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CONTENTS

A COMPARISON OF DEVELOPMENT PROSPECTS IN INDIA AND CHINA

Tapen Sinha*
and
Dipendra Sinha**

I. Economic Preconditions

Both India and China had embarked on two different risky paths of development. Both had inward looking policies. China by necessity and India by choice. China followed a form of Marxian Socialism and India a brand of Fabian Socialism. In the 1950s, China had only one friendly country to bank upon: the Soviet Union. It obtained Russian knowledge of nuclear technology (which, ultimately, gave China the diplomatic muscle, and admission to the United Nations Security Council). In the 1970s, the table had turned. China was no longer friendly with the Soviets, but India was. India got the US irked by its friendliness to the USSR whereas the US used China as a balancing factor in the Pacific region. The Western interest in development in China and in India was a product of political consideration rather than anything else.

Indian economy before 1991 and Chinese economy before 1979 could be characterized by (1) inward orientation, (2) emphasis on heavy industry, (3) state ownership, and (4) discriminatory pricing against agricultural products. Substantial changes have taken place since then.

Comparing India and China has been a pastime for development economists for decades. Rubin (1986) summarizes succinctly some of the recent findings: "China has surpassed India in reducing the daily suffering caused by the most extereme poverty. china has surpassed India in increasing the output of industrial products. India has surpassed China in protecting public and private liberties and the quest for

* Ph.d. Tapen Sinha, Associate Professor of Finance, School of Business, Bond University, Queensland, Australia.
** Dipendra Sinha, School of Economics and Financial Studies, Macquarie University Australia.

knowledge. And India, rather than China, has succeeded in avoiding major famines." (p.68)

II. Population Related Issues

The basic "facts" of welfare are set out in Table 1. Together, India and China account for almost half of humanity. At present, Chinese population is some 20% above India. If the current trends in birth rates in the two countries countinue, by 2030, Indian population will catch up with China. Birth rate in India has not fallen to the level of China whereas crude death rates are in the same ball-park.

Life Expectancy : Life expectancy in China is at least 9 years above India. There has been much discussion in the popular press about the differential. The main reason is a much higher infant mortality rate in India compared with china. In India, men have higher life expectancy than women. In China (as in all developed countries in the world), it is women who live longer, on the average. Instead of comparing life expectancy at birth, if we compare life expectancy given that a child has lived five years, the (conditional) life expectancy between the two countries differs little.

Table 1

Basic comparison of well-being between China and India

Item	India		China	
	1970	1991	1970	1991
Population (in million)	682	866	966	1150
Average annual population growth	2.3	1.8	1.8	1.3
Crude birth rate	41	30	33	22
Crude death rate	18	10	8	7
Population per physician	4900	2500	1400	1000
Life expectancy	49 years	58 years	63 years	67 years

Source : World Development Report (World Bank, 1993).

Table 2

Infrastructure Comparison of India and China for Trade

Item	China	India
Export	$85.0 billion (1992)	$19.8 billion (1993)
Import	$80.6 billion (1992)	$25.5 billion (1993)
Electricity	630 kWh per capita	340 kWh per capita
Railroad	64,000 km	62,460 km
Total surfaced roads	1,029,000 km	1,970,000 km
Airports	330	336
People per phone	100	200

Source : CIA Fact Book (1994).

Table 3

Labor Market Characteristics

Item	China	India
Literacy	73%	52%
Primary Education	135%	97%
Secondary Education	48%	44%
Higher Education	2%	9%

Note : The figures for education are expressed as a percentage of the appropriate age group as reported in the World Development Report (1993).

Medical Care : The cause of lower child mortality can be attributable to (a large degree to) the availability of medical care at the early years of life. Although doctors in China have less schooling than doctors in India, their availability is far more widespread. As a result, *primary* health care is far better in China than in India. In poorer countries, there are fewer doctors available in rural areas than in urban areas. China is slightly more urbanized with 27% of the population living in urban areas whereas in India 26% of the population live in urban areas (World

Development Report 1994). For all of India there is one doctor per 2500 people, the figure is much worse in villages. The situation in China is far better: doctors are much less concentrated in urban areas.

III. Infrastructure

One key element for development is the infrastructure. Foreign investment decision process also depends on the availability of power, transport network, communications and human capital. Some of the infrastructure considerations are set out in Table 2.

Power : One critical factor for production for trade is availability of power. In this area, India lags far behind (340kWh per capita compared with China's 630kWh per capita). Power stations cannot be constructed within a short time span. Indian government has recognized this problem. It has provided incentive for international investors in power generation. When several power generation companies(including Calcutta Electric Supply) recently floated Eurobonds in April 1994, the demands for those bonds were overwhelming. Thus, foreign investment in power generation will provide the needed boost to raise the power supply to the Chinese level over the next decade. China has also embarked on a long term plan to increase the power supply at the rate of 20% per year for the rest of the decade. With large scale power supply deficit (as it exists both in China and India), development plans cannot be implemented. Power supply deficit is the single most important weak point cited by multinational corporations in their evaluation of prospective expansion in a country.

In India, the energy sector in general, and power supply in particular, has become the single largest destination of direct foreign investment. This has not happended in China (if we exclude Hong Kong from consideration). Does this fact demonstrate the long term growth expected by foreign investors in India? Perhaps not. The attraction of foreign investors in the power sector has been the guarantee by Government of India to pay a higher than market rate of interest(in US$) on bonds purchased by foreign investors. The World Bank has warned India against this practice.

Railroads : India has a long history of good railroad network. Indian Railways is the single largest employer in the world with 1,600,000 employees. When we consider that India is only a third as large as China with total land area, the equal size of railroad coverage between the two countries put India in a much more favorable light. The same goes for roads and airports (see Table 2).

Telecommunications : Communications links are far weaker in India with 200 people per phone compared with China's 100 people per phone. Neighboring Pakistan has achieved a figure similar to China's. Indian government is reluctant to break up the monopoly of Indian Telecom. The political fall-out from the 450,000 strong unionized labor force in the government owned monopoly may be fatal for the government(MacDonald, 1994). However, in May 1994, Indian Government gave private foreign telephone companies the green light to develop wireless phone technology. Motorola from the US, Vodafone from France and Singapore Telecom had all expressed interest in this area. In July 1994, Motorola won the first major contract to build cellular phone network in some areas in India. In September 1994, Indian government took further action by allowing 15 year license to private firms to operate in 18 regions (each covering a state). The new policy allows foreign equity to rise to 49 percent. This move has the potential of foreign investment of $20 billion in telecommunications alone (Fernandez, 1994).

Shipping : China has much better equipped port facilities with much more efficient handling of cargo. In comparison, Indian ports and shipping are in poor shape. Withmarket incentives and investment, these facilities can be developed quickly (compared to say, power generation). At present, there are some encouraging signs of such development taking place.

Management : Efficient management of both private and public enterprises is needed for growth. It is not enough to simply privatize public sector enterprises. Efficient management of companies comes from well-educated managers. This is one area where India has a clear long term advantage over China. First, India has by far the highest rate of University graduates among the Third World countries with 9% of the eligible age group enrolled in tertiary education. The figure for China is less than 2% (World Development Review, 1993). Moreover, India has a pool of 2,480,000 engineers and scientists. At least 60 million Indians have working knowledge of English, the lingua franca of the business world. China has very limited number of people in either category.

This language factor will play a critical role in understanding business and business communication over the next two decads. In this respect, India has a headstart.

Infrastructure development can play a dual role in foreign investment. Power, engergy, telecommunications themselves can be a target for foreign investment. Moreover, development in those areas can further aid investment in consumer goods.

IV. Trade and Trade Blocks

India and China both started out on the road to self sufficiency. In the past fifteen years, China has opened up. In 1992, it has a (merchandise) trade of US$164 billion (export plus import). India's (merchandise) trade amounts to US$40 billion in 1992 making China's merchandise trade four times the size of India's. As a percentage of GDP (without Purchasing Power Parity adjustment), China's trade amounts to 28% of the GDP whereas India's trade amounts to 14% of the GDP. Clearly, trade is still a more important issue for China than for India (see, Chart 8). This has a positive consequence for foreign investor in India in the medium term : Domestic demand will dominate the growth in demand. The global recession will affect India less. Past insulation of the Indian economy plays a strong role in Hartmann and Khambatta's(1993) finding of negative correlation between Indian stock market and the rest of the world. However, the current globalization of India will change the situation in the long run.

One common complaint about merchandise trade is that it misses out on the remittances by citizens from abroad. Indian nationals have a strong presence in the Middle-East, Europe and North America. Their remittances in 1993 amounted to US$2.5 billion. Figures for China are much lower : US$253 million in 1993 (World development Report, 1994). However, as a percentage of merchandise trade, these figures are not very significant.

With the entry of China into General Agreement of Tariffs and Trade (and the World Trade Organization), many commentators on India have recommended that India should join Asian Free Trade Association(AFTA) or North American Free Trade Association (NAFTA) as if such an entry guarantees success in export.

Few economists would argue with the proposition that trade enhances welfare. Trade also facilitates foreign investment. The effects of joining trade blocks are not all that clear. But, joining trade block often requires establishment of legal frameworks to guarantee transactions and to honor contracts. This process does help foreign investment.

V. Gradualism versus Shock Therapy

Among the development economists, there were debates for decades wheather changes in an economy should be brought in gradually or by one shot wholesale change. The social cost of shock therapy can be high. In the OECD world, we have seen an example of two experiments being carried out in two neighboring nations: Australia and New Zealand. The cost of sudden change in an economic system is high as any New Zealander will testify. Eastern european experiments with shock therapy did not produce any spectacular success. Although some argue that such changes did not produce instant results because the changes did not go far enough, there is another school of thought about the efficiency of gradualism. Recently, Krueger (1994) puts is succinctly, "The main thing, though, is for the Government to make its intentions [about liberalisation] very clear, and to be seen chipping away all the time."(p.49) Bhagwati echoes similar sentiments(Tyagi, 1994). In China, some changes were sudden but most have been gradual (Naughton, 1994). On balance, changes in China and India are both in the gradualist mode compared with countries in Eastern Europe and the former Soviet Union.

VI. Savings, Investment and Growth

Most macroeconomists consider high domestic savings rate as a precondition for future growth. Therefore, it is instructive to compare savings rates in the two countries.

Savings rate in India have been around 22-25% of income over the last decade. Unfortunately, in the past, higher savings did not lead to higher investment. Financial institutions, which usually serve as a conduit for productive investment, were nationalized. Government tightly controlled interest rates paid on savings and charged on loans. Productive investment did not always win but politically desirable ones did. With gradual deregulation, these disincentives are disappearing.

In China, saving figures are less reliable because of the Marterial Production System of Accounting system used in the past. It has now adopted the Standardized National Accounts System. World Development Report (1994) does not even have an entry for China. Some estimates put savings rate at 35-40% (Naughton, 1994, p.489). Like India, China had designated "priority sectors" in which investments are channelled regardless of profitability. Recently, changes are taking place in China to remedy the situation(Sinha, 1994).

Investment does not necessarily follow from saving. Even though China had higher savings rate than India for decades (although the accounting methods may have distorted the picture), it is only since 1985 that investment as a percentage of GDP has been higher in China than in India.

Sectoral reforms can promote growth. For example, in South Korea and Taiwan, industrial developments were preceded by land reform and agricultural development. It has been shown that these linkages are mostly unidirectional : land reform caused (in the Granger Sims sense) growth in the industrial sector (Kalirajan and Shand, 1992). In India, such linkages are absent (Shand and Kalirajan, 1994). Given that the growth rate in India has been far lower than China/Taiwan/Korea over any length of time, it is tempting to conclude that the reason is the missing sectoral linkage.

VII. Social Problems

Drugs and Diseases : It is well known that there are millions of HIV infected individuals in India. By some counts, the numbers are escalating rapidly. For example, Friedland (1994) reports that the estimated number of HIV infections in India is 1,000,000. It is not clear if this

spread is taking place across all sections of the population. Estimates of HIV infections in China is reported by Dr. james Chin of the University of California at Berkeley at 10,000. The number seems implausibly low. With a flow of tourists into China around 40 million (compared with less than 2 million to India), the spread of prostitution, and drug use is likely to get higher in China.

Diseases have an impact on development. Resources get diverted. Development suffers. Widespread drug abuse affect labor productivity. So do deadly diseases. Therefore, drugs and diseases put a damper on foreign investment.

Impact of free flow of information can be dramatic. In September 1994, outbreak of plague in the western Indian city of Surat was reported. Within weeks, Indians from other parts of India were being denied entry into many countries in the Middle East and Western Europe. All told there were no more than 100 deaths from the disease. Similar outbreak of plague took place in the interior of China in 1992. It did not get any press coverage in the Western countries. Six months later, Chinese health officials in Beijing put the death toll at 200. In 1992, there were two deaths from plague in the United States. It did not get first page coverage in the print media anywhere. Free press can be two edged sword: it can help and it can hurt. If the media suddenly picks up a story, it can blow the news out of all proportions.

Social Unrest : Ethnic and religious tensions are more visible in India. In China, it is probably lower. Moreover, even if there are ethnic violences, they are in the interior of the country (such as in Tibet, or near the Mongolian border) and hence easily suppressed by the regime in power in Beijing. Information within India flows remarkably freely.

Therefore, such problems, regardless of scale, are well publicized in and out of the country. The impact of such tensions is hard to quantify. However, we can gauge the commercial importance of religious riots in India by its impact on the stock market. The well-publicized demolition of the Mosque in Ayodhya in northern India, and the consequent riot around the country that perhaps resulted in 2,000 deaths, paused the Bombay Sensitivity Index only very briefly. The Stock Market scandal of 1992, however, produced a much bigger and more lasting effect(see, Chart 2).

In China, a single identifiable event that got immediate world wide publicity was the events in Tienanmen Square in June 1989. The death toll will probably never be known. The impact on the flow of foreign investment was probably substantial. It is hard (if not impossible) to conclusively prove the effect of that particular event on foreign direct investment. However, Fatehi and Safiazadeh (1994) have shown that protest demonstration had negative impact on investment in the past at least from the United States (into specific developing countries).

VIII. Bureaucracy, Corruption and State Enterprises

Bureaucracy : Bureaucratic red tape in India is legendary. Until the recent changes took place beginning in 1991, License *Raj* ruled supreme. There are two sets of gatekeepers of licenses : the career bureaucrats and the elected officials. Career bureaucrats usually begin their life after passing a set of exams. The epitome of such exams is the Indian Administrative Service that reincarnated from the old British Indian Civil Service. The other is the set of officials elected into the State Assemblies and to the Indian Parliament.

Chinese bureaucracy works in a different way. All the politically powerful people in China are either members of the Communist Party or the relatives of the revolutionaries from Mao's era (the so called "princelings"). The Party has a restricted membership policy. The number of members has never risen to more than 5% of the population in the past. Eligibility to enter the Party is utmost loyalty, ruthlessness and secretive information gathering capacity of the person (The Economist, 1994).

Bureaucracies in the two countries have two completely different methods of entry. Which one is more suited to free market reforms? In China, secrecy is the norm, accountability is absent. In India, politicians have to be re-elected. The other bureaucrats come from a more meritocratic method. Hence, we contend that India's system will be more suitable for development in the long run.

Corruption : The system of bribery is well documented for India. It is also a way of life for the bureaucrats in China (The Economist, 1994). Therefore, it is difficult to tell which system is less corrupt. If, however, leaders in Beijing actually act to clear up the corruption (given that close

relatives of the Paramount Leader Deng Xiaoping's are involved, it seems unlikely), it will be easier than for the leaders in New Delhi because the threat of punishment will be much harsher in China.

State Enterprises : State enterprises in both countries are inefficient, producing outdated goods and services. In the long run, these state enterprises must be run more efficiently. In the past, indian economists thought that state enterprises will make profits and add to the national saving's pool. In practice, state enterprises lost enormous amounts of money. Moreover, because these state enterprises were producing intermediate goods such as steel, electricity, and other essentials for the industry, their inefficiencies had a multiplicative negative impact on the final output (Tyagi, 1994). Similar things must have happened in China as well. Chinese data (especially from pre-1978 era) are hard to come by; therefore it is only a conjecture.

In China, in the past fifteen years, previously state controlled small and medium enterprises have been (more or less) privatized as Town and Village Enterprises (TVE). TVEs have proved to be very profitable. Probably the profitability is accounted for by the incentives for the managers. State Owned Enterprises (SOEs) are either losing money or barely making some. Even if an SOE is losing money, it is allowed to borrow from the state which are rarely paid back (Perkins (1994), p.39). Will state enterprises pose a bigger problem in China? The answer has to be "yes". The reason is simple. There are at least 100 million workers in the SOEs in China (excluding military). The public sector in India employs (a relatively modest) 17 million (including 1.6 million in the profitable Indian Railways). Not surprisingly, China absorbs a much larger percentage of resources through government activities than india (see Chart 7)

India has taken a gradual approach to reform in the state enterprises. In the past, in some sectors, state enterprises were operating in competition with private companies (such as steel). In others, the state monopoly is being phased out. For example, in the air travel sector, India has broken the monopoly of the domestic Indian Airlines. Even though Indian Airlines has a militant union, the union was forced to accept some changes to improve productivity. Anecdotal evidence from travellers points to an improved service from Indian Airlines. The Finance Ministry has issued directives to the nationalized large banks that subsidies from the government will be eliminated in three years. China is moving in a similar direction by introducing incentives for the managers of the SOEs (Groves et al., 1994).

Central Control : Central control of the political system in China is much stronger than in India. However, recent events have shown that regional authorities in China are flexing their economic muscles in defiance of orders of Beijing. For example, they are not paying taxes to the central authority in Beijing the way they are supposed to. So far, Beijing has not taken any drastic action against them. In the future, Beijing may not be so tolerant. As the events of Tienanmen Square show, Beijing government may lash lash out at unexpected moments. In India, no such guess-work exists. Of course, there are speculations whether the opposition might come to power and reverse the gains from reforms. It is unlikely (Tyagi, 1994).

Bureaucracy can help or hinder foreign investment. In Singapore and Thailand, bureaucrats actually help along the process of foreign investment. If the bureaucrats are not convinced about the desirability of foreign investment, they can impose barriers to it. Being more centralized, China was able get the intial process of foreign investment streamlined in the first ten years. however, for the past five years, the impetus has come mainly from the initiatives of the states. India is going through the first phase of this process. Most states have not formulated their strategies very clearly.

IX. Politics

Political systems in India and China are poles apart. India has a one person one vote democratic system of government. It has a bicameral parliament (called the *Samsad*). The members of *Lok Sabha* are directly elected in a first past the post system. There are 550 members of the Lok Sabha. The members of Lok Sabha and the members of the state legislative assemblies elect the members of *Rajya Sabha.* Each state has a unicameral Legislative Assembly. People directly elect the members of the Legislative Assemblies. For issues of the state, the party in power in the state is in-charge.

In China, there is a unicameral parliament called National People's Congress (NPC). There are 2,977 members elected at the county (xian) level. Among them, there are 130 members of the Central Committee. They are (at least nominally) in charge of law-making in China. The President of the NPC is leader of the country *in theory.* Unfortunately, there is a great deal of confusion about who is *really* in charge. CIA Factbook (1994) illustrates the problem when it lists the following about China :

Leaders :
Chief of State :
President JIANG Zemin (since 27 March 1993) ; Vice President RONG Yiren (since 27 March 1993)
Chief State and Head of Government (de facto) :
DENG Xiaoping (since NA 1977)
Head of Government :
Premier LI Peng (Acting Premier since 24 November 1987, Premier since 9 April 1988) Vice Premier ZHU Rongji (since 8 April 1991) ; Vice Premier ZOU Jiahua (since 8 April 1991) ; Vice Premier QIAN Qichen (since 29 March 1993) ; Vice Premier LI Langing (29 March 1993)

There are three possible contenders for the leadership : the Paramount Leader (Deng), the President (Jiang) and the Premier (Li). There seems to be a game of musical chair on all the time to figure out who is the most powerful person in China determined by who sits where at various state functions!

For foreign investors, the pecking order of power in India is well-established but in China, it is not. The developments in China in the last decade have taken place in such a way that the state governments directly dealt with foreign companies. It appears that the central government in China was unable (or unwilling) to impose its constraints on the state government (in collecting taxes). The confusion about who controls what in China is much bigger than in India. This problem adds to the uncertainty about investment in China.

X. Legal Institutions

It has been argued by many leftist intellectuals that investors from

Western countries could not care less about the legal and other institutional arrangements of the country in question as long as these do not imping upon the profit of the investors. This confuses the issue somewhat because some actions in the country may not be affecting investors in the short run, but in the long run, it will increase the inherent riskiness of the country.

CIA Fact Book (1994) summarises the Indian legal system thus "based on English common law; limited judicial review of legislative acts; accepts compulsory ICJ jurisdiction, with reservations" whereas the Chinese legal system is "a complex amalgam of custom and statute, largely criminal law; rudimentary civil code in effect since 1 january 1987; new legal codes in effect since 1 January 1980; continuing efforts are being made to improve civil, administrative, criminal, and commercial law."

Compared with the Indian system, the Chinese system is relatively new. Many of the commonly accepted Western institutions like impartial judicial system is alien to China. In India, these are in place. Therefore, criminal or other misconducts in India go through a proper legal procedure. When Mr. Harshad Mehta, the man at the center of the 1992 Bombay Stock Market scandal accused the Prime Minister of India of involvement in kickbacks, it was widely reported in the Western press. In China, he would have been executed long ago.

XI. Human Rights

In the era of political correctness, human rights seem to be a hot item. Are basic human rights better protected in India than in China? The answer has to be "yes" not withstanding events in the Punjab, Kashmir or Assam. Brutality of the central government regimes in those areas could not be denied. They pale in comparison with what happened in China in 1958-61. Indirect demographic evidence showed that due to bad agricultural policies and political purges, 25-40 million people died in China. For the next two decades, there was no mention of it in the West (Dreze and Sen, 1989). This was human rights abuse on unprecedented scale (perhaps only matched by Adolph Hitler and Josef Stalin). Today, India has a reasonably well established justice system. Summary trials and executions are non-existent. In China, they are endemic (especially for ethnic minorities).

Do human rights matter for development? There is much disagreement among scholars over this issue. If human rights abuse affect law and order in a country, it probably has a detrimental effect on foreign investment. If democratic movement leads to disruption in production, investment becomes less attractive. It is hard to say anything beyond that.

XII. The Middle Class

India has a large middle class: somewhere between 100 million and 240 million. The families in this middle class have access to television, a scooter or a car, a fridge and other amenities of modern living. In contrast in China, there seems to be a growing gulf between the poor and the rich with a conspicuous absence of the middle class (Samad, 1992). In Shenzen or Guangdong, affluence is visible because the rich are concentrated in pockets. Affluence in India is less conspicuous. The middle class in India is scattered all around the country. This distribution of population allows a ready "trickle down" of income and make regional tension less likely. In china, on the other hand, the coastal provinces are booming: far from the remote regions in the interior of the country and far from the seat of central power in Beijing. Both of these make volatile political mix. In India, the middle class forms the most powerful political base because they are wealthy, educated and the majority of politicians come out of their ranks. Therefore, the expansion of the middle class makes Indian parliamentary democracy a stable system whereas wealth accumulation in China is more destabilizing.

In India, the rise of the middle class has been the main force behind the recent economic development. In China, the effect of the middle class has been less visible in promoting economic prosperity. Much of the goods produced are exported either directly or through Hong Kong. This has an important impact on the effects of changes in foreign investment (see below).

For long term sustainable development, the middle class plays a vital role. They provide the impetus for rising consumption of durables making domestic industry floursh. They also provide rising level of human capital in the labor market. is middle class larger in India? Probably. China does not have detailed income inequality statistics covering rural and urban areas. It appears that over the past ten years income inequality in the cities in China has increased (White, 1994). In India, income inequality has not altered substantially in the past twenty years.

XIII. Taxation

It is generally accepted that China has a far more attractive tax structure than India for foreign investors. In 1993, Price waterhouse came up with a comparison between China and India (Upadhyay, 1993). Corporate tax rates for China are 33% compared with 44% in India (without the surcharge). There is a special tax rate of 15% for enterprises in the Special Economic Zones in China. India does not have anything comparable. Withholding taxes of dividend income for non-residents in India is 25% compared with China's 20%. Interest earnings are taxable in India at 25% compared with 20% in China. Royalties in India are taxable at 30% compared with 20% in China. China has established "one stop licensing procedure" whereas India has not. This procedure is a rather recent development for China. Indian government is gradually moving in that direction.

XIV. Foreign Investment

China opened up its economy in late 1979. The composition of foreign direct investment in China and India is shown in Chart 1A and 1B. China has a ten year advantage but China's production is mainly for exports whereas in India the local absorption rate is higher (because of the presence of a larger middle class). It has an important implication: India's manufacturing sector will be less sensitive to changes in foreign conditions. A dramatic illustration from the past can be seen for the Indian stock market. There was no negative impact of the Gulf War even though oil poor India's import bill went up substantially due to higher oil price. Recently, Krugman (1994) has voiced doubts about the foreign investment figures published for China: "It was recently revealed that official Chinese statistics on foreign investment have been overstated by as much as a factor of six. The reason was that the government offers tax

and regulatory incentives to foreign investors, providing an incentive for domestic enterpreneurs to invent fictitious foreign partners or work through foreign fronts." (p. 75)

International portfolio has become a fashion for the large fund manager's world wide. Hartmann and Khambatta (1993) show that Indian stock market has a negative correlation with the developed country stock markets (Correlation of S&P with Indian market for 1987-1991 was -0.03!). However, this figure has to be taken with caution. The data is pre-1991. There was a change of regime at the time. Before 1991, foreign investment in India was negligible. 1987 Crash has little effect on Bombay stock exchange. Thus, applying portfolio strategies with the past data will be misleading.

XV. The Expartiate Factor

Nonresident Indians number in 25 million and nonresident Chinese number in 55million. Chinese are mostly business owners whereas Indians are mostly professionals. It seems that Chinese foreign investment boom is fuelled partly by expatriate Chinese. Some estimates put 75% of total investment in China to the expatriate Chinese (Thomas, 1994, p.39). No such investment flow has come from the non-resident Indians (see Chart 1A and 1B). The reason is simple: Most of the expatriate Chinese are business people whereas most of the non-resident Indians are professionals.

We contend that in the long run, non-resident professional Indians will have a bigger impact on the investment into India. In 1991 we conducted a survey among investment managers from investment advisers of several large firms in New York. We found that managers of Indian origin were significantly more bullish about India over five and ten years. The results for China were inconclusive (Sinha and Sinha, 1994). And the presence of Indians among top investment advisers was quite prevalent. In some companies, more than 25% of managers were either directly from India or second generation people of Indian origin.

To investigate the reason behind the bullishness, we have to look at the professionals more closely. Most of the Indians leaving India did not leave under duress (unlike most of the Chinese). They left India voluntarily to pursue a more combortable life. In fact, many Indians, who live abroad, still retain their Indian passports. They occasionally visit India. Many such Indians have studied in top business schools in the US (and to lesser extent in UK). They later took up jobs with pension funds, investment companies, and large multinational corporations. They can, and do subtly exert enormous influence on the investment decision of a whole range of companies. Given that they are positively disposed towards their place of birth, they are likely to favor investment in India in the long run. We found this invisible force to be present all over the world from New York to London to Hong Kong.

The Constitution of India stipulates that holding another passport automatically strips an Indian of his or her Indian Citizenship. Indian Government has recently realized the potential of this army of 25 million people. To bring them back to the fold, it is about to introduce a "Saffron Card". It will be like the "Green Card" of the USA. It will allow a person of Indian origin to take part in almost all economic activities in India with the exception of voting.

China has no such thing. Unless the government in China changes radically, it will never have such provisions either. Thus, the investment by the expatriate Chinese is driven mostly by speculation: a gamble that has paid off well - so far.

The other fact to consider is this: Given that Indians are not the ones investing in India, there is a far bigger pool where it comes from. Thomas (1994) notes "Now pension funds and foreign institutions are allowed to invest in the Indian stock market. This is a prelude to the flow of much larger funds as indirect investment into India!"(p.37)

In summary, foreign investment in China is mostly a phenomenon of investment of the expatriate Chinese whereas investment into India is not. Therefore, it is likely that investment in India will be more sustainable in the long run.

XVI. Regional Problems

Hong Kong and Taiwan have played a pivotal role in opening up of China. Eighty percent of total investment in China comes from Hong Kong and Taiwan (Segal, 1994). At present, China's investment in Hong Kong exceeds Hong Kong's investment in China. Guangdong is now converging with hong Kong at a rapid pace. The story is similar between

Fujian and Taiwan. What does this mean for the rest of China? In future, the economic might of Guangdong and Fujian may trigger a challenge to the central authority of Beijing. This makes an explosive recipe for future troubles.

For India, no such obvious entry / exit points exist. Thus, future problems arising from state autonomy seems remote. However, tensions do exist between the states and central governments over tax revenue and demarkation of who has control over what. For example, some states in India want to build toll roads. But central government is reluctant to grant states power to do so.

XVII. Conclusion

Few people believe that China can sustain its current boom for long (Hornik, 1994). Events such as death of the paramount Leader might trigger power struggle and consequent uncertainty about the country. In India, such possibilities are remote. It does not have a strong presence of the military in the government. It is a relatively stable democracy.

India has a very large pool of scientific talent that China lacks. china also has a larger regional imbalance in terms of political and economic power. India, on the other hand, has a potential problem arising from heterogeneity in religion and ethnicity.

Foreign companies investing in India are doing so for (1) using well-educated Indians relatively cheaply but not for cheap manual labor. Thus, in the long run, companies seeking cheap labor will move to Vietnam, Cambodia, Laos, Burma, etc and out of China. (2) India has a large middle class that will buy much of the output of these companies.

Legal framework present in India will also play an increasing role in the long run. China will have those problems crop up in the future. A large population speaking English (although with different regional accents!) will also be critical for management.

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Chart 1A

Investment in India 1993

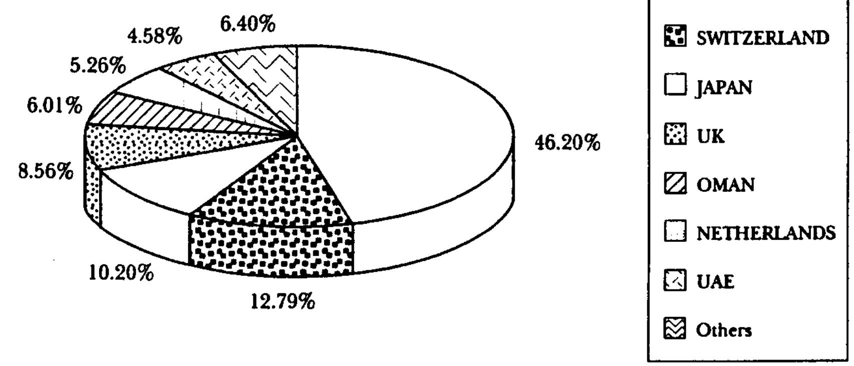


Chart 1B

Investment in China 1989

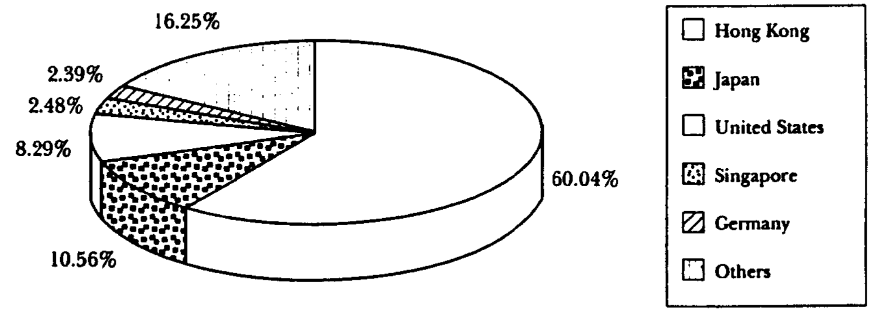


Chart 2

Tracking the Growth of Bombay Stock Market 1991-1993

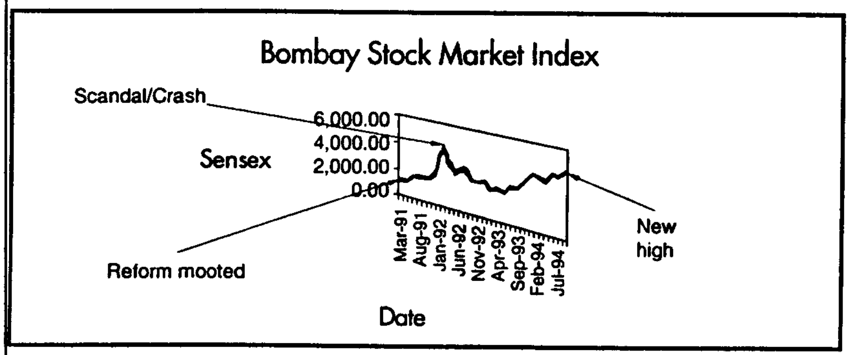


Chart 3

Population of China and India

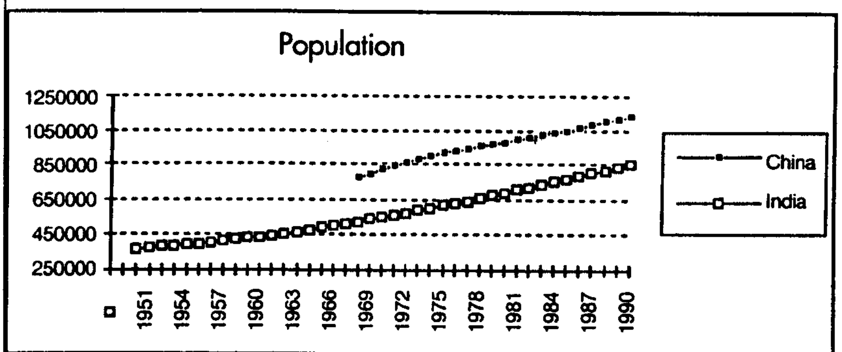


Chart 4

Real Per Capita Income adjusted for PPP

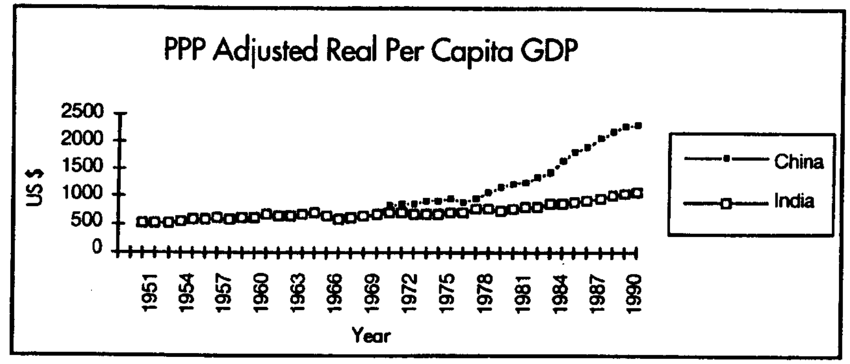


Chart 5

Private Consumption as a percentage of GDP

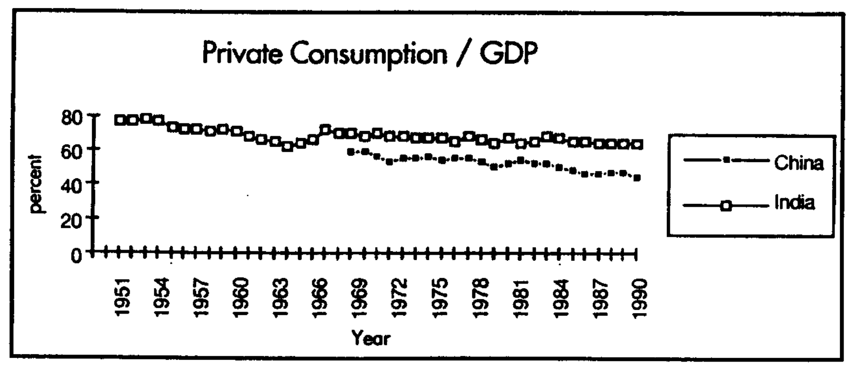


Chart 6

Investment as a percentage of GDP

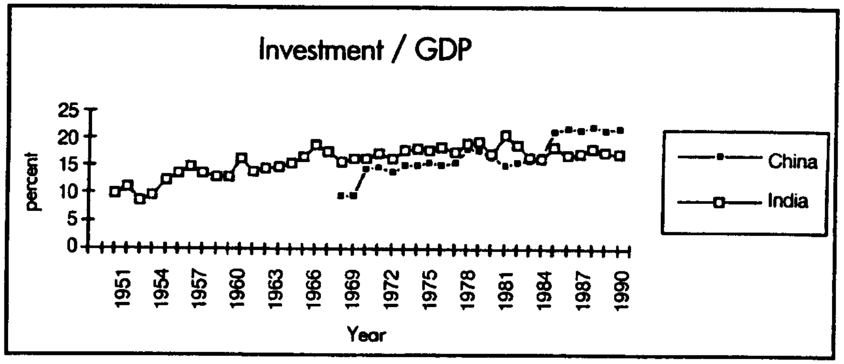


Chart 7

Government Expendture as a percentage of GDP

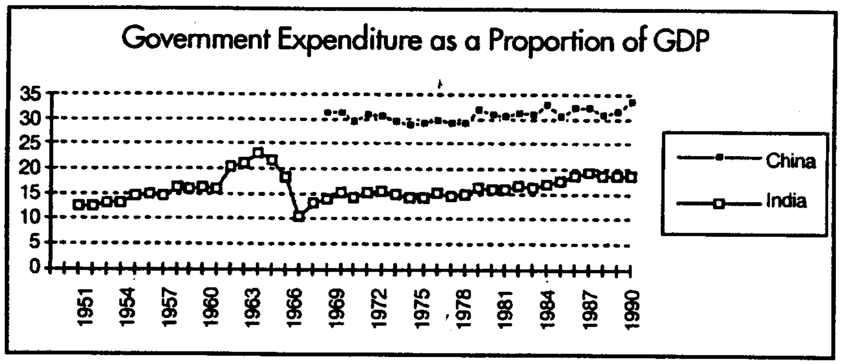
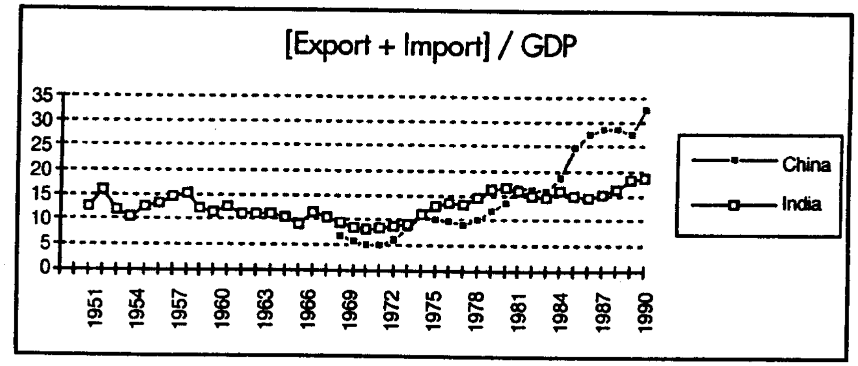


Chart 8

A comparison of a measure of openness



Note : For Charts 3 to 8 we have used Penn World Tables supplied with dXData (1994).