



The Harberger–Laursen–Metzler effect: evidence from five SAARC countries

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Abstract

The Harberger–Laursen–Metzler (HLM) effect predicts that an exogenous adverse shock to terms of trade of a small economy leads to deterioration in its current account balance, and conversely. Most countries across the globe, large or small, have adopted trade liberalization for economic prosperity, which make the terms of trade of much importance for policy making. In this paper, we examine the validity of the HLM effect for five of the eight members of South Asian Association for Regional Cooperation—a South Asian regional intergovernmental organization—over the period 1980–2015. Despite the potential for benefit from trade, the area remains understudied. We apply the cointegration and the Granger (non-) causality tests by employing both time series and panel methods. For a long-run equilibrium relationship, we implement the bounds testing approach, complemented by panel cointegration tests. For causality, in addition to testing for heterogeneous panels, we apply the conventional vector error correction model. We find support for the HLM effect for Bangladesh, Pakistan, Nepal, and Sri Lanka, but not India, the largest economy, conforming to the HLM prediction. The findings should help policymakers in assessing opportunities and challenges caused by exogenous shock from continued globalization and help to stay better prepared to address them.

Keywords Harberger–Laursen–Metzler · Terms of trade shock · Current account balance · SAARC

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