The Employment Challenge

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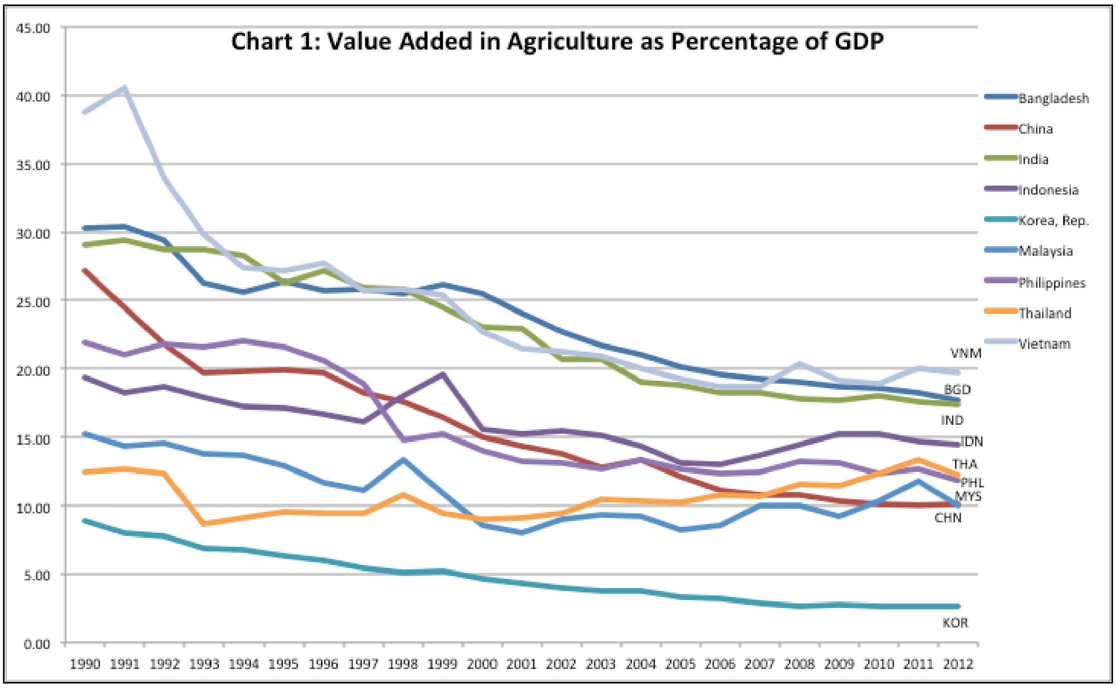
In the immediate aftermath of the Second World War and the decolonisation that followed, industrialisation and the consequent diversification out of agriculture was seen as a prerequisite for economic growth and improved welfare. Such diversification was expected to draw workers out of unemployment or low productivity employment into higher productivity activities, raising average economic productivity and per capita incomes. It was recognised that increases in the productivity of those employed could slow down the aggregate growth of employment. But the investment of the surpluses generated by higher productivity employment were expected to raise growth; and the choice of a judicious mix of technologies was expected to make employment increases more responsive to increases in output.

Hence, countries seeking to raise the average level of productivity, and thereby per capita incomes, in their economies, were expected to imitate the most common trajectory of capitalist development and diversify away from agriculture, especially in favour of manufacturing. The differential levels and rates of growth of productivity across agriculture, industry and services, defined by the exogenously given trajectory of technology, seemed to make this imperative. So the development policy recommended was one geared to realising the required economic diversification.

With the rise to dominance of the ideology of liberalisation, however, the focus of attention shifted. Development policy was required to focus on withdrawing or diluting interventions that resulted in any deviation of domestic price levels and relatives from international or ‘border’ price levels and relatives and on facilitating and supporting private investment, such that investment would be reallocated into areas in which each individual country had an advantage in both production and trade. It should be obvious that, while this could result in a trajectory of growth that was accompanied by a diversification away from agriculture to manufacturing, that is by no means guaranteed.

One question that does arise is whether this shift in policy emphasis since the 1990s away from deliberately directing investment into the manufacturing sector and towards allowing relatively unimpeded market forces to determine the allocation of investment did either alter the development trajectory and in the process change the relationship between employment and growth.

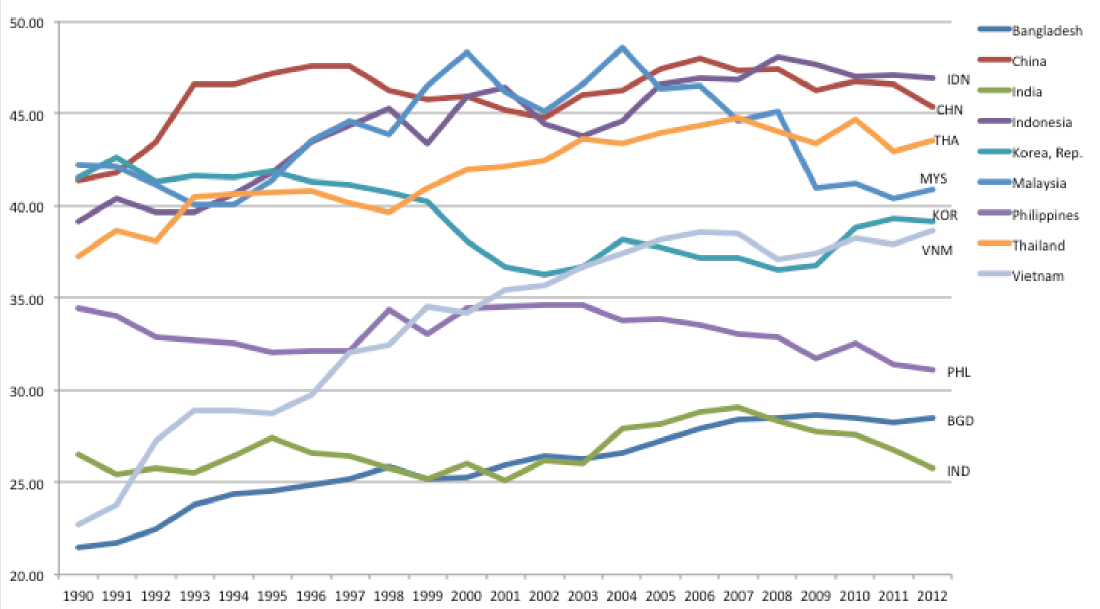
Consider for example a purposively selected sample of Asian countries that fall in four categories: (i) special category countries (South Korea and China) with very specific and diverse initial conditions that they leveraged to pursue mercantilist strategies of industrialisation with considerable success during different periods of time; (ii) second-tier countries experimenting with export-led industrialisation in Asia (such as Malaysia, Philippines and Thailand) that were successful to differing degrees in terms of both economic diversification and growth; (iii) countries with relatively larger domestic markets such as India and Indonesia, which too opted for policies emphasising liberalisation, especially after 1990; and (iv) small, though differentially placed, countries (like Bangladesh and Vietnam) that have also chosen to promote growth driven by external markets. How have these countries performed in terms of economic diversification and per capita income growth since the early 1990s, by when the liberalisation policy was sufficiently generalised?



Assessing this requires recognising the rather different initial conditions with respect to diversification that prevailed in these countries in 1990. Based on arbitrarily chosen ranges, there are four of these nine countries (Vietnam, Bangladesh, India and China) that could be identified as significantly agricultural, with agricultural value added exceeding 25 per cent of GDP, even in 1990. There were three (Philippines, Indonesia and Malaysia) that were moderately agricultural (with agricultural valued added to GDP in the 15 to 25 per cent range). And there were two (Thailand and Korea) that were significantly non-agricultural (with agricultural value added to GDP ratios between 5 and 15 per cent).

Though all of these countries opted for liberalisation in substantial measure, even if to differing degrees, the trajectory of diversification that characterised them varied considerably. There appears to be one common feature, though with exceptions. If we leave out Vietnam and South Korea at the two extremes in Chart 1, there appears to be a gradual but definite trend towards convergence across the selected countries in terms of the ratio of value added in agriculture to GDP, with a faster decline in the share of agriculture in GDP among countries that were initially more agricultural. Among those that were significantly agricultural, there has been a significant decline in the share of agriculture, though the extent of decline in the case of China and Vietnam (of more than15 percentage points) is much higher than in the case of Bangladesh and India (more than 10 but less than 15 percentage points). However, the direction of diversification out of agriculture seems to have varied (Chart 2). While Vietnam has seen a sharp rise in the ratio of value added in industry to its GDP (of more than 15 percentage points) and China and Bangladesh moderate increases (4-7 percentage points), India has experienced relative stagnation in the importance of industry in its GDP.

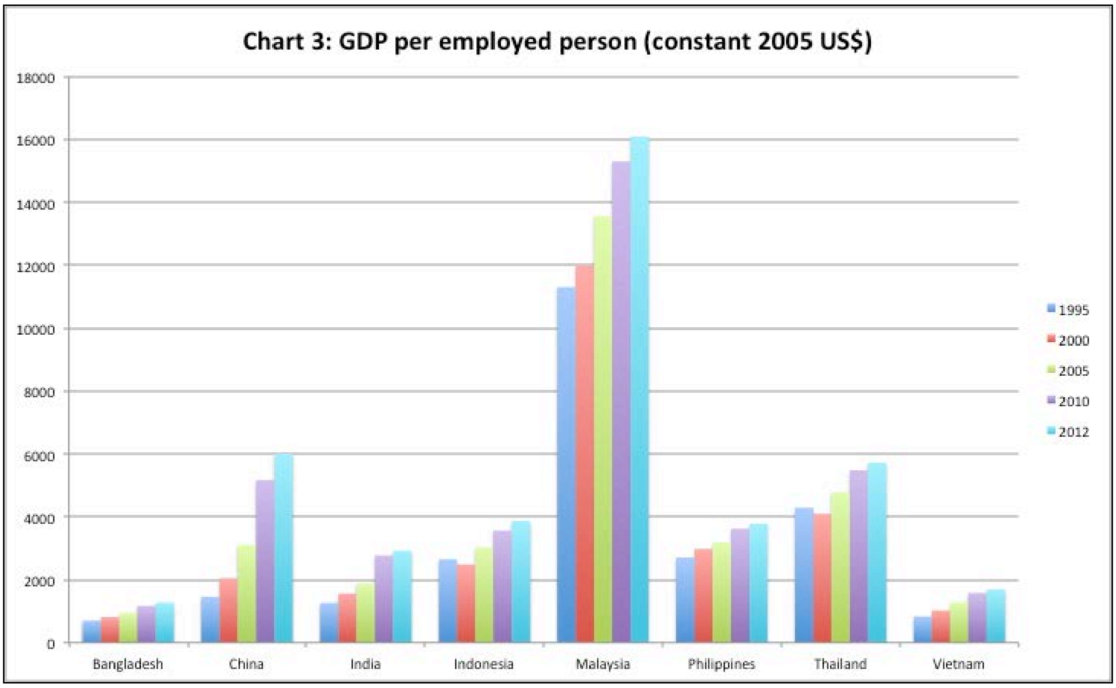
Chart 2: Industry Value Added as Percentage of GDP



In the case of countries that were moderately agricultural, the decline in the ratio of agricultural value added to GDP continued, with the decline being sharp (10 percentage points) in the case of Philippines, and modest (5 percentage points) in the case of Indonesia and Malaysia. In the case of Indonesia and Malaysia, this decline did impact on the share of industry in GDP, which rose by a further 6 percentage points from relatively high levels. (However, in Malaysia, this occurred till before the global crisis of 2007, with the figure falling back to its 1990 level by 2012.) Philippines, on the other hand, saw relative stagnation of the shares of industry at relatively low levels by comparative standards.

And finally, in the case of countries that were predominantly non-agricultural, Thailand saw relative stagnation in the importance of its agricultural sector, while South Korea saw the continued decline of agriculture with the ratio of agricultural value added to GDP touching a low of 2.64 per cent in 2012. Of these countries Thailand experienced a significant increase in the share of industry, whereas South Korea experienced a marginal decline, both from relatively high levels.

Thus, among these selected Asia countries, the classic pattern of diversification has been visible in the case of Bangladesh, China, Indonesia, Malaysia, Thailand and Vietnam. Of these countries, China and Malaysia have registered dramatic increases in aggregate productivity, Indonesia and Thailand moderate increases, and Bangladesh and Vietnam rather limited increases as measured by GDP per employed person in constant 2005 dollars (Chart 3). Clearly, the areas of manufacturing into which countries other than China and Malaysia have diversified failed to deliver the expected increases in productivity. That would have adversely impact the potential for growth in output and employment.



Among countries that did not experience the classic pattern of diversification, aggregate productivity increase was dramatic in the case of Korea (not shown in the chart due to absence of comparable data), significant in the case of India and moderate in the case of Philippines. This does point to the fact that productivity increases are possible even when the diversification is in favour of services. Clearly what matters is the nature of the service sector. Korea appears to have diversified into 'high productivity' services yielding high levels of GDP per person employed, India has possibly seen increases in a combination of low and high productivity services in its portfolio, whereas Philippines probably has not been able to ensure adequate diversification into high productivity as compared with low productivity services.

What emerges, therefore, is a complex picture of the relationship between liberalisation, economic diversification and productivity increase. While liberalisation does not seem to preclude diversification away from agriculture towards industry, some countries do seem to experience trajectories where despite being significantly agricultural, diversification is more in the direction of services than industry. While the experiences of Bangladesh, India and the Philippines suggest that being a laggard in industrialisation works against industrial diversification in a liberalised environment, the experience of Vietnam indicates that even this need not be necessarily true.

However, diversification towards services does not preclude productivity increase (as measured by a crude index like real GDP per employed person), as the experiences of India and South Korea, which are at very different levels of per capita income, indicate. The real problem would, therefore, be employment. Independent of the trajectory of diversification, productivity increases would imply that growth would have to be higher to absorb the unemployed and underemployed labour force. So countries garnering large productivity increases would have to record sustained high growth to address the employment problem. However, the surpluses generated even in countries that diversify into higher productivity activities may not be invested to drive growth enough to absorb surplus labour. Even growth can prove inadequate to deliver adequate employment when productivity is rising. China with its high near-50 per cent investment rate has only partially succeeded here after a long wait.

On the other hand countries that have not garnered productivity increases may find that they record growth rates that are adequate to ensure adequate employment growth. Moreover they may find themselves incapable of delivering reasonably paid and secure employment even those drawn into traditional low productivity sectors. The real challenge of development seem to lie in finding a way of addressing the problem of ensuring decent employment for all, and not just of raising productivity or accelerating growth.

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