The Impact of Terrorism And Political Events On Stock Market: Empirical Evidence From Pakistan

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Abstract:

The aim of this paper is to explore the relationship between political & terrorist activities in Pakistan on the stock market development. The paper presents data on the reaction of financial markets to the terrorist attacks and political instability in Pakistan (2011-2014). T-statistic is used to measure the impact of terrorism and political events on stock exchange market. In order to determine the Average return (AR), moving average method is used .The results of the study have shown that Terrorism and Political events negatively affect stock market returns in the short run; whereas there is no significant relationship between stock market returns, Terrorism and Political events in the long run. A potential limitation of the study was the constraint related to the available yearly economic growth and other economic variables' data. The data for the study was based on the terrorist & political activities for the year 2010 to 2014 on an incident to incident basis. Based on the empirical results, it is being recommended that governments should pay particular attention to economic recovery in the aftermath of terrorist attacks and political unrest and the policies aimed at combating terrorism must be the priority of the government, so that its harm can be reduced, if not exterminated. Political unrest can be addressed through parliament house and judiciary. Terrorism and Political events, with its all kinds of impacts, affect the society and its activities and therefore must be eliminated if an economy needs to prosper. This study envisions the overall impact of terrorist activities and political events, not just as a single activity but also on the health of the economy. For studying this impact, a t-statistics has been used for this study.

Keywords: Stock market development, t-statistics, Average returns (AR), Moving average method.

Introduction:

A huge amount of research has been done on terrorism and political unrest in different fields of studies like sociology, history and political science. With respect to finance terrorism and political unrest has not received too much attention by researchers so far. There are various terrorism and political events like the event of 9/11 terrorist attacks on financial markets, 26/11 Mumbai attack, terrorism attack on Jinnah Airport Karachi 2014 and in PAF (Pakistan Air Base) Quetta 2014 are the significant examples of terrorism and political events like Dr.Tahir-ul-Qadri's arrival in Pakistan on June 2014 and gathering of PTI and PAT in Islamabad August 2014 and has proved that terrorism as well as

Political Unrest are new type of catastrophic risk for investors, which financial institutions are facing right now. The impact of political and terrorism risk on the behavior of KSE- 100 index are analysis in this paper .After the event of 9/11 in all of the world terrorist activities have increased with the ratio of 24% per year (GTD,2014). Pakistan is still paying very high price for being a front line alley in war on terror and Pakistan is the main target of terrorist attacks. According to GTD since Jan 1,1992 till December 31,2012 there had been 5221 terrorist attract .Government is not paying much attention to resolve the root causes of terrorism .Due to this Pakistani people is facing stress and economic s problem .In otherwise , we can say terrorism is a tactic designed used to set in oppressiveness aimed to attain a religious political the act of terrorism on its economy has not been consistent .The terrorist attack of 9/11 on world trade centre was become very big reason of financial crisis's and due to this attack new York stock exchange trading operations remain close for full week. In 12 October,(2002) attacked in Bali island through suicide bomber and killed 203 people and were tourist and injured 241.Indonesia stock market was badly affected and it dropped by 25.54%.The sector analysis has shown that on the first day of the trading the investors has reduced capital between 3.29% to 8.38% and there was very negative impact on the stock market after this event.

On the 7th July (2005) early morning, when terrorist were attached in London and killing 52 civilians and injuries over more then 700. It was worst terrorist incident in the history of the United Kingdom and the London stock exchange was remained uninterrupted FTSE (100 London stock index) was 4% approximately and it adjusted to the shock and trading continuous closed down to 17%. The varying reaction of LSE and NYSE have shown that terrorism have impact of the financial markets.

This studies has shown that fear of terrorism are affecting the investment decision and also shown that when terrorism becomes a part of the environment then investors confidence may not lose and market continued normally.

Keeping in view the importance of financial market for Pakistan's economy, the interest of area in research work is that there is an impact of terrorists' activities and political unrest on KSE-100. Especially, the attack in the key area of business center and political instability affects KSE-100 Index so badly.

A place where trading of the securities are made is called Stock market. It plays a vital role in increasing the surplus. There is a strong link between Stock market and global and domestic stability of a country. The current condition of suicidal bombing and various attacks by Taliban, Al-Qaeda, puts the financial markets in worst condition. There is lack of trust by share holders due to this political and terrorist event. For example in the era of General Pervaiz Musharraf there was a huge amount of political instability. At that time the KSE-100 was at lowest level when there was judiciary war against government and many more events occurs which leads the KSE-100 downwards. These events includes assassination of Akbar Bugti, assassination of Benazir Bhutto, assassination of Shabaz Bhatti, Lal Masjid event, US drone attacks in FATA, bomb blast at Marriot Hotel and many more. Different studies has shown the impact of the Boston bombings on the international stock market and do the comprise with the previous terrorist attacks(9/11,3/11,7/7).In this paper we discuses very clearly that what is the impact of terrorism on the stock market and due to this terrorism impact what news has spread about Pakistan in all over the world .This was first time in the history that Boston police was used twitter as the main instrument of communication .Stock market is playing very important role for the functioning of economy .With the help of the stock market companies can raise funds .Stock market provide the choice for each individual to invest in different companies .Stock market has a very vital role in the economy like1)business expansion2)world spread investing3)increased investor class3)direct job warning.

According to different survey Pakistan is most affected country by terrorism after Iraq .N ISP 2013 to 2018 draft has shown that still position is being not fine and interior minister chardury nisar ali khan has said in his presentation that there is a threat to the integrity in the future. After the taking data by the US national consortium has shown that terrorism and responses of terrorism, Pakistan led the chart .if we shall see different attack then will see that 1405 terrorist attack in 2013,iqra has 1272 attacks and Afghanistan was 1024 incidents .More than of 1/33 % of attacks are occurred in KBk and ratio of attracts in Baluchistan (24pc),fate (19.6pc) and sindh(18pc).The national internal security policy

document says that people were kill in country 5273 personnel of the law enforcement agencies and 17642 were killed in last three years. This paper also discuses about the loss of the economy in last 10 years was $78 billion .This result provides a grin picture of the state of security in the country.

Table 1: Terrorist Events, 2003(Jan) to 2012(Dec)

Year	Rank	Incidents	Fatalities	Injuries	Property Damaged
2003	12	41	97	311	12
2004	11	27	118	182	11
2005	6	59	271	657	16
2006	8	66	77	258	33
2007	6	145	245	578	56
2008	3	197	1145	1984	73
2009	3	492	1009	1738	156
2010	3	651	1378	3415	307
2011	3	683	1518	2864	344
2012	3	911	1466	2458	457

In the finance language we can say stock market is the indicator of the country growth .It provides an estimation about the future economic position .History proves that stock exchange is always work as a predictor of upcoming dejection .There are many studies about the stock market returns and economic activity. Pakistan is a developing country there are three types of stock market in Pakistan.1) Karachi stock exchange2) Lahore stock exchange3) Islamabad stock exchange .Karachi is the biggest stock exchange of Pakistan .It was established on 18th sep 1947 with a capital of 37 million rupees .Now a days there are 583 companies are listed at KSE with a market capitalization 48336.362 billion rupees.

The global terrorism index is helpful to tells about the impact of terrorism on the different countries .The GTD is unique it is based on comprehensively coded data on the domestic and international terrorist accidents there are more than 114000 cases about terrorism.
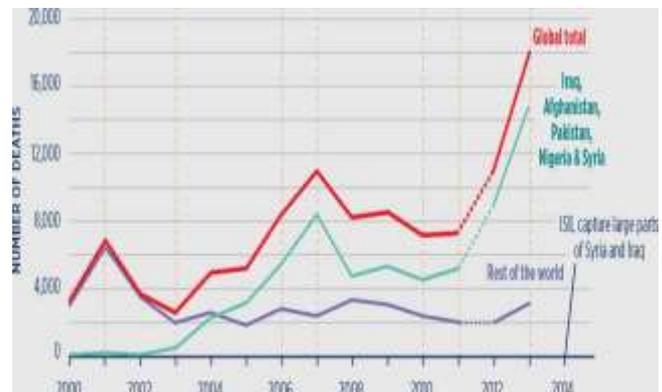
TABLE 2 Ten countries most affected by terrorism in 2011

RANK	COUNTRY	GTI SCORE
1	Iraq	9.55
2	Pakistan	9.04
3	Afghanistan	8.66
4	India	8.14
5	Yemen	7.31
6	Somalia	7.22
7	Nigeria	7.22
8	Thailand	7.08
9	Russia	7.06
10	Philippines	6.81

There are some countries which did not face terrorism effect in 2011 1)burkinafaso2)brazil3)cuba4)malawi5)lativa6)jamaica7)iceland8)singapore9)turkemistam10)co-stakica

IEP has indentified that there some countries which is at risk 1) Mexko 2) Iran 3) Uganda 4) Sri lanka 5) Bangladerh 6) Mali 7) Myanmner

Terrorism accidents in 2000-2013

Objectives;

1) This study show the relationship between terrorism on financial market
2) What is the impact of terrorism on exchange rate?

3) To show the impact of terrorism on KSE index

4) On the basic of different finding to suggest the policy recommendations

Research problem:

What is Impact of terrorism on Karachi stock exchange?

LITERATURE REVIEW:

Many research studies have been done on this topic due to its importance for stock exchange if different countries as the Political instability and terrorism events relation effect the movement of stock Index. Some most relevant studies are briefly summarized below with their results and findings.

Akysha Khan, M. Shakil Ahmed (2005) took three events and examined the data of Stock exchange during 2007-2008. Their study revealed that there is relationship between trading volume and fluctuations in stock returns of KSE 100-Index. The authors applied correlation between the two variables. Dr. Aurangzeb, Tasfoura Dilawer (2005) considered four events and analyzed the data of Stock exchange during 2004-2010. In order to examine the relationship between the variables, authors used correlation, regression analysis and Granger Causality Analysis. The results showed that the stock returns react negatively to terrorist activities.

Sanjay Kumar, Jiangxia Liu (2010) analyzed sixty three events and examined the relationship between the variables by utilizing Logistic Regression Model. Their results showed that terrorism has a strong impact on International Stock Markets. Marc Chesney, Ganna Reshetar, Mustafa Karman (2011) for studied financial markets seventy seven events to examine the relationship between the variables by utilizing a non-parametric methodology and GARCH-EVT approach. The results showed that there almost two-thirds of the terrorist attacks have a negative impact on at least one stock market.

Abdullah Alam (2013) took eleven events to examine the relationship between the variables through terrorism Impact Factor (TIF). The results have shown that in long run, terrorism have negative impact on stock market but in short run there is no such relationship between stock market and terrorism activities. Imran Qaiser, Dr. Nadeem Sohail, Mobashra Liaqat and Adeel Mumtaz (2012) used five events and examined the data of Stock exchange during 2007-2010. In order to examine the relationship between the variables, authors used Multiple Regression Model and ordinary least square method. The results showed that there is a significant negative impact of terrorism on the KSE 100 index and Exchange rate.

Anh Phuong Nguyen and Carl E. Enomoto (2009) analyzed six events to examine the relationship between the variables through utilizing GARCH and Z-statistic. The result showed that acts of terrorism have an impact on market returns in the Karachi and Tehran stock exchanges. Muhammad Tahir Suleman (2012) evaluated *186* events and examined the data of Stock exchange during 2005-2011. The dependent variable is returns of the KSE-100 index and Independent variable is political good and bad news. In order to examine the relationship between the variables authors used GARCH model. The results showed that the good news have positive impact on the returns of the KSE-100 index. On the other hand, bad political news has negative influence on the returns. Alam (2013) has shown the relationship between terrorism and stock market moving after the using the terrorism impact factor.

Aslam and kang (2013) utilize two things KSE (2013) utilize two things KSE100index and terrorist attack news and tells that what was the effect of three hundred terrorist activities on stock market.

ESSADDAN and karagianis (2013) shows that terrorism is an important risk factor after using an event study approach. Ramiah and graham (2013) used the event study the analysis that what was the effect of terrorism of London stock market. Chensey, reshtal (2001) investigated that what was the impact of 78 terrorist events on different countries stock market. Graham and ramiah (2012) used the expections hypothesis to estimate the impact of terrorism on the Japanese stock market. Papordomic and stagiannis (2011) has shown that impact of terrorist attacks march 11th, 2004 in mardrid.

Papadamou and stagiiannis (2011) discus about three major events (Madrid, Valencia and Barcelona) whereas Broursm and derwall (2010) investigate five terrorist attack (9/11, Bali, Madrid, London and mamba) SANDLER AND ENDERS (2002) DEFINE ABOUT the terrorism is the threat of violence for the objectives of political fear. Chen and siens (2004) describes about the 14 main terrorist assaults Berrebi and klor (2005) evaluate of terrorism on the stock market prices.

Further carter and simkins (2004) 9/11 evaluated event impact on airlines stock price by using the multivariate regression model. Eldor and melnick (2004) describes the pates tine terrorism attacks and their impact on exchange rates.

Glaser and weber (2005) describes that level of disagreement between investors and stock return.
One of the earliest studies by abadie and gardeazabal (2003) was analyzed that what was impact of ETA on the share price. chen and siems (2004) studies that what was the stock market reaction to fourteen terrorist. Elda and melnick analyzed that what were the Israeli stock and exchange rate reaction. Drakors(2004) analyzed that how 9/11 attacks increase the risk Drako (2004) shows the beta alteration in the specific period has shown thirteen us airlines Certer and simkins (2004) analysis the 9/11 attacks on the investors reaction.
Zussman and zussman (2006) utilize the stock market data the evaluation the effectiveness of Israeli government. Arincifferi and spangolo (2008) evaluation the terrorist events on six different stock market. Baumert (2009) explain that Madrid bombings were a rare case in which stock market did not stop working.
According to gullet al (2010) shows the Pakistani financial market reaction between 2007 and 2009 and tells that negative impact on Karachi stock exchange. Nikkinen and vahama (2010) shows that results of FTSE 100 index after the worst event of 9/11 Raolyi and martell (2010) analysis what was the impact on the publicly traded firm. Rollias et at (2011) using arch model for analysis that what was impact of Madria and London bombings.

Gaps in literature:

1) This literature review is just focuses on the macro-economic outcomes not tells about the process of these impact.

2) This literatures are just focus on the negative impact did not show impact results from response to terrorism.

3) This literature has just showed the impact on the industrialized countries not only in less developed countries.

4) Literature did not work properly on the portfolio of risks.

5) These literature are not tell properly the behavior OF government after these events

6) This is last but not least, this is little academic research has been turned into readily available policy knowledge.

Methodology:

To test the theoretical model developed with the help of literature, the data has been collected for five years from 2010 to 2014 in Pakistan scenario. An Event study is a statistical method that is used to analysis the impact of an event on the value KSE-100 index. For example, the Martyrs Day has a vital and significant impact on the KSE-100 index. The basic idea here is to find an Average Normal return (expected return) of last 6 months than compare it with the return during the window size. The difference is called abnormal return which is attributable to the event. Event studies are not only used to check that political or terrorism events have an impact on stock exchange.

An event study approached was used to examine the impact of Political and terrorism events on KSE-100. Event window means to the total time period included before and after the event whenever it was taken as the original time frame to analysis the impact of the particular event. In this study event window is of 15 days, it also include the day on which event was occurred i.e, the date when political or terrorist events have been incurred. So, we can say that the event window divided into two parts.7 days before and after the event which takes place. The event determined as t=0, which is the middle of the event window.

The proxy for return is KSE-100 daily index. The formula for calculating return for the KSE-100 index is:

$$R_t = \ln \frac{pt}{pt-1}$$

R_t Means daily return of the company.
$\ln$ Means natural log.
P_t Means value of KSE-100 index at the end of day t.
P_{t-1} Means value of KSE-100 index at the end of the day t-1.

3.8.1Calculation for Abnormal Return (AR)
Formula for the daily abnormal return is:

$$AR_t = r_{et} - r_{rt}$$

Where

r_{et} Daily return of the event window on day t. where t varies from -7…+7

r_{rt} Average/ expected return of regular (or remaining days) of the year on day t.

3.8.2 Calculation for cumulative abnormal return (CAR)

The formula for cumulative average abnormal return had been given as under

$$CAR_t = \sum AR_t$$

Where

CAR_t Is cumulative abnormal return of the specific day t.

AR_t is abnormal return for the specific day.

t is was the number of event windows day prior to the day t.

3.8.3 Calculation for t-statistic

The t-statistic had been calculated by the using the following formula:

$$t - statistic\ (AR) = \frac{AR}{\sigma/\sqrt{n}}$$

T-values identified the positive and negative impact of Political and terrorism events on KSE-100 daily index.

Table 1

Assassination of Salman Taseer

Days	Date	AR	CAR	t-value	t-value
-7	01/25/20	0.004	0.002	0.594	0.2450
-6	01/26/20	0.000	0.001	-	0.1990
-5	01/27/20	-	-	-	-
-4	01/28/20	-	-	-	-
-3	01/31/20	-	-	-	-
-2	02/01/20	-	-	-	-
-1	02/02/20	-	-	-	-
0	02/03/20	0.007	-	0.957	-
1	02/04/20	0.002	-	0.264	-
2	02/07/20	-	-	-	-
3	02/08/20	-	-	-	-
4	02/09/20	-	-	-	-

5	02/10/20	-	-	-	-
6	02/11/20	-	-	**-	-
7	02/14/20	-	-	-	-

* Represent significant value before&** Represent significant values after Event window.
Table 2

Assassination of Shebaz Bhatti

Days	Date	AR	CAR	t-value AR	t-value
-7	02/18/20	-	-	-	-
-6	02/21/20	-	-	-	-
-5	02/22/20	-	-	*-	-
-4	02/23/20	-	-	-	-
-3	02/24/20	-	-	-	-
-2	02/25/20	-	-	*-	-
-1	02/28/20	0.00	-	0.5057	-
0	03/01/20	0.02	-	**3.46	-
1	03/02/20	0.00	-	0.7647	-
2	03/03/20	0.00	-	0.4421	-
3	03/04/20	0.01	-	**2.40	-
4	03/07/20	-	-	-	-
5	03/08/20	-	-	-	-
6	03/09/20	0.01	-	1.8127	-
7	03/10/20	-	-	-	-

* Represent significant value before&** Represent significant values after Event window.
Table 3

Order of Supreme Court to Arrest Prime Minister

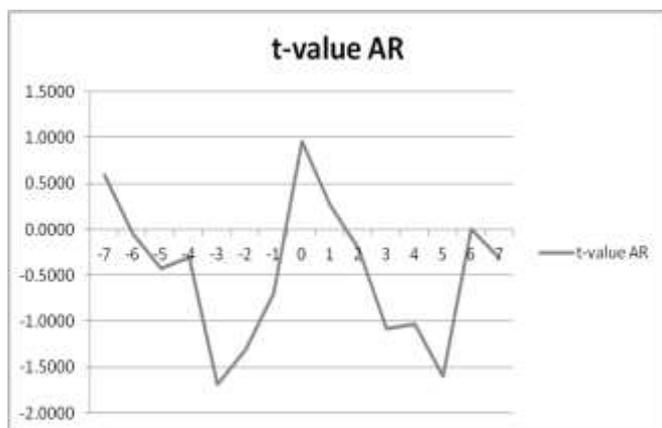| Days	Date	AR	CAR	t-value AR	t-valu
-7	01/04/20	-	-	-0.2776	-
-6	01/07/20	-	-	*-	-
-5	01/08/20	0.004	-	0.7884	-
-4	01/09/20	0.006	-	1.2096	-
-3	01/10/20	-	-	-1.7623	-
-2	01/11/20	-	-	-0.2609	-
-1	01/14/20	-	-	-0.3163	-
0	01/15/20	-	-	**-	-
1	01/16/20	-	-	-0.4105	-
2	01/17/20	0.011	-	**2.14	-
3	01/18/20	0.014	-	**2.64	-
4	01/21/20	0.004	-	0.8130	-
5	01/22/20	0.001	-	0.2887	-
6	01/23/20	0.012	-	**2.26	-
7	01/24/20	0.001	-	0.2959	-

* Represent significant value before&** Represent significant values after Event window.
Table 4

Killing of PAT Members					
Days	Date	AR	CAR	t-value	t-value
-7	06/09/20	-	-	-	-
-6	06/10/20	0.001	-	0.137	-
-5	06/11/20	0.006	0.004	0.925	0.553
-4	06/12/20	-	0.002	-	0.305
-3	06/13/20	-	-	-	-
-2	06/16/20	-	-	-	-
-1	06/17/20	-	-	-	-
0	06/18/20	-	-	-	-
1	06/19/20	-	-	**-	-
2	06/20/20	-	-	-	-
3	06/23/20	0.009	-	1.258	-

Figure 1

Assassination of Salman Taseer

Horizontal axis shows days and vertical axis showst-valuesfor15days.
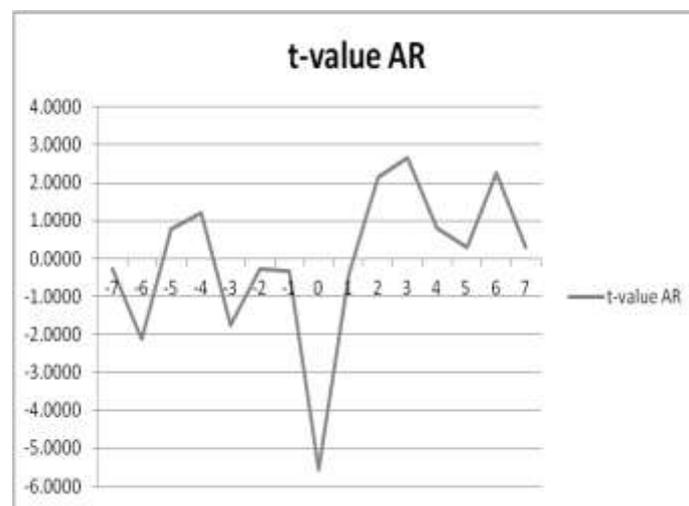
Figure 2

Assassination of Shebaz Bhatti

Horizontal axis shows days and vertical axis shows t-valuesfor15 days.
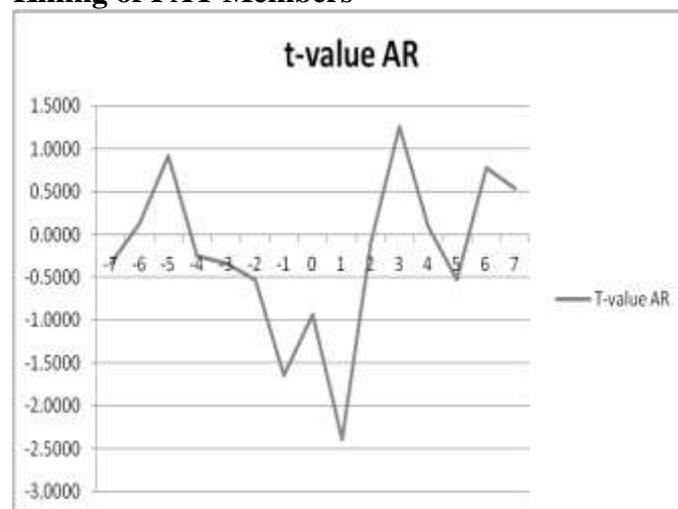
Figure 3

Order of Supreme Court to Arrest Prime Minister

Horizontal axis shows days and vertical axis shows t-values for 15 days.
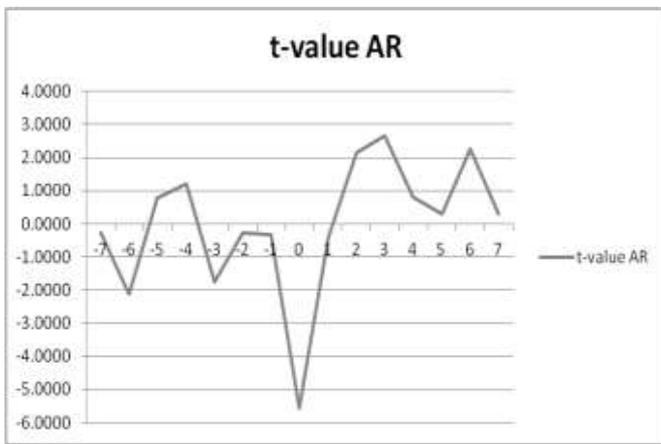
Figure 4

Killing of PAT Members

Horizontal axis shows days and vertical axis shows t-values for15 days.

Figure 5

Martyrs Day called By Dr. Tahir-ul-Qadari

t-value AR

Horizontal axis shows days and vertical axis shows t-values for 15 days.

RESULTS AND DISCUSSION:

To assess the effect of political and terrorism events on the return of KSE-100 daily index during the period January 1, 2010 to September 26, 2014 we showed the results of t-statistics on table 2 of Appendix A. Table 2 (Impact of assassination of Salman Taseer) explains the average abnormal returns, cumulative abnormal return, t-values of AR and t-values of CAR for 15 days event windows of the event.

The t-value of abnormal return (AR) on the day -7 was positive insignificant and till the date of event all the t-values remains negative insignificant, on the day of 0 the t-value was insignificant with positive sign and next day too. From the day 2 to day 5 the event has insignificant t-values with negative sign but on day 6 there is significant with negative sign. Again on the day 7 there is an insignificant t –value with negative sign. The reason for mostly negative t-values after the event date is that the event start affecting the KSE-100 index negatively and due the event on 6th day the KSE-100 crashed.

Appendix A figure 1 shows the values of AR for 15 days event windows. Horizontal axis shows days and vertical axis shows t-values for 15 days

Table 3 of Appendix A (Impact of assassination of Shehbaz Bhatti) shows the values of AR, CAR, t-values of AR and t-values of CAR. The t-value on -5 day is significant with nagative sign, but for next two days the t-value was insignifiacant with negative sign. On the day -2 the t-value was significant with negative sign. On the day of event there was a significant +ve t-value and on the day 3 the t-value is significant with +ve sign. On day 4 and 5 the t-value has a negative insignificant impact on KSE-100 index.

Appendix A figure 2 shows values of AR for 15 days event windows. Horizontal axis shows days and vertical axis shows t-values for 15 days.

Table 4 of Appendix A (Impact of Supreme Court order to Arrest the Prime Minister) shows the values of AR, CAR, T-values of AR and t-values of CAR of KSE-100 Index. The day -6 the t-value is significant with negative sign. On the day of event day 0 there is significant t-value with the negative sign. The reason is that due to the order of Supreme Court to arrest the prime minister has a negative impact on KSE-100 index all for sudden. After the event day the KSE-100 index start recovering and on the day 2, 3 and 6 post event has a significant t-value with +ve sign. The result is that the impact of decision of Supreme Court was short term but has a significant impact. There was a sudden decrease in the KSE-100 index immediate after the decision of Supreme Court but after the event date the KSE-100 start most values of t-values with +ve sign.

Figure 3 of Appendix A shows values of AR for 15 days event windows. Horizontal axis shows days and vertical axis shows t-values for 15 days

Appendix A table 5 shows (Impact of Killing of PAT Members) the values of AR, CAR, t-values of AR and t-values of CAR of KSE-100 Index. All the t-values before the event day are insignificant but the day of event on day 1 the t-value is significant with negative sign causing a major impact on KSE-100 index. On day 2 the t-value is insignificant with negative sign and afterwards all the t-values were insignificant. So the result drive from t-values is that the killing of 14 members of PAT has an impact on KSE-100 index, but the impact was short term and negative.

Figure 4 of Appendix A showed the values of AR for 15 days event windows. Horizontal axis shows days and vertical axis shows t-values for 15 day.

Appendix A table 6 (Impact of Martyrs Day called by Dr. Tahirul Qadari) shows the values of AR, CAR, t-values of AR and t-values of CAR KSE-100 Index. On the day -5 the t-value is significant with negative sign. For next two days t-value is negative and insignificant. On the Day -1 before event date the t-value is insignificant but negative sign. There was a significant negative impact on the date of Event. The t-value is significant with negative sign. All the t-values after the event are insignificant. For the result we can say that the impact of Martyrs day on the stock exchange was significant and short term.

Figure 5 of Appendix A values of AR for 15 days event windows. Horizontal axis shows days and vertical axis shows t-values for 15 days.

Conclusion:

The result of all five events was negatively significant but short term. The political and terrorism events affects on KSE-100.In case of Assassination of Salman Taseer, there was insignificant impact of assassination on Stock Exchange, the t-value is 0.9578 but later on due to the political pressure the stock exchange trends to be affected and the t-values start becoming negative and on 6th day the stock exchange crashed and the t-value become -3.0996 and stock exchange lost a huge amount of index points. Where as in case of orders of arrest of Prime Minister there is a certain decrease in stock exchange index points. In case of orders of Supreme Court to arrest the prime minister of Pakistan, killing of PAT members and Martyrs' day there was a certain significant impact on the KSE-100 and the Index point reduced and t-statics are -5.5612, -0.9309& -6.1612 in that particular day. The results showed that impact is significant but short term.

We can conclude that the impact of political and terrorism events is negatively significant in a short run but in the long run the impact is insignificant and positive.

Recommendations:

Pakistan being a frontier in War on Terror has been damaged severally. Although government of Pakistan has played a vital role in order to reduce the terrorist attacks but since 9/11 till now and much causalities have taken place so far. Terrorism and Political events have not only effect Pakistan through human loss but also caused financial damages. Pakistan government should show their deep interest and make a strategy in order to get rid of terrorists' activities. ISI and other sensitive agencies should come to play their respective role and work out how to stop these terrorist activities. Religious and Political parties (like MQM, PML(N), PML(Q), PTI and PPP etc)should keep in mind what are consequences if they do strikes and halts. Political parties' first priority is to resolve their problems in parliament house not from coming on the road for halts and strikes.

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