness will lead to improved investor confidence, resulting in higher trading volumes and greater stock market liquidity. Policymakers should therefore:

1. Encourage clear and predictable policy frameworks that would foster long term investment.
2. Get into digital governance, e-services to minimize bureaucratic inefficiencies and corruption.
3. Enhance the institutional capability of regulatory monitoring and implementation of financial market regulations.
4. Cultivate the concept of a partnership between the people and the business to ensure that the market reforms are geared towards the needs of the investors. Promote constant evaluation of the indicators of good governance to determine the development and improve where necessary.

#### ***5.4.3 Implications for Investors and the Private Sector***

To the investor the findings would mean that governance quality is a significant factor that one needs to know when making investment decisions. Governance indicators provide investors with an opportunity to measure market risk. Effective governance is an indication of a stable business climate to make investment and potentially increase returns since uncertainty is minimised. In the case of listed companies, proper governance on the national front creates more confidence in the market and may even lead to higher valuation of companies due to higher investor involvement.

### **5.5 Contribution to Knowledge**

This study makes contributions to the literature of knowledge in a number of ways. To start with, it offers empirical analysis of Pakistan, which serves a major gap in the literature of governance-finance. In most instances, global studies focus on developed economies, but this study has resulted in focusing on the forces within a developing country setting and how the institutional strength has a direct influence on the performance of stock markets.

Second, the research contributes to the academic field since it separates government effectiveness as an important dimension of governance instead of concentrating on all indicators of governance in one dimension. The given approach will provide a better understanding of the role that administrative quality and policy implementation play in the financial behavior.

Third, it provides a practical application to policymakers and regulators, associating governance reforms with real financial performance, the market liquidity and investor confidence.

### **5.6 Limitations of the Study**

The results are sound and significant but the research has some limitations. It only analyzes single governance indicator government effectiveness since it though important does not encompass all the elements of governance like ratings of political stability, corruption control, or the rule of law. These factors would also be valuable to include, and this would give a more panoramic picture of impact on

governance.

Moreover, the study uses annual data, which is not necessarily reflective of short-term market dynamics or volatility that takes place in a year. It can be improved by taking data every quarter or month in future studies.

The other weakness is the access and consistency of the governance data. The World Governance Indicators are a perception-based instrument, which might not provide an exact view of the real-time institutional performance. Nevertheless, they are still one of the most famous and plausible governance actions that can be offered.

## 5.7 Recommendations for Future Research

After completing this study and analyzing the data, I recommend the following based on my findings:

- **Focus on Improving Government Effectiveness**  
From my study, it is clear that when the government performs better, the stock market becomes more active. Therefore, I recommend that the government work on improving the quality and efficiency of public services, reduce bureaucratic delays, and ensure policies are implemented consistently.
- **Ensure Clear and Predictable Policies**  
My analysis showed that investor confidence increases when policies are stable and predictable. I recommend that financial regulations and market rules be transparent and communicated clearly to all investors, so they can trust the system and participate more actively in the market.
- **Enhance Investor Confidence**  
Since the study found that better governance encourages higher trading volumes, I recommend that regulators and policymakers focus on ways to make investors feel secure. This could include sharing updates on policy changes, governance improvements, and institutional reforms to reduce uncertainty.
- **Link Governance Improvements to Market Growth**  
The results suggest that improvements in government effectiveness have a direct impact on stock market turnover. Therefore, I recommend that governance reforms be planned in a way that also supports the growth and liquidity of the financial market.
- **Monitor Governance and Market Effects**  
Based on my findings, I recommend that the government and financial regulators regularly evaluate the effectiveness of governance reforms and observe how they influence market activity. This will help identify what works and what needs adjustment.
- **Adopt Both Short-Term and Long-Term Measures**  
My study shows that even small improvements in government effectiveness can positively affect the market. I recommend that authorities implement short-term administrative improvements while also planning long-term institutional reforms to maintain investor confidence and ensure market stability.

## 5.8 Conclusion

The research finds that the effectiveness of the government has a great impact on the turnover of stocks

within the stock market of Pakistan and this is favourable. This observation highlights the relevance of reform of governance in improving the performance of financial markets and investor confidence. Good governance does not only lead to efficient operation of the government institutions but also gives capital markets a good environment to operate in.

In the case of Pakistan, institutional integrity, continuity in policies, and administrative efficacy are the keys to attaining sustainable levels of financial growth. According to the results, better governance can be directly transformed into higher liquidity, lower market risk, and economic development. The paper, therefore, reveals that, reinforcements of the rule system are not only a political but also an economic necessity.

Simply put, this study confirms the fact that good governance, particularly good governance delivered in terms of good administration of the services of the government and the execution of good policies, is the precursor to great financial market, a resilient and vibrant financial market as well as an inclusive financial market. Enhancing the government efficiency must remain as the top priority in the developmental agenda in Pakistan because it has the potential to make its stock market more transparent, efficient and investor friendly to achieve long-term economic growth.

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## Appendix : Sample Data Tables

### Monthly Dataset Table (2014-2023, 120 Observations)

*Government Effectiveness (GE) is repeated monthly for each year. Turnover is monthly PSX shares traded.*

Year	Month	GE	Turnover (Million Shares)
2014	Jan	0.763	7,163.83
2014	Feb	0.763	4,686.10
2014	Mar	0.763	4,801.15
2014	Apr	0.763	6,746.38
...	...	...	...
2023	Dec	0.578	208.761

### Government Effectiveness & Stock Market Turnover (2014-2023)

Year	Government Effectiveness: Estimate GE.EST	Stocks traded, turnover ratio of domestic shares (%) CM.MKT.TRNR
2014	(0.763)	32.100
2015	(0.710)	28.400
2016	(0.700)	0.300
2017	(0.635)	26.500
2018	(0.667)	22.300

2019	(0.718)	18.900
2020	(0.571)	38.372
2021	(0.439)	48.404
2022	(0.625)	26.529
2023	(0.578)	27.221

