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Research Paper

Comparative Study of Economic Growth – China & Indian Context

Economics

KEYWORDS : Growth accounting; potential growth; capital measurement; demographics; China and India

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ABSTRACT

This paper compares the growth prospects of China and India through a growth accounting analysis. Consistent time series for capital stock and employment are constructed using available survey data, and recent revisions to the national accounts for both countries are incorporated. The results allow for a discussion of the sources of growth in both countries, and a consideration of each country's rate of potential growth in light of the outlook for national savings, as demographic shifts occur in each country.

1 INTRODUCTION:

China and India are booming. Superficially it is easy to be impressed. We note that annual growth rates in Gross Domestic Product (GDP) have been sustained over the past few years at 8-10 per cent, sometimes even higher. Analyses of China and India point to the major investment in education that is turning out many thousands of top-class engineers and scientists annually. It seems that so many of our manufactured goods carry a "Made in China" label and that our call centre services are increasingly located in India. The recent rises in energy and commodity prices are partly explained by the rapid growth in demand from China and India. Moreover it seems to be assumed that this level of overall economic growth will continue indefinitely and that unless we in "The West" get involved in it, we will live to regret it.

2 OBJECTIVES OF THE STUDY:

The two purposes of this White Paper are (i) to compare and contrast the high growth rates in the two countries and (ii) to assess the likely outcomes and impact.

3 THE NATURE OF ECONOMIC GROWTH:

The first aspect of this is the significant difference in the nature and structure of growth in the two countries. Growth measured in terms of GDP can be investment-driven and/or consumption driven. In mature economies we can point to the balance between the two. The majority of developed economies see investment at around 20-25% of GDP. In the case of India, the investment share of GDP is slightly above average for the industrialized world. In China the position is very different, with investment accounting for over 40% of GDP sustained over the past 10 years or so.

The more relevant question in the case of China is as follows. Given the high investment percentage within GDP growth, why is China not growing more quickly? The key question in the case of India is different. Given the major social and demographic changes that are being experienced, will India be able to manage the expansion of consumerism and retain a balanced structure of GDP growth without hampering investment in fixed capital formation and avoiding a growth in national, corporate and individual debt?

A substantial part of the answer to these questions is found by studying (a) the extensive versus the intensive pattern of economic development, to reach an understanding of what economists term "total factor productivity" and why it matters and (b) the tools and techniques available to government and industry/ commerce to gain and sustain profitable growth at low risk.

4 "EXTENSIVE" VERSUS "INTENSIVE" PATTERNS OF GROWTH:

The extensive pattern of economic growth is based on continuously increasing resource inputs that are reflected in growing outputs allied to demand stimulation and demand management. This works effectively, though not efficiently, (a) as long as resources are plentiful and (b) there is spare capacity throughout the productive system. This type of growth has been described as a "ratchet" mechanism - if the top line goes up by 10 per cent, then everything contributing to it goes up by (at least) 10 per cent.

The essence of the intensive pattern of economic growth is that resource productivity increases along with growth in output and consumption and a greater rate - in other words there is a better than 1:1 relationship between growth in outputs compared with inputs. This characterizes developed economies throughout the world. It is what drives greater efficiency in value-creating processes and, in modern times, greater production specialization across national boundaries coupled with a high gross percentage of foreign trade (import and export) relative to GDP, even if the net trade balance does not alter much over time.

It was the "extensive" model of economic development that eventually finished off the Soviet Union despite belated attempts at macro- and micro-economic reform. China still looks with horror on this rapid disintegration and has acted early enough to ensure that all but the most strategically sensitive industries are now to most intents and purposes private operations. India has succeeded in abandoning its former addiction to Soviet-style planning early enough to avoid the worst damage. But there remains a massive deadweight of large-scale indigenous industry that is over-resourced, uncompetitive and sustained by the pressure of vested interests. Merely changing the legal form from "state-owned" to "private" is nowhere near a solution.

There is, however, evidence that China is moving into a more intensive pattern of economic development, accelerated by a gradual move towards world prices for commodity inputs and other intermediate inputs together with market-based pricing allied to a market-rational internal cost of capital. This is to ensure that high rates of economic growth can continue, driven increasingly by consumption relative to investment and based on more efficient resource utilization.

What matters above all to a Western company is the quality of decisions made in respect of dealing with China and India as partners in increasingly global supply chains.

5 COMPARE AND CONTRAST:

Government policies in China and India have been very different in terms of the approach to generating growth. The difference illustrates the importance of the consumer sector in a modern economy.

China has directed the massive investment percentage of GDP into the creation of industrial capacity, aimed substantially at export markets. It is therefore vulnerable to downturns in global markets, particularly in the USA. Significantly since 2004 China has commenced a slow re-orientation towards strengthening

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consumption in the home market relative to investment. The savings rate in China has been exceptionally high, and the level of credit in relation to GDP has been very low by world standards. The level of consumption had fallen to 38% of GDP by the end of 2005, just about the lowest level of any major world economy. Coupled with this we note that the excess capacity generated by the high level of investment relative to consumption has resulted in overcapacity, stagnating or reducing prices, growing levels of unsold inventory and pressures on profitability. Excessive construction and the reluctance of the majority of the population to draw down on savings have prompted falling prices in the property sector. One economist has recently calculated that if personal consumption in China as a percentage of GDP had remained at its 1990 level it would be 30 per cent above current levels - a more rational balance in relation to other GDP components (Lardy 2006). There is sufficient spare capacity and inventory backlog in China to enable consumption to rise significantly without resulting in price inflation.

India has followed a different path. The major point of difference has come about as a result of demographic change. The size of India's middle class has quadrupled to almost 250 million people over the past 15-20 years. Overall population growth has slowed considerably, with large gains in per capita income. India's demographics are beginning to resemble those of the developed West - a move away from a high birth rate, overpopulation and predominant poverty towards smaller families and increased average income. There still remains, of course, a major issue of poverty and poor education. If, however, one looks at the economy as a whole, as the current generation of potential baby boomers matures and the consumer sector of the economy continues to prosper, spending power and modern consumer behaviour look set to "trickle down" through the economy for decades. The big issue in all this is that India has relied considerably on a combination of growing domestic market demand and investment in knowledge-intensive industry and services, which has meant that India has been to a great extent insulated from global downturns affecting physical trade. Personal consumption accounts for just over 60 per cent of Indian GDP, making it increasingly comparable with a fully-developed Western economy. Thus it has been argued (for example Das 2006) that India's "boom" is intrinsically more durable than China's, noting that China's population is likely to peak around 2030, whereas India's will continue to grow, on current projections, till about 2065.

6 IMPACT ON EUROPEAN COMPANIES:

Both areas should figure in the thinking of Western companies. They will be a source of new opportunity and new competition.

Growth in the mature economies of North America and Europe will be increasingly difficult to find for the majority of Western companies. Value migration will continue to be a phenomenon of 21st century economics. This means that activities enjoying a comparative advantage in an Asian location will migrate there simply because (a) it is logical that they should and (b) it is becoming easier and less costly to manage such activities as a result of increasingly widespread availability of low-cost technologies of doing business.

If we think how many products and services we now buy from companies that did not even exist a generation ago and how many of these companies are based substantially (if not headquartered) in Asia or the Indian subcontinent, the magnitude of this issue becomes clear. Whether this constitutes an opportunity or threat is something that is under the control of existing management teams. The combination of the WTO (despite its sometimes difficult processes and experiences) and facilitating technologies (especially information technology) ensures that opportunity and threat will increase simultaneously.

India will continue to develop as a market for increasingly sophisticated consumer goods and technical services. It will be a natural location for production of the former for the domestic market and the latter for global markets that can be served by web-based distribution. China will continue to be an attractive location for manufacture and re-export into the Asian region and world markets. This will not be restricted to basic specification goods with a high labour content: there are world-class operations in China producing to standards that are comparable with any in the USA, Japan and Europe.

The Chinese domestic market will, however, open gradually as its middle class grows as a proportion of the total population. Many luxury goods are now sold in the Chinese domestic market. Consumer tastes and preferences, especially amongst younger people, are visibly converging with the developed world.

7 WHERE NEXT FOR WESTERN COMPANIES?

There are two dimensions that Western business has to consider in the Chinese and Indian elements of internationalisation and globalisation - the deals and the learning.

Some Western companies have been demonstrably successful in developing a balance of trade and investment. Central government has tended to stick too long to the "export trade" model in the hope that this will retain jobs and contribute to added value in the face of evidence that the trade-to-investment balance has already changed considerably. Deals are being struck increasingly through investment relative to export trade. Where such a strategy is implemented, the result is not job loss but the creation of more skilled jobs back in the home market and net increase in labour earnings at the level of the domestic economy whilst participating fully in the opportunities presented by globalisation.

What comes next is more challenging and critical for economic and business development. How will Western companies build on the second dimension - the learning - that has been part of this process?

Unless a strong base of "intellectual capital" is maintained, the West will come under increasing pressure, especially in manufacturing, from countries such as China and India. It is not a question of direct labour cost, since direct labour in most of modern manufacturing accounts for a relatively low percentage of total cost. It is the inflation in general operating cost that is the bigger problem.

Quite simply, in an increasingly global business environment Western companies will achieve success only by moving up the value-add chain. In other words, low-skill transactional-type jobs and activity will migrate Eastwards simply because this is a rational consequence of ever-opening economies, and at the same time there will be a compensating increase in the demand for higher-skill services that are used in the creative configuration and rapid re-configuration of such services - predominantly in designing and managing internationally competitive supply chains. Such supply chains are not restricted to materials and products: they include, inter alia, information and finance. It is through competency in the management of high-skill value-adding activity that the future of Western business is to be developed if our companies, large and small, are to compete successfully in the global economy.

8 CHINA AND INDIA AS PART OF GLOBAL ECONOMIC SHIFT:

Globalisation presents us with threats and opportunities simultaneously, and the growth of China and India is a significant factor in this. Partly through the influences of GATT/WTO and partly through advances in technology, primarily information technology, most organisations have easier access to markets than in the past. This means inevitably that our own regional markets are also open to increased competition.

However, the concept of globalisation goes further than the product/market dimension. It includes questions relating to fluid organisations, capital structure and value migration. It relates increasingly to labour supply and deployment. Whereas globalisation was defined customarily in relation to physical trade, it now relates to multiple factor mobility. Globalisation is therefore about developing or sourcing a set of competencies that enable an organisation to contest any market it chooses and to derive competitive advantage from any combination of value-creating activities. Success in the future for Western companies will depend on continuing to develop the core competencies and technologies required designing and managing multifactor supply chains that will give access to the most attractive product and service markets.

9 CONCLUSION:

Against this background B2B International has opened an office in Beijing, China. It has two main business thrusts: (i) to undertake market research for Chinese companies on the China market and (ii) to undertake market research for non-Chinese companies looking to enter the market directly or via collaborative venture. The concepts of marketing and consequently of market research are still in their infancy in China, but the speed with which Chinese companies and managers are taking on board the tools and techniques that we take for granted is truly astounding. It is also part of the impact of globalization on the market research business itself - we are finding that an increasing part of our market research work is concerned with markets for investment and opportunities for sourcing and operational collaboration as well as with opportunities for exporting products to China.

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