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Inclusive growth:
Why is it important for developing Asia?

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Abstract

Although Asian countries attain relatively high growth rates of GDP, many citizens do not seem to benefit from it. To remedy this problem, multilateral development institutions have developed the concept of inclusive growth, defined as growth that allows all members of a society to participate in and contribute to the growth process on an equal basis, regardless of their individual circumstances. The most direct way to achieve inclusive growth in Asia is to bring the objective of full employment of the labor force (i.e., zero involuntary unemployment) to the top of the policy agenda. Specific policies to achieve it are: (i) Redress the neglect of agriculture; (ii) Undertake public investment in basic infrastructure; (iii) Use of industrial policy to accelerate industrialization and structural transformation in general; (iv) Direct fiscal and monetary policies to the achievement of full employment; and (v) Devise Job Guarantee Programs (JGP) to ensure full employment with price stability.

1. Introduction

Since 2007, institutions such as the Asian Development Bank and the World Bank have added the objective of attaining *inclusive growth* to their policy discourse on poverty reduction.[1] By doing this, they acknowledge the widespread sentiment that growth is not benefitting everyone equally. There is a perception that although countries attain relatively high growth rates, many people do not seem to benefit from it. This is certainly not a new concern. About a decade ago, these same institutions were discussing whether growth was *pro-poor* or not, that is, whether growth benefited equally all segments of the income per capita spectrum, or whether it benefited more the higher income groups.[2, 3] These sentiments are also shared today by Asia's policy makers in their policy statements and development plans. They talk about concepts such as "harmonious society" (PRC) or "sufficient economy" (Thailand), and echo the need to address this discontent.

In a similar vein, and reflecting upon the post-crisis global economy, Rodrik argues that there is a "steady divide between what the elites and the common people feel, as well as a

* The views in this paper are the author's own. Large sections of this paper draw from his book *Inclusive Growth, Full Employment, and Structural Change. Implications and Policies for Developing Asia* (2010. Anthem Press: London).

reluctance on the part of the elites and economists to accept that there is a core of legitimate grievance that is not simply a matter of ignorance and narrow self- interest." And: "This [perceptions about multinationals and international banks] would not be a big issue if everybody in the domestic economy were as equally mobile as the multinationals. As a result, there is a very big divide in most modern societies between groups that perceive themselves as globally mobile and therefore view their opportunities and remuneration as set by what is happening in the world (i.e., capitalists and highly-skilled professionals), and the vast majority of most people, who are not globally mobile and whose livelihoods are determined by what happens in the domestic economy. The tension is due to the fact that democratically-led governments have to pay attention to the skilled professionals and capitalists, yet also have to listen to the mass majority of the electorate who are not as mobile".[*, 4]

"Growth is inclusive when it allows all members of a society to participate in, and contribute to the growth process on an equal basis regardless of their individual circumstances."

And Spence paints a clear picture of growing inequality in the US, arguing that it is driven in large measure by the demise of manufacturing and moderately skilled service sectors.[5] This echoes previous concerns about polarization induced by technological change that eliminates jobs in the middle of the wage distribution. This process of specialization in services and high-tech industry widens, for example, the gap between workers holding college degrees and workers holding high-school degrees. Many developing countries are not immune to these developments. Indeed, the relocation of some parts of international supply chains has affected the price of goods, jobs and wages everywhere.

How does the notion of inclusive growth fit into these arguments? In recent work, Ali and Zhuang have defined inclusive growth as "growth with equal opportunities".[6] And in a related paper, Ali and Son further argue that inclusive growth is "growth that not only creates new economic opportunities, but also one that ensures equal access to the opportunities created for all segments of society. Growth is inclusive when it allows all members of a society to participate in, and contribute to the growth process on an equal basis regardless of their individual circumstances."[7] This way, the notion of inclusive growth intends to be broader than the idea of pro-poor growth (which focuses exclusively on poverty reduction) by focusing on development processes that lead to the expansion of economic opportunities.

It could be argued that, one way or another, growth benefits the average citizen; that all concerns are simply transitory issues; and, therefore, the adjective "inclusive" is superfluous. The reality, however, is that large segments of society *feel* that their living standards are deteriorating vis-à-vis those of some privileged groups, with the consequence that the gap is widening. Many societies are failing to transform themselves fast enough to provide sufficient productive and decent employment to the increasingly large labor forces. For these reasons and at the risk of laboring the obvious, the adjective "inclusive" plays a role, if only to alert policymakers of the nature and magnitude of the problem.

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* In the developed countries too there is discontent. In recent work, Sum et al. (2011) conclude that during the slight recovery of the American economy through 2011, earnings and corporate profits have been the major beneficiaries (and not wages) of national income growth. Perhaps there is some truth behind all these complaints.

A telling example is that of the Philippines. In 2010, the country registered its highest economic growth in 3 decades, 7.6%. However, this growth does not appear to benefit the majority of Filipinos, as poverty does not recede and there is no perceptible improvement in key labor market indicators such as unemployment and underemployment. Obviously, the mere quantity of economic activity, as measured by a common indicator like GDP growth, taken alone, "says virtually nothing about whether life for the common Filipino is getting better or worse. It ignores the distribution of income and makes no distinction between workers with top-paying jobs and those workers who can barely eke out a living. It ignores the fact, for instance, that the record remittances which make economic figures so rosy have a heavy social toll in terms of broken families. The booming mining industry which the government touts? That has environmental costs, too, which should count for something when you're calculating economic balance."[8]

The purpose of this paper is to discuss the notion of inclusive growth and the policies to achieve it. Whether this new concept becomes useful or quickly degenerates into a fad and loses momentum will depend on how both multilateral development institutions and policy makers in developing countries *operationalize* it so that it becomes a means to achieve an end. For this to happen, both groups need to be able to transform ideas into concrete policy actions and specific interventions, in terms of both physical investments and reforms. And this requires a better understanding of the constraints that developing Asia faces. Developing Asia is undergoing significant structural transformation (the essence of growth) in a context of globalization and fast technical progress. This creates a permanent tension between the forces of growth in market economies; and the difficulties that market economies have solving problems such as inequality or unemployment.

The rest of the paper is structured as follows. In section 2, I argue that inclusive growth requires achieving full employment of the labor force. In section 3, I discuss whether it is possible to achieve full employment today. Finally, in section 4, I discuss five policies to achieve inclusive growth. Although much of the discussion focuses on developing Asia, many of the arguments apply equally to other developing regions.

"There are about 500 million people unemployed and underemployed in developing Asia."

2. Inclusive Growth as Full Employment

Felipe and Hasan (2006) estimate that there are about 500 million people unemployed and underemployed in developing Asia. During the next decades, developing Asia's labor force will increase significantly, from about 1.7 billion people in 2005 to almost 2.2.billion in 2030.[9] Countries like Pakistan, Bangladesh or the Philippines, where population growth rates are still relatively high, will have to pay special attention to the question of job creation.

In a modern capitalist economy the necessary condition for a citizen to participate in society is that he/she undertakes a meaningful job.[10] Human beings participate in and contribute to society through their capacity to work. A job is the means not only to receive a wage (and therefore to be able to consume) but also to participate in society. Human work is a conscious activity, purposive and fulfilling in that it is the instrument that allows human beings to be *someone*. As human beings, we have a working consciousness that allows us to develop our human creativity, the ability to create meaningful new forms. This attribute is what distinguishes us from other species. Work matters – to us as individuals, to our family and friends and also to the communities and societies in which we live. Indeed, work is one of the most defining aspects of our lives. As a consequence, those unemployed do not benefit from the opportunity and right to participate in society, as they are excluded. Unemployment and underemployment cause not only direct economic costs (e.g., loss of potential output and income, lower tax revenues due to a lower tax base, deterioration of labor skills and productivity), but also social costs such as poverty, misery, malnutrition, and injustice.[11, 12, 13] Persistent unemployment and underemployment lead to social exclusion and violate basic concepts of membership and citizenship, and thus they do not allow inclusive growth. Ultimately, as Sen argues, it is a question of justice "…the unemployed may feel deprived because of the lack of freedom in their lives, and this goes well beyond just the lowness of income".[14] Indeed, analyzing one historical episode of mass unemployment, Solow concluded that "…apathy and the attenuation of social interaction were the main consequences of the experience of prolonged mass unemployment".[15] See box 1.

Box 1: What exactly is so bad about unemployment?

1. Loss of current output and fiscal burden: Unemployment not only reduces potential national output but also imposes a fiscal burden insofar as resources from those working have to be transferred in the form of unemployment subsidy.
2. Loss of freedom and social exclusion: Unemployed do not exercise much freedom of decision and are deprived of opportunities.
3. Skill loss and long-run damage: Unemployed "unlearn by not doing".
4. Psychological harm: Unemployment causes intense suffering and mental agony.
5. Ill health and mortality: Unemployment can lead to dejection, lack of self-respect, collapse of motivation, and even suicide.
6. Motivational loss and future work: Long-term unemployment leads to a loss of motivation.
7. Loss of human relations and family life: Unemployment is disruptive of social relations and weakens the harmony and coherence within the family.
8. Racial and gender inequality: Both are exacerbated by unemployment.
9. Loss of social values and responsibility: Unemployed develop cynicism about the fairness of social arrangements.
10. Organizational inflexibility and technical conservatism: Unemployment may restrict the use of better technologies and resistance to any economic reorganization involving job loss.

Source: Sen (1997)

For these reasons, it is important that Governments pursue policies to achieve full employment of the labor force. This is the surest way to make growth inclusive. Full employment refers to zero involuntary unemployment. It means that no one who is ready and willing to work for an appropriate wage is without a job. This also means zero involuntary part-time employment, a type of underemployment pervasive across the developing world.[*, 16] In developing countries, the latter aspect is very important, because underemployment is a much more serious problem than open unemployment. For this reason, the goal of full employment in developing countries is about reducing underemployment as well as reducing unemployment. Felipe and Hasan (2006) distinguish four types of underemployment: (i) working limited hours; (ii) high-skilled workers being forced to take up low-paying jobs; (iii) overstaffing; and (iv) workers carrying out their work with very little capital, and therefore, the objective of full employment must be complemented with that of generating *productive* employment.[17]

Likewise, the objective of policymaking must also be to generate *decent* employment (i.e., employment that provides living wages, benefits, reasonable job security, and a healthy work environment).

"It is more rational to argue that developing countries cannot afford unemployment and underemployment, than to suppose that they cannot afford full employment."

If the ultimate goal of policy making is to achieve a more equal society, policy efforts must be directed toward achieving full employment.[18] Without disregarding the importance of growth (as an economic objective), it will not, by itself, deliver full employment. A full employment economy delivers great individual and social benefits. However, policy makers throughout the world have moved away from even attempting to achieve it. Despite this state of affairs, there are powerful reasons to argue the case for full employment if key institutions in developing countries, as well as multilateral lending institutions, are serious about reducing poverty, making growth inclusive, and achieving the Millennium Development Goals. First and foremost, an economy running at full employment creates high overall purchasing or spending power. This leads to more buoyant markets, businesses, investment, and employment. A full-employment economy will provide everyone with opportunities. Second, as mentioned above, an economy operating at full employment can deliver great individual and social benefits. Third, employment is a right, and full employment as an objective of economic policy is found in the International Covenant on Economic, Social and Cultural Rights, the International Covenant on Civil and Political Rights, the International Labour Organization Conventions, the Charter of the United Nations (Article 55 and 56), and the UN Universal Declaration of Human Rights (Article 23). In the US, *high* employment is a mandate of the Federal Reserve. The Humphrey-Hawkins Full Employment and Balanced Growth Act of 1978 lists high employment, balanced growth, and price stability as specific policy goals.[†] Fourth, since 2006, decent work is a target of the first Millennium Development Goal,

* Ideally, I am thinking of full employment à la Beveridge, that is, full employment holds when there are at least as many unfilled job openings as there are unemployed individuals seeking work. Society's responsibility is to create more positions than job seekers, so that firms do the search for workers, not the other way around. Certainly this is very unrealistic given the conditions in developing countries. I use this idea simply as a target.

† The Employment Act of 1946 commits the US to the goal of "maximum employment, production and purchasing power". Most likely, although the term

namely, to eradicate extreme poverty and hunger. Fifth, full employment in the developing world contributes to political stability, as the levels of consumption of large segments of the population will be higher than when unemployment is widespread. Moreover, peace and prosperity in the developed world also depend on the well-being of the people in the developing world. And lastly, full employment should be an ethical imperative in today's world. The benefits of full employment outweigh the costs of its achievement. It benefits everyone, including capitalists. They may end up getting a smaller share (in percentage) of the pie, but the size of the pie will be growing possibly faster than with significant levels of unemployment. Therefore, it is more rational to argue that developing countries cannot afford unemployment and underemployment, than to suppose that they cannot afford full employment. In the words of Paul Krugman: "An unsold commodity is a nuisance, an unemployed worker a tragedy; it is terribly unjust that such tragedies are created every day by new technologies, changing tastes, and the ever-shifting flows of world trade."[19] Expressing a similar sentiment, Alan Blinder stated that "high unemployment represents a waste of resources so colossal that no one truly interested in efficiency can be complacent about it. It is both ironic and tragic that, in searching out ways to improve economic efficiency, we seem to have ignored the biggest inefficiency of them all."[20] Relegating vast numbers of people to do nothing or to do rote work is a dreadful waste of human capabilities. It is both morally and economically inefficient. For this reason, full employment must be the natural point of reference for economic policy and for evaluating a government's performance.

3. Is it possible to attain Full Employment today?

"If Globalization is a Bowl of Cherries, why are there so many Glum Faces around the Table?"[21]

To answer this question, we must understand the basic features of today's world and the likely constraints to the achievement of full employment. In essence, we must answer if full employment is compatible with:

(i) globalization, understood as a process whereby countries throughout the world are becoming increasingly integrated. The effects of globalization on the distribution of wealth and jobs were benign until about a decade ago;

(ii) rapid technological progress that materializes in fast declines in transportation and communication costs; and

(iii) the opening of formerly Communist countries, China and India, to the global capitalist market. The perception of the impact of these forces on employment differs across sectors and individuals.

In my view, the answer to the title of this section is a clear *no:* today's free market economies, if left to their own devices, will not generate full employment, insofar as the free market institutional system does not guarantee full employment, much less in a

was not used, it meant "full employment". The Humphrey-Hawkins Act refers, on the other had, to "high" employment, not to "full". In practice, the US government has never adopted policies that guarantee the latter outcome. Rather, it has adopted a variety of "supply-side" policies and some "demand-side" policies in the hope that markets would operate at a sufficiently high level to ensure high employment. Since the market has not done this, the government has been forced to supplement these policies with various "welfare" programs.

developing country.[22] Traditional neoclassical theory puts forward a theory of how, under certain conditions, a market economy will tend toward full employment. This occurs through the workings of the price mechanism. However, the assumptions used to derive this result do not apply and the reality, i.e., the existence of persistent unemployment and underemployment, is that this theory is not too useful. As Keynes showed, even with flexible wages an economy has a tendency toward unemployment. To do this, he demolished the classical notion of "supply curve of labor" and showed that there was no reason to expect that an excess of unemployment would drive down real wages. Keynes showed that even with high unemployment, the employed workers would resist reduction of their nominal wages; and even in case this opposition failed, the subsequent reduction in nominal wages would bring down prices, leaving real wages unchanged.[23]

Moreover, the analysis of the "labor market" as if it behaved like the market for oranges is fallacious. For this reason, Galbraith speaks of a "job structure", that is, "a historically, socially, and politically specific set of status and pay relationships in the economy, within and between firms and across industries".[24] The elements of a job structure are much more complex than the simple supply and demand characterization of textbook analyses. This means that wages are not determined by the workings of supply and demand, but by a very complex process of comparisons within and across occupations and industries, as well as the qualifications of the worker. Once the notions of supply and demand of labor (as in the market for oranges) are questioned, the idea of the "Natural Rate of Unemployment" crumbles.

"The only possible way to approach the state of full employment is to bring explicitly the objective of employment creation to the top of the policy agenda."

Also, globalization has increased international labor competition. This has contributed, among other things, to rupturing the link between wages and productivity growth. In the developed countries, this rupture has undermined the old wage based system of demand growth, forcing in turn to rely on debt and asset price inflation to drive growth. It has also increased income inequality. Restoring the wage-productivity growth link is therefore vital for both economic and political stability.

The only possible way to approach the state of full employment is to bring explicitly the objective of employment creation to the top of the policy agenda. As a consequence, it will be necessary to redirect the objectives of policy away from controlling inflation (rather than promoting employment), balancing the fiscal budget, eliminating current account deficits, lowering barriers to international trade, opening up new investment outlets for MNCs and financial speculators, and eroding public policies and institutions designed to protect working people and the poor.*

It is important to also understand why, despite the obvious benefits of a full employment economy, it is not openly pursued by policy makers. This question was discussed at length by Kalecki, whose analysis continues to be relevant today.[25] He argued that the best way

* This is not to say that some of these objectives are not important. Rather, my contention is that it is a question of priorities. Stiglitz et al. (2006), for example, argue that there is considerable confusion about the role of price stability. Inflation is interpreted by many as an indicator of economic *malperformance*. The problem with this view is that the indicator is interpreted by many as a policy objective, when in reality it is only an *intermediate* variable.

to achieve full employment was by Government spending on public investment. However, Kalecki argued, despite the obvious benefits that an economy running at full employment provides, the business class will, in general, oppose it. There are three important potential obstacles to increasing investment. First, in a market economy the private sector is the generator of wealth. However, in many developing countries, private investment may not collaborate due to, for example, low profitability, large uncertainty, high cost of investment, or because the full level of firms' savings out of profits is not reinvested. One possibility is, of course, to identify and relax the binding constraint on private investment. But perhaps doing this is not easy and may not be enough to increase investment to the necessary levels. For this reason, a policy of stimulating exclusively private investment may not be satisfactory. It is clear that, in these circumstances, the Government will have to step in to reach the desired level of investment. The role of Government investment is not, it must be stressed, to replace or crowd out private investment (much less in a region characterized by excess of saving over investment), but to complement it due to the latter's insufficiency. Indeed, the most effective and egalitarian way to achieve full employment is through a program of public investments targeted carefully at location-specific high employment activities. For this reason, it will be the Government's responsibility to provide a large volume of public sector investment, e.g., in infrastructure. This, I must stress, is not to deprive the private sector from any active role in the economy, quite the opposite. The private sector has to invest in whatever activities it finds profitable. This is the way a market economy will prosper, although this does not guarantee full employment of the labor force.

Moreover, in many developing countries the private sector cannot be relied upon to undertake the required volume of investment and of the appropriate structure. The reason is that nobody can force this sector to invest the required volume and in the areas that a developing country may need. In some developing countries the business class does not play, on a large scale, the role of dynamic entrepreneur that it should (contrary to what occurred in today's developed countries at the time they underwent deep structural changes), driven by 'animal spirits' (i.e., a spontaneous urge to action and willingness to take risks), using Keynesian terminology.[26] In some cases it is due to a poor investment climate (e.g., difficulties in opening a new business), the result of Government-imposed constraints; in other cases, the oligopolistic characteristics of some sectors of the economy favor some privileged groups that enjoy rents. These groups lobby to perpetuate this situation. The problem is neither the high cost of investment nor low returns (in the growth diagnostics terminology of Hausmann et al.) but the desire to maintain a situation of privilege.[27] Investment takes place in the areas that these groups control and at the pace that it suits them. At any point, and for strategic reasons, they might be unwilling to expand capital expenditures simply because it favors their objectives. In many developing countries, the capacity for entrepreneurship that the private sector has must be nurtured and developed, since the driving force in a capitalist economy is the decision to invest and the rate of capital accumulation (and the demand for labor depends on it). But the objective of the private sector is not the maximization of employment and hence it *cannot* be and should not be made responsible for the achievement of full employment. Although some may not like it, this requires some planning.

Stimulation of private investment through, for example, reductions in interest and/or tax rates or through subsidies to private investment, will not deliver full employment. If the economy is already in a boom, measures to stimulate investment further will be pointless.

And in a slump some of these measures may not work, e.g., reductions in interest rates may be ineffective due to the existence of excess capacity. Private investment depends, especially in developing countries, on expectations and political stability. Moreover, a "one-time" reduction in interest or tax rates does not eliminate a downturn (business cycle). Policy makers would have to lower them successively and continuously to keep the investment rate going. Moreover, Vickrey argued that firms' savings out of profits represent income not spent.[28, 29] These savings cause the income of others to fall (through the multiplier effect). This is because savings not immediately transformed into capital simply 'vanish' and lead to reduced income. Therefore, private sector investment is the mechanism through which the sector's profits are recycled into the income stream (i.e., the mechanism through which non-spending is transformed into spending). If a country's total surplus were reinvested, the economy would get closer to the achievement of full employment. But when the total *full employment level of firms' savings* is not recycled into spending by private investment (in fact, Vickrey believed that the private sector would not recycle the full employment level of its savings), some of the *full employment level of output* will not be justified by actual sales, i.e., part of the product will not be sold and goods will accumulate in stock. This will lead to reductions in production and employment. Unemployment is, therefore, the evidence of this gap (i.e., savings that are "kept idle" and not put to productive investment). Income (the equilibrating variable, and not interest rates) will fall and consequently savings will also decline until they are brought back to match *the below full employment level of private investment*. For Vickrey there is only one solution to closing this gap and bringing the economy to full employment: government deficits.

However, achievement of the full employment of labor through a large volume of public investment faces serious political obstacles. Kalecki argued that "The assumption that a Government will maintain full employment in a capitalist economy if only it knows how to do it is fallacious". He gave three "reasons for the opposition of the 'industrial leaders' to full employment achieved by Government spending": (i) the opposition against Government spending based on a budget deficit and the dislike of Government interference in the problems of employment; (ii) the opposition against this spending being directed towards public investment (or towards subsidizing consumption, for example through subsidies to keep down the prices of necessities), except when it is confined to objectives which do not compete with private investment, that is, for construction of hospitals, schools, highways, etc.[30] It is interesting, however, that even these areas are contested today as domains of the private sector, and some argue that public investment crowds-out private investment on the grounds that the former lowers the real rate of return of the latter; and (iii) the opposition against *maintaining* full employment as this may give workers a very strong and dangerous position in the bargaining.[31, 32] No wonder Kalecki asked: "…why do not they [businessmen] accept gladly the 'synthetic' boom which the Government is able to offer them?"[*, 33]

The second obstacle to increasing investment is that the investment goods sector (e.g., the construction sector) may be already running at close to or full capacity and thus may not be able to increase its output.

* It is worth considering the grounds underlying these arguments, given that higher output and employment benefit both workers and firms, as profits rise. Moreover, a policy of full employment based on loan-financed Government spending does not affect profits as it does not require additional taxes. Despite that Kalecki wrote this article more than six decades ago, the argument is still valid and relevant today. One just has to read some newspapers or listen to the business segment of the news.

And finally, the third obstacle is that the country may run into the problem of how to secure an adequate supply of necessities to cover the demand resulting from the increase in employment. This increased demand will induce inflationary pressures as the supply of necessities (especially food) is limited.* This situation has an additional implication. Suppose that the economy is capable of increasing investment. This will lead to more employment and to a higher total *nominal* wage bill. However, the overall wage bill in *real* terms will remain unchanged as a result of the increase in the price level. What is the implication? That although the level of employment has increased (certainly a positive outcome), the real wage rate (i.e., wage per worker) will have declined, and this is an unfair way of financing the acceleration in growth. The conclusion is that the increase in investment under conditions of an inelastic supply of food will cause both a fall in real wages and the acceleration in prices. For this reason, it is important to expand food production in parallel to industrial development. Investment in public transportation and public utilities should be accompanied by measures to expand agricultural production, such as land reform and easy credit to farmers.

This discussion means that in trying to achieve inclusive growth, policy makers cannot throw the costs of capital formation on the wage earners and, in particular, on the poor. In a command economy investment is financed out of the incomes of state institutions and not out of the savings of private individuals; but in countries that have followed the capitalist path of development (i.e., where savings and investment decisions are distinct), who bears the cost of capital accumulation is an important political economy question that needs to be answered. The same way that Governments must be accountable for their actions, policies, goals, and ultimately for their performance and capacity to deliver, the domestic upper and business class of developing countries, in many cases a relatively small group of individuals and families, must also be made ethically and politically responsible for the development of the country. Domestic investment often depends on the decisions of a reduced group of businessmen. As long as private investment cannot be "enforced", the public sector will have to cover the gap up to full employment. Many developing countries, however, cannot enforce the tax collection system, tax evasion is rampant, and the implementation of progressive financial reforms is an uphill battle. Under these circumstances, the funds for investment are hard to extract. Both agriculture and manufacture fail to develop efficiently and growth of total output is swallowed up in growing consumption.

To these arguments, we need to add the economic/technical arguments that make the achievement of full employment a very difficult task. Often, standard analyses rely on the assumptions of perfect mobility and substitution of factors. Under these circumstances, the system "instantaneously" and easily adjusts to changes in technology. Structural change, however, is path-dependent, takes place in historical time, and leads to disproportional growth across sectors. Moreover, capital goods tend to be highly specific, which means that they cannot be shifted easily across lines of production and there is significant uncertainty regarding the future.

Pasinetti and Taylor worked out the conditions to achieve full employment in a system undergoing structural and technological change.[34, 35] Suppose an economy is growing, with some sectors expanding faster than others. Also assume productivity is increasing across sectors with unit labor requirements (i.e., labor per unit of output, or the inverse of labor

* Of course, inflation may not show up if entrepreneurs are unwilling to expand their capital expenditures.

productivity) declining at different rates. Are these trends compatible with full employment? Pasinetti's general answer is no. The reason is that the condition Pasinetti derived is stringent, one that actual economies most likely do not satisfy: that labor per unit of output and demand per unit of labor must be in balance if demand is to support a full-employment output level. This condition obviously runs into difficulties in a dynamic context. First, labor per unit of output tends to decrease in time (since the 1950s, labor productivity has increased at a rate between 0% and 5% per annum, depending on the country). Second, per capita demand for many commodities or services may rise (e.g., iPods today) for some time, but ultimately tends to slow and even decline (demand saturation). If on one hand both unit labor requirements and demand per unit of labor are decreasing in a sector, the sector will lose employment. On the other hand, a rising demand per unit of labor in one sector may compensate a declining unit labor requirement in another sector, thus leading to employment growth. But this is not guaranteed to happen and, in general, the system will not be in balance. This means that in order to support employment growth, a market economy must constantly introduce new commodities and services as it eliminates the old ones.[*] Therefore, some of the major obstacles to full employment lie in the technological conditions of production. In advanced market economies, the main mechanism to enable real per capita demand to increase has been growth in real wages at a rate close to that of labor productivity. In other words, an increase in real wage rates can offset reductions in unit labor requirements by supporting a growing aggregate demand per capita. But, once again, this process is not guaranteed to go on, that is, even if wages go up to offset the decreasing unit labor requirements, higher productivity may not lead to higher output and employment.

The different situations of disproportional demand and productivity trends that arise across sectors may require substantial labor force reallocation in order to maintain full employment. Most developing countries are not able to deal with the social consequences of labor reallocation (e.g., think of the People's Republic of China).[36]

The conclusion of this discussion is that the dynamics of structural change imply that, if left to its own devices (i.e., the vagaries of the market), a developing economy will not achieve full employment. For this reason, the country's institutions, the government particularly, but also the central bank and the business class, must understand the importance of placing full employment at the top of the economic and political agendas.

4. Policies to achieve Inclusive Growth

However difficult the achievement of full employment may be, governments have the responsibility to achieve it. This requires implementing a series of strategies in different areas. I propose the following policies:[37]

(i) Redress the neglect of agriculture: Agriculture is still the largest employer in many developing countries in Asia, including Bangladesh, Cambodia, PRC, India, Indonesia, Pakistan, Papua New Guinea, Thailand, or Viet Nam (in 2000–2004, agriculture was still

* Also, the labor force participation rate may be declining (in countries where unemployment is increasing) as well as the share of time devoted to work. The economy may have mechanisms to counteract these forces. In developed countries, female participation rates have risen steadily. This has permitted households to buy all the new commodities that have entered the market during the last few decades (e.g., computers, new TVs, VCRs, tourism). In some developing countries, labor force participation rates are not increasing (at least when measured in terms of the formal labor market). Nobody knows what other factors may bite in the future to make the attainment of full employment an even more complex problem (e.g., environmental constraints).

"Thailand's labor productivity in agriculture is estimated at about $1,650. In the US, it is about $40,000."

the largest employer in developing Asia in 12 out of 23 countries for which data were available). And in many other countries in the region, although it is not the largest employer, it still employs a very significant share of the labor force.

However, for decades, agriculture has been neglected in large parts of Asia. For example, in 1980, 30% of the World Bank's annual lending went to agriculture projects. By 2007, this share had declined to 12% (adjusted for inflation, the World Bank cut its agricultural lending to $2.0 billion in 2004 from $7.7 billion in 1980). Today, the overall proportion of official development assistance going to agriculture is only 4%. Why has this occurred? An important factor that accounts for the poor state of agriculture is countries' attempt to emulate the experience of the East Asian countries. At the time these countries started growing in the 1970s, the prevailing view was that a significant amount of labor would be transferred from agriculture into industry and services. Likewise, there was some degree of export pessimism with regard to agriculture.

The prospects of achieving fast growth in the exports of labor-intensive manufactures were much better. The experience of East Asia seemed to corroborate these views, which led other countries in the region, especially in South Asia, to also push the export-led growth route. The consequence was the neglect of agriculture in favor of industrialization, although in many cases this strategy did not succeed to the extent that it had previously succeeded in East Asia. This is most obvious in India, where the decline in public infrastructure in rural areas has led to the sector's stagnation. In Viet Nam, large agricultural areas are being lost in the name of industrialization. According to the Ministry of Agriculture and Rural Development, the country loses about 40,000 hectares a year of rice fields to construction of cities, highways, and industrial zones. And in Thailand, the area of land under cultivation declined by more than 13% between 1995 and 2005. This means that Asia's food crisis may not end soon. Moreover, its solution requires international cooperation.

"Increasing employment at the expense of a decrease in real wages should not be acceptable as a policy option."

If growth in developing Asia is to be inclusive, then agriculture will have to be given priority. Thailand's labor productivity in agriculture is estimated at about $1,650. In the US, it is about $40,000. Labor productivity in agriculture in the Philippines, Indonesia, Myanmar, PRC, India, Nepal, Bangladesh, and Cambodia barely reaches $1,000. There is no doubt that if developing Asian countries upgraded their agricultural practices only to the level of Thailand, millions of people would be lifted out of poverty. Another problem is the fragmentation of holdings due to population growth. In the PRC and Bangladesh, average farm size has fallen from about 1.5 hectares in the 1970s to about 0.5 hectares now. Improvements in agriculture will require deep understanding of the transformation that agriculture can potentially undergo. One such transformation is the increasing importance of commercialization and the role of supermarkets.

One could think that the solution may lie in reallocating the labor force out of agriculture toward more productive activities. I have in mind, for example, labor-intensive building and construction, although some industry and services activities could also serve the same purpose. The preliminary answer is yes; indeed, this is (part of) the solution. This encounters, however, an important obstacle. This is the bottleneck of supply of necessities (resulting from the low elasticity of agricultural production) that would arise. Indeed, an increase in employment outside agriculture creates additional income (wages) and, given that workers spend a considerable part of their wage bill on food, if there is no concomitant increase in agricultural output, food inflation will show up. How could policymakers avoid such inflationary pressures? Perhaps the first obvious measure would be to tax necessities (mostly consumed by low-income groups) to contain food inflation. This, however, is not a solution if policymakers aim at achieving inclusive growth. Indeed, increasing employment at the expense of a decrease in real wages should not be acceptable as a policy option, for it amounts to taxing the poor rather than the well-off on the grounds that the latter would not reduce their consumption despite the imposition of a tax (apart from the fact that it limits the expansion of the market for mass consumption articles, an important factor of industrialization). Nevertheless, taxation of the upper-income groups would probably only slightly depress the demand for food, and hence inflationary pressures would remain. Imports of food can also help relieve the problem. These, however, will require that the country in question export enough to pay for its imports. Otherwise, it will run a trade deficit. For this reason, in general, the increase in food supply will depend on domestic output.

If the increase in food supply will largely depend on increasing domestic output, policymakers will have to plan an increase in the supply of food (i.e., an increase in agricultural output), and in general of consumer goods, that matches the demand for them. Therefore, an increase in agricultural output is crucial for many developing countries to initiate economic development. This policy also matters because many developing countries today have a higher density of population on their land than most developed countries had at the time they underwent structural transformation and modern growth. The developing countries are also experiencing higher population growth than the developed countries ever experienced. For this reason, a complementary policy is to prevent large-scale migration from the countryside into urban areas. This requires agricultural policies aimed at absorbing more men per acre and the industrialization of the country side.

(ii) Undertake public investment in basic infrastructure (energy, transport, urban services) targeted at high-employment projects: As I noted earlier, Kalecki argued that the best way to achieve and maintain full employment was by Government spending on public investment (e.g., schools, hospitals, highways, etc.).[38] This policy recommendation remains valid today.

A dynamic economy will need increases in the growth rate of the capital stock (i.e., capital accumulation) in the form of, among others, investment in public transportation and in public utilities. Increases in the growth rate of the capital stock can be achieved in two ways. The first one is to increase the productivity with which capital is used. This route, however, is very difficult. In fact, the empirical evidence shows that capital productivity tends to decline in the long-run.[39] It seems that development entails increases in labor productivity combined with decreases in capital productivity.

The second mechanism to increase the growth rate of the capital stock is to increase the investment-to-output ratio. This is the basis for a policy of industrialization, and is the one followed by the successful East and Southeast Asian economies. The importance of investment for development is crucial. There is no lack of candidate projects: schools, hospitals, transportation, power and telecommunications, are all under-served in much of developing Asia. This is because it plays a dual role. On the one hand investment expenditures are a source of demand when they are incurred. And on the other hand, investment increases the productive capacity of the economy in the long run. This second role is the one I consider here.*

How did the successful Asian countries increase their investment-to-GDP ratios? To see this, it is worth considering the relationship between the labor share, real wage rates and labor productivity. In a context of full employment, if there is a rise in labor productivity, and if the labor share is approximately constant, real wages will have to increase. But it is also possible that the labor share decreases and yet workers see their real wages increase. This will happen if productivity increases fast but such increases are not passed on to wages one-to-one (but these nevertheless increase fast too). Under these circumstances wages will increase by a lesser amount than labor productivity and thus the labor share will decrease. Workers, although they see their share in total income decrease, would tolerate the situation. This was possible in many Asian countries because there was little militancy in the labor force, partly because of a substantial labor surplus in the economy, and partly because of repression by state agencies.

While some Asian countries made huge efforts toward increasing investment (much of it into the manufacturing sector), it is important to also understand that these countries were initially somewhat lucky. In the late 1960s, the developed world started experiencing important internal changes that led them to relocate entire industries or particular industrial processes to the Third World. One important reason was the increase in wages in the advanced economies, resulting from the fact that the social contract established after World War II favored labor. At the same time, rapid technological progress led to the development of highly standardized manufacturing processes. This made it possible to transfer particular stages of production, namely, the labor-intensive processes that required low-skilled workers. What options did companies in the developed world have? Only two: Latin America and East and Southeast Asia. However, Latin America was ruled out for being much more politically unstable. This left only Asia. Thus, in the late 1960s, a number of electronics firms, including Hewlett-Packard, Texas Instruments and others, built factories in Singapore to assemble components, particularly semiconductors. This process was extended to Malaysia, Thailand and the Philippines. But what were the internal conditions that enabled capitalist South-East Asia to respond to the opportunities created by restructuring the industrial core? Brown argues that "one crucial condition [..] was the presence of a copious supply of cheap, largely unskilled, and essentially docile labour". To this one must add the role of women, whose "dexterous fingers and patient temperament fitted them for such repetitive, minutely detailed tasks as electronic components assembly or garment production"; and weak labor unions.

* In his discussion of "what causes periodical crises?" Kalecki (1939, pp.148-149) argued that investment is both an expenditure and an addition to capital accumulation. The tragedy of investment is that it causes crises because it is useful. The basic contradiction underlying investment lies in the different time horizon of the effects of investments on demand and on capacity; that is, the fact that while the impact of former is exhausted in a short time, the one on capacity lasts longer.

This is today an important component of what is referred to as 'China's competitiveness'.[*, 40]

A second condition was that Southeast Asia was resource-rich (except Singapore). This gave it an important advantage in the production of manufactures such as wood products, processed foods, cement, chemical fertilizer and paper, all of which involve the intensive use of local inputs. Finally, a third condition is that these countries possessed an acceptable level of communication, commercial and administrative infrastructure.

However, a dose of luck and these internal conditions do not explain entirely the success of East and Southeast Asia. The key lies, I believe, in the social contract implemented in many countries, and in the political pressure derived from the communist threat.[41] Underlying these, there was a series of complex structures of political, economic and bureaucratic interests that favored the accumulation of capital.

Naturally, the counterpart of the decrease in the labor share was the increase in the capital share. A good deal of evidence suggests that capital accumulation for industrialization is largely financed by profits in the form of retentions, rather than by household savings.[42] Indeed, according to Lewis: "…the major source of savings is profits, and if we find that savings are increasing as a proportion of the national income, we may take it for granted that this is because the share of profits in the national income is increasing."[43] Over the long run, a high rate of retained profits tends to be associated with a high rate of corporate investment. Using data for 30 developing countries for the 1980s, Ros showed that there is a strong relationship between a high savings rate, a high share of manufacturing output in GDP and a high profit share in manufacturing value added in East Asia.[44]

It is important to emphasize a key point about this strategy of industrialization (i.e., the increase in the share of investment). This is that real wages should not fall in the process. This requires both a high rate of labor productivity and that the prices of essential consumer goods be stable, which implies that their supply must rise in step with their demand. Achieving this will also require that investment in the different sectors of the economy, in particular in the capital and consumer goods sectors, be undertaken in the "right" proportions. And it will also necessitate, as already noted, the adjustment of the rate of growth of employment to the limit set by the increase in food supply and articles of mass consumption in general. Certainly this is not easy. Moreover, maintaining the purchasing power of wages is also important because declines in real wages limit the expansion of the market for mass consumption articles. However, given the importance that I have placed on the objective of full employment as the basic measure of a socially equitable economic policy, it may appear that the constraint that real wages do not decrease could pose a problem. For this reason, the lower acceptable limit for society should be that real wages be stable for the better off workers and wage rates of the bottom workers increase. To be more precise, inclusive growth should favor policies that encourage faster wage growth for low-paying jobs than for highly-paid work. This means that, at the low end, wage growth will exceed productivity growth, while at the high end productivity growth will exceed wage growth. This proposal is consistent with the idea of broad-based growth, which should translate into development efforts directed toward raising the standard of living of those at the bottom. This policy implies that, most likely, prices will

* Today, much foreign manufacturing in China is assembly activity and the workforce is disproportionately female and recruited from rural areas. The high female literacy rate has given China a crucial advantage in attracting foreign investment in manufacturing vis-à-vis India.

grow in the low-wage sector as costs rise. Preventing inflation will require some constraint on prices and wages in high wage sectors.[45, 46, 47, 48]

What is the impact of this development strategy on consumption? Given that workers have a high propensity to consume, the decrease in the labor share will affect overall consumption. How should policy makers proceed, i.e., what consumption categories should be reduced? In order to accomplish this in a "fair manner", policy makers would have to restrain the consumption of non-essentials (something that politically is very difficult). For this, appropriate taxes should be imposed. In these circumstances, an acceleration of income (induced by the acceleration of investment) will be accompanied by an increase in the supply of necessities adequate to prevent inflationary pressures. Thus, a higher share of investment in output will be offset by a decline in the share of non-essential consumption via direct and indirect taxation of the upper classes. At what point is the share of investment too high and that of consumption too low? This is difficult to ascertain but there will be signals. Profitability may decrease precipitously leading the economy into a profitability slump. On the other hand, if authorities are not careful and the share of consumption of essential goods goes down, the problem might be under consumption.

(iii) Use of industrial policy, understood as a collaborative effort between public and private sectors, to accelerate industrialization and structural transformation in general: How can developing countries induce structural change and plan transitions to higher growth rates and deeper degrees of structural transformation and diversification? This is a fundamental aspect of the problem of developing countries (the need to increase productive capacity). Indeed, the transition from agriculture into a modern industrial and service economy, and decisions about how much to invest and where, can be viewed as problems of self-discovery and of understanding the externalities that lessen incentives for productive diversification. Today's developed countries directed policies to industrialize. Chang argues that today's developed countries—such as the UK, Germany, France, the US, Sweden, and Japan—used industrial, trade, and technological policies when they were developing and catching up.[49] They used some form of infant-industry policy or tariff protection. More recently, many East Asian countries also used infant-industry protection measures to develop their industrial sectors.[50]

Industrial policy has traditionally been understood as any type of selective intervention or government policy that attempts to alter the structure of production toward sectors that are expected to offer better prospects for economic growth than without such intervention. This type of intervention has its adherents—those who believe in market failures—and its detractors—those who believe in the efficient working of markets. The latter argue that industrial policy interventions have often degenerated into an exercise in "picking winners", a game played by government officials deciding what activities and sectors to promote and to spend public money on.[*]

In a series of papers, Rodrik has argued in favor of a new type of industrial policy. He acknowledges the existence of generic market failures, but argues "that the location and magnitude of these market failures are highly uncertain".He argues that information and

* The literature evaluating the pros and cons of industrial policy is inconclusive. While some authors argue positively about it (e.g., Amsden 1989), others are critical (e.g., Pack and Sagi 2006).

coordination externalities are more important than technological externalities, for the former weaken the entrepreneurial drive to restructure and diversify low-income economies. Rodrik argues that industrial policy is not about addressing distortions in the traditional way (i.e., by enumerating technological and other externalities and then targeting policy interventions on these market failures), but about eliciting information from the private sector on significant externalities and about the constraints to structural transformation (hence industrial policy also encompasses activities in agriculture and services) and the opportunities available. This requires "strategic collaboration" between the public and private sectors to determine the areas in which the country has a comparative advantage. The reason is that entrepreneurs may lack information about where the comparative advantage of a country lies and governments may not even know what they do not know. And certainly most governments do not have the adequate knowledge to pick winners. Uncertainty arising from lack of communication—that is, from one decision-maker having no way of finding out the concurrent decisions and plans made by others—may, if sufficiently great, inhibit investment decisions and arrest growth. In these circumstances, markets alone are likely to undersupply the incentives and demand for new activities necessary to transform the economy. These market failures are more prevalent in developing economies. As Rodrik notes: "The trick for the government is not to pick winners, but to know when it has a loser". This requires the development of the appropriate institutional arrangements for industrial policy. [51, 52]

Industrial policy should be conceived as a joint effort of the state and the private sector to diagnose the sources of blockage in new economic activities and propose solutions to them. Industrial and technological upgrading requires purposeful effort in the form of industrial policy, in particular, effective government action and public-private collaboration. But this needs, first, a government that does not take any particular stand on the activities to be promoted or the instruments to be deployed. It only requires the government to build the private-public institutional setting from which information on profitable activities and useful instruments of intervention can be extracted. The key issue is not whether to protect, but how to protect and promote industry in order to ensure technical progress leading to higher labor productivity.* And second, it needs a private sector that is willing to do its part of the deal, i.e., invest. Understood this way, industrial policy is a powerful tool for successful industrialization and structural change.

(iv) Gear fiscal and monetary policies to the achievement of full employment: Although Governments do understand the problems associated with unemployment and underemployment and make efforts to solve them, the reality is that some of the policies they implement run in the opposite direction. There are several reasons that explain this.[53] In essence, the "deficit fetishism", as Stiglitz et al. refer to it, does not allow Governments to fill the difference between the saving desire of the private sector and the required spending of an economy to run at full employment.[54] Modern Governments that operate with fiat currency are not operationally constrained (like a family). Moreover, given how modern economies work, budget deficits do not lead to increases in interest rates (as the loanable funds model

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* Amsden (2000) and Amsden and Hikino (2000) argue that the new rules of the World Trade Organization (WTO) allow countries to promote their industries, including the manufacturing sector, in particular under the umbrella of advancing science and technology (e.g., by setting up technology parks). Subsidies in exchange for monitorable, results-oriented performance standards are acceptable. Countries can, for example, target national champions. The hurdles that developing countries face are the following: (i) informal political pressures by the developed countries in favor of market opening, (ii) the subjection of countries that make use of WTO rules to promote their industries to "reciprocal control mechanisms", and (iii) their lack of "vision".

predicts) and do not crowd out the private sector. In fact, government spending adds, dollar for dollar, to the country's overall savings. And given that often economies operate below full capacity, government spending is not inflationary. Given this, Governments should spend enough so as to bring the economy much closer to full employment. When this state is approached, then it is true that further spending will lead to inflation. Then there will be no reason for further Government spending (i.e., fiscal deficit). Or put in different terms: if the private sector spent enough so as to bring the economy close to full employment, then there would be no need to run fiscal deficits.

The case for a budget deficit depends on what the deficit is for, and not on what may appear to be *sound* or *unsound* according to any established traditional doctrine. Judging fiscal measures by the way they work or function in the economy is known as the doctrine of "Functional Finance". As with all macro policies, budget deficits should be judged in relation to the results. Moreover, budget deficits have different impacts depending on whether the economy is at full employment or far from it. In the former case, deficits are likely to have adverse effects, e.g., may crowd out private investment by increasing interest rates and lead to inflation (due to excessive aggregate demand), although the empirical evidence linking cause and effect is scant. If the economy is not at full employment, a deficit need not crowd out private investment. Therefore, a budget deficit incurred to achieve full employment should, at least, be considered.

It should not be inferred from these arguments that I am proposing budget deficits without limits. The size of the deficit is market-determined by the desired net saving of the private sector. Full employment is the limit. For this reason, functional finance is not about spending without limit.

The discussion above indicates that government expenditure and fiscal policy in general should be seen from the point of view of how to keep the total spending in the economy at the rate that would buy all the goods that it is possible to produce. Fiscal policy should be conceived as a mechanism that balances the system, exogenously increasing aggregate demand (e.g., by injecting expenditures) whenever private-sector spending falls short of a full-employment level of effective demand, and reducing aggregate demand (by taxing) if this exceeds the full-employment level. This also means that the purpose of taxation is not to finance or allow government spending, but to remove spending power from the private sector so as to reduce current aggregate demand, and maintain the (government-created) demand for the government's money. The key is to ensure that government spending is at the right level to induce neither inflationary nor deflationary forces. However, given the usual private-sector preferences regarding net saving, economic growth will most often require government deficits. Until full employment is reached, deficits can be increased to allow incomes to rise. Once full employment is reached, additional deficit spending will generate additional income that most likely will induce inflation.[*] This also means that, in general, unemployment is the evidence that the government's deficit is too low. Deficit spending increases incomes and generates additional spending, and thus additional employment. This

* Budget deficits can generate inflation before they reach full employment. This will happen when there are bottlenecks that lead to supply constraints and cost-push inflation. Likewise, inflation will happen if the tax system collapses, in which case the government's money (debt) becomes worthless. This would degenerate in hyperinflation.

additional spending will most likely stimulate the private sector, create more jobs, and reduce unemployment.*

"There is a widespread perception that many governments have used unemployment as a way to contain inflation. Surely inflation is bad, but the social costs of unemployment are much worse."

Inflation, and the policies to contain it are also controversial. Inflation can potentially damage developing countries because it erodes the purchasing power of wages and shifts the burden of financing development to workers. This is unethical and conflicts with the idea of inclusive growth. Price increases that lead to real wage reductions (especially for the workers at the bottom of the wage distribution, for whom low inflation is a public good of special importance) are inconsistent with the notion of inclusive growth, and measures should be taken against inflation.

However, Stiglitz et al. (2006) argue that there is considerable confusion about the role of price stability in an economy. Inflation is interpreted by many as an indicator of economic *malperformance*. The problem with this view is that the indicator is interpreted by many as a policy objective, when in reality it is only an *intermediate* variable. Unemployment, meanwhile, argues Galbraith, "has become a price-stabilizing instrument... [because] . . . those who have political voice and influence are more damaged by inflation than by unemployment".[55] The key lies in understanding the causes of inflation, for these have different implications for economic policy.

The misunderstandings about what causes inflation, the belief that low inflation is a pre-condition for growth, and the implications of inflation for the rest of the economy are often a source of confusion. There is a widespread perception that many governments have used unemployment as a way to contain inflation. Surely inflation is bad, but the social costs of unemployment are much worse. Moreover, empirical studies show that (i) low inflation is not associated in general with high growth; (ii) hyperinflation is associated in general with low growth; and (iii) moderate rates of inflation, 20–30% per year, have been associated with rapid growth quite often. This means that, "given the uncharacteristically unified view among economists and policy analysts that countries with high inflation rates should adopt policies that lower inflation in order to promote economic prosperity, the inability to find simple cross-country regressions supporting this contention is both surprising and troubling".[56] Overall, no scientific evidence suggests that a necessary condition for faster growth is that inflation should be as low as possible. What is truly damaging for an economy is unpredictable, unexpected, and volatile inflation, but not steady and predictable inflation. We must, therefore, be concerned with the likely sacrifices being made by many developing countries in terms of output losses (and, consequently, employment) as a result of trying to maintain very low inflation rates. This is even more obvious when moderate inflation around the world is not clearly the result of central banks' policies rather than the result of the increased competition that derives from globalization. The conclusion is that probably many

* I want to stress that I am not advocating budget deficits without limits. Rather, I argue that what seems to happen to many developing countries (i.e., their low level of productive capacity) is the failure to recycle a significant amount of savings out of profits of the private sector into the system as productive and useful investment. Hence, budget deficits have to fill in the gap, given that the private sector's investment is often below the level of full employment.

countries can afford slightly higher inflation rates, possibly permitting higher growth and employment, without derailing the economy.

"The Job Guarantee Program is a theoretically solid proposal that provides a mechanism to ensure full employment with price stability."

(v) Devise Job Guarantee Programs (JGP) to ensure full employment with price stability: Most governments are in a position to promote full employment through direct job creation through the implementation of Job Guarantee Programs. Long-term unemployment and underemployment may be due to skills mismatch or problems with the individuals who are unemployed, in which case the solution is job brokerage or training. But if the problem is job shortage, then improving the match between job seekers and vacancies, as well as training, will not do much. In this case, only direct job creation by an employer of last resort that can offer an infinitely elastic demand for labor can ensure full employment. This is the only way to ensure that everyone who wants to work will be able to obtain a job. Only the government can do this. The JGP is a theoretically solid proposal that provides a mechanism to ensure full employment with price stability.

The JGP is essentially a fixed price (the public-sector wage)/floating quantity (public-sector employment) system that acts as a countercyclical mechanism and as a buffer stock program: when the private sector downsizes in recessions, workers who lose their jobs can find a job in the JGP. And when aggregate demand increases, these workers are hired again by the private sector. The system can be implemented in a variety of ways, depending on circumstances. Under this scheme, the government pledges to hire anyone willing to work at a basic public-sector living (i.e., decent) salary, and the wage bill is paid for by deficit expenditure. But the program does not replace either private-sector or other public-sector employment. The JGP basic salary will act as a minimum wage that will put a floor to wages. It will reduce the downward pressure on wages and will help reduce inequality. If it is appropriately designed, it can connect wages and productivity growth, something critical for building a sustainable demand generating process. This minimum wage will depend on the country, but it could be, for example, a fixed percent of the median wage. This way, it will automatically rise with the median wage, creating a true floor that moves with the economy. Moreover, since it is set with reference to the local conditions in each country, it will reflect what the country can bear.

Authors who propose a JGP argue that this service does not replace unemployment with underemployment and that it is not inflationary.[*, 57] JGPs contribute to maintaining full employment with inflation control. When private-sector demand is high enough to cause wage-price pressures, governments can manipulate fiscal and monetary policies (preferably the former) to reduce them. The resulting increase in JGP employment indicates the degree of private-sector slack that is necessary to solve the distributional struggle that causes inflationary pressures.

JGPs are not inflationary because public employment may be directed toward public works such as infrastructure revitalization that might lead to higher productivity growth in

* Some have argued that JGP cannot be implemented because they would become unmanageable; that corruption would make them fail; that useful (i.e., productive) jobs for all workers would be impossible to find; and that they are too expensive. Mitchell and Wray (2005) address these criticisms. A properly designed JGP system would mitigate or eliminate these problems. The success of a JGP depends on how it is designed and implemented, especially the mechanisms for accountability.

the private sector. This system can help diminish inflationary bottlenecks, as workers in it are available to the private sector. Therefore, in the view of its proponents, an economy can both have stable prices and eliminate unemployment. They also argue that workers' productivity will increase because workers taking part in the JGP will gain skills and knowledge. Workers engaged in the JGP can provide goods and services that markets do not provide, or that are too expensive for poor households (e.g., child and elderly care, tutoring, public safety); small-scale public infrastructure provision or repair (e.g., clean water and sewage projects, roads); or low-income housing.* Many of these activities would contribute to the decline of the informal sector as workers get integrated into formal employment, gaining protection by the labor laws. Jobs created in these programs are labor intensive, requiring little capital equipment. Finally, and somewhat ironically, the JGP can be viewed as a mechanism that contributes to enhancing the flexibility of the labor market: it is a *reserve army of the employed*, not of the unemployed!

5. Conclusions

This paper has discussed the new concept of inclusive growth that some multilateral development agencies have adopted as part of their tool kit. Starting from the definition of inclusive growth as growth that allows all members of a society to participate in, and contribute to, the growth process, I have argued that in a modern capitalist economy the necessary condition for a citizen to participate in society is that he/she has access to a meaningful job. Given this, the paper has offered an interpretation of inclusive growth as a clear policy objective, namely, the achievement of full employment, that is, a state of zero involuntary unemployment. This means that no one who is ready and willing to work for an appropriate wage is without a job. This also means zero involuntary part-time employment.

Developing Asia is home to about 500 million people unemployed and underemployed. This is a major cause of poverty. An economy running as close as possible to full employment can deliver a great deal of benefits, both economic and social. For this reason, being as close as possible to full employment should be an explicit objective of policy makers across developing Asia. I have argued, however, that in today's world, characterized by globalization, rapid technological progress, and the opening of formerly Communist countries, plus China and India, to the global capitalist market, it will be very difficult to achieve full employment. Finally, I have proposed five policies to achieve full employment of the labor force: (i) redress the neglect of agriculture; (ii) undertake public investment in basic infrastructure (energy, transport, urban services) targeted to high-employment projects; (iii) Use of industrial policy, understood as a collaborative effort between public and private sectors, to accelerate industrialization, and structural transformation in general; (iv) Gear fiscal and monetary policies for the achievement of full employment; and (v) Implement Job Guarantee Programs.

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* India's National Rural Employment Guarantee Act, which guarantees 100 days of employment a year for at least one adult in every rural household, is an example of a scheme designed to help the poorest and most vulnerable (Felipe and Hasan 2006, chapter 5). The program is countercyclical with the agricultural season. One possible problem in very large countries is that, if they are net food importers, upward pressure might arise on domestic prices (people would eat more and probably better). Argentina's Plan Jefes y Jefas is another example. In the aftermath of the economic crisis, Argentina created a program that guarantees a job for poor heads of households. The program successfully created 2 million new jobs for poor families, and provided needed services and free goods to poor neighborhoods. Under this program, workers produce, among other things, clothing and furniture sold in formal markets.

Notes

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