

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 the rising concentration of income and wealth, the trends in poverty, employment and unemployment, the nature and extent of social unrest, and how the rich are getting richer, aided by fiscal sops, and outlines a feasible alternative centred on development with equity.

Nearly 60 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. China adopted the socialist model of industrialisation accompanied 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 investments. 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.

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 two or three decades, they have become the new paradigms in the international media after 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 US. 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”. 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.

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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. When a nation is recognised by the rest of world as an important player in the global economy, its citizens generally feel proud and appreciative of the State policies. The media in India and China has highlighted the achievements. Yet public opinion polls reveal a cleavage that rarely gets attention. 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. In the next two sections we take up the trends in poverty, and in 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. Next, I look critically at the logic behind fiscal concessions. Some alternatives are outlined in the final section.

1 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 and 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 US, 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 USA 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.

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 the 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 additional export.

Geopolitical 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 west 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's “open door” policy took shape with its stress on export of Chinese manufactures and import for modernisation (Chandra 2005).

While the us support was crucial, China never surrendered her political or economic sovereignty. In foreign trade a neutral or positive balance was maintained all through, to pay for a rising volume of import. To facilitate export, central allocation of resources to firms had to be altered drastically to enable the latter to seize opportunities abroad; hence an increasing role for the market forces became unavoidable. Since export prospects were brightest in textiles and light engineering, businessmen from the Chinese diaspora in south-east 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 the Chinese personnel to assimilate fully the new technologies. Over the years many restrictions were

Table 1: India and China: The Ratio of GDP Per Capita at PPP

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

Source: Heston (2008).

removed as the SOEs began to prove their mettle in foreign markets (Chandra 1999). Nevertheless, even after joining the World Trade Organisation (WTO) in 2002, China has an aggressive industrial policy. I shall cite just three 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 used to be imported in large quantities in the 1990s, is now exported from China.

On the Left, Hinton (1990), an eminent, though critical, observer and chronicler of the 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, others will benefit later), and the entry of foreign direct investment (FDI) that would necessarily recreate a comprador class as in pre-revolutionary China. Whether or not collective agriculture can survive in a market economy is problematic, though the thriving commune in Nanjye has attracted nation-wide attention (Liu 2008). On the trickle down 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 26 years of reforms 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, the American *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, CNOOC, Huawei Technologies and ZTE. The German publication *Der Spiegel* (2007) in a provocative piece, "Red China, Inc" described how the State Council (Cabinet) 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% 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 and McKay, 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 policymaking, and the country remains perennially vulnerable thanks to unabated fiscal deficits and reliance on capital inflows.

2 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 are getting more and 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 in \$ trillion from 85.3 to 97.9 between 2004 and 2006. (www.bcg.com). No country-wise break-up is 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 annually 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 to 2007, from 4.5 to 10.1 million, and their aggregate wealth in \$ trillion rose from 18.6 to 40.7 over the same years. The HNWI are mostly in US and west Europe, though the emerging countries have become more prominent in recent years. In China their number increased annually by about 15% since 2000 to reach 415,000 in 2007; India had a similar growth rate, though the number was smaller at 1,23,000 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 the *Forbes* magazine. In 2005, it reported 920 dollar 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 are well-regarded; that of 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 are 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 further 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 policymaking 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.¹

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 an intimate collaboration between the government and big business.

One must add that the wealth of the rich has nosedived in the wake of the financial crisis. *Forbes* (web site 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 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.

3 Trends in Poverty

In India rural poverty, i.e., the percentage of the population below the poverty line, has officially declined significantly from 36 in 1993-94 to 26.1 in 1999-2000, and 22 in 2004-05 (ES 2006-07: 14). Using the same survey data, Dev and Ravi (2007) concurred broadly, but 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 2,400 in rural, and 2,100 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 2,400 calories in 1999-2000, as against 56% in 1973-74.² If this is startling, *The Economist*,³ a most well informed neoliberal weekly, 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 to 1.25 PL, and that of the second is in the range 1.25 to 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% on "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 2004-05, 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, 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.⁴ China's threshold for

rural poverty is a daily food intake of 2,100 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), an author 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 2,100 calories. Since they lived in egalitarian communes with their “iron rice bowl”, and China’s per capita daily calorie intake averaged 2,330 during 1979-81 (FAO 2005, Table E.o.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 5,000 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. There is no doubt, in my view, 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 2,940 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.⁵ Their real earnings have hardly increased in the last decade. It would be surprising if they were all above the poverty line.

4 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.⁶ This is not an overstatement. 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 2005.⁷ Two years later, the minister for HR, Weimin, admitted that the situation was grim; 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 do not immediately become “unemployed”, as they 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 labour force. 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, Tables 2-5). However, using the International Labour Organisation’s 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 like Shanghai, Wuhan, etc, Giles et al (2006) found that the unemployment rate rose from 7.1 to 12.5% between January 1996 and November 2001. The problem may be graver still, if one reckons with some 150 to 200 million migrants in urban areas who are often employed intermittently.

Since 1990 there is 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% during 1990-2004, but the urban workforce shrank by 13%, and total employment rose by a mere 22% while net output multiplied by an astonishing factor of 5.3. Since rural workers earn far less than their urban counterpart, 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%, respectively, over the same period. Even then the workforce expanded 2-1/2 times faster in rural than in the 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.

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). The 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.

Table 2: China: Percentage Rise in Employment and Output (1990-2004)

	1990-2004	1995-2004	2000-2004
Secondary sector:			
Employment: Total	22.1	8.1	4.3
Rural	93.4	43.0	29.8
Non-rural	-12.9	-14.7	-14.0
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.

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 million 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 nine years, but the rise was much slower elsewhere. Thus in 2004, the average monthly wage (in yuan) at large enterprises was 18,043, as against 9,079 in other establishments, and a mere 6,343 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. Though reliable statistics over a period are absent, *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 just 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 from 1990 onwards; in manufacturing the total number actually fell from 6.5 to 5.6 million during 1981-2004 (ES 2006-07, 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 separately 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% 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 the 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, although many of them are very traditional and religious. 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 lowly 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 the 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.

5 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 2003.⁸ In the last couple of years comparable figures have not been published, but BBC Monitoring has been gleaned information from Chinese and Hong Kong newspapers and puts it out on its web site, the latest one covering November 2008.

The party has realised that it has lost credibility among large sections of the population and set up several committees and think tanks to explore the underlying reasons and suggest remedies. Indeed, it adopted in 2004 the two slogans of "harmonious development" and "a new socialist countryside". However, the situation has not changed much 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 novel of 1939, *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% in the first five months of 2006. Over the past seven years, the country lost about 6.7 million hectares 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); were it reclassified as development land, it could be worth up to 500,000 yuan per mu. (iv) Peasants would not be so upset if cash from confiscated fields was used to build new schools or clean up rivers. Instead, the money has too often lined the pockets of local officials. According to Watts (2006A), the director of law enforcement in the land ministry, Zhang Xinbao, admitted that there were "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.⁹ In January 2007 China announced the enforcement of a land appreciation tax of 30 to 60% on net gains made from all property development transactions. The new rules, it was hoped, would slash the real estate developers' profits by half.¹⁰ Actually, according to official sources, house prices in 70 large and medium cities in June 2007 had risen by 7% during the previous 12 months.¹¹

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 will take effect in 2009 and is part of an effort to maintain an arable land area of at least 121.0 mha by 2010.

Public opinion polls tell a similar tale. (a) Almost 90% of the respondents in a survey of 2002 regarded current income inequality as too great, and 80% felt that the state should act to reduce it. (b) 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: 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%. Further, 83% of the unemployed were dissatisfied or very dissatisfied about their current living standard; surprisingly, 48% of those working felt the same way.

There are innumerable instances of high-handedness by officials and their protégés. Most shocking was the discovery of hundreds of "slave labourers" serving at various establishments in the provinces of Shanxi and Henan. In June 2007, the owner of a brick kiln, and the son of the local party secretary, was found to have confined 31 persons, including children, and made them work up to 19 hours per day since early 2006. Soon after, some 45,000 policemen began a hunt for slave labour in the two provinces (*Le Monde*, 12 June 2007; *The New York Times*, 16 June 2007).

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*,¹²

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 recent electoral victory of the Maoists in Nepal has greatly encouraged the Indian militants.

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 classes" (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. One may recall that the set of economic reforms launched in 1991 had no popular mandate whatsoever; all subsequent governments lost in parliamentary polls, and yet they all pursued policies scripted in Washington. The National Election Study (Suri 2004) conducted after the 2004 parliamentary elections, and covering over 20,000 respondents, revealed for the first time public perception on a wide spectrum of issues. (i) As many as 43% of the respondents felt that the reforms benefited only the rich, while for 28% the whole country gained. (ii) Overall economic conditions were better in the post-1991 years in the view of 27%, became worse for 19%, and remained unchanged for 51%. (iii) For 41%, the employment situation worsened over the same period, while 17% thought that it had improved. Regarding policy questions: (iv) Sixty-nine per cent as against 17% were in favour of a ceiling on the ownership of land and property; (v) Fifty-two per cent did not support a reduction in government staff, but 45% did; (vi) Forty-seven per cent rejected the policy of privatisation of psus, with only 24% in its favour; and (vii) Forty per cent as against 31% expressed a desire for some restrictions on multinationals.

The recent spate of land acquisition is fuelled by the scheme of "Special Economic Zones" to be probed further in a later section. Everyone will agree that "economic development" in an agricultural country cannot take place with its land-use pattern frozen forever. 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 ovc.

In the current phase of land acquisition, several factors have combined to rouse popular anger. (i) Owing to the job deficit (see Section 4), 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 hits the roof the moment it is reclassified by the state as "non-agricultural". (iii) The State as the acquirer and the eventual private buyer of the land make 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 (Singur and Nandigram) 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.

6 How the Rich Are Getting Richer with Fiscal Sops

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

As against the 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 prod-

	Tax Expenditure (Rs Billion)	Tax Revenue (Rs Billion)
Corporate income tax	576	819
Personal income tax	119	477
Cooperative sector	15	na
Excise duty	305	788
Customs duty	926	405
Less export-credit related	-354	na
Total	1,587	2,258

ucts 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 one-third 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".

Moreover, the tax rules are extremely liberal on "perquisites" for the owners and senior managers of business firms. Thus, when a house is owned or rented by a company and is allotted to an employee, the latter is deemed to pay not more than 20% of the salary, irrespective of the market rent of the premises. For the personal use of a company car with chauffeur, an employee's perquisite is valued at a fixed sum amounting to a small fraction of the cost incurred by the company. The list of perquisites is quite long. The upshot is that much of the personal consumption of company executives is financed by the firms as "business expenses", thereby reducing the taxable incomes of all concerned. Internationally, the classic case is that of Jack Welch, the legendary CEO of GE, US, whose employment contract stipulated a tax-free post-retirement benefit of \$4.5 million a year. While no such case has been reported in India, our exchequer loses 40% of the value of perquisites; the total is yet to be estimated. The sudden burst in conspicuous consumption over the past decade in various forms like five-star hotels, deluxe apartments, golf courses, and so on, are closely linked to the barely noticed fiscal rules in small print.

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 five years; income tax relief at 50% would continue for the next five 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.

As noted earlier, popular anger has targeted the state’s scheme for special economic zones (SEZs), apparently to promote exports as in China. Introduced in 2002, it received a fresh impetus with the SEZ Act of 2005. Opponents have vigorously contested it on several grounds. Vast tracts of land of around 350 sq km were assigned to 237 SEZs (up to October 2006) as virtually “foreign enclaves” within which domestic labour laws will not apply, enforcement of laws on environmental protection will be the responsibility of local administrators bypassing the better equipped national authorities, flows of funds, domestic or foreign, will become quite free, and so on (Tiwari 2006). While I share the critics’ position on these unwarranted steps, I focus here on the fiscal aspects. An SEZ firm will pay no income tax for 10 years, and will be exempt from central indirect taxes like customs, excise duties, etc. There will also be waivers on state-level VAT, stamp duty, electricity duty and so on (www.sezindia.nic.in/income_tax_dev.asp). The Ministry of Finance has estimated the loss of central taxes owing to the SEZs at Rs 1,026 billion in the next four to five years as against a projected investment of Rs 1,000 billion, creating 500,000 new jobs (*The Hindu Business Line*, 25 November 2006: 1).

Coming to China, personal income tax rates (payable by urban residents only) are progressive, ranging from 5% on an annual income of 6,000 yuan (far below India’s threshold of Rs 1,00,000) to 45% on income of 1.2 million yuan (against India’s top rate of 33% for an income of Rs 5,00,000). For businesses, the rate varies from 5% on annual “net income” of less than 5,000 yuan, to a maximum of 35% for income above 50,000 yuan (www.novexc.com). 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, Tables 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 9,422 yuan in 2004, yielding an aggregate income of 5,182 billion yuan.¹³ 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 Capgemini 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 2004.¹⁴ In 2006 it became obligatory for persons with high income to file tax return by 1 April, every year. According to the State

Administration of Taxation, just 1.37 million persons had filed returns by 2 April 2007, or only 16-19% of the six to seven million high-income earners.¹⁵

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% 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% of GDP in recent years. Of the deficit in 2002, 4.5% of GDP was financed by capital transfers from the government [to the SOEs]. The remaining 6-8% 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% in 1995 to 17.3% in 2000 and 21.6% in 2005.

In addition, it is widely known that the SOEs obtain very big loans from the banks at a low interest on bank loans. 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 level 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 schoolteachers, 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 is unlikely that the burden has decreased considerably. Besides, peasant land was literally expropriated (see Section 5) on a large scale. All 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.

7 The Logic behind Fiscal Concessions

It is not that all tax and other concessions are bad in theory. In the early years of reform China had some solid reasons to privilege FDI in manufacturing, especially in exports. As noted in section 1, 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. While many of Deng’s dreams have been fulfilled, new problems have cropped

up. 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. With domestic savings well above 40% of the 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 the 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 (Geng Xiao 2004), it shows again that capital has not really been scarce for quite some time. Most disturbing is the sharp fall in the percentage of private consumption in the GDP from 47 in the early 1990s to just 36 in 2006. In parallel, the share of wage income in the GDP nosedived over the past decade from 53% in 1998 to 41% in 2005. These percentages are probably the lowest in the world. It is ironical 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 2) is not what worried the weekly. The sustainability of China’s growth momentum is implicitly questioned. Moreover, a slowing 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 the state policies worked in the opposite direction, as Kuijjs (2006) pointed out. The household savings rate used to be around 5% of the income around 1978 before the reform, but 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.

The Chinese leaders may be apprehensive that any attempt to change the present policy regime may lead to a sharp fall in GDP growth, and destabilise the “socialist market economy with Chinese characteristics”. The famous Lieberman agenda of economic reform in the USSR in the mid-1960s was abandoned for the same reason; as Lewin (1974) predicted, the maintenance of status quo contributed in no small measure to the collapse of the Soviet economy.

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 transnational corporations (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 IT and IT enabled services (ITES) 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. Do they need the tax sops? Narayanamurthy, the iconic founder of Infosys, called for its abolition that would add Rs 16,000 crore to tax revenue (*The Hindustan Times*, Kolkata, 20 January 2007).

Consider next the special schemes for Uttarakhand, etc, and for the SEZs: (a) Concessions on central taxes (direct and indirect) are likely to exceed the value of investments. If one adds the state-level exemptions, and the existing income tax provisions on depreciation allowance for fixed assets, the investors would have a free lunch twice over. (b) As the Reserve Bank of India (2006, Box 1.1) and Rajan (2006) of the IMF pointed out, both schemes will encourage investors to divert new projects and relocate old factories and business centres from other areas into the favoured regions and the SEZs. Indeed, Bajaj Auto closed down its thriving plant near Pune for two million two-wheelers, the biggest in the country, retrenched over 20,000 workers, and shifted to Pantnagar, Uttarakhand to avail of the tax bounties. (c) The estimate of “new” jobs to be created is illusory, partly because of the diversion or relocation. Also, “modern” manufacturing with its stress on a “lean” workforce is unlikely to create many new jobs. Indeed, Rahul Bajaj, an industrialist in the *Fortune* list of billionaires, opened an auto factory without any unskilled labourer.

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 92-93 (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.

Balasubramanian 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 and 0.453 for hi-tech products, and 1.261 and 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 should have contributed to this anomaly.

Returning to the perquisites, there is no reason why personal consumption of business executives should be considered as necessary for the success of business ventures. Whether one takes a prospective client to a neighbourhood restaurant or a five-star hotel is a matter of “convention” jointly determined by the business communities and the tax authorities. One may refer to the analogous debate on the pay of high-level executives in Anglo-Saxon countries. When a relatively small and closed group of executives in different firms fix one another's remuneration, there is no role of the “market”; the “norms” are set to mutual satisfaction, irrespective of the performance of the firms concerned.

Most of the post-1980 tax cuts and tax sops for individuals and corporations across the world, including India and China, follow from two interrelated 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. On the other hand, there is growing evidence that in recent years millionaires everywhere have been seeking offshore tax shelters to avoid paying any tax at all.

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.

8 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 the GDP growth is maintained, the market forces will automatically redress the imbalances, as the “trickle-down theory”, consistently promoted by the Washington institutions, posits.

There is an apparent support for it in the works of Kuznets. He showed for the US that the inequality increased from around 1880 till the 1920s, and the “levelling” process started during the second world war, 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 the second world war; in Italy and France, the communist parties came close to winning parliamentary elections. Even before the war, a parallel development was taking place in the US under the impetus of President Roosevelt's New Deal policy; many of the leading Marshall Aid administrators and economists from the US, 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 trickle-down theory have no answer. My own hypothesis is again political. The “oil shock” of 1973 emanating from the third world (backed by the USSR) seemed to threaten the average living standards in rich countries; the somewhat excessive militancy of the trade unions alienated the middle classes in these countries; and the economic stagnation in the USSR combined with widespread political disenchantment with Soviet socialism, created a fertile ground for the emergence of the radical right in the Anglo-Saxon countries.

As Stalin (1952) stated long ago, the market as such is “neutral” insofar as it coexisted with both feudalism and capitalism; he believed it could also play a useful role under the Soviet system. By extension, one can argue that market can function under a variety of capitalisms. Much depends on the character of those who control it. The notion of “free market capitalism” is a utopia, obfuscating the invisible hand of the political masters. In short, 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 the 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 the GDP would necessarily fall.

The level of the 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, totalling \$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;

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The EPW Research Foundation (EPWRF) has released the Second Edition of its study on the Annual Survey of Industries (ASI), thus extending its data base for 31 years from 1973-74 to 2003-04 in CD ROM. This study is one of the most coveted data base studies of the institution. This is considered useful for wide sections of professionals - research scholars at universities/colleges/institutes as also policy planners and company executives in India and abroad alike.

We hope that this revised data base work will facilitate more serious research on the nature of industrial growth in India in recent decades and its various dimensions. The CD containing the publication is priced per copy thus :

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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.

NOTES

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