

## **China and India: Is Policymaking by the Two Asian Giants Merging?**

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### **Abstract**

New Delhi and Beijing announced their economic plans for the future within a few days of each other. On 26 February 2010, the Indian Finance Minister presented his government's budget for the fiscal year 2010-11. On 6 March 2010, the Chinese Prime Minister's address to the annual National People's Congress included the budget for the year 2010. This paper suggests that while there are many similarities between the approaches followed by the two governments as indicated in their respective statements, there are also several subtle differences. These include the explicit attention paid to taking care of the poor and reducing income disparities in the case of the Chinese approach. In the Indian approach, there is much greater focus on returning to higher rates of growth. In presenting the budget, the Indian leader had his eye on the foreign investor while in presenting his government's economic plan, the Chinese leader was more deliberately addressing his domestic audience. That said, both governments are setting the stages in their two countries for returning to the high growth trajectory. But adjustments need to be made for correcting some of the distortions that had crept in the previous growth spurts.

### **Introduction**

The question, "Are the two continental Asian giants – China and India – merging?" relates to the way they are managing their economies. "Merging" implies the adoption of basically the same set of policies for moving forward. Both the economies – China more than India – have seen not only large increases in their gross domestic products (GDPs) but have also been through profound structural changes. They are now coming out of periods of economic slowdown that were mostly the consequence of what the economists have termed the "Great Recession of 2008-09".

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At first glance, Beijing and New Delhi, having recently announced policies that they will be following as the recoveries from the recent downturns take hold, appear to have embarked on the same course. The Indian Finance Minister Pranab Mukherjee announced the budget for the year 2010-11 on 26 February 2010 and promised that the rate of economic growth was heading towards double digits. He also opened the economy a little bit more to those outside the country and who are willing to place their bets on an expanding Indian economy. Prime Minister Wen Jiabao delivered his annual economic speech to the National People's Congress on 5 March 2010 where he visualised his country's economy moving ahead briskly. The speech also provided details of the budgetary outlays for the calendar year 2010.

Both leaders were cautious about the international environment in which the two economies will be functioning. "While the global financial condition has shown improvement over the recent months, uncertainty about the revival of the global economy remains. We cannot, therefore, afford to drop our guard", said Minister Mukherjee in his Lok Sabha address.<sup>2</sup> Much the same sentiment was expressed by the Chinese leader. "We must not interpret the economic turnaround as a fundamental improvement in the economic situation. There are insufficient internal drivers of economic growth", said the Chinese leader in his two-hour long address<sup>3</sup>. As S. Narayan indicates, a significant part of the Chinese pickup in growth was policy-driven: "90 per cent of the growth in the last three quarters [January-September 2009] has come through public expenditure on infrastructure projects."<sup>4</sup> In these two economic and policy statements, both capitals indicated that they will not be pulling back on the efforts to stimulate their respective economies. These efforts have paid off but it was not the time to change the basic economic thrust. There was recognition, however, that making the economies dependent on public sector stimulus was not a viable long-term option.

### **Budgetary Priorities and Short-term Objectives**

According to the Government of India's estimates presented in the budget for 2010-11, the economy grew at 6.7 per cent for the year 2008-09. It is expected to grow at a higher rate during the year 2009-10 with the advance estimates pegging the growth at 7.2 per cent during 2009-10.<sup>5</sup> The Finance Minister followed up on his budget speech with interviews with the press, including one with the *Financial Times* in which he said there was no complacency about the economy's ability to climb back on a high growth strategy that will produce GDP increases of 10.0 per cent a year. However, the lack of a parliamentary majority was an obstacle to moves such as raising the cap on foreign investment in the pension and insurance sectors and steps to improve governance."<sup>6</sup> The private sector once again will be the driver of growth as the state pulls back after having taken effective steps to stimulate the economy. The state, however, will continue to help the poorer segments of the population by retargeting

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<sup>2</sup> The quotations from the Indian finance minister's budget speech are from the website <http://indiabudget.nic.in>, accessed on 7 March 2010.

<sup>3</sup> The quotations from the speech by the Chinese prime minister are from "China pledges to close poverty gap", *Weekend Today*, Singapore, 6-7 March 2010, p. 8.

<sup>4</sup> S. Narayan, "Unwinding the Fiscal Stimulus – Dilemmas for India and China", ISAS Brief No. 145, 11 December 2009. [http://www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS\\_Brief\\_145\\_-\\_Email\\_-\\_Unwinding\\_the\\_Fiscal\\_Stimulus\\_22122009115354.pdf](http://www.isas.nus.edu.sg/Attachments/PublisherAttachment/ISAS_Brief_145_-_Email_-_Unwinding_the_Fiscal_Stimulus_22122009115354.pdf).

<sup>5</sup> <http://www.indiabudget.nic.in/ub2010-11/bs/speecha.htm> [accessed on 16 March 2010]

<sup>6</sup> David Pilling, James Lamont and Amy Kazmn, "India confident of growth targets", *Financial Times*, 4 March 2010, p. 1.

the subsidies that, in their present form, go to the more well-to-do segments of the population.<sup>7</sup> Only time and politics will tell whether the few reforms that were introduced would yield the intended results. According to David Pilling, a long-time observer of the Indian economy, “these adjustments could quickly accelerate into meaningful reallocation of government spending. Equally, they could stall on the hill of special interest politics.”<sup>8</sup>

Prime Minister Wen set before his administration a growth target for the year at 8.0 per cent. This was in line with the thinking in Beijing to aim for the lowest rate of growth below which it becomes difficult to manage the expectations of the people. For several years this has been determined at 8.0 per cent. The Prime Minister’s growth expectation is much lower than the consensus estimate of about 10.0 per cent. Recognising that the economy should not become dependent on hand-holding by the state, China will rein back spending after last year’s massive stimulus. The 11.4 per cent planned increase will bring the total lending to US\$1.73 trillion, less than half of last year’s increase of 24.0 per cent. Social spending will increase by 8.8 per cent while spending on rural programs will rise by 12.8 per cent.

### **Growth and Distribution**

Both leaders, while emphasising the importance of high rates of growth in their economies, gave a great deal of attention to their distributive aspects. While the emphasis on redistribution was not new in the Indian way of thinking on economic issues – it was the platform on which the Congress Party was elected last year to another term in office – the stance adopted by the Communist party of China was a relatively new one. A Communist country is supposed to look after its poor and the less advantaged. It does not have to make an explicit commitment to such a policy in its pronouncements and plans. But Prime Minister Wen went some distance in ensuring his country’s citizens that meeting their social needs will be a high priority of the administration he was heading. “We will not only make the pie of social wealth bigger by developing the economy, but also distribute it well. We can ensure that there is sustained impetus for economic development, a solid foundation for social progress, and lasting stability for the country only by working hard to ensure and improve people’s well being” he said in his address. Beijing’s deep concern about the increase in inequality was informed by its experience in 1989. The Chinese senior leaders have always interpreted what they prefer to call the “Tiananmen Square event of 1989” as an expression of economic discontent rather than as a campaign for democracy.<sup>9</sup>

Until recently – in fact up to the Great Recession of 2008-09 that shook the global economic system – the two countries had followed different models. China had relied much more on using external markets to develop scale for its industrial system. In that and several other respects, it had followed the East Asian model of export-oriented industrialisation. India, on

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<sup>7</sup> According to revised estimates of the incidence of poverty in India, based on the work done by the Tendulkar Committee, 37.2 per cent of the Indian population was living in absolute poverty measured by the revised poverty line. The incidence of poverty at 41 per cent of the urban population was higher. See Narayan op.cit.

<sup>8</sup> David Pilling, “Subsidy reform could help India spend better”, *Financial Times*, 4 March 2010, p. 11.

<sup>9</sup> This point was made repeatedly to the author when he was directing The World Bank’s program in China. Among those who discussed the Tiananmen Square crisis with the author were then Prime Minister Li Peng and Zhu Rongji who succeeded Li as prime minister. Both believed that the economy’s failure to provide employment to the educated middle class even though the rates of growth were high was the most important reason for the discontent that manifested at the Tiananmen Square in June 1989.

the other hand, had pursued import substitution for industrialisation for more than forty years after achieving independence. When it opened its economy to the outside world starting in the late 1980s but more fully after 1991, and when the then Finance Minister Manmohan Singh had to deal with a serious balance of payments crisis, the Indians continued to be cautious about foreign participation. Although the “license raj” that owed its existence to Jawaharlal Nehru’s socialisation of the Indian economy was dismantled, the participation of foreign capital remained constrained. It was allowed in a limited way into some sectors of the economy. Its involvement in the sectors of finance and retail trade was quite severely constrained. Foreigners were also not encouraged to participate in the development of the social sectors, in particular education. The Indians, for instance, are now making an effort to open their education sector, but for political reasons still in a limited way. They indicated, for instance, that new incentives will be offered to private operators from the outside to enter the education market.

The Indian budget also promised a major effort in improving the quality and reach of physical infrastructure. The development of high-class highways was to be given special attention. In the budget for the railways, there was promise that quality of the services provided will be greatly improved by developing high speed railways. Here the two countries have adopted different approaches. The Chinese, having anticipated that a rapidly developing economy will need a well functioning transport system, began to invest in highways and railways early on. The Chinese claim that they are now operating the world’s fastest train connecting Shenzhen in the Southeast to Wuhan in the country’s center. The Indians are now playing catch-up.

There are subtle differences in the overall direction of public policies in the two countries. It is growth with continued emphasis on poverty alleviation in the case of India. The Indian leadership emphasised the need to maintain high levels of growth rates while the Chinese leaders are promising to care for the poor. The Chinese policy objectives include considerably greater focus on distribution while maintaining a reasonable rate of growth. There is no explicit reference to distribution in the Indian statement.

The Indian policy statement can be read as more directed at foreign audiences while the Chinese one is aimed more at its own citizenry. New Delhi seemed anxious to make the case to foreign investors that the country should be a major destination for the funds they controlled. With a higher trade deficit than that of China’s and with still lower rate of savings than China, New Delhi is more dependent on foreign capital flows. It would like these to take the form of foreign direct investment. Portfolio investments are welcome but they had proven in the past to be a very volatile source of external flows. However, to receive foreign direct investment in large amounts, potential investors had to be convinced that the Indian economy could expand at the rates that were comparable to those achieved by China and sustained over a long time. Minister Mukherjee, by repeatedly underscoring that a double digit rate of growth was well within India’s grasp and that such a rate of expansion could be sustained over time, was speaking to the foreign investor.

The audience for Prime Minister Wen was mostly within the country. He and his colleagues had heard the people. The people had voiced many concerns. The escalating price of urban housing was one of them. The discrimination against migrant workers – amounting to almost 240 million – was another. Not only are their wages relatively low, they also do not have access to many social services available for the common urban dweller. They are also not

secure about their places of residence. The Chinese law and practice require the unemployed to return to their places of origin. Voices had also been raised about corruption in the ranks of the Communist Party. This was one of the themes explored at the 2010 National People's Congress. Bo Xilai, the "gang busting Communist Party boss of Chongqing" became the poster child of the meeting with the media "gushing over his performance."<sup>10</sup> Reflecting the mood in the country, the Prime Minister pledged to reform the residency rules called the *hukou* system that discriminate against people who relocate from their hometowns and villages.

The more informed public opinion that had the knowledge of such affairs was also worried about the widening income disparity. While Deng Xiaoping had famously said that it was glorious to be rich, he did not envision the kind of wealth accumulation that had occurred under the watch of his successors. It was interesting that an authoritarian structure was being so sensitive to the concerns of the common men and women. The Chinese Prime Minister promised to reduce the gap between the rich and the poor and also between the more advanced parts of the country and those that had fallen behind.

### **Guns or 'Doufu'**

'Doufu' is the Chinese word for beancurd, a dietary staple in the country. It figured frequently in the discussion leading up to the release of the government's budget for the year 2010. It was widely expected that the rate of increase on defence would remain within double digits. It increased by 11.6 per cent in 2004 and 17.8 per cent three years later in 2007. However, the government surprised many China watchers by limiting the rate of increase to merely 7.5 per cent in 2010 – "the first time in 21 years that the rate of increase has fallen below double digits" – according to David Shambaugh of the China Policy Program at George Washington University. Why the change in the trend line? "Given other demands on state expenditures from various sectors – the stimulus, unemployment, insurance – to continue giving the military 15 per cent increase year-on-year does cause some Chinese to raise questions", continues Shambaugh who specialises in the Chinese military.<sup>11</sup> The Chinese, in other words, were moving some of the state resources from guns to 'doufu'.

The expenditure on the military as earmarked in the budget will amount to US\$77.9 billion equivalent to 1.4 per cent of the Chinese GDP. This is dwarfed by what the United States spends. The US expenditure at 4.0 per cent of the nation's GDP accounts for 48.0 per cent of the world total. If Beijing was ever competing with Washington on military build-up, it seems to have given that up for the year 2010. However, competing with India, the other Asian continental power, is an entirely different matter. The Indians seem to be keeping the rapid Chinese military build-up in their mind. That notwithstanding, New Delhi was equally modest in announcing its planned expenditure on defence. In the 2010-11 budget, it was raised to US\$32 billion, up 8.13 per cent from the revised estimates of the previous fiscal year. The outlay on defence was to be 2.37 per cent of the country's GDP considerably more than the proportion for China. "Secure borders and security of life and property fosters development", the finance minister said in his budget speech. "Needless to say any additional

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<sup>10</sup> *The Strait Times*, "Crime buster woos media in leadership bid", 8 March 2010, p. A3.

<sup>11</sup> Quoted in Michael Wines and Jonathan Ansfield, "China slows its military spending", *International Herald Tribune*, 5 March 2010, p. 4.

requirement for the security of the nation will be provided for.”<sup>12</sup> But the armed forces did not seem too happy by New Delhi’s decision to pause in the pace of build-up. According to one Indian defence analyst the men in uniform “were left disappointed with what is being perceived as lack of attention towards modernisation of weapons and equipment and for force accretion as required by existing threat perception and imperatives of defence preparedness.”<sup>13</sup>

Both countries seemed to have decided that for the moment at least it was better to limit defence expenditures and commit more resources for satisfying some of the non-military needs. The main goal for India is to quicken the pace of economic growth – to close the economic gap, as it were, between itself and its giant Asian neighbour rather than to match the latter’s military strength. For China, the goal is to stall the possibility of the recurrence of a Tiananmen Square type of event based on economic discontent.

## **Conclusion**

After having taken very different paths towards the attainment of high rates of economic growth, Beijing and New Delhi are moving forward but are still taking slightly different routes. For India achieving high growth is critical; for China, there had to be renewed commitment to improving the lot of the poor. Both were aiming at rates of growth that would be four to five times higher than the rate of growth of increase in their populations. This will help them to direct more resources for meeting the needs of the poor. And both will attempt to achieve this objective by the efficient involvement of the state in the redistributive process. The budgets presented by the two governments will take the two countries towards these two goals.

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<sup>12</sup> See 2.

<sup>13</sup> Saurabh Joshi, “Defense budget disappoints forces”, *StratPost: South Asian Defense and Strategic Affairs*, 27 February, 2010, p. 1.