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Foreign Lending Dilemma and Poverty in Pakistan, India and Bhutan: A Panel Data Analysis

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ABSTRACT

Purpose: In developing countries foreign lending becomes a problem now a day instead of spend this lending for the development purposes. Ultimately this problem causes poverty in these countries where usage of foreign lending is not in proper ways. The purpose of this study is to investigate the impact of IMF and World Bank lending on poverty in Pakistan, India and Bhutan. In this study corruption, GDP, unemployment, secondary enrolment, and external debt are used as independent variables and poverty headcount ratio as dependent variable. Study finds out the relationship of corruption, unemployment and external debts with poverty and showing the positive relationship while secondary enrolment and GDP showing negative relation with poverty. Moreover study finds out that lending of IMF and WORLD BANK mostly causes poverty in these developing countries instead of reducing poverty because of corrupt government's weak policies for the distribution of loans. It is examined that the countries with strong policies and non-corrupt government can take full advantage of these lending for poverty reduction. But it is noticed that the countries which are the members of IMF structural adjustment programs are facing more poverty problems as compare to those countries which are not involved in these programs or even have less numbers of lending. Those countries are much better than the countries involve in structural adjustment programs.

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1. Introduction

There are different definition of poverty but usually poverty is defines as the condition of having insufficient resources or income. Extreme form of poverty is a lack of basic human needs to sustain as useful and working efficiency such as adequate and nutritious food, clothing, and housing, clean water and health services. Poverty is considering very serious disease in developing countries which is very dangerous like HIV/AIDS. Due to poverty many deaths are occurs in poor countries every year.

Poverty actually caused by different reasons like in Pakistan illiteracy is a main issue. A series of studies have demonstrated that people who live in regions where there are disparities in income have poorer average health status than people who live in more economically homogeneous regions. All standard indicators of social and economic exclusion and differential shows that poverty is quite sever in Pakistan. yet such definition are extremely insufficient to capture broader mean of poverty, which could include social justice , right, participation and equality, essentially all forms of social and economic exclusion, usually based on unequal material relation and their manifestation of inequality power.

Dilemma of IMF and WORLD BANK lending in developing countries is concerned with the poverty reduction. The association between IMF and World Bank programs and poverty is a relatively new area of study. Structural Adjustment programs are programs which make it possible for countries to get a loan from the IMF or the World Bank. But these loans are related with some serious types of conditionality's like some significant policy reforms which have to be complied with before getting the loan. In many developing countries such types of conditionality's raised the issue to find out either the link between these lending's and poverty is positive or negative. Because in the beginning of the century, the International Monetary Fund (IMF) had proclaimed that one of the purposes of its lending activities was to help low-income debtors achieve poverty reduction.

Now the question is what role does the IMF play in exacerbating poverty and inequality in poor countries? The IMF tried to justify its preferred creditor status and advance the idea that low- income debtors had a temporary liquidity problem that could be solved through their financing arrangement that low-income debtors were not actually ruined. IMF thinking on poverty and inequality, particularly among Management, has evolved over the past twenty years. According to Easterly (2001) number of adjustment loans from IMF reduces the growth elasticity of poverty reduction. So that growth does reduce poverty but the study found no evidence for direct effect of these adjustment loans on growth. Fischer (2000)found that adjustment lending's are also associated with currency devaluation in developing countries there is negative association. Using Heckman regression this study found evidence that participating in IMF lending programs is connected to higher poverty rates and more unequal distribution. And these results stayed strong after controlling for other economic variables. Easterly (2003) attempted to overlook the repetition of adjustment lending to the same country study said that repetition changes the nature of the selection problem. Radelet (2006) analyzed the role of IMF in well performing low-income countries. According to him IMF began to play very important role from 1970,s when many countries were facing many types of problems like high inflation low reserves and overvalued exchange rates but with the passage of time some well performing countries not much longer needed IMF program. It argued that IMF should use more non-funding programs in those countries and its role should be less dominant in overall conditionality so that those countries should be able to achieve their development goals that are outside the know-how of IMF like private sector and agriculture Bird (2004) attempted to provide more fundamental analysis of the IMF funds involvement in growth and poverty reduction. Although the IMF presents itself as a monetary institution it plays an important role in providing support to the poor countries via its poverty reduction facility. Granville and Mallick (2005) attempted to analyze the link between the poverty reduction and the debt sustainability in IMF and World Bank in context of developing countries this study was based on UK Development Studies Association Annual Conference. This study build a model on the basis of policy frameworks of IMF to show how demand growth effect the potential rate of growth and the study also linked the consumption deprivation to the key variables of the structural adjustment programs. Holden (2002) attempted to analyze the repositioning of IMF during the 1970 – 2002 one integral part of the institution was the 'international financial structure' the main motive of that integral part was to insure the sustainable growth of underdeveloped countries by reducing the poverty in those countries which had applied for the loans of IMF. Korankye (2014) attempted to analyze the causes of poverty in Africa .and study found the number of factors which were responsible for the poverty in Africa for example limited employment, poor infrastructure, poor usage of resources, wars and unending conflicts, and major reason was the poor policies of World Bank and IMF. Because of those poor policies the funds for Africa were always remained in the hands of corrupt people which caused unequal distribution of resources and money. Momani (2008) attempted to analyze the artificiality of IMF in reducing poverty and inequality. Study said that IMF had claimed that one of its motives of its lending programs was to reduce poverty and inequality. Annand and Kumar (2014) attempted to analyze the inclusive growth and poverty reduction in India. This study was based on the IMF working paper. Waqas and Sarwar (2011) attempted to analyze the impact of education on poverty reduction. This study was based on the data of (HIES) survey from 1998-1999.and study used the logistic regression technique to analyze the impact of education. Study found that Education and health endowments of the individuals were the necessary and important components of human capital which make them productive and raise their standard of living.

1.1 Objective

- To find out relationship between IMF and World Bank Lending and Poverty in developing countries
- To find out IMF and World Bank lending dilemma related to poverty in developing countries
- To suggest some Policy Recommendations

1.2 Hypothesis

H0: There is no association between poverty and IMF and World Bank lending in developing countries

H1: There is association between poverty and IMF and World Bank lending in developing countries

1.3 Significance of Study

This study is based on the panel analysis, before it single country studies have been done to find out the relationship of Poverty and foreign lending. But in this study it is tried to find out the panel analysis. It’s a dilemma for developing countries to come out from the conditionality’s of borrowers. Due to this strict conditionality it becomes harder for developing countries to reduce poverty according to there on desire. This study will contribute to know about the relationship between lending and poverty in Pakistan, India and Bhutan. On the basis of findings some policy recommendations are suggested.

2. Data and methodology

The study is based on the panel data and the data has been collected from “world bank”, “economic survey” and “IMF” and data has been used since (1995-2014).

2.1 Selection of Variables

Study will complete different variables external debts, unemployment, secondary enrolment, GDP (per capita), and corruption as independent variables and poverty as dependent variable.

2.2 Model Specification

To find out the relationship between IMF and WORLD BANK lending and poverty reduction “poverty is taken as dependent variable and unemployment corruption, external debts, GDP, and secondary enrolment are as independent variables. For the regression “random effect model” is selected. Empirical study is performed by using PC Software of statistics E-View7.0 and Stata. In this study the panel data of at least 15 years from 1995 to 2014 has been used. The model is.

Model

Poverty = f(GDP ,unemployment, secondary enrolment, corruption, external debt)

Dependent Variable

Pov = poverty

Independent Variable

SE= secondary enrolment

GDP= Gross domestic product (per capita)

Unemp= unemployment

Lending = external debts

Corruption= corruption index

2.3 Random Effect Model

The random effects model is a generalized linear model; if α_i is a group specific random disturbance with zero conditional mean and constant conditional variance, σ_α^2, then

$$\mathrm{Cov}[\varepsilon_{it},\varepsilon_{is} | \mathbf{x}_{i1},\mathbf{x}_{i2},\ldots,\mathbf{x}_{iT(i)}] = \sigma_\alpha^2 + \mathbf{1}(t = s)\sigma_\varepsilon^2 \;\; \forall\, t,s \mid i \text{ and } \forall\, i.$$

$$\mathrm{Cov}[\varepsilon_{it},\varepsilon_{js} | \mathbf{x}_{i1},\mathbf{x}_{i2},\ldots,\mathbf{x}_{iT(i)}] = 0 \;\; \forall\, t,s \mid i \neq j \text{ and } \forall\, i \text{ and } j.$$

The random effects linear model can be estimated by two step, feasible GLS. Different combinations of the residual variances from the linear model with no effects, the group means regression and the dummy variables produce a variety of consistent estimators of the variance components. [See Baltagi (1995).] Thereafter, feasible GLS is carried out by using the variance estimators to mimic the generalized linear regression of (y_{it} - $\theta_i \bar{y}_{i.}$) on the same transformation of $\mathbf{x}_{it}$ where $\theta_i = 1 - \{\sigma_\varepsilon^2/[T(i)\sigma_\alpha^2 + \sigma_\varepsilon^2]\}^{1/2}$. Once again, the literature contains vast discussion of alternative estimation approaches and extensions of this model, including dynamic models [see, e.g., Judson and Owen (1999)], instrumental variables [Arellano and Bover (1995)], and GMM estimation [Ahn and Schmidt (1995). The primary virtue of the random effects model is its parsimony; it adds only a single parameter to the model. Its major shortcoming is its failure to allow for the likely correlation of the latent effects with the included variables - a fact which motivated the fixed effects approach in the first place.

2.4 Random Equation

$$pov = \alpha i + \beta 1 lending + \beta 2 SE + \beta 3 unemp + \beta 4 corruption + \beta 5 GDP + \mathrm{uit} + \varepsilon\mathrm{it}$$

Where as
β is the coefficient for the Independent variables,
Pov=poverty head count ratio
Lending=external debt
unemp=unemployment rate
Corruption=corruption index
SE=Secondary School enrolment
GDP=Gross Domestic Product

2.5 Panel Unit root test

Checking stationary is necessary because during building models for time series the underlying stochastic process that generates the series must be invariant with respect to time. So the stationary of dependent variable poverty and independent variables, GDP, secondary enrolment, lending, unemployment, corruption are checked by applying the unit root test. Testing for this in data conventionally precedes co-integration analysis. Augmented Dickey Fller (ADF) test is often used to determine degree of integration of variables. Following table shows the results of ADF test. Stationery of all variables has been achieved at 1st difference, this means all variables are integrated of order one (1) and stationary is achieved at none.

Table 1: Unit root Test

Variables	t-statics at level	Prob value at	t-statics at 1st	Prob at first
Pov	3.52612	0.9998	-2.36628	0.0090
GDP	4.35999	1.0000	-1.68540	0.0460
Corruption	0.77354	0.7486	-7.66658	0.0000
Lending	-1.62334		-3.92122	0.0000
S.E	3.53364	0.623	-2.41151	0.0075
unemp	-0.70338	0.9998	-4.18397	0.0000

3. Results and Discussion

Poverty Headcount Ratio is used as dependent variable. GDP, unemployment, secondary enrolment, external debt, and corruption are used as independent variable in this study The results of fixed random effect are given table 2. Headcount Ratio is use for the measurement of poverty which is dependent variable GDP, unemployment; secondary enrolment, external debt, and corruption are independent variable. The independent variables are affecting the dependent variable Poverty Headcount Ratio. GDP and secondary enrolment are showing negative relationship with poverty .while other corruption; lending and unemployment are showing positive relationship. All variables are significant. Validity of random effect model is checked by Breusch and Pagan Lagrangian multiplier test and p value showed that random effect model is fit for this data. Serial Correlation is checked by Pesaran's test of cross sectional independence and p value indicate that there is no serial correlation in this model.

Table 2: Method: Panel GLS (Period random effects)

Variables	coefficient	t-statistics	Prob value
GDP	- 46.84761	-11.67588	0.0000
SE	-9.889908	-8.642901	0.0000
Unemp	2.437818	3.226449	0.0024
Lending	0.206920	3.528211	0.0010
Corruption	2.113950	1.498601	0.0015
C	140.4042	9.422812	0.0000
Pesaran's test of cross sectional independence			0.2271
Breusch and Pagan Lagrangian multiplier test for random effects			0.000

4. Conclusion

Poverty is the depressive topic in the developing economies. Many of the institutions NGO's and the Government institutions are working for the elimination or decreasing the rate of the poverty The situation is getting worse and worse in developing countries behind this many reasons are involve. Like week policies related to the use of loans by IMF and World Bank due to which whole money stays only in the hands of corrupt politician. And the loans becomes useless instead of welfare and development these loans become a burden at the countries and the people of that country these loans cause poverty because when these loans got wasted and when the time comes of repayment of the loans then the government get another loan to reimburse the previous loan and this process keep on repeating itself every year and the loans which were taken for the development and prosperity of the country cause poverty problems in that country.

Moreover study concludes that poverty is the depressive topic in the developing economies. Any of the NGO's and the Government institutions are working for the elimination or decreasing the rate of the poverty. IMF always used to play a rhetoric role in poverty reduction many studies shows that the role IMF is just artificial it actually does not play a prominent role in poverty reduction. While due to its lending many developing countries condition has become much worse due to week policies of both governments and the IMF and World Bank.

But there is always an other side of the picture and the other side of the picture is that the lending's by IMF and World Bank could be prove helpful in the development and poverty reduction of the country but only at one condition that the government should not be corrupt, policies for the consumption of loans should be better .so that the amount of loans may not stay in the hands of corrupt individuals. In this study unemployment, corruption, GDP, secondary enrolment and lending are taken as independent variables, GDP and secondary enrolment shows negative effect with poverty which means when GDP will increase poverty will decrease and same case is with the enrolment. While others unemployment, corruption, and lending have positive impact at poverty when any of these increase poverty will increase and when decrease poverty will decrease. Because poverty rates are much lesser in those countries which are not involved in any program of IMF or which have better policies and a non-corrupt government as compared to the countries which are involved in IMF programs with week policies and corrupt government.

5. Policy recommendation

- Policies of World Bank and IMF regarding to the loans must be improved.
- Individual and political corruption must be reduce so that amount of loans not stays in few hands.
- Enrolment of schools must be increase it will help a lot to reduce poverty.
- With fare distribution of income employment opportunities will increase and unemployment will decrease and as well as poverty.
- These loans should be used in development projects so that government repays the loan by the revenue of those projects instead of taking other loan for the repayment of first one.

6. Limitation of Study

The developing countries which have been chosen for this study are belong to those group who are regular lenders of World Bank and IMF programs. Pakistan India and Bhutan. These three developing countries have almost same income group and similar social and economic conditions. And all these three countries are the lenders of World Bank and IMF.

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