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Column: India's other missing middle

Nirvikar Singh | Updated: Nov 21 2013, 00:00 IST

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The idea of a missing middle in India typically refers to the relative paucity of mid-sized firm. India has many very small firms, and a few very big ones (by Indian standards), but the small ones tend not to grow. This characteristic raises a host of questions about the efficacy of government policy and policy thinking, since it is the growth of firms that creates new jobs, and new jobs are sorely needed in India. But there is also a new angle on the missing middle, which looks at how economic activity is geographically distributed. Here, the missing middle is the lack of growth in medium density clusters of economic activity. The big cities and now the villages (especially those connected by new roads) may be doing well—though starting from different bases—but the challenge for future growth will lie in India's towns and smaller cities.

Klaus Desmet, Ejaz Ghani, Stephen O'Connell, and Esteban Rossi-Hansberg have recently analysed how employment density in India in the year 2001 was related to employment growth over the subsequent five years. Employment density is closely related to city size, with the big metros having the highest densities. In the case of manufacturing, the pattern they found suggested that subsequent growth was, on average, higher the lower the initial employment density. This pattern is indicative of employment spreading out to smaller cities and towns (with lower initial densities). It is what we would observe if the disadvantages of increased congestion outweigh the advantages of clustering in a

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location that already has infrastructure, both physical and social.

However, manufacturing in India is a small, anaemic sector of the economy. Fixing its problems relates to the first kind of missing middle, that of the size distribution of firms. The country's growth has relied heavily on the services sector. Here, the evidence from India is different. In services, initial employment density—that is either low or high—is associated with subsequent employment growth, but this is not so much the case for the medium-density clusters. This result holds for informal as well as formal sector firms, and contrasts with the pattern for the United States and China, where one sees a dispersion of economic activity. India's second and third tier cities are not generating as many jobs as one might expect as the country grows richer.

Does increased geographic concentration matter? There are a couple of reasons for concern. One is the strain on the physical and social infrastructure of the big metros. But all towns and cities have to deal with this as they grow. Another, perhaps more important, is that the metros are distant in many ways from India's rural majority. Their first step to climbing up the economic ladder may be interaction with the economies of towns close to their villages. This is what emerges, for example from the analysis of Shilpa Aggarwal, which I discussed in my last column (FE, A road to development, goo.gl/lyRsgI). If that first step is a limited one, with few and low quality employment opportunities, building rural roads may not do much for inclusive growth.

Indeed, the four authors of the study of India's employment geography take a close look at what holds back India's medium-density clusters, and the results are clear and striking. In explaining the advantage of India's big cities over the second tier, access to basic utilities such as tap water or toilets does not matter. There are only two things that explain what is happening. One is the percentage of population with higher than secondary-level education. The other is the percentage of people with access to telecommunication services. In the latter case, one can conjecture that the lack is not that of mobile phone service, which has penetrated India deeply, but rather the availability of reliable broadband infrastructure and services that such infrastructure makes possible.

The lesson that I would draw from these results is that India's policymakers, sitting in the capital, may have a blind spot with respect to their country. They may see the possibilities for cutting-edge economic growth in cities which are already dense with India's best and brightest, and where investment flows naturally. They may see the needs of India's villages, where poverty is the most pervasive, and where the big blocks of votes are. But they may not see the potential of the country's second and third tier cities and towns, which form the crucial rung in the ladder of India's growth. If they did, they would focus attention on increasing the economic potential of these clusters.

Indeed, the problem lies partly with centralisation: the view from the state capitals is likely to be clearer and more balanced. If states were given funds and clear mandates to develop telecommunications infrastructure and increase access in targeted medium-density clusters, one might begin to break the barriers that hold them back. Of course, there is no magic bullet, and the governance capacity of these cities and districts needs to be built up for sustainable economic growth. But paying attention to the problem is a start.

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