

## THE CHALLENGE OF ENSURING FULL EMPLOYMENT IN THE TWENTY-FIRST CENTURY

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*The recent economic growth process in India exhibits a problem which is increasingly common throughout the developing world: the apparent inability of even high rates of output growth to generate sufficient opportunities for 'decent work' to meet the needs of the growing labour force. This reflects two general tendencies: a shift in the production structure across and within sectors, whereby income expansion is associated with the demand for goods and services produced in more capital-intensive conditions without generating a demand for labour-intensive goods and services; and the associated technological and organisational changes that improve labour productivity.*

*The economic strategy that depended on export markets and credit-driven bubbles to provide the stimulus for growth has been flawed because it did not generate better living conditions for the bulk of the population. Poor employment generation was a central element of this failure. Both external and domestic economic conditions require a change in this strategy. It is argued that this is possible with a shift in emphasis towards wage-led growth, driven by not only direct employment schemes but also greater public provision of basic goods and services that have strong multiplier effects. The focus must be not on preventing labour-saving technological progress from occurring, but rather on ensuring that the surpluses from such activities are mobilised (directly through taxation or indirectly through the provision of incentives) and transferred to demand other activities that employ more labour, even as they improve the quality of life. Investment must also be directed towards activities that lift any possible wage goods constraints on full employment, and especially on ensuring the viability of cultivation. In such cases, full employment can become a growth strategy in itself.*

### I. THE CONTEXT

One of the most fundamental problems that has confronted development policy for at least half a century is that of finding ways of ensuring that economic growth is associated with employment patterns which ensure decent livelihoods for the citizenry as a whole. The recent economic growth process in India exhibits a problem which is increasingly common throughout the developing world: the apparent inability of even high rates of output growth to generate sufficient opportunities for 'decent work' to meet the needs of the growing labour force.

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This has been widely noted in the literature on the basis of both the data emerging from the 2001 Census and the more comprehensive data from the National Sample Survey Organisation (Chandrasekhar and Ghosh, 2006; Sharma, 2007; Sundaram, 2007) and, therefore, there is no need to repeat the evidence here. Nevertheless, some of the more significant features of recent employment trends are still worth noting. First is the deceleration and stagnation of formal employment growth despite accelerated output growth, and the lower intensity of employment in the most dynamic manufacturing and services sub-sectors (Kannan and Raveendran, 2009; Arora, 2010). Second is the stagnation of real wages of almost all categories of workers, despite rapid increases both in labour productivity in some sectors as well as in GDP growth as a whole. This has also been associated with increasing gender gaps in wages (Ghosh, 2008). Third is the increase in labour force participation rates for both men and women, including both those who are actively engaged in work and those who are unemployed but looking for work. This incorporates the net effect of declining rates of labour force participation among the youth (in the age group of 15-29 years) and a rise for the older age cohorts. Finally what needs to be noted are the shifts in the type of employment, with declines in the proportion of all forms of wage employment and corresponding increases in self-employment, often at very low rates of remuneration. This means that around half of the workforce in India currently does not work for a direct employer, not only in agriculture, but also in a wide range of non-agricultural activities. This, in turn, requires a significant rethinking of the way analysts and policy-makers deal with the notion of 'workers', as well as of the policies for generating 'full employment'.

As noted at the start, these problems, and even many of these employment patterns, are not unique to the Indian economy. Many developing countries, including those perceived to be the most successful in terms of output growth rates, exhibit some form of jobless growth, especially in formal sector activities. This reflects two general tendencies: a shift in the production structure across and within sectors, whereby income expansion is associated with the demand for goods and services produced in more capital-intensive conditions without generating a demand for labour-intensive goods and services; and the associated technological and organisational changes that help improve labour productivity.

In general, the reasons for this apparent disjunction between output growth and employment generation are not so difficult to find. First of all, the pattern of manufacturing growth under an open economic regime tends to be such that the responsiveness of employment growth to the growth in output declines. It is worth noting that the combination of high output growth and low employment growth is a feature that has characterised both India and China during the years when they have opened their economies to trade and investment (Chandrasekhar and Ghosh, 2006). Even in China, which is the most successful manufacturing exporter of recent times, the total industrial employment *decreased* by more than 8 million workers between 1997 and 2002, and then increased slightly to reach a total of 230 million workers by 2004 (China Statistical Abstract, 2010). This figure has stagnated at around that level since then, even though industrial production has more than doubled. In other export-oriented developing countries, manufacturing employment has remained stagnant or fallen

slightly. So there has not been an 'export' of jobs from North to South: rather, international competition has generated greater and greater use of labour-saving techniques that have caused manufacturing jobs everywhere to simply disappear.

There are several reasons for this. The most obvious is the impact of trade liberalisation on the pattern of demand for goods and services within the country. As the tastes and preferences of the elites in developing countries are influenced by the 'demonstration effect' of lifestyles in the developed countries, new products and processes introduced in the latter very quickly find their way to the developing countries when their economies are open. Further, technological progress in the form of new products and processes in the developed countries is inevitably associated with an increase in labour productivity. Producers in the developing countries find that the pressure of external competition (in both the exporting and import-competing sectors) requires them to adopt such technologies (Patnaik, 2006). Hence, after the liberalisation of external trade, labour productivity growth in developing countries is more or less exogenously given and tends to be higher than it was prior to trade liberalisation. This is the probably the primary cause of the growing divergence between output and employment growth in the case of Indian industry and some services.

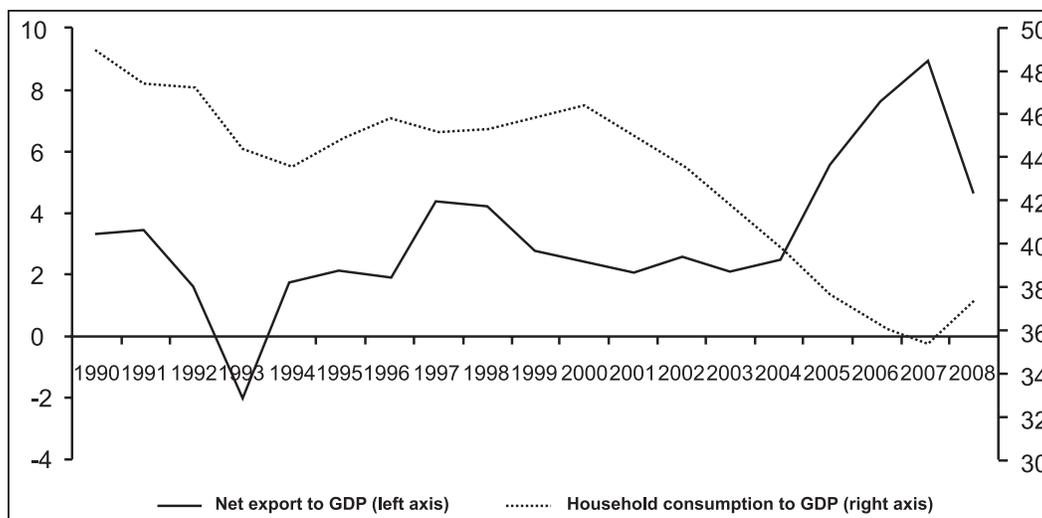
In agriculture, a combination of the agrarian crisis and greater use of mechanised techniques of cultivation has reduced the demand for labour per unit of output. In other sectors, employment growth has been affected by the slowdown or reduction in government expenditure, which has strong direct and indirect employment generating effects. So, the reduction in public spending directed towards the rural areas, or towards the 'social sectors' such as health and education, has meant that there has been less direct job creation by the government, and also a less indirect impact through multiplier effects. In the circumstances, the lack of access to paid employment has forced workers to find any other economic activity, in the form of 'self-employment', largely as a survival strategy rather than as a positive choice. Increased competition between the petty providers of goods and services, and the heightened material insecurity of such production have meant that the risks of production have been shifted down to workers and ensured greater concentration of profits.

Thus, the much-hyped growth in emerging markets did not benefit most people, as profits soared but the wage shares of national income declined sharply. In most countries, ILO data indicate that growth in real wages was well below increases in labour productivity during the period 1990 to 2006, and the wage share of the national income showed declines in all major regions of the world during the two decades between 1985 and 2005 (ILO, 2008).

### **1. Implications of Export-led Strategies**

This broad process, especially in the developing world, is partly related to the fact that the export-led growth model was associated with a suppression of wage costs and domestic consumption in order to be able to remain internationally competitive and achieve growing shares of world markets. Household consumption as a share of the GDP in some of the more 'successful' developing economies declined over this period, in some cases quite significantly, reflecting the strategy of suppressing the home market in order to push out more exports.

Figure 1  
China: Export and Household Consumption



Source: World Bank World Development Indicators online database

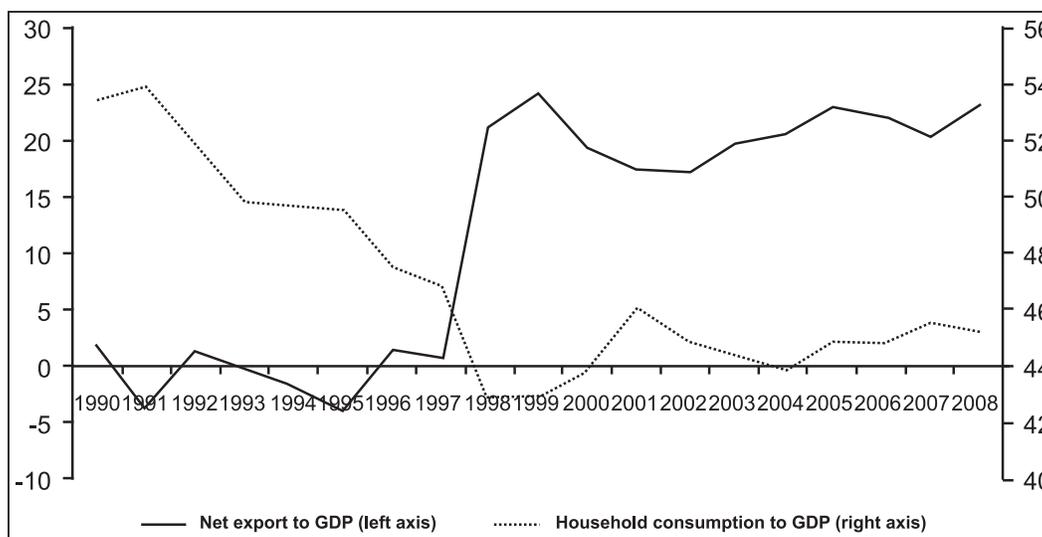
This is evident from a comparison of two important indicators from national accounts data: the share of net exports (exports minus imports) of goods and services in GDP, which indicates the extent of focus on the export-oriented strategy; and the share of household consumption to GDP. Charts 1 and 2 provide evidence of these indicators from two countries, which are currently seen as major successes in the global economy.

China is, of course, the most well-known example of successful export orientation in the world today, and its huge current account surpluses are typically cited as classic outcomes of an essentially mercantilist strategy. It should be noted from Chart 1 that large and rising net exports (relative to the GDP) really constitute quite a recent phenomenon in China, and that the very significant increases date from the early part of this decade. Between 1994 and 2000, the share of household consumption to GDP was largely stable at around 45 per cent, though even this was a relatively low level for a developing country with a low per capita income. But thereafter, precisely during the period when net exports started rising very significantly, the share of household consumption fell drastically, to only 35 per cent in 2007, which is one of the lowest such ratios anywhere in the world.

The evidence of the strategy outlined above is, therefore, very stark in the Chinese case. It is only during the very recent post-global crisis period, when net exports have declined and domestic fiscal and monetary stimulus measures have been implemented in China, that there appears to be a change in the direction of both variables.

Charts 2 and 3 show that this strategy and this outcome are not unique to China. In Malaysia (Chart 2), the impact of the Asian financial crisis was reflected not only in currency devaluation and the need to generate large current account surpluses, but also in a sharp shift in strategy that led to dramatic increases in net exports to average levels of more than 20 per cent of the GDP! This was associated with equally marked declines in the share of

Figure 2  
**Malaysia: Export and Household Consumption**



Source: World Bank World Development Indicators online database

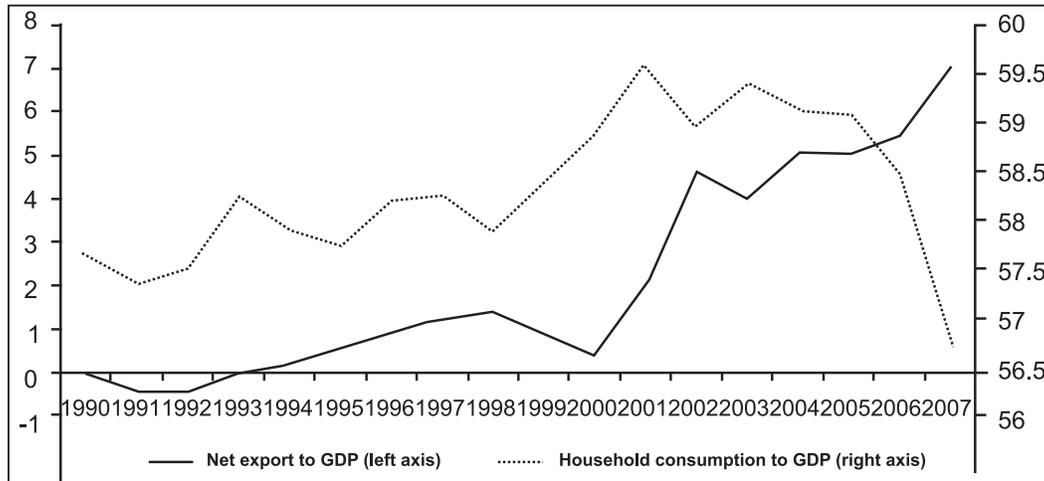
household consumption in the GDP, which fell by nearly ten percentage points and has stagnated at that level since.

It would be a mistake to think, however, that this strategy was adopted only by the developing countries. The case of Germany (Chart 3) was relatively unremarked upon until the recent economic crises of other countries in the eurozone that are adversely affected by Germany's strategy, such as Ireland, Greece and Spain. United Germany started running net export surpluses only from the middle of the 1990s, and they were not significant as a share of the GDP until the turn of the decade. For most of the earlier period, Germany's net exports tended to move broadly in the same direction as household consumption shares. From the early part of the previous decade, this abruptly shifted to notable declines in household consumption shares, associated with fivefold increases in exports to GDP ratios.

This reflects the fact that Germany has kept real wages largely stagnant through a phase of increased labour productivity, allowing all the productivity increases to be absorbed by employers and enabling savings surpluses that have also tended to be exported abroad, both inside and outside the eurozone. It is, therefore, obvious that beggar-thy-neighbour exporting strategies (that also involve beggaring workers within the economy) need not be associated with currency manipulation, but can result from other macroeconomic policies as well.

This led to the peculiar situation of rising savings rates and falling investment rates in many developing countries. For example, in Malaysia, investment rates plummeted from 42 per cent of the GDP to only 21 per cent between 1998 and 2006, even as savings rates rose from their already high levels to rates in excess of 40 per cent (Ghosh, 2009) and a similar story is evident for many other developing countries. This led to the holding of international

Figure 3  
Germany: Export and Household Consumption



Source: World Bank World Development Indicators online database

reserves, which were then sought to be placed in safe assets abroad. This is related to a classic dilemma of mercantilist strategy, which is evident in exaggerated form for the aggressively export-oriented economies of today: they are forced to finance the deficits of those countries that would buy their products, through capital flows that sustain the demand for their own exports, even when these countries have significantly higher per capita incomes than their own. The flows of capital from China and other countries of developing Asia constitute an egregious example of this.

Overall, therefore, an obsession with export orientation has its costs, especially in terms of the suppression of domestic consumption and wage incomes. Not only was this a strategy that bred and increased global inequality, but it also sowed the seeds of its own destruction by generating downward pressures on price because of increasing competition as well as protectionist responses in the North. It is also an increasingly unreliable strategy, given that the major stimulus provided by the US as the engine of world demand is unlikely to continue. Therefore, there is a clear case for a shift towards wage-led and domestic demand-led growth, particularly in the countries with economies that are large enough to sustain this shift.

## 2. Credit Bubbles as Growth Engines

In some other developing countries including India, the strategy has only partly (and usually less successfully) relied on export growth as the basic engine of growth. Essentially, recent growth in India was related to financial deregulation that sparked a retail credit boom and combined with fiscal concessions to spur consumption among the richest quintile of the population. This led to rapid increases in the aggregate GDP growth, even as deflationary fiscal policies, poor employment generation and a persistent agrarian crisis reduced wage shares in national income and kept mass consumption demand low. The substantial rise in profit shares in the economy and the proliferation of financial activities (which together with

real estate accounted for nearly 15 per cent of the GDP in 2007-08) combined with rising asset values to enable a credit-financed consumption splurge among the rich and the middle classes, especially in urban areas, which, in turn, generated higher rates of investment and output over the upswing. The earlier emphasis on public spending as the principal stimulus for growth was thus substituted in the 1990s with debt-financed housing investment and private consumption of the elite and burgeoning middle classes (Chandrasekhar and Ghosh, 2009). The liquidity in the Indian economy resulting from the capital surge has helped sustain a credit-financed, private expenditure-based process of growth in the economy. Credit-financed purchases of housing, automobiles, durables, and ordinary goods and services has driven growth to near 9 per cent levels for the last few years, barring the period of the Great Recession.

With GDP growth rates hovering at around 9 per cent annually, little attention has also been paid to the more disconcerting features of this process of growth. These are reflected in the external balance of payments position, which has grown progressively more fragile and dependent upon inflows of mobile speculative capital. This process can be easily reversed, especially in the uncertain global context when investor expectations are brittle and volatile. Internally too, a debt-based private consumption bubble usually ends in tears, as is evident from the examples of so many countries, including both developed economies like those of the US and Spain in the 2000s, and developing countries like Turkey and South Korea in the 1990s. For purposes of the present discussion, it is also worth noting that even such a growth trajectory does not generate a sustained expansion of employment, since employment becomes vulnerable to the overall volatility and short-term gains do not continue after the bursting of the bubble.

### **3. Global Financial Crisis and After**

While the recent boom was not stable or inclusive, either across or within countries, the slump has been rather more inclusive, forcing those who did not gain earlier to pay for the sins of irresponsible and unregulated finance. The real economic impact of the crisis has mostly been felt in employment, and this is where the effects of the crisis continue to be widespread and serious. Employment has declined sharply in the export-oriented sectors, creating negative multiplier effects across other sectors. The effects on social sectors and on human development conditions, in general, have been marked (Chhibber, Ghosh and Palanivel, 2009; Green, King and Miller-Dawkins, 2010). As the economies slowed down, people faced open or disguised unemployment, loss of livelihoods and deteriorating conditions of living. In the recovery, even though output has rebounded in most regions, employment expansion has remained sluggish and labour market conditions in most countries continue to remain adverse for workers.

Of course, it is well known that over the standard business cycle, as well as in other past experiences of financial crises, employment tends to recover more slowly and to a lesser extent than output (Reinhart and Rogoff, 2008). To that extent, the delayed recovery of employment would seem to be only normal, and not be a cause for excessive concern. But the current crisis has followed a boom in which, despite rapid increases in economic activity,

employment—especially in the formal sector—had simply not kept pace with growth. Thus, labour markets across the world were increasingly characterised by more casual non-formal contracts and the growth of precarious forms of self-employment rather than ‘decent work’. In other words, the boom did not generate enough productive employment, yet the crisis has already had severe and continuing effects in reducing even those inadequate levels of employment across the world. Open unemployment rates remain high even in countries with no forms of unemployment benefits, and there continues to be a rise in self-employment, often in very low-paying and precarious activities, which is essentially a response to the lack of available opportunities for paid employment.

This is of particular concern, since it is increasingly evident that the process of global economic recovery may not continue in a stable and sustained fashion. It is clear that problems in finance have not been adequately addressed or dealt with. The underlying problem of stagnating or declining real estate markets and concerns with sovereign debt (whether in Dubai or Greece and other similarly placed countries) are compounded by continuing disincentives for ‘efficient’ behaviour and incentives for excessive risk-taking in financial markets. Moral hazard is greater than ever before, because bailouts have not been accompanied by adequate regulation (Stiglitz, 2009, Kregel, 2010). Currently, these are being expressed by instability in the markets for sovereign bonds in Europe, especially in ‘peripheral’ countries in the Eurozone, but renewed volatility and contagion effects in other markets are extremely likely. This is also true for developing countries, many of which are still being encouraged to deregulate their own financial markets despite all the evidence of the implications of such deregulation for financial fragility.

This also has direct implications for certain global markets that directly affect people’s lives, that is, those for food and fuel. It is now an open secret that the huge price volatility in food and oil prices that created so much havoc, especially in the developing world, was not related to any real economic forces, but was rather significantly related to the involvement of financial players in such markets (UNCTAD, 2010; Ghosh, 2010), enabled by financial deregulation in the US and Europe. Unfortunately, the international transmission of prices in most countries has been rapid during periods of rising prices but not so marked during periods of falling prices (Ghosh, 2010). Food prices in most developing countries were, in general, considerably higher in late 2010 than they were two years ago (FAO, 2010), and much higher than increases in nominal wage incomes (which have been mostly stagnant). Developing countries are caught in a pincer movement: between volatile global prices, on the one hand, and reduced fiscal space, on the other hand. Price volatility and changes in marketing margins mean that the benefits of price increases generally do not reach the direct producers, even as consumers (who are already hit by stagnant wages and falling employment) suffer from higher prices.

In addition, the unwinding of global macroeconomic balances that is already under way means that the US cannot continue to be the engine of growth for the world economy. In the US, where the debt-driven private consumption boom was the most marked, household savings rates have already started rising from their very low levels (Papadimitriou, Hansen and Zezza, 2009) and a similar process is operating in Europe. It was expected that increased

public spending would act as a substitute for this inevitable repairing of private balance sheets, and that has actually been the case during the past year. However, the remarkably rapid political backlash against ‘excessive’ government spending—even though it has little validity within a Keynesian macroeconomic framework—seems to have affected both the ability and the willingness of governments in the developed economies to engage in further spending to ward off potential recession. The dangers of an early withdrawal of stimulus measures are thus very high.

Other countries must, therefore, find other sources of growth, especially in domestic demand (which should ideally be through wage-led growth) as well as by diversifying exports (UNCTAD, 2010). There is some evidence that this is occurring, but thus far, this is nowhere near the required extent. Stimulating more bubbles in non-tradeable sectors like real estate and stock markets in the hope that this will once again generate more real economic growth is not a sustainable alternative to this, yet this is the direction that most policy measures have taken. Export obsession continues to be relevant in preventing more balanced growth based on the development of domestic or regional markets. Without a significant restructuring of global demand in favour of the large segments of the world’s population that still has to meet basic needs, world growth will not just be more unequal: it will simply run out of steam.

Such re-orientation of economic growth in the world economy has, however, been made more difficult by the pro-cyclicality of adjustment measures being imposed on developing and transition economies that have been hit hardest by the crisis. Despite all the statements to the contrary, the International Monetary Fund (IMF) has continued to impose stringent pro-cyclical conditionality on most of the countries that seek emergency assistance, and others are being forced into deflationary measures by the combination of falling exports and capital flow reversals. For example, in Pakistan, Hungary and Ukraine, the IMF assistance has come with conditions for reducing fiscal deficits through measures such as lowering public expenditure, gradually eliminating energy subsidies, raising electricity tariffs, freezing public sector wages, placing a cap on pension payments, and postponing social benefits. In monetary policy, the focus on inflation targeting has led the IMF to suggest or insist upon higher interest rates even in the context of recession in Latvia, Iceland and Pakistan, and other countries (Third World Network, 2009; UN DESA, 2010). This reduces the current and future growth potential in these economies. Even in developing countries where the impact of the global crisis was less extreme, fiscal balances have been upset first by rising oil and food prices (in importing countries) and then by recession that affected tax collections. Since a lot of policy response has been directed towards preventing institutions from collapse, this means that proportionately more state resources have been directed towards bailouts, and monetary and fiscal incentives for business, rather than towards maintaining public services or increasing employment.

All these features are critical in shaping the international and national contexts within which planning for full employment must occur. There are those who argue that in fact, such features effectively eliminate the very possibility of either planning or full employment. However, in this paper, it is argued that it is both possible and desirable to embark on an alternative trajectory in which these features can be altered, on the basis of a different

perspective on economic policies. This implies shifting away from an export-obsessed model that identifies external markets or domestic credit-driven bubbles as the only feasible means of economic expansion, towards a strategy based on sustainable expansion of wage incomes. Indeed, in the uncertain global context, this may be the only means of feasible economic growth, especially for countries like India. The following section elaborates on what forms this can take, and why planning is essential in this alternative trajectory.

## **II. ELEMENTS OF AN ECONOMIC STRATEGY FOR FULL EMPLOYMENT**

### **1. Wage-led Growth in a Developing Country Context**

In developed countries with relatively strong institutions that can affect the labour market, including collective wage bargaining, effective minimum wage legislation, and the like, it is probably easier to think of wage-led growth and strategies to allow wages to keep pace (or at least grow to some extent) along with labour productivity growth. But what about a country like India, where such institutions are relatively poorly developed and where many, if not most, workers are engaged in informal activities, and are often self-employed? How can wage increases and better working conditions be ensured in such cases? And what does a macroeconomic policy of wage-led growth entail in such a context?

It is possible to make the economic growth process more inclusive and employment-intensive, by directing resources to the sectors in which the poor work (such as agriculture and informal activities), areas in which they live (relatively backward regions as well as urban slums), the resources they control (unskilled labour), and the outputs which they consume (such as food and basic social services). This necessitates ensuring of the greater viability of informal production, through better access to institutional credit for farmers and other small producers, greater integration into supply chains and marketing that improves their returns, and technology improvements that increase labour productivity in such activities. In addition, governments may need to provide increases in public employment that set the floor for wages and improve the bargaining power of workers. Everywhere in the developing world, and particularly in low-income countries, there is need for much better social protection, with more funding, wider coverage and consolidation, more health spending, and more robust and extensive social insurance programmes including pensions and unemployment insurance.

Social policy—the public responsibility for meeting the social and economic rights of citizens—is not only desirable but also contributes positively to development. It is also increasingly evident that social policies which are often seen simply as welfare or redistributive measures (employment schemes, incentivised cash transfers to particular groups, social protection like unemployment benefits) can become important macroeconomic stabilisers, by providing automatic counter-cyclical buffers. The National Rural Employment Guarantee Scheme (NREGS) in India, for example, not only provides a higher number of days of employment per amount spent than any previous employment programme in India, but has also been an important means of injecting purchasing power into a depressed rural economy and limiting the adverse effects of the economic downturn on rural effective demand. Similarly, it is likely that the new health insurance programme in China, whereby the government would

cover up to 85 per cent of the costs of healthcare, will contribute significantly to releasing more disposable income to households, thereby boosting their consumption and adding to domestic demand from this quarter.

A broader interpretation of this also requires increased focus on the public delivery of wage goods (housing, other infrastructure, health, education, even nutrition) financed by taxing surpluses. The last point is often not recognised as a crucial element of a possible wage-led strategy, but it can be extremely significant. Furthermore, such a strategy can be used effectively even in otherwise capitalist export-oriented economies, as long as surpluses from industrialisation and exports can be mobilised to provide wage goods publicly. Indeed, this has been an important and unrecognised feature of successful Asian industrialisation from Japan to the East Asian NICs to (most recently) China. The public provision of affordable and reasonably good quality housing, transport facilities, basic food, school education and basic healthcare all have operated to improve the conditions of life of the workers and (indirectly) therefore, to reduce the money wages that individual employers need to pay workers. This has not only reduced overall labour costs for private employers, but has also provided greater flexibility for producers competing in external markets, since a significant part of fixed costs has been effectively reduced.

## **2. Technology and Employment Generation**

As has been noted earlier, technological progress in the developed countries is almost inevitably associated with an increase in labour productivity. And increasingly, producers in developing countries find that the pressure of external competition (in both exporting and import-competing sectors) requires them to adopt such technologies. This is probably the primary cause of the growing divergence between output and employment growth in the case of Indian industry and some services.

A common tendency is to blame technological change for this. But technological change is itself the outcome of several forces, including not just the incentives created by relative prices but also the changing structures of demand, which are, in turn, determined by changing shares of income. Thus, the pattern of growth is extremely significant for ensuring desirable employment generation. And in this regard, macroeconomic policies and overall growth strategies play a crucial role.

However, it is also important to recognise that while some forms of technological progress can be guided and encouraged, it is neither possible nor desirable to control the process of invention, innovation and adaptation, even when it is dominantly labour-saving. The promotion of more employment clearly should not involve a glorification of drudgery, especially when newer technological developments open up possibilities for less arduous and tedious ways of working. It is no one's case that low productivity employment must be perpetuated, or that labour-saving technological change must necessarily be resisted. Rather, the point is to ensure that jobs are continuously created in the economy in other activities.

The focus must, therefore, be not on preventing labour-saving technological progress from occurring, but rather on ensuring that the surpluses from such activities are mobilised (directly through taxation or indirectly through provision of incentives) and transferred to

demand other activities that employ more labour, even as they improve the quality of life. This means that the surpluses generated from 'productive' activities could be used in a proliferation of service activities in everything from the provision of essential services like health, sanitation and education to entertainment and culture activities.

A critical requirement for this is public expenditure, especially (but obviously not exclusively) in the social sectors. This is typically much more employment-generating than several other economic activities, and, therefore, also has substantial multiplier effects. Spending on the provision of proper health facilities, for example, or ensuring good quality and universal school education, has great employment-generating potential. There is, therefore, a strong case for evolving a growth strategy that allows and encourages labour productivity increases overall while significantly expanding expenditure—and, therefore, income and employment opportunities—in social sectors that positively affect the conditions of life of most citizens.

Obviously, this requires a major role for state intervention, through direct public investment and through fiscal, monetary and market-based measures that alter the structure of incentives for private agents. This point is elaborated in the last section.

### **3. Constraints on a Full Employment Strategy**

#### ***(i) The Wage Goods (Food) Constraint***

The most obvious and widely discussed constraint on a full employment trajectory in developing countries is the wage goods constraint, particularly the agricultural constraint expressed most forcibly in the price of food. It has been argued that the very recognition of this constraint is part of a 'closed economy perspective' on economic development. During the past two decades, greater openness associated with economic globalisation had caused developing countries to perceive this constraint as being no longer operative because of the possibility of food imports and the increased access to international finance to facilitate such imports. However, ever since the global food crisis became particularly marked in 2008, such views are no longer in the ascendant, and in most populous developing countries, it is now recognised that ensuring the domestic availability to (or continuous access to affordable imports of) the most basic wage good, that is, food, is an essential element of a sustainable strategy for full employment.

This, in turn, makes it imperative to address the agrarian crisis, since the cultivation of food must be made more physically and financially viable if the food constraint is to be eased. It is now recognised that even in global markets, demand factors have played very little role in causing prices increases, and the dominant effect has been (other than the speculative forces discussed earlier) in changed conditions of supply. These include the short-run effects of diversion of both acreage and food crop output for bio-fuel production, as well as more medium-term factors such as rising costs of inputs, falling productivity because of soil depletion, inadequate public investment in agricultural research and extension, and the impact of climate changes that has affected harvests in different ways.

These factors have resulted from inappropriate agricultural policies, which, in turn, have resulted from the basic neo-liberal open market-oriented framework that has governed economic policy-making in most countries over the past two decades. One major element has been the

lack of public investment in agriculture and in agricultural research. This has been associated with low to poor yield increases, especially in tropical agriculture, and falling productivity of land. Greater trade openness and market orientation of farmers have led to shifts in acreage from traditional food crops that were typically better suited to the ecological conditions and the knowledge and resources of farmers, to cash crops that have increasingly relied on purchased inputs. However, at the same time, both the public provision of different inputs for cultivation and government regulation of private input provision have been progressively reduced, leaving farmers to the mercy of large seed and fertiliser companies and input dealers. As a result, the prices for seeds, fertilisers and pesticides have increased quite sharply. There have also been attempts in most developing countries to reduce subsidies to farmers in the form of lower power and water prices, thus adding to cultivation costs.

The costs of cultivation have been further increased in most developing countries by the growing difficulties that farmers have in accessing institutional credit because financial liberalisation has moved away from the policies of directed credit and provided other more profitable (if less productive) opportunities for financial investment. Many farmers are, therefore, forced to opt for much more expensive informal credit networks that have added to their costs. The lack of attention to relevant agricultural research and extension by public bodies has denied farmers access to necessary knowledge. It has also been associated with other problems such as the excessive use of groundwater in cultivation; inadequate attention being paid to preserving or regenerating land and soil quality; and the over-use of chemical inputs that have long run implications for both safety and productivity. Similarly, the ecological implications of both pollution and climate change, including desertification and loss of cultivable land, are issues that have been highlighted by both analysts as well as the reports prepared by numerous officially appointed Commissions, but have still been largely ignored by policy-makers in India.

While reversing these processes will take time, it is both possible and essential. It will require not only substantial public investment but also major changes in the orientation of policy-makers.

### ***(ii) The Balance of Payments Constraint***

The second major constraint on a full employment trajectory is also one that has been much discussed in the development literature: the balance of payments constraint. Once again, the period of globalisation led to a widespread perception that such a constraint is no longer operative, especially for developing countries that are 'chosen' by private international finance to be the recipients of significant inflows of capital. However, as has been noted earlier, such a perception was flawed from the start and in the current uncertain world conditions, it has outlived its relevance.

There are two major implications of this. First, developing countries that rely heavily on capital inflows to sustain the balance of payments typically find themselves in a volatile boom-bust cycle (which may take the form of a public or private debt cycle or volatility in other investment flows), in which the boom creates the very conditions of the subsequent bust. This is because capital inflows tend to generate shifts in real exchange rates, causing

real appreciations that shift domestic incentives from tradable to non-tradable sectors and leading, over time, to growing current account deficits that eventually cause declining investor confidence and capital outflows. Second, the consequent balance of payments constraint can operate as a barrier to raising economic activity to full employment levels. This means that developing economies still need to undertake measures that ensure current account balance or deficits financed with stable and sustained capital inflows, which do not involve large future outflows of foreign exchange in the form of debt servicing or profit repatriation.

### *(iii) Finance as a Constraint*

There are at least three significant ways in which structures of finance have operated to constrain the possibility and viability of full employment strategies: the greater volatility of financial markets consequent upon domestic and external deregulation of financial flows; the deflationary bias that is imparted to domestic macroeconomic policies; and the reduced possibilities for directing credit towards strategic and more employment-generating sectors

It is now widely accepted that financial liberalisation has resulted in an increase in financial fragility in developing countries, making them prone to periodic financial and currency crises. These relate both to internal banking and related crises, and currency crises stemming from more open capital accounts. The origin of several crises can be traced to the shift to a more liberal and open financial regime, since this unleashes a dynamic that pushes the financial system towards a poorly regulated, oligopolistic structure, with a corresponding increase in fragility. Greater freedom to invest, including in sensitive sectors such as real estate and stock markets, the ability to increase exposure to particular sectors and individual clients, and increased regulatory forbearance, all lead to increased instances of financial failure. In addition, as mentioned earlier, the emergence of universal banks or financial supermarkets increases the degree of entanglement of different agents within the financial system and increases the domino effects of individual financial failures (Chandrasekhar, 2005; Patnaik, 2006; Ghosh, 2009).

The deflationary bias imparted by mobile finance has been extensively noted (Patnaik, 2006; 2009). To begin with, the need to attract internationally mobile capital means that there are limits to the possibilities of enhancing taxation, especially on capital. Typically, prior or simultaneous trade liberalisation has already reduced the indirect tax revenues of states undertaking financial liberalisation, which is why tax-GDP ratios often deteriorate in the wake of such liberalisation. This then imposes limits on government spending, since finance capital is generally opposed to large fiscal deficits. This not only affects the possibilities for counter-cyclical macroeconomic stances of the state but also reduces the developmental or growth-oriented activities of the government.

Relatively less regulated financial markets also generate economic conditions in which private rather than overall social returns determine the allocation of savings and investment. It aggravates the inherent tendency in markets to direct credit to non-priority and import-intensive but more profitable sectors, to concentrate investible funds in the hands of a few large players, and to direct savings to already well-developed centres of economic activity.

The socially desirable role of financial intermediation, therefore, becomes muted. This certainly affects employment-intensive sectors such as agriculture and small-scale enterprises, where the transaction costs of lending tend to be high, the risks are many, and collateral is not easy to ensure. The agrarian crisis in most parts of the developing world is at least partly, and often substantially, related to the decline in the access of peasant farmers to institutional finance, which is the direct result of financial liberalisation. Measures that have reduced directed credit towards farmers and small producers have contributed to rising costs, and greater difficulty in accessing the necessary working capital for cultivation and other activities, and reduced the economic viability of cultivation, thereby adding directly to rural distress. In India, for example, there is strong evidence that the deep crisis of the cultivating community, which has been associated with a proliferation of farmers' suicides and other evidence of distress such as mass migrations and even hunger deaths in different parts of rural India, has been related to the decline of institutional credit, which has forced farmers to turn to private moneylenders and involved them once more in interlinked transactions to their substantial detriment.

It also has a negative impact on any medium-term strategy of ensuring growth in particular sectors through directed credit, which has been the basis for the industrialisation process through much of the twentieth century. Most of the successful late industrialising countries created strongly regulated and even predominantly State-controlled financial markets aimed at mobilising savings and using the intermediary function to influence the size and structure of investment. They did this through directed credit policies and differential interest rates, and the provision of investment support to the nascent industrial class in the form of equity, credit, and low interest rates. Financial liberalisation that destroys such possibilities also thereby reduces the tendencies for the diversification of production structures and enfeebles the more employment-generating activities. Clearly, therefore, some strategies for control over finance and direction of credit are integral to a feasible strategy for full employment.

Further, the absence of genuine financial inclusion has extremely negative implications for employment generation, since small producers in different sectors are usually the most employment-intensive in their activities. The large-scale exclusion of small producers from feasible engagement with institutional finance has prevented their greater viability and thereby reduced their potential for generating more jobs through positive linkage effects. Instead, those excluded have been forced to fall back on microcredit in terms that are so onerous and short-term that they simply cannot be used for productive investment in any meaningful way. The current crisis in microfinance, which has been reported in several states, reflects this misplaced confidence in microfinance institutions (especially of the profit-making variety) to become effective substitutes for genuine financial inclusion in the provision of productive credit.

#### **4. The Significance of Planning**

All the strategies suggested above necessitate a much greater role for public intervention in diverse forms. The most important of these strategies relate to fiscal policies that facilitate

significantly increased public expenditure, to provide essential wage goods and services to the population in general. These include the greater provision of food and basic housing, as well as sanitation, health and education services, which allow for higher spending on other goods and services out of incomes from wage work and self-employment, and have direct employment effects as well high multiplier effects. In addition, fiscal expenditure is required to undertake and promote investment to manage the effects of climate change, especially for more vulnerable groups and for actively generating and promoting greener technologies.

It is obvious that a more comprehensive approach to agriculture and rural development is required, which reiterates the critical role of public intervention. This involves appropriate policies, which bring back the role of public research and extension as well as State intervention in water management, input provision, and crop price management in order to make Indian agriculture more viable and productive.

Financial policies also require major public intervention for the following reasons: to control speculative activity especially in commodity markets and other financial markets that affect economic stability; to direct credit towards activities that fit in with strategic, longer term and more employment-generating activities; and to provide more genuine financial inclusion of small producers rather than unstable and unfeasible dependence on microcredit.

A major requirement of public intervention relates to the need to ensure that future patterns of consumption and production do not involve a rapacious and unsustainable exploitation of nature, which would generate further ecological problems. Unfortunately, it is true that unsustainable patterns of production and consumption are not only deeply entrenched in the richer countries but are also aspired to in developing countries, including India. At the same time, most of the citizens of the developing world still have poor or inadequate access to the most basic conditions of decent life, such as minimum physical infrastructure including electricity, and transport and communication links, sanitation, healthcare, nutrition and education. Ensuring the universal provision of these facilities would inevitably require greater per capita use of natural resources and more carbon-emitting production. Thus, both sustainability and equity need a reduction of the excessive resource use of the rich, not only in developed countries, but also among our own elites. Incentives therefore have to be generated to prevent or reduce wasteful and ecologically damaging forms of production and consumption. The required changes in patterns of demand and the technologies of meeting them cannot be left to market forces, since the international demonstration effect and the power of advertising will continue to create undesirable wants, and unsustainable consumption and production.

The ongoing process of urbanisation also points to the need for public intervention that is conscious of the needs of both the present and future generations. This is particularly important for promoting the quality of life in urban areas: the relatively high rates of urbanisation imply that within two decades, more than half the Indian population would be living in urban areas. Yet, since we still do not plan for the future to make our cities pleasant or even liveable for most residents, we tend to create urban monstrosities of congestion, inequality and insecurity.

Demographic changes also point to the need for a more forward-looking economic strategy. Much is made of the potential of India's 'demographic dividend', though it is obvious that this can become a nightmare if sufficient productive employment opportunities are not generated for the age cohort in the demographic bulge. But even India will rapidly face the problem of an ageing population as life expectancies increase. The almost complete absence of social security for the bulk of the population and the tendency to ignore the needs of the elderly in the creation of most public infrastructure mean that much has to be done to address this issue, which will become a pressing one within the medium-term time horizon.

Since all these issues clearly necessitate public intervention, it is obvious that they should be coordinated, which cannot occur without a broadly consistent economic framework. Further, to be successful, public intervention cannot simply occur in the form of knee-jerk responses to constantly changing short-term conditions. Instead, planning—not in the sense of the detailed planning that destroyed the reputation of command regimes, but strategic thinking about the social requirements and goals for the future—is absolutely essential.

This may seem to be a banal statement, but it is one that contradicts the dominant economic policy thinking in the country at present. This lack of seriousness with respect to planning is only partly the result of the overall neo-liberal economic orientation of the economic policy framework. It is also related to a general public dissatisfaction with the experience of both planning and public intervention more broadly, which is all too often identified with venality or cynicism, and definitely with lack of accountability to the people. Since State involvement in economic activity is clearly an imperative, it is necessary to develop methods and practices to make such involvement more democratic and accountable to society, and to make the process of formulation and implementation of economic policies more open and responsive to the needs of a majority of the citizens.

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