India and China – why they are on the verge of success?

by Wojciech St. Mościbrodzki (wojmos@interia.pl; www.wojmos.com)

1 The policy changes in China and India

1.1 China – from communist Maocracy to almost-capitalist state

China has always been an empire – as many should notice. However, for many centuries it was a sleeping dragon. When world has reached the modern era after WW2, China was still a semi-feudal (even in communist era) country, with complete obsolete structure of economy and bureaucracy. The Mao's policy slowed the development even more, with significant 15%-20% decrease during cultural revolution period. In late 70s a new strategy was developed, encouraging breakthroughs in agriculture. The private ownership of land was allowed and in a few years (1987-84) almost 98% of peasants took that option. This lead - for the very first time in modern China history - to self-sustainability of grain production (they even had some surpluses).

The same liberalization was applied to small industry and family enterprises. The bigger players, on the other hand, took benefits from country's wider opening. 5 zones and 14 cities were given incentives for foreign investments (in 10 years, number of foreign companies rose from 20 to 200000).

The positive image of Chinese economy is very strong. That empowers the global interest in investment in the country. The FDI in last year reached 115 bln USD (in comparison to roughly 70 bln per annum in 2000-2003) with more than 9% growth rate[1]. The labor market is around 1.3 bln people. China has quickly rose in the economics rating, exceeding such powers as Italy, France and Canada[2]. China strengthen its links to other big players (eg. its second UE trade partner) and their development seems to be unstoppable.

On the other hand, some issues are still to be resolved. Energy consumption level sky rockets and will soon be limiting the growth capacity[3]. China's demand now starts to significantly influence global energy price levels. The social issues will surely emerge because of wealth differences (masses of people still do not benefit from economic boom). The exchange rate policy worries other governments (Us, Japan and other G7 members) and international political tensions caused by fixed juan rate will strengthen. Some entities (EU) introduced taxes accusing the Empire of dumping strategy. Not only big players are afraid of China's growth – the lesser economics (emerging countries) are much more labor-powered (G7 are more capital-driven), and China's tremendous cheap labor market is menacing their prosperity chances.

China's unequaled boost is also threatening the stability of global markets (big changes generate dangers of big shifts): China consumes 30% of world's steel production and they are second oil importer in the world (making them vulnerable to oil crisis). The potential crash on Chinese market can be devastating to the global system, as the Jade Empire produces 20% of world's growth.

---

[1] The government starts to worry abort too Fast growth rate and introduces limitem countermeasures

[2] this gives some idea: In 2005 China was able to reach one day production equal to Austria's yearly GNP!

[3] China is now making great investments In energy production facilities – 4 new dams on Huangho will produce almost 40 GigaWatts.

Recently, the government rose the interest rates. The change was small, but it was perceived as a symptom of change in approach, a will to control inflation (which reached 5%) and some tendency to loose strict administrative rules of economic control (since that change the government used to control investments and credit policy rather by a set of administrative, bureaucratic restricting rules). The credit market responded by shifting to "non-banking" sector, and it is estimated that 10% of the total Chinese GNP is still residing there (that means: out of control).

One of main hurdles in the Chinese economy is actually … the rapid growth that has occurred in the last 10 years. Some economists fear that China's economy is over-heating which means that inflation will become a serious issue (5% right now) in the Chinese economy and that due to China's global economic expansion an over-heating could have major repercussions among other nations. Chinese officials deny that the economy is over-heating, although they do admit that certain areas are "heating up" in that they have weak infrastructures that contribute to the lack of economic control.

Another issue is taxation, which proved to be a problem in stabilizing the Chinese economy. Officials are now planning on implementing tax cuts to certain economic sectors and industries in hopes that the tax cuts will help to regulate the economy. A primary goal of the tax cuts will be to assist in decreasing the investment disparity between rural and urban areas and to encourage government owned corporations to compete with foreign corporations.

By 2005, there were signs of stronger demand for labor with workers being able to choose employment which offered higher wages and better working conditions, enabling some to move away from the restrictive dormitory life and boring factory work which characterize export industries in Guangdong and Fujian. Minimum wages began rising toward the equivalent of 100 U.S. dollars a month as companies scrambled for employees with some paying as much as an average 150 a month. The labor shortage was partially driven by the demographic trends as the proportion of people of working age falls as the result of strict family planning. It was reported in early 2006 that labor costs had continued to increase and a shortage of unskilled labor had developed with a million or more employees being sought. Operations which rely on cheap labor are contemplating relocations to cities in the interior or to countries such as Vietnam or Bangladesh. Many young people are attending college rather then opting for minimum wage factory work. The demographic shift resulting from the one-child policy continues to reduce the supply of young entry level workers. Also, recent government efforts to advance economic development in the interior of the country are beginning to be effective at creating opportunities there.

1.2 India – from social state to modern IT society

India's economy has been floating from mixed (central planned and semi-market) to more and more free market. The reforms continuously introduced since 90s are stimulating the economic growth, even though it is still much to be done. The country's economics is based on agriculture, handicraft, industry and services. Traditionally, the most important sector was agriculture, and even today 60% of people are working in that part of economy. However, the problem is, that they stand only for 25% of GNP. Moreover, traditional law gives heritage to all the children which leads to diminishing of average land plot[4] (which makes usage of machinery more challenging).

[4] More than 50% is 0.5 ha

The industry is strong in heavy part (e.g. steel production), which is quite typical for economies introducing models more or less similar to Soviet one.

However, recent India's strategy (which proved to act well and give promising visions of future) is oriented in to service sector. The globalization and rapid development of communication technology made great opportunities for this type of activity. In last decades India was famous for its call centers, and outsourcing of other IT and financial services. Moreover, the high-tech sector is empowered by significant investments in research and growth of software development.

Before 1980 the country followed Soviet-style of economy, concentrating both on capital-demanding heavy industry and subsidizing hand based and low-skilled cottage industries. This approach was widely criticized by liberal experts. The growth rate and other macroeconomic indices remained at low level (Fig.1), and earned a not honorable term of "Hindu rate of growth" (as opposed to Asian Tigers). The economic reforms that caused a surge in economic growth after 1980 can be attributed to two stages of reforms. The pro-business reform of 1980, initiated by Indira Gandhi and carried on by Rajiv Gandhi, eased restrictions on capacity expansion for incumbents, removed price controls and reduced corporate taxes. The economic liberalization of 1991, initiated by then Prime Minister Narasimha Rao in response to a balance-of-payments crisis, did away with the investment, industrial and import licensing and ended public sector monopoly in many sectors, thereby allowing automatic approval of FDI in many sectors. The results of good policy and political reforms in 90s paved a way for further opening of a country and reducing government controls on foreign trade and investment.

In 1998, India's economy was $1702.7 billion, which accounted for a 5% share of world income. India's economy next year was $3319 billion (by Purchasing Power Parity means) which accounts for a 6% share of world income, the fourth largest in the world in terms of Purchasing Power Parity.

Still, there are problems like unbalanced growth rate and high unemployment rate (Fig.2,3). Moreover, the social pressure will continue to grow, and still unresolved issues of heavy industry and agriculture will pose a threat.

2 Competition or synergy?

Both economies are playing major role in the region, and the total volume of market (esp. labor) is huge. Both countries develop at the very high speed and therefore can expect the competitive clash in short future – mainly in main export areas. Both are offering relatively cheap labor, goods and services. While China is still gathering more benefits in cheap clothing, but India is expected to close the gap. On the IT area, the interesting situation can be seen: while most hardware is produced in China, India is far ahead in software development. This is because hardware production is far less knowledge-dependant while programming needs excellent education and expertise.

China and India will probably soon face the need of competition for energy and raw materials. This will be stimulated not only by boosting industry, but also by consumption means (the higher the standard of living the higher demand for energy-consuming cars, consumer electronics and air-conditioning).

On the other hand, the competitive approach should be also accompanied by comments, that both markets can also support each other. Many experts point that strong, large economy can pull its partners (China is effectively giving support to Korea and helps Japan to overcome its stagnation). China and India can benefit from such a synergy (bilateral trade sky rocketed from 190 mln USD

In 2000 to 7.2 bln in 2004, with expectation of exceeding 15 bln USD in 2006) even though some historic twists can slow down join initiatives (war in 1962).

3 Who is more likely to maintain the momentum?

China's unequalled growth is sometimes addressed as "bicycle economy". That means, the country must be on constant growth or suffer a fall. By economic terms, the development of private companies must remain stable to allow inflexible state-owned enterprises to restructure (and get rid of overemployment).

India's advantages group on knowledge aspects. The government stimulates the high-tech branches (with IT services as perfect working example), which empowers the growth not only of today, but also in future. Moreover, the English language abilities are far more widespread in India than in China (it is both caused by culture openness and state's policy – not mentioning the needs of development in high tech economy areas).

The India's government actively stimulates the research both by industry R&D and academic means. This will form the good base for future challenges.

The macroeconomic indices are quite equal (Fig.7-12). China is slightly better because of its scale, while India has better infrastructure and smaller problems from unbalanced incomes (yet still, they are quite large!).

One cannot forget the political power, which is higher at Chineses' grasp, even though both powers wield nuclear weapons. However, the Beijing has slightly better prestige, as their regime is less predictable (many in US are afraid of "dragon power").

To sum it over: both countries have good base to sustain the development ratio. In the close future it will be shown, if they are going into devastating, competitive rivalry (which is probable) or tend to cooperation (often addressed as "Chindia superpower"). If both countries will succeed in remaining at the quick pace of growth, however, India can benefit slightly more (even though right now they come second) as their strategy is more knowledge-oriented.

REFERENCES:

[1] Difficult friendship of Titans
http://www.gazetafinansowa.pl/?d=swiat&id=629

[2] The sixth economy
http://www.bankier.pl/wiadomosci/article.html?article_id=1373972

[3] http://globaleconomy.pl/content/view/292/28/

[4] China vs India
http://www.businessweek.com/magazine/content/05_34/b3948421.htm

[5] Coftware Wars: China vs India
http://www.wired.com/news/business/0,1367,51706,00.html

[6] Deutsche Bank Report: China and India
http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000192108.pdf

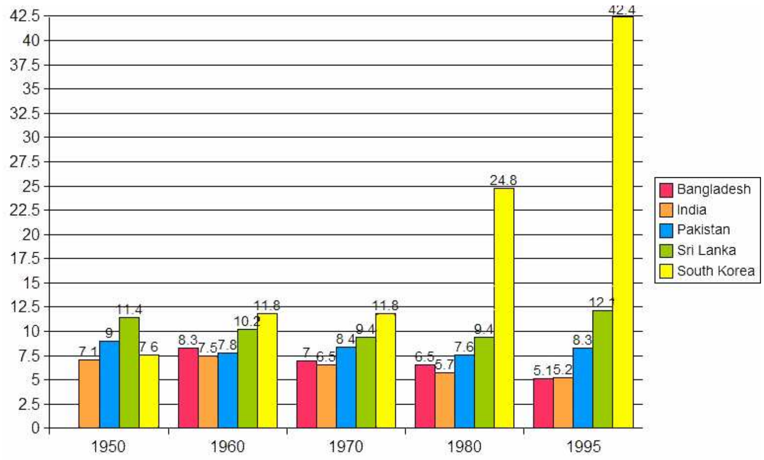

Fig.1: India's before reforms per capita GDP

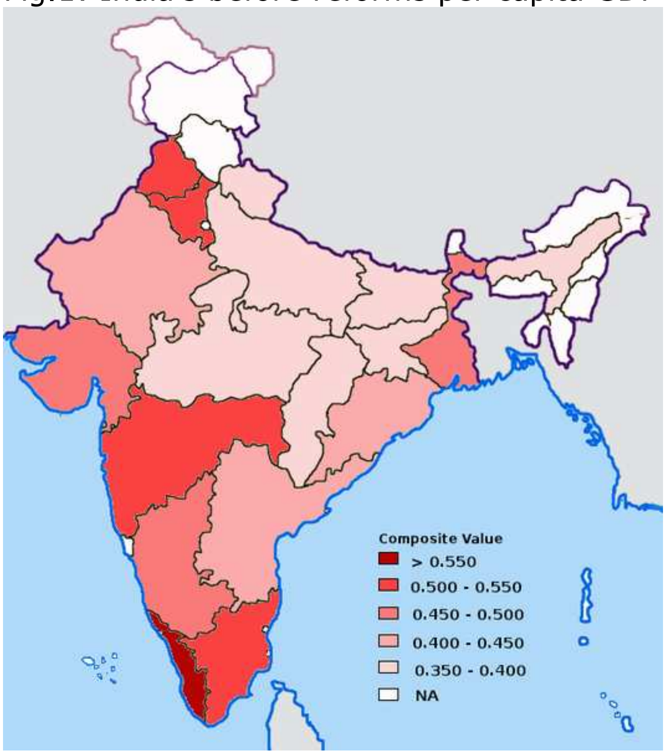

Fig.2: India's composite factor (based on Human Development Raport of 2002): includes education, health care and other social services

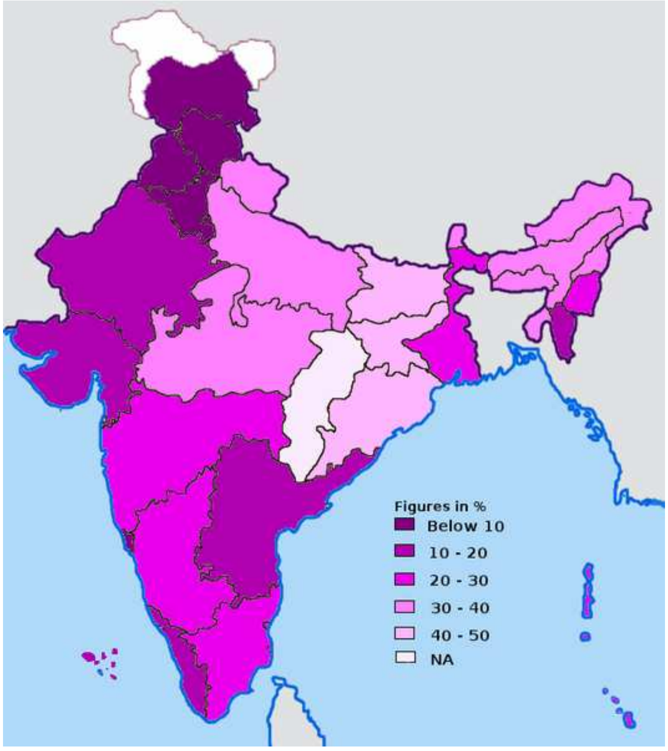

Fig.3: India's poverty index (based on Human Development Raport of 2002)

CHINA versus INDIA					
ECONOMY/SCALE	**Units**	**Year**	**China**	**India**	**China to India ratio**
Population	Million	2003	1288	1064	1.2
GDP (PPP)	$ billion	2003	6090	2908	2.1
Per capita GDP growth	%	1980-2004	8.2	3.7	2.2
Share of manufacturing in GDP	%	2003	39	16	2.4
Living standards					
Per capita GNP (PPP)	$	2003	4980	2880	1.7
Life expectancy	Years	2002	71	63	1.1
Female adult literacy rate	%	2003	87	45	1.9
Under 5 mortality	Per 1000	2003	37	87	0.4
Under 5 malnutrition	%	1995-2003	12.1	45.8	0.3
Poverty ratio (% below $1 a day)		2001 & 2000	16.6	34.7	0.5
INFRASTRUCTURE					
Electricity production	Billion kwh	2002	1640.5	596.5	2.7
Goods hauled (Railways)	Ton-km billions	2002	1508.7	333.2	4.5
Container traffic (ports)	Millions	2003	61.62	3.9	15.7
Air freight	Ton-km millions	2003	5650.6	580.0	9.7
Telephones (land + Mobile)	Per 1000	2003	424	71	6.0
EXTERNAL SECTOR					
Merchandise exports	$ billion	2004	593.4	80.8	7.3
Service exports	$ billion	2004	62.4	51.3	1.2
FDI inflow	$ billion	2004	60.6	5.5	11.0
Tourist arrivals	Millions	2003	33.0	2.4	13.8
Forex reserves	$ billion	2004	614.5	135.2	4.5

Sources: *World Development Indicators (2005); Institute of International Finance, RBI and CSO. 2004 data for India refer to the fiscal year 2004-05.*

Fig.4: India's vs China

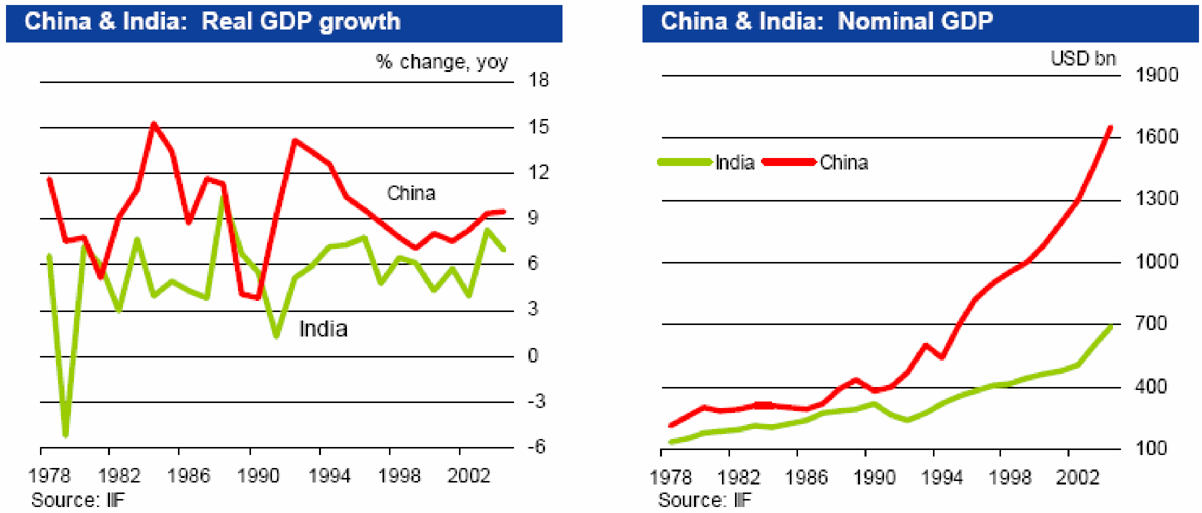

Fig.5: India vs China, Deutsche Bank Report,

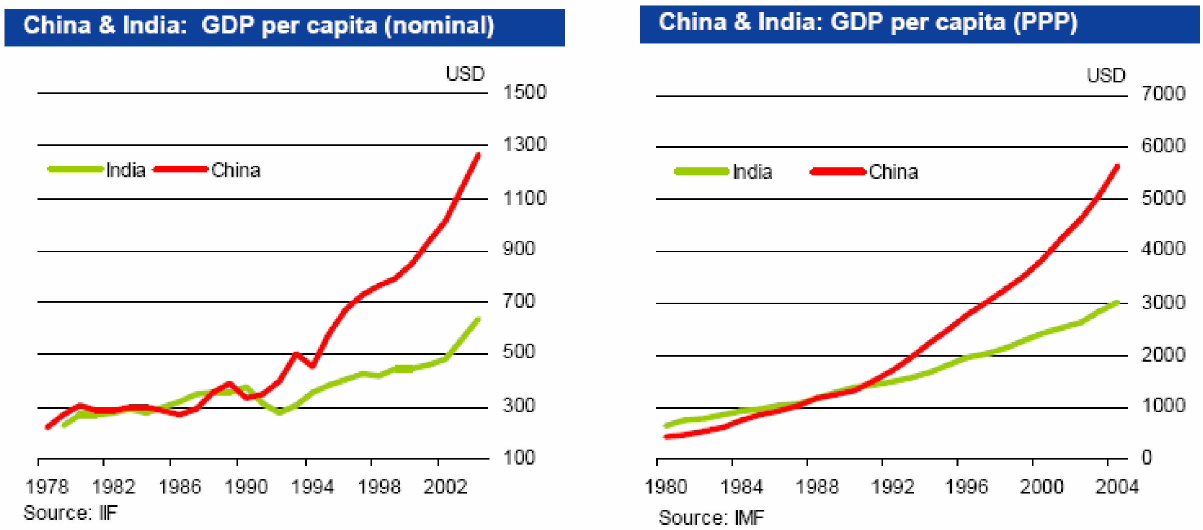

Fig.6: India vs China, Deutsche Bank Report,

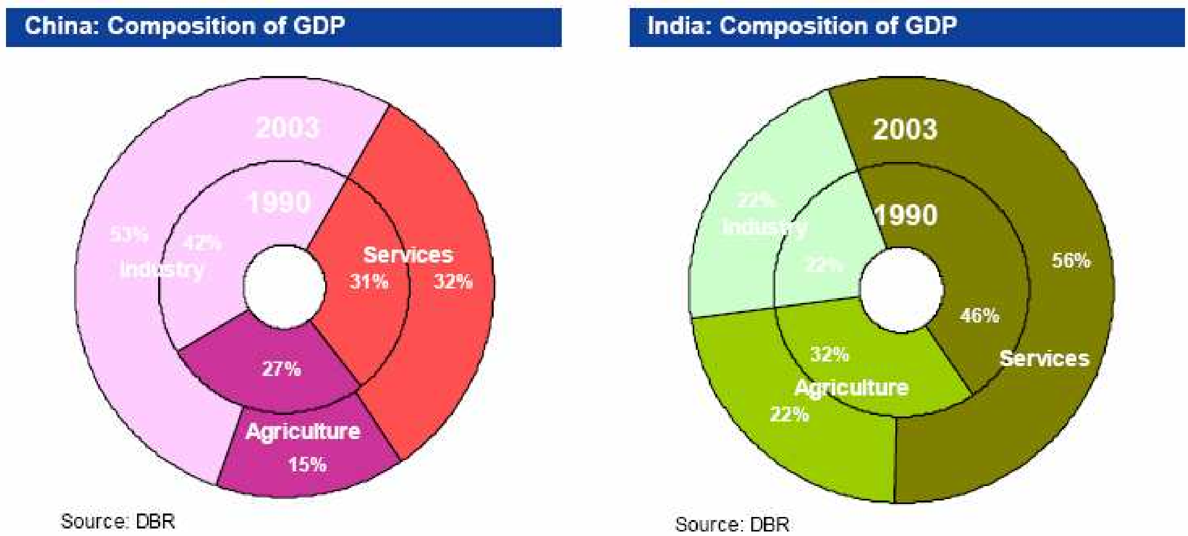

Fig.7: India vs China, Deutsche Bank Report,

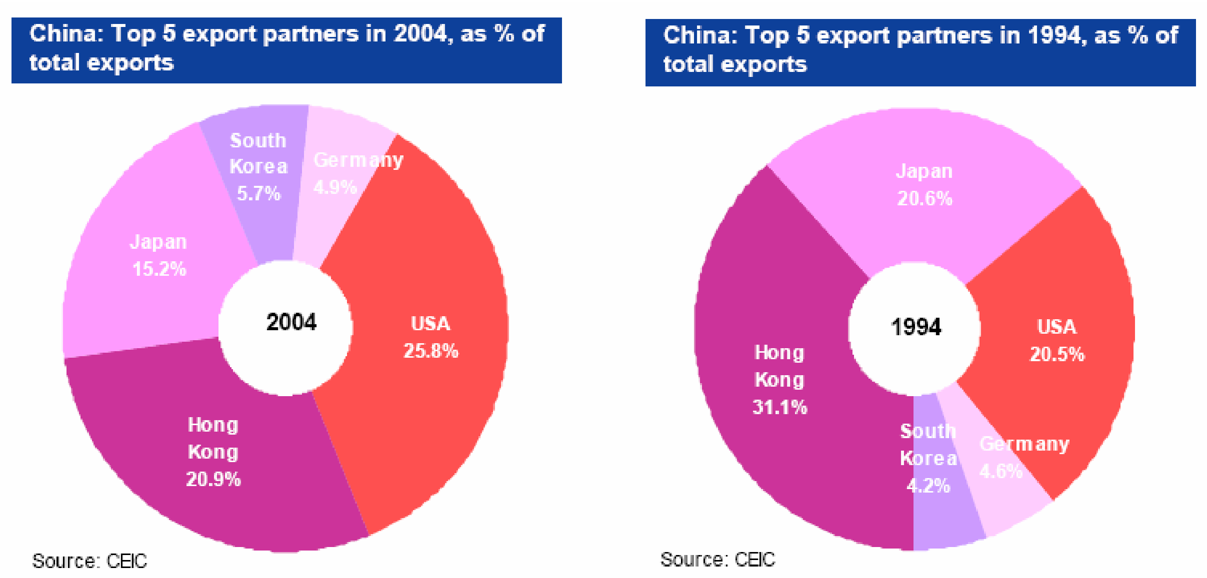

Fig.8: India vs China, Deutsche Bank Report,

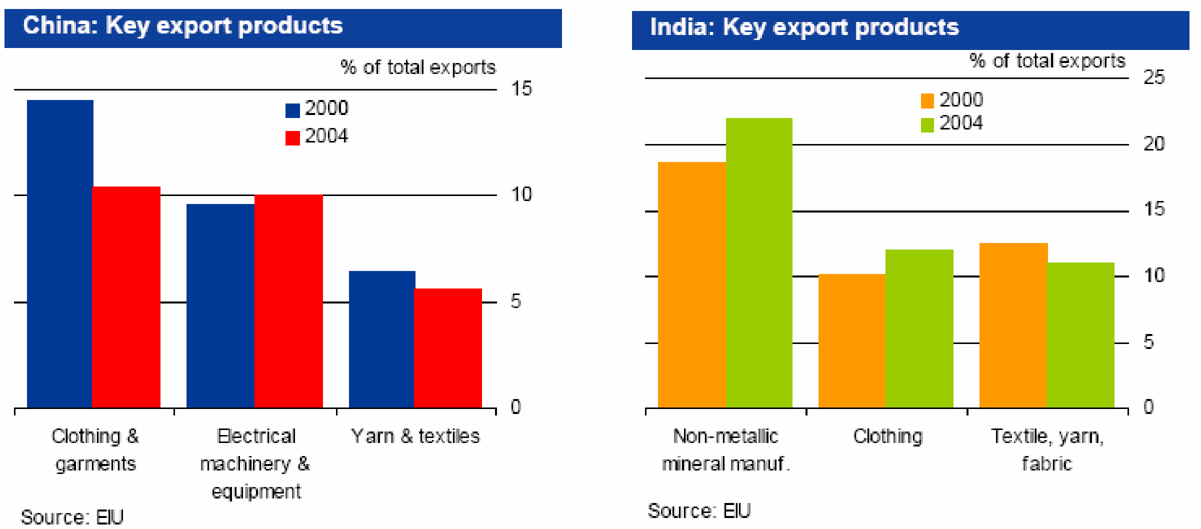

Fig.9: India vs China, Deutsche Bank Report,

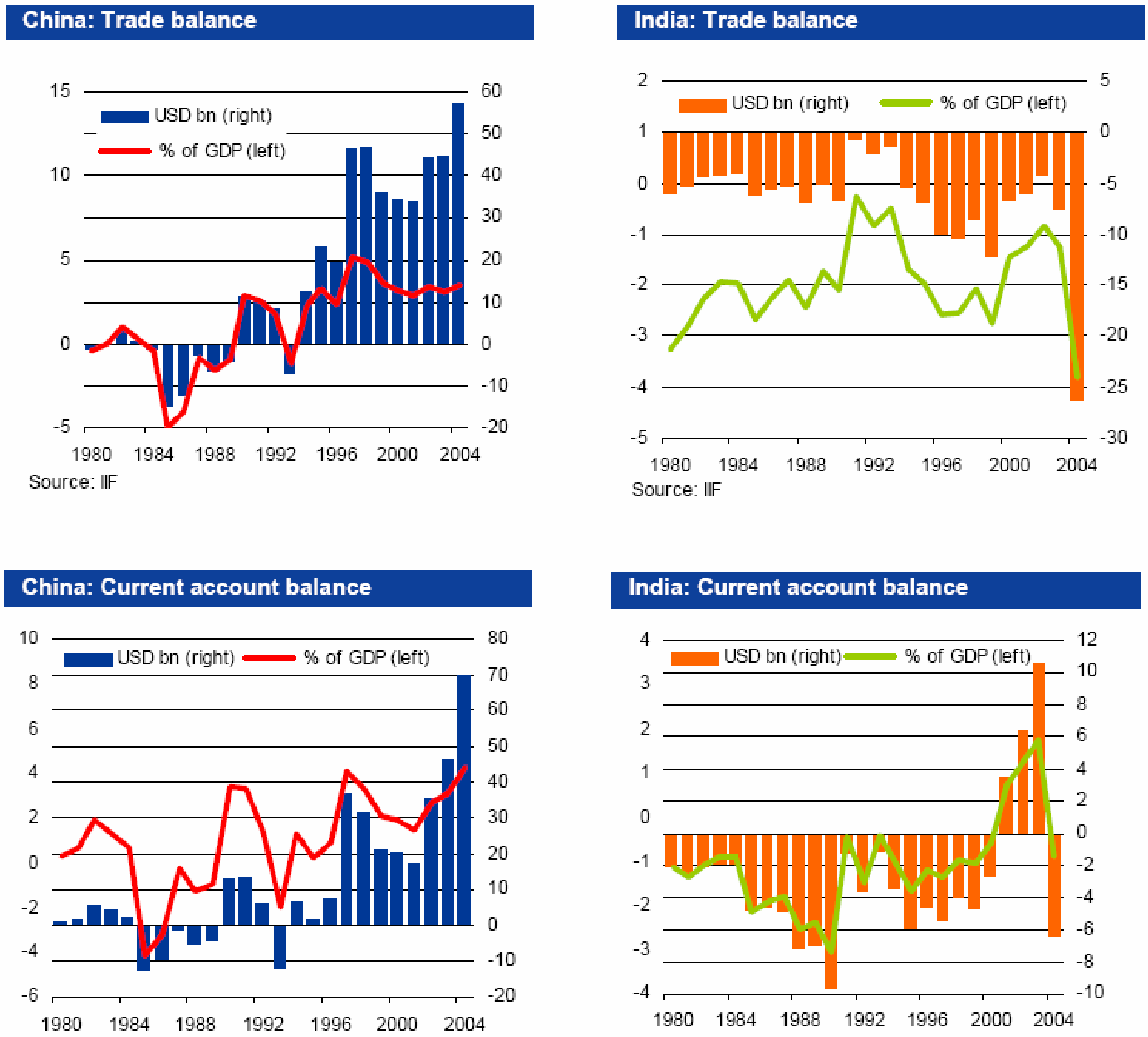

Fig.10: India vs China, Deutsche Bank Report,

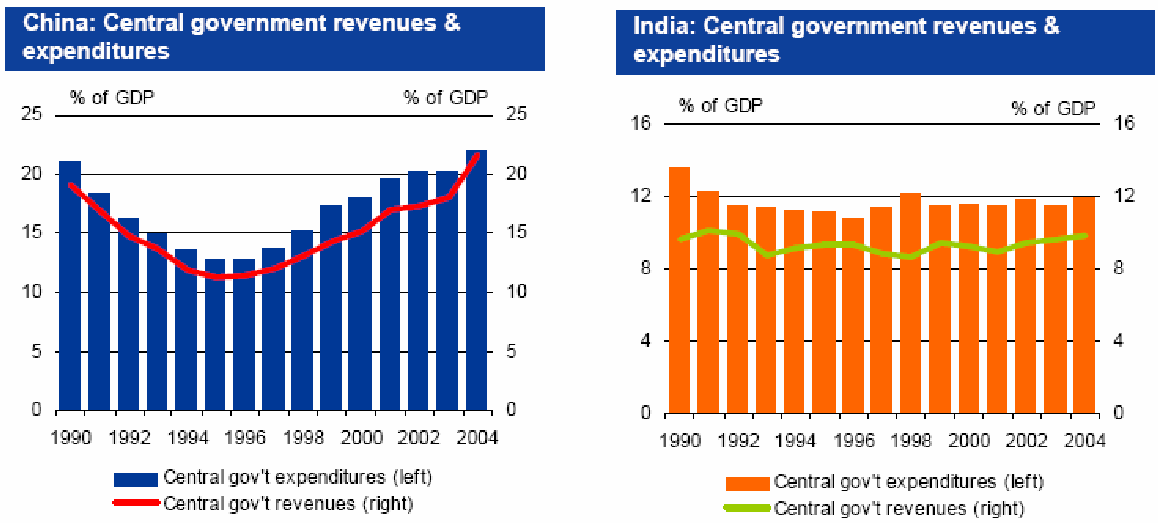

Fig.11: India vs China, Deutsche Bank Report,

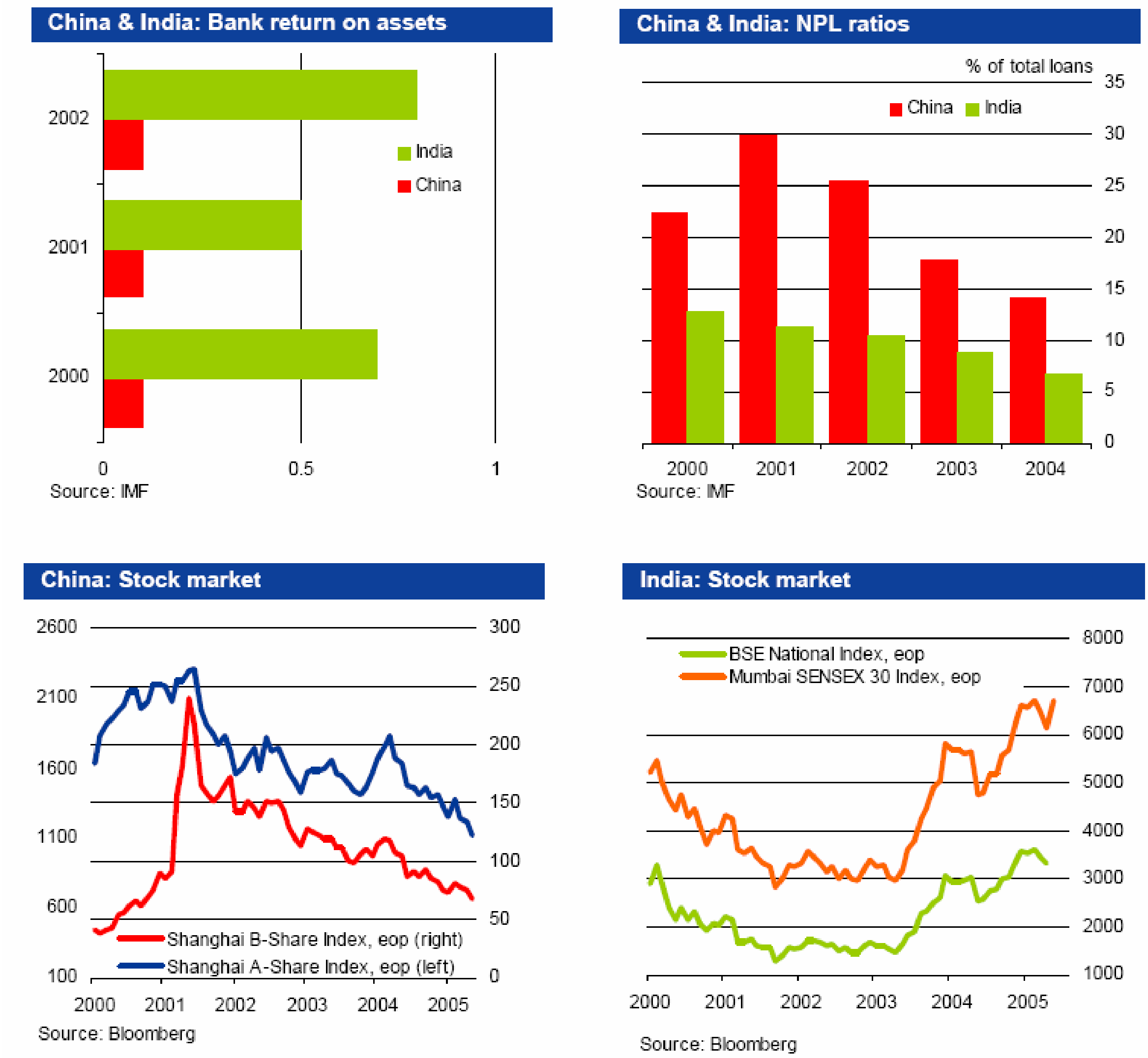

Fig.12: India vs China, Deutsche Bank Report,