

# **Competitive Environment, Wage Inequality and Efficiency of the Indian Economy**

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**Abstract:** A simple two-period dynamic frontier-general equilibrium model is used to evaluate wage inequality between skilled and unskilled labour and efficiency of the economy over the years 1994 and 2002. A competitive environment is simulated, where competitive wages reflect labour productivities. The annual returns to education are calculated. The productivity inequality is significantly higher than the wage inequality in the initial period and lower in the second period. However, productivity inequality would narrow down with a high elasticity of substitution in the initial period. This is because the skilled wage remains below its productivity in the first period and above in the second period. Trade efficiency is crucial for raising the productivity of skilled labour above the wage in both the periods. However, due to human capital formation the productivity of skilled labour remains below the wage in the second period. The economy performs almost at 90 and 50 percents of its potential in both the periods. Lack of trade efficiency is responsible for a lower efficiency of the economy. Larger accumulations of human and physical capitals, not being matched by enough demand in the second period are also crucial in reducing the efficiency. Competitive pressure would remove the existing inefficiencies of the economy.