Need focus on removing obstacles to 'good' jobs

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MSMEs employ about 110 million workers and contribute to about 40% of exports (MSME census, 2006-07), and have a huge role to play in creating quality jobs, improving export competitiveness, and increasing aggregate productivity.(Sunil Ghosh/HT file photo. Representative image)

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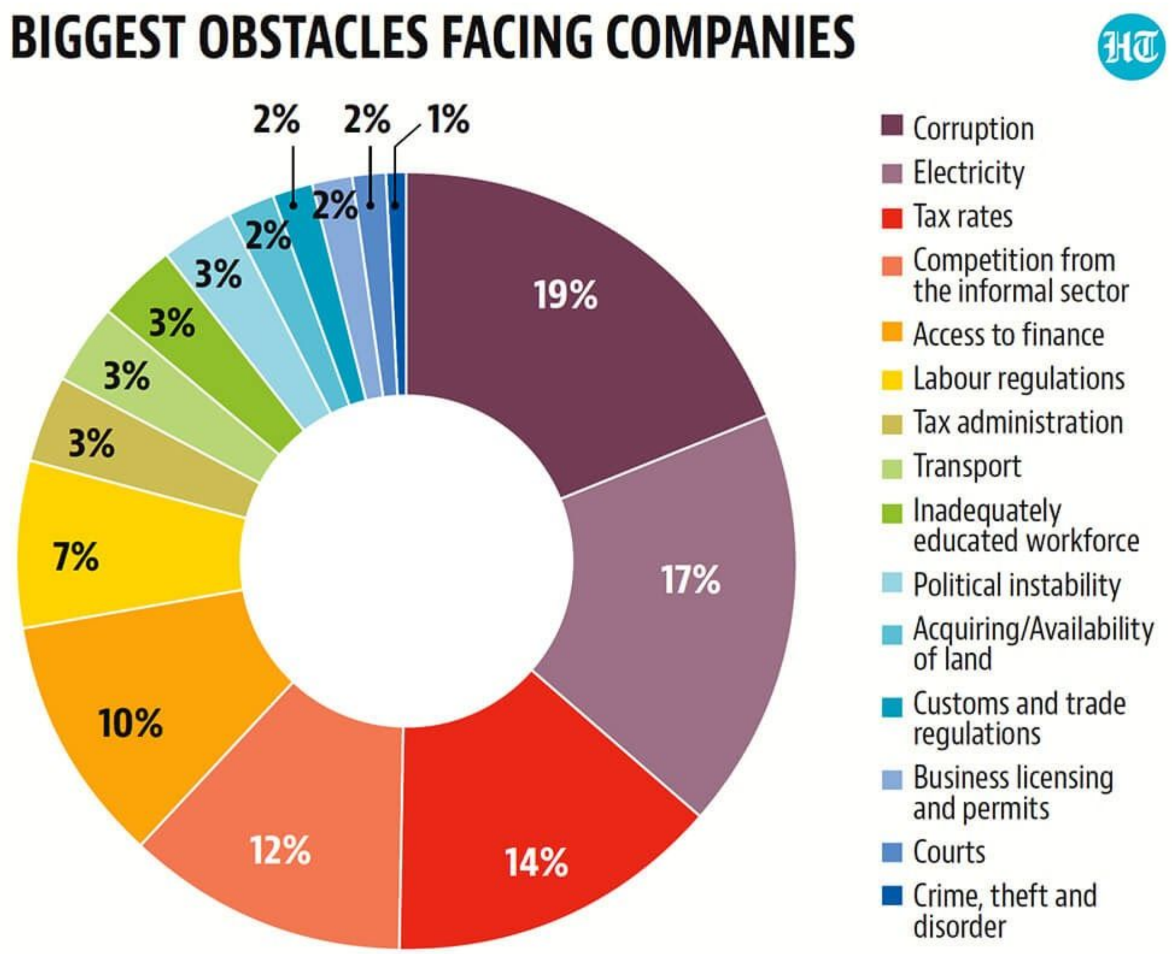
The Covid-19 pandemic brought into sharp focus the plight of thousands of small businesses in the country. As businesses struggled to stay afloat, the government announced a number of measures targeted towards the so-called Micro, Small and Medium Enterprises (MSMEs). Many of these measures, part of the Atmanirbhar Bharat Abhiyan package, are aimed at easing financial constraints faced by businesses. But there are a multitude of obstacles facing businesses, not just financial; easing some of these obstacles could go a long way in raising worker productivity and ultimately lead to the creation of good (high-paying) jobs.

1) Finance not the only constraint

Our argument is built on a unique survey conducted by the World Bank called the Enterprise Surveys. The survey draws a representative sample of businesses and collects a wealth of information, including measures that try to quantify different obstacles faced by such businesses. We use data for the organised manufacturing sector in 2014, the most recent year for which data is available for India. Interestingly, almost 70% of the firms covered in this survey fall under the MSME definition applicable during this survey, and the findings are therefore highly relevant for issues facing such firms. In one of the survey questions, respondents were asked to choose their biggest obstacle from a set of 15 that could potentially affect production.

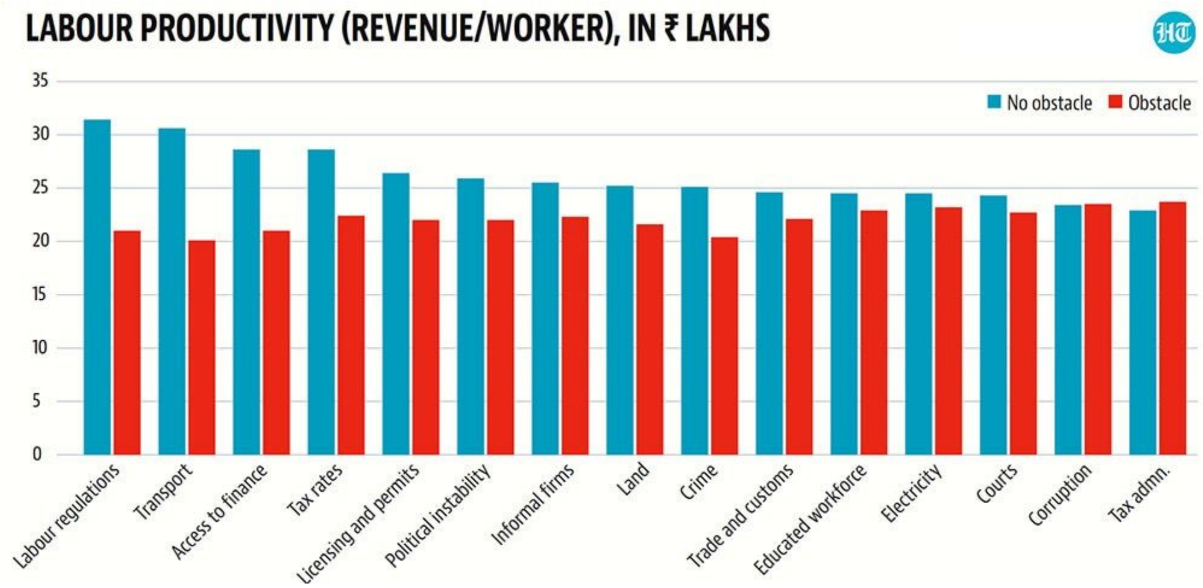
Their response is summarised in Figure 1. Some of the obstacles are clearly more important than others. In terms of their importance, the top six are corruption, electricity, tax rates, competition from the informal sector, access to finance, and labour regulations. Hence, although finance is an obstacle for businesses, it may not be the most severe obstacle. Furthermore, the ranking of obstacles does not change much if we look separately at small and large businesses.



2) Many factors hurt labour productivity

Further analysis sheds light on each of the obstacles. Take electricity. On average, businesses faced roughly 27 power cuts per month, with the average duration of each power cut being around two hours. Of course, one can minimise the disruption from power outages by using generators. In fact, 80% of businesses that faced power outages in the previous fiscal year owned generators. Because power created through generators is significantly more costly, however, this clearly affects the bottom line. Lower profits, in turn, could limit their ability to invest in productivity enhancing technologies. While experts often suggest that the government should encourage technology adoption among MSMEs, this is impossible to achieve without an input as critical and fundamental as uninterrupted and reliable power. Figure 2 suggests that there might be some truth to the above hypothesis. For each of the above-mentioned factors, the plot shows the average labour productivity of businesses that reported the factor to be an obstacle versus those that did not (The survey asked respondents to assign a score between 0 and 4 to each factor, with 0 denoting no obstacle and 4 denoting a very severe obstacle. We assigned businesses with a score of 0 to the No obstacle group and the rest to the Obstacle group).

Out of the 15 factors, businesses that faced an obstacle for 13 of those factors had lower labour productivity compared to their counterparts that did not face an obstacle. The differences are especially stark for access to finance, labour regulations, tax rates and transport. Of course, Figure 2 simply displays correlations, and one needs to be careful before drawing causal inferences. For example, businesses that have lower labour productivity could be located in regions that have less reliable power supply. Nevertheless, a clear negative correlation between labour productivity and severity of obstacle for a wide range of factors is indicative of something deeper: it is likely that some, if not all of these obstacles, could be limiting the ability of businesses to hire more productive workers.

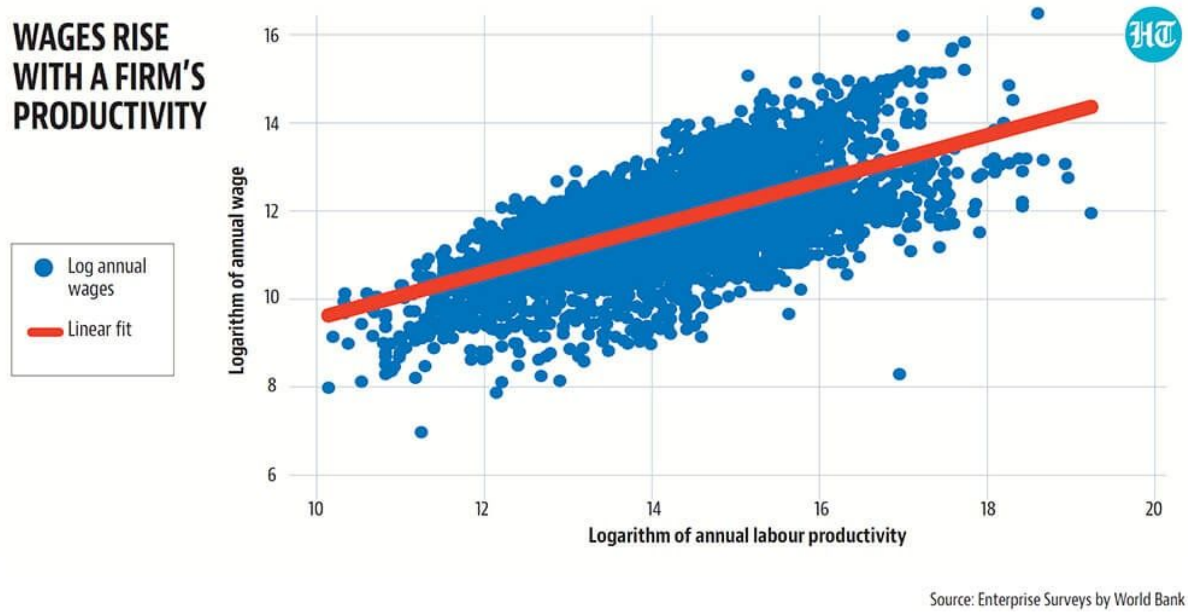


3) Labour productivity matters for wages

Why should policymakers care? Because, at the end of the day, labour productivity is intimately tied to wages. Intuitively, a more productive worker is more attractive than a less productive one. This results in higher demand for the former, ultimately pushing up their wage. This fact is borne out in Figure 3 which plots average annual wages paid by businesses against their labour productivity. It is clear from the figure that businesses with a more productive workforce also pay higher wages. In the aftermath of the Covid-19 pandemic, easing the financial constraints of MSMEs was the top policy priority, and rightly so. From a medium- to long-term perspective, however, help offered to the MSMEs must extend beyond finance.

MSMEs employ about 110 million workers and contribute to about 40% of exports (MSME census, 2006-07), and have a huge role to play in creating quality jobs, improving export competitiveness, and increasing aggregate productivity. To achieve these, policies should also focus on delivering critical infrastructure (electricity access, transportation, land), easing bureaucratic hurdles (courts, tax administration), and liberalising business-related policies (trade and customs, labour regulations, friendly and simplified tax rates). One popular approach for holistically achieving these is through the setting up of place-based policies that have been successful in the US, European Union, and China.

In India, evidence is limited, but some policies have had positive impact, for example, the 1994 tax exemption for backward districts , and the 2003 tax exemptions and capital subsidies for firms in Uttarakhand and Himachal Pradesh. The need of the hour is to design a focused policy in this regard that majorly overhauls the current Special Economic Zones (SEZ) framework (SEZ act, 2005) using learnings from the successes and failures from other countries, and our own past. The upcoming budget is a timely opportunity to think about these structural changes in initiating a transformation.



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