The National Rural Employment Guarantee Act of India, 2005*

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Passed by the Lok Sabha on August 23, 2004 and signed by the President of India on September 5, 2005, the National Rural Employment Guarantee Act (NREGA) has been hailed as a major initiative in the Government of India's commitment to providing an economic safety net to India's rural poor. Data from 2002 show that 71.9% of India's population still resides in rural areas, and coupled with the fact that the majority of India's poor also resides in rural areas, the NREGA can be thought of as a policy to boost rural income, stabilize agricultural production and reduce the population pressure on urban areas.

The NREGA extends to all rural areas of India, including Fifth and Sixth Schedule areas, except the State of Jammu and Kashmir. Among the provisions of the NREGA are the following: (i) every household in the rural areas of India shall have a right to at least 100 days of guaranteed employment every year for at least one adult member, for doing casual manual labour at the rate of Rupees 60 per day; (ii) only productive works shall be taken up under the Programme. The State Council shall prepare a list of permissible works as well as a list of "preferred works". The identification of preferred works shall be based on the economic, social and environmental benefits of different types of works, their contribution to social equity, and their ability to create permanent assets; (iii) the Programme may also provide, as far as possible, for the training and up-gradation of the skills of unskilled labourers; (iv) wages may be paid in cash or in kind or both, taking into account the guidelines and recommendations of the State Council on this matter as far as possible; (v) employment shall be provided within a radius of 5 kilometres of the village where the applicant resides at the time of applying. In cases where employment is provided outside such radius, it must be provided within the Block, and transport allowances and daily living allowances shall be paid in accordance with Programme Rules; (vi) in cases where at least twenty women are employed on a worksite, a provision

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shall be made for one of them to be deputed to look after any children under the age of six who may be brought to the worksite, if the need arises. The person deputed for child-minding shall be paid the statutory minimum wage; (vii) a proportion of the wages, not exceeding 5 per cent, may be deducted as a contribution to welfare schemes organized for the benefit of labourers employed under the Programme, such as health insurance, accident insurance, survivor benefits, maternity benefits and social security schemes.

The NREGA, as it stands, eliminates explicitly two important criteria inherent in Employment Guarantee Schemes (EGS), particularly those that have been instituted in the State of Maharashtra: (i) public works programmes should not compete with agricultural labour hiring decisions and (ii) public works programmes should generate a productive asset that directly impacts agricultural productivity (Basu 2005). However, with most of Indian agriculture characterized by seasonality --- a slack/lean season when agricultural labour demand is low and a peak/harvest season when labour demand is high --- it can be reasonably assumed that the public employment, guaranteed for at least 100 days, will be instituted during the lean season when the rural labour force is most vulnerable. By removing the constraint that productive assets must be created to impact agricultural productivity, the NREGA allows for a certain leeway regarding the location of public works programmes.

The operational dimensions of the NREGA are important, and constitute much of the debate about its efficacy. But equally important in the debate has been its conceptual basis, and whether the problem to which it is addressed, rural poverty, is in fact best addressed by such an Act. There has been considerable discussion, for example, on whether the employment will be targeted to those who are poor, or whether there will be leakage to those above the poverty line.

In this note, we take a slightly different tack to the current extensive debate on poverty targeting. We consider the Act as an intervention in rural labour markets, and ask what the consequences of this are likely to be for wages and employment (Basu, Chau and Kanbur 2005a). We start with the presumption that rural labour markets in India do not conform to the classic competitive labour markets of economics textbooks. If they did, the arguments for the NREGA would be weaker. However, in our view agricultural labour markets in India exhibit a range of hiring arrangements, from sharecropping to seasonal spot wage-labour demand and a variety of credit-labour-land contracts in between (Basu 2002). Thus, the labour market in rural India can best be characterized by imperfect competition with high costs on the part of workers to seek and to switch employment, and with elements of monopsony power that lead to low wages, and above all to equilibrium unemployment.

Assuming the NREGA targets this latter group of unemployed workers, the possibility of an alternative source of income --- call it the disposable income from public works employment calculated as the minimum agricultural wage paid at these programmes minus the cost incurred by workers in reaching and staying at the work site --- raises the reservation wage of all workers in the rural sector, and implicitly confers some bargaining power to rural workers. Thus, apart from the provision of an analog of unemployment benefits, the fact of a guarantee of employment at a given wage through the NREGA introduces *contestability* in the rural labour market. In other words, private firms/landlords in rural areas need to raise the disposable income of workers they hire --- once again defined as the private wage minus the transportation/search cost of seeking private employment --- in order to ensure the same number of available workers as before.

The key question then boils down to whether the NREGA can raise *both* private sector wages and employment. The answer lies in how the labour supply schedule available to private employers in agriculture react to the opposing effects of the NREGA: in effect whether or not the unemployment benefit aspect which provides workers the option of an alternative source of employment and leads to a reduction in the pool of workers available for private employment dominates the contestability effect of the NREGA that makes private employment options more lucrative subsequent to a rise in private sector wages. Intuitively, if the disposable income generated by public works programme is low enough relative to the disposable income generated from private employment, then the contestability effect should dominate, leading to an increase in both private sector wages and employment.

With the wage guaranteed in the NREGA at Rs. 60 per day, the implicit discretion over the transportation and other costs, and over various benefits at the point of employment, is thus revealed as a key factor in determining the efficacy of the NREGA.[1] What, then, should be the guaranteed optimal disposable income for public works employees? The answer lies in the efficiency versus equity trade-off from government intervention. The efficiency argument dictates that the disposable income should be low enough such that the *contestability* effect should dominate the *unemployment benefit* effect of the NREGA. On the other hand, the equity argument dictates that disposable income from public works employment should be high since the NREGA is a tool to redistribute income (through the NREGA fund) to the rural poor. Thus, the equity criterion is inexorably tied to the Government's aversion to income inequality. In general terms, if productivity of private sector workers is low and hence there is low disposable income from employment in agriculture to begin with, then the disposable income from public works should be low. Needless to say, the opposite should be the case when productivity of worker in the private sector is high.

Finally, the ability of guaranteed public works employment can be thought of additionally as a policy that stabilizes employment levels in the rural sector facing shocks. However, the extent to which such programmes can insure workers depends largely on the ability of the government to write and commit to complete contracts. In other words, if the government can credibly announce the wage and the location of public works programme for every state of nature then the employment guarantee act can in principle provide complete insurance to workers. But as stated earlier, the nature of the NREGA leaves considerable discretion for the locational choice of public works programmes and other benefits at the worksite. This, coupled with the inability of the government to fully anticipate productivity shocks, may be viewed as providing only partial stabilization.

[1] See Basu, Chau and Kanbur (2005b) for an analysis of minimum wage laws, wherein the issue of ex post policy discretion with respect to the enforcement of the minimum wage is once again key to the credibility of the law.

Conceptually, in order to better understand the ability of a public works programme to stabilize the labour market, the sequence of events from the announcement to the execution of a public works programme needs to be pinned down. As the NREGA is written, first the government announces the wage to be paid at public works programme. Next, productivity shock, positive or negative, to the private sector is revealed. Subsequent to the revelation of the productivity shock private employers and workers form expectations regarding the location, and hence accessibility of public works programmes ex-post, and private employment contracts are signed. Finally, having observed private employment, the government decides on the location of public works programmes and other benefits, and thus determines the disposable income of workers who seek public employment. In effect, with ex-post discretion on the location of public employment the government can act to either ration or encourage public works employment. During times when the productivity shock is positive, a location for public employment can be so chosen as to make the transportation cost high, and hence disposable income low from public employment while the opposite can be true when productivity shocks are negative. In this latter vein, it is worth noting that in the event where the agricultural sector specifically is exposed to a large negative shock, public works programmes can be instituted and productive assets created, to directly to dampen the level of unemployment in the agricultural labour market.

In the presence of labour market imperfections, an employment guarantee can improve both efficiency and equity. The key trade off is between the unemployment benefit nature of the wage offered, and the contestability introduced into the labour market because of the employment guarantee. A conceptual cut at these issues reveals the key importance of the discretion embodied in the location of public works projects and various on-site benefits that can be made available to workers. While often seen as being “merely” operational in nature, our argument shows that they are the counterpart to central features of the conceptual argument on the efficacy of employment guarantees.

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