

**LIBERALISATION AND IT'S EFFECT  
ON INEQUALITY IN DEVELOPING  
COUNTRIES-A CASE STUDY ON  
INDIA**

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## **ABSTRACT**

**There are both positive and negative aspects to liberalisation policies. Liberalisation policies are no less important than any other kind of economic policies, and so it can only be healthy that what was formerly an obscure and technocratic process has moved to centre-stage politically. What's more, economic development and the alleviation of poverty are now key political priorities in further liberalisation. Hence in order to check for the effectiveness of liberalisation policies in developing countries it is important to measure it from the point of view of how it has reduced levels of inequality. If liberalisation has so far had no impact on inequality within countries, for good or bad, it has become received wisdom that inequality between countries has increased. Yet the overall pattern is less easy to sum up. Within different country groups there have been varying patterns of either increasing or decreasing inequality. Hence a case study is taken on India and with the help of convergence hypothesis using log linear and linear**

regression techniques divergence is  
proved. Liberalisation since 1991 has had no major  
impact on reducing the level of inequality between  
Indian states.

## **1.1 AN OVERVIEW**

**There are both positive and negative aspects to liberalisation policies. Liberalisation policies are no less important than any other kind of economic policies, and so it can only be healthy that what was formerly an obscure and technocratic process has moved to centre-stage politically. What's more, economic development and the alleviation of poverty are now key political priorities in further liberalisation.**

**World trade has been growing since the end of the Second World War, and becoming steadily more significant, with imports and exports expanding faster than global economic output. The ideal of freer trade was part of the Bretton Woods vision – John Maynard Keynes, one of the main architects of the new institutions, had originally hoped to create a world trade authority alongside the International Monetary Fund and World Bank.**

**This internationalist vision, combined with a steady (and continuing) decline in transportation costs, fuelled export growth through a succession of rounds of trade talks. The last of these, the Uruguay Round, created as a legacy the permanent World Trade Organisation, launched on 1 January 1995 in order to make the process of continuing liberalisation less ad hoc, more institutionalised.**

**During the post-war years, the ratio of exports to GDP, measuring the importance of trade, has therefore risen significantly for the world as a whole and for a majority of individual countries. These increasing trade links are one of the most important aspects of globalisation, especially since 1980. In the 1980s, world GDP grew by an average 4.5% a year and merchandise exports 15.2% a year, while the corresponding figures for the 1990s were 4.2% and 14.1%. The share of developing countries in world merchandise exports has climbed from a tenth by value in 1970 to approaching a third of the total.**

**Yet after half a century of trade liberalisation it is clear that desperate poverty is still widespread and income inequality between and within countries unacceptably high. The key questions, then, are whether trade does indeed boost economic growth and development; if so, whether it can alleviate poverty, and whether or not it has exacerbated inequality. There is controversy about each of these aspects.**

**The overwhelming majority of economic research does find a positive link between trade and growth: more open countries on average experience faster growth than less open ones. This is absolutely in accord with economic theory. Freer trade will boost consumer welfare directly by increasing choice and reducing prices. It will allow more people to exploit their productive potential. It will also limit the scope for arbitrary changes in domestic economic policies or for policies built around the demands of specific interest groups.**

**Importantly, according to modern growth theory, it also enhances the flow of ideas, technology and investment across borders. It is hard to see how any developing country could now hope to get access to new technologies without opening up to international trade and investment.**

**Still, trade is clearly one of the essential ingredients in economic growth, which in turn does indeed help alleviate poverty. Growth has not been especially pro-poor (although the reduction of inflation in macroeconomic stabilisations clearly does help the poor the most). But nor has it been pro-rich. Income distribution within developing countries has been little changed by growth, so the poor become better off in absolute terms.**

**Although the number of people living in absolute poverty (on less than \$1 a day) has remained unchanged at about 1.2 billion between 1987 and the present, this is**

**a somewhat reduced proportion (24% versus 28.3%) of the world's population, which expanded by 815m over the same period. This level of absolute poverty is unacceptable, of course, and hence the need for a development focus in future trade negotiations.**

**What developing countries need from trade is the scope to export more labour-intensive products, as that will raise the demand for those products, made by the least skilled and poorest workers, and hence wage rates. With poverty in rural areas the most desperate, that puts a high priority on opening up the highly-protected rich country agricultural markets. There is certainly an urgent need to gear trade (and other) policies towards raising the lowest incomes.**

**If liberalisation has so far had no impact on inequality within countries, for good or bad, it has become received wisdom that inequality between countries has increased. Yet the overall pattern is less easy to sum up. Within different country groups there have been**

varying patterns of either increasing or decreasing inequality. The experience within the rich country group has clearly been that increased trade links through free trade arrangements like the EU and EFTA do lead to an upward convergence in levels of average income.

## **1.2 CASE STUDY ON INDIA**

### **LIBERALISATION IN INDIA**

The Indian government headed by P.V. Narsimha Rao adopted the policy of economic liberalisation in 1991 with the aim of bringing prosperity to the country.

Since then foreign investment worth billions of US\$ has been made in the country but all this has only resulted into more poverty. The rural poverty has increased from 32 percent to 40 percent, and in States like Bihar, Maharashtra, Karnataka and UP, the poor have become poorer.

**The re**  
**The economic liberalisation policy has only helped the rich, who already had the infrastructure and resources, to corner huge sums of money without creating more job opportunities. The employment level has, therefore, gone down during all these years of liberalisation. Thousands of industrial units are lying closed, rendering millions of workers jobless. The new ventures are all going for very high tech projects, having a high degree of automation requiring minimal labour requirement. Every entrepreneur wishes to work with least labour component. As a result of all this the overall employment scenario has become very grim.**

**No wonder, then, that the forces of nationalism in India are against those who favour liberalisation.**

**India has an annual GDP of \$300 billion, vast natural resources, and as many highly educated, skilled middle-**

**class citizens as the total US population. For almost half a century, India's GDP grew by an average of less than 4 percent a year. Taiwan's GDP grew by an annual 8 percent during the same period, and South Korea's by 9 percent. Foreign direct investment in China, the world's largest Communist country, is now running at \$37 billion a year, in India the figure is \$2 billion.**

**In India, the share of unemployed within the labour force is gradually on the rise, from 4.3 percent in 1991 to 5.5 percent in 1995. In the last two years, unemployment definitely must have gone up as the labour content of production has been declining. With employment opportunities stagnating and simultaneous growth in population, unemployment would naturally rise steadily.**

**The Planning Commission of India has estimated that the labour force between the ages of 15 and 59 years would rise from 294.6 million in 1992 to 393.02 million in 2007. Creating jobs for them would really be a**

**difficult**

**task.**

**Even in China, where the process of liberalisation is said to be quite successful, the problem of joblessness has emerged as a big social problem, inspite of the fact that around 70 million unemployed are covered by the "unemployment insurance". In China there are 150 to 160 million jobless people in the cities and villages.**

**The high rate of unemployment is a direct consequence of the new path of economic liberalisation, or the so called, economic development. In the process of improving productivity, updating equipment and upgrading technology for modernisation, and ofcourse for profit maximisation, they resort to laying off workforce making industrialisation or the modernisation a curse for these workers.**

**The process of the so called 'economic liberalisation' can never succeed in India if judicious use of resources, including the foreign investment, is not made and, if the**

**labourforce is neglected the way it is presently being done.**

## **REGRESSION ANALYSIS FOR TESTING OF IMPACT OF LIBERALISATION ON INEQUALITY IN INDIA**

**Hence in order to test for whether liberalisation has an impact on reducing inequalities in India –the following methodologies are used-**

**1)LOG LINEAR OF REGRESSION TO SEE IF INDIAN STATES HAVE SHOWN CONVERGENCE SINCE1991-2001-AFTER LIBERALISATION POLICIES I.E IF STATES HAVE SHOWN A MOVEMENT IN GROWTH TOWARDS REDUCING INEQUALITY.**

**LOG LINEAR REGRESSION**

$$\text{LOGY}=\text{a}+\text{bt}$$

**Y-per Capita SDP**

**t-time**

**a-intercept**

**b-rate of growth or per capita SDP over time**

**Per Capita SDP= SDP/Population**

**Non-Negativity of co-efficients of regression estimated imply divergence and vice versa.**

**After performing the regression the following results were observed:**

**TABLE SHOWING RESULTS OF REGRESSION OF LOG OF PER CAPITA SDP ON TIME**

<b>STATE</b>	<b>a</b>	<b>b</b>
<b>Andhra</b>	7.671698	0.038185

<b>Bihar</b>	7.117595	0.005256
<b>Gujrat</b>	7.9087	0.054884
<b>Harayana</b>	8.052431	0.035983
<b>Karnataka</b>	7.711081	0.041742
<b>Kerala</b>	7.66619	0.06495
<b>Maharashtra</b>	8.119057	0.03088
<b>MadhyaP</b>	7.650968	0.006566
<b>Orissa</b>	7.230022	0.035584
<b>Pondicherry</b>	7.792566	0.096576
<b>Punjab</b>	8.206565	0.028174
<b>Rajasthan</b>	7.57915	0.02801
<b>TamilNadu</b>	7.749333	0.056367
<b>Uttar Pradesh</b>	7.423895	0.019229
<b>West Bengal</b>	7.616495	0.040579

## 2) LINEAR REGRESSION

$$Y = a + bt$$

**Y**-per Capita SDP

**t**-time

**a**-intercept

**b**-rate of growth or per capita SDP over time

**Per Capita SDP = SDP/Population**

**Non-Negativity of co-efficients of regression estimated**

**imply divergence and vice versa.**

After performing the regression the following results were observed-

**TABLE SHOWING RESULTS OF REGRESSION OF PER CAPITA SDP ON TIME**

STATE	A	B
ANDHRA	2108.697	101.1743
BIHAR	1233.973	6.730054
GUJRAT	2663.926	191.6512
HARAYANA	3091.505	138.1738
KARNATAKA	2178.465	118.532
KERALA	2012.309	197.204
MAHARASHTRA	3323.594	128.4674
MADHYAPRADESH	2104.929	13.91854
ORISSA	1363.783	59.12572
PONDICHERRY	1915.985	439.5242
PUNJAB	3643.78	116.7804
RAJASTHAN	1945.758	63.64826
TAMILNADU	2226.896	177.866
UTTAR PRADESH	1666.613	36.29224
WEST BENGAL	1966.998	108.074

After performing the regression in both the linear and log linear cases the co-efficients were found to be positive-indicating divergence-also indicating that states have become more unequal during this period. Inequality has not decreased as a result of liberalisation policies followed since 1991 and thereafter

**till 2001.**

### **1.3 POSSIBLE SOLUTIONS FOR REDUCING INEQUALITY IN INDIA.**

**1)First,the composition of growth needs to be altered to encourage agricultural as opposed to non-agricultural growth in the poorest of areas.**

**2)Widespread tax reform is necessary to increase tax revenues,effect more redistribution and offer support for more rapid economic growth that would enable greater provision for public expenditure for anti-poverty programmes.**

**3)The efficiency of public expenditure and of the social safety net should be improved.This would call for policies that sustain and enhance social expenditure levels and the more effective targeting of subsidies geared towards the poor.**

**4) Last but not the least is the design of a good social-sector policy framework. Several factors are involved and only a bare few are mentioned here**

**a) Society must develop lasting, flexible organisations to protect the poor from the effects of macroeconomic shocks.**

**Second, appropriate safety nets, especially workfare programmes that are well targeted and involve appropriate transfer and credit programmes need to be developed. The relevant expenditures should be protected in real terms even macroeconomic adjustments are made.**

**Third, it is important to build up pressure groups of the poor to ensure that enough funds are made available for social programmes and that those in charge of these expenditures are accountable to the people. Decision-making should be appropriately decentralized to ensure the smooth functioning of the programmes.**



## **1.4 REFERENCES**

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