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Public and private sector jobs, unreported income and consumption gap in India: Evidence from micro-data



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ABSTRACT

This paper documents the wage and consumption gap between private and public sector employees in India. We empirically investigate the wage gap as well as difference in consumption expenditure using household survey from the 2004–05 National Sample Survey of India. Our results show that despite a lower level of public sector income in some of the income quantiles, the consumption of durable goods is not different between these two groups, statistically. After checking for competing explanations, we conclude that the absence of statistically significant consumption gap could be an outcome of ‘unreported’ income earned by public sector workers in India.

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1. Introduction

Corruption is widely seen as an obstacle to the process of development. It distorts prices and raises transaction costs leading to inefficiency in the system. The persistence of both petty and large-scale

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corruption is generally a consequence of poor rule of law, lack of transparency, accountability and regulations, but not restricted to these only. The combination of various facilitators of corrupt practices makes measurement of corruption an extremely vexing exercise. We make an effort to provide evidence of the presence of corruption in the public sector. The contribution of the paper lies in the fact that beyond some sector-specific evidence and a large amount of first-hand experiences with corruption in India, there is hardly any study that captures the consumption equalizing role of corruption across sectors of the economy. Our results cannot pinpoint on the individual levels of corruption, but offers a reasonable estimate of how consumption patterns are influenced by access to unreported income by certain employee groups in India. This seems to be a useful approximation in the absence of dedicated data on bribery like what is available for Ukraine. Our primary hypothesis is that the consumption of durable commodities for certain groups as part of the formal workforce are financed by 'unreported' income. The unreported income might have been received in the form of bribes, or any other extra-legal means. Information on unreported income and consumption gap would have been rather difficult to estimate if the employees we are concerned about were in the informal sector, which is extensively large for India. We provide a comparative analysis between private and public sector employees as part of the organized workforce in India, and this should ideally serve as a documentation of unreported income, which confers a disproportionately higher ability to consume among some, *ceteris paribus*. It is so because, additional purchasing power may come from unreported income (not necessarily bribes) including but not limited to, tax evasion, undocumented income from properties or capital gains earned as black money. It may also arise very differently from a lower propensity to save, due to higher discount rates, etc., except for the fact that the quantile groups, which we observe to display this tendency is unlikely to behave in that manner.¹

Usually, the sources of undocumented income are interlinked and it is rather difficult to isolate the point of origin, empirically speaking.² The common perception is that certain groups, like employees in the public sector, accept bribes. It is also documented that non-public sector employees, typically in organized private sector at comparable positions to public sector officials (for example, the managers, CEOs, etc.) receive higher salaries, although, as we will show, the wage gap in favor of the private sector in India is non-monotonic for all such positions. Everything else remaining same, it should then imply that for 'some' occupational types at least, consumption levels for private sector workers should be higher than their public sector counterparts. Our empirical analysis investigates this hypothesis controlling for major sources of variations (such as job security, fringe benefits, and pension provisions) that may potentially influence the correspondence between consumption gaps and wage gaps across public and private sector employees.

While India continues to be infamous for high levels of corruption in the public sector, the literature lacks credible analysis of its extent and depth. It is well known that public sector corruption in India has been historically facilitated by the so-called 'License-Raj' – a public instrument of economic control that epitomized the bureaucratic practice of red tapes and rent seeking (see for example, Saha, 2001). Despite industrial and trade reforms carried out in the country since early 1990s and subsequent delegation of governance to the grass-root level, i.e., the village 'panchayat' (local decentralized governance with sub-provincial political and economic authority),³ the deep-seated phenomenon of greasing the palm for every economic activity continues. This motivates us to seek a comparison between employees in the private and public sectors earning wages and income from reported and

¹ In many developing countries only a small number of formal units offer post-retirement benefits, such as pension. The relatively large non-formal labor market does not provide standard social security benefits to the workforce (see for example, Tzannatos & Roddis, 1998). This should dissuade workers from consuming up for the sake of 'demonstration effect'.

² For example, a public official paying bribes to another public official to undervalue an asset or property for saving property taxes or registration charges. Generally speaking, India continues to be one of the most corrupt nations in the world with a Corruption Perception Score (compiled by the Transparency International) of 3.3 (out of 10, with 10 meaning the least corrupt case) in 2010. India's nature of corruption, mostly seen as political, is a clear reflection of poor governance in the country. In addition, the incidence of petty corruption being rather high for India, there is a clear case for measuring its impact on income and consumption.

³ See for example, Fisman and Garri (2002) on global relationships between decentralization and corruption. Also, Hillman and Krausz (2004) discuss the link between development failure and corruption.

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