

## Income-Consumption Relationships in Pakistan (1980-2011): A Cointegration Approach

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**Abstract :** The present paper analyses the income-consumption relationships in Pakistan using annual time series data from 1980-81 to 2010-1. The paper uses the Augmented Dickey-Fuller test to check the unit root and stationarity in these two time series. The paper finds that the two time series are nonstationary but stationary at their first difference levels. The Augmented Engle-Granger test and the Cointegrating Regression Durbin-Watson test imply that the two time series of consumption and income are cointegrated and that long-run marginal propensity to consume is 0.88 which is given by the estimated (static) equilibrium relation. The paper also used the error correction mechanism to find out to model dynamic relationship. The purpose of the ECM is to indicate the speed of adjustment from the short-run equilibrium to the long-run equilibrium state. The results show that MPC is equal to 0.93 and is highly significant. The coefficient of Engle-Granger residuals is negative but insignificant. Statistically, the equilibrium error term is zero, which suggests that consumption adjusts to changes in GDP in the same period. The short-run changes in GDP have a positive impact on short-run changes in consumption. The paper concludes that we may interpret 0.93 as the short-run MPC. The pair-wise Granger Causality test shows that both GDP and consumption Granger cause each other.

**Keywords :** cointegrating regression, Augmented Dickey Fuller test, Augmented Engle-Granger test, Granger causality, error correction mechanism

**Conference Title :** ICAEER 2015 : International Conference on Agricultural Economics and Environmental Research

**Conference Location :** Istanbul, Türkiye

**Conference Dates :** January 26-27, 2015