# A Tale of Two Giants: Comparing China and India

Accounting for 40 percent of the world's population and almost 20 percent of the world's output, China and India are two of Asia's—indeed, the world's—economic giants. In addition to their size, these countries have other traits in common. Both are among the fastest-growing economies in the world, and both are transitioning from heavily state-controlled and regulated economies to more market-based economic systems.

Although both countries are experiencing rapid economic transformations, there are significant differences in the ascent of each region. China's reforms started some 25 years ago in response to the failures of Maoist economic policies. Since then, its economy has recorded a phenomenal average annual growth rate of better than 9 percent. India's reforms began in 1991, triggered by a fiscal budget and balance of payments crisis. Its average annual growth rate over that period has been closer to 6 percent. The sources of this difference in growth performance may be found in some key differences between the two countries. For example, China's higher rate of saving has enabled domestic investment of 35 to 40 percent of its GDP, while India's investment rate is about half that.

China and India have taken different paths to economic growth and development. China's growth strategy, like that of its East Asian neighbors, has involved the expansion of labor-intensive manufacturing, such as textiles and consumer goods, to take advantage of an abundant supply of labor. India's emphasis on protecting workers and small-scale businesses has paradoxically limited the scale of growth of its manufacturing sector. Consequently, the relatively less-regulated service sector has been the growth engine of India's economy. The service sector now accounts for over 50 percent of India's output, much higher than the norm for developing economies. India's most visible example of success is the information technology sector; it has burgeoned because of economic reforms and because of the country's abundance of English-language speakers, strong technical education system, and professional talent with programming and managerial experience.

In terms of global trade, China is a much bigger player—its exports and imports of goods amount to about 50 percent of its GDP, compared to around 20 to 30 percent for India. China has experienced huge foreign direct investment inflows. Until recently, India has been much less interested in attracting foreign capital and therefore, less successful. China spends substantially more on infrastructure than India. China's public finances are in better shape than India's finances: India's consolidated fiscal deficit is running at 8 to 9 percent of GDP, one of the highest among developing countries, against less than 3 percent in China. Compared to India, China's labor market has been much more flexible. Labor can move easily from the agricultural sector to the industrial sector, which allows Chinese manufacturers to keep labor costs low. China's overall education level is higher than that of India, with a much higher literacy rate and a larger percentage of children completing primary school. That said, India has a world-class university system that produces a core of well-educated professionals.

China doesn't have the edge in everything. India has a more developed legal system, including more protection of intellectual property rights. India's financial system also is in better shape than China's system. Although both countries have been hampered by the involvement of state-owned banks in directed lending, nonperforming loans are a much smaller problem in India. India's bond and equity markets also are much more efficient.

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What challenges do China and India face? Each country is seeking to find the right balance of political and economic liberalization to fulfill long-run growth possibilities. Since 1979, China has followed a "full steam ahead" process of economic reform that has emphasized growth, even at the risk of major social upheavals. The country is simultaneously trying to manage the transition from a one-party state to a more popular and responsive political regime that many believe is necessary to deal with China's increasingly sophisticated economy and society. Compared to China, India has followed a more cautious and gradual reform process. India's current coalition government, led by the Indian National Congress Party, is attempting to perform a difficult balancing act of maintaining the progress of economic reform while keeping its promise to reduce the grinding poverty that still afflicts the majority of its population. To close the gap with China, India must address infrastructure problems and make its labor markets more flexible.