The Other Side September 10, 2015

Growth and Employment

Recently, the GDP growth rate in the first quarter of the current fiscal year was released: at 7% it was marginally less than expectations. This apart, both the central bank and the Chief Economic Advisor (CEA) seem to have reservations about the revised methodology recently adopted, partly because there is little segmental, micro level data supporting the number: growth in bank credit to industry has slowed down; both top and bottom lines of the corporate sector as reflected in quarterly results are unexciting. Agricultural growth is negative and it is the services sector which accounts for the reported growth. Economist Ashoka Mody was scathingly critical of the new methodology in his blog for creating "*the dangerous illusion that India's GDP is growing rapidly"*.

There are two other numbers reported during the last couple of weeks which seem relevant:

⇒ As the Hindustan Times reported on August 25, there were 75,000 applications for 30 posts of peons in a Chhattisgarh government department!

⇒ The 2011 census has reported a population growth of 200 million over the number in 2001 or something like 20 mn per year. (In a way, this is supported by the 100 mn difference between the number of eligible voters in the 2009 and 2014 elections.)

While the generally accepted number for people entering the job market each year is 12 mn, the census and the electoral roll suggest that it could be even higher. On the other hand, according to the National Sample Survey Organisation (NSSO) data, the number of people employed went up from 537 mn in 2004-05 to 583 mn in 2011-12, or at a little less than 7 mn a year – obviously much less than the number of people entering the job market. About 40% of the people employed were in agriculture, which contributes less than 15% of GDP; the average income in that segment is obviously much lower than the average.

The number employed in construction and services went up from 131 mn to 177 mn, or a growth of 46 mn. One imagines that many of the jobs in this segment are temporary and less than reasonably paid. As the Hindustan Times, from which I have borrowed the above numbers, reported on 6th September, construction contractors do not like to pay more than Rs 200 per day for casual labour. Clearly, unless the economy can create jobs, and that too better paying, at a far faster rate than what it has been doing, we could face the spectre of social instability – and these can only from industry.

There are, of course, a number of reforms that would be needed if industry is to become the engine of job creation – improvement in infrastructure, the ease of doing business, etc. etc. But surely, both the domestic and external values of the rupee would be an important element of job creation. There is a strong connection between interest rates on the one hand, and employment and growth, on the other. To quote just one example, the US Federal Reserve has been waiting for economic and employment growth to pick up before increasing interest rates. And, to my mind, there is little point in avoiding the issue by arguing that, in the long run, there is no conflict between growth and low inflation. Real interest rates do seem very high in what the CEA has described as a deflationary situation. The disproportionate share of capital intensive businesses in the non-performing assets of the banking industry also emphasises the point. In any case, interest rates can influence at best 50% of the CPI (i.e. non-food components).

As for the external value of the rupee, no economy has consistently grown at 8% p.a., perhaps the minimum we need, without a strong increase in manufacturing and exports. And, I am old-fashioned enough to believe that real effective exchange rates (REER) affect export growth as well as the ability of domestic producers to compete with imports. In India, exports have been falling, month after month; orders are plummeting for labour intensive exports like leather goods, textiles, jewellery, handicrafts, while steel and aluminium are unable to face competition from imports. While global slowdown may be a factor, surely the exchange rate is not irrelevant?

In this background, can we afford a single point agenda for the monetary policy? As former Governor, Dr. Bimal Jalan was quoted by the Economic Times (September 3, 2015) "*the real issue is about growth. …. What we need to worry about at this juncture is growth rather than inflation*". Avinash Persaud recently argued (Financial Times, August 25, 2015) that, *"monetary policy cannot confine itself to reacting to the latest inflation data if it is to promote the wider goals of financial stability and* *sustainable economic growth.*" To quote from the draft Indian Financial Code, *"The objective of monetary policy is to achieve price stability while striking a balance with the objective of the Central Government to achieve growth."* In the focus on the former part of the objective are we overlooking the latter part, namely growth and employment creation? (Incidentally, the objectives of the US Federal Reserve are not just price stability but also full employment).

Social instability arising from inability to create employment would be a very heavy price to pay for price stability; the 75,000 who applied for the peons' jobs in Chhattisgarh need regular employment much more than an even lower rate of inflation!

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