India, China and the World

Prabhat Patnaik

During the first decade of this century when both China and India were experiencing high rates of growth, they were often bracketed together as the new "emerging economic super-powers". Terms like "Chindia" were coined to refer to this phenomenon of the two large countries of the world growing impressively in tandem. What was missed in all that euphoria was the fundamental difference between the growth experiences of the two countries. This difference is becoming more apparent now, as the impact of the world capitalist crisis reaches Asian shores; and it consists in the fact that India's economy is far more vulnerable to the crisis than is China's.

One may be critical of China's economic policies, notwithstanding their success in ushering in high growth, for a variety of reasons, but it is undeniable that China's economy is on an altogether different footing today than India's, a fact that was somewhat camouflaged earlier when the world capitalist economy itself was doing well. An important corollary which follows is that those who defend neo-liberal policies in India by citing China's growth-success, as if India can simply replicate China's experience, are completely wrong.

Two aspects of this difference are relevant here. The first is that China's export success was based on manufacturing, while India's export-success, such as it was, related to services, especially to IT-related services. Per unit value of exports, the former creates larger employment than the latter, since the wage rates of those employed in the former are relatively lower than of those employed in the latter. What is more, the relatively-lower paid workers in the former, precisely because inter alia they are lower-paid, tend to spend more of their incomes on domestically-produced goods than the relatively better-paid employees in the latter, who spend proportionately more, directly or indirectly, on imported goods.

The total employment generated per unit value of exports, both direct and indirect, when these exports consist of manufactured goods is therefore larger in the domestic economy than the total employment generated per unit value of exports when these consist of IT-related services. The impact of a unit value of exports in alleviating unemployment and using up labour reserves, which lie at the root of poverty in economies like ours, is therefore larger when these exports consist of manufactured goods as in China. This, together with the fact that China's exports in its area of success was larger in value terms than India's, meant that the export-success achieved in China had a more profound effect on its economy than that achieved in India.

In addition, for the reason already mentioned, viz. the higher import-intensity of the expenditure of the relatively better-paid service sector employees, more imports are demanded per unit value of exports from this sector than per unit value of exports of manufactured goods (a proposition that would be true even after taking account of imported inputs of the manufacturing sector when the manufactured goods are of the relatively simple kind, as in the case of China). Hence the balance of payments effects of export growth when this growth is of exports such as China's would be far more positive than when the growth is of exports such as India's. And this brings us to the second, and even more important, difference between the growth stories of India and China.

China has systematically had a current account surplus on the balance of payments, while India more or less systematically has had a deficit. China's surplus has contributed to the building up of its foreign exchange reserves, while India has had to depend upon foreign capital inflows to finance its deficit; and its reserves have got built up only because this inflow has exceeded the deficit. The implications of this basic difference can be seen through a simple numerical example.

Consider a country whose exports are 100 and imports, for a particular level of domestic economic activity, are 50. If world demand falls because of a crisis, and its exports fall to, say, 80, then it can still maintain its level of domestic activity without any balance of payments difficulties; all that would happen is that its trade surplus, instead of being 50 as was the case earlier would now shrink to 30. True, the decline in exports from 100 to 80 would mean reduced aggregate demand, especially demand for those goods that were being exported earlier; but this deficiency in demand can be made up by increasing its fiscal deficit by 20. The world economy's crisis in other words would not affect such a country: it can maintain its output and employment by expanding its fiscal deficit to offset the decline in world demand for its goods, and can do so with impunity because its balance of payments current account, already in surplus to start with, would not get into the red anyway (unless the decline in world demand for its goods exceeds its initial current account surplus).

Now, consider the case of another country which has a current deficit to start with, at some particular level of domestic economic activity. Suppose its exports are 100 and its imports are 130 and its gets foreign capital inflows of 50 which pay for its current account deficit and add 20 to its reserves. Now, suppose its exports fall to 80, i.e. by 20 as in the previous example, because of the world crisis; then its current account deficit increases to 50 and it cannot do without getting the same amount 50 of capital inflows as before, even when it does not add to its reserves. Any lower amount of capital inflows would mean a depletion of its reserves, which of course cannot continue for long; besides, such a depletion, if it sets off a capital flight by speculators, can make the reserves disappear overnight. If the decline in exports compared to the initial situation is larger than the accretion to reserves in the initial situation, then the amount of capital inflows needed to maintain the same level of output and employment as in the initial situation, will be even larger than the initial situation.

To maintain, or even expand, the inflow of capital, in the changed situation when everybody, including the financial speculators, know that the country's balance of payments situation has become precarious, the country will have to undertake massive measures to entice global finance capital into its shores; and every single one of these measures would be aimed at squeezing the people, for that is precisely what boosts the "confidence of investors" in the economy. Thus, reducing subsidies to the people, raising administered prices, privatizing public sector assets, cutting down on welfare expenditure, making the State retreat from the responsibility of providing the essential services needed by the people, increasing the burden of indirect taxes to close the fiscal deficit, are the typical measures that have to be undertaken by the State to entice finance capital.

But it is not as if these measures, once undertaken, will suffice for ever in enticing an annual flow of finance capital of the requisite order of magnitude to meet the current account deficit. The enticing effect of any particular set of measures wears off after some time, and a whole new set of measures have to be announced in addition to what has been already done. Like a drug addict needing repeated doses of drugs to keep himself going, finance capital requires repeated announcements of pro-finance and anti-people measures to come to a particular country, and since each set of measures is anti-people, their cumulative effect against the people builds up over time. To keep up the level of activity of the country in this second case therefore, there has to be a cumulative attack on the people to entice the flow of finance capital into the country. Besides, since there is no guarantee that finance would still come in to an appropriate extent if such measures are announced, and since finance itself generally wants "austerity" policies that lower the level of activity, such an economy typically ends up with a combination of both lower levels of activity (which in effect means, once we move out of our simple example, lower growth rates), and cumulatively mounting attacks on the living conditions of the people.

The contrast between the two examples given above is the contrast between China and India. China, even in the context of the world capitalist crisis, can still maintain its growth rate with the help of domestic fiscal stimuli that would offset the contractionary effects of reduced exports, without worrying about its balance of payments because it has a substantial current account surplus to start with. But India, which generally has a current account deficit, will only experience a widening of this deficit because of export reduction (as it is already doing), and will make ever increasing concessions to global finance to meet this deficit, because of which it will end up with both a lower growth rate and a growing attack on the living conditions of the people. The Manmohan Singh government at this very moment is engaged in this task of enticing global finance to meet the current account deficit; and we already see a combination of lower growth and mounting attacks on the people.

True, if the world capitalist crisis was just a passing event, so that the export drop was merely temporary, and the desperation associated with the need to attract global finance within the context of "liberalized" economy was a merely transitory affair, then matters might not have been as serious. But the world capitalist crisis, far from being a passing phase, is turning out, for good reasons, to be a protracted one. "Liberalized" economies like India, if they stay "liberalized" during this protracted world crisis, will experience both reduced growth rates and growing attacks on the people, even as global finance is allowed greater control over the nation's resources, and the State becomes fully preoccupied with the task of keeping a group of international financial speculators happy.

China does not face such dire prospects, which is why those who are inspired by China's export and growth successes to endorse "liberalization", who cite the Chinese experience as exemplifying the fate of a "liberalized" third world economy, are so completely off the mark.