

BOOK REVIEW

***Trade Policy, Inequality and Performance
in Indian Manufacturing***

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Reviewed by

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The book is an empirical study on the effects of trade reforms on the Indian organized manufacturing sector during the period 1975-1999, using industries as the unit of analysis and quantitative techniques as the methodology. Several dimensions of industrial performance-productivity, employment, wages and prices have been covered. The focus on manufacturing follows long and illustrious tradition of examining India's international trade. Though in the recent years, the service sector has made an important contribution to India's economic growth yet to undertake a serious examination of trade liberalization in India, we cannot ignore the manufacturing sector which still offers considerable work opportunities for the large number of working poor. Hence, the enormous significance of a study like this examining the relationship between trade policy and manufacturing performance.

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The book is organized into several chapters – an overview of the evolution of India's trade regime- trade as well as industrial policies with emphasis on highlighting the important phases of the trade policy regime (Chapter 2). The evolution of the Indian organized manufacturing is analyzed with reference to trends in wages, employment, production, foreign trade (Chapter 3). The openness-growth debate is examined by asking whether the higher economic growth observed in the Indian economy in the 1980s and 1990s can be attributed to trade policy changes.(Chapter 4). The trade policy- total factor productivity growth relationship for Indian manufacturing is explored to assess whether trade reforms has had a positive impact on TFP growth and prices (Chapter 5). Despite the informal sector accounting for over 80 percent of employment, job creation in organized manufacturing remains a crucial issue especially in the context of quality and labor protection issues. Therefore the issue of whether trade policy reforms have led to an appreciable increase in employment in organized manufacturing assumes significance (Chapter 6). The issue of unskilled-skilled wage gap and trade liberalization is addressed by examining the relationship between international trade and wage inequality in organized manufacturing in India with focus on if the wage rate differences between unskilled and skilled labour have narrowed (Chapter 7). The final issue dealt in the book relates to how different regions in India adjusted to trade liberalization by examining the trends in employment and production across the several states of India. The last chapter highlights the key findings along with policy recommendations.

I highlight two significant contributions of the book – (1) use of trade policy indicators for assessing the impact of trade reforms on manufacturing performance. (2) trade reforms and labor market issues .

Explicit measure of trade policy indicators

Empirical research on the effects of outward orientation on manufacturing performance has generally not untangled the various dimensions of trade policy stance. In particular, researchers have been unable to generate satisfactory indexes of trade policy orientation, although there is a proliferation of indices of trade restrictions. The manufacturing sectors of the developing countries are often subjected to severe trade restrictions in terms of high levels of tariff and extensive import prohibitions via licenses and quotas. Therefore the analysis of the impact of trade policy changes on manufacturing performance calls for the construction of a well-chosen set of measures that represent the complex nature of commercial policy as well as comprehensive information on the direction of change in a country's trade regime. A key component of the trade reform programs has been the elimination, or at least severe reductions, of the coverage of non tariff barriers that have restricted the free flow of goods particularly intermediate and capital

goods for industrial use. Thus to understand the trade regime, we need to look at the multiplicity of instruments that quantify an industry's trade barriers.

Sen draws on the work of Das (2003) which quantifies trade barriers for Indian manufacturing by documenting both tariff as well as non tariff barriers for large number of organized manufacturing industries belonging to intermediate, capital and consumer goods sector for the period 1980-2000. Using the explicit measures of trade policy by industries- effective rate of protection for capturing tariff based protection, import coverage ratio for understanding non tariff based protection and import penetration for overall impact of both tariff as well as non tariff barriers, Sen adds new dimension to the already existing studies that examined the effects of trade reforms on the efficiency of firms and industries in India. The impact of trade policy reforms on productivity and domestic prices are addressed within an econometric methodology using trade policy variables- effective rate of protection and import coverage ratio. This enables the author to portray two very significant results in the context of India's attempt at trade liberalization. One, a reduction in quantitative restrictions has had a positive impact on total factor productivity and two; an increase in quantity competition from abroad has a significant impact on India's domestic market power. Sen is one of the few apart from Goldar and Kumari (2003) and Das (2005) who have examined the impact of trade reforms on manufacturing productivity using quantified indicators of trade barriers.

Trade liberalization and labor market issues

The labor markets in the developing countries have been undergoing transformation since the advent of trade liberalization in the 1990s. The organized manufacturing sector in India, despite its respectable growth following the reform process initiated in the 1980s and 1990s has not been able to perform its role of pulling workers away from agriculture and informal sector activities into the modern sector employment with higher productivity and wages. The decade of 1990s has been characterized as "Jobless" growth as despite growth in manufacturing, employment levels have been low and stagnating. Therefore the policy concern for expanding employment opportunities in organized manufacturing is an immediate issue

The book provides an intellectually rich examination of these concerns by exploring the linkage between trade policy, employment and wages for organized manufacturing. The issue of trade and employment is addressed with three different methodologies- factor content approach, decomposition of employment changes, and labour demand regression. All the three approaches confirm that the impact of trade on employment in India has been limited and the Indian experience mirrors that of African countries. The trade and wage-inequality debate in Indian context seeks to examine if trade reforms in the 1980s and 1990s have led to the narrowing of

wage rate difference between the two components of workforce-skilled and unskilled. Sen examines the trade, skill intensity and wage inequality relationship by examining the Stolper-Sameulson effects and testing if trade induced skill based technological change could be linked to international trade. Regression exercise that links relative skill intensity and wage inequality with trade policy confirms the validity of Stolper-Sameulson hypothesis and trade induced skilled- based technical change hypothesis. The empirical analysis confirms that trade reforms have led to a widening of the wage gap between skilled and unskilled workers.

This exercise is notable once again for using explicit trade policy indicators – effective rate of protection, import coverage ratio and import penetration rates. In the case of testing for S-S effects, the study finds strong negative relationship between policy-based measures of trade policy and relative skill intensity. As regards the examination of relative wage inequality, it was observed that a clear negative and significant relationship between degree of protection and wage inequality.

Overall the in-depth research and analysis throughout the book makes it an important reference for all those interested in understanding India's attempt at trade and other policy reforms. Two limitations that emerge out of this work are namely-first, the absence of any discussion on unorganized manufacturing. In recent years, unorganized manufacturing accounts of a substantial share in both production and employment. Against this background, it would have been very useful to have a comparison between organized and unorganized manufacturing as far as the trends in production, trade, employment and wages are concerned at either 2 or 3 digit levels of NIC classification for the entire period by interpolating the select time-point data on unorganized manufacturing. Further estimates of total factor productivity using a value added specification of production for both unorganized and organized manufacturing would have enriched the trade policy reforms-productivity growth debate for Indian manufacturing. Second, the economic reforms have now been active for more than two decades. Further, much of the debate on the impact of trade policy reforms suggest lagged impact, thereby making it necessary to extend the time period to cover a longer span of reforms. Therefore keeping data availability constraints in mind, it would be useful if the measures of trade policy indicators are created for the period 2000s so as to enable the examination of the lagged impact of trade reforms on manufacturing performance.

The book will be of immense value to scholars keen on pursuing research on trade and industrialization with reference to India. In addition it would be also offer valuable study material for students opting for a course in Indian economics in India and abroad given its sound theoretical underpinnings and careful quantitative evaluation.

Note:

Das D K (2003), *Quantifying Trade Barriers: Has Protection Declined Substantially in Indian Manufacturing?* Working Paper #105, New Delhi, ICRIER documents three trade policy indicators by NIC 1987 three digit classification for 72 industry groups. These indicators were used to explore the trade reforms–manufacturing productivity performance linkage in another research paper- D.K Das (2005), “*Improving Industrial Productivity Does Trade Liberalization Matter? Evidence from Indian Intermediate and Capital Goods Industries*” in Tendulkar, Suresh D *et al* (Edited), India: Industrialization in a Reforming Economy, Academic Foundation, New Delhi. In a related research paper, Goldar, B N and Anita Kumari (2003), "Import liberalization and productivity growth in Indian manufacturing industries in the 1990s", *The Developing Economies*, Vol. 41 No.4, pp.436-60 using explicit trade policy indicators