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The Effects Of Trade Liberalization On Income Inequality In India

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ABSTRACT
Trade liberalization in India, 1991 was a crucial step towards improving the economic condition of the country. It included relaxing various tariff barriers to promote the inflow of foreign goods. The liberalization policy also allowed the entry of several private players into those sectors which were earlier strictly under the control of the government. It opened the Indian market to foreign investors, increased foreign trade, brought consumer sovereignty, and created several job opportunities. While there is no doubt in the fact that Trade Liberalization has played a significant role in India's economic growth by opening several different avenues for the Indian Economy, its drawbacks are often not discussed about.
It led to an increased demand for skilled workers in the Indian market, which contributed to income disparities and unequal wealth distribution in the country.
Through a systematic review of existing literature and data, this research paper investigates the relationship between trade liberalization and income inequality in the country. The research paper considers not only national but inter-regional effects as well to fully understand the effect trade liberalization had on the Indian population.
Key Terms: *Trade Liberalization, Income, Tariff Barriers, Skilled, Unskilled, Wage Gap*

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I. Introduction

Trade Liberalization is the process in which a country removes or lowers tariff barriers to facilitate and encourage foreign trade. Economic growth, increased efficiency and productivity, consumer sovereignty, innovation & competition, increased foreign investments, etc. are some of the key motivations for it. This is the reason several countries (particularly the developing countries from Latin America and South Asia) have decided to slash their pre-existing trade barriers in recent times. Some examples are – China (1978), Vietnam (late 1980s), Mexico (1985), Brazil (1993), etc.

Before the trade liberalization, India was a closed economy i.e., most of the sectors of the economy were under the control of the government. This was done to protect the country's economy from foreign influence post its independence in 1947. The number of private players operating during this time was limited, and to start a private business in a particular sector, license had to be obtained first. This practice of obtaining a license to start a business was termed as 'license raj' which literally means rule of the license holders. Due to the lack of competition among various businesses during this period, employees and business owners developed a laid-back attitude towards their customers, which caused unproductivity. Thus in 1991, the government of India finally felt that the country's economy was ready to face foreign competition and therefore, the New Economic Policy was introduced in India under the leadership of the then Prime Minister P.V. Narasima Rao and the then Finance Minister Manmohan Singh.

This decision resulted in an inflow of foreign capital and improved technology; increased efficiency due to introduction of competition, development of a global market for the country, etc. However, these benefits of economic growth and development were not shared equally among all segments of the society. While some were earning, others were struggling. Income inequality has seen a significant rise in India after 1991, which was when the New Economic Policy was introduced.

This research paper aims to contribute to the existing literature by providing a comprehensive analysis of the effect of Trade Liberalization income inequality in India.

II. Review of Literature

Raymond Robertson (2000)- "Trade liberalization and wage inequality: lessons from the Mexican experience." States that 'trade liberalization in Mexico increased the demand for skilled workers, and, as a result, increased wage inequality.' They suggest that investing in education can decrease the wage gap between skilled and unskilled workers, only if the necessary infrastructure is available

Malvika Mahesh (2016) - "The effects of trade openness on income inequality - evidence from BRIC countries" took inspiration from Calderon and Chong (2001) and using their modified model examined the effect of trade liberalization on BRIC countries and concluded that there is a positive relationship between trade openness and income inequality and that "increased trade openness has worsened the income distribution in the BRIC countries".

III. Methodology:

In this study, I talk about the situation of the Indian economy before and after the Trade Liberalization and the various changes that have taken place due to it.

Using related data, I show how trade liberalization increased the demand for skilled workers, which affected the unskilled workers negatively and created a wealth inequality in the country.

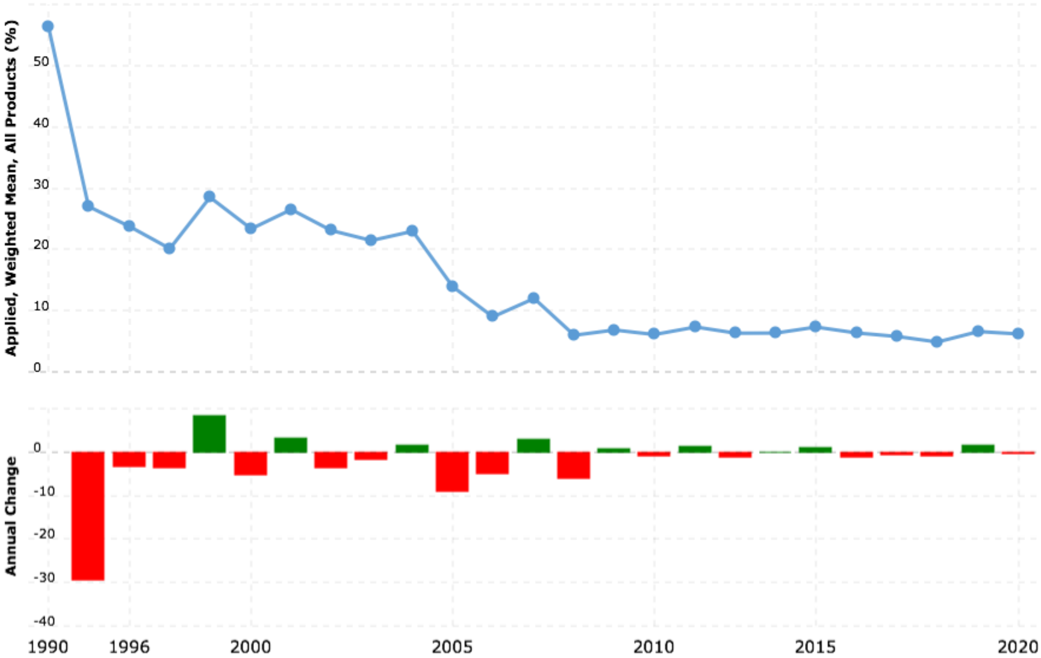
Inter-regional disparities that followed post liberalization have been highlighted by comparing the states of Maharashtra and Bihar. On one hand, there are states which adapted quickly to the new change in economy and on the other hand are those states which have struggled to adapt.

The data used is secondary in nature. Research papers, online sites, journals, etc. are the various sources that have also been used.

IV. Analysis

Post Trade Liberalization India: Post the Trade Liberalization, the India experienced exceptional changes and benefits across the various sectors of its economy.

The Indian government began its path to liberalization by reducing the tariff barriers, easing import restriction, and encouraging foreign investments.



Source: World Bank

This decision helped unlock the country's economic potential as it encouraged the private sector and foreign multinational corporations to invest in the Indian markets. As it can be seen in the data given above, tariff barriers in India have dropped significantly from 1990 to 2020 (from around 50% in 1990 to approx. 8% in 2020), because of which the country's imports, exports, and foreign investments increased tremendously. A substantial increase in the volume and diversity of imports and exports has been observed. Imports led to an increase in the availability of foreign goods and services in the Indian market whereas Exports allowed various Indian Businesses to tap into global avenues. The liberalization also played a crucial role in attracting foreign Direct Investments inflows into the Indian Economy. Several Multinational Corporations established their operations in India. As per data from the world bank, India's imports increased from $22.94 Billion in 1991 to $758.87Billion in 2021.Similarly, exports increased from $22.94 Billion in 1991 to 679.68Billion in 202. The Foreign Direct Investment in India in 1991 was a mere $0.07Billion, which has since then increased to $44.73Billion in 2021.

Skilled - Unskilled Workers Wage Inequality: Skilled workers are those workers who have received formal education and thus possess specialized knowledge, expertise, and the skills required in a particular field.

Blue or White- Collar jobs of professionals such as doctors, engineers, lawyers, scientists, etc.; skilled tradespeople such as plumbers, electricians, carpenters; creative professionals like filmmakers, artists, musicians, designers, etc., are some examples of skilled workers.

On the other hand, unskilled workers are those workers who usually perform those jobs which require little to no training, education, or specialized skills. People who work in jobs like cleaners, farm workers (like harvesters or pickers), parking lot attendants, construction site workers, etc., are termed as unskilled workers. Their jobs often include the use of manual labor or basic tasks that can be learnt easily. The bottom 50% share of income is made up of this group of people. Skilled workers earn higher wages than their unskilled counterparts because their work creates more value and thus is demanded for.

Increased Import and Export brought in new technology along with them which could be operated by highly skilled workers and thus, the demand for these workers increased in India.

On comparing data based on wages of skilled and unskilled workers in the period of 2015-2020, it was observed that the average wages of Low-Skilled workers was on a lower side. It also declined, falling from an all-time high of Rs.13,500/month in 2015/2016 to a record low of Rs.10900/month in 2018.

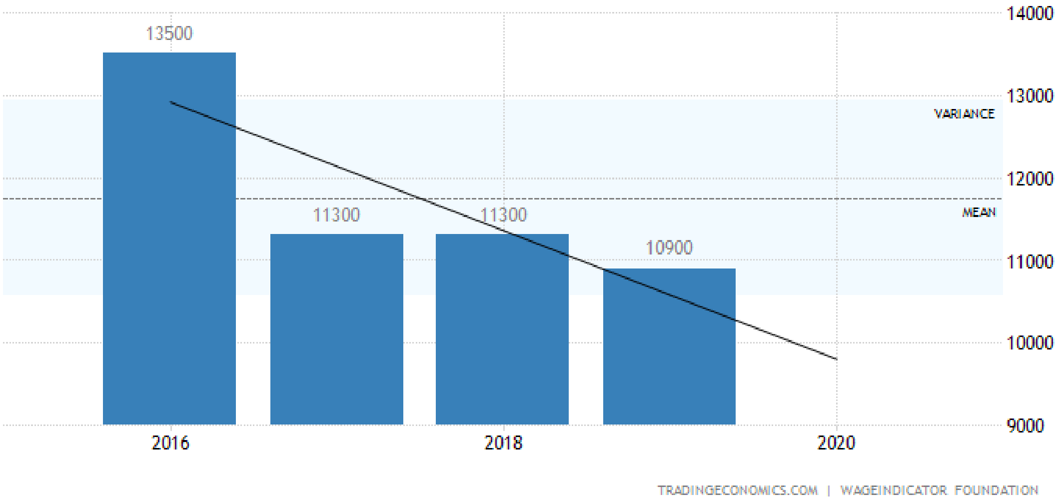


Image above: Low Skilled Workers Wages | Source: Calculated from sample of wages collected by WageIndicator Survey

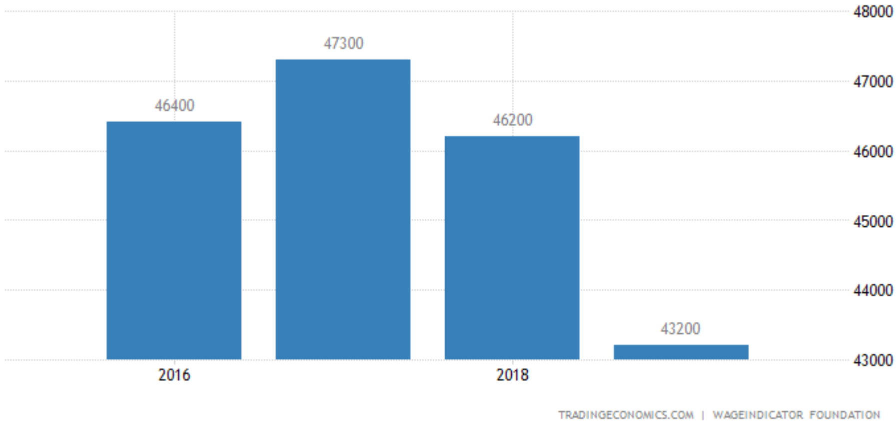


Image Above: High Skilled Workers Wages | Source: Calculated from sample of wages collected by WageIndicator Survey

Skilled workers on the other hand earnt higher wages; anywhere from around Rs.43,000-46,000/month and thus constituted of the top 10% share of income contributors in the Indian economy.

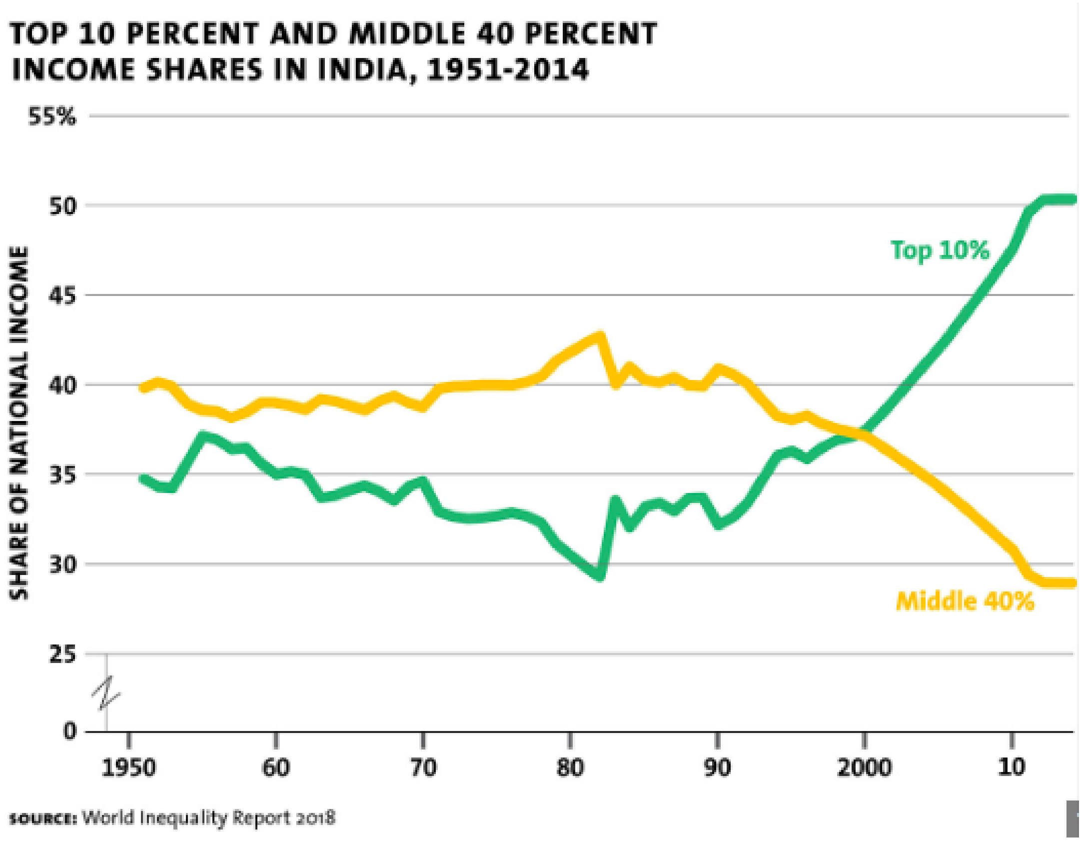
Related	Last	Previous	Unit	Reference
Wages Low Skilled	10900.00	11300.00	INR/Month	Dec 2018
Wages High Skilled	43200.00	46200.00	INR/Month	Dec 2018
Living Wage Individual	10300.00	10100.00	INR/Month	Dec 2018
Living Wage Family	19400.00	19200.00	INR/Month	Dec 2018

Source: Calculated from sample of wages collected by WageIndicator Survey | tradingeconomics.com

The table given above shows the wages of Low Skilled and High Skilled individuals. From the table it can be inferred that low skilled workers fall under the category of Living Wage Individuals, that is those individuals who can only afford the necessities needed to sustain.

High Skilled individuals tend to have some extra due to which they can contribute more towards the GDP of the country.

Income inequality in India is a grave socio-economic issue that reflects disparities in wealth distribution among its population. Only a small portion of the country enjoys their disproportionate control and contribution to the country's total wealth, while a large percentage of the population struggles to meet their basic necessities.



From the above data, we can see that income share of top 10% in India starts increasing and the income share of the middle 40% starts decreasing after 1990.

Furthermore, as per the table below, the income share of the top 1% and 10% is seen to increase post 1991 (Top 1% share increasing from 10.4% to 21.7% & Top 10% share increasing from 34.1% to 56.1%). Whereas the income share of middle 40% and bottom 50% experienced a decrease after 1991. (Middle 40% falling from 44.9% to 29.7% and Bottom 50% falling from 22.2% to 14.7%)

Table 3: Income inequality in India (Share of population groups in total income, in %, 1961 – 2020)				
	Top 1%	**Top 10%**	**Middle 40%**	**Bottom 50%**
1961	13.0	37.2	42.6	21.2
1971	11.7	34.4	44.0	22.8
1981	6.9	30.7	47.1	23.5
1991	10.4	34.1	44.9	22.2
2002	17.1	42.1	39.2	19.7
2012	21.7	55.0	30.5	15.1
2019	21.7	56.1	29.7	14.7

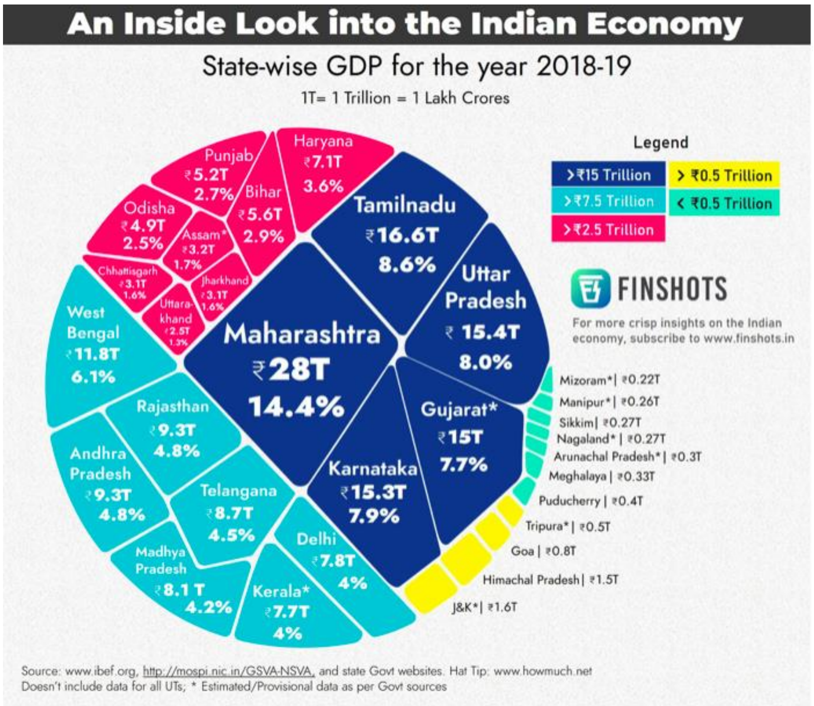
Thus, with reference to the above data, it would be safe to say that there is income inequality in India, and it has increased significantly after 1990, with the richer individuals holding a substantial share of the country's wealth.

State Disparities: So far, this research paper has talked about Trade Liberalization and its effect on differently skilled individuals and on India as a whole. However, it just does not stop there as Trade Liberalization has had a different impact on different states. Some states were quick to adapt while others could not. Through the examples of the states of Maharashtra and Bihar, I would like to support my claim.

Maharashtra and Bihar are two Indian states located in the western and eastern sides of the country, respectively. Both the states have a population of 120 million people and have been a home to some of the most powerful dynasties in Indian history. Large amounts of natural resources can be found in both the states as well. Keeping these facts in mind, one may conclude that both Maharashtra and Bihar are well-to-do states. However, the reality is far from this. While Maharashtra is the richest state of India, Bihar is one of the poorest states of the country.

When Trade Liberalization happened in India, Maharashtra was quick to adapt to it. The state of Maharashtra was more receptive to this new change than other regions and thus was able to leverage the various opportunities presented to it by trade liberalization. According to the India Skills Report 2022, Maharashtra held the top spot among states for most employable talent in 2022. It is India's Second most industrialized state and therefore, most of the workers here fall under the category of skilled workers.

Bihar on the other hand failed to capitalize on the subsequent process of liberalization and opening of the Indian market. The state has a poverty rate of 51% (NITI Aayog 2021) and has a GDP contribution that is 5 times less than Maharashtra.



IV. Suggestions:

Through research, it is quite evident that trade liberalization in India increased the demand for skilled labour in the country, which as a result increased the wage gaps. Most of the schools in the country are old and need repairs. On the other hand, many schools don’t even have sufficient teachers. As per audit, in Delhi alone, around 368 sites need major building repair (31.05%) and 198 buildings need minor repair work (16.7%). Apart from this, there is also a disturbing shortage of over one million teachers in schools, according to a recent UNESCO report. In fifteen years, the report found that about 30 per cent of the current teaching workforce will need to be replaced. Around 1.1 lakh schools in India are single-teacher entities. A total of 19%, or 11.16 lakh teaching positions in schools, lie vacant in the country. In rural areas, the number is as high as 69%. Therefore, investing properly in education and literacy can help overcome this problem of wage inequality. Basic literacy skills can enhance the employability of unskilled workers and can open doors to high-paying jobs. Apart from this, Skill development or training programs for the unskilled will also help in enhancing their capabilities.

V. Conclusion

In conclusion, it has been observed that while trade liberalization contributed to the overall growth and development of the Indian markets, it also caused varying effect on income distribution in the county. It increased the demand for skilled workers, and, as a result, increased wage inequality.

The analysis reveals that post liberalization, there was a sudden increase in the wage gap in Certain segments of the society, such as skilled workers, experienced income gains. On the other hand, individuals like unskilled workers struggled. The liberalizaation has also led to state disparities. The states who could adapt quickly to the change were able to enhance their economy whereas the states who could not adapt faced challenges like poverty and unemployment. The research paper suggests that with adequate investment in education and skill development programs, the problem of wage inequality could be tackled.

Required actions must be taken by the government in order to ensure that the benefits of trade liberalization are more equitably shared.

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