

CHAPTER 1

Awakening Giants, Feet of Clay

A Comparative Assessment of the Rise of China and India

Pranab Bardhan



China and India are the economic superstars of the last quarter century, with China in particular showing remarkable annual economic growth. At the same time, both struggle with entrenched structural problems that could hobble their continued growth. This article compares the two economies and the development indicators of each. Then it looks at deeper social and historical issues as well as ongoing political problems that continue to limit each country.

Introduction

The media, particularly the financial press, are all agog over the rise of China and India in the international economy. After a long period of relative stagnation, these two largest countries of the world, containing nearly two-fifths of the world's population, have had their incomes growing at remarkably high rates over the last two decades or so. India was slightly ahead of China in 1870 as well as early 1970 in terms of the level of per capita income at 1990 international prices—see Maddison (2005)—but since then China has surged well ahead of India. India's per capita income growth rate in the last two decades has been nearly 4 percent, while China's has been at least double that rate, and even discounting for some overstatement in the Chinese official rates of growth, the rate of growth in China has been significantly faster. Journalists have referred to the economic reforms and integration of these large economies into the world economy in all kinds of colorful metaphors: giants shaking off their “socialist slumber,” “caged tigers” unshackled, and so on. Newspaper columnists and media pundits have sent breathless reports from Beijing and Bangalore about the imminent and inexorable competition from these two new whiz kids

in our complacent neighborhood in a “flattened,” globalized, playing field. Others have warned about the momentous implications of “3 billion new capitalists,” largely from China and India, redefining the next phase of globalization (see, for example, Friedman 2005; Prestowitz 2005).

While there is much to admire in the changes in these two large economies (which the West has to learn to live with) and to appreciate their great potential in the rest of this century, it is important not to exaggerate their undoubted achievements. There are many pitfalls and roadblocks that they have to overcome in the near future before they can become significant players in the international economic scene on a sustained basis. At this point the hype about the Indian economy seems quite premature, and the risks on the horizon for the Chinese polity (and hence for economic stability) highly underestimated. In this article, after a comparative study of the two economies in terms of broad development indicators, we will explore some deeper social and historical issues that underlie their differential ability to resolve collective action problems in long-run investment and to manage political conflicts, which go beyond the usual simple aggregative comparisons of an authoritarian and a democratic political regime.

Poverty and Underemployment

Both China and India are still desperately poor countries. Of the total of 2.3 billion people in these two countries (counted among the “3 billion new capitalists”), it is sobering to note that nearly 1.5 billion live on less than \$2 a day (at 1993 purchasing power parity) according to World Bank calculations (see Table 1.1). The absolute number of such poor people in the two countries together in 2001 was about the same as in 1981 (with the large decline in China since then mostly neutralized by the significant rise in India). Of course, the lifting of hundreds of millions of people above poverty in China has been historic. Through repeated assertions in the international financial press, it has become generally accepted that this has been accomplished by globalization. Yet from Table 1.1 one cannot ignore the fact that a substantial part of the decline of poverty in China since 1980 already happened by the mid-1980s (maybe largely as a result of the spurt in agricultural growth following decollectivization and land reform), *before* the big strides in foreign trade and investment in the 1990s (Chen and Ravallion 2004b). The assertions about Indian poverty reduction primarily through trade liberalization in the 1990s are even shakier. The Green Revolution in agriculture from the mid-1960s to the mid-1980s helped many farmers and agricultural laborers climb out of poverty. But in the 1990s, the decade of major trade liberalization, the rate of decline in poverty by some aggregative estimates has slowed down.¹ One careful disaggregated study (Topalova, forthcoming) across districts in India suggests that trade liberalization did not affect urban poverty significantly, but agricultural tariff reduction may have (differentially across districts) slowed down the decline in rural poverty. Such results mainly indicate the difficulty of displaced workers in adjusting to new activities and sectors on account of various constraints (for example, in getting credit or information or infrastructural facilities, and labor market rigidities). In any case, India is as yet a minor player in world trade, contributing less than 1 percent of world exports (China’s share is about 6 percent).

What about the hordes of software engineers, call center operators and back room programmers of India supposedly hollowing out white-collar jobs in rich countries? They must be transforming the economy of India, right? While this is no doubt a major event for the Indian economy that makes the Indian elite proud, one should not lose one’s sense of proportion. The total number of workers in all forms of information technology (most broadly defined) jobs and business process outsourcing

Table 1.1 People Below the Poverty Line (Million)

	1981	1987	2001
<i>Poverty line of \$1.08 a day (1993 PPP)</i>			
China	633.7	308.4	211.6
India	382.4	369.8	358.6
<i>Poverty line of \$2.15 a day (1993 PPP)</i>			
China	875.8	730.8	593.6
India	630.0	697.1	826.0

Source: Chen and Ravallion (2004a).

Note: PPP = purchasing power parity.

to India comes to less than a million workers, which is about one quarter of 1 percent of the Indian labor force. And even if the number of such workers were to double or triple in the next 10 years, this will remain only a blip on the screen if you are thinking of affecting the conditions of Indian workers in general. For all its Nobel Prizes and brilliant scholars and professionals, one should not overlook the fact that India is the largest single-country contributor to the pool of illiterate people in the world, and nearly two-thirds of India’s children drop out of school before the eighth grade. (As for quality of education, one dismal indicator noted by Pratham, a large education NGO, is that even in the fifth grade some 35 percent of the children cannot read or write.) To lift these people out of poverty and dead-end menial jobs and make them part of the billions of “new capitalists” (even if that is what they wanted to be) will remain a Herculean task over many decades to come.

Only 7 percent of the 18 to 23 age group enroll in higher education institutions in India (compared to more than 15 percent in China). As a matter of fact, India’s educational inequality is one of the worst in the world. According to World Bank (2006b) estimates, inequality in adult schooling years in the general population² in India is not just much higher than it is in China and other neighboring countries (like Sri Lanka, Thailand, Vietnam and Indonesia), but it is significantly higher than in most Latin American countries and even in some African countries (like Kenya, Tanzania and Ghana). Of course, even a microscopic minority of the highly educated in a large country is sizeable in absolute numbers and can make a splash in the world markets—for example, it has been reported for some time that there are more IT workers in Bangalore now than in Silicon Valley in California. But the sustainability of this for India as a whole is in some doubt, particularly when the majority of higher

education institutions in the country are currently dysfunctional (with the student's university performance as signal of quality increasingly replaced by that in competitive examinations outside), strapped for government funds³ (and yet ways of mobilizing private resources for public institutions remain largely blocked), over-regulated and politicized, and low in research productivity (measured, for example, by top journal citation index) in science and technology. Already talent shortage is reported to have hit India's capital goods industry, and even for the information-related sector it is felt in some quarters that the reservoir of India's technical and managerial skills may prove rather shallow in the near future.⁴

Apart from information-related services (including interactive design software), India is now doing well in international competition in pharmaceuticals and biotech products, and also lately in some auto parts,⁵ vehicles, and some varieties of steel and equipment. But most of these activities are either highly skill-intensive or capital-intensive. For various reasons India has not yet succeeded in the kind of labor-intensive manufacturing jobs that have transformed the economies of China and now Vietnam. Which of these reasons are more important than others is not yet resolved at the analytical level. But most people agree on the problem of inadequate long-term finance for small firms or of infrastructural deficiencies in India (which we will discuss shortly). Many economists and businessmen also point to the debilitating effects of two long-standing policies in India: one relates to the reservation of a large number of products for small-scale industries (more than 600 such products are reserved for this sector even now), and the other to rigid labor laws, neither policies afflicting China⁶ or Vietnam. The former policy of reservation is supposed to have prevented the utilization of economies of scale and rationalization of production in efficient large factories that can compete in world markets (particularly in terms of quality standardization and timely delivery), apart from acting as a built-in disincentive for a successful small firm to expand its operations. The labor laws (particularly Chapter V-B of the Industrial Disputes Act) make it very difficult to sack workers in large firms even when they are inefficient (or when the market in some line of production declines) or to employ short-term contract labor. This discourages new hires by employers, induces capital-intensity in production, and inhibits entry and exit of firms. The adverse effect of these two policies are particularly visible, critics point out, in the textile and garment sector, where Chinese success in recent years has far outstripped that of India (a country with a long history of textiles). Even after the de-reservation of the garment

sector in India from 2001 onwards and the lifting of the MFA quotas in the US and Europe, India's market share in the world has not substantially improved, while China has already established a dominant share.

Others have pointed out that the impact of these two policies are somewhat exaggerated. On account of various (overt and covert) exemptions, large companies have not always been kept outside the products under small-scale reservation. In textiles there are clear economies of scale in spinning, but not so much in weaving, printing and garments. Indian spinning mills, both on cotton and manmade fiber, have acquired international scales. That production scale did not matter in weaving and garments is evident from Japanese and Taiwanese experience where textiles firms were small, but were supported by large trading houses that secured economies of scale in marketing. Chinese textile firms used to be state-owned and large, and there is an alternative hypothesis of the large size of those Chinese firms: China's huge state-owned textile factories may have partly reflected inadequate development of market-based inter-firm relationships that is evident in industrial clusters like Tiruppur in Tamil Nadu. But now many of the textile firms under joint venture and foreign ownership are relatively small.

On labor laws it has been found by Dutta Roy (2004), in one of the very few statistical studies at the industry level in India, that over the period 1960–1961 to 1994–1995 the impact of job security regulations was statistically insignificant in 15 of the 16 industries studied: the rigidities in the adjustment of labor were about the same even before the introduction of stringent job security clauses in the law (the 1976 and 1982 amendments to the Industrial Disputes Act). More recent case studies of labor practices in 10 states and nine industries over 1991–1998 by Deshpande (2004) also suggest that the Indian labor market is not as inflexible as it is made out to be: many firms were able to change employment as they wanted or increase the share of nonpermanent (casual and temporary) workers. Labor laws are implemented at the state level, and it is well known that many state governments look the other way when they are openly violated—Jenkins (2000) has referred to this as “reform by stealth.” Clearly, there has to be a package deal on job security; allowing more flexibility in hiring and firing has to be combined with a reasonable scheme of unemployment compensation or adjustment assistance, from an earmarked fund to which employers as well as employees should contribute. No Indian politician has yet gathered the courage or imagination to come up with such a deal.

In any case it is evident that without a massive expansion of low-skill labor-intensive manufacturing jobs labor-surplus countries like India cannot lift the conditions of its poor workers in the near future. Manufacturing contributes less than a fifth of India's GDP, whereas in China it is more like half. For all its high rate of growth of income, job growth rates in India have not kept up, and, on evidence from National Sample Survey data, may have even declined from about 2.5 percent in 1983–1993 to about 1 percent in the period 1993–2000 (much below the rate of growth of the labor force). Since on an average India's labor force is younger than China's, it is often said that India has a demographic window of opportunity in the next two or three decades before the burden of supporting the aged hits the economy hard, as it will hit China sooner (the median age of the population is about 24 years in India, 33 years in China). But this assumes India can provide good jobs to this surge of young people in the labor force. So far in the last couple of decades the job expansion rates have been, as we have seen, rather bleak. Even in China, which is now being described as the manufacturing workshop of the world (though as yet, in 2004, China's share in the worldwide manufacturing value added is less than 9 percent, compared to Japan's 21 percent and the US' 24 percent), less than one-fifth of its labor force is employed in manufacturing, mining and construction combined (Banister 2005)—(China actually lost tens of millions of manufacturing jobs since the mid-1990s).⁷ Nearly half of the labor force is still in agriculture in China (about 60 percent in India). As per acre productivity growth has stagnated in agriculture in both countries, how and where the hundreds of millions of peasants will be absorbed is a worrisome question in the foreseeable future for both countries. (The problem is likely to be more acute for India as by the midcentury India is expected to have 220 million more workers than China).

Infrastructure

As indicated earlier, a major difference between China and India in terms of preconditions for job creation and general economic growth is in the area of building and maintenance of infrastructure. Let us now elaborate on this. We shall discuss four kinds of infrastructure: (a) physical (like roads, transportation, communication, power, ports, irrigation, etc.); (b) social (particularly health and education); (c) regulatory (in contract enforcement, starting a business, etc.); and (d) financial (particularly the banking sector).

It is now generally agreed that investment in Chinese physical infrastructure in the last two decades has been simply phenomenal compared to India's, the results of which are now obvious for business. The cost of power for manufacturing is reported to be about 35 percent higher in India than in China. A recent study by the accounting firm KPMG has estimated that a company can expect about 17 significant power shutdowns a month in India, whereas in China the corresponding number is about five. The number of days in turnaround time for ships in Mumbai port is several times that in Shanghai. The number of days it takes for Indian textile exports to go from factory gate to a New York retail outlet is about twice that for China and other East Asian countries. The number of telephone (fixed plus mobile) subscribers per 1,000 in China is about six times that in India, and the number of Internet users per 1,000 in China is nearly four times that in India. Glitzy airport terminals and transportation, industrial parks and multilane highways⁸ that dazzle many a visitor to coastal China are nowhere to be found in India. There have been some noticeable improvements in India in roads, civil aviation, ports and telecommunication in recent years. But in electricity, railway and irrigation water populist politics continues to make it very difficult to charge or enforce appropriate user prices, and this has inhibited both private and public investment in new projects. Firms are resorting to private supply of electricity through generators at a high cost; commercial freight rates on the railways, which bear the burden of cross-subsidizing passenger fares, are much higher than in China; heavily subsidized irrigation water is leading to groundwater depletion through over-extraction and to wasteful production of inappropriate crops (like rice in Punjab or sugarcane in Maharashtra). In any case a fiscal deficit of about 10 percent of GDP makes it hard for the Indian government to invest adequately in public infrastructure. The Chinese fiscal deficit is much lower (about 2 percent) and their tax-GDP ratio (at about 20 percent)⁹ much higher, which along with larger household and corporate savings and foreign investment has made possible the massive investment in infrastructure.

In social infrastructure, particularly in education and health, China has been far ahead of India for several decades now. Adult literacy rate is 91 percent (87 percent for women) in China compared to India's 61 percent (48 percent for women). The student-teacher ratio in secondary schools is about 18 in China to India's 34. Infant mortality rate is 30 per 1,000 to India's 65. Of India's under-5 children, as many as 47 percent are underweight compared to China's 10 percent. The percentage of population

with access to improved sanitation facilities is 44 in China, to India's 30. Ninety-seven percent of births in China are attended by skilled health personnel; in India it is 43 percent. Doctors per 1,000 people, low as it is in both countries, is more than three times as many in China. According to WHO estimates for 1998, the burden of infectious and parasitic diseases (measured in terms of DALY's—disability-adjusted life years—per capita) is seven times as high in India compared to China. But China's health advantage is diminishing, particularly in rural areas and remote provinces, on account of the decline in public health services and increased dependence on private financing of health, which the poor can ill afford.¹⁰ The number of doctors per 1,000 people in China may have even declined somewhat between 1990 and 2002. Some experts have noted that the erosion of public health coverage, coupled with the stringent family planning policy, have resulted in some deterioration in the female child mortality situation in China in the last two decades (in the 0 to 6 age group China now has 119 boys per 100 girls, the corresponding number in India is 108). In both countries the overwhelming majority of people does not have health insurance and turn to poorly regulated private health care providers and quacks. In both countries the HIV/AIDS pandemic is spreading fast and has the potential of a catastrophe (by one conservative estimate the expected number of HIV-infected people in India will be about 20 million in 2010 and about 10 million in China). Another health-related issue is environmental pollution. Reflecting its much higher rate of growth, the per capita carbon dioxide emission in China is more than twice that of India. China has 7 of the world's 10 most polluted cities. (It has been recently reported that 400,000 people die prematurely every year in China from diseases linked to air pollution.) Energy use even per unit of GDP is somewhat higher in China.

Both China and India have the crushing legacy of a heavy-handed and corrupt regulatory bureaucracy. But there are significant differences between the two countries in regulatory delays and entry barriers now. According to the World Bank report on *Doing Business in 2006* (2006a) to start a business requires in India 71 days and a cost amounting to 62 percent of the annual per capita income in the country, whereas in China it is 48 days and about 14 percent of per capita income. Registering property requires 67 days and costs about 9 percent of property value in India, whereas in China it is 32 days and 3 percent. Complying with licensing and permit requirements for ongoing operations requires 363 days and 126 percent of per capita income in China; 270 days and 679 percent in India. Time required for exporting

a standardized shipment of goods is 20 days in China and 36 days in India. In enforcing debt contracts it requires 425 days and costs about 43 percent of debt value in India, whereas in China it is 241 days and 26 percent of debt value. On closing an insolvent business it takes about 10 years in India; in China 2.4 years. As we have discussed before, in hiring and firing of employees in large factories Chinese labor markets are more flexible than India's. Tens of millions of employees have been laid off from Chinese state-owned enterprises with a rapidity (20 million reportedly laid off just in 4 years between 1995 and 1999) that is simply breathtaking and politically unthinkable in the Indian context.¹¹

China's financial stock in relation to its GDP is much higher than India's, largely reflecting the former's much higher savings rate, and accordingly cost of capital is significantly lower than in India. But it is mainly in the efficiency of operation of financial infrastructure that India's condition is significantly better than China's. Even though in both countries the state dominates the financial sector and regularly parks its politically inspired debts there, banks in China are burdened with "bad" loans to a much larger extent than in India.¹² Chinese banks are much more beholden to decisions at the political party level, but (with the exception of some small and innovative new banks) the bureaucracy in the Indian banks is often much too "lazy" and risk-averse (particularly with respect to small borrowers) in its lending policies. In both countries corporate bond markets are anaemic and equity markets are not very important as a source of finance. While insider trading and financial scandals have been rampant in both countries, the Indian stock market is now much healthier, better managed and much less mired in government intervention than its Chinese counterpart, and this has had some differential impact in corporate governance in the two countries. The Indian corporate sector provides more opportunities for domestic private entrepreneurial ventures, and in recent years has nurtured private companies that play a more dynamic role in the global innovation chain. (In any case the public sector still accounts for about 38 percent of GDP in China, while in India it is about 24 percent.) The much larger foreign investment in China than in India may be partly due to the weaker domestic capital market in the former, apart from the differences in physical, social and regulatory infrastructure mentioned earlier.

It is often claimed that China falls into the East Asian growth pattern of recent history where a high savings rate enables large amounts of investment to be shoveled into the growth engine, without much of technical progress to show for it.

First of all, such a characterization of East Asian growth is somewhat misleading for two reasons: (a) when imports of new capital goods embody new technology, it is difficult to disentangle the effects of capital accumulation from those of technical progress; and (b) this is nothing special about East Asia, as almost all countries, including the United States through much of the 19th century (Eichengreen 2002) show a similar pattern in the early stages of industrialization. For China in particular, the analysis of decomposition of economic growth shows (Jun 2003; Wang and Yao 2003; Wu 2003) that between 14 and 25 percent (depending on methods of estimation) of total output growth between 1978 and 2000 is attributable to technical progress. Scattered micro-level evidence seems to suggest a more wasteful use of capital, fuel and other production inputs in China than in India. *Business Week* (2005) reports an analysis of financial data from Standard and Poor's CompuStat for 340 publicly quoted companies from 1999 to 2003, which shows that Indian companies mostly outperformed their Chinese counterparts on returns to invested capital.¹³ At the aggregative level the efficiency with which investment has been used is often (crudely) measured by the incremental capital-output ratio (the ratio of investment to increase in GDP). The current measure for China is about 4 (while that for India is about 3). Thus measured, while investment efficiency is somewhat higher in India, the Chinese level is not out of line with most developing countries. In fact there is some evidence that for much of the period of 1978–2000 there has been an upward trend in this efficiency in China, largely reflecting the pre-eminence of rural industrialization there.

One factor that is reported to have influenced the remarkable pace of Chinese rural industrialization in this period largely under nonstate (and until recently, also nonprivate) auspices is the extensive decentralization that was part of the reform in governance. Fiscal decentralization allowed local governments to retain a large part of the profits made in the village and township enterprises (TVE's), which provided incentives for their further development, and competition for mobile resources among local-government-controlled enterprises induced efficiency (Qian and Roland 1998). Both China (since the early 1980s) and India (since the early 1990s) went for serious decentralization, but their nature was quite different. In India this took the form of regular elections at the local level, but there has been as yet very little devolution of real authority and revenue-raising powers to local governments (Chaudhuri, forthcoming; Government of India 2001). The role of elected officials at the village or district level in most parts of the country

is largely to select beneficiaries of projects (like employment or credit programs) funded from above. In many states the resources meant for the poor have been diverted to nontarget groups through collusion between the local powerful people and the bureaucrats. In China, Party functionaries at the local level (non-Party leaders occasionally chosen in village elections were less effective if their agenda differed from that of Party functionaries) had some real authority and some local revenue shares, which motivated them to play a leading role in local business development particularly in the coastal areas. Unlike in the case of Chinese TVE's (up to the end of the 1990s), in India local business development has not usually been in the agenda of local governments.¹⁴

Institutional and Political Issues

The large autonomy and incentives offered to local governments in China sometimes also induced them to engage in regional protectionism, raising barriers to inter-regional trade. This has meant that while China was getting integrated into the international economy, the domestic market was often territorially segmented, and there is some evidence that internal trade barriers may have even increased in the 1990s (Poncet 2004). India also has many restrictions and taxes on internal trade, and, in spite of 55 years of federalism, is far from approaching an internal common market. In both countries market reforms have been associated with increased regional inequality, with the gulf between the backward regions (western provinces in China and the central heartland in India) and the advanced regions increasing, regular doses of redistributive transfers by the central government notwithstanding.

It has been widely noted that in the economic reform process the Chinese leadership has often been able to take bold decisions and implement them relatively quickly and decisively, whereas in India reform has been halting and hesitant, often marked by two steps forward and one step backward. This is usually attributed to the inevitably slow processes of democracy in India. No doubt there is something to this. For example, given the feverish construction boom in China, highways and dams are built over hitherto inhabited or environmentally sensitive land in a relatively short period of time, whereas in India the decisions will be usually engulfed in massive agitations and intricate political negotiations, the outcome of which is usually uncertain and often long-delayed. The exigencies of political mobilization

and electoral cycles often dictate a rather short political time horizon of decisions in India, and short-run populist compromises with vocal interest groups and buyouts of political support with expensive patronage prevail over long-run policy commitments. The limited ability of the Indian political system to bear the short-run costs of beneficial long-run reforms and a continuing erosion of the institutional mechanisms that enable credible commitments to coherent long-term development policies (including investing in the improvement of India's creaking infrastructure) indicate the extreme difficulties of resolving collective action problems that the contending interest groups face in the matter of much of economic reform in India, even though most of these groups have the potential of benefiting from the reform in the long run.

That the superior Chinese ability to resolve collective action problems and take (and stick to) hard decisions in contrast to India is not a matter simply of authoritarianism versus democracy. I believe authoritarianism is neither necessary nor sufficient for credible commitment to long-run policy. That it is not sufficient is obvious from the cases, say, of many African dictators presiding over weak states and vacillating decisions. That it is not necessary is clear from examples of the post-war history of Scandinavian or Japanese democracies where many coordinated macroeconomic adjustment decisions rising above short-run political pressures have been taken (although in the macroeconomic crisis of the last decade or so the famed Japanese ability to coordinate on hard decisions is looking a bit frayed). I think deeper issues than the formal pattern of the political regime are involved here, and some of these deeper factors may simultaneously influence the nature of collective action in economic management and the pattern of political regime in a country.

The literature on collective action in economics and political science suggests¹⁵ that social heterogeneity and economic inequality tend to have a negative effect on coordination and cooperation in matters of collective action. This has a bearing on the India–China comparison both at the micro and aggregative levels (just as the better coordinating ability of the Scandinavians and the Japanese may be linked to their remarkable social homogeneity and economic equality). In terms of ethnicity, language or religion Chinese society is much less heterogeneous than the Indian (some of the social homogeneity is, of course, the artificial outcome of the centuries-old domination of the Han Chinese and their forcible ironing out of ethnic and linguistic differences).¹⁶ Since the revolution the Chinese economy, both rural and urban, has been characterized by far less inequality in assets (land,

financial assets and human capital) and income. Even in the last quarter century, when inequality has been increasing sharply in China (there is, however, some evidence of a turnaround in the rise in income inequality in both rural and urban areas since 1995, but the rural–urban disparity keeps mounting; Khan 2004),¹⁷ by all accounts the levels of asset inequality even now are significantly below those in India. This relative social and economic homogeneity over several decades has facilitated taking coordinated action in long-term policies in China, and made it easier to enlist the support of a broad range of social groups for necessary short-run sacrifices. In particular, the disruptions and hardships of restructuring in the domestic economy, as the cold wind of international competition blew over enterprises and activities nurtured by decades of Party control, were rendered somewhat tolerable by the fact that China has had some kind of a minimum rural safety net, made possible to a large extent by an egalitarian distribution of land cultivation rights that followed the decollectivization of 1978 (the size of land cultivated by a household was assigned in terms of the demographic size of the household).¹⁸ In most parts of India, for the poor there is no similar rural safety net. Table 1.2 shows that Indian wealth distribution was much more unequal than that in China. In addition, the more severe educational inequality in India, which we have noted before, makes the absorption of shocks in the industrial labor market more difficult (to the extent that education and training provide some means of flexibility in retraining and redeployment). So the resistance to the competitive process that market reform entails is that much stiffer in India.

But China is far behind India in the ability to politically manage conflicts. I was in Beijing the day of the Tiananmen killings and had visited the Square two days before. The scale of (unarmed) demonstration I saw there was something that Indian authorities routinely face every day in several parts of the country. Large societies always generate many kinds of conflict, and an extremely heterogeneous society like India with a great deal of economic disparities and social inequalities is always in some kind of turmoil somewhere. Yet it is remarkable how over the last half century or so the Indian political system has been able to douse the fires and contain many of the conflicts,¹⁹ starting with the language riots in the 1950s, to the armed rebellions of militant peasants or regional separatists, to the sporadic outbreaks of inter-caste and inter-community violence that continue to this day. Defying many dire predictions of the Indian state breaking up, the system has by and large managed conflicts in some ways even better than

Table 1.2 Gini Coefficients of Inequality in Wealth Distribution

	<i>Rural</i>	<i>Urban</i>
China (1995)	0.33	0.52
China (2002)	0.39	0.47
India (1991)	0.62	0.68
India (2002)	0.63	0.66

Source: For China, Li et al. (2005); for India, author's estimate from National Sample Survey data.

a far less heterogeneous and less poor Europe has fared over, say, the last 200 years.

The standard comment is, of course, that democracy acts as a safety valve for smoldering tensions, and this is no doubt true. But again I think there are some deeper forces involved. The same heterogeneity of socioeconomic groups that has hindered collective action in the matter of economic management of long-term policies and investment in India may have also strengthened the demand for democratic rules in inter-group negotiations and bargaining, thereby contributing to the continued survival of democratic processes against all odds.²⁰ Thus, without minimizing the importance of a certain tradition of tolerance and pluralism in the Indian political culture and legal system, and a degree of continuing commitment on the part of India's political and military officials, one can suggest that the general persistence of democracy and the form it has taken has also something to do with the political exigencies of bargaining within a divided ruling class, and the constant need to absorb dissent and co-opt potential rebel leaders and newly emergent groups.

For many centuries Chinese high culture, language and political and historiographical tradition have not given much scope to pluralism and diversity, and a centralizing and authoritarian Communist Party has carried on with this tradition. Jenner (1992) in his provocative book analyzing the link between the "history of tyranny" and the "tyranny of history" in China, describes one of the most basic tenets of Chinese civilization as "that uniformity is inherently desirable, that conflict is bad, that there should be only one empire, one culture, one script . . . one tradition," and that "what is local and different is treated (by the high culture) as deviant." Nurtured in this tradition, there is a certain preoccupation with order and stability in China (not just in the Party) and a quickness to brand dissenting movements and local autonomy efforts as seditious, and it is in this context that one sees some dark clouds on the horizon for China's future. Not merely has the fast pace of economic growth created

many inequalities and job disruptions and dislocations, coastal China is moving far ahead of the inland provinces, as we have noted before. Those left behind are bound to get restive, particularly as fiscal decentralization has meant that the lagging regions have to live with large cuts in community services. These tensions of fiscal federalism are increasing in India too. The better-performing state governments are now openly protesting large redistributive transfers to laggard states ordained by the Finance Commission. In the Indian democratic system, however, some of these laggard populous states (like UP or Bihar) send a very large number of members to the Parliament, and the (shaky) coalition governments at the center can ill afford to alienate them. But in China the hard budget constraint bites and the laggard regions were quite often left to fend for themselves.²¹ This led local officials to impose arbitrary levies on farmers; on top of this, official corruption and increasingly frequent seizures of land for more profitable urban or industrial use (it is reported that at least 40 million farmers have lost their land to the demands of modernization and development) have inflamed many in the countryside. All this, in addition to the increased incidence of industrial dumping that poisons streams and farmland, and, of course, the large numbers of workers laid off from failing state enterprises in the rust-belt provinces (where they sometimes see the rampant asset-stripping by managers), has explosive potential for the future. (From police records it already appears that the number of recorded incidents of social unrest multiplied more than seven-fold in the 10 years since 1994, though most of these incidents are as yet largely localized.)

Of course, the leadership is trying campaigns and exhortations to paper over the cracks, with nationalism fast replacing socialism as the necessary social glue, apart from some genuine attempts at improvements in benefits for laid-off workers, fiscal transfers to backward regions, pollution abatement, and reduction in the disqualifying effects of subsidies and taxes.²² The Party is also slowly (and intermittently) relaxing some of its rigid controls. Some people (wistfully) suggest that in many ways mainland China in recent decades may be in effect following in the footsteps of Taiwan. Taiwan also had a highly disciplined authoritarian (organized on similar quasi-Leninist lines) ruling party—the Kuomintang—presiding over a capitalist transformation, with party committees playing an important role in economic management of enterprises. Taiwan also had a very large state-owned sector, and instead of drastic large-scale privatization of this sector, they allowed the non-state sector (often in small industries) to grow and gradually

eclipse the importance of the state sector. As the economy gathered momentum in high growth the prospering middle classes started demanding political and civic rights and gradually won them, until Taiwan became a full-scale democracy in recent years. Things are, however, unlikely to be as smooth in this transition process in mainland China, and the authorities' preoccupation with maintaining order and stability, and the Party's monopoly of power may make them overreact to difficult situations, sometimes with disastrous consequences. Some others predict that even if China manages a soft landing into some form of quasi-democracy, it will be of the corrupt oligarchic kind under a predominant party like the one that prevailed in Mexico under the Partido Revolucionario Institucional (PRI) for many decades.

Conclusion

Both China and India have made remarkable economic progress in the last quarter century, but both have severe structural and institutional problems that will hobble them for many years to come, and accounts of their blowing away jobs and incomes from the rest of the world are often patently exaggerated. Such exaggeration, in an echo chamber of the "giant sucking sound," only helps the protectionist lobbies in the other countries, and it is music to the ears of the preening ultra-nationalists in China and India. Between the two countries, Chinese economic performance has been on balance much better than that of India, although India's domestic private enterprise in industry and services has been arguably more robust and autonomous. In this article I have tried to probe underneath the contrasting performances of these two vast countries and offer some broad speculative hypotheses. Economic reform and commitment to long-run policies require hard collective decisions (and follow-up collective actions), and I have tried to trace the relative difficulty for India to take these decisions and actions in its more heterogeneous society and conflict-ridden polity. But Indian heterogeneity and pluralism have also provided the basis for a better ability to politically manage conflicts, which I am not sure China's overarching homogenizing bureaucratic state has so far acquired, even though this ability is likely to be sorely needed in the future years of increasing conflicts, inevitable in a fast-growing, internationally integrated economy with mounting disparities and tensions. I have suggested that this requires looking at deeper social and historical forces than simply referring to an aggregative comparison of an authoritarian and a democratic political regime, which is the standard fare in China-India comparative studies.

Questions

1. What are the factors driving the growth of China and of India? How do they differ?
2. Given the information in the article, do you believe this growth will continue? Are the challenges greater for India or China? Why?

Notes

1. For alternative estimates and discussion on this phenomenon in rural India, see Kijima and Lanjouw (2005).
2. The Gini coefficient of inequality in years of schooling was 0.56 for India in 1998-2000; for China in 2000, it was 0.37.
3. In contrast, state financing for higher education more than doubled just in 5 years between 1998 and 2003 in China.
4. According to the McKinsey Global Institute, talent shortage is looming in both China and India. China is producing more engineering graduates than India, but the proportion of them who are, according to them, "suitable" for the professional jobs particularly at the international standard is somewhat higher in India than in China. In 2003 the total number of suitable young engineers (excluding civil and agricultural engineers, but including those with IT and computer science degrees) was 160,000 in China and 130,000 in India.
5. Sutton (2004), in his study of the auto component supply chain in China and India, finds that the performance of car seat and exhaust makers, as well as the performance of the general run of first-tier suppliers to the new car makers in both countries, has reached levels that are at, or close to, international best practice.
6. One major restriction in the Chinese labor market has been that a large part of the floating migrant workers (estimated to be about 120 million in total) did not have housing registration (hukou), a system that has only recently been discontinued; they also face other kinds of discrimination.
7. In India the corresponding fraction of the labor force is about one-seventh.
8. China, that hardly had any superhighways in 1990, has built 30,000 km of it since then (making the system the second longest in the world). In 2004 India spent \$2 billion on its road network; China spent \$30 billion.
9. Just before the fiscal reform of 1994, the Chinese fiscal revenue as share of GDP was more similar to what India's is now.
10. Even the state enterprises that remain in business have largely shed their social protection functions for their employees (including provision of housing, daycare, hospitals and schools).
11. See the estimate of Banister (2005), after adjusting for statistical anomalies in official data.
12. Since 2002 asset reconstruction companies have disposed of a large fraction of the bad loans in China. The Chinese government has poured large sums of money to back these companies and to spruce up the four major state-owned banks for partial sales of shares to foreign banks. The credit ratings for Chinese banks are sometimes better than for Indian banks simply because of this greater ability and willingness of the Chinese government to provide substantial capital infusions.
13. Some unpublished work by Chang-Tai Hsieh and Peter Klenow using Chinese and Indian manufacturing censuses finds that

even though productivity at the four-digit industry level is low in both countries, China has a longer distance to cover.

14. There are some exceptions in Kerala. Consider, for instance, the Manjeri municipality in the relatively backward district of Malappuram in north Kerala. In collaboration with some social groups and bankers, municipal authorities succeeded in converting it into a booming hosiery manufacturing center, after developing the necessary skills at the local level and the finance.

15. For a review of the literature, see Baland and Platteau (2003).

16. The sinologist and historian Jenner (1992) writes on this issue:

Nowhere has the homogenizing effect been more successful than in creating the impression that the Han Chinese themselves are a single ethnic group, despite the mutual incomprehensibility of many of their mother tongues and the ancient hostility between such Han Chinese nationalities as the Cantonese and the Hakkas. While the occupation of Tibet and East Turkestan has failed to persuade most Tibetans and Uighurs that they are Chinese, so that they can be kept in the empire only by force, historical myth-making has so far been remarkably effective, not just in inventing a single Han Chinese ethnicity, but also—and this is a far bigger triumph—in winning acceptance for it.

17. The Gini coefficient of income inequality in China in 2002 is estimated there to be about 0.45 (the same as it was in 1995). From the Market Information Survey of Households data of the National Council of Applied Economic Research, Lal et al. (2001) suggest that the Gini coefficient of income inequality in India is about 0.41 in 1997–98. According to Li et al. (2005), the Gini coefficient of wealth inequality in China increased from 0.40 in 1995 to 0.55 in 2002.

18. Even after some reassignments of landholdings, we can see from Khan (2004) that the Gini coefficient of inequality of per capita landholdings in China in both 1988 and 2002 were about 0.49. For India the data from the 2001 landholdings survey are not yet available, but already in 1991 the Gini coefficient of inequality was about 0.64.

19. Kashmir and the north-east are, however, two areas where the Indian state has repeatedly failed in accommodation and containment.

20. For an elaboration of this argument see Bardhan (1984[1998]).

21. An econometric estimate by Jin et al. (2005) on the basis of a panel dataset from 29 provinces in China suggests that while in the period 1970–1979 the central government extracted about 83 percent of any increase provincial revenue, in the period 1982–1991, with the implementation of the “fiscal contracting system” (*caizheng chengbao zhi*), the percentage fell dramatically to about 25 percent, and to that extent the central government’s capacity to transfer from high-revenue to low-revenue provinces declined. Since the 1994 fiscal reform, however, transfers to laggard provinces have increased substantially.

22. The agricultural taxes and levies are to be eliminated nationwide by 2006.

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