**China and India: Implications for the Global Economy**

**The last century** has seen China and India experience 40 years of economic stagnation followed by a period of great growth. These two giants, which together contain nearly one-third of the world’s population, have had many similarities as well as some striking differences in their development, according to professors Gary Becker, PhD ’55 (economics), and Raghuram Rajan. Becker, Nobel laureate and University Professor of Economics and of Sociology, and Rajan, Joseph L. Gidwitz Distinguished Service Professor of Finance and economic counselor and director of research for the IMF, shared their views with alumni at the GSB’s European Celebration in London last fall and at a special forum in Chicago last spring. Here are the highlights.

**On the opening of China**
**Becker** Around 1978, Chinese leaders began to recognize the system wasn’t working and they opened up some of the agricultural sector. Modest changes had an enormous effect on the output in agriculture, and that encouraged the leaders to extend the change to public enterprises to some extent, and then, increasingly, to other parts of the economy. The result: in the last 25 years, the Chinese experienced an enormous rate of growth not only in the aggregate, but also per capita—among the fastest in the world, if not the fastest in the world, over that 25-year period.

**On reasonable economic policies**
**Becker** Seeing China’s great growth since 1978, the Indian government instituted some major reforms in 1991. They cut tariffs significantly, cut other quantitative restrictions, eased up on the restrictions placed on private investment by Indian companies, eased up on foreign investment, and made many other changes. As a result, since then India has grown rapidly, with recent growth rates over 8 percent. Both countries illustrate that while culture may have a significant influence on the growth process, a country can grow significantly if it introduces even reasonable economic policies. In that sense, economics trumps culture. India’s past wasn’t the major force limiting its growth. When they introduced reasonable—not optimal, reasonable—economic policies, India grew rapidly, as China did also after introducing reasonable economic policies.
On the nature of growth
Becker China has grown by being a labor-intensive, export-oriented economy, with high levels of foreign investment concentrating largely on labor-intensive products like toys, textiles, simple electronics, and exports at a high level.

India’s growth is different. There is a great deal of discussion and, in some quarters, concern about the IT aspects of India’s growth, the outsourcing, computer engineering work, and so on. India is doing that, but it is also in textiles, steel, and a variety of other products. But it has not concentrated nearly as much on being export oriented or labor-intensive export oriented. So there’s a significant difference in the nature of the growth process in both countries, even though they’ve both experienced high rates of growth.

On the hype and the threat
Rajan There is excessive hype about these two countries. These billion consumers are not going to consume anywhere near the level of consumers in developed countries. The base that India and China start off from is very low. Similarly, these producers—these 200 million engineers that we’re scared of—simply don’t exist. There’s a small fringe in India of highly educated engineers who are competing with U.S. workers for jobs, but that’s not much more than one million workers in total. So much of the 2.5 million jobs lost in the IT sector in the United States over the last two and a half years is better attributed to the state of the business cycle, the downturn after the bubble, and improvements in technology and productivity rather than to competition from India. The idea of hordes waiting to compete or to consume is a product of hype not borne out by the data. If you compare the fraction China accounts for in terms of world trade 25 years after its reforms, it looks no different than what Japan accounted for 25 years after it started growing. It looks no different than what Taiwan, Singapore, South Korea, and Hong Kong looked like 25 years after they started growing. Even though it has 1.3 billion people, China doesn’t look any bigger than any of these countries looked 25 years after they started growing.

On the strengths and weaknesses of the two economies
Becker China has a high level of foreign direct investment, flexible labor markets on the whole, and generally flexible prices in product markets. It’s relatively easy to set up businesses. A great deal of energy has been unleashed in China. Its weaknesses: the financial sector, and that China has been very slow in reducing the scale of inefficient public enterprises. A lot of bad debt has been issued as a result of that. The publicly owned financial institutions have been forced to make these bad debts, and there may be hundreds of billions of bad debt issued by the financial sector. And human capital investments, surprisingly, have been low in China.

India has a high-quality higher educational system and a well-developed legal system largely independent of the political sector. China does not have that. On the other hand, India has very low foreign direct investment. India has inflexible labor markets. It has too little investment in education when you go beyond the highly elite IITs and some other universities.

On the prospects for continuing growth
Rajan Both countries will have to encourage the private sector far more than they are doing right now. What are the things that the private sector needs to flourish? One: protection of property rights and protection of contracts. For this you need laws, an independent judiciary, a free press. Second, you need democracy. Third, you need a good financial system to allocate resources. Fourth, you need physical infrastructure: roads, parks, schools, hospitals.

India’s got the first three: property rights, democracy, and a financial system that’s a little better. It’s not great, but a little better than China. China’s got the [physical] infrastructure right. The problem with India at this point is that it is has a huge budget deficit and therefore its ability to invest in these things is limited. Where China has faltered is in the softer infrastructure: the rule of law, contracts, transparency, and democracy. —M.M.B.