International Journal of scientific research and management (IJSRM)
\||Volume||3||Issue||6||Pages|| 3227-3229||2015||
Website: www.ijsrm.in ISSN (e): 2321-3418

Trade Liberalization, Poverty and Inequality

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Abstract:*The question of how trade liberalization affects poverty and inequality remains largely an empirical one. Work has attempted to address the question, focusing mostly on the effect of trade liberalization on within-country income inequality. Work has attempted to address the question, focusing mostly on the effect of trade liberalization on within-country income inequality. Studies using cross-country variation typically find little relationship between trade liberalization and levels or rates of change of inequality. India presents a particularly relevant setting in which to seek the answers to these questions. First, India is the home of one-third of the worlds poor. Second, the nature of India's trade liberalization—sudden, comprehensive, and largely externally imposed facilitates a causal interpretation of the findings. India liberalized its international trade as part of a major set of reforms in response to a severe balance-of-payments crisis in 1991. On trade policy, benchmarks Trade Liberalization, Poverty, and Inequality 295 for the first review of the standby arrangement included a reduction in the level and dispersion of tariffs and a removal of a large number of quantitative restrictions. Specific policy actions in a number of areas notably industrial deregulation, trade policy and public enterprise reforms, and some aspects of financial-sector reform also formed the basis for a World Bank Structural Adjustment Loan, as well as sector loans.*

Keywords: Economic Liberalizations, Poverty Reduction, Privatization, Trade Liberalizations.

1. Introduction

When After the Second World War, India, along with other developing countries, chose a strategy of import substitution as a means of industrializing. In the past two decades, however, many countries have begun to favor global economic integration, and in particular trade liberalization, as a development strategy. Although there is a general presumption that trade liberalization results in a higher gross domestic product (GDP), much less is known about its effects on income distribution. The distributional impacts of trade are particularly important in developing countries, where income inequality is typically pronounced and there are large vulnerable populations[1][2]. If economic integration leads to further growth in income inequality and an increase in the number of poor in developing economies, the benefits of liberalization may be realized at a substantial social cost unless additional policies are devised to redistribute some of the gains from the winners to the losers. According to the new theories, trade liberalization could reduce the wages of unskilled labor even in a labor-abundant country, thereby widening the gap between the rich and the poor. Moreover, even if global economic integration induces faster economic growth in the long run and substantial reductions in poverty, the adjustment might be costly, with the burden falling disproportionately on the poor. Due to the ambiguity of the theory, the question of how trade liberalization affects poverty and inequality remains largely an empirical one. Work has attempted to address the question, focusing mostly on the effect of trade liberalization on within-country income inequality. Studies using cross-country variation typically find little relationship between trade liberalization and levels or rates of change of inequality. However, these studies face significant problems: cross-country data may not be comparable, sample sizes are small, and changes in liberalization may be highly correlated with other variables important to income processes[3][4][5].

India presents a particularly relevant setting in which to seek the answers to these questions. First, India is the home of one-third of the world's poor. Second, the nature of India's trade liberalization—sudden, comprehensive, and largely externally imposed facilitates a causal interpretation of the findings. India liberalized its international trade as part of a major set of reforms in response to a severe balance-of-payments crisis in 1991. Extremely restrictive policies were abandoned: the average duty rate declined by more than half, and the percentage of goods importable without license or quantitative restriction rose sharply. Coincident with these tariff reductions were significant changes in the incidence of poverty and income inequality. To determine whether there is a causal link between liberalization and changes in poverty and inequality, this paper exploits the variation in the timing and degree of liberalization across industries, and the variation in the location of industries in districts throughout India. The interaction between the share of a district's population employed by various industries on the eve of the economic reforms and the reduction in trade barriers in these industries provides a measure of the district's exposure to foreign trade. In a regression framework, this paper establishes whether district poverty and inequality are related to the district-specific trade policy shocks. Because industrial composition is predetermined and trade liberalization was sudden and externally imposed, it is appropriate to causally interpret the correlation between the levels of poverty and inequality and trade exposure. Of course, if there were migration across districts in response to changes in factor prices, an analysis comparing districts over time may not give the full extent of the impact of globalization on inequality and poverty in India. The study finds that trade liberalization led to an increase in poverty rate and poverty gap in the rural districts where industries more exposed to liberalization were concentrated. The effect is quite substantial. According to the most conservative estimates, compared to a rural district experiencing no change in tariffs, a district experiencing the

mean level of tariff changes saw a 2 percent increase in poverty incidence and a 0.6 percent increase in poverty depth. This setback represents about 15 percent of India's progress in poverty reduction over the 1990s[1][4][6][7][8].

2. Literature Review

This study is related to several strands of literature. First, it fits into the recent large empirical literature on the effects of trade reforms on wage inequality. This literature has largely dealt with the experience of Latin American countries: Cragg and Epelbaum (1996), Revenga (1996), Hanson and Harrison (1999), Feliciano (2001), Goldberg and Pavcnik (2001), and Attanasio, Goldberg, and Pavcnik (2004). Currie and Harrison (1997) study the effect of trade liberalization in Morocco. These papers typically find small effects of trade on wage inequality of workers in the manufacturing sector. This paper extends this type of analysis by focusing not only on the effect of trade reforms on relative wages in manufacturing but on regional outcomes in general[1][2][9][10].

This is also one of the first studies to examine the link between trade liberalization and poverty. So far Porto (2004) and Goldberg and Pavcnik(2004) have analyzed the relationship between trade and poverty in the case of Argentina and Colombia respectively. Porto's approach has the advantage of providing a general equilibrium analysis of the relationship between trade liberalization and poverty, bysimultaneously considering the labor market and consumption effects of trade liberalization, but his results rely on simulations based on cross-sectional data. Goldberg and Pavcnik (2004), exploiting cross-sectional and time series variation at the industry level, find little evidence of a link between the Colombian trade reforms and poverty[11][12].

3. Objective of the Study

The main objective of the study is to determine the relationship between trade liberalization and poverty and inequality reduction.

3.1 Research Methodology

The research is fundamental type of research which uses exploratory and descriptive research design. The study is based on secondary data which was collected from the journal, books, news paper, thesis, publish report, planning commission, NSS, economic survey etc.

3.2 Indian Trade Liberalization

P However, the gradual liberalization of the late 1980s was accompanied by a rise in macroeconomic imbalances namely, fiscal and balance-of payments. Deficits which increased India's vulnerability to shocks. The sudden increase in oil prices due to the Gulf War in 1990, the drop in remittances from Indian workers in the Middle East, and the slackened demand of important trading partners exacerbated the situation. Political uncertainty, which peaked in 1990 and 1991 after the poor performance and subsequent fall of a coalition government, led by the second largest party and the assassination of Rajiv Gandhi, the chairman of the Congress Party, undermined investor confidence. With India's downgraded credit rating, commercial bank loans were hard to obtain, credit lines were not renewed, and capital outflows began to take place. To deal with its external payments problems, the government of India requested a standby arrangement from the International Monetary Fund (IMF) in August 1991. The IMF support was conditional on an adjustment program featuring macroeconomic stabilization and structural reforms. The latter focused on the industrial and import licenses, the financial sector, the tax system, and trade policy. On trade policy, benchmarks Trade Liberalization, Poverty, and Inequality 295for the first review of the standby arrangement included a reduction in the level and dispersion of tariffs and a removal of a large number of quantitative restrictions. Specific policy actions in a number of areas notably industrial deregulation, trade policy and public enterprise reforms, and some aspects of financial-sector reform also formed the basis for a World Bank Structural Adjustment Loan, as well as sector loans[13][14].

Following the reduction in trade distortions, the ratio of total trade in manufactures to GDP rose from an average of 13 percent in the 1980s to nearly 19 percent of GDP in 1999–2000 (fig. 7.2). Export and import volumes also increased sharply from the early 1990s, outpacing growth in real output. India's imports were significantly more skilled-labor intensive than India's exports and remained so throughout the 1990s, as which plots cumulative export and import shares by skill intensity in 1987, 1991, 1994, and 1997. India remained committed to further trade liberalization, and since 1997 there have been further adjustments to import tariffs. However, at the time the government announced the export-import policy in the Ninth Plan (1997– 2002), the sweeping reforms outlined in the previous plan had been undertaken and pressure for further reforms from external sources had abated[7][9][15].

3.3 Measurement and basic patterns of poverty and inequality

Place table titles above the tables Measuring poverty and inequality is not a trivial task. For poverty, I use both the head count ratio (HCR) and the poverty gap. The former, which I refer to as the poverty rate, represents the proportion of the population below the poverty line. While the HCR is widely used, it does not capture the extent to which different households fall short of the poverty line, and it is highly sensitive to the number of poor households near the poverty line. Thus, I also analyze the poverty gap index, defined as the normalized aggregate shortfall of poor people's consumption from the poverty line.

The empirical literature on trade liberalization so far has focused predominantly on the manufacturing sector and urban areas because these were the area's most commonly affected by trade liberalization (Goldberg and Pavcnik 2004). Thus, it is rather surprising that the effect of trade liberalization on districts is more pronounced in rural India than in urban India.18 A close look at the evolution of tariff barriers and NTBs in suggests an explanation. Agriculture was not omitted from the 1991 reforms in India. Tariffs of agricultural products fell in line with tariffs of manufacturing and other goods. While quantity restrictions and licensing requirements on both the import and export of agricultural products (out of a concern for food security) were removed later than on other goods, the share of agricultural products that could be freely imported

jumped from 7 percent in 1989 to 40 percent in 1998. Between 1998 and 2001 this number reached more than 80 percent.

4. Conclusion

So far this paper has established that, whatever the India-wide effects of trade liberalization were, rural areas with a high concentration of industries that were disproportionately affected by tariff reductions experienced slower progress in poverty reduction. However, for these areas, there was no discernible effect on inequality

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Shivendra Kumar Dubey received the B.Com. and M.Com. degrees from University of Lucknow in 2011 and 2013, respectively. He has published many research papers in national and international journals. Currently he is teaching in Degree College.