

Growth, Employment and Inequality

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- The Lewis model carries the message that employment increases *pari passu* with growth in the modern sector at gently rising wages

- We now know that unlike in the classical model of development labor is not available at a uniform supply-price to the whole of the 'non-subsistence' sector. In particular there is a hierarchy of wages closely related to the size of firms and it should be emphasized that these differentials are net of measurable worker quality, like education and experience.
- These differentials are only partly due to institutional factors. The main factor driving these differentials is the heterogeneous quality of labor-- which is more pronounced in less developed economies

- Education is an important factor differentiating the quality of labor, even for relatively low skilled workers
- Stability of labor employed in the firm has been recognized to have been a significant factor
- Firms may choose to have a high wage firm-specific labor force with a high degree of on-the-job training

- Given this heterogeneity of wage (and productivity) levels across modern sector firms, where jobs are being created is of crucial significance for both growth and inequality in a developing economy

- There has been a strong bi-modal distribution in employment—even when we confine our attention to the non-household sub-sector in manufacturing—with concentration of employment at the small and large size-groups of establishments, with a conspicuous ‘missing middle’. A related point is that the productivity (and wage) gap between the two extreme size groups is much larger in India than in other Asian economies.
- The size distribution of employment seems to have changed little in spite of the higher rate of growth of value added in the large-scale sub-sector. This is because the employment elasticity in the latter has been low

- This pattern of growth with much of the labor being absorbed in the low –wage-low-productivity sub-sector dampens the demand expansion in manufacturing, and slows down the rate of expansion of employment outside agriculture
- This pattern also contributes to increase in inequality

- The dualistic pattern of development in Indian manufacturing had its origin in the industrial policy adopted for along time with protection of the small-scale.
- The regime of protection for the small-scale was largely dismantled after the reforms, but the dualistic pattern in manufacturing does not seem to have changed significantly
- What are the possible factors at play?

- Many observers have singled out labor legislation which the reform process has not tackled in determined way
- The “Factory Act” cover all workers in the ‘registered’ sector employing 10 or more workers using power, or 20 or more not using power. Additionally, the Industrial Development Act (IDA) with its Job Security legislation section kicks in for units with employment size of 100 or more workers

- The implementation of these central laws are the responsibility of the States of the Union, which can and have supplemented with their individual variations on the labor laws

- How important are labor laws relative to other problems faced by employers? One source of evidence is the World Bank's annual *Invest Climate Assessment (ICA)* and *Doing Business Surveys (DBS)* in a large number of countries
- A comparative study of the ICA for 2006 found that labor regulations were *not* in the list of major difficulties singled out by business respondents: it was in the case of South Africa, but not Brazil

- India's over-all ranking in terms of business climate was fairly low—134 out of a total list of 175 countries. It compares with rank 29 for South Africa, 121 for Brazil, and 93 for China.
- Corruption (37%) tops the list of the five most important business constraints reported, followed by Power (electricity) shortage (29%); Tax Rate (28%); Tax administrations (27%) and Policy Uncertainty (21%).

- It might be suggested that the prime difficulty pointed out by Indian businesses –corruption- partly refers to the bribes needed to be paid to labor inspectors to evade labor laws. But the important point to note is that labor regulations are only a part of the total regulatory framework and businesses seem to think that labor related difficulties are not the most important.

- The ICA Report of 2006 correctly emphasizes the point that managers of existing firms in the formal sector represent a biased sample in so far as they have already succeeded in establishing their existence in the sub-sector. They do not provide an evaluation of the constraints faced by firms which seek to grow in size from the informal to the formal sector.

- Infrastructure problems are high on the list of constraints other than labor regulations. Inadequate supply of power produces not only low productivity of small dispersed units, but it also accentuates the need for heavy lump-sum capital investment for firms needing to provide their own generators for electricity, and biases the economies of scale favoring very large units

- In spite of the recent boom in construction India suffers from an adequate supply of transport systems which have discouraged spatial dispersion.
- The substantial employment in important industries which have dominated the DME sector (6-9 employment size) in India is located in a few cities or towns where they often have to compete for infrastructural facilities with large units.

- Education Policies as have been implemented in India over the years have been biased towards the promotion of tertiary education and has neglected basic primary and low secondary education
- India has suffered from the lack of the plentiful supply of labor with secondary education which seemed to have been instrumental in the development of small-medium industry in East Asia

- The relative neglect of the lower rungs of the educational system in post-colonial India has created an educational divide which in fact has cemented the class divide within the society. The entrepreneurs and administrative employers in the formal sector tend to come from the upper branch of this divide, and are culturally separated from the bottom rung.