PN-ABS-423

Agriculture Trade China India

Policies and Performance since 1950

EXECUTIVE SUMMARY

EDITED BY T. N. SRINIVASAN

INTERNATIONAL CENTER FOR ECONOMIC GROWTH

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—Executive Summary—

Agriculture and Trade in China and India

Policies and Performance since 1950

T. N. Srinivasan
with contributions from
Justin Yifu Lin and Yun-Wing Sung

An International Center for Economic Growth Publication

ICS PRESS
San Francisco, California

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Publication of this executive summary was funded by the United States Agency for International Development (AID), the Pew Charitable Trusts, and the Starr Foundation.

Inquiries, book orders, and catalog requests should be addressed to ICS Press, 720 Market Street, San Francisco, California 94102. Telephone: (415) 981-5353; fax: (415) 986-4878. For book orders and catalog requests, call toll free in the contiguous United States: **(800) 326-0263.**

This is an executive summary of the book *Agriculture and Trade in China and India* by T. N. Srinivasan with contributions from Justin Yifu Lin and Yun-Wing Sung, published by ICS Press in 1994.

Cover design by Irene Imfeld

ISBN 1-55815-331-4

Contents

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Contents of the book *Agriculture and Trade in China and India*

Preface

The world's two most populous countries, China and India, are currently engaged in an attempt to liberalize and revitalize their economies after decades of state control. Although the two nations adopted different political systems in the 1940s—communism in China and democracy in India—they followed similar development strategies from the early 1950s through the 1980s. In both countries, the state was the engine of development, and planning guided economic decisions. Now each is faced with undoing decades of government control, regulation, and ownership of economic enterprises.

China began its economic reforms in 1978 under Deng Xiaoping. Since then it has gradually allowed for greater individual initiative by farmers and businesspeople and has conducted a number of experiments in liberalization in various regions of the country. Productivity in the country has risen dramatically.

India did not begin reforms until 1991, and then only in response to economic crisis. Facing high debt, high inflation, increased oil prices, and the possibility of default on foreign loans, the government made far-reaching changes to the system of foreign trade and payments.

The authors of the book *Agriculture and Trade in China and India* look carefully at the economic history of these two countries since 1950 to determine how the vital sectors of agriculture and trade influenced development. In both countries agriculture accounted for most of the employment and output in 1950 and gradually gave way to industry. Now China and India are discovering, as are many other developing countries, that trade offers great promise for growth if they can harness its potential by competing successfully in world markets. As yet both countries are still struggling to make their export products competitive, and T. N. Srinivasan, Justin Yifu Lin, and Yun-Wing Sung assess the future prospects for the two countries. If they succeed in liberalizing their economies and reaping the benefits of trade, they will serve as important examples to the many other countries, such as those in the former Soviet bloc, that are embarking on this same path. More important, China and India can, together, improve the lives of nearly half the world's population.

This publication is an executive summary of *Agriculture and Trade in China and India*. The International Center for Economic Growth is pleased to publish that important work, which offers valuable insights for scholars and policy makers around the world.

Nicolás Ardito-Barletta
General Director
International Center for Economic Growth

Panama City, Panama
December 1993

Summary of Conclusions

China and India, the most populous and among the poorest countries of the world, have attempted since 1950 to improve their economies and alleviate poverty through similar development strategies but under vastly different political frameworks. Both have undertaken major economic reforms, China beginning in 1978 and India in a piecemeal fashion in the 1980s and comprehensively since 1991. An analysis of their successes and failures is of great relevance to the developing world.

Agriculture and Trade in China and India: Policies and Performance since 1950, outlined in this executive summary, compares, and contrasts where appropriate, the Chinese and Indian policies and performance with respect to agriculture and foreign trade.

The development strategies of both countries gave primary importance to industrialization in general and to the development of heavy industry in particular. The continuing importance of the agricultural sector as a source of employment for an overwhelming majority of the labor force in the two countries is in part a reflection of the failure of the development strategy of both countries to generate productive employment opportunities outside of agriculture.

China is still a dictatorship, while India is a representative democracy with regular elections to the national parliament and the state legislatures. Until the death of Mao Zedong in 1976, China was a command economy in which private producers and markets played insignificant roles in resource allocation and factor accumulation. India is a mixed economy with a large private sector and functioning markets. China began moving away from the command system in 1978 with the introduction of the household responsibility system in agriculture and the development of export-oriented special economic zones in coastal areas. The large industrial state enterprise system, however, has yet to be reformed significantly, although smaller rural and township enterprises have grown rapidly. India also began liberalizing its economy, hesitantly and to a limited extent, in the early 1980s. In 1991 the government of Prime Minister P. V. Narasimha Rao embarked on a bolder, coherent, and mutually consistent set of reforms in several sectors of the economy.

India and China had roughly the same level of per capita income in the early 1950s and had experienced similar growth in the previous fifty years. It is widely accepted, however, that real gross national product (GNP) per capita grew much faster in China than in India after 1950. In the 1980s overall economic growth, as well as the growth of exports, was much faster in China than in India. China was far ahead of India in 1990 in social indicators such as life expectancy, infant mortality, and adult literacy. The apparently superior performance in terms of social indicators and the greater success of reforms in China compared with India call for an examination of their development strategies and their economic reforms.

Agricultural Reforms. In China, land ownership was collectivized in phases. The traditional farming institution of small, independent family farms and a few large landlords was transformed in stages into "people's communes" of around 5,000 households, with the subsistence needs of households, rather than the work contributed by them, becoming the dominant consideration in determining remuneration of each member. The coercive measures and new compensation system significantly reduced the incentives for work and encouraged free riding. The resultant shortage of grain led to the deaths of 30 million people. Although both China and India had experienced periodic famines in their long history before World War II, India has had no famines since independence.

Even this monumental tragedy, however, did not lead the Chinese regime to abandon communes but only to delegate management tasks in each commune to much smaller units called "production teams." The production team remained the basic farming institution until the reforms of 1978 introduced the household responsibility system.

In India, before independence, land ownership was extremely concentrated, and layers of intermediaries between the tiller and the state laid claim to the produce of land. Soon after independence, the Indian Parliament enacted laws ordering widespread changes in tenure, in permanent farming rights, and in the size of individual landholdings. Although most of the land reform laws proved to be ineffective, there appears to have been a reduction in the concentration of the distribution of land owned as well as land operated. In 1966 the National Commission on Agriculture officially recognized a long-standing reality: The organization of production in small peasant farms run with household labor, supplemented with labor exchanged with other households and occasional hired labor, was the most appropriate agricultural system under Indian conditions.

Although institutional changes, such as changes in land tenure, evolved differently in the two countries and there were differences as well as similarities in their agricultural policies, their overall performances did not differ greatly. The rate of growth of agriculture in India and China is modest and less rapid than that in some other low-income countries, such as Pakistan, Indonesia, and Kenya.

Foreign Trade Reforms. Until the reforms of 1978, Chinese foreign trade was monopolized by nine national foreign trade corporations. The profits and losses of these corporations were absorbed by the Treasury. Neither the producers nor the corporations had an incentive to be cost-conscious and efficient. Foreign trade policy shifted with the ideological winds. The country did not exploit foreign trade to achieve efficient development based on its dynamic comparative advantage.

From the 1970s on, foreign trade was no longer viewed as a necessary evil, but as an essential ingredient in modernizing the Chinese economy. Although controls on exports, imports, and foreign exchange transactions remained, exports of all goods and services, and particularly of manufactures, rose rapidly and impressively. The mechanisms used were special economic zones in coastal areas, the provision of incentives (such as foreign exchange retention), tax rebates, direct subsidies on planned exports, and above all the effective use of the exchange rate.

India's development strategy has three broad objectives: economic growth, self-reliance, and social justice. It assigned the state a dominant role in development and made key industries such as railways, telecommunications, and electricity generation the exclusive responsibility of the public sector. Planning has been driven by the perceived need to conserve foreign exchange expenditures.

Since foreign trade was largely in the hands of the private sector, the government established an elaborate system for controlling and allocating foreign exchange. The complexity of the system led to a wide range of implicit exchange rates across the spectrum of imports and exports, with associated efficiency losses.

The foreign exchange and investment licensing system also led to corruption, politicization, and rent seeking in the processing of license applications. The import control regime has confined imports to essential consumer goods, raw materials, and investment goods needed for domestic production and exports. The composition of India's exports has shifted moderately away from primary products to manufactured goods. Yet a diversified and dynamic export sector has not emerged.

There were several attempts to liberalize or reform the system of economic management; however, all of these attempts involved modifying some aspects of the system of bureaucratic and discretionary control over industry and foreign trade and payments without changing the system in a fundamental way. The reforms announced in June 1991 were forced on the government by an unprecedented financial crisis and can be viewed as attempts to make fundamental changes in the system of economic management.

The immediate stabilization measures included an austerity budget and a devaluation of the rupee, while the government made clear its intention to address long-term structural problems through reform of the control mechanisms on foreign trade and private investment, taxation, the financial sector, and public enterprises.

The reforms are too recent, however, to have had any significant impact. The short-run measures to contain the acute foreign exchange crisis were successful, but this was due not to any permanent improvement in the fundamentals of the balance of payments, but primarily to the return of confidence of the nonresident Indians in the Indian economy and support from multilateral donors.

Unlike the Chinese regime, the Indian government has to convince the opposition in Parliament, the press, and labor unions about the need for and the gains from reforms. The Rao government lost its parliamentary majority early in 1993 when one of its regional allies withdrew support.

It is cause for concern that the cost and quality of output (in most, if not all, cases) is not internationally competitive, certainly in India and perhaps in China. The Indian industrial and input licensing system encouraged the creation of small-scale, high-cost plants in many industries and sheltered them from internal and external competition. Most of the industries in the public sector have yielded negligible returns. It is doubtful whether the protected capital goods industries in the two countries have accumulated the dynamic learning experience to bring about significant technical improvement in the equipment they produce.

Both economies, however, have succeeded in building a diversified industrial structure. Both produce a far greater variety of industrial goods, including capital goods, than most other developing countries. They depend to a much lesser extent on imported equipment, and their scientific and technological capability is evident. Both have so far avoided accumulating a heavy foreign debt, although India has become the fourth largest debtor, after Brazil, Mexico, and Indonesia, among developing countries. China has succeeded in eliminating abject poverty and improved the education, health, and literacy of its population, an achievement which is neither nullified nor completely explained by the authoritarian character of the state. Although India's achievements are less impressive, they are nonetheless significant.

An Overview of *Agriculture and Trade in China and India*

In the economies of both China and India, agriculture provided employment to over 60 percent of the labor force as recently as 1990. Agriculture is also a significant source of raw materials for processing industries and for exports. Policies with respect to foreign trade have been central to the industrial development of both economies.

Chinese Agriculture

Traditional agriculture in China until the socialist revolution of 1949 had been characterized by small, independent household farms. Under the land reform program which spread across the nation by 1952, the government confiscated land from landlords and rich peasants without compensation and gave it to poor and landless peasants. Individual household farms were then collectivized in progressive stages.

The first type of cooperative was the "mutual aid team" in which 4 or 5 neighboring households pooled their farm tools and draft animals and exchanged their labor on a temporary or permanent basis, with land and harvests belonging to each household. This evolved in stages into the collective farm, or the "advanced cooperative," in which all means of production were collectively owned. Remuneration was based solely on the amount of work each member contributed. The size of an advanced cooperative evolved to include all 150–200 households in a village.

Collectivization was surprisingly successful in its initial stage, and this encouraged the leadership to take a bolder approach. The "people's commune" was introduced in the fall of 1958; and within only three months, 753,000 collective farms were transformed into 24,000 communes, consisting of 120 million households, over 99 percent of total rural households in China. The average size of a commune was about 5,000 households, with 10,000 laborers and 10,000 acres of cultivated land. Payment in the commune was made partly according to subsistence needs and partly according to the work performed. The right to withdraw from the collective was eliminated.

The commune movement ended in a profound agricultural crisis between 1959 and 1961. The dramatic decline in grain output resulted in a widespread and severe famine. Thirty million people died of starvation and malnutrition. Communes were not abolished, but from 1962 agricultural operation was divided. Management was delegated to a much smaller unit, the "production team," which consisted of about 20 to 30 neighboring households. But despite rapid increases in modern inputs and improvements in varieties in the 1960s and 1970s, the performance of agriculture remained poor. Grain production barely kept up with population growth.

Frustrated by its inability to improve the welfare of the Chinese population substantially after thirty years of socialist revolution, the government initiated a series of sweeping reforms.

- Beginning in 1979, the long-repressed government procurement prices for major crops were adjusted.

- The collective system was replaced by a new household responsibility system which resulted in remarkable growth in the first half of the 1980s. This system was created initially without the knowledge or approval of the central government. It was worked out spontaneously by farmers themselves and spread to other areas because of its merits. Full official recognition of the system as a universally acceptable farming institution was given in late 1981.

- A greater role was given to markets and market considerations, in place of planning, for guiding production in the rural sector. In 1985 the state declared that

> it would no longer set mandatory production plans, including targets that had forced an increase in cropping intensity and the expansion of grain-cultivation area at the expense of cash crops. A decision was made to increase grain imports, cut down grain procurement quotas, and reduce the number of products covered by planning.

The restoration of household farming and the increase in market freedom prompted farmers to adjust their production activities in accordance with profit margins. Grain production and the agricultural sector as a whole registered unprecedented growth between 1979 and 1984, and the overall living standards of both urban and rural populations improved substantially. The success of these reforms encouraged China's political leaders to undertake a series of more market-oriented reforms at the end of 1984 in both the urban and rural sectors.

Grain production, however, stagnated after reaching a peak in 1984. Most people in China, including political leaders and economists, believe that China should be self-sufficient in grain. Poor grain production prompted a call for more conservative, plan-oriented agricultural policies, perhaps even re-collectivization, with the ostensible goal of pursuing economies of scale in agricultural production. But a less costly policy would be to rely on comparative advantages and allow the nation to produce other labor-intensive crops in exchange for part of the grain requirement through international trade. Although China's rural institutional reforms may have become irreversible, poor performance in grain production will always be a political issue in China.

Collectivization did have a favorable impact on income distribution among individual households in rural areas. The major source of income differences in China, however, is regional disparity—the unequal distribution of climate patterns, natural resources, urban centers, markets, and transportation—and these differences cannot be eliminated by means of collectivization. The most important disparity is the gap in living standards between the urban and rural population, a problem that was implicitly acknowledged by the government when it prohibited rural-to-urban migration.

The Future of Market-Oriented Agricultural Reforms. Justin Yifu Lin discusses three essential elements in the continued success of agricultural reforms.

1. The main reason for the cropping sector's poor performance lies in its unfavorable price relative to other products after 1984. Improving the output does not involve re-collectivization, but reform of current agricultural price policies. Since 1984 the government has liberalized the control of most agricultural products. Grain, oilseeds, and sugar, however, are basic necessities for the rural population; and cotton is a major input for industry. The obligatory procurement quotas for these products remain, and their prices are regulated by the government. As a result, farmers are shifting to more profitable non-regulated products. A market-oriented price reform for regulated products is the most fundamental way to end the stagnation in their production.

2. The government's development strategy from the 1950s—including low interest rates, overvalued exchange rates, low wage rates, and low agricultural prices—was designed to facilitate the rapid development of heavy industry. A certain level of investment in agriculture was necessary because of dismal agricultural performance. But the sudden growth brought on by the household responsibility system reform reduced the pressure on the government to invest in agriculture, and funds were diverted to the more profitable industrial sectors. The stagnation of grain production since 1984 has led again to a call to increase government investment in water control, agricultural research, and other support for agriculture. Once the output growth of agriculture as a whole, and grain production specifically, achieves satisfactory levels, however, this pressure will disappear. Therefore, if the basic policy environment favoring industrial expansion is not changed, a cyclic pattern in

public agricultural investment and agricultural growth is inevitable.

3. Private investment in agriculture will also be required. In the household responsibility system, the collectively owned land is leased in very small parcels to individual households for short periods of up to fifteen years. Tenure is insecure as a given tract or land may not be reassigned to the same household in the next contract. These characteristics make investment in land improvements, certain forms of machinery, equipment, tools, and draft animals unprofitable. Since land is still collectively owned and the ideological heritage of collectivism is strong, there is a risk that farmers will revert to certain forms of collective farming. To provide better incentives, the policy of improving tenure security and facilitating the consolidation of landholding through market exchanges, which was introduced in 1985, should be strengthened.

Indian Agriculture

India is a largely rural nation, with agriculture as the occupation of almost two-thirds of the population of working age, a proportion that has declined only very slowly. The share of agriculture in gross domestic product (GDP), however, has declined much more rapidly, thus considerably widening the disparity between the average product of labor in agriculture and that in the rest of the economy. Primary exports including agriculture constituted 20 percent of the total value of exports in 1990/91.

Arable land per capita is extremely modest, and the scope for expanding cultivated area by bringing new land under the plow is limited, although the same land could be cropped more than once a year if moisture were available. Currently, Indian crop yields are low in comparison with other land-scarce countries such as China. A significant portion of India's owner-cultivators are poor. The landless are even poorer. The importance of rapid agricultural growth for alleviating poverty cannot be exaggerated.

India is a mixed economy in which agriculture is in private hands. The agrarian reforms intended to address the extreme inequality in the ownership of land at the time of independence have been largely ineffective, but a relative shift has occurred in favor of small and especially medium owners, accelerated by the green revolution in the mid-1960s.

There has been substantial public investment in irrigation; infrastructure such as transport, communications, and electricity; agricultural research and extension; and rural poverty alleviation programs. In addition, the government has intervened to provide low taxes on agricultural income; subsidies on irrigation water from public reservoirs, on fertilizers, and on livestock development; and assorted agriculture-based poverty alleviation programs.

The government sets procurement prices for purchases from producers of certain goods destined for the public distribution system, and it sets issue prices at which rations are sold to urban consumers. It also sets minimum support prices for a number of grain and fiber crops and statutory minimum prices that processors are required to pay growers for sugarcane, jute, and tobacco.

Indian agricultural performance in the four decades since independence has been spectacular relative to the stagnation in the five decades before independence. It is unspectacular, however, both in comparison with other developing countries and in per capita terms. Overall growth has barely kept ahead of the growth in population. The green revolution, at least in India, was largely confined to increases in cereal yields, mostly wheat and rice, and did not significantly change the trend in the growth of output. It did, however, enable India to maintain the growth of foodgrain output in spite of considerably slower growth in cultivated area by sharply increasing the rate of growth of yield per unit of area.

This slow growth, together with the policy of using any growth in output of foodgrains to substitute for imports, has kept per capita availability of foodgrains at the low level that prevailed in the immediate postindependence years. Although the apparent self-sufficiency in food is viewed by many as an important achievement, the fact that average consumption of grains has remained at a low level has to be set against this so-called success.

Although resources allocated to agriculture have clearly increased, maintaining the rate of growth will likely require the allocation of a larger quantity of resources for two reasons:

1. Major irrigation, which has been the main source of growth in the past, is likely to be more costly in the future, partly because the relatively inexpensive potential sites have already been exploited and partly because there is increased awareness of the environmental costs of large reservoirs.

2. No significant new developments in plant breeding have occurred since the introduction of dwarf varieties of wheat and rice in the mid-1960s. Unless new high-yielding varieties of other major crops and of cereals that grow well in semi-arid areas with little or no irrigation are developed, future growth in agricultural output may be slower than in the past. Development of such varieties would also redress regional imbalances resulting from substantial differences among states in agroclimatic and natural resource endowments, size distribution of land, land tenure, and labor market arrangements.

From a sociopolitical perspective, interstate disparities in agricultural development are of serious concern. To a significant extent, public investment in irrigation and other production-oriented public expenditure can be allocated in a way that offsets initial interstate differences in irrigation development. However, a strategy of reducing interstate disparities in incomes originating in agriculture to address disparities in income *accruing* to residents of different states can be costly if it seriously undermines regional specialization in crop production based on comparative advantage. Clearly, an allocation of investment among states, whether it is in irrigation or other capital, which is based on meeting other objectives besides productivity, will not generate the maximum return possible. The issue is whether alternative policies, such as encouraging interstate migration, for example, are not only feasible but also more cost-effective in reducing income disparities than a nonoptimal (from the point of view of maximum returns) investment allocation.

The most important quantitative restrictions affecting agriculture presently are those relating to foreign trade. Foreign trade in several agricultural commodities is canalized through state trading agencies. Canalization meant that world market prices and prospects did not necessarily determine the trading decisions—indeed the domestic market was to a considerable extent insulated from movement in world prices. It is time to modify, if not abandon, this policy. Now that India has become largely self-sufficient in food, and in view of the likely increase in the cost of future rises in total output, the country should examine whether greater specialization in crops in which India is likely to have a dynamic comparative advantage would be better from the point of view of saving scarce resources.

One-third to one-half of the rural population still lives in abject poverty. It is true that more rapid agricultural growth that is widely shared among crops and regions will alleviate rural poverty. The important and unfortunate consequence of the inward-oriented, capital-intensive development strategy that India has pursued, however, has been that the share of agriculture in GDP has fallen rapidly without an accompanying decline in the share of low-productivity agricultural employment within total employment. Unless and until the economic development strategy itself is changed radically toward an external orientation and internal liberalization, the prospects for a rapid reduction in rural poverty are slight.

China's Foreign Trade Policies

After the Communists took power in China in 1949, the state monopolized and centralized foreign trade to serve its economic strategy. All international trade was conducted by nine national foreign trade corporations under the control of the Ministry of Foreign Trade. These corporations operated according to mandatory plans, purchasing fixed quantities of foreign goods for domestic distribution at fixed prices. All foreign exchange earnings were remitted to Beijing. Because the *renminbi* was overvalued, corporations usually incurred losses on exports and earned profits on imports, but the Ministry of Foreign Trade bore the losses and siphoned off the profits so there was little incentive to be more efficient.

The open door policy that has evolved in China since 1979 involves not only a rapid expansion of foreign trade, foreign loans, and foreign investment. It also involves a significant decentralization and marketization of China's external sector, facilitating direct contacts between producers and end-users. In fact, the open door policy was carried out simultaneously with the reforms of the entire economy.

The open door policy allowed the government to rectify the imbalances engendered by the strategy of unbalanced growth by introducing readjustment, involving a shift in emphasis from heavy industry to agriculture and light industry and a lowering of the savings rate. The rise in consumption following readjustment reduces the resources available for investment and exports, and there is a new willingness to accept foreign investment to relieve savings and balance of payments constraints. Because debt financing can lead to repayment problems in hard times, China also accepts equity financing. Priority is being given to technology imports aimed at modernizing China's existing plants and to technological knowledge, including management skills and even the practices and ideas of a modern society.

The open door policy should not be confused with free trade. Strict foreign exchange controls exist, and China is still trying to avoid importing goods that can be produced domestically. The policy has gone through several cycles of liberalization and retrenchment. In each reform drive, selected regions of the country were opened up—that is, given substantial autonomy in international trade and investment. All three reform drives led to inflation and balance of payments difficulties, and a period of retrenchment followed each reform and liberalization drive.

The First Reform Drive and Retrenchment (1979–1981). In 1979 new central agencies for trade and investment were created by the State Council and direct technical contacts between Chinese and foreign enterprises were facilitated. An increasing number of provinces have set up provincial import-export corporations since 1979. A handful of producer enterprises have also achieved autonomy in exports. Despite these reforms, the Chinese trading system was still highly centralized, with official approval required for all exports and imports, although applications could be processed more quickly. The decentralization which did occur caused some confusion. Local authorities cut export prices to compete, and the prices of native products in which China had a monopoly fell appreciably. China reacted by instituting an export licensing system in 1981.

The Second Reform Drive and Retrenchment (1983–1985). The second reform drive led to the opening of Hainan Island and fourteen coastal cities as well as the radical proposal to decentralize foreign trade to foreign trade corporations. The 1984 reform, if fully implemented, would have revolutionized the Chinese foreign trade system. But it was stalled by the severe macroeconomic imbalance of 1984/85 and remained largely unimplemented.

The Third Reform Drive and Retrenchment (1988–1990). Provincial governments and foreign trade corporations were required to be financially independent and allowed to retain some foreign exchange earnings. The restrictions on the sale of foreign exchange earnings at prices above the official rate were also relaxed in early 1988. The complete financial independence of state enterprises has to wait for the full implementation of the bankruptcy law passed in 1988.

The Fourth Reform Drive (1991–1992). Reforms of the external sector continued because soft loans dried up after the Tiananmen incident and Beijing was under pressure to expand its exports. The government abolished subsidies on exports in early 1991 and raised the rate of foreign exchange retention to 89 percent of export earnings. In early 1993 double-digit inflation again emerged and the *renminbi* depreciated by over 40 percent in the foreign exchange adjustment centers.

Evaluation of the Open Door Policy. The increase in exports and imports since 1979 has been extremely rapid. From 1978 to 1992 the value of China's exports grew at an average annual nominal rate of 17 percent in dollar terms, while imports grew 15 percent annually. The ratio of China's exports and imports to its GDP has also risen rapidly since 1978. India is comparable to China in size and level of development. In the thirteen years of reform and open door policy from 1978 to 1991, China's ratio of exports to GDP rose sharply from 5 to 19 percent, while the same ratio for India hovered around 4 to 6 percent. China's export drive thus appears to have been remarkably successful.

Contrary to the conventional beliefs of China's academics and trade officials, the depreciation of the real exchange rate of the *renminbi* from 1981 to 1985 was moderate and the export response was appreciable. The real exchange rate depreciated rapidly in 1986, and exports and imports have responded rapidly to the devaluation.

Most commodity prices in China have been freed. The *renminbi* is close to convertible on the current account. It appeared in late 1992 that China would join the GATT in due course. Also in 1992 China allowed foreign banks to enter the Chinese market and was planning to gradually free the interest rate.

Decentralization of the external sector should not precede the economic reforms necessary to control and coordinate decentralized economic units. China has decentralized the power to trade without enacting the necessary economic reforms, and this lack of coordination lies at the heart of China's trade problems. Import and export licenses, quotas, and foreign exchange controls are useful interim administrative levers while China moves from a centralized to a decentralized system. In the long term, China should replace import and export licenses and quotas with price instruments such as tariffs and subsidies.

The problem with the open door policy is that it calls for both Communist orthodoxy and economic liberalization. In the long run, however, economic liberalization undermines Communist orthodoxy. Despite the tension between political repression and economic liberalization, they can coexist for a considerable length of time; examples of countries where successful economic development has occurred under repressive political regimes incl e Taiwan, the Republic of Korea, and Brazil.

This tension has accounted for many of the twists and turns of Chinese politics since 1978, but the open door policy seems to be supported by all factions of the Party with the exception of the far left. In its relationship with other countries, China has explored a one-sided interaction with the socialist bloc and has tried self-reliance. Both policies failed, and China has had little choice but to open its doors to the world.

India's Foreign Trade Policies

Indian economic development strategy, particularly relating to industrialization, has been driven by perceived foreign exchange scarcities and the desire to ensure that scarce foreign exchange is used only for purposes deemed "essential" from the perspective of development. Industrialization and self-sufficiency in essential commodities have been important objectives, in no small part because of the fear that dependence on other, more powerful countries for imports of essential commodities would lead to political dependence on them as well.

An elaborate system of government control over production, investment, technology and locational choice, prices, and foreign trade was instituted in the mid-1950s. Srinivasan argues that the development strategy based on import-substituting industrialization and the system of direct, discretionary, nonmarket, quantitative controls failed to produce rapid growth, self-reliance, and eradication of poverty. Instead it led to lackluster growth, an internationally uncompetitive industrial structure, a perpetually precarious balance of payments, and, above all, rampant rent seeking and the corruption of social, economic, and political systems.

India's growth performance in the four decades since planning for national development was initiated has been unspectacular. India's development strategy was inward oriented, and self-reliance was an important objective. The pursuit of this objective has resulted in a diversified industrial structure. Most of India's industries, however, are not internationally competitive in terms of either cost per unit or product quality.

Far from viewing foreign trade as an engine of growth, Indian planners sought to minimize import demand and viewed exports more or less as a necessary evil mainly to generate the foreign exchange earnings to meet that part of the import bill not covered by external assistance. They created an elaborate administrative regulatory machinery in an attempt to control investment and resource allocation in the economy and ensure their consistency with five-year plan targets. Controls over imports and exports were also part of this regulatory system. The system was exceedingly complex, and its rules of operation had no discernible economic rationale.

India's share in world trade declined steadily from 2 percent in the

1950s to 0.5 percent in 1990. Most of the growth in exports in the 1980s was accounted for by just four product groups: leather, gems and jewelry, textiles, and garments. Exports of engineering goods and chemicals, which were once dynamic, suffered a decline in the first half of the 1980s and recovered somewhat in the second half. A diversified and dynamic export sector has yet to emerge.

The proximate reason for major economic reforms announced by the newly installed minority government of Prime Minister Narasimha Rao in July 1991 was a crisis in the economy that was both acute and different from anything experienced in the postindependence era: a drastic fall in the foreign exchange reserves to a level not even enough to pay for three weeks of imports, a near default in the colossal external debt, and a fiscal deficit of nearly 9 percent of GDP. But the deeper reason for the changes was the realization that India's economic development strategy since 1950 and the regulatory framework created to implement it had failed miserably.

The reforms are systemic and go beyond liberalizing the more irksome controls at the margin that earlier economic liberalizations had attempted. The authorities apparently realize that the benefits from reforming one sector would be limited if other related sectors are not also reformed. The needed reforms are conceived as a package of mutually supporting and consistent elements that call for coordinated action in several areas.

Rao's government lost its majority in Parliament when a regional ally withdrew support in 1993, and the favorable potential of the reforms is yet to be seen.

It is clear that a system of economic management must be put in place that relies largely on market forces and that confines state intervention in the economy to investment in some infrastructure sectors such as transport, communication, and major irrigation and to those areas where there are no efficient private sector alternatives, including services such as primary education, primary health care, and agricultural extension and research. If the 1991 reforms are credibly enforced and extended, it should not take India as long as it took other formerly inward-oriented economies, such as Mexico, to climb out of the unavoidable adjustment phase and move onto a path of sustainable, rapid, efficient, and equitable growth.

Future Prospects

It is one thing to devise a coherent reform package. It is an entirely different thing to convince producers and investors at home and abroad that the government is committed to carrying out the package and that the economic and political costs are manageable. In the Indian economy, where the bureaucracy gains power in large part from its discretionary intervention in the resource allocation process, it is natural that it would attempt to retain its power by slowing down, if not sabotaging altogether, the implementation of the reform package announced by its political masters.

There are already some disturbing signs that this might be happening. In 1992 K. S. Krishnaswamy pointed out in the *Economic and Political Weekly* (page 1471) that there have been "no significant reductions in the number and size of ministries and their staff, the delays, hassles," and the *New York Times* (August 15, 1992) agreed: "A year after the new policies were announced by Prime Minister P. V. Narasimha Rao, far less has been accomplished than promised, bureaucratic red tape still hamstrings new investment, both foreign and domestic, and not a single one of India's huge, bankrupt state-controlled industries has been shut." It reports that China is outpacing India in attracting foreign investment. In 1993, Prime Minister Rao's government lost its parliamentary majority.

To be fair, four decades of dirigisme are not easily replaced by market-friendly economic management in a year or two. Fortunately, India has a large, though protected, private sector that is accustomed to operating in a market economy. Financial institutions exist, though there are doubts about their solvency and the efficiency of their functioning. The legal system, for all its slowness, politicization, and corruption, still provides a framework essential for the functioning of markets. In other words, the basic institutional infrastructure exists and does not have to be created anew. What is needed is a vast improvement in its functioning, and in particular, a thorough reform of the financial sector.

Indian farmers, workers, and entrepreneurs will respond as well as their counterparts anywhere in the world given the same incentives. But Indian politicians and bureaucrats could still fail them: the former by fanning communal and sectarian conflicts for short-term political gains and the latter by sabotaging economic reforms. The donor community might once again fail by reneging on commitments to ease the pain of adjustment in the short run through more generous balance of payments support.

Turning to China, Srinivasan quotes the World Bank's 1992 report titled *China: Reform and the Role of the Plan in the 1990s:* "China's economic prospects are extremely bright if the government continues to pursue a strong program of economic reform and appropriate development policies. Many of the economic problems that China has encountered in recent years are considered to be the consequence of incomplete reforms. . . . [T]hese problems can be avoided or minimized in the future if the program of reform is widened and deepened across a broad policy spectrum."

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