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Economics of Caste in India

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Abstract

The caste system in India represents one of the most enduring and economically significant forms of social stratification in the world. This paper provides a comprehensive analysis of the economic dimensions of caste, examining its role in labour markets, entrepreneurship, education, and political economy. Drawing on theoretical frameworks from institutional economics and empirical evidence from contemporary India, the paper argues that caste persists as a fundamental structuring force in the Indian economy through multiple channels: discrimination in labour markets, network-based resource allocation, occupational segregation, and the intergenerational transmission of economic advantage. The paper synthesizes findings from recent scholarship to demonstrate that caste-based economic discrimination imposes significant efficiency costs on the Indian economy while creating durable inequalities that affirmative action policies have only partially addressed. The analysis contributes to broader debates about the relationship between cultural institutions and economic development, challenging modernization theories that predict the automatic erosion of traditional social hierarchies with economic growth.

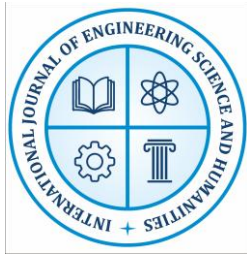
Key words: Caste, economics, labour market, discrimination

1. Introduction

Few social institutions have shaped economic outcomes as profoundly as the caste system in India. Despite constitutional abolition in 1950 and seven decades of economic modernization, caste continues to influence economic opportunities, resource allocation, and life outcomes for over a billion people. The economics of caste has emerged as a critical area of inquiry, illuminating how ascriptive identities intersect with markets, institutions, and policy.

Contemporary economic research on caste has moved beyond simplistic narratives of tradition versus modernity. Scholars now recognize that caste operates not merely as a cultural residue of pre-industrial society but as an active force shaping economic dynamics in India's rapidly globalizing economy. This paper reviews and synthesizes this growing body of evidence, examining how caste structures economic life across multiple domains.

The paper proceeds as follows. Section 2 provides a theoretical framework for understanding the economics of caste, drawing on the work of Akerlof (1976), Munshi (2017), and others. Section



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3 examines caste in the labour market, including discrimination, networks, and migration patterns. Section 4 analyses caste and entrepreneurship, focusing on the role of caste networks in business formation and resource allocation. Section 5 addresses caste and education, including the impact of affirmative action. Section 6 examines caste in politics and local governance. Section 7 considers the persistence and transformation of caste institutions in the contemporary economy. Section 8 concludes with policy implications.

2. Theoretical Foundations

The caste system can be understood as an economic institution that allocates resources, defines property rights, and structures market participation based on birth rather than individual productivity. Ambedkar (1936) recognized that the economic organization of the caste system was based on the division of the population into a hierarchical order that determined economic rights by birth. This created a system of "forced exclusion" that restricted lower castes to the most despised occupations and the lowest wages.

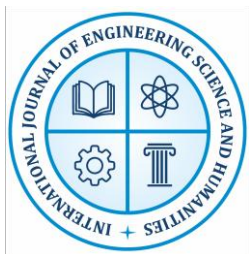
Akerlof's (1976) foundational contribution modelled caste as a system of mutual expectations in which deviations from caste norms are punished through social ostracism, creating a self-reinforcing equilibrium. This framework explains why caste persists despite its economic inefficiencies: individuals face strong incentives to conform because others are doing so. The cost of deviation includes loss of network benefits, social isolation, and economic penalties.

Munshi (2017) extended this analysis by emphasizing the role of caste-based networks in solving market imperfections. The caste system's social architecture—endogamous groups spread over wide areas with dense internal ties—creates exceptionally large and well-functioning networks for insurance, job search, and business support. These networks reduce transaction costs and provide services that formal markets fail to deliver efficiently. However, this internal cooperation comes at a cost: it excludes outsiders and can lock members into traditional occupations.

Recent scholarship has challenged the dichotomy between caste and market as separate spheres. Mosse (2019) argues that the modern market economy does not simply erode caste but is itself structured by caste relations. Rather than markets replacing caste as a coordinating mechanism, caste transforms itself to operate through market processes. This perspective draws on Bourdieu's insight that economic behaviour is influenced by the understanding people have of the economic order, and that this understanding is shaped by socially deposited dispositions or 'habitus'.

3. Caste in the Labor Market

Evidence of caste-based discrimination in Indian labour markets is extensive and persistent. Thorat and Newman (2007) provide a comprehensive framework for understanding caste discrimination, distinguishing between active exclusion (deliberate denial of opportunities) and passive exclusion (discouragement and lower self-confidence leading to poor performance).



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Experimental evidence demonstrates that discrimination persists even when qualifications are identical. Thorat and Attewell (2007) conducted a correspondence study in which equally qualified applicants with caste-signalling names received systematically lower callback rates, with the effect being particularly pronounced for Scheduled Caste and Muslim applicants. This finding has been replicated across multiple settings and time periods.

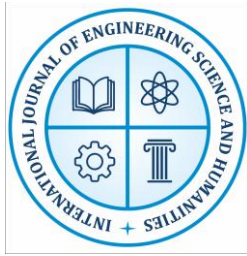
Caste continues to shape occupational distribution, with lower castes concentrated in casual labour and stigmatized occupations. Analysis of National Sample Survey data shows that scheduled castes and scheduled tribes earn significantly less than upper castes, with a wage penalty of approximately 15% after controlling for human capital and other characteristics. In rural Punjab, SC workers are disproportionately engaged in low-status, low-rewarding traditional caste occupations, and are more likely to engage in casual work than non-SC workers.

Munshi and Rosenzweig's (2006) seminal work demonstrates how caste networks simultaneously facilitate and constrain labour mobility. In Bombay, networks of lower-caste men controlled blue-collar occupations for generations, providing access to jobs and social insurance. However, these networks also prevented the next generation from moving into white-collar jobs following economic liberalization in the 1990s. Boys in these communities were channelled into vernacular-language schools linked to traditional blue-collar networks, while girls—who were not part of these networks—were free to access high-return English-medium education. This creates a dynamic inefficiency: networks that facilitated mobility for one generation can become obstacles for the next. The persistence of this pattern reflects the strength of caste identity and the sanctions against those who defect from traditional occupations.

Munshi and Rosenzweig (2016) develop a model explaining India's exceptionally low rural-urban migration rates despite large wage differentials. The key insight is that households participating in rural caste-based insurance networks face a loss of network services when members migrate. Because caste networks provide crucial consumption smoothing, the foregone insurance benefits offset the income gains from migration. Counterfactual simulations suggest that improving formal insurance would have a substantially larger effect on migration than increasing wage differentials. This finding has important implications for understanding the persistence of caste-based institutions. Well-functioning informal networks can paradoxically impede development by reducing mobility, even as they provide valuable services that formal institutions have not yet replaced.

4. Caste and Entrepreneurship

Historical evidence reveals substantial caste-based patterns in business ownership. In 1911, trading castes dominated industrial ownership in Northern and Western India, while Brahmins played a significant role in Eastern and Southern regions. Lower service castes and tribal



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communities were almost entirely absent from large-scale factory ownership. This historical legacy continues to shape contemporary patterns. Varna-based occupational categories (Brahmins, Kshatriyas, Vaishyas, Shudras) traditionally associated with specific economic roles continue to influence entrepreneurial opportunities. Dalit entrepreneurs are concentrated in stigmatized or shunned markets—leather, sanitation, waste recycling—and face barriers to entry in more profitable sectors.

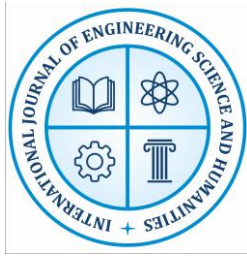
Caste networks play a crucial role in business formation and success. Banerjee and Munshi (2004) demonstrate that capital fails to cross caste boundaries in the Tirupur garment industry, creating a misallocation of resources. Gounder entrepreneurs (a wealthy farming caste) have cheaper access to capital but lower ability than outsiders. Yet capital does not flow from the Gounders to the more productive outsiders because commitment problems preclude such trade across caste lines. Similarly, Anderson (2011) finds that caste is an impediment to trade in groundwater for irrigation in North Indian villages. Lower-caste water buyers have access to significantly more irrigation, and consequently higher agricultural yields, when they reside in villages where water sellers are predominantly of their own caste rather than upper-caste dominated villages.

Dalit entrepreneurs face specific constraints beyond general capital market discrimination. Jodhka (2010) finds that Dalit business owners in Haryana and western Uttar Pradesh face consumer discrimination, especially in sectors like food, health, and education-related businesses. Many attempt to hide their caste identity to avoid discrimination. Despite these obstacles, Dalit entrepreneurship has increased post-liberalization, though largely concentrated at the lower end of the business spectrum.

5. Caste and Education

Caste significantly shapes educational outcomes. Scheduled Castes and Scheduled Tribes have historically lower enrolment and attainment, though substantial convergence has occurred in recent decades. Hnatkovska, Lahiri, and Paul (2012) demonstrate significant convergence in education, occupations, income, and consumption between SC/ST and non-SC/ST households over the 1983-2005 period. However, substantial gaps remain. The education deficit for SC/ST households remains as large as two years of schooling. Moreover, caste-based discrimination within educational institutions persists, as evidenced by a 118.4% increase in caste discrimination complaints in higher education institutions between 2019-20 and 2023-24.

India has implemented one of the world's most aggressive affirmative action programs, reserving positions in higher education and government employment for historically disadvantaged groups. The evidence on its effectiveness is mixed but generally positive. Bertrand, Hanna, and Mullainathan (2010) find that while affirmative action does bring in weaker students at the



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margin, lower-caste students do benefit from attending engineering college, despite the mismatch with upper-caste peers. Bagde, Epple, and Taylor (2016) find that affirmative action improves college performance for reserved groups by improving the quality of colleges to which they gain access. However, reservation policy has not fully addressed economic disparities. Cassan (2017) finds that affirmative action increased school enrolment for SC boys but not girls, reflecting the complex interaction between caste and gender.

Deshpande (2018) finds that the return on education is lower for Dalits than for upper castes, consistent with labour market discrimination. In Delhi, upper-caste graduates who used networks in job searches did better than those who did not, while Dalit graduates who used caste networks did worse than those who did not. This suggests that caste networks may not be effective for upwardly mobile Dalits.

6. Caste in Politics and Local Governance

Caste has played a central role in Indian democratic politics since independence. Political parties have organized vote banks around caste, delivering public resources to specific castes in return for electoral support. The rise of caste-based parties in the late 1980s further entrenched this pattern.

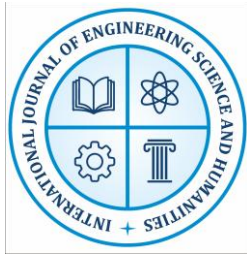
Munshi and Rosenzweig (2017) examine the role of caste in local governance, finding that public goods provision is suboptimal because cooperation is restricted to the elected representative's caste. The representative supplies a non-excludable public good but internalizes only the benefit accruing to their own caste, leading to under-provision for the broader constituency. Counterfactual simulations indicate that full cooperation across castes would dramatically improve public goods provision.

Political reservation for SCs and STs has had substantive impacts. Pande (2003) finds that reservation increases the allocation of public resources to historically disadvantaged groups. ST reservation substantially increased per capita state government spending and reduced poverty. However, the effects of SC reservation are more limited, suggesting important differences between these groups.

7. The Persistence and Transformation of Caste

Contrary to modernization theory, caste has not disappeared with economic development. Mosse (2019) argues that the association of modernity with the market economy and caste with tradition is a discursive construction that obscures caste's role in contemporary economic processes. The market economy does not simply erode caste but is itself structured by caste relations.

Caste endogamy persists at remarkably high rates. Nearly 95% of marriages in India remain within caste, with minimal decline over 70 years of constitutional democracy. This is critical because endogamy reinforces caste networks, maintaining the social boundaries that underpin



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economic institutions. Banerjee et al. (2013) find that even among urban, well-off, highly educated Indians, 70% marry within their caste, suggesting that the cost of marrying outside is typically low because observed matching is close to what individuals would want based on characteristics other than caste.

Caste operates not just through material discrimination but also through cultural mechanisms. Hoff and Pandey's (2006) experimental research demonstrates the "stereotype threat" effect: making caste identity salient reduces the performance of low-caste boys, even when they have equal ability to high-caste boys. This suggests that caste discrimination can become self-fulfilling, with stereotypes creating performance gaps that validate the original stereotypes.

While affirmative action has had positive impacts, it has not eliminated caste-based economic inequality. Chaudhary, Roy, and Swamy (2026) conclude that India's affirmative-action policies addressing caste, tribe, and gender disparities are "necessary, but not sufficient, to lower the influence of the lottery of birth on individual outcomes". The persistence of caste inequality despite extensive policy intervention reflects the deep embedding of caste in social, economic, and political institutions.

8. Conclusion

The economics of caste in India presents a complex picture of persistence and change. Caste continues to structure economic life through multiple channels: discrimination in labour markets, network-based resource allocation, occupational segregation, and the intergenerational transmission of economic advantage. While economic development and affirmative action have reduced some disparities, substantial inequalities remain.

The persistence of caste despite its economic inefficiencies can be explained by several factors. First, caste networks provide valuable services that formal institutions fail to deliver efficiently, including insurance, credit, and job search assistance. Second, caste operates as a focal point for coordination, with individuals facing strong incentives to conform because others are doing so. Third, caste has cultural dimensions that shape cognition and behaviour in ways that persist even when formal barriers are removed.

Understanding the economics of caste requires moving beyond dichotomies of tradition versus modernity or culture versus market. Caste is not simply a remnant of pre-industrial society but an active force shaping contemporary economic dynamics. Policies to address caste-based inequality must therefore go beyond formal legal equality and affirmative action to address the deep embedding of caste in social and economic institutions.

Future research should examine the conditions under which caste networks weaken, the interaction between caste and other forms of inequality (particularly gender and class), and the potential for technological change to disrupt caste-based economic structures. The finding that



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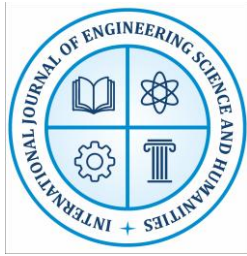
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digital skills yield higher returns for Scheduled Castes and Scheduled Tribes than for other groups suggests one promising avenue for reducing caste-based inequality. However, the overall trajectory will depend on the broader political economy of caste and development in India.

The central challenge for India remains the transformation of an economy in which the accident of birth continues to shape economic opportunities as powerfully as it did centuries ago. The persistence of caste as an economic institution, despite extensive policy intervention and economic change, underscores the depth of its embedding in Indian society and the scale of the challenge that lies ahead.

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