# Export-oriented Growth in India and China:

# Is the World Big Enough?

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## A shared legacy

India and China entered the post-Imperialist era sharing the world's greatest development problems and most of the world's poor people. For the first three postwar decades, both succeeded in raising substantially average output and incomes, while neither was close to the developing world's top performers. Both succeeded in mobilising fairly high savings for investment—rather more deliberately and effectively in China although China's central planning system squandered much of the value of its investment. China grew faster on average than India, with massive swings in policy and performance with the vicissitudes of its centralised politics.

Alongside huge differences in state ideology and policymaking processes, there were many similarities in economic resources, structure and strategy between the two giants. Most basic was their shared abundance of labour relative to other resources necessary for development—land (or natural resources), and capital. This suggested the value of economic strategies focused on production of labour-intensive goods, exporting a proportion to support imports of the technology, capital goods and some natural resource-based products which were necessary for development.

Both India and China turned away from strategies based on exports of goods and services that used intensively their abundant labour and away from integration into an international economy. They both turned towards autarchy, and strong reliance on investment in heavy industry. The export shares of production in both fell markedly, against the world trend, and radically differently from the world's most successful developing countries. Along the way, both suppressed agriculture, holding relative prices of farm products well below world levels. These awkward outcomes required an effusion of regulation of all aspects of economic life. Bureaucratic decision, rather than value in a market, determined how resources were allocated amongst their many claimants.

It is not obvious at first glance why China and India would have come to adopt such similar economic strategy, so far removed from that suggested by their underdevelopment and their resource endowments.

China absorbed a development strategy that favoured autarchy, the domination of decision-making on resource allocation by a central bureaucracy, and the encouragement of heavy at the expense of light industry and agriculture, from Stalin, Lenin and Marx via the Soviet Union. The Soviet model and advice on its application were at hand when the Chinese Communist Party won power in Beijing without a settled approach to national economic policy. The internationally-oriented and market-oriented alternatives were, at the same time, pushed beyond reach by the Korean War and the establishment of a version of the Cold War in East Asia.

India, too, was influenced by the Soviet model of central planning, especially after the South Asian variant of the Cold War saw India closely aligned with Moscow in strategic affairs from the mid-1960s. The die had already been cast in the very different setting of a parliamentary democracy, by Indian leaders' empathy with the postwar sympathy for 'planning' in social democratic thinking in Europe (and the Antipodes), and in particular with British Fabian socialism.

Perhaps of more fundamental importance, India and China were big enough for ambitious dreams. Dreams of drawing their economies' needs from within their own wide boundaries. Dreams of quickly joining the rich and powerful countries of the North Atlantic in the breadth and sophistication of their industrial capacity. Their size suggested to their respective leaderships a capacity to support a large military backed by related industry; and their pride as large countries pressed for the realisation of this possibility. In all of this they were supported by ambivalence about inward-looking economic strategies in the West, before the lessons of experience elsewhere in East Asia had pointed to a more productive course.

**The origins of reform**

Central planning, purposeless regulation and protection can boost, or at least not greatly damage, measured and perceived economic development for a while. They spur investment in new activities, which lifts growth while the investment is occurring, however little it eventually adds to the value of national output. The first industries selected for artificial promotion may be less inappropriate to an economy's resource endowments than those that appear in the later stages of an inward-looking strategy. And some of the damage that economically purposeless regulation imposes on economic performance occurs through social and political processes that emerge gradually over time. Notable amongst these slow poisons is the expenditure of more and more managerial effort on working and second-guessing a political decision-making process—Anne Krueger's political economy of the rent-seeking society (Krueger 1974).

Some of the initial reforms by China's new communist government after 1949 spurred economic activity—notably the establishment of domestic peace after a century of more or less incessant disorder, the first land reforms and their effects on peasant incentives, and the provision of a range of public goods the earlier absence of which had held back production. Both economies seemed to perform well through the early and mid-1950s, and China better, as both demonstrated that it was possible to raise output per head and living standards in these huge and populous economies.

China went faster into an inward-looking strategy favouring heavy industry than India. There were weaker constraints on large, sudden policy shifts in China's Leninist political system than in India's rambling democracy. Encouraged unrealistically by the apparent success of early ventures into collectivisation and central planning, Mao Zedong launched the Great Leap Forward in the late 1950s to span quickly the gap between economic development and structure in China and in the world's most advanced economies. Steel and other heavy industries were big in the advanced economies, so they would be big soon in China. This lurch in economic strategy yielded an early harvest of tragedy, a legacy of bitterness within the Chinese leadership, and cast a shadow of policy instability and uncertainty through the chaos of the cultural revolution (1966–76) into the early years of the era of economic reform.

China seems to have had a greater impetus to growth than India—reflected in a higher savings rate when stability had been established, and higher and more widespread investment in education when political conditions were conducive to it.

By the 1970s, there was realisation in both China and India that economic performance was not all that it could be. Other economies, especially in East Asia, seen by Chinese and Indians as having poorer prospects, seemed to be doing better. This was affecting international standing and perceptions of security, and if there were no change in trend, the giants' relative positions might deteriorate to an extent that threatened the legitimacy of ruling élites. As Bhagwati (1993:83) has said about India

> The worst psychological state to be in is to have a superiority complex and an inferior status. This incongruity cried out to be fixed: reforms were increasingly seen to be the only answer.

Discomfort about the Bhagwatian incongruity came earlier in China, for several reasons. The disruption to economic processes through the cultural revolution (1966–76) increased the reality and perception of underperformance. It created a sense of political crisis and disillusionment with the established political framework that made radical economic reform possible—a possibility expanded by the death of Mao Zedong in 1976. China's perception of its own underperformance was heightened by the success of near neighbours—Japan and Korea, and most pointedly the Chinese economies of Hong Kong and Taiwan which had commenced their swift movement to the average output levels and living standards of developed countries. Most telling of all, the ideological and political breach and clash with the Soviet Union liberated Chinese communist thought from the source of its original commitment to central planning, and the military clashes on the Heilongjiang in 1969 heightened awareness of the strategic consequences of continued economic underperformance.

China's Leninist political system allowed large and swift change in policy and strategy. After several years of incoherent policy, in December 1978 Deng Xiaoping succeeded in winning support in the Politburo for decisive commitment to open the Chinese economy to the outside world, and to accept a larger role for markets in domestic resource allocation. There was no blueprint for reform of economic strategy; the thinking of the Chinese leadership had not developed so far. But there was a clear sense of the direction of necessary change, and willingness to experiment with a wide range of new policies and institutional arrangements in that direction.

The Chinese economy responded dramatically to reform. The most productive of the early reform steps were in agriculture: the acceptance that the household rather than the people's commune should be the basic unit of agricultural production; the acceptance of sale in markets for a large and expanding proportion of agricultural output; and, most powerfully of all in the early stages, the partial removal of the old suppression of agriculture, with the lifting of prices towards international levels.

The huge response of rural China to the reformed incentives cemented political support for reform. Farm output grew prodigiously and farm incomes more rapidly still. A high proportion of the increase in income was saved; and the new policies allowed the savings to be reinvested profitably in rural areas in township and village industries, rapidly expanding off-farm employment and incomes.

There was large response, too, to the open policies, eased and magnified by participation of a large overseas Chinese business community, accustomed to linking abundant labour to world markets for labour-intensive products elsewhere in East Asia. The export trade share of GDP as conventionally measured has more than trebled in the reform period to over 20 per cent; primary products were replaced by labour-intensive manufactures as the main exports; and, dramatically in the 1990s, direct foreign investment became an important source of capital formation and technological up-grading.

Output increased by around 9 per cent per annum on average, and output per head at a rate that more than doubles average incomes each decade.

China's success increased pressures for reform in India. The worst psychological status of all is to have a superiority complex, and an inferior status, and to have a natural rival for superior status doing much better. There was also a strategic edge to the underlying competition with China: left uncorrected, the divergence between Chinese and Indian growth performance would lead eventually to a large shift in relative military weight.

Thus was the scene set for reform in India. The collapse of the former Soviet Union, and the economic model and the trade opportunities that it provided, were psychologically liberating. The immediate impetus was provided by the severe economic crisis in 1991—balance of payments weakness and stagnation in output that no longer seemed amenable to minor policy adjustment (Shand and Kalirajan 1994).

The reforms initiated in 1991 in India have been pursued more or less consistently through all the pressures of a Federal and democratic constitution. The lesser urgency of the background conditions and the different political framework have contributed to less radical and less decisive action on reform in India. But even in this, the similarities are at least as impressive as the differences: reform is gradual in both China and India, with both eschewing the 'big bang' and the shock treatment that have sometimes been favoured by advisers to reforming governments in Eastern Europe and the CIS.

**Starting points**

Today's standard national and economic data show India as having had about the same per capita incomes as China when the latter was entering the reform period—US$240 and US$290 in 1980 (World Bank 1982). These data are inconsistent with earlier data published by the World Bank, which showed much higher levels for China (Garnaut and Ma, 1993). Given the large divergence between Chinese and Indian reported growth rates in the Chinese reform period, it is not possible to reconcile recent years' official data (US$300 and US$490 in 1993: World Bank 1995), with the official data for earlier years.

It is important beyond the satisfaction of curiosity to understand the relative incomes of India and China now, and at the starting points of their reforms. Income levels at the starting point tell us a great deal about the likely evolution of comparative advantage, industrial structure and export and import specialisation in the process of opening to the international economy and of sustained strong growth. They can tell us a great deal about whether India and China are going to compete head to head in the same segments of world markets, or offer each other as many opportunities through complementarity as they block through direct competition in niches in the international markets for labour-intensive goods.

Garnaut, Ma and Huang (forthcoming) have sought guidance in comparison of relative levels of output and incomes by comparing directly per capita consumption or utilisation of a number of goods that are important in expenditure in most developing countries, and in which there is a regular relationship between incomes and consumption in many countries. On a number of these comparisons, the Chinese data fit best with developing countries generally if Chinese official per capita as reported in the early 1990s is multiplied by about 3. India, too, seems to have higher consumption than what is common in developing countries of similar reported per capita income levels, although the divergence is much less than in China. A number of pieces of information seem to place China's per capita income at the commencement of its reforms in 1978 somewhere close to India's in the early 1990s, at the commencement of its own reforms.

Table 1 shows that the demographic characteristics of China in 1975 suggested a per capita similar to or income somewhat higher than India in 1990.

Table 1 **Comparative demographic indicators for India and China**

| | **India** | | **China** | |
|---|---|---|---|---|
| | **1975** | **1990** | **1975** | **1990** |
| Total fertility rate | 5.7 | 3.8 | 2.8 | 2.1 |
| Population growth rate | 2.2 | 2.0 | 1.8 | 1.3 |
| Crude death rate | 15 | 11 | 5 | 7 |
| Life expectancy at birth | 50 | 59 | 64 | 69 |
| Males | .. | 58.7 | .. | 68.4 |
| Females | .. | 59.3 | .. | 71.8 |
| Adult literacy rate | 36 | 48 | 66 | 63 |
| Females | .. | 34 | .. | 62 |

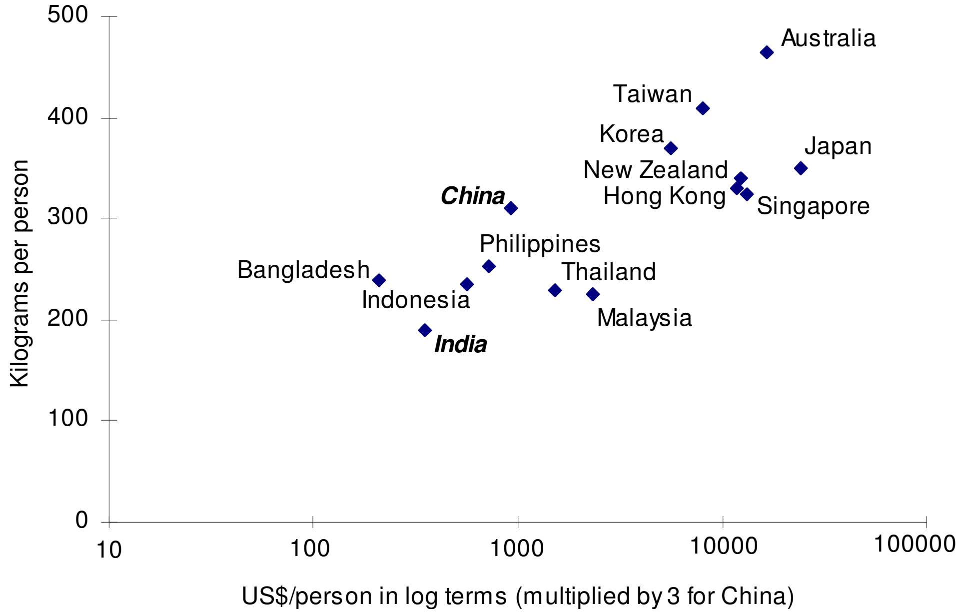
**Sources:** World Bank, *World Tables 1994*; UNDP, *Human Development Report*, 1992; World Bank, *World Development Report 1978*.

Per capita total consumption of grain, including indirect consumption in meat, dairy products, alcohol and other foods, tends to rise with per capita income up to high income levels. Figure 1 graphs the relationship for a number of economies in South Asia and the Western Pacific. If we multiply China's official per capita income by three, both China and India consume about the amounts of 'grain equivalent' that one would expect from their per capita incomes. If anything, India is on the low and China on the high side of the trend line. The same conclusions can be drawn if the comparator is broadened to include major world regions outside China and the Western Pacific (Figure 2).

China, however, would be an extreme outlier in Figures 1 and 2 if it were attributed with the per capita income published by the World Bank.

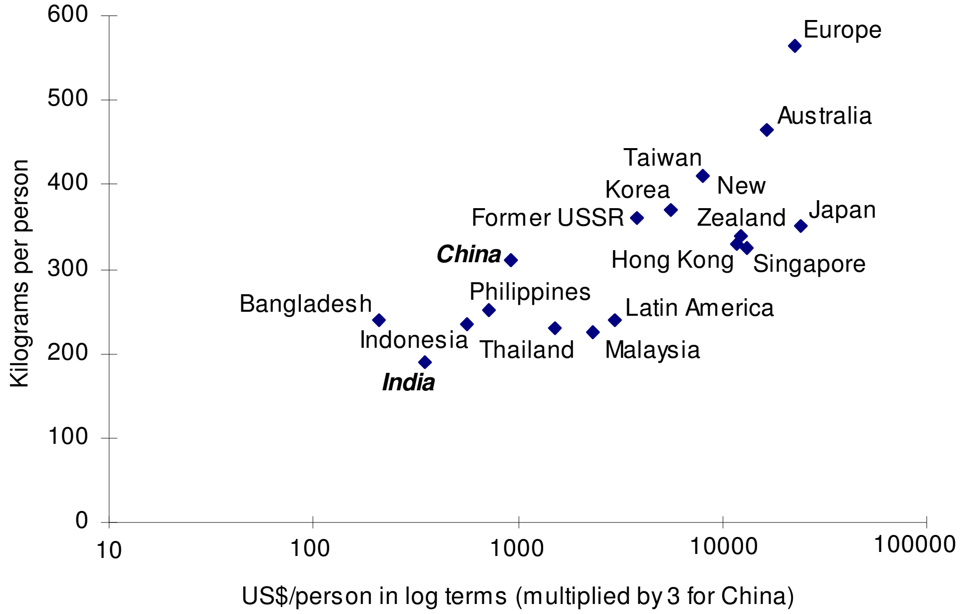
Figures 3 and 4 tell a similar story. India's steel and natural fibre consumption is around what would be expected from India's per capita income—if anything, it is a bit lower than might be expected. China's per capita consumption of steel and natural fibre is around the level that would be expected for a country with three times its officially recorded income, or a bit higher still.

Figure 1 **Consumption of grain equivalent and income in Asia, 1990**



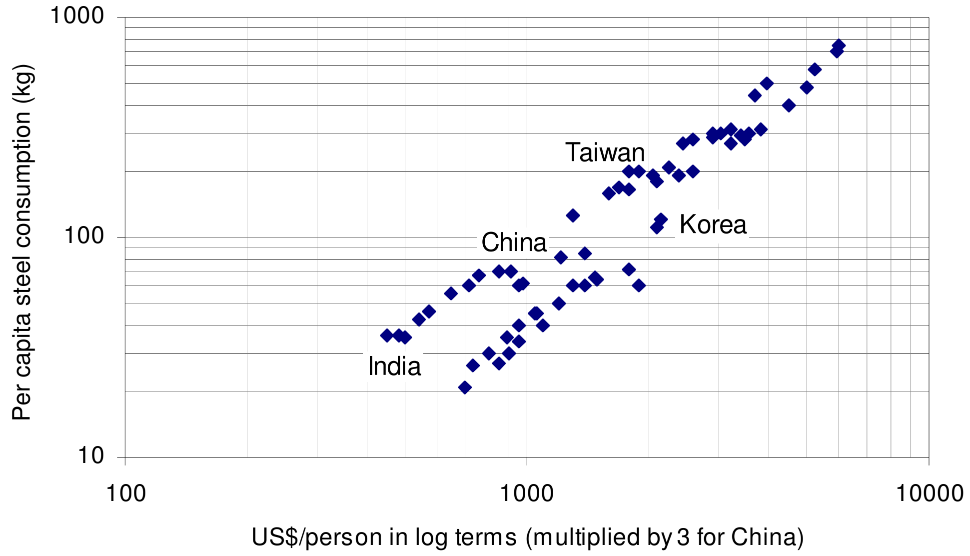

**Note**: Total consumption in this figure include the apparent consumption of grain in meat imports converted into grain using conversion rate reported in Garnaut and Ma (1992).
**Source:** Garnaut, Ma Guonan and Huang Yiping, forthcoming.

Figure 2 **Consumption of grain equivalent and income in Asian economies and major world regions, 1990**



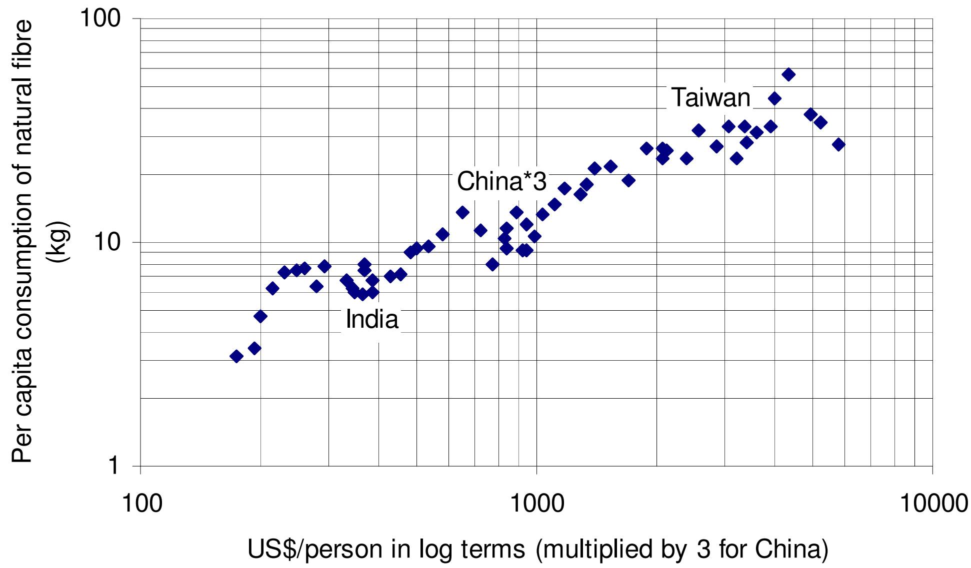

**Note**: The per capita total grain consumption in the United States and Canada was 895 kg in 1990 while average GNP per capita was US$21500.
**Source:** Garnaut, Ma Guonan and Huang Yiping, forthcoming.

Figure 3 **Per capita income and steel consumption in China, Taiwan, Korea, India and many countries**



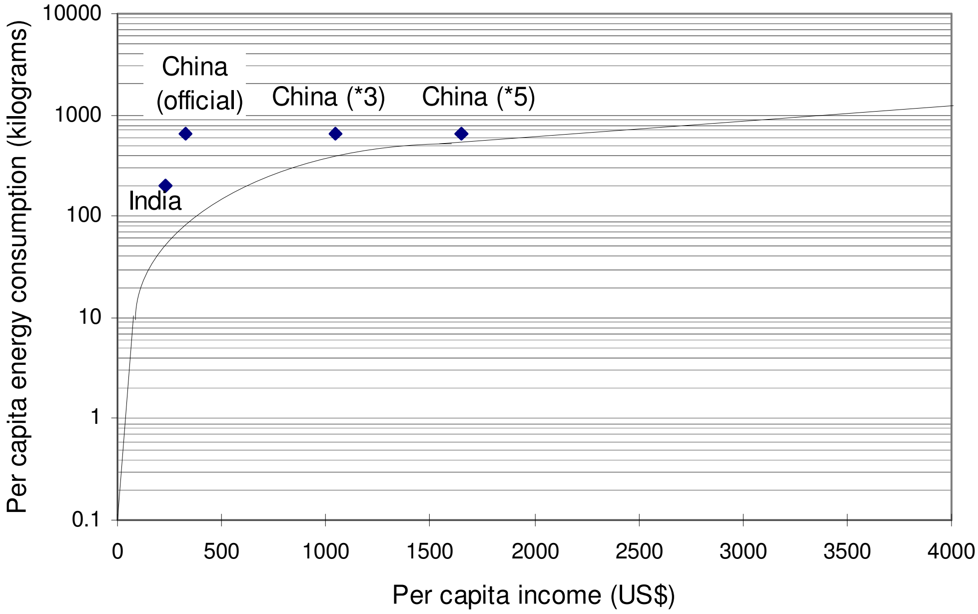

**Source:** Garnaut, Ma Guonan and Huang Yiping, forthcoming.

Figure 4 **Per capita income and natural fibre consumption, China, Taiwan, India and many countries**




**Source:** Garnaut, Ma Guonan and Huang Yiping, forthcoming.

Figure 5 **Per capita income and natural fibre consumption, China, Taiwan, and India**




**Note:** The curve describes the trend relationship for many countries (Garnaut, Ma and Huang 1996)
**Source:** Garnaut, Ma Guonan and Huang Yiping, forthcoming.

Both India and China consume considerably more energy than one would expect from their reported incomes (adjusted in the case of China). This reflects both economies' artificial encouragement of heavy industry with its intensive use of energy—characteristics that are removed only slowly through successful reform.

Comparison of India's with China's per capita output and living standards is not a simple matter, and a number of different cases could be made. It is a matter for further research. On the evidence currently available, the balance of evidence points to Indian income levels in the early 1990s being similar to those in China on the eve of reform in the late 1970s.

Comparison of India and China is further complicated by huge regional variations within both. This is not surprising, given their vast geographic extent, the poor quality and high cost of transport and communications—reinforced by official restrictions on mobility in China, and by ethnic, linguistic and religious difference in India. Average incomes in Madhya Pradesh are only about 20 per cent of those in the Punjab—one about half and one more than double the national average. In China, ignoring the city-provinces of Beijing, Shanghai and Tianjin, average incomes in Guizhou are only about 25 per cent of those in Guangdong.

After making the major corrections required to Chinese income data, average incomes in the richest provinces of India exceed those in poor provinces of China.

**Comparative advantage and export specialisation**

On a world scale, both India and China have a large endowment of labour relative to both capital (including human capital) and natural resources. Their comparative advantage is in labour-intensive goods and services. This emerges in patterns of exports if protection and alternative forms of artificial support for other industries are removed.

India's population density is high on a world scale—283 persons per square kilometre compared with 41 in the world as a whole. It exceeds that of China (121 per square kilometre) by a wide margin. This suggests a somewhat stronger comparative disadvantage in natural resource-based products. It also suggests that India is likely to become a net importer of these goods at an earlier stage of internationally-oriented economic growth than China, and, that net imports are likely to be higher at higher levels of economic development.

But much more of the Indian land mass is economically arable than is that of China or the world as a whole. India's endowment of arable land per person (0.002 square kilometres) is very much larger than China (0.0008) with its vast arid and mountainous inland. An internationally-oriented India is likely to remain a net exporter of agricultural produce into much higher income levels than China, and to be a less intensive importer of agricultural produce at later stages of economic development.

Neither India nor China is an integrated economy with a more or less uniform ratio of population to natural resources and capital. Both have pockets of excellence, of real comparative advantage in technologically sophisticated production, based on parts of the education system and of capital-intensive industry that were once favoured artificially.

These simple facts carry some large implications. The removal of the suppression of agriculture by raising food prices to international levels, which was so important to enhancing growth in rural production and in cementing the political base for reform in China, can also provide powerful support for reform in India.

In China, where average food prices have reached international levels only in the mid-1990s, the extraordinary initial impulse that reform provided to increased agricultural output lasted for about 6 years. China became a net grain exporter briefly in the mid-1980s (US$1635 million) despite huge expansion of consumption with rising incomes. The levelling out of grain production after that, with output per person rarely and only modestly exceeding the 1984 peak, was accompanied by moderate growth in total agricultural output (around 4 per cent per annum, compared with around 7 per cent per annum in 1978–84). In the mid-1990s, continued rapid incomes growth has generated strong tendencies towards increased net imports of agricultural products.

India's larger per capita arable land endowment, and the similarity of its income levels now to those in China in the early years of reform, mean that effective internationalisation and reform of Indian agriculture is likely to have an even larger effect in raising farm incomes and output than in China. With successful internationalisation and reform, India is likely to become a substantial net exporter of agricultural produce, including grain, and to remain in this position for a considerable period (Shand and Kalirajan 1994). A lower propensity to consume food at a given income level (a difference in taste that includes reduced tendency to consume meat) may strengthen these tendencies in agricultural trade.

It is not certain that the lifting of food prices to international levels and the associated lift in output and income would provide as large a boost to non-farm rural economic activity in India as in China. The dynamism of non-farm rural industry has contributed considerably to China's extraordinary overall growth performance in the reform period. Part of this dynamism may depend on phenomena that are characteristically Chinese: particular patterns of informal organisation and exchange; and elements of Chinese family structure applied to business enterprise. In wondering whether non-farm rural output could make a similar contribution in India, however, it is salutary to recall that this element of the success of Chinese reform took the Chinese authorities by surprise. If the institutional conditions existed for a similar response in India, the underlying economics of Indian agriculture would make it even more powerful.

China's longer progress in rapid economic growth spurred by internationally-oriented reform leaves India, on average, with comparative advantage in the simplest, most labour-intensive manufactured goods. China, on average, is one and a half or two decades up the ladder of capital-intensity and technological sophistication in export specialisation.

Regional economic diversity makes this pattern more complex. The most dynamic Chinese provinces are rapidly graduating from comparative advantage in labour-intensive production. The frontier of internationally-oriented growth based on exports of labour-intensive products is shifting into the Chinese inland, which is now competing in international markets with newly export-oriented production from the highest-income parts of India. The success of these regions will open a path for the beginnings of internationally-oriented industrialisation in the mass of India.

Meanwhile, the pockets of internationally competitive manufacturing with greater technological sophistication will promote an element of economically efficient diversification in both India and China. Capital-intensive as a proportion of total manufactured exports are about as important in the export structure of India (32 per cent) as China (34 per cent) (Table 2). That the proportion of labour-intensive goods in exports is so low in India, despite its earlier stage of economic development, is an indication that policy reform so far has not done as much in India to bring industrial and trade patterns in line with underlying economic realities. As internationally-oriented growth proceeds, capital-intensive and technologically sophisticated goods and services will eventually contribute a higher proportion of internationally competitive production. The pockets of internationally competitive capital-intensive production that have been created by history in both countries will provide a base in both for rapid diversification of exports out of labour-intensive products as labour becomes less abundant in later stages of the development process.

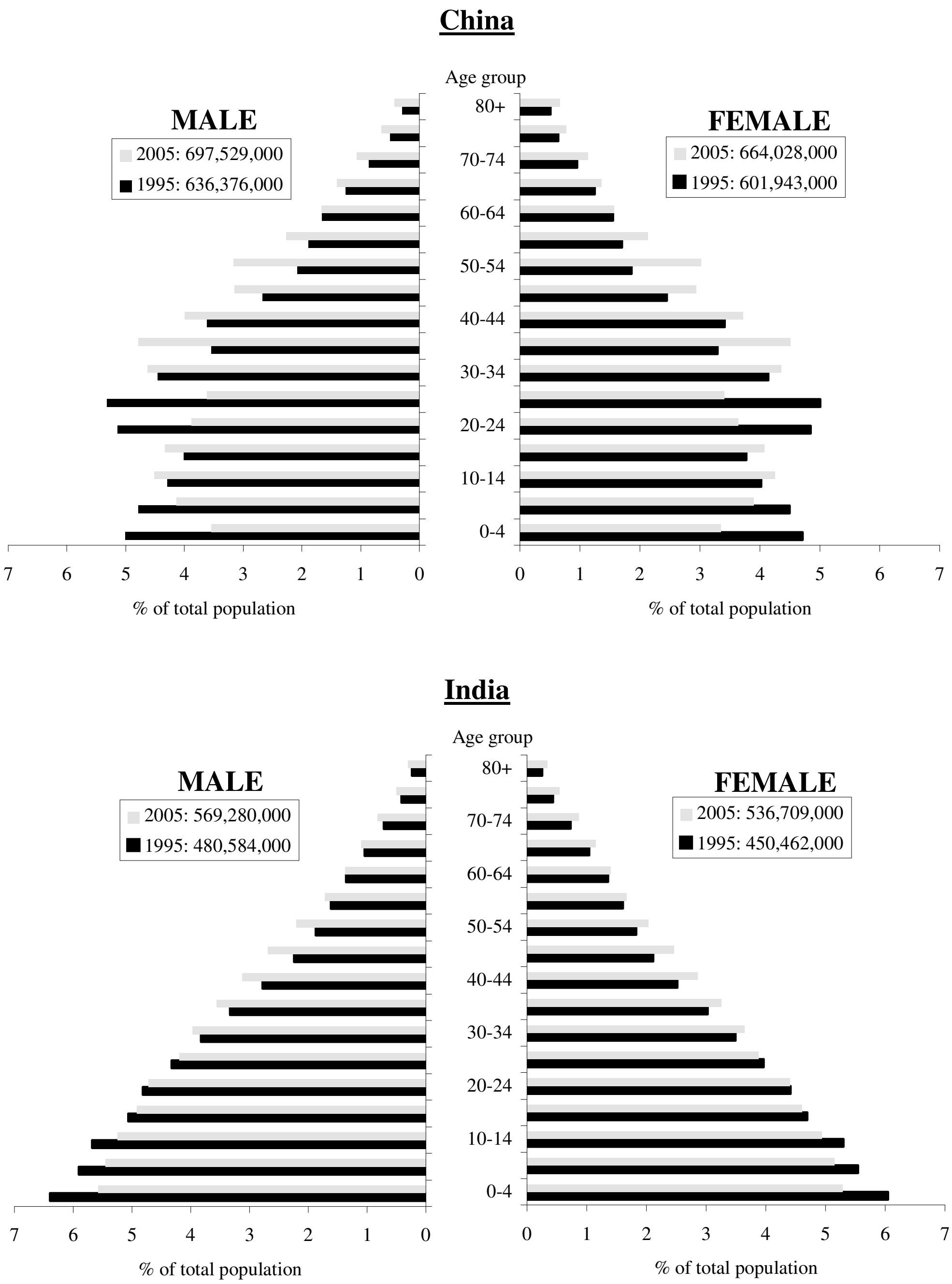
Table 2 **Foreign trade structure, India and China, 1994** (per cent)

| | India | China |
|---|---|---|
| Export share of GDP | 10.5 | 20[a]<br>7[b] |
| Share of | | |
| Agricultural-intensive exports | 22.0 | 9.0 |
| Minerals-intensive exports | 25.0 | 4.0 |
| Labour-intensive exports | 36.0 | 57.0 |
| Capital-intensive exports | 17.0 | 30.0 |
| Exports going to East Asia | 24.1 | 55.2 |
| Share of increase in real value of world exports 1985–94 going to East Asia | 27.1 | 51.7 |

[a] Official GDP
[b] Adjusted GDP
**Source:** International Economic Databank

The evolution of Chinese comparative advantage and export specialisation out of labour-intensivemanufactured goods will be accelerated by distinctive demographic features, including distinctive differences from India. China's fertility rate is unusually low for its average income level—even for its adjusted income level. This is associated with the low annual population growth rate of 1.3 per cent, compared with India's 2.0 per cent. China (1.24 billion) currently has a substantially larger population than India (0.93 billion), but already China's population of children under the age of 10 years has fallen below India's (Figure 6).

Figure 6 **Projected sex and age distribution of population, 1995 and 2005**




**Source:** United Nations, 1993. *The Sex and Age Distribution of the World Populations*, New York.

If these divergent tendencies in fertility and population growth continue, the labour force of India will come to exceed that of China in the early decades of next century. China's relative abundance of labour will diminish more quickly than if it was experiencing a more normally paced demographic transition. This will further improve the international environment for internationally-oriented economic growth in India for the longer period in which its comparative advantage remains strongly in labour-intensive manufactures.

**India, China and the East Asian miracle**

Sustained, rapid economic growth in one after another East Asian economy has drawn international attention over the past decade. It has been popularised in a recent World Bank publication, which applied to it the dramatic epithet 'miracle' (World Bank 1994).

While there is nothing miraculous about the phenomenon, it is certainly distinctive in world economic history. First Japan, Hong Kong and Taiwan, then Korea, followed by Malaysia, Thailand, China and Indonesia, grew at rates that doubled output in one decade, and then kept on going at around these rates—at least until they reached the frontiers of world productivity and incomes, as in Japan in the 1970s and Hong Kong in the mid-1990s.

When China opened to the outside world and embarked on market-oriented reforms in the late 1970s, there was some doubt and international discussion about whether the economy would respond in an East Asian fashion. The differences between Chinese and other East Asian economic structure were sufficiently large for the World Bank to exclude it from the East Asian cases in *The East Asian Miracle.*

While there are special risks to sustained growth in China, close analysis for some time has emphasised the presence in China of the key, common elements of East Asian style growth (Garnaut 1992).

Most fundamental of the common elements is a high degree of cohesion within the national polity around the objective of economic growth. Rapid economic growth, and internationally-oriented reform to launch and sustain it, are highly disruptive. They challenge and churn economic and political élites. They confront and undermine established economic privilege. They outrage some established perceptions of national security ('self reliance') and social justice ('secured by an interventionist state').

Economic reform can be followed consistently only if there is a high degree of broadly based commitment in the polity to the objective of economic growth.

The origins of political cohesion around an objective of economic growth are varied. It seems to require some tradition of authority of an over-arching state—present in the Sinitic societies of Northeast Asia and in India, but absent in large parts of the developing world where sustained strong growth has remained beyond reach. It can be promoted by a persistent security threat, to which the building of a strong economy seems to be a necessary component of an effective response. As in China and India, it can be driven by the tension between a superiority complex and increasing awareness of an inferior status.

Political cohesion around the objective of strong growth is facilitated by a wide distribution of the benefits of growth. One common feature of the successful East Asian economies is that they have a large abundance of labour relative to other economic factors—so that rapid growth based on comparative advantage has a large impact on labour incomes. India and China have the additional advantage, and probably more powerfully in India, that internationalisation requires the raising of farm prices and promotes rising farm incomes.

Some doubt the degree of commitment within the Indian and Chinese polities to the growth objective (Lal 1994). There is room for difference in judgment on matters of such complexity and importance. My own assessment is that the constellation of forces that launched reform in 1991 in India and 1978 in China have strengthened over time, reinforced by successful outcomes—although so far more powerfully in China because of the longer history and larger outcomes of reform.

Sustained rapid growth requires a reasonable degree of price and output stability over time, based on long-term fiscal and monetary restraint. This depends first of all on stability being accorded high priority in national economic goals. Less demanding, as they can be gathered over time by a committed political leadership, but still crucial, are the financial institutions necessary to secure a stable macroeconomic environment, and talented and appropriately trained personnel to operate them.

One of the doubts about whether China can sustain rapid growth in the East Asian style relates to its capacity to maintain macroeconomic stability over long periods. So far it has met the test imperfectly but sufficiently. In China, the particular management problem is to limit credit to loss-making state-owned enterprises. The problem is tending to ease over time as growth in other parts of the economy reduces the relative importance of the state sector.

India shares some of these problems of macroeconomic instability, but generally in less acute form. India has demonstrated an interest in securing, and the capacity to secure, macroeconomic stability throughout its history since Independence. Indian institutions for financial transactions and management in a market economy are older and better developed than Chinese (Lal 1994). While reform presents some special challenges to macroeconomic management, it has not removed factors that have delivered stability.

High rates of savings and investment are a feature of sustained rapid growth in East Asia. Not all high-growth economies had it from the beginning—rapid growth in Taiwan and Korea was kick-started by transfers from abroad, and in these cases and others the savings and investment rates rose within the early years of rapid growth to sustain the process.

Savings and investment rates in China are now prodigiously high—the second in the world after Singapore in 1994 (38.7 per cent for savings and 40.4 per cent for investment). This is accompanied by relatively high and widely distributed investment in education and training. In China, as in Singapore, this is the flywheel of exceptional growth performance. India’s savings and investment rates are at the lower end of the East Asian range (24.8 and 24 in 1994). The record in private and public investment in education is weak, as reflected in low literacy rates.

Aggregate Indian saving and investment rates may rise as growth is lifted to higher levels by successful reform, lifting growth potential. The larger doubts for India derive from its poor record on human capital formation: investment in education must be lifted and spread more broadly if India is to achieve sustained high growth in the East Asian style.

Policy reform to increase the international orientation of the economy has been a key to the initiation of high growth in all successful East Asian economies—excepting only those that were open economies from the beginning, notably Hong Kong and Singapore. On the trade account, the essential step is to even up incentives for export and import-competing production. China's official border barriers as applied in practice have fallen over 17 years to low levels, partly through tariff reduction and liberalisation of quantitative controls, partly through exemptions of various kinds, and partly through evasion. Myriad other barriers add to the costs of international transactions, and it is the reduction of these as much as further lowering of deliberate official barriers, that is the key to deeper integration into the world economy. India has made considerable progress in trade liberalisation in the early years of reform, notably with the reduction of the maximum tariff rate to 50 per cent in the 1995 Budget. The export share of GDP has lifted considerably in response. There are reasonable grounds for optimism that growing confidence in reform and growth will see India meet the test of openness—although it lacks some of the supports that Asia Pacific location (including membership of Asia Pacific Economic Cooperation) is providing for China. The slow pace of reorientation of India's export specialisation towards labour-intensive manufactures—a distinctive difference from successful East Asian economies including China—reflects the continuation of pervasive biases against these activities in the Indian incentive structure.

India and China have both made heavy weather of reforming state enterprises to operate within market disciplines, and more generally to lighten regulatory intervention in resource allocation. Legendary bureaucratic delays in approvals for investment continue in India. This is a major factor why India, while now utilising much more direct foreign investment than in earlier years (US$1.0 billion in 1994), lags well behind China (US$33.8 billion). This may be mainly a reflection of the shorter life of Indian reforms so far—the streamlining of Chinese administrative systems to absorb high levels of direct foreign investment took many years and was rewarded by high direct investment flows only in the 1990s.

A shared characteristic of East Asian growth is geographic location in East Asia itself. This was undoubtedly an aid to China's early reform. Certainly deep integration into the economies of immediate neighbours—Hong Kong, then Taiwan and Korea—has boosted export performance and productive structural change. The fact that the proportion of China's exports going to the world's most dynamic economies (in East Asia) is twice as high as for India helps to maintain momentum in export growth.

However, location in East Asia has been most important for the absorption of ideas and pressures for internationally-oriented reform. Over time location has become a less important disadvantage for India, as Southeast Asia has joined the process of rapid internationally-oriented growth, and as the demonstration effect of China's reform and growth has projected powerfully into South Asia.

**The prospects: two giants compared**

The sustenance of East Asian-style rapid growth over long periods is no miracle. It emerges naturally when a range of conditions is met. Some conditions can be met imperfectly without destroying the basis of sustained rapid growth.

China is now well down the path of East Asian-style growth. There have been doubts about whether it could be knocked from this path by weaknesses in macroeconomic management: inflation fuelled by credit to state-owned enterprises getting out of control. This possibility becomes less compelling as successive inflationary episodes are brought under control, as reforms extend the range of financial instruments for managing aggregate demand, and as the state sector is outpaced by the rest of the economy and recedes in relative importance.

There are larger questions about whether China can build fast enough the system of commercial law that is necessary to support the proliferation of large-scale enterprises, clear rights over complex property, and secure exchange of sophisticated goods and services, all necessary for China's growth to proceed to the world's economic frontiers. There are doubts, too, about whether the political system can evolve fast and far enough to accommodate citizens' aspirations for personal freedoms and capacity to influence policy that comes with high incomes and a sophisticated internationally-oriented economy.

These doubts about China are for the next century, not for the 1990s. India has these weaknesses in lesser degree: if it keeps reform and growth going for the several decades that will be necessary to raise incomes early next century to those of China today, it will be well equipped to maintain and to accelerate growth.

The Indian constraints come earlier: a savings rate that is not quite high enough for growth at East Asian rates, a poor record and current commitment to broadly based human capital formation; and a more equivocal commitment to internationally-oriented reform. The savings rate may rise with stronger economic growth. The education weakness is capable of correction over time with good policy. The cross-currents in commitment to reform are probably inevitable in a huge, rambling, economically underdeveloped democracy, and may turn out to be more important in affecting the pace than long-term directions.

If there is an Indian miracle, it is that the democratic polity could have delivered the reform that has already been locked in place. There are few calls for retreat. Progress may be slow; but the beginning is hardest in a democracy, and India has begun. The success of reform so far has strengthened the base for new steps. Some of the steps still to be taken—notably thorough-going internationalisation of agriculture—could further consolidate the political base for reform.

China has helped Indian reform by showing that sustained, rapid, internationally-oriented growth is possible in a big country.

But do not expect India to be left far behind. The conditions for sustained rapid growth have been met closely enough for India to look forward over the next half dozen years to growth in excess of that experienced previously in any long period in its history, and then stronger growth still as the constraints on reform are overcome.

**Is the world big enough?**

The growth that is associated with both India and Chinese reform is strongly internationally-oriented, with foreign trade growing more rapidly than output. Growth in exports is strongly concentrated in labour-intensive goods as the reforms take root and trade structure reflects more closely comparative advantage.

In the early years of reform in China, doubts were expressed about whether world markets were large enough to support sustained, rapid East Asian-style growth in the world's most populous country. Have these doubts been allayed? And do they arise more acutely as India joins China in internationally-oriented growth?

The Chinese experience of reform and the analysis of this paper provides considerable comfort on this critical point.

China's export growth and change in export structure was more rapid than is so for the case in India. The world economy proved itself capable of accommodating the huge expansion of labour-intensive exports from China. Not without tension and dispute, and considerable tightening of the restrictive effects of European and North American quantitative restrictions on textiles and clothing imports. But smoothly enough to support sustained rapid internationally-oriented growth and structural change in the world's most populous economy.

A large part of the rest of the world's structural adjustment to Chinese expansion of exports of labour-intensive exports occurred within East Asia itself. This is demonstrated in Appendix Tables 1 and 2. Through the period of the emergence of China as the world's largest exporter of labour intensive goods - the decade from the mid-1980s - the share of net exports from East Asia as a whole in world imports of labour-intensive manufactures increased only modestly (Appendix Table 2).

The major part of China's increased share of world imports was accommodated by its taking over of the export shares of the newly Industrialised Economies (Taiwan, Hong Kong, Korea and Singapore), and by increased imports into these economies and Japan (Appendix Table 2).

The analysis of this paper suggests that structural change within China itself will, over the next two decades, accommodate much of the anticipated export expansion so far from China in the reform period has come from the Chinese coastal provinces - the 300 million people in Guangdang/Hainan, Fujian, Zhejiang, Shanghai, Jiagsu and Shandang. Labour and industrial land have already become much less abundant in the more dynamic parts of these provinces. Costs are rising. There are powerful economic forces reducing the competitiveness of labour-intensive products in these regions, showing export growth, and focussing the more rapid expansion on more capital-intensive and technologically sophisticated goods and services. The frontier of labour-intensive export expansion is moving inland.

The dramatic character of China's demographic transition will accelerate these powerful tendencies. Increasingly, labour-intensive "exports" from Chinese inland provinces will take over coastal provinces' shares in world markets, and be absorbed by the high-income coastal provinces themselves. Structural change in coastal China will play the role in accommodating structural change in inland China and South Asia, that developments elsewhere in East Asia played for China in the first one and a half decades of China's reform.

Beyond East Asia, the tendencies in the international trading system over the next decade will be highly favourable to trade in labour-intensive manufactures. The phasing out of quantitative restrictions currently applied within the Multifibres Arrangement, as agreed in the Uruguay Round, is heavily back-ended towards the early years of next century. But it will come soon enough to accommodate the bulk of the increases in Indian exports of textiles and garments as reforms bite more deeply into economic structure over the next decade.

There are prospects, worth nurturing, for Asia Pacific Economic Co-operation's commitment to non-discriminatory free trade by 2010/2020 for developing countries further to underwrite these favourable tendencies after the Uruguay Round settlement has been reflected fully in the international trade regime. The opportunity, and the challenge, is to use the APEC commitments as a base for efforts for generalised movement to substantially free trade in the early decades of next century, under the aegis of the World Trade Organisation.

I conclude on an unambiguously positive note. India’s later start to reform, the geographic heterogeneity of both India and China, the remarkable demographic transition in China, and the potential for early diversification of comparative advantage deriving from historical over-emphasis on heavy industry in both India and China, all support internationally-oriented reform and growth in the period ahead. Favourable tendencies in the international trading system, if they can be maintained, support these prospects. The world is big enough for successful internationally-oriented growth in both India and China.

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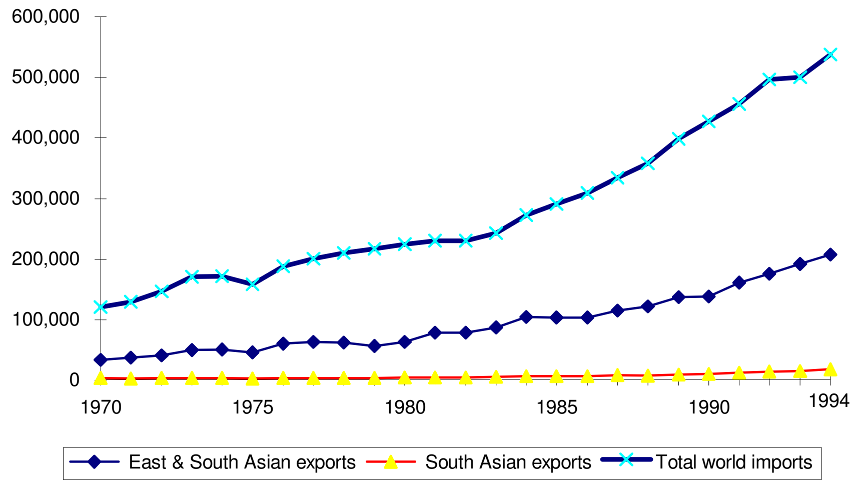
Note:

[1]I am grateful for the assistance of Maree Tait, Karen Haines and Hilda Heidemanns in the preparation of this paper.

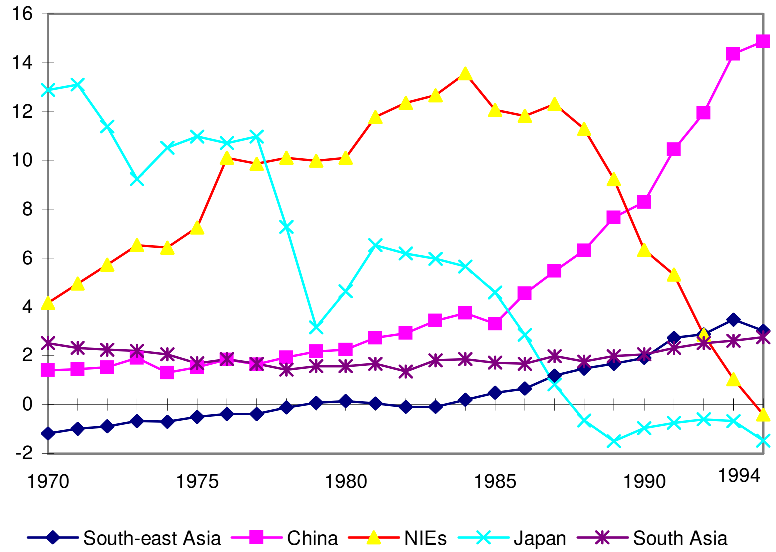
Chart 1 World imports, East and South Asian exports of labour-intensive manufactures 1970-94 (US$m)




*Notes*: Nominal values of exports and imports are deflated by GATT/WTO unit value index for manufacturing exports (1990=100).

*Source*: UN trade data, International Economic DataBank, The Australian National University.

Chart 2 Ratio of net exports to world imports of labour-intensive manufactures, East and South Asia 1970-94 (%)




*Notes*: South-east Asia include ASEAN (excluding Singapore) and Vietnam; NIEs include Taiwan, Hong Kong, Korea and Singapore; and South Asia include India, Pakistan, Bangladesh and Sri Lanka.

*Source*: UN trade data, International Economic DataBank, The Australian National University.