POLICY BRIEF

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Labour Market Challenges and Some Policy Options

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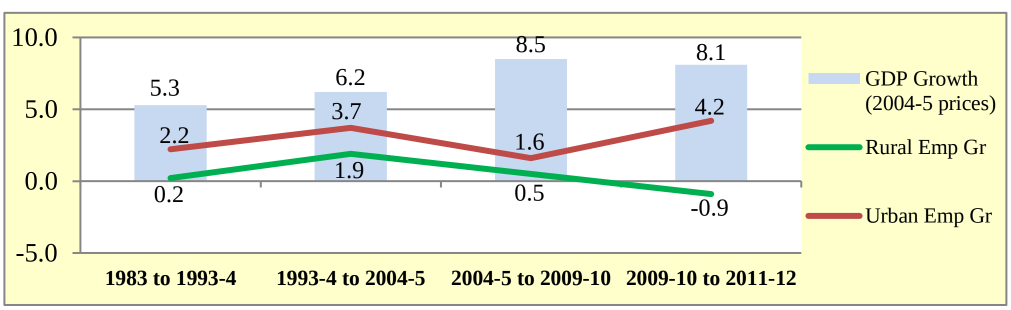
Among the major challenges facing the Indian economy today is the creation of job opportunities for a growing labour force. A rapid expansion in non-farm employment is necessary to reap the benefits of the demographic dividend, which could accrue to an economy experiencing an increase in the proportion of working age population relative to the proportion of its dependent population. The problem of inadequate job creation in India becomes even more alarming if compared with the unprecedented growth that the economy experienced in the first decade of the current millennium. During the period 2002-03 to 2012-13, the compound annual growth rate for gross domestic product (GDP) at factor cost was over eight per cent (Economic Survey, GoI, 2013). However, improved economic growth has failed to create a significant impact on employment generation, thus undermining the potential benefits from the unfolding demographic transition in the economy. It is against this backdrop that this Policy Brief, focuses on issues pertaining to (I) employment in manufacturing sector, and (II) the increased informalisation of formal sector and suggests some policy options to address these labour market challenges.

Output growth not generating employment growth

GDP growth rate has shown a consistent increase for most of the last decade, except for the slight moderation in the aftermath of global financial crisis, which resulted in industrial sector slowdown along with a slackening in the service sector growth momentum. Over the years, service sector has become the main growth driver of the economy, contributing nearly 65 per cent to the overall growth. However, employment growth has been rather sluggish (Figure 1). One of the factors has been the increase in labour productivity experienced by almost all countries in South Asia over the last three decades. In India, from 2004-5 onwards, capital intensity of output has also increased significantly, thereby resulting in declining employment content of output.

Figure 1: Average Annual Growth Rate of Output and Employment (percent)



Source: CSO & NSSO, Government of India (various years). Employment as per usual principal status.

While growth in productivity is welcome, a developing country like India with high unemployment rate cannot afford to have very low employment elasticity (ratio of percentage change in employment to percentage change in output). Employment elasticity for manufacturing sector in 2011-12 was 0.16, which although low in comparison to activities in the non-agriculture sector, was better than the overall average of 0.06 for the economy. Low average elasticity is due to falling agricultural employment – an occupational

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shift common in all developing countries that attempt to modernize their agriculture and expand non-agricultural activities.

I. Manufacturing sector: Sustained growth requires focus on skill development

Manufacturing sector has experienced falling employment elasticity and its growth rate has come down to 8 per cent during 2009-10 to 2011-12 as compared to 12 per cent during 2004-5 to 2009-10. Since then manufacturing growth has plummeted. In the year 2013-14, manufacturing sector declined by 0.7 per cent. Deceleration of investment by private corporate sector has been the primary reason for poor performance of manufacturing sector. The falling investment in manufacturing sector has been attributed to high interest rates, infrastructure bottlenecks, inflationary pressure leading to high input cost, and fall in domestic as well as export demand (Economic Survey, Government of India, 2013-14).

With over 60 per cent of population in working age group of 15-59 years, India needs to create 220 million jobs by 2025. Manufacturing activity has significant forward and backward linkages, as well as cross-sectoral multiplier effects, and therefore, it has to play a critical role in creating new employment opportunities. In general, manufacturing implies adding value to natural resources. Expansion of manufacturing sector will boost the domestic economy as well as increase export earnings through exports of high value commodities instead of raw materials or semi-finished products. Skill development along with research and development in technological innovation will play an important role in that regard. FDI in research and development, and innovation will enhance production potential in the manufacturing sector.

Table 1: Manufacturing Sector in Developing Asia

Country	Share of manufacturing in GDP	Share of MHTM in total manufacturing	MHTM exports in total exports
China	34.1	40.7	59.9
South Korea	27.7	53.4	71.8
Thai-land	36.6	46.1	58.0
India	14.9	32.2	27.0

Source: Economic Survey, Government of India, 2013-14.

What are the major problems?

Since 1980s, share of manufacturing in GDP has stagnated at 15-16 per cent, which is lower than other developing countries in Asia where the range is around 25 to 35 per cent (Table 1). The objective of National Manufacturing Policy (2011) is to increase the share of manufacturing in GDP to 25 per cent by 2025, and also to create 100 million new jobs in the sector. For that to happen, it is absolutely necessary for the manufacturing sector to come out of the recent slump and grow at pre-crisis rate at the minimum.

A sustained growth in manufacturing sector is not possible with less than 10 per cent skilled workforce in the country. Presently, skill gaps exist both in terms of quantity and quality. With less than 8,300 Industrial Training Institutes (ITIs) and Industrial Training Centres (ITCs) with a capacity to train only 1.16 million persons per year, the overall training infrastructure remains grossly inadequate. Studies commissioned by National Skill Development Corporation have identified a skill gap of 240 to 250 million persons until 2022. Close to 90 million of the identified skill gap is expected to be in the manufacturing sector alone.

Low skill attainment is the most critical impediment to a structural shift in employment from lower to higher productivity sector, and also from lower to higher value added sector. Manufacturing sector is potentially a higher technology sectors in an economy. Not only is the share of manufacturing in total GDP in India one of the lowest among developing countries (Table 1), the share of medium and high technology manufacturing (MHTM) in total manufacturing is also one of the lowest. Similarly, India's share of MHTM in total exports at only 27 per cent in 2011 is lower than its Asian peers. Indian manufacturing needs to export more of high value products instead of raw materials, mineral products and semi-finished commodities, if India is to increase its share in total output and its presence in the global market.

Suggestion 1: Better infrastructure utilization with private participation

In order to reduce appalling skill gap and better utilise the existing training infrastructure, classes in ITIs can be organized in different shifts. Placement cells in ITIs and ITCs should play a much more proactive role gathering inputs about specific skill demands emerging in the market from time-to-time, and help in periodic modifications in course curricula to improve employability of students. Private sectors should be encouraged to set up their own training institutions with government support. Also, private sectors should be involved in redesigning course curricula and training modules.

Suggestion 2: Uniformity in training, and private participation in training & research
In terms of quality of training, there is hardly any uniformity maintained across different institutions. There is a need for an independent certification and assessment by an agency which has representation from government, private sectors, and labour unions. In addition, skill development should be made integral to any registered enterprise with support of government programmes and institutions. There has to be a closer coordination between private enterprises and government institutions, and this partnership is required, all the more, in the field of research and development.

Suggestion 3: Regulator for allocation of mineral block
Along with skill development, availability of raw material is an absolute necessity for sustained growth in manufacturing sector. The recent Supreme Court judgment referring to all coal block allocation from mid 1990s being illegal has undoubtedly impacted the performance of manufacturing sector. It is desirable that a regulatory body be constituted to ensure fair and transparent procedure of allocation of mineral blocks.

Suggestion 4: Special focus on small, micro and medium enterprises
Within manufacturing sector, small and medium enterprises contribute 45 per cent of manufacturing output and 40 per cent of total export of the country. This sub-sector employs about 60 million people in over 26 million units throughout the country. Access to credit is the most fundamental problem which small and medium enterprises are facing. Their access to credit is limited due to inability to create tangible assets, and on account of the debt-equity ratio norms followed by banks. In order to address this issue, Task Force on Micro Small & Medium Enterprises has suggested creation of a separate fund using shortfalls of targets by commercial banks and inclusion of lending to small, micro, and medium enterprises as part of priority sector lending.

Suggestion 5: Easing of legal compliance along with social security measures
Legal compliance has often been cited as one of the major roadblocks for industrial growth and development. On an average, a registered enterprise has to comply with 70 laws and regulations. In addition to multiple inspections, registered enterprises have to file close to 100 different returns in a year (National Manufacturing Policy, Government of India, 2011). Simplification of compliances is a must in order to encourage growth and development of manufacturing sector.

II. Rising informality – a concern for decent employment

Like other developing countries, India's labour market is also characterized by simultaneous existence of formal sector (where conditions of employment, by and large, follow rules and regulations laid down by the State); and informal sector (where employment relations are not governed by any State regulation). A shift in workforce from informal sector to formal sector is always desirable from the point of encouraging opportunities for decent and productive employment. One of the positive developments in the India's labour market has been the increase in formal sector employment by 27 million during 2004-5 to 2011-12. As a result, share of formal sector employment has rising gradually over time. Overall, the share of employment (as per usual principal status) in formal sector of the economy in 2011-12 was 21.1 per cent, which was higher than what it was in 2004-5 (15.6 per cent). This increase in formal sector employment is largely driven by construction and service sector. Out of the total increase of 27 million between 2004-5 and 2011-12, construction

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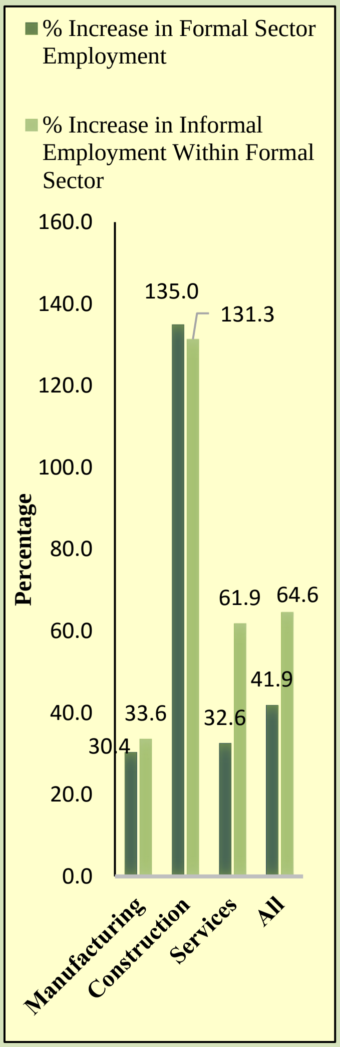
sector alone accounted for 9 million in formal sector employment. However, construction industry experienced a larger increase of employment in informal sector as compared to formal sector. Therefore, even though a major driver of growth in employment experienced rise in formal sector employment, the rise in informal sector employment was at a much faster pace.

What is the major problem?

While growth in formal sector employment is a positive development in the labour market and the economy at large, one has to be cautious while interpreting the trends. Since the beginning of the last decade, there has been a prevalence of informal employment contracts within the formal sector. As pointed out, formal sector employment (as per usual principal status) accounted for only 21.1 per cent of overall employment in the economy. Even within this small formal sector, almost half (49.5 per cent) was informal job contracts in 2011-12, and it was predominant in construction (with 93 per cent of formal sector employment in the form of informal job contracts), as well as in manufacturing sector (59 per cent of formal sector employment in the form of informal job contracts). It was only in service sector as a whole where majority (70 per cent) of formal sector employment had formal job contracts for the employees. Therefore, a major challenge of the Indian labour market today is that even though formal sector employment increased during the period 2004-5 to 2011-12, percentage increase of informal employment within formal sector was higher than the percentage increase of overall formal sector employment. In other words, informal employment within formal sector grew faster than overall formal sector employment (Figure 2).

Figure 2: All India Formal Sector Employment Growth and its Composition (2004-05 & 2011-12, Usual Principal Activity Status)



Source: NSSO, Government of India, different rounds.

Clearly, there is an increasing tendency towards informalisation of the work force. Informalisation of work force is manifest in the casualization of workers. Empirical studies have noted that profitability of organized manufacturing sector in India was driven largely by the reduction in wage costs and reduction in welfare-related expenses on workers. This issue of persistence and rise in informal employment within formal sector poses a serious challenge towards achieving decent work objectives during the 12th Five Year Plan period.

Suggestion 1: Creation of special fund for worker compensation

A special fund can be created with contribution of employers and government which can be used to pay lump-sum compensation to workers in the event of closure or downsizing of enterprise. Also, workers can be provided a minimum pension and medical benefits in such events. Although Rashtriya Swasthya Bima Yojana (RSBY) and Aam Aadmi Bima Yojana (AABY) can take care of health care needs, it would be better to provide cashless health care facilities (not requiring any third party involvement in the form of insurance agents) to such retrenched workers in government hospitals.

Suggestion 2: Allowing labour flexibility along with enhancing social security measures

The government should bring in labour reforms and replace the archaic labour laws in order to promote investment and at the same time keep issues of labour welfare in focus. As far as social welfare measures are concerned, the government should streamline Employees' Provident Fund (EPF), Employees' State Insurance Scheme (ESIS), RSBY, AABY. For the formal sector workers, the government can provide unique number to each employee who is a member of EPF and this number should be the basis of all transfer of benefits from the government as well as from the employers. This unique employee number should be used in getting benefits under ESIS. For the informal sector workers which also include working poor, schemes like RSBY and AABY should be implemented in the right spirit and with adequate infrastructure in place.

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