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INDIA’S JOBS CRISIS, THE MACROECONOMIC REASONS

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‘The Indian economy has historically been characterised by the presence of both open unemployment as well as high levels of informal employment’ | Photo Credit: The Hindu

There are many indications everywhere that India continues to be going through a jobs crisis. Official data sources as well as many on-the-ground reports point to this fact. What are the macroeconomic reasons for this crisis?

At the outset, it is useful to distinguish the two types of employment that prevail in an economy such as India. The first is wage employment which is a result of labour demanded by employers in their pursuit of profits. The second is self-employment where labour supply and labour demand are identical, i.e., the worker employs herself. A further useful distinction can also be made between wage labour and jobs. The first includes all forms of labour done for an employer including daily wage work at one extreme and highly paid corporate jobs at the other. But, jobs generally refer to relatively better paid regular wage or salaried employment. In other words, all jobs are wage labour, but all wage labour cannot be called jobs. When we speak of a jobs problem, we are speaking of inadequate labour demand particularly for regular wage work.

The Indian economy has historically been characterised by the presence of both open unemployment (out of work job-seekers) as well as high levels of informal employment consisting of the self-employed as well as casual wage workers. The last is also called “disguised unemployment” because, being similar to open unemployment, it also indicates a lack of adequate employment opportunities in the formal sector.

This lack of opportunities is reflected by a more or less stagnant employment growth rate of salaried workers in the non-agricultural sector in the last four decades. What explains such constraints in the labour demand of formal sector?

The labour demand in the formal non-agricultural sector is determined by two distinct factors. First, since firms in the formal sector hire workers to produce output for profit, labour demand depends on the amount of output that firms are able to sell. Under any given level of technological development, labour demand in the formal sector rises when demand for output rises. Second, labour demand depends on the state of technology that dictates the number of workers that firms need to hire to produce one unit of output. Introduction of labour-saving

technologies enables firms to produce the same amount of output by hiring a lower number of workers.

Since economic policy is generally framed in terms of output growth (think of GDP or value-added), rather than the level of output, let us examine this argument in terms of growth rates. Employment growth rate is determined by the relative strength of two factors — the output growth rate and the labour productivity growth rate (growth rate of output per worker). If labour productivity growth rate does not change, higher output growth rate increases employment growth rate. In other words, policies that promote higher economic growth would also achieve higher employment growth. On the other hand, if labour productivity growth rate rises, employment growth rate falls for a given output growth rate.

In India, the employment growth rate of the formal and non-agricultural sector remained unresponsive despite a significant rise in the GDP growth rate and the value added growth rate during the 2000s as compared to the decade of the 1980s and 1990s. The lack of responsiveness of employment growth rate to changes in output growth rate reflects a phenomenon of jobless growth. It indicates a strong connection between labour productivity growth rate and output growth rate. Why should this be the case?

As an economy grows, it is generally seen that it also becomes more productive. That is, in the process of producing a greater amount of total output, firms become capable of producing more output per worker. This happens because of what economists call “economies of scale”. As firms produce more output, they find it easier to adopt labour-saving technologies. But the extent to which labour-saving technologies are introduced depends on the bargaining power of labour.

We can make a distinction between two types of jobless growth regimes based on the tightness of the connection between output growth and labour productivity growth.

In the first case, the responsiveness of labour productivity growth rate to output growth rate is weak. The possibility of jobless growth in this case emerges exclusively on account of automation and the introduction of labour-saving technology. But employment growth rate in such regimes would necessarily increase if output growth rate happens to increase. Under weak responsiveness of labour productivity, the positive effect of GDP growth rate on employment would dominate over the adverse effect of labour-saving technologies. Here, the solution to the jobs crisis is just more rapid economic growth.

In the second case, which happens to be the Indian one, the responsiveness of labour productivity growth rate to output growth rate is high. Here, the positive effect of output growth rate on employment fails to counteract the adverse effect of labour-saving technologies. Employment growth rate in such regimes cannot be increased simply by increasing GDP growth rate.

The extent to which labour productivity growth rate responds to output growth rate is reflected by what is termed as the Kaldor-Verdoorn coefficient. In a recent working paper (by us), we show that India’s non-agricultural sector is characterised by a higher than average Kaldor-Verdoorn coefficient, as compared to other developing countries. It is this distinct form of jobless growth regime in India that makes India’s macroeconomic policy challenge qualitatively different from other countries.

The central contribution of the Keynesian revolution in macroeconomics was to highlight the role of aggregate demand as the binding constraint on employment. Fiscal policy was perceived to increase labour demand by stimulating output. The developing countries that inherited a dual economy structure during their independence, confronted additional constraints on output. The

Mahalanobis strategy identified the availability of capital goods as the binding constraint on output and employment, putting forward the policy for heavy industrialisation. The structuralist theories based on the experiences of developing countries highlighted the possibility of agrarian constraint and the balance of payment constraints. Both these constraints led to key policy debates in India, particularly during the decade of the 1970s and early 1990s. Nonetheless, what remained common to all these different frameworks was the presumption that increasing the output growth rate in the non-agricultural sector would be a sufficient condition for increasing the employment growth rate in the formal sector.

But the evidence suggests that the employment challenge can no longer be met only through more rapid GDP growth. Rather, a separate policy focus is needed on employment in addition to the focus on GDP growth.

Such employment policies will need both demand side and supply side components. For example, to the extent firms in India find it easier to automate due to a lack of adequate skilled labour, increasing the quality of the workforce through better public provisioning of education and health care, as well as bridging the skills gap, are important. On the demand side, direct public job creation will be needed.

Financing such expenditures while maintaining debt-stability requires the reorienting of the current macroeconomic framework in a significant way, including increasing the direct tax to GDP ratio by reducing exemptions and improving compliance, and a more imaginative use of macro-policy to pursue a constructive employment agenda.

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