

# ***Poverty and inequality and relationship to informality in India***

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## **Growth and Inequality**

In the 1983-93 decade redistribution helped to enhance the poverty reduction, particularly in the rural areas, in the post-reform decade (1993-2004) the distribution element reduced the extent of poverty reduction significantly *both* in the rural and the urban sectors.

“Distribution neutral growth would have generated a poverty decline in rural India (in the latter period) that was 22 per cent higher; in urban areas the decline in poverty would have been 76 per cent higher” (Papalova,2008)

## **Growth and Inequality**

Inequality increased significantly in India only in the second decade (1993-2004), i.e., the post-reform years.

The increase in inequality was much more pronounced in the urban areas.

In the pervious 1983-93 decade there was a small decline in over-all inequality—about 2 percentage points in the Gini in the rural areas and a 1 percentage point in the urban.

## **Determinants of Inequality**

Wage labor is less than half of the employed labour force in India, the majority being the self-employed. They are somewhat more important in the urban sector.

Two categories of wage earners -- the regulars and the casuals.

Casual labour is the much the most important category of employment in the rural sector, they also figure significantly in the urban economy.

## **Determinants of Inequality**

The degree of inequality is much higher among the regular wage earners, and what is more has been increasing dramatically in the post-reform decade, while the trend in inequality in the casual wage sector has been basically non-existent.

Human capital variable (education) and age in particular play a stronger role in the determination of the earnings of regular workers. For casual workers the single most important explanatory variable was geographical difference.

For inequality in household welfare proxied by per capita consumption expenditure. Household size and education are most important explanatory variables.

## **Industrial Composition and Inequality**

The growth process seems to have been led by the tertiary sector—both in terms of value added and employment, rather than manufacturing. Slow structural change of employment in India has accelerated in post reform period.

The Kernel Density Functions based on APCE showed increase in household welfare in all sectors – primary, secondary and tertiary but increase in APCE is relatively more pronounced for the tertiary sector particularly in post reform period. Analysis of Pseudo-Gini showed that the contribution of the tertiary sector to over-all inequality is highest and it has increased dramatically in post-reform period.

## **Why is Inequality Higher in the Tertiary Sector?**

The relatively faster growth of employment in the tertiary sector is not predominantly due to either the emergence of the finance-business service as a major part of the sectoral reallocation, nor to the substantial entry of surplus labour from agriculture into the tertiary as a sector of 'last refuge'.

No evidence to show that push factor is dominating labor absorption in the tertiary sector even though it has created more jobs in the lowest quintals in the post reform period along with the highest quintile. Even trade, hotel & restaurants that absorbed large chunk of additional labour all through the last three decades does not show declining labor productivity, not even relative to agriculture.

## Dualism in Manufacturing

A strong bi-modal distribution in employment—even when we refer to the non-household manufacturing—with strong concentration of employment at the small (6-9 workers) and large size-groups of establishments (>500 workers), with a conspicuous ‘missing middle’.

The productivity (and wage) gap between the two extreme size groups is much larger in India than in even other Asian economies.

Dualism in manufacturing leads to over-all low productivity in the sector which slows down the rate of growth in the sector and contributes to earnings inequality in it.



## The Impact of the 'Missing Middle' on Growth

*Growth of Market for Manufactured Products:* If most jobs are created in the low wage small-scale segment of the market, the cost of labor would be low, but the expansion of demand for industrial goods would also be low since the increase in per capita income is small.

In large scale segment many firms are based on a high wage-low employment approach, so employment and wage share may be low.

Employment growth is led by the service sector, not manufacturing. The linkage effect of the tertiary sector in terms of promoting a strong multiplier for employment growth is much weaker than that of manufacturing.

## **The Impact of the 'Missing Middle' on Growth**

*Skill Formation:* An adequate supply of skilled labour attuned to industrial work is partly a function of the development of the educational sector (including primary and lower secondary education) but is also dependent on widespread on-the-job training.

Dispersed industrialization is important for such a pool of trained labour over a wide area which is more effectively developed by Mid-Sized firms.

## **Impact on the Pattern of Inequality**

The dualism in manufacturing, with its bi-polar distribution of employment, itself contributes to inequality.

The rate of reduction in the proportion of low income labour in the traditional sectors has been slow.

Inequality is higher in the tertiary sector- partly because it has a sizable labour force of higher than middle education.

## **The East Asian pattern with a more even size distribution of employment**

The strong growth of the SME sector led to a high rate of absorption of surplus labour from agriculture leading to fast growth rate of real wage.

Growth was throughout led by the manufacturing rather than the tertiary sector.

The widespread formation of skills reduced wage-differentials

The growth of subcontracting and spatial dispersion of industry

# Causes of Dualism in Indian Manufacturing

## *The Policy of Protection of Small Scale Units*

The policy of reservation was effectively dismantled in the reform process initiated in the late eighties, and more importantly after the liberalization of 1991. What explains the continued dual size structure in Indian manufacturing as has been documented above?

## *Labour Laws*

Evidence suggests that labour laws is not the primary cause of the discouragement of the informal sector to expand into the formal.

# Critical Issues

- Entrepreneurship
- Location and Land Problems
- Infrastructure
- Hysteresis: Examples are Retail Structure; Learning through Exports

## **Intervention in labour market**

The experience of growth with significant rise in inequality and realization of dualism in both tertiary and secondary sector focused attention that the vast majority of workforce has been left behind at low levels of income even though poverty level declined.

It was widely felt that the growth process alone would not produce a better redistribution. Central to this discussion was distinction between the formal and informal sector.

## **Intervention in labour market**

Among the most discussed labour market interventions, is the discussion on the minimum wage applying to the informal sector.

Minimum wage legislation has existed in India since 1948, but has been applied selectively to specific sectors, and its implementation has varied from state to state.

Recently, extending the coverage and enhancing the level of the minimum wage to the informal sector has been highly supported by the National Commission for the Unorganized Sector (NCEUS).



## **Intervention in labour market**

A critical difficulty about using the minimum wage as a tool of raising the income of low wage earners in the presence of substantial heterogeneity in the quality of labour, setting minimum wages at high levels leads to the substitution of higher quality of labour, thus hurting precisely the poorer sections of the workforce whom the measure is supposed to help.

## **Intervention in labour market**

The costs of enforcement imply that, to be effective, minimum wages have to be backed-up by a guarantee of employment by the state.

The government has in recent years paid particular attention to strengthening and extending the Employment Guarantee Scheme which had a long history in Indian policies. The National Rural Employment Guarantee (NREG) has been the flagship program of the new government after 2009 elections. Its budget has been significantly increased, although it is not clear that there has been any official evaluation of the relative cost-benefit assessment of this scheme compared to other welfare programs.

## ***Social assistance and social welfare***

The last coalition government made social security for the unorganized sector a prime consideration of its social policy. After considering the sweeping recommendations of the NCEUS over nearly two years, a Social Security Act for the unorganized sector was passed by the Indian Parliament on the 30th December 2008.

This piece of legislation did not enunciate any new approach to social security. Rather it constituted a —National Social Security Board which would meet regularly and recommend to the government —suitable schemes for different sections of the unorganized workers.

## ***Social assistance and social welfare***

An important provision in the Act called for the registration of every unorganized worker above 14 years of age and issuance of an identity card which would make him eligible for the social security benefits available upon the fulfilment of the conditions necessary for the benefit (including the payment of contribution if required).

This provision would seem to be important in raising the awareness of workers in the sector about their rights to social security benefits, and could in effect serve as a catalyst for increasing popular demands for needed coverage in the future.

## ***Social assistance and social welfare***

A worrying aspect of the admittedly modest and selective increase in social spending in the current budget is that it has been an element in the significant increase in the budget deficit.

In the absence of major changes in the political economy of the country which enables major increase in its fiscal base by bringing a larger part of unreported income into the tax net, and shuffling of the States' expenditure pattern away from large items (i.e fertilizer subsidies and defence), the expansion of welfare schemes have to be viewed with caution.

The attempt to proceed with fiscally unrealistic social sector spending would come up inevitably against the inflation barrier which in the end hurts the poor proportionately more.