

# China and India: Convergence in Economic Growth and Social Tensions?

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*Do the economic policies or the “business model” adopted by China and India necessarily aggravate inequalities in income and wealth distribution, and thus exacerbate social contradictions? While not providing a definitive answer, the article examines a wide range of quantitative data on wealth, poverty and inequality in the two countries, noting the rising concentration of income and wealth, the trends in poverty, inequality, employment and unemployment, and the nature and extent of social unrest. It also, however poses methodological issues including the comparability of Chinese, Indian and international data. The author outlines a feasible alternative centred on development with equity.*

Nearly sixty years ago India and China

embarked on planned development of their economies. The former opted for a mixed economy with a pivotal role for public enterprises in critical sectors, while there were minimal reforms in the agrarian set-up dominated by feudal or semi-feudal landowners.



**Indian farmer**

China adopted a socialist model of industrialisation preceded by radical land reforms leading to collectivisation. In 1978 China changed track in favour of a ‘socialist market economy’, de-collectivisation of agriculture, and an ‘open door’ for foreign trade and investment. India in 1991 dismantled a very large part of the previous regulatory regime and moved towards freer trade in goods and services and ever fewer controls on cross-border capital flows.



**Chinese farmer**

In recent years there has been a major expansion in two-way trade and investments between the two countries. Their 'business models' appear to resemble each other ever more. Thanks to high-speed growth over 2 or 3 decades, they have become the new paradigms in the international media in the wake of the collapse of the East Asian miracle in 1997. China has emerged as the manufacturing hub of the world. Not only have their firms captured large slices of the world market in textiles, footwear, light engineering and so on, but even in high value-added areas of electronics, telecommunications and machinery they have marked their presence, often with the help of multinationals from industrial countries.

India's domestic manufacturers successfully weathered the storm of liberalisation in 1991, dispelling the Washington-inspired myth of their inefficiency. Actually, the producers not only kept 'competing' imports at a low level, but also began to export on a larger scale than before in medium- to hi-tech areas. Over the past few years they have been floating their shares in Western stock exchanges and acquiring some renowned Western firms. However, India's major breakthrough has been in information technology (IT) and IT-related

services like software development, 'business process outsourcing', etc. Initially, Indians took advantage of the low labour costs here to seize opportunities that opened up with the IT revolution in the USA. Over the years the established firms and start-ups moved into ever more complex areas of software engineering.

The rise of China in the 'hardware' of manufacturing, and that of India in the software segment have worried many in the West who apprehend a loss of America's position, not only in manufacturing, but also as the world's 'innovation capital' as finance replaced industry as the premium profit sector of the US economy. A good part of America's highly skilled 'knowledge workers' may become redundant as the global firms in their drive to reduce costs relocate their research and designing activities in low wage countries.

Much of what has just been stated is common knowledge and there is no need to substantiate them at length. But there is another side to the saga of development. The media in India and China has highlighted the achievements. However, there are many signs of acute, if not increasing, social tension in both countries. This leads to an important question. Do the economic policies or the 'business model' adopted by the two countries necessarily aggravate inequalities in income and wealth distribution, and thus exacerbate social contradictions? This paper does not provide a definitive answer, but examines some of the 'growth-oriented' measures and speculates on an alternative path.

Section 1 highlights the comparative growth rates in the two countries and explores the imperatives behind the reform in each case. India and China not only differed in the 'initial' (pre-reform) conditions, but also in the nature of macroeconomic policy constraints after the reform. Yet both pursued broadly neoliberal policies with a similar, though far from identical, outcome in many spheres. Section 2

provides evidence on the rising concentration in income and wealth in the two countries. The next two sections take up the trends in poverty, employment and unemployment. The nature and extent of social unrest is explored in section 5. The analytical side of the story, namely how the rich are getting much richer with considerable help from the fiscal authorities is explored in section 6. I then look critically at the logic behind fiscal concessions. Some alternatives are outlined in the final section.

### Growth Rates and Reform Imperatives

To comprehend why reforms were undertaken, it is useful to look at the growth story. I use GDP per capita at purchasing power parity (PPP) from 1952 to 2005, all at constant prices of 2000, taken from the widely used Penn World Tables (PWT) version 6.2. As against the official data for China, there are substantial revisions for the years prior to 1980 when the country began to use the UN system of national accounts; as India followed consistently the UN system, her official statistics were used in PWT with minor changes. However, the base year (1952) estimate in PWT for China indicating a per capita income barely 40% of India's, was hardly credible. The revision proposed by Maddison and Wu (2006) putting them at par, seems much more plausible. Both series are presented in Table 1. Following Maddison & WU, China took a small lead over India by 1978, and the gap widened since then; by 2003 China was almost 2.5 times richer. Further, vis-à-vis the USA, India's per capita income stood at 6.3% in 1952, 6.0% in 1978, and 8.6% in 2003, according to PWT. One may draw the following conclusions. (a) China's growth all through the years, before and after the 1978 reform, was greater than that of India. (b) India managed to grow at almost the same rate as the US during 1952-78, a period often called the 'golden age of capitalism' in the West. Even

China failed to 'catch up' with the US over this period. (c) Growth accelerated after the reform of 1991 in India, and after 1978 in China.

Table 1. India and China: the ratio of Indian to Chinese GDP per capita at PPP

	1952	1978	1990	2003
PWT	2.43	1.97	1.13	0.6
Maddison & Wu	1.00	0.91	0.69	0.42

Source: Heston (2008).

What could be the rationale behind China's reform? It can be explained by 'economic imperatives' to a considerable extent. Her industries had developed along Soviet lines with new factories coming up with technologies modified only at the margin. The drawback with this 'extensive' growth was that a great deal of scarce raw materials and fuel were 'wasted' in production, compared to the prevailing standards in the West. Owing to a superabundance of resources the Soviets could ignore the problem for a long time. But China is poorly endowed, and could face an acute shortage of resources if she continued with the old pattern for another couple of decades. It followed that she needed huge imports of Western technology and equipment just to maintain the tempo of growth. In the 1970s and 1980s the USSR also felt the same need, took big loans from Western banks, and fell into a debt trap from which it could not recover. The Chinese leaders scrupulously stuck to the Mao-era policy of national self-reliance and decided to finance import through expanded export.

Geo-political developments offered an unexpected opportunity. By the early 1970s, Sino-Soviet hostility aggravated, reaching a point of no return. At the same time, the Vietnam War stretched US military capability to its limits, heightened by a vigorous domestic opposition to the war. President Nixon came to meet Mao in Beijing in 1972, laying the

foundation for a *de facto* Sino-American *entente* against the Soviets. As the experience of post-war ‘miracle’ economies of Western Europe, and later of Japan, South Korea and Taiwan show, the key factor in their success was *access without reciprocity* to the US market for export, and to import of US technology and equipment for the modernisation of industries. (Chandra 2004) Just as the US was earlier eager to foster the economic growth of her strategic allies as a bulwark against the USSR (and China), in the new situation China became the beneficiary. It was in this context that Deng Xiaoping’s ‘open door’ policy took shape with its stress on export of Chinese manufactures and import for modernisation. (Chandra 2005)

While US support was crucial, China never surrendered political or economic sovereignty. In foreign trade a neutral or positive balance was maintained to pay for a rising volume of imports. To facilitate exports, central allocation of resources to firms had to be altered drastically to enable the latter to seize opportunities abroad; hence an increasing role for market forces became unavoidable. Since export prospects were brightest in textiles and light engineering, businessmen from the Chinese Diaspora in Southeast Asia who had captured large slices of the market in the West during the Cold War era, had to be coaxed to operate from China. That explains why the overwhelming bulk of foreign direct investment (FDI) into the country was export-oriented and came from these sources. For FDI catering to the domestic market in high- or medium-tech areas, China welcomed Western multinationals, provided they entered (as a minority partner) in a joint venture (JV) with state-owned enterprises (SOE), and helped Chinese personnel to assimilate the new technologies. Over the years many restrictions were removed as the SOEs began to prove their mettle in foreign markets. (Chandra 1999) Nevertheless, even after joining the WTO in 2002, China maintained an aggressive industrial policy. I

shall cite just 3 examples. In telecom Chinese firms are now in the forefront globally and have established their own standards for 3G telephony. Most automobiles in China till recently were produced in JVs with leading Western and Japanese multinationals, and the latter used China’s cheap labour to ship back the output to their domestic markets; now Chinese cars are launched in global markets. Power generating equipment that was imported in large quantities in the 1990s, is now exported from China.

On the Left, Hinton (1990), a critical, observer and chronicler of the land reform and Cultural Revolution, characterised Deng’s open door policy as a ‘great reversal’. He castigated the dismantling of the communes, Deng’s trickledown theory (let some people get rich first), and the entry of FDI that would necessarily re-create a comprador class as in pre-revolutionary China. On the trickledown theory, the evidence presented in later sections sharply contradicts it. On the other hand, some Left leaders within the Chinese party wrote to President Hu in October, 2004, admitting that ‘there have been gains economically in the past twenty-six years of reform and opening up, [but] the price for these moves has been enormous.’ (Letter 2004) They did not call for a return to the pre-reform system.

As for the re-emergence of a comprador class, there is some corroborative evidence. Foreign-owned firms account for the bulk of China’s exports. In a large swathe of Chinese industries such firms have a dominant position in the domestic market. Overall, the private sector, more precisely the non-state firms, according to a widely quoted OECD (2005) survey, account for more than half the industrial output; the share of foreign firms is large. As against this, *Business Week* (2005) had a number of reports comparing India and China; one was captioned: ‘The State’s Long Apron Strings: China’s multinationals, powerful as they seem, are still beholden to the Party.

That's both a blessing and a burden'. The companies listed were Lenovo, Haier, Maytag Corp., CNOCC, Huawei Technologies and ZTE. *Der Spiegel* (2007) in a provocative piece, 'Red China, Inc.' described how the State Council and agencies under it, especially the planning agency, the National Development and Reform Commission in Beijing, have played a key role in supervising over the entire gamut of economic policies and closely monitor the performance of all major SOEs, acting as 'the central nervous system'. When Hart-Landsberg (2008) asserts that the accumulation process in China is 'now dominated by private (profit-seeking) firms, led by foreign multinationals, whose production is largely aimed at markets in other (mostly advanced capitalist) countries', the author is plainly wrong on several counts. One, he ignores 'Red china, Inc'. Two, China's own industrial policy, backed by enormous outlays on R&D financed by the state, the state-owned banks and the SOEs, is again passed over. Three, Geng Xiao (2004) showed that a good part of FDI inflows into China was hardly 'foreign'; the percentage of round-tripping by Chinese SOEs in FDI inflows stood somewhere between 26 and 54 percent in the early years of the century. China's Central Bank reported, according to *Reuters*, that one-half of FDI into China in 2004-05 was owing to round-trips by domestic firms through Hong Kong and the Caribbean off-shore centres to avail of tax-breaks. (*The Hindu Business Line*, 10 August 2005.) In short, FDI may not mean 'foreign capital' in the usual sense. Four, China's SOEs are buying up some of the iconic Western firms. Five, China's foreign exchange reserve is now so large (\$1.9 trillion) that the US depends on China's goodwill in many spheres. For instance, Fanny Mae and Freddie Mac, the housing mortgage firm, was nationalised in the wake of the recent financial crisis by President Bush under Chinese pressure, according to several reports.

As for India, there was no compulsion behind the reforms. The myopic political leadership of

both Congress and the coalition of opposition parties that ruled from 1985 to 1991 allowed the fiscal and external payments situation to deteriorate. In both respects a crisis could be easily averted with minor changes in the fiscal regime, and temporary control over imports. Yet, ignoring its pre-poll manifesto, the newly elected Congress government approached Washington for a bailout, and a package of economic reforms was mandated. Indeed, no significant section in India had called for such reforms, and big business in particular was initially lukewarm, if not hostile. However, GDP growth did accelerate a few years later, and many industries progressed, as noted earlier. How far the reform as such made any positive contribution is open to question that cannot be discussed here. On one point there is no doubt. The new regime, by privileging foreign capital, especially capital flows into the stock market, has lost a great deal of autonomy in policy making, and the country remains perennially vulnerable thanks to unabated fiscal deficits and reliance on capital inflows.

### **Inequalities of Income and Wealth**

Since the turn of the century there has been a growing concern about the excessive concentration of income and wealth in most countries and at the global level. One may cite among many others the studies by Milanovich (2002), and by Davies *et al.* (2006) from WIDER. These are based on household income surveys for developing countries and income tax returns in industrial countries, and all point to a rising Gini coefficient, currently at above 0.4 - generally reckoned as a 'danger' mark for social stability, in many countries.

A dramatic picture emerges if one looks at the top of the pyramid. As part of globalisation, world financial markets have become ever more integrated. Global Asset Management Companies (AMC) have sprung up to help clients, rich individuals and firms, move their

financial assets from one location to another to minimise tax payments. Boston Consulting Group, a leading firm, estimated that the global wealth of the 'affluent' individuals (minimum assets of \$100,000) and large firms in different countries rose from 85.3 to 97.9 \$ trillion between 2004 and 2006. (www.bcg.com). No country-wide statistics are available. The total may be contrasted with the CIA estimate of world GDP (at the nominal exchange rate) of \$51.0 trillion in 2006. (www.cia.gov) Thus private wealth was nearly twice as high as world income.

Since 1996, Capgemini, an associate of Merrill Lynch, has been putting out an annual *World Wealth Report* on HNWI (high net worth individuals with assets of at least \$1 million). The number of such persons increased during the 11 years, 1996-2007, from 4.5 to 10.1 million, and their aggregate wealth rose from 18.6 to 40.7 \$ trillion over the same years. The HNWI are mostly in the US and West Europe, though emerging countries have become more prominent in recent years. In China their number increased annually by about 15% a year since 2000 to reach 415,000 in 2007; India had a similar growth rate, though the number was smaller at 123,000 in 2007. The size of wealth is not revealed for individual countries. Assuming a lower average wealth of \$3.0 million for India and China as against the world average of \$4.0 million, the HNWI wealth in \$ billion for the two countries comes to 369 and 1,245 respectively. Allowing for a modest 10% rate return on assets, the annual income of the HNWI would be 3.6% of India's GDP in 2007, and 4.1% for China. On the other hand, the average HNWI income as a multiple of per capita GDP was 302 for India, 122 for China, and only 48 for the world. By this measure, the degree of inequality in India is extremely high, and that in China, though much lower than in India, is almost 2.5 times that in the world as a whole.

More frequently cited in the media is the

annual list of the global rich published by *Forbes*. In 2005, it reported 920 billionaires across the world who had a net worth of \$4.38 trillion; Davies *et al.* (2006) found it close to their econometric estimate. For 2006, *Forbes* identified 49 billionaires resident in India with an aggregate wealth of \$280 billion; this is consistent with Capgemini's estimate cited above. However, for China *Forbes* listed only 40 individuals for 2006 with a total wealth of just \$80 billion; almost certainly, this is an underestimate. The *Hurun Reports* (www.hurun.net) for China 2008 listed as many as 106 billionaires for 2007 with a total wealth of \$243 billion - far higher than that of *Forbes* for the previous year. Moreover, the *Hurun Report* contained 800 names, each owning at least \$105 million, with a total wealth of \$457 billion. This figure is compatible with that of Capgemini. In China, it is not only that the number of millionaires is rising at a fast pace, but their average wealth is increasing faster. (For India comparable information is lacking.) According to the *Hurun Reports*, the assets of the 50th rank-holder went up steeply from \$6 million in 1999 to \$145 million in 2002 and \$525 million in 2006, while the richest person in the last year was worth \$3.4 billion.

The *Hurun Report* revealed that in 2006 one-third of the 500 richest Chinese were Communist Party members; of the top 100 as many as 19 were delegates to the National People's Congress (as against 5 in 2005), while 19 were members of China People's Political Consultative Congress (as against 16 in 2005). Clearly, the rich are getting more deeply entrenched in the policy-making organs of the Party and the state. Another report claims that 90% of China's yuan billionaires are the children of senior cadres in the party or government.<sup>1</sup>

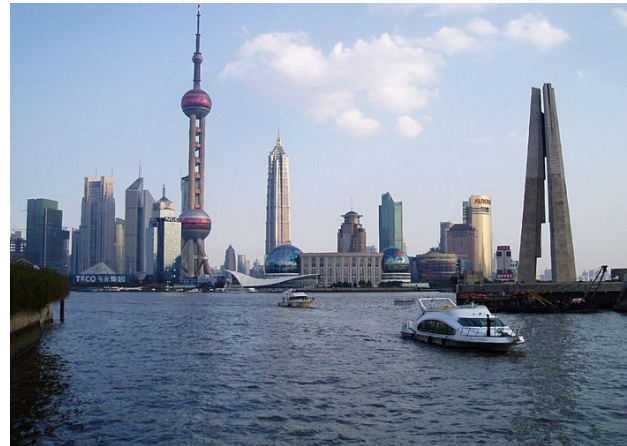
The Indian capitalists have been playing a major role in the formulation of policies by major Indian parties even before independence, and have continued to do so. One need not cite

references to substantiate this proposition. Immediately after 1991 there were some critical voices. But the government managed to regain their confidence through a variety of concessions. In recent years there is has been intimate collaboration between government and big business.



### Mumbai

One must add that the wealth of the rich has nosedived in the wake of the financial crisis. *Forbes* (website 29 October 2008) reported that the combined wealth of the 400 richest Chinese dropped from \$288 billion to \$173 billion during the past year. Similarly, the assets of the 40 richest Indians crashed from \$351 billion to \$139 billion over the same period. (*Forbes*, 12 November 2008.) However, the income of these groups need not have come down to the same extent. Many companies in India have shown higher profits than last year. Thus the rich continue to corner an unduly large part of national income.



### Shanghai

#### Trends in Poverty

In India rural poverty, i.e. the percentage of the population below the poverty line, has officially declined significantly from 36.0 in 1993-94 to 26.1 in 1999-2000, and 22.0 in 2004-05. (ES 2006-2007, p.14.) Using the same survey data, Dev and Ravi (2007) concurred broadly. By contrast, Sen and Himanshu (2004) and Himanshu (2007) concluded that the poverty ratio had hardly changed from 1993-94 to 1999-2000, though it fell subsequently. The official poverty line is defined as that level of per capita consumption in 1962 at which the daily food intake had a calorific value of 2400 in rural, and 2100 in urban, areas. Since the appropriateness of the price index is contested, while the data on the calorie intake for each expenditure group are available, one study used the latter to find that in rural India 75% of the rural population consumed less than 2400 calories in 1999-2000, as against 56% in 1973-74. <sup>2</sup> If this is startling, *The Economist*,<sup>3</sup> wrote that 60% of the Indians were 'poor' without defining the term. My reading is that these families have to devote their entire income to the purchase of goods and services 'necessary for survival', leaving little scope for discretionary purchases.

The National Commission on Enterprises in the Unorganised Sector (NCEUS) made a valuable

contribution by extending the poverty calculus to two new groups, namely the 'marginally poor' and the 'vulnerable'; the consumption level of the first group is in the range 1.0-1.25 PL, and that of the second is in the range 1.25-2.0 PL, where PL is the official poverty line. These two groups spend the overwhelming share of the meagre total on 'essential consumption', leaving just 15% for 'discretionary' items; it is only a shade higher than that for those classified as 'poor'. While the percentage of the 'poor' declined from 30.7 in 1993-94 to 26.1 in 1999-2000 and to 21.8 in 2004-5, that of the 'poor and vulnerable' was much higher and fell marginally from 81.8 to 80.7 and 76.7 over the same years. (Sengupta *et al.* 2008) Clearly, *The Economist* figure cited earlier was an underestimate.

China claims to have virtually abolished rural poverty with the number reduced from 250 to 26 million during 1978-2004. Recently, however, a Chinese Minister, using the World Bank norm of \$1/day, measured at the purchasing power parity of yuan per dollar, put the number of poor for 2004 at 90 million.<sup>4</sup> China's threshold for rural poverty is a daily food intake of 2100 calories, significantly lower than in rural India; further, the need for non-food items is estimated in a non-transparent manner from the household income data on rural China. Had the food 'norm' been related to consumption expenditure, and not to household income, the incidence of poverty would have been higher, according to Khan (2005), who has collaborated with Chinese academics and officials of the National Bureau of Statistics over many years.

Yao *et al.* (2004) made their own estimate of the 'food poverty line'; on non-food expenditure, they allowed for two values and thus came up with two poverty thresholds. Their estimates for rural China ranged from 79.6 to 196.8 million in 1995, and from 103.1 to 187.0 million in 1998, out of a population in 1998 of 936 million. Other Western estimates

gave comparable figures.

Further, Gustafson and Li (2003) found from survey data that for the bottom decile, outlays on health and education as a percentage of income more than doubled from 5.7 to 11.8 during the three years, 1995-98. This result calls into questions the appropriateness of the price index, and hence the reliability of the poverty estimates in recent years.

Equally doubtful is the claim that 250 million peasants in 1978 had a food intake of less than 2100 calories. Since they lived in communes with their 'iron rice bowl', and China's per capita daily calorie intake averaged 2330 during 1979-81 (FAO 2005, table E.0.1), one cannot accept the official figure until independent experts can look at the raw data. Thus one is sceptical not only about the current official estimates, but also about the extent of poverty reduction in post-reform China.

Nevertheless, a seasoned critic of post-reform China and correspondent of *The Observer*, Watts (2006B) on a remarkable 5000 km journey across China, found that, after years of deprivation, even the poorest provinces are sharing in a new-found prosperity, and that for the majority of people he met their living environments had improved. The evidence suggests that poverty in rural or urban China is much less than in India. On the other hand, many developing countries, poorer than China, have a better record on poverty. Particularly disturbing is the fact that although China had a scorching pace of GDP growth over the past 25 years, and energy intake from foods averaged 2940 calories during 2001-03, the 'high' estimate by Yao *et al.* put rural poverty at 25% in 1998.

Yao *et al.* (2004) corroborated the official position that poverty among the 'urban residents' was rare. What about the 150-200 million rural migrants? Compared to the former, the migrants work far longer hours, receive barely one-quarter of the hourly wage,



often much later than the contract date, and have no social insurance.<sup>5</sup> Their real earnings have hardly increased in the last decade. It would be surprising if they were all above the poverty line.

### Trends in Employment and Unemployment

Both in China and in India there is a severe deficit of jobs, although the media highlight labour scarcities in some segments. China in 2006 was facing the 'country's worst employment crisis ever', according to the National Development and Reform Commission; against 25 million young people looking for jobs, only 11 million vacancies were expected.<sup>6</sup> Employment in SOEs shrank by 48 million from 113 to 65 million during 1995-2005, and that in collectively-owned firms fell by 28 million from 36 to 8 million between 1991 and 2005.<sup>7</sup> Two years later, of 10.2 million who lost their jobs from January to October, less than half found new jobs. (*Xinhua*, 21 November 2008.)

It is true that laid-off workers in urban China receive assistance in different forms over varying periods. The official figure on unemployment covers only the 'registered' urban residents with various entitlements, including unemployment benefits from the state. Consequently, many jobless persons are left out of the figures. The official unemployment rate is quite low; the percentage fell from 5.3 in 1978 to 2.6 in 1989, and then rose to 3.1 in 1997 and 4.2 in 2004. (SYC 2005, table 2-5.) However, using the ILO definition of unemployment, and data from a unique unemployment survey conducted in five large Chinese cities in 2002, Giles *et al.* (2005) estimated that unemployment rose from 6.1% in January 1996 to 11.1% in September 2002. Based on a 2001 survey of five cities including Shanghai and Wuhan, Giles *et al.* (2006) found that the unemployment rate rose from 7.1 to

12.5 percent between January 1996 and November 2001. The problem may be graver still, if one reckons that some of the more than 100 million migrants in urban areas are employed intermittently.

Since 1990 there has been a big chasm between output and employment growth in China as shown in Table 2. Rural employment in the secondary sector increased by as much as 93 percent during 1990-2004, but urban workforce shrank by 13 percent, and total employment rose by a mere 22 percent while net output multiplied by an astonishing factor of 5.3. Since rural workers earn far less than their urban counterparts, the wage share has fallen drastically, as noted below. The tertiary sector was more 'balanced' with net output and employment growing at 228 and 92 percent respectively over the same period. Even then the workforce expanded 2-1/2 times faster in rural than in urban areas. The primary sector has been a laggard in both output and employment. This shift of workforce from high to low wage sectors is contrary to the historical pattern of industrialisation. Unless the macroeconomic policies are radically altered, the unemployment crisis is likely to be accentuated over the years.

Table 2. China: Percentage rise in employment and output, 1990-2004

	1995-04	2000-04	1990-04
Secondary sector:			
Employment: Total	8.1	4.3	22.1
Rural	43.0	29.8	93.4
Non-rural	-14.7	-14.0	-12.9

Value-added		430.0
137.8	49.0	
Tertiary sector:		
Employment: Total		92.1
36.3	16.1	
	Rural	158.9
57.4	23.0	
	Non-rural	58.9
23.0	11.1	
Value-added		228.4
104.3	37.6	

Source: SYC 2005, tables 3-4 and 5-2.

That China has been pursuing a highly capital-intensive pattern of development over the past few years is brought out clearly by Kim and Kuijs (2007). Annual growth rate in labour productivity (at constant prices) in the ‘core manufacturing’ sector was 21.4% during 2003-06, while labour cost as a proportion of gross output at current prices fell from 10.7% in 2002 to 6.3% in 2006. Over the same period labour productivity at current prices increased annually by 22.9%, while nominal wages rose by 12.7%.

In a study for the US Bureau of Labour, Banister (2007) looked at Chinese official data from different sources; *total* manufacturing employment, urban and rural, declined from 123.01 million in 1995 to 104.60 in 2004. For large enterprises (‘at and above designated size’) the fall was quite sharp from 71.9 to 56.7 million or by 20% over these years, and somewhat less for other enterprises. The average real wage in large enterprises increased 2.66 times over the 9 years, but the rise was much slower elsewhere. Thus in 2004, the average monthly wage at large enterprises was 18,043 yuan, as against 9079 in other

establishments, and just 6343 in self-employed and household manufacturing units.

The sharp rise in nominal wages and complaints about labour shortage by numerous employers led many observers, inside and outside China, to believe that the era of ‘surplus labour’ is over. *The Economist* (4 September 2008) wrote: ‘the real wages of low-skilled workers barely rose during the 1980s and 1990s, despite big productivity gains; only recently have they increased rapidly’. Further, ‘to attract migrant workers, urban employers have to pay more than rural income, which has increased in recent years, thanks to government policies and higher food prices.’ It concluded that labour surplus ‘may eventually dry up, but it still seems some years away.’

The employment situation in India is as grave as, if not worse than, in China, though for somewhat different reasons. There has been no massive retrenchment of workers comparable to that in China’s state-owned and collectively-owned enterprises. However, the workforce in India’s ‘organised’ sector (covering administration, the public sector enterprises, registered factories, mines, plantations, construction companies and incorporated private enterprises in the tertiary industries) has been remarkably static at between 26 and 28 million since 1990; in manufacturing the total number actually fell from 6.5 to 5.6 million during 1981-2004. (ES 2006-2007, tables 3.1-3.3.) In any case, the organised sector is a small island comprising less than 10% of the nation’s workforce.

According to the Censuses, ‘main workers’ (‘gainfully occupied’ for more than one-half of the usual working year) as a percentage of the total population stood at 33.5 in 1981, rose marginally to 34.1 in 1991, and fell sharply to 30.5 in 2001. By contrast, the percentage of ‘marginal’ workers in the population increased from 3.2 to 3.4 and 8.7 over the same period. (EPWRF 2003) If one counts a marginal worker

as one-half of a main worker, the adjusted participation rate seems to have fallen marginally over the past two decades.

The quinquennial reports on employment and unemployment by the National Sample Survey (NSS) tell a broadly similar story. The proportion of 'principal and subsidiary' workers in the population over the years 1973-2004 fluctuated in a narrow band; it fell from a high of 42% in 1977-78 to a low 40% in 1999-2000, but recovered to 42% in 2004-05. It follows that there was no clear long-term trend.

The NSS provides some insights into unemployment that are rarely available elsewhere. The employment status of each person in the survey is determined not just annually (as in the Census), but also on a weekly and a daily basis. Indeed, the number of workers (unemployed persons) decreases (increases) as the reference period is shortened. In 2004-05, for instance, the unemployment rate for rural men jumped from 1.6% on the annual basis to 8.7% on the daily basis. This is an indicator of underemployment among those who are employed on an annual basis. Over the past three decades the daily unemployment rates showed an irregular pattern within a narrow range. For 2004-05, NSS collected information on three aspects for the first time. Though there are data for each gender in both rural and urban areas, I focus on rural men, aged 15 years or more, who are employed on an annual basis: (i) 11.0% of them *did not work regularly* throughout the year; (ii) 10.7% of them sought or were available for *additional work*; and (iii) 9.2% of them sought or were available for *alternative work*. One should *not* add up these percentages and claim that nearly 31% of the 'employed' were 'underemployed'. The figures just cited merely corroborate the general impression that underemployment is a very significant issue.

Far more important is the fact that India has a very low work participation rate compared to

many other countries. A very high proportion of working age women remain out of the labour force in each NSS survey. Thus in 2004-05 the ratio of women to men workers (annual basis) was only 44% in rural, and 24% in urban, areas. It is misleading to attribute the low rate for women to 'tradition', 'culture', 'attachment to children in the family' and so on. For, among agricultural workers at one end, and urban professionals and business families at the other, women are often economically as active as their men. It is more likely that the low participation rate for women is primarily due to the absence of appropriate job opportunities, keeping in mind their domestic and other compulsions. In that case, the number of 'potential' workers, not actually employed, is several times greater than the number of unemployed, as currently defined.

Unemployment in a more 'inclusive' sense is far more widespread in India than in China where the overall work participation rate is much higher. Subjectively, however, the Indians always faced it and adjusted themselves. But in China memories of full employment, though at a rather low level of remuneration, in pre-reform years are still vivid, leading to strong resentment about the current scene.

In India one observes the same phenomenon as in China of an increasing proportion of workers in low paid jobs. It is worth quoting Unni and Raveendran (2007) in this context:

Overall, while there has been a growth of employment particularly in urban areas, the nature of this growth and the quality of employment generated needs probing. There has been a substantial growth in self-employment in the recent period, 1993-94 to 2004-05. However, much of this work is poorly

remunerated. The sharp growth of regular salaried work among women particularly in urban areas also appears to be in poor quality work. In fact, for the first time in decades, there has been a decline in the real wage rates of regular salaried workers and urban casual workers. The growth of employment in the unconventional places of work and of home-based work among women is one more indicator of the informalisation of work, which has implications for the levels of incomes and security of the workers.

Lastly, while spokesmen of IT and ITES industry in India have highlighted its contribution to employment, the employee strength was just 1.28 million in 2005-06. (Chatterjee 2006.) That was less than 5% of the total for the 'organised' sector, or barely 0.3% of the national workforce.

### **Nature and Extent of Social Unrest**

In China today social unrest, sparked by public anger over issues ranging from land grab without proper compensation, arrogance of authorities towards ordinary citizens, and extortion by corrupt officials, to the yawning wealth-cum-income gap, has reached heights not witnessed since the Communist Party came into power. In January 2006, *Xinhua* put the total number of 'public order disturbances' during the previous year at 87,000 without giving further details. In 2004, there were 74,000 'mass incidents' compared with 58,000 in 2003.<sup>8</sup> In the last couple of years comparable

figures have not been published, but BBC Monitoring has been gleaning information from Chinese and Hong Kong newspapers and puts it out on its website, most recently in November, 2008.

The Party, for its part, adopted in 2004 the two slogans of 'harmonious development' and 'a new socialist countryside'. However, the situation has changed little since then.

Land acquisition for 'development' is an explosive issue. A *Xinhua* reporter observed that agrarian China today resembles in many ways the 'old China' depicted by John Steinbeck in his classic depression era novel, *Grapes of Wrath*. (i) Forty million farmers have lost their land over the past decade owing to urbanisation, and another 15 million await a similar fate over the next five years. (ii) The area of land seized *illegally* for 'development' jumped 20 per cent in the first five months of 2006. Over the past seven years, the country lost about 6.7 million ha of farmland, or 5% of the country's total. (iii) Farmlands confiscated in Fujian Province were valued at 7,000 yuan per mu (1.0 mu = 0.067 hectare); if reclassified as development land, they could be worth up to 500,000 yuan per mu. (iv) Those sums often lined the pockets of local officials. According to Watts (2006A), the director of law enforcement in the Land Ministry, Zhang Xinbao, acknowledged 'more than a million cases of illegal land use in the past six years.' In June, 2006 National Auditor-General Li Jinhua observed that, for 21 out of 34 highway projects reviewed in 2005, officials had violated government regulations by not paying farmers proper compensation, and that local governments had siphoned off 1.6 billion yuan in land compensation funds to meet budget shortfalls or pay bonuses to staff.<sup>9</sup> In January 2007 China announced the enforcement of a land appreciation tax of 30 to 60 per cent on net gains made from all property development transactions. The new rules, it was hoped, would slash the real estate developers' profits

by half.<sup>10</sup> *Reuters* (10 September 2008) reported that Beijing has directed local governments to replace farmland designated for development with equal-sized plots of farmland elsewhere; the directive is to take effect in 2009 and is part of an effort to maintain an arable land area of at least 121.0 mha by 2010. But where will the land come from to fulfil this mandate?

Public opinion polls tell a similar tale. A Beijing survey of December 2002 reported that 80% considered income inequality was 'a major social problem'; in the list of 'the most serious social problem this year', income inequality topped (19.3%). To the question, 'What concerns you most?', the first response was corruption (18.2%), followed by excessive income inequality (16.1%), unemployment (14.7%), and so on. (UNDP 2006, p. 19.) The 2001 survey of five cities by Giles et al. (2006) noted above, also revealed that among the unemployed, 51% felt that their condition had worsened since 1996 ; the corresponding ratio for those working was somewhat less at 21%.

Social unrest in India is characterised by a mixture of armed revolutionary struggle in large parts of the country to usher in a new political order, socio-political movements to remould the traditional balance of caste and class forces within the parliamentary system, and resistance across party lines to the state's neoliberal policies.

According to *The Economist*<sup>12</sup>,

Naxalism now affects some 170 of India's 602 districts—a "red corridor" down a swathe of central India from the border with Nepal in the north to Karnataka in the south and covering more than a quarter of India's land mass. This statistic

overstates Naxalite power, since in most places they are an underground, hit-and-run force. But in the Bastar forest they are well-entrenched, controlling a large chunk of territory and staging operations across state borders into Andhra Pradesh and Orissa. In the tiny, dirt-poor villages scattered through the forest, the Indian state is almost invisible.

The question of reservation of (up to 50% of the total) jobs in civil services and in large private establishments, and of seats in institutions of higher education funded by the state, for the 'other backward' castes (OBC) and the *dalits*, the most oppressed sections of the population, has convulsed the nation over the past two decades, especially in the last couple of years.

Simultaneously, citizens in different parts of the country have protested vehemently against large-scale acquisition of fertile agricultural land for the benefit of private investors, domestic and foreign. After independence, millions of acres of land were taken over for new projects in various sectors, but the major part of it was for 'public purposes' like building dams, roads, factories and so on. 'Fairness' requires that in all such cases, the losers must be 'adequately compensated' - with cash or assets that can help them maintain, if not improve, their living standards. Actually, as Fernandes (2007) pointed out, a whole series of studies found that 60 million persons were displaced, of whom a vast majority was not properly rehabilitated over the period, 1947-2000; among those displaced, 40% were tribals, and 20% each of *dalits* and OBC.

In the current phase of land acquisition, several factors have combined to rouse popular anger. (i) Owing to the job deficit and scarcity of

cultivable land, farmers are most reluctant to part with land. (ii) As in China, compensation is given for 'agricultural' land, although its market value soars the moment it is reclassified as 'non-agricultural'. (iii) The state as the acquirer and the eventual private buyer of the land makes huge profit. (iv) In addition, the private buyers are showered with enormous subsidies for the development of industries (with a lean workforce), commercial real estate for the use of the affluent who in turn benefit from numerous hidden subsidies (see below). In short, the state seems to promote 'primitive accumulation' similar to the 'land enclosure' Acts of 18th century England. Resistance in contemporary India has been so strong in Orissa, West Bengal and elsewhere that the governments at the Centre and the states find themselves in a quandary, slowing down the reform process.

At the moment an uneasy truce prevails. The 'reformers' have not abandoned their goals. The opponents are equally determined to thwart every new move in that direction, but are not strong enough to impose their agenda on the state.

### How the Rich Are Getting Richer

India's Budget, 2006-07, presented for the first time tentative estimates of 'tax expenditure', or tax revenue foregone as a result of various 'exemptions' during 2004-05 as follows.

Tax	Tax
expenditure*	revenue*
billion)	(Rs billion)

Corporate income tax	819
576	
Personal income tax	477
119	
Co-operative sector	15
n.a.	
Excise duty	788
305	
Customs duty	405
926	
Less export-credit related	n.a.
-354	
Total	2258
1587	

As against GDP, the actual revenue was only 7.3%, while exemptions amounted to 70% of the revenue. Further, owing to business lobbies, lower tax rates are fixed for similar activities or products that are hardly justified. Thus corporate profits on the construction of 'small' houses (up to 1,000 sq. feet in area) are fully exempt from tax, but most such apartments can be easily turned into luxury apartments just by demolishing the partition walls. Again, the excise duty on small cars was only 16% or 1/3rd less than on other cars, though not even 5% of the population can own or maintain a small car. These and many other loopholes are not counted as 'exemptions'.

In 2002 the Central government announced for manufacturing firms undertaking new investments or substantial expansion in hilly states of the north like Uttarakhand, Himachal Pradesh and so on, full relief from excise duty for 10 years, and from income tax for 5 years; income tax relief at 50% would continue for the next 5 years. Through substantial expansion,

the investors can enjoy similar benefits for an indefinite period. As many leading firms headed for these states, other state governments began to offer equivalent relief in respect of state-level taxes such as VAT, stamp duty, and so on, while giving away land at a low cost.

The budget for 2006-07 added another major tax relief for the rich. Earlier, short-term capital gains from transactions in shares, mutual funds, etc. were added to current income, and attracted a maximum of 33% tax at the top level; it was reduced to just 10%. Long-term capital gains were taxed at 10-20%; now, one pays just a 'transaction' tax of 0.15% on the sale value. By examining the volume of transactions on the stock exchanges from March 2005 to January 2007, Bagchi (2007) estimated the loss of revenue on this score at Rs 200 billion, or 10% of the actual revenue in 2004-05.

Coming to China, personal income tax rates (payable by urban residents only) are progressive, ranging from 5% on an annual income of 6000 yuan (far below India's threshold of Rs 100,000) to 45% on income of 1.2 million yuan (against India's top rate of 33% for an income of Rs 500,000). For businesses, the rate varies from 5% on annual 'net income' of less than 5000 yuan, to a maximum of 35% for income above 50,000 yuan. (Income tax actually collected by Central and local governments in 2004 amounted to 174 billion yuan from individuals and 396 billion from businesses. (SYC 2005, table 8-12.). Together, these two taxes amounted to just 3% of the current GDP (against 11% for India in 2006). The average annual disposable income per head of the urban population of 550 million was 9422 yuan in 2004, yielding an aggregate income of 5182 billion yuan.<sup>13</sup> Thus personal income tax collected constituted a mere 3.5% of post-tax income or a little less as against pre-tax income. The collection is undoubtedly low.

Following Capegimini reports, in 2004 China had 240,000 dollar-millionaires having a total wealth of \$750 billion. With a modest 10% return, their annual income would be \$75 billion or over 600 billion yuan. If their average tax rate is put at 30%, the potential revenue would be 180 billion yuan, exceeding total tax collected. China's authoritative *China Taxation* published the names of the top 100 taxpayers of 2004. The list included only 12 of the 200 richest Chinese appearing in the *Forbes* list of 2004.<sup>14</sup> In 2006 it became obligatory for persons with high income to file tax return by April 1, every year. According to the State Administration of Taxation, just 1.37 million persons had filed returns by April 2, 2007, or only 16-19% of the 6 to 7 million high-income earners.<sup>15</sup>

On corporate tax breaks, I have no reliable information. Examining the savings-investment balance from a macroeconomic perspective, Kuijs (2006) provides some insight:

Enterprise saving from retained earnings constitutes a large and increasing source of saving in China. In recent years, as enterprise saving increased to around 20 percent of GDP, it has overtaken household saving as the largest source of financing... The saving-investment deficit of enterprises is estimated to be around 11-13 percent of GDP in recent years. Of the deficit in 2002, 4.5 percent of GDP was financed by capital transfers from the government [to the SOEs]. The remaining 6-8 percent of GDP is financed by outside financing, mainly

bank loans and foreign investment... [F]or historical reasons SOEs pay only limited dividends to shareholders, and none at all to the state, their largest shareholder, although the increase in profitability in recent years has stimulated a policy discussion on the distribution of SOE profits... Profits in industry, as a share of value added, increased from 10.6 percent in 1995 to 17.3 percent in 2000 and 21.6 percent in 2005.

In addition, it is widely known that the SOEs obtain very big loans from the banks at low interest. As for the private sector, they not only enjoy high profit rates but also pay, it is generally believed, too little in taxes.

Unlike in other countries, local taxes constitute a great burden on the Chinese peasantry, though it has not been quantified at the national level. It was intensified after the 1994 fiscal reforms that made local governments responsible for their own expenditure without a grant from the centre; simultaneously, the authority of local governments to grant rebates on central taxes was drastically reduced. Thus Mobo Gao (2005) notes that up to 100 different kinds of taxes were imposed on the peasants for development work, salaries of school teachers, interest on debts incurred by local governments, and even the extravagant lifestyle of the local leadership. Indeed, one major factor behind rural unrest was the heavy toll of legal and illegal taxes. Many of the legal ones were abolished by Beijing from 2004, but it remains an open question whether the burden has decreased significantly. Besides, peasant land was literally expropriated (see section V) on a large scale. This supports the

contention of Mobo Gao and many others that the boom in the country is financed to a considerable extent by various exactions from the peasantry.

### **The Logic Behind Fiscal Concessions**

In the early years of reform China had some solid reasons to privilege FDI in manufacturing, especially in exports. As noted in section I, without higher export the country could not import Western technology and capital goods to reduce fuel and other resources used per unit of industrial output. In a quasi-market economy (even the US and the EU fall into this category), special incentives are needed to coax firms to invest in certain sectors. Considering the imperatives of modernisation, a large number of industries, including those catering to domestic demand, received incentives.

The scenario in China today is vastly different. Not only has GDP growth been superlative, China has modernised many of her industries as noted earlier, though a fairly large chunk remains backward. Now, Allaire (2006) has estimated that energy-intensity has come down sharply per unit of industrial production from an index of 100 in 1980 to 45 in 1990 and 20 in 1998. The fall was due partly to greater efficiency and partly to a change in industrial structure from heavy to light industries. China continues to make progress (*Xinhua*, 15 July 2008), but even now in many factories energy use is significantly higher than in rich countries. (c) With domestic savings well above 40% of GDP and in excess of the investment rate, and a huge and barely productive foreign exchange reserve of over \$1,800 billion, or about 40% of GDP, there is no dearth of capital. Since up to 50% of FDI in recent years is actually 'round-tripping' by Chinese firms to avail of the tax benefits for foreign firms, capital has not really been scarce for quite some time. (d) Most disturbing is the sharp fall in the percentage of private consumption in



GDP from 47 in the early 1990s to just 36 in 2006. In parallel, the share of wage income in GDP fell over the past decade from 53% in 1998 to 41% in 2005. These percentages are probably the lowest in the world. It is ironic that the neoliberal weekly, *The Economist* (11 October 2007) captioned a piece, 'A Workers' Manifesto for China: How workers in China are losing out and why it matters for the rest of the world'. The resultant inequality in income and wealth (see section II) is not what worried the weekly. The sustainability of China's growth momentum is implicitly questioned. Moreover, a slow down in China could have serious repercussions, not only in East Asia but also in the global economy.

Actually, over the past decade the Chinese government, the IMF, the World Bank and independent scholars have underlined the need to expand domestic consumption as the engine of GDP growth. But state policies worked in the opposite direction, as Kuijss (2006) pointed out. Household savings rate, which was around 5% of income around 1978 before the reform, rose to 30% in the mid-1990s for a variety of reasons, including the withdrawal of the state from social services like education and health. The proportion fell to 20% in 2000 and stayed there. The high saving rate is basically 'precautionary', and not an indicator of affluence. The savings are put into bank deposits with a low (negative, adjusted for inflation) rate of return, while the SOEs and privileged private firms borrow from banks at a low, often negative, rate of interest. In addition, the SOEs benefit from a massive capital transfer to the extent of 4-5% of the GDP from the state. As a result, production becomes highly capital-intensive across the sectors from manufacturing to infrastructure, and employment stagnates

India has evolved somewhat differently. The new industries since 1950 were set up with Soviet as well as Western technology. Two World Bank (1975; and 1984) studies had

shown that the capital goods industries were internationally competitive; as the conclusion ran counter to the theology of the Bank and its consultants, both reports were suppressed. The abrupt liberalisation of imports and foreign investments in 1991 did cause hiccups initially, but most domestic firms, public and private, weathered competition from the TNCs, and quite a few emerged as world-class companies.

As in all countries, Indian exporters of manufactured goods have always been exempted from paying indirect taxes on goods procured domestically or tariffs on imported inputs. A *new* incentive was added in the mid-1980s when profits earned from exports became tax-free to encourage domestic investment and exports in non-traditional areas. However, even today the latter constitute a quarter of total export, though the absolute value of 'engineering goods' rose from \$1.2 billion to \$21.5 billion during 1987-88 to 2005-06. Currently, 40% of these exports come from labour-intensive small and medium enterprises that do not have access to foreign customers. Hence this incentive enriches the intermediaries in the export business that hardly invest in fixed assets. The overall incentives are so high that many Indian firms overstate export earnings!

India's success in information technology and related services is now an acknowledged fact. Whether for call centres or more complex software engineering, low cost (in comparison with the West) of skilled labour is the driving force, and the industry exports 75% of its output. Some of the leading *Fortune 500* companies like TCS, Infosys, and Wipro pay a corporate tax of no more than 12% on their net income.

Too many exemptions for the corporate sector have greatly reduced the effective income tax rate. For the corporate sector as a whole, it was estimated by the official Task Force on Direct Taxes (2003) at around 20%, while the

statutory rate stood at 40%.

In industrial policy, the scheme of reservation of product lines for small industries has been whittled down after 1991. At the same time, there was a reduction in bank credit to small firms, withdrawal of preference in government purchases, and so on. All this led to the 'unorganised' (or non-corporate) sector losing its percentage share in the GDP from 63.8 in 1990-91, to 56.7 in 2002-03, while its share in the national workforce remained steady at around 92.0-93.0. (NCEUS 2007, table 1.1.) In manufacturing output, the unorganised lost its share from 41% in the 1970s to an average of 32% during 1999-2005.

Balasubramanyan and Sapsford (2007) have made a telling comparison between India and China. Measuring output in US dollars at the purchasing power parity of the national currencies in 2002-03, and utilising UNIDO's *Industrial Statistics Database 2006*, they found that per million labour units, aggregate manufacturing output was 0.919 in China and 0.589 in India; the corresponding averages were 0.762 & 0.453 for hi-tech products, and 1.261 & 1.011 for low-tech products. Similarly, China utilised \$39,406 worth of assets per unit of labour in 'all manufacturing' as against \$72,051 for India; the gap was particularly large for hi-tech industries—\$68,542 in China and \$290,272 in India. In my view, the comparison in respect of hi-tech industries may be misleading, as China assembles these goods from imported components to a far greater extent than India. However, the two authors' argument that a labour surplus country like India has adopted more capital-intensive technologies than China remains valid. The fiscal incentives in India presumably contributed to this anomaly.

Most of the post-1980 tax cuts and tax sops for individuals and corporations across the world, including India and China, follow from two inter-related neoliberal premises. First, the

lower the tax rate, it is argued, the greater is the incentive for tax compliance, and hence the tax yield goes up. It is doubtful if this proposition has been empirically proved for any major country. Indeed, in all countries designated as 'miracle' economies after 1945, namely West Germany, Japan, South Korea and Taiwan the marginal tax rates for the top earners until the end of the 1970s were 80% or more.

The second premise is that a firm's investment depends on its post-tax income. This has never been true. In the years of high-speed growth, the typical profit rate of firms in the same miracle economies was quite low, but that did not impede a high rate of investment through easily available loans at a low interest. Currently, in mergers and acquisition across the world, the acquirers rely heavily on borrowed funds rather than their own accumulated funds. Thus a large stock of undistributed profits is neither necessary nor sufficient for corporate investment.

### **Alternative of Development with Equity**

In defence of the current economic policies in China or India, one may argue that inequalities may have risen but this is essentially transient in nature. If GDP growth is maintained, the market forces will automatically redress the imbalances, as the 'trickledown theory', consistently promoted by the Washington consensus.

There is an apparent support for it in the works of Kuznets. He showed for the US that inequality increased from around 1880 till the 1920s, and a 'levelling' process started during the World War II, gaining momentum after 1945. Broadly similar was the story in Britain or France. What is missing in the conventional narrative is the political factor. The introduction of welfare capitalism in Western Europe was, to a great extent, a response to

the ideological threat from the Soviet Union that won the hearts and minds of the working classes and large sections of intellectuals after World War II; in Italy and France, Communist Parties came close to winning postwar parliamentary elections. Even before the war, a parallel development was taking place in the US under the impetus of Roosevelt's New Deal; many of the leading Marshall Aid administrators and economists from the USA, as agents of the donor state, took an active part in the creation of the welfare state in Europe. The US, too, took several strides in the same direction. (Chandra 2004.)

If the welfare state was the logical outcome of capitalism at an advanced stage of development, how does one explain the retreat from welfare policies and the sharp increase in inequality since 1980 in all industrial countries? The proponents of trickledown theory have no answer. My own hypothesis is again political. The 'oil shock' of 1973 seemed to threaten the average living standards in rich countries; the militancy of the trade unions alienated the middle classes in these countries; and economic stagnation in the USSR combined with widespread political disenchantment with Soviet socialism, created fertile ground for the emergence of the radical right in the Anglo-Saxon countries.

In the end, it is not the market but the alignment of political forces and their relative strength that determine the degree of inequality in a country. Suppose that egalitarians take the reins of power in India or China. If tax concessions are withdrawn, the rights of labour, including migrants, and dispossessed farmers are respected, and so on, would the aggregate investment rate and the GDP necessarily fall? So long as the freedom to move capital abroad remains (as in contemporary China or India), the private corporate sector and rich individuals would increasingly seek opportunities abroad. If controls are imposed on capital mobility at the

same time, the capital outflow can be stemmed. The increase in tax revenue should raise public investments and social welfare expenditure. The latter, in turn, should reduce private expenditure on health and education that constitutes a significant part of total household expenditure of the non-affluent sections. This transfer of income from private producers of these services to the poorer consumers should boost the aggregate consumer demand for goods and services with a Keynesian multiplier effect. Since the domestic savings rate is high, capital would be compelled to find avenues of deployment domestically even at a reduced rate of profit. The nature and structure of investment would, of course, change. But there is no reason to believe that GDP would necessarily fall.

The level of GDP, it is increasingly felt in different circles, is a poor guide to the 'well-being' of a country. Recent studies by behavioural economists have demonstrated that an individual's well-being depends not only on the person's income but also on those of the neighbours. (Luttmer 2004.) A person with a fixed income has a higher level of enjoyment living amidst people at a similar or lower income level, than as a neighbour of much richer people. Thus the case against a high concentration of income is not a socialist dogma, but reflects the aspiration of people in different milieu. Indeed, the human development index in the annual *Human Development Reports* of the UNDP has gained wide currency because the index gives weight to other factors like the Gini coefficient of income distribution, the health status and educational attainment of the average citizen, beside per capita GDP.

Somewhat ambitious is the 'genuine' progress indicator (GPI) of Talbert *et al.* (2007) for the US economy from 1950 to 2004. While per capita GDP over the period increased dramatically from \$11,672 to \$36,595, per capita GPI has stagnated in the \$14,000-

\$15,000 range since the late 1970s. ‘This implies that since the late 1970s, the benefits of economic growth have been entirely offset by rising inequality, deteriorating environmental conditions, and a decline in the quality of our lives.’ For 2004, the positive contribution to GPI comes from personal consumption (adjusted downward for greater inequality since the best year of 1968), services of consumer durables, services of streets and highways, net capital investment, and also the ‘imputed values’ of housework, higher education, and voluntary work, totaling \$11,603 bn. From the total are deducted various social and private costs like those of crime, unemployment, commuting, auto accidents, and pollution of different types; loss of wetlands and farmlands; net foreign borrowing; and so on. Deductions amounted to \$6,45 billion. Thus GPI came to \$4,419 bn as against the GDP of \$11,734 bn. Most notably, \$600 billion spent on wars are not counted either as a positive or a negative contribution to GPI.

One may not agree with the fine details of the GPI. Still, if some corrections are made along these broad lines in the GDP time series for China or India, much of the shine is likely to evaporate, strengthening the case for development with equity.

### **Postscript: Response to the Global Crisis**

When the US financial crisis erupted in mid-2008 and quickly spread to Europe, many believed that India and China were de-coupled from the global economy and would thus escape with minor bruises on the trade front. The two governments maintained a triumphalist posture, claiming that their economic ‘fundamentals’ were strong, and that the financial system was sound; hence GDP growth would at most be tweaked.

By November 2008, China began to feel the

tremor and announced a large package of tax cuts and additional expenditure amounting to \$586 billion over the next 2 or 3 years, or about 5% of GDP each year. Shortly thereafter it came to light that some 20 million migrant workers had returned to their villages as numerous factories closed down owing to a sharp fall in exports that accounted for about 30% of the GDP. Other main economic indicators like imports, industrial output, sale of real estate and urban employment, became increasingly worrisome. Equally disturbing was the plight of China’s main trading partners (Japan, Taiwan and South Korea as well as the US).

As noted above, China in recent years has been trying, though with little success so far, to rely more on domestic demand than on export as the engine of growth. This goal has been reaffirmed in recent discourse. ‘Objectively’, with a huge foreign exchange reserve, a big trade surplus and a low ratio of government debt to GDP, China can afford, for instance, to boost the wages of lowly paid workers, and guarantee a minimum income for all citizens; further, by stepping up sharply fiscal outlays on health and education, the state can raise significantly the disposable income of the masses and hence their purchase of other goods and services. The government under Hu Jintao had in fact earlier taken some steps in this direction, and more are promised under the stimulus package. The biggest one is the outlay on health services by an additional \$123 billion over 3 years, or by 1.2% of the annual GDP. A minor item is the one-time dole of \$1.3 billion to 74 million poor people in urban and rural areas. The coverage of anti-poverty programmes has been extended to 43.2 million rural residents at an outlay of 16.7 billion yuan. However, all these amount to a small part of the stimulus package. The bulk of fresh expenditure is to be channeled into investment, already running at nearly 50% of GDP. The other main item, apart from export tax rebates, is a cut in many indirect taxes to enhance

domestic demand for industrial goods. Thus the subsidy of 13% on household appliances bought by rural households or the scheme for 150,000 rural stores would no doubt benefit affluent rural consumers. However, these constitute only a small part of the stimulus package.

Beijing has taken other bold measures. It doubled the fiscal expenditure over the previous month to \$243 billion in December 2008, a rare feat for any government. Fiscal deficit for 2009 is projected at 3% of GDP - the highest level in six decades. No less dramatic was the rise in commercial bank lending to 4.6 trillion yuan during Q1 2009 (as against 1.3 trillion yuan in Q1 2008), or 90% of the annual target for the current year. Clearly, China has the administrative capability to augment government outlays and bank credit over a short period. The lion's share of incremental expenditure has gone into infrastructure and other investments that boost GDP in the process creating jobs. The fiscal concessions, however, for the most part benefit the SOEs and private firms. Hence elements of the stimulus package seem unlikely to raise the share of household consumption (currently at an unusually low 39%) in GDP.

Global crisis first hit the Indian stock market as foreign investors had till then been the major players. The Sensex (index of equity prices) nosedived 25% during the month of October 2008, and stood at less than one-half of its peak in January 2008; the value of transactions in equities in two major Stock Exchanges fell in step. The financial sector is in deep turmoil.

Most big firms in manufacturing and services had of late become highly dependent on the capital market, domestic and foreign. According to ProjectToday, an online database, from March to September 2008 investment projects totalling Rs 5790 billion (nearly 10% of the GDP) were announced, but the figure fell by more than one-half to Rs 2840 billion during the next six months, owing to a cut in private

investment. (*The Hindu Business Line*, 12 April 2009.) Examining the CMIE data base, EPWRF ('Stimulus Packages Facing Institutional Constraints', *EPW*, 24 January 2009) observed that the amount of investment shelved or abandoned exceeded the level of investment implemented.

High-speed growth in recent years has been fuelled by private corporate investment in manufacturing, services, infrastructure and real estate. Among other major drivers of growth have been the 'modern' financial and service sectors, and export of goods and services - especially the ITeS (information technology and related services); these sectors created many new jobs with high levels of remuneration. Severe retrenchment in these areas led to a ripple effect on professional manpower across the sectors. Thus the real estate sector, for instance, lacks customers for both residential and commercial projects. Demand for many consumer goods has stagnated or fallen. Most damaging is the situation for exports; monthly figures (compared to the previous year) show sharp falls reaching 25% in March 2009. An official survey indicated a loss of one million jobs in export-oriented industries.

India's stimulus package has generally been found to be inadequate. It consists of handouts to affected exporters, cuts in indirect taxes, sops for home loan borrowers, etc. amounting to barely 0.5% of the GDP; the borrowing limit for capital expenditure by state governments have also been raised by another 0.6% of GDP. The Reserve Bank has injected huge amount of liquidity into the financial sector, and reduced the bank rate as well. But banks are reluctant to lend. Out of new deposits collected in the six months to mid-March 2009, banks have lent only one-third, keeping the rest in safe government paper. (H. Damodaran, 'Banks park only a third of fresh monies in commercial credit', *The Hindu Business Line*, 30 March 2009.) Official targets on loans to farmers,

small industries and the weaker sections were missed by a big margin as such credits might lower banks profits.

At one level the contrast between the policy responses of India and China is striking. The fiscal stimulus package of India as a proportion of GDP is quite small compared with that of China. As for bank credit, India (like most industrial countries) lacks the institutions to ensure that higher liquidity is transformed into productive outlays in the economy.

At a more fundamental level, the stimulus packages of the two countries are consistent with important elements of the current neoliberal policy frame. Incentives are aimed at exporters, manufacturers, service providers, and their domestic clients. China has marginally stepped up social welfare and health outlays and sought to create jobs. The Indian Prime Minister has cautioned against any significant rise in fiscal outlays on social sectors in view of the burgeoning fiscal deficit. Thus even if the two countries succeed in maintaining comparatively high rates of GDP growth in an era of global recession, the goal of inclusive growth (India) or harmonious development (China) is likely to remain a chimera, exacerbating social tensions.

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