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# Comparing China and India: an Introduction <sup>1</sup>

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## Abstract

Editors' Introduction to the symposium 'Comparing China and India: Structural Change and Development'.

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While China and India's average incomes remain low, their sustained economic growth of recent decades combined with their enormous populations (that each exceed the size of the OECD) has turned both countries into such large players that their economic scale is only exceeded by the United States, and possibly Japan.<sup>2</sup> So though a large share of their populations remain poor, both China and India are already heavily integrated into the rest of the world's trade and financial flows, making their current and future development impossible to ignore.

Most recently, as the developed world has slipped into a severe and prolonged recession – which many observers are calling a depression – China and India stand alone among major economies in registering positive growth, with the rest of the world's economies hoping that these emerging giants will help to bring the rest of the world out of its deep morass. Nevertheless, these countries are fragile and are still in the midst of ongoing dramatic structural reforms, facilitated by their governments in some straightforward as well as peculiar ways.

Recently, the Chinese case has been cited as an example to the most developed countries of the potential virtues of a state-interventionist growth model to push through dramatic reforms, which could even be of use to market economies that are facing difficulty. Though there are many serious proponents of this view, and numerous

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1 The symposium is based primarily on papers that were presented at a panel on the comparison between China and India's economies held at the 10th bi-annual EACES Conference at the Higher School of Economics in Moscow on August 28-30, 2008. The papers have been updated and substantially revised. We thank the organizers of the Conference and all the participants in the panel for their useful comments on the preliminary drafts of the papers. The views of the authors are strictly personal and do not in any way reflect the views of their respective institutions.

2 The exact size of China and India's GDP at PPP is the subject of considerable debate. The World Bank revised its estimates of both economies' size downward by about 40% last year, following the results of the 2005 ICP round. However, many questions have arisen about the reliability of these results (see Maddison and Wu, 2008; Heston, 2009). Some datasets, such as the Groningen Growth and Development Centre's, estimate the economies' sizes to be much larger (using alternative PPPs). Thus, the relative rank of Japan vis-à-vis India, as well as China and India's per capita income levels – as shown in the first two papers in this symposium – is subject to a substantial amount of uncertainty.

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lessons that can be learned from each country's reform chronology, this line of argument may ignore the most important driving forces of each country's development.

In the case of China and India, we have two contrasting views. According to the opinion of our guest editor, growth has occurred primarily in spite of the state, rather than because of it. Repeatedly, at the key inflection points in both economies' recent growth trajectories, it was those reforms that reduced state intervention in key markets that created the opportunities that followed. In China, for instance, the disbanding of collective farms was an early and vital step, as was the decentralization of state control over business. In India, analogously, the removal of the licensing regime on business was a fundamental reform. This is not to say that the role of government was unimportant in either case. The gradual, yet decisive removal of many sorts of interventions and distortions across both economies is perhaps the most obvious similarity in their growth experiences. While the process was uneven and is still very much still ongoing, government decentralization allowed important reallocations to take place, putting resources into increasingly productive use, introducing growing international competition, and facilitating the productive human and physical capital investments that enabled growth to accelerate.

The contrasting view of the second editor is that, although economic reforms in both countries were essential for the acceleration of economic growth, the role of the state has remained very important as regards the stabilization of the growth trajectory. In China the gradualist approach devised by the state has avoided the severe transitional crisis which struck the former Soviet Union and Eastern European countries in the early 1990s. The decision to avoid introducing a fully convertible currency and open the capital account sheltered China from the 1997 Asian Crisis and from the full effect of the present crisis. In the Indian case, the manipulation of the value of the Indian currency and the remaining controls on capital movements have contributed to avoid part of the effects of the world financial turmoil. The step-by-step approach has proved to be a rather sensible policy. However, in both countries the action of the state in favour of the basic needs of the poorest part of the population has been manifestly too weak.

The papers in this symposium touch on several of these themes and offer alternative interpretations of the pattern of growth and of the insertion of the two countries in the world market.

The first essay, by Sudip Ranjan Basu, examines a series of economic and human development indicators for evidence of the welfare and equity shifts in both economies' growth performance. He finds that while both economies were at nearly the same position in terms of material well-being two decades ago, India was considerably behind in human development terms. And, despite solid economic performance for the Indian economy, China's economic development index grew three times faster over the reform period. Nevertheless, India's human development measures have grown more rapidly than China's, thereby narrowing the gap in development quality. This is all the more impressive in light of the reduction in the regional polarization of these human development measures as well across Indian states.

The second contribution, by Vittorio Valli and Donatella Saccone, discusses the complexity of both economies' economic transformations, and the feedback loops that have promoted the development and transformation of both economies (interpreting it through a fordian lens): by first increasing their scale, then their profits and investment,

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and finally facilitating various types of productivity-enhancing shifts. Evidence for these type of shifts is brought to bear, which seem likely to continue for some time, as the economies become increasingly integrated with the global economy.

The third paper, by Isabelle Bensidoun, Françoise Lemoine and Deniz Ünal, examines the nature of these economies' growing trade integration with the rest of the world, and changing specialization. While China has become a major hub of the increasingly segmented global production process, India has become more specialized in certain niche service sectors, with a proportionately higher price-quality composition. Yet major challenges remain for both: for India to broaden the industrial base of its economy beyond its current services niche, and for China to adjust in light of the crisis to improve its terms of trade.

The final paper, by Ila Patnaik and Ajay Shah, deals with macroeconomic policies and the exchange rate regimes of both economies. It suggests that considerable distortions may have been created by the monetary interventions of authorities that have de facto pegged the exchange rates of both countries' currencies, and thereby led to the accumulation of large quantities of reserves, feeding into imbalances in the global economy that may have even contributed to feed the current crisis.

However, the exchange rate policies of China and India may have favoured the export growth of both countries – albeit probably excessively in the case of China – and contributed to partially shelter them from the world financial crisis. The sharp fall of exports after the eruption of the real effects of the world crisis will probably induce both governments to try to focus more of their growth on the development of their internal markets.

## Notes:

- Heston, A. (2009), 'What Can Be Learned About the Economies of China and India from Purchasing Power Comparisons?', forthcoming in *Emerging Giants: China and India in the World Economy*, Eichengreen, B., P. Gupta and R. Kumar (eds.), Oxford University Press, Oxford
- Maddison, A., Wu H.X. (2008), 'Measuring China's Economic Performance', *World Economics*, **9(2)**, April-June