

## **CHINA AND INDIA: TWO ASIAN ECONOMIC GIANTS, TWO DIFFERENT SYSTEMS**

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### ***Abstract***

In this essay, I am going to focus attention on China and India as new economic juggernauts that are having great influence at the present time. Of course, those two powerful economies may be joined by others that are large and dynamic at the present time, but movements of others do not come up to the pace being set by the above two Asian economic giants. The Chinese economy has exceeded expectations since 1978 by the widest of margins. It is prosperous; it overcame the food supply matter at the beginning; it is now delivering middle class and upper middle class living conditions to its citizens. India is joining the high-growth club of nations, but in their own way, as a democratic nation. Politically and culturally, the two nations differ markedly, but economically they have some great similarities.

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### **1. Introduction**

For a number of years (after the end of the Cold War), the United States was considered by many to be the sole locomotive for the global economy. That is no longer the case, since the American economy has been diverted to a very risky path to avenge the terrorist attack on the World Trade Center and Pentagon in 2001 (September 11, 2001) and attempts to redirect political, social, and

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cultural structure in the Middle East. It is reasonable to believe that the US can once again assume its economic leadership in the world, but new developments have been taking place that have brought additional and quite different locomotive power to the global economy.

In this essay, I am going to focus attention on China and India as new economic juggernauts that are having great influence at the present time. Of course, those two powerful economies may be joined by others that are large and dynamic at the present time, but movements of others do not come up to the pace being set by the above two Asian economic giants.

We have lived through, watched, and admired the Asian Miracle, which featured somewhat smaller economies in South East Asia (ASEAN). Actually they were preceded by amazement at the performance of the NIEs (Newly Industrialized Economies), which covered East Asia, outside the strict ASEAN grouping, not to mention Japan, which seemed to have all the dynamism and strong growth during the 60s, 70s, and 80s.

Many readers will recall, immediately, that the ASEAN countries, the NIEs, and Japan all lacked one important growth feature, namely, sustainability. The financial crisis of 1997-98, the bursting of Japan's "bubble" in 1989, and the sudden declines of NIEs (Hong Kong in 2001, Taiwan in 2001, Singapore in 2001, and South Korea in 1997, 2001, 2003) indicated lack of sustainability. No doubt, there will be revitalization in all these economies, but their long-term track records do not measure up fully to what is happening now in India and China.

## **2. Some Background Issues – China**

All the Asian economies have long histories and interesting cultural developments that make each case worthy of separate and detailed study. For the purposes of this essay, I shall probe the historical roots of present economic performance only since the 20<sup>th</sup>

Century, and particularly, those episodes in which I gained some first-hand information and impressions from multiple visits on the scene, many student-teacher relationships, as well as detailed econometric investigations in the period since the end of World War II.

In the first place, this essay deals with the two largest populations of the modern era – China at 1.3 billion persons and India at 1, getting ready to outstrip its large neighbor. It should be pointed out that Japan, which used to be the dominant Asian economy in the modern era, went voluntarily into a period of low birth rate after World War II. This situation helped Japanese economic growth during the reconstruction period and early growth spurt, at a rate of more than income-doubling in the 60s, but a series of adjustments, shocks, and financial market problems set Japan back as an Asian leader, especially under a burden of a limited work force to support an aged population. It is interesting to speculate whether China's one-child per family (with limited exceptions) will lead to similar complications in the future – not immediately, but within the 21<sup>st</sup> Century. Much depends on future demographic policy and practice in China.

China went into a strictly planned economy after 1949 and is now in a state of transition, from plan to market. It is classified as market socialism, Chinese style, but many Westerners like to think about it as an approach to market capitalism. Prior to the period of reform, starting in 1978, the Cultural Revolution devastated Chinese life and economic conditions. Coming out of this situation, a whole new generation, plus those who suffered under the Cultural Revolution, had to start rebuilding from scratch. Economics was an especially strategic, but neglected, subject in its modern version. Now Chinese economics is self-sustaining, but at the beginning of reform had to rely on foreign teaching and input. The hallmark of this period was step-by-step gradualism. First there was land reform with individual responsibilities transferred to farmers, who did not own the land in a capitalist sense, but who could make agricultural decisions, while delivering some output to the state. An interesting feature of rural reform was the introduction of town-and-village-enterprises (TVEs).

These fit well with agricultural off-season activities and grew, in some cases, to become fairly large enterprises.

After rural reform, came small commercial or small manufacturing establishments, China then took note of export-processing zones in Taiwan and other places, enlarging the concept to special economic zones (SEZs), which housed foreign firms together with domestic establishments by converting wastelands, building shipping facilities, locating airports, locating financial facilities, and generally establishing new, but restricted, cities. At this early stage the Chinese Diaspora joined enthusiastically. Many contributed entrepreneurial skills together with foreign direct investment (FDI). Some of the overseas (or overland) Chinese helped to create universities, libraries, museums, and other important cultural infrastructure.

All these activities during the 1980s provided impetus to the economic expansions of China. At first, my deceased colleague, Irving Kravis, collected scores of prices in China, at the very beginning of reform (1979) and estimated China's per capita GDP (in PPP prices) at about the same level as in the Philippines and about twice that of India. Chinese officials and scholars did not agree, at first, with Kravis because his levels would have penalized China in that they would not have obtained concessionary loan rates from multinational sources. Subsequently the tables turned and after a long period of very strong expansion, except for the Tiananmen disturbance in 1989, some scholars insisted that the Chinese were overstating their growth rates. It is to be hoped that this matter has been discussed and settled among both the scholarly research community and the popular press.<sup>1</sup> Recently there have been remarks that china has been growing faster than reported, presumably to pressure China to appreciate their currency.

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<sup>1</sup> See L.R. Klein and Süleyman Özmucur, "The Estimation of China's Economic Growth Rate", Journal of Economic and Social Measurement 28, (2002/2003), 187-202.

An important feature of the Chinese economic expansion has been an abundance of foreign direct investment (FDI). This prime funding plus excellent foreign trade earnings has enabled China to become number two in foreign exchange reserves, at about \$500<sup>+</sup> bn. It is difficult to believe that in the early period of reform, foreign visitors with “hard” currency had to pay for products from “hard” currency areas (such as Coca-Cola) in the same “hard” currency. Friendship stores stocked and sold many goods in “hard” currency exchange. Now financial transactions are becoming more and more automatically flexible.

A significant relationship between the United States and China was the granting of most-favored-nation treatment. This was not an automatic or permanent award. It had to be reviewed and reviewed annually by the President. After much negotiation, China was granted Permanent Normal Trade Relationship (PNTR) by the Clinton Administration, and that included automatic MFN, together with an effective entry into membership in the World Trade Organization. This was, however, not a one-way benefit, because China had to grant many concessions then to American firms, in order to complete the negotiations successfully.

Where does the Chinese economy move from here? It has exceeded expectations since 1978 by the widest of margins. It is prosperous; it overcame the food supply matter at the beginning; it is now delivering middle class and upper middle class living conditions to its citizens. The next set of macroeconomic goals is very simply stated: The quadrupling of real GDP between 1980 and 2000 was realized by a safe margin.<sup>2</sup> The next goal is to quadruple again in the interval 2000-2020. This is very ambitious. In my combing of historical statistics, I have not yet found believable statistics of such a growth pattern for 40 years for any other significant economy, let alone one with more than 1.0 billion persons. Can it be done? I would not want to make a wager against it, but it will not be an easy task.

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<sup>2</sup> Actually, the period 1978-2003 had even a higher rate than the 7.2%p.a., associated with 20-year quadrupling.

It is one thing to produce such a macroeconomic record achievement, but it does look plausible to me for China to realize a doubling between 2000 and 2010. They already have an excellent start up to 2003, and two major events loom large in the future to make the first-half happen, namely, the Olympics of 2008 and the International Exposition of 2010 in Beijing and Shanghai respectively. The preparation of appropriate infrastructure and the showing of the country to floods of tourists seem to provide excellent settings for realizing more high growth.

There are new features that are accompanying these economic achievements of China. There is surely more income or product, but how is it being distributed? In the process of economic transition, the income distribution is becoming more unequal. There is also regional inequality, but the move towards westward economic development away from the shoreline may help to improve the regional distribution. There are also some signs of “overheating” in 2004, namely inflationary pressures and concern about nonperforming loans by banks. All in all, however, the Chinese economic development under the aegis of a strong Communist Party, political leadership is surely an unusual phenomenon of our times.

### **3. Some Background Issues – India**

In the very early stages of Chinese reform, I met by chance one of their economic delegations, previously known to me, in a hotel in New Delhi. They requested an informal meeting with me, and afterwards, my Indian hosts inquired about the substance of our discussion. I responded that the Chinese economists wanted to know about my impressions of India’s economy and asked me what they should be finding out in their discussions there, which were primarily about technical econometric matters. I then asked my Indian hosts about their impressions of the scholarly and policy questions that the Chinese were posing. The Indians replied to me that the two countries were approaching economic reform issues quite differently and tried, without success, to influence the Chinese to move in a democratic direction. They declared simply that the Chinese were

carrying out economic reform by imposing party mandates while India was trying to realize similar goals by democratic political processes.

When I explained this to Mrs Sheldon Hackney (the wife of the President of the University of Pennsylvania at that time) whom I met soon after at a ceremony in Shanghai at the Jiao Tong University she told me that she would place her bets on India. I chose china, but in autumn 2003 I informed Sheldon Hackney that his wife may have been more perceptive than I had thought, even though she had conceded a win for me earlier.

How is India approaching economic reform, and how is it developing in 2004? In the early part of the 1990s India was developing a skill in mastering software for computers and the information highway. Large international enterprises were sending numerical work for accounting, business operations, performance measures, and other large quantitative tasks to centers in India for processing. These were located, early on, in Bangalore and Hyderabad, where expansion of the information sector has been extremely rapid and large in volume of activity. It has become not only matters of exchange between information sector activities in India with corresponding centers in the United States and elsewhere. The United States has remained as the primary trading partner with India for Software, but that suggests an overly narrow view in terms of what is happening now. India acts as a center for delivering exports of information services to the US and other countries. Indian secretaries serve Canadian doctors in the National Health Services. The workers at the India sites can prepare technical medical reports for individual patients, miles away. The reports are delivered by the Internet. This is a trade transaction between Canadian medical servers and Indian information services.

Similarly, Indian operatives provide hot-line instructions to foreigners (often in the United States from “call centers” located in major centers. The hot-line discussions may be delivered from India’s service-sector to thousands of homes or offices in the programmable sectors of the US economy.

A quantitative view of the changes that have taken place in India in relation to the same changes in China, may be seen in the accompanying table 1.

The growth rate of India's service sector rose from 4.5% to 7.9% from 1971-80 to 1997-2003. China's corresponding growth rates went from 5.2% to 7.7%. The service sector shares of GDP went from 31.6% to 49.5% in India between 1970 and 2001, while the Chinese estimates are from 13.2 to 24.1%, as a share of GDP. It appears that the expansion in delivering services was stronger in India than in China.

Table 1. Value Added by Sector.(Growth Rates and Shares)

	Annual growth rates				Shares			
	71-80	81-90	91-96	97-03	1970	1980	1990	2001
China								
<i>Agriculture</i>	3.5	5.5	4.3	2.9	42.2	30.1	27.0	11.3
<i>Industry</i>	8.9	11.7	16.6	9.4	44.6	48.5	44.6	64.5
<i>Services</i>	5.2	12.4	9.7	7.7	13.2	21.4	31.3	24.1
India								
<i>Agriculture</i>	1.9	3.1	3.8	1.2	44.5	38.1	31.0	23.9
<i>Industry</i>	4.0	7.1	6.1	5.0	23.9	25.9	29.3	26.7
<i>Services</i>	4.5	6.8	7.3	7.9	31.6	36.0	39.7	49.8

Source: Report on Currency and Finance, 2002-2003. Reserve Bank of India p.83.

To get an idea of India's expansion in IT enabled services and business process outsourcing, which is now a dominant effect, deliveries went from \$565 million in 1999-00 to \$2.335 million in 2003-04. There was nearly a five-fold increase in just four years.

Other factors are responsible for the change in India's economic performance. One of the main factors helping china has been the contribution of the overseas Chinese. To some extent it is a matter of funding, but the transfer of entrepreneurial skills is at least as important. Chinese living abroad put money for funding Chinese development into mainland securities (stocks and bonds) but also very important have been the funds for direct investment, such as



FDI, meaning foreign direct investment. Such investment flows carry not only financial resources, for purchasing items of capital and operating activities, but also “know-how” of overseas business executives.

A similar process is developing for India. All along coasts of Africa and Asia, one can encounter Indian citizens who have gone abroad to build their fortunes. Nevertheless, there remains an unbreakable bond with their homebound compatriots. Now, one can find Indian returnees who want to help their country move forward, economically. At the same time, the overseas investors realize excellent earnings. When business projects are in the formative stage, the foreign investors make deals with their resident Indian counterparts as well as with local officials, who can show preference and grant the members of the Diaspora with tax holidays, favorable exchange rates (before, Chinese rates were consolidated in 1994). When all is said and done, the overseas Indians channel investment funds into India, and this is likely to continue on an expanding scale.

India needs conventional output of food, clothing, home construction, entertainment, and other ordinary items that enhance quality of life. Any way that one approaches the subject, there is no doubt that the overseas Indians who have realized good incomes abroad are in positions to help those who remained behind. This is another source of stabilization for India’s future economic growth at high rates of expansion.

India need not settle on conventional techniques for agriculture development. In the future, one could hope for introduction of modern methods of irrigation. They could make their agricultural hinterlands expand without periodic fear of drought. The methods of drip irrigation have enabled Israel to “green deserts”, and the technology that is needed can be made available to India on as favorable a basis as fresh techniques in providing a better life for the entire population, as well as producing fibers for textile production and oil for conversion to motor power.

It is from sources like those mentioned above that India can look to steadier food production – as in the time of the Green Revolution – and in production of fibers for clothing or for export to other big users of cloth and thread. Not only small entrepreneurs, but large enterprises can overcome the traditional periodic shortfalls. India proved that modern software facilities could be developed and used for the purposes of cost saving by Western enterprises. This is only a first step. In the next stage, the fruits of the information sector expansion can be put back into the efficient functioning of India's vast economy. Then there can be realization of efficient firms and entrance into world competition.

Table 2. Growth in Real Gross Domestic Product: Cross-Country Comparison ( Annual percentage change)

Country	Av.	95	96	97	98	99	00	01	02	03P
World	3.5	3.7	4.0	4.2	2.8	3.6	4.8	2.4	3.0	3.2
Advanced	2.7	2.8	3.0	3.5	2.7	3.4	3.9	1.0	1.8	1.8
Developing	5.0	6.1	6.6	5.9	3.5	3.9	5.7	4.1	4.6	5.0
<i>Of Which:</i>										
Argentina	0.1	-2.8	5.5	8.1	3.8	-3.4	-0.8	-4.4	-10.9	5.5
Bangladesh	5.1	4.8	5.0	5.3	5.0	5.4	5.6	4.8	4.9	5.4
Brazil	2.2	4.2	2.7	3.3	0.1	0.8	4.4	1.4	1.5	1.5
Chile	4.4	10.8	7.4	6.6	3.2	-0.8	4.2	3.1	2.1	3.3
China	8.3	10.5	9.6	8.8	7.8	7.1	8.0	7.5	8.0	7.5
India	6.0	7.6	7.5	4.8	6.5	6.1	4.4	5.6	4.3	7.0#
Indonesia	2.7	8.2	8.0	4.5	-13.1	0.8	4.9	3.4	3.7	3.5
Malaysia	4.8	9.8	10.0	7.3	-7.4	6.1	8.6	0.3	4.1	4.2
Mexico	2.6	-6.2	5.2	6.8	5.0	3.6	6.6	-0.2	0.7	1.5
Pakistan	3.6	4.9	2.9	1.8	3.1	4.0	3.4	2.7	4.4	5.4
Philippines	4.0	4.7	5.8	5.2	-0.6	3.4	4.4	4.5	4.4	4.0
Sri Lanka	4.3	5.5	3.8	6.4	4.7	4.3	6.0	-1.5	4.0	5.5
Thailand	2.7	9.2	5.9	-1.4	-10.5	4.4	4.6	1.9	5.3	5.0

Source: World Economic Outlook, September 2003. P IMF projections.# with a continued upward bias (RBI projection). For India the source is Central Statistical Organization and the data pertain to financial year (April-March). Av. is average 1995-2003.

The accompanying table shows how India has taken steps to join the high-growth group of progressive economies. They should be able to emulate China in these respects and maintain high overall growth in their GDP over long stretches of time. India is just becoming visible as a high growth center, while China has shown how to do this for almost 25 years, with hardly a setback.

The test is in place for India now – to enjoy 6-8% annual GDP growth on a steady basis. It can be said that India is now approaching China as an expansive high growth economy, coming up approximately to 7% in 2003-2004, with a good start to make this a sustainable and sustained growth target. It is getting very close to the figure that China is presently aiming to achieve, particularly if fears of overheating lead China to aim for 1 or 2 percentage points lower in their sustained growth rates.

India can join the high growth crowd among leading Asian countries. It can, of course, be demonstrated that such an achievement is within India's grasp. After all the land of Ramanujan, the famous self-taught Indian mathematician, who discovered many important mathematical ideas while serving as a clerk in a small Indian town or city. It turns out that much of his work in the abstract subject of number theory, contributed greatly to the very early stages of modern Indian history.

I repeat, that India is joining the high-growth club of nations, but in their own way, as a democratic nation. Politically and culturally, the two nations differ markedly, but economically they have some great similarities.

#### **4. China and India, Social Issues**

Among obstacles to steady economic expansion are outbreaks of illness or, more generally, dangers to public health. There was such an outbreak in 2003, the SARS epidemic in China and a few other centers, particularly in Chinese enclaves abroad, such as Toronto. After initial stumbling, public health experts rose to the occasion and, for the present (2003-2004), there is no such problem. There

was some economic damage, namely in localized growth rates for a few months, but for annual time periods, there were only slight effects on GDP growth for one or two quarters, at most.

A longer run problem confronts India, namely a high rate of HIV-AIDS infection. In some African countries with much smaller populations than in India, the onset of HIV-AIDS cases has seriously held back economic growth. This is particularly evident in economies that depend heavily on physical labor input for primary sectors of production, such as agriculture, fishing, forestry, and mineral extraction. For example, Botswana was once viewed as an unusual case of fast and strong economic development, when the diamond market slumped, but that difficulty was compounded by a sharp increase in HIV-AIDS cases. Now, that country is not cited as an example of sustainable development.

In the case of India, the incidence of HIV-AIDS, as a percentage of population, is not so large, but the absolute frequency of cases runs into the millions and poses a future threat for development. The UNDP listing of human development indicators reports a higher number of cases for India than for any other country. There are well-known reasons for the occurrence of this disease in India, in connection with the away-from-home life of long distance road travel and mobile construction crews. China has had much less of an AIDS problem, but commentators have often noted possibility of an upsurge in the future, and this could be a growth obstacle for China unless it is taken care of in the immediate future.

Education has played an important role in India's rise to leadership in worldwide exports of software and other export of business services. It is not only education, as such, but higher education in the English tradition. Excellent command of English language, an important means of communication in the information sector activities, that other countries have not mastered as well. India will be challenged in this respect, and China already has their sights set upon this means of penetration in the world market. Education in computer science and other engineering-type activities

will provide avenues of economic expansion for China, India, and many other countries; so competition is something to be reckoned with. An obstacle for India's continuing economic expansion has been the intervention of bureaucracy. The class society is closely related to the preservation of bureaucracy. In the highly competition global economy, slow reaction movement will hold back many potential players, and India should reconsider the place of class-society in future development.

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For a complete biography of Professor Klein It could also be consulted the following webpage:

<http://www.eumed.net/cursecon/economistas/klein.htm>

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