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Ajit K. Ghose

India Employment Report 2016

Challenges and the Imperative of Manufacturing-Led Growth

INSTITUTE FOR HUMAN DEVELOPMENT

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OXFORD
UNIVERSITY PRESS

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Foreword

The *India Employment Report 2016* is the second in the series of biennial publications on issues of labour market and employment in India by the Institute for Human Development. The *India Labour and Employment Report 2014: Indian Workers in the Era of Globalisation* was the first in the series and the first of its kind on development and employment issues in India. It provided a comprehensive view of the employment situation in the country and analysed the labour market developments in the wake of the globalization of India's economy. The report has been widely welcomed and circulated. The present report, *India Employment Report 2016: Challenges and the Imperative of Manufacturing-Led Growth*, follows up on the earlier one and carries the analysis further.

This report provides an in-depth review of the evolving characteristics of India's labour force, develops new tools for a sharp analysis of the change in employment conditions in the first decade and a half of the twenty-first century, and gives a concrete view of the employment challenge that confronts India today. It goes on to identify the kind of growth strategy that would enable India to meet the employment challenge and to elaborate on the policy interventions that would be required for the pursuit of such a growth strategy. Some of the key messages of the report are as follows. Despite substantial improvement in the last decade and a half, employment conditions in India remain poor. The employment challenge, therefore, remains formidable: around 16 million 'new and better' jobs per year will need to be created over the next decade and a half if India's economy is to reach the Lewis Turning Point (the point at which surplus labour has disappeared) at the end of the period. The good news is that, though the challenge seems daunting, it can be met if a strategy of rapid manufacturing-led growth is pursued. From this perspective, the current strategy of the government, as articulated in the 'Make in India' programme, appears to have been well chosen.

It is hoped that the report will stimulate analytical work on labour markets and employment, help focus attention on the need to make employment a central objective of growth, and contribute to development of policies required to achieve appropriately employment-intensive economic growth.

Alakh N. Sharma
Professor and Director
Institute for Human Development
New Delhi

Acknowledgements

The author is indebted to Abhishek Kumar who provided very able research assistance throughout the period of preparation of this report. Thanks are also due to Shipra Nigam for her helpful research assistance and to Balwant Singh Mehta (Institute for Human Development [IHD], New Delhi) for his help with data.

Usha Tankha did a great job of editing, eliminating many errors, and hugely improving the readability of the report.

Sriprakash Sharma (IHD) provided efficient production support in preparing the manuscript. Jyoti Girish (IHD) and Priyanka Tyagi (IHD) provided support in a variety of ways.

Throughout the period of preparation of the report, Alakh N. Sharma (Director, IHD) not only did everything to facilitate the work but also remained a constant source of advice.

Dipak Mazumdar (Visiting Professor, IHD; formerly of the University of Toronto, Canada), Sudipto Mundle (Professor Emeritus, National Institute for Public Finance and Policy, New Delhi), Gerry Rodgers (Visiting Professor, IHD; formerly of the International Labour Organisation [ILO], Geneva), and Ashwani Saith (Professor Emeritus, Institute for Social Studies, The Hague) read some or all of the draft chapters and provided very helpful comments and suggestions. Helpful comments and suggestions were also received from two unknown referees of the Oxford University Press.

The initial ideas and plan for the report were presented at a session of the 56th Conference of the Indian Society of Labour Economics (ISLE) held in December 2014 in Ranchi, Jharkhand. The main findings and arguments of the report were presented at a special session of the 57th Conference of the ISLE held in October 2015 in Srinagar and again at the South Asia Research Network Workshop 'Meeting the Challenge of Employment and Inclusive Growth in South Asia' held in October 2015 in New Delhi. On these occasions, the author received helpful comments and suggestions from many persons, including T.C.A. Anant (Chief Statistician, Government of India), Achin Chakraborty (Institute of Development Studies, Kolkata, West Bengal), Subesh K. Das (Principal Secretary, Planning and Additional Chief Secretary, Government of West Bengal), S. Mahendra Dev (Indira Gandhi Institute of Development Research [IGIDR], Mumbai, Maharashtra), B.N. Goldar (Institute of Economic Growth, New Delhi), Sushil Khanna (Indian Institute of Management Calcutta, West Bengal), K.P. Kannan (formerly Director, Centre for Development Studies, Thiruvananthapuram, Kerala), Noorani Naushad (Senior General Manager (Group HR) Organisation Development at Mahindra & Mahindra), Deepak Nayyar (Professor Emeritus, Jawaharlal Nehru University [JNU], New Delhi), late T.S. Papola (Institute for Studies in Industrial Development, New Delhi), Selim Raihan (University of Dhaka, Bangladesh), K.V. Ramaswamy (IGIDR, Mumbai, Maharashtra), D.N. Reddy (formerly Professor and Dean, Faculty of Social Sciences, University of Hyderabad, Telangana), Chandra Prakash Singh (National Secretary, Indian National Trade Union Congress), Ashwani Saith, Abhijit Sen (formerly Professor, JNU; Member, Planning Commission, Government of India), Ajay Shankar (formerly Secretary, Department of Industrial Development and Policy, Government of India), Ravi Srivastava (JNU, New Delhi), J.J. Thomas (Indian Institute of Technology, New Delhi), and Sher Verick (ILO, New Delhi).

The author greatly benefited from many informal discussions he had with Sheila Bhalla (Visiting Professor, IHD and Professor Emeritus, JNU, New Delhi), Amitabh Kundu (Visiting Professor, IHD; formerly Professor at JNU, New Delhi), Dipak Mazumdar, Dev Nathan (IHD), late T.S. Papola, Gerry Rodgers, Janine Rodgers (Visiting Senior Fellow, IHD), Preet Rustagi (IHD), Sandip Sarkar (IHD), Abhijit Sen, Alakh N. Sharma, Atul Sharma (Visiting Professor, IHD; formerly Professor at the Indian Statistical Institute, New Delhi), and Sher Verick.

The work on the report was supported by funding from the International Development Research Center (IDRC), Canada. Edgard Rodriguez of the IDRC went much beyond his responsibility in encouraging and facilitating this work.

The team at Oxford University Press India expedited the process of publication.

To all of them my sincere thanks.

Executive Summary

The *India Employment Report 2016* addresses two issues of prime importance. What is the nature of the employment challenge that confronts India? What kind of economic growth is required to meet this challenge? The characteristics of India's labour force are examined and recent trends in employment conditions as well as the current scenario are analysed. The historical experience of development and India's chosen development path are scrutinized in an attempt to determine the growth strategy that will allow the employment challenge to be met.

LABOUR FORCE

India today has a labour force of 473 million (leaving out subsidiary workers who number 37 million). This labour force is overwhelmingly (91 per cent) of working-age (aged 15–59 years), largely male (78 per cent), and predominantly rural (68 per cent). Some 2 million children (aged less than 15 years) are still in the labour force and there are about 39 million older workers (aged 60 years or more).

Deceleration of labour force growth

The growth of the labour force has been decelerating; the average annual rate of growth fell from 1.8 per cent during 1983–1999/2000 to 1.4 per cent during 1999/2000–2011/12. One reason has been the rapid decline in child labour with the decline in poverty. Most importantly, however, the growth of the working-age labour force has been decelerating; the average annual rate of growth fell from 1.9 per cent during 1983–1999/2000 to 1.5 per cent during 1999/2000–2011/12. The main reason for this has been the falling labour force participation of working-age women.

Decline of female labour force participation

What explains the declining labour force participation of working-age women? It is not their participation in education, though this has been growing. The labour force participation of non-student working-age women also shows a declining trend. The decline is due to rising household incomes, as illiterate and near-illiterate women from the poorest households withdraw from poor-quality jobs (mainly casual labour and unpaid family work in agriculture).

No youth bulge or demographic dividend

This has been as true for younger as for older women, which explains why the demographic transition has had no effect on the labour force. While the share of youths (age group 15–24 years) in the working-age population was rising between 1983 and 1999/2000, their share in the working-age labour force was actually falling; the 'youth bulge' in the population did not translate into a 'youth bulge' in the labour force. Consequently, even the theoretical possibility of a 'demographic dividend' never arose. In fact, the dependency ratio (ratio of total population to total labour force) steadily increased from 2.6 in 1983 to 2.8 in 2011/12.

Ill-equipped labour force

India's labour force is poorly educated. It is not just that the average level of education is abysmally low but the distribution of education across the labour force is also highly distorted. While a disproportionately large section has little or no education, a disproportionately large section also has tertiary education. It follows that a disproportionately small section has secondary and higher secondary education. While education is not the same as skill, education is what enables workers to acquire new skills with ease, whether on the job or through participation in training programmes. Thus, the current education profile of the workforce actually restricts movement of workers from traditional to modern jobs. This is an outcome of India's misguided education policies in the past, which have paid too little attention to basic education for all and too much attention to higher education for a few.

EMPLOYMENT CONDITIONS

Neither the current state nor the past evolution of employment conditions in India can be read from the standard indicators of employment and unemployment. In the Indian economy, employment growth tends to equal labour force growth. Unemployment, which is small and stable, reflects queuing for 'good' jobs in the organized sector by educated youth from relatively well-off households. Wages are not formed through demand–supply equilibrium; hence, wage growth does not indicate tightening labour markets. During 1999/2000–2011/12, both labour force and employment grew at 1.5 per cent per annum, the unemployment rate was stable at around 3 per cent, unemployment was significant only for young persons with at least secondary education, the unemployed were less poor than the employed, and labour supply was always in excess of labour demand in markets for wage labour.

To assess changes in employment conditions, attention needs to be focused on a different set of indicators—structure of employment—a change in which indicates movement of workers across different types of employment; underemployment, a change in which indicates change in the quality of a given type of employment; and labour income, a change in which also indicates change in the quality of a given type of employment.

Assessing change in employment conditions

There are six types of employment in India's economy as also in each of the production sectors (agriculture, manufacturing, construction, other industries, and services). Ranked in descending order of quality, these are: regular-formal employment in the organized sector; regular-informal employment in the organized sector; regular-informal employment in the unorganized sector; self-employment in the unorganized sector; casual employment in the organized sector; and casual employment in the unorganized sector. The structure of employment refers to the distribution of workers across these different categories. Employment conditions improve when workers move from lower quality to higher quality jobs, or when there is favourable change in the structure of employment. This report develops a summary indicator of this kind of change, namely the employment structure index, a rise in the value of which indicates favourable change in the structure of employment.

Workers in several types of employment, particularly in casual wage employment and in self-employment, do not have full-time work; they are underemployed. A decline in underemployment in any given type of employment indicates quality improvement in that type of employment in so far as it means increased earning per worker for a given level of earning per unit of labour. To track this kind of change, the report develops an empirical measure of underemployment.

A rise in earning per unit of labour from a given type of employment—wage earning from wage employment and non-wage earning from self-employment—also indicates quality improvement in that type of employment in so far as it means increased earning per worker for a given level of employment. To track this kind of change, methods of wage determination are examined and estimates of labour incomes in different types of employment are developed.

Overall improvement in employment conditions results from a combination of favourable changes in the structure of employment and quality improvement in different types of employment. The report uses this framework to assess the changes that occurred in overall employment conditions, in gender inequality in employment, and in rural–urban inequality in employment.

Surplus labour

This assessment is of the changes in employment conditions of the principal workers (persons engaged in, seeking, or available for full-time work). There are many (mainly women), however, who seek work only intermittently (subsidiary workers) or stay out of the labour force altogether, essentially because they cannot hope to find adequately remunerative full-time or even part-time work. If job opportunities grow, many of them would become principal workers. In other words, there exists, at any given point of time, a stock of workers, who are either in subsidiary employment or out of the labour force but who are potentially available for full-time employment in new jobs. The size of this stock can also be considered an aspect of employment conditions. It is particularly important to take account of this stock in defining the employment challenge that confronts India. With this in view, the report develops estimates of surplus labour, that is, stocks of surplus workers.

Improvement in employment conditions during 2000–12

The basic conclusion that emerges from the analysis in the report is that employment conditions improved very substantially during 1999/2000–2011/12. There was favourable change in the structure of employment; the employment structure index showed a significant rise. There was movement of workers from poorer to better jobs: from informal to formal jobs, from casual employment to regular employment, and from wage employment in the unorganized sector to wage employment in the organized sector. Moreover, underemployment of the employed declined in all types of employment. In addition, labour incomes grew in real terms in most types of employment. Thus, there was significant overall quality improvement.

A notable development was the growing importance of 'informal' employment (regular-informal employment and casual employment) in the organized sector, which shows up in a decline in the value of the employment structure index for the organized sector. This did not mean a deterioration in employment conditions in the organized sector since wages rose and underemployment declined. It helped improve the overall employment conditions in the economy in at least four ways. First, there was an acceleration of employment growth in the organized sector. Second, movement of workers from 'informal' employment in the unorganized sector to 'informal' employment in the organized sector led to improvement in employment conditions. Third, it was the growth of 'informal' employment in the organized sector that expanded access of low-skilled workers to jobs in the organized sector. Finally, rapid growth of employment in the organized sector meant low growth of labour force in the unorganized sector, which helped improve employment conditions in that sector.

Despite the substantial improvement in the period 1999/2000–2011/12, employment conditions in 2011/12 remained poor. Just 9 per cent of the employed were regular-formal employees and 17 per cent of the employed were in the organized sector. Self-employment and casual wage employment still accounted for 78 per cent of total employment in the economy. Underemployment was high and labour incomes still low for many of the employed so that the incidence of poverty among the employed remained high. The incidence of surplus labour continued to be large.

For lack of data availability, the period covered in the analysis could not be extended beyond 2011/12. However, projections together with some limited evidence suggest strongly that the trends are maintained in the most recent period. Employment conditions continued to improve during 2011/12–2015/16. But they still remain very poor.

Substantial decline in gender inequality in employment

Employment conditions improved substantially for both female and male workers during 1999/2000–2011/12. But the improvement was larger for women such that gender inequality in employment declined substantially during 1999/2000–2011/12. The favourable change in the structure of employment was more significant for women than for men. The improvement in quality of most types of employment was also higher for women than for men. The degree of underemployment of the employed showed a larger decline for women than for men. Gender gaps in both 'real wage per day of work' and 'real wage earning per employed' also narrowed quite substantially in most types of wage employment.

Despite the reduction, gender inequality in employment remains high. The share of the organized sector in total employment is still significantly lower for women than for men. Outside the organized sector, the quality of women's employment is still significantly lower than that of men's employment. Underemployment is still higher for employed women than for employed men. 'Wage per day of work' is still significantly higher for men in all types of wage employment. Women still constitute a majority of the surplus workers.

Slight decline in urban–rural inequality in employment

Employment conditions improved for both rural and urban workers. For both groups, the share of regular-formal employment in total employment increased and so did the share of organized sector employment in total employment. The share of casual employment in total employment, on the other hand, declined for both and so did underemployment of the employed. Real wage per day of work increased for both groups and so did real wage earning per employee.

The urban–rural inequality in employment declined, though very mildly. The change in the structure of employment was quite similar for the two groups of workers. Underemployment declined in equal measure for rural and urban workers in employment. The urban–rural gap in real wage per day of work as also in real wage earning per employee increased in the organized sector but declined substantially in the unorganized sector. Overall, therefore, both real wage per day of work and real wage earning per employee recorded larger increase for rural workers suggesting a mild decline in urban–rural inequality in employment.

Despite the decline, the urban–rural inequality in employment remains sizeable. Much larger sections of urban workers are in regular-formal employment and in organized sector employment. A much smaller section of urban workers is in casual employment. In short, the structure of employment of urban workers remains much more favourable than that of rural workers. The extent of underemployment of the employed, particularly of the casual employees and the self-employed, is significantly larger for rural workers and the average wage of an urban employee is still more than double that of a rural employee.

THE EMPLOYMENT CHALLENGE

In 2015/16, the estimated stock of surplus workers (persons of working age) is 104 million and the currently unemployed (persons of working age) number 13 million. Thus, there are around 117 million persons of working age who need to be absorbed in 'new and better' jobs. Further, there will be fresh entrants into the labour force; 6–8 million youths are expected to enter the labour force every year over the next decade and a half. They too will need to be absorbed in 'new and better' jobs.

To understand the enormity of the employment challenge, we may consider the conditions that will have to be met to reach the rather modest goal of the Lewis Turning Point, the point at which there is neither surplus labour nor unemployment, in the next 15 years. This will require absorption of the entire incremental labour force of 8 million (at a maximum), a segment of the surplus workers (7.0 million), and a segment of the unemployed (0.9 million) every year. The challenge therefore is of absorbing around 16 million persons in new jobs at rising levels of productivity every year over the next 15 years.

Moreover, of the 16 million persons who will need to be annually absorbed in 'new and better' jobs, around 4 million will be low skilled (with up to primary education), 7 million will be medium skilled (with above primary and up to higher secondary education), and 5 million will be highly skilled (with tertiary education). The employment challenge, therefore, is not just of creating 16 million productive jobs every year but also of creating most of these jobs (11 million) for the low to medium skilled.

Daunting though the challenge is, the report is optimistic about the future. The projection exercises in the report show, for example, that economic growth of around 8 per cent per annum can deliver the required growth of 'new and better' jobs provided that the growth process has the following characteristics:

- First, growth must occur in both organized and unorganized sectors; the 8 per cent overall growth, for example, should ideally result from 10 per cent growth in the organized sector and 5.5 per cent growth in the unorganized sector.
- Second, growth of the organized sector has to be employment intensive so that there is rapid movement of workers from jobs in the unorganized sector to new jobs in the organized sector.
- Third, around half of the additional jobs in the organized sector will need to go to low- to medium-skilled workers.
- Fourth, growth of labour productivity in the unorganized sector has to be high so that workers can move to 'better' jobs within the sector.

Thus, growth of labour productivity in the unorganized sector has to be high and growth of the organized sector has to be employment intensive. Employment growth of 7 per cent per annum in the organized sector, for example, will mean employment growth of just 0.5 per cent per annum in the unorganized sector. Growth of labour productivity in the unorganized sector can then be 5 per cent per annum, implying rapid transformation of poor jobs into 'better' jobs within the unorganized sector.

This prognosis leads to a key proposition about the growth strategy that India will need to pursue if the employment challenge is to be met: *the growth of the organized sector has to be manufacturing led.* Only that will ensure that growth of the organized sector will be rapid and employment intensive. The report analyses India's recent growth experience as also international development experience in an effort to substantiate this key proposition.

FROM SERVICES-LED GROWTH TO MANUFACTURING-LED GROWTH

India has had the unique experience of achieving rapid services-led growth at a low level of per capita income. In history, remote and recent, countries at India's level of development experienced manufacturing-led, and not services-led, growth. For India too, the time is ripe for a transition to manufacturing-led growth.

There are four weighty reasons why such a growth transition is necessary and imperative.

First, services-led growth can no longer be rapid. Growth in the past created a large imbalance between domestic absorption (requiring mainly goods) and domestic production (of mainly services) that led to unsustainably large trade deficits; services exports simply could not finance the required goods imports. Efforts to rein in trade deficits caused growth slowdown. If growth is to be rapid, it must correct this imbalance between domestic absorption and domestic production; and manufacturing-led growth can ensure this.

Second, manufacturing in India has remained undeveloped (as shown by the low shares of manufacturing in its GDP and employment), implying that the potential for manufacturing growth is large.

Third, manufacturing-led growth will generate faster growth of employment in the organized sector than services-led growth, which can help address India's employment challenge. Manufacturing-led growth will also bring accelerated growth of the medium- and low-skilled employment in the organized sector.

Finally, apart from generating direct employment, rapid manufacturing growth will drive rapid growth of employment in other sectors. Rapid manufacturing growth will demand development of physical infrastructure (boosting construction), drive growth of employment in services that are required as inputs in manufacturing, and raise growth of non-traded services through the income effect. Growth of construction will be employment intensive and will generate jobs for low-skilled labour. Further, the employment elasticity in services will be higher when their growth is driven by manufacturing than it has been in the period of services-led growth.

ORGANIZED MANUFACTURING: RECENT GROWTH EXPERIENCE

Organized manufacturing witnessed a number of developments—some of them negative—during the period of services-led growth. First, the industries producing for the domestic market became increasingly dependent on imported inputs. Second, the export-oriented industries recorded poor growth. Third, India's export-oriented industries, namely, textiles, leather and leather products, wearing apparel, and gems and jewellery remained the same over a long period. However, exports were seemingly becoming diversified. This anomaly is explained by the fact that many of the newly exporting industries are not export-oriented industries; they produce for the domestic market. They export tiny proportions of their outputs but their input imports are far larger than their output exports. Fourth, capital intensity grew in most industries but this reflected substitution of capital for labour rather than technological change.

An important point to note is that the growth of capital intensity without technological change tended naturally to lower employment elasticity—the growth of employment for a given growth of output. This tendency was effectively countered by a parallel development: the growth of employment of contract workers. Contract-worker intensity (the proportion of contract workers in all workers) increased in virtually all industries, increasing employment elasticity. Overall, therefore, growth of organized manufacturing remained employment intensive.

POLICY OPTIONS FOR THE FUTURE

The core message of the report is that a strategy of rapid manufacturing-led growth will enable India to meet its formidable employment challenge within a reasonable time horizon. The policy options recommended to implement such a strategy are:

- Rapid growth of organized manufacturing is to be achieved in the context of an economy that will remain open to trade and capital flows. Policies relating to trade and capital flows, therefore, are critical.
- Export promotion should remain an important policy objective; but the kind of export-oriented growth achieved by the East Asian economies can no longer be contemplated.
- Trade policy should curb the growing use of imported inputs in production for domestic markets. Increased use of imported inputs should go hand in hand with growing export orientation of industries. The inappropriate structure of import duties on intermediate and final goods and exchange rate appreciation encourage the use of imported inputs in production for domestic markets and hurt export growth.
- The structure of import duties should be synchronized with the domestic tax structure to ensure that imported inputs do not enjoy undue price advantage over domestically produced inputs.
- The real exchange rate should be stabilized at a level that encourages export growth.
- Stabilization of the real exchange rate will require direct control of flows of foreign institutional investment (FII). This is footloose capital and its flows are influenced not by the domestic economic policies but by the monetary policies of the United States (US), the European Union, and Japan.
- Reliance on FII inflows to finance India's current account deficit should be avoided. The FII inflows do not finance a given current account deficit; they increase it.
- A clear distinction should be made between foreign direct investment (FDI) and FII; the former should be liberalized and the latter controlled.
- Rapid expansion of domestic markets is essential for achieving rapid growth of organized manufacturing. Policy interventions in two areas will be of critical importance: (i) Rapid growth of agriculture, which will call for increased public investment in infrastructure (irrigation and water management systems, cold storage networks, rural roads); bringing green revolution to the eastern states; encouraging shifts to non-cereal products (fruits and vegetables, fisheries, animal husbandry); and promoting agro-processing industries. (ii) Promotion of integrated national markets in agricultural and industrial products. Currently these markets are fragmented.
- Reforms of the Agricultural Produce Market Committee (APMC) acts and replacement of central and state taxes on manufactures by a well-designed goods and services tax (GST) are imperative. The introduction of GST will also help remove the discrimination against manufactures vis-à-vis services built into the existing tax system.
- Policy interventions to speed up development of physical infrastructure and to improve the business regulatory environment are of much importance.
- A major reform of education policy with the goal of universal secondary education as the priority objective is urgently required. The existing education profile of the workforce acts as a constraint on the growth of manufacturing by precluding a large

section of the population from the acquisition of new skills.

- Increasing the supply of skills with imaginative adult education and apprenticeship programmes should be implemented in the short run. Conventional skill development programmes can play only a limited role as they focus on persons with at least secondary education and a large section of the workforce lacks it.
- Capital-intensity growth that lowers employment elasticity should be prevented. Capital intensity in manufacturing industries has been growing not in association with technological change but because of substitution of capital for labour.
- Capital subsidies should be eliminated as they encourage growth of capital intensity involving pure substitution of capital for labour. Exchange rate appreciation also encourages such substitution by cheapening imported capital goods, and should be prevented.
- Labour regulations should be revised with a view to establishing a clear link between wage growth and productivity growth.
- Finally, labour regulations that generate rigidities in employment and constrain employment growth in the organized sector should be reformed. A high employment intensity of growth of organized manufacturing is of much significance.