Chapter 7

CONCLUSION

Since in most developing economies high rates of growth are often accompanied by low employment elasticity, the focus is on small enterprises. The SME clusters are assumed to have greater employment capacities and organisational advantages over large firms because of the benefits of flexibility, specialisation and informational efficiency that they have. The processes of liberalisation and opening up of markets were envisaged as sufficient to redirect global demand for labour intensive goods toward developing countries. This research shows that impulses of markets are not sufficient to orchestrate coordination among markets, capabilities and institutions. There is a 'missing link' between the external forces of globalisation that increases competitive pressure and the capability of a country to leverage the opportunities, created in a liberalised regime.

The SME clusters in LDCs are often characterised by the 'low road' growth path and firms compete on the basis of low wages and deny basic rights to workers. The small enterprise clusters surveyed in this research, share some common features of the 'low road'. The clusters are facing technological underdevelopment and stagnation. The labour markets in these clusters are fairly flexible with contractual labour contracts. Labour institutions such as trade unions are either absent or weak to pursue 'minimum wages' or 'fair wages' for the workers. They cannot hold back labour supply
to these enterprises. However, small enterprises are generally not production sites for low valued products with low labour productivity. The average labour productivity in the smaller units is higher than in other manufacturing activities among similar size units in the rest of West Bengal and India. The share of labour in value-added is not proportionate to productivity. This is because workers attain firm-specific skills and create economic rent by the way of increasing marginal value product of labour. However in an unprotected situation, wage claims of workers are not determined by the marginal labour productivity and do not reflect the claims for worker's skills. This in turn acts as a disincentive for acquiring skill. Moreover, in the absence of trade unions there is none to protect the skill specific internal labour market and the production process increasingly involves 'raw' labour.

Our study further reveals that the existence of surplus labour may be necessary but not sufficient to explain the choice of the owners for a low-road. The advantages of surplus labour can be exploited so long it helps pushing down wages. In that case, the owner of a firm can maintain profitability even bypassing the innovative route, and hence, prefers the low-road. If the prevailing wage level already reached the reservation wage and cannot be pushed down further, then also the cluster may not choose the high-road of competition based on improving quality standards. This fact reveals that intervention in the labour market, in isolation, to restrict the decline in wages would not lead to a high road growth path. The wages paid to the workers in the small enterprises cannot be separated from the profits/incomes retained by
the owners in these enterprises. And, the wage-profit distribution of the revenue is conditioned by the amount of profit which the small producer is forced to share with the trader under compulsion. The relationship between the trader and the small producer is an outcome of a number of market and institutional failures that should be resolved in congruence with interventions in the labour market.

The production organisation in the clusters are not conducive to competition. The relationship between parent and the subcontracting units in Baruipur and in Calcutta represents a hierarchical structure maintained through putting out or semi-putting out systems. The oligopsonic relation between large firms/traders and small enterprises in the clusters leads to suboptimal results. The inter-firm relationships are very flexible and have no long-term trade agreement. Further, the dependence in the parent-subcontractor relationship is reproduced due to imperfect information and also by transferring productive capital to the trader. As a result, although the small producers are capable of producing goods with higher value-added they are never inclined to do so.

As is evident from the foundries in Howrah, the organisation inside the firm characterise a loosely connected triad among owner-trader-labour contractor which is not favourable to competition. The dynamics of the cluster characterises a low-level equilibrium. Remaining confined to the lower end of the market, they survive with traditional technology and with sub-optimal efforts on the part of the low-paid workers. The absence of impersonal
management and systematic assessment of operational facts makes these foundries X-inefficient. Moreover, investments in fixed capital involve long-term commitments to particular products and production volumes. In the foundries in Howrah, the gradual transfer of ownership establishes the dominance of commercial capital. And, the traders with little long-term commitment to the industry fail to play the role of regulating capital in leading the necessary technological upgradations. Rather the owners are interested in transferring working capital to personal assets thereby reducing the potential for long-term growth.

Market failure is prevalent in the clusters surveyed and non-market institutions that ameliorate its consequences are in many instances underdeveloped. Capital invested in these firms remain confined to the informal domain of operation although return to capital is relatively high. Uncertainty in demand inhibits expansion of production capacity even with borrowed funds from formal sources. Besides, the small enterprises who are stuck at the lower level of technology often take refuge to the lower end of the market in the face of global or national-level competition. In developing countries markets often fail to signal the appropriate choice of technology because of widespread information imperfections and missing markets. The learning process to upgrade technology appears to be risky and unpredictable due to information as well as capital market failures. Moreover, the presence of significant technological externalities inhibits individual initiatives for
upgradation. On the supply side markets fail to develop special skills, promotion of quality awareness and also in setting up industrial standards.

Resolving market failures need a coordinated effort that involves a conscious process of capability building. The endowments of traditional skills and cheap labour are not sufficient to attain dynamic comparative advantage. New skills, technological competence, proper administrative capabilities and strong support institutions to provide collective indivisible public goods are the essential elements toward participating in higher value chains. Developments are required at all levels, viz., procurement, processes of production, managerial and organisational efforts in order to improve the durability, reliability and precision of products.

The technological notions of institutions usually ignore the social dispositions of market as reference of analysis. However, the transaction costs characteristics of an industrial institution not only depend upon exogenously given technology. The complex matrix of behavioural standards, embodied in culture and historical realities, critically influence those costs. Institutionalised sanctions as well as incentives are weak in the clusters due to weak generalised morality. Disruptive price competition, procurement of raw materials from public sector plants in illegal way, under invoicing of outputs and evasion of taxes are the frequently chosen paths for survival. As a result, horizontal cooperation among firms becomes weak and cooperative efficiency suffers.
In the absence of appropriate organisations and institutions the shortsighted responses to markets trigger aggregate effects that abort the potential of the clusters. In a liberalised regime although opportunities have increased to get hooked to global value chains, the surgical instrument cluster in Baruipur, the small foundries in Howrah as well as footwear producing units in Calcutta are losing their share in the domestic market let alone global markets. The outcome of increased competition in these clusters are either closing down of units or resulting in a process of self-exploitative fragmentation that is often manifested in the increasing number of units. The sole means of selection through market cannot resist the downward spiral of low growth, lesser earnings and higher exploitation.

In the face of global competition, the organisational or institutional responses are not adequate. The new-institutionalist doctrine however suggests that institutional changes occur as an adaptive response to altered incentives and market in the end drives out institutions that are ill adapted to changing circumstances. This research shows that such a kind of spontaneous emergence of new institutions is not inevitable. Rather passive learning takes a long time in adapting to more demanding situations.

What is needed is remedial intervention which helps to give a direction to the evolutionary process instead of destructive competition. In the context of industrial clusters public intervention is required not only to resolve market failures in the development of small firms. The kind of intervention should be aimed at fostering cooperative efficiency through the
promotion of horizontal cooperation. In a successful industrial cluster the moments of cooperation do not lie only in the relationships among firms of different size. Cooperation is needed in backward and forward linkages and an appropriate balance between labour welfare and profitability that pacifies conflicts between labour and capital. However, in many occasions as in the case of Baruipur the mode of intervention by the government has perpetuated a ‘race to the bottom’. On the other hand, the state policies related to the leather industry are tailored in favour of large and medium enterprises while providing them ample scope to exploit the informal labour market.

Market failures due to existence of information asymmetries, externalities and also the institutional failure to resolve those imperfections only partially explain the low road in these clusters. Asymmetric power relations and conflicts arising between the trader and the small producer reproduce a production relation that hinders the high road growth path. The trader-producer relationships in these clusters may be termed as *contested exchange*. The implicit power relations in this kind of exchange ultimately lead to self-exploitative fragmentation. The outcome in the case of foundries is a survival strategy of evading taxes and other claims of public revenue.

The literature on industrial district often underlines the benefits of homogeneous social and cultural identities that help to form horizontal cooperation in the clusters of developing countries. This is a kind of ‘bonding’ social capital which facilitates a sense of mutual obligation and reciprocity
among small enterprise owners in the cluster. However, this research argues that the homogeneous sociological identities may not result in a horizontal cooperation. And, this failure can be explained by the dynamics of conflicts and power relations in which the production organisations are largely embedded.

Further, the process of self-exploitative fragmentation has political economic implications. Capital invested in the small home-based units are not 'capital' in the general sense, as these are hardly transferable to alternative sites of investments. It has to be applied in a way to valorize the family labour. In these situations, the markets for capital and labour are not separate and independent. They are both segmented markets, as the family labour cannot always have recourse to alternative occupations. A labour turned into a self-exploitative producer, and the producer partially sharing the role of labor — is the dual process giving rise to a band of 'intermediate class', with contradictory locations between workers and entrepreneur proper. Voices of these small producers are mostly unheard in political constructs. As a result, the mode of accumulation of this intermediate class depends upon the extent to which they are capable in influencing policies during implementation rather than in the course of their formulation. In most of the cases, the survival strategy is evasion of taxes, illegal maneuvering of raw materials from public sector plants, paying bribes to officials, and so on.

It is held in common parlance that because of the complex tax systems, higher density of the regulations, social welfare schemes and labour
laws, entrepreneurs avoid formal existence. The advocacy of minimum intervention however ignores the conflicts that arise in the interface between formal and informal firms. Regulations as such are less burdensome to the small enterprises in the context of the contested nature of exchange and uncertainties in demand. The self-exploitative small producer encounters the market and survives in the face of competition, only by increasingly losing the profit margin. Capitalism exorcises the self-exploitative economy from its discursive space, it is the ‘other’ non-capitalist periphery which is suppressed but never extinguished. Public interventions should be aimed at neutralising advantages/disadvantages that emerge due to asymmetric power relations in the vertical production/distribution chain. In that case, costs of compliance to regulations together with the costs of access to markets would not outweigh the benefits of scale economies.

Thus, developing SME clusters as the potential site for gainful employment and growth, is a conscious political process. And, policy changes need to be implemented in the societal context as politics and history play crucial roles in determining the outcome of reforms. Ignoring these contextual specificities generalised attempts to integrate markets may lead to stagnation and closing of units, instead of competitive response. Public institutions should coordinate policies to improve systematic competitiveness of these clusters through remedial interventions such as preferential access to credit, technology and markets. Moreover, demand driven intervention tailored
through functionally separated public institutions could ensure growth without compromising quality.

Inclusive development strategies should be integrated with the broader goals to ensure stronger voice of the marginalised. Policies should be aimed at empowering the small producers in the political space so that they can establish their claims of public goods. Further, development strategies should indulge social action evolving appropriate institutions, and neutralise asymmetric power relations by providing the small enterprises direct access to markets.