

International Conference
The Indian economy in the era of financial globalisation
Maison des Sciences de l'Homme, Paris
28-29 September 2006

Labour under De-regulated Finance: Some Concerns for India

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First Draft (please do not quote without permission of author)

Financial liberalisation has been subjected to divergent view-points, ranging from blanket approval to a total rejection, of the measures which follow and of their impact on the economy concerned. Attention, in these reforms, is usually centred on growth and stability considerations for an economy at a macro-economic level. However, the much acclaimed 'efficiency' argument for stable growth in mainstream theory has been challenged in the literature, both on grounds of conceptual clarity and empirical validity. However, very little attention seems to have been paid in this debate on the impact which financial de-regulation can have on different segments of the economy, and in particular, on employment of labour in industrial activities.

We propose to draw attention, in this note, to the last mentioned aspect of the link between deregulated finance and labour markets. The arguments dwell on the frequently observed phenomenon of booming finance in the presence of a stagnating real economy,

the related motives to siphon off funds from real investments to speculation, and on the tendencies for industry to undergo cost cutting by using labour in its most adaptable and flexible form while minimising additional job creation.

We offer, in Section I, a conceptual background to this dual process relating to the financial market and the status of labour. The arguments are confirmed, in Sections II and III, by a set of observations relating to the Indian economy, which respectively deal with the financial sector under deregulation and the status of labour in industry, where the parallel norms of economic reforms are adopted with impunity in terms of labour market flexibility.

Section I

De-regulated Finance, the Real Economy and Labour

Advocacy of economic reforms including those for the financial sector rests on the possible impact of these on growth via efficiency gains. Relying on the manual of Pareto optimality or even a second best Pareto maxima, champions of free markets have been able to push reforms in different parts of the world while targeting, in particular, the developing areas. It is important to identify the logic behind, especially in terms of the unifying principle to advocate the access to free markets, all agents in these doctrines.

In the mainstream literature on free financial markets, the role of uncertainty (which remains an integral aspect in the actual functioning of these markets), is by assumption often non-existent. This is because all operators in the market are assumed to behave rationally with access to full information. Thus these maximizing rational agents arrive at equilibrium with full utilization of all resources including labour, subject to, in some second best situations, the natural rate of unemployment (NRU).

Assumptions as above, relating to the financial markets generate the portfolio (asset market) equilibrium approach, postulating the much celebrated ‘efficient market’ principle for optimally allocating capital¹. Variants of the optimal portfolio models recognize the role of trading and information costs at equilibrium. However, it is also held that prices have a tendency to quickly adjust to information which is never in private domain. On the whole the system tends to set ‘conventions’ consistent with

¹ Paul Davidson, *Money and the Real World*, 2nd ed., 1978, London, Macmillan.

‘fundamentals’, in terms of a process which is similar to what has been described as a ‘random walk along Wall Street’!² *It is important to point out that with uncertainty having no role to play in the market for capital; speculation in these models is reduced to arbitrage, even in inter-temporal space, which helps to recommend financial liberalization as a policy conclusion.*

A variant of these models advocates an end to what is described as ‘financial repression’ to generate savings, investment as well as growth in the economy. The forces behind include freeing the rate of interest which reaches a level at which the market is cleared. It simultaneously makes for high-risk high-return type of investments in the economy. These doctrines advocate a greater degree of financial intermediation to generate real activities, both by raising savings and by ensuring its deployment along more efficient channels³. *However, an argument as above does not stand scrutiny once we question their underlying assumptions that all savings are automatically invested and that savings respond favorably to higher interest rates offered in the market. Also the assumption regarding the association of high risks with high risk-adjusted returns is found to be empirically unsound, especially under uncertainty.*

In an alternative approach which identifies itself as New Keynesian Economics (NKE), short period under-employment equilibrium in markets including those relating to labour and capital are explained by incomplete (or asymmetric) information. With asymmetric information limiting the capacity of the lenders to separate out the credit-worthy (‘good’) ones amongst the borrowers from those which are the defaulting types (or the ‘bad’), lenders in these models resort to credit rationing to keep out a section of borrowers from the market. The borrowers are assumed to have better information (as compared to the lenders) relating to their own inclinations for default. They are also assumed to have the capacity to choose among investment projects (thus often preferring the high-risk high-return ones) and, most importantly, have an ability to voluntarily exit by default⁴.

² E.F. Fama, ‘Efficient Capital Markets: A Review of Theory and Empirical Work’, *Journal of Finance*, 2001. See also E.F. Fama, Efficient Capital Markets II’, *Journal of Finance*, 46 (5), 1991, pp. 1575–617.

³ See Ronald I. McKinnon, *Money and Capital in Economic Development*, 1973; Shaw, *Financial Deepening in Economic Development*, OUP, New York, 1973. Richard E. Caves and Harry Johnson, *Readings in International Economics* (articles by Swan, Mundell, Corden); Maxwell Fry, *Money, Interest and Banking in Economic Development*, 2nd edition, Baltimore, 1995.

⁴ Jeffrey Sachs, “LDC Debt in the 1980s” in Watchel (ed.) *Crisis in the Economic and Financial Structure* Levington Books 1982; Richard Cooper and Jeffrey Sachs ”Borrowing Abroad: The Debtor’s Perspective”

Circumstances as above are supposed to initiate strategic games of bargaining and negotiations between these ill-informed lenders and rational borrowers, with the former co-opting (or pressing) the borrowers with threat of penalties⁵ which include embargoes on trade, credit or even on withdrawal of assets. Actions of both partners are supposed to be guided by principles of the optimizing principle in terms of ‘rationality’. *An outcome as above, however, deviates from the conventional arguments in favor of financial liberalization. However, on scrutiny these models seem to rely on the same principles, rather unrealistic, of rational agents as borrowers and lenders in the credit markets. In absence of asymmetric information, the market thus is logically expected to land up at an equilibrium which would correspond to the Pareto optima.*

Let us now draw attention to the reality of a de-regulated capital market in operation. Here the first thing which is worth a mention relates to the range of assets, which can be spaced between the liquid (cash and short term demand deposits) and the physical (including real estate). It is also important to notice that with prices adjusting to market forces, portfolio selection of investors in de-regulated financial markets are influenced not only by the current prices and returns on each such assets but more significantly, by the expected changes in both. With uncertainty extorting a heavy toll on future, the investor may in reality choose to move away, from long term productive assets to the short run liquid types which are primarily speculative. (As with Keynes’s liquidity trap, the above characterizes, in a money/credit economy, tendencies to prefer liquidity to financial or real assets which are less liquid). *Portfolio choice of investors in these situations is influenced not just by material conditions of production but by the changing perceptions of future which are necessarily subjective (and subject to herd instincts)*⁶.

Financial deregulation in these situations generates additional demand, both for instruments to hedge and speculate, and for the requisite credit. These instruments,

in Smith and Cuddington, (ed.), International Debt and the Developing Countries Washington 1985, pp. 21-60.

⁵ Bulow and Rogoff, “A Constant Recontracting Model of Sovereign Debt”, Journal of Political Economy vol. 97, 1989.

⁶ Assets in terms of these characterization are however, not subject to a binary classification as with money *versus* bonds in Keynes. Instead, assets here have a range with degrees of liquidity which vary along a whole spectrum. Accordingly the choice of the portfolio is susceptible to uncertainty by an even greater degree. See for the argument, J.R,Hicks, Critical Essays in Monetary Theory.

See also Sunanda Sen Global Finance at Risk:On Real Stagnation and Instability Palgrave Macmillan 2003, pp. 31-39, for an analysis of capital markets under uncertainty.

described as derivatives consist of forwards, futures, options, swaps and the likes, intended to provide covers against risks in the market. Demand for liquidity to finance the purchase of equities, and especially the derivatives, follow a pattern which is different from what is entailed to purchase the fixed rate-fixed price long term bonds⁷. The latter can be identified as the "finance" motive of liquidity demand, as distinct from the first which is treated as speculative or transaction demand, a position taken by Keynes in 1937. Separation of the finance motive from the rest of liquidity demand has led post-Keynesians point at the role of financial innovations in *accommodating (endogenizing)* liquidity demand as arise with the two motives⁸.

With an uncertain future the market thus tends to have a tendency to hold short term assets, the liquidity demand for which are accommodated and provided for under financial de-regulation. Even the long term equities can contribute to the flow of these short term financial assets by having a quick turnover in the secondary market. However, these transactions are incapable of generating demand for real investments *Thus contrary to what is accepted as articles of faith in mainstream economics, financial innovations can have a contractionary effect on the real economy. The above can happen with (a) rising uncertainty in the financial market which draws away finance from the real economy, and (b) financial exclusion of countries as well as households in general with low income, thus reducing consumption, investment and as a consequence, the money multiplier in the real economy.*

It also remains true that in an expansionary process ‘. . . the existing debts are easily validated and units that were heavily in debt prospered: ... it (then) pays to lever’⁹. The easy access to borrowed funds leads to a piling up of debts, especially as long as profit expectations continue to be revised upwards. The snowball effect in the credit market continues as long as there exists a shared consensus in discounting the future. However, as the process continues, the real sector boom may taper off over time; say with external

⁷ See for the argument, Laurence Harris, "Financial Markets and the Real Economy" in Sunanda Sen (ed.) Financial Fragility, Debt and Economic Reforms Macmillan Press Ltd, Houndsmill 1996. See also, Sunanda Sen, "On Financial Fragility and its Global Implications" in the same volume.

⁸ Hyman Minsky, Can 'It' Happen Again? Essays on Instability and Finance 1982.

Paul Davidson, Money and the Real Economy. Chapter 7.

Stephen Rousseas, Post-Keynesian Monetary Economics Macmillan 1986, pp. 38-50.

⁹ Minsky, 1992, p. 65.

shocks or with a saturation of technological innovations resulting in a less than full utilization of existing capacity. This pushes up risks on extending further credit and encourages the financial institutions to innovate financial products to cover risks¹⁰. Thus each unit of new or old investments is now backed, under the impact of greater uncertainty, by instruments of hedging. The process triggers off a rise in interest rate which is initiated by the market with a consequent dampening of asset prices. As for banks, the shortfall in liquidity is compounded by tendencies for debt default which goes up with rising interest rates and falling prices of stocks. The banks/other financial institutions respond by financing even more the hedge instruments, while lending cautiously to the ‘best’ customers in the market. *A scenario as above creates the atmosphere for what Minsky has described as a ‘euphoric economy’¹¹, one where capital appreciation rather than returns on such assets provide the firms the means to meet the rising liabilities due to the rising debt charges. The scene also characterizes a state of ‘ponzi finance’, namely, one where the returns from investments do not cover the costs of borrowings. The process of credit creation which starts off with hedging is transformed over time into speculation and then to ponzi finance¹².*

It is important to point it out here that returns on these risky investments turn out to be high as compared to those in the real sector transactions. It is natural that these speculative investments are easier to be financed as long these are lucrative in terms of profitability. During the phase of credit expansion, banks follow practices as are found profitable in terms of the newly opened up opportunities in the deregulated financial markets. This leads to a re-structuring of bank credit, not just by moving away from the equitable as well as socially desirable channels of productive investments, but also by generating a reduced level of effective demand in the economy.

The economy thus enters into a phase which is one of real deceleration along with continued financial upswing. The end of the real growth channelises credit in the direction of ‘high-finance’ which is typically characterized by speculation, and is led by a

¹⁰ Steve Keen, ‘The Chaos of Finance: The Chaotic and Marxian Foundations of “Mynski’s Financial Instability” Hypothesis’. *Economie and Societé*, no. 10, 2–3/1996, p. 58.

¹¹ Minsky, 1982, pp. 120–4.

¹² Ibid. See also Steeve Keen, op. cit., ‘The Chaos of Finance: The Chaotic and Marxian Foundations of “Mynski’s Financial Instability” Hypothesis’, *Economie and Societé*, no. 10, 2–3/1996, pp. 55–82.

‘euphoria’ which eventually comes to a close.

As pointed out in an analysis of derivatives, ‘. . . the explosive use of financial derivative products in recent years was brought about by *three* primary forces: more volatile markets, deregulation and new technologies’¹³. It has been argued in the literature that the derivatives provide an opportunity for the transfer of risks, from the risk-averse to risk-neutral agents in the market. The consequence, as has been argued, may be a rise in efficient allocation of resources. From a market-oriented perspective, ‘. . . the derivatives thus offer the free-trading of financial risks’¹⁴. The theoretical justification of using derivatives by financial agents thus comes from the claim that these instruments are supposed to provide a better allocation of economic risks.

At this point we need to mention *two* aspects of these derivative instruments in deregulated financial markets both of which are critically important in their functioning. The first relates to the condition that these markets are subject to risks and uncertainty. As it is claimed, ‘. . . in a perfect market with no transaction costs, no frictions and no informational asymmetries, there would be no benefits stemming from the use of derivative instruments’¹⁵. The second aspect is related to the ‘informational aspect’ of derivatives, which in essence is the prevailing uncertainty and risks. As it has been put, ‘...The true stochastic process followed by the underlying asset, and especially its volatility, must be known *ex ante*’. Arguments as above become apparent, as one examines the option pricing formula of the Black–Scholes model where *the rise in the call premium caused by a rise in stock prices* (known as the delta) would be *higher* when the *variance of stock price movement* (with the probability distribution known *ex ante*) is also *higher*¹⁶.

However, an assumption, as above, of full knowledge regarding the probability of stock price movements, subject to a normal distribution, turn out as untenable when the market moves fast and especially, in an unpredictable manner¹⁷. The process often involves a

¹³ Thomas F. Siems, ‘10 Myths about Financial Derivatives’, *Cato Policy Analysis*, no. 283, 11 September 1987.

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ *Ibid.*

¹⁷ *Ibid.*

‘reflexive’ pattern, where the realization of expected events in the market (profits, asset prices, call premiums on options and so on) is influenced by the subjective biases of the actors in the market (which include the seller/buyer, lender, and investor and so on)¹⁸. Critiques of the mainstream position point out those derivatives, by concentrating capital in short-term speculative transactions, divert money from long-term investment. It is also pointed out that derivative trading destabilizes the cash market by increasing the volatility of its fundamentals (such as interest rates, exchange rate of currencies and so on). Finally, the rampant and wide-scale use of these instruments with the failure to prevent the stock market crash in different parts of the world leads to the view that these risky instruments generate systemic disruptions in the market.

Volatility in the international capital market today encompasses, in addition to the volume of these flows, similar fluctuations in stock prices, exchange rates as well as in interest rates. *With a major part of financial flows geared to the hedge funds, returns on finance today can be sustained by the volatility itself in finance.* As pointed out above, calculations of the stock market call/put premiums in the much celebrated formulation of Merton¹⁹ and earlier, of Black and Scholes in the standard models indicate that *these premiums move up when stock prices are subject to a wider range of variance. The rising volume, the frequent instabilities, the changing pattern and their dissociation from real activities increase the importance of analyzing these sources of private global finance in recent times.*

We now dwell on the possibilities that with rates of return on finance (often speculative) higher than returns in the real sector, tendencies can be there on the part of corporate managers, to divert funds away from the real sector in the direction of investments in the high-profit high-risk financial activities²⁰. This will be especially true in an economy which is going through stagnation. The value-added as remains for re-investment in such situations, ordinarily distributed between financial and real assets, can now be more profitably invested in the former at rates of return more favorable as compared to those in

¹⁸ See Gerge Soros, Alchemy of Finance 1987.

¹⁹ Robert Merton, *Continuous Time Finance*, Oxford, 1990. F. Black and M. Scholes, ‘The Pricing of Options and Corporate Liabilities’, *Journal of Political Economy*, 1973.

²⁰ See for an elaboration of this argument, Pierre Salama, “From flexibility to social cohesion through finance” (mimeo) 2006.

the real sector. This is captured in the following formulation:

$$R=rV = [r^fV^f + r^rV^r] \dots\dots\dots(1)$$

$$\text{Thus } r = 1/ V[r^fV^f + r^rV^r]$$

From which

$$dr=1/V[r^f dV^f+V^f dr^f + r^r dV^r+V^r dr^r] +dV/ V^2[r^fV^f + r^rV^r] \dots\dots\dots(2)$$

where V^f, V^r, r^f, r^r are all positive and dV^f by assumption, is also positive

And the symbols stand for,

R: aggregate return on investment;

r: Aggregate rate of return;

V: value added re-invested;

r^f and r^r : rates of return on investments in the financial and real sectors;

and V^f and V^r : Value added which are respectively re-invested in the financial and real sectors.

In a stagnant economy where $r \leq 0$ we get, with dV^f and dr^f both positive, after manipulations,

$$[dV^f/ dr^f \cdot r^f / V^r + 1]r^r dV^r < 0 \dots\dots\dots(3)$$

Where the first term can be written as $\eta_{V^r}^{r^f}$, the elasticity of value added re-invested in the real sector in response to the rate of return therein. For the expression in (3) above with a negative/zero value we need, for $dr^f > 0$, a negative dV^r which implies $\eta_{V^r}^{r^f} < 0$ and also the absolute value $|\eta_{V^r}^{r^f}| > 1$.

We thus witness the possibility that in a stagnant economy (where the overall rate of return in the economy is already nil or negative), the disparity between the booming financial sector and the stagnating real sector reflects itself in the response, on part of the investors, in terms of the allocation of value added which is reinvested. With value added in the real sector declining in response to a rising rates of return, a shift of investible resources to the financial sector is clearly visible. Such outcomes, in the context of our analysis on a financial boom in the presence of real stagnation or low growth, come out as a logical possibility.

Looking beyond the investment strategy of corporates in situations of financial boom combined with real stagnation, we notice the possible impact on the status of labour in

such economies. With cost cutting practices under competitive capitalism in open economies, especially in stagnationist situations, employers pass on the brunt of adjustment to labour by adopting what is known as flexible labour policies. Often these are considered necessary to keep the enterprises floating, especially in an environment of uncertainty in product markets. It becomes a convenient route for the employers to treat the wage bill (and labour employed) as a truly variable cost of production. The changes which come about entail both quantitative and qualitative strategies on part of employers to extract additional surplus value from labour employed. To be more specific, the employers turn the workforce to a casualized, temporary status where it is left with little bargaining power vis a vis the employers. Technology is also often used in a manner which is labour-saving, thus leaving a larger proportion of the value added for buying superior technology or the high return financial assets. Labour flexibility also changes the fabric of labour participation in the production process. These include the stretching of working hours, payment of piece rates at less than the prevailing minimum wage rates etc which are quite common. With these changes there emerges a new trade-off between the employer and the laborer, tilting in favor of the employers.

Section II

De-regulated Finance in India

Indian financial system, prior to 1991, functioned in a tightly regulated and controlled environment, with an administered interest rate structure, quantitative restrictions on credit flows, high reserve requirements and the pre-emption of a significant proportion of lendable resources towards the 'priority' and government sectors.

As in the rest of the economy the financial sector in India has also been subject to wide-ranging reforms since 1991. The measures included, among others, an introduction of current account convertibility in 1993, de-regulation and unification of the interest rate structure, removal of priority credit, marketised borrowing by the fiscal authorities with an end to official borrowings from the RBI (known as deficit finance), introduction of credit-risk adjusted lending by commercial banks (in conformity with the Basel norms relating to capital adequacy), easier access to foreign capital including the FIIs and moves towards a gradual switch-over to the full convertibility of the rupee.

Measures as above have led to a noticeable restructuring of the financial sector in the country. From our point of view the following six changes the details of which are easily available from official source of statistics (like The Economic Survey) are of special significance.

- Growth in capital inflows from abroad and the rising share of portfolio capital with the dominance of FII flows.
- The spectacular growth in market capitalization in the stock market, and especially in the secondary market turnovers.
- Greater volatility in stock prices as well as in trading volume.
- De-regulation in the capital market which include the access of Fijis to the Indian stock market since 1992 and the introduction of derivative trading in stock markets, foreign exchange markets and commodity markets.
- Higher returns on financial sector investments as compared to average returns in industry.
- Changes in corporate portfolios including those of banks with higher share of assets held as stocks.

We offer some evidence later in this paper to indicate that growth as well as returns in the two sectors of finance and industry is already disparate in India. It is possible to confirm an on-going process of financial boom in the country in the presence of a moderate growth in the real sector performance, especially for the industrial segment. We will indicate in the following section how this generates an atmosphere of deprivation and expropriation in the labour market with use of flexible labour to the advantage of capital.

As for the evolution of financial reforms in the country, a Committee on Financial Systems, under the chairmanship of N. Narasimham (1991) recommended wide-ranging measures to de-regulate the financial market. These included, among others, introduction of stricter income recognition and asset classification norms; introduction of higher capital adequacy requirements; introduction of phased deregulation of interest rates and the lowering of statutory liquidity ratio (SLR) and cash-reserve ratio (CRR) requirements for banks, in a bid to ensure additional liquidity in the system. Reforms in the banking sector were further advanced in terms of the recommendations of the Second

Narasimham Committee (1998) which included lower risk-weights for investments in government securities, thus ensuring greater participation of banks in the gilt market.

Indian banks have been able to improve their capital adequacy ratios (CAR) in recent years, but this may have resulted in a much faster growth in investment in government securities as compared to growth in advances. (It is estimated that the banks currently hold 42% of their net demand and time liabilities in government securities, as against the statutory 25% requirement). In addition, banks in India today can venture out to non-bank operations like insurance and the security-related transactions, which provide them with non-bank sources of income. Intensified competition in the banking sector has added to a drive on the part of banks to obtain these alternate sources of income. The options to invest in risk-free government securities on the one hand and to pitch interest rates to the rising market rates on the other, on most advances including those offered earlier as priority credit to the small and medium enterprises are the new outcomes. These are factors which may have affected the volume as well as the terms of credit to those who are only marginally bankable like the poor and the SMEs²¹. In the process credit is being denied to a large segment of small and medium-sized enterprises whose credit ratings do not qualify the eligibility criterion in terms of the Basel capital adequacy criterion. But such units are not necessarily less productive nor are those prone to default when compared to other borrowers who are treated as eligible. Thus the yield on loans to the SMEs has been around 9.5% which has been the same with car loans and even less with mortgages. Despite the eligibility in terms of the returns on such loans the percentage share of loans in these directions has dropped from 36% to 23% of aggregate bank advances between 2000 to 2004²². Even rates on priority lending were de-regulated as

²¹ This has been a direct consequence of application of Basel standards and codes in India which is guided by the Standing Committee (on International Financial Standards and Codes), of the Reserve Bank of India (RBI) since December 1999. These norms require a minimum capital adequacy on part of banks which is determined by the risk component of its assets. Of late the Basel II norms are about to be implemented, which will impose even stricter capital adequacy norms in terms of the credit-risk-adjusted returns (CRAR). Impact of these regulatory norms on credit supply has been both contractionary and discriminating.

²² See for details, Sunanda Sen and Soumya Kanti Ghosh, "Basel norms, Indian Banking Sector and Impact on credit to SMEs and the Poor" IDS Working Paper (forthcoming 2006). See also Sunanda Sen and SoumyaKanti Ghosh, "Impact of Basel II on Credit in India" Economic and Political Weekly, Special number on Money and Finance, April 2005.

these were permitted to be set more freely after 1992. Thus, advances to the priority sector as a whole has so far been de-regulated, both in terms of the interest rates and also in terms of the additional types of priority credit as have been made eligible. *Bank credit has thus been less accessible to a significant segment of the economy which is no less productive than what prevails in the rest of the economy.*

It needs to point out here that the SME sector plays an important role in the Indian economy. The sector currently contributes 40% of the total industrial production in the country and over 34% of national exports. The socio-economic importance of these units is apparent from the fact that the total number of SMEs at 11.39 million units is nearly 95% of all industrial units of the country, while providing employment to nearly 27.13 million people, which is nearly 86% of the total employment in the country²³.

As already pointed out above, de-regulation in the financial sector also had a significant impact on the pattern of financial flows in the economy. More important of these relate to the spectacular growth in the turnover of India's stock market, the rank of which has been 3rd highest after NYSE and the NASDAQ during the last three years. The transformed nature of the capital market also includes the dominant role of institutional investors of foreign origin (FIIs) and the wide-spread use of derivatives in these markets. FIIs were allowed access to the Indian capital market in 2002 while derivative trading which was in practice since a long time in India, was formally treated at par with securities in 1999²⁴. Development of the exchange-traded equity derivatives was made easier over 1993 to 1996 with a series of reforms in the stock market which included the screen-based trading system of the NSE in 1993, the lifting of bans on options trading in 1995 and a phased introduction of derivative products. In 1999 the 30-year ban on forward trading was also lifted. Controversies, around the advance or carry forward system (known as badla) was formally terminated with a ban in 2001, in a plea to create liquidity in the system. While Over the Counter (OTC) forwards trading in stocks is still not legal, it is widely used, in the form of interest rate swaps as well as currency forwards, and is much preferred by the FIIs. According to an unofficial source the volume of OTC transactions in 2004 was of

Sunanda Sen and Ricardo Gottschild, "Basel Norms and Developing Countries" (mimeo) 2006.

²³ Economic Survey, Government of India.

²⁴ J.R Varma Committee on Derivative Trading, Government of India 1998.

the order of Rs 300 crores, a sum comparing (or even exceeding) the value of exchange traded derivatives.

The National Stock Exchange (NSE) which remains the main stock exchange in the country today, followed by the Bombay Stock Exchange (BSE), has a turnover of almost 90% of total transactions in the two main stock exchanges in the country. Aggregate turnovers in the two stock markets went up by 4.5 times between 2002 to 2005. Share of FIIs in total stock exchange transactions was around 81% in 2005 (moving up from .02% in 2002). From the year 2003 derivative turnover has exceeded spot market turnover. Share of derivative trading in aggregate turnovers of the two major stock markets during 2005 was about 65% (rising from 26% in 2002), with Rs 12,000 crores of trading which was twice the size of equities market in India. *These figures indicate the crucial significance of both FIIs as agents and of derivatives as instruments in the liberalised regime of finance.*

An indirect impact of these changes (involving an increased involvement of both FIIs and derivatives) in the market has been the growing volatility in India's stock market. Thus volatility (as measured by the variance) of the weekly returns of the equity market has been consistently rising over the last three years. Volatility in stock prices, at around 2.5% in terms of the variance, has been higher than those prevailing in major stock markets like the US (S&P 500) where it was only 1.41 during 2004 and 2005. The trend in stock prices, however, has also been in the upward direction, with the Sensex reaching newer peaks over the last few years with the current index at around 11000 in August 2006, far exceeding its earlier records during the preceding years.

Average returns on equities, as provided by official sources, ranged between 72.9% (2003) 13.1% (2004) and 42.3% (2005) at the BSE Sensex over the last three years. Similar range of returns prevailed for equities traded at NSE as Nifty. *Comparing the returns in the financial sector to those in industry and services the data on which are available from Prowess data sources, we find a confirmation of our hypothesis that by and large it has been far more profitable to invest in the financial sector as compared to investments in industry or even services.* (In a representative sample of 5,400 manufacturing firms the range of profits varied from large negatives to a maximum of 9-10% in a few cases during the last 7 years).

One observes, with serious concern, the limitations of the guiding principles of the financial reforms (which include the Basel norms) in a country like India where credit needs to be re-directed to units which are deserving, not only in terms of productive contribution but also in terms of social priorities. In this discourse on reforms one observes an over-emphasis on financial stability as a goal in itself, even when it goes contrary to distributional norms as well as growth potentials of the economy, which are no less relevant.

Section III

Labour in major industries

The phenomenon of “job-less growth” can be observed in the Indian economy over the last two decades. It reflects a paradox of lagging employment growth, even in high growth industries, an aspect which has generated wide-ranging debates on the success of economic reforms in general, and of labour flexibility in particular, for employment and the related level of living in the economy. Unemployment rates for males in rural areas (measured as person days per 1000 persons) on a current daily basis rose from 56 (according to 50th round of National Sample survey for 1993-94) to 90 (60th round of National Sample Survey 60th round for January-June 2004). The pattern has been similar in urban areas and also for females in both rural and urban areas²⁵. Employment in manufacturing, which was around 57 lakh persons at end of fiscal years 1987-88 as well as 1988, actually started falling from 1999, with the number at 47.44 lakhs at end of 2002-03²⁶.

Focussing our attention to the organized workers employed in manufacturing industries, we observe a systematic tendency of employment growth falling short of output growth. In a separate study²⁷ we have computed the annual average growth rate of output at constant prices, for industries at a 3-digit level. We notice the performance of a set of industries with AAGR of output growth at 20% or more over the post-reform years. These include office equipment, aircraft and spacecraft, ships and boats, jewellery,

²⁵ Government of India, Economic Survey 2005-2006, p.207.

²⁶ Ibid. p S50.

²⁷ See for details Sunanda Sen and Byasdeb Dasgupta, Political Economy of Labour under Globalisation: Labour in India's Manufacturing Industry 2006 (mimeo), chapter 2. Also published in Indian Journal of Labour Economics 2006.

electronics, furniture and motor vehicles, coming up as sun-rise industries of the current decade. Paradoxically, or as can be expected in terms of the prevailing regime of labour retrenchment and flexible norms, employment growth (measured as AAGR) in these industries had been much lower than the respective AAGRs for output. The pattern, as described above, is all the more evident with the cumulative share of industries grouped according to their share in total output. Thus industries with individual shares between 9.9% and 5.8%, of output collectively contribute 47.66% of aggregate output and only 30.73% of aggregate employment (in the organized sector of Indian industries). The pattern indicates, once again, the rather poor contribution of the high output growth industries in terms of employment. It is revealing to note this inverse relation between output share and employment share for individual industries. Does it indicate the use of labour-saving technology in high growth industries which generate the major part of industrial output in the organized sector?

The pattern in terms of employment growth relative to output was similar in the low growth industries as well where the AAGR had been less than 5%. These include the typical labour intensive items like man-made fibre, tobacco, publishing etc. Was there a tendency for displacement of labour by using labour saving techniques in these industries?

We have tried to explain employment growth in both high growth and low growth industries by factors including technology, invested capital and labour productivity. Our results, drawn from a regression analysis, indicate a strong negative impact of technology (capital-labour ratio) on employment, especially in the high growth industries. In other words, there is a systematic tendency of labour displacement, in the cost cutting strategy under the new regime of the market economy as are adopted by the employers. It is interesting to observe in these results a negative impact of labour productivity on employment.

As can be expected from the disparate growth rates in output and employment, capital elasticity of output has been consistently higher than the respective labour elasticities during the entire post reform years for the HG industries in particular as also for the LG sector. Thus the trend growth rate of capital-labour ratios is found to be positive for most industries. It probably implies that the use of labour saving devices have helped in cost

cutting by increasing output per labourer while the scale expansions in output have failed to generate employment growth?

Thus high output growth industries not only has failed to generate employment growth at the same rate but also has contributed less as their share in total industry employment, as compared to what is contributed by the low growth industries.

Fluctuations in output levels, which have been common with most industries, are matched by similar fluctuations in employment, often moving in the same direction. Volatility of employment has been prominent even in industries with negative growth rates, an aspect which indicates the extreme precariousness of the job situation. Lags in employment relative to output growth are also reflected in the stagnating wage shares to output, both for the high and the low growth industries. But neither employment nor output growth seems to have a favourable impact from technological changes with higher capital intensity!

Looking a bit more closely at the pattern of employment, one comes across two developments in recent years. The first relates to the casualisation of labour and the second to the rising number of man-days per worker, both of which are also substantiated by official statistics. A rough measure of casualisation may be had from a measure of the AAGRs relating to the number of workers as are reported in official statistics as directly employed and as against those recruited through contractors. Of course even those directly employed, include a fair number of casualised workers. However, the status of labour in organized manufacturing is very clearly reflected in the share employed through contractors. These are the workers who are in a casual status with flexible job contracts. We found that the AAGR relating to the number of workers employed by contractors have been consistently higher as compared to similar rates for those directly employed; thus reflecting the heavy incidence of labour flexibility.

At the same time wages seem to be stagnant or even declining, as indicated by the AAGR of wage bill at constant prices. Closure of big industries, especially in textiles with lock-outs have also been cited as major explanations of dwindling employment during the

1980s and 1990s²⁸. There has also been a mention in the literature of the reductions in employment due to a shift in the size class of industrial units²⁹.

As for the volatility in employment one observes a rise even for industries in a state of stagnation, having a low or negative growth rates of output. The synchronized pattern of variations in output and employment, observed for both high and low growth industries indicate the impact of uncertain output market on job opportunities. Volatility of employment has been prominent even in industries with negative growth rates, an aspect which indicates the extreme precariousness of the job situation. Labour thus seems to be having a raw deal, with fluctuating job prospects even in the LG industries where output growth tends to be zero or negligible.

In a field survey we conducted in different states of India which also covered three export processing zones as well as the export oriented diamond industry of Surat in Gujarat, about 341 workers reported a casual status as against 271 with a permanent contract. As for the terms of work, both for the permanent and the casual ones, work as measured by AAGR of man days reported in official statistics does not tally with the growth rate of workers which is much less, thus indicating more work per worker on an average basis. This partly explains the reductions in the reported employment figures due to the stretching of labour hours through overtime (and probably also non-payment of overtime labour) in industries.

Of late, labour market flexibility has brought to the fore issues concerning the security aspect of labour. The notion dwells on aspects affecting their livelihood which include, most importantly, their employment status, both current and as expected during the future. Second, the terms of labour contract, to the extent people are with firm jobs, are also important, including wages as well other benefits/costs as are related to the job contract. Examples include bonuses, housing, medical facilities, transport facilities, leave rules, tenure of job etc. as are obtainable job status of labour. Finally the economic and social status of labour is also influenced by different forms of support, to the extent

²⁸ Deepak Mazumdar and Sandip Sarkar, "Reforms and Employment Elasticity in Organised Manufacturing" Economic and Political Weekly, July 3 2004.

Shuji Uchikawa(ed) Economic Reforms and Industrial Structure in India Manohar New Delhi 2002
 T.S Papola, 'Labour Institutions and Economic Development: The Case of Indian Industrialisation' in TS Papola and GS Rogers (ed) Labour Institutions and Economic Development in India, IILS Research Series no 97, ILO Geneva.

²⁹ Shuji Uchikawa ibid.

available, from the state and/or the social network. For those without a firm job the latter remain the sole means of survival. Using the data we have collected on the basis of our field work in different states of India, we tried to construct indices of security, both for individual criteria like income, jobs, social support from employers and others. Our findings indicate a very poor rating of these indices, even for workers from the export processing zones, who, incidentally are even worse off as compared to those employed elsewhere³⁰.

On the whole labour in India's manufacturing sector thus seems to be in a state of crisis, which sharply contrasts the booming business of finance in the country.

Conclusion

It is now time to go back to the central argument of this paper concerning financial deregulation and the incidence on the workers. Our findings on the immiserisation of labour in India's manufacturing industries can be related to the disparate profit opportunities between the real and the financial on the one hand and the desperate drive on part of employers to make good in the real sector by using labour in the most profitable way, on the other. The drive for the latter is facilitated, this time by the state, by introducing labour flexibility norms and the scrapping of protective labour legislations.

³⁰ See for details: Sunanda Sen and Byadeb Dasgupta, *ibid.* chapters 3 and 4.