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GROWTH PERFORMANCE WITH REFORMS: INDIA AND CHINA

Dr. Deepchand[1]

[1]Assistant Professor

[1]Political Science Umrao Pachari Badi, Jhunjhunu, Rajasthan

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ABSTRACT: India and China are the emerging global players today with high growth rates. Both are aggressively redrawing the world economic landscape through their spectacular performances. The two economies together account for 40 percent of the world population, 9 percent of the world's GDP at market exchange rates and 16 percent of the world's GDP in purchasing power parity terms. Over the last quarter century, both the economies instituted pervasive economic reforms and their growth accelerated. However, they did not follow similar growth paths. For its growth, China has pursued typical East Asian model of manufacturing- led growth; on the other hand, India followed the path of service-sector led growth. While initially, both were largely autarkic nations, not integrated with the world market, China acted more quickly to embrace globalization. China started reforming its centrally planned, non-market economy in 1979. It enthusiastically lowered trade barriers and welcomed foreign direct investment [FDI] with no inhibitions. In addition, China experienced explosive growth in its industrial sector and gained control of the world markets for low-technology, labor intensive manufactures. India's economic reforms began in 1991; more than a decade after China began liberalizing in 1979. The growth rate of the Indian economy doubled from the previous Hindu growth rate as a result of market oriented reforms and opening up of the economy; but the growth still lagged that of China. There was no significant difference in the economic performance of India and China roughly until 1980, when their per capita incomes were also similar. Since then, the economy of China has outperformed India by a wide margin. Starting with more or less the same level of economic development in 1985, China's per capita income today is more than double that of India's. China has miraculously transformed itself to the world's largest exporter, has the world's largest foreign exchange reserves, largest current account surplus, and it would soon be the second largest economy of the world, displacing Japan.

KEYWORDS: Economic, Displacing, Aggressively.

INTRODUCTION

In its developmental process Chinafollowedthe classic pattern of moving from primary to manufacturing sector. Its growth was driven by an expansion of manufactures which were largely exported and a large part of the incremental income was saved and invested in infrastructure. However, India has not focused on manufacturing in the same way as China did. India's trajectory has used the skill of educated middle class to boost services like software, telecom, airlines banking etc. Asia's growth has traditionally been through low-cost manufacturing. No country has grown by expanding its service sector first. The share of manufacturing has always been above 40 percent in China throughout during the last four decades in contrast with India where its share has

wavered only around 25 percent during the same period (table-1).

Table-1:Sector-wise Breakup of GDP in China and India (%)

	1980	1990	2005	2008	2018
INDIA :					
Agriculture	40	33	20	17	27
Industry	23	26	27	29	39
Services	37	41	53	54	68
CHINA :					
Agriculture	30	27	12	11	21
Industry	49	42	47	49	52
Services	21	31	40	40	51

Source: RBI –Handbook of Statistics- various issues.
World Development Report – various issues.

PATTERN OF STRUCTURAL CHANGE

During their process of development both the nations have cut the share of agriculture sector in total investment, along with rapid fall in this sector's contribution to GDP. In India the share of primary sector in GDP fell from 47 percent to 17 percent in last four decades, but its share in employment is still more than 60 percent. Share of manufacturing is as low as 29 percent. Till 1980 share of agriculture was the largest at 40 percent of GDP. By 1990 services overtook agriculture and its share rose to 41 percent. Since then, service sector is the fastest growing sector in India with more than 54 percent of GDP coming from it (table-1). In China industry has always had the largest share in GDP. The share of services has continuously grown since 1980 but still industry contributes 49 percent to GDP while services 40 percent to GDP. The share of agriculture has fallen from 35 percent to 11 percent of GDP in China. The benefitting factors for the manufacturing-sector led growth of China have been: high domestic savings rate, huge FDI inflows and efforts on infrastructure front. High savings were coupled with domestic consumption being held in check. During 90s foreign inflows jumped substantially and much of China's dazzling infrastructure was built during this decade. India's economic growth has been fuelled by service sector benefitting from the skill of educated middle class. India is a rising power in software design services and precision industry. India has taken advantage of buoyant external demand for services. Exports of software and IT-enabled services have risen at the compound growth rate of 38percent a year since 1995. Perhaps, lack of infrastructure was a factor in entrepreneurs choosing services rather than manufacturing. However, with a rise in its savings rate in recent years India is already beginning to compete well in complex manufacturing such as chemicals, engineering goods and machinery, automobiles and auto parts.

DIFFERING FOCUS ON INVESTMENTANDPRODUCTIVITY

Chinese growth model has meant high investment rate. China's investment to GDP ratio has increased from 33.2 percent in 1982 to 44 percent in 2007 compared to a rise in India's investment share of GDP from 21.7 percent to 36 percent during the same period (Table-2). This difference in investment alone is enough to explain the difference in aggregate growth between the two nations. Investment rates have been financed by a high domestic savings rate, lower interest rates, and large retained earnings from corporate profits. China has historically maintained a high rate

of savings. When reforms were initiated in 1979, domestic savings were 32 percent of GDP. Most of the savings during this period were generated by the profits of SOEs. Economic reforms led to substantial growth in household savings. Since then savings as percentage of GDP has steadily risen in China; it has reached 54 percent of GDP in 2008 (Table-3), among the highest savings rate in the world. During its process of growth, China recycled exports revenue into fixed investment. As capacity expands in line with rapid economic growth, the domestic economy does not suffer from high inflation. In fact, inflation has never been very high in China. Massive increases in fixed investment along with better management have also enabled China to raise manufacturing productivity by 20 percent per annum over a decade. It achieved unprecedented economies of scale for productivity gains leading to its industrial competitiveness. In infrastructure, economies of scale have cut capital costs in transportation, telecom and electricity to much below those of any other economy. Although capital accumulation and cheap labor were important; a sharp and sustained increase in productivity, spurred by 1979 marked oriented reforms, was the driving force behind the economic boom of China. Such explosive growth in productivity is remarkable.

Table-2: Investment as percent of GDP in China and India

	1992	2001	2002	2007	2018
China	36.2	38.5	41.0	44.0	54.0
India	23.8	22.3	22.8	36.0	45.0

Source: World Development Report -various issues.

Table-3: Gross Domestic Saving as percent of GDP in China and India

	1992	2001	2002	2008	2018
China	37.7	41.0	44.0	54.0	62.0
India	21.8	23.5	24.2	36.4	42.0

Source: World Development Report -various issues, RBI – Handbook of Statistics.

Two major areas where India's economic growth has suffered when compared with China are lower productivity and low capital accumulation. The bedrock of China's industrial competitiveness is rapid productivity gains and not cheap labor or an undervalued currency. Gopalan's (2001) estimates of labor productivity in manufacturing suggest that except in petroleum products and non-electric machinery, the productivity of Chinese worker is higher than that of an Indian worker by anywhere in between 30 percent to 150 percent depending on the product. India has poor penetration in fixed investment. India's fixed investment was 3.6percent of GDP compared with 9 percent of GDP in China (2005). One of the major areas of difference in the capital expenditure of the two countries is the investment for infrastructure. China's investment in housing construction was 10 percent of GDP versus 4percent for India in 2005 (Statistical Yearbook, China). China's steel and cement demand is about 7 to 10 times that of India. In contrast to India's neglect of the basic infrastructure, China has invested its surplus heavily in infrastructure such as railways, power, telecom, roads and water management. In India, with the opening up of the economy, foreign investment was

concentrated in consumer durable sectors where it is quick yielding and with drawl is easy. China's massive investment in public works proved to be a successful formula for rapid growth and job creation. India has savings rate only a little more than half of China. As a result, it has far less in the way of internally generated funds available to put into infrastructure. However, it may be argued that investment in physical capital is not the only source of growth and in part it could be substituting for other sources which could be contributing more to India's growth. Indeed, growth in total factor productivity according to some estimates was higher in India, in at least part of the 1980-2001 periods.

CONSUMPTION PATTERN

The driving engine of Chinese economy has been investment, while for India it has been consumption. In 2008 the ratio of household final consumption expenditure to GDP was 56 percent in India compared to 37 percent for China (WDR-2010). A relatively higher private consumption to GDP ratio of India shows that domestic consumption of goods and services is a major contributor towards real GDP It is one of the key reasons why India was able to register the current high level of growth, a great attraction for both domestic and foreign investors. China's low private consumption share to GDP reflects country's reliance on investment that crowds out consumption. India's comparatively higher share of consumption to GDP has been mainly due to its active consumerism culture, larger share of household income in GDP and populist attitude of the government. Demand in China comes from exports to developed nations while in India most demand is based on domestic consumption growth. That is why China has surplus in current account while India has a deficit. Although China's share of consumption in GDP is lower compared to India, its absolute consumption spending has been larger, which may be due to its higher per capita income. China's consumption growth has been higher at 7.6percent over the past 10 years compared with India's 5.8 percent. China's consumer product market is about three to ten times that of India. Since 1980s, both India and China have witnessed a clear shift in their consumption basket on account of factors such as changing demographics (a rise in the proportion of young population), increase in per capita income, fast emerging retail sector, and improved access to financing. A declining share of primary products is being observed. However, the penetration rates of consumer products higher in China than in India since China's per capita income is 2.5 times that of India.

TRADE PERFORMANCE

Economic reforms have transformed China into a major trading power. Over the past four decades, it has shown commendable performance on trade front. It has registered rapid growth in exports involving aggressive increases on the world market shares. China has increased its share in world merchandise exports from 1.2 percent in 1983 to 9.1 percent in 2008. During this period India's contribution in world trade has grown marginally from 0.5 percent to 1.1 percent. China's over reliance on exports for enhancing economic growth is clear from the fact that its export to GDP ratio has increased to 38percent in 2005 from 7 percent in 1980. India's exports to GDP ratio stood at 19percent in 2005 rising from 6 percent in 1980 (Table-5). Bottlier (2003) points out that although growth of China's services and merchandise exports

far outpace average growth of world exports, its merchandise exports grew much faster than service exports, so that the share of services exports in total exports has fallen to one of the lowest such ratios for any major country. He notes that, in contrast, India's service exports are growing at about double the rate of its merchandise exports, and if current trends continue, the share of services exports in total exports will exceed 50percent in a decade. Today, China is the largest exporter of the world .The ratio of trade to GDP is 72.5 percent for China while it is 49 percent for India (WDR-2009). India lags China substantially despite an improvement in the trend over the past few years. China's growth in merchandise exports is phenomenal, more than quadrupling during 1983-2002. In India, manufacturing sector has not grown at a desirable pace during 1980s and 2000 period. Manufactures constitute 93 percent of the total exports of China (Table-4) while this sector's share in India's total exports is much lower at 63 percent in 2008.

Table-4: Breakdown of Economy's Total Exports (2018) (percent)

	China	India
Agriculture products	3.0	12.0
Fuels, mining products	3.2	24.4
Manufactures	90.1	59.2

Source: REITI (Research Institute of Economy, Trade, and Industry).

The key factors constraining manufacturing exports of India are: less supportive business environment, lack of world class infrastructure, inefficient tax laws, inflexible labor laws, and government interference. However, in recent years, India has achieved breakthrough in trade. Exports grew at 25 percent a year in 2002-05 compared with 10 percent in ten year period prior to this. Even then India's export base at 19 percent of GDP in 2005 is much lower than that for China with 38 percent and so its export performance is not enough to drive the economy's strong growth. India has taken advantage of its flexible financial market to attract foreign capital for its growth. India has taken a lead in high end commercial services exports mainly IT software, ITES business process. They currently account for 40 percent of India's total services exports. India has notably outstripped China in IT sector primarily because of the lack of facility with English language among Chinese and the absence of experienced project managers in China. India is also ahead of China in pharmaceuticals, chemicals, and automotive products which will continue will continue to remain growth drivers in exports sector. India is beginning to make inroads into manufactured exports with the implementation of reforms and a rise in savings rate since 2000.

Despite entrepreneurial vitality and cheap and abundant labor in the country, manufacturing in India is nowhere near China in terms of contributing to GDP growth. Besides overhauling antiquated labor laws, India must create opportunities by dismantling hurdles to private investment in infrastructure and retail, boosting agriculture – industry linkages and reframing land acquisition rules so factories can start up easily.

ROLE OF FOREIGN INVESTMENT

Much of China's dazzling growth has been due to substantial jump in foreign inflows to

which it opened its door in 1980s. It has been brilliant in attracting FDI as a means to acquire technology, managerial expertise, and factories on a scale and with scope that is hard to believe. In 1990 net foreign direct investment accounted for 1.0 percent of GDP in China compared to only 0.1 percent of GDP in India. In 2005 it rose to 3.5 percent in China and 0.8 percent in India. The total foreign exchange reserves of China are exorbitantly high at an amount of $1528 billion as against merely $ 283 billion for India. Improved physical infrastructure in China provided opportunity for TNCs to produce, move goods and services efficiently and minimize costs so that they can compete globally on cost advantage. In India, FDI and FII inflows have jumped only since 2000. Environmental and bureaucratic obstacles including lack of transparency, hazy rules, cumbersome tax laws, procedural complexities, land acquisition problems, rigid labor laws etc. are responsible for relatively lower foreign inflows in India compared to China. Since liberalization, stock market has become a major source of financing for corporate. A large part of India's recent growth has been driven by liquidity provided by foreign institutional inflows (FIIs). Low interest rates and buoyant assets markets have created a feel good factor that has led to high growth of Indian economy. China has used foreign money to build infrastructure on which liquidity outflows have no impact. China's sprawling success in attracting FDI is partly a historic accident since it has a wealthy Diasporas. During 1990s more than half of China's FDI came from overseas Chinese sources. Indian Diasporas has accounted for less than 10 percent of the foreign money flowing to India.

Creation of special economic zones (SEZ) has been a grand success in China. Over 20 percent of FDI flows into SEZ and it has generated 10 percent of exports. The first SEZ in China was set up in 1980 as soon as the nation embarked on economic reforms. On the other hand, India's SEZ policy was launched in 2001, a decade after the initiation of economic reforms. While China established SEZ close to ports or major industrial locations, in India SEZ have been approved arbitrarily across the country in large numbers. FDI inflows in Indian SEZ are very erratic and insufficient.

QUALITY OF LIFE

As compared to India, China also scores higher than India on human development indicators such as living standards, poverty ratios, female adult literacy, and life expectancy rate by a wide margin. Good education and health facilities are crucial for sustained and inclusive development. They are state subjects in both the nations. Local government has a large share of responsibility for their provision. China has surpassed India by focusing intensively on primary and secondary education. The human development rank (HDI) of China is 92 much ahead of India which is at 134th place. Table-6 provides a bird's eye view of the comparison of the two economies in terms of quality of life indicators.

It has been widely acknowledged that poverty has declined significantly in both the countries since 1980s after both experienced substantial acceleration in their growth of per capita income. In India, official estimates reveal that the proportion of poor in the population, using national poverty line, declined from 45.7 percent in 1983 to 27 percent in 1999-2000 in rural areas, and from 40.8 percent to 23.6

percent during the same period in urban areas. For the country as a whole, poverty declined from 44.5 percent to 26 percent.Sundaram and Tendulkar (2003) estimate the decline to have been from 46 percent to 27 percent in the country as a whole. Hu, Hu, and Chang (2003) report that, according to official data, the proportion of poor in the rural population of China fell steadily from 33percent in 1978 to as low as 3.7 percent in 1999. The incidence of poverty is still very high in India compared to China. Over the past 25 years regional disparities in growth have significantly widened in China as well as India. Rural China and western regions lag far behind urban China and coastal regions. The deliberate policy choice of the Chinese government to concentrate reforms and external opening to coastal cities and SEZs contributed to their growing faster and moving ahead of other regions, particularly in the west. In India, there was no such deliberate effort in terms of policy, however, groups and states, that were initially better placed in infrastructure and human development grew faster than others not so well placed. According to National Sample Survey and RBI estimates on the growth of net state domestic product in 5 fastest and slowest growing states among 16 large states in India during 1980s and 1990s, the fastest growing state, Delhi, grew at nearly 2.5 times than the slowest growing state of Kerala in 1980s and more than 5 times the then slowest growing state of Assam in 1990s.

ESSENCE OF CHINA'S MIRACULOUS SUCCESS

The above analysis clearly reveals how China has gone way ahead of India in almost all the parameters of economic growth and has created a miracle over past three decades. It has enjoyed a sustained stability for this entire period as a precondition for modernizing a huge nation. Indeed, China's model of growth has outstripped all models advocated by the west for developing countries. The strength of the China's model lies in the fact that it enjoys masses support, blends well with the countries own cultural traditions, and it has taken shape in the midst of international competition. Its approach towards reforms provides useful lessons for other transition economies. Such miraculous performance may be attributable to the following factors:

1. Primacy to Poverty Alleviation and People's Livelihood: The secret of unprecedented success story of china is its effort on poverty eradication front. At the time when reforms started, there was widespread poverty in the rural areas of China. Deng Xiaoping's large scale modernization program took off in 1979. Prerequisites for growth already existed since Mao era. China phased out rigid commune system and empowered farmers as a strategy to wipe out poverty. It met with great success. In the process of rapid economic development nearly 400 million people was lifted out of poverty. China has also been successful in introducing flexible labor system.

2. Big Impetus to Agriculture and Rural Economy: Success of reforms on rural front set the Chinese economy moving. China adopted a new agriculture strategy which did not compete with industrial expansion. It focused on mass mobilization of rural labor to work on labor-intensive projects such as flood control, irrigation, and reclamation of land. A massive decollectivisation program was initiated whereby the land was contracted out or distributed to rural agriculture input prices. The farmers were given incentives to work

hard and prosper. All this gave a big push to the rural economy. A Positive chain reaction led to rise of millions of small and medium sized entrepreneurs accounting for more than half of China's industrial output. In India there have not been any major reforms in agriculture since the beginning of reform process in 1991. Over the entire reform period, the government spending on infrastructure for agriculture has been quite low. Total public spending on agriculture dropped to 0.4 percent of GDP in 2004 from 0.6 percent in 1991. Even today only 40 percent of land is irrigated in India.

3. Constant Experimentation Approach: In China growth started with market oriented economic reforms and modernization program introduced by Deng Xiaoping. The government initiated gradual experimentation approach in the rural sector and later followed it up to the industrial sector. After the success of first set of reforms in agriculture sector, the government launched a big-bang industrialization plan with liberalization of product pricing, introducing a new system which involved rewarding local governments for promoting development, reforming loss-making state owned enterprises. This was followed by testing other new ideas like granting of greater autonomy of management to SOEs, encouraging external trade, setting up SEZs, attracting FDI, encouraging high tech joint ventures and other such experiments which became growth drivers for China. This cautious approach of gradual reforms enabled China to maintain much needed stability.

4. Long –term Strategy and Correct Sequencing: During its transformation since 1979, China has rejected both the Soviet model and western style democratization and explored its own path of development. It has shown to the world country's peaceful rise and mutually beneficial cooperation with other countries. As early as mid 1980s, Deng Xiaoping's government framed a strategy of next seventy years of development and modernization for the country. Its successive governments have unswervingly pursued it till this day. China's reform process has reflected a clear pattern of change: soft reforms followed by more difficult ones. Advantage of this approach is that lessons and experiences gained in the first stage of reforms generate conditions for the next stage of change. In 1980, China created SEZ, which enjoyed special policy benefits such as good infrastructural facilities along with lower tax rates. The success of these SEZs led to the creation of more such zones and this has been a corner stone of the success of China's reforms. The reforms of late 1980s and early 1990s were directed towards creating a price driven market economy and reducing the role of state in resource allocation. During late 1990s the reform focused on shutting down loss making enterprises and dealing with insolvency in the banking system. With the start of 20th century, China increased its focus on narrowing income inequalities. Today, one can witness the rapid modernization of infrastructure, including new super highways, airports, telecom facilities among others.

5. Good Governance and Performance Criterion: China has traditionally believed that the quality of a political system has to be defined by its substance, i.e. good governance. It is tested by what it can deliver to its people, and not merely by correct procedures. Their philosophy is that substance will evolve right procedures. Criteria such as performance in fighting poverty, attracting FDI, ensuring cleaner environment have become key factors in the promotion of officials. Representatives

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are chosen from top performers at different levels of responsibility.

6. Innovations and Appetite for Learning: China has undergone a series of institutional innovations in the process of reforms. The country has a long tradition of selective cultural borrowing, drawing useful elements and foreign ideas to enrich its own system. It has exemplified Socialist Market Economy, combining positive role of state-intervention with market efficiency in resource allocation. A good example of China's innovativeness is its land tenure system where land ownership remains public, yet individuals have long term renewable land-use right. The joint ventures between Diasporas and local residents, incentives in tax holidays, lease and ownership rights to foreigners, bilateral tax treaties and many such measures helped China in its development. China has created the world's largest real estate market in less than two decades. It has to its credit world's second largest expressway network in one decade. The country has adopted its own path of development rejecting both the Soviet Model and western style democratization.

7. An Enlightened, Strong Developmental State: The state of China took economy's initial conditions into consideration and exploited all favorable internal and external factors. The specific design and sequence of reforms were induced rather than imposed. Chinese state has been successful in shaping national consensus on the need for reforms and modernization. Over the years China has ensured political and macroeconomic stability. It remains state-run but is witnessing an increasing commercial class and is very pro business. India is a democracy but also with a strong bureaucracy and continues to be under state control on many key industries. Structural changes made in the Chinese economy can be demonstrated through development of Shanghai and its modern infrastructure. Shanghai has achieved a growth rate of 10 percent for last ten years. The state has followed the policy of decentralization of economic decision making to local governments and the creation of incentives for local governments. Indian economy is plagued by ethnic and religious tensions, and it has also had a long standing dispute with Pakistan over Kashmir. China, on the other hand, has enjoyed two decades of tranquility; it has been able to focus almost exclusively on economic development.

LESSONS TO LEARN AND ROAD AHEAD

Although India's growth performance has been impressive, it needs to be made more inclusive through stimulating agriculture growth. Country's service sector is strong but manufacturing is weak and the two sectors need to be linked. In India a manufacturing boom is required to employ its huge population. China's promotion of SEZ for manufacturing sector suggests that well designed and sector specific government policies can improve the investment climate of a country and allow developing countries to compete globally in new fields. SEZ, in China, have been instrumental in enhancing exports and attracting foreign investment. India has not been successful in developing SEZ to the desired extent. Large real estate companies have grabbed land from the state government at throw away prices. India must redesign its SEZ policy, emphasizing on a greater role of the government in developing the zones. A whole new package that suits India's need is required to ensure the success of SEZ. Infrastructure has to be developed on a war

footing using foreign exchange reserves and public sector off loadings. India's strong entrepreneurial business culture, increasingly favorable demographics, and growing middle class fuelling domestic consumption can be an advantage in making India an economic prowess. The country offers better long term returns on stocks than China, given the outlook for corporate earnings and economic growth. Greater economic freedom has to be created by reducing government interference, reducing fiscal burden and striving to balancing development in different regions of the country.

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