

The Trade Balance of Pakistan and Its Impact on Exchange Rate of Pakistan: A Research Report

Uzma Malik Shamsa Noor Samina Jahangir Nazish Tariq Amna Ramzan Rahat Fatima
M.Sc. Economics, The Islamia University of Bahawalpur, Pakistan, Bahawal Nagar Campus

1. Introduction

Trade balance is a difference between a country's imports and its exports. Debit items include imports, foreign aid, domestic spending abroad and domestic investments abroad. Credit items include exports, foreign spending in the domestic economy and foreign investments in the domestic economy. A country has a trade deficit if its imports are more than it exports; the opposite scenario is a trade surplus. It is also referred to as "trade balance" or "international trade balance."

Balance of trade data shows the imports and exports of goods and how a country competes in a global marketplace. Investors and policymakers are increasingly using trade balances to determine the health of the economy and its relationship with the rest of the world. Imports and exports can include physical goods and intangible services .i.e. Middle Eastern nations have stronger physical exports due to the international oil trade. A negative balance of trade is a bad sign for a country's long run economic health. Balance of trade data is a very important piece of understanding the global puzzle of international trade. Much like an income statement, balance of trade data clearly defines whether a trade deficit or trade surplus.

Countries generally try to create trade policies that encourage a trade surplus. They consider this to be a favorable trade balance because it's like making a profit as a country. You'd prefer to sell more, so you can get a higher income, and have more capital for your residents. This will translate into a higher standard of living by hire more workers. It will reduce unemployment and generate more income for your residents.

To maintain this favorable trade balance, leaders often resort to trade protectionism. They protect domestic industries, by levying tariffs, quotas or subsidies on imports.

A trade surplus is not always a favorable trade balance. China and Japan have both become dependent on exports to drive economic growth. To maintain this surplus, they both purchase large amounts of U.S. Treasuries to keep the dollar's value high, and the value of their currencies low -- making their exports competitively priced.

Trade deficits are usually considered to be an unfavorable balance of trade. A country that imports more in consumer products than it exports in raw materials doesn't give its domestic businesses the experience needed to make those higher value-added products. Furthermore, it could eventually deplete its natural resources, and it is dependent on global commodities' prices.

In special circumstances, a trade deficit can actually be a more favorable balance of trade. For example, Hong Kong has a trade deficit, but most of its imports are raw materials which it converts to finished goods and re-exports output. Canada's slight trade deficit is a result of its strong economic growth, which allows its residents to enjoy the higher standard of living afforded by diverse imports.

2. History of Trade Balance

Pakistan got independence in 1947. Pakistan is facing a continual trade deficit during globalization era Persistence deficit balance of trade is very dangerous for an economy like Pakistan and policy makers and economists are needed to take steps towards this issue. (Mohammad, 2010) Historically there are only two fiscal years in which Pakistan's balance of trade remained surplus. In 1951-52 Pakistan earned foreign exchange through export of raw jute and secondly in the fiscal year 1972-73 when the Bhutto government imposed high tariff on import of luxury items and devalued the Pakistan rupee to give the export bonus for local exporter. (Mohammad, 2010)

During 1973, the major component of import was crude oil. The oil price increased impact on the balance of trade adversely and the deficit was fulfilled by external capital account borrowing that cause to raise external debt burden as a result of external borrowing 40 to 45 percent budget expenditure goes to the debt servicing and little amount remains for public sector development program.

Pakistan external debts amount reaches to more than \$45 billion and would reach at more than \$52 billion after IMF loan and this is an increasing trends as yet. Extensive portion of our reserve is used for debts servicing. (Mohammad, 2010), Almost 45 percent of population living below the poverty line. Therefore, Pakistan needs to make and design the policy of liberalization and privatization instead of contain imports

Examining the exports and imports performance for the floating period of 1982 to 2008, it is evident that imports increased at a faster rate than the exports of the country. In 1982, a decline of 10.28% had occurred in the exports of Pakistan against the imports which showed an increase of 11.09%. After that both the sectors showed a mixed picture for a period of 10 years. During 1992, although the exports showed an improvement of 24.19%, yet this growth was smaller than the imports of the country which kept 34.35% growth rate. In 2002,

both the exports and imports showed an abrupt and sharp deceleration. However, the exports growth rate only being 4.06%, was larger than the imports growth rate of 1.22%. After that both the exports and imports sectors showed improvements. However, the import sector showed a faster growth than the exports which showed a slowdown. In 2008, the exports growth was only 16.26% as compared to the 35.66% rise in imports of the country. Another reason for that Pakistan exports are mainly consisted of agricultural goods such as Cotton, Textiles, Leather, rice and Sports Goods etc. On the other hand, its imports mostly consist of Machinery, Chemicals, Petroleum Products, Transport equipment's, Steel and Oil etc. Analyzing the percentages of the major exports and imports of Pakistan during the period 1999-2008, it is evident that Pakistan's exports were consisted of 59.1% Cotton, 5.1% Textiles, 6.9% Leather, 6.9% Rice and 3.3% Sports Goods in 1999. However, in 2008 after a period of 10 years, the structure of exports remained the same i.e. 51.9% of Cotton, 2.1% Textiles, 5.8% Leather, 9.8% Rice and 1.6% Sports Goods. Whereas, for the same period, the imports of Pakistan were consisted of 17.9% Machinery, 16.6% Chemicals, 15.5% Petroleum products, 5.7% Transport equipment's, 3.1% Iron & steel, 8.7% Oil, 2.8% Fertilizer and 2.4% Tea. And like the exports, the imports structure of Pakistan remained the same i.e. 18.5% Machinery, 12.3% Chemicals, 28.8 % Petroleum products, 5.5% Transport equipment's, 3.3% Iron & steel, 4.3% Oil, 2.2% Fertilizer and 0.5% Tea during 2008.

One more reason for the worst trade balance of the country is that Pakistan's exports and imports are concentrated on only few countries. Various economics strategies, reforms and policies were adopted to resolve the issue but all is vein. Global trade trends and policies have great influence on international trade, economic activity and growth. The aim of trade policies was to stimulate domestic output, protection to domestic industries, consumer protection and promotion of export etc. The government took steps in the early 2000s to liberalize and deregulate the exchange and payments regime. Pakistan moved to a dual exchange rate system in 2000. Export growth in 2000/01 was primarily due to higher exports of primary commodities such as rice, raw cotton, and fish, and other manufactures such as leather, carpets, sporting goods, and surgical instruments. Imports increased in 2000/01 primarily due to higher imports of petroleum and petroleum products, and machinery.

The US Central Intelligence Agency (CIA) reports that in 2001 the purchasing power parity of Pakistan's exports was \$8.8 billion while imports totaled \$9.2 billion resulting in a trade deficit of \$399.9 million. (Piana, 2006). The International Monetary Fund (IMF) reports that in 2001 Pakistan had exports of goods totaling \$9.13 billion and imports totaling \$9.74 billion. The services credit totaled \$1.46 billion and debit \$2.33 billion.

3.Current Pakistan Balance of Trade 1957-2015

Pakistan recorded a trade deficit of 192781 PKR Million in May of 2015. Balance of Trade in Pakistan averaged -23866.44 PKR Million from 1957 until 2015, reaching an all-time high of 6457 PKR Million in June of 2003 and a record low of -280964 PKR Million in August of 2014. Balance of Trade in Pakistan is reported by the Pakistan Bureau of Statistics.

Actual	Previous	Highest	Lowest	Dates	Unit
-192781.00	-188772.00	6457.00	-280964.00	1957 - 2015	PKR Million

Pakistan has been running consistent trade deficit since 2003 mainly due to high imports of energy. Since 2012, China has emerged as Pakistan's largest trading partner replacing the United States. In recent years, the biggest trade deficits were recorded with China, India, United Arab Emirates, Saudi Arabia, Kuwait and Malaysia. Pakistan records trade surpluses with the United States, Afghanistan, Germany and United Kingdom. (Economics, 2015)

Table 1: Pakistan current balance of trade

Pakistan Trade	Current	Previous	Highest	Lowest	Unit
<u>Balance of Trade</u>	-192781.00	-188772.00	6457.00	-280964.00	PKR Million
<u>Exports</u>	198851.00	202874.00	275483.00	51.00	PKR Million
<u>Imports</u>	391632.00	391646.00	472228.00	96.00	PKR Million
<u>Current Account</u>	778.00	-770.00	1418.00	-4213.00	USD Million
<u>Current Account to GDP</u>	1.10	-1.10	4.90	-8.50	percent
<u>External Debt</u>	62649.00	63960.00	66490.00	33172.00	USD Million
<u>Terms of Trade</u>	55.87	54.41	94.83	49.17	Index Points
<u>Remittances</u>	4346.00	4287.00	4695.00	906.00	USD Million
<u>Gold Reserves</u>	64.48	64.48	65.44	64.38	Tons
<u>Crude Oil Production</u>	95.00	95.00	98.00	50.00	BBL/D/1K
<u>Foreign Direct Investment</u>	2816.40	2665.30	3184.30	2099.10	USD Million

4. Factors that affect the trade balance

1. Tax-based trade restrictions.(i.e. tariff, quota)
2. Difficult to calculate recording.(i.e. Smuggling)
3. The cost of production (land, labor, capital, taxes, incentives, etc.) in the exporting economy.
4. The cost and availability of raw materials, intermediate goods and other inputs.
5. Exchange rate fluctuation.
6. Multilateral, bilateral and unilateral taxes or restrictions on trade;
7. Environment and safety standards.

Pakistan is with the cost of oil imports primarily responsible for the trade imbalance. The growth of exports and remittances of Pakistanis are working in abroad (mostly in the Middle East) help Pakistan to keep the payments deficit in check. For example, remittances from overseas workers peaked at \$2.9 billion in 1982/83, and then dropped to \$1.4 billion in 1997/98 and \$1 billion from 1999 to 2001. This trend especially accelerated during the Gulf War, when nearly 80,000 Pakistanis in Kuwait and Iraq lost their jobs. Only about 25% of these jobs had been regained a year after the end of the conflict.

5. Macroeconomic Performance of Pakistan

During the study period (1947-2008), the macroeconomic performance of Pakistan remained unsatisfactory. The main reasons for that were the poor monetary and fiscal policies, large debt burden, worse balance of payments situations and continuous political instability in the country. Another reason for that was the longer periods of economic recessions spread over a longer period of 10 years from 1969-70 to 1978-79 and for 14 years from 1991-1992 to 2004 to 2005.

This section shows the trends in the major macroeconomic variables of Pakistan, particularly focusing on the GDP, economic growth, and inflation and trade performances. The details are as follows:

5.1 GDP

Trade balance effect the GDP: other things remain constant, a surplus increases GDP and deficit reduces it. Annual trade surpluses are immediate and direct additions to their nations' GDPs, if GDP increase governments may deliberately increase the capacity of their infrastructure by providing a nation's schools and colleges may provide job applicants specifically suited to the producer's needs. All national factors of production, including education contribute to GDP, whereas trade deficits make no net contribution to their nations'.

5.2 Economic growth

The strength of an economy can be judged from its economic growth. Whereas the economic growth is refers to the improvement in the major sectors of the economy. The economists usually use real GDP growth rates for its measurement.

During the study period (1973-2008) the real GDP growth rates of Pakistan also showed fluctuated trends. During 1973, the real GDP growth rate of Pakistan was 6.8% in which the contribution of the agriculture sector was 1.7% that of the industrial sector, 10.3% and the services sector, 9.6%. After that it showed a downward movement and reached to 2.80% during 1977. This was because of the sharp cuts in the growth rates of the agriculture, industrial and services sectors which stood 2.5%, 2.9% and 3.0% respectively. After that the GDP growth rates showed a 62 upward movement and reached to the second largest level of 8.7% during 1985. The major reason for that was the improvement in the agriculture, industrial and services sectors which stood 10.9%, 7.8% and 7.9% respectively. After that the GDP growth rate showed once again a downward trend and fell to 2.30% during 1993. However, this was only because of the agriculture sector which showed a fall of 5.3% against the improvements in industrial and services sectors which showed improvements of 5.5% and 4.6% respectively. There were signs of improvement for a period of three years when it touched the record lowest level of 1.70% during 1997. The major reason for that was the poor growth performance of agriculture (0.1%), Industry (-0.3%) and services (3.6%) sectors. This poor performance of the economy was continuing and it again reached to 2% during 2001. However, during 2005 the economy showed a record improvement of 9% real GDP growth rate which was because of the improvements in the agriculture (6.5%), industrial (12.1%) and services (6.0%) sectors. During 2008 the growth rate of the GDP once again fell to 4.10% because of the poor performance of both the agriculture (1.0%) and Industrial (1.4%) sectors. However, the services sector showed a growth rate of 6.0%.

5.2.1 Current Pakistan's GDP 1960-2015

The Gross Domestic Product (GDP) in Pakistan was worth 246.88 billion US dollars in 2014. The GDP value of Pakistan represents 0.40 percent of the world economy. GDP in Pakistan averaged 59.69 USD Billion from 1960 until 2014, reaching an all-time high of 246.88 USD Billion in 2014 and a record low of 3.71 USD Billion in 1960. GDP in Pakistan is reported by the World Bank Group. (Economics, 2015)

Actual	Previous	Highest	Lowest	Dates	Unit
246.88	232.27	246.88	3.71	1960 – 2014	USD Billion

The gross domestic product (GDP) measures of national income and output for a given country's economy. The gross domestic product (GDP) is equal to the total expenditures for all final goods and services produced within the country in a stipulated period of time. (Economics, 2015)

5.3 Inflation

Inflation adversely affects the overall economic growth including the financial sector development, induces uncertainty, discourages savings and affects the exchange rate of a country. Considering such adverse impacts of inflation on the economy, there is a consensus among the economists that *price stability is the prime objective of monetary policy of the central banks in all the countries* (Hasan, et al 1995). During the study period, it showed a sharp upward trend and *increased* from 9.68% in 1973 to double digit levels 30% and 26% during 1974 and 1975 which was the *biggest rise* of inflation in the history of Pakistan.

The two main reasons for that were

1. The 1973 world oil price hike
2. Nationalization policy of the economy during Zulfikar Ali Bhutto government.

After that it stood at 11.12% in 1982 and *decreased* to 5.61% with a decline of 49.55% in 1983. During 1991, it was reached to 12.66% showing an *increase* of 109.60% compared to 6.04% inflation rate in 1990. The main reason for that was the Gulf war. The *average inflation rate* was 7.4% over the period 1982 to 1993. The low public expenditures, tight monetary policies, covering the supply of goods and reversal of nationalization policy helped in lowering inflation rate. During 2003, it declined and touched its *historical low level* of 3.1% with a decline of 12.42% against 3.54% in 2002. Tight monetary and fiscal policies of State Bank of Pakistan and government helped in creating that low inflation environment in the country (Khan and Schimmelpfennig, 2006). However, during 2008, inflation again surged to 12% with an *increase* of 54.44% as compared to 7.7% in 2007. A rise in import prices was the main reason behind that sharp shoot up of inflation (Khan and Gill, 2010). In short, during 1973-2008 the country experienced double digit inflation in 15 out of 36 years with the highest and lowest levels of 30% and 3.1% during 1974 and 2003 respectively. Current, the year-on-year CPI inflation has declined to 2.1 percent in April 2015 from 8.2 percent in June 2014. Soft international commodity prices, stability in exchange rate, contained government borrowings from SBP, moderate aggregate demand, and SBP's earlier conservative monetary policy stance have remained the key factors in controlling inflation this year. (SBP, 2015)

5.3.1 Current Pakistan Inflation Rate 1957-2015

The inflation rate in Pakistan was recorded at 3.20 percent in June of 2015. Inflation Rate in Pakistan averaged 7.98 percent from 1957 until 2015, reaching an all-time high of 37.81 percent in December of 1973 and a record low of -10.32 percent in February of 1959. Inflation Rate in Pakistan is reported by the Pakistan Bureau of Statistics. (Economics, 2015)

Actual	Previous	Highest	Lowest	Dates	Unit
3.20	3.16	37.81	-10.32	1957-2015	Percent

In Pakistan, most important categories in the consumer price index are food and non-alcoholic beverages (35 percent of total weight); housing, water, electricity, gas and fuels (29 percent); clothing and footwear (8 percent) and transport (7 percent). The index also includes furnishings and household equipment (4 percent), education (4 percent), communication (3 percent) and health (2 percent). The remaining 8 percent is composed by: recreation and culture, restaurants and hotels, alcoholic beverages and tobacco and other goods and services.

5.4 Imports

Commodities (goods or services) bought from a foreign country. Major imports of Pakistan are;

1. Machinery.
2. Petroleum.
3. Chemicals.
4. Vehicles and spare parts.
5. Edible Oil.
6. Wheat.
7. Tea.
8. Fertilizers.
9. Plastic material.
10. Paper Board
11. Iron ore and steel.

5.4.1 Imports of Pakistan

These imports accounted for 73% of total imports during 2006-07. Among these categories machinery, petroleum/petroleum products and chemicals accounted for 53.4% of total imports.

5.4.2 Direction of Imports of Pakistan

Pakistan's imports are highly concentrated in few countries. Over 40 percent of them continue to originate from just seven countries namely, the China, USA, Japan, Kuwait, Saudi Arabia, Germany, UK and Malaysia. Saudi Arabia is emerging as major supplier to Pakistan followed by the USA and Japan. The shares of USA and Japan, with some fluctuations, exhibited a declining trend because of the shift in the import of machinery/capital goods and raw materials to other sources. On the other hand, the share of Pakistan's imports from Saudi Arabia has been rising due to higher imports.

5.4.3 Pakistan Imports 1957-2015

Imports in Pakistan decreased to 391632 PKR Million in May of 2015 from 391646 PKR Million in April of 2015. Imports in Pakistan averaged 58693.92 PKR Million from 1957 until 2015, reaching an all-time high of 472228 PKR Million in August of 2014 and a record low of 96 PKR Million in April of 1959. Imports in Pakistan are reported by the Pakistan Bureau of Statistics.

Actual	Previous	Highest	Lowest	Dates	Unit
391632.00	391646.00	472228.00	96.00	1957 – 2015	PKR Million

5.6 Major export of Pakistan

1. Raw cotton, Textile products and Cotton yarn.
2. Rice.
3. Leather and leather products.
4. Carpets and rugs, Tents.
5. Textiles.
6. Surgical instruments.
7. Sports goods.
8. Readymade garments.
9. Vegetable, fruit and fish.
10. Engineering goods.
11. Chemicals and Pharmaceutical products.

5.6.1 Exports of Pakistan

Exports were targeted at \$18.6 billion or 12.9 percent last higher than year. Export of food group declined by 3.5 percent. This declined is caused by a 2.6 percent and 14.3 percent decline in exports of rice and fruits. Export of rice declined due to lesser production caused by adverse weather condition which kept the domestic price higher. It was more profitable to sell within the country than to export. Exports of textile manufactures grew by 0.2 percent. Prominent among these are export of knitwear 13.9 percent, readymade garments 6.8 percent, made up articles 8.9 percent, cotton yarn 4.6 percent and towels 2.6 percent. Exports of other textile materials registered a high double digit growth of 17.2 percent. Export of raw cotton, cotton cloth and bed wear on the other hand registered a decline. (Einfopedia.com, 2015)

5.6.2 Direction of Exports of Pakistan

Although Pakistan trade with a large number of countries its exports are however highly concentrated in few countries including USA, Germany, Japan, UK, Hong Kong, Dubai and Saudi Arabia which account for one-half of its exports. The United States is largest export market for Pakistan, accounting for 28.4 percent of its exports followed by UK and Germany. Japan is fast vanishing as export market for Pakistan as its share in total exports has been on decline for one decade, reaching less than one percent from 5.7 percent a decade ago.

Pakistan needs to diversify its exports not only in terms of commodities but also in terms of markets. Heavy concentration of exports in few commodities and few markets can lead to export instability. Other issues which need to be addressed include low value added and poor quality, obsolete use of machinery and technology, higher wastage of inputs adding to the cost of production, low labor productivity, little spending on research and development, export houses lacking capacity to meet bulk orders, inability to meet requirements of consumers in terms of fashion and design, non-adherence to contracted quality and delivery schedule, lack of marketing techniques etc.

5.6.3 Pakistan Exports 1957-2015

Exports in Pakistan decreased to 198851 PKR Million in May of 2015 from 202874 PKR Million in April of 2015. Exports in Pakistan averaged 34827.49 PKR Million from 1957 until 2015, reaching an all-time high of 275483 PKR Million in September of 2013 and a record low of 51 PKR Million in April of 1958. Exports in Pakistan are reported by the Pakistan Bureau of Statistics.

Table 2: Data of export and import :(1985-2013)

Year	Export (PKR Million)	Import (PKR Million)	Year	Export (PKR Million)	Import (PKR Million)
1985-86	3070	5634	1999-20	8569	10309
1986-87	3686	5380	2000-01	9202	10729
1987-88	4455	6391	2001-02	9135	10340
1988-89	4661	7034	2002-03	11160	12220
1989-90	4954	6935	2003-04	12313	15592
1990-91	6131	7619	2004-05	14391	20598
1991-92	6904	9252	2005-06	16451	28581
1992-93	6813	9941	2006-07	16979	30540
1993-94	6803	8564	2007-08	19052	39966
1994-95	8137	10394	2008-09	17688	34822
1995-96	8707	11805	2009-10	19290	34710
1996-97	8320	11894	2010-11	24810	40414
1997-98	8628	10118	2011-12	23624	44912
1998-99	7779	9432	2012-13	24460	44950

6. What is exchange rate?

Exchange rate is defined as the price of a nation's currency in terms of another currency. An exchange rate thus has two components, the domestic currency and a foreign currency, and can be quoted either directly or indirectly.

1. Direct quotation: the price of a unit of foreign currency is expressed in terms of the domestic currency.
2. Indirect quotation, the price of a unit of domestic currency is expressed in terms of the foreign currency.

Factors that influence exchange rate include (1) Interest rates, (2) inflation rate, (3) trade balance, (4) political stability, (5) internal harmony.

6.1 Exchange rate of Pakistan

Pakistan is a small open economy in Asia which came into being on 14 August, 1947. The small size of the economy is evident from its total GDP which stood 12,084,380 million rupees in which the shares of money supply, foreign exchange reserves and remittances were 45.59%, 6.97% and 3.92% respectively during 2007-2008. (shaheen, 2013) Whereas, the openness of the economy can be judged from the share of its exports and imports in GDP which reached to 11.63% and 24.42% during 2008. Rupee is the name of Pakistan currency, the official code of which is PKR. It consists of 1, 2 and 5 rupee coins and 10, 50, 100, 500, 1000 and 5000 currency notes. A strong and competitive financial system is considered more important for the macroeconomic stability. How to make a financial system stable, this largely depends on the conduct of the monetary policy. Whereas, monetary policy refers to the use of different instruments such as bank rate, cash reserves requirements and open market operations for the achievement of desired goals i.e. higher economic growth, price stability, trade surplus and exchange rate stability. Although, monetary policy is used for the correction of most of the macroeconomic variables, yet, among these variables, exchange rate has always remained at the core its major objectives. It is one of the key macroeconomic variables which connect the country with the rest of the world in both the goods and assets markets and have strong influences for the internal and external sectors of the economy. In contrast, a poor exchange rate policy risks misrepresenting trade opportunities and results in the misallocation of resources in an economy. In Pakistan, monetary policy is based on targeting monetary aggregates (i.e. growth of money supply). As USA is one of the major trade partners of Pakistan and dollar is the most trading currency in the international foreign exchange markets, the exchange rate of rupee is usually measured in terms of US dollar. (shaheen, 2013) Although the role of exchange rate was small during the fixed exchange rate era, however in the wake of speedy process of trade liberalization and financial integration of the economies, the role of exchange rate has increased significantly in the conduct of monetary policy and overall macroeconomic performance. Although fluctuations in exchange rate can be beneficial for an economy, a large number of studies showed that these positive impacts of the exchange rate become doubtful when it is studied for the developing countries like Pakistan where agriculture fulfills most of the needs of domestic and foreign sectors and looking to their heavy dependence on foreign countries for its exports and imports.

The State Bank of Pakistan (SBP) has the responsibility for maintaining monetary and economic stability in the country. In 1997, SBP and its Central Board were empowered to formulate, conduct and implement monetary policy independently in the country and a Monetary & Fiscal Coordination Board was established to ensure that fiscal policy is well coordinated with the monetary policy (Akhtar, 2007). Like other developing countries, monetary policy in Pakistan has passed through several stages during the last few decades. In 1971, the rupee was delinked from pound sterling and attached with US dollar. After a devaluation of 130% in nominal terms of rupee during 1972, the nominal exchange rate appreciated from 11.03 to 9.9 i.e. 10.24% in nominal terms and 13.70% in real terms. After that the exchange rate of rupee was kept fixed against US dollar for almost 9 years i.e. 1973 to 1981. However, at the beginning of 1980s the US economy faced a large budget deficit which forced the government to raise the interest rate. This increase in the US interest resulted in a massive inflow of capital from abroad and led to appreciation of dollar against rupee. Since rupee is attached with dollar, it is also overvalued because of the market pressure. This made Pakistan's exports expensive and imports cheaper in the international market and resulted in the deterioration in the trade balance. Hence, for maintaining exports competitiveness in the international market and improving trade balance, the State Bank of Pakistan (SBP) delinked the rupee from US dollar and moved to manage float system in 1982. With this move, the nominal exchange rate of rupee increased from 9.9 to 12.84 i.e. it is devalued 29.69% in nominal terms and 24.74% in real terms. In 2000, the State Bank of Pakistan adopted a market based exchange rate system. However, the rupee continued its downward movement and the nominal exchange rate further devalued from 51.78 in 1999 to 58.03 in 2000 i.e. showing a decline of 12.07% in nominal terms and 11.87 % in real terms respectively. During 2008 the nominal exchange rate was 62.55 showing a depreciation of 2.17% in nominal terms. However, in real terms the rupee showed an appreciation of 6.02%.

Table 3: Exchange rate of Pakistan: 1960-61 to 2015

Year	Exchange rate	Year	Exchange rate	Year	Exchange rate
1960-61	4.76	1979-80	9.91	1998-99	46.13
1961-62	4.76	1980-81	9.91	1999-20	51.77
1962-63	4.76	1981-82	9.91	2000-01	51.33
1963-64	4.76	1982-83	12.71	2001-02	58.65
1964-65	4.76	1983-84	13.48	2002-03	61.23
1965-66	4.76	1984-85	15.15	2003-04	58.23
1966-67	4.76	1985-86	16.14	2004-05	57.34
1967-68	4.76	1986-87	17.18	2005-06	59.45
1968-69	4.76	1987-88	17.6	2006-07	59.67
1969-70	4.76	1988-89	19.22	2007-08	60.54
1970-71	4.76	1989-90	21.45	2008-09	62.78
1971-72	4.76	1990-91	21.42	2009-10	83.76
1972-73	4.76	1991-92	24.84	2010-11	85.66
1973-74	7.33	1992-93	2596	2011-12	89.56
1974-75	9.91	1993-94	30.14	2012-13	96.89
1975-76	9.91	1994-95	30.15	2013-14	102.23
1976-77	9.91	1995-96	33.23	2014-15	101.20
1977-78	9.91	1996-97	38.34		
1978-79	9.91	1997-98	43.13		

6.2 What the impact of Trade balance of Pakistan on exchange rate

I have taken data from 1995-96 to 2007-08 of trade balance and exchange rate and examined that trade balance and exchange rate -0.42% correlate to each other or -0.42 % weak relationship exists between them by using the statistical technique Correlation coefficient . Correlation coefficient measures the strength and the direction of a linear relationship between two variables. It is denoted by r. The value of r is such that $-1 \leq r \leq +1$. Negative value indicates a relationship between *trade balance* and *exchange rate* such that as values for *TB* increase, values for *EX* decrease. A correlation greater than 0.8 is generally described as *strong*, whereas a correlation less

than 0.5 is generally described as *weak*. So there is weak and inverse relationship b/w *trade balance* and *exchange rate*

Table 4: Exports, Imports, Trade and Exchange rate

Year	export	Import	balance of trade	exchange rate
1995-1996	8707	11805	-3098	33.23
1996-1997	8320	11894	-3574	38.34
1997-1998	8628	10118	-1490	43.13
1998-1999	7779	9432	-1653	46.13
1999-2000	8569	10309	-1740	51.77
2000-2001	9202	10729	-1527	51.33
2001-2002	9135	10340	-1205	58.65
2002-2003	11160	12220	-1060	61.23
2003-2004	12313	15592	-3279	58.23
2004-2005	14391	20598	-6207	57.34
2005-2006	16451	28581	-12130	59.45
2006-2007	16979	30540	-13561	59.67
2007-2008	19052	39966	-20914	60.54

6.3 How exchange rates affect the balance of trade?

Depreciation of currency means, to officially reduce the value of home currency in relation to gold or the foreign currency. Usually countries commence depreciation to reduce the gap of deficit external balance; because economists consider currency depreciation could actually be beneficial for the economy. Since a weaker currency will boost exports, which in turn will increase employment and this, as a result, will improve the economic growth but it can be said that depreciation or devaluation is not a long lasting approach to improve the economy. (Shaheen, 2000-2010). If the value of Pak-Rupee against the US dollar decreases; it has a positive impact on the exports of the country. This helps to temporarily boost up the exports of the country. While due to the decrease in the value of Pak-rupee, the imports become dearer and expensive for the country which adversely affects the balance of payment position of the country. (Shaheen, 2000-2010)

7. Conclusion

Findings of this study as well as previous study show that Convergent or divergent dynamics of imports and exports are the first causes of trade balance changes. Everything that impact asymmetrically on imports and exports can impact the trade balance.

The variables are taken as determinants like GDP, export, import, inflation balance of trade economic growth are the major component of balance of trade deficit. Stability of exchange rates may create a positive environment for encouraging the investment, and this can improve balance of trade. It has been established that exchange rate and balance of trade have a weak correlation with each other. Pakistan need to made effective exchange rate policy. Current Macroeconomic conditions towards the end of FY15 have further improved compared to the beginning of the fiscal year. Current account deficit has narrowed down; average annual inflation is significantly below the target; there is a marginal uptick in real GDP growth; and foreign exchange reserve buildup continues. (SBP, 2015)

8. Policy recommendation.

- Pakistan should import capital goods and machinery to support domestic production capacity and value added goods should be exported instead of primary goods and raw materials.
- Pakistan needs to diversify its export to other products like chemicals items, electronics items and other consumer and capitals goods. Far East and other countries (like Japan, south Korea, Taiwan, Hong Kong, Malaysia etc.) recently increase their export of textile products that created more competition in international market which cause to deteriorate Pakistan's terms of trade.
- Many countries gradually shifted their export from primary goods to capital or value added goods that may be a role model for Pakistan to adopt.
- The government policies may be significant to boost export. Providing social and physical infrastructure to

the local producers and exporters like roads, rail roads, electricity, law order and consistent economics policies etc.

- European Union imposed antidumping duties on import which adversely affected Pakistan's exports. It is suggested that diplomatic channels should be used to take more concession in this regards.
- Existence of WTO (World Trade Order) and FTA (Free Trade Agreement) may provide opportunity to have an access to new markets.
- It was observed that per capita productivity of textile sector in Pakistan is very low, if compared with other countries of the region (China and India). So it is required to enhance education facilities, skills development program, on job training and innovation in the field of export relating.
- It was evaluated that cost of production in Pakistan is very high compare to other countries of the region (Bangladesh, India, China, Malaysia etc.) due to high price of electricity, high rate of interest, high rate of taxes etc. Generally this is a real threat to Pakistan's export and specifically to textile export. Different regional countries like Bangladesh, china, India, focus on subsidization on their export sector which is also a challenge to Pakistan export sector, so Pakistan needs to make a policy to cater the challenges.
- SME (small and medium enterprises) are also playing a significant role in Pakistan's export along with facing problem and challenges of different kinds, so it is suggested to the government should focus on the measures to sort out the problems and challenges. The above mention policy and recommendation may be very useful to increase Pakistan exports and lessen the balance of trade deficit.
- Government should formulate a strategy to be free of the country's dependency on workers' remittances.
- Pakistan should expand its international market.

References

- Businessdictionary. (2015). Retrieved from Businessdictionary.com: <http://www.businessdictionary.com/definition/exchange-rate.html#ixzz3dajQr6IO>
- Economics, T. (2015). *Trading economics*. Retrieved from <http://www.tradingeconomics.com/einfopedia>. (n.d.). *einfopedia*. Retrieved from [www.einfopedia.com: http://www.einfopedia.com/exports-of-pakistan.php](http://www.einfopedia.com/exports-of-pakistan.php)
- Einfopedia.com. (2015). *Einfopedia.com*. Retrieved from Einfopedia.com: <http://www.einfopedia.com/exports-of-pakistan.php>
- Mohammad, S. D. (2010). Determinant of Balance of Trade: Case Study of Pakistan . *European Journal of Scientific Research*, 13-20.
- Mysmp. (2011). *Mysmp in deth financial market analysis*. Retrieved from Mysmp.com: <http://www.mysmp.com/forex/balance-of-trade-forex.html>
- Piana, V. (2006). *Economic of web institute*. Retrieved from [economicswebinstitute.org: http://economicswebinstitute.org/glossary/tradebalance.htm](http://economicswebinstitute.org/glossary/tradebalance.htm)
- SBP. (2015, May 23). *Monetary policy*. Retrieved from SBP: <http://www.sbp.org.pk/>
- Shaheen, F. (2000-2010). Fluctuations in Exchange Rate and its Impact on Macroeconomic Performance of Pakistan. 410-418.
- shaheen, F. (2013). Fluctuations in Exchange Rate and its Impact on. 8-9.

The IISTE is a pioneer in the Open-Access hosting service and academic event management. The aim of the firm is Accelerating Global Knowledge Sharing.

More information about the firm can be found on the homepage:

<http://www.iiste.org>

CALL FOR JOURNAL PAPERS

There are more than 30 peer-reviewed academic journals hosted under the hosting platform.

Prospective authors of journals can find the submission instruction on the following page: <http://www.iiste.org/journals/> All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Paper version of the journals is also available upon request of readers and authors.

MORE RESOURCES

Book publication information: <http://www.iiste.org/book/>

Academic conference: <http://www.iiste.org/conference/upcoming-conferences-call-for-paper/>

IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digital Library, NewJour, Google Scholar

