

Can India Match China?

This depends on the performance of both countries. The principal internal constraints on China's growth are institutional: the lack of a rule of law, the consequent uncertainty of property rights, the inefficiency of state enterprises and the profound weakness of the financial system. Important symptoms of these weaknesses have been the reliance on foreign entrepreneurship and an offshore financial and legal centre, namely, Hong Kong.

Behind these weaknesses lies something more profound: a political system that is unlikely to prove suitable for an increasingly sophisticated economy and society. The political transitions from one-party state to a more democratic regime could prove highly problematic. An important symptom of China's institutional weaknesses is the inefficiency with which capital is used. China's investment rate has been substantially higher than those of other fast-growing Asian economies at comparable levels of development, but its economic growth is not.

The explanation for this is partly the scale of investment in infrastructure needed by such a vast country. But it is also partly the fact that 60 per cent of all loans between 1993 and 2000 went to state enterprises. It is astonishing that, in the world's fastest growing economy, as much as 40 per cent of existing loans is considered bad, the scale of this waste of capital is breathtaking.

China does not only confront domestic challenges. It may well also confront external constraints. China's extraordinary success in export markets has been a powerful engine of growth. Yet it is hard to believe that this can continue, now that China is such a huge player in world trade and its own economy is already so open.

The challenges ahead are large, by any standards. But it is a good bet that China will continue to grow rapidly for at least another two to three decades.

This will require continuing and painful reforms, but the alternative of letting the economic dynamism slow must seem worse to China's policy makers.

If China's growth does remain rapid, can India match it? The optimistic view has been well expressed by Vijay Kelkar, a former senior civil servant. Mr. Kelkar argues that India's political stability, well-entrenched democracy, relatively effective financial system, deepening international economic integration and improving environment for provision of infrastructure augur well for future growth.

More fundamentally, India enjoys a greater demographic dividend, with the population of working age expected to rise as a share of total until 2050, unlike in China. While the quality of the labour force is also improving, the private savings rate should continue to rise as living standards improve and the child dependency ratio and the child dependency ratio falls, finally, the growth of productive has been reasonable good in India since 1980, with total factor productivity (the rise in output per unit of input of labour and capital) increasing at about 2 per cent a year.

Yet India, too, suffers from many constants. Public sector dis-saving imposes a significant limit on capital formation. The political and legal systems, though well developed, are also cumbersome and inefficient. Politics lacks a focus on development. Hitherto; in addition, the growing supply of labour has not been

matched by a rise in demand. As a result overall employment has risen at only 1 per cent a year over the past decade. Literacy remains too low. There is also evidence that trend growth has slowed since 1996-97 to below 6 per cent a year.

Faster growth is certainly possible in India.

But that will also need substantially higher savings and investment, greater inflows of FDI and much more rapid industrialisation.

What then should the world expect of the Asian giants? More of the same is the reasonable answer. Morgan Stanley concludes an excellent analysis with the view that “today it is India and China”. This is not wrong, even though it will remain more China than India of some time. Lord Desai concludes, in similar vein that “China will again become a viable great power; India may become a great democracy.”

As Arvin Virmani of the Indian Council for Research on International Economic Relations has noted, by 2025 China is likely to be the world’s largest and India the world’s third-largest economy, at purchasing power parity.

The impact of the rise of two giants on the world’s demand for resources, centre of economic gravity and balance of power will be enormous. Adjusting to such changes has always proved difficult. The rise of China and India is likely to pose the biggest challenges of all.

Comparison between India and China

Firstly, the two Asian giants share many commons as following:

1. During the 19th and 20th centuries, the two Asian colossi fell far behind the rapidly growing economies of western Europe and North American.
2. After both of these giants gained independence in the 1940s, India became the world's largest democracy and China a communist despotism. Though they differed in their politics, both embraced similar economic ideas. Scarred by their countries' experience with 19th century imperialism, their leaders feared renewed subordination to foreign economic interests. Both saw capitalism as both unjust and inefficient. So both embraced socialist economics.
3. The pursuit of socialist self-sufficiency failed. By the 1970s, neither had begun to regain its historic position. However, both economies have begun the journey from state controls to the market and from would-be autarky to international economic integration. Both begun to catch up on the world's leading economies.

But China has done far better than its rival India. The following contrasts should be considered:

1. In 2002, China's gross national savings were 44 per cent of gross national income, while India's were only 22 per cent.
2. In 2002, China's trade in goods was 49 per cent of gross domestic product, while India's trade in goods was 21 per cent.
3. In 2003, China generated 5.8 per cent of world merchandise exports, which make it the world's fourth-largest exporter, and 2.6 per cent of world exports of commercial services, which make it the world's ninth-largest. India generated just 0.7 per cent of world merchandise exports, which put it at 31st, and 1.4 per cent of world exports of commercial services, which put it at 21st.
4. By 2001, China's weighted average tariff was down to 12.8 per cent, from 35.6 per cent in 1992, while India's was still 28.4 per cent, down from 70.8 per cent in 1992.
5. In 2003, the stock of inward foreign direct investment in China was \$501.5bn, against just \$30.8bn in India. In the same year, the FDI inflow into China was \$53.5bn (12.4 per cent of capital formation) against \$4.3bn into India (4 per cent of capital formation).
6. In 2000, India's overall illiteracy rate was 35 per cent, against just 6 per cent in China.
7. In absolute terms, China is now spending eight times as much as India on infrastructure. As a share of GDP it is spending more than three times as much.
8. Between 1996 and 2002, private investment in Chinese telecommunications was \$13bn, against \$9.2bn in India. In energy, it was \$14.3bn in China, against \$7.5bn. In transport, it was \$15.9bn, against just \$2.3bn.
9. Between 1990 and 2002, China's agricultural value added grew at 3.9 per cent a

year, against 2.7 per cent in India and its services grew at 8.8 per cent a year, against 7.9 per cent in India.

10. In China, the share of the population engaged in agriculture dropped from 68 per cent in 1981 to 45 per cent in 2001, against a slower decline, from 67 per cent to 59 per cent, in India.
11. India's consolidated fiscal deficit is running at 10 per cent of GDP, against less than 4 per cent in China. India's public sector savings have been running at minus 3 per cent of GDP, against a surplus of 1-2 per cent in the 1990s.

Why has China performed so much better than India?

To answer this question, we need to appreciate the difference not just in economic strategies, but also in the polities

Both China and India are the heirs of great civilizations. But China's civilization is inseparable from its state, while India's is inseparable from its social structure, above all from the role of caste. This difference permeates the two country's histories and contemporary performance. "for India, the problem is achieving unity in diversity". China, however, is a "unitary hard state, which can pursue a single goal with determination and mobilize maximal resources in its achievement".

These political and social differences explain, in large measure, the contrasts between the two strategies. China has largely replicated the growth pattern of the other east Asian success stories, though its financial system is weaker and its economy more open to foreign direct investment than those of Japan and South Korea. Its growth is based on high savings, massive investment in infrastructure, universal basic education, rapid industrialization, an increasingly deregulated labor market and an internationally open and competitive economy.

India's pattern of growth has been extraordinarily different, indeed in many ways unique: it has been service-based and apparently jobless. Savings are far lower than in China, as is investment in infrastructure. India's industrialization has hardly begun. Literacy is low, while elite education is well developed. India's formal labor market is among the most regulated in the world. Regulations and relatively high protection against imports continue to restrict competition in the domestic market.

It is not difficult, therefore, to see why China's growth has been far higher than India's. China has not only saved and invested far more, it has exploited, to a far greater degree, the opportunities afforded by the global economy. Its population is also more skilled, while the social and economic transformation it has embraced is more profound.

Will the two giants continue to grow as rapidly?

They can do so. The potential for rapid growth is determined by the gap in average productivity with the world's leaders and the quality of each country's institutions and policies.

On the former point, if China replicated the catch-up performance of Japan or South Korea, relative to the US, it could grow extremely rapidly for another three decades. On the latter, Transparency International ranks China 71st equal in the world for corruption, a little ahead of India, on 90th equal. In the 2005 Index of Economic Freedom, China is ranked 112th, while India is ranked 118th. The World Bank's investment climate and "doing business" indicators suggest that China and India both offer problematic business environments, with the law's delays and the insolence of office a slightly more serious handicap in India than in China.

The quality of institutions and policies is, in short, poor in both countries. Yet this also indicates the room for large improvements in the years ahead. Bad institutions are both constraints and opportunities.