THE IMPACT OF TRADE LIBERALIZATION ON POVERTY: A CASE STUDY OF PAKISTAN

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ABSTRACT

This paper gave evidence on the impact of trade liberalization on poverty during the period of 1973-2012. Poverty (head count ratio) was taken as a dependent variable while trade liberalization, foreign direct investment, unemployed labor force rate and per capita income were considered as independent variables. To determining long run and short run relationships among variables Autoregressive Distributed lag (ARDL) test was used. The study presented, absolute and relative values point out that trade liberalization had higher impact on poverty. The study also presented poverty rate which could be reduced by utilization of unemployed labor force. Our skilled and trained workers should be given opportunities to work.

KEYWORDS: Poverty, Trade Liberalization, Foreign Direct Investment, Unemployed Labor Force Rate, Per Capita Income

INTRODUCTION

Economic development and change in any society is result of organized factors. These factors may be consisting of social, financial, natural and political factors. Sometime, these few factors are responsible for positive or negative impact on development. There is one feature that poverty may be existing due to change in these factors. Poverty has been ever proved a major challenge of a country. It is a wide spread world problem that affecting the economic growth of the developing countries.

“Poverty has many faces, such as hunger, lack of shelter, being sick and not being able to see a doctor, not being able to go to school, not having a job, fear of the future, living one day at a time. Poverty is losing a child to illness brought about by unclean water. (World Bank, 2006).

Poverty and inequality has been most important problem in Pakistan. For poverty lessening there are some economic policies which can have a approvable , the variables trade liberalization(TL), Foreign Direct Investment(FDI), Unemployed Labor Force(UMPL) and per capita income(PCI) are most closely variables in the level and tendency of poverty over the time in Pakistan. Poverty can be overcome by promoting FDI, human resources and capital. As Ekanayake et al (2008) checked that both remittances and foreign direct investment significantly uphold growth in developing countries. However, this positive relationship is challenged in several studies.

During 1970s Pakistan’s economy suffered as well as benefited from international events. In 1971 east Pakistan sapration, Oil price hike of 1973 become the reason to increase the poverty ratio. The World Bank (2002) report draws national and regional poverty trends during the 1990s and concludes that poverty in Pakistan was as high at the end of the 1990s as at the beginning of the 1990s. On the basis of these studies one can conclude that poverty has almost doubled from 1990-91 to 1998-99. In 1980s, after the money owing crisis many countries faced very high inflation and
deterioration of balance of payment positions. Fundamentally, LDCs are asked to liberalize their economy through adopting Structural Adjustment Programs (SAP). The progress towards liberalization could be seen during the period the 19th century. The WTO (World Trade Organization) formed necessary principles of trade liberalism poverty reduction.

“The Poverty Reduction Pakistan Strategy” was introduced after SAP in Pakistan. It introduced many policies relevant to increasing the demand for labor and improving its supply, such as the restoration of economic growth, the Khushal Pakistan programme (KPP), and land for poor farmers. There are different affects of policies in every country. China and Uganda are the countries which enhance their trade by adopting different trade policies. The objective of the study is to show the present scenario of poverty in Pakistan and to analyze the relationship between trade liberalization and poverty in Pakistan. This paper organized as follow: second section represent reviews, third describe model setup and data while forth section present the estimation results and finally concluding remark.

LITERATURE REVIEW

The characteristic of the studies conducted on poverty in Pakistan, starting with review of the different previous studies,

Aradhya.S et al, (2007), studied impact of international trade on income and income inequality. Their estimation was depend upon two models, in first model the dependent variable was log per-capita GDP and independent variables were trade, democracy, litsec and land lock. Here they took land lock as a dummy variable. In first model they used a panel data of sixty countries over a period of 1985 to 1994. In second model dependent variable was log gini index and independent were trade landlocked, democracy Index corruption Index. In second model 44 samples were used from 1984 to 1997. They used OLS method. They find that trade openness increase inequality in developing countries while it had positive impact in developed countries.

Greenaway et al (2002) showed a positive and significant impact of trade liberalization on economic growth. Recent work by the World Bank presents that poverty declines with economic growth, but the effect of growth on inequality is different across countries.

Georgantopoulos.G.A et al, (2011), studied the impact of globalization on income distribution: The dependent variable was income distribution while independent variables were trade openness, foreign direct investments and remittances. They used the method of ordinary least squares (OLS), augmented dickey-fuller (ADF). They collected data of Hungary from 1990 – 2009. They find that introducing the national economy into the international markets would reduce inequality, and international trade had positive effect on an economy.

Heshmati.A, (2003), examined the relationship between income inequality and globalization. That analysis based upon the panel data covering sixty two countries over the period of 1995-2001. He used globalization as a dependent variable and independent variable were income inequality, economic integration, personal contacts, technology, political

1 Structural Adjustment Program was the policies implemented by the IM and World Bank in developing countries. Through some conditionalties it implement “free market” programs and policy
2 The Poverty Reduction Strategy Papers (PRSP) was first developed in 1999, initiated by IMF and WB after the widespread failures of the Structural Adjustment Programmes.
3 Khushal Pakistan Program has been extended to all districts. It works for the betterment of social sector and human capital.
4 Secondary school enrollment.
5 Completely surrounded by land.
6 Measure of inequality expressed in percentage.
engagements. He used gini coefficient, and least squares parameter to estimate the equation. He found that globalization over the period of time increasing the inequality. In developing country there was need to better allocation of recourses and trade policies.

Mahdi.S, (2009), studied the trade liberalization and poverty reduction in developing countries. The dependent variable was poverty while independent were, trade liberalization, structural adjustment. He took data from 1970-2002 .He used graphs to differentiate the situation of developing countries. The result was showed that trade liberalization had not much positive impacts .Many people in Africa and South Asia who were away from any settlement.

Topalova.P, (2005), studied trade liberalization, poverty and inequality. Household survey data was collected through national sample survey (NSS). It covered about seventy five thousand rural and forty five thousand urban households. He used OLS method. The variable which he used as a dependent was Tariffs and independent was migration, poverty and inequality in rural and urban India; he found that both rural and urban industries had their contribution in trade. Local intensity of liberalization had no effect on local poverty. Trade liberalization could be more benefited for rural labors if they would migrate in response to wage. He concluded that individual participation and well being had positive effect on economic customs.

To conclude it is evident from theoretical and empirical literature that the relations between trade liberalization, economic growth and poverty reduction are positive and can be connected by suitable policy interventions. It shows that the economy of Pakistan would-be gained progress from more trade liberalization but only if it is focused by other pro-poor policies. The possible growth-suggest tendencies of both trade liberalization and development spending can relate to construct positively that can potentially attain from further trade liberalization.

**METHODOLOGY AND DATA SOURCE**

In this section poverty was taken as a dependent variable while trade liberalization, foreign direct investment, unemployed labor force rate and per capita income were considered as independent variables. To determining long run and short run relationships among variables Autoregressive Distributed lag (ARDL) test was used. Time series data set comprised from for the period 1973-2012. The data was collected from Economic Survey of Pakistan.

**RESULTS AND CALCULATIONS**

The time series data was used in this analysis, the ADF test was used for unit root problem in the variables. The ADF test was performed at level as well as first difference. Unit root test indicates that per capita income was stationary at level. Poverty (pov), unemployed labor force (UMPL) and trade liberalizations (TL) were non-stationary at level but stationary at first difference. Similarly foreign direct investment (FDI) was non stationary at level but stationary at first differences. The overall results of unit root test indicated that poverty, trade liberalization, unemployed labor force, foreign direct investment and per capita income were stationary only at first difference whereas, per capita income was stationary at level.

These mixed results suggest using ARDL model for the estimation. This study applied ARDL technique to conclude the co-integration among poverty, unemployed labor force, foreign direct investment, trade liberalizations and per capita income.

**RESULTS OF AUTO REGRESSIVE DISTRIBUTED LAG (ARDL)**

The results of Auto Regressive Distributed (ARDL) showed the positive and negative effect of interdependent
variables on poverty. The results showed that the value of T-statistic notified about the significant of the variable and negative or positive sign shows the relationship of independent variables with dependent variable. F-statistic showed the significance of overall model. And the estimation indicates that the effect of unemployed labor force (UMPL) on poverty was negative in short run situation and positively affected the economy of Pakistan in long run. Its value of t-stats was significant for both short run and in long run period of time.

Trade liberalization has insignificant but positively impact on economy both in short run and long run. (Mahdi.S.T,2009) many researchers assume significant impacts of the trade reforms, but the results are not the same as many people in Africa and South Asia are still a way from any benefits.

The per capita income (PCI) had significant in short run and insignificant in long run. T.statistic had positively impact in short run and negatively in long run short run. The above result could be due to the fact that there could be more variation in income of higher income groups as compared to middle-income groups.

Result shows that foreign direct investment (FDI) has significant impact on the poverty in short run, while it has insignificant and negative impact in long run. (Muhammad, 2012) Indicates that exports and FDI did not cause each other; therefore, FDI did not have significant effect on economic growth in long run. The value of F-statistic showed that overall model was significant, while the value of R-square indicated that model was normal.

NORMALIZE EQUATION

This study normalized the coefficient in the model LPOV (-1).the normalize equation is as below,

\[
LPOV = 0.560 - 0.036LTL + 0.485LPCI* -0.153LFDI * + 0.196LUMPL
\]

In equation (LTL) and LFDI show the negative relation in long run. Negative relationship of LTL with depended variable is possible. Many people in Africa and South Asia are away from the benefits because of the Trade Reform (Mahdi.S.T, 2009). Unskilled works do not play an important role in the utilization of foreign direct investment (Borenszteina.E, et al, 1998). In long run LPCI and LUMPL have positive relation to poverty. Azeem, M.M, et al 8 indicated that because of stable prices in the long run, per capita income has positive effect. While in above equation * sign is showing the significance of the variable.

RELATIVE AND ABSOLUTE CONTRIBUTION OF VARIABLES TO POVERTY

The relative and absolute contribution of each explanatory variable on poverty is calculated because of the different trend of explanatory variable in regression.

The results of absolute contribution of every independent variable on poverty shows that the calculated values of trade liberalization (0.2157) is highest among all variables .It shows that trade liberalization has highly affect on poverty . Similarly, the result of relative contribution of every independent variable on poverty shows that the calculated value of trade liberalization (1.9944) is higher. Both absolute and relative values point out that trade liberalization has higher impact on poverty.

CONCLUSIONS

The result shows that during this time period 1973-2012, there are different impacts of independent variables.

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\(^7\) Result available by the author

Trade has always been considered an important engine of growth and development. The absolute and relative values point out that trade liberalization has higher impact on poverty. Overall findings of the study suggested a positive relationship between trade liberalization and Poverty of the country. According to the report of United Nation (2004) most little developed countries (LDCs) undertook deep trade liberalization in 1990s. Many LDCs facing hardest trading policies to derive benefited from liberalization. However, trade liberalization is a necessary but not sufficient condition for economic growth and poverty reduction. Per capita income has not significant but it has a negative effect on poverty meaning that an increase in the per capita income lowered the poverty rate. Poverty rate can be reduced by utilization of unemployed labor force.

Lastly, it is contented that if Pakistan wants to reduce poverty, it needs;

- The foreign capital and the development of some financial institutions should as promote as they need.
- Government should introduce the sources of earning among people.
- Labors’ level of income should be improved.
- Our skilled and trained workers should be given opportunities to work in the foreign labor markets.

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