

# CAPTURING THE GAINS



*economic and social upgrading  
in global production networks*

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Capturing the Gains 2012  
ISBN: 978-1-907247-91-0

Global inequality, rising  
powers and labour standards

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February 2012

Working Paper 2012/09

## **Abstract**

The paper analyses growing inequality in the rising powers, concentrating on the situation in China and India. It describes the various processes that are currently underway to reduce inequality in these economies. These processes include a combination of tightening the labour market, as best seen in China, increasing rural productivity and government measures to boost basic rural incomes in all such countries. Reductions in inequality in the emerging economies have a global macroeconomic effect of increasing consumption and investment, counteracting the current global slowdown. They also have the benefit of creating more space at the bottom for poorer economies to take up more of the world's low-skill production, as the emerging economies themselves move up to higher-skill production and exporting. This sequential upgrading is being driven by the growth of emerging economy markets and by wage increases in the emerging economies.

## **Keywords:**

Global inequality, instability of accumulation, rising powers, labour standards, social minimum, sequential upgrading.

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## **Acknowledgements:**

Parts of the analyses in this paper were first outlined in Nathan (2010) and Mazumdar and Sarkar (2008). Our thanks to the various participants in seminars at the University of Manchester, Beijing Normal University and the Institute for Human Development, New Delhi, who commented on portions of this paper. Particular thanks to Will Milberg, Khalid Nadvi and Shane Godfrey for detailed comments and suggestions to improve the paper.

## **1. Introduction**

In the discussion of labour standards it is necessary to make a distinction between two sub-groups of rising powers (Desai, 2010), known collectively as the BICS countries – the high labour–land ratio countries of the Northern Hemisphere (China and India), and the low labour–land ratio countries of the Southern Hemisphere (Brazil and South Africa). These two sub-groups are also differentiated on a per capita income basis. The two Southern Hemisphere countries are both middle-income countries, while the Northern Hemisphere ones are lower middle-income (China) and low-income (India), respectively. From the point of view of raising global labour standards, the latter two, which are labour-abundant economies, are critical. When their labour forces joined the global market, there was a virtual doubling of the global labour force (Freeman, 2005) and global labour standards are crucially affected by standards in this half of the global labour force. Of course, the labour forces of other, albeit smaller, countries in Africa, some parts of Asia and Central America must still be taken into account. However, it is argued in this paper that raising labour standards in the two rising powers of China and India is crucial to raising labour standards in those smaller countries that are also part of the global system. In brief, the upgrading of labour, and consequently production too, in China and India is important for the taking over of the bulk of the world's low value, labour-intensive manufacturing tasks by the currently poorer and poorest countries.

At the same time, better labour standards are important, not only for the wellbeing of workers, but also for macroeconomic stability. This is a generally neglected dimension in the discussion of the ongoing global crisis. In a straightforward Keynesian analysis of global macroeconomics, a low share of wages needs to be compensated by a correspondingly high level of investment. A key feature of the imbalance in the current global crisis is the rise in profits as a share of total global income. Correcting this imbalance, through an increase in wages' share of income, will be an important part of making global growth more stable.

After this introduction, we discuss some approaches to global inequality, in order to identify the type of inequality that has macroeconomic implications. This is followed by a discussion of two main components of this inequality – those related to wages and profits, and those related to the rural–urban scenario. After that, we review the analysis of the processes of historical transitions in inequality and the necessary features of such transitions. The review combines the analyses of Arthur Lewis and Simon Kuznets to identify the features of the transitions occurring in China and India and the actions being taken to promote a reduction in inequality. In this section, we also bring in the experiences of the other two BICS countries, Brazil and South Africa. Brazil, under its former President Lula, had some success in reducing its very high levels of inequality. In concluding the paper, we look at the following question: how would a reduction in inequality in China and India (and the other emerging powers) impact poorer countries in the world today?

### **Global inequality and macroeconomics**

There is no single universally accepted measure of global inequality. Rather, there are three such measures. It is thus necessary to clarify which one is relevant for the macroeconomic considerations to be discussed here.

Concept 1 is a simple calculation of inequality based on countries' unweighted income levels.<sup>1</sup> Concept 2 is a population-weighted comparison of countries' income levels. In a Concept 1 calculation (or UN General Assembly calculation, as Milanovic, 2005, refers to it), Sierra Leone's income level would count for the same value as China's, while in a Concept 2 calculation, based on the countries' relative populations, China's income level would count for more than two hundred times that of Sierra Leone. Under the Concept 2 calculation, the rise of the Asian countries, particularly the growth of the large economies of, first, China and then India, has had an impact on reducing global inequality. In this sense, after a long historical period dating back to the Industrial Revolution, during which global inequality has increased as Euro-America has pulled away from Asia, a reduction in inter-country global inequality is now occurring. This reduction may be said to be due to the spread of technology, knowledge and managerial and labour capabilities in manufacturing and modern services – what was formerly the monopoly of Euro-America has now spread substantially around the world.

However, along with the reduction in inter-country global inequality, there has been a rise in intra-country inequality. Most importantly for the global picture, this rise in inequality has occurred in key emerging powers, such as China, India, Brazil and South Africa. Taking the four BICS countries together, their levels of inequality are somewhat higher than in the OECD countries. Among them, however, Brazil and South Africa both have very high levels of inequality, the highest among the world's major economies. Of further importance is the fact that inequality in these countries, except for Brazil, has increased in the 2000s as compared to the 1990s. The Gini coefficient increased by 24 percent in China, by 16 percent in India and by 4.5 percent in South Africa. In Brazil it decreased by nine percent in the 2000s compared to the 1990s; even at the end of the decade, in 2009, it was still at a high level of 0.538, but that figure represented a fall compared to the value of 0.597 in 1995 (Barbosa and Moretto, 2011: 19). This, of course, is part of the new geography of global income inequality (Firebaugh, 2003) as within-country inequality is gradually gaining in importance relative to between-country inequality.

This brings us to Concept 3 inequality, which deals with each person (or household) as a single unit on an equal basis, and measures the resultant inequality in incomes.<sup>2</sup> Concept 3 inequality is a combination of two factors, inter-country and intra-country inequality. Calculations by Milanovic (2005) and the World Bank (2005) show that inter-country inequality still contributes more than two-thirds of global inequality. However, within-country inequality is rising and becoming more important as a component of global inequality (World Bank, 2005).

To analyse the macroeconomic implications of inequality, what we need is to look at factors that influence global savings, investment and consumption, as key macroeconomic variables. Thus, it is Concept 3 inequality – global inter-household inequality – that is useful for this purpose. Income can be taken to be composed of two portions: firstly, wages and, secondly, profits and other property incomes, including rents. Growing income inequality of the within-country type can be taken as an indicator of an increase in the share of total income that can be attributed to profit, or to non-labour income generally.

In the standard classical or Keynesian analysis, all wages are consumed and profits are saved. An increase in the profit share means that the resultant savings have to be covered by investment, otherwise there would be a shortfall of aggregate demand and a resulting downturn. In the

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<sup>1</sup> This section is based on the analysis of Milanovic (2005).

<sup>2</sup> Most developing countries, such as India, calculate not income but consumption per household. Consumption, then, is taken as a proxy for income. OECD countries mostly collect income figures.

contemporary world, however, households contribute substantially to total savings. In India, for instance, the rise in household savings from 6.6 percent of GDP in the 1950s to 23.8 percent of GDP in the period between 2003–04 and 2006–07 has contributed substantially to the rise in investment, and the rate of growth in the country (Mohan, 2008). Household savings are even higher in China, but in China retained profits too make up a substantial part of savings. Without sticking to the assumption that workers consume all they earn, it is still correct to state that savings out of wages will be much less than savings out of profits. In that case, an increase in profit share, signalled by an increase in inequality, will require a corresponding increase in investment for there not to be a downturn.

For individual economies, an excess of savings over investment can always be transferred to another country, by buying government bonds and/or making other investments in that country. The most famous case of this behaviour has been the transfer of excess Chinese savings to the USA, which has had negative net savings. Such shifts lead to accumulations of claims by one country on another. For any individual country, it is possible for there to be such an excess of savings over investment without a deflationary effect. However, for the world as a whole, such an excess will lead to deflation. A shortfall of global investment over global savings will result in global effective demand being less than production, with all its consequences for global employment and 'decent' work.

A high level of inequality leads to a high savings rate and thus requires a high level of investment; this is an unstable situation. Investment is already inherently unstable, depending not only on the current economic situation, but also on expectations about the future. However, with global savings having been pushed up by the declining share of wages, an unstably high level of global investment is called for. Of course, high savings and high investment are conducive to high rates of growth, of the type the world has seen for more than two decades. However, the high level of investment required by the high level of inequality makes for an unstable economic situation. The higher the amount of investment needed to maintain employment, the more unstable is the economic situation. A transition to a lower level of global inequality, on the other hand, would increase the component of consumer demand in total aggregate demand and, thus, reduce reliance on a high level of investment, which may be difficult to sustain.

The former chairman of the US Federal Reserve, Alan Greenspan, referred to 'irrational exuberance' (something that Keynes referred to as 'animal spirits'), to account for over-investment during the dot.com bubble. However, such animal spirits, or to put it in a less metaphorical manner, capitalists' expectations of the future market, are a key factor in investment. With a higher share of profits, there is more to invest. It is fine so long as investors' expectations of market growth continue to keep them investing enough to cover savings. However, the greater the extent of inequality, the more the investment required, and the greater effect even small shortfalls in investment could have on employment.

Growing income inequality thus means that the share of consumer demand will fall and the share of investment in aggregate demand needs to correspondingly increase. This is the macroeconomic relation that makes the current course of accumulation unstable. The importance of paying attention to inequality may be shown by one more point. Excess Chinese savings (savings glut) that found their way into the US market (money glut) and kept interest rates low are blamed for encouraging US financial institutions to aggressively extend housing loans in the risky, sub-prime loan market. However, had inequality not increased in the US, there could have been an expansion of US housing loans with a smaller degree of risk. The US Congressional Budget Office (CBO),

which releases authoritative data on the distribution of households' pre- and post-tax income, has revealed that 'the increase in income inequality (both pre- and post-tax) as measured by the change in the shares of income going to different income classes, was greater from 2003 to 2005 than over any other two-year period covered by CBO data' (Bernstein, 2007). A high rate of inequality and long-term stagnation of real wages (Milberg and Schmitz, 2010) contributed to the weakening of the US mortgage market, which was a key factor in the ensuing global crisis.

In the ongoing global crisis there is a lot of necessary attention being paid to creating a new financial architecture. However, it is our contention that changing the regime of global accumulation is not only a matter of a new architecture. There is also the matter of inequality, in the form of a rising profit share and a declining wage share, in the global economy and the manner in which it impacts on the stability of accumulation and growth. This rising share of profits is directly related to the structure of global production, with the spread of global off-shoring in global production networks (GPNs). The factors in this rise of inequality will be discussed in more detail below, but we present the main arguments here.

What is usually referred to as a savings or money glut, is described by Milberg and Schmitz (2010) as a 'profits glut'. Taking the US and China as reflecting the developed and emerging economies, off-shoring by firms in the US has resulted in a reduced demand for labour in the US with the shift to low-cost labour in China. As a result there was a reduction in costs. In the condition of monopolistic profits, this reduction in costs is unlikely to be passed on to consumers in the form of lower prices; rather, profits rise. In the US there is a fall in the wage share and a rise in the profit share, or profit glut. But this increased profit in the US does not get invested. Investment in plant and equipment is not required, as that is undertaken by supplier firms in China. The increased profit is used to increase shareholder value (Milberg and Winkler, 2009), or held as financial assets. At the other end, in China too there is a profit glut, as wages were held down while productivity went up. This increased profits of Chinese firms, which, together with high household savings, showed up as a savings glut. The profits glut in the US and the investment of excess Chinese savings in US Treasury bonds, together result in a money glut. Thus, behind both the observed money glut in the US and the savings glut, there lies an increase in the share of profits in both ends of the global production network, in both the US and China.

As Milberg and Schmitz (2010) emphasise, their profits glut hypothesis offers a firm behavioural explanation for global imbalances. Their analysis was restricted to explaining a profit glut in the US. We have extended it to the global level by bringing the China situation into the picture. The profit glut on both sides of the globe reinforces the point that a correction of global macro-economic imbalances needs a change in the profit-wage share on both sides of the globalising world.

## **Wages and inequality**

What are the factors that lead to a rise in income inequality? When the growth in wages is less than overall economic growth, the wage share declines. Nevertheless, in the case of rapid economic growth, a falling wage share may go along with a substantial rise in wages. The global wage report for 2008–09 (ILO, 2008) compared two periods, 1995–2000 and 2001–07, for 38 major countries and found that the wage share fell in the latter period in 28 of them. It also found that the overall decline in wage share showed a significant secular trend, except in the case of the Czech Republic, Iceland, Romania and Sweden. Long-term studies on European countries show

that the wage share peaked around the mid-1970s, but has declined at an accelerated rate since then.

It has been argued that globalisation plays an important role in the declining wage share. In the past decade, countries whose trade as a percentage of GDP was growing were also those with a faster decline in wage share. One possible explanation is that intensification of competition – particularly the presence of large, low-wage exporters in the market for labour-intensive products – has been an important factor in reducing the wage share. Another reason may be that, as economic growth has shifted from developed to developing countries, the higher proportion of self-employed individuals in the latter has in effect reduced the global wage share. Further, in a global production network (GPN) structure, when labour-intensive low-wage production activities shift to less developed countries (LDCs), it reduces the wage share within labour-intensive products, since the wage share in developing countries tends to be substantially lower than that in developed countries.

Along with an increase in the profit–wage inequality, wage data, as calculated from United Nations Industrial Development Organisation (UNIDO) manufacturing wage figures (Galbraith, 2007) also show an increase in the wage inequality (the ratio of the wages of skilled or high-skilled labour to unskilled or low-skilled labour). The increase in wage inequality holds for both developed and developing countries; or, to use terms that more accurately represent the nature of the difference, industrialised and industrialising countries. As pointed out by Galbraith, there has been a clear increase in inequality since the late 1980s.

It is not just that China and India are industrialising and that profit shares are rising, but also that during this process the rural–urban divide in these economies has been increasing and this affects the global distribution of income. Milanovic points out:

... we seem to be in the presence of an interesting situation where world inequality is driven by what happens to the relative incomes of the three large areas: (1) the rich countries of the West, (2) urban incomes in China and India, and (3) rural incomes in these countries. The ratio between 2 and 3 has been rising... (2005: 115).

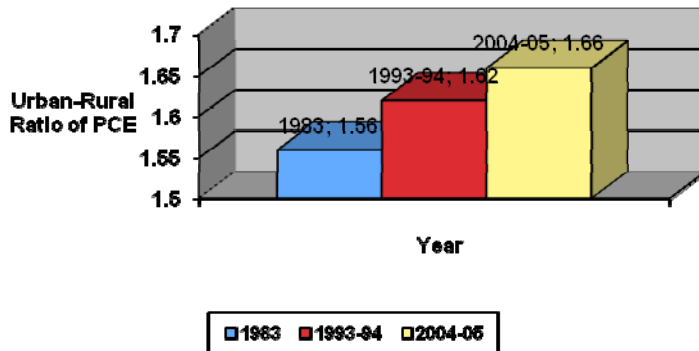
This trend of growing urban–rural inequality in China and India is also representative of what is happening in other countries, such as Thailand, Indonesia, and Bangladesh. The crucial ‘swing’ factor in global inequality is the ratio of Milanovic’s item 2 to item 3. *Ceteris paribus*, if that increases, world inequality goes up; if it decreases, world inequality goes down.

### **Rural–urban inequality in India and China**

In this section we look at the rural–urban inequality in these two countries. This, again, is a somewhat neglected dimension in the discussion of inequality.

To summarise the picture of urban–rural inequality in India, the ratio of urban to rural average incomes increased from 1.56 in 1983 to 1.66 in 2004–05 (see Figure 1 below). Further, as Sarkar and Mehta (2010) show, most of the increase in rural–urban inequality is due to the rapid growth of the top deciles of the urban consumption classes.

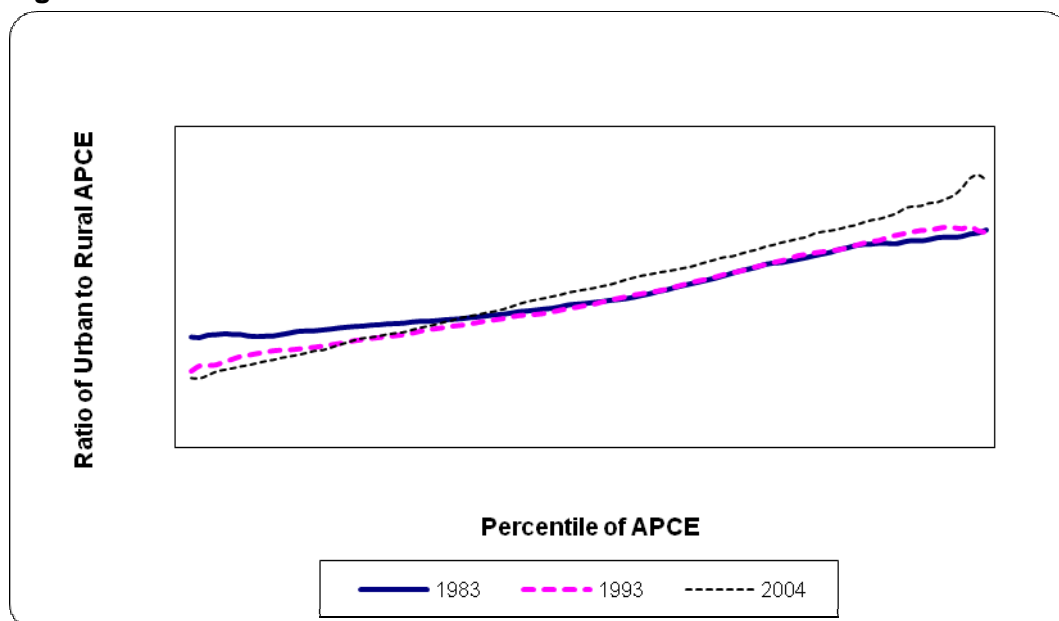
**Figure 1. Ratio of urban to rural mean per capita consumption expenditure (PCE)**



Source: Sarkar and Mehta (2009). Note: India collects data on household consumption as a proxy for income.

India’s rapid economic growth has not translated, even somewhat, into equal benefits for all sections of the population, so that there is a growing rural–urban inequality. It is not as though the rural population has not benefited. In fact, even the rural poor have benefited. As the Government of India’s Economic Survey for 2010 points out, the bottom rural quintile has benefited to some extent, with the per capita average consumption expenditure of the bottom rural quintile increasing in real terms from Rs. 68.89 in 1977–78 to Rs. 84.55 in 1999–2000 and Rs. 90.35 in 2004–05 (Government of India, 2010: 23, Box 2.1). This, however, is less than the one-fifth of the aggregate increase in income that would be the quintile’s equality-neutral growth share (ibid). As in the figure below, the top sections of urban India are clearly pulling away from the rest, while the ratio of rural to urban average per capita consumption is falling in the bottom quintiles.

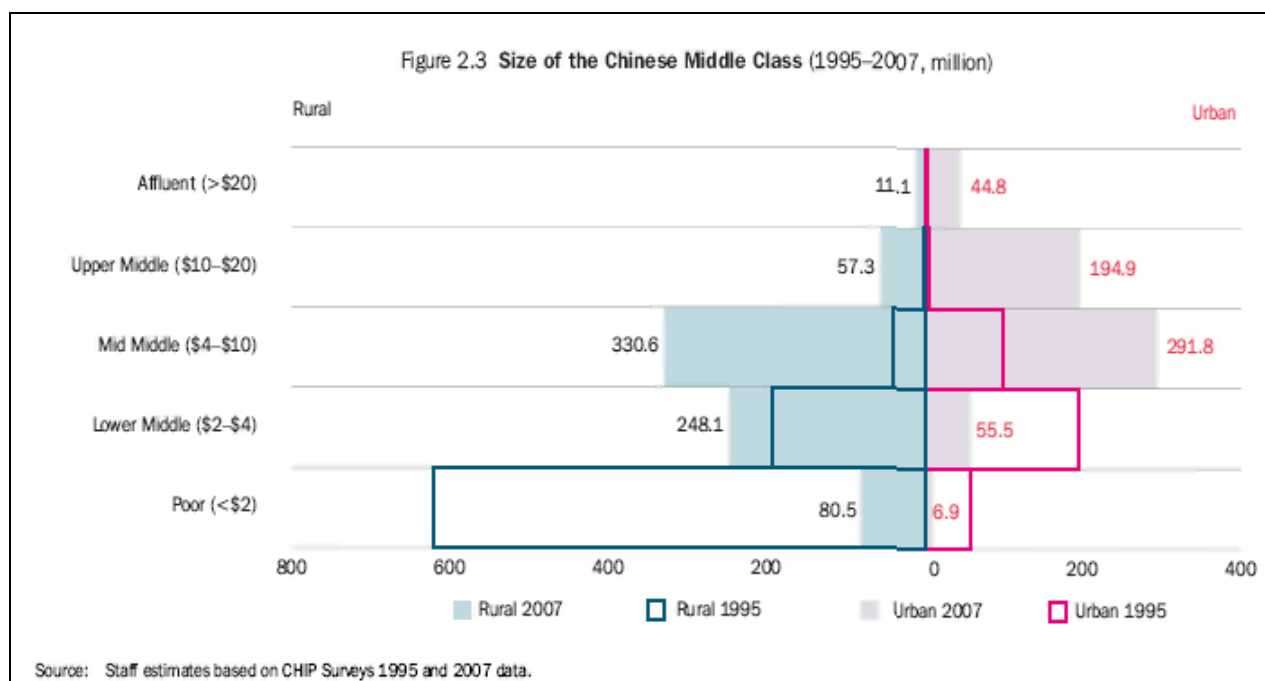
**Figure 2. Urban to rural ratio of APCE**



Source: Sarkar and Mehta (2010: 45-55).



**Figure 3. Size of the Chinese middle class (1995–2007)**



Source: ADB (2010).

For China, we take figures from the Asian Development Bank (ADB, 2010). The figure above shows the number of persons belonging to different income groups in the rural and urban areas of China in two years: 1995 and 2007. A greater proportion of people in the upper middle and affluent sections pulls up the average income substantially. The total numbers in these higher income brackets are much larger in urban areas than in rural areas and have risen at a much faster rate. The consequence has been twofold: (1) an increasing gap between the average incomes of rural and urban areas; and (2) an increase in the within-country inequality as a whole.

In China during the first phase of its reforms, which concentrated on the transfer of agricultural land from collective to household ownership, the urban to rural per capita income ratio fell from 2.5 in 1978 to 1.8 by 1984. However, in the subsequent industrialisation phases, the urban to rural ratio rose to 2.8 in 1994 and then 3.3 by 2007 (Yao, 2011: 117). The absolute rural to urban income gap increased from 200 yuan per capita in 1978, to over 7,000 yuan per capita in 2007.

Overall, the top deciles of urban India and urban China are pulling closer to the average income levels in developed countries, while the inequality between them and their respective rural counterparts is now the crucial factor in world inequality (Milanovic, 2005). With the increasing feminisation of agricultural work in India, and in China too, the contemporary rural–urban inequality in these countries is also a matter of gender inequality.

The growing rural–urban inequality in both of these major Asian countries, as well as in others such as Thailand, has led to various forms of unrest. In China, this has taken the form of tens of thousands of incidents of rural protest, including attacks on state and Communist Party officials. India has seen the spread of armed agrarian movements (the so-called ‘Maoist’ movements) in

areas largely populated by the *Adivasis* (or, 'indigenous peoples'), who not only have not benefited from India's rapid growth, but have suffered a loss of their livelihoods through the enclosure of their lands and forests for the country's mineral-based industrialisation. In the vast semi-arid regions of the Deccan Plateau, agrarian distress has manifested itself in the large number of suicides of farmers, which has directly led to farmers receiving loan waivers.

## **Inequality trajectories**

Factor incomes can broadly be divided into two parts: income from profit or rent (property income) and wage income. The analysis of growing inequality boils down to two aspects: (1) the growing share of profit/property income and the corresponding decline in the share of wage income; and (2) increasing wage inequality stemming from differences in the earnings of skilled and unskilled workers. Inequality analyses fall broadly into two groups. One looks at the current labour market scenario and the demand and supply of different types of labour of varying skills. The other is carried out over a given time period, examining inequality over a broad historical transition. These two types of analysis are not mutually exclusive, even though the first gives a detailed, microscopic view, while the second presents a telescopic view in the historical context of change.

There are arguments that view present-day globalisation as increasing the demand for skilled labour. Acemoglu (2002) ascribes higher returns to skilled labour in the North to skill-biased technological change. Feenstra and Gordon (1999) emphasise the role of outsourcing in increasing the demand for skilled labour in the South, relative to unskilled labour, thus resulting in a rise in wage inequality. Even low-skill, labour-intensive production tasks that are outsourced to developing countries are skills-intensive from the point of view of the composition of labour in developing countries (Goldberg and Pavcnik, 2007).

These analyses are made in relation to growing wage inequality, but they do not explain the growing share of profits or what amounts to the same thing: the declining share of wages in global production. For that, there would need to be productivity increases that are not matched by wage increases, leading to a higher share of profits. Further, as discussed in Nathan and Sarkar (2011), the spread of internationally splintered production, or GPNs, leads to a concentration of surplus profit or rent in developed countries' lead firms. This, in turn, means that only a small set of workers in the lead firms get a share of these rents, while further down the production networks, market-based wages prevail. For instance, the rents or excess profits that Apple attains are possibly shared only with the small number of direct Apple employees, who number 43,000, against whom Apple earns net revenues of \$400,000 per employee. The vast network of 700,000 workers in China and elsewhere who produce Apple products do not receive any share of Apple's rents.<sup>3</sup>

An additional dimension is the growing inequality within rich countries. The globalisation of production in many industrialised countries has dampened wages and employment among low-skilled workers, and more recently among workers at all skill levels (Milberg and Winkler, 2009). The wage share has also declined as increases in productivity, real or financial, have largely been captured by shareholders rather than workers.

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<sup>3</sup> All Apple figures from Duhigg and Bradsher (2012).

The second strand of analysis starts out by asking if there is a historical specificity to this structure of inequality. Or, is it a structure that is set for all of capitalism's history? Simon Kuznets (1955) first drew attention to the relation between income level and income inequality: as income rose from a low level there was an increase in inequality, which stabilised at a medium level of income and then fell as income increased further. This inverted-U was an empirical observation. Having observed it, Kuznets then went on to hypothesise a reason for it, finding one in the inter-sectoral transition that characterised the process of industrialisation.

The phase of growing inequality is that of the industrial transformation of an agrarian society. There is a growing inequality between town and country. Within industry, there is growing employment, but at the same time there is an increase in both income inequality and wage inequality. On the one hand, capital accumulation is reflected in a higher share of profits. On the other hand, the bottom wage in industry, though it may be higher than what could have been earned in the agrarian economy, is held down by the Lewisian shift of workers from agriculture to industry and from rural to urban areas. At the same time, as the demand for high-skilled labour grows and outstrips its supply, there is also an increase in the skill premium in wages. Thus, along with an increase in income inequality, there is also an increase in inequality in wages within industry.

What brings about the transition from higher to lower inequality? There is a political economy process leading to a fall in inequality: the spread of education, democratisation, the growth of trade unions as a countervailing power to capital, and the intervention of the state:

... countervailing power, modern industrial relations, democratization and the rise of the welfare would assure, past a certain point, declining inequality in the overall structures of pay. From this, Kuznets inferred that the relationship between income and inequality would follow an inverted "U" shape: first rising, and then falling, as the ordinary process of industrialization unfolded (Galbraith, 2007).

Furthermore, this transition that Kuznets analysed in individual countries is now taking place on a global scale.

There has been much debate on whether the Kuznets hypothesis (that inequality first increases and then falls as incomes rise) is valid or not (e.g. Deininger and Squire, 1998 and the references therein). Further, there is the obvious point that in the present era, say from the post-OPEC oil price rise in the mid-70s onwards, there has been an increase in inequality in the developed countries too. But the important point of Kuznets analysis is that he brought in structural (the transition from an agrarian to an industrial economy) and institutional (the growth of trade unions, democratisation and the rise of the welfare state) factors in explaining changes in inequality. It is the analysis of transitions in the labour market that we carry forward in the next section.

## **Inequality transitions and the labour market**

The question is: how do the factors of transitions in inequality impact on the labour market? This needs to be looked at in both global and national contexts and in terms of the interaction between the two.

The inter-sectoral transition observed by Kuznets was also analysed by Arthur Lewis (1956) and the two analyses together remain crucial to an understanding of inequality transitions. Lewis saw a

shift of surplus labour from agriculture, at a near constant wage rate, as the source of labour supply for industrialisation. However, there would be a point at which there would cease to be surplus labour to shift from agriculture. With this Lewisian turning point (Fang, 2008), the period of surplus labour in the economy would end.

At this point, there is likely to be an increase in wages. While earlier rises in wages may have been confined to highly-skilled workers, with the labour shortage, a rise in wages could extend down the line and lead to an increase in the wages of low-skilled workers. As a result, there will be a decrease in inequality – provided policies are geared to maintaining full employment. The Lewisian turning point is then related to the Kuznets shift from increasing to decreasing inequality (Fang 2008).

At one level, it would seem that it is possible to secure an increase in wages at the bottom only after the Lewisian turning point has been reached. However, noting the rural connection to the base urban wage, it is likely that measures that lead to an increase in rural wages and incomes will have an effect on urban wages.

Increasing the base rural income, or social minimum, will also have an effect on inequality. An implication of this will be to push an economy from a 'low road' to a 'high road' in the industrialisation process, in which increases in agricultural productivity can play a key role. Alternatively, a high level of migration, with relatively high incomes at the destination relative to the rest of the economy, could leave the possibility of a 'high road' only.<sup>4</sup> Also, as Freeman (2005) points out, an increase in wages in the emerging powers would have an effect on moving the world transition itself from a low to a high road.

Even approaching or going beyond the Lewisian turning point does not bring automatic changes in the distribution of income. The distribution of income is subject to the institutional framework of the economy. An increase in labour productivity is a necessary but not a sufficient condition for a rise in wages. The institutional factor of trade unions or government policies favouring a rise in wages needs to be brought into the picture.

In the two rising powers, India and China, at the macroeconomic level, an increase in wages and thus of consumption is not required for the same reason. In India, investment is still greater than domestic savings, with the shortfall being made up largely by remittances. Thus, India is not contributing to global excess savings, rather it is absorbing some non-domestic savings through remittances.

On the other hand, for China, the increase in wages as a share of income is particularly important from the point of view of its role in the world economy. With China's savings in excess of 50 percent of GDP, and investment around 35 percent, there is a massive gap of approximately 15 percent of China's GDP that has to find an outlet in buying other countries' bonds and other forms of external investment. These are the excess savings that end up sustaining 'excess' American consumption. Reducing excess savings requires an increase in consumption, both by increasing the wage share (of income) and by reducing the rural-to-urban inequality.

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<sup>4</sup> This might tell us something about why Kerala, a province of India, did not take the 'low road' but is now taking the 'high road' to industrialisation.

## Measures and processes to raise the floor and reduce inequality

All four BICS emerging economies have undertaken measures to raise the floor of income, though only Brazil has been successful in reducing inequality. Rather than just measures, which would suggest government or public interventions to raise the floor, we should also refer to processes that have raised this floor. Such processes, in the sense of that which occurs independently of direct government measures, have been important in both China and India. However, the manner in which government interventions have become necessary is also intertwined with the nature of the growth process.

In South Africa, growth in the post-apartheid period was skills-intensive (Bhorat et al., 2011). There was a rise in demand for skilled and semi-skilled (relative to unskilled) workers, which, in turn, led to an increasing level of inequality in South Africa. Its government responded by increasing the level and reach of various social protection schemes, increasing grant income as a proportion of total household income. From contributing 35 percent of household income in the bottom decile in 1995, the share of grant income went up to between 50 and 60 percent by 2005 (Bhorat et al., 2011: 25). Even for households in the fifth income decile, grant income made up 40 percent of the total income. Government income transfers increased the social floor of incomes, but did not reduce inequality, which continued to increase over the post-apartheid period.

The Brazil experience was a combination of a growth process and government measures (Barbosa and Moretto, 2011). The growth process increased the number of formal sector jobs. Along with that, the government increased the minimum wage, by two-thirds over the decade of the 2000s, and the coverage and scale of income transfers to the poor through the *Bolsa Familia* programme. The increase in both formal sector jobs, which are 'decent' jobs, and the minimum wage increased wages as a share of national income by 1.2 percent per year in the second half of the 2000s (Barbosa and Moretto, 2011). At the same time, for the poorest (family incomes up to just a quarter of the minimum wage), the income from government schemes amounted to 28 percent of family incomes – much less than South Africa's 60 percent, but still quite substantial.

China is a clear example of a country experiencing a shift in the overall labour supply and demand situation. As argued in detail in Yang (2011) and Fang and Wang (2010), China's strategy of concentrating on labour-intensive industrialisation has led, over the last decade, to a shortage of labour, including unskilled labour. Having passed the Lewis turning point, wages, even for migrant workers, have begun to rise. As the authors point out, in 2010 the average earnings of migrant workers went up by more than 19 percent over the previous year's figures. The earnings of migrant workers are important, both in reducing wage inequality and in moderating or reducing the rural–urban inequality. Given that Chinese urban residential restrictions – the so-called *hukou* registration system for urban residents – make most rural–urban migration either temporary or circular, part of the incomes of migrant workers must be remitted to rural locations and, thus, any increase will reduce the rural–urban income gap.

At the same time, when the 2008 world economic recession hit, it was still necessary to take measures to increase rural demand. There was a retrenchment of many migrant workers involved in export production. This would have meant a reduction in rural incomes, through a fall in remittances. The Chinese government stepped in to stimulate rural demand, abolishing most rural taxes and providing direct support for increased consumer spending. Whether the rural–urban inequality has fallen as a result is not clear.

The Chinese government also undertook two sets of measures, one involving income transfers for those still unable to earn the poverty-line income and the other involving setting up the institutional structure of a developed labour market. Of particular importance has been the Contract Labour Law, which states that everyone other than temporary workers must be covered by a contract. In a sense, this is a step towards setting up the institutional structures that Kuznets pointed out as being necessary for a transition to a lower-inequality regime.

The Indian example is an interesting one. There has clearly not been a Lewis turning point so far, as there is surplus labour in both the formal and informal labour segments. 'Interestingly, notwithstanding the strong trend toward informality and the absence of any kind of tightness in labour markets, real wages increased for all types of employees' (Ghose, 2011: 7). The average real wage has increased, not only for regular labour but also for casual labour, by 2.5 percent per annum during the period from 1993–94 to 2004–05, with an even higher rate of increase in the last five years.

If there was no tightness in the labour markets for either regular or casual labour, why did real wages increase? In the important case of casual labour, as pointed out elsewhere in this paper and also in Ghose (2011), the important outside factor that determines the reservation wage is the incomes of the self-employed in the unorganised sector. If the productivity of the self-employed in the unorganised sector were to go up, then that would push up the wages of casual labour. Ghose (2011) points out that there are two pieces of evidence to support the thesis that the productivity or labour incomes of the self-employed have increased: the mixed income (from a combination of self-employment and wage labour) went up by 1.64 percent per annum from 1983 to 1993–94 and by 2.4 per cent from 1993–94 to 2004–05 (Ghose, 2011: 8). A further piece of supporting evidence is that poverty incidence among the self-employed went down between these periods.

Thus, even without a transfer of workers into the organised sector, as has happened in China, in India there has been a growth of productivity in the unorganised sector that has pushed up the wages of casual labour. However, the growth of productivity in the unorganised sector, which includes almost the entire rural economy of India, has not been enough to reduce the rural–urban inequality, which increased over each of the above periods (1983 to 1993–94 and 1993–94 to 2004–05; see Sarkar and Mehta, 2009).

For the large numbers of the rural population still below the poverty line, the Indian government initiated the rural employment guarantee, now called MGNREGS. This provides a maximum of 100 days of employment as manual workers, per poor rural household. This too seems to have raised the rural social minimum of earnings, although the contribution of such government transfers seems to be less than in South Africa or even Brazil. It made up less than 25 percent of the total household consumption of the rural poor in 2009-10.

What we see from the above accounts is that, in all BICS countries, the social minimum, particularly in the rural economy, has been raised by a combination of the effects of the growth process, and government measures. The former is an endogenous factor, related to the nature of the growth process, while the latter is exogenous, being related to government policy.

The balance between the two varies from country to country. In South Africa, the minimum has been raised almost entirely through income transfers and has had nothing do with the growth process, which was skills-biased. In Brazil, there has been an increase in formal sector jobs, but that will have benefited the middle class, even while helping to reduce inequality. The social

minimum, however, has been raised through exogenous policy steps – increasing the minimum wage and the scope and coverage of income transfers. In China, the change has mainly been due to endogenous growth-related processes that have led to a tightening of the labour market and an increase in real wages, even for unskilled labour. This has been supplemented by government support for base rural incomes. In India too, the growth-based endogenous factor has mainly been responsible. In India's case, unlike China's, this has occurred not through a tightening of the labour market, but through an increase in the productivity of the self-employed (Ghose, 2011).

An important difference needs to be pointed out between China and the other three countries. In the case of China, the increase in the social minimum has largely been the result of a tightening of the labour market, since the economy passed the Lewis turning point. In a sense, the increase in the social minimum has come about since full employment, without underemployment, was reached.

In the other three cases, however, the raising of the social minimum has occurred even in situations of substantial unemployment and underemployment. Will the raising of the price of labour, then, have any effect on the growth path and value chain development? In the case of South Africa, it has been pointed out (Bhorat et al., 2011) that there is a skills bias in the growth path. In the case of India, there have been numerous discussions on its relative failure in labour-intensive, or low-skilled labour-intensive, manufacturing and the raising of the real wage rate should further intensify the existing skills-bias in that sector. Brazil too has a skills-bias, with an absence of low-skilled manufacturing.

In each of these three countries, along with the skills bias in the growth process there is a simultaneous existence of a large reserve of underemployed low-skilled or unskilled labour. The strengthening of the skills biases in these countries will not enable these economies to increase the employment of low-skilled labour in manufacturing. As a result, since each of these economies has free-trade (or, almost free-trade) arrangements with some of their neighbours, which are also low-wage countries, one would expect to see a flow of capital into setting up low-skilled manufacturing in the latter.

The above process is clearly happening already in the case of South Africa. South African capital is setting up garment factories (CMT or Cut, Make and Trim) in low-wage Lesotho rather than high-wage South Africa itself (Morris et al., 2011). In the case of India, discussions with Bangladesh garment exporters and researchers have revealed that a large part, possibly more than 50 percent, of Bangladesh garment exports are now being sourced through Indian 'full package suppliers'. With the recent decision to remove all tariff and quota restrictions on Bangladesh exports of garments to India, it is likely that even large Indian retail chains will start to source garments from Bangladesh.

Additionally for exports to the Europe, the EU's acceptance of South Asia as a region for rules of origin, means that Indian supplies of fabric etc. to Bangladesh will not count as an import, while Chinese supplies will. This will privilege Indian over Chinese suppliers. For Indian full-package suppliers to EU markets there is the further advantage that Bangladesh, as a LDC, has the right to GSP<sup>5</sup> -based zero-tariff exports. With India not having zero-tariff export rights, Indian full-package

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<sup>5</sup> GSP, or Generalised System of Preference, is a programme designed to promote economic growth in the developing world by providing preferential duty-free entry.

suppliers will tend to increase the extent to which they source CMT tasks from Bangladesh. Of course, the lower wage rates would be the main factor in any possible development of an Indian-Bangladesh production network, with Bangladesh taking over low-skill CMT tasks.

The effects of higher wages on the nature of exports and investments are clearest in the case of China. Yang (2011) and Fang and Wang (2010) point to the growing skills intensity of Chinese exports. Higher wages are pushing China's exports 'up the value chain'. The sequential upgrading previously observed in the cases of South Korea and Taiwan is now occurring in the case of China. Simultaneously, there is a movement of low-skill tasks to lower-wage areas, either in China itself, to the low-wage areas of the west and south-west of the country, or to other low-wage countries, such as Vietnam, Cambodia or Indonesia. The current Chinese policy encapsulates this as 'go west, go out and go up'.

Earlier in the paper we pointed out that as firms went up the value chain, there was an increase in the skills intensity of labour employed.<sup>6</sup> This is a micro-economic, firm level effect. Most GPN analysis has been concerned with such a firm-level relationship between upgrading and skills-intensity of employment. In the previous paragraph, however, we have shifted the analysis to the macro-economic level. As wages go up, the effect of higher wages is to force firms in that country to upgrade. To put it another way, we can use the term 'social upgrading' to refer to the increase in wages and generally to improvements in the conditions of labour, and 'economic upgrading' to refer to firms' moving up the value chain. Then, in the first case, the firm level analysis is that of economic upgrading being followed, usually with a lag and depending on appropriate institutional conditions, by social upgrading. But when social upgrading, represented simply as an increase in the wage level, takes place in the economy as a whole, then this social upgrading would force an economic upgrading of firms in that economy. This is how one can understand the 'sequential upgrading' that has taken place, with first Japan, then Korea and the other newly industrialised economies (NIEs), and now China too, moving up the value chain and vacating space at the bottom to countries with lower wages. In each case, an increase in wages within the country concerned forced firms to upgrade and also move out. Among the emerging economies, this movement is becoming clear in the case of China and would lead one to expect that a similar building of regional production networks, including both low-wage regions within the emerging economy and low-wage countries in the region, but centred around the other emerging economies, is also likely to occur.

## **Conclusion**

The rise in labour standards in the emerging economies can be linked to three factors. First is the change in the countries' labour markets. Productivity-based growth generates pressure for increased wages. Such an increase, however, is not automatic, but is mediated by necessary institutions, such as trade unions etc. In China, there are already signs of a growth in workers' struggles and unions, and a rise in wages.<sup>7</sup>

Second is the increase in agricultural productivity and/or some other basis for an increase in rural incomes, which increases the opportunity cost of migrant labour and thus creates pressure for a rise in wages at the low end. This is partly happening in India because of an increase in rural

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<sup>6</sup> Thanks to Will Milberg for drawing our attention to the importance of the distinction being made in this paragraph between the micro-economics and macro-economics of firm upgrading and wages.

<sup>7</sup> We do not go into any detail on this matter, but it is clear even from various newspaper reports, that within the last few years there have been substantial increases in wages and consumption in China.



productivity, through a shift from farm to non-farm sectors, and through the rural employment guarantee that has raised the floor of rural incomes. China also took measures to increase rural income and consumption in the wake of the global slowdown that affected its exports.

The third factor is government policy providing income transfers to the poor and raising the minimum wage. In the case of both Brazil and South Africa, government policy measures have been important in raising the floor. A rise in the minimum wage and government programme-based transfers of income in Brazil, and a high level of government programme-based transfers in South Africa, have been the main avenues for raising the floor.

The impact of these measures, however, is not and will not be limited to the four countries themselves. As a consequence of the rise of production costs in China, there has been an expansion of low-end garment manufacturing in Bangladesh, Vietnam and a few other countries. Initially, this started as a 'China plus one' policy brought in by buyers aiming to reduce their dependence on Chinese suppliers after the SARS epidemic of the early years of this century saw the first disruption of supply lines through overdependence on China. Subsequently, however, the rise in wages in China has seen more labour-intensive tasks being shifted to lower-income countries, the benefits of which have been increases in employment and wages.

The concomitant rise in employment in, for instance, Bangladesh, also spurred a series of workers' strikes in that country, resulting in a 75 percent rise in nominal minimum wages for garment workers. Nevertheless, there has not been a slowdown in investment, domestic or foreign, in the Bangladesh garment industry as its minimum wage, at \$45/month, is still the lowest in Asia, and much lower than its nearest competitors, Vietnam and Laos, whose minimum wages are \$84/month (ILO, 2011).

At a global level, however, these rises in labour standards are constrained by a number of factors: the labour surplus situation in the global labour market, particularly at its lower end (or the condition of the Lewis transition at a worldwide level), the necessity of adequate increases in aggregate demand to balance possible supply, and the building of appropriate labour-market and regulatory institutions. However, so long as there are economies with surplus labour, their means of entry into global production will be through wage competition at the low end. An attempt to set a global minimum wage, which would have a major effect on global inequality, will be resisted by those countries whose per capita incomes are currently well below that level. As wages rise in countries such as China and India, however, they will move towards producing more high-value products, leaving low-value products for even poorer countries.

Consequently, a major impact of an increase in wages in China and India and the other emerging powers will be to create space for poorer countries to enter global production at the low end. The process that began with Japan after the Second World War, continued with South Korea, Taiwan and Hong Kong, and then spread through south-east Asia and China, does not end with China and India. There will be a continuation through to poorer countries. Of course, these countries will need to have the necessary institutional conditions and capabilities to carry out these manufacturing functions, but one would expect, after seeing the experiences of small and poor countries such as Cambodia and Bangladesh, that, given the incentive of higher incomes, the necessary institutions and capabilities will be built.

This raises another question, though, the so-called composition problem: are there market avenues for increased production? If all developing countries manufacture low-end products,

where will be the markets for all these products, since their major destination is the stagnant markets of developed countries? Two factors must be addressed in looking at this question. One is that historical experience shows that there has in fact been a type of 'sequential upgrading' (Ozawa, 2009). As labour is absorbed in low-end tasks, wages rise and the country soon loses its advantage in low-end tasks. This first occurred in Japan in the 1950s; in the 1960s, Japan vacated this position and it was filled by Korea and the other NIEs, which, in turn, lost their competitiveness to the ASEAN countries, to be followed by China and, even later, Vietnam, Cambodia, Bangladesh, etc. In this process, those already in the global production systems moved up the value chain, while new entrants, with their advantage of lower wages, took over the lower-end tasks.

The difference in the current scenario is that China and India are large countries with substantial labour reserves in both the rural economy and the urban informal sector (Nayyar, 2009). However, as discussed earlier, there are signs of labour shortages developing in China, though India still has a fair distance to go. A combination of poor infrastructure, labour rigidities and the legacy of a historical policy of preventing large units in key labour-intensive areas, such as garments, leather products and soft toys manufacture, has reduced the labour-absorbing impact of India's rapid growth.

More important, however, is the fact that the emerging economies, as they grow, are not only sources of export products, but are also themselves large consumers. Of course, the extent to which emerging economies become large consumers depends, in turn, on the extent of inequality. The greater the inequality, the less will be the resulting demand for low-end, labour-intensive consumer goods. China, as the second-largest economy in the world, is the world's largest exporter in a large number of products, but it is not, correspondingly, the largest importer of consumer products. China is a major importer of raw materials and its trade with Africa and South America both follow the 'manufacture for raw materials' pattern. It has yet to emerge as a major importer of consumer products; a development that is possibly hampered by the high levels of inequality and thus low consumer demand in China.

The extensive inequality in China, constraining the growth of the consumer market, limits the role it can play as an engine of global growth by promoting the export of labour-intensive manufactures from lower-income countries. In the case of India, the large labour reserve also limits its role in promoting labour-intensive imports from lower-income countries. The recent move by India to open up its domestic garments' market to Bangladesh exports is a step in the direction of 'non-reciprocal access' (Stiglitz and Charlton, 2005) that larger and better-off economies can adopt to promote development in smaller and worse-off ones. The development of regional production networks is visible in the case of South Africa too, and is also likely to occur with Brazil. An increase in the social minimum earnings in the emerging economies can be important in providing more scope for smaller and poorer economies to extend their place in global production by taking over the low-end tasks in the global economy.

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