

Economic Reforms, External Opening and Growth: China and India

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1. Introduction

It is widely recognized and fairly non-controversial that China and India, accounting for 37% of the world's population in 2005, have been the two fastest growing major economies of the world (Table 1) since 1980. A very recent forecast by the Nobel Laureate, Robert Fogel of Chicago University, suggests that the share of the two in global population will decline to 34% by 2040, while their share of global GDP at purchasing power parity exchange rates will more than triple to 52% (with China accounting for 40%) from 16% in 2000. Per capita GDP at purchasing power parity exchange rates is forecast to grow at 6% a year in India and 8% in China during 2000-2040, reaching, \$85,000 for China and \$24,000, for India (Fogel 2007). By any stretch of imagination, these are staggering numbers. However, they assume that the growth in per capita incomes of the two decades until 2000 could be sustained over four decades after 2000, an assumption that needs justification. Fogel does not provide one in any detail.

Somewhat controversial is the belief that, but for economic liberalization and the break from insulation from external markets for goods, services and investment, there would have been no acceleration in the average annual rate of real GDP growth after 1980 compared to the preceding three decades earlier in either country. What is non-controversial is the fact that growth acceleration, economic reforms and external opening were observed together, and hence were associated with each other. But as we all know,

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it is hazardous to infer causation just from association and correlation. Clearly, not only reforms and external opening happened, but also other factors that could have contributed to growth acceleration changed as well. For example, the global economic environment in terms of falling world interest rates, inflation and growth volatility has been remarkably favourable since the 1980s, and could change for the worse in the future (Rogoff, 2006). In claiming that reform and opening caused the growth acceleration since the 1980s, one would in fact be making a counterfactual assertion. It is that, taking into account the changes in other factors favourable to growth, had there been no reform or opening, growth acceleration either would have been absent altogether or at least would not have occurred to the same extent..

Counterfactual assertions would be credible only if they are derived from an appropriate theoretically founded, empirical model of the economy. Such a model would not only incorporate the domestic and external economic, political and social factors as well as random shocks that could influence the growth process, but also describe the observed facts and data adequately. Building such a satisfactory model is not simple; nor is it easy to select one from many equally plausible models. It is no surprise, therefore, in most of the literature the contribution of reforms and external opening to growth acceleration is not based on a complete empirical model in the above sense. Instead it is based on a combination of an often implicit model, analytical reasoning, and plausible identification of the presence in the data of evidence of the operation of one or more of the mechanisms or channels through which reforms and opening could in principle or theory would have contributed to growth acceleration. In other words, by and large, the approach in most of the literature is one of an analytical description of history rather than

of econometric analysis.¹ I will also be following the same course in this talk. In particular, I would argue that (a) the acceleration in growth came about only after reforms that abandoned insulation from the global economy and increased the role of competitive markets in resource allocation in both economies, (b) except for the East Asian gang of four that had adopted similar reforms much earlier, no other developing country has experienced sustained rapid growth over two decades or more prior to the 1980s and (c) that significant reduction in poverty in China and India occurred only after growth or acceleration. These facts strongly suggest without conclusively establishing that reforms and external opening played a causal role in accelerating growth and reducing poverty.

I will first make a few remarks on the economic reform and growth processes in general in the two countries. Although there were many elements in the reform agenda, in this talk I will focus on the opening of the external sector. Certainly other items of the reform agenda are important and I will comment on some of them in my concluding remarks. Still, external opening clearly was an essential, as well as major, item of the reform agenda in both countries. However I will argue that India's opening was reluctant and partial while China's was purposive, enthusiastic and far reaching, and this difference largely explains their differential performance. I will conclude with some remarks on the challenges faced by the two economies as they go forward.

2. The Reform and Growth Process

2.1 Instrumentality of Growth for Poverty Eradication

¹ I do not share the enthusiasm of some for the methodology of cross country growth regressions as a means of identifying the economic, institutional and political determinants of growth. I will ignore this literature altogether as I do not believe anything useful can be learned from such regressions.

At the outset, let me draw your attention to the fact that in India rapid growth was never viewed as having an intrinsic value in and of itself, but only as the primary instrument for elimination of mass poverty. In the late nineteenth century Dadabhai Naoroji in a series of papers and speeches had drawn attention to India's massive poverty and the failure of the colonial government to address it. His paper "Poverty of India" was read before the Bombay Branch of the East India Association of London in 1873 and is included in Naoroji (1899). In 1938, Subhash Chandra Bose, the then president of the Indian National Congress (INC), had appointed a National Planning Committee (NPC) with Pandit Jawaharlal Nehru as chairman. Interestingly, Mahatma Gandhi was not at all enthusiastic about planning or the appointment of the committee. However, Nehru, an admirer of Soviet planning, actively guided and participated in the deliberations of the NPC and its many sub-committees. A note, prepared by Professor K.T. Shah for the guidance of the sub-committees, further amplified Nehru's memorandum of June 1939 to the NPC. It explicitly laid down the fundamental objectives of national planning as:

"To ensure an adequate standard of living for the masses. An adequate standard of living implies a certain irreducible minimum... Estimates of economists ... put down this minimum at figures varying from Rs. 15 to Rs. 25 per capita per month in the present value of the rupee... The national income must, therefore, be increased greatly during the next ten years to ensure an irreducible minimum standard for everybody...[and] also to bring about a more equitable distribution of wealth... for the minimum standard which can and should be reached [an] increase in national wealth of between two an three times within the next ten years [is required]. It is with this object that we should plan now."

(IIAPR, 1998, pp 54-54, emphasis added).

Clearly the instrumentality of inclusive and rapid growth (at an annual average rate between 17.5 and 12.5 percent) for poverty eradication is evident in the note. It further elaborated what it called “objective tests” for evaluating progress of the plan to eradicate poverty. These included among other things, a nutritional intake of 2,400 to 2,800 kcals per day for an adult worker, diminution of unemployment and liquidation of illiteracy.

After its fifth session in September 1940, the NPC did not meet during the war.² It held two meetings in September and November of 1945 and an informal meeting in 1946. Its final session was held in March 1949 two years after India’s independence. Much, though not all, of the work of the NPC and its sub-committees had been completed by its fifth session. Even today, the reports of the sub-committees and Nehru’s memorandum on them are interesting to read. In a way, the thinking of many Indians on development, growth, foreign trade and the role of the state in the economy can be traced back to the NPC.

India’s constitution was adopted in January 1950. The Planning Commission (PC) was established in March 1950. The first five- year plan formulated by the PC achieved its modest growth target. A far more ambitious, but less successful, second five year plan was followed by the third five- year plan for 1961-66. Even as he was introducing the third plan in India’s Parliament, Prime Minister Nehru, was challenged by a socialist member, Mr. Lohia, who complained that the fruits of the first two plans were not shared by the masses. Nehru, in his characteristic way, replied by saying that, while

² As is well known the entire leadership of INC including Gandhi and Nehru were incarcerated by the colonial government in 24 hours after Gandhi launched a non-violent civil disobedience movement (Quit India Movement) on 8th August 1942 calling for immediate independence of India. Although Gandhi was released from prison in 1944 due to his failing health after his 21 day fast, all political prisoners were released only by early 1946.

in his tours of India's vast rural areas he found that people are better fed and clothed, nonetheless it would be worth examining how the fruits of growth were being shared. He appointed a Committee headed by the eminent statistician Professor P.C. Mahalanobis to enquire into the distribution of levels of living. Around the same time, an expert group appointed by the PC defined a national poverty line. The Perspective Planning Division of the PC used this poverty line in formulating what it called a fifteen year (1961-1976) development plan to assure a "minimum level of living", (reminiscent of NPC's irreducible minimum standard) for all by 1976. This plan called for an annual growth in real GDP of 7% a year.

My purpose in recounting this history is to make three points: first, rapid growth has always been viewed in India, to use Jagdish Bhagwati's felicitous phrase, as a "pull-up" strategy for raising the levels of living of the poor and certainly not as a "trickle-down" strategy. The latter derisive phrase is used by some in India even though they should know better. Second, the growth envisaged was always inclusive – otherwise it could not have achieved its intended "pull-up" outcome. Third, only those suffering from amnesia, apparently including the authors of the Approach Paper of the Eleventh Plan, would characterize their vision of "inclusive growth" as new! Last, and this is my most important point, the failure of planning was not in not having a vision of inclusive growth, but one of delivering it. Table 1A makes this abundantly clear. During 1950-80, planning did not deliver rapid growth – per capita GDP grew at about 1.25% per year only. The issue of its inclusiveness or otherwise is irrelevant. Even had it been inclusive, it could not have made a dent on poverty and it did not: national poverty (Table 2) hovered around 45% of the population.

What about China? As is to be expected in a country that was taken over by the Communist party of China (CPC) in 1948, communist ideology largely drove its economic development from early on until the reforms after 1978. Industry had been completely nationalized by 1958 and foreign trade even earlier. By 1956, when agricultural collectivization started, almost all rural households were members of a cooperative.³ Communes were initiated in 1958. Development strategy was Stalinist in its unbalanced emphasis on industrial growth (especially heavy industry). The disasters of the Great Leap Forward (1958-62) entailing an estimated decline of two-thirds of grain output and an excess mortality of 30 million due to famine are well known. The decade (1966-76) of Cultural Revolution depressed the growth of output. By the time of Mao Ze Dong's death in 1976, the Chinese economy was in a critical shape. In fact, as Angus Maddison has shown, around 1950, India's per capita income was about 25% higher than China's and the slightly faster growth of China during 1958-80 (Table 1A) enabled it merely to wipe out this initial gap, but no more by the time reforms were initiated in 1978. Tables 1 and 2 show that, as in India, in China also rapid growth and poverty reduction is a post 1980 phenomenon

2.2 The Origins and Contents of Reforms

It is clear that the time was ripe for reforming and restructuring the Chinese economy when the Gang of Four were overthrown and Deng Xiaoping took over.

According to Saich (2001), by the late 1970s senior leaders of the CPC, including Deng,

³ Interestingly the land policy subcommittee of the NPC passed a resolution recommending the application of the cooperative principle to the exploitation of land with all agricultural land vesting collectively and absolutely in the people of India and that collective and cooperative farms be developed, to begin with on "culturable waste" land. One member wanted to experiment first before extending collectivization and another did not want peasant farming with heritable holdings to be ruled out while experimenting with cooperative farming with individual ownership and collective farming with joint ownership of land and distribution of produce. After independence cooperative farming was promoted for a brief period. Fortunately, collectivization was never tried.

had concluded that the solution to the country's economic, political, and social problems required a major overhaul of the system. In their panegyric of China's development priorities, Yusuf and Nabeshima (2006) attribute to Deng Xiaoping a vision of a Xiaokong Society, in which economic well-being, if widely shared will go hand in hand with social harmony. Deng apparently used Xiaokong Society as the touchstone of a good society with Chinese characteristics. The authors state that Jiang Zemin reiterated Deng's vision at the 16th National Congress of the CCP in November 2002. The current Prime Minister, Wen Jiabao apparently indicated in 2004 that an all-around Xiaokong Society was the guiding tenet of China's development. Apparently, inclusiveness as exemplified in Xiaokong society is the buzzword in China and India!

Although the Indian economy's growth and poverty record during 1950-80 was by no means stellar there was no obvious economic pressure for reforms from any part of the polity or society. The party in power used the discretionary economic control system to dispense patronage and rents. Rent receivers were concentrated and lobbied to ensure that the system continue to dispense rents. Those hurt by the system by and large did not see the link between their situation and the control system and in any case, were too diffused to organize and lobby.

In 1966 India experienced a severe macroeconomic and balance of payments crisis and approached the World Bank and the IMF for assistance. It had been obliged to make changes in policies (e.g. devalue the rupee, liberalize imports, etc.) in response to the conditionalities of assistance. Once the crisis eased by 1968 and also because of the renegeing by the World Bank of its promised non-project assistance to ease adjustment costs of liberalization, the government abandoned liberalization and reverted to its pre-

crisis policies. This reversion was also driven by the opposition of senior leaders of the ruling party and the political vulnerability of the then newly chosen Prime Minister, Mrs. Indira Gandhi. Her party lost several seats in the election of 1967. She did not attempt any liberalization thereafter until shortly before her assassination in 1984. My point is that whatever reforms there were originated in a crisis and did not last. There was no pressure from below for reforms.

Indira Gandhi's son and successor, Rajiv Gandhi, did experiment with relaxing a few of the restrictions on trade and investment, encouraged by young economists, appointed by him to senior positions in economic ministries, who had earlier served on the staff of the World Bank. Several committees appointed by the government had also emphasized the harm caused to the economy by rigid controls and recommended reform. But to the best of my knowledge, neither the young senior bureaucrats nor the committees recommended systemic reforms. Consistent with past practice they recommended ad hoc piecemeal reforms intended to remove or moderate controls that proved to be particularly onerous.

Rajiv Gandhi's liberalization increased the potential output from existing capacity. But for the potential to be realized, demand had to be expanded. However, with no improvement in international competitiveness of domestic producers, the demand increase had to come from domestic sources rather than from exports. Domestic demand was raised through fiscal stimulus by running fiscal deficits financed by borrowing at home and abroad as well as partial monetization. This fiscal profligacy, though it would turn out to be unsustainable, provided the demand stimulus for accelerating growth (Table 1A). And with rapid growth came reduction in poverty (Table 2) during 1980-90.

By 1990-91 the gross fiscal deficit had grown to about 9.5% of GDP and together with the steep rise in oil prices during the Iraq war of 1990, put pressure on prices and the exchange rate, fueling expectations of an imminent devaluation of the rupee. This was compounded by a political instability with two changes of prime ministers within a year. Expectations of devaluation led to capital flight, a fall in the country's foreign exchange reserves to less than two week's worth of imports, and a spectre of imminent default on external debt leading to a downgrading of India's credit rating. Thus, with the assassination of Rajiv Gandhi in May 1991 during the election campaign and the assumption of power by the government of Prime Minister Rao, it was clear that the country had to approach the World Bank and the IMF once again. But unlike in 1966, Indian policy makers realized that systemic, rather than piecemeal, reforms were essential and that a return to status quo ante after the crisis had passed was no longer tenable. In my view, there could be two reasons for their perception: first, the bankruptcy of Soviet-style economic planning which was India's model since the 1950s, had formally been revealed by the collapse of the Soviet Union in 1991. The second was the phenomenal growth of China since its reform of 1978. The fear of being permanently left behind by China with whom India had fought and lost a border conflict in 1962 was extremely unpalatable. Thus, the reforms of 1991 were born.

In China there was no macroeconomic crisis to induce reforms. As noted earlier the disastrous decline of the economy during the Great Leap Forward and Cultural Revolution gave birth to reforms.

2.3 Characteristics of the Reform Process

Zhao (2005) criticizes the common perception of Chinese reforms process as “gradualism” in the sense of the process being designed to reach specified goals by gradual stages, for the reasons that there was no blueprint for China’s reform and liberalization and whatever liberalization measures that were eventually adopted came out of a series of experiments, either in a location or in an industry to identify successful measures that could be adopted more broadly, and ideally nationwide. This process did not preclude, in Zhao’s view, of radical reforms such as those following China’s accession to the WTO in 2001 or its making Renminbi convertible for current account transactions. In fact other reforms more radical than those cited by Zhao include the exchange rate and tax reforms of 1994. The process also allowed for occasional slow down of the process, if experimental reforms showed disappointing results. Among the examples cited by Zhao of the empirical and experimental approach is that of the creation of just four Special Economic Zones (SEZs) in 1980. After their remarkable success, they were extended to Hainan Island (which was not a success) and 140 coastal cities in 1988. The success of these coastal zones led to the extension of SEZs to inland regions in 1990s and to the whole of Western Region in 1999.

Zhao’s claim that there was no blueprint for reforms when China initiated its reform process is much too sweeping and does not seem to be consistent with the facts. Other writers, such as Shanguin (1999) see these successive stages in the process. The main components of the first stage (1978-84) focused mainly on rural areas, particularly the replacement of agricultural communes with the household responsibility system and free sale of most output at market prices as well as the creation of four SEZs and the replacement of surrender of profits by urban enterprises by taxes. The second stage

(1985-92) focused on urban areas, particularly on reform of state-owned enterprises, introduction of share holding system, freeing enterprises to make their own investment decisions and the creation of more coastal SEZs including the island of Hainan. The third stage, which began in 1992 and still continuing, is the creation of a socialist market economy as the Chinese call it. It included access to WTO in 2001, financial sector liberalization and further reforms of SEZs. It is true that the successes (and failures) at each stage encouraged further reforms (as well as corrections to earlier ones) at the next stage. In other words, experimentation and learning, rather than engaging in a haphazard process not without a blueprint, would be a more appropriate description of Chinese reforms. The experimentation also had the implication that there was learning from differences both in reforms and in their outcome, in different provinces, townships and villages. Thus the process, though centrally directed and controlled by the CCP nonetheless was not entirely 'top-down,' but had some significant 'bottom-up' elements. The centre gave sufficient flexibility for provincial governments to adopt models or pilots that were better suited to local circumstances.

On the other hand, the Indian reform process originated in a severe macroeconomic crisis. Its resolution necessitated the request for assistance from the World Bank or IMF. Both imposed conditionalities for their assistance. These two facts shaped the agenda of reforms with an immediate focus on fiscal consolidation, devaluation of the rupee and unification and market determination of exchange rates (with interventions by the Reserve Bank of India as appropriate), trade and investment liberalization as well as some financial sector reforms. Some of the other components, such as the successful telecommunication and broader financial sector and tax reforms

came subsequently. This meant that components other than those driven by the exigencies of crisis resolution and even some such as fiscal consolidation driven by it, were inherently caught up in the vicissitudes of India's democratic politics. In any case, there was little by way of experimentation as in China, using states as laboratories. The reform process was thus largely 'top-down' and directed by the central government. In part this was due to the fact that the Indian Constitution, though formally federal, had assigned a strong role for the centre in taxation and jurisdiction. In part it was also due to the fact that the states did very little on their own even in sectors in which they had been assigned jurisdiction by the Constitution either exclusively or concurrently with the Centre.. However, the differential performance of different states under the reforms has opened up the possibility, even without Chinese style experimentation. Also it remains to be seen whether some states will take the initiative to relax the draconian labour laws, particularly in SEZs as they have the freedom to do so.

In many respects, the economic and political environment in India of 2007 is vastly different from that in 1950 when the constitution was adopted and the Planning Commission was established. For example, coalition governments at centre and caste/region based parties did not exist then.. The consensus then on the need for planning a dominant economic role of the states and insulation from world markets no longer exists. In other words the constitutionally specified system of political and economic management has become anachronistic and has to be reformed. In this context, I have proposed the creation of a Fiscal Review Council with representation at the highest level by the Centre and states(Srinivasan (2007)). It would be a forum in which states would in particular have an opportunity, not only to review each other's fiscal

policies but also those of the Centre. I have also suggested that the Planning commission be reconstituted as a Public Investment Bank for the reason that the rationale for the traditional five- year and annual plans no longer exist, but the need for public investment by the Centre, States and even local bodies in crucial sectors remains.. Continuing with anachronistic institutions, ritualistically going through five- year and annual plans, while chanting the mantra of “inclusive growth” as if it is a new vision with no new strategy for realizing it is utterly pointless.

China of course is no participatory democracy and is unlikely to become one any time soon. CCP dominance will continue. That said, it is worth recognizing that the leadership of the CCP has been opening the political system in a limited way, for example, allowing “capitalists” to become members and “elections” for local leadership. The top leaders of CCP are also concerned with rising inequalities in income distribution particularly between rural and urban areas and also about the damage to environment arising from rapid growth. Again, in the panegyric of Yusuf and Nabeshima (2006, p5), Premier Wen Jiabao’s conception of the all-round Xiaokong Society involves “putting people first and promoting reforms and innovation in accordance with the “five balances:” balancing urban and rural development, balancing development among regions, balancing economic and social development, balancing between man and nature, and balancing domestic development with opening wider to the outside world.” I have no way of judging whether this “Xiaokong society” is founded on an operational strategy for achieving it any more than the “inclusive growth” vision of India’s Planning Commission. Maybe the forthcoming National Congress of the CCP will clarify the issue!

2.4 Sources of Growth

The successful use of rapid and inclusive growth as an instrument for elimination of poverty necessarily means that it can be sustained for an adequately long time. In the 1950s when the late and unlamented Soviet Union was at the top of the growth league, the question was raised whether Soviet growth was largely accounted for by growth in inputs or whether growth in total factor productivity (TFP) contributed a large share. It was argued that, if it was the former, because of diminishing marginal returns to inputs sustaining a given rate of growth of output would require more and more inputs per unit of output so that sooner or later it would become unsustainable. On the other hand, the force of diminishing returns need not operate on TFP, so that any rate of growth to which the major contributing factor is TFP would be more likely to be sustainable. Indeed the issue of sustainability of the then Soviet growth and the fear of its consequences for the West were it sustainable, spawned the growth accounting literature.⁴ The same question was raised by Young (1995) with respect to the rapid growth of the nearly industrializing countries of East Asia. Clearly in measuring TFP as the residual (called the Solow residual), obtained by subtracting the contribution of the growth of measured inputs from observed growth of output involves assumptions about production technology, issues relating to input measurement, level of aggregation and many more. For example, in the case of India, there are no time series data on appropriately measured input of labour, sectorally or in the aggregate. All available studies use proxies for the missing data. Also, any accounting, including growth accounting, is a backward-looking, purely

⁴ Interestingly Chinese rapid growth is also raising similar fears as demonstrated in the World public opinion surveys of the Chicago Council of World Affairs (2007) and the Pew Research Centre (2007). Apparently neither organization views Indian growth as threatening since the survey respondents were not asked about their perception of India!

descriptive decomposition exercise, and not a forward-looking one based on a causal framework. All these caveats are well known. Having drawn attention to them, I will simply report a subset of the growth accounting exercises for China and India in the literature (Tables 1B-1D) without describing the methodology and data used by any of the authors, let alone evaluating them.

The study of Bosworth and Collins (2007) from which Table 1B is taken covers the period 1978-2004. China began its reforms in 1978. India's hesitant reforms started in the mid-eighties, but its growth acceleration in some accounts dates back to the late seventies. As such, comparing China and India during 1978-2004 and treating the comparison as a post reform story seems plausible. It is seen that in the economy as a whole, labour productivity in China grew at more than twice the rate in India. However, the contribution of TFP to this growth was similar, 52% for China and 48% for India. It is comforting that the contribution of TFP is large though not overwhelming. In agriculture and industry, China's labour productivity growth was much faster than India's - more than three times for agriculture and more than twice for industry. While in agriculture the contribution of TFP at 57% for India was considerably higher than 41% for China, in the case of industry it was the other way around, 63% for China and at 24% for India. It is in services that the gap in labour productivity growth between the two countries is much narrower, with India's growth rate being 71% of China's. Nearly 69% of India's growth in labour productivity of the services sector was accounted for by TFP growth

Table 1C goes further than Table 1B in including, roughly speaking, the pre-reform period for both countries. Table 1D also provides estimates of TFP growth for periods

roughly coinciding with the pre-reform era. Although the rates of labour productivity growth and of TFP in the period after 1979 (roughly the post reform period) are not identical between Table 1B from Bosworth and Collins (2004) and Table 1C from Herd and Dougherty (2007), the differences are minor. The most interesting findings from Table 1C are: in China the rate of growth of labour productivity went up by about 2.5-2.9 times, and the rate of TFP growth went up by 8-14 times in the post-reform period as compared to the pre-reform period. In India similar, though less dramatic, results are seen – labour productivity growth went up by 2.2 – 3.5 times and TFP growth by 3.6 – 5.0 times. TFP growth rates for the pre-reform period in Table 1C, though different from Table 1B, are not substantially different. Clearly the reform era was associated with substantial increases in productivity.

3. External Opening: Foreign Trade and Capital Flows

3.1 Perspectives on Foreign Trade and Integration with the World Economy

India's ambivalence about integrating the Indian economy with the world economy is long-standing. The Note guiding the sub-committees of the National Planning Committee (circulated presumably in 1939) states categorically that "The principal objective of planning the national economy should be in attaining, as far as possible, national self-sufficiency and not primarily for purposes of foreign markets. This does not exclude international trade which should be encouraged but with a view to avoid economic imperialism. The first charge on the country's produce, agricultural and industrial, should be to meet the domestic needs of food supply, raw materials and manufactured goods. But outlets for surplus goods may be exploited to meet the requirements of India's international indebtedness." (IIAPR (1998), p53). Clearly the

concepts of comparative advantage and specialization are completely absent in this view. Although it suggests Adam Smith's notion of foreign trade as a vent for domestic surplus, i.e. beneficial exchange of commodities in domestic excess supply for those in domestic excess demand under pure competition at world prices, it is clear that this not what was meant. The operational notion was the drive for self-sufficiency across the board, with a minimum value of exports (or more precisely a current account surplus) being generated for external debt service. Interestingly in the revised instructions to the subcommittees circulated after the war in November 1945 there is a recognition that "the growing demand for international cooperation and the removal of trade barriers which had characterized international economic relations before 1938... will react radically upon the principal objective of attaining national self sufficiency." At the same time it expressed optimism that although "there are many difficulties in the way of giving effect to the ideal of full and free international cooperation in matters economic, but if the ideal is to be accepted, these difficulties could be overcome." (ibid, p63)

Unfortunately the ideal was never accepted in post independence India. India and pre-revolution China were two of fifteen countries that were invited in 1946 by the United States to negotiate reductions in tariffs, which ultimately led to the signing of the General Agreement on Tariffs and Trade (GATT) by India and twenty two other customs areas/countries. India was also a member of the Preparatory Committee for the United Nations Conference on Trade and Employment held in Havana during November 1947. In March 1948 this committee debated and revised a draft, originally proposed by the US, of a charter for an International Trade Organization (ITO) that was to be discussed and adopted at the Havana Conference. In the tariff negotiations and in the Havana

Conference, India and other developing countries were already pushing for freedom to impose barriers on their imports while asking for freer access for their exports in developed country markets. As is well known, although the charter for the ITO was adopted and signed by fifty- three countries in Havana, the ITO never came into being because the US, in particular, chose not to ratify it. The GATT, which was meant to be the commercial policy chapter of the ITO charter came to be applied provisionally. It was replaced by the World Trade Organization (WTO) in 1995, nearly 40 years thereafter.

During the long history of the GATT and the eight rounds of multilateral trade negotiations sponsored by it, India resisted the initiation of various rounds of trade negotiations for liberalizing trade and signed the agreements concluding each round (including the eighth, the Uruguay Round) with reluctance. In the moribund Doha round negotiations initiated under the auspices of the WTO in 2001, India has been more forthcoming than in the past, but nowhere near accepting the “idea of full and free international cooperation in matters economic” envisaged by the National Planning Committee in 1945. India has always been the champion of “Special and Differential Treatment of Developing countries in the GATT/WTO and continues to advocate to make full use of the permitted exemptions from WTO rules as a developing country.

At its meeting in November 1945, the NPC considered foreign capital investment in Indian enterprises. Given its perception that with its control over India’s economic and political life foreign interests had “both warped and retarded national development’ it concluded that “the investment of foreign capital in Indian enterprise should not ordinarily be permitted in a form which would entitle it to ownership and management in

respect of industries of national importance.” (IIAPR, 1998, p142). However, in view of “India’s capital requirements in coming years she may need capital from other countries. It is not, however, in her interest to accept it, if it is required for essential industries, except in the shape of loans or credits, raised by or through the state.” Thus only foreign debt, that too as sovereign debt, was the only form of foreign capital envisaged by the Committee. In fact until the eighties India’s external debt was almost entirely sovereign debt owed to other governments and multilateral lending institutions.

In my view, India’s controls on foreign trade consisting of tariffs and quantitative restrictions implemented through a complex set of import and foreign exchange licensing regulations, and restrictions on foreign ownership originated in the recommendations of the National Planning Committee of 1938 under the chairmanship of Jawaharlal Nehru. However there is no evidence to suggest that the Committee had in mind the extensive, intrusive and discretionary system of controls instituted after independence. Nor is there any evidence that they anticipated the political and administrative corruption such a system would inevitably induce. Although the post 1991 foreign trade and investment regime is no longer one of actively insulating India from world markets and is in fact promoting foreign trade and inviting foreign investment, the liberalization of trade policy instruments and the restrictions on foreign investment has not gone far enough.

China, like India, was one of the original twenty-three Contracting Parties of the GATT in 1947. After the communist revolution, Taiwan was permitted in the UN and the GATT to pretend that it was China. Taiwan announced that it would withdraw from the GATT in 1950. People’s Republic of China never recognized Taiwan’s decision. It notified the GATT in 1986 of its wish to resume its status as a Contracting Party and

renegotiate the terms of the status. The GATT in effect treated China as if it was applying for accession to GATT anew.⁵ The negotiations for accession dragged on till GATT was subsumed by WTO in 1995 and were concluded only in 2001, fifteen long years after China's notification of its desire to resume its membership. The accession procedures of the GATT/WTO require that an applicant has to conclude bilateral market access negotiations with the then members of the GATT/WTO as well as multilateral negotiations with the working party of the GATT/WTO. The two negotiations together lead to the report of the Working Party that stipulates the terms of accession including a draft Protocol of Accession. Accession becomes effective only after the formal approval of the Working Party Report by the members of GATT/WTO and the applicant.

As is to be expected, although as many as 44 members of the WTO were interested in negotiating bilateral market access deals with China, not much progress was made until China concluded its bilateral agreement with the US in November 1999 and with the EC in May 2000. Even then Mexico did not conclude its agreement until 2001. The essential aspect of the bilateral market access agreement at the time of accession is that the terms imposed on the applicant could go beyond the terms that the incumbent members have to satisfy. For this reason, China as an applicant had to satisfy more stringent conditions than, for example, India, a member of WTO. In particular, China agreed to the establishment of a transitional product-specific safeguard mechanism for a 12-year period after accession which allows WTO members to access it if Chinese exports cause market disruption. A separate transitional safeguard for textiles permits other WTO members to take action against market disruption caused by Chinese textile

⁵ For a thorough discussion of the issues relating to China's accession to the WTO and the likely impact of accession on China's economy, see Bhattasali et al (Eds) (2004).

exports until the end of 2008, three years after the expiry of the Multifibre Arrangement. China agreed not to avail of certain WTO provisions available to it as developing country and accepted a cap of 8.3 percent of the value of output on domestic support in agriculture below the 10 percent cap for developing countries. In sum, Gertler (2004) concludes that as part of its bid to join the WTO, China has significantly reduced its tariff and non-tariff barriers. These go beyond what it would have been committed to do, if ,like other developing country signatories, it had participated in the Uruguay Round agreement of 1994. Mattoo (2004) concludes that China's service sector reforms are the most radical ever negotiated in the WTO.

Why did China agree to abide by many restrictions not applicable to other developing countries, such as India, and deeply cut its tariff and non-tariff barriers? Bhattasali, Li and Martin (2004) suggest that China's policy makers saw its WTO accession agreement as a means to fulfilling broader goals such as its peaceful emergence as a great trading nation without running into trade tensions that the emergence of a new major trader inevitably generates. Equally important, it would seem, was their use of commitments undertaken in the accession agreements for accelerating domestic reforms. Bhattasali, Li and Martin cite Jin (2002) as describing the accession agreement "as a wrecking ball for what remains of a closed economy." They also say, rightly, that the implementation of accession commitments involved reforming laws relating to trade issues but also reforms that went beyond those required by the accession agreement. In fact China had begun reducing its trade barriers even prior to its accession. According to Messerlin (2004, Table 19.3) import protections in China (in terms of tariff or tariff equivalent in 1995 were respectively 4.8 percent, 25.3 percent and 10.3 percent

respectively in agriculture, manufacturing and services. The post-accession values of these were 3.5 percent, 6.3 percent and 5.2 percent respectively. Even the protection on manufacturing had been brought down to 13.3 percent in 2001 just prior to accession.

I have not seen any analysis showing that India ever viewed its commitments under multilateral trade agreements concluded in the eight rounds of trade negotiations under GATT as means for accelerating domestic reform. The commitments were undertaken after considerable resistance during the negotiations and accepted reluctantly, only because the alternative of formally terminating membership in the GATT was less appealing. China did not share India's apparent belief that reduction in barriers against imports is not a action that brings gains to the domestic economy but a concession to foreign exporters. It seems to have viewed such reductions as a favour to itself in that they brought gains in and of themselves but also through their enabling domestic reforms.

3.2 Trade Barriers in China and India as of 2005-2006

Table 3A summarizes the tariffs barriers in China and India. Part A relates to tariffs on imports into these two and Part B relates to tariff faced by their exports. It is very clear that barriers to imports into India are much higher than on imports into China. Simple average bound tariffs in China are a modest 15.8% on agricultural and 9.1% on non-agricultural products in contrast to a massive 114.2% and a high 34.9% respectively in India. The simple average China's tariffs applied on an MFN basis is close to its bound while India's is far below the bound, whether measured as a simple or import weighted average. In other words, even if India committed to reducing its bound levels in the Doha round, unless the reductions are substantial there will be no impact or applied levels. It is no surprise that the US and EU are demanding significant reductions in

India's bound levels and India, true to its traditional resistance to liberalization, is resisting the demand. Moreover only 10% or fewer of tariff lines carry a tariff (bound or applied) of more than 25% in China whereas in India, more than 89% of tariff lines have a bound tariff of 50% or more, and more than 90% of tariff lines have an MFN applied tariff of 25% or more. In terms of value of imports, whereas 65% or so of the total value of imports attracted a less than 10% rate of applied tariffs in China, a large 90% of the value of imports in India attracted a MFN applied tariff of 25% or more. Part B of Table 3A shows that MFN tariffs (simple and weighted) faced by China's exports to its major markets were around 5% or less, except in Korea where it was 13.1%. India also did not face particularly high average tariffs in its major export markets.

The details of tariffs in Table 3B, with respect to All, Agricultural and Non-Agricultural products also show uniformly lower barriers in China. For example, in India in the case of all products, more than 70% of tariff lines compared to China's 16.4% carried a bound duty exceeding 15%. The differences between the two countries with respect to MFN applied tariffs exceeding 15% was however much smaller. This again reiterates the point made earlier, that unlike China, India has a long way to go in reducing bound levels before they are close to applied MFN levels. In the case of agricultural products, in India more than 90% of tariff lines carry a bound and applied tariff of more than 15%. China is far less closed to agricultural imports.

Table 3C relates to anti-dumping measures (ADMs), the most pernicious among protectionist measures. India has become the foremost user of ADMs among members of the WTO since its inception in 1995. India has reported having initiated 457 measures (out of a total 3,044 reported by 98 members of the WTO) of which 93 were against some

products imported from China. Out of 142 measures reported by China, only 4 were against imports from India. Until India grabbed this dubious distinction, around 2000, the US and EU were the most frequent users of ADMs and now they are second and third after India. Both have targeted a large number of their ADMs against China and also against India, through lower, but significant numbers. Clearly, that although China is a target of ADMs by the EU, India and United States, China makes much less use of ADM herself. Once again it is clear that China's markets are far more open than India's.

Taken together, the use of tariff and non-tariff barriers to trade by the two countries demonstrates that India has a still a significant way to go before it is as open as China. Second, although several Indian Finance ministers have publicly announced their intention to bring down Indian tariff bounds to "East Asian" levels they have not done so. However they succeeded in reducing applied MFN tariff levels significantly. Still India's simple average applied tariff rate at 37.6% for agricultural and 16.4% for non-agricultural products (China's rates being roughly half of India's) would place it among the most protected economies in the developing world. India being a leader in the use of ADMs is discouraging too. There seems to be no recognition of the symmetry that import barriers are equivalent to taxes on exports, let alone a strategy of reducing import barriers either unilaterally or as commitments in WTO negotiations as a means to accelerate growth.

3.3 External Opening: Outcomes

It is no surprise that the significant and systematic opening by China to foreign trade and investment compared to the reluctant and limited opening by India led to differential outcomes in the external sector. Table 4 quantifies these outcomes. Part I of

the table shows that in 1953, China and India had similar shares of world merchandise trade. With its relentless pursuit of an import-substituting industrialization strategies, India had reduced thirty years, in 1983, its share of world exports by two-thirds to just 0.5% and its share of world imports by half to 0.7%. China's export share remained unchanged at 1.2% where import share decline by a third to 1.1%. With China's external opening policy, by 2006 its share in world merchandise exports (imports) rose to 8.0%(6.5%)and made it the third largest exporter and importer in the world. India's exports (imports) share also rose but to a modest 1.0% (1.4%) making it only the 28th largest exporter and 17th largest importer.

Table 4, Part II shows that even as early as 1981-83 merchandise trade accounted for 16.7% of GDP in China compared to 7.4% for India. By 2005 this share had risen by roughly four times in both countries to 63.6% and 28.5% respectively. For a country of China's size and per capita income, a trade share exceeding 60% is very high making it an outlier. India's performance, though vastly improved relative to 1981-83, is by no means unusual.

With the well-known and widely recognized success of India in software and information technology enabled services, it is to be expected, that as compared to its shares in world merchandise exports and imports, India does better in trade in commercial services with a share of 2.7% (tenth largest) in world exports and an equal share 2.7% (twelfth largest) in world imports. China with an export share of 3.2% (8th largest) and import share of 3.8% (7th largest) outperforms India (WTO (2007c)). However, India's share of 2005 in total service exports of computer, information,

communication and other commercial services at 66.4% was much higher than China's 38.6% (Table 4, IIIB).

Table 4, Parts IVA and IVB document the data on foreign capital flows. It is well known that private capital flows to developing countries began growing after the 1980s. By 1990, flows of foreign direct investments (FDI) to China at \$3.5 billion far exceeded the flows to India at a paltry \$0.24 billion. By 2005 FDI flows to China had grown to a phenomenal \$79 billion while flows to India had grown only to \$6.6 billion. The effect of India's balance-of-payments crisis in 1991 is seen in a net outflow of \$4.0 billion in bonds in 1990 with China experiencing a negligible outflow. Although both countries had positive net inflow of bonds in 2005, these flows were modest at \$2.7 and \$3.7 billion respectively for China and India. Equity flows, which were nil in 1990, grew significantly to \$20 and \$12 billion respectively to China and India in 2005. Once again the substantial excess of capital flows to China could be attributed to its more welcoming attitude. Also in almost every indicator of doing business (such as the time required to build a warehouse) china outperforms India (World Bank, 2007a, Table 5.3).

In external debt (Table 4, Part V), interestingly while China's total long term debt grew rapidly from a low \$4.5 billion in 1980 to \$135.3 billion in 2005, still it was only modestly higher than India's \$14.3 billion in that year. Most of it is either public or publicly guaranteed in both countries.

In addition to comparing aggregate indicators (Table 4, Parts I-V) of outcomes of trade policy, it is also instructive to compare disaggregated performance indicators. In Srinivasan (2004a, Table4) I had compared China's and India's participation in World and major (North American and European) export markets during 1978-2000 in

garments, fabrics, leather and leather products, jewelry and others, all of which, except possibly fabrics, are labour intensive. I found that in almost every commodity and market, China's share had grown rapidly between 1978 and 2000 (prior to China's accession to the WTO in 2001), whereas India's share had grown much less, if at all. For example, the share of China in global garment markets quintupled from under 4% in 1978-1981 to more than 20% in 1998-2000, while India's share hardly grew from 4% to 5%.

Panagariya (2007) provides a more recent comparison. He shows that in its pattern of exports, as its stock of physical and human capital increased, China has moved away from light manufactures such as apparel, toys, sporting goods, etc. towards more sophisticated products that included office machines, telecommunications and electronic apparatus and equipment, and electrical machinery that also employed large numbers of workers. India's leading exports continued to be either skilled-labour intensive or capital intensive. He rightly attributes this difference between the two countries to India's domestic policies (e.g. draconian labour laws and reservation of products for exclusive production by inefficient small scale industry) that virtually guaranteed the failure of labour-intensive products in the export markets.

Under the trade policy review mechanism of the WTO (an 'early harvest' outcome of the Uruguay Round of Multilateral trade negotiations) there have been four reviews of India's trade policy since the WTO came into being on 1 January 1995, the latest in 2007. Since China became a member of the WTO only in late 2001, the first ever review of its trade policy was done in 2006. The latest report for India and the first for China are both comprehensive and delve into detail on all aspects of trade policy including the ones

discussed in this paper. The report of WTO's Secretariat on China (WTO (2006b) pp x-xi) notes that "since beginning of its programme of economic liberalization, and especially as a result of its accession to the WTO, China has carried out major trade and trade related reforms. The tariff is entirely bound and applied rates are generally at or close to bounds...this lends a high degree of predictability to the tariff: ...Non-tariff measures have also been falling progressively." In contrast, the Secretariat report on India (WTO (2007b), pp viii-ix), while noting its overall downward trend in tariff rates, observes "with the exception of few applied tariffs, which are at their corresponding bound rates, the difference between the bound and applied rates is considerable. This difference gives the Government considerable scope to raise applied tariffs, scope that was used to raise tariffs on some agricultural products in recent years." This considerable scope in effect makes India's trade policy discretionary and uncertain. The report also notes India's continuing use of anti-dumping measures, aimed mainly at China, the EC, Chinese Taipei and Korea. Also India, as the report notes, uses export barriers in part to ensure stability in domestic supplies (and prices) of certain products. For example, onion exports have been banned off and on; exports of raw cotton have been restricted when a rise in domestic prices was seen as threatening the domestic textile industry, and so on. Once again such barriers introduce policy uncertainty for those relying on imports from India.

According to WTO (http://www.wto.org/english/tratop_e/region_e/region_e.htm), taking into account all regional trade agreements (RTAs) that have been notified to the GATT/WTO--- in force but not ratified, signed but not yet in force, currently being negotiated and those in the proposal stage--- there are in all 400 RTAs scheduled to be

implemented by 2010 of which free trade agreements (FTAs) and partial scope agreements account for 90% while customs unions account for less than 10%. Those who view rapid progress toward a liberal, non-discriminatory multilateral trading system as the only desirable and legitimate goal for the members of the WTO to pursue, among whom I count myself, cannot but view this proliferation of PTAs, be they RTAs or FTAs, as alarming. In particular, in RTAs involving one or more industrialized countries and developing countries as members, the former often insist on intellectual and foreign investor protection, labour and environmental standards on through provisions, which either do not exist or go beyond the corresponding provisions in multilateral agreements. It is not necessarily in the interest of developing countries to enter into such agreements.

Unfortunately, both China and India are among the proliferators, each involved in dozen or more PTAs at various stages of negotiations, including one with each other. India, while affirming its strong support of multilateral liberalization has nonetheless sought out RTAs in recent years believing them to be building blocks towards a non-discriminatory multilateral system (WTO (2007b) p24). It escapes one's mind how inherently discriminatory RTAs with their negative lists and exceptions could ever be building blocks towards a non-discriminatory system. China's attitude toward RTAs is similar: it believes that a regional economic integration process consistent with WTO rules will not only promote regional but also worldwide liberalization by achieving further tariff reduction and broader market access for services and investment. It considers the regional integration process as complementary to the multilateral trading system.

Unfortunately, a regional integration process consistent with WTO rules envisaged by China is an oxymoron. The reason is that the system by which a proposed RTA is examined for its consistency with the GATT/WTO rules has been a complete failure. The Annual Report of the WTO for 2005 (p59) frankly admits that the committee on Regional Trade Agreements (CRTA) entrusted with the compliance of RTAs with relevant WTO provisions, “made no progress on its mandate of consistency assessment due to long-standing, institutional and legal difficulties. Since the establishment of the WTO, members have been unable to reach consensus on the format, and the substance, of the reports on any of the examinations entrusted to the CRTA.” This being the case, the Chinese and Indian claims (or for that matter those of other members of the WTO) of their pursuit of RTAs as a complement to the pursuit of Multilateralism is at best an article of faith and at worst outright duplicity and, in any case, not one that is founded on reality. The WTO’s Annual Report rightly concludes that “The lack of an effective mechanism [for consistency assessment] exacerbates the systemic challenges that RTAs may pose to the MTS [Multilateral Trading System].”

I had proposed some time ago, that instead of a futile pursuit of consistency assessment of RTAs with the existing provisions (mainly Article XXIV of GATT) of WTO, members should repeal Article XXIV and related provisions and replace it with a simple requirement that the discriminatory provisions of any PTA be extended to all members of the WTO on a MFN basis at the end of, say five or no more than ten years, from its coming into force. This way the damage that RTAs inflict through discrimination can be contained.

Turning to an empirical analysis, Roland-Holst et al (2005) claim that in their simulations “most of the gains from the former [WTO style global trade liberalization] can be achieved for Asia by a regional FTA arrangement.” Unless I have completely misunderstood their results (in their Table 4), they in fact show that China and India stand to gain far more with global trade liberalization, than from Asian regional trade liberalization. Only when they throw in a simulated 3 percent annual reduction in intra-Asian trade costs, the regional liberalization yields much higher welfare compared to global liberalization, but without any reduction in trade costs, a comparison which makes little sense.

Let me conclude this long discussion of external opening with what I see as a surprisingly quiet role of China compared to India in the Doha round of multilateral trade negotiations. One would have thought that China, as the third largest trader in the world compared to the distant twenty-eighth largest trader India, would play a far more visible role. Yet China has shown a lack of leadership almost amounting to a lack of interest in the outcome of Doha. India is the leader of the so-called G-20 group of developing countries including China that was formed at the Cancun Ministerial meeting of the WTO in November 2003. India is a member, and China is not, of G-4, a quad of countries comprising of Brazil, India, the EU and the United States that has met several times (most recently in June 2007) to push Doha negotiations along. My guess, and it is only a guess and I have no way of confirming or disproving it, is that China is not in sympathy with the negotiation positions of Brazil and India, which include a continuing emphasis on Special and Differential treatment of developing countries in effect exempting them from rules binding on other members of the WTO, a continuation and avoiding erosion

of discriminatory tariff preferences in markets of industrialized countries, and also an unwillingness to open their markets much farther. China, which is not a recipient of tariff preferences and which has succeeded beyond all expectations by (a) unilateral opening of its economy, (b) accepting more deregulation of its trade as part of its 2001 WTO accession agreement than had the then members of WTO, and (c) avoiding retaliatory overuse of ADMs in spite of being a target of ADMs by others, has little reason to rock the boat, so to speak. In other words, the global trading system is functioning satisfactorily from the Chinese perspective and as such, it is not a serious 'demandeur' in the Doha round. India can learn a lesson or two from China in this respect.

4. Summary, Conclusions and Future Prospects

Historically, rapid, sustained and inclusive growth has been viewed as the primary as well as the most effective instrument for eradication of mass poverty in India. At best, since the ascension to power of the visionary Deng Xiaoping, one sees a similar perspective about growth in China. I made the case that for the first three decades (1950-80) of planned development in India, growth, inclusive or not, was anemic and it could not and did not reduce poverty. I pointed out also that during the same three decades, China's growth though somewhat faster than India's, mainly served to bring China's per capita income to the same level as India's by 1980, starting from a level around 25% lower in 1950. Thus the growing disparities in growth and per capita incomes between the two countries are entirely a post-1980 phenomenon of much faster growth in China. Nearly two and a half decades of rapid growth has reduced poverty considerably but not completely eliminated it in either country. Sustaining rapid growth for a sufficiently long time is essential for eliminating of poverty.

The reform agenda from 1978 in China and from 1991 in India (leaving aside the piecemeal and hesitant reforms of the mid-eighties) are multifaceted. I focused on important and major component of reform, namely external opening, which most analysts would agree contributed to the acceleration in growth since the 1980s in both countries. I argued that historically, going back to the colonial era, foreign trade and investment had been viewed with suspicion in India. The negative perception of external trade and investment, together with the pursuit of import substitution across the board, not only reduced India's share in world trade and made India uncompetitive in world markets, but adversely affected growth. Even after decades of significant reforms that opened the Indian economy to external trade, India is still one of the most protected economies in the developing world.

During the era of Mao Ze Dong until his death in 1976, foreign trade did not figure much in China's five- year plans. Since Deng took over in 1978 China has opened up the economy far more than India has and her surprisingly used external opening to accelerate domestic reforms. A milestone in this process was China's accession to the WTO in 2001. The accession agreement required China to accept conditions that the then members of the WTO including India did not have to satisfy. But China willingly entered into the agreement conscious of its importance in the domestic reform process. As a founding member of GATT and the WTO, India on the other hand has never been eager to embrace trade liberalization and always emphasized on exemptions from GATT/WTO rules as a developing country. It has also been an avid user (and current leader in the use) of the most pernicious of protectionist instruments, namely, anti-dumping measures. The differences in attitudes towards opening as well as in the extent

of opening between China and India are reflected in outcomes. In 2006 China's share in world merchandise exports was 8% compared to India's paltry 1.0%. In 2005 China received \$79 billion of FDI compared to India's \$6.6 billion. China's per capita income in 2005 was \$1740 (\$660 in purchasing power parity exchange rates) compared to India's \$730(\$3460) according to World Bank (2007a, Table 1.1).

Turning to future prospects, both countries face significant challenges. First, in both countries rapid growth has been accompanied by regional divergence in growth. Although the evidence on trends in real income inequalities among individuals or households is scarce and beset with measurement problems, they are believed to have been increasing in both countries. With the hukou system of household registration still in place, large movement of workers from China's interior and rural areas to the coastal zones has meant that such migrant workers, in contrast to those who are registered in the zone, do not enjoy housing, education or health benefits associated with registered households. This has contributed to a rise in inequality; and, growing inequalities could pose a threat to political stability.

India's participatory democracy provides a safety-valve for responding to demands for addressing inequalities. There is no such safety-valve in China's one-party authoritarian system. Keefer(2007) claims that "both countries highlight the role of political checks and balances, whether between parties or branches of government as in India, or between factions of a party as in China." This is a bit simplistic: factions, if any, in China's CCP are not analogous of those in the Liberal Democratic Party in Japan's democracy. There is no institutional framework, at least as yet, within an authoritarian party, such as the CCP, which would allow factions to emerge representing alternative policy choices, so

that competition among them leads to a winner with the best alternative. In my view, the successes of the CCP thus far in managing (suppressing ?) conflict is explained by its known willingness to use repression without hesitation as in the Tiananmen Square incident. As long as the army and CCP are united the possibility of reverting to repression to contain incipient conflicts cannot be ruled out.

In Srinivasan (2007) I have discussed the major challenges facing the Indian economy. In my view the challenge is two-fold: to revive the reform process in areas where it appears to be stalled, and complete it in others. Among the latter reforms, the most urgent is to bring about fiscal consolidation. The fact that India is currently one of the most protected countries in the world means that barriers to trade have to be brought down significantly. SEZs have been created largely in imitation of China's SEZs, but the particular aspects of China's SEZs, namely the provision of adequate infrastructure, allowing flexibility in hiring and firing, and welcoming unrestricted foreign ownership, limiting fiscal sops to attract investors, are not present in Indian SEZs. The recent mishandling of acquisition of land for SEZs and the creation of too many of them at relatively small scales do not bode well.

In any case, successful SEZs are no substitutes for a change in policies that make the entire country attractive for investors, domestic and foreign. A major challenge is to transform India's poor investment climate into a more salubrious one. Although India is unlikely to face a threat to its exchange rate or a severe balance of payments crisis originating externally, still if the benign external environment of low interest and inflation rates were to turn adverse, India could face a crisis, if high fiscal deficits, high debt to GDP and government debt to revenue ratios are not addressed. Although reforms

of the financial sector have gone far, still some severe challenges remain. With the government owning nearly 75% of the assets of the banking system, a market-based discipline is not easily brought to bear on banks.

Reforming the agricultural sector and enabling a large share of workers there and informal sectors to move to more productive employment opportunities elsewhere is a major challenge. Notwithstanding the success of the service sector, it is utterly unrealistic to imagine that the stage of manufacturing can be skipped by moving workers from the low productivity primary sector to the high tech service sector. India's manufacturing sector is still relatively small. Achieving rapid growth of the manufacturing sector that is labour intensive and supplies huge domestic and export markets, depends on further opening of the external sector. India's poor infrastructure (power, transportation, roads, ports) is a major constraint on growth. Improving it requires not only substantial step up in investment but also institutional reform (particularly in electricity generation transmission and distribution). Attracting private investment, domestic and foreign to the infrastructural sector through institutional reforms is a major challenge.

China also faces a challenge in restructuring its agricultural sector and the rural economy so as to move tens of millions more workers to higher productivity activities. Reform of State owned enterprises has to be completed. Unlike in India, the share of China's service sector in GDP is still modest. Removing impediments to the expansion of this sector by shifting emphasis away from relatively export-oriented manufacturing is a challenge. Like India, China also faces bottlenecks in land, water and energy resources. The environmental damage from 25 years of rapid growth has to be remedied and future

growth has to be made more environmentally friendly. And, unlike India's financial sector, China's is not in good shape. Restructuring the banking system as well as capital markets in order to make them more efficient and market oriented is essential. Finally investment rates are very high – in fact, the much higher investment rate in China compared to India is not commensurate with the differences in growth rates. This suggests inefficiency of Chinese investment and perhaps “over-investment” in some sectors. Balancing by shifting demand away from exports and domestic investment to domestic consumption is urgent.

Table 1A: Growth of Real GDP (Average, percent per year)

	1950-80	1980-1990	1990-2000	2000-2005	2006	2007
China¹	4.40*	10.3+	10.6++	9.6++	10.7~	10.4~
India²	3.75**	5.7+	6.0++	6.4***	9.4***	
Low Income	-	4.4	5.0	5.6		
<p>1. Calendar Years</p> <p>2. Except for 1980-1990 and 1990-2000 data for other periods represent fiscal years so that 1950-80 relate to 1950-51 to 1980-81, 2000-2005 to 2000-2001 to 2005-06, and 2006 to 2006-07.</p> <p>Sources: * Maddison (1998); ** Author's estimate; + World Bank (2005), Table 4.1, ++World Bank (2007a, Table 4.7), ~ World Bank (2007b), *** RBI (2007) for 2000-2005 and CSO (2007) for 2006 -2007.</p>						

Table 1B: Sources of growth of Productivity/worker: 1978-2004

	Growth rate of output per worker		Contribution of:			Total Factor Productivity (TFP)
			Capital	Land	Education	
Total Economy	China	7.3	3.2	0.0	0.2	3.8
	India	3.3	1.3	0.0	0.4	1.6
Agriculture	China	4.3	2.8	0.0	0.2	1.8
	India	1.4	0.4	-0.0	0.3	0.8
Industry	China	7.0	2.2		0.2	4.4
	India	2.5	1.5		0.3	0.6
Services	China	4.9	2.1		0.2	1.9
	India	3.5	0.6		0.4	2.4

Source: Bosworth and Collins (2007), Tables 1 and 2

Table 1C: Analysis of factors behind growth in China and India

China:

Period average compound growth rates

	1950-1979	1980-1989	1990-1999	1999-2005
GDP	5.62	10.62	9.94	8.75
Employment	2.6	2.9	1.17	1.01
Labour productivity	2.95	7.51	8.66	7.67
Capital deepening	2.61	2.96	4.81	5.09
Total factor productivity	0.31	4.39	3.68	2.45
<i>Memorandum item</i>				
Capital stock	7.3	8.24	9.71	10.04
GDP per capita	3.45	9.11	8.74	8.13
Labour productivity	2.95	7.51	8.66	7.67
Participation	0.49	-0.27	0.13	-0.45
Demographics	0	1.78	-0.07	0.89

India:

	1950-1979	1980-89	1990-99	2000-05
GDP ^a	3.54	4.94	6.00	6.47
Employment	2.26	2.11	1.56	2.61
Labour productivity	1.25	2.78	4.36	3.76
Capital deepening	0.76	0.94	1.90	1.98
Total factor productivity	0.49	1.83	2.44	1.76
Human capital	0.29	0.38	0.38	0.16
Residual	0.20	1.45	2.06	1.60
<i>Memorandum item</i>				
Capital stock	3.81	4.02	5.42	6.68
GDP per capita	1.30	2.68	3.86	4.80
Labour productivity	1.25	2.78	4.36	3.76
Participation	0.11	-0.65	-0.60	0.17
Demographics	-0.05	0.56	0.12	0.83

Source: Herd and Dougherty (2007)

Table 1D: Other pre-Reform TFP Estimates

	India		China		
Virmani (2002)	1950-65	1.9	Hu and Khan (1997)	1953-78	1.1
	1965-80	0.1			
IMF	1960s	-1.0 to 1.1			
Ahluwhlia (1992)	1960-80	-0.5a			

a: Manufacturing only

Table 2: Poverty
(proportion of population below poverty line)

India (official)	1951-52	1961-62	1973-74	1977-78	1983	1987-88	1993-94	1999-00	2004-05
Rural India	47.4	47.2	55.7	53.1	45.7	39.1	37.3	27.1	28.3
Urban India	35.5	43.6	48.0	45.2	46.8	38.2	132.4	23.6	25.7
Combined	45.3	46.5	54.1	51.3	44.5	38.9	36.0	26.1	27.5

Sources: Datt, G (1999, 1998), Deaton (2003), GOI (2007)

	1978	1990	1996	1998	2001	2005
China (National Poverty Line)*	30.7 ^a	9.5 ^a	6.0	4.6	---	
China (World Bank, \$1/day Poverty Line)**		31.5	16.4	16.1	14.3	10.2

a = rural areas only
Sources: *Park and Wang (2001) for 1978 and 1990 and World Bank (2007a), Table 2.6 for 1996 and 1998; ** Yusuf and Nabeshima (2006).

Table 3: Trade Barriers

A. Tariffs (summary). CHINA IMPORTS

Part A.

Summary		Total	Ag	Non-Ag	WTO member since		2001		
Simple average final bound		10.0	15.8	9.1	Binding coverage:	Total	100		
Simple average MFN applied	2006	9.9	15.7	9.0		Non-Ag	100		
Trade weighted average	2005	4.7	15.4	4.2	Ag: Tariff quotas (in %)	5.0			
Imports in billion US\$	2005	602.7	26.0	576.7	Ag: Special safeguards (in %)	0			

Frequency distribution		Duty-free	0 <= 5	5 <= 10	10 <= 15	15 <= 25	25 <= 50	50 <= 100	> 100	NAV
		Tariff lines and import values (in %)								in %
Agricultural products										
Final bound		5.8	8.1	25.0	25.2	26.3	7.0	2.5	0	0
MFN applied	2006	6.0	7.2	25.8	25.5	25.8	7.3	2.3	0	0.3
Imports	2005	1.1	40.5	25.7	5.2	3.9	19.7	3.9	0	1.3
Non-agricultural products										
Final bound		6.8	18.3	46.9	14.7	12.0	1.4	0	0	0
MFN applied	2006	7.3	19.9	45.5	14.3	11.5	1.6	0	0	0.4
Imports	2005	43.6	22.5	29.0	2.7	1.1	1.1	0	0	0.1

Source: WTO (2007a)

Table 3: Trade Barriers, *continued*

A. Tariffs (summary), INDIA IMPORTS

Part A.

Summary		Total	Ag	Non-Ag	WTO member since		1995		
Simple average final bound		49.2	114.2	34.9	Binding coverage:		Total	73.8	
Simple average MFN applied	2005	19.2	37.6	16.4			Non-Ag	69.8	
Trade weighted average	2004	14.7	60.6	12.3	Ag: Tariff quotas (in %)		0.7		
Imports in billion US\$	2004	102.7	5.2	97.5	Ag: Special safeguards (in %)		0		

Frequency distribution		Duty-free	0 <= 5	5 <= 10	10 <= 15	15 <= 25	25 <= 50	50 <= 100	> 100	NAV in %
		Tariff lines and import values (in %)								
Agricultural products										
Final bound		0	0	1.3	0.1	2.5	6.7	53.0	36.2	0.3
MFN applied	2005	2.5	0	1.4	3.0	0.4	80.5	10.7	1.4	0.3
Imports	2004	0.4	0	5.1	3.7	0.0	48.5	41.5	0.8	2.3
Non-agricultural products										
Final bound		3.2	0.5	0.0	0	15.0	50.0	0.8	0.3	6.1
MFN applied	2005	2.4	1.8	0.2	84.8	5.2	4.2	1.1	0.2	6.0
Imports	2004	7.7	4.4	28.6	55.5	3.5	0.2	0.1	0.0	0.3

Source: WTO (2007a)

Table 3: Trade Barriers, *continued*

A. Tariffs (summary), CHINA EXPORTS

Part B Exports to major trading partners and duties faced

Major markets	Bilateral imports		Diversification		MFN AVG of traded TL		Pref. margin	Duty-free imports	
	in million		95% trade in no. of		Simple	Weighted	Weighted	TL	Value
	US\$		HS 2-digit	HS 6-digit				in %	in %
European Communities	2005	193,337	88	1,521	5.9	4.0	1.9	56.8	71.5
United States	2005	193,299	83	996	4.0	3.6	0.0	41.1	53.8
Hong Kong, China	2005	134,909	73	915	0.0	0.0	0.0	100.0	100.0
Japan	2005	107,681	85	1,231	7.9	4.8	0.6	59.7	69.8
Korea, Republic of	2005	38,648	89	1,397	10.5	13.6	0.1	13.3	34.2
Canada	2005	24,271	79	1,078	4.2	5.1	1.0	65.4	57.3

Source: WTO (2007a)

Table 3: Trade Barriers, *continued*

A. Tariffs (summary), INDIA EXPORTS

Part B **Exports to major trading partners and duties faced**

Major markets	Bilateral imports		Diversification		MFN AVG of traded TL		Pref. margin	Duty-free imports	
	Year	in million US\$	95% trade in no. of		Simple	Weighted	Weighted	TL	Value
			HS 2-digit	HS 6-digit				in %	in %
European Communities	2005	22,970	85	1,269	5.9	5.3	2.2	56.5	56.5
United States	2005	16,490	74	636	4.3	4.7	0.6	69.5	66.4
China	2005	9,740	29	119	8.9	3.4	0.1	8.5	58.7
Hong Kong, China	2005	4,584	19	59	0.0	0.0	0.0	100.0	100.0
Singapore	2005	4,063	60	308	0.1	0.0	0.0	99.9	100.0
Japan	2005	3,181	57	310	11.0	2.5	0.6	54.0	64.2

Source: WTO (2007a)

Table 3: Trade Barriers, *continued*

B. Tariffs (details), All Products

Country/Territory	Year of MFN applied tariff	Binding coverage in %	Simple average		Duty-free		Non ad valorem duties		Duties > 15 %	
			Bound	MFN applied	Bound	MFN applied	Bound	MFN applied	Bound	MFN applied
			Share of HS 6 digit subheadings in per cent							
1	2	3	4	5	6	7	8	9	10	11
China	2006	100	10.0	9.9	6.6	7.1	0	0.4	16.4	16.0
India	2005	73.8	49.2	19.2	2.8	2.4	5.3	5.3	70.4	21.6

Source: WTO (2007a)

Table 3: Trade Barriers, *continued*

B. Tariffs (details), Agricultural Products

Country/Territory	Year of MFN applied tariff	Simple average		Duty-free		Non ad valorem duties		Duties > 15 %		
		Bound	MFN applied	Bound	MFN applied	Bound	MFN applied	Bound	MFN applied	
Share of HS 6 digit subheadings in per cent										
1	2	4	5	6	7	8	9	10	11	
China	2006	15.8	15.7	5.8	6.0	0	0.3	35.9	35.4	
India	2005	114.2	37.6	0	2.5	0.3	0.3	98.5	93.1	

Source: WTO (2007a)

Table 3: Trade Barriers, *continued*

B. Tariffs (details), Non-Agricultural Products

Country/Territory	Year of MFN applied tariff	Binding coverage in %	Simple average		Duty-free		Non ad valorem duties		Duties > 15 %	
			Bound	MFN applied	Bound	MFN applied	Bound	MFN applied	Bound	MFN applied
			Share of HS 6 digit subheadings in per cent							
1	2	3	4	5	6	7	8	9	10	11
China	2006	100	9.1	9.0	6.8	7.3	0	0.4	13.5	13.0
India	2005	69.8	34.9	16.4	3.2	2.4	6.1	6.0	66.2	10.7

Source: WTO (2007a)

Table 3: Trade Barriers, *continued*

C. Anti-Dumping Measures

AD Measures Reported, January 1, 1995 - December 31, 2006

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Totals	Rank out of 38
China, PR	0	0	0	0	0	0	0	5	33	14	16	24	92	6
European Community	15	23	23	28	18	41	13	25	2	10	21	12	231	3
India	7	2	8	22	23	52	38	64	53	29	17	16	331	1
United States	33	12	20	12	24	31	33	25	12	14	18	5	239	2
All countries	119	92	125	170	185	227	167	216	221	151	131	137	1,941	

Source: http://www.wto.org/english/tratop_e/adp_e/adp_stattab7_e.xls

Table 3: Trade Barriers, *concluded*.

D. Anti-Dumping Measures as reported versus Exporting Country

Exporting Country	Reporting countries					Rank out of 98
	<i>China, P_R</i>	<i>European Community</i>	<i>India</i>	<i>United States</i>	<i>Totals:</i>	
China, P.R.	0	72	93	64	536	1
European Community	8	0	37	0	63	13
India	4	28	0	19	127	6
United States	20	11	24	0	175	3
Totals for 01/01/95 - 31/12/06	142	362	457	373	3044	
Rank out of 42	7	3	1	2		

Source: http://www.wto.org/english/tratop_e/adp_e/adp_stattab3_e.xls

Table 4: Foreign Trade and Investment Indicators, *continued...*

I. Share in World Merchandise Trade by Region and Economy (percent)

	1948		1953		1973		1983		2006	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
China	0.9	1.1	1.2	1.7	1.0	0.9	1.2	1.1	7.5	6.3
India	2.2	3.1	1.3	1.4	0.5	1.5	0.5	0.7	0.9	1.3

Source: WTO (2006a), Tables II.2 and II.3

(http://www.wto.org/english/news_e/pres07_e/pr472_e.htm#appendix_table3), Appendix, Table 3.

Table 4: Foreign Trade and Investment Indicators, *continued*

II. Share (%) of Merchandise trade (imports + exports) in GDP

	1981-83	1990	2005
Low Income	25.8	23.6	41.1
China	16.7	32.5	63.6
India	7.4	13.1	28.5

Source: World Bank (1997, 2007a), Table 6.1

Table 4: Foreign Trade and Investment Indicators, *continued*

IIIA. Trade in Commercial Services: Total Exports

Total Service Exports (\$, millions)	1980	1990	2005	Share in World Exports (%) 2006
Low Income	9,253	13,307	84,840	
China	2,512	5,748	73,909	3.2
India	2,949	4,610	56,094	2.7

Source: World Bank (1997, Table 4.10; 2007a, Table 4.6)

WTO (http://www.wto.org/english/news_e/pres07_e/pr472_e.htm#appendix_table5), Appendix, Table 5

Table 4: Foreign Trade and Investment Indicators, *continued...*

IIIB. Share of computer, information, and communication and other commercial Services (%)

	1980	1990	2005
Low Income	32.1	51.2	58.9
China	5.6	18.7	38.6
India	30.5	42.7	66.4

Source: World Bank (1997, Table 4.10, 2007a, Table 4.6)

Table 4: Foreign Trade and Investment Indicators, *continued*

IVA. Foreign Capital Flows (\$ Millions): Composition

	FDI		Bonds		Equity		Bank & Trade-Related Lending	
	1990	2005	1990	2005	1990	2005	1990	2005
Low Income	2,233	20,522	116	-2,144	7	12,471	1,623	3,902
China	3,487	79,127	-48	2,702	0	20,346	4,668	2,442
India	237	6,598	-3,959	3,722	0	11,968	1,458	4,338

Source: World Bank (1997, Table 5.2, 2007a, Table 6.8)

Table 4: Foreign Trade and Investment Indicators, *continued*

IVB. Foreign Capital Inflows: Share in GDP

	China		India	
	1990	2004	1990	2004
Gross Private Capital (% of GDP)	2.5	10.9	0.8	5.9
Gross Foreign Direct Investment (% of GDP)	1.2	3.6	0.1	1.0

Source: World Bank (2007a), Tables 6.1

Table 4: Foreign Trade and Investment Indicators, *concluded*

V. External Debt (\$ Billions)

	Long Term			Public & Publicly Guaranteed			Private Non-Guaranteed		
	1980	1990	2005	1980	1990	2005	1980	1990	2005
Low Income	101.94	266.7	338.6	77.54	259.3	298.2	5.09	7.50	40.4
China	4.50	45.5	133.3	4.50	82.9	90.8	0	0	50.9
India	18.33	72.5	114.3	18	71.0	88.7	0.3	1.49	34.1

Source: World Bank (1987, 2007a, Table 4.16)

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