Comparing India and China’s Economic Growth

This editorial is based on **No Leapfrogging in sight** which was published in The Indian Express on 03/07/2023. It talks about the comparison of India’s economy to that of China in 2007 and the emerging differences.

For Prelims: International Monetary Fund (IMF), Twin Balance Sheet Problem, International Labour Organisation (ILO), Gross Domestic Product (GDP) Ratio

For Mains: Differences Between the Economies of India and China, Steps that Can be Taken to Improve the Indian Economy

India's **current economic situation is similar to China's in 2007.** According to Moody's, India's economy has **recently surpassed USD 3.5 trillion and is expected to exceed USD 3.7 trillion in 2023, similar to China's comparable economic size in the past.** In terms of **per capita income,** China had USD 2,694 in 2007, while the **International Monetary Fund (IMF)** projects **India's per capita income to rise from USD 2,379 in 2022 to USD 2,601 in 2023.**

While **there are some similarities between India's current economic situation and China's in 2007,** the **differences between them are more significant** and have important consequences for India's growth path. These **differences affect how India's economy develops in the future.**

What are the Differences Between the Economies of India and China?

- **The Gap in Investment Ratios:** China's **investment to Gross Domestic Product (GDP) ratio** has been consistently high, averaging around 40% from 2003 to 2011, while **India's investment ratio during its high growth phase was around 33%,** lower than China's.
  - This suggests that **China has been allocating a large proportion of its economic resources toward investment,** which has contributed to its rapid economic growth.
  - From 2012 to 2021, the **gap between China and India widened even more**, with China's investment ratio averaging almost 43% while India's fell to around 29%.
- **Twin Balance Sheet Issue in India:** India's investment landscape encountered a significant slowdown, **predominantly triggered by the** twin balance sheet problem.
  - The twin deficit problem (**Current Account Deficit (CAD)** and **Fiscal Deficit**), especially the worsening current account deficit, may **compound the effect of costlier imports, and** weaken the value of the rupee thereby further aggravating external imbalances.
- **Disparity in the Composition of** Exports and Imports: In fiscal year 2022-23, India's exports of goods and services reached over USD 770 billion, while imports were around USD 890 billion. However, **in 2007 when China's economy was of a similar size, China's exports had already exceeded USD 1.2 trillion,** primarily driven by the export of goods rather than services.
  - Additionally, China's imports were USD 950 billion, **indicating a higher level of**

integration into the global economy.

- **Difference in Tariff Rates:** China has successfully positioned itself as a central hub for global supply chains, **partly due to its consistent reduction in** tariff rates. From 2003 to 2007, China's average tariff rate decreased from 10.69% to 8.93% and further declined to 5.32% in 2020. **This reduction in tariffs has facilitated China's integration into global trade and attracted** foreign investments.
  - In contrast, India's tariff rate dropped from 25.63% in 2003 to 8.88% in 2017, indicating progress in trade liberalisation. However, **since then, India's tariff rate has been increasing, which may hamper its ability to attract investment** and fully integrate into global supply chains.
- **Labour Force Participation:** China has consistently maintained a high labour force participation rate over the years. In 2007, **China's labour force participation rate was almost 73%** (for individuals aged 15 and above, according to estimates by the **International Labour Organisation (ILO)**). However, this rate has gradually declined and currently stands at around 67%.
  - On the other hand, **India's labour force participation rate is estimated to be around 50% in 2022**, which suggests a lower proportion of the population actively participating in the workforce compared to China.
- **Lack of** Employment Generation: While a significant number of jobs have been created in construction and services such as trade and transport in India, formal manufacturing **is much more productive in terms of output per worker.**
  - According to the economic survey**, formal manufacturing is twice as productive as transport, 2.5 times more productive than trade, and 3.75 times more productive than construction.**
  - However, the challenge lies in the limited job opportunities being generated in the formal manufacturing sector, which **hampers India's economic growth potential.**
- **Participation of Women:** The difference in labor force participation between China and India is mainly attributed to the **participation of women**. In China, **the female labor force participation rate was 66% in 2007, but it has declined to 61% in 2022.** In India, the **female participation rate was much lower at 30% in 2007, and it has further decreased to 24% in 2022.**
  - This means that **a smaller percentage of women in India are actively engaged in the labor force compared to China.**

What are the Similarities Between India's Current Economic Situation and China's in 2007?

- **Sectoral Distribution of the Labour Force:** In 2007, **41% of China's** labour force worked in agriculture**, 27% in industry** (including construction), and **32% in services.** In comparison, **for India in 2021, the figures were 44% in agriculture, 25% in industry, and 31% in services**. It's important to note that **the actual number of people in each sector differs between the two countries.**
  - This comparison **provides insights into the sectors where a significant number of people are employed.**
- **Decline in the Labour Force in Agriculture:** In China, the rate of decline was around 1.5 percentage points per year from 2003 to 2019, while in India, **it was around 1 percentage point.** The question **arises regarding the future employment prospects for those leaving the agricultural sector in India if this trend continues.**
  - This **difference in the transition away from agriculture between India and China reflects the challenges and opportunities each country faces in managing** labor market dynamics and ensuring productive employment for their populations.

What can be the Way Forward?

- **Increase Investment Activity:** Encouraging both domestic and foreign investments by creating a favorable business environment, simplifying regulatory procedures, and providing incentives for industries.
- **Boost Exports:** Promoting exports by identifying sectors where India has a **comparative**

advantage, improving infrastructure and logistics, and providing support to exporters.

- **Enhance Female Labour Force Participation**: Taking steps to increase the participation of women in the workforce through gender equality measures, access to education and skill development etc.
- **Generate Employment Opportunities in Formal Manufacturing**: Focusing on creating more job opportunities in the formal manufacturing sector for low- and semi-skilled workers. This **can be achieved through policies that promote the growth and productivity of the manufacturing sector,** adoption of advanced technologies, and skill development programs.
- **Maintain a Conducive Investment Climate**: Continuously improving ease of doing business, reducing bureaucratic hurdles, enhancing transparency, and strengthening governance to attract investments and boost economic growth.
- **Emphasise Education and Skill Development**: Investing in education and **skill development programs** to equip the workforce with the necessary skills for the evolving job market, fostering innovation and entrepreneurship.
- **Strengthen Infrastructure**: Prioritising infrastructure development, including transportation, **logistics**, power, and **digital connectivity**, to support economic activities and **facilitate trade and commerce.**
- **Foster Regional and International Collaborations:** Actively engaging in regional and international collaborations to **expand market access, participate in global value chains, and leverage opportunities for growth and development.**

Conclusion

India presents an immensely attractive opportunity for global businesses. With its vast market, abundant labour force, and stable government, it serves as an ideal destination for manufacturing and investment. However, to fully harness its potential, India must take proactive measures to enhance its competitiveness on the global stage. By implementing strategic reforms and creating a favorable business environment, India can solidify its position as a highly enticing hub for businesses worldwide.

Drishti Mains Question:

How can India catch up with China’s economy despite all the obstacles the Indian economy has faced till now?