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In this brave new world, Chindia's uneven rise continues

By Martin Wolf

"Chindia" is the word coined by the Indian politician, Jairam Ramesh, to denote the two Asian giants that contain 38 per cent of the world's population between them. Nor is size their only similarity. Both are heirs of ancient civilisations; both were, until recently, desperately poor; and both are among the world's fastest growing economies. Yet the differences are also striking. By looking carefully at them one can learn more about their prospects for continued growth.

The economists' technique of growth accounting helps shed a bright light on the story. A recent paper by Barry Bosworth and Susan Collins of the Washington-based Brookings Institution does just that*. It compares performance over the 1978-2004 period, but the years since 1993 are particularly interesting, since they succeed India's post-1991 reforms.

The broad picture is of Chinese growth of 9.7 per cent a year, against India's 6.5 per cent. So, given differences in population growth, India's real income per head grew at less than half China's (see chart). Employment generated only a small proportion of the growth: 1.2 per cent a year for China and 1.9 per cent for India. In China, output per worker rose at the staggering rate of 8.5 per cent a year. Increases in physical capital per worker accounted for half of this latter increase and increases in pure efficiency – what economists call "factor productivity" – for the rest. India's output per head rose at 4.6 per cent a year. Given China's high investment, it is not surprising that India's accumulation of physical capital contributed less than half the growth of China's. But factor productivity also had almost double the impact in China.

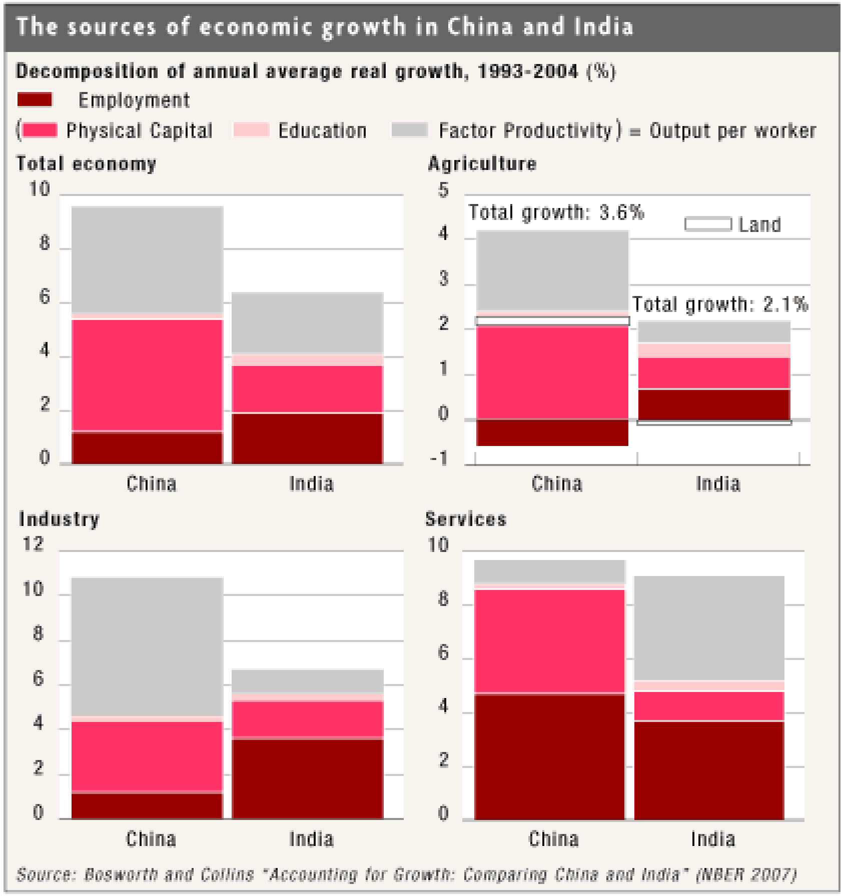
The paper also provides illuminating contrasts with east Asian economies, other than China; namely, Indonesia, South Korea, Malaysia, the Philippines, Singapore, Taiwan and Thailand. India's growth of output per head between 1993 and 2004 was as fast or faster than that of the aggregate of these seven economies over any lengthy period between 1960 and 2003. Factor productivity generated a contribution to India's growth of 2.3 percentage points a year between 1993 and 2004. For the east Asian countries, the corresponding figures were 1.2 percentage points between 1960 and 1980, 1.4 percentage points between 1980 and 1993 and just 0.3 percentage points between 1993 and 2003.

In agriculture, China's growth rate was 3.7 per cent a year against just 2.2 per cent for India. Employment growth was negative in Chinese agriculture and marginally positive in Indian. The big difference was in the growth of output per worker, with China, again, accumulating capital far faster and achieving much faster growth in factor productivity.

In industry, China's growth rate was 11 per cent a year, of which employment contributed just 1.2 percentage points. Output per worker rose at 9.8 per cent a year. Of this, no less than 6.2 percentage points was generated by rising factor productivity. Meanwhile, India's industrial growth was just 6.7 per cent a year. Factor productivity contributed a mere 1.1 percentage points a year to this growth. But employment growth contributed 3.6 percentage points.

Now turn to services. Here India's growth rate was close to China's: 9.1 per cent a year, against 9.8 per cent. Output per worker contributed 5.1 percentage points of the growth in China and 5.4 percentage points in India. Here is the one sector where Indian productivity growth matched China's. Rising factor productivity contributed 3.9 percentage points to Indian growth and just 0.9 percentage points to China's.

The results for India are largely what one would expect. But China's productivity – and particularly factor productivity – performance is far better than previous studies have shown. This is partly because of revisions to the national accounts, which have raised the level and growth of the services sector. Also important are technical assumptions about the impact of the capital stock on output, which matter for China because the capital stock grew so much faster than the economy.



Evidently, this effort is heroic. Nevertheless, the broad picture is highly suggestive. Both of these economies have sustained a remarkable performance, though with China's clearly superior. India's outstanding sector is services; China's is industry. Employment growth outside agriculture is low and the share of agriculture in employment still high: 47 per cent for China and 57 per cent for India in 2004. China's productivity performance has been astonishing, largely because of rising output per worker in industry, though it has also done well in agriculture and services. India's productivity performance is also quite good, overwhelmingly because of services.

The implication, as the study itself concludes, is that "the supply-side prospects for continued rapid growth in China and India are very good".

With a remarkably open economy and gross fixed investment at 43 per cent of gross domestic product last year, it is hard to identify significant constraints on China's growth in the medium term. A breakdown in the global economic and political system would presumably do it. So might domestic political or social instability. In the long term. Failure to persist with reform would also be a danger.

India's fixed investment has been far lower. But it is already close to 30 per cent of GDP. If the fiscal position continues to improve and the inflow of long-term capital from abroad to accelerate, the investment rate could rise still further. Partly because infrastructure is poor and industrial performance disappointing, the upside for Indian growth is also bigger than for China's. But India also suffers from serious handicaps. The most important, apart from weak infrastructure and a relatively ineffective government, is the scale of mass illiteracy. Adult male literacy was only 73 per cent and female literacy a deplorable 48 per cent in 2002, against 95 and 87 per cent, respectively, in China.

Chindia is on the move. Since China's standard of living is roughly a fifth of that of the high-income countries and India's one-tenth, the fast growth of the giants might persist for a generation. As Shakespeare might have said: O brave new world, that has such countries in't!

*Accounting for Growth: Comparing China and India, Working Paper 12943, February 2007, National Bureau of Economic Research, www.nber.org