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## ***China and India: Issues for Sustaining High Growth***

***— Common Problems Include Legal System Inadequacies: Regional Cooperation Offers One Solution—***

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- **China and India need to go further toward reform and opening**
- **China's main problem is wide disparities, while India's is insufficient infrastructure**
- **Hopes are pinned on the contribution both countries can make to rebuilding the world economic order**

China and India have continued to grow rapidly even as the economies of most other countries decelerated under the impact of the global financial crisis. During 2010 it became clear that China's gross domestic product (GDP) had exceeded the scale of Japan's.

This high growth in China and India is expected to continue for some time. A Goldman Sachs study projects that China's GDP will be 1.3 times larger than that of the United States in 2050, while India's will be 0.8 times as large. Relative to Japan, the two countries in 2050 will have GDPs that are 6.7 times and 4.2 times larger, respectively. With this outlook in mind, the Japan Center for Economic Research prepared a report focused on India's economic situation and comparing it with China's, clarifying the tasks both countries need to tackle. (The author was the chief researcher in this project.)

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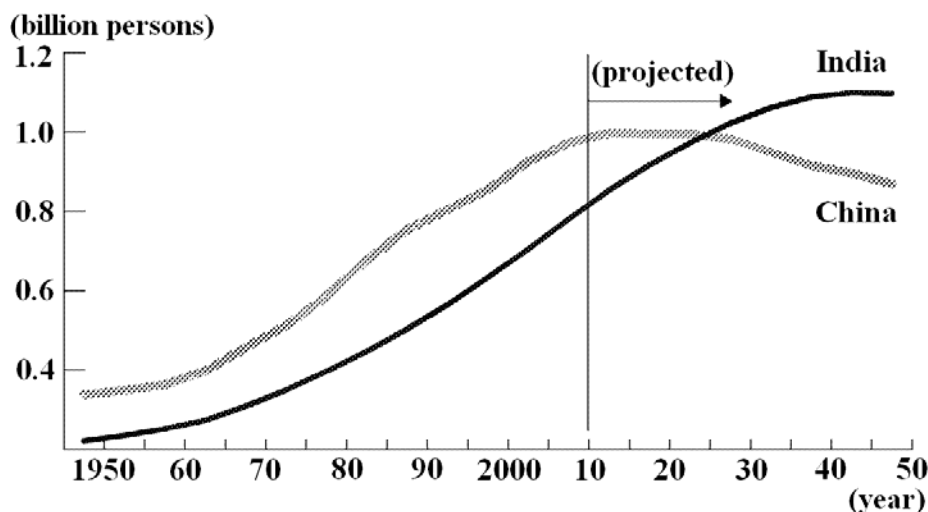
China's rapid growth began with the adoption of the reform and opening policy in December 1978, while India's began with the introduction of an economic reform program in 1991. Both countries had previously enforced regulations that led to the unproductive use of labor, capital, and the other factors of production; the reforms enabled these resources to be used more efficiently, and economic development picked up speed. A particularly important contribution was made by policies to relax the controls on foreign capital and accord foreign companies preferential treatment. This triggered an inflow of foreign capital, which boosted growth.

In recent years China and India have modified their posture toward foreign capital. China is moving toward a policy of nondiscriminatory treatment, handling foreign companies in the same way as domestic companies, while focusing preferential policies just on selected industries. India, meanwhile, is establishing special economic zones and placing increased emphasis on preferential measures for foreign businesses.

It should not be forgotten that one factor underlying the high growth in both countries is an advantageous demographic structure for economic development. A large share of their populations consists of people in their productive years (ages 15 to 64), and the dependent segment, which is the total of the children (ages 0 to 14) and the elderly (ages 65 and over), is fairly small. A low dependency ratio presents a potential for high growth, or “demographic bonus,” since each worker has few dependents in need of support.

At present, however, China’s population is aging as a result of its one-child policy, and the proportion of elderly is on the rise. Given this situation, the country will no longer be able to enjoy the merits of a demographic bonus in the future. India currently has a large population of children, and as they grow up, the working-age population will swell. But India will find that its demographic bonus does not translate into an advantage for economic development unless it creates jobs for the growing ranks of workers.

### Working-Age Population in China and India



Source: United Nations.

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Both countries have many issues they must resolve. Among the common tasks they need to tackle are going further toward reform and opening, upgrading the legal system, securing energy supplies, protecting the environment, and fostering human resources. In both countries reform and opening paved the way to high growth, but

import tariffs, restrictions on foreign capital, and other protective policies continue to be applied in some industries, such as the automotive industry. To some extent these policies are a legitimate means of fostering infant industries, but a gradual shift toward liberalization is nonetheless needed to prevent them from imposing a growing burden on consumers and other industries and becoming a drag on economic growth.

Barriers to the entry of foreign companies also exist in both countries. Some are embedded in the systems regulating foreign companies, while others result from questionable application of labor laws and other parts of the domestic legal system. As China and India act to enhance transparency, they need to make the application of legal provisions stable and highly reliable, and they also should work out arrangements enabling information to be promptly disclosed. Another indispensable requirement is securing capable staff of regulators for efficient and fair enforcement of the legal system.

Both countries have abundant reserves of coal, which occupies a prominent position among their energy sources, but because of the rapid diffusion of cars and other such trends, demand for oil and natural gas is expanding. As these trends are expected to continue, one of the issues China and India must deal with is securing supplies of oil and natural gas in a situation where their dependence on imports for these resources is on the rise. Both countries are making active use of “resource diplomacy” to acquire stable energy supplies from overseas, but keeping the environmental impact in mind, they also need to strive toward using energy resources more efficiently.

In the area of fostering human resources, the urgent needs in India include improving elementary education in order to secure workers for the production of goods and fostering highly talented workers who have received secondary and higher education. In China, meanwhile, shortages of unskilled labor are becoming conspicuous, as is reflected in the rising wages of the workers who make manufactured products for export. China also needs to educate highly skilled workers and researchers so that companies can move forward on not just manning assembly lines but also developing new products and performing other sophisticated jobs.

In addition to these common issues, China and India confront various separate issues that require resolution. The most critical issue facing India is an insufficiency of infrastructure. Apart from the telecommunications sector, where mobile phones have spread spectacularly, the nation has run into problems in the logistics sector, where roads and railroads need improvement, the electric power sector, and many other infrastructure fields. Inadequate infrastructure impedes smooth business activities and blocks the introduction of foreign capital. The area of infrastructure is under the control of government agencies, and populism in politics has hindered application of the rule that users should bear the costs. Another problem is the low productivity of workers who are vigorously defended by labor unions.

Among the most serious issues facing China is extreme widening of regional disparities and income differentials. Subsequent to the start of reform and opening, differences in the degree of development greatly widened between coastal regions, which achieved rapid growth by taking advantage of the opportunities provided by globalization, and interior regions, which were unable to do the same. In a similar fashion, huge income gaps opened up between people depending on whether they had or lacked the ability to benefit from the merits of globalization. Because the widening of such disparities has not only produced social unrest but also suppressed consumption, China has been unable to accomplish one of its tasks, which is to shift from growth led by external demand to growth led by domestic demand. In order to narrow the differentials, the government needs to engage in investment and income redistribution.

A competitive relationship in such areas as industrial development has led to some trade and investment friction between China and India, but diplomatic efforts have prevented this friction from becoming serious and also promoted cooperation to utilize the two countries' complementary relationship in resolving issues that both are confronting. This cooperation has just gotten off the ground in a number of areas where good results are anticipated, such as improving infrastructure, dealing with environmental problems, and developing energy resources. For cooperation to make progress, many barriers will have to be cleared away, including mutual mistrust and relations of rivalry.

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While bilateral cooperation will surely be useful, regional cooperation drawing in Japan and other Asian countries offers an important and effective means for dealing with some of the issues facing both countries. It should be especially beneficial to make use of an arrangement Japan is ardently backing: the Comprehensive Economic Partnership in East Asia (CEPEA). This is a group encompassing the members of ASEAN (Association of Southeast Asian Nations) and Japan, China, and South Korea, plus India, Australia, and New Zealand. Consideration is being given to preparing a free trade agreement for CEPEA and embarking on cooperation in infrastructure and other areas.

The outbreak of the global financial crisis in 2008 was a signal that the world economic order brought into being after World War II under the leadership of the industrial nations has become dysfunctional. The backdrop to this situation is the remarkable development of the emerging countries represented by China and India, which have radically redrawn the global economic map. No time should be lost in getting to work on rebuilding the world economic order which has fallen into a dysfunctional state.

The Group of Twenty, whose members are the world's leading countries including China and India, plus the European Union, held a summit meeting in November 2008 to discuss the response required for the global financial crisis, and agreed to continue implementing stimulus policies aimed at recovery. The joint implementation of these policies successfully averted a plunge into a major financial panic and depression, but the world economic order is still not functioning as it should.

Summits of the G-20 countries, including their heads of state or government, were regularized at the 2008 meeting and are now being held annually. The items on the agenda include many of the important issues facing the world economy, such as reform of international financial institutions and financial regulations as well as development, the environment, and trade. It is hoped that China and India, which have achieved high growth by making skillful use of the opportunities provided them by globalization, will contribute to the rebuilding of the world economic order through such forums as the G-20.

The rapid economic growth of China and India is expected to continue far into the future. It will be useful for Japan, which is becoming a nation with many senior citizens, few children, and a shrinking domestic market, to strengthen economic ties with China and India through trade and investment so as to sustain and increase the present level of prosperity. No doubt a key strategy for Japanese companies will be to locally develop, manufacture, and sell products that meet the needs of the enormous Chinese and Indian markets. The Japanese government, for its part, should actively promote the establishment of CEPEA, which can serve as a regional framework enabling Japanese businesses to operate freely in China, India, and the rest of the East Asian region.

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