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AN EMPLOYMENT-ORIENTED ECONOMIC POLICY

Relevant for: Indian Economy | Topic: Issues Related to Poverty, Inclusion, Employment & Sustainable Development

Innumerable tasks with respect to the economy await the winner of the parliamentary elections now under way, but two may be mentioned and they are connected. The first is to review the conduct of macroeconomic policy. Though it must come across as arcane, this is an element of public policy that makes a difference to whether we enjoy economic security or not. This brings up the second task for the winner, namely employment generation.

The macroeconomic policy pursued in the past five years needs overhauling. The government has continued with fiscal consolidation, or shrinking the deficit, while mandating the Reserve Bank of India (RBI) to exclusively target inflation leaving aside all other considerations. This has contracted demand. That high fiscal deficits and high inflation per se can never be good for an economy does not justify a permanently tight macroeconomic stance. The rationale given for one is that it is conducive to private investment, said to be shy of fiscal deficits and held back by inflation. Both the deficit and inflation have trended downward in the past five years, yet investment as a share of national income has remained frozen.

Now, while fiscal consolidation was something the Narendra Modi government had inherited, it has taken credit for having moved India onto the path of ‘inflation targeting’. Arguably though, India has seen a virtual inflation targeting since 2013 when the policies of the RBI became more closely aligned to the practices of central banks in western economies. Thus in 2013-14 the real policy rate saw a positive swing of over four percentage points, and it has more or less remained there. Admittedly, at double digits, inflation had been high in 2012-13 but that could have been due to abnormal hikes in the procurement price and not due to runaway growth. However, as the theory underlying inflation targeting asserts that it reflects an over-heating economy, an interest-rate hike is triggered. The high interest rate regime in place since 2013 could not but have had a negative impact on growth by raising the cost of capital to industry. The negative impact of a high policy rate may, however, have appeared elsewhere too.

A regime of high interest rates can be bad not only for investment — and thus for growth and employment — but also for financial stability. Sharp increases in interest rates can trigger distress. A trade-off between low inflation and financial stability could emerge depending upon how the former was purchased. If low inflation is achieved via high interest rates it can trigger financial instability in two ways. The first is via the direct impact on the cost of financing in a floating interest-rate regime; a higher policy rate translating into a higher borrowing rate. Second, if rising interest lowers growth, revenue will grow more slowly for firms. Both these mechanisms can render once-sound projects unprofitable, leaving banks stressed. It appears that this did not find a place in the operating manual that goes with the ‘modern monetary policy framework’, with inflation targeting as its primary focus, instituted in India in 2015. That our concerns are not purely imaginary is evident in the fact that there has been a growth of non-performing assets of banks even after a change in the method of classification first resulted in their surging in 2015. This feature along with the spectacular collapse of the giant Infrastructure Leasing and Financial Services Ltd (IL&FS) recently point to the need to review the role of the RBI.

Experience suggests that it must be tasked with far greater responsibility for maintaining financial stability while being granted wider powers. It goes without saying that the Finance Ministry and its nominees on the RBI Board should desist from insisting upon actions that could jeopardise financial stability in trying to quicken the economy. At the same time, the RBI’s

leadership may want to reflect on the mindset that leads to publicly lecturing the government of India on the fate of incurring the “wrath of financial markets”. Whatever be the compulsions of securing the balance of payments, such a view privileges the interests of international finance capital over the public interest in a democracy. It also suggests that the movements in the financial markets are to be treated as the bellwether in economic policy-making. Actually, over the past 30 years, from Mexico to southeast Asia, financial markets can be seen to have been fickle, self-serving and capable of causing great harm as they switch base globally in search of profits through speculation.

The entire gamut of macroeconomic policy in India needs re-thinking. In the heated public debate on job creation that we have seen recently, the link between macroeconomic policy and unemployment has not been flagged. When policy holds back investment, and we have seen above that it can, the prospect for employment growth is weak. The conduct of macroeconomic policy in India in recent years has compromised the principle that its two arms of fiscal and monetary policy must be used in a countervailing matter if aggregate demand is not to be affected. Instead, for too long, macroeconomic policy in India has been contractionary across the board, impacting employment adversely.

Even as we shift towards macroeconomic policies that maintain the level of aggregate demand, we can assist the unemployed by strengthening the employment programme we already have, namely the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS). Three actions may be taken towards this end. First, there have been reports that though the budgetary allocation for the scheme may have increased, workers face delay in payment. This is unacceptable, especially in this digital era when beneficiary identification and money transfer are cheap and reliable. Second, as has been suggested, there is a case for extending the MGNREGS to urban India for there is unemployment there. Of course, some rationalisation of existing public expenditure would be needed to generate the fiscal space needed, but we may yet expect a positive sum outcome when this is done imaginatively.

However, as with macroeconomic policies, a thorough review of how the MGNREGS works on the ground is necessary. In the context, we often find a reference to “asset creation”. This is an important criterion but we need not rule out the provision of public services under the scheme. The point is to ensure that we have desirable outcomes beyond just the job statistics. There is reason to believe that this matter is given no importance in the implementation of the scheme at present. An example would make this clear.

In Kerala, employment under the MGNREGS is also organised to clear the vegetation at the roadside. However, what at times is found to remain after the MGNREGS work team has left is the garbage that was earlier concealed by the undergrowth. The organised ‘cleaning’ expertly skirts the garbage unconscionably deposited at the roadside! This is more than just a matter of aesthetics and can be dangerous when, for instance, waste from abattoirs has been dumped in the shrubbery. It makes a mockery of publicly-funded programmes that they can leave us worse off, and speaks of the unaccountability that pervades so much of government intervention in the economy. But recognising the hazard opens up an opportunity for improvement. The MGNREGS should target the waste dotting our countryside, and when extended to urban India should aid municipal waste-management efforts. We would then have a cleaner environment and have at the same time created jobs. That would a fitting tribute to the man after whom the programme is named, one who had worked for a clean India much of his life.

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