

6 Summary and Policy Recommendations

The key motive of the present study was to estimate the monetary losses in the welfare of the ordinary as well as the poorest households of Pakistan due to selective protectionist policy against the relatively liberalizing trend in the general economy. The existing literature on the evidence of a trade-poverty link provides details of two main cases coupled with individual case studies and cross-country analyses. The first case is mostly known as the Latin American failure and the second case is known as the East Asian success story with liberalized trade policy. Latin American countries (namely, Costa Rica, Mexico, Chile, Colombia, Argentina, and Uruguay) liberalized their trade policies in the 1980s and observed a rise in wage inequality. The higher skill premiums after trade liberalization widened the gap between skilled and unskilled wages and thus resulted in worsened poverty figures. On the other hand the East Asian countries (Hong Kong, the Republic of Korea, Singapore, and Taiwan) followed liberalized trade policy during the 1960s and observed higher wages for unskilled workers, which reduced the skilled-unskilled wage gap. The lower skill premiums in the region resulted in improvement in the well being of the poorest households. The conflict of the evidence from the two cases may not be termed as failure and success of open trade policy; rather, it can be the point of the time of globalizing for both regions that caused the disparity in outcomes. East Asian nations integrated into the global trade sector during the 1960s with a large unskilled labor force and benefitted from the comparative cost advantage. However, Latin American countries opened for trade during the 1980s, when many countries like China, India, Pakistan, and Bangladesh had already penetrated the world market with large numbers of unskilled workers. Latin American labor during the 1980s, though unskilled in comparison with the labor from the developed world, could not qualify as unskilled in comparison to the new influx of unskilled labor from other Asian countries. Consequently, their

comparative advantage was brushed away by these Asian countries. Secondly, the East Asian early globalizers, now having the experience of two decades in manufacturing and trading, had accumulated large stocks of capital and began pursuing more capital. The rise in the East Asian demand for capital gave a big push to the global demand for technology. It bore its effects on the skill premium in Latin American countries, too.

Individual and cross-country case studies of different developing countries have had diverse outcomes regarding the impact of trade openness on poverty figures. For example Dollar and Kraay (2001) found no evidence of a systematic relationship between changes in trade and changes in inequality. Thus they opine that the poor gain equally proportionate increase in their incomes as the average national income rises as a result of trade liberalization.

The present study should be perceived as an attempt to further the string of individual case studies investigating the link between poverty, household welfare, and liberalized trade regimes. The study applied H-O and S-S models to establish a link between trade liberalization and poverty in Pakistan. H-O assumptions suggest that developing countries find a comparative advantage in importing capital-intensive goods and exporting labor-intensive goods. This is true since developing countries like Pakistan are labor-abundant countries and acquire labor as a relatively cheap factor of production and thus enjoy a low cost advantage in producing labor-intensive goods. On the other hand, developed countries, having abundant capital, find it advantageous to produce capital-intensive products at home and import labor-intensive products from abroad. The theoretical settings provided in S-S Model are used to establish association of liberalized trade policy with poverty. S-S Model predicts expansion in the labor-intensive export sectors of developing countries and contraction in the capital-intensive importing sectors as a result of liberalized trade policy. Consequently, the returns to the factors of production in the two sectors

change respectively. Expanding sectors reward their workers with higher wages, and contracting sectors penalize their workers with layoffs and cuts in salaries.

To empirically test the applicability and soundness of the theoretical findings of the two models, the study developed a set of regressions involving the estimations of changes in the domestic prices of nontraded goods with respect to change in the calculated domestic prices of traded goods, and changes in the households' labour income as a result of protectionist policy in the selected goods against the relatively liberalizing general economy. Finally, the loss in household welfare is estimated resulting from the selective protectionist policy against the general liberalizing trend in the domestic prices of the selected traded and nontraded goods and the labour incomes in agriculture and manufacturing sectors. Two welfare approaches have been applied to measure the predicted change in the average and the poorest households' welfare. MCS predicted loss in the welfare of the ordinary households as a result of protection using Marshallian estimated demand quantities. The protectionist policy in the selected goods led to the consumption of different bundles of consumer goods, and different levels of the households' utility levels. As the Marshallian approach includes the income effect in the total effect of a price change along with the substitution effect while predicting household welfare, the estimates seem to be overestimated. HCV approach adjusts the welfare estimates downward to have an idea of accurate measure of loss in household welfare caused by the substitution effect only. The Hicksian approach anticipated a relatively smaller loss per year in household welfare (PKR -591.65) than the Marshallian approach (PKR -655.65), the core outcome of the study that the protectionist trade policy hurts the households remains unaffected in both approaches. Given that the objective of the study is to measure the price effects of the protectionist trade policy in selected goods against the relatively liberalized general trend in the

economy, the Hicksian approach is relied upon as an accurate measure of households' welfare since it excludes the income effect from the price effect.

Further, the impact of selective trade protection on the welfare of the poorest households is estimated separately. The demands of the poorest households are calculated from the available data on the budget shares allocated to the consumer goods and their estimated domestic prices. The poorest households' demands for the selected goods are then employed to measure the change in the poorest households' MCS. Due to the lack of appropriate data on the poorest households' consumption, the poorest households' demands are not estimated but calculated from their budget shares allocated for the selected goods.

According to the estimations under both welfare approaches, an ordinary household loses profoundly due to the protection in the selected goods against the relatively liberalizing trend in the economy in general. The poorest household loses more (PKR -4204.97) than the loss to an ordinary Pakistani household (PKR -2663.255) because the protection hurts agriculture sector more severely than the other sectors amid rewarding the relatively capital oriented manufacturing sector.

Due to unavailability of the data on goods from other sectors, the regressions on the labour income-price link involve only the agriculture and manufacturing. The empirical results on the association between labour incomes in agriculture and manufacturing and the domestic prices of selected traded and nontraded goods predict a fall in agriculture labour income (PKR- 2973.88) and gain (PKR 1390.56) in the manufacturing labour income owing to the selective protection. The net loss in the ordinary Pakistani household's labour income is thus PKR -2071.61. Given that more than 81% of the total work force is clustering in three important sectors—namely agriculture, construction, and wholesale and retail trade—and there is a positive and statistically significant correlation

of labour income in agriculture with labour incomes in construction and wholesale and retail trade, the predicted labour income effect does not seem to be limited to agriculture workers alone. The workers from the other two sectors are likely to suffer the loss due to the selective protection. Further, the average percentage of unskilled workers in the three sectors (excluding manufacturing) is 73.58%, which is a significant portion of the total number of unskilled workers in the country. Since unskilled workers are approximated mostly as the poor in the country, so the loss in the labour incomes of (agriculture) unskilled workers may be treated as a loss in the labour income of the poorest households.

Summarizing the whole cascade of empirical evidence and estimated predictions, it can be asserted that a liberal trade policy is set to bring improvements in the welfare of an ordinary and the poorest household in Pakistan, with the welfare loss to the poorest household seemingly larger than to an ordinary household because the poorest households cluster in agriculture and the sector is hurt severely under trade protection. Therefore, more open trade policy can be recommended to policy makers in Pakistan as a development and households' welfare tool. Poverty in the country can be controlled, and the household welfare can be boosted by following an export-oriented policy similar to that of East Asian countries. Trade protection even in the selected goods hurts the poorest households and distorts the domestic prices of household consumption goods. Further, to ensure that the benefits of trade reforms reach the agriculture workers, land reforms and the competitive market principles can be initiated and implemented in the agriculture sector. The country's feudal structure, particularly in the agriculture sector, seems to be the biggest impediment to the benefits of trade reforms reaching down to agricultural workers.