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MASTER'S THESIS

**Comparative Analysis of
India and China Focused on
the Economic and Political
Development.**

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Thesis Project

Thesis Title: Comparative Analysis of India and China Focused on the Economic and Political Development

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India and China are two large Asian countries which share some common characteristics, but there are also differences between them. Both of these two countries are experiencing rapid economic growth. They are so called emerging markets. They have managed to attract a lot of foreign direct investments. Also some local companies from these countries have become large global players. Indian Tata is a good example of such company. Both countries are important sources of innovation in all kinds of possible sectors from business management to medicine. It is a well known fact, that many companies have moved their research and development centers and manufacturing activities to China. Concerning the differences, the most striking difference is the regime. China is a totalitarian state, where as India has a democratic regime. This thesis will compare which forces were promoting the rapid economic growth in these two countries. Few parts of the thesis will focus on the historical development of both countries in the modern history with stress on politics and economics. Other part of the thesis will briefly deal with the property rights and their protection. The ownership of property and enforcement of these laws will be examined. Another factor which will be compared in connection with laws is the judicial system and the effectiveness of courts. Also the corruption level will be compared. The reason for the analysis of these aspects in connection with the economic growth is that good protection of property rights encourages people to invest and start businesses. Effective judicial system, low corruption and laws which ensure that business and people honor contracts which they sign increases the level of trust which people share toward each other. And trust is essential for businesses to develop and also to attract FDI. Another part of this thesis will focus on the measures which were undertaken by governments in these two countries to promote the economic growth and to attract foreign direct investments. Other chapters will examine economic characteristics of every country concerning labor costs, land costs, size of different industries and so on. This chapter will also analyze strengths and weakness of economic systems in both countries and the development of their markets. Another chapter of this thesis will try to determine which

pattern of economic growth these two countries have followed. Especially it will try to determine whether the country has followed the Kuznet's pattern or Marx's pattern. Needed information for this thesis will be retrieved from different statistical databases and also from different papers and books dealing with politics or Economics in China and India. This thesis will contain two hypothesis which will be either proved or rejected. The first one is that the main reason, why foreign investors are attracted to these countries is low cost of doing business (especially cheap labor) and everything else is of lesser concern. Second hypothesis will be that these two countries can no longer be qualified as emerging markets, because they have already emerged. Methods which will be used in this paper are analysis of historical data, including analysis of timelines and comparative analysis. In order to determine whether economic development follows Kuznet's or Marx's pattern of growth an application for all needed calculations will be created in Microsoft Office Excel.

Potential Sources:

Alan Greenspan, "Věk Turbulenci", *Fragment* 2008

Bardhan Pranab, *Awaking Giants, Feet of Clay: assessing the economic rise of China and India* (New Jersey: Princenton University Press, Amazon Kindle Edition 2010)

Gari Gereffi, "Development Models and Industrial Upgrading in China and Mexico", *European Social Review* 2009, p. 37-51

The Economist

www.imf.org

www.worldbank.org

Yujiro Hayami and Yoshihisa Godo, "Development Economics: From Poverty to the Wealth of Nations", *Oxford University Press* 2005

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Annotation

There are many papers or books which individually analyze or provide a comparison of either political or economic aspects of China and India. Usually they are focused on certain characteristics and then there are some which deal individually with economy or politics in general. This thesis attempts to combine the knowledge in these papers into a single volume in order to provide an extensive comparative analysis. In addition this thesis contains a research which compares the patterns of the economic growth in these two countries and which also determines whether they follow Kuznets or Marx pattern. The results show that China has already started to follow the Kuznets pattern while India's economic growth maintains a mixture of both Kuznets and Marx pattern. Charts and tables supporting these results are included in the appendix. Plus all the data and calculations are included in two Microsoft Office Excel documents which may be found on the CD. This thesis is divided into six chapters. The first two are predominantly focused on the political development and the contemporary political situation. The rest of the chapters first deal with the economic development and then provide a comparison of the contemporary economic situation in these countries with special focus on things like the shape of the financial system, agriculture, poverty or the economic freedom. The last subchapter in chapter six concludes that these two countries should no longer be classified as emerging markets.

Keywords

India, China, politics, economy, development, Kuznets, Marx, growth, comparison

DECLARATION:

I hereby declare that this thesis is my own work, based on the sources and literature listed in the appended bibliography. The thesis as submitted is 145 813 keystrokes long (including spaces), i.e. 81 manuscript pages.

Peter Krchnák

15.05.2011

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0. Introduction

China and India are two highly populated large countries which's economies are growing considerably quickly. China is even predicted to overcome America as the biggest economy in the following few decades. Because of the large population of these countries and their rapid economic development, a lot of attention is focused on them. This paper provides a comparative analysis of these two countries which deals with two aspects. The first one is the political development and the contemporary political system and the second one is the economic development and the contemporary economic situation. The first half of the first chapter looks at the history of China and the political shifts which have occurred there. The second half of the first chapter is focused on the political history of India. The second chapter compares the contemporary political systems in these countries. The third chapter is focused on the economic development in China especially on the period of the reforms in 1980s which have started its rapid economic development. The chapter is divided into 4 subchapters. The first one briefly deals with period of the completely planned economy, the second deals predominantly with the domestic reforms, the third with the foreign direct investments and fourth subchapter is focused on the international trade. The fourth chapter which is focused on India is similarly organized like the third chapter. The fifth chapter compares the main drivers of the economic growth in these countries and provides a comparison of their patterns. The sixth chapter deals with various contemporary economic characteristics of these two countries and also presents a case that, these countries should no longer be called the emerging markets. The final part of this thesis is a conclusion which summarizes the findings of this paper.

1. Political Development in India and China

The goal of this chapter is to provide a brief overlook of the political history of India and China mostly focused on the period since the 19th century till the present. This brief overlook especially talks about the changes in the leadership of these countries.

1.1. China

The Chinese civilization has a long history dating back more than 3000 thousand years before Christ. In 221 B.C. kingdoms which's lands are included in contemporary China were united by the Qin dynasty. The last Chinese dynasty was the Qing dynasty which was established in 1644. It was believed that the Chinese emperor had a "mandate from heaven" to rule the country so in other words the emperors drew their legitimacy from god. It is interesting that this belief was maintained till the beginning of the 20th century.¹

China remained a monarchy with the emperor as a leader till the beginning of the 20th century, but the decline of the power over the country held by the Qing dynasty had already begun in the 19th century. There were several reasons for this. For example the economic stagnation in the country or the loss in Opium War which forced China to give up some territories and grant economic privileges to Great Britain and some other countries which today are part of the so called West. The political and economic situations in China were not good at this point and it was also obvious that China was lagging behind the Western countries in the technological development. There was a pressure on the ruling dynasty to adopt the Western technology and reform the country, but the Qing court refused to do that.² Hence people remained dissatisfied and many of them decided to revolt and overthrow the Qing dynasty which meant the end of feudalism in China.

On the 10th of October in 1911 the Xinhai Revolution began. Those who participated in this uprising were inspired by the ideas of Sun Yat-sen who ironically did not take part in this revolution because he was not in China at that time. This uprising started in Wuchang and it was initiated by the members of the New Army (modernized

¹ "Xinhai Uprising," Cultural China, 2.3.2011 <<http://history.cultural-china.com/en/34History2963.html>>

² Department of State: Bureau of East Asian and Pacific Affairs, „Background Note: China,“ 5.8.2010, 2.3.2011 <<http://www.state.gov/r/pa/ei/bgn/18902.htm>>

Chinese armed forces). One of the events which helped to start the revolution against the ruling dynasty were the floods around the river Yangtze, which caused a lot of damage and around 100 000 deaths. This flood was significant, because back then big natural disasters were considered as evidence that the emperor lost his mandate from heaven to rule. So this disaster probably had a strong psychological effect on the Chinese who lived around this river and it also added some legitimacy to the insurgency.³ The emperor did not take any action for several weeks which gave time to the uprising to grow and eventually more and more provinces declared independence and joined the revolution.⁴ The uprising was successful and the Quing dynasty was forced to give up the power, but on the other hand its high ranking officials remained in office in order to avoid the civil war. General Yuan Shikai became the first president of the first Chinese republic. He was an autocratic ruler and he even attempted to declare himself the emperor of China, but he was not successful in this. He died in 1916.⁵

After Yuan Shikai's death the government collapsed and the era of "warlords" began. This means that changing coalitions of military provincial leaders were competing for the power over the country. During this era Sun Yat-sen established a revolutionary base in Southern China. He managed to organize the Chinese Nationalist People's Party (KMT) which later forged an alliance with Chinese Communist Party (CCP) and they set out to unite the divided nation. By 1927 most of the Chinese territory was under their control. At this time Chiang Kai-shek was the leader of the nationalists. He turned against the CCP and executed many of its leading figures. Those who remained were forced to flee. In the end they found refuge in the mountains located in the eastern China. The Chinese communists managed to reorganize and they started to compete for the leadership of China with the KMT.⁶

However for a brief period of time these two groups managed to form an alliance once again in order to push Japanese from China who had been occupying some of its territories back then. Chinese conflict with Japan became more intense in 1937. On the 17th of July the Chinese and Japanese soldiers clashed outside Beijing. This event

³ Cultural China, Xinhai

⁴ Cultural China, Xinhai

⁵ U.S. Department of State, Background China

⁶ U.S. Department of State, Background China

basically marked the beginning of war between China and Japan.⁷ The Chinese finally managed to drive the Japanese out from their country after the WW2.

Chinese however did not enjoy a very long period of peace because a civil war or the so called War of Liberation started. This was the war between KMT and the CCP which was led by Mao Tse-tung. It is important to mention that both superpowers had a limited presence in this civil war. CCP was receiving a limited aid from the fellow communist USSR and its opponents who were nationalists on the other hand received support from the USA. In the end the CCP was the victor and Mao Tse-tung proclaimed the People's Republic of China on the 1st of October 1949.⁸ In 1949 China was not in a good shape. She was ravaged by a long period of military conflict, its economy did not do very well and it had been experiencing a huge inflation for some time. The inflation was caused by the excessive government spending. Since 1935 the government had a full control over the quantity of money in circulation. The government decided to abuse this privilege and it started to pay for its liabilities by printing new money. Between 1946 and 1949 50-65 percent of the government spending was covered by the monetary expansion and of course this meant that the amount of money in circulation was quickly increasing, thus the inflation occurred.⁹

CCP led by Mao Tse-tung was inspired by Marxism and Leninism. They implemented a political and economic model based on the Soviet examples. In the beginning of the CCP reign, the party achieved many successes like the important curbing of a high inflation rate or the rebuilding of many destroyed industrial facilities. These achievements meant that the party was very popular. CCP also managed to spread its influence into almost every aspect of Chinese life and it established a totalitarian regime.¹⁰

Mao's era is especially connected with two campaigns which have had a major impact on the life of the Chinese. The first is the infamous Cultural Revolution and the second one is the Great Leap Forward. Cultural Revolution was started in order to

⁷ Cultural China, "Republic of China (1912-1949)", 3.3.2011
<<http://history.culturalchina.com/en/183History6971.html>>

⁸ Cultural China, Republic of China

⁹ Ebeling M. Richard, "The Great Chinese Inflation," *The Freeman: Ideas on Liberty*, Foundation for Economic Education, December 2004, 3.3.2011 <<http://www.thefreemanonline.org/from-the-president/the-great-chinese-inflation/>>

¹⁰ U.S. Department of State, Background China

revitalize the revolutionary feelings in the Chinese. Mao and the others who were involved in this campaign were directing the anger against other leading officials in the party. These people were removed from their posts. This was an obvious removal of potential opposition. Mao was named into the position of the supreme commander of the nation and army. Also the intelligentsia of China was attacked in this period by the so called Red Guards. Intellectual elites in China were considered to be the members of bourgeoisie and an ideological influence of such sort of people was unwanted. This campaign started in 1966 and ended in 1977 when it was declared so by the party leadership and the gang of four was arrested (Jiang Qing, Zhang Chunqiao, Yao Wen Yuan, Wang Hongwen - four important figures of the Cultural Revolution).¹¹ The Great Leap Forward was an economic program which had some negative consequences for the Chinese economy. This economic policy started because Mao wanted to part with the Soviet model of socialism. In this program China was supposed catch up with other advanced economies like Britain or USA in a very short time. Land was collectivized very quickly and over 23500 communes were created. People owning the land together were supposed to be more effective in the production of agricultural goods. The idea was that these communes would be able to produce enough food for themselves, which they would be able to eat free of charge. This period is also characterized with massive industrialization at the expense of agriculture.¹² Especially a lot of steel plants were built. Even the communes were encouraged to build furnaces in their back yards. The deficit of China climbed during the execution of this program quite considerably, because the government was spending a lot of money for industrialization of the country. This campaign collapsed and China did not reach its goal to catch up with the advanced nations especially because of unrealistic goals which were supposed to be fulfilled in a very short time span. The consequences of this program were disastrous. Beside the fiscal deficit the most serious consequence was the great famine which hit the country and caused millions of deaths. This famine occurred because of the mismanagement of agriculture and caused a lot of unrest among people.¹³

¹¹ „Cultural Revolution,“ *Chinas Communist Revolution: A glossary*, BBC, 15.04.2011
<http://news.bbc.co.uk/hi/english/static/special_report/1999/09/99/china_50/cult.htm>

¹² „Great Leap Forward,“ *Chinas Communist Revolution: A glossary*, BBC, 15.04.2011
<http://news.bbc.co.uk/hi/english/static/special_report/1999/09/99/china_50/great.htm>

¹³ „China’s Great Leap Forward,“ *Chicago Chronicles*, The University of Chicago, 15.04.2011
<<http://chronicle.uchicago.edu/960314/china.shtml>>

The chart below shows the development of the Chinese GDP since 1961. Once can see that 5 recessions occurred since 1961 till 1977.

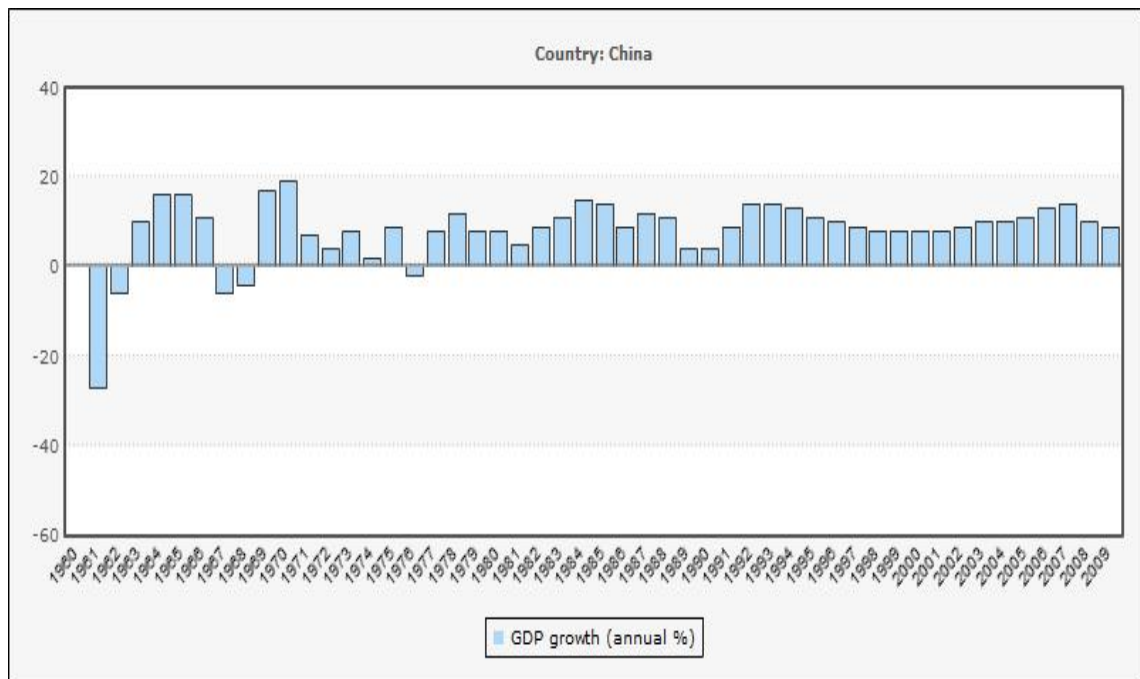


Chart1: annual GDP growth in China in %

Source: World Bank

Further the chart shows that a very sharp decline in the GDP growth occurred in the early 1970s and in 1977 even the already mentioned recession arrived. This poor economic development among other things convinced the Chinese leaders that the planned economy was no longer capable of securing the economic growth, so in the late 1970s CCP decided to abandon it and instead they started to incorporate capitalistic principals into the Chinese economy. China was encouraged to accept capitalism by its obvious successes in other Asian countries and also in Japan. The government also condemned Mao's Cultural Revolution and the Great Leap Forward policy. This economic campaign which caused such dissatisfaction among the people is one of the main reasons why the government decided to change the economic policy. After Mao's death it needed to cut the attachment to the previous regime in order to gain the support from the population again. At this point there was an intellectual movement asking for the acceptance of some western principals and a change from the totalitarian regime to a democratic one. However the Chinese government completely refused to "westernize". Another reason why this intellectual movement failed was that the idea of "westernization" did not reach 800 million people living in the rural areas. Instead of accepting the western values, the Chinese government decided to stress the uniqueness of the Chinese culture and started to support the

nationalistic feelings in the Chinese from which it started to draw legitimacy. Another change in legitimacy which occurred was that after the economic reform, the Chinese government started to base its legitimacy on the good performance of the economy. Before these changes, the legitimacy of the government was based on the revolutionary ideas of Marxism and Leninism.¹⁴

This is the time when the Chinese government established a mixture of totalitarian regime and capitalism which also includes, with a certain degree, the central planning of the economy. This mixed system has lasted till today. The economic reform was a very important step for China, because it enabled this country to become an important economic giant. Today the government of China is based on a constitution from 1982, which has been since then amended several times. The government is divided into three branches: executive, legislative and judicial. The executive branch consists of the president, the vice president, the State Council and the prime minister (premier). The legislative branch is represented by the National People's Congress and the Supreme People's Court represents the judicial branch. China has 22 or 23 provinces depending on one's opinion about Taiwan. Newer the less China counts Taiwan as one of its provinces. Then there are 5 more autonomous regions which belong to China and 5 municipalities which are directly under the State Council. Except CCP there are 8 more political parties, but these are under the influence of the CCP.¹⁵

1.2. India

Similarly to the Chinese culture, the Indian culture has a long history which can be traced back to approximately 2500 B.C. The area of today's India used to be divided among various kingdoms. The kingdoms which's lands are part of today's India were united for the first time by the Mughal Dynasty in the 17th century under the Mughal Empire. Also in the 17th century, precisely in 1619, British East India Company (EIC) established its outpost in Surat which is located on the north western coast of India. This

¹⁴ Samuel P. Huntington: *Střet Civilizací: Boj kultur a proměna světového řádu*, trans. Ladislav Nagy (Rybka Publishers, 2001) p.115

¹⁵ U.S. Department of State, Background China

was the outpost from where the EIC started to expand its rule over India.¹⁶ In this chapter, for the sake of simplicity, the word India will (except its present meaning) also refer to the land which used to be the British colony including the territories which do not belong to India today

In 1720s when the Mughal Empire was collapsing, many European nations were competing for the dominant influence in this part of the world. In the end it was the Great Britain which managed to establish a dominant presence in India via the EIC. They had their own army which consisted of both British and local soldiers called sepoys.¹⁷ The victories of this army in the battle of Plassey in 1757 and then later in the battle of Buxar in 1764 marked the beginning of the expansion of the power of EIC in India.¹⁸

The victories in the battle of Plassey and the battle of Buxar gave the EIC a control over contemporary Bengal and Bihar. First the EIC was exempt from the duty to pay taxes and then later in 1765 it was given the power by the Mughal emperor to collect taxes. By 1850s the EIC controlled or had a strong political influence in many princely states which constitute not only contemporary India but also Pakistan and Bangladesh. Originally the EIC was ruled by the governor and 24 directors. These 24 directors constituted the Court of Directors, which had ten committees subordinated to it. The directors of the company were appointed and answered to the Court of Proprietors. But when the power of the company increased and it started to administer increasing number of territories, Britain wanted to exempt the territories from its control and subordinate them directly to the Crown. However the British government was not able to achieve this, but instead an act was passed which stated that the EIC administers the lands for Great Britain with a certain degree of autonomy. This act also appointed a new position for the company which was the Governor General who had administrative powers over the whole British India. This act was significant because it introduced a lot of governmental control into the company.¹⁹ The main resource of the governmental revenue before the arrival of the British but also

¹⁶ U.S. Department of State: Bureau of South and Central Asian Affairs, "Background Note: India," 14.7.2010, 5.3.2011 < <http://www.state.gov/r/pa/ei/bgn/3454.htm> >

¹⁷ Robert McNamara, „A Timeline of India in 1800s: The British Raj Defined India Throughout the 1800s,“ *19th Century History*, About.com, 6.3.2011
<<http://history1800s.about.com/od/thebritishempire/tp/indiatimeline01.htm>>

¹⁸ Banerjee Abhijit and Iyer Lakshmi, „History, Institutions and Economic Performance: The Legacy of Colonial Land Tenure Systems in India,“ *The American Economic Review* Sep. 2005: 1192

¹⁹ „British East India Company,“ *New World Encyclopedia*, 21.10.2008, 11.3.2011
<http://www.newworldencyclopedia.org/entry/British_East_India_Company>

after that was the taxation of land. In 1841 the revenue stemming from the taxation of Land represented 60% of the revenue of the British government in India. This meant that the policies concerning the tax collection were among the most discussed ones.²⁰

As it was mentioned in the last paragraph, in the half of the 19th century the EIC had a very dominant political influence in the Indian subcontinent. One of the important manifestations of this dominant position was the Doctrine of Lapse introduced by the Governor General of India Lord Dalhousie. This doctrine was a rule for the annexation of territories under the British influence. According to this doctrine any princely state which's ruler did not have a son who would replace him, could have been automatically annexed. EIC could also annex states with rulers which they found incompetent. Before the adoption of this doctrine the ruler of a princely state without a direct successor had a right to adopt any male of the royal family to replace him. In some princely states the Rajas or Maharajas adopted several boys who were brought up in the palace as the royal candidates in case the emperor would not have a son. This was a very important Hindu tradition which the doctrine of Lapse abolished. The princely states which were annexed by this doctrine were for example Satara, Udaipur or Awadh. This doctrine was one of the policies which added a fuel for starting a so called Sepoy Mutiny which is discussed later in this thesis.²¹

EIC managed to become a military authority in India and the taxation was very high in the territories which were subordinated to their rule. It is also important to mention that the EIC did not allow any local to hold a higher office in their territories, because they considered them excessively corrupt and unreliable. The high tax and also some others policies contributed to the start of a mutiny of local people (Indian or Sepoy Mutiny).²²

The Sepoy Mutiny was the outcome of cumulating resentment against the British. Natives were simply refusing to accept the reforms, new laws and Christianity which the British rulers were trying to force on them. A critical spark for this revolution was the fact that EIC lost the loyalty of the Bengal army. Sepoys started the uprising in Meerut in

²⁰ Abhijit and Lakshmi, History: 1192

²¹ „Doctrine of Lapse,“ 31.1.2009, 8.3.2011 <http://www.indianetzone.com/14/doctrine_lapse.htm>

²² Kallie Szczepansky, „The British Raj in India,“ About.com 8.3.2011
<<http://asianhistory.about.com/od/colonialisminasia/p/profbritraj.htm>>

1857. Here the sepoys of the Bengal army shot their British officers and started their march on Delhi, which they eventually conquered. News about this revolt spread quickly and other mutinies against the British appeared in northern and central India. This revolution was suppressed in 1858. The casualties were high on both sides.²³

This rebellion was an important milestone for the British rule in India. When this mutiny was finally suppressed the British government decided to discharge the EIC with administering the colonies and instead the British Crown decided to assume direct control. The Mughal Emperor was deprived of his position and exiled. Queen Victoria was given the title of the Empress of India, which meant that the British government maintained the right to directly intervene into any internal matters of any princely state. After the abolishment of the EIC, the British Sovereign started to choose the governor-general directly and the governor-general became known as the Viceroy of India.²⁴ The Viceroy held the highest administrative position in India and he was an official representative of the British Crown. The Viceroy divided India into provinces which were headed by a governor, lieutenant governor or a chief commissioner. Viceroy had a power to appoint the last two positions. Another role of the Viceroy was to oversee the rulers of the most powerful princely states such as the Maharaja of Mysore or the Maharaja of Gwalior. The first Viceroy was Earl Canning who among other things abolished the doctrine of lapse.²⁵

Other important reforms were the start of tolerating Hinduism and Islam and the acceptance of more locals into public services and basically giving more freedom to the local people. Further the British started to import more of the back then modern technologies in order to modernize this colony and people living in it. The education and modernization of people living in the colony had been the goal of the British people also before the start of the Sepoy Mutiny, but after the mutiny the progress in this goal started to be much faster. 28000 miles of railway was built by 1904 and new canal schemes doubled the land which was irrigated. The increased capacity of the steamships and completion of the Suez Canal allowed some portion of the local farmers to sell surplus crops. Another aspect of modernization at this time was the development of industry and

²³Peter Marshall, „British India and the Great Rebellion.“ BBC, 17.2.2011, 8.3.2011
<http://www.bbc.co.uk/history/british/victorians/indian_rebellion_01.shtml>

²⁴ Szczepansky, British Raj

²⁵ „Governor-General of India,“ New World Encyclopedia, 14.10.2007, 14.3.2011
< http://www.newworldencyclopedia.org/entry/Governor-General_of_India >

especially the textile industry in the western part of India. Education started to bloom as well. Many universities and schools were opened in the cities and villages by Hindus and Muslims. Natives were adopting the inventions, knowledge and “know how” from the West while preserving the local Hindu and Islamic culture, hence one cannot talk about westernization, but rather about the renaissance of the native Hindus and Muslims.²⁶ Indians have preserved the Hindu traditions till today. Just like China, India is another example of a country where people adopted and decided to modernize their society by accepting the inventions from the West without accepting the Western lifestyle.

Another important factor in the history of India is the nationalist movement which has achieved the Indian independence from the British. This movement was led by the Indian intelligentsia. These people were usually English-educated and English was the lingua franca for the people who were participating in this movement.²⁷ A very important part of this struggle for the Independence was the Swadeshi Movement. This movement was planned by the elites like Lala Lajpat Rai or Aurobindo Ghose. The basic idea of this movement was to promote the Indian products and convince other people to prefer them to the British products. This movement was successful and provided a large boost for various kinds of the Indian industry.²⁸ Also the Indian press played an important role in the struggle for independence. By 1875 there were already 478 newspapers available. Some were published in English and some in other local language. The newspapers were scrutinizing the British rule and they also helped with building the political movements, institutions and so on.²⁹

A very important institution which played a major part in helping India to acquire her independence was the Indian National Congress. It was established in 1885 and it represented the entry of the new educated middle class into the politics. During its session in Calcutta in 1906 a call for “Swaraj” was issued. “Swaraj” is a form of self-government in a way which already back then existed in Canada or Australia.³⁰ The movement achieved its highest importance when Mohandas K. Gandhi became its leader in 1920. He

²⁶ Marshall, British India

²⁷ „Causes of Indian Nationalist Movement,“ indianetzone, 1.11.2011, 16.3.2011
<www.indianetzone.com/47/causes_indian_nationalist_movement.htm>

²⁸ „Swadeshi Movement, Indian History,“ indianetzone, 1.11.2011, 16.3.2011<http://www.indianetzone.com/26/the_swadeshi_movement_indian_history.htm>

²⁹ Causes of Indian, 16.3.2011

³⁰ „Indian Freedom Struggle (1857-1849),“10.02.2011, 16.3.2011
<http://india.gov.in/knownindia/freedom_struggle2.php>

remained its spiritual leader till 1948. During his leadership the Indian National Congress became a mass political movement. Gandhi managed to expand the membership and increased the popularity by mobilizing people who were living in rural areas. Gandhi's idea of a protest was a peaceful passive resistance. Gandhi was originally loyal to the British government, but after a while he started to consider them unjust and unfair toward the Indians and that's how he got the inspiration for the noncooperation movement. The Congress led three campaigns in this spirit: the Non Cooperation Movement in 1920-1922, the Civil Disobedience Campaign in 1931-1932 and the Quit-India Movement in 1942.³¹ Even though all these movements were eventually stopped in a very violent way by the British, they were significant demonstrations of the dissatisfaction of Indians with the British rule.

India finally became independent two years after WW2. The British prime minister Clement Richard Attlee sent a cabinet mission to India. Its objective was to assess the political situation in India. At this point the formation of independent India was basically inevitable and this committee was supposed to come up with an idea for the best way for the creation of free India. The recommendation of the cabinet mission was the forming of an interim government and convening a constituent assembly in India. This assembly consisted of the elected representatives from the Indian states. The interim government was headed by Jawaharlal Nehru who was a member of the Indian National Congress. However members of the Muslim League refused to participate in the Constituent Assembly and were pushing for a separate Muslim state of Pakistan. At this point there was a lot of tension between Muslims and Hindus in India, so the creation of two separate states with a Hindu majority in one and a Muslim majority in the other was necessary. The plan for the partition to India and Pakistan was devised by Lord Mountbatten, who was the Viceroy of India back then. This plan was eventually accepted and Pakistan appeared on political maps. India finally became independent on the 15th of August in 1947.³² The constitution of India which is still valid today was accepted in January in 1950. India is a federal republic. It consists of 28 states and 7 union territories. The head of the federation is a president and the head of the government is a prime minister. These two posts constitute the executive branch of the government. The most

³¹ "Indian National Congress," ENCYCLOpedia.com, 15.3. 2011
<http://www.encyclopedia.com/topic/Indian_National_Congress.aspx >

³² Indian Freedom, 16.3.2011

influential parties are the Indian National Congress or the Bharatiya Janata Party. The legislative branch is represented by the bicameral parliament which is divided into the Council of States and the House of the People. And finally the Supreme Court represents the judicial branch. The state is democratic and everyone who is 18 has the right to vote.³³ When it comes to the economy, India is a capitalistic country.

³³ Department of State, Background India 16.3.2011

2. Comparison of the Political Systems in India and China

The present political systems of India and China are very different. In China there is a dictatorship of the proletariat and it is a totalitarian country, on the other hand India is not a totalitarian country. The previous subchapters briefly discussed the governmental structures of these two countries and the aim of this subchapter is to discuss them in more detail.

2.1. Comparison of the System of Government

The first major difference between these two countries is in the system of government. The Chinese constitution establishes China as a multinational unitary state, whereas India is a federation of states. The decision of China to establish a unitary state is particularly interesting since countries which spread across large territories tend to be federations. The example to this would be India itself, USA or Canada. However when it comes to economy China is quite decentralized. Officials in different regions are rewarded when the region for which they are responsible prospers and they are quite free to choose appropriate steps to ensure it. Their political carriers are very closely linked to the economic performance of the territories which are assigned to them.³⁴

In China except the National People's Congress there are also the so called local people's congresses (LPC). They are established on the level of provinces, autonomous regions, municipalities, counties, autonomous counties, autonomous prefectures, townships, ethnic townships and so on. These congresses are directly subordinated to the central government. The term of a deputy in LPC of a province, autonomous region, municipality or a city divided into districts is 5 years. In every other LPC the deputies serve only 3 years. LPCs observe the implementation of the constitution, laws and other administrative rules and regulations in the territories which they are responsible for. They also adopt resolutions (dealing with their regional economic and cultural issues) to the extent which is permitted to them by law. Further they can examine and approve plans for local development of culture, economy and public services. LPCs at and above the county

³⁴ Bardhan Pranab, *Awaking Giants, Feet of Clay: assessing the economic rise of China and India* (New Jersey: Princeton University Press, Amazon Kindle Edition 2010) 165

have some additional powers. They can alter inappropriate decisions made by their Standing Committees (working bodies of congress, they maintain the administration while the whole congress is not in session). That is because these committees are established only for congresses which are at and above the county level. Further the congresses at county level and above can choose and recall the judges of people's courts and procurators of the people's procuratorates at the corresponding level.³⁵

Since India is a federation of states the political powers are exercised on two levels: the union level and the state level. Every state has a governor who acts basically as the executive of the state and the president is the head of the whole union. Further the constitution divides the legislative powers between states both on the geographical bases and on the basis of the type of the legislation. According to the article 245 a state legislature can enact laws which affect a territory within that state or the whole state. The Parliament of India which is the highest legislative body can enact laws which affect the whole India. Article 246 divides laws into 3 lists: Union List, Concurrent List and State List. This division is based on the subject a law concerns. The parliament has an exclusive power to legislate on the matters included in the Union List, whereas states have an exclusive power to pass laws concerning items in the State List. The Concurrent List includes policy areas in which both parliament and individual states can legislate. In this case it is clear that a conflict between a law passed by a state and a law passed by the parliament may arise. The article 254 of the constitution provides a solution for such conflict. It basically says that if a law passed by a state is not completely in accord with a law passed by the parliament it must receive the consent of the president of India in order to be valid and if a new law passed by the parliament is not completely in accord with a legislation passed by a state, the provisions of a state law which are conflicting are considered void.³⁶

2.2. Comparison of the Legislative branch

The second difference is that the Indian legislative body is bicameral while the legislative body of China is unicameral. It was already mentioned that the Indian

³⁵ „Local People's Congresses and their Standing Committees,“ GOV.cn, 2006, 22.3.2011

³⁶ Shri P.M. Bakshi „Concurrent Powers of Legislation under List III of the Constitution,“ Ministry of Law and Justice, 26.03.2011 <http://lawmin.nic.in/ncrwc/finalreport/v2b3-3.htm#_ftnref1>

parliament consists of the Council of States (Rajya Sabha) and the House of the People (Lok Sabha) plus president is a member of the parliament as well. Members of the House of the people are directly elected by voters in 543 parliamentary constituencies. In every constituency there is only one winner. Then there are two nominations representing the Anglo-Indian community. These nominations are appointed by the president of India. So currently Lok Sabha consists of 545 members each elected for 5 years. The elections to Rajya Sabha are indirect and they are carried out by the legislative assemblies of individual states and union territories (in case of the union territories only Delhi and Pondicherry have legislative assemblies). Each state is divided into electoral districts which yield one representative each. Every member is nominated for 6 years and one third of this house is renewed every 2 years. This means that in contrast to Lok Sabha, Rajya Sabha is a permanent body. States use the first-past-the-post system of elections. States in Rajya Sabha are proportionately represented with respect to the population size of every state. The president has a power to nominate 12 members to this house.³⁷

Representatives to the National People's Congress, which is the highest legislative body in China, are elected indirectly by deputies of people's congresses on the provincial level. Their term is 5 years. Voters in China can elect representatives to the people's congresses only up to the county level. The deputies of higher level congresses are chosen by the deputies of congresses on the closest lower level.³⁸ This is another difference of the legislative bodies of these two countries. People in India have more influence on national politics since they elect the lower house of parliament directly and each elected representative has more responsibility to his voters since each constituency yields only one representative. In China this feeling of responsibility to the electorate on the national level is basically nonexistent since the deputies to the NPC are elected indirectly. Further the NPC meets only once in 5 years therefore they elect the so called Standing Committee of the NPC which is a body elected for 5 years as well and they carry out the duties of the NPC when it is not in session. There is also the Central Committee which meets once a year and its member are chosen by the NPC as well.

³⁷ „The Electoral System of India,“ Indian Elections, 20.03.2011

< <http://www.indian-elections.com/electoralsystem/index.html> >

³⁸ “Election of NPC deputies,” China Daily, 03.04.2009, 20.03.2011

< http://www.chinadaily.com.cn/business/2009npc/2009-03/04/content_7547220.htm >

NPC has the power to: a) formulate, revise and amend the constitution plus overseeing its implementation b) to enact and revise laws c) elect the members of The Standing Committee d) elect the president and the vice president of the People's Republic of China e) choose the premier upon the nomination of the president f) choose other members of the State Council upon the recommendation by the premier g) select the chairman of the Central Military Commission along with other members which are nominated by the chairman h) elect the president of the Supreme People's Court i) elect the procurator-general of the Supreme People's Procuratorate j) approve and examine plans for the national economic and social development k) examine and improve the state budget l) decide on a territorial matter such as approval of provinces or autonomous regions and so on.³⁹

The legislative powers of the Standing Committee (SC) are more limited than those of the NPC but they are very similar. The SC cannot accept laws which would not be in accord with the laws enacted by the NPC and some laws can only be passed by the NPC itself. The last legislative limit is that the SC cannot amend the constitution. Further the SC has the right to: a) interpret the law and constitution b) supervise the implementation of the constitution c) supervise the work of other state organs d) choose officials or remove them from positions in other state institutions such as the military committee or the ministries, further they can decide to appoint or replace the extraordinary and plenipotentiary ambassadors e) decide on important matters such as ratification of treaties, declaring wars, granting pardons and so on.⁴⁰

As it was already mentioned the legislative body of India is bicameral and proposals of new laws or amendments must be passed by both houses of the parliament. The only exceptions to this rule are the money bills which may be introduced only in the House of the People, hence it is the will of this house which prevails. Further Lok Sabha grants funds for running the administration of the country. When certain circumstances occur, the parliament has the right to assume legislative powers which are normally reserved for the legislative assemblies of individual states. Further the parliament has a power to: a) initiate amendments to constitution b) remove the judges of the Supreme and

³⁹ „Major Functions and Rights of the NPC,“ GOV.cn, 2006, 22.3.2011
<http://www.gov.cn/english/2005-09/02/content_28450.htm>

⁴⁰ „The Standing Committee of the NPC,“ GOV.cn, 2006, 22.03.2011
<http://www.gov.cn/english/2005-09/02/content_28456.htm>

High Courts c) remove the chief election commissioner d) remove the comptroller and auditor general.⁴¹ In addition to these powers, the constitution of India grants the parliament a power to elect and impeach the president and vice president and to admit new states into the union or change the boundaries of the existing states.

Other big difference between the legislative bodies is that in the Chinese case the NPC, SC and other local people's congresses are basically dominated by the Chinese communist party, although there are members of other political parties in the SC or representatives of organizations uniting workers or women. The reason for this is that all these institutions and political parties are substantially influenced by the communist party as well.⁴² In India, the representatives in the Parliament come from different political parties or are independent. There is not a dominance of one party and its ideology over all the other parties or institutions.

2.3. Comparison of the Executive branch

The previous subchapter shows that in India and China, the president is elected by the highest legislative bodies rather than directly by all the citizens. In India it is the parliament which elects the president and in China it is the NPC. On the other hand the difference is that in China the president can be reelected only once, whereas in India there is no term limit.

The Constitution of China in the article 80 describes the functions of the president. According to it the president has a duty to: a) promulgate statutes b) appoint and remove Premier, Vice-Premiers, ministers of ministries or commissions c) appoint or remove the Secretary-General or Auditor-General of the State Council d) confer state medals and titles of honor e) order issues of special pardons f) proclaim martial laws, mobilization orders and the state of war. The president exercises all these powers in pursuance of the decisions of the NPC and its Standing Committee. The article 81 of the constitution states the president receives foreign diplomats on behalf of the People's Republic of China and appoints or recalls plenipotentiary representatives abroad upon the decision of SC. The article 81 further gives the president the power to ratify or abrogate treaties or other

⁴¹ „Parliament,“ india.gov.in, 16.09.2010, 22.03.2011 < <http://india.gov.in/govt/parliament.php> >

⁴² U.S. Department of State, Background China

important agreements with other countries. Since president's actions are based on the decisions of the NPC and SC, the president's role as the head of state has predominately only a symbolic and ceremonial significance, because the president does not make decisions concerning the administration of the country.⁴³

The constitution of India vests the executive power in the president. It does so in article (Ar.) 53. However it also states, that this power is not necessarily exercised by the president directly. This power can be exercised through officials who are subordinated to him or her and this is rather the case in practice. According to the article 74 the president should act upon the advice of the Council of Ministers (CM). However the president is not required to act instantly and may ask the CM to reconsider its decision. Further the president can ask the council to discuss an advice proposed by an individual minister. The following articles grant the president these powers and duties. Ar.75 - power to appoint the prime minister and other ministers upon the advice of the prime minister. Ar.124 and Ar.217 - power to appoint or recommend a removal of a judge of the Supreme Court and a judge of the High Court. Ar.148 - power to appoint the Attorney-General and Comptroller-General. Ar.155 - power to appoint a governor of a state. Ar.263 - power to create special councils which are required by the public interest. Ar.280 - power to appoint members of the finance committee. Ar.316 - power to appoint the members of the Public Service Commission. President also has the power to appoint the plenipotentiary representatives and receive the foreign diplomats. As it was already mentioned the president has the power to appoint 12 members to the upper house and 2 to the lower house of the parliament. Ar.85 and Ar.86 - power to summon the parliament for a session. President has the power to dissolve the House of the People as well. Ar.10 - power to make a final decision (based on the opinion of the Election Committee) about the disqualification of a MP. Ar.111 - power to give or withdraw the assent for a bill. Ar.146 - states that the rules of conduct of the government officials and their salaries which have been proposed by the parliament must be approved by the president. Ar.123 - power to take an immediate action and promulgate an ordinance which seems to be required for a given situation (possible only when circumstances require it and parliament is not in session). Such ordinance may remain valid for 6 weeks at most. Ar.274 - every bill concerning taxation must be recommended by the president. Ar.143 - power to address the

⁴³ „Status of the President,“ GOV.cn, 2006, 22.03.2011
<http://www.gov.cn/english//2005-09/02/content_28467.htm>

Supreme Court with very important questions of law. Ar.240 - power to make regulations for peace, progress and good government of the union territories. Ar.112 - duty to present an annual budget required for the salaries and pensions of government officials, under this article the president has also the power to recommend demands for grants. Ar.72 - power to grant pardons and suspend convictions or sentences of a person for an offense. Ar.352 - grants president emergency powers when a serious threat to the whole country or a single state arises.

In both countries the president is the highest representative of the country and the commander in chief of the armed forces, but as one can see in both countries the true executive power is largely vested in the prime minister and the individual ministries, because the presidents in both countries most of the time act upon the advices of these ministers, or these ministers make decisions on the behalf of the president. However the constitution of India grants more powers to the president than the constitution of China does. The president in India holds limited financial and legislative powers and the his or her power of is largely expanded in a case of emergency. There is no mention of emergency powers of the president in the constitution of China. However the contemporary president of China Hu Jintao is the General Secretary of the Central Committee (CC) of CPC. This adds him more political power. The CC carries out the work of NPC when it is not in session. The secretariat of the CC is the working body of this institution. The General Secretary is responsible for conveying the meetings of the Political Bureau and its Standing Committees and he also presides over the work of the secretariat of the CC.⁴⁴

It was already mentioned that in both countries the real executive power is vested in the prime minister (called Premier in the case of China) and other ministers creating the State Council in China and the Council of Ministers in India. The duty of these two organs is basically the same. They make decisions on the behalf of the president or advice the president to take certain action. This advice is basically binding the president to take the recommended action. The premier of China is nominated by the president, the same is done in India, but the difference is that the prime minister is always the leader of the party which won the majority in elections and is almost always from the lower house of the

⁴⁴ „Constitution of the Communist Party of China,“ 21.10.2007, 26.03.2011
<<http://english.cpc.people.com.cn/65732/6758063.html>>

parliament. The prime minister is the chairman of The Planning Commission of India as well.⁴⁵ The other difference is that the premier in China can serve only two consecutive terms at most, whereas the constitution of India sets no term limit for the prime minister.

2.4. Comparison of the Judicial Branch

The highest judicial organ in India is the Supreme Court of India (SCI). In China, this position is held by the Supreme People's Court of People's Republic of China (SPC). According to the article 124 of the Constitution of India, all the appointments of the judges to the SCI are done by the President of India after (but not necessarily in all cases) consultations with other judges in the SCI and High Court. In China the appointments to the SPC are done by the NPC.⁴⁶ The big difference is that the SPC is not a fully independent judicial body. The article 128 of the Chinese constitution states that, the SPC is responsible to the National People's Congress and its Standing Committee. This implies that the judicial independence does not exist in this case. On the other the Indian constitutions ensures, to a certain degree, the independence of the judges of the SCI. A judge remains in this office until he or she turns 65. The judge can be removed from the office, only when the president proposes it to the both houses of the Parliament and both houses must approve this removal.⁴⁷

The organizational structure of the SPC is as follows. The head is the president. There are several vice presidents. These positions are followed by the presiding judges, the vice presiding judges and the judges. The court is divided into several tribunals with different specializations: criminal, economic, administrative, civil and other tribunals which may be set up if some situation which requires it arises.⁴⁸ The SPC has three areas of responsibility: a) trying cases with the highest level of importance in China, hearing appeals of decisions of higher people's courts and trying cases which the SPC finds to be under its jurisdiction. b) supervision of people's courts at various levels, overruling decisions which are found to be wrong, revisions of cases tried at lower levels and

⁴⁵ „Indian Prime Minister,“ indianetzone, 11.01.2011, 27.01.2011
<http://www.indianetzone.com/2/indian_prime_ministers.htm>

⁴⁶ „The Supreme People's Court,“ GOV.cn, 19.01.2010, 28.03.2011
<http://www.gov.cn/english/2008-03/16/content_921794.htm>

⁴⁷ „Constitution,“ The Supreme Court of India, 28.03.2011,
<<http://www.supremecourtfindia.nic.in/constitution.htm>>

⁴⁸ „The Organizational Setup of the SPC,“ GOV.cn, 2006, 28.03.2011

decisions about interrogations. c) giving judicial explanation of laws in the judicial processes which must be carried out nationwide.⁴⁹ Further the SPC has the right to give approval to hearings for crimes which are not specifically mentioned in the criminal law and the right to approve the death sentences or to delegate the right for this approval.⁵⁰

Contemporarily the SCI consists of 29 judges appointed by the president of India. The head of this court is called the Chief Justice. Since the number of judges is so high and the court receives a lot of cases there are usually 2 or 3 judges present during a trial. But sometimes 5 judges are required to attend a trial. 5 judges are also required when a dispute of opinions or some other controversy needs to be settled.⁵¹ The jurisdiction of the SCI is separated to 3 parts: original, appellate and advisory. The original jurisdiction includes cases of dispute between the government of India and one or more states or cases of dispute between two or more individual states. The SCI has the exclusive power to decide this type of cases. The SCI has also the right to withdraw cases from high courts if they are similar to a case which is being tried by the SCI and when this case includes a question of law of general importance. When a case is withdrawn from a high court the SCI will decide this case itself. Another duty of SCI is to protect the fundamental rights of the citizens of India which are guaranteed in the constitution. The appellate jurisdiction of the SCI includes cases of civil and criminal law. The appellate jurisdiction can be invoked by a certificate granted by the high Court. The first occasion when this can happen is that a case involves a question of law which requires an interpretation of constitution. The second occasion occurs when a civil law case involves a question of law of general importance or when the High Court decides that the said question has to be decided by the SCI. There are three occasions when criminal cases can be appealed to the SCI. The first one is that the High Court reverses a decision about the acquittal upon an appeal and sentences someone to death or imprisonment for life or longer than 10 years. The second one occurs when the High Court withdraws a case from a court subordinated to it and sentences the accused either to death, imprisonment for life or imprisonment for more than 10 years. The third occasion arises whenever the High Court decides the case is fit for the appeal to the SCI. The advisory jurisdiction is defined by articles in the

⁴⁹ "Judicial System: The Supreme People's Court of the PRC," Supreme People's Court of PRC, 25.09.2002, 28.03.2011 <<http://en.chinacourt.org/public/detail.php?id=24>>

⁵⁰ „The Functions and Rights of the Supreme People's Court (SPC),“ GOV.cn, 2006, 28.03.2011 <http://www.gov.cn/english/2005-09/02/content_28480.htm>

⁵¹ „History,“ The Supreme Court of India, 29.03.2011 <<http://www.supremecourtfindia.nic.in/history.htm>>

Constitution and in several acts like Gold (Control) Act, Monopolies and Restrictive Trade practices Act and so on. The SCI has also the power to punish for the contempt of court including the contempt of its self.⁵²

2.5. Concluding Remarks

The political life in China, but also the life of the Chinese citizens is dominated by the Communist Party of China. Socialist ideas are incorporated in the constitution and it also states that the Chinese have a duty to protect it and modernize as a socialist society under the democratic dictatorship of the Communist Party of China. Even though democracy is mentioned in the Chinese constitution several times, people living in the Western society would hesitate to label China as a democratic state. Western ideal of a democracy is not represented by a one party dominance. In sharp contrast to this India does not have a totalitarian regime. People representing diverse ideas and political parties are able to compete for political positions at the state or national level. It should also be mentioned that the fact that society is divided into castes has a considerable influence on the politics of India. Also the separation into castes does not help to equalize the opportunities for well being for everyone.

⁵² „Jurisdiction of the Supreme Court,“ The Supreme Court of India, 29.03.2011
<<http://www.supremecourtfindia.nic.in/jurisdiction.htm>>

3. Economic Reforms in the 20th Century in China

Early in the 19th century the China's share of Income was quite large. Back then together with India, the income of these two countries constituted almost half of the world's income. This share had rapidly decreased over time and in 1950 the combined income of these two countries represented only one tenth of the whole income in the world, however the decreasing trend has reversed. Today their combined income represents approximately one fifth. In terms of GNI China is ahead of India today and its annual rate of growth is far steeper.⁵³ The graph below demonstrates this claim. The chart further shows that in the 80s China was behind India, but this situation changed early in the 90s. But both India and China have recorded a decent growth in this indicator since 1980. From the data provided by the World Bank it is easy to calculate the average annual growth rate. For India and China the average growth rates for GNI are 7,25% and 12,15% respectively.

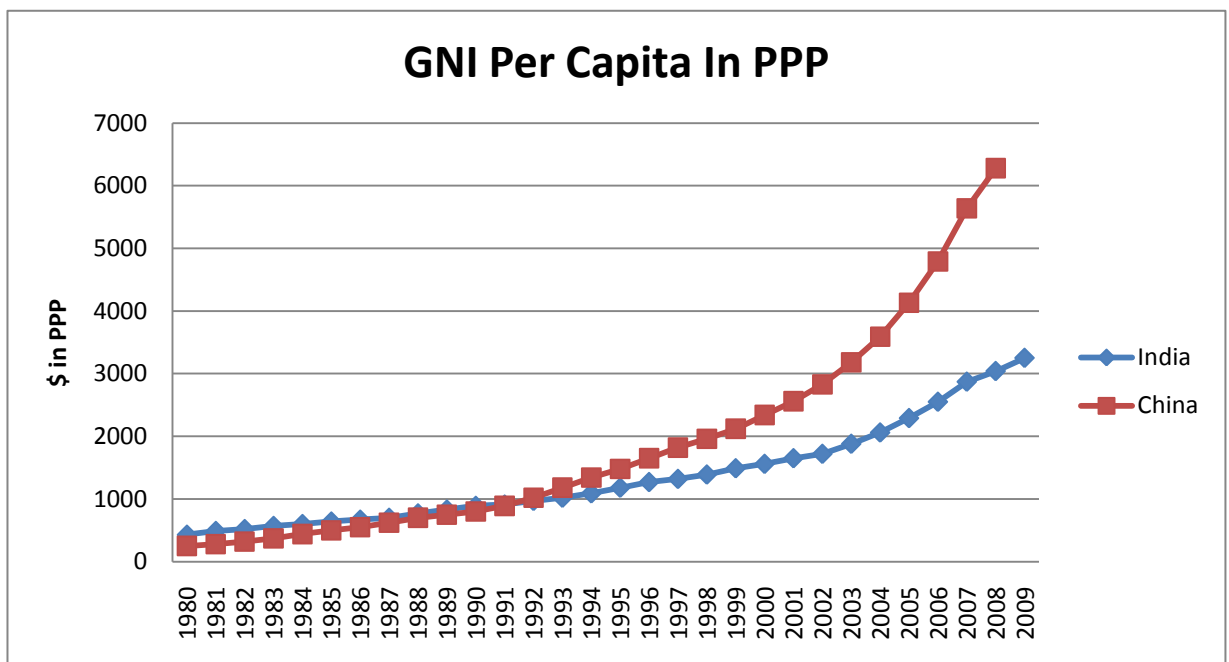


Chart 2: Gross National Income in \$ PPP measured annually for India and China
Source: World Bank

When it comes to other indicators of the economic strength of the nation, one can find a similar story. In the half of the 18th century, China and India were responsible for 32.8% and 24.5% of the global manufacturing output respectively. This means that

⁵³ Bardhan Pranab, *Awaking Giants*, l. 59

they were the world's first and second largest producer of manufactured goods. This share however was decreasing and in 1980 China produced only 5% of the global manufacturing output and India only 2.3%.⁵⁴ But today China is the 3rd biggest manufacturer in the world and India is the 12th. There are predictions that by 2025 China will have gained the biggest share in the production of manufactured goods and India will have become the 7th largest manufacturer in the world by the same year.⁵⁵ The share of the global GDP of these two economies is also rising. Contemporarily China is the 3rd largest contributor to the global GDP. However in 2030 China should be the 2nd largest economy and India the 5th largest economy in the world.⁵⁶

This chapter aims to examine the reforms in the 20th century in China which have helped this country to improve her economy in such a way that today she is in a position of an economic giant again and is very closely watched by the rest of the world. The following 4th chapter has the same goal but instead of China it focuses on India.

3.1. Era of the Centrally Planned Economy (1949-1978)

Since 1949 till 1978/1979 China was a country with classical centrally planned economy common in the socialist countries. However as mentioned in the second chapter, this changed in 1978 when the Chinese government decided to adopt capitalistic principles into the economic system of the country.

One can say that the early socialist period in this country produced good bases for the economic reforms and a start of a period of high economic growth. During this period a good minimal social infrastructure was built meaning that workers had an easy access to health care and education. But the social infrastructure was not the only well developed thing at this time. Power plants and connections to the electric network were spreading quickly across China. This was a good base for the spread of agroprocessing and rural industrialization. Another thing which helped with the rural industrialization in

⁵⁴ Huntigton, Střet p.90

⁵⁵ Finfacts Team „China to reclaim 1830 position as top manufacturing nation in 2020; US share in global service sector output will remain far larger than China's,“ Finfacts.com, 11.06.2007, 30.03.2011 <http://www.finfacts.ie/irelandbusinessnews/publish/article_1010305.shtml>

⁵⁶ „Emerging Markets Representing Larger Percentage of World GDP,“ Seeking Alpha, 06.09.2010, 30.03.2011 <<http://seekingalpha.com/article/223947-emerging-markets-representing-larger-percentage-of-world-gdp>>

China and contributed a lot to the economic growth of the country was a system of regional economic decentralization. As it was mentioned in the 2nd chapter, the Chinese officials have their political carriers linked to the economic performance of the regions which are governed by them. This means that local people's congresses on a county level for example had been in charge of local factories for quite some time, when the reforms arrived, meaning that they had gained a considerable experience and they had created wide manufacturing networks as well. When the reforms came, the production brigades of the early commune system benefited from this experience and already established networks and many successful village and township enterprises occurred, which led eventually to a big industrialization of the rural areas. China was also characterized with very egalitarian land redistribution. This provided some safety net in the rural areas and it also mitigated the effects of various disruptions which are associated with market reforms in their early years. Another factor which helped the reforms was that for a poor country China was spending a lot on research and development. China's spending on R&D expressed as a share of GDP was among the highest ones in the group of poor countries even in 1980. And last but not least the Chinese women have a record of high participation in the labor force and are well educated so their contribution to the economic growth is quite significant.⁵⁷

However this era of planned economy had also its drawbacks which were damaging for China. Industry suffered from several problems which are characteristic for planned economies. One such problem is an unsystematic development of natural resources. This led to imbalanced output-capacity ratios, meaning that there was a lack of preparatory work at mines relative to the rate of exploitation. In this period the only criterion determining success or failure were the gross output targets. This led to practices which boosted the output in the short run, but did not provide for continuing development and full recovery at each location. The mining of coal, copper or other natural resources suffered a lot because of this practice and shortages of supplies for factories or households were occurring. Other problems were bad allocation of machinery, low labor productivity and big material waste.⁵⁸ The main problem of the planned economy is that it ignores interactions between market forces therefore a lot of

⁵⁷ Bardhan Pranab, *Awaking Giants*, l. 165-179

⁵⁸ Elspeth Thomson, „Reforming China's Coal Industry,” *The China Quarterly* Sep.1996: 727-735

inefficiency is present in the system. Plus in the case of China one cannot omit to mention the disastrous effects of Mao's Great Leap Forward program.

3.2. Reforms in 1978-1990s in China

One can distinguish 4 reasons for the start of the economic reforms at this time. Firstly the CCP needed to distance itself from the very unpopular Cultural Revolution and the Great Leap Forward agendas in order to regain the support of the people. Secondly the party officials recognized that the planned economy is unsustainable in the long run because of its flaws and that eventually this economic strategy has to be abandoned. Thirdly, as it was mentioned in the 1st chapter the officials in the Chinese government were impressed by the remarkable economic development of other Asian countries like Taiwan or Singapore, which were already capitalistic. And the fourth reason was that also the people were ready for the reform.⁵⁹ One could probably add a 5th reason, which was the death of the zealous Mao Tze-tung. This event opened the window of opportunity for the start of the reforms, which were launched by the 11th party Congress.

Reforms which moved China closer to capitalism were initiated by the farmers in the Anhui province. These farmers were testing the existing commune control of the use of land. They were also assisted by the local administrators. In a few years a large movement of the Chinese farmers demanding the control over the land use was launched across the whole country and as we know today this movement was successful. The so called household responsibility system was the outcome of this movement. It is a contracting system of the state with individual farm households about their land use. The land is taxed and the produce is a subject of procurement by the state. The mechanism of this system is quite simple. A farming household signs a contract with the state for certain amount of produce it has to supply. Once this limit is crossed the household may keep the rest of the produce for itself and this was a major change. It was not possible before, and this change turned out to be a major incentive for farmers. The increase in agricultural output was immediate. The output rose by 7.1% annually on average since 1979 till 1984, whereas during 1970-1978 the annual average

⁵⁹ Gregory Chow, "The Chinese Economy," *Perspectives*, Overseas Young Chinese Forum, 2010, 02.04.2011 < http://www.oycf.org/Perspectives2/12_063001/chinese_econ.htm >

growth was only 2.1%. The fact that farmers were given the freedom to reallocate land and labor to other crops than traditional grain crops had a considerable effect on this increase as well. The estimates say that about 50% of the growth in agricultural production may be attributed to the new household responsibility system.⁶⁰

The reforms in nonagricultural sectors of the economy were carried out basically in the same spirit as the reforms in agriculture. Managers of various enterprises signed contracts which made them responsible for the performance of a company. These contracts gave them more freedom over decisions about the management of companies. The higher degree of control and responsibility accompanied with the possibility of higher earnings was once again a big motivation for industrial and other sort of enterprises to increase production and become more effective. This is why reforms worked even without changing the ownership of these enterprises which were still owned by the state. These performance contract created a mixture, in which both the centrally developed economic plan was followed but at the same time the market forces entered the economy. The fact that the changes were not so radical in the initial stages minimized the resistance toward these reforms and in 1990s the outright privatization of state owned enterprises or township and village enterprises (TVE) started to be quite common.⁶¹

TVEs contributed a lot to the industrialization of the rural areas in China which was one of the major effects of this large scale economic reform. In 1978 TVEs contributed only 6% to GDP, whereas in 1996 this share climbed up to 26%. TVEs benefitted from two aspects. Firstly in the villages there was a lot of cheap labor. Secondly TVEs had an easy access to the credit from the local credit cooperatives and the local government officials usually acted as informal credit guarantors. These cooperatives were abundant with funds from local farmers whose profits had dramatically increased since the reform in the agricultural sector. And of course the motivation for TVEs to increase production was the fact, that like in the agricultural sector, the TVEs could keep the profits from the surplus production.⁶²

⁶⁰ Bardhan Pranab, *Awaking Giants*, l. 338

⁶¹ Bardhan Pranab, *Awaking Giants*, l. 338-377

⁶² Bardhan Pranab, *Awaking Giants*, l. 354

The enterprises in China initially focused on the production of the labor intensive products which required hardly any advanced technological inputs. This benefited China, because labor intensive industries create new jobs. Today however the production of Chinese factories is shifting more toward high-tech products which require more technological inputs.⁶³

3.2.1 FDI - China

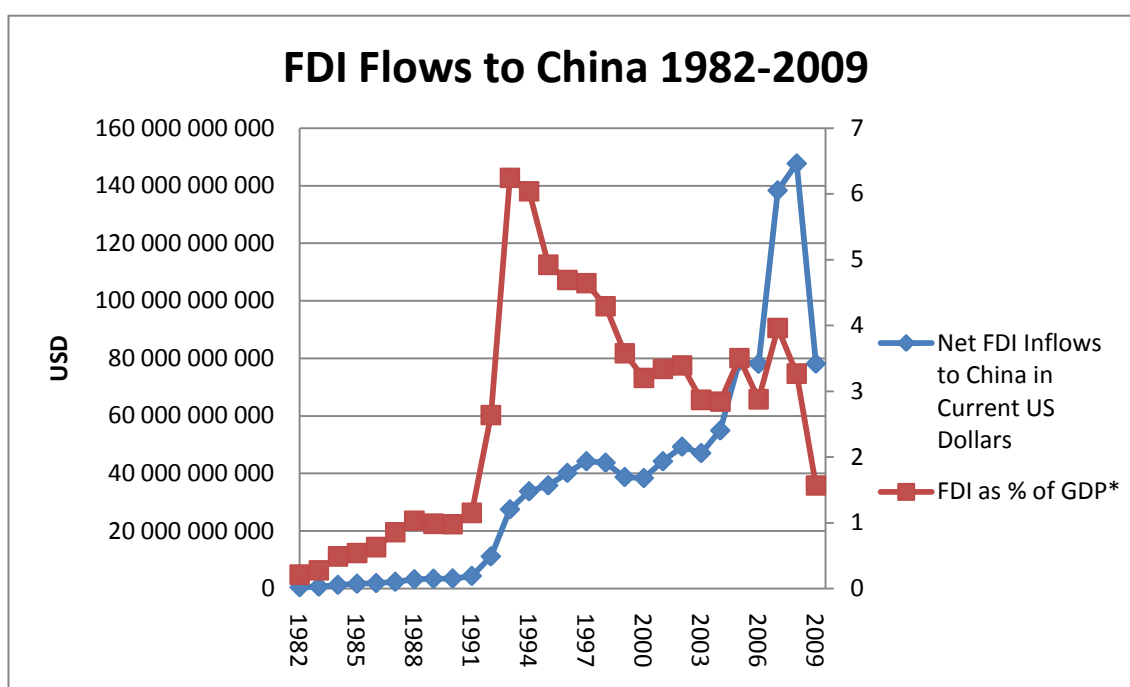


Chart 3: FDI Flows to China 1982-2009 in Current US Dollars

*Right vertical axis represents % of GDP

Source: World Bank

The chart above shows the inflow of FDI to China. Attempts to attract FDI started another wave of reforms. Before 1978, the Chinese were trying to keep the economy of their country isolated and self-sufficient. This strategy however did not prove to be very beneficial. In 1970s it started to be apparent that China was lagging behind other developed nations in terms of the technological development, which of course had a negative impact on the Chinese economic development as well. Therefore the Chinese government decided to partially open the economy to foreigners in order to

⁶³ Bardhan Pranab, *Awaking Giants*, l. 402

allow the imports of advanced technologies from the foreign countries to close the before mentioned gap in the development. The way in which the government decided to attract the FDI, was by a creation of special economic zones (SEZs).⁶⁴ Tatsuyuki Ota identifies 8 different purposes of these zones: “(i) transfer of hi-tech industries into the SEZs; (ii) experiment and acquisition of modern technology and management expertise; (iii) creation of employment; (iv) earning of foreign exchange through promotion of exports; (v) promotion of economic development and regional development; (vi) creation of economic links to the domestic economy with Hong Kong (close to Shenzhen), Macao (close to Zhuhai), Taiwan (close to Xiamen) and overseas Chinese communities (Shantou); (vii) experiment of new economic reform with market forces; (viii) setting-up of a link between the economic hinterland and overseas.”⁶⁵ In these zones the foreign investors received various forms of preferential treatment such as the tax exemptions, more flexible labor laws, less bureaucracy, well developed infrastructure and so on. Another way in which SEZs are attractive for various enterprises is that these zones create industrial clusters what means that companies that decide to set up operations there are able to benefit from the economies of scale.⁶⁶ The first four SEZs were set up in 1980. Their locations are: near Hong Kong in Shenzhen, Zhuhai, Shantou and Xiamen. All these zones were set up near the coast for an easy access to the sea. Then in 1984 it was decided that new SEZs would be established and 14 coastal cities would provide special incentives for the foreign joint ventures. Also the economic and special technical zones were set up in the coastal cities with the aim to develop technology-intensive industries in the country. Pearl River Delta, Southern Fujian Delta, Yangze River Delta are the three areas on the coast which were designated as the open economic zones (OEZ). Their purpose was similar to the SEZs. OEZs are supposed to attract foreign investment and help to develop the export production. Companies which were importing materials in order to assemble them into products designated for exports did not have to pay any import duty. These zones did not attract only foreign investments into manufacturing, but also into services, constructions, tourism and so on. The creation of these economic zones was a very significant step for

⁶⁴ Tatsuyuki Ota, „The Role of Special Economic Zones in China.s Economic Development As Compared with Asian Export Processing Zones : 1979 – 1995,“ *Asia in Extensio*, www.iae.univ-poitiers.fr, p.2, 03.2003, 05.04.2011 <<http://www.iae.univ-poitiers.fr/EURO-ASIE/Docs/Asia-in-Extensio-Ota-mars2003.pdf>>

⁶⁵ Tatsuyuki Ota, *The Role* p.4

⁶⁶ Saeed Khan, „India’s SEZ: Business Zones Development,“ *Social Science Research Network*, p.3, 10.2008, 11.04.2011 <<http://ssrn.com/abstract=1292195>>

the Chinese economic development because it marked the change in the strategy from the inward oriented policy toward the policy of openness and integration into the world market.⁶⁷

These economic zones were very attractive for foreigners. This is proved by the fact, that even though in early 1980s the private property rights were not protected by the legislation, foreign companies decided to invest in China. Basically from almost 0 amounts of FDI flowing into the country, China is now the second most attractive country for foreigners to invest in. FDIs have created new jobs and introduced managerial and technological improvements.⁶⁸ The high technology and capital imports mean that the Chinese workers were able to and also forced to acquire new skills. This in turn led China to have exports which include more skilled labor intensive products.⁶⁹

However the introduction of the economic zones, where enterprises received preferential treatment from the government also had its negative side. Initially the SEZs were not very successful in attracting FDIs which brought imports of advanced technologies or which would be export oriented. A lot of investments into the economic zones actually came from the domestic sources which were seeking the preferential treatment. In the beginning only about 20% of produced goods were used for exports, which in combination of increasing imports created large current account deficits. These zones also required a lot of investments plus the preferential treatment means that the government was also losing potential profits from taxes and other fees. One could say that in this initial period the SEZs were quite cost ineffective even despite attracting a lot of FDI and boosting the economic growth. This prompted the Chinese government to make some modifications concerning these zones. In mid 1980s and early 1990s other sorts of zones which were mentioned earlier, were created and it was also decided that SEZ's main purpose would be attracting high-technologies, and from there these technologies and managerial know-how would be channeled to the rest of the country. As a result the SEZs underwent many changes. The most significant impact of this decision was the rise of the electronics industry, which for example in Shenzhen accounted for 45% of manufacturing output in 1987 despite the fact that only few years

⁶⁷ Tatsuyuki Ota, *The Role* p.3

⁶⁸ Bardhan Pranab, *Awaking Giants*, l. 351

⁶⁹ Gary Gereffi, "Development and Models and Industrial Upgrading in China and Mexico," *European Sociological Review* 2009, p.40

before that it was almost nonexistent. The FDI inflows to the zones started to be very large in this period. The employment rose and the income per capital in SEZs and in similar areas with preferential treatments also climbed. However the major drawback was that these increases were of course accompanied by high inflation and because the increase in per capita income in the zones was so sharp, large regional income disparities occurred in the country. Then later in the 1990s the government was trying to remove them. So as one can see, the attempts to attract FDI do not always have only the positive effect.⁷⁰

But even though FDIs might have some drawbacks, the Chinese economy remains open to them and recently the Chinese Ministry of Commerce announced that it intends to propose measures which would make China even more Attractive for FDI. The goal of these measures will be the boosting of the activity in mergers and acquisitions.⁷¹

3.2.2. International Trade - China

Prior to 1978 the trade with foreign nations was a subject of quantitative quotas included in the economic plan for a given period. The companies which were under the control of the Ministry of Foreign Trade were responsible for fulfilling these plans and were the only ones which were allowed to trade with other nations. However the Chinese planners for foreign trade ignored many aspects of the international markets such as exchange rates or relatives prices hence the share of the Chinese share of the total international trade in the world decreased from already low 1.5% to even lower 0.6% in 1977. Changes concerning the trade with other countries were introduced basically along the other changes in the economy which started in the early 1980s. The rules regulating the international trade were during the 1980s and 1990s. Firstly the Chinese have abandoned the quantitative plans and instead they adopted tariffs and quotas as the new tools for the trade regulation. The Chinese officials were acting in a very protectionist way early in the 1980s. The average tariff rate was 56% and also the government restricted the trade with many commodities by quotas and import licenses.

⁷⁰ Tatsuyuki Ota, The Role p.19-21

⁷¹ Ding Quing-fen, "FDI Barriers Likely to be Eased Further," China Daily, 08.04.2010, 28.04.2011
< http://www.chinadaily.com.cn/bizchina/2010-04/08/content_9701826.htm>

However the protectionist practices have been eventually forsaken by the Chinese authorities. The tariffs were decreased to 15% on average before China entered the WTO in 1992 and the number of goods which is regulated by the quotes has also significantly decreased. Another factor which helped to increase imports was the creation of the economic zones mentioned in the previous 2 articles which were supposed to attract FDI. Companies which were involved in the export processing enjoyed privileges from the government. They were receiving various incentives to import materials for production of finished goods for exports. Later they were allowed to import materials duty-free. The rapid increase in FDI and the spread of companies focused on export processing means that larger and larger proportion of imports to China was subject to lower tariffs or were duty free imports. This had a spillover effect and in the second half of 1990s the government started to include some categories of domestic companies to the group of the privileged ones which did not have to pay import tariffs. In 1994 the revenue from import tariffs was only about 3% of the value of all imported goods. It is interesting to note that initially the Chinese trade policy was contradicting itself a little. On the one side there were high tariffs on imports of which many were quantitatively restricted as well. However on the other hand there were many companies (and especially foreign companies), which were enjoying special privileges and they were exempt from the duty to pay tariffs for their imports.⁷²

It is important to mention that China does not allow the exchange rate of its currency to fluctuate almost at all. Right now it keeps its currency undervalued, which is viewed by other countries as an unfair because it undermines their competitiveness.

⁷² Lee Branstetter, „China’s Embrace of Globalization,“ *Working Papers*, National Bureau of Economic Research, p. 07.09.2006, 08.04.2011 <<http://www.nber.org/papers/w12373>>

4. Economic Reforms in the 20th Century in India

After the WW2, the Indian government had socialist tendencies as well. The layout of the analysis of the reforms in India is similar to the case of China. First the period before the actual reforms is discussed and then later, the reforms themselves are examined.

4.1. Period after the WW2 and before the Reforms in 1980s

Just like in the case of China, after the WW2 India also decided that the economy should be under the governmental control and the government adopted its first five year plan which was similar to those in the Soviet Union. A lot of industrial enterprises were nationalized and very extensive and strict regulations were introduced for all the industries. It was very difficult to start a new business, introduce new products or changes to already existing products. Just like in the case of China, the Indian economy was basically isolated from the rest of the world in this period. The duties on imports were heavy (on some imports the duty is still heavy today) and domestic companies could not invest abroad. These measures were adopted in order to boost the consumption of domestic products and keep the capital at home. However just like in the case of China, the economy was going down the hill. Its performance was very weak compared to the peers. Between the years 1973 and 1987 the average growth of the economy was just 2%, whereas the Chinese economic growth accelerated after the reforms in this period to 8% on average, but India was not lagging only behind China. This gloomy state of the economy forced the Indian officials to adopt some reforms.⁷³ However the reforms were not as successful as in China. There are several reasons for this. First one is that the education of the Indian workers and participation of women in the economy was not and still is not as high as in China. The second reason is that the infrastructure in India was not very well developed. And it is a well know fact that even today India cannot boast very good infrastructure, which is a major obstacle for businesses of all kinds.⁷⁴

⁷³ Sam Staley, „The Rise and Fall of Indian Socialism: why India embraced economic reform,” Reason Magazine, 06.2006, 06.04.2011 <<http://reason.com/archives/2006/06/06/the-rise-and-fall-of-indian-so>>

⁷⁴ Bardhan Pranab, *Awaking Giants*, l. 429

4.2. Reforms in 1980s and 1990s

The reforms in India were mainly about extensive deregulation of various industries and liberalization of trade. As it was mentioned in the previous subchapter, before the reforms companies needed to undergo a lengthy bureaucratic procedure for an approval for the expansion of production or for the changes in their products. Also the establishment of companies was very difficult, plus the production of certain products was reserved only for certain companies and no one else was allowed to manufacture them. The reforms changed this and made it easier for the companies in India to change their production for example and also since the start of the reforms the list of products which may be manufactured only by selected companies has been diminishing. Originally the Indian government restricted private investment into certain sectors of the economy. This practice has been abolished as well and plus some privatization of public companies was allowed. Other changes which helped companies to prosper were the lowering of taxes and the changes in their structure.⁷⁵

Interesting thing about India is that only about 55% of the nonfarm output is in the corporate sector and only 15% of employment is generated by the organized sector. So as one can see, the Indian economy is largely informal. Never the less the reforms had an impact, even though a big part of the Indian economy was not regulated anyway. Both formal and informal sector benefitted from the deregulation and freer market. Most likely some links were created between these two sectors like for example the subcontracting of people working in the informal sector by the businesses in the formal one.⁷⁶

However India has never achieved such expansion of manufacturing of labor intensive products as China has. There are probably four reasons for this. First one is that small companies have troubles with maintaining finances in the long term.⁷⁷

Second one is that India has rigid labor laws.⁷⁸ The most rigidity is caused by the V-B chapter of the Industrial Disputes Act. This act makes firing inefficient workers or redefining a job description of a worker very difficult for large companies. Because of

⁷⁵ Bardhan Pranab, *Awaking Giants*, l. 399-412

⁷⁶ Bardhan Pranab, *Awaking Giants*, l. 426

⁷⁷ Bardhan Pranab, *Awaking Giants*, l. 460

⁷⁸ Bardhan Pranab, *Awaking Giants*, l. 460

this act even the hiring of contract labor for a short term is difficult to do. These laws also inhibit the entry or exit of firms from the market. Further Rigid labor laws discourage companies from hiring new workers, thus production in companies is more likely to be capital intensive rather than labor intensive.⁷⁹ Companies find it more difficult to expand as well if the labor laws are rigid, because expansion usually involves hiring new workers, but as it was already mentioned, companies are discouraged from hiring. It is also widely accepted fact that rigidity in labor laws increases the unemployment rate in a country with such laws. Other negative impact of the rigidity of the labor laws in India stems from the fact that the majority of labor force is employed in the informal sector of the economy in small scale businesses. This informal sector offers lower salaries than the formal factory segment and the productivity of labor in the informal sector is lower as well. However the absorption of workers from the informal sector to the formal one is hindered by the low flexibility in the labor market, thus rigid labor laws in India also prevent more prudent increase in the average wage and labor productivity.⁸⁰ Making labor laws more flexible would benefit workers and their employers as well.

The 3rd reason is a really bad shape of infrastructure in the country.⁸¹ If engineering networks and communications are not well developed it is extremely difficult for companies of any kind to prosper. For example the bad development of communications such as the lack of highways makes it difficult for a manufacturer to acquire desired inputs and deliver products to potential customers as well.

The 4th is the already mentioned reservation of right to produce a lot of type of goods for small scale manufacturers. There are several problems which this rule causes. Firstly it hinders the exploitation of the full potential of the economies of scale. This is because the large scale industries would be more effective in manufacturing products than the small scale ones are and it also prevents the full rationalization of production in larger factories. Secondly it takes away incentive for small businesses to expand their area of operations.⁸² Thirdly this type of policy most likely damages competition as

⁷⁹ Bardhan Pranab, *Awaking Giants*, l. 472

⁸⁰ T.N. Srinivansan, "India's Reform Of External Sector Policies And Future Multilateral Trade Negotiations," *Economic Growth Center Discussion Paper Series*, Yale University, June 2001, p.18

⁸¹ Bardhan Pranab, *Awaking Giants*, l. 460

⁸² Bardhan Pranab, *Awaking Giants*, l. 460-472

well. If there is only one or a small number of companies which produce certain type of goods and other companies basically cannot enter the market, the companies which are already in the market have no incentive to innovate, improve their products or make the production more effective and thus lower the prices for their goods. This rule however is not such a big issue as it used to be, because there are only a few goods now which's production is regulated by this rule.

4.2.1. International Trade - India

Just like China, India initially after its independence in 1947 decided to close and isolate its economy from the rest of the world which led to the marginalization of India from the world trade. The contribution of exports to GDP was declining and the Indian exports were also rising much slower than in the rest of the world. India's economy remained basically closed for other countries till the beginning of 1990s when the reforms concerning the international trade began.⁸³ Before 1991 when the reforms concentrated on the trade with other nations began, India was protecting its domestic enterprises by really high tariffs. The average tariff rate was 87% and the highest tariff rate climbed all the way to 355%. The second way in which the Indian government protected its domestic firms, were the quantitative restrictions which covered the majority of products (90% of manufacturing products) which were imported. India was following the import substitution strategy in this period.⁸⁴

After 1991 several changes took place. Firstly, the list of products which's imports are limited by the quantitative restrictions have been significantly shortened. For example the share of products in the manufacturing sector (expressed as a percentage of the sectoral GDP) limited by quotas was 90% before the reforms started, but after 1991 this share has been decreased to 36%. However such significant shortening of the list of products covered by the quantitative restrictions did not occur in every sector of the economy in the 1990s. Before 1991 imports of 94% of the agricultural goods were regulated by the quantitative restriction and this number had decreased only to 84% by 1995. But in 2001 most of the quantitative restrictions on all sorts of products were abolished. Now the balance of external payments is controlled by

⁸³ Srinivansan, India's Reform, p.1-2

⁸⁴ Srinivansan, India's Reform, p.4

the floating exchange rate rather than by various quantitative restrictions. Secondly the average tariff and the maximum tariff rates have been decreased to 24.6% and 45% respectively. However the average tariff rate has been slightly increased since.⁸⁵ The reduction of tariffs for imports meant that the producers in India were no longer significantly discouraged from using foreign inputs, which resulted in the introduction of a whole variety of new products and a lot of the Indian companies along with the consumers benefited.⁸⁶

Exports from India used to be controlled by the governmental regulations as well. Prior to the liberating reforms, some exports were subsidized and exports of certain goods were restricted. There were several sorts of restrictions which were used. Beside quantitative limits and bans on exports of some goods, there were also taxes or minimum export prices. Indian government was especially keen on regulating agricultural exports. In this sector some of the restrictions persisted till April 2001 when they were finally abolished. The Indian Rupee used to be pegged to the British Pound. This led to a substantive depreciation after the abolishment of the Breton Woods, when the Pound depreciated which of course benefited the Indian exports. Another major depreciation occurred in 1991. The Rupee depreciated by 22.8% which back then in the real terms was 16.3%. After this depreciation the government decided to withdraw the export subsidies. It has to be mentioned that in 1991 there were some temporary measures adopted as a response to the liquidity crisis which came that year. These measures included export licensing or dual exchange rates. However these measures were only temporary and they had been withdrawn by 1993.⁸⁷

4.2.2. FDI - India

The Indian government decided to attract FDI in a way which is similar to the Chinese method. Initially the Indian authorities decided to set up export processing zones (EPZ). Setting up of various forms of special zones for economic purposes was and still is a favorite practice in the countries which have a lot of bureaucratic regulations and barriers for the inflow of investments or international trade and which

⁸⁵ Srinivansan, *India's Reform*, p.4-7

⁸⁶ Bardhan Pranab, *Awaking Giants*, l. 437

⁸⁷ Srinivansan, *India's Reform*, p.1-5

suffer from the poorly developed infrastructure. These EPZs, SEOs and other sort of economic zones provide a relatively swift solution for getting past these problems. Changing all sorts of laws and regulations takes a long time and building or improving infrastructure across the whole country is costly. So this is why many countries including India have decided to set up special zones in order to attract the FDI (but investments from domestic sources as well) into the country.⁸⁸ The Chart below shows the flow of FDI to India. Even though India tries to attract foreign investors like China, one can immediately see that India is not as attractive for investors as China.

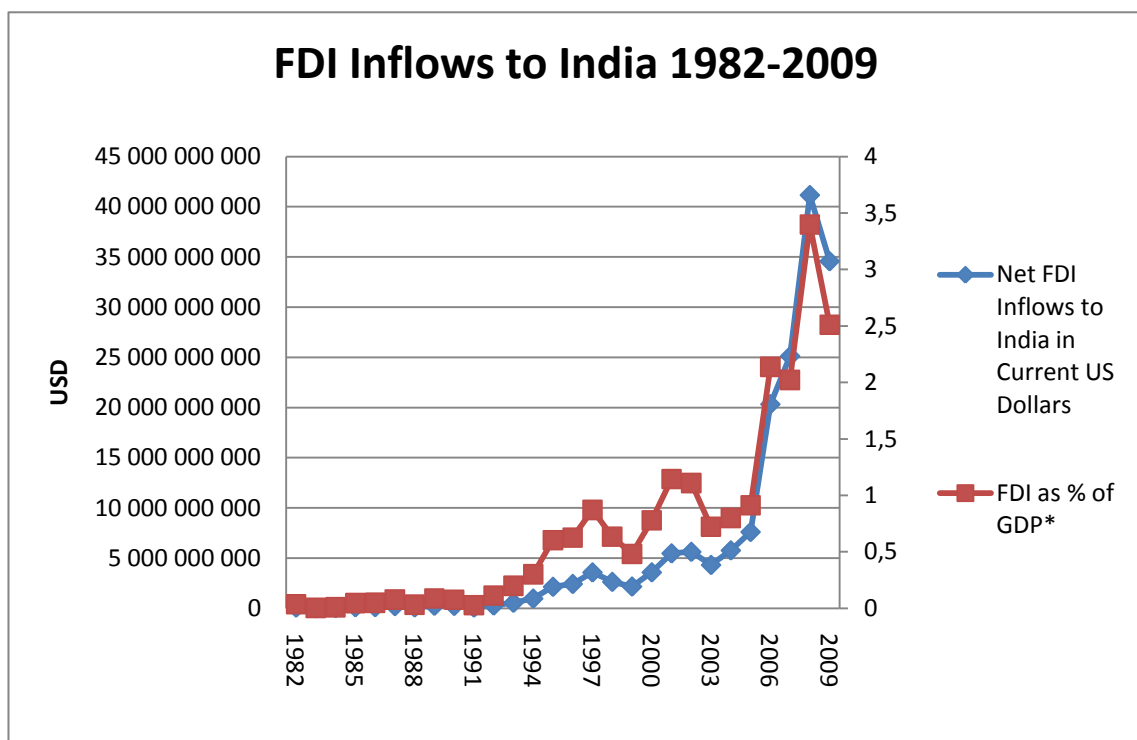


Chart 4: FDI Inflows to India in Current US Dollars

*Right vertical axis represents % of GDP

Source: World Bank

EPZs were introduced in India before the already mentioned reforms of the economic relations with other countries and foreign businesses which took place in 1991, but the attitude of the Indian officials toward the foreign investors who were willing to invest into the country was not very friendly in this period. EPZs were the only areas where foreigners had the limited access. Generally the limit of equity participation for foreigners was 40%, the approval from the government was required

⁸⁸ Khan, „India’s SEZ p.3

for the technology transfer, investors had to accept export obligations and they also had to gradually increase the share of Indian inputs in the company's production process. These restrictions and limiting conditions are the reason why India was not a very popular destination for FDIs.

Later the Indian government recognized that attracting the FDI may have potential benefits, such as those which were described in the Chinese case and so it decided to ease the access for the foreign companies to the country's economy. The Indian government decided to pass the so called Trade Related Investment Measures which have eased the process of investing into India. Particularly this agreement has removed the export obligations and the requirement to increase the share of the Indian domestic inputs in the production. But the abolishment of these measures is not true for all the industries and in some cases these measures are still applied. Other accepted measures which have eased the process of investing into India are the discretionary mechanism of approval via the Foreign Investment Promotion Board and an automatic approval mechanism through the Reserve Bank of India. This mechanism was used especially for the investments into the infrastructure.⁸⁹ The government decided to open new SEZs too. The officials found that EPZs did not work as well as it had been expected. India was inspired to open SEZs by the Chinese. The main difference between an EPZ and a SEZ is that EPZ is just an industrial enclave whereas SEZ is an integrated township with a very well developed infrastructure. It was also decided that all the original EPZs will be converted to SEZs. However even the SEZs were not as attractive for the investors from abroad as it had been expected. Therefore further legislative changes were made and the SEZ act was enacted in 2005. The biggest change it introduced to the administration of the SEZs in India is the establishment of the single window clearance mechanism (SWCM). Before this act, incentives for investors making investments into SEZs had to be approved by different institutions and ministries. This act has set up the board of approval and assigned the whole administration of SEZs to its members and to the office of the Development Commissioner.⁹⁰ It used to be quite common that the actual amount of FDI which flowed into the country was half of the number had been approved by the federal government. This is because many of the approved projects were stopped by the bureaucratic machinery of individual Indian

⁸⁹ Srinivansan, *India's Reform*, p.3

⁹⁰ Khan, „*India's SEZ* p.5-6

states.⁹¹ In addition to the introduction of the SWCM, the act provides new tax incentives for investors and it also makes some changes in the SEZ infrastructure, like setting up the free trade and warehousing zones, offshore banking units and financial service centers in SEZs and so on.⁹²

SEZs turned out to be very beneficial for India. Thanks to these zones new sorts of products started to be manufactured in India, and thanks to the exports of these new products the India's image has been improved in the international market. Thanks to the SEZs a new technique in the jewelry sector has been invented. This innovation, a so called wax setting technique, has promoted the jewelry production to a highly advanced and modern large industry. In 2002-2003 the exports of jewelry from SEZs accounted for the total of 55% of all the jewelry exports from India. SEZs are also responsible for the IT boom in India. When Tata and Burroughs as partners established a facility in a SEZ, the Indian software exports experienced a major boost. Ever since a lot of technology oriented companies such as Hewlett-Packard or Nokia have invested into India and have set up facilities there. Another way in which SEZs benefit India is that companies which set up operations there create a lot of jobs for locals.⁹³

However the SEZs also provide reasons why there are people in India who are against them and SEZs are a very hot topic for discussion. People who are against the SEZs include farmers, politicians, scholars and others. There are many complaints against the land acquisition procedure and the displaced farmers are those who are particularly dissatisfied with it and there are also worries that a lot of fertile land is lost to SEZs. Plus there are worries that SEZs may distort economy and bring substantive income inequality. There are also many who believe that the loss of the potential revenue under the current SEZ policy is greater than the benefits which SEZs bring.⁹⁴

⁹¹ "India Foreign Direct Investment," EconomyWatch, 12.04.2011

< <http://www.economywatch.com/foreign-direct-investment/fdi-india/> >

⁹² Khan, „India's SEZ p.6

⁹³ Khan, „India's SEZ p.6-9

⁹⁴ Khan, „India's SEZ p.10-11

4.3. Concluding Remarks

The history of the economic development of India and China can be summed up as follows. Both countries after the WW2 started basically as planned economies where the income was low. In order to achieve acceleration in the economic development they relied on the theory of the balanced economic growth and on the Harrod – Domar model which supports both the planned economy and investment controls by government in order to maintain high savings. However later the model of the planned economy failed in both countries and the government realized that in order to maintain the high economic growth and keep the standard of living of the citizens improving the capitalistic principals have to be implemented into the system. Eventually both countries adopted them and today they are mostly capitalistic. However despite all the reforms which were adopted the governments of these countries are still criticized for maintaining a lot of control over the economy. This point is more developed in chapter 6.

In China different private companies have developed a clientelistic relationship with the government. They support the government and accept its dominance. In return they get an easy access to the state resources, political protection and partnerships with the officials. The predictable and stable political environment is more beneficial for these companies than the true democracy which entails the changing composition of leadership.⁹⁵

One more thing which should be mentioned here is that there is a common misconception that the integration into the global market place is the sole factor which has helped to boost the economic growth in these two countries. This is not completely true. The integration into the global market has helped, but a lot of the growth has been caused by domestic factors as well.⁹⁶

⁹⁵ Bardhan Pranab, *Awaking Giants*, l. 1179

⁹⁶ Bardhan Pranab, *Awaking Giants*, l. 130-143

5. The Economic Growth and its Patterns

This chapter examines which sectors are the main engines of the economic growth in the two countries which are being analyzed and in the second part of this chapter it is determined whether these countries follow the Kuznets or Marx pattern of the economic growth. The charts and tables which support the results mentioned in this chapter are included in the appendices 1-20. Two Microsoft Office Excel documents with all the data on which these results are based can be found on the CD. The Appendices 21-23 further contain the charts which show the GDP growth of both countries and the current composition of GDP.

5.1. Drivers of the Economic Growth and the Challenges They Face

In both countries the high economic growth rates which have been preserved till today started after the economic reforms had been implemented. These reforms are very significant because in both countries they represent the shift from socialism to capitalism. The growth in India has always been associated with the boom in services, whereas the Chinese growth has always been connected to manufacturing.

When one talks about manufacturing in China one cannot omit the supply chain cities. This term has two meanings and both meanings are important for the Chinese manufacturing. The first one refers to the giant company specific factories. In this case the whole supply chain of a firm is brought together in order to minimize the transaction costs and take advantage of the economies of scale. The second meaning of this term applies to the single product industrial clusters (cluster cities). These have evolved in the coastal regions. The clusters cities do not consist of only manufacturing facilities producing a specific product, but they also attract related businesses hence creating a network which is beneficial for all the enterprises involved. Examples of these clusters are for example Datang (production of socks), Hayiu (production of casual wear) or Xintang (production of jeans).⁹⁷ These large clusters take advantage of the cheap labor force which consists of the young Chinese. Many export oriented enterprises in these clusters are owned by foreign firms, which count on the cheap labor as well. However

⁹⁷ Gereffi, Development and Models, p. 46-47

the supply of cheap labor is slowly, but surely running out. Because of the demography control of the Chinese government the workers are getting older and there are not as many newcomers. This gives workers more power to demand higher wages, which is exactly what is happening. Factories are forced to compete more for workers and they have to offer higher wages also because some older migrant workers would not move in order to work for a low salary. The effects are the rising real wage of the workers and the increase in the cost of imports from China. Maybe sooner or later China will have to change its target market for exports and will have to rely more on its domestic market.⁹⁸ Beside manufacturing China is a favorite place for research and development as well. Companies like to establish R&D centers there, because the Chinese engineers boast good quality and their wages are relatively low. The high interest in establishing R&D centers in China is underpinned by the fact that in 2004 China registered more than 600 multinational R&D centers whereas in 1997 only around 50 such centers were registered.⁹⁹ Never the less the main drivers of the economic expansion in China today are exports and the government's investments into infrastructure.¹⁰⁰

India is well known for the performance of software and other IT related businesses, but not all the growth in the service sector can be attributed to the growth of the software, telecommunications or financial services. There is evidence that a lot of growth occurred in the traditional unorganized services, which probably benefited from the spillover of the changes which occurred after the reforms in the organized ones.¹⁰¹ It should be noted that recently the manufacturing has started to contribute more to the economic growth in the country.¹⁰² A big obstacle for the faster growth of the industrial sector in India is the problematic distribution of electricity and frequent blackouts. These frequent black outs cause damage to the equipment of factories and are responsible for big disturbances in the production process. This is why most of the medium and large companies have their own private power generators which are more reliable, than those owned by the public distributors of the electric power. However this method of the production of the electricity is costly. The cost of power production for

⁹⁸ "The next China," *The Economist*, 31.07.2010

⁹⁹ Gereffi, *Development and Models*, p. 40

¹⁰⁰ "China," *Index of ECONOMIC FREEDOM 2011*, The Heritage Foundation and The WALL STREET JOURNAL, 20.04.2011 < <http://www.heritage.org/index/Country/China> >

¹⁰¹ Bardhan Pranab, *Awaking Giants*, l. 454

¹⁰² „India“, *Index of ECONOMIC FREEDOM 2011*, The Heritage Foundation and The WALL STREET JOURNAL, 20.04.2011 < <http://www.heritage.org/index/Country/India> >

manufacturing in India is 35% higher than in China.¹⁰³ Also one cannot omit outsourcing of many different kinds of business for which India is a very favorite destination. Call centers are probably the best known example. And like China, India hosts many R&D centers of companies from the rich world as well.

5.2. Kuznets vs. Marx Pattern of the Economic growth

The earlier phase of the economic development of the advanced capitalistic countries in the beginnings of industrialization was akin to the Marx's ideas about capitalism. High savings and investments were typical for this period, because as Marx said, income was concentrated in the hands of capitalists. The capital's income share is higher than the labor's share, hence the income inequalities are more pronounced. This initial phase of the economic development is called the Marx pattern of the economic growth. The pattern of the economic growth which occurred later, once the economies developed to a certain degree is called the Kuznets pattern of the economic growth. Kuznets pattern in contrast with the Marx pattern decreases the income inequalities.¹⁰⁴ The summary of both patterns can be found in the table below.

Marx Pattern vs. Kuznets Pattern			
Variable (expressed in real terms)		Marx (Phase1)	Kuznets (Phase 2)
Income per Capita	Y/N	Increase	Increase
Labor Productivity	Y/L	Increase	Increase
Capital per Capita	K/N	Increase	Increase
Capital-Labor Ratio	K/L	Increase	Increase
Capital-Output Ratio	K/Y	Increase	Decrease
Capital's Share in Income	$r \cdot K/Y$	Increase	Decrease
Saving Rate	S/Y	Increase	Constant
Interest Rate	r	Constant	Constant
Wager Rate	w	Constant	Increase
Relative Contribution of TFP	$G(A)/G(Y/N)$	Small	Large
Relative Contribution of TFP	$G(A)/G(Y/L)$	Small	Large

Table 1: Kuznets vs. Marx Pattern of Growth

Source: Hayami & Godo, *Development Economics*, p.162

¹⁰³ Bardhan Pranab, *Awaking Giants*, l. 817

¹⁰⁴ Yuriyo Hayami & Yoshida Godo, *Development Economics: From the Poverty to the Wealth of Nations* (Oxford: Oxford University Press):161

As one can see in the first four rows of Table 1, the patterns look the same. Income per capita, labor productivity, capital per capita and capital-labor follow an increasing trend. However there is a difference which is not seen on the first glance. In the Kuznets pattern of economic growth the Y/N and Y/L are increasing faster than the capital per capita and the capital-labor ratio. This results in a decreasing trend of K/Y . In the Marx pattern it is exactly the other way around. The fifth row of Table 1 shows that K/Y is increasing if the economic growth is following the Marx pattern. This means that K/N and K/L are rising faster than Y/N and Y/L . The last two rows show another significant difference in the production functions. Decreasing trend of the returns to capital is overcome by a large shift in the production function in the Kuznets pattern of the economic growth. This is indicated by the large values of the relative contributions of TFP (total factor productivity). In the Marx pattern these shifts do not occur or are only small. In the Marx pattern the decreasing returns to capital are only overcome by adding more capital per worker. The fact that the capital's share of income is increasing in the Marx pattern of growth implies that in this first phase of the economic development after industrialization the technical progress is biased toward the capital-using and labor-saving direction. In contrast the Kuznets pattern suggests that the technical progress is biased toward the labor-using and capital-saving direction. In the Kuznets pattern the capital's share of income is decreasing while the wage is increasing and the interest rate is constant. Increasing savings in the Marx pattern indicate that "wealthy capitalists" own a major share of income and their tendency to save is high, therefore the saving rate expressed as the ratio of GNI in row 7 of Table 1 is increasing. It must be mentioned that in the phase 1 of the economic development the high propensity to save can be maintained only when the technology develops in the capital-using direction so the high level of return from capital is maintained. Marx also assumes that laborers do not save anything which is a big difference from the Kuznets' assumption. In Kuznets' pattern the constant saving rate along with the increased labor's share of income and together with the rising wage rate relative to the interest rate reflect the labor's high propensity to save.¹⁰⁵

Some of the variables are self explanatory and in some cases a clarification might be needed. Labor is expressed as the total amount of hours during which all the

¹⁰⁵ Hayami & Godo, Development Economics, p.163-164

workers in a country worked in a given year. Wage rate is hence expressed as an average hourly wage. Capital (K) is represented as an estimate of the stock of fixed industrial capital in a given year. Real interest rate is represented by the lending rate adjusted for inflation, which is measured by the deflator of GDP. $G(\dots)$ represents the growth rate of any variable which is in the parentheses. $G(A)$ meaning the rate of growth of total factor productivity is calculated in the following manner.

$$\text{Formula 1: } G(A) = G(Y) - \alpha G(L) - \beta G(K)$$

What G stands for was already explained. α represents the production elasticity of labor (L) and β stands for the production elasticity of capital (K). So they express by how much the GNI (Y) will increase if a 1% increase occurs in labor or capital input. The following simple equations show how α and β can be calculated.

$$\text{Formula 2: } \alpha = w \cdot L / Y$$

$$\text{Formula 3: } \beta = r \cdot K / Y$$

w stands for wage rate and r for interest rate. A meaning the total factor productivity explains the share of growth of GNI which cannot be assigned to the increases in labor or capital inputs. This growth is then caused by an improvement in technologies and know-how. And Formula 1 shows how to calculate growth in this aspect of GNI growth.¹⁰⁶

Data for calculations which are required for determining the growth pattern of a country have been obtained from various sources. Data concerning the real GDP, real GDP per capita and the real interest rate are retrieved from the World Bank's statistical database called World dataBank. These data can be easily found under the category named World Development Indicators & Global Development Finance. Collecting data about labor in individual countries was more complicated. Calculating average hourly wage required some assumptions which were necessary to make since all the data about this variable could not be found. Real average hourly wage is calculated as follows. Data containing average annual wage of workers in China have been obtained from the

¹⁰⁶ Hayami & Godo, Development Economics, p.146-147

Statistical Yearbook 2006 and 2009 which is regularly published by the Chinese National Bureau of Statistics. However these data are expressed in current Yuans, therefore they had to be transformed to the real terms. For this transformation data from World Bank were used.

$$\text{Formula 4: } arw_t = aw_t * (RGDP_t / GDP_t)$$

arw_t – average real wage in year t

aw_t – average wage in current prices in year t

$RGDP_t$ – GDP in constant prices in year t

GDP_t – GDP in current prices in year t

$RGDP_t / GDP_t$ shows a real value of 1 Yuan in a given year, hence if average wage is multiplied by this multiplier, the product is the real wage rate. There is one more problem about these data. There is gap between 1985 and 1990, therefore the assumption was made, that the wage was rising by an equal amount between these years. Average daily wage rates for India have been obtained from the statistical database of the Labor Bureau of India under the Annual Survey of Industries. Like data for China, wage rates in India are also recorded in current Rupees, therefore Formula 4 had to be used for their transformation to the real value. This data cover the average wages connected with the activities in manufacturing. These data were collected because the database in which they are included is the most coherent one and manufacturing right after the state sector employs the highest share of workers in the category of formal employment. Unfortunately data for wages in the state administration could not be found. Further the arw_t had to be calculated for 1 hour of work. Number of hours during which workers worked in both countries is obtained from the statistical database of the International Labor Organization called LABORSTA under the heading “4A Hours of work, by economic activity (Per week)”. The problem with these data when it comes to China is, that they do not cover the whole required period. Hence the average amount of hours worked was used for all the calculations. Estimation of the stock of fixed capital for China required collecting data from several sources. The most recent estimate of the stock of the fixed industrial capital is retrieved from the paper by Kuan Chen, Gary H. Jefferson, Thomas G. Rawski, Hongchang Wang, Yuxin Zheng. The paper is called Estimates of Fixed Investment and Capital

Stock for Chinese State Industry and it was published in China Quaterly in 1988. This estimate is already adjusted for depreciation however it is not in real Yuans, therefore this datum has to be adjusted by the use of the same approach as in Formula 4. The only difference is that the wage rate is replaced by the amount of capital. The following formula was used for estimating the amount of fixed capital in China in the years following 1985.

$$\text{Formula 5: } \text{Cap}_t = \text{Cap}_{t-1} * (1 - d_{t-1}) + g_t$$

Cap_t – amount of fixed capital in the country in year t

Cap_{t-1} – amount of fixed capital in the country in year t-1

d_{t-1} – average depreciation rate in year t-1

g_t – gross fixed capital formation in year t

The average depreciation rate of capital was calculated by Chong-en Bai, Chang-Tai Hsieh and Yingyi Qian in a paper called The Return to Capital in China. Amounts of gross fixed capital formation are provided by the World Bank in World dataBank. It is quite obvious that data collected in such manner as this cannot boast a pinpoint accuracy, but it is the best estimate that could have been made from the available data. Data estimating the fixed industrial capital in India are retrieved from a document called Time-Series Data on Annual Survey of Industries, which is published by the Ministry of Statistics and Programme Implementation. The amounts are recorded in current Rupees therefore they have to be converted to the constant prices by the same sort of multiplier which is used for the conversion of other variables. Data for China cover the period since 1987 till 2008. Period covered by the data concerning India starts in 2001 and ends in 2008. The reason for the choice of these periods is data availability. Unfortunately because of the short span of data for India, the results concerning India may not be very accurate. The reason why data are selected in the national currencies is that the comparison is focused on the domestic trends in the economy, which are then being compared. The focus of the research is not the sole comparison of the values of different variables which would require conversion of individual currencies to dollars for example (this would however cause undesirable distortions for this research which would be caused by the fluctuations in the exchange rates) or even better to the power purchase parity units. But since the domestic trends such as growth of the real domestic

product per capita in a country is what the research is focused on, these conversions are not needed. It should also be noted that since the inputs are not 100% accurate, the estimates of their trends are also only roughly accurate. However the level of accuracy of collected data should be enough for the purposes of this thesis. The accuracy problem is also mentioned in Development Economics, a book by Yuriyo Hayami and Yoshida Godo. The methodology in this book is applied to the calculations in this thesis. Findings of this research are presented in the following way. There is a table for India and China which is basically the same as the one summarizing the characteristics of the Kuznets and Marx patterns of growth. The actual trend which is followed by a variable is highlighted in red in the case of China and in green in the case of India. A short summary of results accompanies each table.

5.2.1. Results

The following table contains the results for China. Charts and a table supporting the comments below this table are available in the appendix.

CHINA - Marx Pattern vs. Kuznets Pattern*			
Variable (expressed in real terms)		Marx (Phase1)	Kuznets (Phase 2)
Income per Capita	Y/N	Increase	Increase
Labor Productivity	Y/L	Increase	Increase
Capital per Capita	K/N	Increase	Increase
Capital-Labor Ratio	K/L	Increase	Increase
Capital-Output Ratio	K/Y	Increase	Decrease
Capital's Share of Income	$r \cdot K/Y$	Increase	Decrease
Saving Rate	S/Y	Increase	Constant
Interest Rate	r	Constant	Constant
Wager Rate	w	Constant	Increase
Relative Contribution of TFP	$G(A)/G(Y/N)$	Small	Large
Relative Contribution of TFP	$G(A)/G(Y/L)$	Small	Large

Table 2: China – Marx Pattern vs. Kuznets Pattern; *trend which is being followed by a given variable is highlighted

Source: own work

The variables in the first four rows behave according to the hypothesis of both Marx and Kuznets. They share the same expectations about the tendencies of these variables in the economic development thus one cannot determine which pattern is being followed in the economy by looking only on these four variables. The expectations start to differ in the fifth row. The capital output ratio had behaved according to the Marx's expectations and only recently a slight decrease occurred. Maybe it is too soon to say that this is a beginning of a stable trend but if the growth rates of the first four variables in the table are examined, one may be tempted to say that it actually is a beginning of a new decreasing trend. As it was mentioned earlier in this chapter, if Y/N and Y/L are growing slower than K/N and K/L , K/Y is increasing. However the difference between the growth rates keeps getting smaller and in 2007 the growth rates of Y/N and Y/L were both higher than those of both K/L and K/Y . On the other hand the $r \cdot K/Y$ exhibits a clear decreasing trend, which is according to the Kuznets expectations. One can say that the saving rate is constant in China. In the beginning of the analyzed period the saving rate was kept at approximately the same level. Then a period of slight increase occurred which was followed by a period of a slight decrease. After this decrease an increase followed which was recently replaced by a constant rate. When it comes to the real interest rate, it is clear that it is not constant. It keeps fluctuating quite rapidly and right now it is in a state of decrease. However the trend concerning the wage rate is quite clear. It is increasing and if one looks on the chart in the appendix one can see that the rate of increase has risen quite considerably since the beginning of the series. If one looks on the results concerning the relative TFP values one can see that they are quite high which is a condition described by the Kuznets pattern of growth. So one can safely claim that China's economic growth has already reached a transition point where its pattern meets almost all the requirements for phase 2 of the economic development.

Following are the results for India. The presentation of results follows the same procedure as the case of China. The table which summarizes the outcomes of the research concerning India can be found on the next page. Charts and a table supporting the conclusions here are located in the appendix. One can once again the first four variables behave as expected by both Kuznets and Marx. The capital-output ratio has been increasing for a few years now. This increase has replaced the decreasing trend which the variable was following since 2001 till 2004. True the value of this variable is

still lower than it was in the beginning of the analyzed period, however the new increasing trend has been quite persistent for the last few years and if one examines the growth rate of the first four variables, one can draw a conclusion that this variable will most likely keep rising in the near future. The development of the capital's share of income has followed a similar path. It was decreasing since 2001 till 2004 and since then it has increased again. Once again just like in the case of China one cannot say that the real interest rate in India is stable. The interesting thing is that even though every variable so far is behaving according to the Marx's expectations, the wage rate is rising. And the rate of increase is quite high. And as in the case of China the relative contribution of TFP is large. The overall picture shows that India is slowly leaving the Marx pattern of the economic growth. The wage rate which's rate of increase is quite sharp and the large contribution of TFP point to this departure.

INDIA - Marx Pattern vs. Kuznets Pattern*			
Variable (expressed in real terms)		Marx (Phase1)	Kuznets (Phase 2)
Income per Capita	Y/N	Increase	Increase
Labor Productivity	Y/L	Increase	Increase
Capital per Capita	K/N	Increase	Increase
Capital-Labor Ratio	K/L	Increase	Increase
Capital-Output Ratio	K/Y	Increase	Decrease
Capital's Share in Income	$r \cdot K/Y$	Increase	Decrease
Saving Rate	S/Y	Increase	Constant
Interest Rate	r	Constant	Constant
Wager Rate	w	Constant	Increase
Relative Contribution of TFP	$G(A)/G(Y/N)$	Small	Large
Relative Contribution of TFP	$G(A)/G(Y/L)$	Small	Large

Table 3: India – Marx Pattern vs. Kuznets Pattern; *trend which is being followed by a given variable is highlighted

Source: own work

Phase 2 is the pattern of the economic development which should be followed by advanced countries, so one can say that the Chinese economy is more developed than the Indian according to these results, because right now India is following a mixture of these two patterns. It is true that today the Chinese economy is more advanced than the Indian one, so the results should be compatible with reality.

6. Comparisons of Selected Contemporary Characteristics of Both Economies

The previous chapters focused predominantly on the economic development of both countries. This chapter is focused on the contemporary state of some selected characteristics. The first one which is compared is the economic freedom in these two countries.

6.1. Economic freedom

The Heritage Foundation defines this term as follows: “Economic freedom is the fundamental right of every human to control his or her own labor and property. In an economically free society, individuals are free to work, produce, consume, and invest in any way they please, with that freedom both protected by the state and unconstrained by the state. In economically free societies, governments allow labor, capital and goods to move freely, and refrain from coercion or constraint of liberty beyond the extent necessary to protect and maintain liberty itself.”¹⁰⁷ The Heritage Foundation, in association with the Wall Street Journal regularly publishes the Index of Economic Freedom. In this index there are 183 countries which are ranked according to their level of the economic freedom. Currently India holds 124th place and china 135th. Their scores are 54.6/100 and 52/100 respectively and according to the criteria of this index their economies are classified as mostly un-free.¹⁰⁸ The final score is calculated as an average of the 10 separate scores for different categories of freedom. These categories are: business freedom, trade freedom, fiscal freedom, government spending, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption and labor freedom.

The score of India has improved since 1995 and it maintains a slightly increasing trend.¹⁰⁹ On the other hand, the Chinese score has remained at approximately the same

¹⁰⁷ „What is economic freedom?“, *Frequently Asked Questions*, The Heritage Foundation, 20.04.2011 <<http://www.heritage.org/index/FAQ>>

¹⁰⁸ “Index of Economic Freedom World Rankings,” *Ranking the Countries*, The Heritage Foundation 20.04.2011 <<http://www.heritage.org/index/ranking>>

¹⁰⁹ “India,” Heritage Foundation

level since 1995.¹¹⁰ Both countries are criticized for maintaining a lot of governmental control of the economy and not allowing the markets to operate freely. The Indian government does not have as much power over the economy as the Chinese but they still keep a lot of regulations in the system, which discourage growth in the private sector. The table below shows and compares the scores in individual categories of economic freedom. Articles providing a closer look on the state of individual categories of freedom are following this table.

Index of Economic Freedom - Scores for India and China in 2011		
Category	India	China
Average	54.6	52
Rank in the World; Rank in the Region	124/183; 25/41	135/183; 29/41
Business Freedom	36.9	49.8
Trade Freedom	64.2	71.6
Fiscal Freedom	75.4	70.3
Government Spending	77.8	87
Monetary Freedom	65.1	75.3
Investment Freedom	35	25
Financial Freedom	40	30
Property Rights	50	20
Freedom from Corruption	34	36
Labor Freedom	67.2	54.9

Table 4: Index of Economic Freedom Scores for India and China in 2011

Source: The Heritage Foundation and THE WALL STREET JOURNAL

When it comes to the freedom of business, both countries are criticized for regulatory framework which poses a main obstacle for starting or running a business. India is specially criticized for ineffective legal framework and China for corruption.¹¹¹ However the level of corruption in India is also quite substantial. For example The

¹¹⁰ “China”, Heritage Foundation

¹¹¹ Unless otherwise cited, the information in this and in the next 9 articles are obtained from the INDEX of ECONOMIC FREEDOM 2011 published annually by the Heritage Foundation and THE WALL STREET JOURNAL

Economist reported in an article about the high level of corruption in the Indian government, that Ratan Tata had put off launching of the Indian domestic airlines because the officials had expected bribes.¹¹²

Today the average weighted tariff in India is 7.9% and in China it is 4.2%. As one can see these tariffs are quite low, which is a plus. However both countries are criticized for non tariff barriers in the international trade for which 20 points were subtracted from the trade freedom score in both countries. These barriers include export and import licensing, complex and nontransparent customs and so on. Both countries are criticized for bad enforcement of the intellectual rights, and India is especially criticized for its bad infrastructure. For example the ports provide quite poor facilities for ships. In 2006-2007 The turnaround of a ship took 3.6 days on average. This is a lot since in the best ports this is a matter of few hours. However 3.6 days is a substantial improvement from 8.1 days in 1990-1991. This was achieved by the increase in the competition within the ports and between the individual ports.¹¹³

Fiscal freedom is basically concerned with the tax burden. Both countries collect approximately the same amount of taxes in terms of the percentage of GDP. The tax income represents 18.6% and 18% of GDP in India and China respectively. India has higher top corporate tax rate but lower personal income tax rate than China. On the other hand china supports new technological firms by lowering their tax rate to 15% and small businesses have to pay only 20% tax in China.

Government in China spends considerably less than the government of India. The Chinese government spent only 20.8% of GDP last year whereas the Indian government spent 27.2%. The cumulated debt of the government is 78% in India and only 30% in China.

When it comes to the monetary freedom, both countries are criticized for adopting measures which distort domestic prices. Both governments maintain the price control of some commodities, which are labeled as essential. These are energy, selected agricultural products, raw material and medical drugs. China is especially criticized for

¹¹² „Rotten to the core?“ *The Economist*, 27.11.2010: 59

¹¹³ Bardhan Pranab, *Awaking Giants*, l. 919

subsidizing its state-owned enterprises what allows these enterprises to sell their products for prices which are lower than their real market price. India is experiencing high inflation rate and so is china. In 2010 the inflation rate in India reached 11%. The inflation rate in China is lower. Between 2007 and 2009 the average inflation rate was 2.3%. Now it is around 5%. Increase in the prices of food is responsible for a substantial part in the in this increase plus in the case of China there is a worry that the inflation is a first sign of the overheating economy.¹¹⁴

India's investment freedom score is 10 points higher than China's, but is still only 35 which is still approximately 15 points below the world average. Both countries are criticized for nontransparent and burdensome regulation and poor legal protection of contract enforcement. Other limitations are prohibitions in investing into some areas of the economy or the capes on investments, and the strict regulation of capital transactions. India is specially criticized for local inputs and export requirements.

Financial freedoms scores are 40 and 30 for India and China respectively. In both countries the financial sector is largely controlled by the state. In India 28 state owned banks control 70% of the assets. In China 4 state owned banks control 50% of the assets. India has troubles with the equal distribution of the financial services. Acquiring financing is often very difficult especially in some areas and this very damaging for the development of enterprises in the private sector. This problem was also already addressed in chapter 4. In china, the banks distribute their funds especially to the state-owned enterprises which are favored by the government. Before the 1990s the private sector enterprises in China had a bad access to bank financing. However the situation has improved for them since 1990s. The officials acknowledged the importance of the private companies at the 15th party congress in 1997 and since then they have adopted certain measures to make their access to funds from banks easier.¹¹⁵ In China the financial system is an important tool for managing the economy. In both countries the participation of foreigners in the financial system is quite limited. In China, the barriers for entry of the foreign banks have been gradually removed, but they still account only for 2% of the market. In India the foreign banks keep 10% of the

¹¹⁴ "Inflated Fears," *The Economist*, 08.01.2011: 65

¹¹⁵ Bardhan Pranab, *Awaking Giants*, l. 1165

market share, and foreigners are allowed to hold 5% of the assets of the domestic banks. Participation of foreigners in the capital markets is limited in both countries.

China's score for the property rights is very low and it is well below the world's average. On the other India's score of 50 is slightly above the world's average. However India is still criticized for poor legal protection just like China. In India, it takes courts years to decide certain cases and in China, the officials are free to ignore the judicial decisions. Intellectual property rights are another point of criticism. Both India and China cannot boast an effective protection of these rights. In India the government tried to address this problem by amending the Copyright Act in 2009. In China all the land is state-owned and it is only possible to lease it. In India, the land can be purchased but the land transfers are problematic.

India and China received very similar scores for the freedom of corruption and these scores are quite low, which means that corruption is a substantial problem in both countries. In both countries the government procurements are affected by the corruption. The corruption in India is also viewed as a major obstacle for foreign investors. In China the corruption is wide spread in banking, finance and constructions.

The non salary cost of workers is not very high however firing an employee is very costly in India. In China, firing an employee may require consultations with a labor union or the employment bureau. In China the labor regulation is rigid. This rigidity damages the employment and the productivity of workers.

This subchapter concludes with a small detour from the topic. As one could see so far neither India nor China are economically the freest countries. Businesses have to deal with extensive corruption and regulations of many sorts. True foreign businesses do get some special treatment in the special zones which were already mentioned, but they still have to deal with the problems in these countries at least partly. This leads one to a conclusion that the main attraction of these countries for foreign companies is still the relatively cheap labor force.

6.2. Savings, Financial and Capital Markets.

Financial and capital markets are very important aspects of the modern economies. Institutions which take part in these markets should provide prompt distribution of funds to the most effective use, which is basically conducted by quick matching of lenders and borrowers by financial intermediaries like banks for example. This subchapter examines the state of the financial and capital markets in both China and India.

Important source for financing investments in both countries are household savings and in China, the high savings of enterprises have become more important recently. The lending of households is largely conducted through the deposits in banks or post offices. The household savings in these countries are very high. There are several reasons for that and one of them is that the spread of state-owned banks and post offices have helped to mobilize them.¹¹⁶

Financial systems in these two countries are dominated by the state owned banks. In China the vast majority of the financial assets is in the form of the bank deposits and currency. This amount is approximately 160% of GDP. Bank deposits in India are also the most common form of the financial assets (68% of GDP), but their share of GDP is not so significantly larger when compared to other forms of assets. In India banks lend 60% of their deposits and in China 130%.¹¹⁷

The major reason why banks have been nationalized in India is that the state is interested in providing credit to agricultural sector, small companies and the household enterprises (the so called primary sector). Loans to these three categories of borrowers are usually not very profitable and private banks would hardly lend any money to this sort of borrowers or if the banks lent some money, the interest rate would be very high. The banking regulation is supposed to make it easier for this kind of borrowers to obtain a loan. However the public banks did not manage to solve the problem of insufficient lending in the primary sector. The reason is predominantly a very rigid bureaucracy in the public banks and many careful clerks, who are afraid of being investigated for a fraud in case a client defaults. One thing which may help to change situation in the

¹¹⁶ Bardhan Pranab, *Awaking Giants*, l. 955-975

¹¹⁷ Bardhan Pranab, *Awaking Giants*, l. 1015-1029

banking sector in India is the competition from the foreign banks. Also it is important to note, that the Indian debtors pay two times higher interest rates than their counterparts in China.¹¹⁸ In China the lending is concentrated in 4 state owned banks. The majority of loans goes to the state owned enterprises and private sector accounts only for one third of the loans in the country. These banks are usually not run by the professionals but rather by bureaucrats or politicians. The main problem of the banks in China until recently had been the ratio of the nonperforming loans.¹¹⁹ In 2002 it was as high as 26% of the total amount, but in 2009 this number was reduced to 2%.¹²⁰ The competition of the banking sector in China has improved since the banks which are owned by the state have abandoned their traditional specialization and they have developed as the joint-stock banks. Joint-stock banks are mostly focused on the coastal regions and their presence inland is not very strong, even though they are allowed to operate in the whole country.¹²¹

Equity markets are another source of funding. In India the equity market used to be very fragmented and limited to few participants. This changed in 1990s with the adoption of measures which have increased liquidity, transparency and competition. Further these reforms have helped to improve regulation and supervision as well. An important step was the establishment of the Securities and Exchange Board of India (SEBI), which is an independent regulatory body. Another important step in the development of the Indian equity markets is the setup of the National Stock Exchange (NSE) managed by a professional team. This exchange has rapidly grown and it has reduced trading costs and increased liquidity in the markets. NSE is the 3rd largest exchange in the world when it comes to the number of transactions. On the other hand bond market in India is not in a very good condition. It is small and liquidity is low. The corporate bond market is regulated by SEBI and it is harmed by very cumbersome regulations which discourage offerings of bonds and their trading. In China, the situation concerning the bond markets is very similar. However the equity market in China is not as well developed as in India. It is highly speculative and insider trading plays a very important role. The two domestic exchanges in China were established in

¹¹⁸ Bardhan Pranab, *Awaking Giants*, l. 1029-1066

¹¹⁹ Bardhan Pranab, *Awaking Giants*, l. 1066

¹²⁰ The World Bank, „Bank nonperforming loans to total gross loans (%),“ *World dataBank: World Development Indicators & Global Development Finance*, The World Bank Group, 28.04.2011
< <http://databank.worldbank.org/ddp/home.do?Step=3&id=4>>

¹²¹ Bardhan Pranab, *Awaking Giants*, l. 1094

1990 and in 2005 the market capitalization on these markets was the 15th highest in the world. Vast majority of the listed companies are state owned and listing must be approved by the China Securities Regulatory Commission. China has tried to improve the condition of this market by making the listing easier for small firms and also the process of approving a listing has been made more transparent. It is important to mention that the main participant as well as the regulator of the equity market in China is the government.¹²²

6.3. The Agricultural Sector

A substantial number of people in both countries still work in the agricultural sector. In China 45% percent of workers are in the agricultural sector and agriculture is responsible for approximately 12% of GDP. In India 55% of the work force works in the agriculture and this sector contributes 18% to the Indian GDP. Agricultural sector however is more productive in China than in India in the absolute terms because the yield of crops per hectare is higher.¹²³

The reforms which were mentioned in chapter 3 had a significant impact on the Chinese farmers. Firstly they have started to offer a lot more of their produce in the market. Secondly they have moved from the land-intensive products to labor-intensive ones. The reforms have also accelerated a rapid growth in the agricultural production. The high yields of the land have been achieved by the start of the green revolution. In India the green revolution started in 1960's. The green revolution was particularly popular in the areas with a lot of water, and the state subsidized the electricity costs or fuel costs in order to encourage the pumping of this water. This prompted the agricultural sector in India to rise. Then later the Indian government was forced to raise the input subsidies and the support prices for grain in order to maintain this growth. The subsidies in India today are a considerable fiscal burden and lead farmers to a wasteful use of the inputs which lead to an environmental damage. In China the farmers receive subsidies too, but they are not so high. Another problem with the agricultural subsidies

¹²² Bardhan Pranab, *Awaking Giants*, l. 1102-1114

¹²³ Bardhan Pranab, *Awaking Giants*, l. 649

in India is that only a minimum of them actually reaches those for who they are meant and plus they crowd out public investments.¹²⁴

Another difference in the agricultural sector between these two countries is that in China, the land is distributed among the rural farmers more equally than it is in India. Egalitarian land distribution has some advantages. One of them is that it is a good protection against poverty and secondly, smaller farms are more effective in terms of land productivity. The big advantage of the small farmers is that they can use family labor, which does not require costly supervision and also something can be saved on wages. However the positive effects of this advantage for small farmers keep diminishing. This is because small farmers have worse access to the required funds for modern equipment which is very costly for small farms and plus small farmers cannot afford to pay for marketing which is essential for selling products in the markets which are becoming larger and larger. In both countries the average farm size keeps reducing.¹²⁵

The form of distribution of agricultural products is different in both countries. In India the agricultural products are predominantly purchased first by the government distribution agents, who then sell them to wholesalers and other distributors. The Indian government claims that this is for the protection of the small farmers who would be otherwise exploited by the wholesalers. However this system is encumbered by the nontransparent bureaucracy and regulations. There are efforts to change this state monopoly system and some supermarket chains are trying to buy directly from the farmers. However these efforts to change meet with a strong opposition from small traders and the state distribution agents. Another way in which farmers can sell their crops, especially those which have higher value, is the contract farming, which again is more spread in China than in India.¹²⁶

Another difficulty which both countries face is the problem with rights concerning the property ownership and tenures, plus both countries are criticized for low compensations to farmers in case their land is ceased. Another thing which is

¹²⁴ Bardhan Pranab, *Awaking Giants*, l. 663-697

¹²⁵ Bardhan Pranab, *Awaking Giants*, l. 759-774

¹²⁶ Bardhan Pranab, *Awaking Giants*, l. 774

problematic in China is that, the land is still owned by the communes and relocation of farmers is not an exception. This fact discourages farmers to invest into the land development. However the Chinese have recognized this problem and some measures have been adopted to improve the situation.¹²⁷

6.4. Poverty and the Standard of Living

Both countries have experienced a quite dramatic transformation of their economies from planned to mostly market economies. The implementation of the reforms which have caused this transformation also marked the start of the quick pace of the economic development. It is important to have a look at how the quick pace of the economic growth and the economic transformation have affected the living standards of people and the income distribution.

Both India and China have achieved quite remarkable reduction of the poverty stricken population. For example if one takes the absolute poverty line to be 1 dollar or less in PPP per day then the percentage of population living in poverty in China was 73.5% in 1981. This was reduced to 8.1% in 2005. In India this number was 42.1% in 1981 and in 2005 it was only 24.3%. The decrease of the amount of people living in poverty in India is really substantial but it is less significant when compared to what has been achieved in China.¹²⁸

There are several reasons why the Chinese have achieved higher poverty reduction. First of all as it was mentioned before, both countries have a lot of people working in the agricultural sector especially in the rural areas. Therefore the equal distribution of land is very important and China has more egalitarian land distribution than India. Then in China there are not many minorities. However in India the minorities constitute a larger share of the population and the cases of discrimination are quite common. The “criminal tribes” are a good example of this discrimination. The members of the Pardhi tribe are especially unfortunate. Many tribesmen in India are considered to be outright criminals. That is why they are often barred from villages or cities. It is difficult for them to find a job or education. There have been some measures

¹²⁷ Bardhan Pranab, *Awaking Giants*, l. 720-746

¹²⁸ Bardhan Pranab, *Awaking Giants*, l. 1322

adopted to help these people in order to improve their situation however the results are quite insignificant yet. It is especially because a lot of them lack even the most basic form of education.¹²⁹ Another important aspect determining the poverty level in a country is the equality of opportunity to get an education. The Gini coefficient concerning the distribution of education is very high in India. For the period of 1998-2000 it was 0.56, which is even higher than the Chinese 0.37.¹³⁰ However the Chinese Gini coefficient for the distribution of education highly differs in individual provinces and unfortunately for China the regional disparities continue to widen. The inequality of opportunity for education is problematic for both countries, because it also undermines the development of the human capital, which's increase is one of the essentials for lifting people from living below the poverty line and thus increasing the social welfare.¹³¹ The importance of the human capital is nicely pointed out in the research conducted by Yan Wang and Yudong Yao who showed that the human capital contributed almost 32% to the economic growth in the pre reform period and almost 14% in the reform period.¹³² Next reason why the poverty reduction in China has been much faster than in India is that the growth elasticity of poverty in China is higher than in India. This means that 1% of the economic growth in China reduces poverty more than 1% of the growth in India, plus the Chinese economic growth is faster as well. The reasons for this are the higher inequality of opportunities (ethnicity, access to education...) and the fact that India has not experienced yet any extensive labor intensive industrialization, which is present in China.¹³³

There is a popular belief that the integration into the global market played a major role in the poverty reduction in both countries. This is not true. Various researches have pointed to the fact, that most of the poverty reduction has occurred due to the domestic factors (agricultural growth, public investments) rather than because of the foreign trade (such exports of labor intensive goods) or FDI. For example in China the poverty reduction was quite dramatic already in the initial period after the reforms concerning the situation of farmers (discussed in chapter 3) were accepted. This was

¹²⁹ „If they were crooks, wouldn't they be richer?“ *The Economist*, 24.04.2010:53

¹³⁰ Bardhan Pranab, *Awaking Giants*, l. 1385

¹³¹ Shaohua Chen and Yan Wang, „China's Growth and Poverty Reduction: Recent Trends between 1990 and 1999,“ *The World Bank* 18.07.2001:14

¹³² Yan Wang and Yudong Yao, „Sources of China's Economic Growth, 1952-99: Incorporating Human Capital Accumulation,“ *The World Bank*, 07.2011:14-15

¹³³ Bardhan Pranab, *Awaking Giants*, l. 1385

before the integration of China into the global marketplace. Another research has shown that in India, the integration into the global market has caused the pace of the poverty reduction to slow down.¹³⁴ However there are also some positive effects such as the technological progress which have been brought by the globalization to these countries and have helped to fight against the poverty.¹³⁵

The income disparity has increased between the rural and urban areas and also within these areas in both countries.¹³⁶ A lot of research conducted recently also shows that the income disparities are rising. The Gini coefficient has increased. This is not good for the fight against poverty, because income inequalities are one of the factors which increase the poverty levels.

When one discusses poverty in countries like China or India one cannot omit a considerably new phenomenon which is micro finance. It means relatively small loans to the poorest members of the society, usually in order to help them start a new business or support their existing one. Microfinance as a mean of fighting against poverty is quite popular today. There are even social networks like Wokai (focused on China) where people from all over the world pitch in for the loans of applicants which create and post their profiles there. The actual impacts of microfinance are a subject of a heated discussion today.

Another important indicator of the society's welfare is the access to the health care. This is a category in which neither India nor China excels. Healthcare is expensive for the poor and sometimes even out of reach. The situation used to be much better in China in the pre reform era when every citizen regardless of whether he or she lived in a city or a village had a free access to health care. Back then basically in every village there were village doctors. China also put a lot of effort into the preventive care. This has changed after the reforms. Now the Chinese citizens have to pay for health care and for many of them who are poor and especially in the rural areas, the healthcare is unaffordable and out of reach. The situation with the accessibility of health care is similar in India, where a lot of people cannot afford it as well. People in India are forced

¹³⁴ Bardhan Pranab, *Awaking Giants*, l. 1347-1381

¹³⁵ Shaohua Chen and Yan Wang, *China's Growth and Poverty Reduction*, p.14

¹³⁶ Bardhan Pranab, *Awaking Giants*, l. 1440

to go to the private practitioners because reportedly the service in state hospitals is exceptionally poor. The health indicators in China however are still better than in India because of the good healthcare coverage the Chinese citizens enjoyed during the period before the economic reforms started ¹³⁷

6.5 India and China – Are they still emerging markets?

Emerging market is a term which was coined in 1981 by Antoine van Agtmael, the owner of the Emerging Markets Management. He came up with this term in order to persuade investors from the rich world to invest in to the countries in the developing world. It was basically a marketing move. In 1981 the term developing world in finance meant some dirty place which is not worthy of any investments. However the opposite was true. Therefore a term has been coined which provides a more sound name for the countries which were classified as the third world and it worked because ever since the investments have been pouring into these countries. However after 30 years a lot has changed and it seems that some emerging markets have already emerged. ¹³⁸

Investors today believe that 70% of the world's economic growth will appear in the emerging markets in the next few years and whole 40% of this growth will appear in China and India, the largest countries which are still classified as emerging markets even though they probably should not be, because they have already emerged. One of the reasons supporting this statement is that there is not anymore only a cheap and unskilled labor in India or China. India and China have invested a lot into education and today there are 75000 and 60000 engineers graduating every year in India and China respectively. The proof that the they are really qualified is that a giant like General Electric's health-care division has opened an research and development center in India in Banglore and Microsoft has opened an R&D center in Beijing in China. And these are just two out of many more as it was already mentioned in chapter 5. This fact implies that the center of innovation is moving away from the rich world. These centers focus mainly on the so called frugal innovation, which means taking complex products and simplifying them as much as possible in order to reduce their cost and this cost reduction can be quite drastic. An example of this is an ECG scanner invented by GE

¹³⁷ Bardhan Pranab, *Awaking Giants*, l. 1492-1666

¹³⁸ „Schumpeter: An emerging challenge,” *The Economist*, 17.04.2010:62

which sells only for 800\$ whereas the price of a usual one is around 2000\$ and the cost of ECG scan per person is reduced to only 1 dollar.¹³⁹ A device like this one is likely to have an impact on the medical industry, since in those countries where health care is provided by the government, the cost cutting is essential as the population ages and more and more people need medical attention. Another business model innovation is connected with medicine too. Devi Shetty a heart surgeon in India owns a chain of hospitals which is focused only on 1 type of surgery which is another cost reduction measure and it is quite likely that sooner or later facilities like this will appear in the rest of the world in order to make healthcare more affordable. Also the innovations from China influence or in the near future will influence the competing businesses from the rest of the world. One such innovation is the BYD's cheap lithium-ion battery which cost 12\$ instead of 40\$ which is a usual price for such battery. China is also producing very cheap cars which may become a competition for other car manufactures like Volkswagen or GM.¹⁴⁰

One has to also consider the big companies which come from these countries. China has 3 companies in the top 10 list of the world's biggest companies when ranked according to revenues. These companies are Sinopec, State Grid and China National Petroleum. Among the first 500 there are 46 companies which are Chinese. On the other hand India has only 8 companies in the first 500 and perhaps the most known of them is Tata.¹⁴¹ These companies are important players in the global business arena. Among the Chinese companies one should not omit Lenovo, which has bought the personal computer division from IBM. This acquisition made Lenovo the 4th biggest vendor of the personal computers in the world. Also Tata has made an interesting acquisition when it bought the British Jaguar Land Rover and Corus Group.

Many major companies in the world already sell their goods or provide their services in these two countries. Companies like Unilever, Procter & Gamble or from the other area of business Mercedes already provide their specially customized products for

¹³⁹ „The world turned upside down: a special report on innovation in emerging markets,“ *The Economist*, 17.04.2010:5

¹⁴⁰ „The world turned upside down: a special report on innovation in emerging markets,“ *The Economist*, 17.04.2010:6

¹⁴¹ „Global 500,“ *Fortune*, 26.07.2010, Cable News Network, 02.05.2011
<<http://money.cnn.com/magazines/fortune/global500/2010/countries/China.html>>

consumers in these countries. Plus it is also important to note that, the consumers in the emerging markets are outspending those in America.¹⁴²

These two countries are no longer those which were classified as emerging markets 30 years ago. They have already emerged. Chinese companies as well as the Indian have made many acquisitions in other countries and many of the companies coming from these two countries create a tough competition for the companies from the rich world especially when it comes to prices. They are no longer just the manufacturing centers (especially in the case of China) but they are also becoming the hotbeds of innovation for products and management techniques. Consumers there have access to the products or services from companies which are very well known in the world. Therefore these countries should no longer be labeled as emerging markets, but a new term should be invented for their category.

¹⁴² „The world turned upside down: a special report on innovation in emerging markets,“ *The Economist*, 17.04.2010:9

7. Conclusion

Both Indian and Chinese are nations with a long history. In both cases the present political situation and the area which these two countries occupy on the political map consolidated only after the end of WW2. Before that India with today's Pakistan was a part of the British colony. China experienced the foreign influence as well but not in such extend as India did. On the other hand China experienced an internal conflict several years after the monarchy was overthrown and this conflict had not ended till 1949 when Mao as the leader of the communist party ceased the leadership of the country and established a totalitarian regime and the dictatorship of the proletariat which are still present today. On the contrary India became independent soon after the end of the WW2 and she has become a democratic country. China claims to be democratic in its constitution, but the Chinese democracy is very far away from the ideal which is held by the West and even the 8 puppet political parties do not improve the image of the Chinese democracy. When it comes to the story of the economic development one can spot some similarities. Initially in both countries the economy was basically controlled by the state. This did not work out well, so the market principals were incorporated into the system which proved to be helpful. After the reforms which have introduced capitalism into both countries, (China however still maintains elements of the planned economy and the financial system for example is dominated by the state) the economic development has picked up a very fast pace which has helped a lot of people to get out of poverty. This economic growth is mainly fueled by manufacturing in china and by services in India. The research and calculations included in this thesis show that India is following a mixed pattern of the economic growth whereas China has most likely already achieved the Kuznets pattern. Because of the rapid economic growth and cheaper labor, these countries are in the spotlight of major global corporate players which have moved parts of their business there (especially R&D and manufacturing) and they are also an attractive market for many companies from all over the world. Now both India and China are becoming the new hubs of innovation. Today there are companies coming from these two countries (Tata, Lenovo...) which are big corporations and the companies which are located in the developed world are in their spotlight which is searching for potential acquisitions. Today simply the term emerging markets does not quite capture the character of these two economic giants.

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