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Trade Liberalization and Service Sector Growth: A Case of Selected South Asian Countries

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ABSTRACT

The current study attempts to find how trade liberalization effects services sector growth of selected South Asian economies. Yearly panel data for 1990-2020 was utilized for four selected countries; Pakistan, India, Bangladesh, and Sri Lanka. Long run results of panel Autoregressive distributed Lag ARDL model indicates that trade openness and capital investment have positive and significant impact on services sector whereas government - household consumption expenditure, labor force, and inflation have inverse relation with service sector growth. In order to enhance the third largest sector of the economy and to boost its growth, study concludes with the empirical findings that governments of these countries require to reformulate their trade policies which should be less restrictive. Moreover, should put effort to design strategies on; creating free trade zone or south Asian economic union that will be a source of employment for less skilled workers as well, low-cost skill development schemes and restructuring regional labor markets.

1 Introduction

Manufacturing led development for the former times remained the traditional means for job creation and prosperity. In other words, manufacturing believed to be the main source of economic growth of nations across the world. But in many developing economies over the last three decades, the service sector has surpassed the manufacturing sector in size. In developing economies, the services sector generated an average of 55% of GDP and 45% of employment in 2019 (World Bank report, 2021). This economic transformation which is driven by services sector is possible on account of new opportunities for scale, innovation, and spillover effects which in past were supposed to make manufacturing more productive. Based on its rapid expansion, the service sector is sometimes known as the tertiary sector of an economy. This sector includes all tasks performed by people who donate their expertise and time in an effort to raise sustainability, performance, productivity, and potential. In recent years, the service sector has expanded very quickly and now accounts for a sizable portion of output, income, and employment in developing nations. In addition to this, productivity per worker in the service sector is rising relative to the agricultural and industrial sectors. However, the services sector is now also becoming dominant in developed economies as well.

Higher level of education, skills, and experiences in human resource plays a significant role in increasing economic growth. In general perception for sustainable growth in any country, productive resources and technological innovations are needed. Thus, one of the main resources of any nation is labour, which can be expanded with; faster population growth, accumulation of physical capital, which can be raised with higher investment rates, and accumulation of human capital which can be increased by higher investment rates, human capital also further relates to both the size and caliber

of the labour force. It is evident now a days that high growth rates are being enjoyed by those nations that successfully utilize their human capital.

Hence, services sector is significant for the long-term growth prospects of any country and particularly in south Asia since the 1990s. Role of services sector has become increasingly important due to its key contribution to enhancing the trade and investment flows with in the region as it increases productivity, competitiveness, and a major share in employment. By its principle labor-intensive nature this sector helped in receding poverty as well as the remittance earnings from manpower exports have become an important source of foreign exchange earnings in the region.

Trade liberalization refers to the term and in general understanding to trade openness, which has been regarded as a key component of any development policy at the global level since the late 1970s. Traditional international trade theories predict that trade liberalization can add value to products. Trade leads to a static increase in the efficiency of production and resource allocation in the economy. Today, world has become a global village and recent time in the nation's history is known as the era of globalization. There is no possibility of surviving today without foreign trade. Countries are currently concentrating on liberalizing their trade policies, thus capitalize opportunities of comparative advantage to the best of their ability. Recently, it has been revealed that trade openness or liberalization is one of the most important tools for boosting economic growth. Trade in services sector activity makes it easier for producers and consumers to interchange the relevant services and products related to this.

It is believed that trade liberalization significantly contributes in the growing global economic disparity. It is widely believed that trade liberalization brings negative impacts on employment and wages for low-skilled employees in industrialized nations. Concerns about trade liberalization are making international labour standards worse. Traditional Stolper-Samuelson theorem predicts that trade liberalization will raise the price of the abundant factor (unskilled labour) in developing countries and, reduce the skilled wage premium and wage inequality. This is the symmetric alternative to the theory that trade expansion is a significant cause of rising inequality in industrialized nations.

The purpose of the current study is to investigate the significant influence of trade openness on the services sector growth of South Asian economies. Reviewing the preexisting research literature gave insight that many of the earlier studies focused on finding the linkages within their particular countries or they categorized countries into groups like developed nations, developing nations, and low- or high-income countries but the present study aims at finding the effect of trade openness on the services sector growth of specific geographical region which is South Asia and more precisely includes Pakistan, India, Bangladesh, and Sri Lanka.

2 Literature Review

Specifically focusing on exports, Mohammad and Alauddin (2005) investigated Bangladesh's trade liberalization process and its effects on the development and structures of exports, imports GDP, and other pertinent macroeconomic indicators. Cointegration testing and distributed lag modelling were employed in the investigation. The findings demonstrate that both the lowering of anti-export bias and the import GDP ratio, which serves as a stand-in for capital imports, have a considerable long-term impact on exports.

The relationship between trade liberalization and labor demand elasticities was examined by Akhter et al. (2007). This analysis employed firm-level data from Pakistan that covered the entire period of trade liberalization. This study looked at whether trade liberalization increased Pakistan's industrial sector's own price and labor demand elasticities. The study used a fixed effect and random effect model, and the findings suggest that the theoretically predicted link between more trade liberalization and lower labor demand elasticities may not hold practically. All eleven industries'

labor demand elasticities reveal a lack of response to trade liberalization under the fixed effect model, however under the random effect model, the great majority were taken into account independently.

Bushra (2009) investigated the role of human capital and job characteristics, or supply-side determinants, in wage setting during a period of trade liberalization. For the years 2005-2006 and 1990-1991, she developed a model using the Mincerian earning function and Labor Force Survey data to estimate various salary determinants, calculate rates of return to various educational backgrounds, and determine relative occupational wage shares. The study's findings revealed a growing wage disparity between men and women, some degree of stability in the rate of return to most educational levels, but an increased return to the highest level of education during the period of trade liberalization, and slightly shifting relative wage shares across occupations.

Shastri et al. (2010) looked at how India's employment situation changed after adopting a trade liberalization policy and the potential consequences of additional trade liberalization. Trade liberalization may increase labor productivity in developing economies, but it also has a different influence on their salaries and employment, according to economic theory. The majority of the time, more trade has been linked to higher employment but lower pay. The effect of trade liberalization on employment is particularly significant in this setting. According to this report, policies and programs should be created for unorganized sectors as well, especially those that are connected to export markets.

Rubiana and Gunjan (2010) viewed the connections between trade liberalization, skill up gradation, and industrial delicensing in Indian manufacturing facilities throughout the 1980s and 1990s. Three sources provide the study's data. To assess the degree of industrial de-licensing a plant has experienced, regression discontinuity and difference-in-differences approaches respectively were utilized. Study came to two significant conclusions: First, industrial de-licensing throughout the 1980s seems to have raised the relative need for skilled personnel via capital-and output-skill complementarities after adjusting for the size-based exemption rule that determined whether or not a facility faced licensing constraints. Second, since trade was liberalized in the early 1990s, capital- and output-skill complements are often weaker, regardless of de-licensing. According to the study, trade liberalization might not have had a significant impact on increasing the relative demand for skilled workers in the early 1990s.

The South Asian Association for Regional Cooperation (SAARC) countries' employment levels were studied by Asghar et al. (2014). For the theoretical and literary examination, nations such as Pakistan, India, Bangladesh, and Sri Lanka were chosen. It was discovered that trade liberalization may have favorable effects in some nations, but that this is not a necessary requirement, and it does not necessarily follow that trade liberalization is beneficial. The government should give economic agents an institutional and legal framework to work within.

Atif et al. (2015) used panel data analysis to investigate the impact of trade liberalization on economic growth and human capital in low- and high-income Asian economies such as India, Indonesia, Japan, Malaysia, Pakistan, South Korea, Singapore, and Sri Lanka. For the assessment of explanatory variables within countries, the Fixed Effect Model was used in this study. The study's findings show that trade openness has a positive impact on human capital for both developed and developing countries, but it is more significant in developed countries due to well-trained human capital. During the selected time period, both groups of countries experienced trade-led growth. According to the study, investment in human capital is a critical need for developing countries to reap the full benefits of trade openness.

Ajmair et al. (2016) incorporated Autoregressive distributed lag (ARDL) model for evaluating the factors affecting services sector output growth by employing annual data for the years 1975 to 2014. Results of this study show that foreign trade, government expenditures, market size, and population growth are the relevant long run determinants of service sector output growth. While as for the short

run results foreign trade and personal remittances have effects on services sector growth. Thus it is suggested that for intended augmented overall economic growth concerned authorities should implement such policies which increase services sector output of the country.

Ambreen et al. (2017) used a time-varying parametric approach to conduct empirical research to identify the factors that contribute to the growth of the services industry in Pakistan (Kalman Filter). Inflation, domestic lending to the private sector, gross fixed capital creation, remittances received, and trade openness have negative effects on the growth of the services sector, whereas foreign direct investment and gross national expenditures have positive and large influences. The study's suggestions were that, in order to achieve long-term growth in the services sector and improve overall economic growth in the nation, the relevant authorities should increase gross domestic expenditure and foreign direct investment.

Ajmair et al. (2018) assessed impulse response of agriculture, industrial, and services sector growth shocks to macroeconomic indicators of their growth as well as their own shocks. Their study carried out analysis based on Amisano and Giannini (1997) AB model in structural vector auto regression. The study's findings demonstrated that the agriculture sector's growth impulse reaction to both internal and external shocks to gross domestic expenditures was favorable. The expansion of the agriculture sector was, however, significantly impacted by inflation and remittance shock, whilst the impact of permanent crop land shock was mixed. Results for the industrial sector demonstrate a mixed response of the industrial sector's growth impulse and external debt to the other factors. Increased manufacturing sector growth was brought on by shocks to the external debt. The report recommended maintaining the focus on measures intended to curb inflation in order to accelerate GDP development in three important sectors.

Maryem et al. (2018) examined the effects of liberalizing a nation's service regimes on the growth of the two important sectors (telecom and finance). The Fully Modified Ordinary Least Square (FM-OLS) Estimation Technique was used in the study. The results of the model that was incorporated demonstrate that liberalization has a beneficial effect on the growth of particular sectors. According to the study's findings, the government must take intentional action to create a climate that would encourage investment, notably in the services sector's robust sub-sectors of banking and telegram.

The factors influencing the service sector's contribution to Pakistan's GDP was examined by Kashif et al. (2019). For data analysis they used Auto Regressive Distributed Lag model. The empirical analysis demonstrates that trade in services and foreign direct investment have a strong beneficial impact on the contribution of the service sector to GDP. While population growth and employment in the service sector show adverse effects. Long-term implications of household consumption and government spending are currently negligible. According to the study, authorities need to address current concerns and make changes to existing laws that might boost the contribution of the services sector.

3 Theoretical Framework

Numerous economists have periodically studied sectoral growth, trade openness, and its implications on output. This section outlines some of these studies while keeping in mind their significance: The process by which underdeveloped economies transition from a reliance on traditional subsistence agriculture to a more modern, urbanized, and industrially diverse manufacturing and service sector is the focus of structural-change theory. He uses contemporary econometrics as well as techniques from neo-classical price theory and resource allocation to explain how this transformative process works. The "two-sector surplus labor" theoretical model of W. Arthur Lewis and the "pattern of development" empirical study of Hollis B. Chenery and his coauthors are well-known exemplary instances of the structural-change approach.

The fundamental character is One of the most popular early theoretical models of development, developed in the middle of the 1950s by Nobel laureate W. Arthur Lewis and later refined, formalized,

and extended by John Fei and Gustav Ranis, centered on the structural transformation of a largely subsistence economy. The Lewis two-sector model—which is still occasionally used—became the dominant theory of the development process in developing countries with excess labour for the majority of the 1960s and early 1970s. This is especially true when looking at China's recent growth and labour markets in other developing countries. The underdeveloped economy, according to the Lewis model, is divided into two sectors: a traditional, overcrowded, rural subsistence sector with zero marginal labour productivity, which Lewis characterized as surplus labour because it could be removed from the traditional agricultural sector without reducing output, and a high productivity modern, urban industrial sector into which labour from the subsistence sector is gradually transferred.

The concept of variance in relative factor endowment was first established by Hescksher (1919) and Ohlin (1933), and it eventually became the basis for international trade. They talked about the scenario in which there are two countries with an abundance of relative factors of production. Let's say there are two factors of production for two goods. If one commodity is labour intensive and the other is capital intensive, both countries use their abundant factor of production to produce goods. The continuous return to scale and factor price equalization theorem are the foundations of the H-O Model. They felt that there was only one nation that required a lot of labor. The other country, on the other hand, exports its capital-intensive products to labor-intensive nations for less money.

The H-O Model concept was developed by Stolper Samuelson in 1953. As unskilled labor is a plentiful factor of production in developing nations, he described how international commerce would lead to an increase in the wages of this workforce. This pay increase is the reason for a decrease in income disparity in the trading nation. According to some formulations of the theorem, trade liberalization would result in wages for one element (skilled or unskilled) being equal across all nations.

4 Methodological Issues

The following section present the data collected and sources of data, methodology for the empirical estimation of the linkages between trade liberalization and the services sector growth of the certain South Asian nations like Pakistan, India, Sri Lanka and Bangladesh

Data Source

This study utilizes secondary source of Panel data for the year 1990-2020. Data for the selected variables is collected from various sources consisting Bureau of Statistics Pakistan, different volumes of Pakistan Economic Surveys and mainly from World Bank Development Indicators (WDI). Measuring units of dependent and independent variables are taken in Current US$ whereas population is taken in total count and all variables are further adjusted in natural logarithm.

Model Specification

Following operational model is incorporated for evaluating the impact of trade liberalization on services sector of south Asian counties. For present analysis, study has taken services value added as a proxy for services sector growth, trade openness index for trade liberalization, total labor force, gross fixed capita formation, gross national expenditure and inflation as GDP deflator. General form of model is quantified as:

$SVA = f\ (TOI, GFCF, GNE, TLF, INF)$

Multi regression equation of the above model is specified as:

$\alpha = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \text{---------} + \beta_n X_n + \mu_t$

$SVA = \beta_0 + \beta_1\, TOI + \beta_2\, GFCF + \beta_3\, GNE + \beta_4\, TLF + \beta_5\, INF + \mu_t$ ..... (1)

$LSVA = \beta_0 + \beta_1\, TOI + \beta_2 L\, GFCF + \beta_3\, LGNE + \beta_4\, LTLF + \beta_5\, INF + \mu_t$ ..... (2)

Table 1

Description of the Variables

Variable	Abbre.	Description
Services Value Added	SVA	Services fall under the International Standard Industrial Classification division of value added in, transportation, government financial, professional, and personal services like education, health care, and real estate services, as well as wholesale and retail trade (including hotels and restaurants). Import tariffs and imputed bank service fees are also included. The net output of a sector is the sum of all the sector's outputs minus any intermediate inputs.
Trade Openness Index	TOI	Trade openness explains how a nation's economy is structured in relation to global trade. The ratio of the sum of exports and imports to the aggregate GDP of the countries is used to calculate the degree of openness and is based on the actual size of registered imports and exports of an economy.
Gross Fixed Capital Formation	GFCF	After subtracting disposals, gross fixed capital formation is the sum of investments in fixed assets made by resident producers over a specific time period. It also includes specific increases in the value of non-produced assets realized by producers or institutional entities. It shows how much of the newly created economic value is invested as opposed to consumed.
Gross National Expenditure	GNE	Gross national expenditure is the total spending made by all members of the economy. Gross national expenditure is the sum of consumption plus investment plus government expenditures. GNE (formerly domestic absorption) is the sum of household final consumption expenditure, general government final consumption expenditure, domestic investment.
Total Labor Force	TLF	The labour force consists of people over the age of 15 who provide labour for the production of goods and services for a set period of time. It includes both those who are currently employed and those who are looking for work, as well as first-time job seekers. However, not every worker is included. Students, low-wage workers, and family members are frequently overlooked. The number of employees fluctuates throughout the year as seasonal workers arrive and depart.
Inflation	INF	Inflation is the rate at which prices rise over a given time period. Inflation is typically defined as a broad measure, such as the overall increase in prices or the cost of living in a country. We take GDP deflator as a proxy of inflation

Source: World Development Indicators

5 Data Analysis, Results and Discussion

An authentic source of data and variables selection plays a crucial role for an effective empirical research. This section deals with the quantitative analysis by employing panel data comprising of 4 countries Pakistan, India, Bangladesh and Sri Lanka for the year 1990-2020. The data was taken from the data base of world development indicators and for the estimation of variables statistical software Eviews was used.

Unit Root Test

Table 2

Results of Panel Unit Root Tests

Variables	Intercept	Intercept & Trend	None	
	LLC Test	**LLC Test**	**LLC Test**	**Conclusion**
SVA	1.3021	3.650	-1.26	I(1)
	(0.903)	(0.99)	(0.10)	
IM	-3.022			I(1)
	(0.001)	___	___	
EX	0.434			I(1)
	(0.66)	___	___	
GDP	1.042	3.322	-1.37	I(1)
	(0.851)	(0.99)	(0.08)	
TOI	-8.506			I(1)
	(0.00)	___	___	
GFCF	0.764	3.421	-2.55	I(1)
	(0.777)	(0.99)	(0.00)	
GNE	0.233	1.654	-1.78	I(1)
	(0.592)	(0.95)	(0.03)	
TLF	3.582	3.561		I(1)
	(0.999)	(0.99)	___	
INF	-2.209	-0.86	-3.01	I(0)
	(0.013)	(0.19)	(0.00)	

Note: Fisher tests is computed using an asymptotic Chi-Square distribution. All other tests assume asymptotic normality.

The panel unit root test results shown in above table for the dependent and independent variables by utilizing the Levin Lin & Chu test, Im – Pesaran – Shin W-stat, ADF Fisher Chi-square and PP-Fisher Chi-square stats. Stationarity test result reveals mixed trend which indicates that for further empirical analysis Panel Autoregressive Distributed Lag Model (ARDL) can be used.

Short Run and Long Run Estimates of Panel ARDL

Table 3

Panel ARDL Results

	Long Run Coefficients			
Variables	**Coefficient Value**	**Standard Error**	**t-Statistic**	**Prob.**
TOI	1.310	0.6507	2.013	0.05
LGFCF	3.042	1.5173	2.005	0.05
LGNE	-1.451	1.2409	-1.169	0.25
LTLF	-5.298	2.9011	-1.826	0.07
INF	-0.008	0.0045	-1.950	0.06
	Short Run Coefficients			
D(TOI)	-0.140	0.1428	-0.980	0.33
D(LGFCF)	0.344	0.3772	0.913	0.36
D(LGNE)	0.418	0.3028	1.380	0.17

D(LTLF)	-0.328	0.4633	-0.708	0.48
D(INF)	0.006	0.0017	0.402	0.69

Table 3 above presents the overall estimated results from equation 02, indicating the effects of trade liberalization on the services sector growth of the particular economies of South Asian region. This empirical study employed services value added SVA as a proxy for services sector growth and as a dependent variable in the equation with trade openness index, Gross fixed capital formation, Gross national expenditure, total labor force and GDP deflator proxy for inflation as the explanatory variables. The selected method for investigation is panel ARDL, with Akaike info criterion which is used as lag selection criterion having log likelihood 449.76 and standard deviation 0.072

Long run estimates show, trade openness have a positive and significant impact on the services sector with coefficient value 1.31 which means that 1% increase in trade openness causes 1.3% raise in the services growth of the region. This finding is also evident in the study by (Kashif et al., 2019), (Maryam et al., 2018), (Asghar et al., 2014). Study by (Atif et al., 2015) also manifested this finding in a particular scenario of developed countries. This result is also in line with the H-O theory but opposed by the findings of (Ambreen et al., 2017) for the case of Pakistan. Thus, the minimum or less barriers on the trade like tariffs and non-tariff barrier as quotas will lead to spur more income generating opportunities, expansion in total output, enhancement in technical knowledge and mobilization of human resource across the region.

Results above states that, Gross fixed capital formation having positive coefficient value 3.04 with statistically significant effect on the services. Thus 1% increase in gross fixed capital formation lead an increase of 3.04% in services growth. This finding is supported by study (Atif et al., 2015). Result suggest that capital investment stimulates growth of services sector and is been crucial in promoting competition among domestic and international markets.

Gross national expenditure has a negative coefficient of -1.45 and is insignificant in long run whereas have positive 0.41 in short run. This indicates that 1% rise in gross national expenditure will bring 1.45% reduction in the services sector growth. These results contradict with the findings of (Ajmair et al., 2018) (Ambreen et al., 2017)

Present study indicates that in long run there is a negative contribution of labor force in services sector growth, as the coefficient value is -5.29 and is significant. This means that 1 % raise in total labor force causing services sector growth to retard by 5.29%. The result contrast with the findings of (Kashif et al., 2019) whose evaluation indicate a negative effect of population on service sector in case of Pakistan. (Akhter et al., 2007) study also depicts empirically weak link or unresponsiveness towards service sector growth. This negative impact is because that in selected under consideration countries the ratio of unskilled workers is very high as there is lack of technical education and training as well as lack of professional education. Also there is a greater degree of wage inequality among different sectors of the economy.

GDP deflator has a negative coefficient of 0.008 and significant in the current study which goes as 1% increase happens in inflation the service sector growth declines by 0.008%. These results shows that numerous service subsectors are prone towards change price levels. Normally employment in these subsectors has less formal tendency which generally has high price elasticity.

6 Concluding Remarks and Suggestions

Trade openness is assumed to be a major indicator for growth in developing as well as developed nations. Proponents of impact of trade openness on the sectorial growth advocate some main channels i.e., capital accumulation, factor price equalization, development of skills, advancement in knowledge and transfer of technology. Higher degree of trade openness benefits more to the economies; but the fruits of openness can be achieved by aiming on the development of efficient third largest sector of the economy. It is evident from the studies that competitiveness of the services sector

along with the well-functioning regulatory system is essential for ensuring the gains to service sector from trade liberalization in the south Asian economies.

Results obtained in the present study suggested that trade openness and capital investment are pivotal for services sector growth. It is essential for governments and authorities of South Asian countries to reformulate their trade policies which enables less restrictive flow of output of services sector and gain remittances. Strategies focusing on creating free trade zone or a union within a region will help domestic service provider firms, individuals to progress as well as source of employment for the masses with or without the requisite skills. As labor force has negative effect on services sector growth, governments of these nations must take necessary measures to increase their consumption expenditure to provide health and education facilities so that these be easily accessible by the low-income groups. Lower consumption expenditure by household adversely effects services growth, which is most likely because of less supply of services due to high ratio of unskilled and untrained workers. To take benefits from consumption side, need to establish more technical and professional institutes on grass root level which target to deliver rather making revenue. Public policies may play favorable part in youth development besides this these policies must target to design low-cost skill development schemes and restructuring regional labor markets.

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