Readings in International Economics
Autumn 2011 - Winter 2012

Case studies of emerging economies: China and India

20 December 2011

Comparison of emerging economies I

- (1) Eastern European emerging economies (the EU-10)
- (2) South American emerging economies (Brazil and Argentina)

- **I. Common characteristics**
- 1960s-1980s: closed economies with predominant state-owned sectors and authoritarian regimes (in case (1), socialist planned economies)
- 1980s-1990s: a number of deep financial crises and a strong reliance on the IMF
- 1980s-1990s: higher levels of poverty and income inequality

Comparison of emerging economies II

- **II. Common characteristics (1990s)**
- opening to international trade and foreign capital inflows
- macroeconomic stabilization, economic liberalization, privatization of the SOEs (the “Washington Consensus”)

- **III. Common characteristics (2000s)**
- high rates of economic growth
- a rising middle class
- lower levels of poverty and income inequality

The impact of the global financial crisis (2008-2009)

- Compared to Eastern Europe, the negative impact of the global financial crisis (2008-2009) on Brazil and Argentina was much smaller because of:
- (1) relatively lower dependence on international trade (the trade-to-GDP ratio) and foreign capital inflows
- (2) relatively lower dependence on exports to advanced countries
- (3) the current account deficit and the external debt were within manageable limits

Today's case studies: China and India

China: a chronology of main events

- 1949: establishment of the People's Republic of China
- 1949-1978: the planned economy era ("the Great Leap Forward" 大躍進, "the Cultural Revolution" 文化大革命)
- 1979: start of market reforms (e.g. gradual opening to international trade and FDI)
- 1992: "socialist market economy"
- 2001: accession to WTO
- Since 1979, China's GDP has grown at an average annual rate of 9.4%

	Brazil	India	China
Population (mln. people) in 2011	195	1,189	1,337
GDP growth rate (%) in 2009/2010	- 0.6/7.5	6.8/10.1	9.2/10.3
GDP (PPP) per capita (USD) in 2010	11,270	3,400	7,540
Currency	Brazilian real (BRL)	Indian rupee (INR)	Chinese yuan (CNY) or RMB

The national flags of China and India

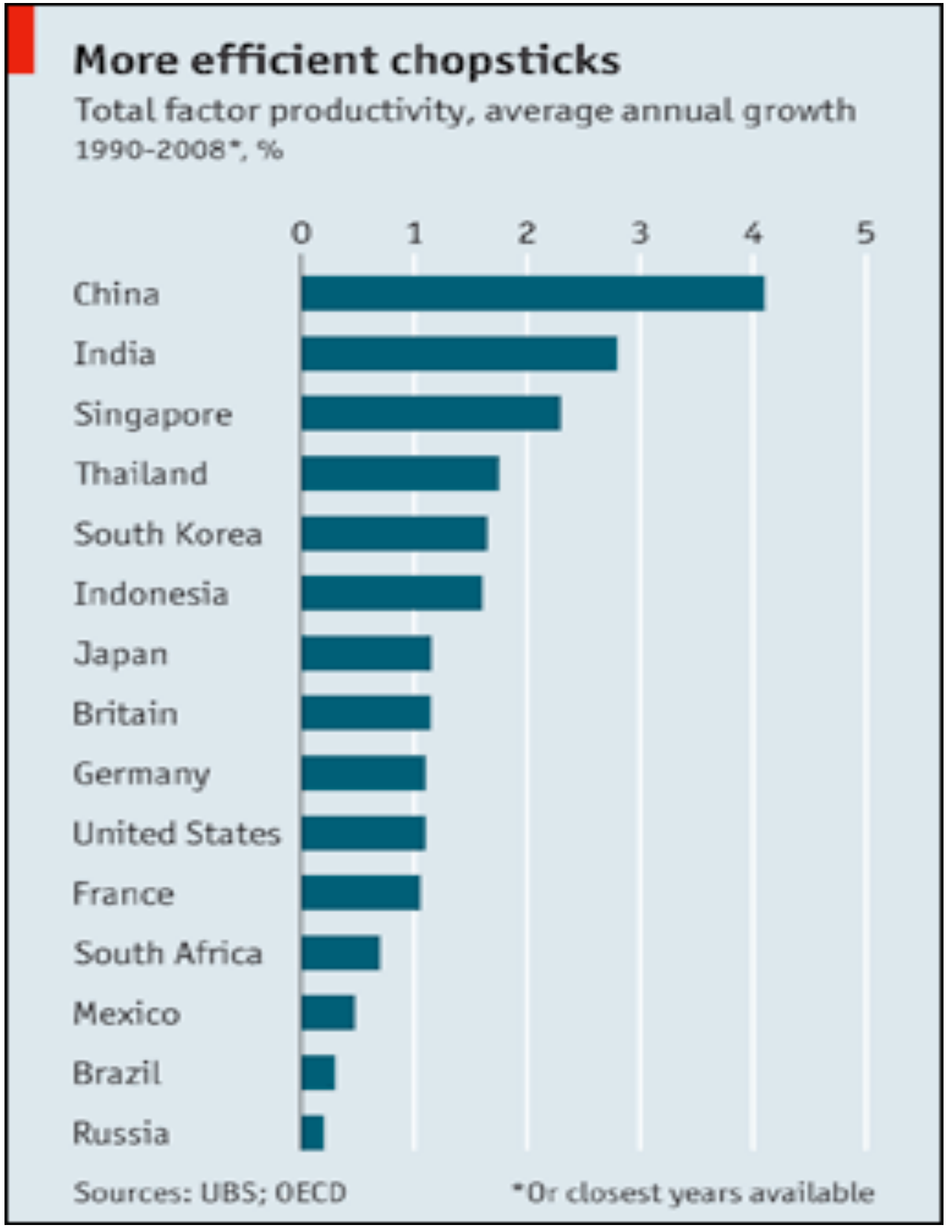
India: a chronology of main events

- 1947: independence from British rule
- In 1947, the average annual income in India was $439, compared with $619 for China and $770 for South Korea
- 1947 - 1991: an Indian version of socialism (Jawaharlal Nehru, Indira Gandhi, Rajiv Gandhi)
- The “Hindu rate of growth” (1950s – 1970s)
- 1991: a BOP and external debt crisis, rescue by the IMF
- 1991: start of the New Economic Policy (led by Manmohan Singh)
- Since 2004: rapid economic growth of more than 8% on average

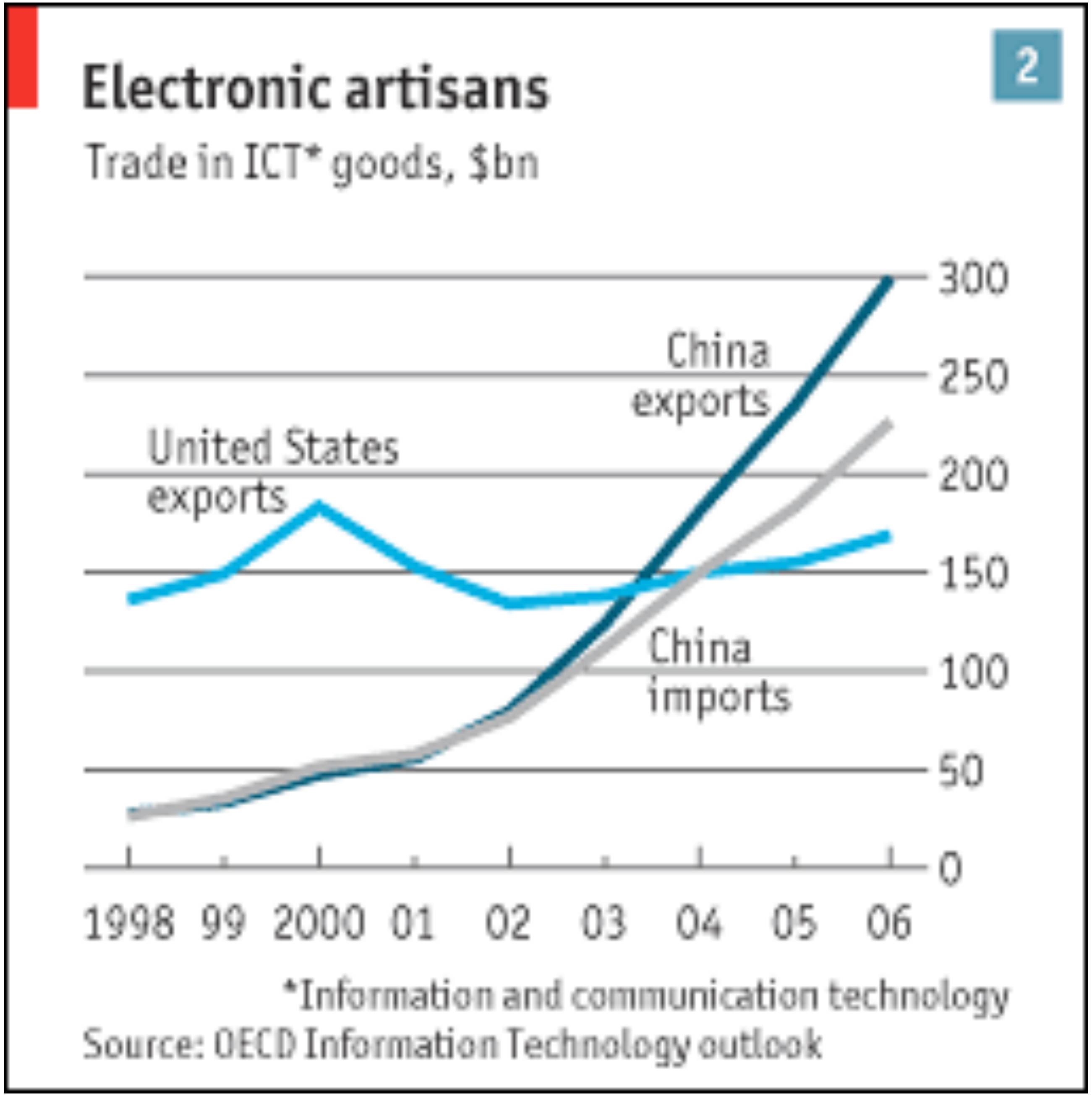
China and India: similarities I

- 1. Big countries with large populations
- 2. Strong role of the state, the “commanding heights” are preserved for large SOEs
- 3. Change of the economic structure from agriculture to industry and services
- 4. High real GDP growth has led to the decline of poverty and the rise of a growing middle class
- <u>The main drivers of high GDP growth</u>: personal consumption, investment, exports

China and India: rapid growth of productivity



China: rapid growth of hi-tech exports



China and India: differences I

- **I. Export structure**
- China’s export structure is more similar to that of an advanced country, e.g. a high proportion of capital-intensive and technology-intensive goods
- The proportion of hi-tech exports in manufactured exports: China 30%, India 5%
- In comparison, the structure of India’s exports looks more like the that of a developing country -- a higher proportion of light industry goods (textiles, leather, etc.)
- But India’s main exports also include software

China and India: differences II

- **II. Current account balance**
- Large CA surpluses of China (9.8% of GDP in 2008 and 5.8% of GDP in 2009) vs. growing CA deficits of India (- 2.1% in 2009 but more than - 3% in 2010)
- The gap in India's current account has been increasingly financed by short-term debt (not by the more stable FDI)
- **III. Foreign exchange reserves**
- China has the world's largest forex reserves ($3.197 trln. in June 2011); India is ranked number 7 with $311.5 bln. in May 2011)

China and India: differences III

- **IV. Socio-economic indicators (Table I.3 on p. 4 of Sharma's book; World Bank's development data)**
- Poverty is more common in India
- According to the World Bank, in 2005 about 26% of the Indian population lived on less than $1.25 a day; the same indicator for China was 16%
- Most of the poor live in the rural areas
- In India, the adult literacy rate (63%) is much lower than in China (94%)

China and India: differences IV

- V. The share of agriculture in India's GDP (about 18% in 2008) is a little higher than that of China
- The most dynamic sector of India's economy are services (e.g. trade, hotels and restaurants, banking, insurance, IT services, etc.)
- VI. The share of services in India's GDP (about 57% in 2009) is higher than that of China (42.7%)
- Rapid development of India's software sector: TCS (Tata Consultancy Services), Infosys, Wipro, etc.

India’s big manufacturing companies

- Like China, India also has some big manufacturing companies
- But the main difference is that they are private, family-owned conglomerates
- Examples: LNM Group (part of which was Mittal Steel), Tata Group, Reliance Industries, Ranbaxy Laboratories, Mahindra, etc.

MITTAL

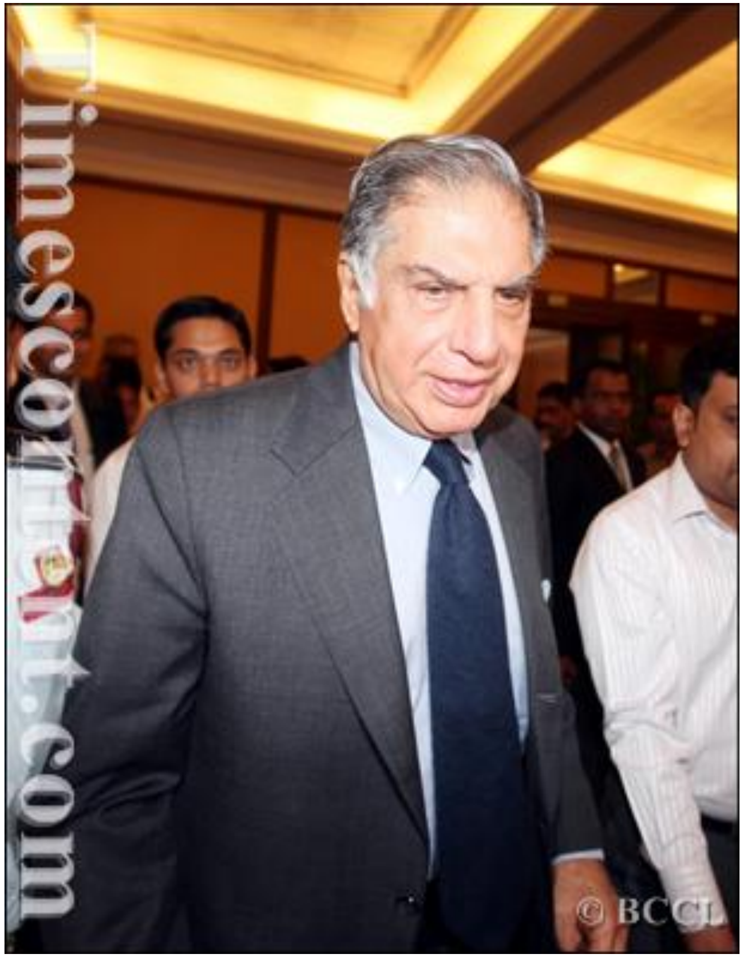
TATA
Leadership with trust

Lakshmi Mittal (the LNM group)

- Chairman and CEO of ArcelorMittal, the largest steel company in the world
- The 6th richest person in the world according to the Forbes magazine with a personal wealth of US$31.1 bln.

Ratan Tata (the Tata group)

- 114 companies in seven business sectors
- For example, Tata Steel, Tata Motors, Tata Communications, etc.
- Bought Tetley, Corus, and Jaguar Land Rover in the UK
- Started the production of Nano, the world's cheapest car (about $3,000)

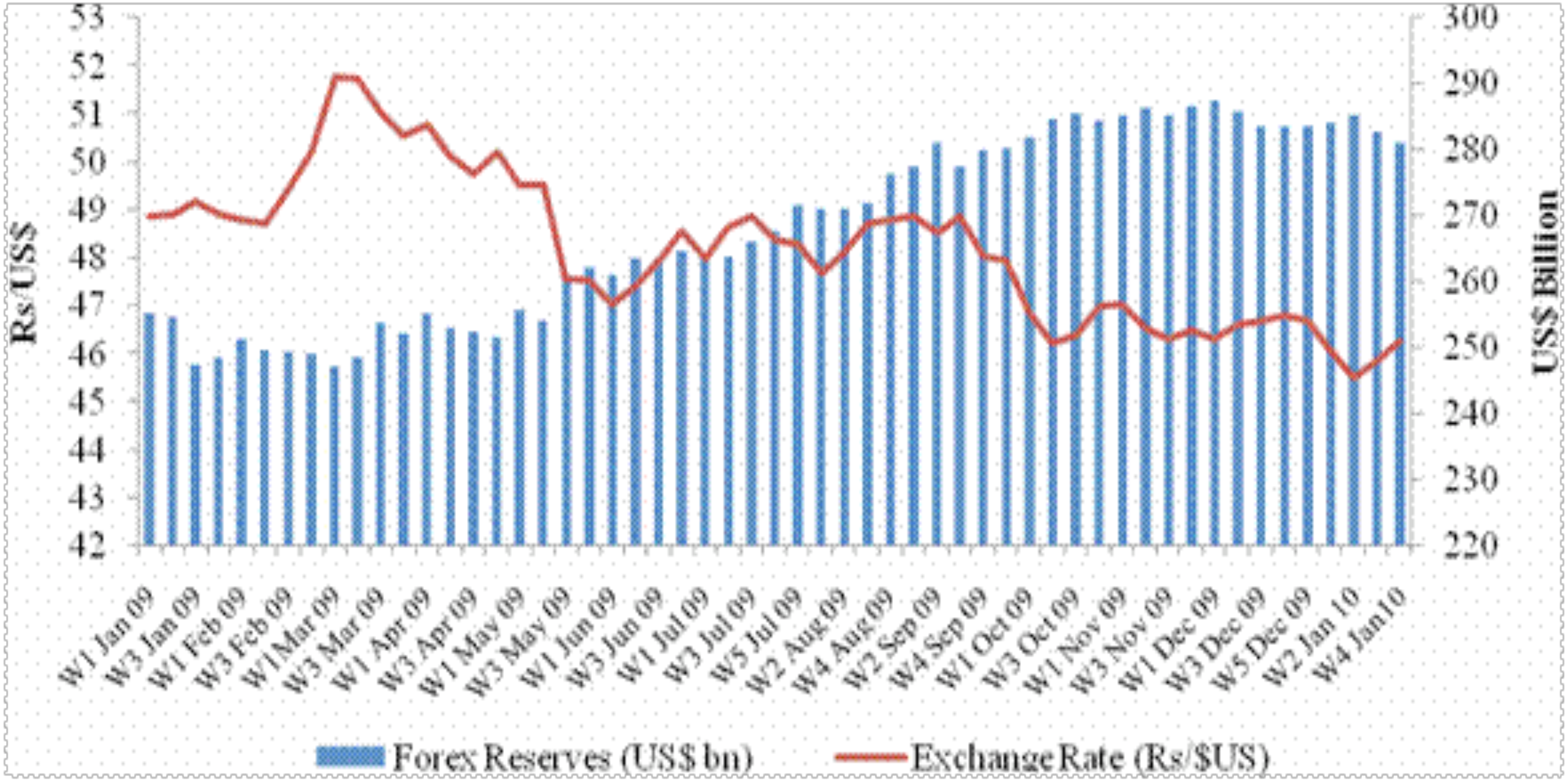


Tata's logo and the Nano car

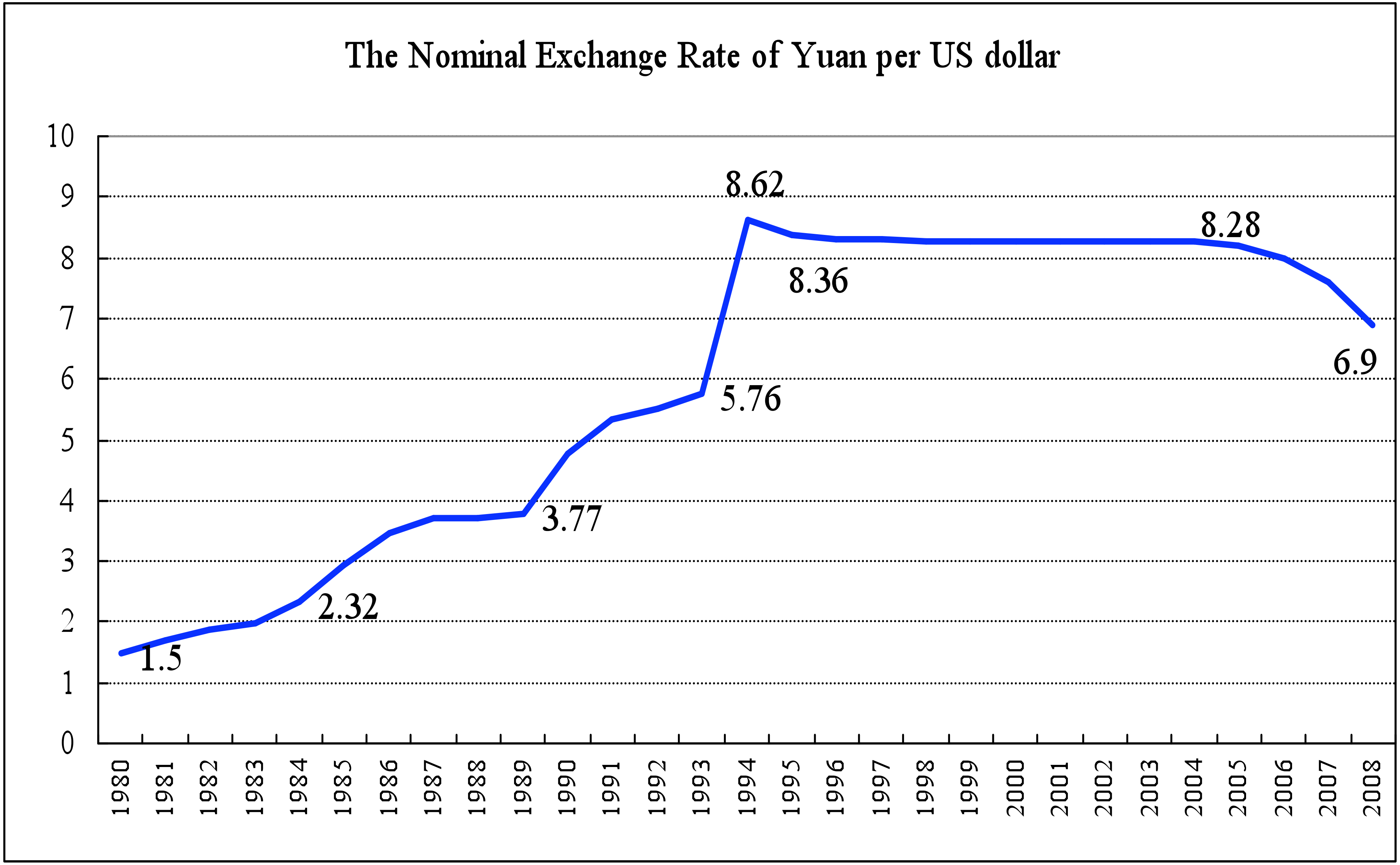
China and India: currency appreciation in 2009-2010

- Since March 2009, the Indian rupee has been appreciating against the dollar – from 51.75 rupees per dollar in mid-March 2009 to about 45 rupees per dollar in November 2010
- The appreciation has been triggered by the resumption of foreign capital inflows into the country after India's economy proved to be resilient to the global financial crisis

Forex reserves and rupee appreciation



The movement of the RMB/USD exchange rate



The Indian rupee's depreciation in 2011

Waiting for the bounce

Indian rupee against the dollar, inverted scale

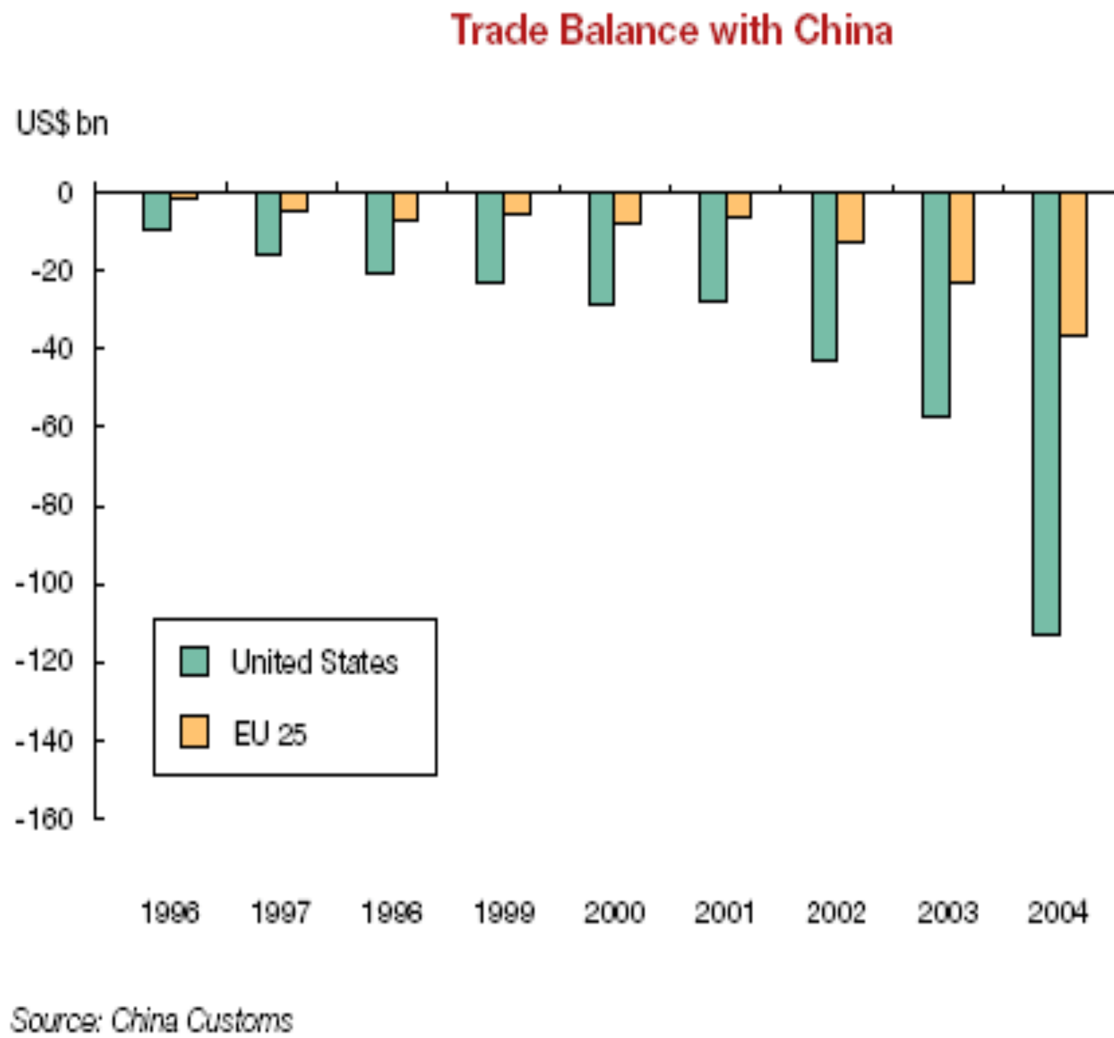
Source: Thomson Reuters

The difference between the Chinese and Indian currencies

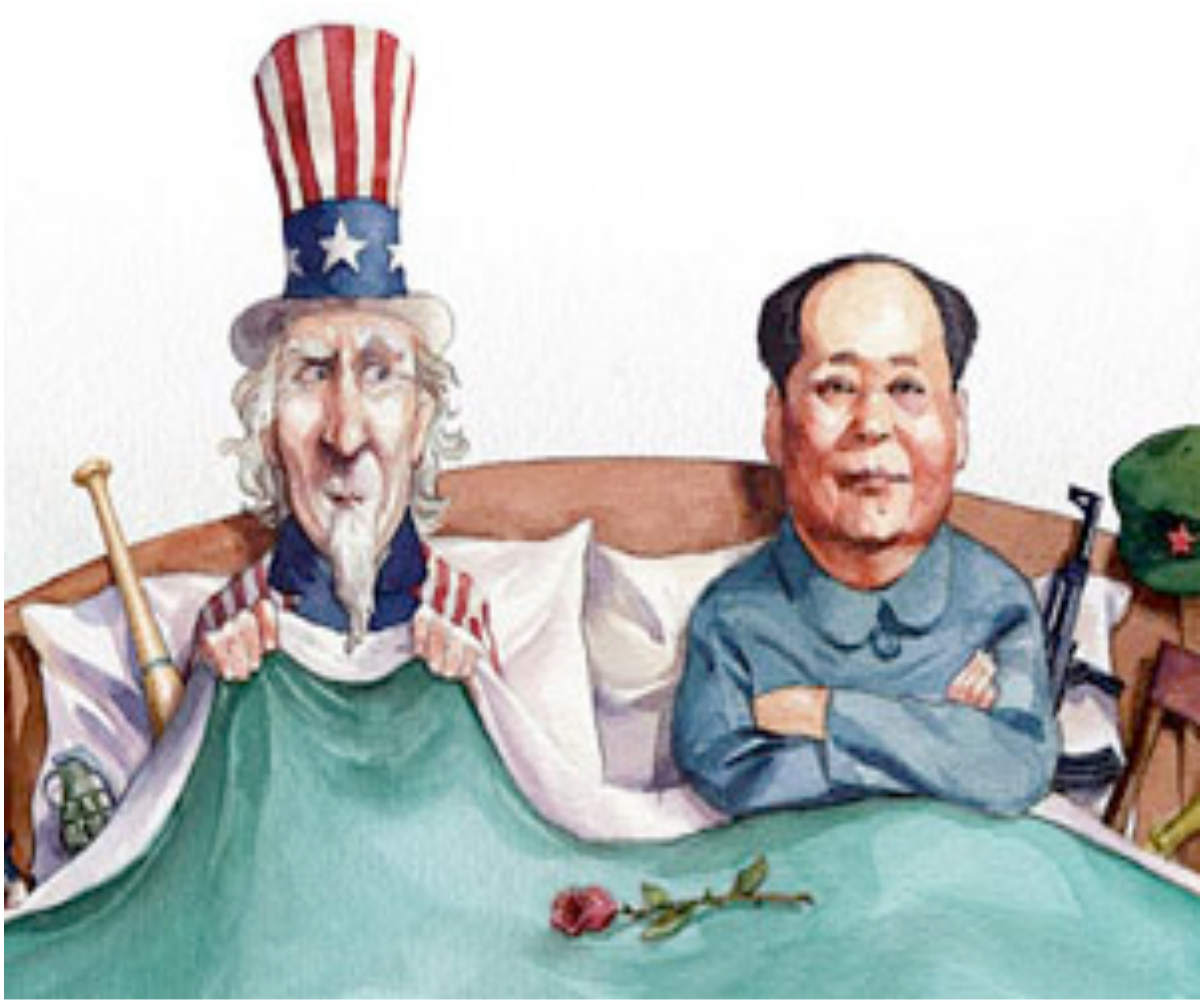
- Since Sept. 2011, the Chinese yuan has continued appreciating against the USD, while the Indian rupee has kept falling
- On 15 Dec. 2011, \$1 = 6.37 CNY but \$1 = 53 INR

The RMB exchange rate and trade imbalances

- US pressure on China to allow further RMB appreciation because of the rising trade imbalances
- China is reluctant to cede due to the fear that further RMB appreciation will damage its export manufacturing sector



But the US and China are also tied by mutual dependence ("Chimerica")



A shift in the global power balance in favor of China

- **(1) The US economy has been undergoing a deep recession since the burst of the "subprime loan" bubble**
- To boost its economy, the US has to issue more government bonds and needs China to buy a large part of them
- China has already surpassed Japan as the world's biggest holder of US government bonds
- **(2) The world economy has benefited from the huge public spending package implemented by the Chinese government in 2009-2010**

(a 4 trillion RMB public spending package, or about 14% of Chinese GDP: four times bigger than the US' equivalent)

The impact of the global financial crisis on China and India

- The impact of the 2008-2009 crisis on China was relatively small due to the huge public spending package
- One channel through which the public spending package in China has worked is bank lending → the Chinese state-owned banks have expanded lending
- But there are strong concerns about the bubbles in the Chinese stock and property markets, as well as the possible rise of banks' bad loans
- Recently, there are also indications that the Chinese property bubble has started to burst