

China and India: economic performance, competition and cooperation: an update[☆]

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Abstract

China and India chose similar economic development strategies in 1950 of near autarky, industrialization, and the dominance of the state in the economy. China came out of insulation and began reforming its economy in 1978. India's hesitant and piecemeal reforms, initiated in the 1980s, became systemic and broader in 1991. Since 1980, China has grown at an average rate of around 10% per year and India at 6%, though both have experienced a slow down since 1997. China became the world's fourth largest exporter in 2002. India's exports also grew, though not as fast as China's. Both are experiencing a protectionist backlash. The paper reviews the economic performance of the two countries, particularly of the macroeconomy and of the external sector. It argues against exaggerating the significance of the growing regional disparities within each country, it argues against exaggerating their significance. The two compete in world markets, and therefore, have a common interest in a liberal world trading system. Their cooperation in the Doha Round of trade negotiations would be mutually beneficial and would promote the interests of developing countries.

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1. Introduction

The ancient civilizations of China and India had close and friendly contacts with each other for millennia. Although a border conflict in 1962 interrupted these, fortunately, the two countries have resumed their traditional relationship. Since the Communist Party gained control of China in 1949, and India gained independence in 1947, both turned to economic development. They chose similar development strategies that involved deliberate insulation from the world economy, industrialization, and the economic dominance of the state¹. China began reforming its closed, centrally planned, non-market economy in 1978. Although India always had a large private sector and functioning markets, these were subject to rigid state controls and the state owned the “commanding heights” of the economy. The deleterious effects of the controls and state ownership, to which Dutta rightly draws attention in his comments, have been widely documented.² India initiated hesitant and piecemeal reforms in the 1980s. These became systemic and far broader after India experienced a severe macroeconomic crisis in 1991. The political environments under which reforms were initiated and implemented in the two countries and their consequences were very different. India continues to be an open, participatory, multi-party democracy, while China has an authoritarian, one party regime, though it is liberalizing. After recounting the differing rationales as well as the similarities and differences in the content of their reform agenda, I reviewed in Srinivasan (2002) the achievements of reforms and remaining challenges, particularly regarding reforms of state-owned enterprises (SOEs). I concluded with an analysis of the competition between China and India in world markets and the potential for their cooperation in the Doha Round of multilateral trade negotiations under the auspices of the World Trade Organization (WTO).

¹ Dutta points out that China was more successful in industrialization as measured by its much higher share than India of industry in GDP. Although Indian development strategy did not deliver a large share of GDP for industry, it nonetheless created a diversified, but largely internationally uncompetitive, industrial structure. In China, draconian savings and investment during the Mao years delivered sizable, but inefficient, industrialization. The real issue is not about the difference in their shares of industry in GDP between the two countries. It is whether in *either* society, the chosen path of industrialization since 1950 was socially optimal. My answer is that it probably was not: the cost in India was slower growth and greater poverty (both in terms of real consumption and in terms of slower reduction in mortality and morbidity) for millions. In China, it was misery (and even death) for several millions during the attempt at forced industrialization of the Great Leap Forward and later during the horrors of the Cultural Revolution.

² The net losses of state-owned enterprises as off-budget items are not normally included in the fiscal deficit figures. Still, contrary to the implication of Dutta in his comments, their contribution to overall macroeconomic imbalance was not significant until the 1980s when fiscal profligacy replaced the macroeconomic conservatism of the previous three decades. Dutta is also way off in his assertion that Indira Gandhi’s slogan of “Garibi Hatao” or “Remove Poverty” in India and Deng Xiaoping’s slogan, “It is glorious to get rich” in China date to roughly the same time in the 1970s. In fact, even before independence, the plans for India’s development put out by various groups across the political spectrum all had poverty eradication as the overarching objective. The slogan “Garibi Hatao” used by Mrs. Gandhi came much later in the 1971 election campaign. Deng coined his phrase during his famous southern tour in the early 1990s. In any case, it would be simplistic to attach too much importance to either slogan: what mattered is not the slogan but the policy framework. India’s development strategy did not deliver sufficiently rapid growth to reduce poverty significantly. By the same token, Deng’s policy, rather than the slogan, delivered China’s rapid growth.

Table 1
GDP per capita (1990 international dollars): 1700–1998

	1700	1820	1870	1913	1950	1973	1998
China	600	600	530	552	439	839	3117
India	550	533	533	673	619	853	1746

Source: Maddison (2002).

This paper updates Srinivasan (2002). Section 2 is devoted to macroeconomic prospects and problems. Section 3 is concerned with external sector issues, in particular, the spectacular performance of China relative to India in their competition in world markets as well as the emerging perception in India of the opportunities in the large and rapidly growing Chinese markets. It also notes the protectionist backlash that China's growing dominance in world trade and India's success in Information Technology have induced in the US and Europe. Section 4 concludes with a discussion of the cooperation of China and India in the failed fifth ministerial meeting of the WTO in Cancún, Mexico, in September 2003 and its importance for the resumption and successful conclusion of the Doha Round.

2. Macroeconomic prospects and problems

2.1. Sustainability of growth³

Maddison's (2002) estimates of China's and India's per capita real incomes show that, starting from roughly equal levels in 1870, India forged ahead of China until the outbreak of the First World War. Though both experienced declines in their per capita incomes thereafter (China more so than India) by 1950, India's per capita income was about 40% higher than China's, and it took roughly the next three decades for China to catch up. Since 1980, China has forged much farther ahead (Table 1).

China and India were the star performers in aggregate GDP growth in the 1980s and 1990s. China's average growth of 10% per year during 1980–2001 had slowed to a range of 7–8% per year during 1998–2002. It is projected to grow at 8% in 2003 (World Bank, 2003a, Table 4.1; World Bank, 2003b). Given that China was hit by the SARS

³ Dutta seems to have misunderstood this section. Clearly, it is a matter of elementary arithmetic that if a country with an initially lower per capita income is to catch up with a country that has a higher per capita income, its per capita income has to grow faster than the other's. Indeed, as I note, faster Chinese growth prior to 1978 was catch-up growth that merely enabled China to make up for its lower per capita income than India in 1950. This, however, has little to do with growth acceleration per se. It is also possible, and indeed likely, that the growth rate along the optimal path of transition to a steady state would initially exceed the steady state growth rate, thus involving an initial step-up and a later step-down in growth rates. My discussion of sustainability is not about catch-up and transitions. It arises from my concern, particularly from an Indian perspective, that for making a serious dent in poverty, sustained and rapid growth for the next several decades is needed. I discuss whether such a sustained and rapid growth is likely. I am puzzled by Dutta's comment that "[t]he thesis of sustainable rate of growth has been responsible for an average annual rate of growth at 5–6% for India."

epidemic in 2003, and economic growth in China's major markets in Europe and North American had slowed since 2000, its performance is remarkably good. Growth continues to be fueled by a rising ratio of fixed investment to GDP, which is expected to reach 42.2% in 2003. [World Bank \(2003b\)](#) notes that this rate of investment exceeded the levels reached in the early 1990s when the economy was believed to be overheating. Furthermore, much of the investment is apparently supported directly or indirectly by poorly monitored sub-national entities. Clearly, a rapid growth of such investment would erode its efficiency and could threaten future macroeconomic stability.⁴

In India, the average annual rate of growth of GDP was close to 6% during 1980–2001. It reached a peak of 7.8% in 1996–1997 from the low of 1.3% in the crisis year of 1991–1992. Since then, it has fluctuated between a low of 4.0% in 2002–2003, a year in which the economy was affected by a serious drought to a high of 6.5% in 1998–1999. With bountiful monsoon rains in 2003, growth is expected to be 8.1% in 2003–2004 ([CSO, 2004](#)). Investment as a proportion of GDP has ranged between 23.1% and 27.7% of GDP since 1991–1992 ([RBI, 2003a](#), Table 211).

Macroeconomic data in general, and savings and investment rates in particular, are subject to potential biases and significant measurement errors in both countries. One has to avoid reading too much from such data. Also, China is still not a market economy and prices in China may not have the same role and meaning as they do in a market economy. One cannot, therefore, lightly dismiss the argument of those who claim that measured Chinese growth may be overstated perhaps by as much as 2–3% per year.⁵ They also claim that in contrast, the Indian statistical system, though not as biased as the Chinese, nonetheless does not cover all output, and this bias may be growing over time. This in turn would imply that Indian GDP, and possibly its growth, may well be understated in official data. If these claims are conceded, the difference between the “true” Chinese and Indian growth rates could be insignificant. However, taking official data of both countries at face value, there is a difference of about 4.1% between Chinese and Indian growth rates during 1990–2001. Since Chinese fixed investment rates exceeded India's by about 15% on average, one could argue that this difference in investment alone is enough to explain the difference in aggregate growth between the two countries. Such an argument would be somewhat simplistic since 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 (TFP) according to some estimates was higher in India, in at least part of the 1950–2001 period. For example, [Maddison \(1998, Table 3.101\)](#)

⁴ Going by official Chinese data, the rate of inflation is low and the current account is in surplus. This means that at least there is no evidence of excess demand, a symptom of overheating. Macroeconomic data on savings and investment seem to be inconsistent with balance of payment data in China. If we assume a domestic savings rate of 30% and a current account surplus of 3%, rate of investment would be 27%, not much higher than India's (*Economist*, November 13, 2003).

⁵ [Rawski \(2001\)](#) speculates that cumulative GDP growth during 1997–2001 was no more than one-third of official estimates and possibly much smaller. His speculation is not widely shared. For example, [Lau \(2003\)](#) has questioned the methodology underlying Rawski's speculation. On the other hand, growth may be understated if national growth estimates are based on output and growth data supplied by provincial governments. The reason is that they may have an incentive to understate output and growth to the extent the central government's share of taxes provinces collect depend on their reported output.

estimates that total factor productivity *declined* by 0.78% per year in China during 1953–1978 and *increased* by 2.25% per year during 1972–1995. Ahluwalia (1992) estimates that TFP in India's manufacturing sector declined by 0.5% per year during 1960–1980 and increased at the rate of 2.8% per year in the 1980s.

In both countries, the issue of sustainability into the future (of say, the next two decades or so) of current growth rates is important. Clearly, if the high rates of savings and investment are not sustainable, and the efficiency of investment is doubtful, then Chinese growth rates will decline. Indeed, with greater quality and a larger number of various consumer goods (including durables, such as passenger cars) becoming increasingly available in the market, Chinese households may consume more and save less out of their rising incomes than they are doing now. Also, the process of phasing out of SOEs and ushering in of truly private enterprises that respond to market signals may not be smooth and could affect growth adversely. On the other hand, China's accession to the WTO and its further integration with the world economy could be expected to improve the efficiency of resource use through greater competition, inflow and adoption of better technology, and improvements in financial intermediation from the operation of foreign banks and other intermediaries could more than offset the effects of any decline in investment. On balance, I do not foresee any significant decline in Chinese growth in the near to medium-term future.

In India, the official Tenth Five-Year Plan (2002–2007) projects an 8% average rate of growth for the period of 2002–2007. Given the slower average growth of 5.5% per year in the recent past (1997–1998 to 2002–2003), legitimate queries have been raised about the feasibility of attaining and sustaining an average annual rate of growth of 8% or more in the next couple of decades. Of course, failure to do so would doom the prospects of any substantial reduction in mass poverty. However, there are reasons to be optimistic. India has farther to go in integrating its economy with the world economy and in attracting foreign direct investment (FDI) than China (more on this in Section 3), and both could have growth augmenting effects. India's domestic reform process, after having slowed down since the late nineties, is gathering momentum. Clearly, with an augmentation of the forces of competition (domestic and international) and acceleration of the pace, broadening and deepening of reforms, the target of 8% growth could be attained and exceeded. Whether these necessary steps would come about is an issue: for example, the overall fiscal deficit of all levels of government taken together, and not including the losses of SOEs, was 10.4% of GDP in 2002–2003 and is projected to be 9.8% in 2003–2004. These exceed the 9.3% reached in 1990–1991 on the eve of the macroeconomic crisis (World Bank, 2003c, Table 2.2). Unless the fiscal deficit is brought down significantly, the prospects of reaching and sustaining 8% growth are dim.

Progress in some vital aspects of reforms, such as privatization, liberalization of restrictive labor and bankruptcy laws, reform of electricity generation, transmission and distribution has been chequered—with steps forward as well as setbacks. Hopefully, after the next general elections, to be held during April–May 2004, a government will come to power with credible commitment to reforms (i.e., with a willingness to enact reforms) and a parliamentary majority to pass needed legislation (i.e., with the ability to enact reforms), without watering it down too much for achieving a political accommodation with conflicting interests.

2.2. Fiscal situation

China appears to be in a much better fiscal position as compared to India, with a very modest fiscal deficit of 3.3% of GDP and a debt/GDP ratio of only 26.3% in 2002 (World Bank, 2003b).⁶ In contrast, the central government's fiscal deficit in India in 2002–2003 was 5.9% of GDP with the deficits of states adding another 4.6% of GDP. The overall debt/GDP ratio was 75.3% (RBI, 2003a, Tables 223 and 224). However, World Bank (2003b) points out that a costly reform agenda lies ahead for China that includes pension/social security reforms and dealing with accumulated non-performing loans (NPLs) of the four largest publicly owned banks. Although NPL to assets ratio had declined to 26% by the end of 2002, this is believed to be the outcome of large increases in new loans rather than a contraction of old NPLs through better collections. The sterilization of the enormous inflows of foreign capital through the issue of ad hoc bills by the central bank at interest rates exceeding the rates earned on foreign assets of the bank in effect adds to the fiscal deficit, if it is properly treated in budget accounting. Although the current level of budget deficit could be sustained indefinitely by restricting expenditures to 22–23% of GDP, the costs of future reforms might require a combination of policies on the tax and expenditure sides.

The potential budgetary impact of addressing the NPL of state-owned banks in India is more serious than in the case of China because of the better fiscal health of China, as noted earlier. This is so even though the ratio of gross NPL to total gross assets of commercial banks was only at 4.8% at the end of 2001–2002 (RBI, 2003b, Chart VI.I) compared to the reported figure of 26% for China. The reason is that first of all, the Indian norms for recognition of NPLs is more liberal compared to international norms and the practice of “ever-greening,” i.e., of rolling over loans so that they are not deemed non-performing, though denied by the regulatory authorities as happening, is said by other knowledgeable sources to be significant. Battacharya and Patel (2002) note that the Indian banking system suffers from a large and increasing role of the government in the financial sector, high regulatory forbearance and the absence of efficient bankruptcy procedures. With the dominance of large public sector banks in the financial sector, the “too big to be allowed to fail” syndrome is very much evident: one of the government-owned banks has been recapitalized three times in the last decade! With the rupee not convertible for capital account transactions, and with controls on capital outflows continuing, and foreign exchange reserves exceeding \$106 billion in early April 2004, there is no imminent threat of a speculative attack on the rupee. This in turn means that the pressure to clean up the NPLs of the banking system from a fear of exchange rate crisis is not there. However, the fact that NPLs of public sector banks represent contingent liabilities of the government is in part reflected in the rating of India's sovereign debt by international credit rating agencies. Clearly, sooner or later the NPL problem has to be faced if the Indian rupee is to be made convertible on capital account.

⁶ Bahl, Roy, and Martinez-Vazquez (2003) argue that China's governance is much less decentralized than indicated by the large share of sub-national governments, which have little by way of formal revenue raising powers. In their view, the present system is probably not sustainable. It is hard to predict the effect of greater decentralization on China's future fiscal health.

2.3. Trends in poverty

Finally, the fact that poverty has declined significantly in both countries since the 1980s after both experienced substantial acceleration in their growth of per capita GDP has been widely noted. However, in India, because of changes in design of the household expenditure survey in the 1990s, a problem of potential non-comparability of poverty estimates over surveys has emerged. This has led to research on alternative ways to check on the seriousness of non-comparability and to adjust for it to provide comparable estimates. In addition, there were issues relating to the price indices used to update poverty lines. Needless to say, some strong assumptions have to be made in all such exercises, and researchers naturally differed in their assumptions and methodologies and reached varying conclusions about the decline in poverty. It is fair to say that all of them agree that the poverty ratio did not increase in the 1990s, and differ only on whether it declined, and if so, whether the decline was faster in the 1990s than in the 1980s, when growth started to accelerate and poverty began to decline. Official estimates (GOI, 2003, Table 10.6) show that the proportion of poor in the population (using national poverty lines) declined from 45.7% in 1983 to 27.1% in 1999–2000 in rural areas, and from 40.8% to 23.6% during the same period in urban areas. For the country as a whole, poverty declined from 44.5% to 26.1%. Sundaram and Tendulkar (2003) estimate the decline to have been from 49% to 29% in rural areas, from 38% to 23% in urban areas, and from 46% to 27% in the country as a whole. Deaton's (2003) calculations show that rural (urban) poverty declined from 37.3% in 1993–1994 to 30.2% in 1999–2000 and from 32.2% to 24.7% in urban areas. Sen and Himanshu (2003) dispute some of the assumptions underlying the estimates of Sundaram and Tendulkar (2003) and Deaton (2003). Their exercise, based on survey data for 1987–1988, 1993–1994 and 1999–2000, lead them to conclude that, although the proportion of poor did probably decline, the reduction was no higher during 1994–2000 than it was during 1987–1994, and the absolute number of poor did not decline.

Historically, the Indian statistical system led the world in measurement of poverty. Large-scale sample surveys were pioneered by Professor P.C. Mahalanobis at the Indian Statistical Institute in the 1940s, and it was but natural that after independence in 1947 steps were taken to undertake large-scale household expenditure surveys, initially to supplement national accounts statistics and later to measure trends in levels of living. India also has a distinguished tradition of attempts to cross-check estimates from various sources of data and of vigorous debate about, as well as experiments with, alternative methodologies (Srinivasan & Bardhan, 1974; Deaton & Kozel, 2003).⁷ In China, household surveys and poverty estimates based on them, as well as a debate on the statistical system, are fairly recent (Park & Wang, 2001). This has to be kept in mind in interpreting the data. Hu, Hu,

⁷ Recently, a National Statistical Commission (NSC, 2003) comprehensively and critically examined the statistics. In Srinivasan (2003), I comment on the report of the commission. Dutta is certainly right in asking for substantive research on Chinese economic statistics. However, he asserts, without providing any argument other than his (and other scholars') repeated visits to China, that the recent works of those who question China's national income statistics and, consequently, its rate of growth cannot be accepted. Not having myself done the needed research, nor having seen such research by others that is comparable to that on Indian statistics, I have merely stated (in footnote 6) the differing views on Chinese statistics without arguing for acceptance of any of them.

Table 2

Regional disparities of income per capita: China (at current prices in US dollars)

	1990	2002
Urban	316	930
Rural	144	299
Rural income as a percent of urban	45	32
Coastal region	481	1857
Shanghai	1184	4020
Western region	240	596
Guizhou	167	373

Source: IMF (2003), page 354.

and Chang (2003, Appendix Table 1) report that, according to official data, the proportion of poor in the rural population of China fell steadily from 33.1% in 1978 to as low as 3.7% in 1999. World Bank (2003d, Table 1.4) estimates (using one dollar a day consumption poverty line) suggest that the poverty proportion fell from 32.9% in 1990 to 16.1% in 2000.

2.4. Widening regional disparities

In both China and India, there was significant widening of regional disparities in growth and poverty reduction. As is evident from Table 2, rural China and western regions lag far behind urban China and coastal regions. The top panel of Table 3 provides data on growth of net state domestic product in five fastest and slowest growing states among sixteen large states in India during the 1980s and 1990s (the crisis year of 1991–1992 has been omitted). The bottom panel of Table 3 provides data on rural and urban poverty ratios for three years—1987–1988, 1993–1994, and 1999–2000—in five highest and lowest poverty states. It is seen that the fastest growing state, Delhi, grew at nearly 2.5 times or more than the slowest growing state of Kerala in the 1980s and more than five times the then slowest growing state of Assam in the 1990s. Also, the highest poverty state had a poverty ratio which was anywhere between 4.5 times to nearly 10 times the poverty ratio in the lowest poverty state, depending on the year and region (rural or urban). Turning to rural poverty, Bihar, Orissa and West Bengal are high poverty states in all three years. Punjab and Haryana are low rural poverty states in all three years. Four states are common among low rural poverty states in any two years. Orissa and Madhya Pradesh are high urban poverty states in all years. Three states are common among high poverty states in any two years. The same five states happen to be low urban poverty states in all three years.

The relation between growth and poverty is rather muted. Delhi, which is largely urban, has low poverty in all years and high growth in both periods. Orissa has low growth in both periods with high rural and urban poverty in all years. Punjab and Haryana have low urban and rural poverty in all years, but Haryana had *high* growth in the 1980s and Punjab *low* growth in the 1990s. Put another way, while there is considerable stability over the three years in which states happened to have high or low poverty ratios, there is considerable change in growth ranking of states between the 1980s and 1990s. Unless rapid growth is sustained over a reasonably long period of time, its impact on reducing entrenched poverty cannot be expected to be significant. This is consistent with the lack of close association

Table 3
Regional disparities in growth and poverty: India

Low growth ^a				High growth ^a			
1980–1981 to 1990–1991		1992–1993 to 1999–2000		1980–1981 to 1990–1991		1992–1993 to 1999–2000	
Kerala	3.00	Assam	2.20	Delhi	7.30	Delhi	9.20
Assam	3.20	Orissa	3.40	Haryana	6.30	West Bengal	7.10
Orissa	3.90	Bihar	4.10	Rajasthan	6.30	Karnataka	6.90
Madhya Pradesh	4.00	Punjab	4.10	Maharashtra	5.80	Tamil Nadu	6.60
West Bengal	4.40	Uttar Pradesh	5.00	Andhra Pradesh	5.50	Rajasthan	6.40
High poverty ^b				Low poverty ^b			
Rural		Urban		Rural		Urban	
1987–1988				1987–1988			
Orissa	58.7	Bihar	51.9	Punjab	12.8	Himachal Pradesh	7.2
Bihar	53.9	Karnataka	49.2	Haryana	15.3	Assam	11.3
West Bengal	48.8	Madhya Pradesh	47.3	Himachal Pradesh	16.7	Punjab	13.7
Tamil Nadu	46.3	Uttar Pradesh	44.9	Andhra Pradesh	21.0	Delhi	15.1
Madhya Pradesh	42.0	Orissa	42.6	Gujarat	28.6	Haryana	18.4
1993–1994				1993–1994			
Bihar	58.0	Madhya Pradesh	48.1	Punjab	11.7	Assam	7.9
Orissa	49.8	Orissa	40.6	Andhra Pradesh	15.9	Himachal Pradesh	9.3
Assam	45.2	Tamil Nadu	39.9	Gujarat	22.2	Punjab	10.9
Uttar Pradesh	42.3	Karnataka	39.9	Kerala	25.4	Delhi	16.1
West Bengal	41.2	Andhra Pradesh	38.8	Haryana	28.3	Haryana	16.5
1999–2000				1999–2000			
Orissa	47.8	Orissa	43.5	Punjab	6.0	Himachal Pradesh	4.6
Bihar	44.0	Madhya Pradesh	38.5	Haryana	7.4	Punjab	5.5
Assam	40.3	Bihar	33.5	Himachal Pradesh	7.5	Assam	7.5
Madhya Pradesh	37.3	Uttar Pradesh	30.8	Kerala	9.4	Delhi	9.2
West Bengal	31.7	Andhra Pradesh	27.2	Andhra Pradesh	10.5	Haryana	10.0

Sources: *Poverty Estimates*: Deaton (2003), Table 5, Official Estimates for 43rd (1987–1988), 50th (1993–1994), and 55th (1999–2000) Rounds of the National Sample Survey. *Growth Estimates*: Author's calculations based on Table 5 of RBI (2003a).

^a Trend growth rate per year in (real) state net domestic product.

^b Ratio of poor among the population using statewide poverty lines.

between poverty and growth states in Table 3, given that there was a considerable change in growth ranking over time.

In the Chinese case, the deliberate policy choice of the government to concentrate reforms and external opening to coastal cities and special economic zones contributed to their growing faster and moving ahead of the other regions, particularly in the West. In India, there was no such deliberate policy choice. However, as is to be expected and natural, those individuals, groups and states that were initially better placed in terms of their infrastructure and human capital grew faster than others not so well placed. To a considerable extent, this is also true of China. The real issue is not so much the widening disparity but whether there are forces and policies in place that would enable the lagging regions to catch up and converge to the leading ones over time. On this, the evidence is mixed, if one goes by the empirical findings of several cross-regional growth regressions as reported in Srinivasan (2004). Clearly, if there are no prospects of relatively rapid convergence, the stability of India's federal democracy and the control of the Communist Party in China could be put in doubt.

3. External sector

3.1. Trade in goods and services

China continues to outpace India in global integration. In 2003, it was the world's fourth largest exporter of merchandise, with a share of 5.9% of world exports (WTO, 2004, Appendix Table 1). China is ninth in commercial service exports, with a share of 2.5% (WTO, 2004, Appendix Table 3). Its growth in the share of merchandise exports is phenomenal, more than *quadrupling* during 1983–2002 (WTO, 2003a, Table II.5). India is below a distant 30th in world merchandise trade, with a share of 0.7% in 2003 (WTO, 2004, Appendix Table 1). Its exports grew only 60% during 1983–2002 (WTO, 2003a, Table II.5). In service trade, India was the twentieth largest exported with a share of 1.4% (WTO, 2004, Appendix Table 3). A more disaggregated picture in terms of the changes in the shares of India and China of several labour-intensive exports in the world as well as in the major markets of North America (Canada and the US) and the European Union reveals China's success relative to India's even more starkly. This is shown in Table 4 (reproduced from Srinivasan, 2004). In almost every commodity and market, China's share has grown rapidly since 1978, whereas India's share has grown much less, if at all.

Gopalan's (2001) estimates of labor productivity in manufacturing suggest that except in petroleum products and non-electrical machinery, the productivity of a Chinese worker is higher than that of an Indian worker by anywhere from 30% to 180%, depending on the product. Of course, these estimates must be treated with caution, given a number of factors including the heterogeneity of labor and of products within broad manufacturing sectors; possible biases in the exchange rates used to convert each country's output (or the value added in domestic prices) to US dollars; and the fact that the comparison is confined to the productivity of a single factor, namely, labor. Gopalan also provides cost comparisons for Chinese and Indian manufactured goods, some of which both countries sell in third markets and some of which China exports to India. These comparisons indicate that China has

Table 4

China's and India's participation in world and major export markets

	1978– 1981	1982– 1984	1985– 1987	1988– 1991	1992– 1994	1995– 1997	1998– 2000
World markets							
China							
Garments	3.93	6.93	8.74	14.95	18.78	19.70	20.45
Fabrics	5.15	7.48	8.28	8.25	7.87	8.87	9.36
Leather and leather manufactures	0.41	0.61	0.75	2.55	2.94	4.07	4.82
Jewelry	1.13	1.05	1.36	2.69	5.97	7.14	9.48
Others	1.07	1.93	3.27	7.73	14.6	16.9	18.1
India							
Garments	3.95	3.43	3.46	3.82	4.40	4.97	5.27
Fabrics	2.04	1.38	1.45	1.43	1.99	2.10	2.42
Leather and leather manufactures	8.85	7.45	7.13	5.52	4.03	3.42	3.44
Jewelry	0.61	1.02	1.40	2.18	2.21	2.97	4.61
Others	0.31	0.24	0.20	0.25	0.29	0.30	0.31
North American markets							
China							
Garments	3.73	8.00	8.81	13.19	21.30	21.42	20.59
Fabrics	3.73	5.31	5.61	5.66	6.25	5.84	6.52
Leather and leather manufactures	0.14	0.45	0.49	2.57	6.67	7.65	8.44
Jewelry	0.50	0.42	0.25	1.77	3.99	5.51	8.13
Others	0.72	1.51	2.98	9.92	20.89	25.62	26.57
India							
Garments	4.89	4.14	4.12	4.60	5.80	5.56	5.34
Fabrics	6.02	2.64	2.69	2.98	4.62	5.93	5.73
Leather and leather manufactures	9.38	8.89	6.51	4.09	3.05	2.33	2.05
Jewelry	0.39	0.83	1.34	2.46	4.57	7.01	9.60
Others	0.19	0.11	0.14	0.22	1.28	1.09	1.01
European markets							
China							
Garments	1.84	2.40	3.15	6.25	10.04	10.34	11.80
Fabrics	1.54	2.15	2.08	1.78	1.70	2.05	2.92
Leather and leather manufactures	0.33	0.37	0.31	0.86	1.14	1.27	1.89
Jewelry	0.47	0.26	0.51	1.41	3.07	4.08	5.97
Others	0.40	0.71	1.22	2.94	6.41	6.76	7.99
India							
Garments	3.90	3.47	3.61	4.26	5.39	6.00	4.65
Fabrics	1.54	1.18	1.30	1.60	1.99	2.28	2.26
Leather and leather manufactures	9.90	8.51	8.26	7.65	7.45	7.09	6.12
Jewelry	0.88	1.23	1.59	1.91	2.60	3.39	4.28
Others	0.33	0.27	0.22	0.29	0.86	0.87	0.71

Sources: United Nations, *Comtrade Data Base* (New York: United Nations Statistical Office, 2001).
 “Garments” refers to the three-digit SITC categories 843, 844, 848; “Fabrics” to 652, 653, 654, 657;
 “Leather” to 611 and 612; Jewelry to 897; and “Others” to categories 764, 778, 842, 847, 851, 893, 894.

lower costs in many products than India, though once again, one has to keep in mind that the exchange rates used might be distorted. It is no surprise that China has gained, and India has lost, market shares in third markets. Unless India catches up and becomes internationally competitive, this trend is likely to continue in the future.

Bottelier (2003) points out that in exports of commercial services, India lagged less behind China, being the 19th largest exporter in 2002, with a share of 1.5%. Although growth of China's service and merchandise exports far outpace average growth of world exports, its merchandise exports grew much faster than service exports, so that the share of service 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 service exports in total exports will exceed 50% in a decade.

There is one service sector, viz. Information Technology (IT), in which India has notably outstripped China. Last year (2002), India's IT exports were almost \$10 billion, compared with \$1.5 billion from China. Interestingly and tellingly, according to a report by consultants, 40% of China's IT exports involved Indian IT companies based in China (Luce & Kynge, 2003). The same authors quote the Chief Financial Officer of Infosys, the Indian IT giant that has won contracts with China's financial sector, as saying that India is five to seven years ahead of China in the software sector, primarily because of the lack of facility with the English language among Chinese and the absence of experienced project managers in China. However, he expects that China will catch up with India very quickly.

India is also ahead of China in pharmaceuticals. Luce and Kynge (2003) point out that the United Nations buys more than half of its vaccines from a private Indian company. Much of China's vaccine production does not meet international standards. Recently, two Indian pharmaceutical companies, along with a South African company, have entered into a contract with the Clinton Foundation to supply generic anti-retroviral drugs to treat AIDS at a much lower cost than Western companies. The fact that in both software and pharmaceuticals it is India's highly educated who are the driving force raises the possibility that: "If India can turn into a fast-growth economy, it will be the first developing nation that used its brainpower, not natural resources or the raw muscle of factory labor, as the catalyst" (Kripalani & Engardio, 2003, p. 70). Clearly, successful use of brain power by India, with service exports as the engine of growth, would be in sharp contrast to China, whose growth acceleration was driven by manufactured exports that exploited its cheap labor.

3.2. *Fear of Chinese competitiveness*

I noted in Srinivasan (2002) that the competition from lower priced imports of manufactures from China elicited a defensive response from Indian industrialists to seek protection, and the government granted it through the levy of antidumping duties on China's imports. Recently, Indian entrepreneurs have joined their counterparts in the industrialized countries in viewing the huge and growing Chinese markets as commercial opportunity. Luce and Kynge (2003) quote K.K. Modi, the head of an Indian manufacturing company that exports specialty chemicals to China's leather

industry as saying that, “nobody fears the Chinese market any more—everybody just wants a piece of it.” Mr. Modi is not alone—many Indian executives, including those in India’s IT sector, are seeking to boost their presence in China. Some of the exporters to China are exploiting the relatively lower cost of IT professionals and engineers in India. This cost advantage in India has been recognized, not only by IT companies in the US and Europe, but also by Chinese manufacturers. Luce and Kynge cite the case of Huawei, a Chinese telecom equipment maker, which is planning to invest \$100m to develop software in India. The perception of China as offering rapidly growing opportunities for Indian exporters is reflected in rapid growth of bilateral trade, which doubled in the last two years and is expected to reach \$7.5 billion at the end of 2003. In the three years 1999–2000 to 2002–2003, India’s exports to China increased at an average of 50.2% per year, and imports from China at 26.6% per year (RBI, 2003c, Box VI.6).

The infamous Multifibre Arrangement (MFA), under which quotas on various items of textiles and apparel are bilaterally negotiated between exporting (mostly developing countries) and importing (mostly industrialized countries) had governed textiles and apparel trade since 1974. In the Uruguay Round of multilateral trade negotiations, an agreement was reached to eliminate the quotas of MFA in a phased manner, starting from January 1, 1995, and concluding by January 1, 2005. With several products already free of quotas, China has been able to capture an increasing share of world trade in such products. As seen in Table 4, during 1998–2000, China’s share in world exports of garments was 20.45% and of fabrics 9.36%. India’s shares were a modest 5.27% and 2.42%, respectively. Fritsch (2003) refers to an estimate from a World Bank study that, after the complete phase out of MFA quotas in 2005, China’s exports will grow even more and capture nearly half of the world’s clothing exports by 2010. He correctly points out that without the assured markets of bilateral quotas, many developing countries have to compete with more efficient producers, such as China. In Bangladesh, which is the focus of Fritsch’s article, there is apprehension that such competition could devastate a garment industry that currently anchors the economy, sustains millions of families and employs mostly women. It is an open question whether the Indian textile and apparel industry is, or could become, competitive enough to thrive and grow a quota-free market. Among other things, restrictions limiting production of garments to small-scale producers have only recently been removed. If more efficient producers who can bring costs down by exploiting scale economies enter the market, India would become competitive. It is too soon to tell whether such entry is taking place to any significant extent.

3.3. Protectionist backlash against China and India

Periods of recessions, such as 2001–2003, are breeding grounds for protectionist pressures. The phenomenal growth of China’s exports, particularly during a recession, and the threat it poses to less competitive industries, particularly in industrialized countries, is generating a protectionist backlash directed against it. Taking advantage of the special safeguards provision in China’s agreement with it as part of its accession to the WTO, the US decided to begin a three-month negotiation on temporary quotas to

limit imports of bras, bathrobes and some other apparel.⁸ Earlier, the US had increased, temporarily, tariffs on steel imports from the rest of the world, including China, on the grounds that a surge in imports was materially injuring its domestic steel industry. This US action was contested in the WTO's dispute settlement system whose Appellate Body ruled that the US action was in violation of US rules, thus opening the door for retaliatory action by its trading partners. China had threatened such action. Fortunately, the US has lifted the offending tariff and retaliation is no longer relevant. In any case, China has little to gain, and much to lose, in a trade war with its most important trading partner, the US. This being the case, the threat was not credible and perhaps served only as an expression of China's concern over the damage that rising protectionism in the US and elsewhere would inflict on it.

India is also facing a backlash from its success in the IT sector. It is no surprise that with unemployment rates stubbornly resisting to come down despite recent signs of recovery in the US, many in the US view outsourcing of IT jobs as exacerbating, if not causing, a jobless recovery. Service sector activities, even those involving high technical skills, are being outsourced by the US and European companies to India (and China). According to the *Financial Times* (2003, March 1), "India has been on the front line of outsourcing for a decade, and roughly half of the world's largest 500 companies and many government agencies now contract out IT and business process work to India." A less prosaic and more dramatic illustration of the nature of outsourcing to India was provided by the well-known columnist and writer, [Thomas Friedman \(2002\)](#):

If you lose your luggage on British Airways, the techies who track it down are here in India. If your Dell computer has a problem, the techie who walks you through it is in Bangalore, India's Silicon Valley. Ernst & Young may be doing your company's tax returns here with Indian accountants. Indian software giants in Bangalore, like Wipro, Infosys and MindTree, now manage back-room operations—accounting, inventory management, billing, accounts receivable, payrolls, credit card approvals—for global firms like Nortel Networks, Reebok, Sony, American Express, HSBC and GE Capital. ...GE's biggest research center outside the US is in Bangalore, with 1,700 Indian engineers and scientists. The brain chip for every Nokia cellphone is designed in Bangalore. Renting a car from Avis online? It's managed here.

A somewhat hysterical, though not entirely untypical reaction, is of [Clive Thompson \(2001\)](#): "Eventually the United States won't make any hard goods, won't do the cerebral stuff and won't fulfill the orders. Then, what's left? Brand building? Business development? Shopping? Would you like fries with that, sir?" According to [Rai \(2004\)](#), "Nearly two dozen states have voted on legislation to ban government work being contracted to non-Americans. More recently, the United States Senate approved a bill aimed at restricting outsourcing of contracts from two federal departments. The House has not

⁸ In fact, China's accession protocol allows for invoking by its trading partners of transitional product specific safeguards without any procedural protection at all, and for the continued use of "non-market economy" status for anti-dumping investigations. The criteria for demonstrating material injury are very weak. I owe Will Martin for this observation and for bringing [Messerlin \(2003\)](#) to my attention.

acted on similar legislation.” However, in the recently passed Omnibus Appropriations Bill, which has already been signed by the President, there is a provision, in the section relating to the Departments of Treasury and Transport, that bans outsourcing. Whether it applies only to these two departments or to the federal government as a whole is unclear. The issue of outsourcing has become a major issue in the campaign for the 2004 Presidential election. In any case, these are ominous developments.

3.4. China and India as drivers of regional growth

There is little doubt that China’s rapidly growing exports to countries outside of Asia-Pacific in Asia has generated equally rapid growth in imports by China from other Asian and Pacific countries, not just from its neighbors in East Asia but also from Australia, India and Indonesia. According to [Perlez \(2003\)](#), Japan’s current “recovery is being driven by a surge in exports to China. Australia’s healthy economy is being kept that way by Chinese investments in liquid natural gas products. China is now South Korea’s largest trading partner . . . In Indonesia, Malaysia and the Philippines (and to a lesser extent in Thailand) . . . China’s main interest is to scoop up what it can for its modernization. Indonesians call this new relationship with Beijing as “feeding the dragon.” Although India is by far the largest (and rapidly growing) market in South Asia, it is yet to have a major impact on the trade of its neighbors in South Asia in spite of the creation of the South Asian Preferential Trade Area (SAPTA) in 1997. To a significant extent, this reflects the hostile relations between India and the next largest market in South Asia, viz., Pakistan. Pakistan is yet to grant a most favored nation status to India. Unless the relations between the two normalize, the prospects of SAPTA are not bright. However, India–Sri Lanka bilateral trade and investment have grown rapidly since the conclusion of a free trade agreement between the two became operational in March 2000. Recent signs of a warming of Indo-Pakistani relations, if they lead to their normalization, could make India the engine of growth for South Asia, as China already is in the Asia-Pacific region.

3.5. Foreign direct investment

China receives a much larger flow of net foreign direct investment (projected at \$57 billion in 2003) than India’s (under \$4 billion in 2001–2002).⁹ In [Srinivasan \(2002\)](#), I discussed some of the reasons for this difference. In short, as [Luce and Kyne \(2003\)](#) succinctly point out, “whether it is China’s cheaper, more reliable power supply or the more rapid turn around at its ports, China remains an incalculably better environment for most manufacturing than India, which is slowly waking up to this.” This environment and the bureaucratic obstacles at all levels of government in India in large part explain the huge flow of FDI to China relative to India. The Indian government has recognized FDI as key for achieving the Tenth Plan target of 8% annual growth and appointed a steering committee on FDI in 2001. It reported in 2002 with several recommendations for making India more attractive as a destination for FDI.

⁹ I largely agree with (and have said similar things in my earlier papers) Dutta’s remarks about FDI.

3.6. *Exchange rates and foreign reserves*

Although China's trade surplus with the United States has been growing, its overall trade surplus is modest since it is running a growing trade deficit with Asia-Pacific countries that offsets in large part its trade surplus with the US. The economic logic that only a country's overall trade and current account balances have economic significance and not its bilateral balances with any one or a subset of trading partners, has never been understood by politicians anywhere, and in particular, in the US. As Japanese trade surpluses created an anti-Japan backlash in the eighties, it is now China's turn to be at the receiving end of US pressure.

China has accumulated a substantial (projected at \$383 billion by the end of 2003) foreign exchange reserves, exceeding its annual imports. India has done the same—its reserves, around \$92 billion at the end of 2003, exceed by a substantial margin the likely imports of \$60 billion. This raises the issue of the appropriate level of reserves, and whether both countries have accumulated far too much relative to what would be needed to smooth volatility in export earnings and import expenditures and to contain any potential financial crisis like the one experienced by East Asia in 1997.¹⁰ Since neither the renminbi nor the rupee is convertible on capital account and capital controls are in place in both countries, *prima facie* the probability of an exchange rate crisis of the type experienced by countries with open capital account and fully convertible currencies is very low. This is not to say, of course, that a balance of payments (BOP) crisis that makes the prevailing exchange rate unsustainable cannot arise—after all, despite capital controls and an inconvertible (on capital account) rupee, India experienced a severe BOP crisis in 1991, which resulted in the devaluation of the rupee and other policy changes. Still, given that partial insurance from other sources of external funds (e.g., from the IMF) is in principle available, should self-insurance through reserves be pushed as far as the current level of reserves in China and India seem to have done?

Any attempt to determine the appropriate level of reserves has to be based on an analysis of the appropriate exchange rate regime for either country, and the related issue of whether the benefits from integration with the global financial markets outweigh the costs. Without doing such an analysis myself, let me cite Kenneth Rogoff of Harvard, the former Economic Councillor and Director, Research Department of the IMF, on the issue:

My interpretation of the evidence not just from Asia but from the whole world, from Europe's experience, from floating rates, from the Bretton Woods system, is that policy makers vastly overrate the risks of having volatile exchange rates and vastly underrate the indirect costs that can come from all the policies that they have to try to suppress them. Certainly I wouldn't say that India has gone too far at the moment in accumulating reserves, it has a very strong position but I think all the countries in Asia are reaching a point when they have to start asking the question how much is enough, that basically a lot

¹⁰ There are some who claim that the unification renminbi-dollar exchange rate in 1994, prior to the Asian crisis, was in fact a devaluation of the renminbi. At that time, the exchange rates of other East Asian countries were fixed relative to the dollar and hence appreciated relative to the renminbi, and this appreciation contributed to the East Asia crisis. I am not entirely persuaded by this claim.

of the reserves that the Asian economies are accumulating—even outside of Japan—we are talking about close to a trillion dollars, are basically low interest rate loans from the emerging markets to United States and Europe, and this is very costly. There are opportunity costs to the domestic economy. How much is enough and at what point should one risk letting the exchange rate appreciate. Knowing the multilateral aspects of it, I realize that there are some outside the IMF who call for greater flexibility in Asian currencies in order to strengthen demand from the rest of the world. I think that is an issue worth considering but it is not the one I want to focus on. From the Asian economies' own perspective, and this is true for India, it is true for China, it is true for virtually all the countries in the region, moving to a regime of greater flexibility would be something that is advisable, would not bring the cost many policy makers fear, and in fact would allow the economies to reduce the level of recession and that would have many positive growth effects. (Rogoff, 2003)

Rogoff's conclusion does not imply that US pressure on China to revalue the renminbi was justified or that India should also let its rupee appreciate, but only that greater flexibility in exchange rates would be appropriate in both countries. The Indian exchange rate regime is one of managed float (although Rogoff prefers to characterize it as a crawling peg), and it does allow some flexibility. It is possible to argue that the Indian central bank (i.e., Reserve Bank of India) has inappropriately intervened to prevent the rupee from appreciating, and this has cost the Indian economy in terms of foregone growth. But this is an argument that the flexibility inherent in the managed float regime has not been utilized appropriately. It is not the same as arguing that India should *immediately* make the rupee fully convertible and adopt a regime of *clean float*. The latter argument is not persuasive for the simple reason that domestic financial sector reforms are incomplete, and it is risky to open the capital account under the circumstances. In any case, there is no country in the world, developed or developing, that allows a clean float of its currency. On the other hand, there are long term benefits from a convertible currency and by credibly committing to a fully convertible rupee for at a not too distant and specified future date, the pressure to complete the financial sector reforms by that date would become significant.

What about China? Again, the problems in the financial sector, particularly the overhang of NPLs are serious, and an immediate revaluation might worsen the problem. Besides, it has not been established by anyone, least of all by the US Treasury, that the current renminbi-dollar exchange rate is too far from a long-run equilibrium rate. If it is not, and China moves to a floating regime, that US Treasury might find, to its surprise, that the exchange rate does not move from its current level! Unfortunately, China is likely to succumb to the pressure to revalue if newspaper reports (*Financial Times*, February 10, 2004) are to be believed.

It is not unlikely that if India's reserves continue to climb, and outsourcing gathers further momentum, there would be charges of "currency manipulation" against Indian authorities, as the Chinese are currently being charged with. China and India should cooperate in resisting such accusations and pressures and decide on their exchange rate policies in their own interests. Finally, as Rogoff rightly points out, by continuing to accumulate reserves in terms of US dollar assets, China, India, and other Asian countries are financing US current account deficits. As Alan Beatty (2003) points out: "In theory,

Asians' role in financing the US current account deficit could give them enormous economic or even political leverage, since a sudden shortfall in capital inflows would spark a slide in the dollar and possibly a sharp rise in interest rates." But he rightly concludes that: "A wholesale flight from the dollar, if it drove up interest rates and forced the US into a rapid tightening of consumers' belts, would also hurt one of the principle buyers of Asia's exports." Chinese and Indian policy makers are sophisticated enough to realize this and can be expected to slow the accumulation of reserves, if appropriate, and allow greater exchange rate flexibility in due course.

4. China, India and the Doha round of multilateral trade negotiations post-Cancún

The opponents of outsourcing, who are increasingly vocal, are the more recent entrants to the anti-globalization movement. The latter, which organized violent street demonstrations on the occasion of the Third Ministerial meeting of the WTO in Seattle in December 1999, has since repeated it, though not so violently, at every annual meeting of the World Bank and IMF, and most recently, at the Fifth Ministerial of the WTO at Cancún, Mexico, during September 10–14, 2003. At the governmental level, the demand by the US and the EU that a "social clause" be instituted in the WTO to permit the use of trade sanctions to enforce labor standards is also a protectionist response to competition from low wage, developing countries such as China and India. Such a clause is already part of every regional trade agreement to which the US is a party, since the North American Free Trade Agreement. In fact, the then-President Clinton's embrace of the demand on the eve of the Seattle Ministerial of the WTO in 1999 significantly contributed to its collapse. It is clear that China and India have a common and vital interest in diffusing protectionist threats.

The Cancún Ministerial Meeting of the WTO was expected to review the status of multilateral negotiations (MTNs) launched at the fourth meeting in Doha, Qatar in November 2001. In particular, it was to set the negotiations back on track after the setbacks of having missed several crucial deadlines set at Doha, and deciding on modalities¹¹ by explicit consensus of members for negotiations in certain areas, such as, for example, the so-called "Singapore issues" of investment, competition policy, government procurement and trade facilitation. The meeting ended with no agreement on any of these.

Leading developing countries (DCs), namely, Brazil, India, China, and South Africa, formed a group of twenty (G-20) plus members ([Appendix A](#)) to articulate and negotiate for the developing countries (DCs) at the meeting. In the ministerial at Punta del Este in 1986, which launched the Uruguay Round, there was also a group of ten DCs led by Brazil and India. But this group in effect disintegrated at the meeting. At Cancún, G-20 stuck to its positions until the end. There is no doubt the fact that the world's fifth largest exporter and

¹¹ Forming a group such as G-20 for bargaining in multilateral negotiations has little to do with economic integration, à la the European Union (EU) or other such groups. In this context, I do not understand Dutta's reference to "ad-hoc grouping of sovereign nation state economies based on one or another commodity group(s)" and his implication that the formation of the EU necessarily maximizes economic gains to the world.

sixth largest importer, namely China, was a member of G-20 has a lot to do with why G-20 was taken far more seriously at Cancún than the G-10 was in Punta del Este in 1986.¹² China and India have a vital interest in ensuring that the failures of Cancún get reversed and the Doha Round of negotiations resumed, their continued cooperation is very important.

Robert Zoellick, the head of the US delegation at Cancún, petulantly reacted to the failure of the multilateral process at the Cancún ministerial railed against the developing countries and asserted that the US will pursue with renewed vigor bilateral and regional preferential trade agreements. Since the US was pursuing this option already with maximum vigor, it is not obvious that Zoellick's threat to go regional and bilateral has become more credible with the collapse of the Cancún meeting. Nonetheless, the fact that a proliferation of preferential trade liberalization is much less beneficial than multilateral trade liberalization suggests that if the US indeed succeeds in concluding regional agreements, those outside of such agreements, such as China and India, stand to lose significantly.

Regardless of Zoellick's threat to go bilateral and regional, preferential trade agreements (PTAs) are proliferating. India is a member of SAPTA and has free trade agreements with Nepal and Sri Lanka and is vying to become a member of ASEAN. Until recently, China was virtually alone among members of the WTO in not being a part to any PTA. Unfortunately, it is now heavily engaged in negotiating a PTA with Thailand and promoting an Asian Free Trade Area. I argued forcefully in [Srinivasan \(2002\)](#) that PTAs are inferior to multilateral trade liberalization. In fact, the Most Favoured Nation principle was formulated in the 19th century in response to the chaos created by overlapping bilateral and plurilateral PTAs with different levels of preferences. There is no reason to unlearn the lessons learned long ago and reembrace PTAs.

Unfortunately, some Asian leaders, such as President Roh Moo-Hyun of South Korea and Singapore's Prime Minister Goh Chok Tong, held up the European Union as a possible model for Asian Economic Integration ([Mallet, 2003](#)). This is fundamentally misguided. It confuses economic integration with political integration in order to acquire a credible voice in decision making on global issues, i.e., to move to a multipolar world in which unified positions would be articulated by credible groups of countries (say EU, Russia and possibly the Commonwealth of Independent States, one or more groups from Africa, Asia and Latin America) and act as a check on the currently dominant US in a unified world. Economic integration in the sense of preferential trade and investment arrangements, short of a common market and monetary union, is neither necessary nor sufficient to bring about political integration.

It is worth recalling that the origins of the EU were fundamentally political, namely, a desire to prevent yet another European war between France and Germany that inevitably escalates into a world war. Trade preferences were only incidental to the creation of the European Coal and Steel Community, which eventually evolved into the EU. There is as yet no evidence of a desire to have closer political integration in Asia. Concluding a PTA does

¹² Forming a group such as G-20 for bargaining in multilateral negotiations has little to do with economic integration, a la the European Union (EU) or other such groups. In this context, I do not understand Dutta's reference to "ad-hoc grouping of sovereign nation state economies based on one or another commodity group(s)" and his implication that the formation of the EU necessarily maximizes economic gains to the world.

not necessarily change this, as is evident from the conclusion of SAPTA—it has not improved Indo-Pakistani relations. Fortunately, India and Pakistan have just begun to implement confidence building measures, and much more than SAPTA, the grant of MFN status to India by Pakistan will help in improving confidence. Chinese–Indian relations are also getting better. Certainly, the rapid growth of bilateral trade and mutual interest in seeing it grow further helped. But the essential point is that neither past growth, nor the expected future growth, is based on trade preferences granted by either to the other.

The role of PTAs promoting intra-regional trade is exaggerated. Mallet (2003) quotes from a study by Francis Ng and Alexander Yeats of the World Bank: “Since the mid-1980s, east Asian intra-trade [excluding Japan] has been growing at a rate roughly double that of world trade and at a rate far higher than the intra-trade of Nafta or the European Union.” What is more, East Asian integration was not driven by governments as the European one was. In fact, Mallet (2003) points out: “The one area that has tried to push ahead with a formal free trade zone—the 10-member Association of South East Asian Nations (ASEAN)—has little internal trade compared with the rest of East Asia.” Instead of making any futile attempt to forge economic ties on a preferential basis, Asian nations would best concentrate their efforts in ensuring that the multilateral process of trade liberalization that ran into a road block in Cancún is resumed. Clearly, joint action by China and India in this regard would be very important.

The multilateralism of the WTO is incompatible with the preferential trading arrangement of any sort. Many such agreements, though called “free trade” agreements, have little to do with free trade. Their rules of origin (ROOS) for availing of preferential treatment are invariably complex and provide great opportunities to trade lawyers to create non-transparent and opaque protectionist measures by manipulating them. For example, the free trade agreement (FTA) between the US and Singapore apparently includes 203 pages of text on ROOS! China and India should propose a repeal of Article XXIV of GATT/WTO on Customs Unions and FTAs and replace it with one which ensures that trade preferences of any regional or other agreements are extended to all members of the WTO on a MFN basis within a specified (say, five years) period after the conclusion of such agreements. The rationale for this is that the primary driving force behind most regional agreements, as argued earlier, is political. The political benefits of such agreements ought to be adequate to prevent defection even if the incentives of trade preference are limited to minimize the damage they inflict on non-members, to a specified period.

In the resumed negotiations, both countries should continue to insist that first, issues that are not trade related, such as labor standards, should not be in the mandate of the WTO. Second, both should resist giving direct representation to non-governmental entities in the WTO. The reason is that since national and international policies relating to trade would be the means for implementing any decisions in the WTO, it has to remain an inter-governmental organization. Clearly, the so-called “civil society,” national and multi-national, naturally should be heard—but the fora for the hearing have to be primarily the national political arena. Through influencing the positions of national governments through a participatory process they will indirectly influencing the decisions at the WTO. Giving them a direct representation formally in some form, such as observer status, would be counterproductive. The deeper problem of the possible undemocratic and non-participatory character of some national polities such as China’s, and hence their

denial of hearing to their civil societies does indeed arise—but a sustainable solution to absence of democracy does not lie in giving representation to civil society in an inter-governmental organization. The notion of democracy in its decision-making process has no meaning, but transparency certainly has.

Third, the dispute settlement system of the WTO is ultra-legalistic in contrast to the political system of GATT. There are pros and cons for either system. However, an effective access to a legalistic system depends on being able to hire expensive legal expertise, which poor members may not be able to do without assistance. Also, the quality of the jurisprudence of the system would be compromised if it is overloaded with too many disputes, as seems likely. One unfortunate consequence has been the clamor to bring into the ambit of WTO, based on the successful inclusion of trade-related aspects of intellectual property rights (TRIPS), other issues such as labor standards, environment, etc., not because of their trade relatedness, but only because of the availability of WTO's dispute settlement system to enforce disciplines through trade sanctions. China and India should explore and propose better alternatives to the present system.

It is well known that the only economic rationale for dumping, namely predation, is no longer plausible, if it ever was. Still, anti-dumping measures (ADMs) have been the preferred instruments of protection for various reasons (Srinivasan, 2002). The US and EU have long been frequent users of ADMs, and developing countries such as India have now begun to use them extensively. India is now a major user, in particular against imports from China. For example, during 2001–2002 (July–June), in all 309 ADM investigations were initiated, of which as many as 76 were by India, followed by the US (58), Argentina (26), and the EU (23). China initiated *none* in this period but was the affected exporter in 46 of the investigations. At the end of 30 June 2002, there were in all 1189 ADM measures in force, of which 150 were accounted for by India and only 17 by China. The US alone accounted for the largest number, 264, followed by EU's 219 (WTO, 2003b, Tables III.5 and III.6). ADMs are the most distortionary and discriminatory among protectionist instruments. Messerlin (2003) provides a comprehensive and thorough discussion of ADMs from the perspective of China's options in the WTO. Since other less distortionary means, such as safeguards measures, are allowed by WTO rules, ADMs are neither necessary nor desirable. China and India should propose repealing the articles of WTO dealing with ADMs.

To conclude: China and India have a lot to gain, both from trading with each other and cooperating in the WTO. Each can learn from the other's policies, their successes and failures. This paper discussed a subset of economic issues common to both countries without touching on others, such as privatization of SOEs, reforms of the labor market (e.g., dealing with the “hokou” system in China and labor laws in India), financial sector reforms and, above all, political reforms. Although it may sound chauvinistic and naive, there is no doubt that China can learn a lot from the functioning of a vibrant, but somewhat chaotic, multiparty participatory democracy in India.¹³ After all, as the Chinese become

¹³ I have no idea how Dutta came to attribute to me the notion that, “pluralistic democratic form of government in India made the process [of reform] so slow” and that “democracy in India vis-a-vis the one-party rule in China is inferior.” Neither notion is in my paper. I firmly believe that democracy has intrinsic value regardless of its instrumental role, if any, in economic growth.

richer and economically free, they are likely to demand personal and political freedoms. Hopefully, the Communist Party of China will anticipate and accommodate such demands, as it seems to have started doing already.

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Appendix A

Membership of the G-20

Pre-Cancún	
Argentina	Guatemala
Bolivia	India
Brazil	Mexico
Chile	Pakistan
China	Paraguay
Colombia	Peru
Costa Rica	Philippines
Cuba	South Africa
Ecuador	Thailand
El Salvador	Venezuela
Egypt ^a	Kenya ^a

^a Not formally members, but supportive of G-20 text.

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