THE TIMES OF INDIA

Wednesday, October 6, 2010

# THE MIRACLE AND THE PARADOX

## China at 60 plus

Deepak Nayyar

The People's Republic of China began life on 1st October 1949. The six decades since then have witnessed an economic transformation without parallel in human history. It would be no exaggeration to describe it is a miracle. Everybody would agree. There is also a paradox. Poverty persists. And inequality is rising rapidly. But that is not in the news.

The first half of the twentieth century, 1901-1950, was characterised by economic stagnation: in real terms, growth in national income was 0.3 percent per annum whereas growth in per capita income was negative at -0.3 percent per annum. In sharp contrast, in real terms, growth in GDP was 5 percent per annum during 1951-1980 and 10 percent per annum during 1981-2008, while growth in GDP per capita was 3 percent per annum and 8.8 percent per annum respectively. It is no surprise that, in nominal terms, GDP per capita rose from $92 in 1960 to $3267 in 2008, so that it multiplied by 36. Some part of this increase was obviously attributable to inflation and exchange rate changes. Even in constant 2000 dollars, however, GDP per capita multiplied by 18. Much of this was the outcome of rapid growth and the power of compound growth rates. If GDP grows at 10 percent per annum it doubles every 10 years. If GDP per capita grows at 8.8 percent per annum it doubles every 8 years. This acceleration in the latter was reinforced by lower population growth rates.

Social indicators of development also registered impressive progress. Life expectancy at birth is 73 years. Literacy rates are about 95 percent. Infant mortality rates are down to 18 per 1000 live births. Enrolment and completion rates in primary school are close to 100 percent. Gender equality in school education is almost there. However, progress is much less in indicators such as the under-five mortality rate, the proportion of underweight children, births attended by skilled health personnel and access to sanitation facilities. Of course, social indicators are statistical averages, just as per capita income is an arithmetic mean. And neither captures the well-being of the poor.

It would seem that poverty reduction in China has also been significant. The proportion of the population below the poverty line of $1.25 per day dropped sharply from 84 per cent in 1981 to 16 per cent in 2005. But the number of people below this poverty line, which is a critical minimum, was 208 million in 2005. However, the proportion of the population below the poverty line of $2 per day was much higher, even if it dropped from 98 per cent in 1981 to 36 per cent in 2005. And the number of people below this higher poverty line was 469 million in 2005. It is also worth noting that, in 2005, 15 per cent of the world population below the poverty line of $1.25 per day and 18 per cent of the world population below the poverty line of $2 per day lived in China. This is seldom recognised.

The persistence of poverty in China despite such rapid economic growth is the paradox. The explanation lies in rapidly rising inequality. Theory and history both suggest that income distributions change slowly over time. But income distribution in China has worsened at an unprecedented pace when compared with experience elsewhere or earlier.

The first manifestation is the distribution of income between people. Economists measure such inequality with the Gini coefficient which has a value of *one* when all the income in an economy accrues to one person and *zero* when every person in an economy has the same, equal, income. In China, this Gini coefficient rose from 0.29 in 1980 to 0.36 in 1990, 0.39 in 2000 and 0.47 in 2004, from among the lowest to among the highest in countries of the world in just 25 years.

The second manifestation is the distribution of income between wages and profits. Between the late 1990s and the late 2000s, in a short span of a decade, the share of wages in GDP fell from around 53 percent in the late 1990s to 40 percent in the late 2000s, while the share of profits in GDP rose from about 19 per cent to almost 32 per cent. This was an outcome of a strong bias in policies. Interest rates on household bank deposits are very low so that corporations can get cheap credit. Inputs such as energy, natural resources and land are also cheap for corporations, while taxes are low and state-owned firms do not pay much in the form of dividends to the government. Thus, corporate profits are high and household incomes are low. It explains why, in China, private consumption as a proportion of GDP dropped from around 48 per cent in the late 1990s to about 36 per cent in the late 2000s. This proportion is 70 percent in the United States and 64 percent in India.

The moral of the story is simple. China should endeavour to increase the share of wages in GDP and the share of households in national income. It would be good for its people. It would also be good for the world economy which needs China to shift from export-led growth to consumption-led growth.

*The writer is Professor of Economics, Jawaharlal Nehru University, New Delhi.*