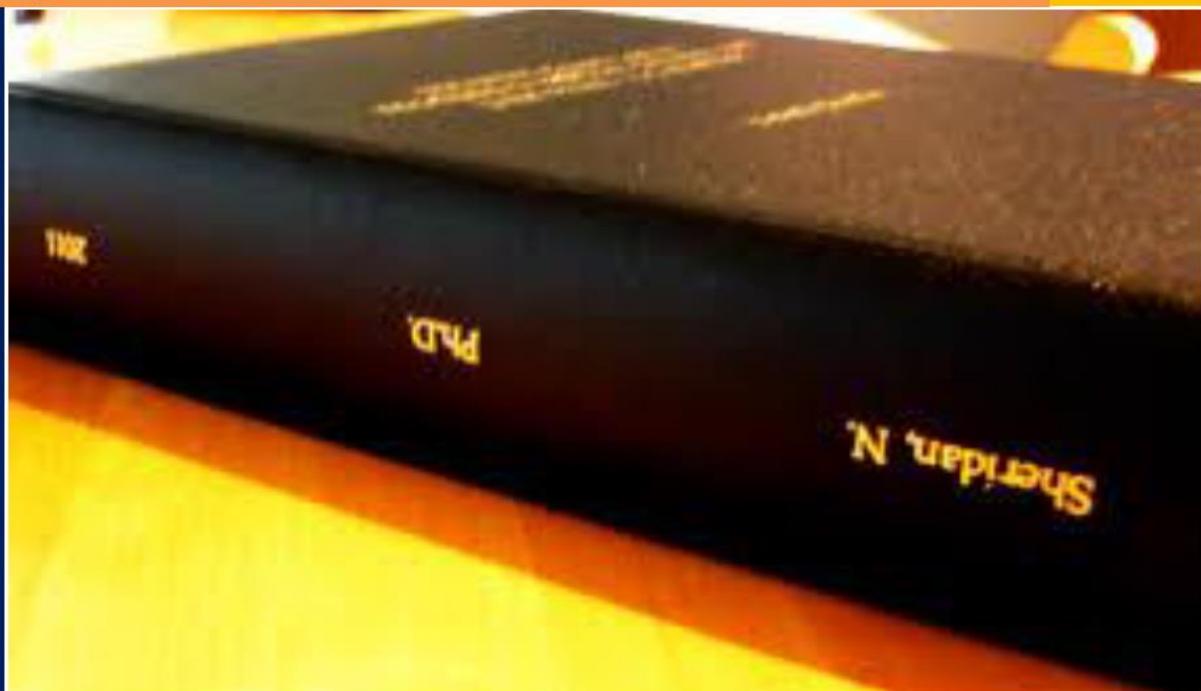


Scholarly Research Dissertatia



SR Dissertatia



The Impact of Trade Liberalization on Agricultural Growth in Pakistan



The Government
Sadiq College Women
University Bahawalpur Pakistan

SUBMITTED TO

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SUBMITTED BY

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APPROVAL CERTIFICATE

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Date _____

DEDICATED TO

ALMIGHTY ALLAH,

HOLLY PROPHET (PBUH),

MY LOVINING PARENTS, SISTERS, BROTHERS

AND

MY RESPECTED TEACHER

MISS HIRA FARIDI

AUTHOR DECLARATION

I Rozina Nawaz Roll No: 5, in the department of economics at the Govt. Sadiq College Women University of Bahawalpur do here by solemnly declare that the thesis entitles “The Impact of Liberalization on agricultural growth rate in Pakistan” submitted by me in partial fulfillment of the requirement of MSc in the subject of Economics is my original work. I solemnly declare that this is my original work and has not been submitted or published earlier and also shall not be submitted in future. It shall also not be submitted to obtain any degree to any other University or institution.

ROZINA NAWAZ

FORWARDING CERTIFICATE

The research entitled “Impact of trade liberalization on agricultural growth rate in Pakistan” is conducted under my supervision and the thesis is submitted to the Govt. Sadiq Girls College University of Bahawalpur in the partial fulfillment of the requirement of the degree of MSc. of Economics.

Miss Hira Faridi

ABSTRACT:

Trade liberalization has long been recognized as a key element in sustainable development. Liberalized Trade has been adopted by many developing countries to increase agricultural growth and therefore reducing inflation rate. Although various research studies have been conducted to understand the concept of trade liberalization and agricultural growth rate but aimed of this study to empirically determine the relationship between trade liberalization and agricultural growth rate and check the correlation among the variable by using time series data for the period 1973 to 2012. The imperial analysis shows that a positive relation holds between trade liberalization and agricultural growth rate in Pakistan. Agricultural growth rate is a dependent variable and independent variables are i.e. Arable Land, Number of Tractors, Trade Liberalization and inflation rate. Annual time series data is taken from World development indicator. Auto regressive distributed lag model are used to check the relation. The obtain results indicate that the relationship between trade liberalization and agricultural growth is positive.

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Chapter: 1

Introduction

There is no general understanding on what is meant by trade policy reform. As recommended to developing countries in recent years, it generally involves greater reliance on markets for channeling investment and other resources into the trade able sector. An important component of this process is lessening dependence on direct and in- direct controls in foreign trade. It is this more limited process that is the subject of the present analysis and is referred to hereafter as Trade liberalization. Trade liberalization is the process of reducing or removing restrictions on international trade. This may include the reduction or removal of tariffs, abolition or enlargement of import quotas, abolition of multiple exchange rates, and removal of requirements for administrative permits for imports or allocations of foreign exchange. In recent years, trade in agriculture has not only attracted growing attention but is being viewed as the vehicle for global growth and equity. By expanding markets and by removing distortions caused by high levels of protection in agriculture, global trade will not only facilitate competition but spur growth in an area that is linked directly to poverty and hunger. The main goal of agricultural trade has been said to be provision of enabling environment for a majority of the world's poorest to take advantage of the enormous opportunities to improve incomes and enjoy healthy lives. The World Bank estimated that more rapid growth associated with a global reduction in trade protection could reduce the number of people living in poverty.

Trade Liberalization policies have been widely adopted in developing countries in recent years. Pakistan is no exception.

This study focuses on the effects of trade liberalization policies on the agricultural export and import performance. Trade liberalization is expected to have an impact on agricultural sector and its export sub-sector through various transmission channels; mainly through exchange rate, capital formation (machinery, equipment, buildings, fertilizers, pesticides, animal feed, drainage and irrigation water and other structures) and prices etc. Trade liberalization has among other things entailed substantial reduction in the role government in production and marketing, abolition of controlled prices, removal of export taxes, relaxation of foreign exchange and import controls, and bolstering the participation of the private sector in the economy.

Trade liberalization has been a key policy debate in the development liberalization since the early 1980s. The centerpiece of this debate has placed a particular emphasis on the role of openness on economic growth and productivity as part of development strategy. Removal of trade barriers has become a powerful economic policy in both developed and developing nations today, while import and export tariffs, quotas, and export subsidies were common.

The early years of Pakistan's economy can be characterized by a weak industrial base, dominance of the agriculture sector, lack of well-organized infrastructure, and above all economic and political instability. To this end, Pakistan adopted a restricted trade regime and protected its domestic industries with high tariff and non-tariff barriers. The period of the sixties was the period in which the industrial base was laid and in which rapid expansion of large scale manufacturing industries started in the country.

While the highly protected trade regime remained effective in this period, some additional policies were introduced to encourage industrial exports from the country: an overvalued exchange rate, export bonuses, preferential credit access to industries with export potential and automatic renewal of import licenses. However, industrial expansion did not continue at the same rate in the next decade. In fact, it suffered a setback in the next decade due to the nationalization of industries. Although the government nationalized different types of industries in the country, it took three additional trade liberalization measures to encourage exports during this period: devaluation of the Pakistani Rupee by 57% in 1972, elimination of the export bonus scheme, and the discontinuation of restrictive licensing scheme. These steps stimulated exports especially of manufactured products.

More recently, developing nations, such as Pakistan, have also been implementing trade liberalization policies. Further, most countries' experience on trade policy reforms suggest that agricultural production growth and domestic welfare gains raise along with trade policy reform implementation. The major goals of the trade liberalization policy framework introduced in 1970 in Pakistan were to increase the availability of goods and services to consumers, and to expand the opportunities to the agricultural sector, enhancing market competition, as well as increasing investments while raising agricultural productivity and output in the country.

Traditional trade theory implies that free trade policies improve welfare of any economy by reducing dead weight loss associated with trade barriers such as taxes, subsidies, and quotas. However, net welfare effects of free trade have been debated over time.

Some studies show that there is little or no evidence suggesting that trade liberalization induces accelerated agricultural production growth, whereas some analyses provide empirical evidence confirming the link between trade openness and agricultural production growth. Moreover, research points out that trade liberalization and agricultural productivity may both feed on each other. Agricultural productivity can be gained from trade openness, along with liberalized trade policies, as agricultural products need to be more competitive to get expected agricultural production levels. Overall, international trade with more liberalized policies certainly may improve social welfare by improving international openness to the rest of the world, mobilizing capital, labor, goods, and services across borders. Furthermore, the advancement of foreign trade can have a significant impact on wages, employment, and investment, which finally, can result in a higher aggregate output in the agricultural sector while broadening a country's development. The trade liberalization policy framework introduced in 1977 was supposed to increase the availability of goods and services to consumers and expanded the opportunities to agricultural sector, enhancing market competition, increasing investments, raising agricultural productivity, and output. Economic development requires increasing of real Gross Domestic Product (GDP) of a country over a long period of time.

The increase in real GDP is a representation of economic development and manpower, capital accumulation, natural resources, entrepreneurial abilities, and technology play a vital role in increasing real GDP. Simultaneously, the agricultural sector also increases real GDP by generating agricultural surplus and increasing agricultural sector results surplus by increasing agricultural production, and utilizing the surplus labor from the agricultural sector. Trade policy reforms further encourage and motivate trade liberalization which tends to ultimately increase welfare derived from an efficient allocation of domestic resources in the agricultural sector.

Because international trade can act as an engine of growth, trade reforms facilitate international trade to be more accessible and simple. Efficient allocation of domestic resources reduces the production of import substitutes and increase production of exportable products which finally increases total output of the agricultural sector. On the other hand, increasing of exports and adjusting for efficient resource allocation generate comparative advantages which eventually can result a higher producer surplus from the agricultural sector. Trade liberalization also helps to increase consumer welfare by lowering price of import goods and import substitutes. Thus, international trade with more liberalized policies certainly may improve international openness to the rest of the world by mobilizing capital, labor, goods, and services across borders. Furthermore, the increasing of foreign trade can have a significant impact on wages, employment and investment which finally does result on a higher aggregate output in the agricultural sector while broadening a country's development.

1.1 Objectives of the study.

1. To determine the impact of trade liberalization on agricultural growth in Pakistan.
2. To propose suitable policy implications to get a positive impact of trade on agriculture in Pakistan.

1.2 Significance of the study.

Agriculture contributes about 24 percent of the gross domestic product (GDP) and employs 47 percent of the national employed labor force. The contribution of the agricultural sector to the GDP has declined gradually since Pakistan came into existence, from over 50 percent in 1949-50 to about 24 percent in 1996-97. Agriculture still remains the major sector of the GDP composition.

A major part of the economy depends on farming through production, processing and distribution of major agricultural commodities. Generally, we define the significance of agricultural sector in the economy of Pakistan in six ways. First, the agriculture sector provides food to the rural and urban consumers. Second it provides raw material to the local industries. Third Pakistan agricultural based economy so it is the most important source of foreign exchange earnings. Fourth, it provides a market for industrially produce commodities. Fifth, an increase in agricultural output can increase government savings by an increase in indirect tax collections, and finally, increases in agricultural terms of trade may boost household saving and aggregate investment. Agriculture plays a significant role in Pakistan's national economy, since agricultural products provide a good deal of the raw materials for the industrial sector. Agricultural land covers nearly a quarter of the total surface area of Pakistan. Agriculture contributes about 12 per cent of the GDP and employs 9 per cent of the total workforce. Hence, developing the agricultural sector will not only benefit the rural population, it will also promote Pakistan's overall economic status despite the importance of the agricultural sector, and Pakistan has a widening agricultural deficit and growing food dependence. Increased exports should bring in foreign currency and may also trigger more efficient production methods, thus narrowing the agricultural deficit or even eliminating it.

1.3 Organization of the Study

In the next chapter we see the literature review of the previous study that tells how trade liberalization effect on the agricultural growth rate in Pakistan. Chapter 3 is the theoretical framework in this chapter we discuss the source of the data and explain the relationship of dependent and independent variables.

Chapter 4 is the methodology in which we discuss the methodology used in the research paper and explain the results which come from the econometric models and the last chapter is conclusion in which conclude the relationship of the variables and recommended the policies for increases the agricultural growth rate.

Chapter 2

Literature Review

Thindwa and Seshamani (2014) tried to investigate the impact of trade liberalization in Malawi. Its aim was to establish the relationship between the trade liberalization and the growth of tobacco export during the period 1970 to 2009. Exchange rate, inflation rate, regional integration, arable land, IMF credit and FDI net inflows were the independent variables and tobacco exports were dependent variables. Time series data were used. Ordinary Least Square techniques were used to estimate a linear relationship between tobacco exports and all the independent variables. All independent variables directly relating to trade liberalization have been found to be insignificant. The econometric results showed that the only factors that are significantly related to the growth of tobacco export earnings in Malawi were FDI inflows and availability of arable land for tobacco farming. Trade liberalization has had no notable impact on the tobacco sector. Silva et al., (2014) tried to investigate the trade liberalization effects on the agricultural production growth in Sri-Lanka. It was based on national data from 1960 to 2010. A number of multiple regression models incorporating macro level data were estimated using the Ordinary Least Square (OLS) method. This study used only the secondary data. Agricultural production growth was dependent variable. Gross Domestic Product, Trade openness, Total investment and real interest rate were used as explanatory factors. The trade liberalization had a positive effect on agricultural production growth. This analysis also concluded that the trade openness, investment and interest rate were significant factors that were positively related to agricultural production growth.

This study suggested that the continuous support to the agricultural sector including natural resource conservation policies and proper skill development programs may be useful to increase the total agricultural output in Sri Lanka.

TalukderD (2014) has investigated the Agricultural Trade liberalization and Welfare of Rural Household in Bangladesh. The purpose of this paper was to analyze the impact of agricultural trade liberalization on the welfare of rural households in Bangladesh with a view to providing a complementary policy framework. The study used data from both primary and secondary sources and applied multiple mathematical, statistical and econometrical models to achieve its objective. The study found that agricultural trade liberalization had positive impacts on the welfare of rural households. However, the liberalization policy was not effective in bringing about its full potential due to shortcomings associated with socio-economic factors and weak economic institutions. It argues that the impacts of agricultural trade liberalization on the welfare of rural households depend not only on liberalization itself but also on other complementary reforms in non-trade areas. The study pointed out that the agricultural trade liberalization policy was not adequate to confer a benefit upon the poor households. Furthermore, the agricultural trade liberalization policy caused damage to the environment because of an increase in the inappropriate use of chemical fertilizers and pesticides in the post- liberalization era. Therefore, the government should consider the recommended policies to improve the welfare of rural households. The study suggests that the government should invest in research and development for technological innovation, and human resource development through training and extension services for efficient use of inputs.

Oluchukwu et al., (2013) tried to examine the impact of trade Liberalization on Nigeria Agricultural sector.

This study attempted to examine the impact of trade liberalization on Nigeria agricultural performance (model one) with special interest on export sub-sector (model two) using time - series analysis. It was stated clearly that performance of Nigeria agricultural sector and its export sub-sector was the function of trade liberalization. In this work trade liberalization was decompose into macroeconomic variables as thus agricultural degree of openness, agricultural capital formation, agricultural export to import price ratio, real exchange rate and foreign investment on agriculture. The test on hypothesis of model one revealed that two explanatory variables (EP/IP,LOG(FIA)) were statistically significant and three variables (LOG(ADO),LOG(ACF),REXR) were not statistically significant while that of model two revealed that two explanatory variables (ADO,LOG(FIA)) were statistically significant and three variables (ACF, EP/IP,REXR) were not statistically significant having passed the rule of thumb and conventional t-criteria.

The F-statistics which test the overall significant of the entire regression model revealed that the overall regression of both models were statistically significant, The Error Correction Model of Ordinary Least Square (OLS) results from the time -series analysis confirm that agricultural degree of openness and agricultural export to import price ratio were significant in the both models; whereas, agricultural capital formation, real exchange rate and foreign investment on agriculture were not significant. Therefore, it becomes necessary for policy makers to formulate policies that will eventually enhance investment in agricultural capital formation, real exchange rate and foreign investment on agricultural in Nigeria as this will lead to increased output and promote exportation of agricultural products.

Shaheen, S. (2013) was analyzed the impact of trade liberalization on Economic growth of Pakistan over (1975-2010).

Trade Openness Gross Fixed Capital Formation (GFCF), Foreign Direct Investment (FDI) and inflation were explanatory variables While Real GDP was dependent variable. This study Co-integration approach developed (1990) for long run relationship. Residual test was used to check the overall fitness of model. Akaike Information Criteria (AIC) and Schwartz Criteria (SC) were used for selection of optimal lag length. For finding the relationship between trade liberalization and economic growth time series econometric techniques such as co-integration were utilized. The results concluded that the trade liberalization and Gross Fixed Capital Formation have positive relationship and significant impact on economic growth. Foreign Direct Investment and inflation negatively effect on growth of the economy.

Manni and Afzal (2012) investigated the effect of trade liberalization on economic growth on developing countries. They analyzed the achievements of the economy in terms of important variables such as growth, inflation, export and import after trade liberalization. Trade liberalization as a dependent variable an inflation, exports and imports as a independent variable. Simple ordinary least square technique as methodology for empirical finding. The data was collected from World Development Indicators 2010. The result finding showed that greater openness has a favorable effect on economic growth of Bangladesh. Both real exports and imports have increased with greater openness. The empirical evidences and policies suggestions the study tries to reveal the overall effect of trade. Liberalization on economic growth of Bangladesh. It can be positive contribution of trade liberalization policy study in developing countries. Fonseca and Rayp (2011) "A view of Trade Liberalization on the Agricultural labor Market in Brazil.

The purpose of this study was to analyze in a qualitative way the impacts of trade liberalization on the agricultural labor market in Brazil, including the difference between skilled and unskilled workers from 1989 until 2009. The overall results have shown that trade liberalization contributes to the improvement of economic welfare by means of a larger output, lower domestic prices, and higher labor demand. The benefits of this economic improvement tend to benefit the most skilled rural workers, mainly in trade-oriented sectors, thus contradicting the predictions of the HOC theorems.

The openness has generated more mechanization in the sector which provoked a high demand for skilled workers, although the agricultural sector is labor intensive with typically non skilled workers connected to the production. Trade liberalization has had limited impact on wages and employment concerning unskilled workers. The benefits of this economic improvement tend however, to benefit the most skilled rural workers, mainly in trade-oriented sectors, thus contradicting the predictions of the HOS theorems.

Malik (2010) tried to investigate the impact of economic reforms and trade liberalization policies on agricultural export performance of Pakistan. The major purpose of this study was to examine the effects of both domestic supply-side factors and world demand on agricultural export performance. Four indicators of economic reforms and trade liberalization policies were considered namely competitiveness, diversification, openness and world demand for agricultural products. The effects were analyzed in dynamic term both in the long-run and short-run, using co-integration vector error correction (VECM) method.

The empirical results suggested that agricultural export performance was more sensitive to the domestic supply side conditions which change due to the policies. These findings supported the importance of domestic policies designed to improve the domestic supply conditions aimed at promoting agricultural exports. The empirical conclusions also indicated that there exist a unique long-run or equilibrium relationship exist among real value of agricultural exports , competitiveness , diversification , openness and world demand for agricultural products.

Adnan and Jafri (2011) tried to investigate the impact of trade openness on the real agricultural sector growth in Pakistan, by using the data from 1971 to 2009. The real agricultural GDP was dependent variable but skill labor force/ human capital, physical capital and trade openness were independent variable. They employed Ng- Perron unit root test in order to determine the order of integration, autoregressive distributed lag model for long run association and modified Granger causality test to determine the short run and long run causal direction. The results indicated that positive long run relationship between trade openness and real agricultural growth. The Granger causality test results confirm the long run causal direction from trade openness, human capital, and physical capital to real agricultural sector gross domestic product (GDP). The empirical results show that agricultural raw material import also positively impact on agricultural growth. Anwar et al.,(2010) tried to analyze the impact of trade liberalization on export of cotton from Pakistan. Time series data were used for this analysis. This study was based on over the periods of 1971-2008.

The main sources of time series data on all variables were Economic surveys of Pakistan, State Bank of Pakistan, Food and Agricultural Organization (FAO), All Pakistan Textile Mills Association (APTMA) and International Cotton Advisory Committee (ICAC), obtained over the period 1971-2008. The quantitative analysis of this study showed that both domestic and international trade policies had impact on export of cotton lint. World demand for cotton positively affected the export competitiveness and increase in trade openness led to higher export of cotton. Competitiveness (LCM) showed the maximum contribution towards the increase in export of cotton lint. Export of cotton lint (CXt) were depend on the world demand for cotton lint (DWt), Competitiveness of cotton lint in International market (CMt) , Concentration of export (CIt) and Openness of agricultural sector Opt .Domestic policies which have positive impact on supply side performance also lead to better export performance. Agricultural export was responsive to domestic and international policies. The competitiveness in cotton export showed its maximum contribution in increasing the cotton lint export from the Pakistan along with agricultural export openness. Agricultural policies should focus on the increased production of agricultural products and agricultural trade in consistent with trade liberalization policies. The infrastructure facilities required to improve the productivity and marketing should be improved to boost the exports of the country.

Carter and Zhu (2009) have analyzed that the impact of Trade Liberalization and Agricultural terms of trade in China. They used data from 1978-2005 to estimate the impact of China's trade openness on the relative price of domestic agricultural to industrial products. These findings implied that trade openness improved the economic welfare of China's agricultural producer's industrial product. The price of agricultural products to industrial was a dependent variable. GDP and trade openness were independent variable.

The price scissors have negatively affected China's agriculture and the trade liberalization will worsen the situation, work on price and the relationship to openness, is scarce. In result suggested that the domestic terms of trade between agricultural and industrial products and the resultant economic welfare of then farm producers, were indeed influenced by the country's integration into the world market, but not in a negative way. In results it was positively related to the country's trade openness. Compared with trade openness in agriculture, market integration in the industrial sector has a more significant impact on domestic terms of trade in favor of agricultural products. We concluded that the purchasing power and economic welfare of China's farmers has improved with China's transition to a market economy, policy measures such as price supports, should be discouraged as such instruments will stimulate oversupply, lead in to price declines, not to mention the burden on the government's budget if agricultural price increases lead to inflation, then the net effect for farm producers might not always be positive.

Fabiosa.J.F (2008) tried to investigate what effect free trade in agriculture has on developing country population around the world. In this paper, the impact of agricultural trade liberalization on food consumption through changes in income and prices was considered, first, agricultural trade liberalization were estimated to raise economic growth in developing and industrialized countries. Since food consumption of households with lower income were more responsive to changes in income, their food consumption increases more under a trade liberalization regime, second, trade liberalization were expected to raise world commodity prices Since, in general, border protection was much higher in developing countries and the level of their tariff rates was likely to exceed the rate of price increases, countries examined would have lower domestic prices under liberalization. Again, given that low-income countries were more responsive to changes in prices, food consumption in these countries would increase more.

The great consequence of Agricultural liberalization was to poor developing countries and households because this sector was a significant source of income as well as a major expenditure item (i.e., food) in their household budget. Finally, empirical evidence showed that if there was any harm on small net selling producers in a net importing country, it was neither large in scale nor widespread because the substitution effect dominates the net income effect from the lower domestic prices.

Salami, H. (2006) tried to investigate the effect of Agricultural land Productivity Improvement and Trade Liberalization in Iran. The policy package was that consist of increasing land productivity , removing input subsidies and expanding exports appeared to be an appropriate policy option for increasing the supply of agricultural and non-agricultural output, improving real household income, and enhancing labor employment. This policy was an appropriate domestic policy for Iran. In results , there was an expansion of agricultural sector which in turn leads to expansion of food manufacturing and service sectors, mitigated the unemployment problem, improved the Iranian welfare as the real GDP increased and improved the food security in Iran, as the price of food products decreased. In other words, the Iranian economy could not benefit from joining the WTO unless this is accompanied by a set of policies which result in an improvement in land productivity in the agricultural sector.

Nyo.T.P(2005) tried to analyze the Impact of Trade Liberalization on Agriculture sector in East Asia by using GTAP model. Implementation of trade liberalization in East Asia were expected to lead to a structural change in regional food markets whereby food production would shift from highly protected regions to low-protected regions or non-protected regions.

This study also analyzed that the impact of trade liberalization policy on East Asian region for selected commodity groups- rice, fruits and vegetables, fish and fish products, oilseeds and sugar.

The Impact of removing tariff on agricultural price and volume of trade were also high. As Agricultural products remain sensitive, detailed treatments on Agricultural trade like prolonged timetable for Liberalization were required for the establishment of East Asian FTA. Greater degree of flexibility should be allowed for a low cost transition process. An open food and Agricultural system would complement the restricting of the Asian economies by removing the Possibility of future distortion. The process of trade liberalization will increase the competitiveness of the agriculture sectors in the importing countries.

Shafaedin, M. (1994) tried to investigate the impact of Trade Liberalization on Export and GDP growth in least developed countries, Particularly in Africa. Trade liberalization has been recommended to these countries with the aim of expanding GDP and exports and diversifying the production and export structure into manufactures. The policy of trade liberalization has failed in LDCs because of three reasons: when it was under external pressure; they are related to how the reforms were perceived, their context and timing and the particular circumstances of individual countries. In many LCDs, exports of manufactures did not increase, indeed, many LCDs witnessed deindustrialization where there was some export expansion, and It was not accompanied by a building up of supply capacity. Trade policy should be development-oriented, aimed on a selective basis at building up supply capacity, both at the national level and at the level of the firm; it should be an integral part of industrial and development strategy. As a tool of development, trade policy is not necessarily synonymous with trade liberalization, and success in “liberalization” per se is not a guarantee of “success” in development.

Trade policy should serve to achieve the long-run objectives of development. Malaga et al., (2011) tried to investigate the impact of trade liberalization on agricultural sector growth in Sri-Lanka based on national data 1960 to 2010.

The study used the Ordinary Least Square (OLS) method to estimate multiple regression models. Agricultural production growth was the dependent variable and trade openness, Investment, Real interest rate were independent variable used. Two Dummy variables (D1 & D2) were added for trade liberalization and Trade Agreements. This Analysis concluded that the trade openness, investment, interest rate Free Trade Agreements were significant factors that were positively related to Agricultural productivity. The new trade policies would have been responsible for more efficient use of the country resources in terms of increased welfare. It emphasizes that there should be lot of improvements in this agricultural sector. Mainly, more attention should be given to reduce unspecialized and excessive workers in the agricultural sector to improve agricultural productivity. Most critical issue at present is that the agriculture does not bring a consistent economic gain to the farmer. This may be due to the government has not paid adequate attention to provide farmers with input and marketing facilities in time.

2.1 Research Gap.

In literature review different researchers and different variables and different techniques by capturing time series data mostly from 1973-2012. The main gap between above mentioned researcher's study and my study is mainly focused on trade liberalization, arable land, number of tractors and inflation rate and main concern of my study is impact of Trade Liberalization on Agricultural growth rate in Pakistan. Time series data is used by applying ARDL method.

Chapter 3

Theoretical Framework

Trade liberalization on agricultural growth is a most debated topic among the economist. Mercantilist, Smith and Ricardo emphasized on importance of international trade. Neo-classical growth theories which provide a great deal of modern economic growth theories explained that trade liberalization have positively influenced the economic growth in the medium term but cannot continuously affect growth in very long run. De Silva (2013) focused on the liberalization effects on economic growth as a whole. However, this study assess whether the trade liberalization policies enhance the growth of the agricultural sector by removing trade barriers such as export and import quota and tariff. More importantly, this study contributes to literature on economic growth by examining the trade agreements' effect on agricultural production growth with liberalized trade policies in Sri Lanka. Trade liberalization increases capital inflow which takes several forms like FDI which is an important source of capital inflow which fulfills the investment gap in the economy. Capital inflow increases investment level in the economy which leads towards more production, more output and increases market size. Further increase in production process will cause increase in employment level which reduce Inflation rate. It provides developing economies access of new technological innovation of developed countries. It provides both consumer and producer, easy access to larger markets so they can gain the benefits of economies of scale. Another important impact of trade liberalization operates through knowledge and technology transmission.

There is strong evidence that trade liberalization enhance the efficiency and productivity through knowledge and technology spillover. Impact of trade liberalization on human capital formation also provides another channel to increase the GDP growth.

In long run trade liberalization positively affect the human capital formation in the economy by providing employment opportunities and by knowledge and technological transformation. There has been no trade theory that is said to supersede the others among all trade theories even though the concept is an age-long phenomenon. However, we adopted in this study theories that support/criticize free trade and technology transfer; these theories are stated below

3.1. The theory of absolute advantage

Which is attributed to Adam Smith discusses the benefit a country can achieve by actively participating in the international division of labor. Smith argued that specialization in production leads to increase in output. This theory advocates that a country that trades internationally should specialize in producing only those goods in which it has absolute advantage. The country can then export a portion of those goods and import goods that it's trading partner produce more cheaply. According to Smith, this approach would lead to global efficiency. Smith based his theory on the assumptions of:

- (i) The trade involves only two countries
- (ii) Only two goods are traded by the two countries
- (iii) The countries have the same level of resource input.

Comparative advantage theory of David Ricardo in which proposed that countries can benefit from each other even though one has absolute advantage over the other in the production of both goods.

The comparative advantage comes if each trading partner has a product that will bring a better price in another country than it will at home. If each country specializes in producing the goods in which it has a comparative advantage, more goods are produced, and the wealth of both countries increases.

This theory is based on the following assumption:

- (i) There is perfect competition in all markets. This means that
 - (a) Firms are price taker.
 - (b) Firms choose output levels that equalizes the price with the marginal cost ($P = MC$),
 - (c) Output is homogenous across all firms
 - (d) Free entry exit.
 - (e) Perfect information.
- (ii) Only two countries are involved in the trading
- (iii) Both countries produce only two goods
- (iv) Labor is the only factor of production and it is homogenous and can freely move between industries but is immobile between two countries, and
- (v) There is no cost of transportation between countries.

3.2 Heckscher-Ohlin theory

It seeks to explain the pattern of international trade as determined by the relative factor of production existing in countries. This theory postulates that, trade arises from differences in comparative costs which in turn arise from inter-country differences in relative factor endowments. This means that countries should make use of locally abundant factors to produce export goods and import goods that are locally scarce. By implication the emphasis of this theory is that countries should rely on factor endowment. This links international trade to the international movement of labor and capital. The theory is based on the following assumptions.

- (i) There are no transport costs and impediment to trade.
- (ii) There is also perfect competition in commodity and factor market.
- (iii) All production function is homogeneous of the first degree.
- (iv) The production function differs between commodities but is the same in both countries.

3.4 Ricardian theory of comparative advantage

Porter's theory of competitive advantage suggests that the pattern of trade is influenced by four attribute.

- (i) Factor endowments: this refers to nation's position in factors of production such as skilled labor or infrastructure necessary to compete in a given industry.
- (ii) Domestic demand conditions: this relates to the nature of home demand for the industry's product or service.

(iii) The presence of related and supporting industries: this relates to the presence or absence in a nation of supplier industries or related industries that are nationally competitive.

(iv) Firms strategy, structure and rivalry: this relates to the conditions in the nation governing how companies are created, organized and managed and the nature of domestic rivalry.

3.5 Export-Led Growth Theory

Export-led growth is a policy strategy and a process by which a country aims at accelerating its rate of economic growth by relying upon an expansion of its exports. Its objective is to derive several growth-related benefits from export expansion, such as providing employment to its hitherto underemployed resources, higher rate of capital accumulation, up gradation of technology through greater imports, and so on. Theory tells us that economic development of a country can be stimulated by several factors. And amongst others, a central role is played by

1. An increase in the quantity and quality of its productive resources

2. Their more productive utilization.

The strategy of export-led growth is devised to strengthen these two contributory factors. In this strategy, a country tries to specialize in those products in which its factor endowment imparts it a comparative advantage. This means that the said country tries to increase employment of its unemployed or under-employed resources. Viewed from another angle, it is a strategy of more productive allocation of its productive resources and thereby acceleration of its economic growth.

It is also in the nature of things that international trade, together with other economic contacts that are associated with it, provides a profitable channel for the inter-country transfer of technology.

The benefits of research and development undertaken in one country tend to spread to its trading partners as well. International trade stimulates growth of trading countries both by what may be termed “demand motoring” and “supply motoring.” This means to say that international trade brings into operation a continuous interaction between demand and supply forces and helps them accelerate their growth rates. For example, trade adds to employment of their resources. This strengthens the demand of both traded and domestically consumed products. The resultant increase in production enables the producers to take advantage of the economies of scale, cut costs and prices, and stimulate demand still further. Similarly, some economists think that the consumer of an open, trade promoting economy more so those of a country pursuing export-led growth strategy) face a higher risk of “demonstration effect” which can retard its rates of saving and capital accumulation.

Some economists point out that, in the very nature of things, exports of poor developing countries tend to suffer from deteriorating terms of trade, so that a major portion of the benefit of growth in their productivity is appropriated by the richer countries. Positive and significant impact of Trade Liberalization on Agricultural growth suggests that Pakistan should focus on export-led growth. Pakistan should take some measures to enhance the levels of foreign direct investment directly or to private sector to improve its agricultural growth rate.

Chapter 4

Data and Methodology

4.1 Source of Data:

The data used in this study are gathered from secondary source and it is the time series data covering period from 1973-2012. Data on Agricultural growth, trade liberalization, number of tractors, land and Inflation rate are collected from world indicator of Pakistan.

4.2 Problem Area:

Problem area is in Pakistan.

4.3 Analysis of Data:

Econometric method will be employed for this purpose.

4.4 Sample size:

Our study employed annual data 1975-2012.

4.5 Model:

In the model Agricultural Growth is the dependent variable and GDP, Trade openness, number of tractors, CPI are the independent variables. The functional form of the dependent variable is as under; $AGRO=f(\text{Trade}, \text{land}, \text{tractors}, \text{CPI})$ where $AGRO$ =Agricultural growth rate
Trade=Trade liberalization Land=Arable land Tractor=Use of tractors CPI=Inflation rate the econometric model is $Y(\text{Agro}) = \beta + \beta_1(L)+\beta_2(\text{Tr})+\beta_3(\text{TL})+\beta_4(I)+u\dots\dots\dots$

4.5.1 Independent variable

Trade Liberalization:

The removal or reduction of restrictions or barriers on the free exchange of goods between nations. This includes the removal or reduction of both tariff (duties and purchases) and non-tariff obstacles (like licensing rules, quotas and other requirements). The easing or eradication of these restrictions is often referred to as promoting “free trade.” Two measures are used to measure trade liberalization. First, the trade-GDP ratio that is obtained by dividing the sum of exports and imports by GDP. Second, import duties as percentage of total imports.

Inflation

Inflation is defined as the annual rate of increase in prices and is represented by the Consumer Price Index (CPI). Inflation is a situation in an economy where the demand of money is fewer than its supply. Inflation reduces the value of money and other monetary items. Inflation is a situation when due to high prices, power of common men to purchase something decreases with the lowering value of currency. People then purchase fewer goods or in other word, inflation reduces the purchasing power of an individual. Low purchasing power can also be thought as an individual has low income for his expenditures. So whenever there is high rate of unemployment in an economy, people will have less money to spend. Three types of inflation (overall, food and non-food) and provides that money supply and gross domestic product (GDP) are important factors for inflation rate.

Arable Land.

Arable has its Latin roots in the word arable, which means "to plow." Arable soil is ground that can be plowed and cultivated.

Chances are — if you are using the word arable, then either the word land or the word soil is following it; however, you might also see the phrase "arable crops" meaning those crops that are able to be grown on arable land.

Tractors

A vehicle having a powerful gasoline or diesel motor and usually large, heavily treaded rear tires, used especially for pulling farm implements or machinery that is used in agricultural growth rate.

4.5.2 Dependent variable

Agricultural growth rate:

Agricultural growth rate is the science or occupation of cultivating land and rearing crops and livestock; farming; husbandry.

4.6 Methodology

Estimation:

To check the relationship empirically different econometric techniques are used. To check stationary of series the unit root test has been applied, while ARDL approach is applied to determine long run relationship between dependent and independent variables. Moreover, for short term relationship Vector Error Correction Model (VECM) has been used. These are the techniques of time series analysis. Time series analysis comprises methods for analyzing time series data in order to extract meaningful statistics and other characteristics of the data.

Time series forecasting is the use of a model to predict future values based on previously observed values. Or a time series is a sequence of data points, measured typically at successive points in time spaced at uniform time intervals. The first step of time series analysis is unit root test.

4.6.1 Unit Root Test:

A unit root test is a statistical test for the proposition that in a autoregressive statistical model of a time series, the autoregressive parameter is one. Before processing the any time series data the first and most important step is to check the presence of unit root or the problem of non-stationary. The non-stationary time series gives the spurious results by (Harris 1995). We obtained high very high r-squared values and significant t ratios, although the mostly trending time series are unrelated. Thus we can say that the relationship among the variables is meaningless. So therefore the unit root test is used to check that whether the time series are stationary are not. The limiting distribution of statistics is obtained under both the unit root null and a sequence of local alternatives. Minimum Lagrange Multiplier Unit Root Test with Two Structural Breaks The endogenous two break unit root test of Lumsdaine and Papell is derived assuming no structural breaks under the null. Thus, rejection of the null does not necessarily imply rejection of a unit root per se, but may imply rejection of a unit root without break. Similarly, the alternatives do not necessarily imply trend stationary with breaks, but may indicate a unit root with breaks. In this paper, we propose an endogenous two-break Lagrange multiplier unit root test that allows for breaks under both the null and alternatives hypotheses. As a result, rejection of the null unambiguously implies trend stationary.

4.6.2 Auto Regressive Distribution lags Model (ARDL)

ARDL stands for Autoregressive-Distribution Lag. Regressive models of this type have been in use for decades, but in more recent times they have been shown to provide a very valuable vehicle for testing for the presence of long-run relationships between economic time-series.

I'm going to break my discussion of ARDL models into two parts. Here, I'm going to describe, very briefly, what we mean by an ARDL model. This will then provide the background for a second post that will discuss and illustrate how such models can be used to test for co-integration, and estimate long-run and short-run dynamics, even when the variables in question may include a mixture of stationary and non-stationary time-series. In its basic form, an ARDL regression model looks like this.

4.6.3 ECM (error correction method)

An Error Correction Model is a dynamical system with the characteristics that the deviation of the current state from its long-run relationship will be fed into its short-run dynamics. An Error Correction Model is not a model that corrects the error in another model. Error Correction Models (ecms) are a category of multiple time series models that directly estimate the speed at which a dependent variable X returns to equilibrium after a change in Y an independent variable. Ecms are a theoretically-driven approach useful for estimating both short-term and long-term effects of one time series on another. Thus, they often mesh well with our theories of political and social processes. Ecms are useful models when dealing with co-integrated data, but can also be used with stationary data.

A rough long-run relationship can be determined by the co-integration vector, and then this relationship can be utilized to develop a refined dynamic model which can have a focus on long-run or transitory aspect such as the two VECM of a usual VAR in test rough long-run relationship can be determined by the co integration vector, and then this relationship can be utilized to develop a refined dynamic model which can have a focus on long-run or transitory aspect such as the two VECM of a usual VAR in Johansen test.

4.6.4 Hypothesis

The hypothesis that are tested in this study are

H_0 ; There is no long run relationship among the variables; $\beta_1 = \beta_2 = \beta_3 = 0$

H_1 ; There is a long run relationship among the variables; $\beta_1 \neq \beta_2 \neq \beta_3 \neq 0$

Chapter 5

Results and Discussion

5.1 Stationary or non-Stationary analysis

Variable	Level		1 st Difference		Decision
	t-statistic	Critical value	t-statistic	Critical value	
Agro	-1.92275	-3.61049	-4.013214*	-3.679322	I(1)
Trade	-3.610453*	-2.938987	-7.033416	-3.615588	I(0)
Land	-2.191051	-3.610453	-6.709168*	-3.615588	I(1)
Tractors	-1.279577	-3.610453	-5.396149*	-3.615588	I(1)
CPI	-4.955987*	-3.66166	-6.965746	-3.615588	I(0)

Table 5.1 Stationary or non-Stationary analysis

Discussion

For checking the stationary, ADF unit root test has been applied, some variables have order of integration 1 but other variables have order of integration 0. So we have to apply ARDL model. In results, with our dependent variable some variables have order of integration 1 while some variables have order of integration 0.

5.2 Autoregressive Distributed Lag Estimates

Regressor	Coefficient	T-Ratio	Prob]
AGRO(-1)	-.53340	-3.0459	.005
AGRO(-2)	-.22451	-1.4104	.169
TRADE	45.3445	1.8639	.072
TRACTOR	.1476E-4	1.4212	.166
TRACTOR(-1)	.5831E-5	.40384	.689
TRACTOR(-2)	-.1728E-4	-1.6536	.109
LAND	-.3470E-6	-.96626	.342
CPI	-.26719	-1.8091	.080

Table 5.2 Autoregressive Distributed Lag Estimates

5.3 Estimated Long Run Coefficients using the ARDL Approach:

Regressor	Coefficient	T-Ratio	Probability
TRADE	25.7946	1.9981	.055
TRACTOR	.1886E-5	.68818	.097
LAND	-.1974E-6	-.99953	.326
CPI	-.15199	-1.7588	.089

Table 5.3 Estimated Long Run Coefficients using the ARDL Approach

DISCUSSION

AS we take Agricultural growth rate as a dependent variable and number of tractors, Trade Liberalization, Land and Inflation rate (CPI). Dependent variable is Agricultural growth rate used 38 observations for estimations from 1973 to 2012. Trade Liberalization is the independent variable and Agricultural growth rate is independent variable. Trade Liberalization is Positively related to Agricultural growth rate. As Trade liberalization increases Agricultural growth rate also increases. And the value of T-Ratio is 1.9981 and Probability is .055 which is significant. CPI is negatively related to Agricultural growth rate. As one % increase in independent variable decrease -.15199 in Agricultural growth rate (Dependent variable). The T- statistics is -1.7588 and Probability is .089 which is significant. Number of tractors is the independent and Dependent variable is Agricultural growth rate. As one unit increase in independent variable will cause increase in Agricultural growth rate both are positively related with each other. The value of T-statistics is .68818 and probability is .497 which is significant. Land is an independent variable that is negatively related to Agricultural growth rate. The value of T-statistics is -.99953 and probability is .326 which is insignificant

5.4 Error Correction Representation for the Selected ARDL Model

Regressor	Coefficient	T-Ratio	Probability
dAGRO1	.22451	1.4104	.168
dTRADE	45.3445	1.8639	.072
dTRACTOR	.1476E-4	1.4212	.165
dTRACTOR1	.1728E-4	1.6536	.108
dLAND	-.3470E-6	-.96626	.341
dCPI	-.26719	-1.8091	.080
ecm(-1)	-1.7579	-6.3608	.000

Table 5.4 Error Correction Representation for the Selected ARDL Model

DISCUSSION

As we take agricultural growth rate as a dependent variable and number of tractors, trade liberalization, land and inflation rate (CPI). In result R2 is .75477 which is greater than adjusted R2 .69755 and DW-Statistics is 2.1137 this shows the significant results. Trade Liberalization is the independent variable and Agricultural growth rate is dependent variable. Trade Liberalization is highly positively related to Agricultural growth rate. As Trade liberalization increases Agricultural growth rate also increases. And the value of T-Ratio is 1.8639 and Probability is .072 which is significant. CPI is negatively related to Agricultural growth rate. As one % increase in independent variable decreases -.26719 in Agricultural growth rate (Dependent variable). The T-statistics is -1.8091 and Probability is .080 which is significant. Number of tractors is the independent and dependent variable is Agricultural growth rate. As one unit increase in independent variable will cause increase in Agricultural growth rate both are positively related with each other. The value of T-statistics is 1.4212 and probability is .165 which is significant.

Land is an independent variable that is negatively related to Agricultural growth rate. The value of T-statistics is -0.96626 and probability is 0.341 which is insignificant. ECM is negative because it should be negative and it is also significant. Because short run equilibrium exists. Error correction Model are the category of multiple time series model that directly estimate the speed at which agricultural growth rate returns to equilibrium after a change of 1.7579 in Independent variables.

5.5 Diagnostic Tests

Test Statistics	LM Version	Probability
Serial Correlation	.80379	.370
Functional Form	.022472	.881
Normality	19.1483	.000
Heteroscedasticity*	.017399	.895

Table 5.5 Diagnostic Tests

DISCUSSION

Above results indicate that econometric problems like autocorrelation, conflict to normal distribution has not been observed. Similarly, no model specification error exists with reference to functional form. Presence of Heteroscedasticity does not affect the estimates and as time series in equation are of mixed order of integration so it is natural to detect Heteroscedasticity.

5.6 Bound Testing

F-statistic	95% Lower Bound	95% Upper Bound	90% Lower Bound	90% Upper Bound
7.2445	2.5296	3.8482	2.0448	3.2226

Table 5.6 Bound Testing

Discussion

In result, F-value is 7.2445 which is greater than Upper bound limit 3.8482

Chapter 6

Conclusion and Policy Recommendation

6.1 Conclusion

The paper empirically analyzes the impact of trade liberalization on agricultural growth rate Pakistan over the period 1973-2012 by utilizing ARDL technique. Results reveal that trade liberalization, tractors and land has positive impact on Agricultural growth while inflation is negatively related to Agricultural growth. This result highlighted the importance of trade liberalization in order to enhance agricultural growth. Based on these findings, the study suggests that Pakistan should go more of trade liberalization policies to enhance more economic growth. A high rate of inflation, particularly inflation in food prices, is a constant danger to the wellbeing of the poor. There is no doubt that high rate of inflation if not checked effectively, will undo most of the effects of policies to enhance growth. Role of trade liberalization and Agricultural growth rate also increased due to Global recession of 2008-09 which support the positive link between trade liberalization and Agricultural growth rate. For Trade Liberalization to be a significant contributor to Agricultural growth rate growth, Pakistan should focus on improving infrastructure, capital accumulation, establishing entrepreneurship, developing a secure macroeconomic framework and conditions favorable for investments. All these will help to speed up Agricultural growth of economy.

6.2 POLICY RECOMMENDATIONS

Pakistan should improve the performance of its mediating factors for trade liberalization to be effective in promoting agricultural growth rate.

- Agriculture is the engines of economic growth. Agriculture sector has been resilient and strong throughout. This will bring about greater results. In addition, investment in human capital along with the application of appropriate technology would also be useful.
- Pakistan should take all necessary measures to save erosion of soil and provision of rich fertilizers to make up deficiencies of soil created by effects of climate change such as loss of organic matter and rich top soil to increase crop production
- Government should create an investment friendly environment in order to boost the economy and agricultural growth rate. In this regard, laws should be made conducive and encouraging for foreign investors and to attract FDIs.
- In order to enhance economic efficiency simultaneous coordinated progress is required on many fronts like the hardware of energy security, industry, technology, FDI, exports etc. and the software of economy such as human development agricultural growth rate and inflation alleviation.

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