The making of ... two economic superpowers ?!

Tetsu Kawakami, Henri L.F. de Groot

In terms of population, India and China are by far the two largest countries in the World. Especially the economic development of China over the past two decades has been impressive. In this contribution, we investigate the sources of economic growth and prosperity and address the prospects for further development of the two largest countries in the world.

Background

One out of three people in the world is Indian or Chinese. Both China as well as India are therefore potentially important players in the world economy. For a long time, their economic performance was stagnant and relatively poor. Table 1 reveals the evolution of per capita income of India and China from 1700 onwards.[1] The two countries performed more or less similarly in 1700. At the end of the 19th century, India clearly took over and outperformed China for almost a century. Comparing China and India to other countries in the world, both countries were in 1960 among the poorest performing countries of a group of 97 countries[2] (in 1960, India ranked 90 whereas China ranked 96). During the last two decades, the economic performance of both countries has improved substantially. In 2000, China ranked 68 whereas India ranked 78. Especially the performance of China has been impressive over the past two decades. For several years, it had double-digit growth rates of real GDP. These developments raise several interesting questions. First, why did China and India develop so differently during the past two decades? Are the high growth rates that China achieved sustainable? And are they also within reach for India? Is the increase in per capita income in both countries equally spread (among different groups of the population and among different regions)? What are the environmental implications of the impressive growth performance? These are questions that we will address in this contribution.

Transformation into liberalized economy succesfull

Sources of growth[3]

The sources of economic growth of India and China are diverse and difficult to clearly disentangle. Nevertheless, there are two key factors that help us in understanding the Chinese miracle as well as the relatively poor performance of India.

An important change in both countries has been the (slow but gradual) transformation into more liberalized economies. Traditionally, both countries were insulated from the world economy, heavily relied on a strategy of industrialization, and were strongly dominated by the state. China began its reforms in 1978. In contrast, in India it took until the early 1990s before reform really took off. The increased competition and reliance on market forces had positive consequences for economic performance. It resulted in an improved efficiency of resource use. Both countries are still far off from a well-functioning market-economy, though.

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).

Capital accumulation is a second important driver of economic growth. In this respect, China is strongly outperforming India. Its investment rate (in fixed capital) exceeded India's by 15% on average. The superior performance of China in this respect is due to a combination of a relatively high savings rate and relatively strong inflows of foreign direct investments (see below for a further elaboration).

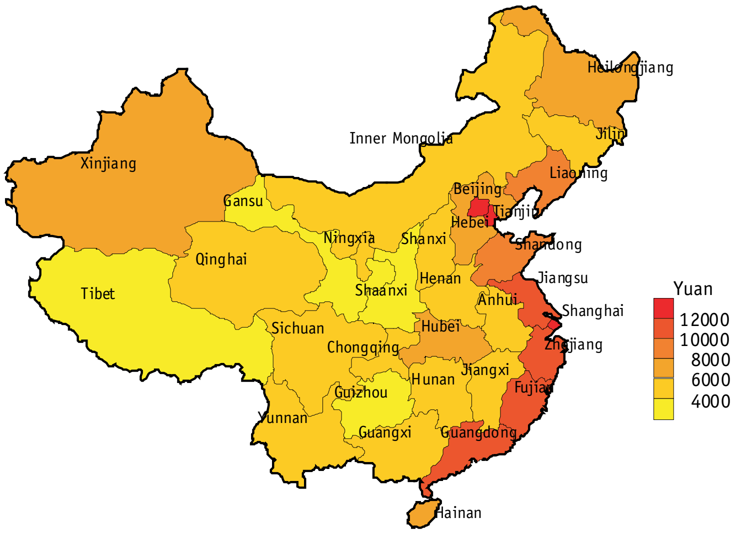

Figure 1. Regional distribution of per capita real GDP in China (1998)

Growth sustainability

An important question is whether the growth performance of China can be sustained and what the prospects for India are. Although predicting is not what economists are typically good at, there are some clear positive signs for both countries for the next few decades. For China, the accession to the World Trade Organization (WTO) will strengthen its embedding in the world economy, increase competition, further attract foreign direct investments and increase the inflow and adoption of superior Western technologies. Further liberalization and reforms of state-owned enterprises will improve the allocation of scare resources which will also positively influence economic performance. At the same time, it has to be acknowledged that savings and investment rates are likely to decline in the coming decades, reducing the rate of capital accumulation. There are also huge challenges ahead in developing a sound pension system, dealing with non-performing loans and privatizing the state-owned enterprises.

The prospects for India are also good, although India clearly has a longer way to go than China. Especially the integration of the Indian economy in the world economy is still limited. This among others is reflected in the limited inflows of foreign direct investments. Also the government is in a relatively bad situation with a large fiscal deficit (more than 10% in 2002). Strong and painful reforms are clearly needed.

Distributional issues

The impressive economic performance of India and China masks substantial differences across different groups of the population and different regions. Although poverty has been strongly reduced (from 33 to 16 % according to World Bank (2003) estimates), poverty is still substantial. Also India has managed to substantially cut poverty rates (from 45 to 26 %), but also here poverty is still a serious problem.

Also the regional distribution of prosperity has been very unequal. The Chinese government has deliberately chosen to concentrate reforms and external opening to coastal cities and special economic zones. This has contributed to their fast growth and moving ahead of the other regions, particularly those in the West. It is only recently that also the mainland is seriously improving its performance. Figure 1 reveals the strong regional variation of per capita income as it exists today.

Poverty still a serious problem

A similar picture of regional inequality emerges for India (see Figure 2). There the fastest growing state, Delhi, grew nearly 2.5 times faster than the slowest growing state of Kerala in the 1980s and more than four times the then slowest growing state of Assam in 1990s. 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.

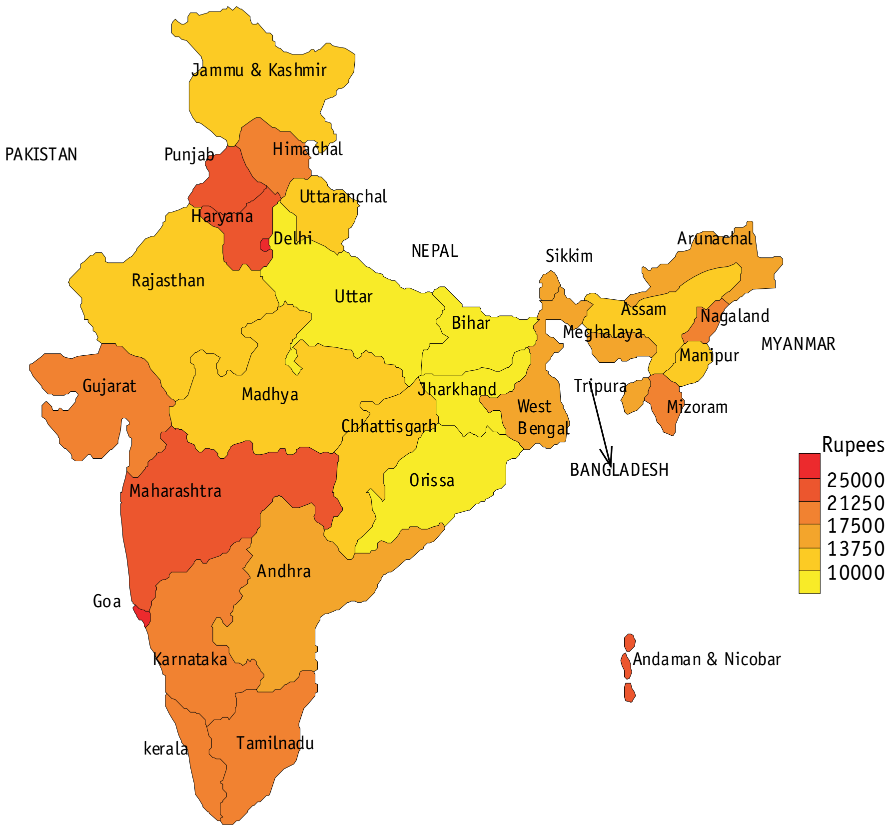

Figure 2. Regional distribution of per capita real GDP in India (2000)

Position in the world economy

There is little doubt that the present high growth performance of China was partly achieved through the economic internationalization resulting from the open-door policy which was accelerated in late 1980s. Furthermore, China obtained a full membership of World Trade Organization (WTO) in December 2001. In 2003, China was the world's fourth largest exporter of merchandise with a share of 5.9 % of world exports and

China largest recipient of FDI in the world

the ninth in commercial service exports with a share of 2.5 % (WTO, 2004). As for foreign direct investment, China became the largest recipient, overtaking the United States. China receives a much larger flow of net foreign direct investment (projected at $57 billion in 2003) than India's (about $4 billion in 2001-2002) (Srinivasan, 2004).

While in 2003, India is below a distant 30th in world merchandise trade with a share of 0.7% (WTO, 2004), she lagged less behind China in exports of commercial services, being the 19th largest exporter in 2002 (Bottelier, 2003). In particular, India is ahead of China in information technology (IT) and pharmaceuticals. These facts show that the difference of the driving force for growth between China and India would be that the former often comes from manufactured exports that exploited its cheap labor, and the latter from successful use of brain power (see also Figure 3). India also attached some weight to foreign direct investment by appointing a steering committee on FDI in 2001.

Environmental sustainability

Economic growth over the past decades in China and India has noticeably increased their income as well as reduced overall poverty levels. Growth has not been totally benign, though. Environmental pollution is damaging human health, air and water quality, agriculture and ultimately the economy. Deforestation, soil erosion, water pollution and land degradation continue to worsen and are hindering economic development in rural areas, while the rapid industrialization and urbanization in booming metropolises are straining the limits of municipal services and causing serious air pollution problems.

China and India are the second and sixth largest energy consumers, respectively (the largest is the United States). Their continued dependence on coal for the purpose of electricity generation has led to pretty high levels of carbon dioxide intensity (carbon emissions per dollar of GDP). In 2002, the estimates according to the United States Energy Information Administration indicate 0.55

metric tons of carbon dioxide per thousand dollars in China and 0.39 in India (0.55 in the United States).[4]

Both countries are categorized as a non-Annex I country under the United Nations Framework Convention on Climate Change, meaning that they have not agreed to binding targets for reduction of carbon dioxide emissions under the Kyoto Protocol. The Chinese government is, however, undertaking efforts to reduce emissions of pollutants through improved pollution controls on power plants as well as policies designed to increase the share of natural gas in the country's fuel mix, particularly around major metropolitan areas. The Indian government has also introduced initiatives aimed to discourage firms from generating electricity using older, inefficient coal-fired plants.

Conclusion

China's reform of its closed and centrally planned economy that started in 1978 has led to the present impressive growth performance. In contrast, India's reforms took off at the early 1990s only, and the income gap between China and India has widened during the past decades. However, India's growth performance has been substantial too, at an average rate of around 6% since 1980. Both countries still have a large amount of potential for further economic growth, in particular through their further integration into the world economy and the associated further inflow of foreign direct investment. In terms of economic as well as social and political stability, addressing the unequal regional distribution of economic growth and the environmental problems are essential for the next few decades.

References

Bottelier, P. (2003), *China as an exporter of services. What lies ahead?*, Washington DC: World Bank.

Maddison, A. (2002), *Growth and interaction in the world economy: The west and the rest, 1000-2000 AD*, Presented at Harvard University.

Srinivasan, T. N. (2004), "China and India: economic performance, com-petition and coope-ration: update," *Journal of Asian Economics*, Vol.15, pp.613-636.

World Bank (2003), *World Development Indicators*, Washington, DC: World Bank.

World Trade Organization (2004), *Stronger than expected growth spurs modest trade recovery*, Geneva: World Trade Organization.

Tetsu Kawakami is a visiting Post-doc to the Department of Spatial Economics of the Vrije Universiteit. His home country is Japan. He has done extensive research on the economic development of China. Henri de Groot is affiliated to the Department of Spatial Economics.

Footnotes

[1] There are serious measurement problems involved in the numbers that we show. The data that we use are the best ones that are available to date, but need to be interpreted with some caution.

[2] The group of 97 countries that we used for this illustration are countries for which the World Bank reports information on per capita income in constant dollars for both 1960 as well as for 2000.

[3] This section builds on Srinivasan (2004).

[4] GDP figures are based on purchasing power parity exchange rates.

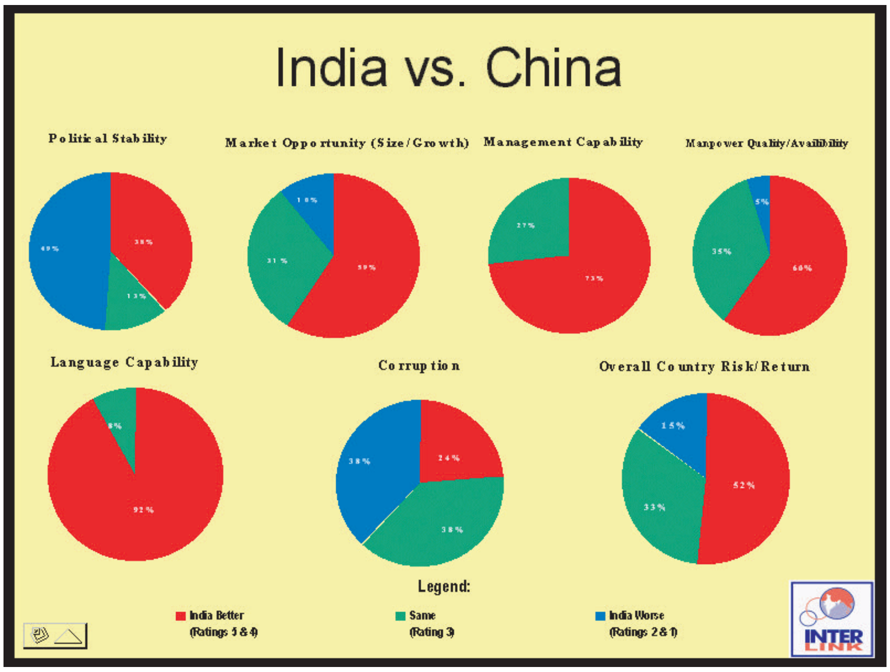

Figure 3