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**JUNE 20–22, 2013**

**New Catalysts for Change**  
**THE BRICS'S MIDDLE CLASS STARTS TO FLEX THEIR MUSCLES**  
**Panel**

**JUNE 20, 2013**  
**09:45–11:00, Pavilion 4, Conference Hall 4.3**

**St. Petersburg, Russia**  
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**Moderator:**

**Charles Robertson**, Global Chief Economist, Renaissance Capital

**Panellists:**

**Chandrajit Banerjee**, Director General, CII

**Sergei Borisov**, Vice President for Small Businesses Development, Sberbank

**Sergei Katyrin**, President, Chamber of Commerce and Industry of the Russian Federation

**George Magnus**, Senior Economic Adviser, UBS Investment Bank; Author, 'Uprising'

**Hu Shuli**, Editor-in-Chief, Caixin Media Company

**C. Robertson:**

Ladies and gentlemen, thank you very much for coming today to talk about the middle classes. I am very optimistic about the power of the middle classes. I think all of us in this room can count ourselves as middle class, and we can be very pleased with ourselves, because the middle classes represent greater wealth. They represent high savings, and investments. They push for better education standards, so that our children have better futures. As the middle class gets bigger, corruption tends to fall, because we, the middle class, want transparent government. But this does also create some challenges. We demand more of the government. We want them to invest well in education. We tend to want them to invest in pensions and social security, and this can create problems in the long term. Europe's problems today may be because Europe is too middle class.

We have got a range of representatives from many countries here today. Chandrajit Banerjee is from the Confederation of Indian Industry (CII). India is a country that has been growing extremely well over the last ten years. With over a billion people, the size of the middle class in India is going to be world-changing. From China, we have Hu Shuli, who comes from a country which, again with a billion people and a higher per capita GDP today, is already changing the world. We have seen that in commodity prices globally. From the external side, we also have George Magnus, a former Chief Economist for UBS and an expert on emerging markets. And then, we are very fortunate to have, from Russia, two representatives: Sergei Borisov, Vice President for Small Business Development at Sberbank, and Sergei Katyrin, from the Chamber of Commerce and Industry. If I can start with Mr. Magnus: you have looked at many emerging markets, over a few years. Perhaps you could give us a couple of thoughts about the middle class, and what this means for the world?

**G. Magnus:**

Thank you very much, Mr. Robertson, and a very good morning, ladies and gentlemen. There are roughly, according to international organizations, 1.8 billion people who are defined as middle class in the world today, that is, earning

between USD 10 and USD 100 a day, and the IMF thinks that this is going to grow to about 3.25 billion by 2020, and to almost five billion by 2030. Over three quarters of the increase in this middle class population will be in Asia. The significance, of course, is because we associate a rising middle class with things that are dynamic and, basically, good in economic terms, like entrepreneurship, innovation, sophistication, modernity, and so on. In fact, if you want to look at these numbers in more detail, the United States and Western Europe, for example – which today constitute about 48–50% of this universe of middle class people – are going to drop to about 22%. So, clearly, if you believe your spreadsheets, then the next 20 years are, as they say in American basketball, a slam-dunk. In other words, it is inevitable, and it is going to happen, without fail.

My point about this, which I would like to make here in the introduction, is that it is not preordained. It does not necessarily mean, just because the spreadsheets say it will happen, that it will happen, or that it will happen everywhere. As Mr. Robertson indicated at the beginning, the rise of the middle class is potentially a very disruptive social and political phenomenon, which, obviously, we would welcome, but actually, we should be aware of what that implies. The key thing, really, is that the rise of the middle class is not about GDP, and it is not about the kinds of projections that we would make, even though we feel very enthusiastic about what we see going on around us. The last twenty years are not necessarily a good guide to the future, as every piece of financial advice always says in the small print at the bottom. The key thing, which we will come to during the discussion, is that what happens to the development of the middle class really depends on what happens politically, in terms of the development of constructive, strong government institutions, and the right balance between the role of the state and the role of the private sector, because you do not get entrepreneurship and innovation unless you have a very vibrant private sector. You have to have the right trade structure, you have to be able to diversify into the things that will bring money into the country and allow it to save and invest, and there are many other things that we will come across during this discussion.

So my overall bottom line, really, for this discussion, is that we stand on the cusp of huge potential, to have a much, much more prosperous world in the next 20

years, as more and more people, potentially, become so-called middle class, in terms of rising per capita income. But I do not think that we should assume that this is necessarily going to happen everywhere, or in a linear fashion.

**C. Robertson:**

If I could move to India, because India is the country with the biggest numbers, absolute numbers in the long term, but still a per capita GDP of under USD 2,000. In Russia, or Brazil, or Poland, we are talking USD 10,000 to USD 12,000. So, India has the furthest to go. There has been some interruption of growth in the last 12 months. I was wondering, Mr. Banerjee, if you could explain how you see India developing here?

**C. Banerjee:**

Thank you. It is great to be back here, year after year, and thank you for giving us this opportunity, from India. Let me, first, talk about how the middle class is shaping up in India. We have heard some global numbers; let me talk about some Indian numbers. We are today talking in terms of 31 million households in India which are classified as middle income, or middle class, and if you really look at the growth of the middle class over the last few years, in 1995, we were talking about 4.6 million households in the middle-income group. As recently as 2005, we were talking about 13 million households, and today we are talking about 31 million. And the number is going to go up to anything between 125–130 million households by 2025. So that is very strong pressure in terms of the numbers that we are dealing with in India, in terms of the number of households that are coming in. We are expecting around 265 million people to be in that group in the next five years. So the numbers are quite big, and if you really look at the next ten years, we are talking about anywhere between 500–550 million people in the bracket which would be termed as middle income and middle class. But what is happening, really, is that we have very unique factors in India and I wanted to highlight a couple of them. India today enjoys a young demographic base, and the middle class is dominated by that. Fifty percent of our population is below the age of 25, and two thirds of our population is below the age of 35. The

majority of those people are, again, classified as being within the middle-income group, the middle class.

Second, about 65% of Indians are in the working age group of 15–64 years old, which is, again, predominantly the middle class, and gives the country a significant edge in terms of cost competitiveness and low labour costs. This is a very significant number. If you really look at the size of the Indian economy, we are going to add the largest numbers to the labour force by 2050, and the majority are really going to come, again, from the middle class.

The third area where the middle class is having a very strong impact in India is around the issues of education and skill levels. They say that in India there is no unemployment; there is unemployability. That is the issue today, and the government and private sector have got together to really look at the middle class and train around 500 million people by 2020. So, these are big numbers, big targets, and it is really coming from the middle class, in terms of how you raise your education level, how you really focus on government policies which will raise education and skill levels, and which will, in turn, generate more employment and employability, again, further strengthening the middle class and its voice. So that is, I would think, a very important factor to note.

The fourth point is urbanization in India, which is also having an exceedingly strong impact on the definition of markets, and that is, again, a trend which is going hand in hand with how the middle class is growing and how urbanization in India is really taking place. For the first time, the urban population in India has grown at a faster rate than the rural population, and, again, it is dominated by the middle class. Eighty-seven cities in the country will have a population of more than one million this year, which is a phenomenal number – again dominated by the middle class. So, that is how we are really seeing the middle class defining these elements. I will just touch on my last point, which concerns three issues: technology, social media, and connectivity.

### **C. Robertson:**

We will come back to that. If I can move to Ms. Hu; I know you have also talked about urbanization as part of the process of the development of the middle class

in China. Perhaps you could give us a couple of minutes on China's outlook as well?

**S. Hu:**

Thank you very much, and good morning. I just want to say that the concept of middle class is internationally understood. However, it is not that popular, or mentioned that much, in China. People in China are more likely to talk about 'local people', 'people in the rural area', 'people in the urban area' – actually, right now, most of the middle class are gathered in the urban areas. So, once we talk about the middle class, actually, we are talking about urbanization. It is the same thing. I think it is a little bit tricky to talk about the concept of the middle class. The first challenge in China is to define the term. Some define it by income and others by different parameters, including assets and education. I try to use both. If we define the middle class as those who earn three times China's GDP per capita, exclude the richest 10%, and make sure that all of them are asset owners, we reach a figure of 250 million. China has 250 million people in the middle class, and because of the gap between urban and rural areas, I have to mention the relevant proportions: 38% of the urban population is middle class, a large number, but only 18.5% of the country's total population can be classified as such. So the number is already significant in cities, but a large majority of Chinese people are still on low incomes, or are lower middle class; they have a lower middle income.

If we look carefully at the goals of the new Chinese leadership, they plan to expand the middle class; these are their own words. They aim to improve the quality of life for the middle class. So in terms of income, the Chinese Communist Party (CCP) Congress has unveiled a promise to double people's income by 2020, seven years from now, and in terms of quality of life, Chinese leaders have talked about better jobs, better lives, a nice environment, better medical care, and a reliable social safety net for everyone. All of these goals are most important to the middle class. There comes the real challenge. If the first phase of the Chinese urbanization process is to turn rural land, not people, but rural land into a base for urban development, the next step which China has to take is

to urbanize people. This means that people need to really migrate to cities, and stay there, with the same standard of living as the middle class, or have the opportunity to become middle class. Seasonal migration alone does not urbanize people, and so offers no way to expand the middle class.

Right now, in China, our big challenge is to urbanize people, so that migrant workers can settle down in cities, can become more skilled labourers, and can feel more comfortable spending money. Urbanizing people is an important part of expanding the middle class, and their increasing ability and skills are also economic drivers which can move China up the production value chain. We have already waited too long, and we cannot afford any further delay, because the growth of the middle class in China is very unbalanced. There are other important issues that we have thought about in the past, but here, I want to place more emphasis on urbanization and balance.

**C. Robertson:**

Thank you. It would be great to hear from you, Mr. Katyrin, about how you see the middle class and Russia working together.

**S. Katyrin:**

I think that not just in Russia, but in all the BRICS countries, and maybe in a few other countries too, the middle class is going to become a dominant force in the very near future, a fact that will do much to determine the actions taken by both politicians and business figures. I think that almost everyone sitting here would say that in their countries today, the level of education, the level of medical care, and many other things are being determined by the demands made by the middle class. This is the standard from which the government must begin, from which it often does begin.

Today the middle class makes up about 20% of the population in the BRICS countries. If that class is not satisfied with the level of medical care, the level of education, and many other factors, then it means that all economic activity is conducted on a rotating basis. Members of the middle class make some money and want to spend it wisely. They have no way to spend it in their own country,



where there is no good education or good medicine. So what do we end up with? These people's children go to school abroad, members of the middle class and their families try to get medical care abroad, and they try to go on holiday abroad. They come back to their own country only on a temporary rotation, to earn money.

If politicians, business leaders, and the government do not respond to this in the way that they should, then we will end up with workers on rotating shifts, who come here, make their money, and then leave to spend it in other countries. These people usually own property abroad, sometimes even in more than one place. Not enormous yachts or islands, but still, it is property they use when they are not at work.

This is a fairly serious challenge. And if the economy is not going to work for the middle class, if it is not going to serve them, then we are going to start having breakdowns.

It is absolutely not the case that all Russians are going on holiday only to Spain, for example, or somewhere else. Things get better or worse in one place or another, and people move first to one place, then the next, in order to get medical care, buy things, or go on holiday. But this process that the middle class is engaged in is going on all around the world. People in many different countries are giving serious thought to how to respond to these challenges, how to improve education and medical care, and many other things. If you take a look today at government programmes in place in the BRICS countries, for example, you will see that the overwhelming majority of them are aimed at responding to these challenges appropriately and pleasing the middle class.

And there is one more important factor, maybe the most important one: politics. The middle class has always been an ownership class, and has been a stabilizing force in politics. When there exists a middle ground, an inert mass, a pendulum cannot swing to the extremes, either to the right or to the left. This mass always restrains it. There are people who have something to lose both in their own country and abroad. They will always fight for stability. A stable situation can be entrenched a bit to the right or a bit to the left of centre, but one

way or another, the country needs stability – political stability and economic stability.

I will conclude at the same place I began. I think that the middle class is in fact going to become a dominant force in most countries in the near future. Thank you.

**C. Robertson:**

Perhaps we can now move over to Sergey Borisov, because we were talking about how the middle class wants stability, but you are suggesting that the middle class must be entrepreneurial, they must be willing to take risks, they must be ambitious and pushy. I was just wondering what you would be able to tell us about that.

**S. Borisov:**

Thank you Charlie.

Here in Russia, we often go through the exercise of trying to come up with a definition of the middle class. I think that we will have a hard time working out a single definition for the BRICS countries. We have different price policies and different climatic conditions. Some of us need fur coats, some of us do not. The demand is not the same. But still, in general, we can say that a member of the middle class is someone who has enough to live on, enough for his or her own education and his or her children's education, and enough for leisure time; in the best case, he or she owns a car and a computer. That is the minimum that defines sufficiency.

The size of the middle class is increasing in Russia. I cannot say that it is increasing quickly, but at the beginning of our transition to a market economy, the middle class comprised less than 20% of the entire population. Now, however, according to the experts, the middle class represents around 30% of the population. The wealthy make up another 10%. The remaining 60% are those who belong neither to the middle class nor the wealthiest. About fifteen million people here live below the poverty line, which is very dangerous for the economy, for the country as a whole, and for national security. We have a fairly

high decile dispersion ratio, indicating the difference in income between the poor and the rich, of approximately 15 to 16. In Germany this ratio is around six and in the Scandinavian countries it is three to four. This is a dangerous trend for Russia.

I have done a great deal of work on the topic of small business. I was the head of the biggest small business organization in Russia for ten years. I had the opportunity to meet with experts from many different countries. One very interesting person once said to me in a conversation, "Tell me what small business is like in your country and I will tell you what kind of middle class you have." Small business is the main occupation of the middle class in any economy. It puts all the rest in motion. Sergei said correctly that attitudes toward doctors will be more consistent and more demanding if the middle class is stable. Small business is innovative in its very essence. If decent conditions are in place for competition, a small business will compete for orders, for a place in the sun, and will stimulate the demand for education. That means that there is a demand for quality education and money will flow into the education sector. For my business to be stable, I need to be healthy, so I go see doctors and pay them more. This means that the middle class will grow in those sectors as well.

Our middle class is still not completely stable, since it is partly made up of those working in the natural resources sector. Russia has symptoms of the so-called 'Dutch disease,' in that when there is oil, the dollars fly in. That is also a fairly dangerous situation. If the price of oil or gas falls, then the money that used to flow in from the natural resources sector will not come to top up the budgets of middle class families.

As far as small business is concerned, unfortunately, we have not achieved any great heights. It is true that over the past decade it has grown by close to 37% and now contributes about 23% of the GDP. I know that this number is much higher in other BRICS countries, not to mention developed countries. In terms of jobs, 25% of workers are employed by small businesses. But wise men say that it is not where you are now, but the direction in which you are headed that matters most. We have decent institutions, decent laws, and a decent tax system, although we have made a few mistakes in constructing the pension

system, which caused damage to small business. Today we can talk about that openly. I would therefore associate the future of Russia's middle class in large part with the vigorous development of small and medium-sized businesses.

Thank you.

**C. Robertson:**

That is similar to what Mr. Magnus was talking about regarding the strength of the private sector. That is part of what will drive growth, and small and medium-sized enterprises will be part of that. Just thinking in terms of the problems and opportunities, education has come up, and it came up at a conference earlier this year: Anatoly Chubais was saying that he is more scared by the education drain from Russia than he is by the capital flight out of the country. It worries him more. I was looking at some numbers for things like literacy, and Russia does extremely well, with 100% literacy, and this is very successful – better than most emerging markets. However, while the Russian population is better educated than almost any emerging market, the number of new, technical journals, the number of new research papers coming out of Russia, has been falling for 20 years. It seems like there has been a lack of investment in education here. So, that is an area in contrast to India and China, where the number of technical and scientific papers being produced is going up dramatically. The government seems to have done a better job investing in education, at least from the starting point, so I am interested in thoughts on education but also this long-term issue of pensions and social security.

At the moment, my belief is that pensions are very low in India and China, but as countries get richer they demand more, and the government, when times are good, spends more. We have seen this in Korea. There was an election in Korea just a few months ago, and the lady who won that election won promising much more social security, much more welfare spending. Now in Europe, that is causing us problems, but in Russia we have already seen that too. Putin has been increasing spending on pensions considerably. You have got two issues here. I would love to have your thoughts on education and what can be done to improve education in Russia now, and also the issue of pensions. If I could come

back to Sergei because you did mention this, and then perhaps Mr. Magnus could talk about the middle-income trap and some of these related issues?

**S. Katyrin:**

We used to say that Russia has two misfortunes. I am not going to repeat the rest – those who have read Gogol will remember.

In terms of science today, I believe that we have one misfortune. In Soviet times, we had the State Committee for Science and Technology (SCST), the main purpose of which was to implement the results of scientific research and to transform a discovery into a concrete product. Back then, this turned out quite poorly. We used to have a great deal of fundamental research, in scientific fields connected with defence and many other fields, but it has always been difficult to implement them. Today, in my opinion, this is not happening at all. I think that everyone understands this – including both government leaders and scientists. This is why those people representing fundamental science and the academic institutes are giving serious thought to how to apply in industry the research that has been accomplished in the academy. Sometimes an entire research team will work for over a year on research such as this. But unfortunately, as of today, we have not achieved any great success.

That is the main problem. I cannot say (although I am not an expert) that science in Russia is seriously lagging behind in any particular area. There are probably certain areas of research where we look weaker, and some where we look stronger, than all our competitors. I cannot say that all our research has ground to a halt, that there are no scientists, that nobody is discovering anything, and so on. I believe that the main problem, which is much more serious now than it was previously, is the implementation of new research findings. The networks that would allow us to transform discoveries into products ready to be put on the market were never created, either in Soviet times, when everything was done by brute force, or in our current market economy. I think that the lack of these networks is one of the reasons that more and more scientists are leaving for abroad. I must emphasize that scientists are not just leaving for abroad to try to realize their potential there. They are also taking their ideas with them. Many of

them are not even leaving; they are just putting their ideas into practice there, understanding that it can be done quickly and they can make a lot of money from their discoveries. Today this can be done from within Russia. More and more often, we see that discoveries made by Russian scientists, both young and not so young, are being transformed into finished products outside our country's borders.

Science probably has various other problems as well, including organizational, financial, and other kinds of problems. But I would place the problem of implementation high up on the list. If we do not learn how to do that, then no matter how great our research might be, people are going to leave the country in order to make money, go places where their ideas can be put in action quickly, effectively and, when possible, with little expense.

In terms of pensions, this is a difficult period. I am not going to comment on all of it. We are going to face some serious battles and I would even say some fierce battles. Certain measures taken in the past with respect to small business, as Sergei has already said, were extremely unsuccessful. They forced us backwards, not so much in the material sense as in the moral sense. You can toss a person out of the legal business sector into the shadows in a single day with a decision like that. To get those people to come out of the shadows, to get them used to following the rules again, keeping their accounts, filing their taxes, filling out the forms – that could take many decades. I think that we have brought the damage upon ourselves.

Pension reform will continue, however, and some kind of happy medium will be found, a decision that will allow us to make use of pension funds. You know that the lack of cheap and long-term funding is a big problem here and I am speaking about the Russian economy as a whole, not just the pension system. There will probably be a way of putting into action this tool that is so vital for the economy.

Thank you.

**C. Robertson:**

I will just mention one thing. I looked at these education levels, and found that Russia has produced more Nobel prize-winners, so far, than China, India, Brazil,

and South Africa put together. So, Russia's intellectual tradition is fantastic. What is changing is that so many other countries are catching up, and the last three Nobel prize-winners from Russia have left the country, which addresses Sergei's point, too. But, over to you.

**S. Borisov:**

In Russia, the population has indeed historically been well-educated. Perhaps we have a yearning for knowledge in our blood. We have had basic primary school education since Soviet times, since the times of the planned economy. Since then we have lost a bit and gained a bit – the skills for surviving in a market economy, are one example. But the biggest problem today, especially for the middle class, for small business, is insufficient demand for knowledge and potential from people who could become permanent members of the middle class and go into small business.

We have a decent system of basic education, but we have no system to disseminate the specialized knowledge necessary in market conditions. The OPORA RUSSIA organization here conducts an annual survey of entrepreneurs. We asked them this question: "What is interfering most with the development of your business?" Many of you, especially those among our guests here, will probably think that the answer is administrative barriers and bureaucracy. Those have been the usual answers for many years now. That is partly the case, but this factor is no longer among the top priorities. Today, entrepreneurs are stating unanimously that the biggest problem is the lack of qualified staff, people capable of doing business under competitive conditions, under market conditions. 47% of entrepreneurs are saying this. In second place are taxes. I will tell you exactly which taxes in a moment. In third place is access to capital.

In terms of business innovation, we are not skilled enough at commercializing research results. We have not learned how to build those networks. We still do not have the knowledge necessary to work in small production companies because, unfortunately, there are very few of those companies.

In regard to pensions. Nobody would dispute the fact that pensions should be respectable. Here in Russia, we believe that our senior citizens should receive

respectable pensions. But we must not put the cart before the horse. First, that money needs to be earned: earned by the whole world, the whole country, making use of our colossal potential. To make it clear to everyone what Sergei was talking about, I want to tell you about the mistake we made, the mistake that entrepreneurs were talking about as early as two years ago, before these measures were introduced. We calculated the sum that would need to be received from the market and sent into the pension system, and we assigned to each entrepreneur not a relative rate, for example, 20–30% of income, but an absolute rate. If you cannot pay that fixed sum, then you cannot be an entrepreneur. Over the past months, around 600,000 individual entrepreneurs have shut down their businesses in this country. This is the wrong way to replenish the pension fund and it is also dangerous. We simply shrank the middle class and expanded the sector of the economy that is in the shadows.

**C. Robertson:**

Well, I would just like to bring in Mr. Magnus first, because he has looked at the middle-income trap, he has looked at countries struggling with issues of education budgets, welfare spending, and I think that has a bearing on both India and China.

**G. Magnus:**

I would just like to emphasize something that I touched on at the beginning, which is that some things matter disproportionately as you get richer. Obviously, if we think about the BRICS, it is a disparate group of countries. They have very little in common, actually, but, obviously Brazil and Russia are high middle-income countries, India is a low middle-income country, China is a middle middle-income country. But some things matter disproportionately as you get richer, and the things that matter a great deal include shifting the structure of your economic model towards, as I said before, entrepreneurship, innovation, being smarter. There are some things you can only do once. You can only join the World Trade Organization once. Russia is a very recent member, so maybe some of the benefits of joining the WTO will come through in ways for Russia, as



they came through for China before, but you can only join international organizations like this once. You can only do labour transfer from low-productivity rural activity to high-productivity manufacturing once, you can only urbanize to 80–90% of the population once, you can only get 90% of your children enrolled in school once. So once you have done all of these things, you have to get smarter; you have to think about ways in which you can make your institutions work harder.

I think we have touched on two or three of the things that really matter: education, social spending, and innovation or R&D. While we can celebrate a lot of what the BRICS and other emerging markets have achieved in the last 20 years, we should also be aware that the process in the future is going to be, really, at least as hard as it has been, if not harder, than in the past. For example, if you look at education, enrolment in what we call the tertiary sector – so universities and technical colleges after secondary school – in G7 countries, it is about 65%, in Asia, it is about 30%, and in Latin America, about 40%. So, there is a long way to go, if you want to get up to that high income level, and it requires a lot of careful thinking about how you get young people into tertiary education, and what you teach them when they get there. There is no point bringing out people with degrees or qualifications which actually are not particularly useful to the economic development path or model that you choose to pursue.

The same goes with innovation and R&D. I mean, Mr. Robertson, you mentioned scientific papers before, and obviously a lot of research is going into patents and I think, according to the US Patent Office, China is actually number one, now, in terms of patents. Actually, what matters is not the volume of patents but the patents that are cited by your peers in other disciplines, or in the same disciplines. On that basis, there is still, again, a long way to go, because obviously there is a lot of plagiarism, a lot of duplication that goes on: people, scientists, engineers, are often incentivized to produce papers for reasons other than adding to the stock of knowledge. So, again, with R&D, the US and some of the higher-income countries in Europe still have quite a strong edge in terms of R&D spending as a share of GDP. And then, finally, public social spending. In

China, it is still extremely low; it is about 7% of GDP, compared with about 17% in Brazil and in Russia, but even that is at the bottom end of the OECD. The OECD minimum public social spending as a share of GDP is about 21–22%. So, how do you pay for that, especially in aging countries? In Russia and China – I call them the hares, rather than the tortoises, in global demographics, because these are the countries that are aging very quickly – the burden of pensions spending and healthcare is rising very, very quickly because of the speed with which the population is aging, with which the age structure is increasing. So, how do you pay for that? I have not come across better examples, really, to date, than that you have to pay for it by having a diversified, dynamic industrial structure which is heavily centred on manufacturing. China has it, it has done it already, but actually, most of the other BRICS countries and emerging countries do not have that kind of intensity of manufacturing.

So, I think that when we think about this in the future, about how we can afford better education, better social spending, better living standards for the middle class – which is what we are here to talk about – the thing is that you have to come back, really, to what your industrial model, your economic model looks like. Is it appropriate for what you aspire to in the next 10, 15, 20 years? I think in many cases, there are a lot of questions that need answering.

**C. Robertson:**

I am conscious that I had at least one more question that I wanted to ask, and that in about ten minutes, I would also like to open this up to questions from the audience.

**S. Katyrin:**

I will add to what the professor has said. Implementing innovations in one country or another can be hampered in large part by the failings of basic institutions. For Russia, the low level of competition, and in some sectors the absence of competition, means all these innovations are not in demand on the market. There is no market for innovation, nobody to sell these innovations to, because innovations get implemented in places where people want to win a

competitive battle. If there is no competitive battle, why buy them and implement them? This is an obstacle that has emerged from history, one we have not yet overcome. The higher the rate of competition, the more potential there will be for implementing innovation.

Thank you!

**S. Hu:**

I think it is very common for the middle class in China to share the same higher expectations of their living standards, especially on education and social welfare issues. But here, I want to emphasize several special points, just some of the special characteristics of China's middle class. I think number one is that the Chinese economy, in the past few years, has developed at a great rate but at a very high cost environmentally. So, the middle class in China, right now, is very, very sensitive about environmental issues. They start to have very high requirements – totally different from before – in terms of their living standards, and the new projects starting in their own cities. All the unrest in recent years which has led to violence, in most regions at least, has been related to environmental issues. That is the first special characteristic that I want to mention.

The second is that the development of China has been very fast, and unevenly distributed from region to region, with more wealth in the coastal areas and less in the inland areas. People, the middle class, are very, very sensitive about that unbalanced distribution, which leads to the widening of the income gap between the rich and poor. The middle class are very sensitive about this unbalanced situation and speak with a very strong voice, not only for themselves but also in favour of social fairness and trust. They are the major group who are thinking about in-depth change in this area, and are strong supporters of welfare.

The third characteristic, I think, is that there have been a lot of property confidence issues in China recently because of the growth of the middle class, who are very aware of property rights issues. There have been conflicts surrounding land issues and housing issues, and the middle class are working together to show their dissatisfaction.

I also want to emphasize a fourth characteristic. The Chinese middle class are the major users of the Internet and so, even though China is a country under one party's leadership and lacks freedom of the press in certain ways, actually the Internet helps the middle class in China. We have a recent development called a microblog, which allows the middle class to share their opinions directly. Right now, there are 200 million microblog users who can instantly express their different opinions through microblogs. So this is a very special channel in China, through which people can understand the basic demands, the values, and the chant of the middle class.

**C. Robertson:**

Thank you. Mr. Banerjee, before I come to you, I would like to introduce one last question from me, before moving to the audience. A couple of years ago, I wrote a research report at Renaissance about democratization, saying that as countries get richer, they all become democracies. I did not just write this because I work for Prokhorov, I wrote the piece because it seems to be totally accurate, unless you export a lot of oil. So, in Saudi Arabia, in Kuwait, it is a different story. There is another strong link: not just that all countries become democracies, but also that all countries become less corrupt. At low-income levels, corruption is a big problem. If you look at Transparency International's surveys, all countries with low incomes, including India, will have a significant problem with corruption. But as countries get richer, the middle classes demand transparency, and we have been seeing that in India over the last year or two. Big corruption scandals. We are seeing it in China, where the middle class is even stronger and also wants to reduce corruption, and there is even an anti-corruption campaign happening in Russia. So, starting with India, feel free to touch on the education and pensions stuff, but I would be quite interested to see what you see as the strengths of the middle class and the impact that is now having on Indian politics.

**C. Banerjee:**

Let me get to the issue about education and pensions first, and then I will come to your question. Now, over the last few years, we have been seeing very strong government involvement in the education sector, especially because it has been driven by demand that is really coming from the middle-income group. The gross enrolment ratio, which is the number of people going into higher education, has leapt over the last decade, and this increase is the result of proactive targeting, increasing the number of colleges, doubling the number of technical institutes, increasing the number of vocational institutes. But one important thing which I really wanted to talk about is that in India we are seeing a growing trend of public–private cooperation in tackling this issue of education. A large proportion of the private sector is getting involved, and it is extremely beneficial for the private sector to get involved in targeting that level of education in the country. So, on the one hand, you have the private sector getting involved in vocational training and the privatization of the existing government system, and, on the other hand, we are also seeing a lot of public–private partnership (PPP) models emerging in the education field, which is one way of tackling the huge issue of education which is also a challenge for India.

Coming on to the social side, and specifically, the regulatory framework governing pensions, which is now very strong in India. I think that this is very evolved; we have regulatory mechanisms on that. Secondly, today, the middle-income group really spends about 50% on household expenses, and saves 50%. So, our growth is propelled by the type of savings rate that we have in the country, and the number of institutions that we have seen develop in India in terms of options – the private sector is getting very heavily involved in the financial sector. The types of options that individuals have in terms of savings are remarkably different from what was available in the past. So, one does see quite a bit of a change, but at this time, of course, a strong balance is required in terms of the types of demands that come from the middle class for social security. In the absence of social security of certain kinds, we are also faced with challenges as to how we deal with some of our regulatory mechanisms in India. So, that is a process which will take time to evolve.

I will come to your third point, which is basically about the issue of corruption and how we have been able to deal with it. I think we are going through a situation of short-term pain for long-term gain, in the sense that we have seen movements in India where there has been a lot of discussion about accountability in more and more areas. The demand for accountability, not only from the government but from all institutions, has become very strong, and this movement, as you will know, has come from the middle class, and primarily because the demographic of the middle class is dominated by young people. I think that is extremely important because that has far-reaching implications for the political system and the social system, and it is extremely important that we are seeing this in India coming very consciously from the middle class, and very effectively so. I think that this is going to be defining for the future of India.

**G. Magnus:**

Can I just say, I think that is extremely optimistic. I hope you are right, but there is a very prominent Indian commentator whose name escapes me just now, who basically talked about the degradation of state institutions as the reason why India has failed, so far, to diversify its economy, to create jobs, to create power and infrastructure, and so on. So, I think you are right, there is hope that a rising middle class will demand political change, but I am not quite sure how long that is going to take to happen, and I think that the requirement for political reform, be it in India, or as Ms. Hu has said, in her own country, is just absolutely critical. Without that, this middle-income trap that I have been talking about is actually just around the corner. Maybe further away for India because it is a poorer country, but a very real prospect.

**C. Robertson:**

If I could just open this up, if anybody else would like to add in a question? I know we are on the sexy stuff now, of politics, but if anybody wants to ask an extra question, please raise your hand. I have a couple at the front.

**R. Beltrán:**

Hello, I am Rubén Beltrán, Mexican Ambassador to the Russian Federation, and I want to congratulate the panel. Of course, we are focussing on the BRICS countries, but I thought it would also be a good idea to have some sort of benchmark as to how the rest of the world's emerging economies are doing, in terms of what you were just saying; in terms of income, in terms of investment in science and technology, education, and also the development of democracy and other issues that have been highlighted here. Thank you very much.

**C. Robertson:**

And there was just one more. Just at the front please, in the grey suit.

**From the audience:**

Yamalo-Nenets Autonomous Area, Novy Urengoy Division of OPORA RUSSIA.  
The agenda poses the question of what measures – it is understandable why – should be taken by the state and by the business community. I would like to hear an answer to that question. What measures should the state take and what should the business community do?

My opinion, to be brief, is this. The state should not interfere with the business community, it should ask it questions, but also listen to it. Thank you!

**S. Katyrin:**

And the business community should ask questions of the state.

**C. Robertson:**

Thank you. I will come back, now, to Mr. Banerjee, if you would like to add something?

**C. Banerjee:**

One of India's strengths, and where that optimism comes in, comes from the fact that we have a very strong democracy in place. I think that leads me to believe that we would be able to deal with the type of responses that we are seeing from civil society, and especially, as you rightly said, when it comes from the middle

classes, when it comes to issues which relate to governance, which relate to the overall issue of how we are able to deal with the social fabric, and especially government interventions. I think that we are a bit of a noisy democracy, there is no doubt about it, and that leads to various decisions, at times, taking a little longer than normal. When we are coming to a decision, I think, what is very important in the context of India is that we have really taken it through a huge number of levels in terms of society, in terms of checks and balances, before we are able to come up with a proper regulatory mechanism. I think that is becoming quite established and institutionalized in India, and the optimism that you see in India really comes from that. I think that is going to be a very important factor as we go ahead.

**C. Robertson:**

Given that we have seen demonstrations in China, recently, and also in Russia, in December 2011, do you think it is middle-class pressure which has encouraged the anti-corruption campaigns from the leadership in both China and Russia? Do you think it is the middle class that has caused the anti-corruption campaign?

**S. Hu:**

Yes, I think that the middle class is the cause. Just imagine, fairness and justice – the middle class is very sensitive about those kinds of issues. It is part of their values, to do something to make the country better, including anti-corruption campaigns and also fairness towards poor people in society. So yes, I think it did.

**S. Katyrin:**

If you mean Bolotnaya Square, I do not think that that has very much to do with corruption. More likely, the demonstrators there were not happy with the election results. That is the way it always is. Some people are happy with the election and some are not. However, I do think that certain processes taking place in the country are probably what brought many people to that square.



First, in terms of corruption, it seems to me that the direct route to victory over corruption – difficult and long, but direct – is to ensure transparency in all processes stipulated in laws and other regulations. Every Russian citizen here today knows, I think, that besides official corruption, we also have the so-called unofficial sort, when we bring a box of chocolates to the kindergarten teacher, we bring a cake to the schoolteacher, or we bring presents to a university lecturer. That is deeply ingrained in many of us. Everyone ought to know that for, say, 100 roubles, they can drop their child off at kindergarten at 8:00 in the morning, no gifts necessary, no chocolates – they just need to pick their child up again at 17:00. That right there is perhaps one way to fight corruption. This evil exists everywhere in the world, but it surfaces to a greater or lesser extent in different places.

Second, I mentioned other legal regulations, but the most important things are the directly applicable laws, when there are no reference rules, when it does not say that a particular procedure for placing orders is to be established by a minister, an agency head, or somebody else. References such as these are a direct route to corruption and they should not exist in the legislation. I cannot say that we will beat corruption right away after passing laws such as this, but either way we need to drastically curtail this practice.

And third, when people talk about corruption, they always refer to some sort of bureaucrats apparently coming down to oppress us from who knows where. There are always at least two parties involved in corruption: the people who give, including some sitting here today, and the people who take. And if both sides do not start fighting against this, then it is unlikely that either one of them will win.

Thank you!

**S. Borisov:**

I find an unambiguous connection between democratization, the establishment of the middle class, and the growth of small business. When a person is busy and has their own business to manage, they want to develop it. They display responsibility, naturally, it is hard to distract them from their goal, and they normally take no part in political intrigues. They do not want demonstrators to

break their windows or destroy their shops. And on the other hand, if a person is not busy, if they are wandering around with nothing to do, if they have not found their vocation, if the state has not helped them discover their potential, then, of course, they become excessively politicized. And they become nutritious plankton for extremism. It has been said that there were probably no entrepreneurs on Bolotnaya Square. But you may remember that after the liquidation of small types of businesses, a great many small kiosks and shops, a lot of entrepreneurs in Moscow started asking what they should do, where they should go. There has been no answer to that question. This is where the state should have stepped forward and given them an education, offered the initial resources to do something else, and so forth.

In regard to corruption: a coward sees danger everywhere. We have a high level of corruption here, but we have nevertheless begun to build good institutions and mechanisms. For instance, we – I mean the business community – have insisted on building a fantastic system that allows us to assess regulatory controls. Now, without our permission, no innovations can be adopted, even initially, and no laws go through. We have put in place a filter sussing out the potential for corruption and tricks hidden in draft legislation.

Seven or eight years ago, corruption took up 10% of the profits of the average small businessman. Today that figure is 5%. We can see the progress, but 5% of profits is still an exorbitant figure. This means we do have work to do.

### **G. Magnus:**

I just had a quick comment, actually, which was to answer your question. Actually, both of the Sergeis have answered it more eloquently than I probably would have been able to, but my immediate response to your question was the rule of law. You asked what governments should do about bad business practices, or corruption, and lots of countries have laws, but sometimes, it is rule by law rather than rule of law. In other words, whoever happens to be in control, running the state or the authority, actually, fundamentally has sway, holds influence over the judiciary and over legal processes and judicial arbitration. So, I am not saying – I am a Brit – that we are perfect, and I am not saying that

Western countries really are devoid of corruption or of bad practices, but it is all relative. Mr. Robertson has already referred to one survey, the World Bank's Doing Business survey, and there are lots of other surveys of institutional practices which rank countries according to the quality of their judicial systems and governance, and so on. I think that one way, and it is an important way although not the only way, in which governments should try to eradicate or lower the proliferation of corruption is to have a strong, independent judiciary, where people feel included and have rights to protect their claims, whatever they happen to be. So, I know it is easy to say, as we are sitting here; and it is a very difficult process to do, and there are very strong vested interests that sometimes militate against it, but it is a struggle that I guess we will have to continue with.

**C. Robertson:**

Ladies and gentlemen, I would like to wrap by just drawing a couple of numbers to your attention. In China, in 2003, there were 7 million cars in the entire country. Today, 14 million are sold every year, 20 million vehicles altogether. They sell more in six months than China ever had ten years ago. And today, in China, there are about 56, I think, cars per 1,000 people, maybe 58. In India, it is still around 16. India is about to see an explosion of car purchasing, of industrialization, we think, over the coming year. This is going to be the power of the middle class. Russia will be selling commodities to this middle class, but also innovation, in terms of some of the Internet and technical innovation that is already happening here. This, I think, is a very positive story, as long as countries can get over the middle-income trap which George Magnus has been warning us about, and governments have to deal with the demands of more money for education, more money for spending, but still support small businesses and keep the country entrepreneurial. I think it is a big challenge; it is going to be a very interesting five to ten years ahead.

I would like to thank you very much for coming, and also thank the panel for their fantastic thoughts. Thank you very much.