

STRENGTHENING PAKISTAN'S ECONOMIC DEVELOPMENT THROUGH INTERNATIONAL TRADE

Shabbir Ahmad ^a, Noor Al-Huda Abdul Karim ^b

^a Department of Economics, CEMIS, University of Nizwa, Oman.

^b Department of Economics, FME, Sultan Idris Education University, Malaysia.

^a Corresponding author: shabbir@unizwa.edu.om

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Abstract: In the present era of globalisation, trade policy in Pakistan has been made more liberal in order to gain more socio-economic benefits for local people. The main objective of this paper is to analyse Pakistan's foreign trade and discuss how the variable, which is an important component of national income can help strengthen the country's economic development. A set of annual time series data on Pakistan's gross domestic product (GDP) from 1981 to 2010 was used to estimate the model of economic development that relates to trade variable. Using a simple regression method, the findings suggest that there is a significant influence of foreign trade on the country's economic development in which the GDP variable is taken as its proxy. It confirms the theories of international trade that argue, in order for economic development to be achieved, foreign trade activity must be promoted. In the classical free trade theories of Adam Smith (1776) and David Ricardo (1817), discussion on international trade activity was focused on comparison of labour productivities between countries. The main point of these theories is that, economic development is strengthened when a country can minimise cost of labour and maximise production of output to increase level of exports to other country. In relation to Pakistan's trade, the size of imports is always larger than the size of exports, which indicates trade deficit. Government intervention through strategic trade policy is therefore needed to increase exports through productivities of factors of production from potential economic sectors. Efforts to expand and increase overseas markets for exports are also important.

Keywords: Economic Development, Gross Domestic Product, International Trade, Productivities, Socio-Economic Benefits

INTRODUCTION

After independence in 1947, Pakistan has implemented a series of Five-Year Plans to achieve economic development in the country. In the early period 1947-1953, Pakistan's economy was largely dependent on agriculture and the planning implementation was so weak that the planning efforts had failed. In the 1960s, the economy experienced a respectable average growth rate, 6.8 percent. The rates of inflation and unemployment in the period were low, 3.8 percent and 1.43 percent, respectively. The agriculture and manufacturing sectors contributed to a high growth rate of employment, 72.7 percent of national labor force (Nadeem, Ghazanfar & Ahmad, 2001). During the Second Five-Year Plan (1960-1965), the rapid industrial development was due to gradual liberalization in the economy. Administrative controls were removed and favorable macroeconomic environment was provided for the private sector with maintenance of monetary discipline and price stability (Khan, 2002).

In 1972, the newly-elected government managed the economy through annual planning, not through five-year planning. As a result, there was a drop of 5 percent in the annual average growth rate in the period 1972-1977. Massive public sector investment and expenditures were unable to reduce the problematic budget and current account deficits in the

country's balance of payments. For the trade account, the government increased foreign loans to overcome the large trade deficit but it increased debt burden on the economy (Khan, 2002).

Economic growth in Pakistan was getting better in the 1980s when the military government that took over the elected government re-introduced the five-year development plans. In the period 1982-1989, the average growth rates of gross domestic product (GDP) and trade were about the same, each with 6.3 percent. In 1990s, Pakistan gradually liberalized its trade as a part of the Structural Adjustment Program of the International Monetary Fund (IMF) that was first accepted by the government in 1988. After 1995, Pakistan reduced import duties and eliminated various subsidies to improve its trade deficit (Siddiqui & Iqbal, 2005). The government was able to reduce trade deficit, on average, from 10.5 percent in the first half of the 1980s to 5.7 percent of national GDP during the first phase of the program 1988-1993 (Hayat, 1999). In 1998-1999, the country suffered serious economic and social setbacks such as decelerated economic growth rates, accumulation of large external and public debt, increasing unemployment, rising rate of inflation, rising income inequality and worsening poverty incidence. As a result, a comprehensive economic revival program was launched in 1999, aimed at achieving macroeconomic stability through productive and institutional capacity and reducing debt burden of the country (Qayyum, 2001; Husain, n.d.). The program was able to reduce current account deficit from 4.5 percent of GDP during the 1990s to 1.9 percent in 2000/01 (Husain, n.d.)

Pakistan has responded to the rise of globalization with the implementation of more liberal trade policy. For example, in the 2005/06 trade policy, the average ad valorem tariff rate has been reduced from 50 percent in 1995 to 15 percent in 2005 (World Bank, 2007). In recent trade policy 2009/2010, trade liberalization is geared towards improving economic growth and increasing socio-economic benefits for the people in the country (Government of Pakistan, 2009).

FOREIGN TRADE AND ECONOMIC DEVELOPMENT

Foreign Trade

During the 1950s, Pakistan implemented import substitution strategy and imposed very high tariffs and quantitative restrictions on imports to protect domestic production. In the 1960s, the country's

average effective rate of protection was 271 percent. It was too large compared to 27 percent in Mexico, 33 percent in Taiwan and 49 percent in Philippines and 118 percent in Brazil (Lewis & Guisinger, 1968; Scitovsky & Scott, 1970 cited in Anwar, n.d.). As a result, the production of industrial structure involved high costs. In 1970s, nationalization of major industries and inefficiencies in the industrial structure caused deceleration in industrial growth from 9.9 percent in the 1960s to 5.5 percent in the 1970s. In the late 1980s, there was a major shift in trade and industrial policy from the import substitution strategy to export promotion strategy with trade liberalization. The domestic resource cost declined from 3.3 percent in 1980-81 to 1.44 percent in 1990-91 (Anwar, n.d.). However, the wide variety of tariff measures and exemptions had put Pakistan's trade in a critical condition.

Pakistan, which is a member of World Trade Organization (WTO) has set tariffs in the reforms for trade liberalization below the bound tariffs under the organization. The general level of binding in Schedule XV of WTO was between 20 to 50 percent (except in agriculture), while the present tariff rates imposed by the country are between 0-35 percent (except automobiles). In addition to intensive trade reforms, devaluation measures were also used to increase exports (Anwar, n.d.). Despite these initiatives in the 1990s, Pakistan's exports performance was still very low. In 1998, Pakistan's exports were only US\$8.4 billion compared with the other developing countries such as India (US\$33.7 billion), Indonesia (US\$48.9 billion), Thailand (US\$56.3 billion), Malaysia (US\$73.5 billion) and China (US\$183.8 billion) (Asian Development Bank, 2011).

Table 1 displays some data on Pakistan's trade for the period 1990-2010. In average of five years, the growth of trade was 18 percent in 2005-2010, which was smaller than the growth in 1990-1995, 27 percent. Manufactured goods constituted the largest share of exports for Pakistan. Its share of exports increased from 56 percent in 1990 to 72 percent in 2010. Noticeably, Pakistan had larger imports than exports. Trade deficit increased throughout the period 1990-2010. Pakistan's major imported items are capital goods and industrial raw materials for production of capital and consumer goods. High demand for these items was to increase production of output for the purpose of exports and domestic consumption. In terms of trade share in GDP, it declined by 1.5 percent from 2005 to 2010.

Table 1: Pakistan's Foreign Trade, 1990-2010 (fiscal year ending 30 June)

Item	1990	1995	2000	2005	2010
Exports ¹ (Million Rupees)	<u>106,469</u>	<u>251,173</u>	<u>443,678</u>	<u>854,088</u>	<u>1,617,458</u>
<i>Primary commodities</i>	21,641	28,113	53,832	92,019	287,490
<i>Semi-manufactures</i>	25,167	62,624	68,208	86,483	170,609
<i>Manufactured goods</i>	59,661	160,436	321,638	675,586	1,159,359
Imports ¹ (Million Rupees)	<u>148,853</u>	<u>320,892</u>	<u>533,792</u>	<u>1,223,079</u>	<u>2,910,975</u>
<i>Capital goods</i>	48,420	112,305	140,045	441,527	812,016
<i>Industrial raw materials for</i>					
1. <i>capital goods</i>	10,439	16,754	30,712	101,719	209,051
2. <i>consumer goods</i>	61,562	148,419	287,801	557,226	1,509,081
<i>Consumer goods</i>	28,432	43,414	75,234	122,607	380,827
Trade balance ¹ (Million Rupees)	-42,384	-69,719	-90,114	-368,991	-1,293,517
Total trade ¹ (Million Rupees)	255,322	572,065	977,470	2,077,167	4,528,433
Balance of Payments (% of GDP)					
Total trade	<u>31.3</u>	<u>30.7</u>	<u>25.0</u>	<u>30.7</u>	<u>29.2</u>
Exports + re-exports	12.5	13.2	11.5	13.3	11.3
Imports + re-imports	-18.8	-17.5	-13.5	-17.4	-17.9
Balance on goods	<u>-6.3</u>	<u>-4.3</u>	<u>-2.0</u>	<u>-4.1</u>	<u>-6.6</u>

Note: ¹ The figures do not include re-exports and re-imports.

Source: Asian Development Bank and Federal Bureau of Statistics, Pakistan.

Table 2: Pakistan's Trade with Top Ten Major Countries, 2002-2010 (million US Dollars)

	2002	2004	2006	2008	2010
Exports to					
1. United States	2,418.9	3,119.2	3,604.0	3,480.3	3,389.0
2. United Arab Emirates	834.6	982.0	1,550.8	2,537.7	1,571.3
3. Afghanistan	223.1	464.9	1,316.3	1,865.0	1,395.0
4. China, People's Rep. of	235.6	299.7	915.6	915.5	1,572.7
5. United Kingdom	716.4	970.3	874.5	968.6	913.0
6. Germany	486.4	664.0	639.1	826.5	898.5
7. Italy	275.9	530.7	486.8	662.1	579.4
8. Saudi Arabia	389.7	336.0	438.2	717.0	452.1
9. Turkey	110.1	219.1	344.4	532.9	681.8
10. Hong Kong, China	477.7	589.9	594.3	415.2	455.9
Total exports to the ten countries	6,168.5	8,175.9	10,764.0	12,920.9	11,908.6
Imports from					
1. China, People's Rep. of	699.6	1,499.2	4,664.8	6,590.6	7,629.3
2. Germany	488.9	706.6	1,395.3	1,364.8	972.9
3. France	164.7	173.3	557.5	628.4	497.0
4. Canada	78.3	209.4	386.0	580.8	590.6
5. Australia	276.8	395.0	257.7	401.3	539.0
6. Belgium	276.1	183.6	315.9	369.5	376.3
7. Brazil	17.3	76.1	213.1	339.9	368.0
8. Finland	29.3	78.5	135.3	201.1	99.8
9. Austria	20.9	51.8	171.5	163.4	99.9
10. Egypt	39.6	54.6	54.9	126.5	148.2
Total imports from the ten countries	2,091.5	3,428.1	8,151.9	10,766.4	11,320.8

Source: Asian Development Bank

Table 3: Population, Employment and Selected GDP Indicators for Pakistan, 1990-2010 (fiscal year ending 30 June)

Item	1990	1995	2000	2005	2010
Population (<i>million</i>)	109.71	124.49	139.76	153.96	166.52
Labor force (<i>million</i>)	31.68	34.22	40.52	46.82	56.90
Employed (<i>million</i>)	30.70	32.39	37.35	43.22	53.70
<i>Agriculture</i>	15.68	15.14	18.07	18.60	24.20
<i>Manufacturing</i>	3.93	3.40	4.31	5.94	7.10
Unemployment rate (%)	3.1	5.3	7.8	7.7	5.6
GDP/capita ¹ (<i>Rupees</i>)	3,851	4,296	25,487	29,834	34,119
Sectoral share in GDP ¹ (%)					
<i>Agriculture</i>	<u>25.8</u>	<u>24.9</u>	<u>26.0</u>	<u>22.4</u>	<u>21.2</u>
<i>Industry</i>	<u>25.6</u>	<u>25.8</u>	<u>23.3</u>	<u>26.3</u>	<u>26.4</u>
<i>Manufacturing</i>	17.6	17.3	14.7	18.3	18.6
<i>Mining</i>	0.5	0.5	2.3	2.7	2.5
<i>Construction</i>	4.1	4.0	2.5	2.1	2.6
<i>Electricity, gas & water</i>	3.4	4.0	3.8	3.2	2.7
<i>Services</i>	<u>48.6</u>	<u>49.3</u>	<u>50.7</u>	<u>51.3</u>	<u>52.4</u>
<i>Transport & communications</i>	9.5	10.2	11.3	10.4	10.1
<i>Wholesale & retail trade</i>	16.5	16.3	17.5	18.7	17.0

Note: ¹At constant prices, 1980/81=100 for the 1990-1995 and 1999/2000=100 for the 2000-2010 statistics, respectively.

Source: Asian Development Bank and Federal Bureau of Statistics, Pakistan.

As indicated in Table 2, the United States was Pakistan's first trading partner for exports, followed by United Arab Emirates and Afghanistan. In 2010, China ranked third after the United Arab Emirates. Total exports from the top ten countries were the largest in 2008. It declined by 7.8 percent in 2010. Exports from these countries had a share of 62.4 percent in the country's total exports in 2002 but the share decreased to 59.3 percent in 2010. United Kingdom, Germany and Italy are the three member countries of European Union (EU) getting important for Pakistan's export markets. In terms of imports, China was the first major source for Pakistan, followed by Germany. Imports from the ten countries constituted 18.6 percent share in the country's total imports in 2002 and the share increased to 28 percent in 2010. Five of the ten countries are from the EU.

Economic Development

In this study, the general indicator of economic development is GDP. Higher level of aggregate output being produced is to indicate higher level of economic development in a country. Table 3 exhibits some related socio-economic indicators from 1990 to 2010 that are important to highlight economic development in Pakistan. Total number of employed persons in agriculture was the largest compared to other sectors. In the case of manufacturing sector, its contribution share of number of employed persons in the country's total aggregate employment did not reach 15 percent throughout the years. Unemployment rate in Pakistan was below 4 percent in 1990. The rates were above 8 percent in 2000 but dropped to less than 6 percent in 2010. The GDP per capita grew by 11.6 percent from 1990 to 1995 and it increased to 17.0 percent from 2000 to 2005. However, it decreased to 14.4 percent from 2005 to 2010. In terms of sectoral share in GDP, services took the first place in which wholesale and retail

trade contributed the largest share in the sector. In the sector of industry, the share of manufacturing had increased above 18 percent in 2005 and 2010. The shares of other sub-sectors were below 5 percent in the industry.

THE CLASSICAL TRADE THEORIES OF ADAM SMITH AND DAVID RICARDO

Adam Smith (1776) and David Ricardo (1817) are the two famous classical economists in favor of free trade who worked on how nations would gain benefits from trade activity by emphasizing labor productivities in the nations concerned. Adam Smith developed a concept of *Absolute Advantage*. Assuming there is free trade practice, all nations would gain benefits simultaneously if they specialized in accordance with their absolute advantage. Labor division and specialization are the two important things that would increase labor productivities. Assuming there are two countries in the world. Based on Smith's concept, international trade occurs when more quantities of goods could be produced by one hour's work in the countries. Smith's concept of *Absolute Advantage* is determined by only a simple comparison of labor productivities. If one country has higher labor productivities in producing both goods, it is possible that the other country has no absolute advantage. David Ricardo had thus developed a concept of *Comparative Advantage* to strengthen Smith's concept. Instead of absolute values of labor productivity, Ricardo's concept is determined by labor productivity ratios in producing two goods in two countries. The pattern of comparative advantage will not be affected if a country has absolute advantage in both goods. Adam Smith's concept is much related to increasing labor productivity in helping increase level of economic development in a country while David Ricardo's concept is more concerned with how abundance of resources in two countries can be efficiently allocated by utilization of their respective labors.

MODEL AND DATA ANALYSIS

In this analysis, economic model is as follows:

$$ECDVT=f(TRADE) \quad (1)$$

where *ECDVT* is Pakistan's economic development, which is proxied by Pakistan's total real GDP (in Rupees) and *TRADE* is Pakistan's total real trade (in Rupees). Total trade is the sum of exports and imports (include re-exports and re-imports). The data on these two variables were adjusted by using GDP deflator to the based year 2000=100 in order to obtain their real values. Annual data on Pakistan's GDP and GDP deflator were taken from annual series of Key Indicators published by Asian Development Bank (ADB).

The coefficient sign on the *ECDVT* variable is expected to have a positive relationship with the *TRADE* variable. In other words, higher level of economic development in a country is related to its larger size of trade. The analysis covers *ECDVT* data from the year 1981 to 2010. Data on trade were also collected from the Key Indicators of ADB.

The following log-linear model is estimated using a simple regression method.

$$\ln ECDVT_t = b_0 + b_1 \ln TRADE_{t-1} + \varepsilon_t \quad (2)$$

where b_0 is the intercept, b_1 is the slope coefficient that measures the elasticity of *ECDVT* with respect to the lagged explanatory variable, i.e. *TRADE*, ε is a random error term, and t refers to the t -th time period (time period $t = 1981, 1982, \dots, 2010$).

FINDINGS AND DISCUSSION

Table 4 shows the estimation results of the *TRADE-ECDVT* model. The coefficient on the *TRADE* variable has the right sign and is significant at the one percent level of significance to explain Pakistan's economic development. Its positive sign suggests that increase in trade contribute to higher level of economic development in the country. From the table, the elasticity of *ECDVT* to change in *TRADE* is close to unity. One percent increase in trade would lead to 0.93 percent increase in the level of development.

The model specification explains about 97 percent of the variation in economic development in Pakistan. In the overall test of significance, the calculated p-value of the F-statistic suggests a strong significant model of *TRADE-ECDVT* in this study.

The results support the classical free trade theories of Adam Smith and David Ricardo that a nation would gain benefits from trade. The important point of their theories is the capability of a country to minimize cost of labor and maximize production of output to increase its total exports, which can influence economic development achievement in the country.

According to Kobrin (2007), openness to the world economy is a necessary condition for economic development. Indeed, Pakistan's trade liberalization initiative had fulfilled more than its obligation to the World Trade Organization (WTO) agreements. As a result, the country faced serious problem of trade deficit. In Frank (1968), trade can be an "engine of growth" when world trade policies are re-shaped in the interest of developing countries. Although major imported items of Pakistan consist of capital goods and raw materials, Pakistan has to take initiatives to counter its trade deficit. Increasing total exports more than total imports needs increasing strength of capital and labor productivities and more focus on what to produce in the country.

(1)

Table 4: Estimates of the Trade Effect on Economic Development in Pakistan

Independent variable	Estimated coefficient	Standard error	t-ratio	p-value
$TRADE_{t-1}$	0.929	0.033	28.15	0.000
Constant	15.950	0.449	35.51	0.000

Adjusted R-square = 0.9659. F-statistic (from mean) = 792.252 (p-value = 0.000).

Agriculture is the most important sector in Pakistan. However, it is time for the country to pay serious attention on the sector of industry especially manufacturing because the production of manufactured goods does not involve climate change and seasonal work. Guided by the present trends in demand for goods and services in the world economy, the government together with relevant agencies can identify potential sub-sectors in all the economic sectors that can help increase exports of the country.

Expanding and increasing overseas markets for exports are another effort in pursuit to boost Pakistan's exports. Establishing more bilateral trade relations with various countries in various regions can promote cooperation between them in areas such as industry, investment, science and technology, human resource development, tourism, etc. This is what had been done by Pakistan when establishing trade relationships with the member countries of the Association of Southeast Asian Nations (ASEAN) (Yahya, 2004).

Trade promotes economic development, which in turn bringing socio-economic benefits through industrial activities. Pakistan's strategy to increase export trade needs a large size of foreign and domestic investments in potential industries with availability of improved and expanded infrastructure facilities. These private investment activities will contribute to increase in employment opportunities, households' incomes and thereby help to reduce poverty in the country.

CONCLUSION

In this paper, the estimated $TRADE-ECDVT$ model used annual time series data from 1981-2010 for its dependent variable and 1980-2009 for its explanatory variable. The results from the simple regression estimation agree with the theoretical expectation that trade positively influences economic development in a country. In favor of the classical trade theories of Adam Smith and David Ricardo, although their concepts of *Absolute Advantage* and *Comparative*

Advantage have many unrealistic assumptions that include the world consists of only two countries and two goods, they provide basic ideas for economic development in a country. Trade can benefit Pakistan in terms of increase in market size for goods, increases in productivities of factors of production, technology improvements, increasing private investment activities, which are needed to accelerate the pace of economic development.

In other trade strategy, finding new markets for exports by increasing number of bilateral and regional trade relations with many more countries in various regions should bring a wide range of economic cooperation that benefits Pakistan for its economic development program. Finally, building capacity to formulate effective trade policies is important to realize long-term sustainable economic development in the country.

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