


Opinions

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The Relationship between Trade Liberalization and Job Matching Process in India: Implication for the Korea-India CEPA



Woong Lee

PhD, Research Fellow, India-South Asia Team
Korea Institute for International Economic Policy 

India's acceptance of the IMF bailout program following the exhaustion of its foreign reserves in 1991 set off unexpected and external driven (exogenous) economic reforms. This case has provided researchers with an attractive opportunity to explore the relationship between economic outcome and economic reform including trade liberalization. Economists have used 1991 (before and after) as the dividing point to examine a series of economic reform that influenced economic performance in India.

Among a variety of economic topics, we choose the Indian labor market, more specifically the job matching process, in order to study the link between trade liberalization (an external reform)

and the state of the labor market in India. In addition, to incorporate different degrees of economic reform over time, we divide the period of economic reform, which is after 1991 to present, as follows: (1) the period of economic reform by external factors after the 1991 reform (from 1992 to 1997); (2) the period of economic reform that reflected strong requests from domestic firms' and industries' (from 1998 to 2002); (3) the period of economic boom (from 2003 to 2008); and (4) the period after the global financial crisis (after 2009).

We employ the aggregate matching function to represent the job matching process. The matching function is simple but most representative of all methods for showing labor market frictions in an economic model, and explaining why unemployment and vacant jobs coexist. It is one of the most important elements in search-matching models and has been widely used in macroeconomics and labor economics. The importance and popularity of the matching function was proven when its developers (Diamond, Mortenson, and Pissarides) won the 2010 Nobel Prize in Economic Science for 'fundamental contributions to search and matching theory'.

In the basic framework of the matching function, the openness of an economy as well as import penetration ratio are incorporated to examine the effect of trade liberalization on new job hires. This approach is indirectly related to the link between trade liberalization and unemployment because of the direct negative relationship between the number of new hires and unemployment.

Our preliminary results suggest that overall trade liberalization did not influence the job matching process in India, which is shown by the absence of statistical significance between openness or import penetration and new job hires, while controlling for volumes of job-seekers, job vacancies, and other factors. Our findings do not differ from the results of past studies.¹

However, in the analysis of the 4 periods defined in our research, our findings show that new job hires and trade liberalization are negatively related in phase 2 (1998 to 2002: the period of slowed economic reform due to demand of domestic firms and industries). This finding im-

¹ An example is Hasan, R., Mitra, D., Ranjan, P., & Ahsan, R. N. (2012), "Trade liberalization and unemployment: Theory and evidence from India", *Journal of Development Economics*, 97(2), 269-280.

plies that a gradual liberalization to protect domestic sectors could actually cause a decline in new job hires, and in turn, an increase in unemployment.

Our findings suggest that trade liberalization is not harmful to the Indian labor market because the effect of openness on new job hires, and hence on unemployment, is limited in India. Thus, our results recommend that the Indian government continue to promote external economic liberalization. In connection with this issue, incoming upgrade negotiation for the Korea-India CEPA is important for India as well as Korea. Our previous research already emphasized that India's trade deficit with Korea could decrease with further cuts in tariff rates between the countries.² Therefore, we expect bilateral trade between Korea and India to increase and trade deficit of India to decrease through the upgraded Korea-India CEPA, which will extend the range of free trade items and expedite the reduction of existing CEPA tariff rates.

The 2nd Korea-India Joint Committee, which was scheduled in Seoul in 2012, has not yet been held; and of course, the upgrading negotiation for the Korea-India CEPA has also been delayed. However, we anticipate that the joint committee will be held within this year. During President Park's visit to India early this year, the two states reaffirmed the need to increase the bilateral trade through the upgrade of the CEPA. Modinomics also raises our expectations for a speedy upgrade of the CEPA.³ KIEP

² Woong Lee, Young chul Song and Choong Jae Cho (2011), "Two Years On: Achievements and Challenges in Trade Sector of Korea-India CEPA", KIEP World Economy Update 11-03, Korea Institute for International Economic Policy. (Dec. 9)

³ Newly inaugurated Prime Minister Narendra Modi's business-friendly and market-oriented policies are dubbed as 'Modinomics'.