Constraints to achieving full employment in Asia

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In this paper Dipak Mazumdar of the University of Toronto looks at constraints to achieving full employment in Asia. His purview includes East and Southeast Asia and South Asia. He first sets out what the objectives of a policy for full employment in those countries should be. In his view such a policy should be geared to the objective of increasing the earnings of labour, and will generally include three components: (i) to increase the income per earner in the non-wage sector; (ii) to reduce the gap in income per earner between the wage and the non-wage sectors; and (iii) to increase the proportion of employment in the dynamic parts of the wage sector. Generally, all three components go together in a successful employment policy. Mazumdar reviews a number of characteristics of Asian labour markets including wage differentiation by firm size and the role of the informal sector. He stresses the continuing importance of the agricultural sector in influencing the supply price of labour. He looks at major elements of industrial and trade policy in the Asian countries and concludes that a “golden mean” is needed between the “inefficient, autarkic solution of South Asia” and the “often uncontrolled policies favouring foreign borrowing-cum-export expansion strategies pursued by many countries in the East and Southeast Asia region”. Finally he concludes that increasing the growth rate of non-agricultural production is only the beginning of the story. The way the increased output is divided between wage increases and employment increases, and also the way the informal and the formal sectors relate to each other, are crucial determinants of the employment implications of non-agricultural growth.

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I. Meaning of full employment in Asian economies

The meaning of full employment in Asian economies (as in other developing countries) is not the same as generally used in the developed market economies. Textbooks written with the latter in mind have in the background the concept of an integrated labour market in which the overwhelming majority of job-seekers work for a wage determined in the labour market. If a job-seeker is not employed for the established wage rate for his type of labour (however determined) he will be openly unemployed. Thus the objective of a “full employment” policy is to minimize the proportion of the unemployed in the labour force, consistent with the requirement that a certain amount of unemployment (“frictional” unemployment”) is necessary to ensure smooth functioning of the labour market. The distinguishing characteristic of the labour markets in developing countries are first, that a very large proportion of employment is not in the wage labour market: self-employed earners and unpaid family workers constitute a substantial part of the labour market. Secondly, although there is large interchange of labour between the wage and the non-wage sectors of the labour market, there are many reasons why the rewards to labour are not equalized between these broad segments of the market geared to the objective of increasing the earnings of labour, will generally include three components: (i) increase the income per earner in the non-wage sector; (ii) reduce the gap in income per earner between the wage and the non-wage sectors; and (iii) increase the proportion of employment in the dynamic parts of the wage sector. Generally, as we shall see, all three components will go together in a successful employment policy.

A couple of points of elucidation are in order on the proposed criteria. First, the criterion (iii) recognizes that there is a hierarchy of earnings per worker in every economy, and that one of the objectives of employment policy would be to encourage a larger proportion of workers to move into the sector of “good jobs” (Lewis 1958). But such sectors are not pre-determined. New sectors with increasing productivity (and earnings) are constantly emerging. Although securing a foothold in the growing sectors is sometimes a matter of chance selection, preparing workers with requisite skills is an essential element of enhanced opportunities. It also needs to be stressed that training in specific skills is best done within individual enterprises. What general employment policy can do is to provide workers with a broad spectrum of general skills which enable them to move around the range of emerging opportunities in the labour market. This underlines the importance of the type of education policies with their emphasis on late primary and secondary education which are often noted in the economic growth East and South-East Asian countries, and which might have been deficient in South Asia.

One other point should be stressed in defining the contents of a “full employment” policy in developing countries. The determinants of the supply of job seekers in an economy, whether developed or developing, are two: the rate of population growth in the working age group; and the rate of participation of labour in the labour force. In the medium term the natural population growth rate will be of minor importance directly, since those who will be in the labour force for up to 15 years ahead will already have been born. But the changes in participation rate will be of importance even in the medium run, and of much greater importance in the developing countries. This is because the shift of labour from household to market activities is much more pronounced in the growth of developing economies. This is particularly true of women workers. But we should take care to note the specific nature of changes in participation rates. For example, the shift of households to urban market work might reduce the participation rate of women, but this
might be due to institutional barriers to women’s work rather than to optimizing decisions of households. The increase in income per earner, consequent on the decline in participation, might be a false signal of labour market progress. Thus it might be as important to think in terms of income per capita as of income per earner, although the latter is closer to the concept of returns to labour. We now turn to a more detailed discussion of the structure of labour markets in the rural and the urban sectors, with specific reference to the role of the non-wage sector in each.

Rural Labour Markets

In the literature of development economics the theory of “surplus labour” has been advanced to describe the typical labour market situation in the rural sector. With the pressure of population on land the marginal product of labour falls well below any positive return to a unit of labour which can sustain the working strength of a worker - the level which provides the floor to the wage level in the wage sub-sector of the rural economy. But this “surplus” labour is not openly unemployed, it is absorbed in the family farm. Both work and income are shared out among the members of the family, so that the income of an adult worker in the family farm would approximate the average rather than the marginal product of labour in such farms.

More recent research, particularly village studies in the early seventies in Java, has helped to sharpen the idea of surplus labour. Empirically it was established that the concept did not imply a great deal of idle time even in the slack agricultural seasons. In fact at low levels of income, participation rates of women and children in agrarian families is high, and every member of the labour force has to spend long hours of work trying to eke out a tolerable level of income. Rather the phenomenon is described in terms of (a) a multiplicity of occupations for a typical worker; and (b) a hierarchy of earnings per hour in the different activities, with the earnings in the major agricultural activity viz. the cultivation of rice being so much higher than in the other activities in home industry, trade and services. Surplus labour could be said to exist in the sense that a great deal of labour time of rural workers was devoted to the marginal activities with low earnings. This definition, in fact, was already available in a theoretical model of Hymer and Resnick (1969) which contained little empirical detail, but was derived from intuitive observations in Ghana and the Philippines. Hymer and Resnick called the marginal activities in the rural labour market Z-goods. We shall adopt this nomenclature in the subsequent discussion.

In Asian economic studies a broad generalization is often made between South Asia with its population pressure and South-East Asia where land is relatively less scarce. It is expected that the incidence of surplus labour in the sense defined above would be less in East and Southeast Asian countries (ESEA hereafter). Clearly the rural labour market situation varies from country to country and estimating its actual dimension is only possible in country-specific studies. But we should draw attention to the point that even in economies in which the land-labour ratio could be expected to be relatively high, the surplus labour problem might be significant for other reasons. Thailand is a case in point. In recent decades large tracts of unoccupied land has been available for resettlement of agricultural population from other regions of the country. But we nevertheless see two ways in which the incidence of surplus labour remains significant. First, there is strong seasonality in the demand for labour in the way the Thai agricultural system has evolved. Secondly, there is a severe regional problem which internal migration flows have been unable to eradicate. The difference in income per earner (or per capita) between the poorest
North and North-Eastern countries and the other regions, particularly those surrounding Bangkok, is large and persistent.

**Urban Labour Markets**

The co-existence of two broad sectors in the urban labour market, widely separated by their level of earnings unrelated to the human capital attributes of the workers, has also been emphasized in the analysis of the developing economy. The high wage sector is called the “formal” sector because it is dominated by large firms or government employment, in which well defined wage and employment contracts prevail. The “informal” sector by contrast has flexible work arrangements. The most important part of it is, of course, self-employed petty traders and businesses, but it also includes such large groups as casual day labour and wage workers in small enterprises (typically not subject to legal registration). The dichotomy runs parallel to the Latin American distinction between the “regulated” and the “unregulated” sectors. Since in Latin America attempts at regulation have extended into the economy of the self-employed much more so than in Asia, the “informal” sector is also seen as a sector dominated by evasion of regulation.

There are two separate aspects of the formal-informal sector dichotomy which are relevant to questions of efficiency and equity in urban labour markets and to employment policy. The first is the causes of the earnings differential between the sub-sectors: are they being artificially maintained by institutional mechanisms like minimum wages, government regulation etc. Second, what is the degree of vertical mobility from the informal to the formal sector. Clearly if there is easy transition to the high wage sector, problems of efficiency and equity will be much reduced.

The popular Harris-Todaro model postulated a “formal” sector in the urban economy where wages are maintained at a high level through institutional pressures. Migrants from the rural areas pour into the urban sector in the expectation of breaking into the high-wage segment, but since only a small part of them can succeed, they crowd into the “informal” urban market, eking out a living at low incomes. The Harris-Todaro model of migration and income determination has not been borne out in subsequent empirical work. The literature has leaned toward an alternative view which hypothesizes that the urban labour market is segmented due to economic forces. Unlike in Latin America, which has been much more urbanized for a long time, and where social security legislation and workers’ movements have a long history, institutional intervention is weak and of more recent origin in most Asian economies. Also in such countries as India, historical research has shown that substantial wage differences in favor of large factories existed well before the coming of trade unions and labour legislation. The wage difference can be traced to the higher productivity of factories with modern technology and are sustained by efficiency wage and profit-sharing considerations.

A second aspect of labour market segmentation is the limited vertical mobility of workers. Although new workers may find it relatively easy to enter the informal sector, their further progress into the formal sector is difficult or limited. This hypothesis, if true, has serious implications for the distribution of income in the urban labour market. The large difference in earnings between the two sectors along with limited entry into the high-wage sector creates a "labour aristocracy" in the urban labour market. The relatively small proportion of the labour force employed in the sector shares in the high income generated in the modern economy, whereas
a large number of workers are left more or less permanently in the low wage-low productivity sector.

Labour movement into the high-wage formal sector may be restricted owing to institutional factors, such as the "closed shop" practices of unions. However, it is unusual for such restrictions to exist in formal collective bargaining agreements. If employers are found to depend heavily on union representatives to fill vacancies, there must be strong economic reasons for it. As already noted, employers attach great importance to the social solidarity of the work force in large establishments. Where unions are strong, union leaders and management both tend to want to achieve a socially integrated and motivated work force. Managers might well depend on unions to introduce new recruits. Nonetheless, a "closed shop" might operate even without unions. If employers attach more importance to the productivity-augmenting effects of a cohesive work force than to getting new workers at the lowest wage possible, they will depend on the foremen and senior workers to help in recruitment. As a result, the field of new recruits may be restricted to the set with close kinship or community ties to those already employed.

A second factor inhibiting mobility from the informal to the formal sector is the operation of internal labour markets in large establishments. Firms that encourage a lifetime commitment in their workers typically recruit them at a young age at a relatively low point of the career structure. Vacancies higher up the structure are filled by promoting workers internally rather than by recruiting older workers from outside. Thus, the opportunity to move into a formal sector job decreases significantly with the years spent in the informal sector.

The foregoing factors lie on the demand side of the labour market. Segmentation can also occur when labour with different attributes is offered to the market. When these attributes are used as "labels" in the hiring of employees, the labour market may split up into noncompeting groups. The most important of these supply-side attributes are sex and education. Because of the traditional concentration of women in the service sector, especially in domestic service, a disproportionate number of women work in the informal sector (see Mazumdar 1976). Even when women workers are used in the large-scale manufacturing sector, they are usually concentrated in certain occupations or industries. Young unmarried girls in Japan, for example, tend to work in textile industries. In India's textile industry, women workers are employed only in specific occupations labeled "magi" (female) jobs. In India the proportion of females in industrial employment in the formal sector has been small and has declined over time.

The informal sector is also home to a large number of self-employed one-man businesses as well as owners of small establishments who contribute their family labour, and sometimes employ one or two wage workers. The earnings of these petty entrepreneurs show a wide dispersion extending beyond the distribution of wage earnings in the formal sector at both ends. But the upward mobility of such workers is limited by their lack of access to capital and extended product markets.

In sum, the informal sector contains a heterogeneous collection of workers with different degrees of entrepreneurial skills and capital. Those who are mostly selling their labour power with little entrepreneurial assets find substantial barriers to movement to the high wage segment, while entry into the self-employed sector showing high returns to enterprise is limited by the need for prior acquisition of a minimum amount of human and financial capital.
II. Policies to promote employment - an overall framework

Policies to increase the absorption of labour are not just those maximizing employment wherever possible, but need to create conditions in which more jobs are created in the segments with higher wages. The increase of the proportion of employment in these segments could also be expected to narrow the inter-sectoral differences in the returns to labour. This is indeed the idea stressed by W. Arthur Lewis in the much discussed model of growth with “unlimited supply of labour”. The process of transformation envisaged by Lewis was one of drawing labour out of the subsistence sector with surplus labour into the growing "capitalist" sector. (The latter would largely be industry, noting that the plantation sector would be of limited significance as a leading sector in this period). As long as conditions of surplus labour persisted labour would be available at a constant real wage in the developing sector. Until the "turning point" was reached, signifying an exhaustion of surplus labour, the real wage rate would not increase in the agricultural sector either. However, the average product of farm households would increase if labour were transferred out without a fall in farm output. Thus the gap between labour earnings in self-employment and wage labour markets is reduced continuously.

The expansion of demand for labour in the wage sectors outside agriculture has been at the centre of attention of development strategies. Perhaps the most important topic in the controversies about alternative strategies of demand expansion has been the alternatives of import substitution and export expansion. Closely related to this discussion has been the role of the State in policies affecting the creation of new employment. In much popular discussion intervention by the State has been linked with the pursuit of one or other of these alternatives. For example, the World Development Report 1995 (World Bank) distinguishes between "three patterns" of economic growth," (p.13): (a) the East Asian pattern with "a strong export orientation (which) reduced economic rents and a labour policy (which) did not favor privileged groups of workers;" (b) the inward-oriented development strategy, allegedly "pursued to varying degrees" by most countries in Sub-Saharan Africa, Latin America, the Middle East, and South Asia, which "benefitted a limited number of 'insiders,' capital holders and workers employed in the protected sector;" and (c) the centrally planned economies which "were for decades exemplars of an economic model antithetical to the market model of the high-income industrial countries." The Report singles out the strategy of East Asia as being so much superior for ensuring sustained growth in incomes and wages. It will be seen that the Report implicitly assumes that several different elements of economic policy are bound together in the "strategy" pursued. Although this might have been true for some countries, export orientation, non-participation of the State in economic enterprise, and labour regulation favouring protected workers are logically and empirically separate packages of policy. Their relative importance in affecting the growth rate would be very different in different economies, and indeed their effect might not be in the same direction at all.

The weakest link in the chain of associated policies suggested is labour regulation. To suggest that labour market dualism is created by labour legislation is probably incorrect in most situations. In any event labour regulation, if significant, is often secondary to other regulatory policies, for example, those affecting capital and product markets, and does not exist independently of them. There is no evidence given in the WDR that the East Asian strategy "mostly avoided sharp divides between modern sector and rural workers." (p.13). Research suggests that inter-sectoral differentials in earnings are of similar magnitudes in India and Indonesia.
These issues are discussed in more detail below in Sections III. But before coming to this we need to draw attention to a basic point about the limitations of pursuing a package of policies directed solely at expanding the demand for labour in the wage sector à la Lewis. In terms of the Lewis model, if the reservoir of surplus labour is large in the subsistence agricultural sector - as is likely to be the case in the most populous Asian countries - it is extremely unlikely that moving the demand curve for labour outward in the non-subsistence sector is going to be adequate in increasing labour earnings substantially in the former. It is necessary to pursue the supplementary strategy of increasing the supply price of labour directly in the subsistence sector by increasing land productivity. In his subsequent analysis of economic growth in the "golden age" of non-European growth 1870-1913 (an extension of his original model which seems to be much less well known), Lewis contrasts the differential impact of trade on the standard of living of the temperate countries and the tropics. The rate of growth of trade, mainly in primary commodities, from the tropics was nearly as high as from the countries of recent settlement, and both almost equalled the rate of growth in trade of the "core" industrial countries. Yet the standard of living of workers was much higher in the temperate countries than in the tropics and increased over time relative to that in the latter. (Lewis, 1978, Chapters 7, 8). This was because the supply price of labour, reflecting the level of productivity in food production, was much higher in the temperate countries, and continued to increase over time relative to the levels in the tropics. "The tropics were held back by their need for a technological revolution in agriculture such as has been occurring in Western Europe over two centuries [which supplied labour to the temperate regions.]" (Lewis, 1978, p. 202; phrase in parentheses not in the original). The essential point is that when a large portion of the labour force is employed in food production, it is the productivity in this sector which sets the supply price of labour to the rest of the economy, and unless exports are large relative to GDP, wages in the economy will not increase, except in some enclave sectors, unless the supply price increases through an increase in food productivity.

It might be useful at this point to refer to the large discussion in the literature surrounding price policies, and in particular government intervention to support farm prices. Such policies have been widely practiced in East Asian economies in particular, as in many OECD countries to increase prices of agricultural products substantially above what would be the market determined levels. These policies are one way of increasing the productivity of agriculture in value terms, and hence attain the objective of increasing the supply price of labour as discussed above. But there is a basic distinction between such policies and those aimed at increasing yields per acre through investment in rural infrastructure and better supply of farm inputs. Policies of price support increase agricultural incomes by turning the terms of trade in its favour. Thus they achieve the objective of higher farm productivity by redistributing income from non-agriculture to agriculture. Policies directly impacting land productivity, on the other hand, attain the same objective by increasing total income in the economy, although incomes in agriculture increase relatively faster than otherwise. The latter is less likely to choke off expansion of employment in the non-agricultural sector. For while the wage cost increases with the supply price of labour, aggregate demand also increases. Policies to increase agricultural productivity are further discussed in section V.
III. Policies impacting on labour absorption in non-agriculture

A. Import substitution vs. export expansion policies

As a broad generalization South Asian countries aimed at making a dent in their surplus labour problem by policies of industrialization through import substitution policies, while ESEA countries, after an initial phase of import substitution, quickly switched to export expansion as the dominant tool. The limitations of the ‘South Asian’ paradigm are now well known. The most fundamental point is that the domestic market for manufactured goods in the low income economies is small, and the proportion of employment in large-scale manufacturing, which import substitution targets, is too low to provide a base for large expansion of effective demand based on the home market, even though the physical demand for industrial consumption goods would appear to be potentially large. Thus the opportunity for expansion of manufacturing production are soon exhausted after imports of consumer goods have been fully substituted by domestic production, in the absence of sufficiently large increases in per capita income in the sectors like agriculture, services and small-scale manufacturing, which provide the bulk of employment in poor economies. The old models of industrialization accepted too readily the conclusions relevant to command economies that stressed the supply of capital goods as the crucial bottleneck to industrial growth. Such models ignored not only the importance of the limitations of the small market (in terms of income), but also how difficult it is to anticipate what the bottlenecks in the process of industrialization might turn out to be. In India it was never predicted that the supply of power rather than steel would be the critical bottleneck. The second point relevant to the weakness of the import substitution strategy is that the closed economy which develops creates inefficiencies which can prove very difficult to remove. The absence of competition in the world market not only leads to managerial inefficiency and wrong techniques of production, but more importantly slows down drastically the transfer of technology from the dynamic parts of world manufacturing. Thirdly, the non-competitive environment is the breeding ground of groups with a vested interest in the augmentation and sharing of “rents” created. The social costs to the consumer of rent-seeking has been shown to be huge.

South Asian countries which persisted with the IS strategy far too long are finding it difficult to move out of the inefficiencies and vested interest created even if their economic philosophy now recognizes some of the weaknesses of the strategy outlined above. As against this experience is the record of ESEA countries moving into an export oriented policy of industrialization. For two or third decades this type of development seemed to have done wonders for some of these countries. The rate of growth of GDP of this group was higher than any other region of the world. What is more relevant to the present discussion, the degree of inequality accompanying this growth process was quite low. Some of the countries which first participated in this process like Taiwan, China, and the Republic of Korea achieved virtually full employment and recorded real wage growth at a rate which was unprecedented in economic history. Other countries coming into this growth process somewhat later like Indonesia and Thailand, also experienced substantial growth in labour earnings and the reduction of poverty, even though large pockets of low incomes persisted in particular sectors or regions of these economies.

Export oriented strategy has held its predominance in the discussions of Asian development strategy for the last three decades. The success of the initial “Asian Tigers” was sought to be emulated by other Southeast Asian countries, and even the South Asian countries started moving towards this strategy in so far as the baggage carried from the IS era permitted.
Recent events have brought the uncritical acceptance of this strategy into serious disrepute. Doubts expressed all along about the uncompromising “exports at all cost” strategy have suddenly found a much larger audience. The critique of the EO strategy can be discussed under three main heads: (i) the sustainability of the post-World War II expansion of trade; (ii) problems connected with the world pattern of trade; and (iii) the instability associated with dependence on certain types of foreign capital.

(i) Growth of trade

There has been a dramatic fall in transport and communication costs since 1920. Together with the reduction in barriers to trade it has fuelled the massive increase in world trade since the Second World War. This recognition of fast growth in trade is not new. It has been in the concern of observers and a large number of policy makers in developing countries for at least 25 years. But equally there has been a long-term concern about the ability of the world economy to maintain a sustained rate of growth of this magnitude, without periodic serious disruptions as happened after the oil crisis of 1973. In his famous Nobel Lecture of 1980 Arthur Lewis had the following to say about trade as an "engine of growth:"

“...The extraordinary growth rates of the two decades before 1973 surprised everybody. We know that the world economy experienced long swings in activity; that world trade, for example, grew faster between 1830 and 1873 than it grew between 1873 and 1913, that is to say between 4 and 5 per cent before 1873, compared with between 3 and 4 per cent after 1873. But a jump to 8 per cent was inconceivable ... The fact that world trade was growing rapidly was not recognized until the second half of the 1960s. Then nearly every country discovered the virtues of exporting. Now we are in danger of being caught out again. Since 1973 the growth rate of world trade has halved and nobody knows whether this is temporary or permanent.” (Lewis, 1980, pp. 555-56).

As it turned out, the interruption after the oil shock was indeed temporary. After a decade of slow growth between 1974 and 1983, the rate of growth of the volume of trade recovered to 6.4 per cent per annum in the second half of the eighties. But in the nineties the growth rate has slowed down again to around 4 per cent. It is expected that further trade liberalization through the Uruguay Round and other measures would restore the growth rate to the higher trend level of the ‘60s and ‘70s again. But as against this much vaunted prediction is the spectre of prolonged recession in OECD economies. These remarks are not meant to revive fears of the "slowing down of the engine of growth," but only to guard against the undiluted optimism of the EO strategy.

If world trade expands at a slower rate we would be back to the old problem pointed out by William Cline and others that while it may be possible for individual developing economies to have a significant export expansion, the group as whole would have difficulty in attaining a sustained and sizable rate of growth of the demand for labour by concentrating on the export sector.
(ii) The pattern of trade

A major critique of world trade in the context of North-South development issues was the classic statement made by Ragnar Nurkse (1959) in his Wicksell lectures. The essence of the argument was that world trade was dominated by the exchange of goods among the developed countries. The flow of trade thus passed the developing countries by. In terms of its quantitative significance, trade could indeed be a hand-maiden of growth for the developed countries, but could scarcely have a major impact on growth in the developing world.\(^1\) Has the pattern changed in the phase of rapid expansion of trade in recent decades?

There has indeed been a break in the traditional dependence of developing country trade on primary commodities. The developing countries' share of manufactured exports to the developed countries increased from 5 to 14 per cent between 1970 and 1990.\(^2\) This is all to the good, but the less optimistic side of the picture is that much of this growth is really due to the growth in one region, primarily the East and South-East Asian economies and China. A recent international document reported:

“The share of Asian developing countries increased from 4.6 to 12.5 per cent between 1970 and 1991, but those of Latin America and sub-Saharan Africa fell. The overall developing country share increased only slightly as a result of these divergences in performance. Over the same period the share of the former socialist countries fell from 10 to 5 per cent. The upshot is that the share of the developed market economies remained unchanged at 71 per cent. Thus the major shift was a redistribution among the non-industrialized countries, with Asia gaining relative to the rest.” (ILO, 1995, p. 32).

The imbalance in the growth of trade, including that of trade in manufactures, extends to sub-regions of Asia. As can be seen from Table 1, ESEA has a stolen a march of many leagues over South Asia in the expansion of exports, and furthermore the role of intra-Asian trade involving the two regions is quite limited relative to the networks connecting them to markets outside Asia. It is, of course, quite normal in the process of economic development for growth to be initially concentrated in a particular region and then to spread to other areas. In fact, there has been considerable mobility of industry within the ESEA region, as producers have responded to changing labour costs. As wages have increased in the older industrializing countries, the Republic of Korea and Taiwan, China, they have moved up the skill-intensive scale of the industrial structure, and industries which use less skilled labour more intensively have migrated to Indonesia, Thailand and Vietnam, and also to China. While such evidence of the normal process of diffusion of industrial development is widespread, concerns exist of the more limited participation of South Asia in this process, in spite of its massive supply of low wage labour. An important aspect of this phenomenon is the distribution of Direct Foreign Investment (FDI) among the countries of the region. While the total value of FDI has grown remarkably over time, the figures in Table 1 show that the share of ESEA remains several times that of South Asia. In practice, differences in levels of per capita income and wages have played only a limited role in

\(^1\) This idea, indeed, was one of the elements of the import substitution strategy of development which dominated policy making in much of the third world in the '50s and '60s.

\(^2\) This and other statistics referred to in this paragraph are taken from ILO (1995) p. 33. The ILO figures are in their turn derived from UNCTAD (various years).
the country-wise distribution of FDI in Asia. With the sole exception of China, foreign direct investment is mostly going to middle income countries (both low and upper MICs).

### Table 1. Matrix of intra-Asian exports, 1993

<table>
<thead>
<tr>
<th>From/To</th>
<th>NIEs</th>
<th>China</th>
<th>CARs</th>
<th>SE Asia</th>
<th>South Asia</th>
<th>Pacific Islands</th>
<th>DMCs</th>
<th>Japan</th>
<th>World</th>
</tr>
</thead>
<tbody>
<tr>
<td>NIEs</td>
<td>46.6</td>
<td>50.7</td>
<td>-</td>
<td>35.2</td>
<td>5.9</td>
<td>0.3</td>
<td>138.6</td>
<td>33.0</td>
<td>377.5</td>
</tr>
<tr>
<td>China</td>
<td>27.2</td>
<td>-</td>
<td>0.2</td>
<td>2.8</td>
<td>1.7</td>
<td>-</td>
<td>31.9</td>
<td>15.8</td>
<td>91.6</td>
</tr>
<tr>
<td>CARs</td>
<td>8.0</td>
<td>0.2</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>0.3</td>
<td>0.04</td>
<td>0.8</td>
</tr>
<tr>
<td>South East ASIA</td>
<td>35.6</td>
<td>3.2</td>
<td>-</td>
<td>7.2</td>
<td>2.1</td>
<td>0.1</td>
<td>48.2</td>
<td>26.5</td>
<td>135.8</td>
</tr>
<tr>
<td>S. Asia</td>
<td>3.0</td>
<td>0.50.1</td>
<td>-</td>
<td>1.2</td>
<td>1.3</td>
<td>-</td>
<td>6.1</td>
<td>2.4</td>
<td>34.6</td>
</tr>
<tr>
<td>Pacific Islands</td>
<td>0.3</td>
<td>54.8</td>
<td>-</td>
<td>0.3</td>
<td>0.03</td>
<td>0.06</td>
<td>0.7</td>
<td>0.9</td>
<td>4.3</td>
</tr>
<tr>
<td>DMCs</td>
<td>112.7</td>
<td>17.4</td>
<td>0.2</td>
<td>46.6</td>
<td>11.0</td>
<td>0.5</td>
<td>225.8</td>
<td>78.7</td>
<td>644.7</td>
</tr>
<tr>
<td>Japan</td>
<td>81.9</td>
<td>0.6</td>
<td>33.6</td>
<td>3.8</td>
<td>0.3</td>
<td>137.1</td>
<td>-</td>
<td>362.6</td>
<td></td>
</tr>
</tbody>
</table>


The regionally unbalanced pattern of trade expansion within the world economy - and within Asia - remains a matter of policy concern. The last observation, that a good part of the export achievement of ESEA has been associated with foreign capital inflow, poses yet more questions about the long-term viability of the EO strategy - which have burst on the world economic scene in recent months.

### (iii) Instability of export-oriented economies

The risks of over-dependence of developing economies on international markets have been recognized for sometime. On the demand side massive fluctuations in the terms of trade have plagued economies dependent on primary export crops for a century of modern economic growth. Recently instability in the market for industrialized goods has become nearly as important for some newly industrializing countries. ESEA economies have been forced to adjust their patterns of export goods to rapidly changing market opportunities and evolving cost - particularly labour cost - conditions. It has been suggested that one of the reasons why Thailand was the first country to usher in the wave of the recent crisis in ESEA was the lack of flexibility in its costs and production structure.

More importantly, the export oriented countries have been heavily dependent on foreign capital inflows which financed their high investment ratio over and above the domestic savings available. Such capital movements have been notoriously unstable - and again that is not a new story. The foreign investment from European countries, most notably the United Kingdom, which financed the expansion of tropical trade in the nineteenth century showed enormous ups and downs. What might have been somewhat different in the recent years of ESEA growth is (a) the over-indulgence in export promotion in the face of overvalued currencies which the foreign capital inflow helped to sustain; and (b) the heavy dependence, of private borrowers in particular, on short-term dollar-denominated foreign debt. The rate of export growth had to slow down as costs increased and other countries with less overvalued exchange rates became more competitive in dollar prices. With the onset of difficulties, short-term capital was free to leave without much delay. The downward
pressure on exchange rates caused by the deteriorating external current and capital accounts was magnified by the change in investors’ expectations. As the exchange rate spiralled downward, the domestic financial cost of repatriation of capital continued to increase - and this had enormous multiplier effects on the national capital market. Thus the shocks emanating from the external finance sector added enormously to the real problems of adjustment in the economic structure, and a huge crisis emerged.

Where is the golden mean?

The broad lessons from the Asian experience are very clear. Neither unrestricted import-substitution nor over indulgence in export expansion has been beneficial to the overall objective of sustained growth and employment creation in the non-agricultural sector. Asian policy makers are in search of the golden mean. This implies retraction from the inefficient, autarkic solution of South Asia as well as from the ambitious, and often uncontrolled, policies favouring foreign borrowing-cum-export expansion strategies pursued by many countries in the ESEA region.

B. Problems of employment creation and equity in non-agriculture

We have so far discussed broad strategies of industrialization as instruments of economic growth. But growth in the sense of increase in income or value added per worker is only one aspect of a successful employment policy. The other important aspect is the creation of new employment - and at reasonable levels of real wages. The strategy of increasing growth might founder from the employment angle if the elasticity of employment with respect to output growth is low, or if the pattern of growth is such as to create unequal distribution between the sectors with high and low levels of earnings.

The older models of economic growth expected the manufacturing sector to be the leading sector in the absorption of labour in developing economies. The classical Clark-Fischer hypothesis, basing itself on differential income elasticities of demand for the products of the three sectors, predicted that in the early stages of development, as the share of employment in the agricultural sector falls, industry would be absorbing a larger share of the growing employment than the tertiary sector. Only after per capita GDP have reached a high level would the increasing income elasticity of demand for services lead to a relative increase in tertiary employment. The changes in the sectoral composition of employment in the evolution of less developed countries in recent decades has been rather different from this expectation - and different from the historical experience of today’s developed countries. As the share of agriculture in total employment declined, it is the tertiary sector which has been in the forefront of labour absorption rather than the manufacturing sector. This has been true of not only the slow growing economies of South Asia, but also of ESEA where the growth rate was much higher in the seventies and the eighties. It can be seen from the data reproduced in Table 2 that the only two cases where manufacturing employment grew relatively were the Republic of Korea and Taiwan, China and in only the decade of the seventies.

While a changed structure of production and technological development might account for some of the factors behind this recent experience of labour absorption, there are two sets of issues which are of concern to the policy maker. The first is the low elasticity of employment (i.e., low rate of employment increase relative to output growth) in the large-scale formal sector; and secondly, the distribution of employment between the low wage informal (or small-scale) and the high wage formal sectors of the non-agricultural economy. We discuss briefly these two aspects of the problem in turn.
Table 2. Change in the sectoral shares of employment (percentage points)

<table>
<thead>
<tr>
<th></th>
<th>1971-80</th>
<th>1980-91</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Agricultural</td>
<td>Manufacturing</td>
</tr>
<tr>
<td>ESEA</td>
<td>-1.3</td>
<td>+3.3</td>
</tr>
<tr>
<td>Rep. of Korea</td>
<td>-14.4</td>
<td>+8.3</td>
</tr>
<tr>
<td>Taiwan, China</td>
<td>-15.6</td>
<td>+11.1</td>
</tr>
<tr>
<td>Thailand</td>
<td>-1.4</td>
<td>+0.3</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-14.8</td>
<td>+6.1</td>
</tr>
<tr>
<td>Philippines</td>
<td>-1.4</td>
<td>-0.7</td>
</tr>
<tr>
<td>Indonesia</td>
<td>-2.7</td>
<td>+1.3</td>
</tr>
</tbody>
</table>

Source: ADB Key Indicators 1985, 1993; for Taiwan, China, Kuo (1981), *The Taiwan Success Story*, Boulder. Table 2.3, pp 15.

Note: For Taiwan, China 1955-61: - 5.2 +1.3 +3.7, 1961-71: - 11.1 +5.4 +5.5

(i) **Employment elasticity in the formal manufacturing sector**

Given the rate of growth of output or value added in the sector, the share of the output going to labour is determined partly by technology and partly by labour market pressures. Generally speaking the share of wages in value added does not change drastically over a period of time in nominal terms. But the share in *real* terms can and has been affected by relative price movements. In particular, the trend in the ratio of producer prices (determining the real value of output) to consumer prices (determining the real wage) is of crucial significance in determining the share of real output which is available to labour. If, for example, producer prices fall over time relative to consumer prices, even if the share of labour in nominal terms remain constant, workers will suffer a fall in the real output available to them to augment the size of the real wage bill.

While the internal terms of trade is an important variable affecting the real share of wages, this real wage cake can be used to augment employment or real wage per worker. There is a trade-off between the two, and the way the cake is divided between the two variables depend on partly on market pressures and partly on the labour system in the economy concerned. Mazumdar (1997) has used time series data of value added, employment and real earnings per worker in the (formal) manufacturing sector of different countries to suggest how different regions have empirically determined the tradeoff between employment and wages (see also the earlier discussion in Mazumdar and Basu 1994). The relevant statistical calculations are presented in Table 3 for three sub-regions of Asia.

Of the sub-regions of Asia, China stands out as having had a markedly adverse price effect, particularly in the second period shown. Thus while the rate of growth of real value added in manufacturing was almost as high for China as for South East Asia in both periods, the growth rate of the cake which could be divided between employment and real earnings per worker was much smaller for China. In the decade of the seventies China opted for a strategy that favoured real wage growth rather than employment growth. One third of the growth in output (net of the price effect) was allocated to employment, and two-thirds to wage increase in the seventies. This
contrasts with the experience of Southeast Asia which divided the output growth in exactly the opposite way - one-third in real wage increase and two-thirds in employment growth. In the next decade China and Southeast Asia moved much closer to each other - with the available output growth being divided almost equally to support wage increase and employment growth.

Turning to South Asia, a spectacular change seems to have occurred in this region between the two periods. Output growth was at a much slower rate than in China and Southeast Asia, and net of the price effect, practically the same in the seventies and the eighties. But while in the seventies nearly the whole of the output growth went to support employment growth, the situation was reversed in the eighties with the bulk of the output growth supporting real wage increase.

Table 3. Output, real wage and employment growth: Sub-regions of Asia, two periods

<table>
<thead>
<tr>
<th>Period/region</th>
<th>Output</th>
<th>Real wage</th>
<th>Employment</th>
<th>Price leakage</th>
<th>Pp/Pp</th>
<th>Pc/Pc</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1971-80</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>10.63</td>
<td>7.18</td>
<td>2.18</td>
<td>1.27</td>
<td>1.08</td>
<td>-0.003</td>
</tr>
<tr>
<td>South East Asia</td>
<td>12.40</td>
<td>3.20</td>
<td>9.89</td>
<td>-0.69</td>
<td>1.07</td>
<td>14.53</td>
</tr>
<tr>
<td>South Asia</td>
<td>4.60</td>
<td>0.45</td>
<td>4.75</td>
<td>-0.6</td>
<td>0.91</td>
<td>10.44</td>
</tr>
<tr>
<td><strong>1981-92</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>12.04</td>
<td>4.26</td>
<td>3.29</td>
<td>4.49</td>
<td>1.02</td>
<td>4.24</td>
</tr>
<tr>
<td>South East Asia</td>
<td>12.35</td>
<td>6.37</td>
<td>5.86</td>
<td>0.12</td>
<td>1.20</td>
<td>4.93</td>
</tr>
<tr>
<td>South Asia</td>
<td>6.15</td>
<td>3.79</td>
<td>1.00</td>
<td>1.36</td>
<td>0.97</td>
<td>7.56</td>
</tr>
</tbody>
</table>

Source: Table 2, Mazumdar 1997. The original data are from UNIDO and the price indices from World Tables (World Bank).

\[ P_{\text{p}} \cdot P_{\text{p}} = \text{the percentage annual rate of growth of the producer price index} \]

\[ P_{\text{c}} \cdot P_{\text{c}} = \text{the percentage annual rate of growth of the consumer price index} \]

\[ \alpha = \text{the elasticity of the wage bill with respect to value added in manufacturing. If } \alpha \text{ is unity the share of wages (in nominal terms) remains constant over the period.} \]

The price effect is equal to: \( \alpha \cdot P_{\text{p}}/P_{\text{p}} - P_{\text{c}}/P_{\text{c}} \).

\[ = (\alpha - 1) \frac{P_{\text{p}}}{P_{\text{p}}} + \left( \frac{P_{\text{p}}}{P_{\text{p}}} - \frac{P_{\text{c}}}{P_{\text{c}}} \right) ... (1)^3 \]

See Mazumdar (1997), Section II, for a full explanation.

Briefly, the first term in (1) could be called the ‘wage share effect’ of price changes over time. If \( \alpha \) < 1 the share of wages in net output falls over time in current prices. In this case the first term in (1) is negative, showing that a certain part of the real output growth, as measured by this term, is not available for the growth of the real wage bill. The second term is the rate of change in the ratio of producer to consumer prices or the so-called ‘domestic real exchange rate’ (DRER). One can intuitively grasp its importance by considering the case of an inflationary economy in which the exchange rate depreciation lags behind the rate of inflation-a common enough scenario in developing countries. In this case the consumer price level which affects the real value of workers’ wages, increases faster than producer prices which are tied to international prices of traded goods. Thus the second term in (1) is also negative implying that a portion of the real output growth is used to keep the wage bill growing at the same real rate. Both these “price effects”, if negative, can be thought of as ‘leakages’ from the real output growth - which decreases the rate of growth of the portion available for supporting employment or real wage growth.
While China seems to be correcting the inequitable trend in the employment-wage trade off in the second period, South Asia moved away in the eighties rather spectacularly from the equity norm. More rapidly rising earnings per worker in the eighties in Southeast Asia might be traced to a shrinking of the reservoir of low productivity labour, as the modern sector expanded rapidly. But no such significant change in the supply-demand equation in the labour market can be traced in any of the countries in the sample for South Asia. Thus the rather sharp tilt towards wage growth in the wage-employment trade-off in the eighties has to be ascribed to important institutional changes in the modern manufacturing sector of South Asia. This trend in labour market outcomes in the formal labour markets of South Asia has been noted and widely commented on by observers using different data sets. Hanson and Lieberman (1989) noted "a confluence of factors at work in the early to mid-eighties (which) can in large part explain the sharply deteriorating performance of Indian manufacturing in generating new employment opportunities, even while it was moving to high growth path in terms of output" (p.108). The authors pointed the finger at the 'insider bias' of India's industrial and labour relations system for this outcome. Other references are ILO-ARTEP (1993, ch 2.4) Lucas and Fallon (1991).

(ii) The size-distribution in manufacturing and the ‘wage-gap’ between small and large firms

Distribution by size-groups in manufacturing could be considered with respect to either value added or employment. In fact, the former is the more basic of the two and is the product of two separate variables: first, the distribution of employment by size groups; and second, the differences in productivity or value added per worker as between size groups. In what follows we will work with these two variables to shed more light on the economic processes involved. Wages generally increase proportionately with labour productivity (Berry and Mazumdar). Thus the extent of productivity differentials between small and large units would reflect differences in wage levels between them. In so far as informal sector undertakings would have wage and productivity near to the levels found in the smallest size group in the formal sector, the large-small productivity differential in the formal sector would also be a measure of the economic distance between the informal and the formal sector firms in the economy concerned.

Turning to the question of economic welfare, the two variables mentioned have implications for both economic efficiency and the distribution of earnings or labour income. A very large productivity differential implies that factor prices facing firms of different sizes are widely different, and hence factor ratios (particularly the capital-labour ratio) also vary widely. Thus we could expect the ratios of marginal products of capital and labour to be very different among enterprises of different sizes implying that economic efficiency could be improved significantly by reducing the differentials in factor prices and the resultant misallocation of inputs. The extent of the loss in efficiency would also be determined by the numbers of enterprises with ‘inappropriate’ factor ratios - and hence by the pattern of distribution of firms in the different size classes.

Both factors also affect the distribution of labour earnings. Given the size distribution of employment, the larger the productivity (and hence wage) differential between the size classes, the more unequal would be the distribution of wage earnings. For a given productivity differential the worst scenario for unequal distribution of earnings is the concentration of employment in the small and very large size groups, with the middle size groups conspicuous by their virtual absence. Since in Asian economies the modern or ‘formal’ manufacturing sector (the part under the
purview of the Census of Manufacturing) exists side by side with a large ‘informal’ manufacturing sector, the existence of a distribution of employment heavily skewed to the large size groups would precisely signify the existence of this kind of bi-polar distribution for manufacturing employment as a whole.

Empirically the comparative material on the size distribution of manufacturing can be studied only with reference to the ‘organized’ sector on which data are regularly collected by the Census of Manufacturing or the equivalent national organization. Most of these censuses have a lower cut-off point of five employees. Thus the statistical material would generally exclude the so-called informal sector in manufacturing. But since the characteristics of the small size groups of forms in the ‘organized’ sector would reflect the conditions of the ‘informal’ sector in manufacturing, conclusions on inter-country differences of the small-large comparison on the basis of the Census material can be used to approximate the differences in the entire distribution for manufacturing including the non-formal sector. A comparative study of this kind has been done for Asian countries by Mazumdar (1998).

At one extreme of the Asian pattern is the situation in Taiwan, China and Hong Kong, China where the distribution of employment is fairly evenly spread across all size groups - ranging from the small (<50) through the middle to the large (>200) - and secondly, the difference in labour productivity (and hence wages) between the small and the large is kept to a minimum - of the order of 2:1. This is the type of manufacturing development which is most ‘optimal’ from the point of view of both efficiency and equity.

At the other extreme from Taiwan, China stands the example of India in our sample of Asian countries. The extreme peculiarity of the Indian structure is immediately apparent. India has an exceptionally large proportion of employment in the lowest size group of 6-9 workers and an exceptionally low relative value added per worker in this group. Evidently the Indian policies of reservation for the small scale sector, together with measures which implicitly discouraged the vertical mobility of small units, led to the creation of mass of low productivity, small enterprises existing at the bottom of the industrial structure. These coexist with a fairly large proportion of very large units employing more than 500 workers. The result is the phenomenon of the “missing middle” with a strikingly small proportion of employment in medium scale firms, employing say between 50 and 500 workers. The labour productivity in these middle sized enterprises is not so much lower than in the large units in India- almost of the same order of magnitude as in Japan and the Republic of Korea. But the big difference is in the relative scarcity of such units.

The experience of the Philippines, Indonesia and Thailand are rather close to the Indian pattern, though not so extreme. Government policies increased the distance between small and large enterprises in terms of their capital intensities, and hence labour productivity. The ratio of productivity between the largest and smallest size-groups were 8:1 for India, 6:1 for Indonesia, as against 2:1 for Hong Kong, China, and Taiwan, China.

The case of the Republic of Korea is particularly interesting in showing the way government policies and objectives could have a significant effect on the size structure of enterprises in manufacturing. In the early years of fast industrialization state policies encouraged the growth of large firms and conglomerates. The selective support of large units was achieved by a combination of measures - fiscal, financial and those relating to external trade and borrowing. Among the more important were effectively subsidized interest rates, privileged access to foreign borrowing and export incentives for the corporate sector. But the trend towards large firms and establishments started to be reversed in the 1980s. The tilt towards SMEs in government policies was not driven by the desire to promote employment or increase the employment elasticity of
output growth in manufacturing. Quite the contrary, the labour market motivation seems to have been the shortage of labour and the rising wages affecting profitability in large firms. At the time in the mid-seventies, when the policies to help SMEs were moved into high gear, the Republic of Korea was in the midst of the push towards heavy industry, unemployment levels had fallen to historically low figures, and the large scale-small scale wage differential was being squeezed. The government measures have derived added strength from the high wage increases starting in the mid-eighties.

The review of the experience of the Republic of Korea and Taiwan, China in the evolution of the size distributions of employment suggests three important points of conclusion:

S First, government policies can shape the size distribution of firms;
S Secondly, overemphasis on growth through large firms runs into problems of high costs of labour and management which ultimately threaten to erode competitiveness;
S Thirdly, there are distributional implications of the size distribution of manufacturing firms: the degree of income inequality in the Republic of Korea peaked in the late seventies when the share of large enterprises in manufacturing reached its highest point. Since then the inequality index has fallen significantly along with the shift of the size distribution of employment and value added to smaller establishments;

IV. Policies impacting on labour absorption in agriculture

The employment problem in agriculture in Asia has to be viewed differently from that of non-agriculture. It is probably true to say that in most countries in Asia - even in some of those in East Asia where the transfer of labour from agriculture to the other sectors has been substantial - agriculture remains the most important “residual” sector in the sense that labour not finding employment at adequate wages elsewhere is thrown onto this sector for a livelihood. Since much employment in Asian agriculture is on family farms, there is no floor to labour earnings in agriculture as in the wage economy. The earnings of labour is equated to the average product, irrespective of the value of the marginal product. If then the demand for labour outside agriculture is not adequate, relative to the growth in population, labour will press on this sector threatening to lower the average product. Policies should then be concerned with increasing land productivity in agriculture which will increase the average product of labour and with it - as already mentioned - the entire supply curve of labour. This will have an independent effect of raising labour incomes throughout the economy - independent, that is to say, of the impact of employment creation policies which create movements to the right along the supply curve.

Apart from the primary effect of increasing the supply price of labour, an upward trend in land productivity and hence average product of labour in agriculture induces demand for a variety of off-farm activities including trade, transport and simple manufacturing (the Z-goods as mentioned in Section I). This increased demand is met to a large part by labour time supplied by members of the farm household themselves, thus leading to a multiplier process of increasing income in the family farm sector. The evidence for this is to be found in a series of village studies conducted in Java in the seventies.4

4Studies which illuminated the nature of rural labour markets included those by Hart (1976), White (1976), and Penny and Singarirbun (1973), and White and Makali (1980). For a synthetic summary of this picture see Lluch and Mazumdar (1985), chapter 3, where further references are given
The transformation in the Javanese farm sector, starting in the seventies, also throws light on the investment process in agriculture necessary to increase rural incomes. Indonesia was wise enough to use its windfall earnings from the oil price hike to support policies to raise agricultural productivity. Public sector investment in rural infrastructure and the financing of the green, fertilizer revolution through publicly financed subsidies and extension services led to a continuing increase in the marginal as well as the average product of a unit of labour in rice production. With a more or less constant real wage the investable surplus in rice increases - thus further strengthening the cumulative process of growth in this sector. The other side of the coin is, of course, the increase in household income already referred to which ensures an expanding market for both agricultural and other goods and helps to sustain the growth process.

This process of rural transformation has been underway for a number of Asian countries since the sixties and the seventies. But it is generally recognized that it has gone much further in ESEA than in South Asia. A clear indication is to be found in the large disparity in land productivity in paddy which existed in 1990 (Table 4). Note that the figures on yield subsumes the effect of cropping intensity. An important component of successful investment in agriculture is raising land productivity through multiple cropping.

Table 4. Yield of Paddy (kg/ha), 1990

<table>
<thead>
<tr>
<th>ESEA</th>
<th>Indonesia</th>
<th>Korea</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Taiwan</th>
<th>Thailand</th>
<th>Vietnam</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>4385</td>
<td>6080</td>
<td>2866</td>
<td>2723</td>
<td>4600</td>
<td>2000</td>
<td>3246</td>
<td>5741</td>
</tr>
</tbody>
</table>

South Asia

<table>
<thead>
<tr>
<th>Bangladesh</th>
<th>India</th>
<th>Pakistan</th>
<th>Myanmar</th>
<th>Sri Lanka</th>
</tr>
</thead>
<tbody>
<tr>
<td>2774</td>
<td>2620</td>
<td>2468</td>
<td>2923</td>
<td>2993</td>
</tr>
</tbody>
</table>


Clearly the table has to be used with caution. In particular, yields depend a good deal on relevant factor and product prices facing farmers. Land-abundant countries will optimally have lower yields than land-scarce economies. But the enormous gap in yields between ESEA countries and South Asian ones in particular do suggest that South Asia lags seriously behind in agricultural development. However, in some sense the data reproduced in the table is ground for optimism about the possibilities of the future rather than a cause of pessimism about the relative failure of South Asia. It shows the potential that exists in raising land productivity in South Asian agriculture. Some of the policies followed in ESEA countries in agriculture might be difficult to emulate. Countries like the Republic of Korea and Taiwan, China, not to mention Japan, were fortunate in having land reform imposed on them by external political events. While it is widely maintained that successful land reform could be a major contributor to ushering in an era of fundamental agricultural transformation, it is difficult to push through such policies without major political changes. The half-hearted attempts in South Asian land reform policies are adequate testimony to this point.

At the same time some policies which have been important parts of the package of State support for agriculture in ESEA might not be so widely supportable in terms of economic welfare. While part of the explanation of high yields in some of the ESEA countries might be indeed due to the high support prices for farm products provided by government policy, it has
cost domestic consumers a substantial welfare loss. We have also drawn attention to the point in Section II above that artificially raising the price of farm products essentially imposes a tax on the non-agricultural sector which slows down its growth rate below the level it might have otherwise attained. It is not enough to counter that the price support policies in ESEA are merely meant to offset the protectionist policies for agriculture in OECD countries which dampen the price of farm products in world markets. The more cost-effective way to proceed is to attack these policies directly through relevant international action.

Leaving aside protectionist methods, there is a wide range of policies which can be pursued much more vigorously in the South Asian context than has been done so far. The provision of well-directed public investment in infrastructure and in the education and health sector must take pride of place in the package needed to raise land productivity. It is closely followed by state support of policies to provide basic inputs - seed, fertilizer and water.

V. The role of the State

The discussion above has spread over a number of areas which have touched on issues of policy and the way the State could provide the leadership in policies to attain ‘full employment’ in the special sense relevant to developing economies. It might be useful in this concluding section to bring together these points, and to remark on their practicability.

In many parts of the world, not least in Asian economies, it has all too easily been assumed that the responsibility of the State is to be a direct provider of jobs, as producer of either services or goods. This has been true not only in non-market economies, but also in the market economies, with varying degrees of involvement. There is a fairly wide consensus today that this type of direct participation by the State in the production of goods and services has been often overdone, and has led to counter productive results with loss of economic efficiency, waste of resources and a slowing down of the growth process. It is fairly clear from an examination of recent economic history that the State’s role in economic development is best served in providing the framework for economic agents to develop and sustain the growth process.

The major component of the State’s economic policy geared to support economic growth is the maintenance of macro-economic stability. The power of the State is enormous in fiscal and monetary affairs - which together determine such key variables in the macro -economy as the inflation rate, the balance of payments and the exchange rate. Preoccupation with physical targets of ‘planned development’ has frequently detracted attention from balanced policies in this crucial area of economic performance. The cost to economic growth has been unmeasurable. Recent events in ESEA have brought to the forefront an extra element in the polices needed for macroeconomic stability. This is the control of the financial sector, and particularly its relationship with the outside world. Weak financial structures, not supervised by the central governmental apparatus, have led to the overdependence of the system on fluid foreign capital flows, which have exposed many of these economies to dangerous short-term instability. We have yet to see how far such short-term instability will impact on their long-run growth capability.

On trade policy, we have already discussed that State policies have erred on the side of excess both in import substitution and export oriented polices, though in different regions and countries of Asia. The search for the golden mean goes on. The State has clearly a leadership role to play in the area of industrial-cum-trade policy. Past failures in policy making cannot support an absolute case for a “hands-off” laissez-faire approach. But while the need for informed
leadership is clearly recognized, this is the area of policy in which the vested interest of powerful
groups are likely to be strongest. The political economy of the State is not a subject which can
easily yield prescriptions for action, however useful it might be in analysing past records.

The discussion in Section III examined in some detail the problems of employment creation
in the non-agricultural sector. It was concluded that increasing the growth rate of non-agricultural
production is only the beginning of the story. The way the increased output is divided between
wage increases and employment increases, and also the way the informal and the formal sectors
relate to each other, are crucial determinants of the employment implications of non-agricultural
growth. State policies affecting factor markets - of both labour and of capital- are of essential
importance in this area. Labour policies, working with or without labour organizations, which
increase the cost of labour well above its supply price dampen the creation of employment for
given levels of output growth, and also reduce welfare by increasing the wage and productivity
gap between the formal and the informal sectors. Financial policies which reduce the price of
capital for large firms have similar effects. It has been argued persuasively that State policies
which augment capital market segmentation are more important than labour policies in
intensifying these welfare-reducing outcomes.

In the last section, the paper turns to the overwhelming importance of increasing land
productivity in agriculture as a tool of increasing labour welfare and hence the employment
objective. The role of the State in this area of economic development is also of paramount
importance. While Asian agriculture is in the hands of countless numbers of small farmers, and
will continue to be so, their economic performance is dependent on public policies in creating the
social capital which produces strong external economies for all. Particularly important in this
respect is investment in infrastructure, but improvement in education, health and nutrition can also
have strong effects on production, quite apart from their desirability in their own right. Lastly,
the transfer of technology for agricultural growth, and the provision of essential ‘modern’ inputs
are important components of State policy which have done much to increase land productivity,
especially in ESEA countries. The lag in the development of such policies in South Asia is a
matter of concern.
References


