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Institutions and economic growth: Cases of China and India

Fırat Kimya[1]
University of Virginia, Deparment of Politics, Charlottesville, VA
e-mail: ffk3yu@virginia.edu

Abstract

This study inquires why China managed to generate more economic growth than India despite the premises of Acemoğlu and Robinson's theory of inclusive and extractive institutions which claim that sustainable economic growth is only possible under inclusive institutions. This study attempts to show that Acemoğlu and Robinson's theory is insufficient to explain the case of China. By using the most-likely case methodology, the period of 1979-2010 is analyzed and economic growth performance of China and India are compared. While the dependent variable of this study is defined as the level of economic growth of a country which is measured by GDP and GDP per capita values, the type of the institutions –whether inclusive or extractive– that a country possesses are used as independent variables. All in all, it is argued in this paper that the theory of inclusive and extractive institutions is insufficient in explaining the better developmental performance of China over India. In order to present a more detailed and comprehensive answer for the case at hand, this study presents four alternative explanations which are more helpful in explaining the role of various dynamics in Chinese economic growth when compared to explanations presented by the theory of inclusive and extractive institutions.

Key words: Inclusive and extractive institutions, growth, China, India, most-likely case.

JEL classification: O10 O43 O53.

1. Introduction

This study deals with the question of why China achieved to generate significantly more economic growth than India contrary to Acemoğlu and Robinson's theory of inclusive economic and political institutions which they present in their renowned book, Why Nations Fail. The question is intriguing not

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only because China achieved a 'miraculous' economic development for a significant period of time but also the country is considered as an autocracy while India is a long-term democracy.

This study utilizes the most-likely case methodology since Acemoğlu and Robinson's theory fails to explain Chinese case that does not only make the theory most likely true but also strongly undermines it (George and Bennet, 2004). Hence, the literature review of the study mainly focuses on the theory presented by Acemoğlu and Robinson as the most-likely case methodology requires. Following the premises of most-likely case methodology, first their theory of inclusive and extractive institutions is unfolded. After specifying the main independent and dependent variables of the study, case selection is explained and the two cases are analyzed deeply. Since the main case of this study is claimed to be a most-likely case for the theory of inclusive and extractive institutions, I present four alternative explanations and discuss them in order to provide detailed and comprehensive answers for the research question of the current study. While the first alternative explanation assumes that China has a more competitive economic environment than India, the second one is related to the respective state capacities of the two countries. The third explanation emphasizes that China has a stronger diaspora than India, and the last one investigates the effects of the interdependence with the US economy on two countries' growth processes. In the light of the alternative explanations that I bring forward, I argue that theory of inclusive and extractive institutions is not a sufficient tool to explain why China, as a long-term dictatorial one-party state, achieved to generate more economic growth than democratic India.

However, claiming that Acemoğlu and Robinson's theory does not have strong explanatory power for the case at hand neither mean the rejection nor disdain of institutionalist theory. In addition, the aim is not to exalt authoritarian governance, and describe the shortcomings and weaknesses of democratic institutions. The study mainly intends to provide a more nuanced understanding of inclusiveness which can be helpful in understanding why an undemocratic state can also possess stronger, more inclusive economic institutions than a democratic one. Therefore, inclusiveness of institutions has to be discussed in a broader framework where the strength of the institutions, and areas of micro inclusion are also taken into consideration, and going beyond the theory's understanding of inclusiveness and extractiveness which mostly focus on whether a country has a democracy or an authoritarian regime.

2. Inclusive and extractive institutions

The study of institutions is one of the central themes of political science literature. Various socio-political, economic, and historical issues have been analyzed by taking the role of institutions into consideration. A basic definition of an institution would be;

> "In a general way, an "institution" can be viewed as a relatively stable collection of practices and rules defining appropriate behavior for specific groups of actors in specific situations. Such practices and rules are embedded in structures of meaning and schemes of interpretation that explain and legitimize particular identities and the practices and rules associated with them." (March and Olsen, 1998: 948)

In political science, depending on their "inclusive" nature, institutions can be one of the most significant pillars of democracy by creating a milieu of consensus, compromise, negotiation and bargaining (Lijphart, 1999). In their influential study on the other hand, Acemoğlu and Robinson analyze the effects of the institutional structure on a country's economic development, and well-being (Acemoğlu and Robinson, 2012). They categorize institutions in terms of their inclusiveness and extractiveness: inclusive political and economic institutions, and extractive political and economic institutions. Political institutions that are sufficiently centralized and pluralistic are defined as inclusive (Acemoğlu and Robinson, 2012:81) and if either of these conditions fail, the institutions become extractive. On the other hand inclusive economic institutions include those which secure property rights, provide an impartial system of law, allow people to choose their careers and entry of new businesses, enable people to fulfill their potentials. In addition, they create inclusive markets, facilitate economic activity, growth, and acquiring prosperity, and "pave the way" for two key inputs of economic well-being: education and technology (Acemoğlu and Robinson, 2012:77). Sustainable economic growth therefore, is seen possible only under inclusive political and economic institutions.

How a nation can create inclusive economic institutions to achieve economic growth and prosperity? Acemoğlu and Robinson's answer for this question include a strong emphasis on the role of political processes and the political institutions which determine the fate of economic institutions (Acemoğlu and Robinson, 2012: 43). According to the authors, political institutions ensure stability and continuity, and have the power of regulating and governing society, and hence becoming an indicator for existence of democracy (Acemoğlu and Robinson, 2012: 42-43). By this way, inclusive political institutions can foster inclusive economic institutions. In other words, their general argument holds that fate of economic institutions are in turn determined by political institutions (Subramanian, 2013). In addition, inclusive economic institutions and inclusive political institutions have a symbiotic relationship. Inclusive economic institutions can only exist in presence of inclusive political institutions, and they cannot coexist with extractive political institutions. They claim that either of them would experience a transformation from inclusiveness to extractiveness, and vice versa (Acemoğlu and Robinson, 2012: 82).

Because, the economic dynamism that is brought by inclusive economic institutions would lead to a creative destruction which would definitely transform the nature of extractive institutions. Since the fate of political and economic institutions is seen interdependent by Acemoğlu and Robinson, from this point onwards, they will be referred either as inclusive or extractive institutions.

Two neighboring African countries, Botswana and Zimbabwe is presented as affirmative cases. While the former is seen as a successful example of how inclusive institutions lead to economic prosperity and growth, the latter is a "failed nation". Botswana, one of the poorest countries of sub-Saharan Africa during 1960s and 70s, with its inclusive institutions, achieved to generate economic prosperity and reached at the same level as some European countries like Estonia and Hungary (Acemoğlu and Robinson, 2012: 409). While Botswana's inclusive institutions nourished stability and continuity, remaining under extractive institutions did not provide any good for its neighbor, Zimbabwe.

However, Acemoğlu and Robinson do not claim that economic growth and prosperity under extractive institutions are not possible. They argue that such a growth would either be unsustainable and meet an inevitable collapse, or lead transformation of the structure of institutions. As an example of unsustainable economic growth, they present Soviet Union which experienced economic growth under extractive institutions for almost 40 years but failed to sustain the growth process since its economic growth did not lead to a "creative destruction" (Acemoğlu and Robinson, 2012: 92). According to them, the Soviet growth failed at producing innovation and technological development which paved the way for its economic collapse. By using the Soviet Union example as a springboard, they explain why sustainable economic growth cannot be achieved under extractive institutions. The first reason is that innovation which is seen as a crucial condition for sustainable economic development is not possible under extractive institutions mainly because of resistance from the established elites. Only in some exceptional cases such as South Korea and Taiwan, elites may prefer "more output, more revenue, and more growth" which permits a certain degree of growth under extractive institutions.[2] Secondly, the coveted nature of political power under extractive institutions will lead to political instability since many different factions would fight to obtain it (Acemoğlu and Robinson, 2012: 430). These examples all reiterate their central thesis of the authors which is sustainable economic growth and prosperity is only possible under inclusive institutions.

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2 "China, India, and All That", http://whynationsfail.com/blog/2012/11/2/china-india-and-all-that.html

3. Methodology

The dependent variable (DV) of this study is the level of economic growth of a country which is measured by GDP and GDP per capita values. In addition, in order to trace economic development during the given time period more accurately, the annual percentage growth rates for GDP and GDP per capita values are measured as well. The independent variable (IV) of this study on the other hand is the type of the institutions –whether inclusive or extractive– that a country possesses. As was pointed out, Acemoğlu and Robinson think that the fate and structure of economic institutions are determined by the political processes, and political institutions. Therefore, the type of institutions that a country possesses is measured by its level of democracy, and existence of its democratic institutions.

In order to present a clear operationalization of the IV, the data from another study by the same authors is used (Acemoğlu et al., 2001). Similar to the current study, in that study too, GDP per capita level is used to measure outcome of economic development. In addition, Acemoğlu and Robinson measure inclusiveness and extractiveness by looking at the index of democracy in 1900, degree of constraints put over executive office from the Polity III data set, and an index of protection against expropriation, data obtained from political risk services (Acemoğlu et al., 2001: 1378). However, in this study the Polity IV data is used for the operationalization of the IV for three main reasons: first reason is that the index of democracy in 1900 is contained by the Polity IV data set, since it has the earliest democracy scores (Marshall et al., 2013). The second reason is that, Polity III data set is already updated and combined with the Polity IV data set. Therefore, Polity IV data set now contains the scores related to the constraints over executive office as well Marshall et al., 2013: 47). Lastly, while measuring democracy, Polity IV takes a regime's degree of respect to private property rights which can give an idea about the possible risk for expropriation by the state. In order to have a more robust measure of inclusiveness, data from Freedom House and Parliamentary Power Index are incorporated into the analysis as well.

This study will analyze period of 1979-2010. China has been experiencing a remarkable degree of economic growth since 1979 with the process of "opening-up" marked by economic liberalization policies of Deng Xiaoping (Beeson, 2013). The time period is restricted to 2010 in order to see the effects of 2008 global financial crisis on economic growth since almost all of the countries suffered from severe decline in foreign direct investment, export demand, and faced with fiscal and financial problems (Öniş and Güven, 2011). 2008 global financial crisis is substantially significant since it led to a remarkable downturn for almost all of the liberal market economies in the world. Last but not least, the most-likely case method is conducted, and economic growth of China in the given time interval is analyzed as a disconfirmatory case for Acemoğlu and Robinson's theory of inclusive and extractive institutions.

As mentioned above, China is chosen as the most-likely case for Acemoğlu and Robinson's theory, and it is compared to India. The two countries are in close geographical proximity,[3] have similar population figures,[4] they both are ancient civilizations of the world, have experienced Western colonialism, and have a large diaspora around the world, especially in Europe and the USA (Zhu, 2007). However, these two countries differ starkly in terms of their institutional structures: according to Polity IV data, Chinese regime is an autocracy while India is a democratic country (Figure 1). China is considered "not free", while India is classified as "free" by the Freedom House.[5] In addition, according to Parliamentary Power Index, China scored 0.34, and India did 0.63 (Fish and Kroenig, 2009). Therefore, by taking Acemoğlu and Robinson's operationalization into consideration, it can be claimed that China possesses extractive institutions, and India have inclusive institutions. As a matter of fact, it should also be noted that Acemoğlu and Robinson themselves also consider China as a country which achieved economic growth under extractive institutions;

> "As in the Soviet Union in its heyday, China is growing rapidly, but this is still growth under extractive institutions, under the control of the state, with little sign of a transition to inclusive political institutions. The fact that Chinese economic institutions are still far from fully inclusive also suggests that a South Korean–style transition is less likely, though of course not impossible." (Acemoğlu and Robinson, 2012:93-94)

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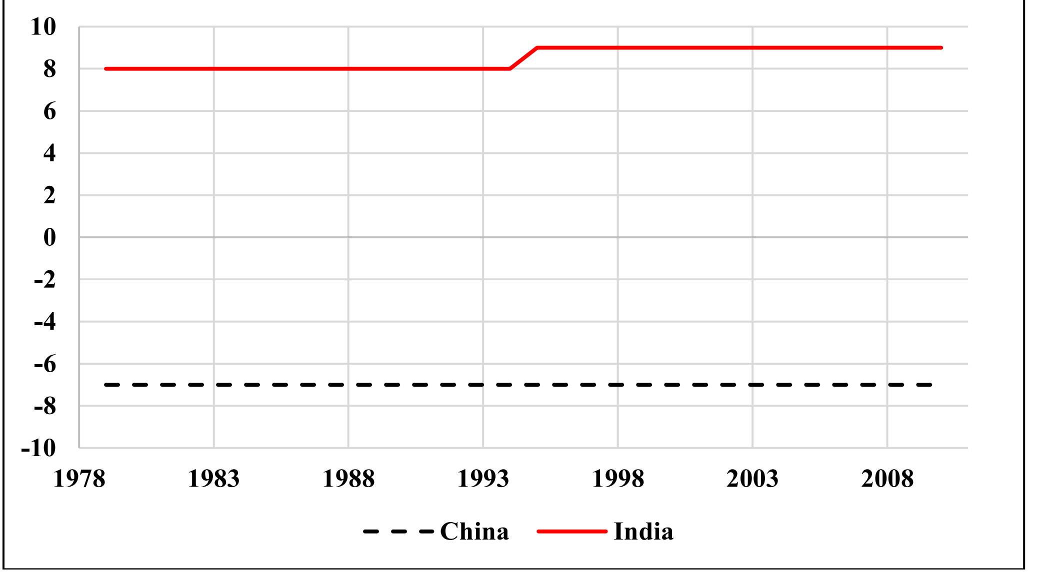
3 *China:* Eastern Asia, bordering the East China Sea, Korea Bay, Yellow Sea, and South China Sea, between North Korea and Vietnam - https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html & *India:* Southern Asia, bordering the Arabian Sea and the Bay of Bengal, between Burma and Pakistan, https://www.cia.gov/library/publications/the-world-factbook/geos/in.html

4 *China:* 1,367,485,388 (July 2015 est.), https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html & *India:* 1,251,695,584 (July 2015 est.), https://www.cia.gov/library/publications/the-world-factbook/geos/in.html

5 *China:* Freedom Rating: *6.5*, Political Rights: *7*, Civil Liberties: *6* & *India:* Freedom Rating: *2.5*, Political Rights: *2*, Civil Liberties: *3* - https://freedomhouse.org/report/freedom-world/freedom-world-2015#.VwY1vPmLSM8

Figure 1
Democracy Scores for China and India (1979-2010)[6]



As was pointed out, Acemoğlu and Robinson see the inclusive institutions as the most critical ingredient of economic development since only they can create inclusive markets, enable economic activity, growth, and prosperity, and "pave the way" for two engines of economic well-being: education and technology (Acemoğlu and Robinson, 2012: 77). Therefore, one would expect that India, a long-time democratic country with inclusive institutions, to generate better economic growth than China, a long-time autocratic countr y. However, comparison of Chinese and Indian economies disproves their theory's expectations. There is a huge gap between the economic development levels of the two countries where China enjoys a superior position. Chinese GDP is almost five times larger than India's (Figure 2) making China the second biggest economy after the USA, while India ranks the ninth.[7] The gap between the two countries' GDP per capita is even wider while China ranks the 79th, India ranks the 143rd[8] (Figure 3).

6 http://www.systemicpeace.org/inscrdata.html
7 China: 10.354.832, India: 2.048.517 (Million $), http://databank.worldbank.org/data/download/GDP.pdf
8 China: 7590, & India: 1581 (US $), http://data.worldbank.org/indicator/NY.GDP.PCAP.CD

Figure 2

GDP Trends in China and India (US $), 1979-2010[9]

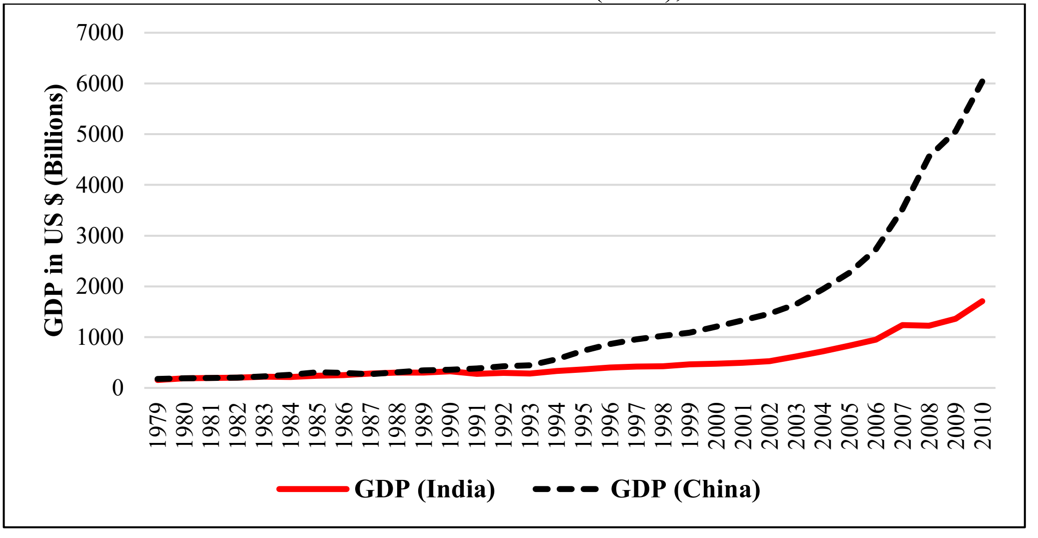
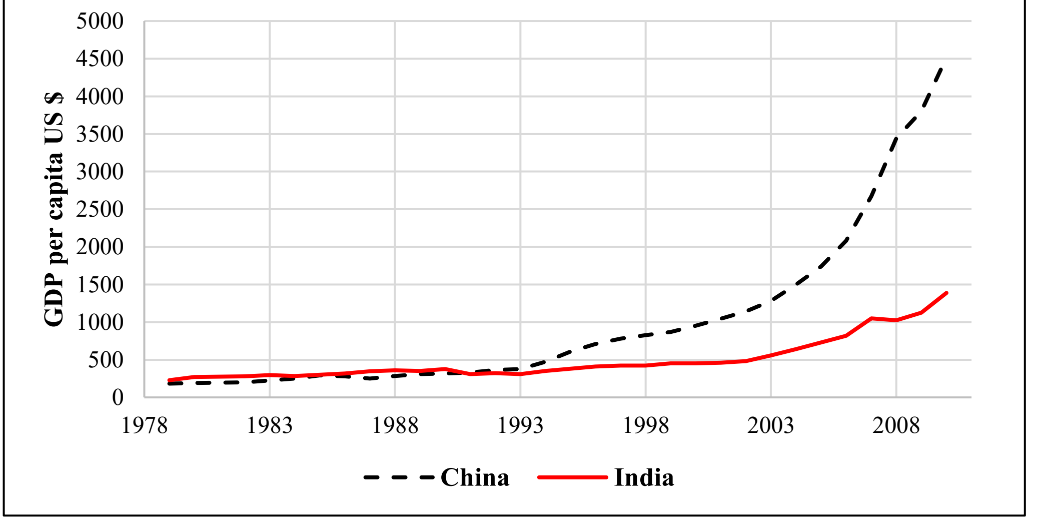


Figure 3

GDP per capita in China and India, (US $), 1979-2014[10]

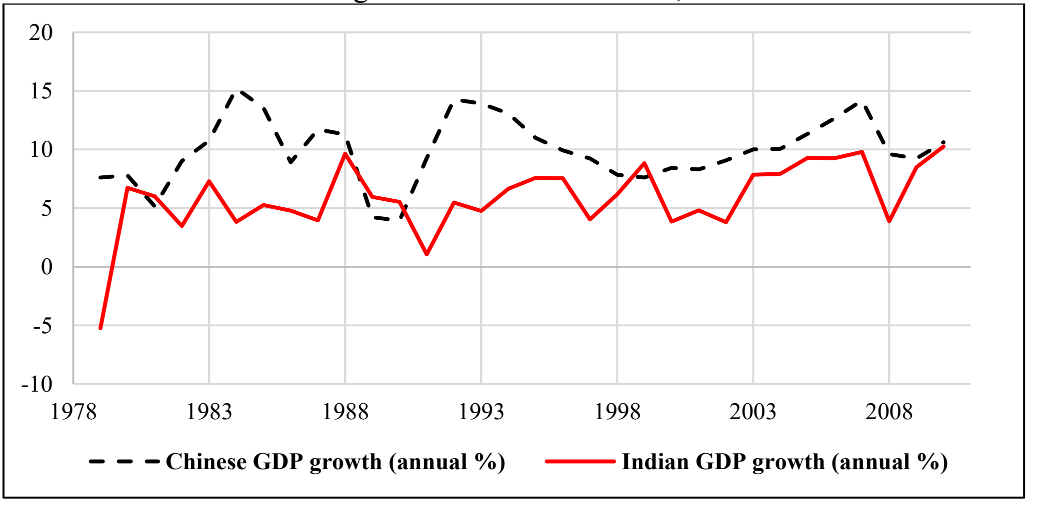


9 http://data.worldbank.org/indicator/NY.GDP.MKTP.CD

10 http://data.worldbank.org/indicator/NY.GDP.PCAP.CD/countries/1W?display=graph

In addition, Chinese economic growth rates are also remarkable. Although both Chinese GDP and GDP per capita are almost five times larger than India's, China surpassed India in terms of annual percentage of GDP (Figure 4), and GDP per capita growth (Figure 5). Considering that China has a GDP of 10.354.832 US million $, its superiority over India even in terms of GDP and GDP per capita annual growth rate can be considered as a significant economic success. Last but not least, China has also a better place in human development index since it ranked as the 90th country while India is the 130th.[11] The intriguing point is how and why China presents such a successful story of economic development with its extractive institutions. It becomes even more interesting when China's last 31 years of economic adventure is compared with India's, a country which has similar material capabilities to some certain extent, and also possesses inclusive institutions that are supposed to provide a better environment for economic growth.

Figure 4
Annual GDP growth in China and India, 1979-2010[12]



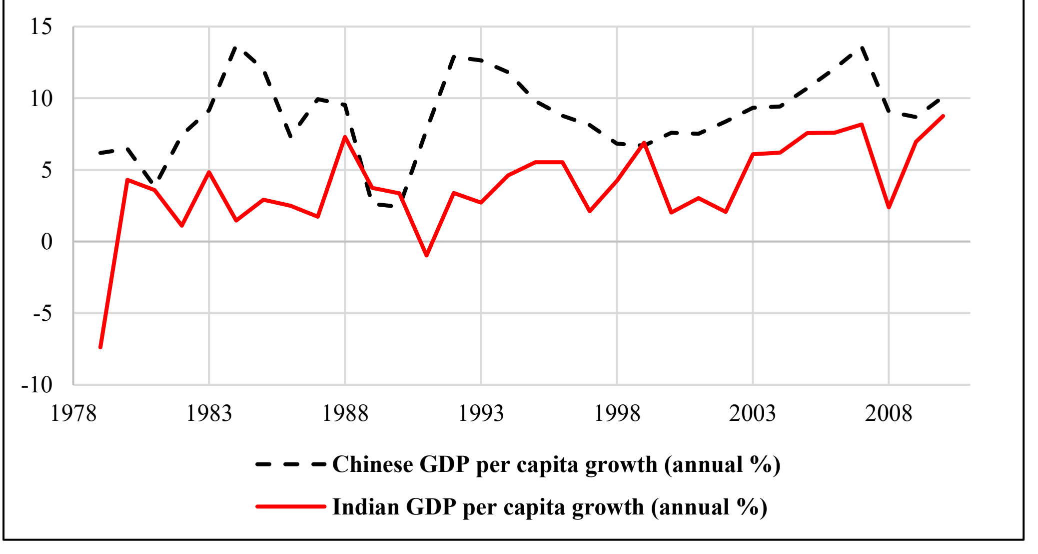
Before moving to the next section of this study which elaborates more on determinants of rapid growth in China and presents four alternative explanations for this very process based on comparison of China and India, Acemoğlu and Robinson's responses to Subramanian's critiques should be mentioned. Subramanian argues that Acemoğlu and Robinson's theory of economic development is not compelling enough since it falls short of explaining why India

[11] http://hdr.undp.org/en/countries/profiles/IND & http://hdr.undp.org/en/countries/profiles/CHN
[12] http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators#

is too economically underdeveloped given the inclusiveness of its political institutions while China is economically more developed despite its authoritarian state institutions. India and China are particularly important because they make up the two thirds of world population (Subramanian, 2013). However, they refute Subramanian's claim of leaving out China and India in their theory on the grounds that China cannot be considered developed due to its low per capita income levels compared to other high income countries such as USA or Germany.[13] In addition, they do not view Indian political institutions sufficiently inclusive, and assert that having an electoral democracy is not same as having inclusive institutions.

Figure 5

Annual GDP per capita growth in China and India, 1979-2010[14]



Having the critical approach embraced by Subramanian and Acemoğlu and Robinson's defense of their theory in mind, following sections delineate more on why China surpassed India in terms of economic growth and which parts of their theory needs further revision. First of all, this study does not claim that India has a bad economic growth performance but it only performs poorly compared to China. Secondly, current analysis neither contends that Acemoğlu and Robinson refute possibility of growth under extractive institutions nor that they disregard dynamics of growth that will be discussed in the following sections. Rather, this study

13 "China, India, and All That", http://whynationsfail.com/blog/2012/11/2/china-india-and-all-that.html

14 http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators#

attempts to shed light on specific mechanisms that led to historically unprecedented economic growth in an authoritarian regime that remains almost untouched by the authors. Last but not least, by creating areas of micro and macro inclusions in its economic institutions while lacking inclusive political institutions, China presents a challenge for their theory. In addition, absence of a clear operationalization of the idea of sustainable growth poses another challenge by Chinese case which provides substantial growth numbers since 1979. Hence, this study attempts to demonstrate that the concepts such as sustainable growth or inclusiveness needs further elaboration since they fail to explain Chinese case, and their failure became even more apparent with comparison of China to India.

4. The unchained dragon

In several occasions, Acemoğlu and Robinson emphasize that Chinese institutions are extractive (Acemoğlu and Robinson, 2012: 94, 151, 420, 423, 426, 436, 439, 440 and 443). According to them, Chinese economic growth process is similar to that of Soviet Union's, a process based on adopting existing technologies under a strong centralized state rather than developing new ones. Since property rights are not protected in China similar to Soviets because of the high risk of expropriation for entrepreneurs, the innovation of new technologies is not seen possible (Acemoğlu and Robinson, 2012). Therefore, the "unsustainable" economic growth of China will end when the country reaches at the living standards of a middle-income country (Acemoğlu and Robinson, 2012: 442). Whether Chinese economic growth will come to an end or not is a highly disputable issue since the authors do not make a clear operational definition of "sustainable economic growth". However, Chinese economic growth of 1979-2010 presents a successful example of economic development over a long-time period. Some studies even argue that China can maintain its economic growth at least 50 more years (Yifu, 2011). Therefore, China constitutes as an interesting case of economic development which make an analysis of its economic growth process highly necessary.

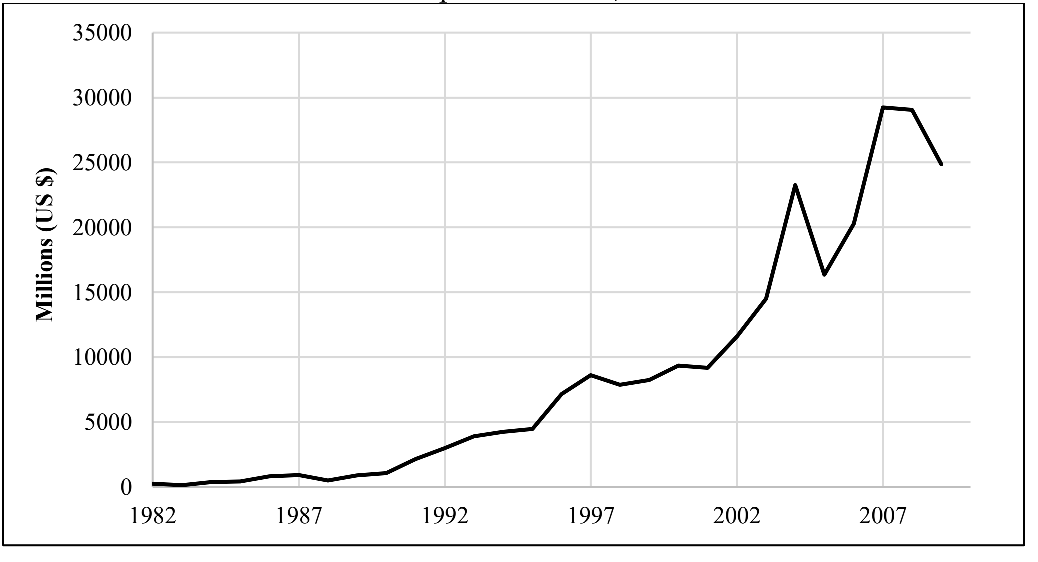
What were the main dynamics that triggered Chinese economic growth? Following Mao's death, there was an intense ideological debate over the economic path that China should follow which resulted in a power struggle between the Mao's chosen successor Hua Guofeng, and reformist Deng Xiaoping. The first group defended to remain loyal to Mao's orthodox understanding of Marxist-Leninist policies, the second group on the other hand, led by Xiaoping, supported open market economy with a pragmatist approach (Qian, 2000). Determined to upgrade Chinese economy, Xiaoping expressed his thoughts over which policy China should adopt by saying "It doesn't matter whether a cat is white or black so long as it catches mice." (Qian, 2000: 153). Eventually, Xiaoping's pragmatist approach prevailed, and China, one of the most closed economies of the world by 1978, started to open its economy, and welcomed foreign direct investment (Qian, 2000: 154). From 1979 to 2010, Chinese annual GDP growth was around 10% per year on average. The country doubled its economic income and output at almost every 10 years, and so far, China has lifted more than 700 million people out of poverty (Ramo, 2004). How then, did this “economic miracle” happen?

An important part of the shift in Chinese economic planning was the transfer of centralized power to the local governments. Through decentralization, local government bodies became responsible for economic planning and production which created entrepreneurial-minded local officials who pursued the philosophy of “learning by doing” through conducting local economic experiments, and implementing the successful ones (Yusuf, 1994). The central government also holds local governments responsible for local financial self-accounting, and puts budget constraints on them (Shevchenko, 2004). This self-sustainability policy accompanied by severe budget constraints granted local governments to retain residual tax revenues which motivated them to promote local economic production. In addition, the Communist Party also has been forcing local governments to increase production and wealth accumulation via existing enterprises rather than privatizing the existing ones as well as creating new local enterprises (Shevchenko, 2004: 175). This in return, significantly increased competition in the market because private enterprises have already been entering the market in increasing numbers since opening up. This dramatic increase in competition boosted Chinese economic production (Goldstein, 1995). Since the state-owned enterprises triggered the process of competition, Chinese economy is characterized as “local state corporatism” (Ma, 2000). In addition to increasing their revenues by promoting economic production to face rigid budget constraints imposed by the central government, local cadres were highly enthusiastic for economic efficiency for the reasons related to their future careers. Under the strict hierarchical structure of the Chinese Communist Party which values meritocracy, these local cadre officials were aware of the fact that the only way to increase their incomes, elevate their ranks in the party, and hence have a better life is possible through successful management of local economic enterprises (Ma, 2000). This resulted in the emergence of “Cadre Entrepreneurs” who were directly involved in profit-making activities (Shevchenko, 2004).

As protestant ethic is claimed to have an important role in the emergence and development of capitalist economy, some scholars also emphasize the role of Confucian culture in Chinese economic success since Confucianism promotes hard-work, interpersonal trust, diligence, knowledge, and thriftiness (Yifu, 2011). Although it is hard to measure the role of Chinese culture in creating China’s sui generis economic development process, it is clear that the country undertook a successful economic planning. Other authors on the other hand, give less credit to the centrally planned economic reform process run by the communist party but emphasize the role of private entrepreneurs who created an environment that was compatible for growth (Nee and Opper, 2012). They argue that while the Chinese government lacked the appropriate policies conducive to growth, the market-driven structural change in Chinese economic policies was a bottom-up process, rather than a result of top-down, centrally planned journey. Similarly, Vogel argues that launching the market-oriented Special Economic Zones was not led by Xiaoping but Hua Guofeng who was Mao's immediate successor (Vogel, 2013). Therefore, both Nee and Opper and Vogel attributes agency of the Chinese reforms process to different actors. However, it still does not change the fact that reforms occurred under extractive institutions even though they may have been carried out by different actors.

Figure 6

ICT Service Exports in China, 1979-2010[15]



Finally, sympathizers to Chinese experience claim that the country will continue to grow in the same speed in the next 40 years, and maintain its economic growth at least 50 years more considering the potential created by the current economic planning (Yifu, 2011). The reason for this positive perception is related to the high capital accumulation generated by growth which is accompanied by the transformation of industrial structure, and technological innovation (Yifu, 2011). During the beginning of "opening-up" process, China used the advantages of

15 http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators#

backwardness, moving up the stages of economic development through imported technologies (Lin, 2010). As opposed to Acemoğlu and Robinson's claim that technological innovation is hardly possible under extractive institutions, China upgraded its exports from simple toys, textile materials, and cheap products to sophisticated high-value electrical machinery, and information and communication technologies (Lin, 2010). In a sense, China resolved both its Gerschenkronian and Kaldorian collective dilemmas by moving into a more innovative phase of production (Waldner, 1999). Today's China is a technology exporting country, particularly leading the information and communication technology (ICT) industry (Figure 6). All these factors contributed to China's fame as a successful example of growth under an authoritarian regime, and also made the country a model of economic development to be emulated as an alternative to the Western democratic model of economic development (Li et al., 2010).

India, the other growing giant economy of today, has a rather different story. Under British colonial rule, India's raw materials were exploited and the country became a huge market for British manufactured goods. However, colonial rulers invested relatively more in state building process in India compared to some other countries under their rule which left country with a modern centralized state structure. After its independence, India inherited a centralized state which had monopoly over the use of coercion, a constitutional parliamentary government, and a social structure where public and personal realms were separated through a bureaucratic apparatus built upon a functioning civil service (Kohli, 2004). In addition, British colonial rule has already created a national market, built basic infrastructure, and established an open trading economy, institutions all conducive to economic growth. On the other hand, the state's ability to pursue developmentalist policies was limited during the first few decades after independence mainly because of substantial amount of power possessed by local elites and political mobilization of various nationalist groups (Kohli, 2004: 228). Hence, a possible cooperation between state and private business groups as it was observed in developmental states such as Japan and South Korea did not take place in India.

During the Nehru era, India witnessed the democracy to take its roots within the country, and adoption of state-led economic growth strategy with import-substitution industrialization (ISI) policies (Mukherji, 2009). Nehru increased the state's control over economic affairs by implementing policies through the Planning Comission which was not entirely embracive towards private investment but not totally against it since there were private banks, and foreign entrepreneurs continued to enjoy a relatively favorable investment environment (Mukherji, 2009). Although the country had a sluggish economic growth during this period, its growth numbers were bigger than China (Balakrishnan, 2014). In following decades, another prominent political figure, Indira Gandhi on the other hand embraced an anti-Western political discourse and promised poverty alleviation which made Indian economy even more closed and intensified the impact of populism and redistribution in domestic politics (Kohli, 2004). During 1970s, countries such as Brazil and South Korea were pursuing an export-led growth strategy while India embraced its ISI policies fiercely. Only after the second half of 1980s India was able to partially liberalize its economy and took some pro-business measures and invested in private corporate sector which improved its growth performance during 1990s (Kohli, 2004: 281).

It is clear that India has been demonstrating remarkable growth since the country became more business friendly. Mukherji attributes successful growth strategy beginning from 1990s to three main driving elements: (i) industrial de-licensing that allowed private sector to produce whatever they liked, (ii) devaluation of Rupee which made Indian exports more competitive in the global market, and (iii) tariff liberalization and preferential trade agreements which not only reduced prices of Indian products but also pushed the state and Indian companies to become more competitive (Mukherji, 2009). With these new policies in operation, India started to benefit one of its most valuable economic resources: cheap labor. Therefore, the country has been showing a continuous growth and together with China, it aspires to become one of the two largest economies in the world in a near future.

The next section explores the dynamics of economic performances of China and India by comparing the two countries in different dimensions. Four alternative explanations are presented in order to explain why a country under extractive institutions achieved to generate more economic growth in a substantially long-time period than a country that possesses relatively more inclusive institutions.

5. China has a more competitive economic environment than India

The first alternative explanation is that China has a more competitive economic environment than India which enabled her to generate more economic growth in the given time period. Data from the global competitiveness index of the World Economic Forum is used in order to measure the level of internal economic market competitiveness of both countries (Table 1).[16] In terms of overall score, China ranked the 28th, while India is the 55th. Existence of competitiveness is a significant indicator of an efficient open market economy; and except for the "financial market development", China gets higher scores than India in all other dimensions. However, it is still puzzling that China, a country under extractive

[16] http://reports.weforum.org/global-competitiveness-report-20152016/economies/#economy=CHN & http://reports.weforum.org/global-competitiveness-report-2015-2016/economies/#economy=IND

institutions, possesses and open and competitive market structure than a country under inclusive institutions. Three reasons can account for the differences between the two countries; India's economic growth policies which favored established big business that eventually negatively affected market competition, China's highly flexible labor policy, and lastly, China's policy of establishing autonomous Special Economic Zones.

Table 1

Level of Competition in Chinese and Indian Economies

	Rank/140		1-7 (best), 2015-2016		Trend	
Countries	China	India	China	India	China	India
Overall Global Competitiveness Index, 1-7 (Best)	28	55	4.9	4.3	2012-13: *4.83* 2013-14: *4.84* 2014-15: *4.89*	2012-13: *4.32* 2013-14: *4.28* 2014-15: *4.21*
Institutions	50	60	4.1	4.06	2012-13: *4.22* 2013-14: *4.24* 2014-15: *4.22*	2012-13: *3.91* 2013-14: *3.86* 2014-15: *3.84*
Goods Market Efficiency	58	91	4.4	4.2	2012-13: *4.31* 2013-14: *4.32* 2014-15: *4.42*	2012-13: *4.21* 2013-14: *4.18* 2014-15: *4.13*
Labor Market Efficiency	37	103	4.5	3.9	2012-13: *4.60* 2013-14: *4.63* 2014-15: *4.55*	2012-13: *4.24* 2013-14: *4.08* 2014-15: *3.81*
Financial Market Development	54	53	4.1	4.1	2012-13: *4.31* 2013-14: *4.32* 2014-15: *4.30*	2012-13: *4.90* 2013-14: *4.83* 2014-15: *4.34*
Business Sophistication	38	42	4.3	4.2	2012-13: *4.25* 2013-14: *4.31* 2014-15: *4.38*	2012-13: *4.31* 2013-14: *4.38* 2014-15: *4.18*
Innovation	31	42	3.9	3.6	2012-13: *3.85* 2013-14: *3.89* 2014-15: *3.91*	2012-13: *3.56* 2013-14: *3.62* 2014-15: *3.53*

After opening its economy in 1991, Kohli claims that India favored pro-business rather than the pro-market economic policies (Kohli, 2007). Whereas pro-market growth strategy facilitates exit and entries to the market, increases competition, efficiency and openness, the pro-business strategy mainly supports established producers, and indigenous big businesses (Kohli, 2007). While the big business establishments in India enjoyed the benefits of this growth strategy, small scale entrepreneurship was hurt, and emergence of new enterprises was limited. In addition, Kohli claims that throughout 1980s, India's economic opening was prevented by the two important chambers of commerce, *FICCI* and *Assocham*, of which negative effects lagged until the end of 1990s (Kohli, 2007: 107). Lobbying efforts of the big business holders continued in 1990s under "Bombay Club" who argued that rapid liberalization and foreign investment would destroy India's indigenous industry (Kohli, 2007: 107). India was already in a disadvantageous position compared to China since it started its liberalization policies a dozen years later, in 1991 (Felipe et al., 2008). The policies which favored the big players in the game, hindered the economic competition even more. For example, barriers to entry and restrictions on development in service and manufacturing industries continue to favor big businesses while small scale businesses are restricted to the manufacturing of 836 pre-defined products (Felipe et al., 2008). In other words, in addition to suffering from regulatory business barriers to foreign and domestic investment, India also had to deal with pressures and lobbying efforts of big indigenous business holders which decelerated its economic opening process, and thereby contributing to India's lagging behind China in terms of economic growth (Zhu, 2007). As can be seen from Table 1, in terms of "Goods Market Efficiency" which measures efficiency in areas such as domestic competition, extent of market dominance, and effectiveness of anti-monopoly policy, China bested India by being ranked 58th, while India is 91st.

Employment on short-term contracts based on job performance, and flexible hiring policies are important components of flexible labor policy, pursued in liberal market economies (Wade, 2013). Table 1 shows that the biggest gap between the two countries is in terms of "Labor Market Efficiency" where China ranked 37th and India 103rd. One more obstacle for India's further economic liberalization is its rigid labor policy. Labor laws in India make it very difficult for investors to employ on short-term contracts, and fire the workers even if they are inefficient or when "market line in some production declines." (Bardhan, 2006) This in turn, discourages new hiring by employers, decreases the number of entry and exit of firms to the market, and induces capital intensity in production. On the other hand, Chinese factories are much more flexible than Indian ones in hiring and firing practices. For example almost 20 million Chinese workers have been laid off in only 4 years during period of 1995-99 (Bardhan, 2006: 8). This helps China to attract both domestic and foreign investment more than India. Therefore, Bardhan claims that rigidity of labor law in India is one of the main contributors of Chinese success over India, especially in textile and garment sectors.

Establishment of Special Economic Zones (SEZ) that operate under local autonomous economic regions is an important element of Chinese growth policy. These SEZs enjoyed lower tax rates, implemented principles of liberal market economy, and gained the authority to ratify investment projects up to $30 million. (Qian, 2000). Shenzhen, Zhuhai, Shantou, Xiamen, and Shantou SEZs established in 1980, and their successes in operation and attracting investment led to the opening of 14 new coastal cities in 1984 that had the same privileges as SEZs do (Qian, 2000). In 1992, in the third phase of Chinese economic opening, most of the cities along the coast of Yangtze River were granted the same privileges which not only increased investment in Chinese market but also speeded up the functioning process economy. Rise in the investments also opened the way for privatization which was also promoted by the central government with the motto of "grasping the large and releasing the small" (Qian, 2000: 163). For example, this strategy influenced the transition of Chinese national innovation system from a government-centered to an enterprise-centered innovation web which increased the role of private enterprises even more (Li et al., 2010). On the other hand, China is criticized for its prudence in liberalizing its financial system, and as can be seen in Table 1. China's policy of closed capital account is mainly associated with its fear of losing control over strategic assets, and awareness of the risks posed by rapid financial liberalization (Li et al., 2010). However, China crowned its liberalization process by joining the World Trade Organization in 2001 which almost completed its opening and integration to the world economy (Beeson, 2013).

6. Does the state capacity matter?

The second alternative explanation is that China has a higher state capacity than India which helped her to generate more economic growth in the given time period. Tilly defines state capacity as "the extent to which interventions of state agents in existing nonstate resources, activities, and interpersonal connections alter existing distributions of those resources, and activities…" (Tilly, 2007: 16). According to Tilly, Chinese state is a high-capacity state, and its acts affect "citizens' resources, activities, and interpersonal connections significantly." (Tilly, 2007: 17). State capacity is a key component of governance where governance is defined as necessity to establish collective goals and creating means to achieve these goals. The degree of bureaucratic centralization, quality of bureaucratic governance, and government's effective control over financial resources are all indicators of state strength (Bakir, 2015). In order to measure state capacities of India and China, three different variables from the Worldwide Governance Indicators of the World Bank Data; Regulatory Quality, Government Effectiveness, and Political Stability & Absence of Violence/Terrorism, and corruption data from Corruption Perception Index of Transparency International are used. The figures illustrate that China is superior to India in all four (Figure 7, 8, 9, and 10) dimensions.

Figure 7

Regulatory Quality in China and India, 1996-2010[17]

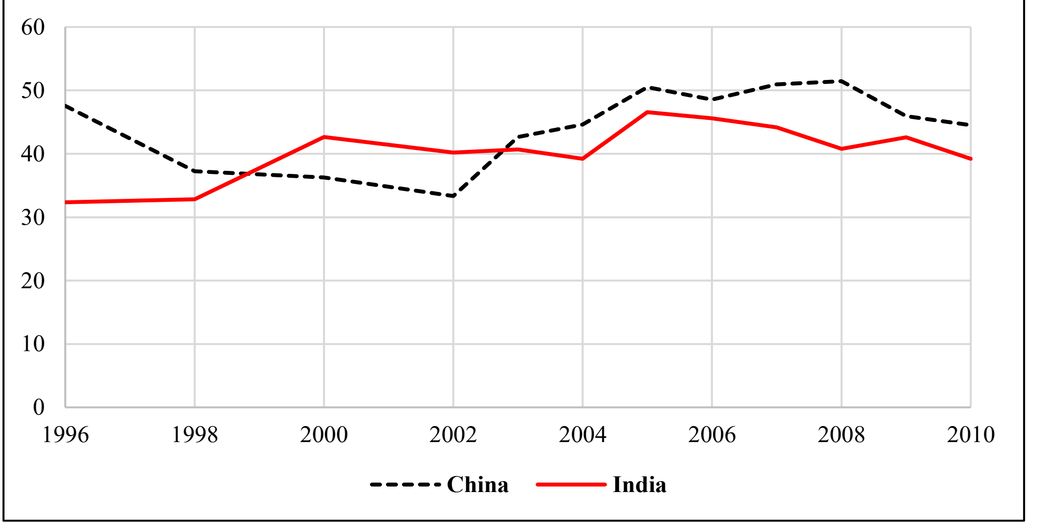
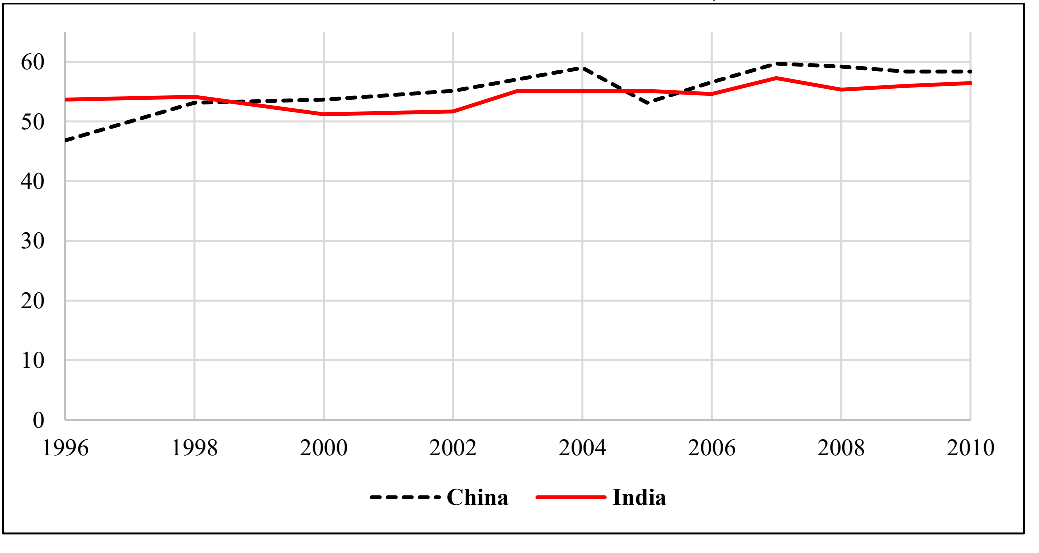


Figure 8

Government Effectiveness in China and India, 1996-2010[18]



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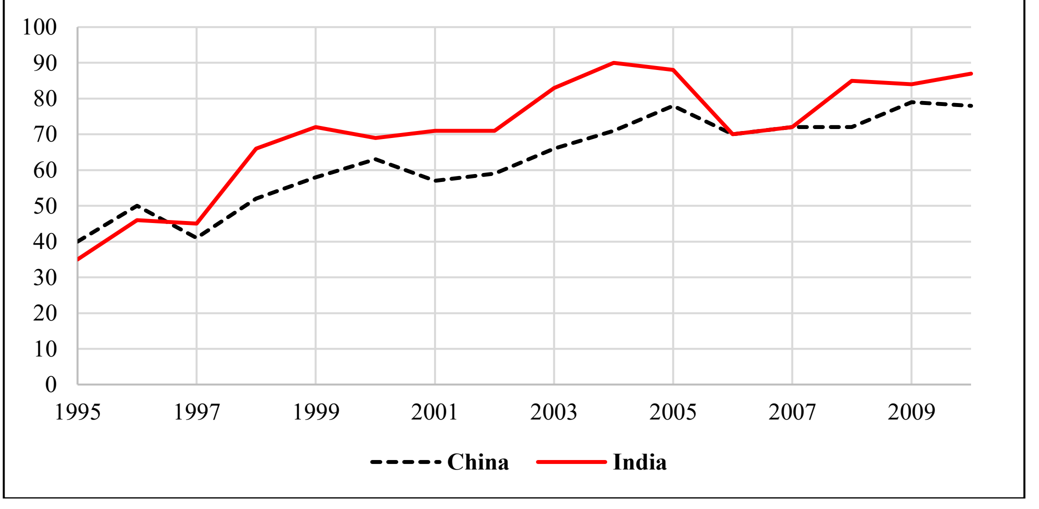
17 http://databank.worldbank.org/data/reports.aspx?source=worldwide-governance-indicators

18 http://databank.worldbank.org/data/reports.aspx?source=worldwide-governance-indicators

Figure 9

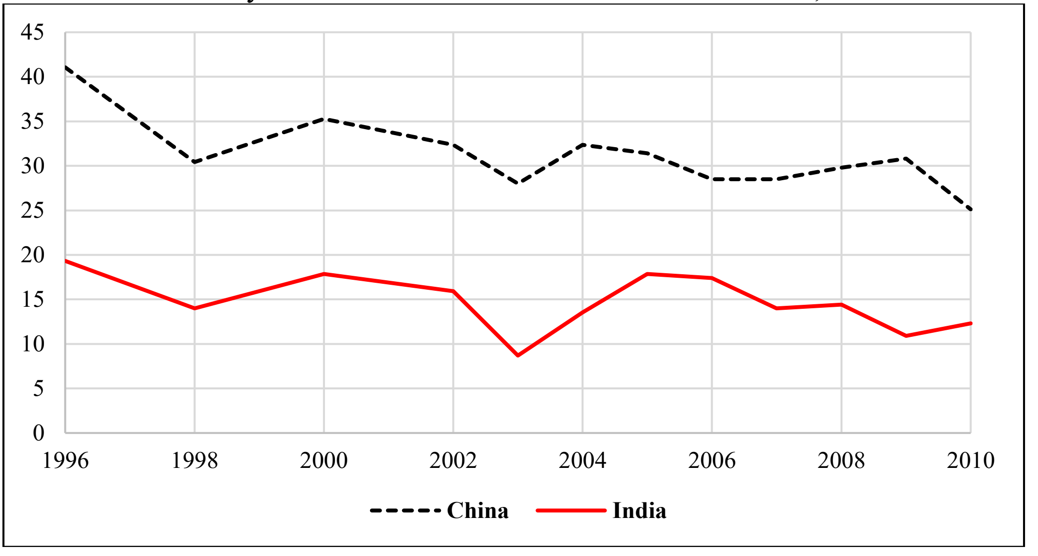
Corruption Rankings, (India has more corruption than China, and hence higher rankings in the index)[19]



These four indicators were also used by different studies to measure state capacity (Hanson and Sigman, 2013: 17) showing that China has a higher state capacity than India. One of the data sources that is used by Ottervik's study over conceptualization of state capacity is also world governance indicators (Ottervik, 2013: 16). In his study, Ottervik claims that Chinese government has been more effective in terms of mobilizing its resources pointing to the role of the state capacity in China's ability to generate more economic growth than India. In addition, China (over 80%) also doubles India (over 40%) in terms of tax compliance. (Ottervik, 2013: 27). Kohli relates India's inability to increase its tax base to the fragmented authority structure in which some significant economic sectors like service and agriculture largely remained untaxed (Kohli, 2007). However, as mentioned before, because of strict budget policy imposed by the central government and the self-sustainability principle, local governments in China exhibit great efforts in terms of tax collection which allowed China to double India in this level. To that end, in China, after tax and fiscal system reform, national and local tax collection bureaus were established each of which was responsible for collection of their own taxes (Qian, 2000).

[19] http://www.transparency.org/

Figure 10
Political Stability and Absence of Violence in China and India, 1996-2010[20]



Another repercussion of state capacity can be seen in the role of regulatory bureaucracy in doing business (Table 3). China is faster and more efficient in making decisions and also implementing them compared to India (Bardhan, 2006). Two reasons are presented for India's lag; the first is the intricate negotiation processes in India before ratifying an investment which usually either delay or extend the duration of a given project, and the second, the negative influence of short-run populist compromises and clientelism which makes commitment to long-term projects difficult (Bardhan, 2006: 10). In addition, Bardhan thinks that China is better than India in terms of solving collective action problems, having the ability to take hard and bold decisions which simply cannot be explained by authoritarianism. Therefore, state capacity would be a better explanation than a simplistic "democracy slows down India" argument.

In addition to its ability to generate more economic growth, Chinese state has also been more successful than India in terms of fighting poverty, improvement of education and health conditions. In terms of fighting poverty for example, while China saved more than 700 million people from poverty, India stayed at 24 million, which put her behind China in this area as well (Table 2). The same situation is also valid in terms of life expectancy values (Figure 12). Comparison of literacy

[20] http://databank.worldbank.org/data/reports.aspx?source=worldwide-governance-indicators

Table 2

Number of poor (millions) at 1.90$ per day (2011 PPP)[21]

Year	1981	1984	1987	1996	2002	2005	2010
China	877.8	785.4	659.5	512	409.1	244.4	149.6
India	402	410.6	424.2	432.1	378.3	…	…

Table 3

Doing Business in China and India, World Governance Indicators[22]

Business Indicator	China	India
Average number of procedures required to build a warehouse (2005-2010)	30	42
Average number of procedures required to connect to electricity (2008-2010)	5	7
Average number of procedures required to register property (2005-2010)	4	7
Time required to enforce a contract (days, 2005-2010)	405	1420
Time required to register property (days, 2005-2010)	28	64
Average time required to start a business (days, 2005-2010)	39	43
Average cost to start a business (% of income per capita, 2005-2010)	8	67

rates of the two countries is another indicator of how the Chinese state functions more efficiently than the Indian one (Figure 11). While China was behind India in terms of literacy, now it surpassed India by almost more than 20 percent. China did not only increase the literacy rate of its people, it also increased the education level of its officers. By 2003, it was estimated that almost 70 percent of civil servants in China had university degrees since the job market became highly competitive in the country (Rothstein, 2014).

21 http://databank.worldbank.org/data/reports.aspx?source=poverty-and-equity-database

22 http://www.doingbusiness.org/data

Figure 11
Literacy Rate in China and India, 1980-2010[23]

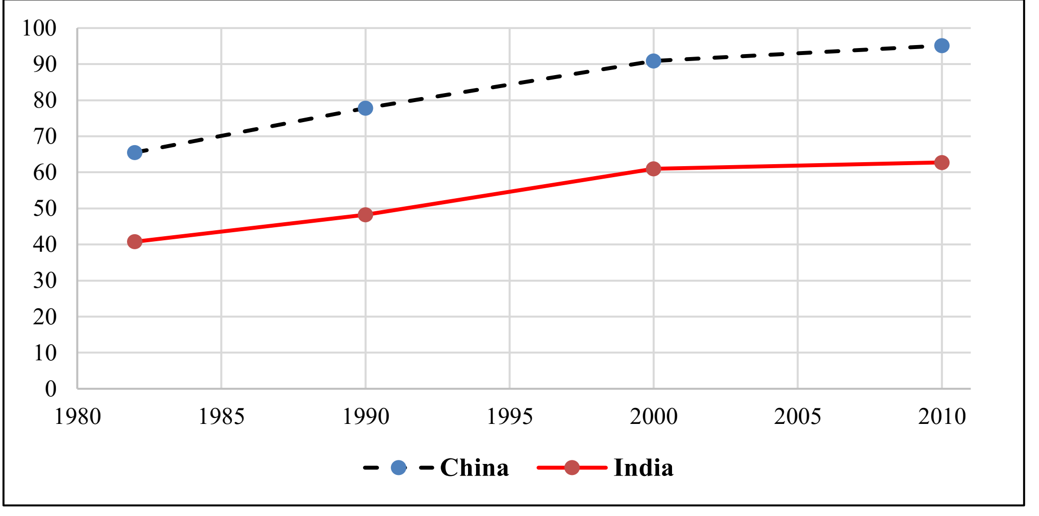
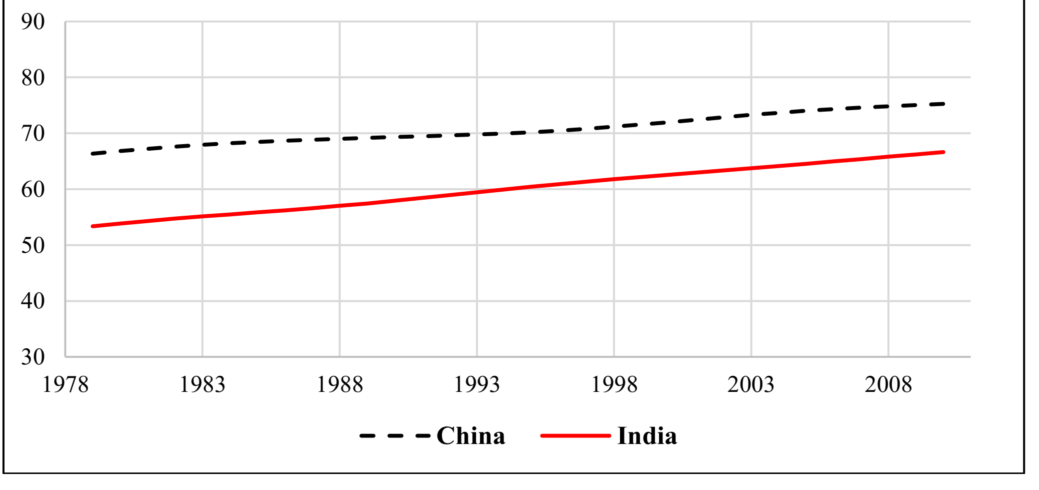


Figure 12
Life Expectancy Values in China and India, 1979-2010[24]



23 http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&Type=TABLE&preview=on#

24 http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators&Type=TABLE&preview=on#

Another strength of Chinese state capacity is claimed to be stemming from its sui generis bureaucratic structure, namely the "Cadre Organization" (Rothstein, 2014). According to Rothstein, the reason why China scores low in commonly used measurements of quality of governance is related to the absence of a Weberian type of bureaucratic structure (Table 4) in the country which is neutral, impersonal, rule of law oriented, and predictable (Rothstein, 2014). Bothstein claims that low quality of governance in Chinese formal institutions is compensated by high quality of governance in its informal institutions since high level of interpersonal trust between bureaucrats, officers, and party members has been significantly effective in terms of generating economic growth.

Table 4

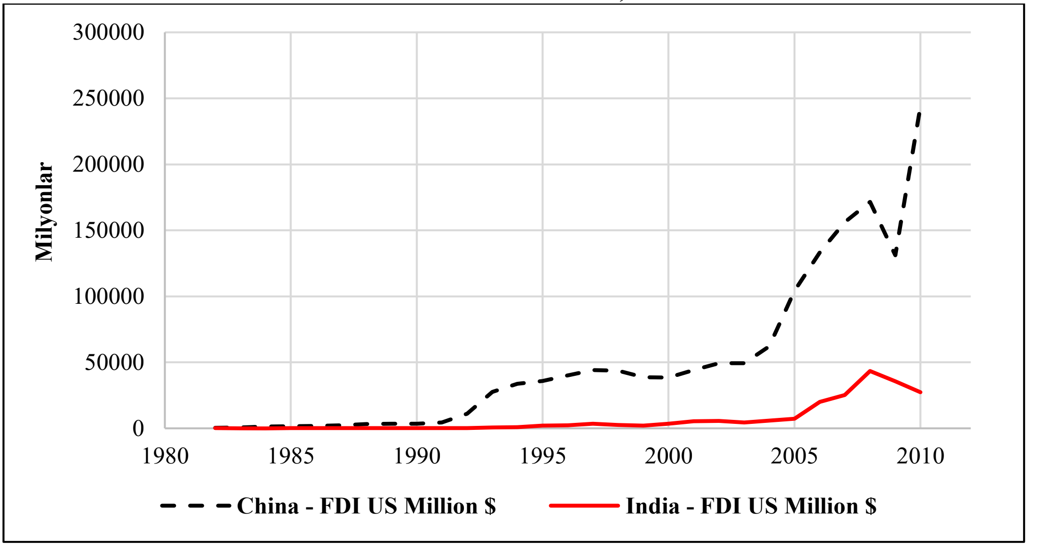
Weberian Bureaucracy and Cadre Organization, (Rothstein, 2014: 15)

	Weberian Bureaucracy	Cadre Organization
Recruitment	Formal Merits	Commitment
Internal Steering	Universal Rules	Policy Doctrine/Mandates
Formal Control	Substantial	Negligible
Operational Logic	Legal Rationality	Performance Rationality
External Relations	Predictable	Change-oriented
Internal Cohesion	Weak	Strong
Leadership Style	Rule-oriented	Mission-oriented
Relations to Clients	Neutral	Persuasive
Motivation	Incentives	Fulfillment of Mandates
Tools	Routine	Flexible

Chinese state itself also values government effectiveness, efficiency, and stability. Chinese leadership is convinced that economic growth can only be maintained by improved government, responsive, competent, and professional state (Brødsgaard, 2004). The Chinese state therefore, embraced the motto of "stability overwhelms anything else", and continue to keep authoritarian strength of the country unspoiled rather than make a move towards inclusive institutions (Li et al., 2010). So far, Chinese Communist Party (CCP) seems to be successful in this sense, and differently from other authoritarian state structures where power is mostly personalized by a leadership figure, China created a type of "institutionalized authoritarianism." CCP has established an orderly, deliberate, and peaceful succession process where rival factions within the party balance each other (Nathan, 2003). As was pointed out, Acemoğlu and Robinson claim that power struggle among different factions in countries that have extractive institutions would hinder sustainable economic growth. However in China, it is claimed that there is not an intense power struggle between different groups within the party but rather they balance each other. In addition, meritocracy-based promotion in bureaucracy, reward and punishment system based on the actual performance rather than party loyalty all contributed CCP's ability to form a high capacity state with an efficient and responsive government.

Figure 13

FDI Inflow to China and India, 1982-2010[25]



7. Non-required Indians vs. "Fallen Leaves"

The third alternative explanation is that China has a more active diasporic community than India which helped China to attract much more foreign direct investment (FDI) than India in the period of 1982-2010 (Figure 13). By 2010, China attracted almost nine times more FDI than India ($243 vs. $27 Billion). In this period, FDI played a constructive and significant role in Chinese economic growth, and it is one of the most salient reasons that led differentiated economic growth rates between the two countries (Felipe et al., 2008).

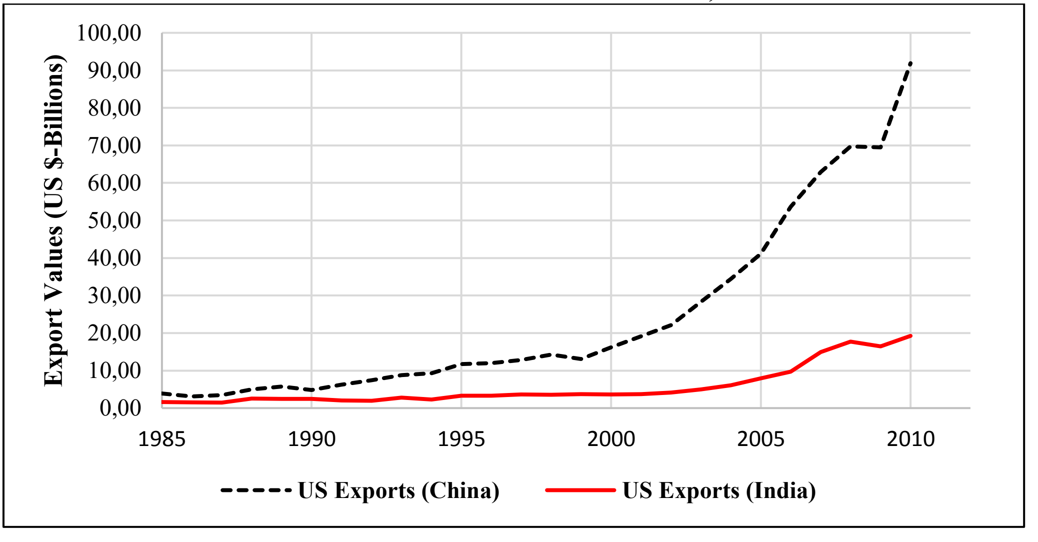
What is the exact role of diasporas in FDI? By 2013, Chinese overseas population was estimated to be around 60 million while India's 25-30 million (Sahoo, 2015). These two largest diasporas of the world were created as a result of

[25] http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators

demographic changes carried out by Western colonialists to fulfil the need for cheap labor, and the free flow of labor from China and India in 1970s and 90s (Sahoo, 2015). Chinese diaspora played the most significant role during 1980s, the period of Chinese economic opening. Not only most of the investment to the Special Economic Zones came from the risk-tolerant Southeast Asian Chinese investors, they also helped China to develop its technological base by establishing 53 science and technology parks (Smart and Hsu, 2004). It is estimated that the Chinese diaspora provides almost 70% of FDI in China while it is nearly less than 10% for India (Zhu, 2007). China's positive perception of its overseas ethnic community is a crucial step for attracting investment from Southeast Asia, Hong Kong, Macau, and Chinese in North America. Chinese who live abroad are seen as "fallen leaves" which are eventually supposed to return to their roots (Zhu, 2007: 289). On the other hand, for a long time non-resident Indians (NRI) who immigrated to a different country were offically named "not required Indians" since they were considered both too poor, and thereby useless, and traitors who left during British colonial rule (Zhu, 2007: 288). Although Indian state tried to break this attitude and embrace NRIs by establishing Ministry of Overseas Indian Affairs in 2004 as China did by establishing Overseas Chinese Affairs Office 36 years ago in 1978, NRIs still complain about their treatment by the Indian government, difficulties attached to making donations or investments in their homeland, mainly because of the inefficient bureaucratic organization of the Indian government (Zhu, 2007). In contrast, Chinese expatriates highly associate themselves with their homeland, eager to make investments in the country, feel proud with the international status of China, and if necessary they are ready to help China to maintain this position (Gungwu, 1993).

However, it does not mean that Indian expatriates did not contribute to India's economy at all. They played a crucial role in developing of India's software industry which makes up 2% of Indian GDP (Davone, 2007). They had a positive influence over the decisions of companies like Yahoo, Hewlett Packard, and General Electric to establish R & D centers in India. In addition, 71 of 75 MNCs located in the Bangalore Technology Park had managers and staff of Indian origin (Davone, 2007: 6). Therefore, India wants to attract more investment from its diaspora. The country started projects like "Know India" (2004) and "Study India" (2012) to strengthen emotional bonds with its expatriates (Lum, 2012). However, so far China seems more successful in terms of reversing the brain-drain. China launched a project named "1000 Talents" in order to invite Chinese academics and professionals who earned PhDs in overseas, and offered them salaries 20 times higher than what local faculty members make (Lum, 2012). Being aware of the fact that it cannot prevent people from leaving China, the country tries to assure their returns. The 1000 Talents project appeared to be very successful. By 2012, 2,263 scientists and scholars returned to their homeland under this program (Lum, 2012: 3). This indicates that Chinese state's institutional capability is not only limited to attracting investment from its expatriates but it is also successful in reversing the brain-drain. Therefore, China is now highly open in sending its students to Europe and North America for education, and currently not only government but also banks also started to provide funds to cover students' educational expenses (Pieke and Speelman, 2013). For example, by 2010, estimated number of Chinese students in European Union countries reached to 120.000 which is six times higher than that in 2000 (Pieke and Speelman, 2013). All in all, Chinese governmental policies, institutional arrangements, and its positive perception of its expatriates all helped China attract investment from its diaspora more than what India achieved so far.

Figure 14
USA's Trade Relations with China and India, 1985-2010[26]



8. A Behemoth interdependence: China and the USA

The fourth and last alternative explanation is that China has more interdependent economic relations with the USA than India. The USA has the highest GDP value ($17.42 trillion)[27] in the world, and one of the most significant markets for both Chinese and Indian economies. Towards the end of 1960s, the

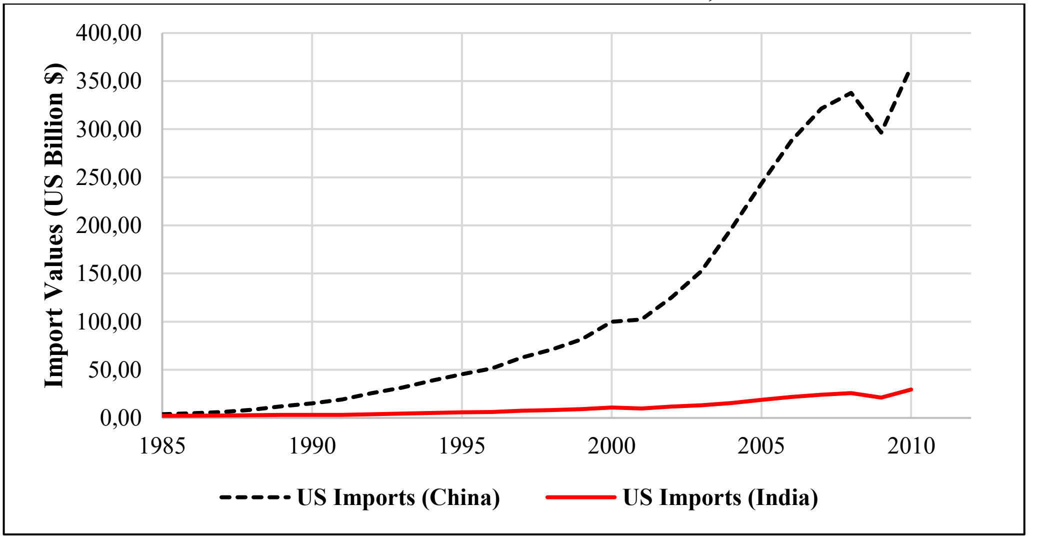
[26] https://www.census.gov/foreign-trade/balance/c5700.html#1985
[27] http://data.worldbank.org/country/united-states

clash between the USSR and China, namely the Sino-Soviet Split, encouraged Nixon government to develop a connection between Beijing and Washington (Lüthi, 2012). This marked the beginning of Chinese-American rapprochement. Especially after the economic opening of Xiaoping, Chinese and American relations started to grow on an economic basis. After the visit from CCP leader Deng Xiaoping to the USA, US leaders became confident that China committed itself to liberal market economy, paving the way for long-term investments from the US (Gangwu, 1993).

By 2015, the trade volume between China and the USA reached to almost $600 Billion while it is around at $66 Billion for India (Figures 14 and 15)[28] However, during the 1980s, no one could forecast that Chinese-American trade volume would be nine times higher than Indian-American one. As the figures below demonstrate, Sino-American trade volume was around $8 Billion in 1985, while it was approximately $5 between India and the USA. Come 2010, China increased its trade volume to $455 billion, while India stayed at $50 billion, and never reached three-digit numbers. Certainly, this has played a crucial role in Chinese economic growth, and its success over India. Today, the US and Chinese economies are highly interdependent, and an economic downturn in either of these two countries can significantly affect the other. Even the disputes over Taiwan's status or crisis generated by the events of Tiananmen Square did not harm the economic relations between these countries and conomic interdependence remains resilient yet. Therefore, it is argued that this relationship created an integrated hyper economy, namely the *"Chimerica"* (McNally, 2012).

[28] https://www.census.gov/foreign-trade/balance/c5700.html#1985 & https://www.census.gov/foreign-trade/balance/c5330.html#1985

Figure 15
USA's Trade Relations with China and India, 1985-2010[29]



9. Conclusion

The theory of inclusive and extractive institutions is undoubtedly a significant contribution to the social science literature. However, relationship between democracy and economic growth is a highly complex issue, and usually requires case-specific analysis, and consideration of regional socio-political, economic, and historical dynamics rather than making macro generalizations. Comparison of Chinese and Indian economies in the period of 1979-2010 therefore, shows the importance of a detailed analysis in understanding the role of institutions in economic development.

Although China does not possess inclusive institutions like India, Chinese *sui generis* institutional arrangements, its successful adaptation of liberal economic policies and efficient bureaucratic structure helped it to generate more economic growth than India in the given time period. This study presented four alternative explanations in order to explain Chinese success over India, since theory of inclusive and extractive institutions' explanatory power somehow remained insufficient. This study calls forth a focus on dynamics that boosted Chinese economy such as economic competitiveness, higher state capacity, ability to attract more FDI from diaspora, and huge interdependence with the US economy. China's ability to establish an open economy, and efficient institutionalized authoritarian

[29] https://www.census.gov/foreign-trade/balance/c5330.html#1985

state structure under extractive institutions make it necessary to review the boundaries of inclusiveness and extractiveness. Therefore, a more useful and detailed operationalization inclusiveness and extractiveness is necessary. In addition, boundaries of "sustainable economic growth" remains to be questioned and defined as well. Operationalization of such variables would be helpful to minimize deterministic nature of the theory where it is consistently claimed that sustainable economic growth can only be achieved under inclusive institutions. By being as a most-likely case for Acemoğlu and Robinson's theory, analysis of China presents a good starting point for such a review.

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Özet

Kurumlar ve ekonomik kalkınma: Çin ve Hindistan örneği

Bu çalışma Acemoğlu ve Robinson’ın sürdürülebilir ekonomik kalkınmanın ancak kapsayıcı kurumlar altında mümkün olduğunu iddia eden kapsayıcı ve dışlayıcı kurumlar teorisinin aksine Çin’in neden Hindistan’dan daha iyi bir büyüme performansı sergilediğini sorgulamaktadır. Bu çalışma Acemoğlu ve Robınson’ın teorisinin Çin örneğini açıklamakta yetersiz kaldığını göstermeyi amaçlamaktadır. En olası vaka metodolojisi kullanılarak 1979-2010 dönemi Çin ve Hindistan’ın ekonomik büyüme performansları karşılaştırılmıştır. Kişi başına düşen milli gelir ve gayri safi milli hasıla ile ölçülen ekonomik büyüme düzeyi çalışmanın bağımlı değişkenini oluştururken, bir ülkenin sahip olduğu kurumların yapısı –kapsayıcı veya dışlayıcı olmaları– da çalışmanın bağımsız değişkeni olarak kullanılmıştır. Sonuç olarak bu çalışmada gösterilmektedirki kapsayıcı ve dışlayıcı kurumlar teorisi Çin’in Hindistana kıyasla neden daha iyi bir büyüme performansı gosterdiğini açıklamakta yetersiz kalmaktadır. Mevcut analize daha detaylı ve kapsayıcı cevaplar sunabilmek adına bu çalışma, Çin’in Hindistan’a nazaran neden daha iyi bir büyüme performansı gösterdiğini kapsayıcı ve dışlayıcı kurumlar teorisine göre daha iyi açıklayan dört alternatif bakış açısı sunmaktadır.

Anahtar kelimeler: Kapsayıcı ve dışlayıcı kurumlar, büyüme, Çin, Hindistan, en olası vaka.

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