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Growth and employment in the era of globalization: Some lessons from the Indian experience

Amit Bhaduri

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Subregional Office for South Asia, New Delhi

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Executive Summary

The paper examines the current growth process that the Indian economy is going through, discusses its impact on employment and redistribution and goes on to present an alternative growth model that is more socially inclusive. In an era of globalization, India has witnessed extremely high growth rates of GDP, but employment has failed to keep pace, as evidenced by the decline in employment elasticities of output. The author provides a political economy critique of the present growth paradigm and argues that the corporate logic of efficiency that is often extended to the national economy tends to have results opposite to that which was desired. Instead, he presents an alternate growth model which has employment at the centre and growth results from employment generated, or an 'employment first' model of development. The author then puts forward the institutional requirements of such a model, and argues that decentralised governance is at the heart of such an inclusive employment strategy.

Foreword

Increasing economic integration in the last two decades has been a cause for much polarized debate and analysis - especially in terms of its impact on developing countries. Some highlight its benefits, others its cost.

This paper by Prof. Bhaduri observes that among the developing countries, China and India have witnessed a rapid growth in GDP since the inception of globalization. But the high growth in output has not led to a corresponding high growth in employment in either of these countries. A very low level of output elasticity of employment has been registered in all the sectors as evidenced by falling employment elasticities. There has been growing unemployment, particularly among the youth. Urban unemployment among the educated youth is on the rise.

In the context of India, the author examines the latest NSS data. The increase in employment growth rate in the latest NSS rounds has largely been attributed by an increase in self-employment. The distinct fall in wage employment suggests the adoption of self-employment as a compulsion to engage oneself in any kind of job for a livelihood. The fall in employment growth in agriculture has been sharper than any other major sectors aggravating rural distress.

High growth in output coupled with low growth in employment means increase in labour productivity, particularly in the organized sector which has been a major cost cutting measure. Prof. Bhaduri argues that as each country tries in isolation to gain a larger share of the world market, there takes place 'a race to the bottom'. In the process, the countries are forced to reduce unit production costs by cutting wages, lengthening the hours of work at the same wage, restricting workers' rights, etc.

The paper provides a political economy critique to the current development paradigm that India is following and argues for an alternative model which has employment at the centre. He lays down institutional requirements for such a model to ensure genuine development in the country through achievement of full employment. Transparency accountability at all levels and peoples' participation at various decentralized levels of local government can pave the way for an employment oriented development in India.

This paper is part of a series of papers that was commissioned by the ILO Delhi office to understand the employment challenges that currently face India.

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Introduction

The controversy about how greater economic openness under globalization affects the course of economic development is unlikely to be settled soon.

On one side are those economists who, in conformity with the governments of most rich industrialized countries, multinational corporations, international financiers, the International Monetary Fund (IMF), the World Bank and the World Trade Organization (WTO), claim that globalization is the imperative of our time, and that developing countries can only benefit from trade liberalization and greater openness (Dollar and Kraay, 2004; Krueger, 1998; Sachs and Warner, 1995).

On the other side are those economists who point out the various pitfalls in this argument, citing the asymmetrical character of globalization, especially the fact that no less than some 60 countries in different parts of the world simply got poorer over the last decade (Ocampo and Taylor, 1998; Rodrik, 1999; Storm and Rao, 2004; Storm, 2005; UNDP, 2003).

While the jury is out on the debate, and a near unanimous verdict is unlikely on such a politically loaded economic question, some related stylized facts have come to be accepted almost unanimously.

First, on the positive side of globalization, the two largest and most populous countries, China and India, have been reporting a rate of growth in GDP which is considerably above the global average. This period of rapid growth in both these countries, coincides substantially with the current phase of globalization (dating from around the late 1970s), giving credence to the view that globalization has acted as a significant stimulant to the growth rate in both countries.

On the negative side of globalization, personal, regional and occupational distribution of income in China, i.e., distribution in most of its dimensions, seems to have deteriorated (Gustafsson and Li Shi, 2002; Riskin, Zhao Renwai, Li Shi, 2001). While relative poverty has almost certainly increased in China, and most probably in India, what this means for absolute poverty remains statistically contested. Finally, high growth in GDP has not meant a correspondingly high growth in employment either in India or in China (Ghosh, 2005).

High growth of output, coupled with low growth in employment over time, must raise questions about the economic and political sustainability, even the desirability, of such a process of growth. In particular, sluggish growth in decent employment opportunities contributes not only to income inequality, it also thwarts economic mobility for the poor majority and raises doubts in their mind about any positive link between high growth and expanding economic opportunities. A land afflicted with extensive poverty and nearly jobless growth may soon begin to resemble, for many of its less fortunate citizens, the hell once described by the Italian poet Dante. On the gate of its entrance is written boldly, "Abandon all hope, ye who enter here."

The employment scene

There is both social and statistical evidence for the fact that the employment scene in India is dismal. For the very poor, it is not the luxury of employment with a well-defined wage contract that hangs in the balance, but simply the question of having access to a minimum livelihood. The malaise of a pattern of hopeless growth for a significant section of the poor population is becoming increasingly apparent.

Visible symptoms are appearing in both rural and urban areas of India. Disgruntled youth in urban and semi-urban areas, who have just a few years of schooling, find little possibility of regular employment. In rural areas, shrinking opportunities for livelihood are spreading despair among the people living there.

The result is a desperate rage among the poor that manifests itself in various forms of political extremism.[1] The varying symptoms of discontent can no longer be wished away in the name of high growth. For both political and economic reasons, it has become imperative now to examine closely the reasons why India's high economic growth has failed to create adequate jobs for its people.

It has often been pointed out that demographically, India is moving towards an age composition that will be among the youngest in the world. According to the 2001 Census of India, in 2000, there were 190 million youth in the age group of 15-24 years; this increased to around 210 million in 2005. By 2020, it is said that the average Indian will be 29 years old, as compared with 37 years in China and the US, 45 in West Europe and 48 in Japan (Chandrasekhar, et al., 2006).

From the demographic point of view, the employment challenge is especially acute in India because the young and the inexperienced usually find it even more difficult to find regular employment, while they also form a more politically volatile group.

The 61st round of the National Sample Survey (NSS), which is the most recent round, 'On the Employment and Unemployment Situation in India', delineates how the problem is becoming increasingly pressing. Between 1993-94 and 2004-05, the unemployment rate has increased significantly in the 15-24 years' age group. It was much higher among youth as compared to the rest of the population. Urban youth who have received secondary education faced a higher unemployment rate than less literate youth in rural areas.

Thus, open unemployment was the highest at nearly 28 per cent (by current daily status) for young urban women (20-24 years) and at 19 per cent for urban males (15-19 years). Converted into absolute numbers, the magnitude of the problem is easy to see. At the beginning of 2005, around 56 million youth were unemployed on a particular day, while 36 million remained usually unemployed.

It is also worth stressing that this massive worsening of the unemployment situation among the youth is not explicable in terms of longer years of schooling because, despite a lower participation rate of the youth in the labour force due to unavailability of jobs, there has virtually been no increase in the percentage of young educated people. India might be growing at a high rate, but it is leaving out a significant section of its youth from any benefits of that growth process, a particularly lamentable situation for the country because it shows that it is unable to take advantage of its 'demographic dividend'.

When one examines the overall growth rate in employment, the data seems to indicate that the employment growth rate has accelerated in the more recent years.

Notwithstanding the dismal picture of unemployed youth, the computations from the various rounds of NSS data suggest that compared to the 1993-94 to 1999-2000 period, when the employment growth was about 1.1 per cent, in the 1999-2000 to 2004-05 period, it has more than doubled to 2.6

[1] *According to official data, Naxalite extremism has engulfed some 120-160 of the 607 districts in the country in recent years.*

per cent. However, the downside to the situation is that this growth in employment has been almost entirely achieved through a massive increase in self-employment in both urban and rural areas, and even in agriculture, which is likely to have been forced upon the poor by lack of regular wage employment and various forms of casualization of labour. A sign of this is a distinct fall in wage employment in agriculture. Without social security of any sort in most cases and the widespread distress in agriculture faced by the majority of the population, what India is probably facing is very unsatisfactory growth, or even shrinking of decent employment opportunities, despite a high growth in output.

The relationship between employment and output growth

The performance of employment in relation to output growth is the outcome of a range of factors. It is influenced by:

a. Sectoral growth rates;

b. Sectoral employment elasticities, and

c. The initial (base/final year) sectoral weights in output and/or employment composition.

Thus, a convenient statistical decomposition (keeping also in view data requirement) could proceed by breaking up the aggregate employment elasticity of output or GDP (n) into,

(1) $n = (\Delta L/L)/ (\Delta Y/Y) = \Sigma g_j w_j / \Sigma r_j k_j$,

where g_j = employment growth rate of sector j, r_j = output growth rate of sector j and w_j and k_j are employment and output weight of sector j, respectively.

Further, the output weights can be converted into employment weights by looking at sectoral productivity differential ratios, e.g., services producing 51 per cent of output with 22 per cent of labour force implies services has a productivity m_j (for any j = agriculture, industry or service), (0.51/0.22) = 2.32 times the national average. Agriculture contributing about 26 per cent of output with 60 per cent labour has a productivity (0.26/0.60) = 0.43 times the national average, and industry has a productivity (0.23/0.18) = 1.28 times the national average. By definition,

(2) $k_j = (Y_j /Y) = (y_j L_j / yL) = m_j w_j$.

Further, the sectoral elasticities are given as,

(3) $n_j = (g_j / r_j)$

Recombining (1), (2) and (3) in various ways depending on data availability, we can obtain alternative measures of aggregate, sectoral or sub-sectoral elasticities of employment. However, so long as the data base is similar, they must all yield similar estimates.

Various estimates, mostly using a similar database, are available. The Planning Commission of India reports an almost steady decline in employment elasticities in both agriculture and manufacturing. The former declined from about 0.64 for the period from 1972-73 to 1977-78 to 0.01 for 1993-94 to 1999-2000, while for the same periods, the latter declined from 0.55 to 0.33. The overall elasticity declined from 0.61 to 0.16 (Nayyar, 2006). Another estimate comparing the pre-reform period from 1983-84 to 1987-88 to the post-reform period from 1993-94 to 1999-2000 tells a similar story of decline in the aggregate elasticity from 0.62 to 0.16 with more detailed sectoral breakdowns (Dasgupta and Singh, 2005).

Thus, looking at the picture till 2000, it can be said without much exaggeration that the experiences of India's high growth suggest that despite economic liberalization in the first round, the country was moving almost in the opposite direction in terms of output and employment growth. As already mentioned, the picture may have changed somewhat between 2000 and 2004, but until a clearer picture emerges about what the growth in self-employment really entails, it is wiser to suspend judgement.

Thus, during the period 1994-2000, despite an average output growth of nearly 8 per cent, employment growth has been only 1.02-1.07 per cent, implying output elasticity of employment of about 0.15. The aggregate elasticity is so low precisely because agriculture with a high output weight of about 60 per cent had elasticity of only 0.02, while the corresponding elasticity for industry was 0.38. In services, which is the fastest growing sector in the economy, contributing 51 per cent of the output, but only 22 per cent of employment in 2002, the elasticity was 0.35 (Papola, 2005).

The most undeniable feature of India's dismal performance in terms of employment growth is the stagnation of employment opportunities in agriculture, which still provides livelihood to the majority of Indians.

Two facts stand out here. Decline in employment growth in agriculture has been sharper than in other major sectors because the labour productivity differential has increased steadily over time between the agriculture and non-agriculture sectors (industry and services). The slow growth of agricultural employment is not primarily due to high labour productivity growth in agriculture as compared with the other sectors. On the contrary, it is due to overcrowding without provision of adequate livelihood in agriculture.

It is also a valuable lesson of the recent Indian (and Chinese) high growth experience that despite high output growth, the non-agricultural sectors are unable to provide enough jobs to make a dent in the overcrowding that exists in agriculture. Thus, we might suggest that the non-agricultural sectors in India are registering high growth in output and labour productivity with an aggregate employment elasticity of around 0.30, which is too low to lift average livelihood in agriculture. The consequence is an increasingly overcrowded, low productivity agricultural sector with a miserable rate of employment growth and no route of escape to the non-agricultural sector.

This indeed is the central problem that the Indian economy faces and simply pushing for still higher growth will not make this problem go away. Using standard national income statistics of the distribution of GDP and employment by sectors, the following table has been computed to illustrate how an almost 'scissors crisis' is developing between labour productivity in the primary (mostly agricultural) and the secondary and tertiary (non-agricultural sectors), all considered as ratios of the national average labour productivity, i.e., in the above algebraic decomposition m_j, where j represents the primary, secondary and tertiary sectors with subscript p, s and t, respectively.

Labour productivity as a proportion of national average in	1987-88	1993-94	1999-2000
Primary sector (m_p)	0.51	0.48	0.41
Secondary sector (m_s)	1.53	1.18	1.69
Tertiary sector (m_t)	2.28	2.05	2.09

Source: CSO

Corporate logic for efficiency and economic openness

A high growth in GDP with a low growth in employment necessarily implies that most of the GDP growth is accounted for by a growth in labour productivity, and not by expansion in employment. In this sense, jobless growth is driven mostly by relatively high labour productivity growth, rather than employment growth. It can be argued that this emphasis on raising labour productivity at the cost of the level of employment results to a significant extent from the thrust to integrate more rapidly with the world market. As globalization tends to increase the relative importance of the external vis-à-vis the internal market, the compulsions of globalization take the form of exploiting successfully this greater dependence on the world market through greater international cost competitiveness.

Since the size of the total world market is beyond the control of any individual nation state, especially for a country like India, the case is implicitly or explicitly made for focusing on increasing the share of India in the world export market. In so far as the main route for achieving this is greater international cost competitiveness, a host of measures that help in reducing unit production cost becomes justified. A general aim of all these measures is to achieve wage restraint in relation to labour productivity, and this justifies measures directed towards promoting productivity rather than employment growth.

The routes to higher productivity can be many, e.g., higher productivity through downsizing the labour force, longer hours of work without proportionate increase in pay, i.e., 'efficiency wages', which helps to raise productivity in relation to wage rate per worker, voluntary retirements, privatization, casualization of labour and more flexible employment contracts by reducing labour hoarding costs using strategies such as outsourcing to the informal sector and banning workers' right to strike (D'Souza, forthcoming; Das, forthcoming). A common economic thrust of all these measures is to improve the international cost competitiveness of the economy as it becomes more open.

The principle of applying the micro logic of corporate management about the reduction in labour cost to the economy as a whole, and viewing it in effect as a single corporation which is expected to increase its international market share by out-competing rival trading nations by cutting costs, appeals to economic nationalism as well as to untutored economic common sense. This sort of reasoning underlies even the Washington Consensus and many of the 'conditionalities' set by the IMF for 'stabilization', and by the World Bank for 'structural adjustment' in developing countries. And yet, the reasoning often turns out to be seriously flawed because the micro logic applicable to a single corporation might involve some serious macro fallacies when applied to the system as a whole.

At the most obvious level, it ignores the fact that all countries cannot be winners at the same time in the zero sum game of competitive cost cutting in order to produce an export surplus. Since the shares add up to unity, a larger share for some countries of the global market must mean a smaller share for the others, and the export surpluses of some countries must have their counterparts in the import surpluses of other countries. In this sense, the policy must fail for some countries if it succeeds for others. It becomes in effect a 'race to the bottom' as each country tries in isolation to gain a larger share of the world market. In that process, they might be forced to adopt measures such as reducing competitive unit costs by cutting wages, lengthening the hours of work at the same wage, restricting workers' rights, and refusing pensions and social security by casualizing labour. In short, the increasing pressure to introduce greater flexibility in employment contracts becomes the name of the game.

This race to the bottom for cutting unit costs has a high political cost for developing countries because it leads to the systematic undermining of solidarity and political cooperation among them. Most countries gain little individually from this race, and they definitely lose collectively because they weaken their international bargaining position. Thus, the economic fallacy of composition that results from not taking into account the zero sum nature of the game of international competition manifests itself as a political weakness in the developing countries' international negotiating position in trade. At home, it erodes the credibility of the governments with the poor sections of the working population.

Openness under globalization has several dimensions involving not only the market for goods and services traded internationally, but perhaps even more importantly, the market for capital for investment and financial flows. The same logic of the race to the bottom spreads also to other aspects of openness under globalization and affects policies involving foreign investment and even the financial markets. Competitive liberalization amounting to little more than competitive concessions to big business becomes the general pattern. Concessions to direct domestic or foreign corporate investment involve competitive tax breaks for national corporations as well as MNCs, enforcing labour discipline through the law enforcing machinery of the state, granting special banking insurance and other financial facilities to potential corporate investors and other similar measures.

Particularly telling in this respect is the recent proposal for Special Economic Zones (SEZs) in India. Until September 2006, the Board of Approvals Committee of the Indian Ministry of Commerce approved 267 SEZs, 'deemed as foreign territories', with sizes of between 1,000 and 14,000 hectares in different parts of the country.[2] There is also a move to acquire tribal land for private corporates, often at below market prices.

The Panchayat Extension to Scheduled Areas, or PESA, Act of 1996 requires *gram sabhas* to be consulted in land acquisition. However, this is seldom done, and a recent report provides some details of the process which is not always democratic (*Nandini*, 2006).

In a variation on the same theme, in many parts of the country, land cultivated by the peasants is being handed over to various corporations in the name of industrialization, although only a fraction of the land will be used for setting up industry. A race to the bottom has started even among the Indian states for providing corporations with land to set up industries.

As a model for organizing production, corporatization often involves creating or extending control over a long value chain in production. It can take different forms like vertical integration or various forms of outsourcing and sub-contracting to formal or informal subsidiaries. Available estimates suggest that intra-firm trade accounts for no less than 40 per cent of international trade in manufacturing and services. While vertical integration in production has been the more traditional model for manufacturing MNCs, in recent years, in several areas of services, sub-contracting and outsourcing have become the dominant mode for extending the value chain (Palit, forthcoming).

From the point of view of the mainstream economic theory of endogenous institutional development (Coase, 1937), the size of the corporation would be determined by balancing the cost at

[2] *So far, 134,000 hectares have been acquired for 67 multi-product SEZ projects, mostly by state industrial development corporations.*

the margin between producing within the firm (e.g., vertical integration) and procuring or transacting through the market (e.g., sub-contracting to another firm). As the relative importance of the external vis-à-vis the internal market increases under globalization, entering the intra-firm value chain becomes an important reason for favouring MNC investments. In so far as developing countries are concerned, they are usually able to penetrate foreign markets and the international distribution system by becoming a part of the established intra-firm trade network. They try to achieve this by lowering the transaction costs for MNCs in their countries in one way or another, and the race to the bottom appears again in the guise of lowering the transaction costs for the corporations.

This way of becoming a part of the corporate value chain leads at times to the lopsided development of enclaves for exports without sufficient forward or backward linkages in domestic production. As a result, development fails to spread either over a sufficiently wide range of economic activities or to the poorer section of the population. A glittering urban centre or a high-tech exporting zone developing in isolation, detached from the poverty and backwardness that surrounds it, has too often been the outcome of such strategies. The result is an increase in relative poverty and deprivation, leading to social tensions of various sorts. Unless safeguards are put in place, the strategy of creating SEZs would run the same danger in India.

Global finance: A defining characteristic of globalization

A different aspect of globalization has increasingly become its defining characteristic over the years. It had its origin in the financial deregulation of capital markets that has been taking place since the mid-1970s in countries that are members of the Organization for Economic Cooperation and Development (OECD). Over the years, it has phenomenally increased the volume of private trade in foreign exchange. In comparison to its daily volume of some $1.2 trillion (BIS, 2001; 2002), the total foreign exchange reserves of all the central banks together barely amount to a couple of days of private trade. Foreign trade and investment together do not account for even 4 per cent. In formulating their economic policies, national governments can no longer ignore the sentiments of private traders in the financial markets. Expansionary fiscal policies for fighting unemployment through budget deficit or higher taxes on the rich to expand government programmes are generally not favoured by financial markets; instead, regressive tax cuts favouring the rich and stimulation of the stock and real estate markets through monetary or taxation policies are seen as preferred options for managing demand. Politically, it makes a mockery of the original Keynesian and social democratic vision of cooperative capitalism, in which a neutral state is supposed to follow even-handed policies benefiting both capital and labour. The typical consequences of abiding by the sentiments of the financial market have been an over-sensitivity to inflation, a tight money policy to discourage capital outflows through insistence on greater independence of the central bank and, most importantly, a near-paralysis of expansionary fiscal policies through higher government expenditure under the false pretence that wage restraint and labour market flexibility or labour training can substitute for expansionary demand management policies.

Viewed from this angle, the Fiscal Responsibility and Budget Management (FRBM) Act of 2003 has implications that might have been less obvious at first sight. It is interesting that the Act was not crisis-driven, but strategy-driven, because it was enacted at a time when the Indian economy was not facing an international payments crisis; instead, our foreign exchange position was comfortable and the stock market was booming.

However, this Act, by reducing government spending in some needed areas, certainly does not serve the interests of the poorer sections of the Indian population. It is a cruel joke of academic economics in the present Indian context to talk of inter-temporal optimal choice involving future generations, when about half of our children in the present generation remain undernourished and we have the highest number of illiterates and homeless. By virtue of this Act, the Central and state governments are restrained from spending in social sectors such as basic education, health, and social security, especially in the unorganized sector.

This is particularly unfortunate at a time when the excess demand from higher government spending can be met to a significant extent through utilization of existing excess capacity in many of the critical construction materials and wage goods sectors, and a comfortable reserve of foreign exchange has accumulated to smooth over particular supply-side bottlenecks.

In these circumstances, the standard Keynesian argument has a good chance of succeeding in expanding productive employment without inflation. It must be added here that any such rural employment expansion programme cannot succeed in generating productive employment under the present system, unless the government can induce local investments and get panchayats to execute the spending.

Even in a scenario not so favourable to rural employment expansion, greater spending might lead to some increase in prices, mostly the prices of wage goods. But, in effect, it would mean a redistribution of income in favour of the poorest sections among the unemployed. In this case, should not the natural response of the government be to try to strengthen and decentralize the public distribution system in rural areas?

The imprint of rising financial interests on India's development strategy has been unmistakable in recent years. Economic policies are being formulated increasingly with a view to the sentiments of the financial markets, and there is a reason for this. The Indian stock market is pathetically small in relation to the vast global private trade in foreign exchange, so the rupee and Indian stocks can easily be set into an uncontrollable downward spiral by a few large international players speculating against some Indian stocks or the rupee, while the increasing quantitative importance (about 52 per cent of inflows in October 2006) of anonymous participatory notes (PNs) can leave unnamed the origin of any such crisis.

The confidence that the team of economic policy makers enjoy at the IMF and the World Bank is a critical part of the story because those two institutions are in a pivotal position to influence the perception of private foreign investors like multinational corporations, banks and other financial institutions.

Employment generation and the internal market

From the broader economic perspective, the most important consequence of this style of economic management has been the neglect of domestic demand. On the one hand, the attempt to integrate hurriedly with the world market for goods and services through labour productivity growth results in insufficient employment generation. On the other hand, the attempt to integrate with the world financial system, through crippling government spending, has constrained pro-poor social and economic expenditure, especially rural employment generation activities. In a mutually reinforcing process of cumulative causation, India's non-inclusive growth causes and is caused by inadequate growth in employment, especially for the poorer sections of the population.

It is not always recognized that in a large sized economy like India, which has a relatively small foreign trade sector, the disadvantage of slower growth in domestic market size easily outweighs quantitatively even a relatively rapid expansion of the export market. With expenditure on domestic consumption and investment goods as the determinants of the internal market from the expenditure side of national income, the quantitative importance or the statistical weight of consumption expenditure far outweighs that of the external market in India, roughly defined as export minus import.

For instance, on a rough estimate, a 1 per cent decrease in total consumption expenditure in India might require a 12-fold increase in exports to compensate for the fall in demand (other things held constant) for maintaining the same level of aggregate demand.

The message from such arithmetic is unambiguous. In the case of India, it would be unwise to depend exclusively on the expansion of exports for maintaining adequate aggregate demand, and great caution should be exercised in stimulating export at the cost of domestic consumption demand.

Employment and pro-poor growth would begin to be complementary once we begin to focus on expanding the size of the domestic market. Globalization and emphasis on the external market predispose us to look upon increases in labour productivity as a mere cost-cutting measure. The cost reduction is important for corporations to increase their market share and their profit margin. The same logic applies if economic policy makers focus only on the external market for increasing our share of the global market, but not if the emphasis is on the internal market. However, once we recognize the importance of the domestic market, this corporate logic of management for increasing labour productivity no longer applies.

It is easy to see the inherent fallacy of composition in this corporate view of management. Suppose all corporations in the economy downsize their labour force by half and the total employment drops to half. If wage remains the same, labour cost also reduces by half because each person produces double the amount, but gets the same wage as before. With employment reduced by half, the total wage bill of the economy also reduces to half. As a result, domestic purchasing power and the size of the domestic market are reduced. As already pointed out, in most cases, because of sheer differences in statistical weights, exports are unlikely to rise to compensate for the loss in consumption expenditure and maintain the same level of aggregate demand.

The problem that the corporations would now face is the lack of a market to sell their products. Therefore, even if their profit margin per unit is higher due to the lowering of labour costs, they might well end up failing to sell a large part of their production and making less, rather than more, total profit. This has been described as the consumption or wage-led 'stagnationist regime', particularly in view of the fact that weak expansion of domestic demand due to a weak acceleration-like effect on investment would not stimulate private investment adequately (Bhaduri and Marglin, 1990).

The downsizing of the labour force is only one example of how the microeconomic logic of cost reduction encouraged by corporate management differs from the macroeconomic logic of managing the whole economy. The difference between the microeconomic and macroeconomic logic is not merely a matter of change of scale. The essential economic logic becomes different due to a possible 'fallacy of composition', which arises from the failure to take into account the impact on aggregate demand of the various micro measures intended to cut costs and raise the micro-efficiency of corporations. It warns us that one part like a single corporation or household is not the same as the whole of the economy.

There are many important examples of such fallacies arising precisely on this account. A reduction in the wage rate by one individual firm might benefit it, but when many firms take recourse to the same route of cutting wages, it leads to a lowering of total demand in the domestic market with adverse consequences for sales and profits of all the firms. Similarly, more advertisement might help a firm to increase its market share, provided others do not follow suit.

Therefore, in formulating economic policies for the government, it is essential to avoid confusing corporate or household management with that of the economy. This confusion stems basically from the failure to see that major macroeconomic variables such as labour productivity and wage invariably play two-sided roles in the economy. They affect both supply through cost, and demand. Through cost reductions, they tend to affect positively the size of the external market, but at the same time, through demand reduction, they affect negatively the size of the internal market.

For employment expansion not to degenerate into a self-defeating strategy of simply transferring income from the state, two mutually reinforcing conditions have to be satisfied. On the supply side, income generation must be productive for the society, and in this sense, it has to differ from the pure Keynesian demand management view of 'digging holes in the ground to fill them up'.

This is especially important in India because any such pro-poor strategy of growth will become unsustainable over time without the productive use of unemployed labour. The issue is not keeping the fiscal deficit down, but ensuring that spending is decentralized in a way that it helps to create locally useful productive assets.

On the demand side, employment generation has to expand the domestic market sufficiently without large leaks into imports. This would be more feasible if expansion of employment were biased heavily towards the poorest sections of the rural population, as intended, for example, in the National Rural Employment Guarantee Scheme.

An expanding domestic market for the poor is likely to stimulate a pattern of private investments through the 'acceleration effect', which is more suited in terms of the composition of goods produced for the less privileged population in the country. It is from this perspective that an employment oriented growth strategy needs to be attempted. Merely chasing the target of a high rate of economic growth without considering simultaneously its employment and distributive implications can turn out to be counter-productive.

Focusing on the domestic market will also enable us to look at labour productivity from a very different angle. Instead of the exclusive obsession with cutting costs and restraining wages to improve our international competitiveness and efficiency through higher productivity, we face the problem of how to create an expanding domestic market involving the poor and the economically marginalized. In this context, we must recognize the most obvious thing, which we seem to have lost sight of in the name of international competitiveness. Higher labour productivity is desirable, not merely to cut the unit cost of production, but because higher labour productivity will provide us with more goods and services for a better standard of living. This can happen only if higher productivity goes hand in hand with more employment, but not at the cost of employment growth.

Employment guaranteed at a reasonably satisfactory wage will provide a larger domestic market for the expansion of employment and productivity. This should indeed be the central focus of an alternative design of economic policies.

Trade regimes and internal market

The received wisdom for policies in favour of a more liberalized trade regime should be examined critically from the perspective of the important role played by the internal market in promoting employment and growth. The general belief is that freer trade enhances consumers' welfare by allowing the consumers to substitute domestic goods by cheaper or better quality foreign goods. The argument remains valid only so long as the level of domestic employment is not affected by this substitution. And this is precisely the assumption made by conventional theory, where substitution takes place along the 'production possibility frontier', maintaining throughout the assumption of full employment of resources.

However, once we recognize the importance of the size of the domestic market in determining the level of employment, this view becomes questionable. Substitution against domestically produced consumption or investment goods provides only the initial impulse from the demand side. This initial reduction in the demand for domestic goods tends to get magnified through a sort of multiplier chain reaction. The contraction in demand may spread to different industries and sectors of the economy in a round by round convergent 'reverse multiplier process'. It operates to reduce in a magnified way the size of the domestic market and employment (Bhaduri and Skarstein, 1996).

An example from agriculture might illustrate this argument. Imagine a more liberalized trade regime which leads to the substitution of higher cost or lower quality domestic products by superior foreign agricultural products. It enhances consumers' welfare. However, the sharp fall in demand and sales would force the agriculturalists to either close down or reduce drastically the level of production.

In standard theory propounding the virtues of liberalized trade under all circumstances, the unemployed labour from agriculture would be relocated automatically to some other economic activity because full employment is assumed. But the scenario in real life is less reassuring. In a country already suffering from significant unemployment in agriculture, most of the unemployed labour will not find alternative employment.

The result would be a reduction in domestic purchasing power and in the size of the domestic market. This would lead, in turn, to a reduction in the demand for goods produced by other industries, such as textiles, in the economy, and the resulting drop in their sales would lead to further cutting of jobs and hence purchasing power in those industries. Thus, a chain reaction might go on to affect the demand for such goods as grains, meat and textiles through the 'reverse multiplier process', which tends to magnify several times the original reduction in demand and employment brought about by the substitution of domestic goods by foreign goods in a more liberalized trade regime.

Two points are worth emphasizing in this connection. First, only in the initial round of demand contraction are domestic goods substituted by superior foreign goods. In the subsequent rounds, there may not be any more substitution between domestic and foreign goods, but only an all-round reduction in domestic production and employment in various industries (e.g., in textiles) due to a reduction in domestic demand.

Comparing the number of jobs and livelihoods lost as a result of this process, with the gains from substituting only in the initial round superior foreign goods for domestic goods, it is far from certain that the gains would outweigh the losses. It would be impossible to maintain that the liberalized trade had increased the welfare of society as a whole. It is only the questionable assumption of full employment in standard theory that makes the case for freer trade favourable by diverting attention from its impact on domestic demand and employment.

This argument needs to be qualified in an important respect. When buying essential foreign goods not available domestically, no substitution between domestic and foreign goods is involved in the first place. As a result, the contraction of domestic demand through the reverse multiplier discussed earlier would not be relevant. It is in this context that we need to consider critically many policies that are under consideration in India, such as infrastructure development through foreign borrowings that typically tend to substitute domestic production with foreign production, with a negative impact on the expansion of the domestic market through the reverse multiplier process.

The extent of emphasis to be placed on the relative importance of the internal market over the external market should be considered in relation to the benchmark of moving rapidly towards a full employment society. Employment, in turn, means giving income to the people to expand their purchasing power, and thereby the size of the domestic market. On the other hand, it must also mean their productive engagement in production. This is the essential economic content: The right to regular income for a decent living would have to be matched by the duty to contribute to social production.

To explore the possibilities of productive and sustainable full employment in the least developed countries, we must pose the relationship between GDP (gross domestic product) growth and employment growth somewhat differently, indeed more imaginatively. We should not think of employment as the consequence (endogenous variable) of GDP growth and reject as unhelpful the notion of 'growth first and employment later'. This will not succeed in the context of most of the least developed countries, no matter how the growth is financed. We have to reverse the strategy instead to one of 'employment first, with growth as its consequence'.

The problem of how full employment is to be achieved can be analysed in two logically distinct steps: first, with reference to the productive capacity of the real economy, and second, with respect to the method of financing it. If the domestic economy is capable of providing most of the goods and services for sustaining the employment programme over the short and the long run, a method of financing it can be found. Notwithstanding the FRBM Act, money is only an ingenious human device meant to make the real system work better, not worse.

At one level, the difference between money and the goods that money can buy is simple. The domestic economy cannot produce real goods and services if the capacity to produce is not there, but a government can always 'print money' by creating liabilities with the central bank. By this arrangement, the government borrows from the central bank, and this liability of the government becomes an asset of the same value in the books of the central bank, which now creates its own liabilities to the public in the form of currency notes. Creating or printing money in this sense is no more than juggling with double entry book-keeping. It is ultimately the government which borrows from the public, but the borrowing has to be routed through the central bank, which usually has the authority to print currency notes.

It is also useful to distinguish between the two modes of financing imports, i.e., between foreign capital inflow through borrowings from abroad, and foreign equity investment. In the former case, the debt has to be serviced by paying interest in all circumstances, irrespective of whether the project financed from this debt makes a profit or not. In that sense, it is 'debt-creating'. In the latter case of genuine equity investment, dividend is paid from gross profit, and there is usually no servicing obligation if the project fails to make a profit, and in this sense, the investment becomes 'non-debt-creating'.

When foreign capital inflow is debt-creating and, therefore, the debt has to be serviced in all circumstances, the argument that the government has 'no money' due to Acts like FRBM and, therefore, has to borrow from abroad becomes even less tenable. It is not reasonable to argue that the obligation to service debt to foreigners is in any way less demanding than servicing domestic debt to the public; indeed, the former can usually be more burdensome because the debt servicing has to be done in foreign exchange.

A fundamental difference exists between financing through foreign and domestic borrowing by the government. It is related to the property of money as legal tender. By law, the national currency has to be accepted in settlement of all payments, but this naturally holds only as far as the law of the land holds. However, since the national currency of a developing country would almost invariably be a 'soft' currency, 'hard' currency loans have to be repaid in hard currency, dollar for dollar, euro for euro, or yen for yen. Consequently, foreign exchange has to be there to service foreign debt, by exporting, further borrowing abroad, or as aid. A foreign exchange crisis is a symptom that the government is running the risk of default, at least in the perception of the foreign lenders.

This would happen far less dramatically and less abruptly with respect to domestic lenders and domestic debt because the national currency is legal tender. The government can always borrow from the central bank the amount required to service its domestic debt, unless the government willingly ties its hands on this count with laws such as the FRBM Act, or unwarrantedly strives for the independence of the central bank from this employment-generating development perspective.

For the government to remain credible and the debt to be sustainable over time, the ratio of debt to income cannot be allowed to increase indefinitely. This, in turn, requires the rate of growth of GDP to exceed the interest rate at which the government borrows (Domar, 1950; Avramovic, 1964; Solomon, 1977; Bhaduri, 1987). Although the complete algebraic demonstration of this proposition is somewhat elaborate, its essential economic logic is easy to see. If 'v' is the incremental capital output ratio, then '1/v' is the income stream generated per unit of investment financed by borrowing. Assuming 's' is the (average and marginal) propensity to save, 's/v' is the saving generated per unit of borrowing which can be used to service debt at an interest rate 'i'. Consequently, 's/v' has to be greater than or equal to the interest rate, for debt to be sustainable, where 's/v = g', the rate of growth, by simple decomposition, also known from the Harrod-Domar formula.

From this point of view of sustaining debt, the rate of growth of GDP is important, even if the growth is financed mostly by domestic borrowings.

The determinants of the growth rate are many. However, economic analysis normally decomposes, as in the above formula, the growth rate into the productivity of investment ('1/v'), and the share of investment (= saving) in GDP.

A serious lacuna of the standard view has been to treat the productivity of investment as technological data. If excess capacity and unemployment exist, more investment by creating a larger domestic market can raise capacity utilization and, therefore, the productivity of investment. For instance, suppose a shoe factory is set up with an investment of, say, Rs 3 crore, producing an average annual output of Rs 1 crore. This implies that the incremental capital output ratio, or the productivity of this particular investment, is 1:3. Suppose now that the full employment programme creates more demand for shoes, and the factory doubles its production to meet the demand. This would raise the productivity of the same investment to 2:3. Thus, it would be a mistake to assume in general that the productivity of investment is technologically given at 1:3, and cannot be influenced by the state of demand.

In many industries and activities, the productivity of investment could rise in this manner due to higher capacity utilization through the expansion of the domestic market. Standard theory misses this obvious point because it assumes that there is always enough demand to ensure the full utilization of all the resources in the economy. In general, this is an untenable assumption.

We also need to remind ourselves that the overall productivity of investment in the economy depends on the composition of investment, i.e., how it is distributed among the various sectors of the economy. For instance, a more decentralized scheme for investments using a lot of unemployed labour would normally raise the overall productivity of investment. More specifically, a greater number of labourers employed with some simple equipment at the local level would typically raise output per equipment, i.e., the productivity of investment.

While this would usually be achieved at the cost of relatively low labour productivity, we need to remember that even if labour productivity is low for such decentralized investment schemes, these workers would have been otherwise unemployed labour with virtually zero productivity.

We could consider this problem from another angle. Growth can be examined either in terms of the amount and productivity of investment as in the preceding discussion, or in terms of the amount and productivity of labour employed. A more useful way in the present context is to view growth in GDP directly in terms of employment.

Growth in employment and growth in labour productivity together add up to growth in GDP. If the growth rate of employment were increased by 1 per cent, the GDP growth rate would also increase, so long as labour productivity did not fall by more than 1 per cent, i.e., an employment elasticity of productivity which is less than unity in absolute value. In short, so long as we are able to raise the employment growth rate without a compensating fall in labour productivity growth, the economy would continue to grow faster. This should be the central criterion for raising or accelerating the growth rate through expansion of employment financed by public expenditure, in contrast to viewing labour productivity as a cost reducing device as discussed earlier.

Institutional requirements

A considerable degree of decentralization would be absolutely essential for the success of the employment programme. Decentralization can begin only if local governments are established, strengthened and not treated simply as implementing agents for the national government. They must have a considerable degree of authority and fiscal autonomy.

The second pillar for a successful full employment programme through decentralization requires transparency at all levels. Many of the local governments may turn out to be corrupt or incompetent, or both. But this does not justify a case against decentralization because it would usually be equally true for the central and the local governments. Making the reasonable assumption that inefficiency, corruption and vested interests are randomly distributed at all levels of government, we should give neither the central nor the local government exclusive supervisory power over the project. Many local governments would undoubtedly fail, but some would succeed. And extensive decentralization means that their large numbers would allow for this experimentation to proceed with several chances of success. This is a decisive advantage of decentralization, especially when the governance for development is distant, immune to local pressures and often callous at the central level.

The right to information at all levels is a necessary condition to bring about the accountability necessary for reducing inefficiency and corruption. Only when transparency and accountability through fixing of responsibility are enforced at all levels can the march towards genuine development through full employment begin.

It needs to be emphasized that the principle of symmetry has to be respected in ensuring transparency and accountability. If the national government wants to hold local governments accountable, but refuses to be accountable itself, the asymmetrical exercise of authority would soon lose legitimacy in the eyes of the local governments and the people. Therefore, the development schemes for employment generation would require an equal degree of transparency at both the central and local levels, especially regarding how the funds are allocated and used, and what work is being done with them.

For regulating and monitoring the work of the local governments, a different kind of design is required, rather than simply more supervision by the Central bureaucracy. The representatives of the local governments would normally face the local community more frequently than those of the Central government. If the employment budgets of the local bodies are kept open for public inspection by law, this can create conditions that are more conducive to continuous accountability.

This is far more difficult with the Central government because of its larger and more distant administration, and because of the complexity of accounting, but it is feasible at the level of the local government. It would make most information relating to any particular employment project easily available, e.g., names and addresses of the persons given employment, the wage rate, the number of days worked, the type of work done, and the total money spent in relation to that sanctioned for the project. The information has to be on public display in each local government office as a matter of routine by law, and as a pre-condition for receiving funds. In short, the nationalized banking system can provide both support and counter-checks, strengthened by the greater transparency and accountability of the Right to Information Act, 2005, without creating further bureaucratic structures (Bhaduri, 2005).

Strangely enough, there's almost no serious initiative toward this end in sight. We hear instead of road maps for liberalizing the capital account, establishment of special economic zones through forcible acquisition of land by the state and Central governments, privatization of basic services in the name of public-private cooperation and restriction of the scope of the Right to Information Act. Unless public spending is genuinely decentralized by giving financial autonomy to the *gram sabhas* to decide on local investments, and panchayats to execute the spending, large-scale productive employment generation cannot become a reality in rural India.

In order to ensure that the money is well spent on a project, its physical progress should be monitored. For reasons already mentioned, this should not be the job of the Central politicians and bureaucrats. Instead, a mechanism should be designed which relies as far as possible on the twin principles of self-selection and self-supervision in three different ways.

First of all, all adults offering to work for the minimum wage at which employment is guaranteed by the government should be given employment. Mostly, it would be the poor that volunteer for such low-wage employment.

Second, the project chosen by the local bodies should try to benefit directly as far as possible those who are employed. This would create the necessary condition for self-supervision. Since employment would be given mostly to local people, those employed in the project would also have a voting right in the choice of the project. Local governments would be told that their track record in the first project would count in being given funds for the next project. Initially at least, short-yielding projects and their quick completion should be preferred in establishing the track record for receiving future funds.

Finally, the money should be channelled to the local governments through the nearest branch of a bank. When a project is completed according to the bank and the local government, it would count as an asset of the local government against which it can borrow further from the bank.

The completion of the project would have to be certified by one or more randomly chosen bank officials (not from the same local branch to avoid corruption), as well as all the representatives of the local government. While this would be one check on the physical progress of the project, the other check would be its self-supervision established through sensitivity to local needs.

The local government should have the right to charge a price or fee for the use of a local public good from all users, except those who were employed directly at the minimum wage to work on the project. The reason for this is not simply equity. This would also be a way of introducing the idea of a 'social' component in 'private' wages. Through this, the workers on the project would gradually learn to demand its services and proper functioning as a right, and not as a favour done to them. Naturally, how many people pay to use the facility created by a project would be a self-supervised indicator of the extent to which it really satisfies local needs. This should become a critical factor in determining the asset value of the completed project.

Accountability at all levels, combined with productive participation by the poor through the twin principles of self-selection and self-supervision at various decentralized levels of local government, can chart out the new path of employment oriented development in India. People, rather than large corporations, would be at the centre of such a growth process. This is the only way to genuinely inclusive growth, which democratic governments in poor countries can ignore only at their own peril.

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