

Economic Reforms and Global Integration

T.N. Srinivasan*

1. Introduction¹

In the last two decades of the twentieth century, China and India enjoyed historically unprecedented average rates of growth of their real Gross Domestic Product (GDP) at 10% and 6% per year respectively. Fewer than 10 countries of the world exceeded India's growth rate and none exceeded China's during this period (World Bank, 2001: Table 4.1). The population of India was estimated at 1.027 billion on March 1, 2001 and that of China at 1.278 billion on February 1, 2000 (Banthia, 2001: 29). World Bank (2001, Table 1-1, reports China's per capita Gross National Product, rechristened by the World Bank as Gross National Income (GNI), in 1999 as US \$780 (\$3550 at purchasing power parity exchange rates) and India's US \$440 (\$2230). Although still very poor, with their large populations and rapid growth of GDP, both constitute large domestic markets for a variety of agricultural and industrial products and services. The prospects of selling profitably in these huge markets have attracted exporters and investors of the industrialized countries. With both engaged in integrating their economies with the world economy, they now compete in markets in the rest of the world for their exports and for external capital. China is one of the five recognized nuclear powers. India, after its nuclear tests of 1998, aspires to be recognized as one. India fought a border conflict in 1962 with China, which is also the prime supplier of nuclear and missile technology to India's archenemy, Pakistan. Any potential conflict between China and India has wider significance beyond the region. Given their emerging economic strength, as well as

possible competition for dominance as the leading Asian power, it is important to analyze their recent economic performance in a comparative framework.²

After all, China and India, the two most populous and poorest countries of the world, have attempted to develop economically and alleviate poverty through similar development strategies, but under vastly different political frameworks, namely, a single party (communist) dictatorship in China and a multiparty democracy in India. China began its economic reforms and opening to the world economy in 1978. India began relaxing its rigidly controlled economy in a piece-meal fashion in the 1980s but its significant opening to the world economy and deeper domestic reforms did not begin until after the severe macroeconomic crisis of 1991. With experience of reforms and globalization for more than twenty-five years in China, and a decade in India, much more information and critical analysis (particularly of the Chinese economy) have become available.

The primary focus of this chapter is an analysis of economic reforms, post-reform performance and future prospects of both economies. In Section 2, I describe the state of the two economies as they initiated their development efforts, their politico-economic social frameworks, and their achievements in terms of important socioeconomic indicators; Section 3 is devoted to their pre reform development strategies. In the subsequent two sections, I describe the background to, the rationale for, and contents of reforms in China since 1978 (Section 4), and in India since 1991 (Section 5). I concentrate primarily on reforms of foreign trade, industry and the financial sectors. I discuss agricultural reforms only briefly, primarily because the reforms of the two countries are not comparable, with India yet to initiate significant reforms. Section 6 details the achievements of reforms in

both countries. Section 7 concludes with an assessment of yet to be initiated, but needed, reforms and the likely future prospects of the two economies.

2. Economic, Political and Social Frameworks and Economic Performance

The Chinese Communist party took the reins of government of a unified country in 1949 after a protracted civil war and foreign invasion. British colonial rule in India ended in 1947 with the establishment of the two independent countries of India and Pakistan. The governments of both China and India turned to planning for national development soon thereafter: China's First Five-Year Plan (FYP) covered the period 1952-1957 and India's covered 1951-56. India's FYP's were occasionally interrupted with annual plans and the Cultural Revolution interrupted the Chinese FYP sequence. Thus, China's Tenth FYP for the period 2001-2005 is currently being carried out and India's for 2002-2007 is on the anvil. Thus, China's was a command economy with the private sector playing an insignificant role in resource allocation until recently. Although India's was and still is, a mixed economy with a large private sector, state regulation of economic activity was very extensive until the reforms of 1991.

In its first detailed report on the Chinese economy, the World Bank (1983) concluded that India and China had roughly similar per capita incomes in the range of \$50-60 (in 1952\$) in the early fifties.³ China's population was a little over 1.5 times that of India's 360 million in 1951. India had a more diversified industrial structure and a more extensive network of transport and communications (three times the route kilometers of railways, and more than 3.5 times of highways per square kilometer of land area) as compared to China even in 1979. On the other hand, in China the average yields per hectare of rice and wheat were double, and more than one and a half times respectively

those of India. Crude birth rates were about the same (around 37-38 per thousand) while the crude death rate of China at about 17 per thousand was significantly lower than India's 24 per thousand (again in the early fifties), perhaps reflecting the better nutritional status enjoyed by the Chinese population because of higher foodgrains output per head.

The available data are consistent with the conclusion that India and China had roughly the same level of per capita income in the early 1950s and had experienced similar growth in the previous fifty years. Maddison's estimates of per capita real gross domestic product (GDP, in 1980 dollars adjusted for purchasing power parity) for China and India go even further back. These respectively, are: \$370 and \$350 in 1830 and 1870; \$415 and \$399 in 1913, US\$338 and US\$359 in 1950, and US\$774 and US\$513 in 1973, and US\$1,748 and US\$662 in 1987 (Maddison 1991:39). There is likely to be a wide margin of error surrounding each of Maddison's estimates. Still they are consistent with the widely held belief that real GNP per capita grew much faster in China than in India since 1950. In terms of absolute size of GNI, China was the seventh and India the eleventh, largest economy in the World in 1999. (World Bank, 2001, Table 1.1)

In the 1980s the rates of economic growth and exports were much faster in China than in India. Real GDP rose by 2.5 times, and exports by more than 3 times in China between 1980 and 1990 while in India the corresponding figures were 1.8 times for both GDP and exports. Between 1950 and 1980 real growth in China's foreign trade was about the same as that in GNP so that the share of trade in GNP hardly changed (World Bank, 1983). Since 1980, however, China's trade expanded phenomenally and faster than GDP, raising its share in GDP from about 13% in 1980 to a high of 37% in 2000. In India the share of trade in GDP fluctuated--until the early 1960s it averaged over 12%, only to

decline to a low of less than 10% in the early 1970s and to rise slowly thereafter to about 16% in 1979-80. Since then the share has moved within a narrow range of 18-20%. While India's share in world exports of goods was stable around 0.5% in the 1980s, and slowly rose to 0.6% in 1999, China more than tripled its share from 1.2% to 3.6% between 1983 and 1999 (WTO, 2000: Table II.2).

China was far ahead of India in 1999 in social indicators, such as life expectancy (70 in China versus 63 years in India), rate of infant mortality (10 per 1000 live births versus 71), and adult illiteracy (9% versus 38% among males, and 25% versus 56% among females). Table 1 provides information on selected economic and social indicators for the two countries in 1999. Table 2 reports on trends in development during 1965-1999 and also during the subperiods 1980-1990 and 1990-1999. Table 3 provides information on trends in selected policy variables since 1980.

3. Development Strategies Prior to Reforms

Not only were India and China at a similar stage of development in the early fifties, both also adopted similar development strategies then. Leaders of both countries were heavily influenced by the then perceived success of the Soviet Union in rapidly industrializing a largely rural economy in a relatively short span of four decades without significant external assistance. This, of course, is no surprise in the case of the communist leadership of China. The future Indian Prime Minister Jawaharlal Nehru had visited the Soviet Union in the late 1920s and came away very impressed with their planning.⁴

Professor P. C. Mahalanobis, whose model had provided the analytical foundation for India's development strategy in general, and its Second Five Year Plan (1956-1961) in particular, had visited the Soviet Union and was familiar with the Soviet planning system.

Although apparently Mahalanobis independently arrived at it, the model had been formulated in the Soviet Union by Fel'dman in the 1920s. In the model the share of investment devoted to augmenting the stock of capital in the equipment producing (heavy industry) sector determined the long-run rate of growth of the economy, and the larger this share the greater was the growth rate. This finding rationalized Soviet Union's development strategy that emphasized heavy industry and its later adoption by China and India.

Both countries shifted relatively rapidly away from agriculture. In China the share of value added originating in agriculture fell from 68 percent in 1949 (Lin, 1994: Table 2.2) to 18 percent in 1999 (World Bank, 2001: Table 4.2). In India the share of agriculture in GDP fell from 52 percent in 1950-1951 to 25 percent in 1999-2000 (Central Statistical Organization, 1989, Press Information Bureau, 2001a,b). In India, however, the share of manufacturing industry in GDP rose only very slowly, from about 11 percent in 1950-51 to about 15 percent in 1999-2000, while in China this share rose to 38 percent in 1999 from less than 12 percent in 1949. In both countries the capital-intensive nature of investment in industry meant that the share of agriculture in total employment remained high, at least in their pre-reforms comparable data are not available on the share. It is very likely that after more than two decades of reforms, the share of agricultural employment in China has fallen significantly, but in India it is still high, nearly two-thirds, in 2000.

Both China and India implemented their industrialization programmes through State controls on investment and on foreign trade. Indeed both economies followed virtually autarkic policies which imposed a heavy cost on both in terms of efficiency of resource allocation and foregone growth. Further in the early 1950s both China and India

had virtually no capital goods producing industry. This meant that most of the equipment needed for investment had to be imported, at least until enough capacity for producing equipment had been built. Heavy industry was capital-intensive as well. Thus the emphasis on heavy industry made substantial demands on foreign exchange and investment resources. In order to generate these resources both countries relied on administrative controls on investment and import quotas, rather than on the markets and the price mechanism. In China, prior to the reforms of 1978, state-control over economic activity was direct and total, since agriculture was collectivized, almost all of industry was state-owned, and most services were supplied by the state. In India's mixed economy, the control mechanism had to ensure that industrial development in the private sector conformed to the national plans by preventing diversion of investible resources and foreign exchange to privately profitable but socially undesirable activities.

4. China's Economic Reforms: Background, Rationale and Content

4.1 Background

I will be brief in describing the well known and oft told story of China's economic development prior to the watershed events of the death of Mao Zedong in 1976, the fall of the "Gang of Four", the rehabilitation and assumption of power by Deng Xiaoping, and finally, the reforms initiated in December 1978 at the 3rd Plenary Session of the 11th National Congress of the Communist Party of China. In keeping with communist ideology, the Chinese State had nationalized industry by 1958 and monopolized foreign trade, even earlier. By 1956, when agricultural collectivization started, almost all rural households were members of a cooperative. Agricultural communes were initiated in 1958. Development strategy was Stalinist in its unbalanced growth of industry (especially heavy

industry). Autarkic policies led to a significant fall in the share of world trade from about 1.25% in 1952-1955 to 0.75 percent in 1978 (Sung 1994: Table 4.1). Growth was achieved through higher rates of investment and labour force participation, but with negligible increase in total factor productivity (Sung, 1994:109). The disasters of the Great Leap Forward or GLF (1958-1962), with an estimated decline of two-thirds in grain output and excess mortality of over 30 million are well known. The decade (1966-76) of Cultural Revolution (CR) resulted in a slow down in the growth of output to about 4.5% per year, compared to 12.2% per year during 1949-57 and 15.3% per year during 1962-66. The worst economic performances were during 1958-62, during the GLF followed by the withdrawal Soviet aid when growth in total output declined at the rate of 3% per year, and the first two years of CR (1966-67) when the decline was even faster at 7% per year.⁵

4.2 Rationale for Reforms

The turmoil of the Cultural Revolution had severely dislocated the economy and it would have been natural for those who came to power after the death of Mao to focus on economic recovery. But there were no obvious pressures for the institution of radical reforms. Qian and Wu (2000: 8) claim that the “Primary Objective of the Party [Communist Party of China] is to maintain power” and that the political will of the leadership for economic reform is based on the central proposition that economic reform is good for economic development, which in turn is good for maintaining the Party’s power. The two authors further claim that the experience of the disastrous consequences for the national economy and living standards of the people because of the central focus of the Party on political movement during the CR,

“had an enormous effect on the mind-set of some top leaders. They were convinced that without economic development the Party could not survive, in

other words, a necessary condition for maintaining Party's power and regaining popular support was economic development. To a large extent, the displacement of the dogmatic ideology in favour of pragmatism was due to the backlash of the Cultural Revolution. The proposition of economic development became even more compelling after the 1989 Tianenman Square incident, because it was the only source from which the government would gain its legitimacy. In Deng Xiaoping's words "[economic] development is the hard rule"... (ibid. 8).

The authors argue that the commitment of political leaders to economic development for the purpose of maintaining power, led not only to the start of economic reform in 1978, but also to their pushing for more reforms and deepening them through the decision of the 3rd Plenum of the 14th Congress of the Communist Party of China in November 1993 to establish a Socialist Market Structure.

The claims of Qian and Wu seem plausible. In the absence of any freedom for political expression in China, there is no reliable way of assessing popular support. Presumably challenges within the party to its leadership could be viewed as reflecting the lack of popular support for the policies of the leadership. In any case Deng Xiaoping, unlike Mao Zedong, had always been pragmatic and in fact, Mao had found himself Deng's pragmatism useful earlier. As such, with Deng's rehabilitation after the death of Mao in 1976, and the fall of the Gang of Four, a shift towards pragmatism in Chinese policy was inevitable. On the other hand, Qian and Wu may well be right in that Deng's rehabilitation itself would not have occurred had other leaders of the Party not drawn the right lesson from the Cultural Revolution about the importance of economic development for staying in power. For the purposes of this chapter, it is not necessary to resolve this issue.

4.3 Contents of Reforms

In important ways integrating the centrally planned Chinese economy into the

world economy that is driven largely by market forces differs from integrating the mixed economy of India. A reasonably well functioning legal system for enforcement of contracts, and a financial system sufficiently well developed to include a range of financial intermediaries including commercial banks, term lending institutions and insurance firms, are the foundations of a market economy. While India had functioning legal and financial institutions, in China they had to be built up from scratch. Much of China's foreign trade on the eve of reforms was carried out by state trading agencies. In India, except in food, fertilizers, petroleum and minerals, foreign trade were in private hands.

Paraphrasing Shangquan (1999, 19-21), Chinese reforms during 1978-98 were undertaken in three successive stages. Reforms in the first stage (1978-84) consisted of: the introduction of household responsibility system in place of agricultural communes; free sale of output at market determined prices but for a relatively small proportion delivered to the state at fixed prices, formation of township and village enterprises; replacement by taxes of surrender of profits by urban enterprises; and opening to the outside world through the creation of 4 special economic zones and 14 coastal open cities.

The second stage reforms (1984-85) were focused on urban areas and on state owned enterprises. These consisted of: introduction of a variety of contracts on enterprise leasing and management responsibility systems; creation of a share-holding system to facilitate mergers, leases, auctions as well as bankruptcy of enterprises: development of markets for production materials capital, labour, information and technology: role of mandatory plans reduced drastically and enterprises were free to

make their own investment decisions; contracting of fiscal budgets, strengthening the regulatory role of the central bank; and further opening of the economy through the creation of the Hainan and Pudong special economic zones.

In the third stage from 1992 on, reforms concentrated on the establishment of a socialist market economy. They consisted of: replacing the fiscal contract system by the tax-sharing system, with turn-over and value-added taxes at its core; regulation of money supply and supervision of financial systems entrusted to the central bank; transformation of state-owned banks into commercial banks; extension and deepening of the price and foreign trade reforms of earlier stages; legal and regulatory reforms; and reform of government institutions concerned with education science and technology.

The first stage reforms, by providing incentives for increasing productivity of land and rationalizing the use of labour, were highly successful in raising the incomes and welfare of the overwhelming majority of the Chinese population, namely, the peasants. This success encouraged the leadership to proceed with subsequent stages of reform with popular support. After two decades of reform, Chinese economy has been radically transformed. Peasants and enterprises are essentially free to decide what and how much to produce in response to market signals, prices for most products are determined by the market, and market forces determine resource allocation, albeit under a regulatory system adapted to a market economy.

5. Indian Economic Reforms: Background, Rationale and Contents

5.1 Background

Indian economic reforms of 1991 represent a radical shift from the dysfunctional development strategy of the previous four decades, which, as noted in Section 3, pursued

import-substituting industrialization, with the state playing the dominant role in the economy. Its foundations were laid prior to independence and attracted wide support across the political spectrum. As such, there was no significant political support for reforms until internal and external events forced them in 1991.

5.1.1 Industrialization

Industrialization, through import substitution and public sector production with emphasis on heavy industry, was viewed as the only means for eradicating India's poverty by India's political and economic leaders even before independence. They advocated planning and put forward their own plans for development. These included the plans of Visveswaraya (1934), National Planning Committee (Nehru, 1946), industrialists (Thakurdas et al, 1944) and labour unions (Banerjee et al, 1944).⁶

In the post-independence period, the Industrial Policy Resolution of 1948 (amended and elaborated in 1956) had set the broad outlines of India's industrial development strategy by distinguishing industries according to the end use of their outputs (e.g. capital, intermediate and consumer goods), their ownership (public, cooperative, private, and joint) and their size or technology (cottage, village, small-scale, and organized). Development of key industries, such as railways, telecommunications and electricity generation, steel, petroleum, heavy machinery including electric generators, was assigned to the public sector.

5.1.2 Foreign Trade and Investment

India's insulation from world markets until the reforms of 1991 stemmed from a long standing distrust of markets and international trade in general, and the fear that greater involvement in foreign trade would inevitably retard India's industrialization.

Visveswaraya, the authors of the plans of industrialists and labour unions as well as Nehru's National Planning Committee, which went in the furthest, were unanimous in expressing such distrust.⁷ The insulation was enforced through import tariffs, export taxes and quantitative restrictions on both. The import weighted average of tariffs on all imports on the eve of reforms were 87 percent, with the average for consumer goods being 164 % (World Bank 2000b: Annex Table 6.6). There was an enormous variance in tariffs across commodities with rates on some imports exceeding 300 percent and also tariff escalation based on the stage of processing. Such escalation led to extremely high rates of effective protection on some of the manufactured goods. Taking the explicit subsidies on some purchased inputs such as fertilizers, the implicit taxes through export restrictions and other means, and presumed exchange rate overvaluation, there was disprotection of agriculture as a whole. Foreign trade in a number of agricultural commodities was reserved for state monopolies. Around 90-95% of all trade prior to reform (World Bank, 2000b: Annex Table 6.3) was covered by quantitative restrictions (QRs) and other non-tariff barriers. The net result was a drastic fall in India's share in World trade from 2.5% in the early 1950s to around 0.6% in 1991.

Until the reforms, India's policy with respect to private foreign capital of all types Foreign Direct Investment, (FDI), Portfolio Investment and Debt had been as restrictive as the policy regarding trade in goods and services. Restrictions included limits on entry into specified priority areas, and upper limit of 40 percent on equity participation, and requirements on technology transfer, phased manufacturing, and export obligations. Chopra et al. (1995) estimate that government approvals were needed for 60 percent of new FDI in the industrial sector and that FDI averaged only around \$200 million annually

between 1985-1991. Most of capital flows consisted of foreign aid, commercial borrowing and deposits of non-resident Indians.

5.1.3 Controls on Economic Activities

The First Five-Year Plan (1951-56) set the overall interventionist framework of policy. The Second Plan (1956-61) articulated an inward oriented development strategy that emphasized investment in heavy industry such as steel and machinery. The massive investment (relative to resources available for its financing) envisaged in the Plan precipitated a macroeconomic and balance of payments crisis. In the wake of the crisis, an elaborate system of controls (that was expanded in subsequent decades) was put in place to enforce the plans and their underlying development strategy.

At its most expansive and inclusive, the system involved industrial licensing which determined the scale, technology, and location of any new investment project (other than small ones) and controlled the expansion, relocation and change in the output or input mixes of operating plants; the exchange control system under which required exporters to surrender their foreign exchange earnings to the Reserve Bank of India and importers were allocated foreign exchange through import licensing; capital issues control on access to domestic equity and debt finance; price controls on some vital consumption goods (e.g. foodgrains) and critical inputs (e.g. fertilizer); made-to-measure protection from import competition, granted to domestic producers in many 'priority' industries, including in particular the equipment producers.⁸ The agricultural sector was insulated from world markets, subject to land ceiling and tenancy legislation, and forced to sell part of the output at fixed prices, but it was also provided subsidies on irrigation, fertilizer and electricity. Large commercial banks, were nationalized in 1969, and

subjected to controls on their deposit and lending rates and directed to extend credit to priority sectors.

The crucial aspect of all the regulations is that they were essentially discretionary rather than rule-based and automatic. This created uncertainty about their fair implementation. Devising a set of principles to govern the operation of the control system and translating them into operational decisions were impossible tasks given the multiplicity, and often mutually inconsistent, policy goals. Further the controls were largely in the form of quantitative restrictions unrelated to market realities. A chaotic incentive structure, and the unleashing of rapacious rent seeking and political corruption, were the inevitable outcomes of the control system. Indeed the system, instituted in the name of planning for national development, instead became a cancer in the body politic.⁹

5.1.4 Performance of State Owned Enterprises

The actual performance of the state owned enterprises (SOEs) did not conform to the role envisaged by policy makers, namely, to promote private sector development and channel it in socially desirable directions through appropriate pricing and supply of key inputs produced by them. The outputs of SOEs were often of poor quality, costly, and inadequate to meet the demand for key industrial inputs and infrastructure services. Commercial SOEs were run less as commercial enterprises but more as promoters of the welfare of their employees and managers who were bureaucrats and politicians. Finally, there was no accountability for the management since, first of all, its reward was not based on performance and, second, performance itself was influenced by some of the activities forced on the enterprise in the name of public interest and not related to its core function. Thus, by and large, the public sector acted as a brake on, rather than a promoter

of, private sector development. Choice of location, technology, employment and pricing policies of the public sector became politicized so that efficient development was precluded. Far from generating resources, the public sector became a monumental waste and liability for taxpayers.

The industrialization strategy based on public investment in industry and public control over private investment, though grossly inefficient, did, however, generate a diversified industrial base, and a capability for designing and fabricating industrial plants and machinery. But the strategy virtually ignored considerations of scale economies, vastly restricted domestic and import-competition, encouraged capital-intensive production by subsidizing the use of capital and making labour costly through restrictive labour laws. The consequence was a high cost and globally uncompetitive industrial sector, which was also out of tune with India's capital scarcity and labour abundance.

5.1.5 Macroeconomic Policies

Until the early eighties India's macroeconomic policies were conservative. Current revenues of the central government exceeded current expenditures so that there was a surplus available to finance in part the deficit in capital account. In the early eighties, because of lax fiscal policies current revenue surpluses turned into deficits, so that the government had to borrow at home and abroad, not only to finance its investment, but also its current consumption.

Fiscal deficits, as published in government budget documents, have tended to understate the real imbalances. The reason was that the rates of interest at which the government appropriated a large share of the loanable resources of the banking system, through statutory liquidity ratio (38.5% maximum), and cash reserve ratio (15%

maximum), were administratively set below what would have been market clearing levels. Also, at least in the early years, external borrowing was largely on concessional terms from multilateral lending institutions and from bilateral, government to government external aid. As the eighties wore on, the government also resorted to borrowing from abroad on commercial terms both from the capital market and non-resident Indians (NRIs). In 1983-84, out of \$22.8 billion of public and publicly guaranteed external debt, roughly 17% was owed to private creditors. On the eve of the macroeconomic crisis in 1990-91, external debt had tripled to \$69.3 billion, of which around 30% were owed to private creditors (World Bank 1996: Table 3.1 (a)). Thus debt to private creditors grew five-fold in seven years. Since the gross fiscal deficit was too large to be financed entirely by drawing on savings, part of it was domestic and external monetized.

Although fiscal expansionism was unsustainable, with some liberalization in the form of delicensing of some industries and permitting flexible use of capacity in others through changes in product-mix within the licensed capacity under so-called “broad banding”, and relaxation of some import restrictions, it did generate growth.¹⁰ The average annual rate of growth of real GDP in the sixth and seventh plans, which covered the eighties, was 5.5 and 5.8 percent respectively, much higher than the so-called Hindu rate of growth of 3.5 percent of the earlier three decades (Government of India, 1999: Appendix Table 1.2).

By 1990-91, the gross fiscal deficit had grown to about 10% of GDP. If one includes the losses of non-financial public sector enterprises, the consolidated public sector deficit stood at around 10.9% of GDP in 1990-91, of which nearly 4.3 percent of GDP was for interest payments on domestic and external debt (World Bank, 2000b:

Annex Table 8.6). An analysis by Willem Buiter and Urjit Patel (1992) showed that unless corrective steps were taken, India face fiscal insolvency.

The rising fiscal deficits, and the steep rise in oil prices during the Gulf crisis of 1990, put pressure on prices and the exchange rate, fueling expectations about imminent devaluation of the currency. Political instability in 1990, as reflected in two changes of prime ministers within a year, led to a lack of confidence of non-resident Indians (NRIs) in the government's ability to manage the economy. The expectation of a devaluation of the rupee and the fall in confidence, led to the withdrawal of their deposits in Indian banks by NRIs and withdrawal of capital by other external investors. Foreign exchange reserves dwindled to a level that was less than the cost of two weeks worth of imports. The spectre of default on short-term external loans loomed and led to a downgrading of India's credit rating.

5.2 Rationale for Reforms

5.2.1 The Economic Crisis of 1990-91

The severe macroeconomic and balance of payment crisis certainly called for immediate policy action. In earlier crises such as the one in 1966, the government approached the IMF and World Bank for assistance and had to make such changes in policies as were mandated by the conditionalities attached to their assistance. But once the crisis eased the government reverted to its pre-crisis policies. In contrast, even though the government sought assistance from the IMF and the World Bank in the 1991 crisis, this time policy makers realized that a return to status-quo-ante with respect to policies was no longer tenable. There were two main reasons for this. First was the collapse of Soviet Union and East European economies, which undermined central planning as a

means for achieving rapid growth and economic development. The second was the phenomenal growth performance of China since its opening and reforms in 1978. Although, the rapid growth of other outward-oriented East Asian economies such as Korea and Taiwan had been evident much earlier, Indian policy makers dismissed their experience as irrelevant with the argument that India was a much larger economy than the East Asian economies, even though Korea's industrial sector was rapidly approaching the size of India's. However, Chinese success was a different matter all together: Not only China was a large economy which succeeded with economic reforms and opening to world markets, but its success exacerbated India's feeling of insecurity vis-a-vis China, since India's defeat by China in the border clash of the early sixties. Indian policy makers realized that systematic and deep reforms were needed, and in particular, India had to abandon its insulation from the world economy, if India were ever to grow rapidly enough to catch up with China. Thus the reforms of 1991 were born.

5.3 Contents of Reforms of 1991

The major thrusts of the reforms of 1991 related to measures to address the macroeconomic and balance of payments crisis through fiscal consolidation and limited tax reforms, removal of controls on industrial investment and on imports (other than consumer goods), reduction in import tariffs, creation of a less unfavorable environment for attracting foreign capital, prudent management of movements in the exchange rate while allowing market forces to play a major role in its determination, making rupee convertible for current account transactions and finally, opening energy and telecommunication sectors for private investment (domestic and foreign).

5.3.1 Fiscal Consolidation and Tax Reforms

Macroeconomic stabilization was the immediate objective of the reforms. The Central Government's fiscal deficit was sharply reduced from 6.6% of GDP in the crisis year of 1990-1991 to 4.7% in 1992-1993, and 4.8% the year after, (Government of India, 2001: Table 2.1). However, the deficit has since risen, and is expected to be at least 5.3% in year 2000-2001. Further the fiscal deficit of states has risen substantially from about 3% of GDP in 1990-1991 to 4.6% 1999-2000 (Reserve Bank of India, 2000). In all, the deficit of the center, states and non-financial public sector enterprises, in 2000-01 is likely to end up at its level of over 10.9% of GDP crisis year of 1990-1991. Thus the task of fiscal consolidation is yet to be completed.

Tax reforms involved reductions in income and corporate tax rates and rationalization of customs and excise duties and elimination of several tax exemptions. The current maximum marginal rate of income tax at 30% is moderate by international standards.

5.3.2 Industrial Sector

The reforms of 1991 abolished industrial licensing except in a few industries and reduced the number of industries reserved exclusively for the public sector. Restrictions under the Monopolies and Restrictive Trade Practices Act were eased. Entry requirements (including limits on equity participation) were eased and private investment was allowed into sectors such as power, which had been reserved, for public sector investment only. Disinvestment of equity in the public sector was also initiated. The reforms, by focusing primarily on the private sector, and not addressing the problems of state owned enterprises (SOEs), have exacerbated them: while SOEs can no longer expect their deficits to be financed through the budget, the competition from the entry of private units has worsened

the deficits of erstwhile public sector monopolies. Paradoxically SOEs still need ministerial and other bureaucratic clearances for their commercial decisions.

In the belief that it would generate employment, certain products had been reserved for production by "small scale and cottage" industries. The fact that the reservation was an anomaly in the era of reforms and liberalization was recognized by a government committee in 1997, which concluded that, "the case for reservation is fundamentally flawed and self-contradictory... the policy crippled growth of several industrial sectors, restricted exports and has done little for the promotion of small-scale industries" (as quoted in World Bank 1998: p.27). Many of the reserved products were major export items, including garments accounting for a third or more of India's exports. Clearly without a change in the reservation policy, India stood to lose its market share in world exports of garments after the phase-out of quotas under the Multifibre Arrangement in 2005, unless garment producers can compete effectively in world markets. After nearly a decade of reforms, the removal of the reservation of production of garments for the small-scale producers was announced, early in 2000. But orders for implementing the removal were issued only in August, 2001. Removal of a similar reservation of leather products has been announced. Hopefully larger and more efficient firms would enter and compete efficiently in world markets.

5.3.3 Tariff and Nontariff Barriers

The reforms of 1991 abolished import licensing for most imports. External trade in agricultural commodities was largely left out. By 1996-97, import weighted average tariffs on all imports had come down to 25% from its level of 85% in 1990- 91. Since then it has slowly risen to 30% in 1999-2000. QRs on some imports were removed, starting in

1996-97. However, those remaining, mainly on consumer goods and agricultural products, were removed only recently on March 31, 2000 and April 1, 2001.

5.3.4 Foreign Direct Investment and External Debt

The reforms of 1991 affected FDI only to a limited extent. A Foreign Investment Promotion Board (FIPB) was established to approve FDI in some industries, on a discretionary basis. In addition, the Reserve Bank of India (RBI) granted automatic approval of FDI that met stipulated requirements. Indian firms with good standing have been allowed (since February 1992) with government approval to issue equity and convertible bonds abroad in European and American capital markets. Since September 1992, registered foreign institutional investors (FIIs) have also been permitted to purchase both equity and debt securities directly in the Indian capital market subject to certain upper limits.

As a consequence of the limited liberalization, FDI increased from \$77 million in 1992 to \$3.6 billion in 1997. It is estimated at 2.2 billion in 1999. India's share of total FDI in all developing countries rose from 0.6% in 1992 to a peak of 2% in 1997 and then fell to 1.2% in 1999. However, over 1992-1997, China attracted massive flows of FDI amounting to 194.4 billion (cumulative) compared to 9.4 billion for India (Government of India, 1999: 86). India's share in the total portfolio investment for all developing countries increased from 1.7% in 1992 to 13.4% in 1994 and declined to 38% during 1999. Portfolio investment is volatile: it fell from \$4.7 billion in 1994 to \$1.5 billion in 1995, only to rise to \$4.6 billion in 1996. It hit a low of \$343 million in 1998 (World Bank, 2000c).

6. Results of Reform

6.1 Growth in Aggregate and Sectoral Output and in Productivity

India began systemic reforms in 1991, more than a decade after China initiated its reforms in 1978. However there was some limited liberalization in the eighties in India. It is appropriate therefore to compare the performance of the two economies in the eighties and the nineties. Table 2 provides the relevant data published by the World Bank (2001, Tables 1.4 and 4.1) for the two periods 1980-90 and 1990-99 and for the longer period of 1965-99. China's average growth rate of 10.7 % per year during 1990-99 was the second highest among 140 countries. Only 9 countries exceeded India's growth rate of 6.0% per year for the same period. During 1980-90, among 122 countries, China's average growth rate was again the second highest at 10.1%, whereas 10 countries had growth rates exceeding India's 5.8%. Even if one adjusts for possible overstatement of Chinese growth rates, by about 1.0% – 1.5% per year (Lardy, 1998, p.9, there is little doubt that both countries were star growth performers during 1980-2000.

6.1.1 Growth in Inputs and Productivity

One of the prime objectives of economic reforms in both countries was to increase the efficiency of resource use, that is, to get more output from the resources used, or equivalently to increase the contribution of total factor productivity gains relative to that of primary factor inputs in the growth process.

Although both economies grew rapidly since 1980, there was a significant difference between the two in the relative contributions of factor inputs and productivity gains to growth. The growth accounting exercise of Hu and Khan (1997) for China suggests that "while capital formation alone accounted for 65% of pre-1978 growth, with labour adding another 17%, together they accounted for only 58% of the post-1978 boom, a slide of almost 25 percentage points. Productivity increases made up the rest."

Thus Total Factor Productivity (TFP) “increased at an annual rate of 3.9% [GDP increased at 9%] per annum during 1979-94, compared with 1.1% [6 percent for GDP] during 1953-78." For India, IMF (2000: 11) estimates that the trend growth in TFP increased steadily after 1974 reaching 2½% per annum by 1996. World Bank (2000b: 130) estimates TFP growth between 1.3% and 1.5% per year for the period 1979-80 to 1997-98, depending on whether the elasticity of output with respect to capital input was assumed to be 0.75 or 0.65. However, in the three years (1994-95 and 1996-1997) of the post-reform era, when GDP growth averaged 7.5% per year, TFP growth accelerated to an annual rate between 2.4% and 2.8%. For India's manufacturing sector, Ahluwalia's (1992) calculations show that TFP in the manufacturing sector declined at an annual rate of 0.5% during 1960-1980 and increased at the rate of 2.8% per year in the eighties. More disaggregated analysis using different methods (growth accounting and production function estimation) by NCAER (2001) suggest that "where the estimates indicate an increase in average productivity growth in the nineties, the change is insignificant" Goldar (2000) summarizes the available (TFP) studies on India.

There are serious and well understood methodological and measurement error problems in TFP calculations, and depending on the method used what one researcher attributes to TFP growth another might attribute to economies of scale and/or positive externalities. Nonetheless the above estimates for China and India have been derived using similar methods. Moreover they are consistent with other known features of the growth process in the two economies. In China the move to household responsibility system in agriculture after 1978 provided relatively more secure property rights. This move, together with the drastic reduction in forced deliveries to the state at below market

prices, greatly raised the incentives for more efficient use of resources, particularly labor, in family farms. Rapid growth in farm output enabled workers to move out of agriculture to work in township and village non-farm enterprises. In the manufacturing sector the post -1978 reforms granted greater autonomy to enterprise managers and allowed larger proportion of output to be sold at remunerative market prices. Above all foreign investment, particularly in the special economic zones, linked China to international markets and transferred productive technology. It is not at all surprising that these factors led to faster growth in, and greater contribution to total growth from, TFP.

In India, prior to reforms of 1991, given the strait-jacket in which producers were placed through controls on investment, location, technology and input choice, imports of inputs, and foreign investment, and the absence of competitive pressures, it should surprise no one that there was no growth in TFP except in the eighties when the rigors of some of the controls were relaxed. There is some support for this in the TFP growth estimates of Ahluwalia (1992) and World Bank (2000b: 130) though other estimates by NCAER (2001) are not conclusive.

6.1.2 Sectoral Composition of Growth

Turning to sectoral composition of output growth (World Bank 2001: Table 4.1), in China, between 1980-90 and 1990-99, there was a significant increase in the growth of industrial output from 11.1 to 14.4% per year, and a significant decrease in the growth of output of services from 13.5% to 9.2% per year. There was a relatively small decrease in the growth of agricultural output, from 5.9% to 4.3% per year. In India between the same two periods, growth of industrial output declined slightly from 6.9% to 6.7% per year, although the growth of its manufacturing component increased slightly from 7.4% to

7.5% per year. Growth of agricultural (service) output rose from 3.1%(7.0%) to 3.4% (7.8)% a year. (World Bank, 2001: Table 4.1)

6.2 Poverty and Other Social Indicators

The available data (and problems with data quality should not be understated) suggest that rapid growth was associated with a significant reduction of poverty in both countries. According to Asian Development Bank (2000: Table 3.1) the proportion of population living below a national poverty line, the so-called Headcount Ratio (HR), declined from 28% in 1978 to 9% in 1998 in China. Government of India (2001: Table 10.5) reports that the HR declined from 51.3% in 1977-78 to 26% in 1999-2000. In comparison with the slow growth of GNP at an average of 3.5% per year, and a fluctuating HR around 55% in the three decades 1950-80, the near doubling of the growth rate and halving of the HR since 1980 are remarkable achievements for India. Compared to India, China's relatively greater emphasis on education and health since the revolution and hence its much better achievements in social indicators are well known. However, by and large China accomplished much of these achievements by the early sixties. For example, by mid 1970s, life expectancy at birth had increased from around 36 years during 1948-49 to 62 years, and in the subsequent three decades the increase was only 10 years. Life expectancy of the Indian population reached 60 years only in the early nineties. India is catching up faster since 1980 in some indicators, but not in others. For example the under-five mortality rate, at 177 per thousand, was nearly 2.7 times China's rate of 65 in 1980. By 1999, India's rate had halved to 90, which was about 2.5 times China's 37 (World Bank, 2001: Table 2.19). Unfortunately adult illiteracy at 45% among males over 15 years of age was only twice that of China's 22% in 1980 (World Bank

2000a: Table 2.12). By 1999 it had fallen by roughly a third to 32% in India, whereas in China it had fallen by more than a half to 9%, so that India's rate is nearly 3.7 times that of China (World Bank 2001: Table 2.14).

6.3 Exports, Capital Flows and External Debt

Both China and India experienced a significant increase in the average annual growth rate of the value of their merchandise exports between 1980-90 and 1990-98, from 12.9% to 15.8% in the case of China and from 7.3% to 10.4% in India (ibid., Table 4.4). A major contributor to India's exports of goods and services is the software sector. Receipts from software exports have grown at an annual rate exceeding 50 percent in the five years ending in 1999-2000. Valued at \$4.02 billion in 1999-2000, they accounted for nearly 8% of the total value of exports of goods and nonfactor services. If availability, cost and efficiency of telecommunications and power sectors do not constrain it, software exports are projected to grow even faster in the future. However, India's advantage relative to China in terms of having a large pool of software technicians who operated in the English language is eroding. China could surpass India as a software power in a decade. In fact in 1999 China had 12.2 personal computers per 1000 people as compared to India's 3.3 and July 2000 had 0.69 Internet hosts per 10,000 people versus India's 0.32 (ibid: Table 5.10).

Between 1990 and 1999, total long-term net resource flows to China quadrupled, from \$10.1 billion to \$42.7 billion. Flows to India fluctuated between \$3.4 billion and \$7.6 billion during the same period. FDI in China grew 11 times, from \$3.5 billion in 1990 to \$38.8 billion in 1999. In India FDI grew 13 times, but from a much smaller, \$162 million in 1990 to \$2.2 billion in 1999 (World Bank, 2000c). Apart from attracting

considerably larger volume of foreign capital, China saved a much larger proportion of its income--domestic savings accounted for 30% of GDP in 1998 versus 21% in India. Gross domestic investment in China was 38% of GDP in 1998 as compared to 24% in India. In addition, there has apparently been no capital deepening in China, with the incremental capital-output ratio (ICOR) having remained virtually constant during the period of rapid growth.¹¹ Srinivasan and Tendulkar (2001, Ch.2) estimate that the implicit ICOR for the economy as a whole was 5.7 during 1950-80 and it fell to 4.0 during the 1980s when there was limited liberalization and to 4.1 during 1992-93 - 1999-00. Clearly in both economies the period of liberalization and rapid growth was also one with no capital deepening, suggesting that capital was used efficiently given their labour abundance.

China's and India's total external debts in 1999 were respectively \$154 billion and \$94 billion. World Bank classifies both as low, on the grounds that the present value of China's (India's) debt was only 14(16) percent of its GNP, and total debt service accounted for 9 (15%) of its exports. However the share of volatile short-term debt in China's total debt, at 11.5%, was larger than India's 4.3% (World Bank, 2001: Tables 4.16 and 4.17). A substantial part of China's foreign capital came from overseas Chinese in the form FDI. Although NRIs contributed to India's external borrowings, accounting for nearly a seventh of India's total debt of \$97.8 billion at the end of March 2000, their participation in FDI was minor. Overseas Chinese played a significant role in the spectacular growth of China since 1978. Gopalan (2001, 611) estimates that 54% of FDI inflows into China originated from Hongkong, Singapore and Taiwan, and 6% from Virgin Islands, which, is said to be a haven for illegal capital stashed abroad by Chinese.

Also, Gopalan suggests that “Round-tripping” of capital that was deliberately sent abroad and brought back to avail of concessions offered to FDI inflow might have accounted for 25%-40%.

7. Looking Ahead

7.1 Slow-down in Aggregate Growth and the Importance of Further Reforms

Aggregate rate of growth in China and India seems to have slackened. In China annual rate of growth of GDP steadily declined for seven years, from 14.2% in 1992 to 7.1% in 1999.¹² India’s growth rate recovered from a low of 0.8% in the crisis year of 1991-92, reached a peak of 7.8% in 1996-97, and then fell to 4.8% in 1997-98. In 1999-2000 and 2000-01 the growth rate was respectively 6.4% and 5.2% (Press Information Bureau, 2001 a,b). Although growth rates of 14% or more could not possibly be sustained for long, still the fall to 7% in China and stagnation around 6% in India strongly suggest that the process of reforms has slowed. Needless to add that without rapid growth, sustained over a long enough period of time, eliminating poverty and providing a reasonable standard of living to their large populations would be impossible.

The broad thrust of reforms in both economies (of course with differences in emphasis) has been, first, to reduce the involvement of the state in the economy and increase that of the market; second, to bring about a greater integration with the world economy; and third, to modify existing economic (e.g. financial), political and administrative (e.g. division of power and responsibilities between levels of government, legal system) institutions and create new ones if necessary, to provide a foundation for an efficiently functioning market economy. The difference in nomenclatures, 'socialist market economy' in the Chinese parlance and a 'mixed' economy in the Indian parlance,

are of little significance in this context. Given the thrust of reforms it is easier to identify the financial, physical and institutional constraints on future sustainability of reforms, and hence, of past growth.

The relatively modest success of Indian reforms cannot be attributed to their rapidity. Indeed they have been as gradual, if not more gradual, than China's. The more relevant distinction is between India's reforming existing and functioning markets, financial and legal institutions, in the context of a vibrant participatory democracy, and China's creating markets and new institutions as well as recreating those destroyed during the Cultural Revolution, the reform process being controlled by the authoritarian leadership of the Communist Party. This is not to say, of course, that the leadership of the party and the government in Beijing was fully aware of, and had a firm grip over, what went on in the provinces or that there were no divisions and debates on alternative courses of action within the Party. It is only to say that the process of reform in the competitive politics of India with different parties ruling in different states and a coalition of some of them ruling at the Centre, and the control of central bureaucracy over its state counterparts being weak is considerably more complex.

7.2 Politics of Reform of SOEs

Both China and India had heavily invested in SOEs, although, as would be expected in a communist state, the size of the state sector was much larger than in India. In India the share of the public sector in gross fixed capital formation at current prices was 25.6% in 1950-51 the first year of planning, it grew to 49.8% in 1964-65, declined from then on to 38.8% by 1974-75 only to climb back to a peak of 53.6% in 1986-87. In the crisis and reform year of 1991-92 it had fallen to 43.0%. It stood at 29.9% in 1999-

2000. (Central Statistical Organization, 1989; Press Information Bureau, 2001a,b).

Lardy (1998: Table 2-2) reports that on the eve of reforms in China in 1978 investment in state and collective enterprises in China accounted for 87% of total investment in fixed assets. This share has come down to 69% by 1996. OECD (2000: Table II.1) reports the same 69% share for 1998.

Both China and India tried to reform their large State-owned enterprises (SOEs) with limited and different degrees of success. Their approach and strategies were also very different. There is no Indian counterpart to the dynamic township and village enterprises (TVEs) of China. The reform of SOEs, particularly if it involves privatization and possible retrenchment of workers, has been, and remains, a major political issue (more on this in the following section) in both countries. Another area in which there are major differences between the two countries is the structure and reforms of their financial sector. While corruption is a significant issue in both countries, the facts that in India a legal system does not have to be constructed from scratch as in China where the legal system, such as it was, was destroyed during the Cultural Revolution, and the absence of democracy in China, make the approach to elimination of corruption different in the two countries.

The authorities in China, unlike their counterparts in India, did not have to deal with trade unions in SOEs in considering their options for reforms. Nevertheless they also were concerned about the possibility that reforms, particularly privatization, might result in large-scale unemployment of workers in SOEs. Besides, as Lardy (1998: 3) points out, China "initially lacked the legal, institutional, and governance structures that are required to support an economic system based predominantly on private ownership.

Thus, early and rapid privatization of state-owned firms could not have been expected to improve economic efficiency. Instead China undertook other liberalizing measures that facilitated the extraordinary growth of nonstate industry, particularly township and village enterprises. As a result, the share of output produced by state-owned sector of the economy has fallen dramatically since the reform began".

Although the share of output produced by SOEs declined, Lardy (1998) reports that employment in SOEs increased by 40 million between 1978 and 1984 and stabilized thereafter. Yet SOEs continued to absorb a disproportionately large share of investment resources. What is more, despite a continuous increase in the number of loss making SOEs, few were allowed to close down. Lardy (1998:4) suggests that, "Unwilling to tolerate the level of urban unemployment that bankruptcy of loss-making firms, the state assumed the burden of subsidizing growing losses through fiscal subsidies and, increasingly, through so-called policy loans from the state-owned banking system. Since the late eighties these indirect subsidies absorbed 10 percent or more of gross domestic product every year".

According to Lardy (1998: 4-5) China's gradualist reforms have created three economic trends that are unsustainable in the long run. First, is the growing debt of SOEs, with their total liabilities far exceeding the value of their assets. Second, unsustainable lending by state-owned banks and other financial institutions has led to a rapid rise in loans relative to output and to an unusually rapid expansion of money supply as well as a rising and large share of nonperforming loans. Third, the decline in government revenues by two-thirds relative to output between 1978 and 1995, has eroded the capacity of the government to finance normal expenditures from the budget. The

government has taken steps to address some of these problems. Four companies have been established to manage non-performing loans (NPLs) and sales of distressed state-owned assets, at discounts exceeding 70% have been launched. One the companies, Huarong, is about to offer \$2 billion of non-performing assets for sale in London and has hired an international accountancy firm to promote the sale in New York after the London presentation. (Financial Times, June 6, 2001:8).

Interestingly the very same problems of restructuring or privatizing SOEs, NPLs in state-owned banks and fiscal imbalance threaten the sustainability of India's growth. However the origins and the seriousness of the problems, the political economy of the constraints in addressing them and their impact on the growth process are very different. For example, the budgetary implications of dealing with the NPLs of State-owned banks and recapitalizing them are far more serious in the case of India than in China, given its much higher public debt to GDP ratio. In India it is illegal to close down bankrupt enterprises (private as well as publicly owned) without government permission, which is rarely given. A Board For Financial Industrial Reconstruction (BIFR) was set up in May 1987 to make recommendations to the government on appropriate actions to deal with enterprises that have to be restructured or wound up. Government of India (2001:146) reports that till the end of December 2000, 4,575 enterprises including 251 SOEs were referred to BIFR. It registered 3,296 of them, recommended rehabilitation of 557 (45 SOEs) and closing down of 824 (35 SOEs). 249 companies (8 SOEs) were declared no longer in need of restructuring and for 35 (3 SOEs) net worth became positive. However not a single enterprise has been wound up, although winding up notices were issued in 102 (14 SOEs) cases.

In India for political reasons privatization is described as “disinvestment” by which is meant the sale to private buyers of a part (but not enough to give them management control) of the government's equity in a SOE. In 2000 the government committed itself to reducing its equity in non-strategic SOEs to 26% or less and to 33% in state-owned banks. A Disinvestment Commission (DC) was set up in 1996 to advise the government on the modalities of Disinvestment. Its term ended in 1999 and was not renewed. Instead a new Department of Disinvestment was created. During its existence, the DC recommended action on 58 of the 64 cases of SOEs referred to it. Yet as of mid 2000, the recommendations were being implemented in only 13 cases. This shift from disinvestments to strategic sale involving the transfer of management and control to private hands has, not resulted in any change. For example, Singapore Airlines, which was one of the bidders for purchase of State-owned Air India, pulled out of the sale process, citing a hostile environment for privatization in India.

The political economy of privatization in India's competitive politics can be illustrated by two examples. In the state of Maharashtra, the then government of the Congress Party had negotiated a contract with ENRON, a foreign energy firm, to invest in a large power plant. The power generated was to be sold to the state electricity board (SEB), a state-owned monopoly.¹³ The Congress was voted out of office in 1996 and the newly elected government of the opposition Shiva Sena initially cancelled the contract. Later it renegotiated the power purchase agreement (PPA) and the terms of investment in two phases. ENRON completed the project and has been producing power. The Shiva Sena government was also voted out of office and the successor coalition government of which Congress Party is the senior partner wants to renegotiate the PPA. Whatever be

the merits of the case, it is very likely that external investors would conclude that investment in India is subject to significant political risk. The second example is that of a state-owned aluminum producing plant in the newly created state of Chattisgarh. The central government announced the sale of 55 percent of its equity in the plant to a private entrepreneur. However the Chief Minister of the state, who belongs to the opposition Congress party, demanded that the sale be rescinded and offered to buy the equity from the Central Government. After some legal wrangles, the sale finally went through.

Apart from privatization and foreign investment becoming issues of political competition, there is also the opposition of labour unions, regardless of their political affiliation. In fact the Bharat Mazdoor Sabha, a trade union affiliated with the ruling Bharatiya Janata Party (BJP) at the centre, has opposed privatization of SOEs. In his budget for 2001-2002, the Finance Minister, Mr. Yashwant Sinha, has announced a proposal to introduce legislation that would require government permission to retrench workers or to wind up an enterprise only if it employed more than 1000 persons. He has also proposed to increase the severance payment to retrenched workers. If introduced and passed, this legislation would be a major step forward since it would exempt an overwhelming majority of enterprises from having to seek government permission to restructure. Predictably the labour unions are adamantly against the legislation.

The drag on growth from poorly performing SOEs arises from the fact that they are dominant in the infrastructural sector (e.g. power, railways, and ports). The SEBs which generate, transmit and distribute power, have been running losses, in part because of heavily subsidized sale of power to politically important groups such as farmers and outright theft of power. Although they are required by law to earn a rate of return of not

less than 3 percent of their fixed assets, the realized rate of return in 1999-2000 was minus 41.2 percent (Government of India, 2001:Table 9.4)! Investment in future capacity is constrained by the poor resource position of the SEBs and the reluctance of private investors to enter. In fact three foreign investors decided in 2000 to cancel their announced investment. However, several states have enacted electricity reform acts. The central government has signed memoranda of agreement with some state offering financial and technical support in return for their unbundling transmission and distribution and privatization of distribution in a time bound manner. It remains to be seen whether the center would be able to enforce reforms, if the financial assistance is provided ahead of reforms. In the meantime, as disinvestment stagnates, the drag of loss making SOEs on the public budget continues.

7.3 India: Achieving Fiscal Consolidation and a Sound Banking System

After a decade of reforms the consolidated deficit of the public sector (inclusive of centre, states and non-financial SOEs) in 2000-01, as noted earlier, is likely to exceed its pre-reform level of 10.9% of GDP in 1990-1. Thus fiscal consolidation still remains elusive. A major contributor to fiscal imbalance at the center and states are subsidies on food, fertilizer, irrigation water, electricity, and low charges for public services such as education and health. Non-merit subsidies (i.e. those that cannot be rationalized on social justice and externality grounds) accounted for more than three-fourths of the implicit and explicit subsidies of the order of 14.5% of GDP in 1994-1995 (Government of India, 1998). Political considerations have precluded any serious attempt to reduce subsidies. Interest payment on public debt and the expenditure on wages, salaries and pensions of employees eat up most of the revenue of government. In his budget for 2000-2001, the

Finance Minister has announced plans to reduce government employment, following the recommendations of the recently established expenditure reforms commission.¹⁴ This and the introduction of a Fiscal Responsibility Act in Parliament are hopeful signs.

Reform of the financial sector in general, and banking system in particular, have been on the government's agenda for over a decade. Several committees appointed by the government had made recommendations including appointed in February 1999 on reforming weak public sector banks. Although a few private domestic and foreign banks operate, the state-owned banks dominate the commercial banking sector. According to IMF (2000: Table V.2), the risk-weighted capital ratio of 27 large public sector banks has gradually increased to 11.2% in 1998-1999. However net NPLs accounted for 8.1% of outstanding loans of public sector banks, while the same ratio for their domestic private and foreign counterparts were respectively 6.9% and 2.0% in the same year. What is even more disturbing, the number public sector banks with net NPLs above 8% of all outstanding loans was as high 14 out of 27 in 1998-99. Had norms for classification of a loan as non-performing, such as those in advanced countries, been applied instead of less stringent Indian ones, the quantity of NPLs, would have been much higher. There is a long way to go for the banking sector to become sound and until then making the rupee convertible on the capital account would be premature.

7.4 China and India in the World Economy: Bilateral Trade and Competition in World Markets¹⁵

After the border war of 1962 bilateral trade was suspended and did not reopen until 1977. Although superficially it might appear that the two countries have similar factor endowment ratios and there is not much complimentary between their commodity

production structures to induce trade, there is still a potential for a much greater volume of trade than is taking place at present, particularly in intra-industry trade. There is evidence that after languishing in the eighties, trade has grown significantly in the nineties. In the year 2000 total trade was of the order \$3 billion as compared to a paltry \$2.45 million when trade reopened in 1977. India imported \$1561 million worth of goods from China and exported \$1353 million. The rate of growth of trade between 1999 and 2000 was a phenomenal 47%. There are a number of products, such as coking coal, iron ore, raw silk and silk fabric where there is potential for a substantial expansion of trade. Also, possibilities exist for two-way trade of items within broad product categories such as steel, textiles and apparel.

Bilateral trade in services and flows of FDI are increasing as well. India's lead in software, and China's capability in hardware, have opened up possibilities of increasing trade in products and services of the Information Technology Sector. Indian software companies and training institutes have a significant presence in the Pudong Software Park in Shanghai. A dominant Chinese software company has an office in India's software capital of Bangalore and many Chinese software engineers are also being trained there. China has established a base for production of washing machines and colour television sets in India to cater to the Indian market. India has just begun cultivating a Chinese developed hybrid rice variety which can yield twice as much of rice per unit of land as some of India's own dwarf varieties of high yielding rice.

Gopalan's (2001, p35) estimates of labour productivity in manufacturing suggest that except in petroleum products and non-electrical machinery, the productivity of a Chinese worker is higher by anywhere from 30% to 180% depending on the product.

Needless to say, that given the heterogeneity of labour, and also products, within broad manufacturing sectors, possible biases in the exchange rates¹⁶ used to convert output or value added in domestic prices in each country to their U.S. dollar values, and the fact the comparison is confined to the productivity of a single factor, namely, labour, these estimates of Gopalan have to be treated with caution. Gopalan (2001, Table 11, p48) also provides price comparisons for Chinese and Indian manufacturers in some of which both compete in third markets and others, which Chinese export to India. These comparisons indicate that China has lower costs in many products than India, though once again, one has to keep in mind that the exchange rates used might be distorted. It is no surprise, that China has gained, and India has lost, market shares in third markets. Unless India catches up and becomes internationally competitive, this trend is likely to continue in the future¹⁷. The entry of cheaper Chinese products created an almost panicky reaction by Indian producers who demanded the imposition of anti-dumping duties on Chinese imports. The government has unfortunately conceded this demand by imposing anti-dumping duties on some Chinese imports in May, 2001.

The contrast between China's ability to attract massive inflows of foreign capital compared to India was noted earlier. Perkins (2000) argues that since much of the capital and direct investment came for overseas and Hongkong Chinese who had expertise and experience in producing and selling in world markets, China was able to expand its imports and impart a dynamism to its economy without having to wait for the creation of market institutions and culture domestically. However whether the flows of the magnitude that China has been receiving are sustainable into the future is an open question. Lardy (1998:201) suggests that the fall in foreign direct investment (FDI) in

1996 and 1997 portends future reductions as well. Whether or not there is a slow down in FDI in China, it is clear that without creating a more welcoming and less politically determined process of approval, India is unlikely to attract a substantial volume of FDI.

Even without being a member of the WTO (as India has been since its founding) China already enjoyed one of the most significant benefits of membership, namely, most favoured nation treatment, from every major country in the world, (except the United States which grants it on an annual basis until 2001). China and Taiwan, China have become members of the WTO in January 2002. A world bank study (Lanchovina et al, 2000) suggests with accession to WTO, China's share in world exports would rise to 6.3% from its pre accession level of 4.6%, with large gains in exports of apparel, textile, electronics and metals, in part because of the phase-out of MFA, and also because of some of Taiwan's electronics firms are relocating in the mainland. India competes with China in the world markets for some of these products. Be that as it may, according to the Asian Development Bank, China will face significant challenges in implementing its commitment to cut tariffs, remove nontariff barriers, and allow foreign participation across a wide range of sectors as part of its agreement with existing members of the WTO as a prelude to its entry.¹⁸

7.5 Widening Regional Disparities and Income Inequalities

In Section 5 the rampant economic and political corruption engendered by India's preform state controls on economic activity was pointed out. The expectation that reforms, which did away with many of the controls, would reduce corruption has not yet been borne out. In China, at least until the reforms of 1978, the rents (as well as resources directed to rent seeking) were modest. The scope for consuming rents was limited because the goods

available for consumption were few in number and poor in quality. Accumulating rents was not attractive either since private wealth was difficult to hide or conspicuous consumption was politically risky. This is not to deny the existence of luxurious party "guest houses," but only to suggest that the diversion of resources to such activities was limited. In post reform China, with wealth accumulation no longer frowned upon, and with the phenomenal increase in the supply of consumer goods (particularly imported durables), the diversion of resources for rent seeking has increased substantially. Chinese policy makers, however, have attempted to eliminate any potential rents quickly. Yet given the still rudimentary and segmented markets in China and the fact that guanxi (i.e., connection) is still important in getting ahead, it is unlikely that rents have been eliminated.

In the post-reform era a widening of regional disparities has been observed in both countries. To a certain extent this is natural: those regions (and individuals) which are better placed initially to take advantage of the opportunities opened up by the reforms are likely to grow faster. The real issue then is whether the socio-economic system would enable regions, which are initially disadvantaged to catch up with the initially advantaged in a reasonable period of time.¹⁹

In China, the report of the Central Committee of Communist Party cites "growing social and economic inequality and official corruption as over-arching sources of discontent. The income gap is approaching the "alarm level", it says, with disparities widening between city and countryside, between the fast-growing East Coast and the stagnant interior, and also within urban populations" (New York Times, June 3, 2001: p. 8). In India also regional disparities are significant and some states which were better placed in terms of human capital and infrastructure have grown faster than others after

external opening and reforms. Clearly in both countries growing regional disparities is a serious political issue.

8.0 Conclusion

At the end of five decades of development since 1950, China had far outstripped India in economic performance in terms of levels of growth, education, health and of living standard of its population, and integrating its economy with the world economy. In 1950 both had roughly the same per capita real income, similar social indicators, and were very poor. An overwhelming majority of their population lived in rural areas and were dependent on agriculture for their livelihood. India had an initial advantage with more arable land per head, a more diversified industrial base and better-developed transport and communications infrastructure. China had a more productive agriculture with higher crop yields per hectare of land. Both adopted state directed autarkic industrialization as their development strategy and virtually insulated their economies from the world economy.

Until the 1980s, China's economic performance was not much superior to India's. China's faster average rate of growth of 6% per year during 1950-80, compared to India's 3.5%, was primarily due to the Chinese dictatorship extracting greater savings (around 10% of GDP higher) and labour from the Chinese population, and not due to any superiority in productivity growth. China invested more in education and health and achieved higher rates of literacy and life expectancy compared to India's by the mid seventies. Also, China devoted a greater share of investment to industry and infrastructure so that by 1980 China was far more industrialized than India was. China abolished private property rights in land and forced the peasants into communes. India,

other than abolishing the so called Zamindari system, did not undertake any serious redistribution of land or reform tenancy. However, Indians were not subjects of cruel experimentation as the Chinese were during the Great Leap Forward and the Cultural Revolution. Nor did they experience famines and excess mortality of 30 million or more as the Chinese suffered as subjects of the experiments. Above all Indians enjoyed personal and political freedoms as citizens of a vibrant democracy that Chinese are yet to enjoy.

The two decades after 1980 saw the emergence of both countries as star growth achievers in the world. However, China's growth rate during 1980-2000 was about 4% higher than India's and its overall performance outstripped India's. The fact that China initiated reforms more than a decade earlier than India explains only a small part of this difference, since India also liberalized its economy to a limited extent in the 1980s. Also, China's investment rate continued to exceed India's by 10%-15% on an average in the eighties and nineties. A third contributing factor is China's greater success in export performance and attracting FDI, though a large part of it came from overseas Chinese. However these factors in themselves are not adequate to dismiss the argument that Chinese reforms, in particular their contents and modalities of implementation, are very different from their Indian counterparts and it is this difference that contributed to the Chinese success.

This argument, though plausible, can be stretched too far, as the World Bank (1992b) did, in its adulatory and insufficient by critical evaluation of Chinese reform. The Bank found four consistent themes in the Chinese approach to reforms gradualism, partial reform, decentralization, and mutually reinforcing reforms in several areas. It

claims that “in almost all areas of reform, implementation has been spread over time, often several years, and usually after experimentation. Typically, such experiments take place in designated ‘reform areas’ and after one results of trials are observed, they then spread to other parts of the country” (World Bank, 1992:37). Given the vastness of China and the inadequacy of its transport and communication networks as of then, it is not credible that the leadership designed ex ante a large enough number of independent trials of alternative reform strategies, implemented them, received and evaluated their results in time to implement the most successful alternative.

A more plausible story is that the success of Chinese reforms has been in part due to China’s being a closed dictatorship. Chinese leaders did not have to respond to pressure groups that stood to gain or lose from reforms and to a critical press. The top leaders were thus able to resolve their different views about the direction and pace of reforms by putting into practice each view and letting the performance of the economy determine which was most appropriate. The reforms therefore appeared to proceed in a two-step-forward-one-step-back manner. Further, the dominance of the coalition helped keep the bureaucratic apparatus intact and reasonably efficient while the pro-market policies of its paramount leader Deng Xiaoping took hold. The authoritarian roots of Chinese success were noted by the former Russian Prime Minister Yegor Gaidar, who is reported to have said that he too would have found China’s method of change easier but that it was possible only with a “powerful structure of authoritarian rule” (*New York Times*, October 7, 1992). This said, it is important to note that the Chinese success is also in part due to the reforms being gradual and experimental, allowing the possibility of correcting policies that failed and reinforcing those that proved fruitful.

Of course, the heavy investment in physical and social infrastructure prior to reforms paid off handsomely, once the reforms provided the incentives for peasants and producers to use resources efficiently. Clearly the changes in incentives in moving from a commune based agriculture to the household responsibility system was phenomenal and so was the response. In India, agriculture had always been in private hands, and there had been no major reforms of land ownership and tenancy. The reforms of 1991 also largely left agriculture out. As such, unlike in China, there could be no spectacular change in Indian agricultural performance after the reforms. Surprisingly, Indian agriculture did relatively well. The crop production index (1989-91=100) stood at 67.1 and 70.9 respectively for China and India during 1979-81. It more than doubled to 141.5 by 1998-2000 in China and in India it rose by 70% to 122.1 (World Bank 2001:Table 3.3).

According to Lau et al (2000), the “dual-track” system of Chinese reforms i.e. continuing to enforce the existing plan, while simultaneously liberalizing the market, had the potential to avoid creating losers from reform. While claiming that the potential was largely realized, they also recognize that by protecting workers in SOEs, interests of workers outside the state sector, particularly the migrant workers from rural areas, would be hurt as has happened already. World Bank (1992b. 67) on the other hand claimed that “By using the gradual approach, and by not subjecting the state sector to major shocks, China has succeeded in avoiding severe social costs during its transition. The Chinese effort has focused much less on changing old enterprises and more on generating new opportunities.” In fact by keeping the SOEs dominant without attempting to make them competitive, China simply absorbed the cost of their inefficiencies. This option was not

available to other developing countries, such as India which undertook reforms while in the midst of a macroeconomic and fiscal crisis. It would seem that China has not really avoided potential social problems but merely postponed them at a resource cost.

The agreements that China has signed as part of the process of its entry into the WTO would force China to deal with the SOEs and the problems of NPLs in its banks, to which in large part the SOEs were the contributors. Although India's SOEs need to be reformed, they are not as large a part of the industrial sector and the economy as a whole and in China. The growing income disparities across regions and social groups is a potential problem for both. Being a democracy, India has political safety valves to address the concerns of the losers and ensuring that the stability of the system is not threatened by social discontent. Whether the Chinese communist party, whose leadership is showing flexibility by envisaging the admission of "capitalists" into the party, will be flexible enough to accommodate the problems of rural migrants and other losers from reforms is not clear. In any case, the substantial slow down in growth as has been seen in both economies, if it persists, would make it considerably more difficult to tackle incipient social unrest and to eradicate poverty once and for all.

Table 1 Selected Indicators for China and India (1999)		
	China	India
Population* (millions)	1,254	1027
GNP per capita (US\$)	780	440
Average Annual Rate of Growth; GDP per capita 1965-1999	6.4	2.4
Inflation Rate (GDP Deflator, % per year (1980-90) (1990-99)	5.9 8.2	8.0 8.5
Share in GDP,		
Agriculture	18	28
Industry	49	26
Manufacturing	38	16
Gross Domestic Investment/GDP	37	23
Gross domestic saving/ GDP	40	20
Life expectancy at birth	70	63
Total fertility rate	1.9	3.1
Labor force in agriculture, 1980 (% of total labor force)		63
Merchandise exports (billions of US\$)	195	37
Manufactured exports (% of merchandise exports)	88	76
Merchandise imports (billions of US\$)	166	45
Aggregate Net Resource Flows (billions of US\$)	42.7	3.4
Total outstanding external debt (billions of US\$)	154	94
Total debt service/ exports of goods and services	9.0	15.0
Overall central government deficit, including grants (1998) (% of GDP)	-2.2	-4.8

* China's population estimate is as of February 1, 2000 and India's as of March 1, 2001.
SOURCES: World Bank (2000c and 2001) and Banthia (2001)

Table 2 Trends in Development		
	China	India
Average Annual Rate of growth of GNP (percent)		
1965-1999	8.1	4.6
1980-1990	10.1	5.8
1990-1999	10.7	6.0
Average Annual Rate of population growth (percent)		
1965-1999	1.7	2.1
1980-1999	1.3	2.0
Average Annual Rate of Growth of gross fixed capital formation		
1965-1999	10.0	5.5
Agriculture Value Added (Average per year) (billions of constant 1995 US\$)		
1965-1998	86.9	66.1
1980-1990	91.8	69.0
1990-1998	137.8	92.8
Industry Value Added (Average per year) (billions of constant 1995 US\$)		
1965-1998	121.8	46.1
1980-1990	102.5	47.4
1990-1998	300.3	82.7
Services Value Added (Average per year) (billions of constant 1995 US\$)		
1965-1998	88.5	75.1
1980-1990	86.6	75.9
1990-1998	199.3	137.9
Foreign Direct Investment (percent of gross capital formation)		
1990	2.8	0.2
1999	10.5	2.1
Exports of Goods and Services (Average Annual Rate of growth in volume, percent)		
1980-1990	13.9	-3.4
1990-1998	10.7	2.7
Imports of Goods and Services (annualized growth in volume, percent)		
1980-1990	15.8	-2.8
1990-1998	9.4	5.4

SOURCE: World Bank (2000a, 2001)

Table 3 Policy Trends		
	China	India
Trade Policy		
Import Duties (% of imports)		
1980		26.2
1998	2.8	24.2
Export Duties (% of exports)		
1980		1.8
1998	0.0	0.1
Mean Tariff (%)		
1980	49.5 (1982)	74.3 (1981)
1999	16.8 (1998)	32.4
Gross capital Formation (% of GDP)		
1990	35.0	25.0
1999	37.0	23.0
State-Owned Enterprises		
Investment/ Gross domestic investment (%)		
1985-90	37	35.4
1990-97	27.6	32.4
Proceeds from privatization (millions of US\$)		
1990-1999	20,593.2	8,983.4
Investment in Infrastructure with private participation (US\$ millions, 1995-1999)		
Telecommunications	5,970.0	9,176.7
Energy	12,922.1	7,910.8
Transport	9,650.8	2,223.1
Water and Sanitation	605.4	872.2
Capital Market Development (1995) (Indices range from 1-10, with higher numbers indicating more developed markets)		
Market Infrastructure (efficiency in settlement and post-settlement actions)	7.6	3.8
Institutional Development (quality of financial reporting, protection of investor rights, market openness)	3.9	5.2

Sources: World Bank (1997, 2000a, 2001)

References

- Abler, D. and J. Das (1998), "The Determinants of the Speed of Convergence: The Case of India," Applied Economics, 30, 1595-1602.
- Asian Development Bank (2000), Asian Development Outlook 2000, Hong Kong: Oxford University Press.
- Bannerjee, B., G. Parikh, and V. Tarkunde (1944), People's Plan for Economic Development of India, Bombay, Indian Federation of Labour.
- Banthia, J. K. (2001), Provisional Population Totals, Census of India, 2001, Series 1, Paper 1 of 2001, New Delhi, Registrar General & Census Commissioner, India.
- Buiter, W. and U. Patel (1992), "Debt, Deficits and Inflation: An Application to the Public Finances of India," Journal of Public Economics, Vol. 47, 171-205.
- Cashin, P. and R. Sahay (1996), "Internal Migration, Centre-State Grants and Economic Growth in States of India," IMF Staff Papers, 43, 123-71.
- _____ (1997), "A Reply to Rao and Sen," IMF Staff Papers, 44, 289-91.
- Central Statistical Organisation (1989), National Accounts Statistics, 1950-51-1979-80, New Delhi, Department of Statistics, Government of India.
- Chopra, A., C. Collins, R. Hemming, and K. Parker with W. Chu and O. Fratzscher (1995), "India: Economic Reforms and Growth," Washington D.C., International Monetary Fund, Occasional Paper No. 134.
- Dayal-Gulati, A. and A. Husain (2000), "Centripetal Forces in China's Economic Take-off," Working Paper WP/00/86 (revised), Washington, D.C.: International Monetary Fund.

- Demurger, S., J. Sachs, W. Woo, S. Bao, G. Chang and A. Mellinger (2001), "Economic Geography and Regional Growth in China," paper presented at the Asian Economic Panel, Cambridge, MA, April 26-27, 2001 (processed).
- Desai, P. (1975), "Discussion," American Economic Review 65, No. 2, 365-68.
- Goldar, B. (2000), "Productivity Growth in Indian Manufacturing in the 1980s and 1990s," New Delhi: Institute of Economic Growth (processed).
- Gopalan, R. (2001) "China's Competiveness", New Delhi, Department of Commerce, Government of India (processed).
- Government of India (2001), Economic Survey 2000-01, New Delhi: Ministry of Finance, Government of India.
- _____ (1999), Economic Survey 1998-99, New Delhi: Ministry of Finance, Government of India.
- Gurley, J. (1975), "Discussion," American Economic Review 65, No. 2, 368-71.
- Hu, Z. and M. Khan (1997), "Why is China Growing Fast?" Economic Issues, No. 8, Washington D.C.: International Monetary Fund.
- IMF (2000), India: Recent Economic Developments, Country Report No. 00/155, Washington, D.C.: International Monetary Fund.
- Kumar, D. (1992), "The Chinese and India Economies from ca 1914-1949," CP No. 22, Research Programme on the Chinese Economy, STICERD, London: London School of Economics.
- Lanchovina, E., W. Martin, and E. Fukase (2000), "Modeling the Impact of China's Accession to the WTO" Washington, D. C., World Bank (processed).

- Lau, L, Qian, Y. and G. Roland (2001), "Reforms Without Losers: An Interpretation of china's Dual – Track Approach to Transition," Journal of Political Economy, 108(1), 120-143.
- Lardy, N. (1998), China's Unfinished Economic Revolution, Washington, D.C.: Brookings Institution Press.
- Lee, B. and D.S.P. Rao (2001), "Comparisons of Purchasing Power, Real Output and Productivity of Chinese and Indian Manufacturing." School of Economics and Finance, Queensland University of Technology (processed).
- Lin, Justin (1994), "Chinese Agriculture: Institutional Changes and Performance," Chapter 2 in T. N. Srinivasan, Agriculture and Trade in China and India, San Francisco, International Center for Economic Growth.
- Ma, G. and R. Gournaut (1992), "How Rich is China: Evidence from the Food Economy," Working Paper, Department of Economics, Research School of Pacific Studies, Canberra: Australian National University.
- Maddison, A. (1991), "Postwar Growth and Slowdown: A Global View," in G. Gahlen, H. Hesse, and H. G. Ramser, eds., Wachstumstheorie und Wachstumspolitik, Tubingen: J.C.B. Mohr (Paul Siebeck).
- Malenbaum, W. (1956), "India and China: Development Contrasts," Journal of Political Economy 64, No. 1, 1-24.
- _____ (1959), "India and China: Contrasts in Development," American Economic Review 49, No. 3, 284-309.
- Mattoo, A. and A. Subramanian (2000), "India and the Multilateral Trading System Post-Seattle: Defensive or Proactive?," Washington D.C., World Bank (processed).

- NCAER (2001), "The Impact of India's Economic Reforms on Industrial Productivity and Competitiveness," New Delhi: National Council of Applied Economic Research (processed).
- OECD (2000), Reforming China's Enterprises, Paris: Organisation for Economic Cooperation and Development.
- Press Information Bureau (2001a), Quick Estimates of National Income, Consumption Expenditure, Saving and Capital Formation, 1999-2000, Press Note, New Delhi, Press Information Bureau, 30 January 2001.
- _____ (2001b), Advance Estimates of National Income 2000-01, Press Note, New Delhi, Press Information Bureau, 5 February 2001.
- Qian, Y. and J. Wu (2000), "China's Transition to a Market Economy: How Far Across the River?", Working Paper 69, Center for Research on Economic Development and Policy Reform, Stanford University, Stanford, CA.
- Rao, M. G. and K. Sen (1997), "Internal Migration, Centre-State Grants, and Economic Growth in States of India," IMF Staff Papers, 44, 283-89.
- Rawski, T. G. (1989), Economic Growth in Prewar China, Berkeley: University of California Press.
- Reserve Bank of India (2000), Handbook of Statistics On The Indian Economy, Mumbai, Reserve Bank of India.
- Richman, B. (1975), "Chinese and Indian Development: An Interdisciplinary Environmental Analysis," American Economic Review 65, No. 2, 345-55.
- Shangquan, G. (1999), Two Decades of Reform in China, Singapore, World Scientific.
- Srinivasan, T. N. (1993), "Indian Economic Reforms: Background, Rationale and Next

- Steps,” New Haven: Yale University, processed.
- _____ (1994), Agriculture and Trade in China and India, San Francisco, International Center for Economic Growth.
- Sung, Yun-Wing (1994), “An Appraisal of China’s Foreign Trade Policy, 1950-1992,” Chapter 4 in T. N. Srinivasan, Agriculture and Trade in China and India, San Francisco, International Center for Economic Growth.
- Thakurdas, P., J. Tata, G. Birla, A. Dalal, S. Ram, A. Shroff, and J. Mathai (1944), A Plan of Economic Development of India, London: Penguin Books.
- Visveswaraya, Sir M. (1934), Planned Economy for India, Bangalore: Bangalore Press.
- Weisskopf, T. (1975), “China and India: Contrasting Experiences in Economic Development,” American Economic Review 65, No. 2, 356-64.
- Wood, A. and M. Calandrino (2000), “When Other Giant Awakens: Trade and Human Resources in India”, Mumbai, Economic and Political Weekly, XXXV (52 and 53), 4677-4694.
- World Bank (1983), China: Socialist Economic Development, Vol. 1, Washington, D.C.: World Bank.
- _____ (1996), India: Country Economic Memorandum, Report No. 15882-IN, Washington, D.C.: World Bank.
- _____ (1997), Private Capital Flows to Developing Countries, Washington, D.C., World Bank.
- _____ (1998), India: Macroeconomic Update, Washington, D.C., World Bank.
- _____ (2000a), World Development Indicators, Washington, D.C., World Bank.
- _____ (2000b), India: Policies to Reduce Poverty and Accelerate Sustainable

- Development, Report 19471-IN, Washington, D.C., World Bank.
- _____ (2000c), Global Development Finance, Washington, D.C., World Bank.
- _____ (2001), World Development Indicators, Washington, D.C., World Bank.
- WTO (2000), International Trade Statistics 2000, Geneva: World Trade Organization.

Footnotes

* Samuel C. Park Jr., Professor of Economics, Yale University and Visiting Fellow, Center for Research on Economic Development and Policy Reform (CREDPR), Stanford University.

¹ The first three sections draw on Srinivasan (1994), Chapter 1. This is a revised version of a paper presented at seminars in Beijing, New Delhi and Shanghai. I thank my discussants, Zhan Minqiu and Wen Fude at Beijing, V.S. Seshadri at New Delhi and Huang Renwei at Shanghai and participants of these three seminars for their valuable comments. Thanks are also due to the editors, Harry Harding and Francine Frankel, for their valuable substantive and editorial suggestions. I thank CREDPR for research support Jessica Seddon for research assistance.

² Interestingly, such an analysis was deemed important already in the fifties (Malenbaum, 1956 and 1959). At its annual meetings in December 1974, the American Economic Association (AEA) held a session on China and India with papers by Richman (1975) and Weisskopf (1975) and comments by Desai (1975) and Gurley (1975). Malenbaum wrote fairly early in the development of the two countries, and the AEA discussion in 1974 preceded the death of Mao Zedong, a full revelation of the horrors of the Cultural Revolution (CR) and Deng Xiaoping's initiation of reforms in 1978. Besides, as Desai (1975) pointed out, the information (particularly with respect to China) on which comparisons were then based left much to be desired. Nonetheless, Malenbaum was right about the importance of a comparative analysis of the development strategy, policies and performance of China and India.

Indeed this chapter is devoted to such an analysis and not to a theme more in keeping with the other chapters of the volume, namely, bilateral economic relations between the two countries. The reason is that historically economic interactions between China and India have been much less important than their cultural interactions. This is in part due to high cost of transport across the Himalayan border. The border war of 1962, and the subsequent chill in bilateral political relations, effectively eliminated much trade and other economic relations between the two countries. Although in the nineties, bilateral trade has been growing rapidly, and the prospects for a substantial penetration of each in the other's market are good, these phenomena are very recent. With China's entry into the World Trade Organization (WTO) and the launch of a new round of multilateral trade negotiations under the auspices of the WTO in 2002, competition between China and India in third markets is likely to intensify on the one hand, and on the other, as large poor and labour abundant developing countries the two would find much common ground in their negotiating positions. The chapter by James Clad covers these issues.

Since there is not much to describe or analyze about China-India economic relations of the last half of the twentieth century, this chapter is devoted to a comparison of their economic development. Strategies and performance since the early fifties. Although it might seem natural in a comparative analysis of two economies to devote equal space to each economy

and discuss each with a common structure, it is not so in this case. The reason is that the dominance of the State in the Chinese economy, which was total and direct prior to the reforms, is still very significant and the control of the communist party of the government is complete. By contrast, in India's multiparty democracy, with a large private sector, state control over the economy has been incomplete, indirect and subject to political pulls. Because of these differences, not only more space will be devoted to the discussion of India's complex development history compared to a relatively straight forward Chinese history, but also a rigid common structure will not be adopted for the discussion.

³Compared with data on India, data on the Chinese economy, certainly for the period prior to 1978, and to a lesser thereafter, have been relatively sparse, of uncertain reliability and whose internal consistency has not been subject to rigorous examination. In China's command economy the relative prices of goods and services were distorted and did not represent the marginal rates of substitution in their use or of transformation in their supply. This meant that GDP and GNP at domestic Chinese prices were not good indicators of China's production capacity or welfare of Chinese citizens. These distorted values at domestic prices correcting for these distorted and converted them to U.S. dollar makes using exchange rates is virtually impossible. For example, the World Bank (1992:48) reported China's per capita GNP in 1990 as \$370 and India's as \$350 and that the average annual rates of growth of GNP per capita during 1965-90 in China and India were respectively 5.8 percent and 1.9 percent. If these data are correct, then projecting backwards, China's GNP per capita in 1965 would have been only 41 percent of India's! No knowledgeable analyst of the two countries must subscribe to this relative value of China's GNP per capita in 1965. A plausible explanation for these paradoxical figures is that the figure of \$370 as China's 1990 per capita GNP reflects the consideration that a more realistic figure would have soon made China ineligible for loans from International Development Association, the soft loan affiliate of the World Bank. In fact Ma and Gournaut (1992) suggest that only if China's per capita income were to be 3-4 times the income reported by the World Bank would the consumption pattern of China be comparable, as one would expect, to that in Taiwan and Hong Kong. Rawski reworked the estimates of output in China for the period 1914-1949 and concluded, "with the exception of the war period 1937-49, China's economy has now experienced seven decades of rising aggregate and per capita output stretching back to 1914 if not earlier" (Rawski 1989: 347-48). However Kumar's careful examination of Rawski's reworking of Chinese data and Indian data for the period 1914-1949 led her to conclude that "the safest view is still that overall growth story was not very different in the two countries--a slow growth of population, and slow or no growth in per capita income, in marked contrast to the post 1950 experience in both countries. The per capita income of both India and China was very low in 1949 and given the margin of error, it is not worth arguing about which country was the poorer. The demographic data suggest that the physical quality of life was higher in China, but this is based on unreliable data" (Kumar 1992:30).

⁴Nehru was the chairman of the National Planning Committee established in 1938 by Indian National Congress, the then dominant political party that led the struggle for India's independence from the British. This committee, which completed most of its work before Nehru's arrest by the colonial government in 1940 articulated a development

strategy, main elements of which were incorporated in post independence planning. Besides this committee, just prior to the end of the Second World War, other groups (for example, businessmen, labor unions, and followers of Gandhi) published their own ideas for India's development in the post independence era. Even the colonial government, anticipating the end of the Second World War, prepared plans in the early forties for post-war development. Except for the Gandhians and the colonial government, there was a broad consensus on a state-led and planned industrialization strategy, a consensus inspired in part by Soviet experience.

⁵These data are drawn from a presentation of Peter Bottleier on the occasion of the 50th anniversary of the People's Republic of China, Stanford University, 16 November 1991.

⁶ Visveswaraya (1934: 351-353), an engineer cum statesman and an advocate of a planned economy for India, asserted that "India cannot prosper except through industrialization [which] has to be organized, planned and worked for ... India may be an industrially developed country or it may be a market for manufactured goods from outside and not both". Nehru's National Planning Committee advocated industrialization with emphasis on heavy industry and large-scale manufacturing with the arguments that

(a) "...The problems of poverty and unemployment, of national defense and of economic regeneration in general cannot be solved without industrialization." (Nehru 1946: 401); (b) "The three fundamental requirements of India ... are a heavy engineering and machine-making industry, scientific research institutes, and electric power." (ibid.: 416) and (c) "Thus even the enthusiastic advocates for cottage and small-scale industries recognize that big-scale industry is, to a certain extent, necessary and inevitable; an attempt to build up a country's economy largely on the basis of cottage and small-scale industries is doomed to failure." [ibid.: 413]

⁷ Visveswaraya (1934: 353) stated the case succinctly "India may be an industrially developed country or it may be a market for manufactured goods from outside and not both." The Committee viewed "the objective for the country as a whole was the attainment, as far as possible, of national self-sufficiency. International trade was certainly not excluded, but we were anxious to avoid being drawn into the whirlpool of economic imperialism. To base our national economy on export markets might lead to conflicts with other nations and sudden upsets when those markets were closed to us." (Nehru 1946:403).

⁸There was the infamous "indigenous clearance angle": any applicant for a license to import equipment was required to advertise in the relevant trade journal his intention to apply for a license. If any domestic manufacturer of a substitute responded saying that his product could meet the applicant's needs, the application was denied whether or not the product in fact met the needs and also whether its quality, cost or time of delivery were comparable to that of the intended import.

⁹ With a legal ban on corporate contributions to political parties, opportunities to create rents through the administrative mechanisms and to divert part of the rents for use in Indian electoral campaigns proved irresistible to the politicians in power. The recent expose (the so-called "Tehelka" tapes) of corruption in defense contracts is only the latest in a long list of similar episodes.

¹⁰ Ever since the sixties there have always been attempts at moderating the rigors and the unintended side effects as well as distributional consequences of the control system. The earliest of these occurred after a severe macroeconomic crisis in 1966 that forced the government to approach the International Monetary Fund (IMF) and The World Bank for assistance. As part of the agreement with the two institutions, the rupee was devalued in June 1966 and for a brief period of two years controls on foreign trade were relaxed. Mrs. Indira Gandhi, who had come to power less than six months earlier, was politically vulnerable. Many senior leaders in her own party as well as opposition parties were adamantly against devaluation and liberalization. Their opposition, and the failure of the World Bank to deliver the substantial non-project assistance that was promised in support of liberalization, led Mrs. Gandhi to abort ongoing liberalization. She did not attempt any liberalization thereafter until shortly before her assassination in 1984. The second liberalization in the mid eighties was initiated by Rajiv Gandhi, (who succeeded his assassinated mother) and the young economists appointed by him at senior levels in his office and economic ministries. They had served on the staff of the World Bank and were keen on releasing rigid controls. It so happened that foodgrain and foreign exchange reserves were comfortable at the time. This enabled Rajiv Gandhi's government to experiment with relaxing a few of the restrictive trade and investment policies without feats of triggering a balance of payments crisis. This liberalization did increase the potential output from existing capacity. But for the increased potential to be realized, demand had to be expanded. However, with no improvement in international competitiveness of domestic producers, the demand increase had to be domestic and not from exports. The domestic demand was stimulated by fiscal expansion financed by borrowing at home and abroad and some monetization of fiscal deficits. This expansion, although unsustainable as it turned out to be, enabled the economy to absorb the increased output and grow.

¹¹ World Bank (1983, Appendix Table A. 23) data suggest that Indian ICOR was marginally higher than China's in the sixties and seventies.

¹² However preliminary data for 2000 indicate a slight pick up to 8%. Nonetheless, Primer Zhu Rongji, in his report on the outline of the Tenth Five Year Plan to the Fourth Session of Ninth People's Congress on March 5, 2001, recognized that, given the overall conditions of all sectors of the economy, the target growth rate for the tenth plan had to be set at 7% a year, somewhat lower than the target for the ninth plan and achieving this lower target would still need arduous efforts and better economic performance.

¹³ Since the SEB was bankrupt ENRON insisted on a guarantee of payment from the state government, the owner of SEB, if the latter failed to pay. Further the state government itself was in financial difficulties so that ENRON received a counter-guarantee from the

central government that it would pay if the state government failed to do so. The present situation is that the state government led by the Congress Party, which is the opposition party at the center, does not want to pay and the center refuses to honour its guarantee!

¹⁴The previous government had raised emoluments of government servants over and above the levels recommended by the Fifth Pay Commission while at the same time rejecting its recommendation to reduce government payroll by 30% over 10 years. However the savings from downsizing government are likely to be very modest.

¹⁵This section draws heavily, with thanks, on the comments of Zhang Minqiu at the Beijing Seminar. I have also relied on the handout India's Trade With the East China Region from the Consulate General of India in Shanghai.

¹⁶To the best of my knowledge, Lee and Rao (2001) are the first to undertake a direct comparison for the period 1952-1995, of the productivity of manufacturing industries of the two countries using sector specific purchasing power parity exchange rates. They found that labour productivity of India has declined from 71% of Chinese labour productivity in 1952 to 37% in 1995.

¹⁷Wood and Calandrino (2000) undertake a detailed comparison of China's and India's manufacturing sectors in terms of employment and foreign trade and decompose India – China differences into contributions of level and balance of exports and imports, composition of exports, imports, investment, household and government consumption, input-output coefficients and relative sectoral labour productivities. Their bottom line, based on actual Chinese performance is that if India were to reduce its existing barriers to trade, particularly to exporting, it could double its per capita income and increase its exports five fold within a couple of decades.

¹⁸It is unlikely that the formalities of China's entry would be completed before the fourth ministerial meeting of the WTO at Doha, Qatar in November 2001. A new round of multilateral trade negotiations is expected to be launched at this meeting. It is likely that China may be allowed even before its formal entry into the WTO as a member, to take part in these trade negotiations, rather than remaining as an observer (New York Times, June 10, 2001:10). India and China would find it in their interests to cooperate in the negotiations that would set the agenda for the next round. Both have a common interest in further liberalization of agricultural trade, tightening the rules on antidumping measures, and above all ensuring that non-trade related issues, such as labour and environmental standards, are not brought into the WTO.

¹⁹At the aggregate level, one approach to this issue is to ask: do regions with initially different levels of income nonetheless converge over time to the same level and rate of growth per capita income in the long run? This is the so-called "absolute" convergence hypothesis. It is to be contrasted with the "conditional" convergence hypothesis, which suggests each region converges to its own long run level and growth of per capita income. There is a growing literature on testing the hypotheses of absolute and conditional convergence in both countries. Sachs et al. (2001) and Dayal-Gulati and Husain (2000) find support only for conditional convergence in China. In India, Cashin

and Sahay (1996, 1997) found evidence of absolute convergence. Rao and Sen (1997) suggest that in fact findings of Cashin and Sahay should be interpreted as supporting conditional convergence. Clearly, finding of conditional convergence, since it is consistent with regions growing at different rates in the long run, could mean growing disparities across regions. In India there is evidence of growing disparities between Southern and Western coastal states on the one hand, and the interior and northern states on the other in growth rates, with the former growing faster than the latter in the post reform era. Coupled with the fact that the incidence of poverty is higher, and the share of country's population larger, in the latter states, there has been legitimate concern that if sustained in the future, these growth disparities will threaten the stability of India's federal democracy.