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India's Job Creation Challenge

Three years into office, India's Prime Minister Narendra Modi is yet to deliver on his campaign promise of creating jobs for the millions of youth who are flooding the labour market each year. Although the recent discourse about jobs in India has focussed on the job losses on account of demonetisation of high value currency late last year and the hasty implementation of the Goods and Services Tax earlier in July 2017, the employment problem is deeper and more structural in nature. Even as employment data are deficient and unreliable, there is no doubt that the problem is large and growing. There can be no simple or single solution to a challenge as complex as this – innovative policies and energetic action are needed on a whole range of fronts. Making a headway on solving India's employment problem will remain Modi's most formidable challenge and one that will determine his legacy.

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When India's Prime Minister Narendra Modi's government was up for evaluation as it completed three years in office in May 2017, virtually every report card highlighted the government's dismal performance on the jobs front as Modi's biggest failing.

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Jobs – The Main Plank of Modi's Campaign

This should not be surprising since Modi swept to power in 2014, promising India's poor and middle classes that he would "restore their dignity" after years of swelling inequality, and made job creation central to his economic platform for an "aspirational India". Recent data put out by the country's Labour Bureau show that Modi has not delivered on that campaign pitch. The average annual employment generation in the organised sector in the first two years of the National Democratic Alliance government (2014-15) has fallen to less than half of the average in the last five years of the previous government (2009-13) [See Table 1]. The situation in the unorganised sector is much worse; not only have new jobs not been created, but, in fact, millions of existing jobs have also been lost because of two big ticket policy initiatives of the government – the demonetisation of high value currency in November 2016 and the introduction of a nationwide Goods and Services Tax (GST) in July this year.

Table 1: Changes in Employment in Selected Sectors (in millions)

Year	Q1 Jan-March	Q2 Apr-June	Q3 Jul-Sept	Q4 Oct-Dec	Full Year
2009	0.25	(-) 0.13	0.50	0.64	1.26
2010	0.06	0.16	0.43	0.21	0.86
2011	0.17	0.21	0.31	0.23	0.93
2012	0.08	0.07	–	0.17[2]	0.32
2013	0.11	0.09	0.14	0.08	0.42
2014	0.04	0.18	0.16	0.12	0.49
2015	0.06	(-) 0.04	0.13	(-) 0.02	0.13

Source: India's Labour Bureau

Unemployment – A Structural Problem

It is possible, as the government claims, that the negative impact of demonetisation on jobs will be transient and the teething problems of GST will soon be resolved. Even granting that most of the jobs lost in the unorganised sector will be regained, it will

[2] Combined figure for Q3 and Q4.

amount, at best, to a restoration of the status quo. The much larger and deeper unemployment problem which is structural in nature will still remain a formidable challenge. The ballpark estimates suggest that, annually, about 12-13 million people – or roughly a million a month – join the labour force while the economy is not even able to create half as many jobs. This huge supply-demand imbalance shows not only that the employment problem is huge and growing but that it could also reach explosive proportions.

Data Deficiency

A big problem in addressing India's employment problem is the lack of reliable data. The National Sample Survey shows unemployment in 2011/12, the latest year for which data are available, as 2.2 percent. This is a clear underestimate as it does not take into account disguised underemployment and unemployment. Millions of people engaged in low paid, low productive jobs in the unorganised sector are reckoned as fully employed. Besides, nearly half the country's labour force is 'trapped' in agriculture for want of an alternative and the surplus labour, whose marginal productivity is zero, too is counted as employed. The government, it seems, does not even have hard numbers on employment, let alone hard measures to address the problem. The data deficiency is a problem that Modi inherited, and, to his credit it must be said, that he appointed a task force to study the unemployment statistics and advise the government on improving data capture and analysis.

Growth – A Necessary Condition for Job Creation

For a problem as large and complex as unemployment, there is no simple or single solution. Job creation has to be central to every policy initiative of the government. So, what has to be done?

The most basic requirement and, indeed, a necessary condition, for job creation has to be rapid growth. Development experience from around the world clearly evidences a strong correlation between faster growth and higher job creation, suggesting that the pursuit of employment strategies in a low growth environment can be a futile exercise. Although the ballpark estimates suggest that an additional one percentage point of growth would generate a million jobs, this is not an iron law. The relationship between the growth rate and jobs is non-linear. Besides, the job intensity of growth would depend not just on the quantum of growth but also on the quality of growth. The task for the government, therefore, is to generate not only rapid growth but job creating growth.

Five Point Agenda for Action

The following is a five point agenda that should inform the pursuit of such a job intensive growth.

i. Manufacturing Revolution

First, the manufacturing sector has to be the focus of any employment strategy simply because productivity goes up by a factor of three to four as labour shifts from agriculture to industry. According to the traditional development theory, as countries become rich, they shift from agriculture to industry to services and then graduate to post-modern societies. For some time over the last three decades, it was believed that India defied this traditional development paradigm by jumping straight from agriculture to services, bypassing the manufacturing sector. That leapfrog seems to have caught up with India as it is now evident that the country cannot create jobs in the numbers that it has to without generating a ‘manufacturing revolution’, which explains the Prime Minister’s call for ‘Make in India’.

An inevitable question that arises in the context of ‘Make in India’ is whether the country can replicate the spectacularly successful Chinese model of the export of manufactures to the rich world. That will be difficult simply because the world today is a lot different from the one China faced when it opened up in the 1980s. When China opened up, world demand was expanding at a scorching pace, providing a ready and expanding market for Chinese exports. In contrast, all indications are that rich world growth will remain subdued. Moreover, the China growth model leveraged on offshoring which was then gaining popularity as the preferred mode of production. In contrast, India today is staring at reshoring production back to the industrial countries, given growing protectionism and declining comparative advantage of inexpensive labour in the face of automation and robotics. And then there is the issue of demographics. As industrial countries age, they will consume more services and less manufactures; and services are less tradeable than manufactures, further curtailing the scope for exports.

However, there is no need to despair just because the option of an export-led growth of the Chinese variety is less promising today. India has the advantage of a large domestic market, and at a per capita income of US$1,800 (S$2,450), any increase in income will quickly translate into consumption. The necessary condition for widening and deepening the domestic market is to ensure that the benefits of growth are widely disbursed. That will put the economy on a virtuous cycle, whereby higher consumption will stimulate demand which will spur higher production, faster growth and more jobs.

Within the manufacturing sector, the small and medium enterprise (SME) segment needs special attention because it is more job intensive per unit of capital invested. Such attention has been woefully lacking, giving rise to the problem of the “missing middle”. India has a small number of large capital intensive enterprises and, at the other end, a large number of tiny enterprises, while the middle segment with investment in the range of ₹100-300 million (S$20.75-S$62.25 million) and employing 100-1,000 workers is scarcely populated. It is this SME segment that can adapt technology, improve productivity and be competitive at the global level and, most importantly, create jobs.

What can be done to promote the SME sector? The agenda for action is standard fare. The most important thing to do is to improve the ease of doing business – by way of access to credit, raw materials, markets, reliable and efficient infrastructure and a rule of law. Stringent labour laws which make firing (and therefore hiring) difficult need to be revised so as to make entrepreneurs comfortable about expanding jobs. Indeed some State governments have embarked on labour law reforms although it is too early to see its impact in view of other factors which are presently inhibiting investment. Second, the government has to redeem its promise made two years ago of scaling down corporate tax so as to improve margins, especially for the SME sector. Third, industrial subsidies need to be restructured to shift investor bias away from capital and towards labour. Presently the bulk of industrial subsidies or concessions are based on interest or credit or depreciation. These can be replaced by wage subsidies – subsidies for additional jobs created. These can be designed such that there is no additional fiscal burden.

ii Services Sector

The second area of focus has to be the services sector which accounts for a half of the total non-agricultural employment. The services sector too suffers from the missing middle syndrome as viewed from the productivity dimension. At one end is the high profile, high productivity but relatively small software sector and, at the other end, millions of tiny, low productivity service enterprises in the unorganised sector. Here again, the focus has to be on populating the missing middle in a range of sectors – construction, tourism, health and education, transport and repair and maintenance with sectoral policies that fit into an overarching strategy for job creation.

iii Start-ups

The Prime Minister hit the right button in terms of job creation by giving a call for 'Startup India' whereby entrepreneurial and technically qualified youth are encouraged to start their own enterprises and create jobs rather than seek wage employment themselves. Encouraging start-ups requires an extensive supportive ecosystem by way of tax policies that encourage angel investing and soft credit; a technology infrastructure that facilitates innovation and incubation; and legal infrastructure that mandates and enforces high standards of corporate governance. To be sure, the failure rate of start-ups will be high as this is in the very nature of start-ups. However, the employment generation by the start-ups that survive can be significant. Given that this is a virgin area, there is a lot of slog work and learning by doing as well as extensive counselling and guidance.

iv Skill Formation

The fourth area of focus in job creation has to be skill formation. Currently, only about five per cent of the total workforce has vocational skills and this weak skill endowment is hurting both production and productivity. For nearly a decade now, the government has been involved in an extensive programme to widen the skill base but the results have been disheartening. People who have received skill training have been unable to find jobs, while, paradoxically, businesses complain about not finding skilled personnel to fill jobs. Evidently, there is a mismatch in the demand-supply balance of skills or the model of skilling adopted is flawed, or both. The government recognises that skill is a merit good and, as such, will not attract private investment. The private sector will not be inclined to spend on skill training simply because it cannot be certain of appropriating the benefits of its investment; rival enterprises typically poach away skilled workers. On the other hand, the government, as experience has shown, is an inefficient provider of skills simply because it has no market sense of the demand for skills or any demonstrated expertise in imparting skill training. This dichotomy points to the need for revisiting the public-private partnership model for skill training, and recasting it based on the lessons of experience from around the world.

v Non-crop Agriculture

The final area of focus in job creation, surprising as it might seem, has to be agriculture. It is true, as indicated earlier, that there is huge surplus labour in agriculture, and if agricultural productivity goes up as the government wants it to, tens of millions of labourers will shift out of agriculture who will have to be found jobs in the non-agriculture sectors. Even if the government were to succeed in a job-intensive expansion of the manufacturing and services sectors, it is highly improbable that the entire surplus from the agriculture sector can be found blue and white collar jobs; a significant proportion may have to be accommodated in the agriculture sector itself.

This need not be a hopeless enterprise. The non-crop agriculture – dairy, poultry, other livestock, horticulture and sericulture – offers immense scope for employment expansion. However, this will not happen unless the government intervenes with energetic policies to make corrections for market failures which are inhibiting the growth of these sectors. Two areas need special attention. The first is the development of a wide and robust value chain for processing, storage and distribution. The second is policy and institutional reforms that will encourage collectivisation of farmers to reach minimum scale.

Demographic Dividend and Jobs

In development economics, it is now fashionable to talk about India’s demographic dividend, which is to say that India has a large and growing young population. This young population, especially in a global situation where other rich countries and even emerging economies are experiencing population stabilisation or even population declines, gives India a unique advantage. These young people, it is said, will work, earn, and save which will turn into further investment and then higher growth, putting India on a virtuous cycle of growth and investment.

The important point though is that the demographic dividend is not inevitable; it will materialise if and only if India is able to generate productive jobs for the hundreds of millions of youth who are flooding the labour market. That will remain Modi’s most formidable challenge. It will also determine his legacy.

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