

## RELATIONSHIP BETWEEN GLOBALIZATION AND POVERTY IN PAKISTAN: ROLE OF INSTITUTIONS

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### ABSTRACT

*This paper aims to investigate the role of institutions in the long-term relationship between globalization and poverty. The autoregressive distributed lag (ARDL) model of co-integration is employed to estimate the long-run equilibrium relationship in the context of Pakistan over annual time series data spanning from 1984 to 2015. The KOF index is used to measure globalization, and the weighted average of five variables— democratic accountability, government stability, law and order, corruption control, and bureaucratic quality—is used to assess institutional quality. Our results demonstrate that the impact of globalization on reducing poverty would increase in the presence of high-quality institutions. However, the size effect of institutional quality is not large enough to reap the full benefits of globalization in mitigating poverty in the country. Other control variables in the model reveal that unemployment and government spending increase poverty, whereas GDP growth is found to reduce it.*

**Keywords:** Globalization; KOF Index; Poverty; Institutional quality; ARDL; Pakistan.

**JEL:** F6; I3; D73; C5

### INTRODUCTION

One of the prime objectives of policy makers is to minimize the incidence of poverty and to ensure communal welfare. Poverty is characterised by the absence of adequate financial resources to maintain a decent living standard. As a result, it is impossible to expect a poor person to contribute to the socioeconomic development of a society. Hence, poverty acts as a drag on economic development and the uplift of the whole society. Poor resource allocation means that the budget allocated for non-development, e.g., current expenditure, is greater than that for development expenditures. Where the former plays no significant role in poverty alleviation, the latter is considered crucial for poverty reduction. Higher resource allocation for development projects will reduce poverty by generating employment opportunities for the underprivileged (Sanusi & Nass, 2012).

Moreover, the proper implementation of devised development plans necessitates stability in the political arena and complete transparency. It has been argued that differences in economic institutions are the primary causes of prosperity gaps across nations (Acemoglu & Robinson, 2008). Institutions should have a considerable impact on economic outcomes including economic development, growth, inequality, and poverty if they are the main determinant of incentives, according to economists who recognize the importance of incentives in the economy (Acemoglu & Robinson, 2008). Hence, institutional quality plays a substantial role in reducing poverty. The significance of globalization is similar. Being a part of a globalized and integrated world, every country must adhere to the international community's poverty alleviation standards.

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In the context of Pakistan, poverty has always been a key policy concern owing to its detrimental implications on overall growth. According to the head count index, Pakistan has a ratio of 15%, indicating that 15% of the total population lives below the poverty line. Due to the inconsistency and resultant instability in the economic setup, this index showed a very sluggish downward trend. One reason behind this sluggish decline in poverty is the poor quality of domestic institutions. According to the data, Pakistan's highest institutional quality score is 2.7 on a scale of 0–6; this indicates poor bureaucratic quality, regime instability, high corruption, and weak law and order. Pakistan's overall globalization score is 58.3 percent, which is considered moderate.

The goal of the current study is to investigate the relationship between globalization and poverty while taking into account the function of institutions in a developing nation like Pakistan. In this modern era, institutions play a vital role in influencing the outcomes of different government policies related to growth and distribution of income and the ultimate goal of poverty alleviation. Besides these, the existence of strong institutions in a developing country ensures the accrual of full benefits of globalization in reducing poverty. This article is aimed at how institutions might help reduce poverty and the ways that globalization affects these impacts in the context of Pakistan. The remainder of the study is divided into four sections: Section 2 is a review of the literature; Section 3 presents description of the model; Section 4 is empirical results; and Section 5 discusses conclusion and policy implications.

## LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Fischer (2003) argued that globalization offers more opportunities to people and aids in poverty reduction. In line with that, Friedman (2000) viewed globalization as a driving force behind growing tourism and the active role of MNCs, which leads to more job opportunities and a reduction in poverty. In the age of globalization, the international community plays a role in poverty reduction (Friedman, 2000). International organizations set goals for poverty reduction and people's well-being that must be met by domestic countries (Fischer, 2003; Ulleberg, 2009; McNeil & St. Clair, 2011; Cimadamore, 2016). Empirical studies undertaken by previous researchers demonstrate that globalization aids in poverty alleviation. For instance, using Generalized Least Square (GLS) on panel data, Figni and Santraelli (2006) demonstrated a negative and significant relationship between globalization and poverty. Similarly, Florence et al. (2014) used the autoregressive distributed lag model (ARDL) on a data set from the Nigerian economy to illustrate a negative association between globalization and poverty. Bergh and Nilsson (2014) verified this link using a Fixed Effect Model across 114 countries from 1983 to 2007. Bharadwaj (2014) found a negative and significant relationship using Panel Regression for a sample of 35 developing nations from 1990 to 2012.

According to Sindzingre (2006), the role of globalization in alleviating poverty can be regarded as an outcome of strong institutions. Globalization's impact on poverty is influenced by the presence of an institutional system. Institutions amplify the consequences of globalisation on poverty, whether they are favourable or unfavourable (Sindzingre, 2006). Previous empirical studies have verified the link between institutional quality and poverty. Chong and Calderon (2000) in their study demonstrated that institutional quality is likely to reduce poverty in a set of 49 nations from 1960 to 1990 using Ordinary Least Square (OLS) and Two-Stage Least Square (2SLS). According to previous studies, Hasan et al. (2006) found that institutional quality has a detrimental effect on poverty after conducting a regression study for 100 developing nations between 1990 and 1999. Pribble et al. (2009) used OLS for 18 Latin American countries from 1968 to 2001 and demonstrated that democratic governments play an effective role in poverty alleviation. Literature reveals the existence of a bidirectional relationship between institutional quality and globalization. Institutions play an important role in fostering globalisation. In the context of weak institutions, a poverty trap may be created because globalization's benefits would be confined to the affluent (Sindzingre, 2006).

In 1970, for the first time, the United Nations committee for developing planning designed poverty reduction strategies and argued that this objective could be achieved by increasing growth rates and social change. Following the United Nations' lead, a number of international organizations have made the subject a priority. For instance, the International Labor Organization (1977) conducted a number of studies on income distribution and poverty under the umbrella of the world employment program. The World Bank also prioritised poverty reduction strategies and released the World Development Report, which identified three key factors for reducing poverty. These factors were intended to promote pro-poor growth, human capital development, and the development of social safety

nets for the poor. The Asian Development Bank (1999) added macroeconomic stability and good governance as another crucial component in poverty reduction. ADB (1999) added that economic and political stability are required to achieve pro-poor growth and human capital development. The World Bank (2000) came up with another analytical framework to curb the issue of poverty. According to the report, empowerment, security, and opportunity can assist in poverty reduction. In recent years, the literature on globalization and poverty has gained importance. The International Fund for Agricultural Development (2001) published a report by adding a dimension of globalization to the poverty literature. Thus, the aim of the current study is to employ the dimension of political institutions used by ADB (1999) and that of globalization used by the International Fund for Agricultural Development (2001) to determine their impact on poverty.

## **MODEL SPECIFICATION, DATA AND ECONOMETRIC METHODOLOGY**

### **Model Specification and Data**

For the purpose of empirical investigation, an econometric model is constructed which is based on models adapted from Tebaldi and Mohan (2010) and Bergh and Nilsson (2014). A model constructed for an objective of empirical analysis is written as:

$$POV_t = \alpha_0 + \alpha_1 INS_t + \alpha_2 GLOB_t + \alpha_3 INS_t * GLOB_t + \alpha_4 UNEMPL_t + \alpha_5 GDPG_t + \alpha_6 GOVEXP_t + \mu_t \dots\dots\dots (1)$$

Where POV stands for poverty, INS stands for institutional quality, and Glob represents globalization. Along with core variables, the study also incorporated some control variables, including unemployment (UNEMPL), GDP growth (GDPG), and government expenditures (GOVEXP). The letter  $\mu_t$  indicates random error term across time. In addition, an interaction term between institutional quality and globalization has been introduced to the model, with the goal of examining the impact of globalization on poverty in the presence of institutional quality.

This study used secondary time series data for the years 1984 to 2015. Utilizing secondary data sources such as the WDI published by the World Bank, KOF, and the International Country Risk Guide (ICRG), the data on the Pakistani economy was extracted. Bergh & Nilsson (2014) used the KOF index to trace the relationship between globalization and poverty. Bergh and Nilsson (2014) propose utilizing a combination of variables for globalization rather than a single indicator. Hence, this study also used the KOF index of globalization, which is a weighted mean of social, economic, and political globalization. The benefit of using the KOF index is that it captures several aspects of globalization that would otherwise be overlooked if only one indicator had been used. Dreher (2002) sought to create the KOF index of globalization for the first time.

In order to capture the institutional framework and to scrutinize its effect on poverty, researchers have used different indicators. For example, Hasan et al. (2006), Cepparulo et al. (2016), and Pribble et al. (2009) used social and welfare spending, left-right ideology, democracy, and executive ideology, while Chong & Calderon (2000) and Tebaldi & Mohan (2010) used the expropriation risk index, rule of law, corruption in government, and quality of bureaucracy. The five metrics of institution quality employed in this study are government stability, law and order, corruption control, and bureaucracy quality, democratic accountability. All variables have been rescaled to a range of 0 to 6. After rescaling each variable, the weighted mean of five variables, ranging from 0 to 6, is calculated. 0 indicates a low level of institutional quality, whereas 6 indicates the active participation of the institution.

### **Econometric Methodology**

Researchers used several methodologies to investigate the relationship between institutions, globalization, and poverty, as well as other factors that influence poverty. Hasan et al. (2006), Chong and Calderon (2000), and Pribble et al. (2009) used OLS in this context, while Tebaldi and Mohan (2010) and Cepparulo et al. (2016) used the Generalized Method of Moments (GMM). Bergh and Nilsson (2014) used GMM to investigate the relationship between globalization and poverty. For Agrawal (2015), Florence et al. (2014), and Pervez and Rizvi (2014) to investigate the determinants of poverty, they used co-integration techniques. Therefore, a co-integration technique would be sufficient

given that the goal of this study is to examine the long-term relationship between globalization and poverty in the context of institutional quality. One advantage of the co-integration technique over OLS is that it allows for the determination of LR relationships between variables. Applying OLS to non-stationary time series produces misleading results (Gujrati, 2009).

The variables used in this study have a mixed order of integration, which means that some series are integrated in order 0 while others are integrated in order 1. Additionally, this study covers a small sample period of only 31 years. In the given scenario, only the Autoregressive Distributed Lag (ARDL) Model is an appropriate technique as it gives consistent results in situations in which the independent variables are mix-integrated. Similarly, the techniques are found efficient in small sample studies. Furthermore, endogeneity is not a concern with the ARDL technique since residuals are uncorrelated (Pesaran & Shin, 1998).

## EMPIRICAL RESULTS

**Table No. 1 Unit Root Test Results**

Series	At Level	At First Difference
Pov <sub>t</sub>	-3.562 (0.874)	-3.568*** (0.001)
Gdpg <sub>t</sub>	-2.960** (0.023)	—
Exp <sub>t</sub>	-2.960 (0.647)	-2.963*** (0.001)
Unempl <sub>t</sub>	-2.967 (0.296)	-2.976*** (0.000)
Glob <sub>t</sub>	-3.562 (0.691)	-3.568*** (0.000)
Inst <sub>t</sub>	-2.967* (0.070)	—
GlobInst <sub>t</sub>	-2.960 (0.589)	-2.963*** (0.001)

Note: \*, \*\*, \*\*\* shows level of significance at 10%, 5% and 1% respectively.

The series of GDP growth and institutional quality are stationary at level, whereas other series, including poverty, government expenditures, unemployment, globalization and interaction terms become stationary at 1<sup>st</sup> difference I(1). The ARDL is the only workable method because it has been discovered that the independent variables are in a mixed order.

## Bound Test Results

**Table No. 2 Bound Testing for Co-integration**

Significance Level	Critical Bound Values		
	I(0)	I(1)	F-Statistics
5%	2.45	3.63	4.28

F-statistics value (4.28) is greater than upper bound value (3.63) at 5% level of significance. Since the results demonstrate the presence of a long run relationship among variables, the next step is to determine the long run coefficient of variables.

## ARDL Results

**Table No. 3 Estimated Long Run Coefficients Using ARDL**

Variable	Dependent Variable Poverty	
	Coefficient	P-value
INS <sub>t</sub>	-1.297***	0.002
GLOB <sub>t</sub>	-1.249***	0.000
INS <sub>t</sub> *GLOB <sub>t</sub>	-0.113***	0.007
UNEMPL <sub>t</sub>	12.054***	0.000
GDPG <sub>t</sub>	-3.521***	0.002
GOVEXP <sub>t</sub>	3.3642***	0.000
	R <sup>2</sup> = 0.92	Adjusted R <sup>2</sup> = 0.81

Note: \*\*\* shows level of significance at 1%.

Source: Author's own calculation using Eviews 9.

The results demonstrate that institutional quality tends to alleviate poverty in Pakistan. Improvement in institutional quality is likely to reduce poverty by 1.29%. Its coefficient is significant at the 1% significance level. Theoretical literature also supports the idea that there is a link between poverty and poor institutional quality. According to Sanusi and Nass (2012), when institutions are strong, the government will launch new investment projects that will give the unemployed a chance to find work. Similarly, corruption would be low under conditions of high institutional quality. Ikejiaku (2009) argued that a low level of corruption implied that funds were being used for the welfare of the poor, and thus poverty would be reduced. The result conforms with the empirical findings of Chong and Calderon (2000), Hasan et al. (2006), Pribble et al. (2009), Tebaldi and Mohan (2010), and Cepparulo et al. (2016).

The existence of a negative relationship between poverty and globalization is confirmed. Globalization leads to poverty eradication by 1.24%. Its co-efficient is significant at a 1% significance level. Globalization demonstrates economic integration in the world, and it has the potential to reduce poverty by providing opportunities to the poor. According to Friedman (2000), globalization is crucial because it helps countries integrate with the rest of the world. Integration also has the added benefit of attracting foreign capital, which improves the country's internal conditions. As a result of globalization, capital inflows are capable of creating job opportunities and reducing poverty. The findings are consistent with those of Figni and Santraelli (2006), Florence et al. (2014), Bergh and Nilsson (2014), and Bharadwaj (2014).

The interaction term between institutions and globalization is captured by a variable denoted as  $INS_t * GLOB_t$ . Its co-efficient is negative and significant. The results indicate that in the presence of institutional quality, globalization improves. Institutional quality mediates the effect of globalization and poverty, bringing it down by 0.11%. Its co-efficient is significant at a 1% level of significance. The interaction term indicates that institutions quality plays a critical role in advancing globalization in a country. Fakher (2014) empirically proved that institutional quality contributes to enhancing globalization. Unemployment increases poverty as people fail to have any income source. The results infer that unemployment will intensify poverty by 12.05%. The co-efficient of unemployment is significant at a 1% level of significance. Unemployment theory also reveals the existence of a positive relationship; unemployed people earn no income and live in a state of poverty. Such a person does not have enough money to fulfil his needs and to attain essential facilities, so he becomes worse off (Nayyar, 2006). In developing countries, no compensation is given to unemployed workers. The income deficit lessens consumption expenditures. Thus, unemployment causes a reduction in the welfare of people via lower consumption (Streeten, 2002). The result is similar to the empirical findings of Power (1995), Anowor and Okrie (2017), and Yousaf and Ali (2014) that unemployment intensifies poverty.

Empirical findings reveal that GDP growth helps in poverty reduction. Its coefficient is negative and significant at a 1% significance level. Growth indirectly effects poverty by providing employment to the poor and offering them a source of income. Theoretical literature illustrates the existence of a negative relationship between both. Fischer (2003) is of the view that for poverty reduction, sustained growth is required. According to Solow (1956), labor productivity leads to long-run growth, which increases labor income and reduces poverty. The empirical result is in line with the empirical findings of Ravallion (1997), Son and Kakwani (2004), Kakwani et al. (2004), Afzal et al. (2011), Bharadwaj (2014), Oyewale and Musiliu (2015), Agrawal (2015), and Boukhatem (2016).

The results identify that government expenditures are positively related to poverty. Poverty will rise by 3.36% as government spending increases. Its co-efficient is significant at a 1% significance level. According to theory, government expenditures are only significant in reducing poverty if they are used for people's welfare (Streeten, 2002). Remarkable government expenditures escalate the budget deficit due to inflation. Inflation has negative consequences for the poor due to its detrimental effect on income (Mishkin, 1984). This result is in line with the empirical results of Berg and Nilsson (2011), who also found that government expenditures have a poverty intensifying effect.  $R^2$  shows 92% of variations in poverty are being explained by independent variables included in the model. It means the abovementioned model is a good fit for Pakistan's economy over the period from 1984 to 2015.

**Table No. 4 Estimated Short Run Coefficient Using ECM**

<b>Dependent Variable: Poverty</b>		
<b>Variable</b>	<b>Coefficient</b>	<b>P-value</b>
$\Delta \text{INS}_t$	-1.050**	0.042
$\Delta \text{GLOB}_t$	-1.012***	0.000
$\Delta \text{INS}_t * \text{GLOB}_t$	-0.092***	0.000
$\Delta \text{UNEMPL}_t$	1.942***	0.001
$\Delta \text{UNEMPL}_t (-1)$	-1.146**	0.039
$\Delta \text{UNEMPL}_t (-2)$	-1.850***	0.002
$\Delta \text{UNEMPL}_t (-3)$	-2.189***	0.004
$\Delta \text{GDPG}_t$	-1.166***	0.000
$\Delta \text{GDPG}_t (-1)$	0.396	0.118
$\Delta \text{GDPG}_t (-2)$	0.411	0.105
$\Delta \text{GOVEXP}_t$	0.960***	0.003
<b>CointEq (-1)</b>	-0.809***	0.006

Note: \*, \*\*, \*\*\* shows level of significance at 10%, 5% and 1% respectively.

Source: Authors' own calculation using Eviews 9.

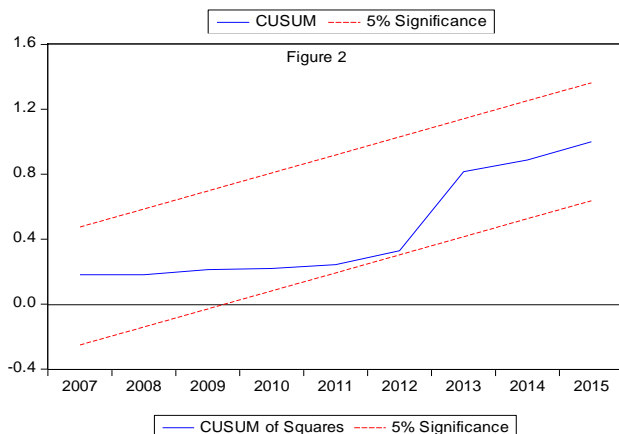
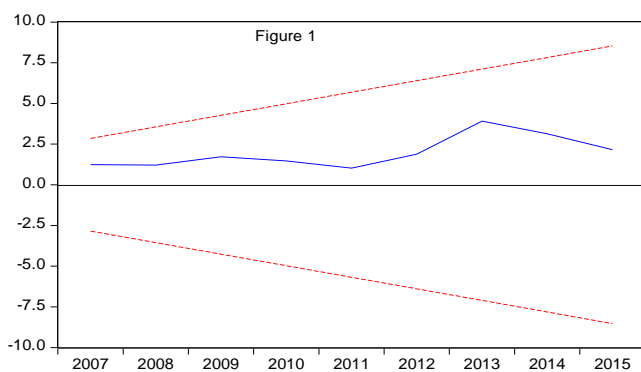
Error Correction Term (ECT) as derived from ECM shows the speed of adjustment of SR relation. Error correction model is written as:

$$\begin{aligned} \Delta POV_t = & \sum_{i=1}^{\rho} \alpha_1 \Delta POV_{t-i} + \sum_{i=1}^{\rho} \alpha_2 \Delta GLOB_{t-i} + \sum_{i=1}^{\rho} \alpha_3 \Delta INST_{t-i} + \sum_{i=1}^{\rho} \alpha_4 INSTGLOB_{t-i} \\ & + \sum_{i=1}^{\rho} \alpha_5 \Delta UNEMPL_{t-i} + \sum_{i=1}^{\rho} \alpha_6 GDPG_{t-i} + \sum_{i=1}^{\rho} \alpha_7 \Delta EXP_{t-i} + \eta ECT_{t-1} + \mu_t \end{aligned}$$

Where,  $\eta$  measures the speed of adjustment towards equilibrium. It also signifies the restoration of short-run disequilibrium over the long run. In the long run, the short run dynamics readjusts and restores equilibrium over the long run. ECT for this model is negative and significant at a 1% level of significance. Its value is 0.80, indicating that the adjustment speed is 80% and that in this model, 80% of short-run disequilibrium readjusts per period. Results indicate that the model is stable and poverty has a long-run equilibrium relation with independent variables included in the model.

#### **CUSUM (Cumulative Sum) and CUSUM Square Tests**

CUSUM and CUSUM Square tests of recursive residuals are used to check the stability of the model (Brown et al., 1975). The figures below show the outcome of these two tests. The figure clearly depicts that the cumulative sum of recursive residuals lies between the 5% critical lines. This means that parameters are stable, as the cumulative sum does not exceed the limit.



## CONCLUSION AND POLICY IMPLICATION

The long-term co-efficient results of ARDL provided evidence that there was a strong link between poverty and globalization. The results reveal that institutional quality plays a significant role in alleviating poverty. The interaction term of globalization and institutional quality also appeared to be negative and significant, indicating that in the presence of high quality institutions, the impact of globalization on poverty-alleviation increases. However, as indicated by the coefficient size, the impact is not very large. Empirical findings reveal that unemployment is a major determinant of poverty. Unemployment escalates poverty in Pakistan. GDP growth appeared to be negative and significant, indicating growth helps in poverty reduction. The coefficient of government expenditures emerged as positive and significant, demonstrating that poverty would increase due to a rise in expenditures. The result signifies that the role of institutions is necessary for enhancing globalization; institutions affect the long-term relationship between poverty and globalization. Institutions directly as well as indirectly alleviate poverty via improving globalization in a country.

On the basis of the above findings, different policies are recommended to alleviate poverty in Pakistan. The first recommendation is that in order to fully grasp the benefits of globalization further improvement in institutional quality is required. Secondly, in order to alleviate poverty, there is a need to curb unemployment in the country. For this purpose, the government must play an active role in job creation. Findings reveal that government expenditures have a poverty-intensifying effect in Pakistan. Therefore, in order to minimize the incidence of poverty, there is a need to adopt a pro-poor expenditure pattern.

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