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China and India: Country Role Models of Development Success?

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Abstract

The paper discusses views on China and India as country role models. In so doing the article recounts the economic and political reforms pursued by the two countries. The paper also outlines the outstanding reforms and the bottlenecks that could jeopardize economic performance and development going forward, drawing lessons for other developing countries.

Keywords: China, India, reforms, growth, development

JEL classification: O2, O43, O53, D73

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Tables appear at the end of the paper.

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1 Introduction

China's and India's rapid growth and economic policies, as well as their role in international trade and capital markets, have generated a large amount of interest and research. Much of the attention focuses on their growth prospects and on their faculty to influence global governance.

Two salient characteristics of China and India are the vast size of their territory and their enormous populations. They are two of the most populous countries, accounting for nearly 40 percent of the world's population in 2006 (see Table 1). China's economy is also one of the largest, with a GDP exceeding US$2 billion. At the onset of the reforms in the late 1970s, China was the 10th largest economy in the world and by 2005 became the fourth largest—following the United States, Japan and Germany (Jefferson et al 2006). Real GDP per capita growth rate in China and India is significantly higher than that of the world's rate, and above growth in other developing countries and higher income groups, particularly in recent decades (see Table 2). Further, growth trajectory in both nations has followed a similar pattern to advanced countries and other successful East Asian economies at comparable stages of development (Nayyar 2008).

Interestingly, China and India have almost no commonalities in terms of history, culture, religion, language and political institutions with most of the developing world. Although these conspicuous diversities make a comparison difficult, attempting to relate the political economy and ensuing performance of these countries is unavoidable. And, surely, they represent role models for their neighbours and the developing world in general.

The purpose of this essay is to comment and to synthesize the papers on China and India as country role models, by Yang Yao (2009) and Nirvikar Singh, respectively. In what follows I will overview the exceptional elements of China and India (2009), departing from the most significant economic and political reforms which set both countries in their current development path. The commentary proceeds to outline outstanding reforms and potential bottlenecks to China's and India's economic performance and development. Finally, the relevant policy lessons for developing countries are examined.

2 China and India: country role models?

China and India's economic success has been largely interpreted as the result of thriving economic and political reforms, which have allowed them to increasingly engage in, and in some instances dominate, global trade and financial activities. However, the political economy view of such phenomena cannot be overlooked, particularly in the case of China. It is, therefore, pertinent discussing the role of the government in designing and implementing successful development policies and structural reforms. Subsequently, important changes in both countries' politics and economic principles are discussed. Also, I comment on key economic and structural reforms.

2.1 Ideological shifts and the role of the government

In the last three decades China has evolved from a centrally planned economic system to an emerging market economy. Yao (2009) provides a political economy interpretation of China's growth in the reform era. That is, he tries to convey how the country's political and economic ideologies have evolved following the establishment of the People Republic of China in 1949 and the death of Mao in 1978. According to Yao, the recurrent mistakes during that period made possible the resurgence of a new political leadership, which conducted the ideological shift during the reform processes. The author also identifies two major explanations for China's government and the Chinese Communist Party (CCP) to develop into a disinterested organization in the reform era: first, the creation of an *equal society*, which was possible by forgoing the emphasis on an interest group (i.e., the working class). This further facilitated the transformation of the government into a disinterested body, and allowed to adopt economic reforms and growth-oriented policies. Second, *the CCP's conscious ideological adjustments*, whereby the Party embraced a flexible approach to economic institutions and strategies.

Yao's key hypothesis is that the existence of a fair and independent government in China during the last three decades explains the success of the economic reforms, and the resulting high economic growth. In the light of the analytical model, the rest of the paper goes on to argue why China's success can be attributed to its disinterested government. Therefore, there is nothing miraculous in China's high economic growth and, therefore, its policies could serve as model to other nations. However, China's main political party, the CCP, is closely intertwined with the notion of government—reflecting the party's leading role in the country's operations. As I argue later, this element of China's success will be difficult to replicate in other developing countries with democratic and multi-partisan political regimes.

Yao's paper concludes that despite China's unique historical and political setting, its experience and key policy lessons could be applicable to other developing countries, as long as there is a disinterested government. There is not, however, overall agreement in the profession about the notion of disinterested government. The public choice theory of politics and economics advanced by Buchanan (1986) is critical of the disinterested government concept, and regards politics as an arena for the clash of conflicting self interest.

Likewise, Singh's (2009) paper underlines India's development strategies, starting from a historical overview of how and why the strategies were adopted. The author reviews India's distinct features including the role of initial conditions, predominantly human capital advantages derived from public provision in higher education, geographical location, and infrastructure. But, in contrast to China, the highlight of India's development strategies was not the central working of a disinterested government, but economic modernization through industrialization. This approach echoed British influence on India's post-colonial political and economic maturity. Also, being a democracy has allowed, to some extent, the interaction between public and private agents in purse of development, away from the centrally planned economies' modus operandi. Another dimension of India's development strategy is international trade and finance, and the role of liberalization policies which are discussed later on.

A salient argument expanded by Singh in explaining India's development is the 'accidental' nature of the high-skill/technology-intensive nature of India's production and trade platform. The quality of human capital fostered the development of an advanced service sector, encompassing information technology (IT), IT-enabled services and financial services. The growth of the IT sector during the 1990s is singled out as India's primary development strategy. The gradual liberalization in the electronics industry, which started in the mid-1980s and accelerated in the 1990s, was central in this success. Furthermore, given the high-skilled nature of the human capital employed in these activities, the sector has not been prone to the country's severe labour laws. Consequently, as Panagariya (2006) states, India was able to take the opportunities granted by the world markets. As in China, the strategies conducive to higher growth and improving economic performance pose relevant challenges. These include deficits in social and human capital indicators, increasing income and regional inequality, social stratification, lack of large-scale manufacturing employment creation, and quality of governance. These drawbacks are not, however, specific to China and India but also remain part of the growth trajectory in developing countries.

2.2 Economic reforms and structural adjustment

Yao and Singh try to articulate the role of economic reforms mandated by domestic factors. They also express the influence of engagements in multilateral agreed adjustment plans in shaping development policies—mostly in India.

Yao identifies three determinants of the reform process in China. (1) *The growth consensus*, regarded as the result of the restoration of a pragmatic leadership in the 1970s, reflecting the countrywide goal of achieving economic growth and prosperity. On balance, the growth consensus had positive effects in stimulating China's economic performance and growth, but the undesirable consequences, as stated by the author, cannot be overlooked. These include, inter alia, environmental degradation, spatial inequality,[1] the erosion of social networks, and the debilitation of the institutional stance. (2) The introduction of a *dual-track price system in 1978*, aimed at liberalizing price controls, led to the coexistence of both planned and market prices for identical goods in the economy.[2] By 1993 the dual price ended for most industrial products, and by 1994 the dual exchange rate regime was eliminated. The main objective of the policy was to tender decision-making power to enterprises and the introduction of a market mechanism in order to improve microeconomic efficiency. Despite its potential benefits, a twofold price system can also be harmful to various interest groups and to economic growth, particularly during the price adjustment phase. (3) The privatization of state-owned enterprises (SOEs), a key element of China's economic reforms and a key feature of its disinterested government. The privatization of SOEs started in the mid-1980s and was accomplished by the new millennium. Privatization in China has differed from that in the former Soviet Union and European countries, following a bottom-up system, whereby privatization were initiated experimentally in several localities and then formalized and promoted by the central government (Cao et al. 1999; Guo et al. 2003).

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1 Wan (2008) provides a comprehensive study of growth, poverty and inequality in China.

2 China's transition from a planned to a market system followed a different path from Eastern Europe countries and the former Soviet Union, challenging the conventional wisdom about economic and political transition. Qian (2000) details that during the first stage of reforms (1979–93), the centrally planned system was reformed incrementally (i.e., piecemeal approach to reform) to improve incentives and increase the scope of the market in resource allocation. In the second stage (since 1994), new institutions supporting a market system are being developed.

Yao's paper clearly shows that China has followed a heterodox path for its economic policy conducting to structural reforms, and they do not concur with standard economic conventions. However, since the 'growth consensus', China has followed similar policies to the rest of the developing world, coined in international arrangements such as IMF's supported programme and the well-known Washington consensus (see Table 3).

Conversely, India's path has been more conventional. Singh stresses the role of international, as well as domestic factors, in shaping India's development model. These embrace, inter alia, domestic structural adjustment (i.e., fiscal, monetary and exchange rate policies) conducing to a relatively successful macroeconomic management, trade liberalization, elimination of restrictions to capital flows and increasing technology transfer. For India, the 1991 payments crisis was a turning point to begin the reforms. These reforms—which have been sustained and taken further still—have paid off. Undoubted, growth has accelerated, and poverty, rural and urban, has declined. India's dramatic transformation has changed the fortunes of 1.1 billion people. However, rapid growth must be sustained in order to continue alleviating poverty (Panagariya 2008).

In India, trade liberalization and other macroeconomic reforms signified a large reduction in the external tariffs on manufactures, more flexibility in the exchange rate, eliminations of restrictions on foreign direct investment, and the controls on domestic investment and production were significantly removed. Overall, they resemble the reform and liberalization efforts by a large number of countries after almost generalized debt and payment crises in the developing world. India's growth rate has remained high, even accelerating, but still far from China's spectacular growth rate.

2.3 Reform challenges

As already discussed, both papers manifestly outline the importance of reforms in the development processes of China and India. These policy reforms are not exclusive of the Asian giants, but have already been attempted by other developing countries, as part of autonomous efforts to improve social and economic conditions, or as structural adjustment programmes commanded by international financial institutions.

Trade liberalization, privatization, capital account liberalization and the like have characterized developing countries' economic reforms. The reform agendas promoted by the development literature and in policy circles encompass significant overlapping elements. Emerging policy consensuses acknowledge the economic and social costs of the reforms. These costs are considered in Yao's and Singh's studies.

The real challenges for China and India, which also apply to other developing countries is promoting the reforms that are stalled. China faces important challenges as far as internal mobility, asset ownership, financial reforms and property rights are concerned.[3] For India, privatization is important, but introducing more flexibility to the labour market is a pressing issue. Both countries confront serious urbanization problems resulting from the internal mobility and growth processes. In summary, the pending institutional reforms, necessary to sustain economic growth and development are:

3 Jefferson et al. (2006) discuss in more detail the areas still requiring institutional reforms in China.

China	India
Policies to facilitate internal labour mobility (e.g., reforming the houku and social insurance systems) Land ownership reform Banking sector reform Improve competition laws Trade-related intellectual property rights Further regional integration Urbanization	Labour mobility in agricultural and low-skill insensitive manufacturing sector Elimination of labour rigidities in the formal (organized) sector (expressly in large manufacturing activities) Infrastructural reform (i.e., bottlenecks in energy, airports and ports) Urbanization

3 Policy lessons

First, a key lesson emanating from Yao's and Singh's papers, particularly for developing economies, is the adoption of a pragmatic approach to economic reforms (which was the turning point in China's economic development), and the adaptive capacity of the countries' economic agents to this process.[4]

Second, industrial policy has been at the heart of development policies and strategies in developing countries, albeit not particularly so in India. As in the case of other strategies and economic reforms, policy implementation produced varied outcomes, and different levels of success.

Third, it is widely recognized that distorted trade regimes hindered growth and development (Santos-Paulino and Thirlwall 2004). Trade, and the liberalization of commercial polices, have played a primary role in growth success both in China and India, where both countries have effectively opened up to global markets. Further, the interface of trade liberalization and domestic reforms has contributed to the leading countries economic success, akin to developing and transition country role models. The substantial restructuring of state-owned enterprises is another area of policy accomplishment in China and India.

Fourth, development policy should not only depend on picking the winners but reaching a Pareto optimum between the government and private agents' decisions and choices. That is, the formulation of economy-wide and development strategies should be a balanced outcome of both parties, reflecting the country's evolving comparative advantages. These policies and processes should also adjust to the ever changing global economy field.

Finally, after reviewing two compelling country cases, the experiences of China and India contain important lessons for developing countries about what is needed for economic development to exult. As Bhagwati (2006) states, sustainable development should succeed in achieving openness to the world economy, economic freedom and political freedom.

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4 Recent research emphasizes the importance of pragmatism when implementing reforms, reflecting the costs for vulnerable groups and countries (e.g., World Bank's Growth Report 2008).

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Table 1: Population rate in China, India and selected country groups

Countries	Total and % of world					
	1960		1980		2006	
China	667.1	22.1	981.2	22.1	1311.8	20.1
India	434.8	14.4	687.3	15.5	1109.8	17.0
Brazil	72.7	2.4	121.6	2.7	189.3	2.9
South Africa	17.4	0.6	27.6	0.6	47.4	0.7
CIBS	1192.1	39.4	1817.8	41.0	2658.3	40.7
Regions						
Low income	847.1	28.0	1379.2	31.1	2419.7	37.0
Lower middle income	1060.8	35.1	1604.6	36.2	2276.5	34.8
Upper middle income	419.2	13.9	594.5	13.4	811.3	12.4
Latin America & Caribbean	214.7	7.1	356.6	8.0	556.1	8.5
East Asia & Pacific	902.5	29.9	1359.1	30.7	1898.9	29.0
South Asia	565.0	18.7	903.3	20.4	1499.4	22.9
Sub-Saharan Africa	225.5	7.5	386.2	8.7	781.8	12.0
High income	695.2	23.0	852.8	19.2	1030.7	15.8
World	3022.3	100.0	4431.0	100.0	6538.1	100.0

Source: Author's elaboration.

Data from World Bank's World Development Indicators (available at: http://data.worldbank.org/data-catalog).

Table 2: Average real GDP per capita in China, India and selected country groups

Countries / Regions	Real GDP per capita (2000 US$) and growth rate (%)									
	1960-69		1970-79		1980-89		1990-99		2000-07	
China	92.6	0.9	142.7	5.3	277.2	8.2	628.4	8.7	1,310.4	9.4
India	193.2	1.6	217.4	0.6	263.4	3.4	367.7	3.7	546.3	5.6
Regions										
East Asia & Pacific	140.0	1.6	210.7	5.0	358.7	6.0	697.5	6.8	1,244.6	7.9
South Asia	200.8	1.8	223.9	0.6	274.2	3.3	372.6	3.3	527.5	5.0
Sub-Saharan Africa	476.0	2.0	579.7	1.2	555.5	-0.8	504.7	-0.7	543.0	2.2
Middle East & North Africa	868.2	4.5	1,234.7	3.4	1,321.6	-0.5	1,411.9	2.0	1,682.7	2.4
Latin America & Caribbean	2,285.1	2.5	3,115.1	3.2	3,469.9	-0.3	3,677.2	1.2	4,105.1	2.2
Euro area	7,805.6	4.9	11,699.5	3.3	14,416.9	2.0	17,746.0	1.8	20,784.3	1.5
Economic classification										
Low income	249.9	1.4	290.5	1.3	295.0	0.3	314.3	0.7	366.9	3.0
Lower middle income	250.8	2.0	345.4	3.4	470.5	3.4	688.5	4.2	1,076.1	6.5
Middle income	599.0	2.7	838.6	3.4	1,044.9	1.6	1,233.8	2.0	1,655.8	4.9
Upper middle income	1,867.2	3.4	2,750.2	3.8	3,296.1	0.6	3,407.1	0.6	4,044.6	3.4
High income	10,460.7	4.3	14,856.3	2.9	18,434.8	2.2	22,907.7	1.8	26,992.2	1.8
World	2,805.3	3.4	3,659.7	2.1	4,183.8	1.3	4,795.9	1.2	5,527.6	1.9

Source: Author's elaboration.

Data from World Bank's World Development Indicators (online).

Table 3: New reform agendas?

Washington Consensus (WC)	Rodrik 'augmented' WC (WC + 10)	Growth report
Policy reforms	Corporate governance	Leadership Quality of policies Bad ideas
Fiscal discipline Redirection of public expenditure priorities towards primary health care and education, and infrastructure Tax reform	Social safety nets Targeted poverty reduction	Macroeconomic stability Infrastructure: human capital, education, health Equity & equality of opportunity
Financial liberalization	Independent central banks/inflation targeting	Financial sector development
Competitive exchange rates	Non-intermediate exchange rate regimes	Exchange rates
Trade liberalization	WTO agreements Flexible labour markets	Labour markets Export promotion and competitive industrial policy
Liberalization of FDI inflows	Prudent capital account opening	Technology transfer (FDI, international talent exchange) Capital flows & financial markets opening
Privatization of state enterprises		
Markets deregulation		Competition and structural change
Legal security for property rights	Anti-corruption	Effective government
-	-	Urbanization & rural investment
-	-	Regional development
-	-	Environment & energy

Source: Williamson (1990), Rodrik (2006) and Commission on Growth and Development (2008).