

## ECONOMIC REFORM OF INDIA AND CHINA: PAST AND FUTURE

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### ABSTRACT

*India and China are leading the shift in centre of economic gravity towards Asia, and the economic prospects of economies throughout the world have become increasingly dependent on sustained demand in the two Asian giants. Continued success cannot be taken for granted, though we know from history that growth trajectories are not sustained on autopilot. China's investment and industry-heavy growth has allowed for steady growth but has also led to imbalances. India's growth has trended up, but governance issues are constraining further progress. The paper tentatively characterizes the existing economic growth patterns and problems in China and India; summarizes how governments want to adjust their growth strategies; introduces some key features of the policymaking process and some of the institutional and political economy problems; and sketches some tentative economic scenarios. China's investment and industry-heavy growth has allowed for steady growth but has also led to imbalances.*

**KEYWORDS:** *India and China in Initial, Economic Reform, Policy Process and Challenges.*

### Introduction

China is the world's largest autocracy. India is the world's most populous democracy. Both economies have maintained steady GDP growth even as countries in the developed world grapple with financial and economic crises. China and India fascinate the world but appear to provide almost no unifying road-map for industrialization, human development, or globalization. Beyond macroeconomic indicators and simple observations that these are developing countries with diverse and large populations, what is often missed is that these two countries offer two distinct yet internally variegated road maps for globalization that can provide lessons for other countries. In the post-neoliberal era where the International Monetary Fund, the World Bank, and other bastions of "Washington Consensus" debate the extent and scope of austerity measures and advocate some form of state intervention, the economic development trajectories of these two countries and their internal variations question conventional wisdom on the effects of state intervention, competition, and markets on innovation, economic growth, and regime stability. Beginning in the 1980s, both China and India liberalized foreign direct investment and exposed their economies to foreign technology and knowledge transfers. Rather than one straight path out of economic misery toward industrial development, however, both countries have gone separate ways, which reflect how nation-specific ideas and norms and institutional legacies interact with the globalization of industries. In the aftermath of the Tiananmen Square Incident, China's leaders sought to modernize infrastructure and enhance the national technology base while at the same time maintaining political stability in the hands of the Chinese Communist Party. Over the past three to four decades, China and India have attained spectacular prominence due to their rapid and sustained economic progress. The Chinese economy has been thriving at almost double-digit growth rates since 1980. Although the Indian economy did not grow as fast as China's, it has nevertheless been among the ten fastest growing economies in the world over each of the two decades, 1980-1990 and 1990-2000 (Izurieta and Singh, 2008, p.2).

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Before proceeding further, it seems pertinent to delineate three important caveats. First, the statistical data on employment suffer from a number of important limitations (Ghose, 2008, p.47), and therefore do not allow a coherent comparison between China and India. Particularly, the data for same periods on a given set of variables are not readily available, but an effort has been made to include statistics from a variety of sources to plug in the gaps in years as much as possible. Secondly, our discussion begins within a broad analytical context, but then gradually concentrates on two dimensions of economic growth (composition of Gross Domestic Product [GDP] and international trade, mainly exports) and two dimensions of employment (employment by sector and by type). Thirdly, it is presumed that the reader is familiar with key terms and categories related to economic growth and employment (such as formal and informal sector, regular wage employment, manufacturing, merchandise, etc.), as they are used in the literature on China and India. These categories are not defined here, except in such cases where a non-standard definition is used.

### Reform Since 1978

Opening up and gradual market-oriented reform were key to China's impressive industrialization and growth performance over the last decades. Since 1978, China introduced a sequence of market-oriented reforms that dramatically improved economic incentives and efficiency and reduced distortions. In line with the Washington Consensus, and motivated by an increasingly open and transparent multilateral trading system, opening up to foreign trade and promoting exports were key elements, accentuated by the WTO accession in 2001.<sup>2</sup> In line with both the Washington Consensus and strategies of other East Asian countries, China also increasingly pursued orthodox macroeconomic management.

China	India
<i>Policies (in reform period)</i>	
Steady opening up to global economy, emphasis on export promotion	Gradual opening up to global economy
Active government role mobilizing resources	Less explicit role government
Explicit preference and encouragement of industry and investment	Less explicit preference & encouragement
Emphasis on infrastructure	
<i>Strength</i>	
Rapid supply side growth without macroeconomic tension	Does not create international friction
<i>Weakness</i>	
Has led to economic, social, environmental and external imbalances	Weaker supply side growth; macro economically less robust

Source: Fung Global Institute.

An important driver, particularly since the late 1990s, is that in a policy setting favorable to industry and capital, flourishing industrial firms ploughed back increasingly large profits into new capacity. With wage increases lagging behind productivity growth, the share of companies' profits in GDP could rise-pushing up the national savings rate.

### Analytical Framework

What does economic theory tell us as far as the effects of increased integration on economic growth and employment are concerned? In order to answer this question, we need to first specify, what is meant by "integration"? In general, the term refers to liberalization and openness of an economy in the corridors of market-driven globalization (Kozul-Wright and Rayment, 2007, p.29). The term has been defined more concisely by Izurieta and Singh (2008, p.1) in the specific context of China and India as follows: China's and India's "integration is taking place under 'current globalisation,' which consists of free-trade, free capital movements and domestic labour market flexibility (instead of free international movement of labour)". In this sense, the term "integration" is distinct from "globalisation"; the latter is an instrumentality for achieving the former (Mahtaney, 2007, p.197). The opposite is true for skilled labour. The overall effects on employment depend on labour market regulations and institutions. If wages are difficult to change, total employment falls. It is important to note that such predictions are based on important assumptions, which may not correspond to realities. The comparative advantage of skilled-labour of advanced countries as predicted by the trade theory, for example, does not hold true for China and India due to increased outsourcing. This point will be further elaborated in the following sections.

### Differences in Effects of Global Integration on Economic Growth

During the past two to three decades, China and India have attained extraordinary levels of economic progress by any standard. During 1980-90, China's and India's GDP grew at an average rate of 10.3 per cent and 5.7 per cent per year, respectively (Srinivasan, 2006, p.3716). During 2005-07, the

average growth rates were even higher at 11.7 per cent for China and 9.6 per cent for India (World Bank, 2009). Although India's GDP growth has been lower than China, it is still remarkable as compared to its so-called 'Hindu growth rate' of 3.6 per cent per year between 1951-52 and 1980-81 (Acharya, 2004, p.4537). Indeed, as Srinivasan (2006, p.3716) has observed, China and India are the only countries in the world which have been able to sustain their rapid growth over two and a half decades since 1980, regardless of occasional fluctuations. The share of agriculture in GDP was not much different in China (26.8 per cent) and India (33.0 per cent) in the year 1990s. The share reduced dramatically during 1997s in both countries, but more so in China. In 2005, agriculture constituted just 11.4 per cent of China's GDP, as compared to India's 19.6 per cent. In the year 2012 share reduced 10.1 per cent in China and 12.4 in India. While industrialisation in the wake of increased integration led to reduction of agriculture's share in GDP, effects have had been quite different on the shares of industry and services sectors.

**Table 1: Composition of GDP of China and India (% of GDP)**

Year	CHINA				INDIA			
	1990	1997	2005	2012	1990	1997	2005	2012
Agriculture	26.8	17.1	11.4	10.1	33.0	24.5	19.6	12.4
Manufacturing	25.3	31.1	34.1	35.2	16.7	17.7	15.1	17.6
Other Industries	08.6	13.8	14.3	10.1	n/a	05.0	04.3	06.7
Service	39.3	38.0	40.2	44.6	41.0	50.6	61.1	63.0

Sources: (1) China: Calculated by Ghose 2009, from World Bank's World Development Indicators database. (2) India: Reserve Bank of India 2008; Panagriya 2008: 283. (3) Central Intelligence Agency, US.

When the reforms began, China was already substantially industrialized, as manufacturing and other industries together were 33.6 per cent of its GDP in 1980. China's manufacturing sector has grown steadily since 1980 along with other industries. The picture of India is quite different in the sense that the exports of both manufactures and services increased substantially in the post-reform period, but its manufactures exports were about a half of China's. On the other hand, its share of services exports was almost three times higher than that of China in 2012 (Table 2).

**Table 2: Export Structure of China and India by Sector (% of Total Exports)**

Year	Agriculture	Manufactures	Merchandise 1	Services
<b>India</b>				
1983	16.8	31.0	30.2	21.9
1990	13.5	48.6	20.2	17.7
1993	13.2	51.8	18.4	16.6
2000	9.2	49.9	15.3	25.7
2005	6.3	42.2	17.8	33.7
2012	5.2	39.1	19.1	36.6
<b>China</b>				
1984	18.9	43.0	47.3	9.7
1990	14.7	65.4	26.0	8.6
1997	7.5	75.2	12.9	11.8
2005	3.4	83.7	7.4	8.9
2012	3.2	84.7	5.6	6.5

The effects of inter-sector transfer of labour on employment are associated with the corresponding output growth of these sectors (Table 1). Its implications appear to be far more serious for India than China. Dasgupta and Singh (2005) argue that India defies the Kaldorian pattern of growth, as its economic growth is led by services.

#### **Current Challenges in India and China**

Sharing the benefits of growth more equally and improving access to public services are the major challenges for both China and India. It is to be expected that income inequality rises as a country takes off. However, countries such as South Korea have shown that, with good, inclusive policies as health, education and housing, growth can be broadly shared and inequality can be contained in a rapidly growing economy. In China and India, access to education, health and other public services is distributed unequally, with access in poor areas, and for poor people generally, substantially worse than in better off areas and for better off people. Especially in India, large groups of society (on the countryside, women)

have particularly poor access to such services. China and India both saw GDP per capita catching up with the US in 1980-2010, although both still lagged far behind in 2010 (Table 5). We can use the Cobb-Douglas production function of Box 1 to compare the levels of the factors determining production.

- With investment much higher in China and India than in the US, as a share of GDP, their capital-labour ratios increased to 14.3 and 6.5 per cent of the US level by 2010, up from 2.8 per cent and 4.2 per cent respectively in 1980.
- The capital-labour ratios (K/L) are now closer to the US level than GDP per capita (Y/L). Thus, economy-wide, the capital-output ratio (K/Y) in both is now higher than in the US. This may seem counter-intuitive. But it is consistent with distortions in capital and labour markets in both countries that make production relatively capital-intensive, given their level of development and underemployed labour in low productive agriculture.
- As to the mobilisation of labour, China has a substantially larger share of the population works than in the US, reflecting both China's "demographic dividend" and a high participation rate. In India the share of employment in the population is substantially lower than in the US, reflecting mainly very low participation of women.
- Both China and India started out with much lower levels of education and skills than the US. Both have caught up-China more than India. These crude estimates, using average number of years of education, suggest that the average Chinese worker is now half as skilled as his US peer and the average Indian worker one-fourth as skilled. However, these estimates are not adjusted for the quality of education.
- Our estimates suggest that, with TFP growth substantially faster in China than in India in recent decades, China's level of TFP is now slightly higher than India's. Nonetheless, it is still very low compared to that in the US, pointing to the need and room for further catch up.
- In all, the key reasons why India's GDP per capita is now lower than China's are: a much lower share of the population works, the capital stock per worker is half of that in China, and people are on average less educated.

It is sometimes said that India is about 10 to 12 years behind China in its reform and development process. With regard to GDP per capita this is about right, in the sense that India's GDP per capita from 2010 to 2011 was 5 per cent less than China's was in 2000.

#### **India and China: a Comparison**

India and China: A Comparison unlike China, India is a dynamic and resilient democracy with a huge domestic market and growing capabilities in high-tech services (Hsueh, 2011). China has, however, an in-built political advantage over India under which the state has the power and authority to regulate different sectors of development in accordance with its political philosophy. On the contrary, India does not enjoy this advantage in a cobweb of coalition politics. This was recently manifested from the reversal of the UPA government's decision to invite Wal-mart into India's retail sector on account of a vociferous opposition from all mainstream political parties. Notwithstanding the nature of India's coalition-based politics, the corrupt and unaccountable politico-bureaucratic system is mainly responsible for the impeded socio-economic development.

#### **Conclusion**

Empirical evidence suggests that the increased integration of China and India into global economy has had quite different effects on economic growth, but somewhat similar effects on employment. In respect of economic growth, the effects are conspicuously different in output structure, i.e. the engine of growth in China is manufacturing sector whereas in India, the growth is led by the services sector. Accordingly, the composition of their international trade is strikingly different; the largest share of China's exports comprises of manufactures, whereas in India, both manufactures and services constitute major proportion of the exports but the latter's share is increasing rapidly. By contrast, employment effects are quite similar, and are evident in the rise of unemployment problem, decline of employment in the formal sector, and slow growth of regular wage employment. There is a need to generate a steady process in both China and India that leads to the growth of regular wage employment which exceeds the rate of labour force growth.

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