No country for young workers: How demonetisation has hurt a generation of Indians

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Reuters

The disruption that the demonetisation of high-value currency notes on November 8, 2016, caused to people's lives, livelihoods and the Indian economy is still fresh in many people's memories. The direct impact on the informal economy that largely operated in cash, and the consequent ripple effects across everyone connected with it directly or indirectly, was widely reported at the time.

Over the years since high-denomination cash was made to suddenly disappear, it has come back at higher levels than before. In the face of this reversal, it becomes important to evaluate the longer-term trajectory that the economy has taken post-demonetisation. The return of cash makes improbable any claims of positive effects through the strong formalisation of the Indian economy. The negative outcomes, however, may not have been erased by the increased cash intensity of the economy.

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The economy does not work like an elastic rubber band where once the stress is released, it comes back to the pre-stress configuration. Negative events tend to have long-lasting effects. Small firms that close because of a lack of demand do not reopen automatically once demand comes back. When people are unable to repay loans, taking a loan again, especially from informal sources is not as easy.

Hence, one can expect that there would be some longer-term negative effects of the shock that was demonetisation, unless subsequent economic policy served to help those who were affected and alleviate these effects.

As we look at how India’s labour market has fared in the years following demonetisation, we find that the situation had worsened substantially even before Covid-19 struck.

Immediate consequences

For the Indian labour market, the announcement of demonetisation came on the back of an already dismal economic situation. According to the Centre for Monitoring Indian Economy’s Consumer Pyramid Household Survey, between May to September 2016, a few months before the announcement of demonetisation, overall employment rate or workforce participation rate was approximately 43%.

This rate refers to the the number of individuals employed as a proportion of the population of working age people.

Between January to April of 2017, only a few months after the announcement of demonetisation, employment rates had fallen to 42%. Although this one percentage point fall does not seem like a significant effect, when seen in terms of absolute number of the workforce, this adds up to a loss of 9.5 million (95 lakh) jobs during this four-month period. (We have used the population projections from the United Nations World Population Prospect 2019 to get the projected working age population, 15 years and older, and have applied the employment rate numbers to it).

To put this in context, this number is comparable to the entire population of a city such as Hyderabad.

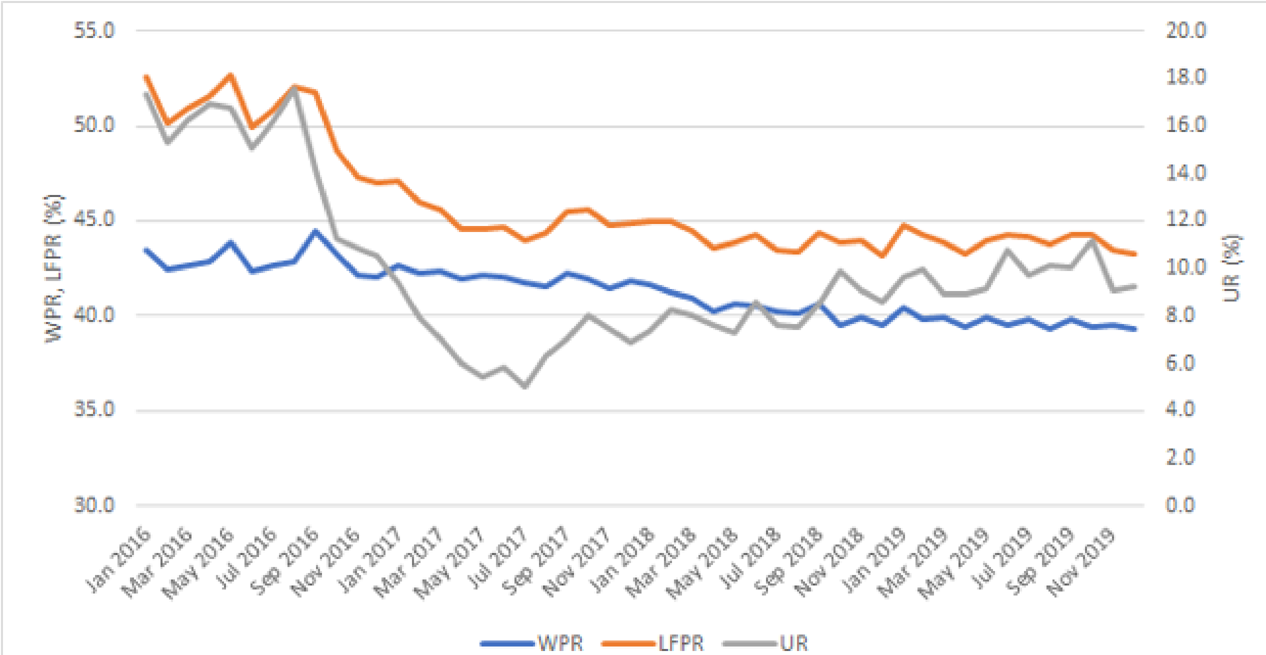


Fig 1. Graph showing the trends in employment rate, labour force participation rate and unemployment rate from January 2016 to November 2019. Source: CMIE-CPHS, multiple waves.

Along with the small but significant reduction in employment rate, demonetisation was also followed by a steep fall in the labour force participation rate, which is the share of people working, looking for work or willing to work as a share of the working age population. The labour force participation rate dropped from around 50% before demonetisation to around 45% in the months immediately after it, translating to about 47.7 million (4.77 crore) people withdrawing from the labour force.

A part of this reduction can be explained by the decline in the employment rate. But a large part of it came from people who were looking and/or willing to work before but were not looking for work after that.

Those people, who do not have work but are looking and/or willing to work, are termed “unemployed” and their share of the labour force is termed the unemployment rate, which in this case declined. While a declining unemployment rate is typically interpreted as a positive development, in this context, the declining unemployment is not because those looking for jobs found them, but because they stopped looking.

This is called the ‘‘discouraged worker’ effect, where shrinking employment prospects leads to potential workers stopping even looking for work and withdrawing from the labour force entirely, resulting in a fall in unemployment. In fact, the fall in unemployment after demonetisation can be attributed largely to a fall in the unemployment rates among young and less-educated workers.

It is likely that such workers recognising their bleak chances in the labour market stopped seeking employment.

The longer term

Since 2017, the employment rate has kept declining, going below 40% in 2019. According to United Nations population estimates mentioned earlier, the working age population of India increased by 32 million between 2017 and 2019. Hence, even to just maintain the employment rate of 42%, the economy would need to create around 13 million new jobs in these two years. But instead of that we lost about 6.7 million jobs, which shows up as a reduction in the employment rate.

This, of course, is on top of the 9.5 million lost in the months immediately after demonetisation.

In this period, the unemployment rate has steadily increased from the low point it hit in the months immediately after demonetisation. While this could be a positive sign of the return of some of the "discouraged" workers into the labour market, the declining employment rate means that their chances of finding jobs are still diminishing. Hence, a part of the increase in the unemployment rate could also be a result of previously employed workers losing their jobs and moving into unemployment. The latter is possible since during the same time, we see a decline in employment rates too.

Notably, these trends observed in the Centre for Monitoring Indian Economy's Consumer Pyramid Household Survey data are also seen in the official labour surveys carried out by the government of India's employment and unemployment surveys conducted by the Labour Bureau and the Periodic Labour Force Surveys.

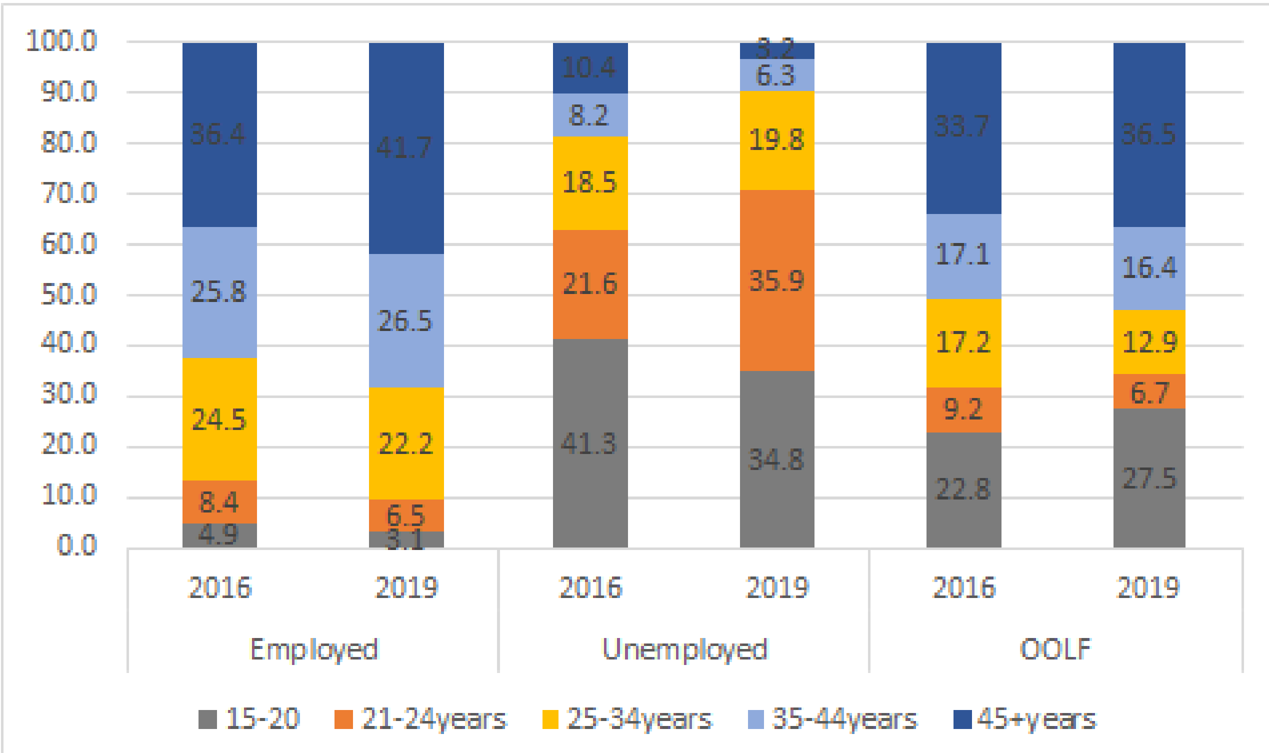
One can see about a three percentage point fall in the employment rate and a significant increase in the unemployment rate. This mirrors the story of shrinking work opportunities in the economy, even as the working age population increases.

	LFPR	WPR	UR
2016-17 LB	52.4	50.5	3.7
2017-18 PLFS	49.8	46.8	6.0
2018-19 PLFS	50.2	47.2	5.8

All estimates are for 15 years and above using Usual Principal and Subsidiary status definition. The first row presents estimates from the employment unemployment survey conducted by the Labour Bureau. The second and third rows present estimates from the 2017-'18 and 2018-'19 rounds of the Periodic Labour Force Survey conducted by the National Statistical Office.

Alongside the shrinking of the workforce and increase in unemployment, we also observe a shift in the composition of the workforce and unemployed, pre and post demonetisation. Most strikingly, the workforce, which is all the people who are employed, has become older with the share of 15-20 year olds and 20-24 year olds declining over the three years. Together, they accounted for about 13% of the workforce in 2016. By 2019, they accounted for less than 10%.

Strikingly, their share in the unemployed has increased during this period. These trends are broadly confirmed in official employment surveys too by comparing the Labour Bureau 2015-'16 estimates with the periodic labour force surveys 2018-'19.



Source: CMIE-CPHS. 2016 and 2019 estimates are from the second wave, that is May-August. The first pair of bars shows the age composition of the workforce, that is the people who have paid work. The second pair of bars shows the composition of the unemployed, that is the people who do not have paid work but are looking and/or willing to work. The third pair shows the composition of the people who are out of the labour force or OOLF, that is the people who are neither working nor looking or willing to work.

This is an alarming development, given that the working-age population is turning younger. The changes in the composition of the workforce show that younger people are finding it hard to get work, and are increasingly either actively looking for work or are withdrawing from the labour force altogether.

This inability of the economy to provide work to young workers has several ramifications. The younger generation is not only being deprived of work but also of the opportunity to gain experience and create social capital; and these deficiencies have been shown to reduce earnings for workers in the long term.

This also creates a pool of young people who are not in gainful employment who are then amenable to mobilisation for other purposes, including for creating social instability.

Clearly, demonetisation seems to have set in to play a shrinking of India's workforce, alongside a specific lack of opportunities for young workers. Whether this is entirely because of the demonetisation is a question over which empirical economists will continue to debate. But the more important question is the lack of any effective measures by the government to tackle the employment crisis.

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This article is part of a series looking back on five years of demonetisation prepared by the Centre for Financial Accountability. Read the entire series here.

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